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Making a Killing: The Cause of Misfire in Counter-Terrorist Financing Regulation

A Dissertation submitted in partial satisfaction
of the requirements for the degree of

Doctor of Philosophy

in

Political Science

by

Ian Oxnevad

June 2019

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ABSTRACT OF THE DISSERTATION

Making a Killing: The Cause of Misfire in Counter-Terrorist Financing Regulation

by

Ian Oxnevad

Doctor of Philosophy, Graduate Program in Political Science
University of California, Riverside, June 2019
Dr. John Cioffi, Chairperson

Financial regulations designed to counter the financing of terrorism have spread internationally over past several decades, but little is known about their effectiveness or why certain banks get penalized for financing terrorism while others do not. This research addresses this question and tests for the effects of institutional linkages between banks and states on the enforcement of these regulations. It is hypothesized here that a bank's institutional link to its home state is necessary to block attempted enforcement. This research utilizes comparative studies of cases in which enforcement and penalization were attempted, and examines the role of institutional links between the bank and state in these outcomes.

The case comparisons include five cases in all, with three comprising positive cases in which enforcement was blocked, and two in which penalty occurred. Combined, these cases control for rival variables such as rule of law, state capacity,

authoritarianism, and membership of a country in a regulatory body while also testing for the impact of institutional linkage between a bank and its state in the country's national political economy.

Within cases, institutional linkages and independence are traced through the creation of histories for each bank, and its role in its home state's political economy. These histories are developed using documentary data from court cases, bank publications, existing historical studies, economic studies, memoirs, government reports, and diplomatic data. This same data is used to examine the adoption of financial regulations designed to counter terrorist financing, and the defensive measures taken by states to defend their banks.

The finding of this research concludes that institutional links between banks and their home states are necessary to block attempts at regulatory enforcement. The implications of this research are profound for both studies of international law and finance, as well as for issues of counterterrorism and security at the policy level. The key theoretical takeaway for questions of international finance is that state power continues to matter despite assertions of globalization and a neoliberal financial order.

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Introduction

International politics in the 21st century has thus far been characterized by terrorism and financial crisis. The new millennium's optimism came to an abrupt halt in September 2001, when Al Qaeda hijacked jets and crashed them into the World Trade Center in New York, and the Pentagon in Washington DC. With nearly 3,000 casualties, few at the time could imagine that the literal fusing of capitalism's epicenter and religious fanaticism in a fireball would open a new era of financial regulation. This new era of financial rules and geopolitics related to counter-terrorist finance (CTF) not only heralded the creation and expansion of a set of financial institutions worldwide, but was also driven by the power politics and security considerations behind them.

The expansion of financial regulations designed to counter terrorist financing served to further integrate different countries into the American-led international financial system, and brought a liberalized financial system into direct conflict with the logic of national security. On the practical level, the expansion of these regulations mixed the market-oriented world of financial institutions and bankers with that of terrorists, spies, and law enforcement. Complicating matters further, the international prominence of the dollar and the origins of the CTF regime in a US legal system characterized by adversity brought other states and their banks into complicated issues of jurisdiction and hegemony. This research is about the efficacy of these regulations; and more importantly, the determinants of enforcement outcomes of these regulations when banks finance terror.

Since 2001 the research on threat finance has grown substantially; however, research on both anti-money laundering (AML), and CTF lacks theoretical cohesion, as well as a clear theoretical and analytical center. Largely due to divisions within political science as a discipline, work on threat finance has either focused on the political economy of regulatory growth and harmonization, or on the financing and resource management of specific terrorist groups. With scholarly attention divided between the financial regulatory world and terrorism, a focus on banks and financial institutions as actors, and their relationships to terrorist groups has been neglected. This inattention to banks leaves a theoretical blank spot for understanding the inner-workings of counter-terrorist financing institutions within the financial system. It is banks that connect the worlds of regulation and terrorist groups, and this connection warrants focusing upon them as a unit of analysis.

Criminal organizations and terrorist groups have long used financial institutions for holding wealth, moving it around the globe, and laundering it to separate funds from illicit activity. Since the advent of AML/CTF rules in the 1970s, banks have also taken on the additional role of serving as instruments of security for the states that regulate them. Tasked with following customer due diligence rules, collecting data, adhering to sanctions regimes, and gathering financial intelligence, banks have emerged as the intersection of criminal and terrorist organizations on the one hand, and the states seeking to counter them on the other. With banks comprising the central actor involved in the phenomenon of threat finance, this lack of scholarly focus on them as a unit of analysis leaves significant questions unanswered.

Regarding terrorist financing and CTF, literature focused on the regulatory side of the equation outlines a contradictory understanding of the effectiveness of such institutions. At the international level, an image emerges of profound regulatory harmonization and deepening. Beginning in the 1980s onwards, great powers and financial centers pioneered the development of financial regulation as a means of advancing security against the threat of transnational crime and terrorism. Embodied first in the domestic regulatory regimes of the United States and United Kingdom, such institutions quickly spread across the industrialized world, despite overall financial deregulation. In the 1990s, these regulations spread further internationally, with institutions such as the UN passing resolutions to combat money laundering and terrorist financing. The 1989 founding of the Financial Action Task Force (FATF) by states of the G7 brought additional pressures on states to adopt AML/CTF measures. After 2001, such regulations spread worldwide in a global effort to insulate the financial system from crime and utilize financial regulations to combat terrorism.

While the international CTF regime has proliferated, and such regulations are now legally present in virtually every state,¹ little certainty remains about their effectiveness. Aside from a select few rogue states, such as North Korea, Iran, and others, AML/CTF regulations have been adopted by states across the globe. Yet, even in states that are not rogue nations, the overall success of the international threat finance regime remains a mystery. One problem stems from the unknowable nature of how much illicit finance exists within the international banking system at any given time. Estimates largely

¹ It should be noted here that certain states such as rogue regimes in North Korea and elsewhere are not considered. in this trend.

consist of educated projections, and even approximated levels of laundered money and terrorist funds remain unknowable. Adding to this empirical challenge in assessing effectiveness is the uncertainty of how committed banks are to upholding the spirit of the AML/CTF regime. The incorporation of financial institutions operating under a profit motive into an extension of a state's security apparatus creates a number of conflicting interests. Unfortunately, assessing accurate amounts of illicit funds in the international financial system remains impossible, as does using this as a metric for analyzing the CTF regime's effectiveness. However, some measures of effectiveness, such as enforcement outcomes, can be tested.

The focus of this research is the outcome of enforcement efforts against banks that are suspected and penalized for financing terrorism. This is a basic, yet critical question that must be answered if any theory is to develop regarding the determinants of success or failure on the part of AML/CTF regulations. Unlike the actual amount of illicit funds in the financial system and true levels of bank compliance, enforcement outcomes are observable, and become analyzable once a bank comes under regulatory scrutiny for financing terrorism. Furthermore, as the empirical record of banks facing state pressures for financing terrorism illustrates a range of outcomes, theories of enforcement outcomes become testable as a result.

This study tests the role of institutional linkages between a bank and its home state's regime as the determinant of enforcement outcomes against banks for financing terrorism. If CTF regulations are widespread at the international level, and have supposedly been adopted by most states around the globe, why does such divergent

enforcement occur? Why does a British bank in London face similar enforcement levels for financing terrorism as a Jordanian bank in Amman? Why does a bank in a rich tax haven like Luxembourg face closure for terrorist financing similar to a bank in the failed state of Somalia?

This research answers these questions by positing an institutional theory of linkage between a bank and its home state government as the determining factor in enforcement outcomes. Specifically, I hypothesize that an institutional link is necessary to block enforcement. My theory states that when a bank is institutionally linked to its home regime it will escape attempted enforcement through active defenses implemented by its home state.

This first chapter discusses the emergence of financial regulations as a means of security against crime and terrorism, and pays particular attention to existing scholarly theories of regulatory compliance and effectiveness in this area in an effort to introduce readers to an otherwise obscure area of political economy. In this first chapter I also posit my own theory of CTF enforcement outcomes, and attempt to bridge the existing gaps in the literature through drawing upon theories of institutional change to explain this phenomenon. I hypothesize that in cases where banks enjoy an institutional connection to their home states, the adoption of an AML/CTF regime will not overtake this existing relationship; and by extension, any enforcement efforts deriving these regulations will therefore be blocked and misfire due to the overriding ability of the bank's home state.

This theory carries significant implications for the existing understanding of the international CTF regulatory regime, and indicates that the success or failure of these

rules has less to do with regulatory harmonization, and more to do with the purview of the governments that must enforce them and characteristics within national political economies. One possible implication of this research, is that regulatory outcomes may not be determined so much by a given regulatory regime's sophistication so much as they are driven by a states pursuing their national interests. Certainly, if states defend banks that are institutionally linked to their ruling regimes, the implication stands that banks are a means of states extending and fortifying their own power.

Part Two of this of this piece tests my theory utilizing comparative case studies, and tests for the causality of institutional linkage in determining the CTF enforcement outcomes against banks that finance terrorism. This selection of cases controls for a number of rival explanations, such as the home state's membership in regulatory bodies, levels of authoritarianism, the overall regulatory health of the home state's economy, and rule of law within the given state. In accounting for institutional linkage, the case studies disaggregate this linkage by examining the bank's importance to the stability of its home state regime, as opposed to the bank's overall importance to the national economy.

Within each positive case, or those cases where banks enjoyed blocked enforcement, I first trace the origins of the bank in its home economy and establish its relationship to its home state regime. Next, I discuss to what degree the states in these positive cases adopted the internationally driven AML/CTF institutions. In these positive cases of blocked enforcement, I demonstrate that these pre-existing relationships between bank and state perpetuate despite the adoption of fortified financial institutions. Last, I discuss the scandal phase of these banks coming under regulatory pressure for financing

terrorism, and how such enforcement was blocked by defensive measures undertaken by the bank's home state. Empirically, I examine the positive cases of the Bank of China in the PRC, Al Rajhi Bank in Saudi Arabia, and Turkey's Halk Bank.

Each positive case is afforded its own corresponding chapter in Part Two, while analysis of two negative cases will serve as the focus of the final empirical chapter. In this chapter on negative cases, I will address potential rival causes such as authoritarianism, a state's status as a tax haven, and the effects of liberalization efforts while further disproving the importance of de jure regulatory presence within a country in explaining enforcement outcomes. Each negative case exhibits banks where enforcement occurred and remained unblocked. These negative cases include Arab Bank in Jordan, and the Bank of Commerce and Credit International. Finally, the last chapter provides a conclusion that recounts my theory and causal explanation, a brief review of my methods, and implications for both policy and future research.

Chapter 1: Enforcement Outcomes in Counter-Terrorist Financing

I. Introduction: The Origins and Efficacy of Threat Finance and the Anti-Money Laundering and Counter-Terrorist Financing Regime

When discussions of either international finance or terrorism arise, few observers conceptually connect the two phenomena. Scholars of terrorism who focus on financing have rarely left the metaphorical battlefield while producing a formidable corpus of non-theoretical descriptive case studies of specific terrorist organizations and their funding. Conversely, scholars of international regulations who substantively address issues of terrorist financing have focused on institutional issues at the international level, such as regulatory harmonization and development. Despite the financial sector serving as the meeting point between CTF regulations and the terrorist groups themselves, little work has focused on banks as the unit of analysis, and little theory has developed as a result. This research bridges this gap in terrorist financing literature by focusing upon the bank as the primary unit of analysis, and by testing the bank's connection with its home nation-state as the explanatory variable that explains when CTF enforcement measures are either blocked or carried out. Due to the esotericism of terrorist financing as a subject, this section first explains terrorist financing as a phenomenon, the growth of threat finance institutions, and the role of banks within them while outlining the existing schism in the literature mentioned above.

While terrorism has increased over the past several decades, and the AML/CTF regime has grown in conjunction with the threat it poses, the increase in depth and scope of threat finance regulation has occurred within an environment of overall deregulation

and liberalization in international finance during the same era. It is worth establishing this frame of reference for the simple reason that it provides a jumping off point for illustrating that state prerogative, rather than institutional harmony, guided the growth of the AML/CTF regime worldwide. In other words, this spread of threat finance regulation grew out of states' concerns for traditional security and power, rather than institutionally driven considerations. Beginning in the 1970s, banks and financial institutions helped the US and UK catalyze the deregulation of the international financial sector, and it was these same states that simultaneously designed financial regulation to safeguard their security interests against the threat of organized crime and terrorism.

Since the collapse of Bretton Woods in 1971, the international financial system has undergone a profound transformation in the direction of deregulation. International capital mobility and the banking sectors of major financial centers not only increased in magnitude and velocity, but did so in a manner that augmented the importance and role of the financial sector in the overall international economy. This deregulatory shift coincided with a steady fortification of the financial sphere in two important respects. First, despite the turn to deregulation and liberalization, banks themselves slowly became extensions of the state in efforts to monitor and combat the non-state threats of crime and terrorism. Second, both the deregulatory wave and the subsequent fortification of finance emerged out of the US and UK, before expanding worldwide in the post-Cold War era. Analyzing these trajectories will begin with the latter and then turn to the question of how banks became extensions of the state. Additionally, the concept of money laundering will be juxtaposed against terrorist financing.

The liberalization of international finance has often been portrayed as evidence of the erosion or ineptitude of state power when faced with the ostensible force of globalization and free capital flows. The collapse of Bretton Woods in 1971, and domestic turns towards neoliberalism in the United States and Britain in the following decades fosters this notion. Since the rescindment of Bretton Woods the international economy has followed a trend of overall deregulation in the form of a removal of capital controls, privatization of state enterprises, and market liberalization. Scholars such as Susan Strange theorized that the global economy essentially outgrew the authority of states, such that “markets are the masters of governments”.² Regarding international finance in particular, Strange posited that whatever “international” regulatory system should emerge to deal with finance’s incipient instability would have to be “national” in nature, and that the United States as the predominant power would have to embrace its “national interest” in implementing international institutional controls on the financial system.³ Also writing in the 1990s, Benjamin Cohen echoed Strange’s assertion that “states have been thrown on the defensive”, and that a “transcendent market” may indicate an “irreversible erosion of state authority” in light of such forces.⁴ What neither Strange nor Cohen envisioned at the time was the emerging security dimension of international finance taking place over the same timespan. For purposes here, the emergence of “fortified finance” is defined as the institutional and regulatory harnessing of financial institutions by states for the enhancement of thwarting threats posed by terrorism, criminal organizations, and other

² Susan Strange, *The retreat of the state: The diffusion of power in the world economy*. Cambridge university press, 1996, 4.

³ Susan Strange, *Casino capitalism*. Manchester University Press, 1997. 171.

⁴ Benjamin Cohen, “Phoenix Risen: The Resurrection of Global Finance”, *World Politics*, Vol. 48, No. 2. January 1996, pp. 268-296, 293.

states. Ironically in the case of Strange's assertion, the United States *did* embrace its national interest in promoting a fortification of the financial sector. With the US leading the way, other states around the world followed suit.

Competing Logics of Finance and National Security

The first problem with the propositions mentioned above by other scholars stems from overlooking the role that states played in fostering the new “globalized” financial order, and the contingent national character of the firms within it. Helleiner notes that states, rather than passively accepting a new international financial structure, actually fostered the creation of the international neoliberal order through allowing greater freedoms to “market actors” and removing capital controls.⁵ Helleiner notes that the US played a particularly important role in the fostering of this “new order” as it sought to preserve “policy autonomy” in the economic realm beginning in the 1970s.⁶ American banks would benefit from domestic reforms at the same time, including the Federal Reserve's turn to monetarism under Volcker's chairmanship from 1979 into the 1980s.⁷ Across the Atlantic, Britain underwent a similar shift with the coming to power of Margaret Thatcher in 1979 and the abolishment of exchange controls.⁸ Helleiner mentions that London and New York, the premier banking centers, contended in liberalizing their regulatory structures to compete with one another.⁹ Over the course of the 1980s, capital control liberalization would sweep the bulk of the industrialized world

⁵ Eric Helleiner, *States and the reemergence of global finance: from Bretton Woods to the 1990s*. (Ithaca: Cornell University Press, 1996).

⁶ Ibid, 112-113.

⁷ Greta R Krippner, *Capitalizing on Crisis*, (Cambridge: Harvard University Press, 2011), 116-119.

⁸ Helleiner, 150.

⁹ Ibid, 151.

towards financial neoliberalism and offer “financial market operators” freedoms they had not yet seen in the postwar era up to that point.¹⁰

The shift to deregulation and liberalization in international finance spread with the push of Western powers, and expanded with the subsequent ending of the Cold War. This expanded liberalization has led some commentators to conceptualize international finance as nearly ungovernable, particularly in the wake of the financial crisis of 2008. Other scholarly observations assert that great powers and their firms remain central to the international financial sector. Drezner notes that in the realm of financial regulation, the production and dissemination of regulatory governance actually comprises a club good that is largely both the product great powers more so than the output of international financial institutions.¹¹ Drezner’s “great powers” are those governments who rule over large domestic markets, and that a “concert” of such powers is a prerequisite for international governance.¹² In the case of “multinational firms”, rather than functioning as unanchored economic mavericks in the global economy, Doremus et al note that firms’ domestic institutional and legal political economies influence their behaviors and operations.¹³ In short, states continue to predominate in importance in international financial flows due to the embedding of firms in their national economies. Furthermore, it is the coordination of states to allow liberalized finance to flourish.

¹⁰ Helleiner, 166.

¹¹ Daniel W. Drezner, "All politics is global." *Explaining International Regulatory* (Princeton: Princeton University Press, 2007), 147.

¹² Drezner, 5.

¹³ Paul N. Doremus, William W. Keller, Louis W. Pauly, and Simon Reich, *The Myth of the Global Corporation* (Princeton: Princeton University Press, 1998).

Despite the trend towards liberalization of finance both internationally and within major domestic financial sectors, security threats from non-state actors drove states to push for a fortification of finance through the passage of new laws and regulations. Similar to the trajectory of liberalization, these new financial security regulations would first form in the US and UK before spreading throughout the industrialized world, and then advancing globally after 9/11. Additionally, as exchange rate liberalization moved across states for the economic motivation of financial competitiveness, these fortified regulations would spread due to non-economic considerations of security.

It would be a mistake to conceive of the intersection between international finance, state security, and banking as a new phenomenon. The relationship between financial influence and security has existed since the first organized polities minted their own coinage to finance warfare. Yet, while the connection between the first two phenomena is relatively clear, the position of banks in the security matrix is more nebulous. In the lead up to WWI, Herbert Feis notes that “financial force” was often deployed as a method of building alliances, and that “political calculation” often guided major bank lending between European states, their respective allies, and their imperial holdings.¹⁴ Indeed, Viner’s account of the pre-WWI era in Europe concurs with Feis’s assessment in that financial negotiations comprised a part of “balance of power diplomacy”.¹⁵ Regarding the role played by bankers in this context, Viner asserts that financiers served as “passive” and often “unwilling instruments” of diplomats, given that

¹⁴ Herbert Feis, *Europe: The World’s Banker 1870-1914*, Publications of the Council of Foreign Relations, Yale University Press, 1930, xv-xvi.

¹⁵ Jacob Viner, “International Finance and Balance of Power Diplomacy, 1880-1914”, *The Southwestern Political and Social Science Quarterly*, Vol. 9, No. 4. March 1929, pp. 407-451, 447.

bankers were primarily driven by profit motives rather than politics.¹⁶ This observation in the early 20th century on the banker's role in international politics echoes later findings by Kirshner that bankers are often risk averse and supportive of "cautious national security strategies".¹⁷ It must be noted that this pre-WWI era and its dynamics stand far from apocryphal, particularly as the pre-1914 era levels of capital mobility and integration reflects many of the same characteristics of this liberalized period that began apace in the 1980s.¹⁸ In a similar parallel to the globalization of both eras with banks serving as instruments of power politics, the era from the 1970s to the present is one in which banks have again become mechanisms for states to advance their security interests. Contrary to the urbane conceptions of financial institutions that predominate in the subfield of political economy, banks are components of great power politics.

The fortified finance regime that crystalized in the 1970s served the political purpose of linking states back to the US through financial mechanisms despite the closing of the gold window. The dollar's primacy as the international reserve currency, and the pricing of oil in the dollars virtually tied most of the world to the American financial sector despite the end of the Bretton Woods system. As fortified finance emerged beginning with the US Bank Secrecy Act of 1970, American regulations designed to forestall tax evasion, money laundering, and eventually terrorism served as a new institutional mechanism of injecting power politics into the financial system.

¹⁶ Viner, 450.

¹⁷ Johnathan Kirshner, *Appeasing Bankers: Financial Caution on the Road to War*, Princeton University Press, 2007, 1.

¹⁸ See, Maurice Obstfeld, and Alan M. Taylor. "Globalization and capital markets." In *Globalization in historical perspective*, pp. 121-188. University of Chicago Press, 2003.

Due to the primacy of the dollar in major bank transactions around the world, the adoption of the fortified finance regime by other states was virtually assured. Despite this “globalized” realm of international finance with the US as the hub, national security concerns took on a new friction in the post-Bretton Woods world. Unlike in the gold-based system that predominated until 1971, banks and states in the emerging fortified financial system gradually adopted American and Western financial regulations for continued access to the US financial sector. If gold-backed dollars offered a buffer for other states economically linked to the US, the new regulations became virtually mandatory for continuing connection. However, financial integration does not guarantee that states share mutual security interests. This incongruity is pronounced in the near-universal adoption of the fortified finance regime, and the diverging results within it. Politics, and states pursuing their own interests, determines how this friction is negotiated.

Terrorist Financing and the Fortified Finance Regulation

If banking firms served to aid states in achieving security goals in the past in the context of great power competition, they would be called on again to fight organized crime and terrorism. More specifically, states would effectively harness the financial sector for the purpose of using AML/CTF regulation to augment the generation of criminal evidence and intelligence. Furthermore, the use of financial regulation by great powers to combat these phenomena also corresponds with the evolving threat of terrorism and transnational crime as a whole.

Due in part to Hollywood movies and other popular conceptions of terrorist groups, many people perceive terrorist financing as existing outside the formal financial sector. However, both terrorist financing and the closely related phenomenon of money laundering do involve otherwise ordinary banks and actors within the financial field. Since the regulatory institutions designed to curtail both phenomenon are inextricably linked, it is worth noting their similarities and where the phenomena diverge. Contrary to popular conceptions of terrorist organizations financing their operations through obscure channels separated from the mainstream economy, terrorist financing indeed relies in part on the formal banking sector for financial services. This is not to claim that terrorist financing is a straightforward or simple phenomenon. Rather, terrorist organizations operate as normal economic actors as much as they do armed political groups. Terrorist organizations raise funds through multiple means, may include legal and illicit activities, and may include the transfer of non-cash instruments along with the formal movement of funds through mainstream financial mechanisms. Timothy Wittig postulates that terrorist financing not only encapsulates both the “raising and spending” of money, but also the “capacity to move and store required resources” until needed by the terrorist group.¹⁹ Wittig’s definition of terrorist financing expands beyond formal monetary vehicles in that he conceptualized it as the “transfer of value”.²⁰

For the purpose of this research, the concept of terrorist funds will follow the definition of money that is derived from licit or illicit sources but is destined for the facilitation of violence against civilians perpetrated by a non-state actor for the

¹⁹ Timothy Wittig. *Understanding terrorist finance*. Palgrave Macmillan, 2011, 9.

²⁰ *Ibid*, 10.

achievement of a political purpose. Defined separately, terrorist financing will be defined as the provision, movement, transfer, integration, or obfuscation of the ownership or purpose of such funds. The utility of disaggregating terrorist funds from terrorist financing is twofold.

First, terrorist funds are often procured by terrorists themselves through crime, fundraising, or state backing while counter-terrorist financing (CTF) measures have been enacted to influence the behavior of states and banks in order to prevent and monitor the movement of these funds in the international financial sector. Terrorist funds, whether legally obtained or not, are useless unless they can be effectively transferred, banked, and invested by actors into vehicles that can facilitate the meeting of an actor's financial needs. For this research, "terrorist financing" is not treated as the funds themselves. Instead, terrorist financing is defined as the handling and movement of such funds by banks and other financial actors.

The second purpose for disaggregating terrorist funds from terrorist financing simplifies the empirical reality that both the activity of financing terrorism, and its enforcement, often involves a series of actors who are concentric in their efforts. For example, the entirety of terrorist financing often expands beyond the actions of a terrorist organization, and may include banks operating under a profit motive, states seeking to strengthen their strategic position through backing various groups, corrupt regulators, and even international organizations and non-profits. Similarly, counter-terrorist financing can likewise include international organizations, coalitions of states, supranational

entities, private transnational associations, national judiciaries and various law enforcement and intelligence agencies.

Non-cash instruments, both legal and illicit, play a role in financing terrorism. Terrorist groups as a whole are remarkable in their ability to diversify their income, as funds from legitimate business activity, charitable donations, and state sponsorship often mix with revenue from an array of criminal activity ranging from human and drug trafficking to theft, blackmail and fraud.²¹ In theory, such portfolios may seem suspect given how inexpensive terrorist acts are to commit; however, the maintenance of a terrorist organization's support operations carry significant costs. The day-to-day expenses of a terrorist organization can include the provision of safe houses, recruitment, training, and propaganda operations as well as more mundane activities.²² Indeed, instead of solely comprising cloak and dagger organizations driven purely by fanaticism, terrorist organizations exhibit a significant degree of banality in their financial operations and orientation. Additionally, a number of organizational, structural, and financial incentives exist that serve to drive terrorist groups to utilize the formal financial sector in conducting their financial affairs.

Terrorist groups are like any other organization that exhibits internal divisions over resource allocation and finances. Like any organization with limited resources and funds, terrorist groups can reap the benefits of the efficiency and availability that banks

²¹ Nikos Passas, "Terrorism Financing Mechanisms and Policy Dilemmas", in *Terrorism Financing and State Responses*, eds. Jeanne Giraldo and Harold Trinkunas (Stanford: Stanford University Press, 2007) pp. 21-38, 24-27.

²² Rachel Ehrenfeld, "Funding Evil: How Terrorism is Financed and the Nexus of Terrorist and Criminal Organizations", in *Terronomics*, eds. Sean S. Costigan and David Gold (Hampshire: Ashgate Publishing, 2007) pp. 27-48, 27-28.

can offer. Work by Jacob Shapiro notes that terrorist organizations face profound tradeoffs that position managerial efficiency in the planning of violence and resource administration against considerations of operational security.²³ In other words, in order to ensure effective managerial control of a terrorist organization, terrorists must take steps that increase efficiency while necessarily expanding vulnerability to do so. Shapiro and Siegel note that for terrorist organizations with a more centralized hierarchy, terrorist leaders who seek efficiency will entrust “middlemen” with tasks related to resource oversight and that these mid-level managers are often faced with the temptation to embezzle funds for private gain.²⁴ Contrary to the more grandiose and dangerous activities of terrorist combatants and others within a terrorist organization, financial middlemen enjoy greater material payoffs for their role, are seldom killed, and enjoy lower conviction rates upon arrest than their more martially-oriented counterparts.²⁵ In short, unlike the common misperceptions in the popular imagination, literature on terrorism indicates that groups have a number of rational incentives to turn to the formal financial system.

Terrorist groups obtain funds through a number of fronts, ranging from the self-funding opportunities afforded by outright fundraising through non-profits and the profits of legitimate businesses, to the proceeds of drugs trafficking, crime, and the backing of state sponsors. During the Cold War, terrorist funding derived predominantly from

²³ Jacob N Shapiro. *The Terrorist's Dilemma: Managing violent covert organizations*. Princeton University Press, 2013.

²⁴ Jacob Shapiro, “Underfunding in Terrorist Organizations”, *International Studies Quarterly* 51, no. 2, June 2007, pp. 405-429.

²⁵ Jacob N. Shapiro, “Vulnerabilities and Inefficiencies”, in *Terrorism Financing and State Responses*, eds. Jeanne Giraldo and Harold Trinkunas (Stanford: Stanford University Press, 2007), pp. 56-71, 61.

states. During the great power standoff, the Soviet Union aided terrorist and guerilla groups in the Middle East, Europe, Africa, and Latin America.²⁶ While state-derived funding for terrorism has decreased since the 1990s, much of the self-funding techniques that terrorist organizations and criminals utilize were learned by such groups at the tutelage of the Soviets during this period. For example, the Soviets actively advocated the use of narcotics trafficking by their non-state surrogates as a means of weakening the social fabric of the West, and most terrorist groups that arose under Soviet influence have made the drug trade a centerpiece of their operations.²⁷ It was largely in response to the drug trade that the regulatory enlistment financial firms for security began in the United States, and unfolded to combat the laundering of its illicit proceeds.

At the height of the height of the Cold War in the 1960s, concerns in American regulatory circles arose about the production of criminal proceeds within the US and the role played by offshore tax havens.²⁸ Indeed, according to the gravity model developed by Walker in 1999, and one of the most reliable models used to estimate the illicit laundered finance to date, the United States serves as the top destination for such funds. The US is followed next by the Cayman Islands and then by a mixed combination of

²⁶ Rachel Ehrenfeld, "Funding Evil: How Terrorism is Financed and the Nexus of Terrorist and Criminal Organizations", in *Terrornomics*, eds. Sean S. Costigan and David Gold (Hampshire: Ashgate Publishing, 2007) pp. 27-48, 30.

²⁷ Ehrenfeld (2007), 31. See also Samuel Pope, "Diversion: An unrecognized element of intelligence?." *Defense Analysis* 3, no. 2 (1987): 133-151, and Viktor Suvarov. "Spetsnaz: The Soviet Union's Special Forces." *International Defense Review* 16, no. 9 (1983): 1209-1216.

²⁸ Nicholas Ryder, *Money Laundering—An Endless Cycle?: A Comparative Analysis of the Anti-Money Laundering Policies in the United States of America, the United Kingdom, Australia and Canada*, (New York: Routledge, 2012), 40.

large industrialized economies and offshore financial centers.²⁹ Estimates of illicit funds within US jurisdiction are by their nature impossible to quantify, though estimates have ranged from \$100 billion to half a trillion dollars as of the early 2000s.³⁰ The Bank Secrecy Act (BSA) of 1970 initiated American efforts to combat the movement of such funds, and imposed reporting requirements on US banks to file currency transaction reports (CTRs) with the US Treasury Department for the transfer of funds in excess of \$10,000.³¹ It was the American BSA that sowed the seeds of future regulatory growth in fortified finance.

Within the US in particular, early fortified financial regulation expanded both the obligations imposed upon the private sector as well as the purview of state power related to the countering of illicit finance garnered by criminal activity. American counter-narcotics efforts in the 1980s included passage of the Money Laundering Control Act of 1986, the Annunzio-Wiley Act of 1992, the Money Laundering Suppression Act of 1994, and the Money Laundering and Financial Crimes Act of 1998.³² Two elements from these legal and regulatory developments would later prove critical to CTF regulations. First, the Annunzio-Wiley Act mandated that banks file “suspicious activity reports” (SARs) with the Treasury Department, and stipulated that banks monitor, surveil, and report deviant financial behavior from a client’s typical profile while the 1998 law

²⁹ Brigitte Unger, *The Scale and Impacts of Money Laundering*, (Cheltenham: Edward Elgar Publishing, 2007), 80. See also, John Walker, "How big is global money laundering?." *Journal of Money Laundering Control* 3, no. 1 (1999): 25-37.

³⁰ Ryder, 41.

³¹ Jason Campbell Sharman, *The money laundry: Regulating criminal finance in the global economy* (New York: Cornell University Press, 2011), 21.

³² Ryder, 41-42.

stipulated that both the Justice Department and Treasury improve linkages with the financial sector regarding AML efforts.³³

Administratively, these US laws created the blueprint of a pipeline linking the government to the financial sector. Now mandated by law, banks and financial firms would collect information and intelligence relevant to criminal activity and channel it to the government. This institutional apparatus would see replication in Europe and in other Western countries before being widely adopted around the world after 2001. The US also augmented its fortification of the financial regime by opening violating banks to civil penalties. Under the Anti-Terrorism Act of 1990, US nationals who are victims of terrorism enjoy the option to suing banks that financed terrorism.

By the late 1980s, regulatory anti-money laundering efforts explicitly took on a security-related orientation with the Anti-Drug Abuse Act of 1988 that called for the creation of an “International Currency Control Agency” that would institute and coordinate the collection of transaction reports from around the world in an effort to combat money laundering.³⁴ While this agency never came to fruition, the Financial Action Task Force (FATF), the premier AML and CTF institution to pressure states and institute rules at the international level, was founded in 1989.³⁵

That such US-led efforts emerged simultaneously with overall Reagan-era deregulation is not unique, particularly as European states began implementing similar regulatory measures to counter terrorist threats west of the Iron Curtain. Italy, West

³³ Ryder, 42.

³⁴ Sharman, 23.

³⁵ Ibid, 23.

Germany, and Spain, all faced indigenous Leftist threats at the time in the guise of the Red Brigades, the Baader-Meinhoff Gang, and Basque separatists respectively. To counter these threats, Western European states began instituting AML laws in the mid-1980s under the auspices of the Council of Europe.³⁶ The United Kingdom implemented the Drug Trafficking Offences Act in 1986, the same year as its US equivalent was implemented, effectively criminalizing money laundering in the British banking sector. The British focus on developing its own national CTF efforts also arose during this period of deregulation, but did so as a result of countering the financing of the Irish Republican Army via its Terrorist Financing Unit.³⁷ It is important to note that in the British context, such moves coincided with liberalization of the UK economy under Margaret Thatcher. If the 1980s ushered in an era in which Anglo-American banks could enjoy a freer reign, it also opened an era in which such banks were deputized as extensions of state security through AML and CTF regulations.

The liberal orientation of the Anglo-American political economic model is worth noting here, and is not inconsequential. If the global AML/CTF regime as it currently operates developed in these states under the design to curtail banks from financing terrorism, the argument can be made that AML/CTF institutions were designed for banks operating in a liberalized financial sector.

³⁶ Sharman, 23. See also Barry AK Rider, "Law: The War on Terror, Crime and the Offshore Centres: The 'New ' Perspective?" in *Global Financial Crime: Terrorism, Money Laundering, and Offshore Centres*, ed. Donato Masciandro (Aldershot: Ashgate, 2004), 61-95.

³⁷ Jeanne K Giraldo and Harold A Trinkunas, "Explaining Government Responses", in *Terrorist Financing and State Responses*, ed. Jeanne K Giraldo and Harold A Trinkunas, (Stanford: Stanford University Press, 2007), pp. 282-296, 283-284.

The effectiveness of the overall fortified finance regime is uncertain, as it is similarly unclear how much illicit finance is within the banking industry at any given time. However, financial regulations designed for banks within a liberal financial context are unlikely to work effectively in political economies with heavy state involvement or ownership in the banking industry. Yet, as liberalization has spread to varying degrees across the world without fully disrupting peculiarities of national political economies, the fortified finance regime is remarkably similar. This is not only a policy problem for how well the fortified finance regime may work in locales far removed from where it originated. This is also an institutional problem of whether or not an imported institutional arrangement will effectively displace existing dynamics within a country's political economy.

These domestic changes within major financial centers with the aim of countering the movement and integration of criminal funds in the financial system were quickly followed by regulatory changes at the international level during the same timeframe. At the United Nations, the Vienna Convention of 1988 asserted that signatory states criminalize money from drugs trafficking and enforce such measures through the tracking and freezing proceeds from the activity.³⁸ At the bank level, the creation of the Financial Action Task Force and rules from the Basel Committee on Banking Supervision would increase the pressure financial firms to participate in the security arena. Additionally, while this participation would begin with AML efforts in the context of a “war on drugs”,

³⁸ Sharman, 25.

it would later prove instrumental in placing banks within counter-terrorism efforts following 9/11.

At the heart of all AML/CTF institutions is the idea of banks “knowing” their customer. Such “know your customer” (KYC) stipulations mandate that banks have knowledge of the beneficial owner of bank accounts, and that banks report suspicious activity and cooperate with police agencies in their respective jurisdictions. The effort to spread these customer due diligence mandates was spearheaded by the US in 1986, when Federal Reserve Chairman Paul Volcker pressed central bankers at the Bank for International Settlements.³⁹ Paralleling the findings by Johnathan Kirshner that banks are loathed to entertain notions of war, central bankers initially resisted such US efforts to fortify the financial sector against criminals and terrorists.⁴⁰ However, in 1988, the Basel Committee put forward mandates that banks certify the legitimacy of their customers’ financial activity.⁴¹ These international mandates effectively hybridized the Anglo-American anti-money laundering model, ironically, with that of Switzerland by combining the “data gathering” component of the former with the “deep customer knowledge” approach of the latter.⁴² In practice, banks are the mandated actors to surveil and discover nefarious activity on the part of criminals and terrorists. Once reported, the state then follows through with further investigations, and potential arrests or prosecutions. In theory, all countries that adopted the fortified finance regime follow this model of state-bank cooperation for reasons of security.

³⁹ Peter Reuter, and Edwin M. Truman. "Chasing Dirty Money." *Institute for International Economics, Washington, DC* (2004), 79-80.

⁴⁰ Reuter and Truman, 79.

⁴¹ *Ibid*, 80.

⁴² Reuter and Truman, 80-81. See also, Basel Committee on Banking Supervision 1988.

The founding of the FATF in 1989 would prove an international turning point at the level of international institutions in fortifying the financial landscape. Founded in 1989 as a product of American and French pressure, the body put forth a list of “Forty Recommendations” outlining expected standards of international cooperation among member states. These recommendations, initially instituted in the context of the war on drugs, included the creation or tasking national regulatory bodies as financial intelligence units (FIUs) to serve as the go-between between private banks and national police or judicial agencies. Under such mechanisms, private banks (and later insurance firms, casinos, gold and diamond dealers, etc.) are tasked with gathering information on customers for the purpose of establishing a customer’s “normal” behavior that can then be utilized to detect illicit activity.⁴³ Related to French pressures, France at the time served as the primary target of Al Qaeda in the 1990s for its involvement in assisting North African governments against the terrorist group.⁴⁴

Structurally, the FIU is the central link for efforts of international coordination against money laundering and terrorist financing, and generally fall into four primary types. While all FIUs serve as a state’s focal point for collecting data from financial firms and pursuing investigations of suspicious activity, they differ in terms of their national importance depending where body is situated within the state. According to the International Monetary Fund, an FIU can either be administrative, based in law enforcement, the judiciary, or a hybrid of the previous three forms.⁴⁵ The administrative

⁴³ Sharman, 27.

⁴⁴ Gunaratna, 161-168.

⁴⁵ *Financial Intelligence Units: An Overview*. International Monetary Fund, 2004, 9.

type, often found in ministries of finance or central banks, and is often favored by the private sector.⁴⁶ In contrast, the law enforcement type of FIU is not only a regulator, but also a law enforcement agency in its own right.⁴⁷ As examples, the American Financial Crimes Enforcement Network (FinCEN) is administrative in nature and embedded in the Department of the Treasury, while the UK's National Criminal Intelligence Service is a law enforcement body. There are 152 states with FIUs worldwide that coordinate the collection and sharing of financial intelligence in order to thwart money laundering and terrorist financing.⁴⁸

Combined, the implementation of KYC standards for the financial sector and the implantation of state agencies to connect the private sector with courts, police and intelligence agencies laid the groundwork for the fortification of the financial sector. After 2001, these institutions expanded around the world, while also deepening their mandate beyond crime to include terrorism. As state-sponsorship of terrorism around the world decreased in its scope, terrorists, in seeking greater levels of independent revenue and efficiency, have turned to crime as a means of augmenting funds from donations and what state backing remains in the 21st century.⁴⁹ As a result of this shift, banks became an even greater focal point for terrorists seeking to comingle illicit and legally obtained funds for the propagation of terrorist attacks and organizational capability.⁵⁰ This enlisting of banks for purposes of security, while seemingly novel, is neither new nor

⁴⁶ *Financial Intelligence Units: An Overview*. International Monetary Fund, 2004, 12.

⁴⁷ *Ibid*, 13-16.

⁴⁸ The Egmont Group of Financial Intelligence Units, <https://www.egmontgroup.org/en/content/about> (accessed May 4, 2017).

⁴⁹ Louise I Shelley. *Dirty entanglements: corruption, crime, and terrorism*. Cambridge University Press, 2014, 177.

⁵⁰ *Ibid*, 195-197.

harmonious in pertaining relationships between states and banks. While this tension and divergence in the interests and outcomes between banks and states will be further explored in the theoretical section below, the incorporation of CTF measures into the overall institutional effort to combat illicit finance as it relates to terrorism must first be explored.

The phenomena of money laundering and terrorist financing share both an empirical and theoretical overlap, despite their crucial differences. Both terrorist financing and non-political criminal proceeds are by their nature intended to be secret and withheld from public eye. In order to achieve such secrecy, terrorist and criminal funds share similar trajectories as actors endeavor to obfuscate the true owners of such funds while also integrating much of them into the normal economy. However, terrorist funds differ conceptually from criminal funds in two important respects. First, terrorist funds are often legally obtained through donations and charities, and are only then channeled to terrorist activity.⁵¹ Second, smaller amounts terrorist proceeds obtained illegally through crime may never need to enter the financial sector at all if they are immediately directed towards terrorism, thereby negating the need to launder in the first place.⁵²

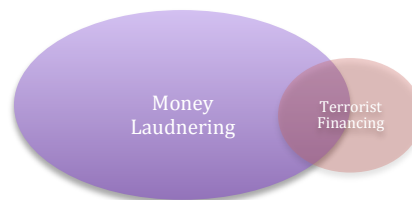
Conceptually, this movement of non-political criminal funds into the economy has been called “money laundering”, while terrorist financing is both money laundering and “money dirtying” as terrorist funds may move from a mix of legal and illegal sources to an illegal activity. Anne Clunan conceptualizes terrorist financing as carrying “pre-

⁵¹ See, Millard Burr and Robert O. Collins. *Alms for Jihad: Charity and terrorism in the Islamic World*. Cambridge University Press, 2006.

⁵² See Petrus C Van Duyne in *Criminal Finances and Organizing Crime in Europe* by Petrus C Van Duyne, Klaus von Lampe, and James L. Newaell. Wolf Legal Publishers, 2003, 9.

crime” and “post-crime” components such that the former is often comprised of legally derived funds that have no inherent need to be laundered while the funds derived from criminal activity and destined for actual operations are more akin to traditional money laundering.⁵³ Understanding this difference between the two types of funds is critical to understanding the expansion of pre-existing AML efforts into strategies designed to counter the funding of terrorism. While AML goals are prohibitive in their aim to deprive criminals from enjoying the financial benefits of crime, preventing terrorist activity is necessarily forward looking and often warrants greater political consideration and proactivity on the part of states.

Figure 1.1: Money Laundering and Terrorist Financing: The obfuscation, holding, or transfer of things of value, or their ownership, in which the value is derived from, or destined for an illicit activity.



Prior to 9/11, and partly due to the older predominant trend of terrorist groups historically having operated with state backing, most countries utilized economic sanctions rather than financial regulation to parry the funding of terrorism.⁵⁴ Many well-known cases of economic sanctions, such as those against Iran, Libya, and other states were designed to largely to thwart terrorist activity. It was only when governments began adapting to terrorists’ self-funding operations and to the operations of criminal

⁵³ Anne L. Clunan, “The Fight Against Terrorist Financing”, *Political Science Quarterly* 121, no. 4, 2006, 570.

⁵⁴ Giraldo and Trinkunas, 2007, 283.

organizations that financial regulation began to be added to states' geopolitical arsenals to combat threats from non-state actors. International cooperation to counter terrorist financing began increasing in the 1990s, not under the auspices of the FATF, but rather under the United Nations and its Convention against Terrorist Finances, and UN Security Council Resolution 1267 that specifically targeted Al Qaeda in Afghanistan.⁵⁵

The 2001 attacks shifted concern of both international AML institutions and great powers from a crime-centric approach to one that fused pre-existing efforts to stop money laundering with a new approach designed to counter terrorism. At the international level, both the UN and the FATF extended new stipulations and regulations. The UN passed Security Council Resolution 1373 days after the 9/11 attacks, and created the Counter-Terrorism Committee that requires states to seize and freeze the assets of terrorist groups within their own jurisdictions and share information with other states.⁵⁶

For the FATF, the organization added 9 Special Recommendations for states to counter terrorist financing, thus adding to its previous 40 Recommendations against money laundering. At the national level, over 100 countries passed laws to counter money laundering and terrorist financing, while 154 ratified the 1999 UN Convention on the Suppression of Terrorist Financing.⁵⁷ Even tax havens, largely through “naming and shaming” pressures from the FATF, have adopted AML and CTF statutes.⁵⁸ Switzerland,

⁵⁵ Giraldo and Trinkunas, (2007), 284.

⁵⁶ David Cortright, George A Lopez, Alistair Millar, and Linda Gerber-Stellingwerf, “Global Cooperation Against Terrorism: Evaluating the United Nations’ Counterterrorism Committee”, in *Uniting Against Terror*, ed. David Cortright and George A Lopez, (Cambridge: MIT Press, 2007), pp. 23-50, 23.

⁵⁷ Anne L. Clunan, “US and International Responses to Terrorist Financing”, in *Terrorist Financing and State Responses*, ed. Jeanne K Giraldo and Harold A Trinkunas, (Stanford: Stanford University Press, 2007), 266.

⁵⁸ See Van Duyne (2003), 9. See also, Sharman (2011).

Luxembourg, and the Channel Islands, all notorious tax havens known for their bank secrecy laws, increased their regulatory rigor to combat the laundering of drug proceeds.⁵⁹ Other tax havens such as the Cayman Islands and Jersey complied with FATF recommendations by instituting the guidelines into law.⁶⁰

With the exception of a few rogue states, if the 2001 terrorist attacks on the United States led to a diffusion of fortified financial regulation across the world, why do such divergent enforcement outcomes against occur? Furthermore, in the post-2001 era, why do some banks enjoy protection from enforcement measures while others do not? Despite the nearly universal *de jure* presence of fortified financial regulation, scholars and practitioners alike decry the ineffectiveness of these widespread regulations. Observing the ubiquity of the AML/CTF regime around the world gives the impression that such regulations are effective by their very presence. Yet, scholarship of the same regulatory regime offers a number of diagnoses as to why they are inefficient at curtailing terrorism.

At the policy level, scholars such as Ibrahim Warde argue that the overall approach that the US has taken to combat threat finance is divorced from the overall sociopolitical trends in which terrorist financing takes place.⁶¹ More specifically, Warde argues that approaching the problem of terrorist financing from the “supply side” of terrorist funds, rather than addressing the demand, or support that the terrorist

⁵⁹ Ronen Palan, *The Offshore World: Sovereign Markets, Virtual Places, and Nomad Millionaires*, (Ithaca: Cornell University Press, 2003), 48-49.

⁶⁰ Ronen Palan, Richard Murphy, and Christian Chavagneux, *Tax Havens: How Globalization Really Works*, (Ithaca: Cornell University Press, 2010), 206.

⁶¹ Ibrahim Warde, *The Price of Fear: The Truth Behind the Financial War on Terror*, (Berkeley: University of California Press, 2007).

organization enjoys, is the crux of CTF inefficacy.⁶² Another issue raised by Warde, and echoed by Wittig, is the importance of cultural context in which individuals conduct their financial affairs, and the need for CTF efforts to take such economic nuance into account.⁶³ While critical scholars focus largely on the US, and within the temporal context of the post-2001 era of CTF regulations and policy, the theme of power politics and domestic political will arises in other critiques as to why the overall institutional regime is ineffective.

Warde and Wittig both note formal banks are often not present or active in local economies in which terrorism is present. However, former Assistant Secretary to the Treasury for Terrorist Financing, Juan Zarate notes that a number of banks were involved in facilitating financing for terrorist groups or sanctioned state-sponsors of terrorism.⁶⁴ While Zarate places terrorist financing in the context of a state's acumen and ability to wage financial warfare overall, Gurule characterizes CTF efforts as a "dismal failure" in the sense of the overall legal regime to being unable combat the phenomenon.⁶⁵ Gurule notes that criminal prosecutions against terrorist financiers in the US have been lacking, while asset freezes worldwide declined over the course of the 2000s.⁶⁶ In short, states are not following through on the necessary enforcement measures, despite the widespread de jure presence of the threat finance regime across multiple jurisdictions. Sharman argues

⁶² Warde, 174.

⁶³ Ibid, 178, and Timothy Wittig. *Understanding terrorist finance*. (London: Palgrave Macmillan, 2011).

⁶⁴ See, Juan Zarate, *Treasury's War: The Unleashing of a New Era of Financial Warfare*, (New York: United States Public Affairs, 2013).

⁶⁵ Jimmy Gurule, *Unfunding Terror: The Legal Response to the Financing of Global Terrorism* (Cheltenham: Edward Elgar, 2008), 373-379.

⁶⁶ Ibid, 379.

that states, even those without financial sectors,⁶⁷ adopted costly AML/CTF regulations from outside not to combat money laundering and terrorist financing, so much as due to socially coercive pressures from outside powers.⁶⁸

The literature on terrorist financing clearly indicates that state power matters not only in how the international AML/CTF regime emerged and spread, but also in explaining why the regulatory institutions are ineffective in the curtailing of financing terrorism. However, as the costly adoption of AML/CTF regulations has taken place across the majority of states, enforcement outcomes have nonetheless varied widely despite the presence of these regulations. In short, the international regulations designed to curtail threat finance are not only ineffective in precluding the entry of terrorist funds into the banking system, but the presence and de jure adoption of the AML/CTF regime is not by itself enough to ensure enforcement. The substantive question then remains as to what precludes enforcement from occurring, and why some banks get away with financing terrorism while others are forcibly closed or fined as a result.

II. Theory

One of the challenges studies of terrorist financing have faced is the conceptual separation of states, banks, and terrorist financiers. Rather than conceiving these three types of actors as inhabiting separate environments, my research includes the three types of actors not as isolated entities so much as intimately connected actors within the same political economic universe. States often do have close connections to their respective

⁶⁷ For a humorous example, Sharman analyzes the case of Nauru, an island nation in the Pacific that has a strenuous AML policy in spite of lacking any banking institutions in its territory, 113-117.

⁶⁸ Sharman, 5.

financial sectors or specific banks. Similarly, terrorist financiers are not simply following the Hollywood parody of carrying pallets of cash to and from remote locales so much as they are seeking financial efficiency. In recruiting banks and the finance industry as a tool of fighting terrorism, states have effectively made banks the meeting point between governments, terrorist groups, and the financial industry. For this reason, it is critical to fill the existing void in the literature and focus on banks as a unit of analysis. These conceptual problems derive from the lack of cohesion

A second challenge in the literature of terrorist financing is the dearth of developed theory about the phenomenon across the fields of comparative politics and international relations. Research on terrorist financing largely falls into three categories. The first category is that of descriptive case studies of specific groups with little theoretical value outside of specific counterterrorism policies devoted to individual groups. The second category is that of critical studies of American efforts to develop legal frameworks devoted to countering terrorism and money laundering. The third category in the literature is comprised of institutional research focused regulatory harmonization. Frustratingly, these literatures not only offer little generalizable theory but also do not congeal into a cohesive substantive focus. My research attempts to rectify this paucity and discord.

Unlike prior studies, my research conceptualizes states, terrorist financiers, and banks as co-inhabitants of the same institutional universe at the level of the national political economy. Furthermore, I posit a generalizable theory that transcends the

aforementioned scholarly discord and asserts that institutional linkages between states and banks determine the process of enforcement outcomes.

III. Hypothesis

I hypothesize that a bank's institutional linkage to its home state is necessary, but not sufficient, for blocked enforcement to occur. Other factors may block enforcement once a bank comes under regulatory scrutiny for terrorist financing, but state-bank linkage remains a common structural institutional arrangement in national political economies around the world. Surely, banks may deflect enforcement through their own legal channels and without short-circuiting the regulatory regime. However, states ultimately hold the prerogative to acquiesce to import regulatory institutions, determine to what degree they are followed, and ultimately decide how to enforce them.

Formalized in Figure 1.2 outlined below, I hypothesize that institutional linkage L is necessary but not sufficient to block regulatory enforcement E . If an institutional linkage between a state and bank is present, then CTF regulatory enforcement against that bank will be blocked. Conversely, if there is no linkage ($\sim L$), then enforcement will not be blocked once the bank is targeted ($\sim E$). In other words, enforcement fails.

Figure 1.2: Necessary condition of institutional linkage to block enforcement.

$$(L \supset E) \equiv (\sim L \supset \sim E)$$

Falsifying this conditional hypothesis requires testing that successful enforcement occurs in cases where the bank has institutional linkage with its state. For these cases, a chapter examining negative cases is employed drawing upon the same historical tracing of the historical independence of the banks in question. If enforcement $\sim E$ takes place in

the presence of linkage L , then the state should not take up defensive measures in order to protect the bank. Additionally, it is imperative to demonstrate that institutional linkage L leads to blocked enforcement E .

In order to begin falsifying and proving the necessity of institutional linkage in blocking enforcement requires first establishing that an institutional linkage is present, followed by demonstrating how the linkage leads to blocked enforcement. Establishing blocked enforcement and existing linkages between the targeted bank and its state requires creating a history of the bank and its role in its country's political economy. Establishing these histories warrants tracing the development of the banks in question, and their relationships with their home governments up through the country's importation of CTF regulations. Tracing the relationship between the bank and its state must account for any critical junctures that separated the two, and whether the linkage was present at the time of the enforcement attempt.

Causally, I argue that a state's adoption of the regulatory regime does not fundamentally alter existing institutional relationships between states that are linked to its banks. If anything, the architecture of the regulations, and its pipeline of information collection and surveillance between financial institutions and the government actually strengthen existing linkages between the two actors. Then, once a bank comes under regulatory scrutiny, the home state's bureaucracies and government will actively negate enforcement attempts.

Regarding the diffusion and adoption of threat finance institutions, previous research clearly indicates that state power is critical in guiding the propagation of

AML/CTF regulatory institutions around the world. The security interests of countries with major financial centers in the US and Europe cultivated the original basis for the CTF institutions. In turn, these regulations spread around the world and were copied by the majority of states at the national level. These multiple international mechanisms facilitate cooperation among states, such as UN conventions and resolutions, as well as the moves by the FATF, are extensions of power by influential states.⁶⁹ Even the ability of many offshore tax havens to slither around AML statutes and institute lax enforcement is largely the product of many havens enjoying the backing of former colonial powers such as France and the UK, who in turn pressure many international bodies from attempting to coerce their offshore surrogates.⁷⁰

The puzzle then is why certain banks escape enforcement from the states in which they are embedded, and escape enforcement when their home states have adopted CTF institutions from abroad and integrated them into their national regulatory regime. This question is one of institutional theory as much as it is one of a state's security concerns and power politics. The findings of Warde, Sharman, and Wittig all portray the image of a helpless situation with ever increasing layers of CTF regulations, poorly crafted to localized economic realities, piling upon preexisting ones with ever diminishing returns in stopping terrorist financing. However, the mystery why banks sometimes suffer and sometimes escape enforcement for terrorist financing has not been explored.

⁶⁹ See Sharman (2011), and Cortright et al (2007). See Appendix A for a list of states that have adopted the global CTF regime.

⁷⁰ Palan, Murphy, and Chavagneux, 206-208.

In answering this question, I argue that when banks exhibit an institutional linkage to their home state, incoming CTF institutions will not supersede these preexisting connections. As a result, once that bank becomes targeted for financing terrorism by the CTF regime, the home state will take measures to block the enforcement warranted by the CTF institutions, and these institutions will then misfire. More succinctly, when a bank is linked to its home state, enforcement attempts against it will be blocked by the state with which it is tied.

The development and spreading of CTF institutions around the world over the past several decades illustrates profound institutional change in realm of financial regulations and fortified finance in general. Fortified finance developed and emerged first in major developed economies with formidable financial centers before being spread worldwide. However, the vast majority of states already had existing financial systems, complete with their own unique institutional arrangements within their national political economies when CTF regulations emerged and dispersed. Preexisting relationships between banks and their home states, if critical to that nation's political economy and regime stability, are not easily displaced by fortified financial regulations imported from abroad. In determining the outcomes of CTF enforcement, the continuity or change of these preexisting institutional arrangements between banks and their states answers this question. If incoming CTF institutions only partially integrate into existing institutional arrangements between banks and their home states, rather than transforming them, they will not be effective in penalizing banks that finance terrorism.

Literature on CTF regulations has neglected questions of institutional change at the domestic level of states where banks finance terror, as well as neglect questions of enforcement outcomes. This neglect stems in large part from the ontological assumptions particular to the subfield of international political economy; namely, treating the international political economy as a single cohesive system rather than as interactions between separate countries with their own unique political economies. Indeed, the institutional matrix of regulations designed to keep banks from financing is “global” in its de jure intention. With the majority of states instituting financial intelligence units to monitor and enforce CTF compliance at the national level, coordination of these efforts through international organizations like the Egmont Group and the FATF, the formation of regional compliance bodies, coordination at the UN level, at the European Union, and elsewhere, the international fortified finance regime is indeed global. However, the substantive area of the AML/CTF regime is both one of *national* security as well as one of *global* institutional diffusion and adoption.

In historical terms, the fortified finance regime is new at the international level. In contrast, domestic political economies often carry old structural arrangements that predate the arrival of these regulations by many decades. Such preexisting arrangements are not easily displaced once a state’s economy has developed around specific arrangements that may originate with the state’s development. Just as a “global” political economy has not dissolved distinct national economic characteristics, it is doubtful that the fortified finance regime will dislodge relationships between banks that are vital to their states.

While fortified finance may predominate over the global financial system, the usefulness of these regulations is highly suspect. First, the fortified finance regime originated as a means of curtailing the wealth of apolitical criminal organizations. Unlike terrorist groups, the growth of profit-seeking criminal organizations is not often in the security interest of any state. In contrast, terrorism is elementally political, and states may support or combat such groups as befitting their security interests. Yet, the “globalization” of the CTF component of the fortified finance regime after 2001 functions on the assumption that states do not have an interest in supporting terrorist groups, similar to the assumption that states will have no inherent interest in supporting criminal organizations. In short, the international CTF regime functions off of the assumption that states have a unified interest in curtailing terrorists from raising funds and using banks to hold and transmit them.

Following the Cold War, international relations research exhibited a newfound optimism in the usefulness of institutions and their ability to facilitate cooperation and peace. Contrary to the assertions made by scholars such as Francis Fukuyama,⁷¹ the “global” world characterized by cooperation, democracy and capitalism did not arise. Certainly, the ostensible spread of neoliberalism across the world lends itself to the notion of a highly integrated international financial system. In parallel, the rise and spread of the post-2001 CTF regime around the world offers the appearance of states acting decisively to make international finance safe from terrorism. However, states pursuing their own security and interests continue to characterize the international system

⁷¹ Francis Fukuyama. *The end of history and the last man*. Simon and Schuster, 2006.

into the new millennium, and there is no reason to think that banks or other financial institutions are somehow immune to such a pursuit.

In international relations, prior research by both scholars and practitioners hammers home the notion that state power predominates over cooperative impulses among states. Realist scholars have long cast doubt on the efficacy of international institutions, with scholars such as Mearsheimer asserting that institutions have no “independent effect” on state action such that institutions only have import “on the margins”.⁷² States have historically at times supported terrorist groups in order to pursue their own interests. By extension, there is no reason to believe states will not support banks if threatened by regulatory moves from abroad. If a casual glance at the international threat finance regime shows a deep and unified regulatory effort to curtail terrorist financing, such a view glosses over differing goals of state security.

If states have diverging security interests, they also have different political economies. While the threat finance regime has spread de jure across the majority of states, and states have gone through implementing FIUs and other mechanisms to curtail terrorist financing, the international regime lacks the flexibility to work effectively in unique political economic conditions at the national and local levels. Warde argues that in many states, particularly those in rural locales such as Afghanistan, parts of the Middle East and Africa, banks and other financial institutions are uniquely enmeshed within unique social, religious, and cultural contexts for which “US-style paperwork” is ill-

⁷² John J. Mearsheimer, “The False Promise of International Institutions”, *International Security*, Vol. 19, No. 3, (Winter, 1994-1995), pp. 5-49,7.

suited.⁷³ Indeed, Sharman notes that in the rush to jump on board with the international fortified finance regime, over 180 states adopted a “standard set” of policies and regulations in an effort to comply with dominant states in pursuit of curtailing money laundering and terrorist financing.⁷⁴ In noting the mimetic approach states have taken to adopt the fortified finance regime, and that this regime can vary from awkward to alien in how it functions within local and national political economies, threat finance scholars uncover the second macro level problem facing international CTF institutions.

If the first fundamental flaw in the international CTF regime stems from its outright rejection of the notion that states pursue their own security interests, and that there is no unified global interest in curtailing terrorist financing, the second derives from its institutional design. The current AML/CTF regime originated and developed in states with advanced political economies characterized by financial liberalization throughout the process in which the regime emerged. Certainly, states such as Afghanistan, Somalia, and others cannot simply import financial regulations designed for banks in the West. However, this observation underscores a larger institutional problem in political economy; namely, that regulations from advanced liberal-market economies are often ill suited to institutional arrangements in political economies elsewhere.

If the international AML/CTF regime has been virtually uniform worldwide since the aftermath of 9/11, the political economic context in which it was developed was not. During the 1990s and into the 2000s, the post-Cold War international economy raised debates about whether the distinct political economic models of the postwar era were

⁷³ Warde, 178.

⁷⁴ Sharman, 1.

“converging” towards a dominant model characterized by liberalized financial sectors. Questions arose as to whether longstanding institutional frameworks that comprised distinct national political economic models would persist in their unique differences.⁷⁵ More specifically, scholars questioned whether or not political economies dominated by bank-based financing would persist in an era in which capital markets played an increasing role.

Scholarship on comparative political economies indicates that convergence across models was elusive.⁷⁶ Suzanne Berger argues that when institutional convergence does not take place, preexisting institutions survive as the result of the state or influential interest groups exerting “extramarket reinforcement” to protecting or prolong the tenure of unique social and political economic configurations.⁷⁷ Indeed, in regards to external pressures on national political economies to converge, uniqueness will persist such that “space for political vision and choice” will remain.⁷⁸ While research on the persisting diversity in national political economies has largely centered upon advanced industrialized states, this principle is transferrable to less developed countries and their economies.

The persistence of singular institutional configurations within national political economies relates to the question of why certain banks escape enforcement for financing terrorism. In piecing together any puzzle, it is first necessary to find the frame and edges

⁷⁵ See Kozo Yamamura and Wolfgang Streeck et al, *The End of Diversity?: Prospects for German and Japanese Capitalism*, (Ithaca: Cornell University Press, 2003).

⁷⁶ See Yamamura and Streeck et al, 2003.

⁷⁷ Suzanne Berger, “Introduction”, in *National Diversity and Global Capitalism*, ed. Suzanne Berger and Ronald Dore, (Ithaca: Cornell University Press, 1996), 1.

⁷⁸ Berger (1996), 25.

before revealing images at the center. We know that banks are often the tools of states in pursuing their geopolitical objectives,⁷⁹ even though it can be divined from Kirshner's research on banks and war that financial institutions are loathed to be such political tools.⁸⁰ As political economies based upon bank financing have retained this characteristic despite market pressures to converge, we also know that the CTF regime that spread after 9/11 was adopted in a manner ill suited to local conditions,⁸¹ and were adopted in a mimetic fashion where the regulations were largely copied from existing rules pervasive in the developed liberal market economy of the US.⁸²

If CTF regulations were originally designed for financial sectors with a liberal market orientation, and such regulations were adopted into political economies where banks are institutionally linked to states and thereby both tools of their states while also shielded from market pressures, these banks should likewise be protected by their states when they finance terrorism. My theory is straightforward in that banks that are vitally linked to their states will be protected once such banks come under regulatory scrutiny, and that CTF regulations will misfire as a result.

IV. Variables and Conceptualization

Less common in the West where the fortified finance regime developed, many financial institutions elsewhere in the world have long-held relationships with the country in which they are embedded. For this research, an institutional linkage between banks and their home states is defined as a formal structural relationship between a financial

⁷⁹ See Viner, 1929, and Feiss, 1930.

⁸⁰ See Kirshner, 2007.

⁸¹ Warde, 2007.

⁸² Sharman, 2011.

institution and the national government in whose political economy it is embedded. The reasons for such a linkage may include the bank serving as a coalition binder for the ruling regime, the state serving as the predominant stakeholder of the bank in question, or deep career linkages between a state and a financial institution.

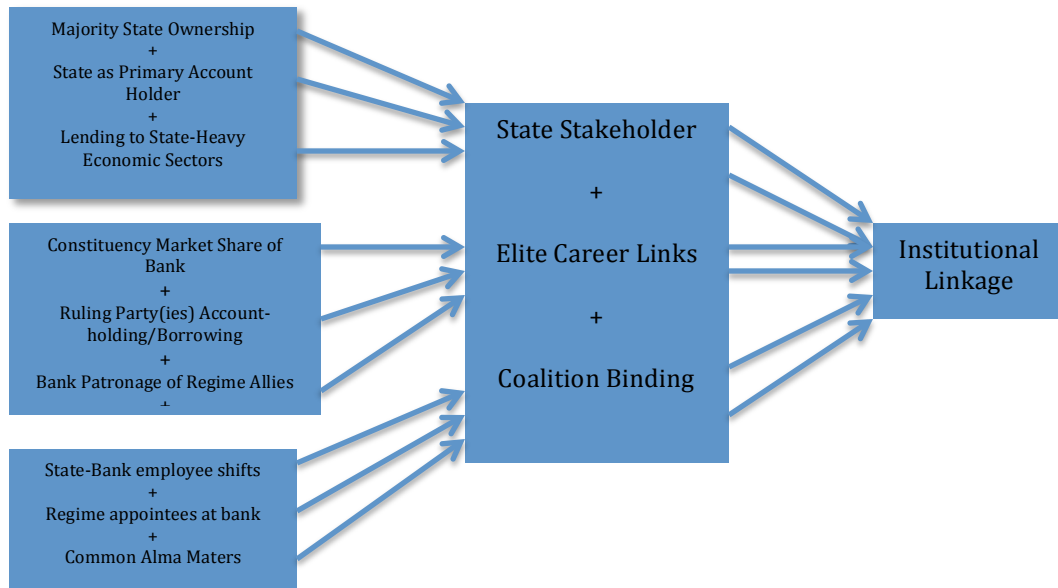
If a bank enjoys a relationship with its home state in the form of an institutional linkage, certain observable indicators will illustrate its presence. In the event that a state is a primary stakeholder in a given bank, such a bank may exhibit outright state ownership or cater to the state as the premier client and account holder. Similarly, if a state is the premier stakeholder in a given bank, that bank may operate as a source of primary lending to specific sectors of the economy in which the state is actively involved. Certain areas of business such as infrastructure, major corporate lending, energy, or the financing of state affairs such as arms deals with foreign states or the dispensing of economic aid abroad are liable to institutionally link a bank to its home state.

Depending upon the intimacy and proximity between a state's government and financial sector, a bank can exhibit institutional linkages to its state in the form of elite career ties. Namely, mid and high-ranking corporate officers from the banking industry may spend part of their careers in the financial sector while spending another portion of their careers in the regulatory realm. Professional acumen in the regulatory realm and the financial world is often highly transferrable given the ostensive need for banks to follow certain regulatory procedures and protocols, while officials in finance ministries and other governmental bodies are likely to enjoy greater pay and benefits in the corporate sector. Similarly, financial officers may traverse the bank-state divide through political

appointments at higher levels while such elites, regardless of immediate employment, are likely to have matriculated from similar schools of higher learning.

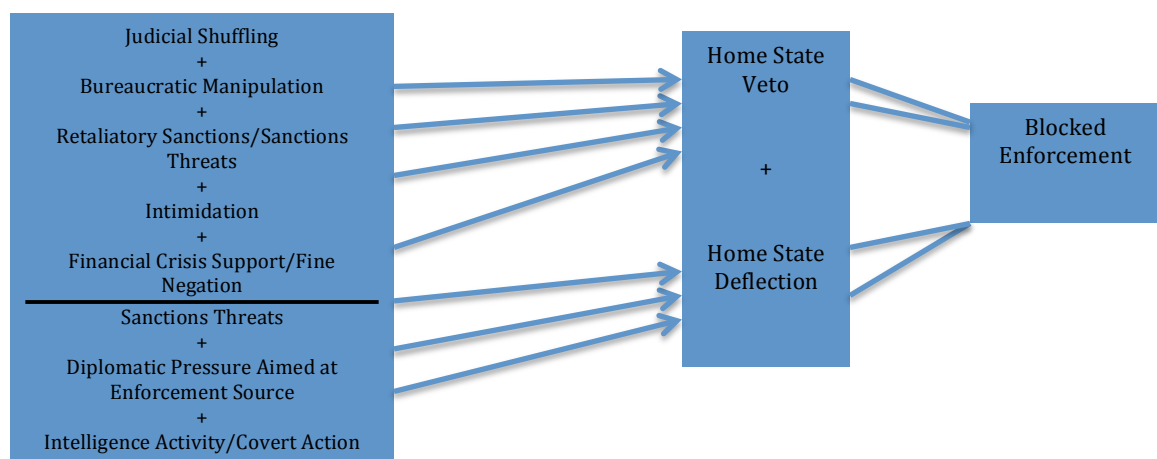
If the bank as a corporate entity displays deep ties with its home state, a bank in question may operate as a coalition binder for a ruling party or cadre. If a country is at least semi-democratic, a bank could serve as a primary lender for a political party's electoral constituency. Similarly, authoritarian regimes reliant upon certain domestic interest groups, be they a primary ethnic or religious affiliation, the military, or a specific industry, may have key societal supporters reliant upon specific banks in the country's economy. If a ruling government holds a constituency reliant upon a certain bank, or set of financial institutions for purposes of lending or patronage running from the state to different parts of the populace, such linkages I conceptualize as coalition binders.

Figure 1.3: Independent Variable: Institutional Linkage



While my causal variable for the misfire is institutional linkage between a bank and its home state, my dependent variable is the actual blockage of such enforcement efforts. Conceptually, “blocked enforcement” can manifest in the form of a home state’s veto of the enforcement process, or the home state’s active deflection of enforcement efforts. Both a veto and a deflection are defenses undertaken by a state for the purpose of defending a bank, although each has a number of potential observable indicators. A state’s veto of the enforcement process is only possible at the *national* level where a regime may engage in activities ranging from bureaucratic reshuffling, judicial interference, outright political intimidation of various domestic actors, pardons of suspected officials, or undermining external enforcement through state-backed financial support to the bank in question. In contrast, deflection implies action at the *international* level, where a bank’s home regime may utilize organs of state to influence enforcement efforts at their source abroad. If deflection is taking place, a state may rely on diplomatic means, intelligence agencies, or threat of sanction as a means to dissuading potential enforcers from acting against a given bank.

Figure 1.4: Dependent Variable: Enforcement Blockage



V. Cases and Method

The unit of analysis for this study is the bank. As noted above, banks are where regulations, the financial system, and terrorist groups converge. These are case studies of banks placed within the unique political economies of the states in which they are embedded, and banks that came under regulatory scrutiny for financing terrorism. In this regard, the unit of analysis incorporates the ensuing banking scandal that emerges once this bank is targeted with how the institutional relationship between a state and its terrorist bank fares once this occurs.

While the true case universe of banks that finance terrorism cannot be known empirically, the universe of cases in which banks are caught financing terrorism or have been investigated for financing terrorism can be studied and analyzed. Theoretically, one of the main questions that this study seeks to address is why, in the face of ever broadening and deepening AML/CTF regulation around the globe, do banks experience such divergent outcomes once these regulations are triggered. Due to this question, the universe of potential cases is temporally bound by the scope condition of these regulations not only existing, but also spreading and getting adopted by states that have banks that finance terror. Due to the fact that such regulation has only seriously spread globally during the several decades, this universe of cases is relatively new.

As noted above, the true population of banks that finance terrorism cannot be known. Dishonest banks tend to not profusely advertise their crimes to public scrutiny. However, the universe of banks that have come to public scrutiny for financing international terrorism is not only known and growing, but also fairly dispersed around

the globe. Fortunate for theoretical purposes, this spatial dispersion of cases ranging from rich OECD economies to failed states that span multiple continents offers greater leverage for controlling for variables related to economic development, political systems, and culture.

VI. Rival Hypotheses and Case Coding

Figure 4 outlines a list of major terrorist financing cases in which banks have come under regulatory scrutiny. As noted in the table, the countries involved include industrialized economies, failed states, democracies, authoritarian regimes, and offshore tax havens. A number of rival hypotheses exist, such as poor rule of law, low state capacity, tax haven status, membership in a regulatory body, and authoritarianism. These rival hypotheses do not explain enforcement outcomes.

The first, and most obvious rival hypothesis of blocked enforcement is a state's membership in a regulatory body. One of the startling aspects of the threat finance regulatory regime is the widespread diffusion that the regime has experienced since it was conceptualized in the US and Britain, and in a slew of de jure adoptions of the regime after 2001. Not only is every country in this universe of cases involved in some sort of international regulatory body, enforcement occurred even for Somalia's Al Barakat Bank, despite Somalia's status as a failed state. The second obvious rival hypothesis of blocked enforcement is authoritarianism.

While every case of blocked enforcement took place in an authoritarian country, authoritarianism did not prevent enforcement against Arab Bank in Jordan. Both Arab Bank and the Saudi banks, Al Rajhi and National Commerce Bank, inhabit similar

regulatory and political environments. Additionally, both Jordan and Saudi Arabia illustrate similar levels rule of law and regulatory quality. Both states are Sunni Arab monarchies in the same geographic region and both enjoy alliances with the United States. Yet Arab Bank faced moderate enforcement for financing terrorism, similar to the European cases of BN Paribas and Standard Chartered, while Al Rajhi Bank and National Commerce Bank escaped enforcement.

Conversely, both Al Taqwa and BCCI faced severe enforcement and were shut down completely in their tax haven home states in Europe. Al Barakat, a bank in the failed state of Somalia experienced an identical regulatory shutdown as the banks in these Western tax havens. Banks surrounded by European of rule of law, dense regulatory environments, high levels of state capacity, and liberal democracy effectively suffered similar penalization as a bank in a failed state. A cursory glance at the table below indicates that some variable other than rule of law or state capacity is leading to the observed enforcement outcomes.

Figure 1.5: Table of Potential Cases (Rule of Law and Regulatory Quality Data from World Bank Governance Indicators, 2010)

| Bank | Link Bank and State | Foreign policy importance of bank | Home State | Regulatory Presence ⁸³ | Terrorist Financing and Enforcement Outcome | Rule of Law Rank for Home State ⁸⁴ |
|---|---------------------|-----------------------------------|----------------------------|--|---|---|
| Standard Chartered <u>Negative</u> | No | Yes | United Kingdom | <ul style="list-style-type: none"> FATF Member | Yes (Moderate) | <ul style="list-style-type: none"> Regulatory Quality: 1.73 Rule of Law: 1.76 |
| HSBC <u>Negative</u> | No | Yes | United Kingdom | <ul style="list-style-type: none"> FATF Member | Yes (Moderate) | <ul style="list-style-type: none"> Regulatory Quality: 1.73 Rule of Law: 1.76 |
| Al Rajhi Bank <u>Positive</u> | Yes | No | Saudi Arabia | <ul style="list-style-type: none"> MENAFATF Member FATF Observer | No (Non-Enforcement) | <ul style="list-style-type: none"> Regulatory Quality: 0.183 Rule of Law: 0.25 |
| Bank of China <u>Positive</u> | Yes | Yes | People's Republic of China | <ul style="list-style-type: none"> FATF Member Eurasian Group Member Asia/Pacific Group on Money Laundering Member | No (Non-Enforcement) | <ul style="list-style-type: none"> Regulatory Quality: -0.217 Rule of Law: -0.328 |
| Al Barakat Bank <u>Negative</u> | No | No | Somalia | <ul style="list-style-type: none"> None | Yes (Severe Enforcement)-Innocent | No Data-Failed State |
| Lebanese Canadian Bank <u>Negative</u> | No | No | Lebanon | <ul style="list-style-type: none"> MENAFATF | Yes (Severe Enforcement) | <ul style="list-style-type: none"> Regulatory Quality: 0.076 Rule of Law: -0.689 |
| Arab Bank <u>Negative</u> | No | Yes | Jordan | <ul style="list-style-type: none"> MENAFATF Member | Yes (Moderate Enforcement) | <ul style="list-style-type: none"> Regulatory Quality: 0.25 Rule of Law: 0.202 |
| BCCI <u>Negative</u> | No | No | Luxembourg | <ul style="list-style-type: none"> FATF Member | Yes (Severe Enforcement)* | <ul style="list-style-type: none"> Regulatory Quality: 1.687 Rule of Law: 1.831 |
| Al Taqwa <u>Negative</u> | No | No | Switzerland | <ul style="list-style-type: none"> FATF Member | Yes (Severe Enforcement) | <ul style="list-style-type: none"> Regulatory Quality: 1.64 Rule of Law: 1.76 |
| National Comm. Bank <u>Positive</u> | Yes | Yes | Saudi Arabia | <ul style="list-style-type: none"> MENAFATF Member FATF Observer | No (Non-Enforcement) | <ul style="list-style-type: none"> Regulatory Quality: 0.183 Rule of Law: 0.25 |
| Halk Bank <u>Positive</u> | Yes | Yes | Turkey | <ul style="list-style-type: none"> FATF Member | No (Non-Enforcement) | <ul style="list-style-type: none"> Regulatory Quality: 0.38 Rule of Law: 0.117 |
| BN Paribas <u>Negative</u> | No | Yes | France | <ul style="list-style-type: none"> FATF Member Observer to FATF Latin America Observer to MENA FATF Observer to Caribbean FATF | Yes (Moderate Enforcement) | <ul style="list-style-type: none"> Regulatory Quality: 1.31 Rule of Law: 1.41 |

⁸³ Source: Financial Action Task Force, <http://www.fatf-gafi.org/about/membersandobservers/> (Accessed September 5, 2016).

⁸⁴ Source: World Bank Governance Indicators (2010).

For this study, I examine five case studies in total. Three of the cases are coded as “positive”, and are cases in which a bank escaped enforcement due to defensive actions by their home state blocking enforcement efforts. Two cases are coded as “negative”, and exemplify cases in which enforcement efforts were carried out through penalization banks that finance terrorism. The three positive cases include the Halk Bank in Turkey, Al Rajhi Bank in Saudi Arabia, and the Bank of China (BoC). The negative cases include Arab Bank in Jordan, and the Bank of Commerce and Credit International (BCCI), now defunct and formerly based in the Cayman Islands and Luxembourg.

Every case except the Bank of China and BCCI centers upon Middle East, and all involve banks that have been subjected to at least attempted regulatory enforcement for financing terrorism. Among the positive cases, while all three banks are based within authoritarian countries, authoritarianism itself does not determine the process of regulatory misfire. Jordan, in which Arab Bank suffered penalties for financing Hamas, is based in an authoritarian Sunni Arab monarchy, similar to Saudi Arabia. However, Al Rajhi Bank, a Saudi bank with historical links to Al Qaeda, has suffered no penalization to date, despite efforts from regulators and the families of terror victims. Similarly, BCCI, once based in a tax haven with bank secrecy laws, experienced the counter-intuitive penalty of complete closure for its illicit activity and financing of terrorism.

Regarding institutional linkage, it must be stressed that linkage does not necessarily connote total state ownership. Certainly, while both Turkey’s Halk Bank and the Bank of China remain predominantly state-owned enterprises (SOEs), Al Rajhi Bank in Saudi Arabia has a downright cliquish and private history, centered upon ownership by

a predominant Saudi family and traces its activities to the era of the Kingdom's founding and ongoing relationships with the royal family. In short, state ownership is not necessary do derail regulatory enforcement. This stipulation is also worth noting due to the theoretical observations made by previous scholars who decried the application of cookie-cutter CTF regulations around the world without taking into account local and national political economic circumstances.

Other rival causal explanations exist alongside institutional linkage, the most obvious two being lack of a regulatory presence and poor rule of law within the states in question. China, Saudi Arabia, and Turkey all rank low on markers of rule of law. However, low rule of law is not sufficient to explain regulatory misfire, particularly as Jordan ranks similarly with Saudi Arabia despite the divergent regulatory outcomes for their banks.⁸⁵ Additionally, the very fact that Al Barakat Bank in Somalia, a failed state without any official ranking of rule of law suffered the same fate as BCCI in Luxembourg indicates that the presence of another variable accounts for allowing enforcement to proceed.

Regulatory presence, the strongest rival explanation, seems to play no role whatsoever in determining regulatory misfire. While Luxembourg became a FATF member in 1990, and BCCI came under massive regulatory pressure in 1991 a year later, regulatory membership cannot explain Turkey's membership since 1991 and Halk Bank's escape from enforcement despite its massive laundering of terrorist funds for Iran in the late 2000s. The Financial Action Task Force (FATF) is not the only AML/CTF

⁸⁵ See Figure 4 and World Bank rule of law rankings.

international body, but does serve as a benchmark for measuring institutionalized fortified finance.⁸⁶ These rival explanations will be explored in Chapter 5 on the negative cases of Arab Bank and BCCI.

VII. Data

In first establishing the existence of an institutional linkage between a bank and its home state, and then tracing this relationship through the adoption of CTF regulations through the scandal phase in which enforcement is blocked or carried out, I employ data derived from documentary sources. As noted in the introduction, every one of these cases is public knowledge and experienced coverage including media reports, lengthy trials, and legislative hearings. Along with documentary court data and governmental documents, I employ histories, memoirs, and other governmental and bank data to construct specific histories of the banks being examined. Additionally, I utilize diplomatic material in the form of emails and cables from various government agencies obtained and released by the whistleblower dissemination site Wikileaks.

From the standpoint of data, few concise bank histories exist. With the exception of the Bank of China, little historical work has been done on the banks mentioned in this research. Aside from accounting records, even banks themselves retain few documents of their institution and its relation to the economy in which it is embedded. Documents such as annual reports, other economic research on the country in question, banker memoirs, and media statements are used to construct the histories of these banks and their relationship to their state. Documenting the institutional development of the banks also

⁸⁶ See Sharman, 2011.

draws from previous works on national political economies, as well as from previous scholars' research and data on specific banks in the countries in question from economic historians and other political economists.

Material from Wikileaks, enforcement bodies, and trial data is critical for analysis of the scandal phase in which the enforcement is attempted. This data provides additional background relevant to the suspected terrorist financing, and in some cases indicates that terrorist financing did indeed occur. Additionally, trial data and the manner in which it was obtained highlights when a bank's home state cooperated with the regulatory action, and when it assisted its bank in blocking enforcement. Documentary data from Wikileaks offers additional analytical benefits through offering the observer a look into diplomatic activity related to enforcement attempts.

Chapter 2: Bank of China

I. Introduction

Perhaps the largest question in international politics in the new millennium is what role China will play in global affairs in the coming decades. Undergoing rapid and profound economic growth since the early 1980s, the contemporary People's Republic of China (PRC) bears little economic resemblance to its Maoist predecessor. As a result of the economic and financial reforms that first catalyzed this growth under Deng Xiaoping, Chinese banks comprised four of the top five largest banks in the world as of 2016.¹ China's banking industry remains the premier domain of the "Big Four" (the Industrial Commercial Bank of China, the Bank of China, the China Construction Bank, and the Agricultural Bank of China) that make up four of the top five largest banks in the world.

Beginning in 2006, plaintiffs in the United States began filing suits against the Bank of China for financing terrorism for Islamic Jihad, Hamas, and Iran. The cases against the bank were dismissed in 2015. First, this chapter will establish the longstanding linkages between the Bank of China and the Chinese state in its various manifestations since the late Qing Dynasty. Next, China's "liberalization" and its adoption of fortified finance will be discussed, along with how China's regulatory adoptions mixed with the formation of its own domestic financial surveillance regime. Third, this chapter will examine the Bank of China's involvement in terrorist financing and how the adversarial nature of the American legal was utilized by Israel to counter

¹ Tom Farthing, "The Banker Top 1000 World Banks 2016 ranking", *The Banker*, June 29, 2015, <http://www.thebanker.com/Top-1000-World-Banks/The-Banker-Top-1000-World-Banks-2016-ranking-WORLD-Press-IMMEDIATE-RELEASE> (accessed July 18, 2017).

China's financing of terror. This section also explores how China brought diplomatic leverage and a domestic bureaucratic veto to block enforcement actions against the bank.

II. The Development of the Bank of China

Over the course of the bank's history, allegations of terrorist financing serve as but a relatively minor crisis when compared to the upheavals the bank survived since it was founded in 1911. Despite the cataclysms that mark modern China's historical epochs since the decline of the Qing dynasty, the Bank of China has served as a tool of Chinese state policy since it opened. This institutional linkage between bank and state has not only survived critical junctures such as the Republican revolution, the Japanese occupation during WWII, and the Communist revolution, but also maintained strong linkages to the state through the Beijing's supposed "liberalization" of the financial sector and adoption of CTF regulations.

Since its genesis in the late Qing period, the Chinese state remained the perennial stakeholder in the Bank of China through either government function or outright ownership. While the state's status as primary stakeholder survived the collapse of the Qing, the Republican era on the mainland, Japanese occupation, civil war, and varying degrees of Communist and statist rule, the bank took on an additional role as securing Beijing's growth priorities through domestic lending to local government during the reforms of the late 1970s and 1980s. As will be illustrated below, the state's role as primary stakeholder in the bank has deep roots in the bank's history and continues to the present. While the state has long been a stakeholder in the bank, the bank has served as a means of binding the Communist Party's coalition through domestic lending beginning in

the 1980s, and both coalition binding and state stake-holding have survived both China's financial "liberalization" and the importing of the international AML/CTF regime.

This chapter will first outline the role of state stakeholding in the bank over the course of its history, and then discuss the role the bank plays in domestic financing for local government. The bank's role in the various institutional changes made to the Chinese economy through the reform era of the late 20th century will also be discussed, and it will be demonstrated that state stake-holding not only survived Beijing's supposed liberalization, but also has served as a means of an economic binding agent for the CCCP's ruling coalition through domestic lending. The third section of this chapter will then discuss the banking scandal in which the Bank of China stood accused in US courts for financing terrorism and the subsequent deflection of sanction the bank enjoyed. Last, the Bank of China case will be placed within the theoretical context predicated in the preceding chapter.

Origins of State Ownership

Chinese banks and the role that they play within the country's modern statecraft cannot be understood without placing them within the context of Beijing's grand strategy. Facing rapid decline beginning in the 19th century and continuing through ensuing eras and into the present, Chinese political thinkers of varying ideological orientations centered upon the notion of *fuguo qiangbing*, or "enrich the state and strengthen military power" as the guiding principle of the state.² It was in this early era, when the waning Qing dynasty struggled to repel European and Japanese encroachment from abroad and

² See, Orville Schell and John Delury, *Wealth and Power: China's Long March to the Twenty-First Century*, (New York: Random House, 2014).

contain civil unrest at home, the Bank of China originated. It is worth noting here that the Bank of China, and perhaps large Chinese banks overall stand in stark contrast to the observations of other scholars that assert banks are loathed to be the instruments of states. In China, bank and state, if indeed are distinguishable in management, are indistinguishable in their purpose of strengthening China's position in the world. The state's involvement in the Bank of China is deep, and the peculiar institutional linkages that connect them have survived multiple eras of modern governance in China's political history, spanning the waning days of the monarchy to contemporary China's position as a rising international power.

In the late 19th century, banks in China were comprised of three types, the *piaobao* or “draft shops”, “native banks”, or *qianzhuang*, and *yinhang* “silver shops”, which were Western banks operating in the country.³ This early differentiation is critical to understanding the first major banks established by the Qing dynasty, particularly as the first major commercial banks established indigenously by the Qing bore the title of *yinhang*,⁴ conceptually emulating major Western banks present in China at the time of their founding. Prominent Chinese thinkers in the late 19th century such as Feng Guifen advocated that China “self-strengthen”, or seek to understand copy elements of what were seen as Western strengths at the time, including in the area of economic and financial development.⁵

³ James Stent, *China's Banking Transformation*, (Oxford: Oxford University Press, 2017), pp. 205-207.

⁴ *Ibid*, 207.

⁵ Schell and Delury, 47.

Innovators within the Qing administration, while under the influence of the “self-strengthening” movement, not only grappled with a number of foreign political pressures in the form of Western encroachment and a rising Japan, but also economic difficulties derived from these pressures. Gluts of foreign exchange swamped the Chinese currency market following the Sino-Japanese War in 1894-95, and due to foreign currency exchanges remaining the exclusive purview of foreign banks since the Opium Wars in mid-19th century, Chinese enterprise and the Qing administration began seeking mechanisms to promote the use of silver coins and “serve China with Chinese currency”.⁶ The founding of the “Treasury Bank” in 1905, to later be renamed as the Da Qing Bank in 1908, was the fruit of such efforts. The purposes to which the Da Qing Bank was tasked, was foundational and state centered. By the dawn of the Republican period in 1911, the Da Qing Bank comprised 35 branches throughout China,⁷ oversaw all government-related transactions, operated as the state’s treasury and central bank, and purveyed the issuing of official banknotes.⁸ Uprisings that began in the 1890s finally culminated with the 1911 Revolution and the establishment of the Republic of China. The Da Qing Bank, due in large part to its unique relationship with the state, survived to become the Bank of China in 1912 when it forged a new relationship with the incoming government while maintaining institutional continuity. Through various arrangements, this government oversight and ownership has persisted to the present.

⁶ “The Republic of China and Bank of China: Keeping Pace with History (1912), official website, Bank of China, http://www.boc.cn/en/aboutboc/ab7/200809/t20080926_1601882.html (accessed July 22, 2017).

⁷ Ibid.

⁸ Stent, 208.

The Da Qing Bank was founded with hybrid ownership in equal shares held by the government and private shareholders within one corporate structure.⁹ The bank's founders formulated the institution as a stock company, based on China's 1904 first real corporate statute (*gongsi lu*) that drew from a hybrid of characteristics from British and Japanese models at the time.¹⁰ Aside from its partial state ownership, the Da Qing bank utilized a unique dynamic of corporate governance that combined "government supervision with merchant management" that sought to use private business elites and their special expertise, often garnered from abroad, with active government support through policy and planning.¹¹ This mixture of institutional arrangement would virtually entirely translate from the Da Qing entity to the rebranded Bank of China shortly after the Nationalist takeover.

According to a November 14, 1911 report by the bank's Shareholder's Association which represented the private equity interest in the bank, local revolutionaries often mistook Da Qing branches and the bank itself as being "wholly state owned", and as a result took to looting branches and the de facto Chinese treasury.¹² In reaction, the bank's private shareholders contacted the incoming Republican government, and a "new" relationship between state and bank would be forged.

⁹ Bank of China, official website, http://www.boc.cn/en/aboutboc/ab7/200809/t20080926_1601882.html (accessed July 27, 2017).

¹⁰ Yuanyuan Peng, *The Chinese Banking Industry: Lessons from history for today's challenges*, (New York: Routledge, 2007), 44. See also, W. Goetzmann and E. Koll, "The history of corporate ownership in China: state patronage, company legislation, and the issue of control", NBER, 2004.

¹¹ *Ibid*, 45.

¹² Bank of China, official website, http://www.boc.cn/en/aboutboc/ab7/200809/t20080926_1601882.html (accessed July 27, 2017).

Ownership in the Republican Period

Shortly after the Republican government was founded in 1912, the new Republican Attorney General nominated the Da Qing's Managing Director, Chen Jintao, to become the new Minister of Finance for the Republic of China.¹³ It was under Chen Jintao's direction that the Da Qing Bank transitioned into the Bank of China as the central bank for the new republic.¹⁴ Jintao not only advocated to the Republican government for this transition, he remained in the original bank's head office to oversee the transition. While the Qing government's equity in the bank was allocated to recuperate war-related costs, the Republican government took management of the bank's properties and took an ownership share equivalent to that of the deposed Qing dynasty. This new arrangement continued the half-private, half-state ownership structure. Meanwhile, the private shareholders obtained equivalent level of equity in the new Bank of China, soon to be the new central bank. In late January 1912, the Da Qing's shareholders formed the new bank and chose new board members; by February 14, the Bank of China opened and began opening branches at the same locations as the by then defunct Da Qing Bank.¹⁵ The bank smoothly transitioned, maintaining a dual public-private between private shareholders and the state as a stakeholder.

The continuity between the two banks was not limited to the figure of Chen Jintao. The bank remained a stock company with the half-government and half-private split in ownership, with most private shareholders continuing to hold respective shares in

¹³ Bank of China, official website, http://www.boc.cn/en/aboutboc/ab7/200809/t20080926_1601882.html (accessed July 27, 2017).

¹⁴ Ibid.

¹⁵ Bank of China, official website, http://www.boc.cn/en/aboutboc/ab7/200809/t20080926_1601882.html (accessed July 27, 2017).

the new venture. Furthermore, the bank's staff, properties and even the banknotes produced remained unchanged. In the case of the banknotes, the only marked difference between those of the Bank of China and its Qing predecessor was the name of the issuing bank on the bill.¹⁶ For the government's share, both the Qing government and the Nationalists owned and administered the state's half of the bank through the Ministry of Finance.¹⁷ The relationship between the Ministry and the bank serve as the structural vehicle of government stake holding until Communist takeover when the People's Bank of China (PBC) replaced this mechanism.

At first glance, to those unfamiliar with the Bank of China's history, the Communist takeover under Mao in 1949 appears as a complete state-led takeover of Chinese banks. In the case of the Bank of China, the Nationalist Koumintang (KMT) had already seized control of the bank in the 1920s, making the transition of the bank one of continuous state control. The Nationalist takeover and the bank's resistance to it is worth discussing given the dynamics of private equity interests within the institution and the state's role in commandeering it for its own political insular purposes. Additionally, it was during this period between the Republican revolution and the Communist takeover that the Bank of China took on a number of characteristics that would later enable it to function as an international bank during the Maoist period and into the later reform era under Deng Xiaoping. The first would consist of expansion and development with the building of Western-style professionalization under the guidance of a foreign-educated

¹⁶ Peng, 48.

¹⁷ Ibid, 44, 48-49.

managerial class. The second, and more lasting, characteristic was the bank's premier role in China's foreign exchange business.

When the new Republican government officially seized control of China just prior to WWI, China's political situation was one of regional and national disarray. The young Nationalist government, in seeking to consolidate rule and secure its position against localized warlords, required access to funds for both institution building and containing ongoing regional resistance and the local level. Out of the need for survival, with its branches being looted by local warlords, the shareholders of the old Da Qing Bank petitioned the incipient Republican leadership under Sun Yat-Sen for the creation of a new bank-state relationship in which the bank would recast itself with a new 50-50 shareholder-state split of bank ownership, and a new purpose for the bank to function as the central bank for the new Chinese republic. However, the Nationalists' unquenchable thirst for funds would stress the relationship between the state and the bank, leading to a brief fracture between the private shareholders and the government.

As noted previously, the Chinese term of "bank", or *yinhang*, was originally confined only to foreign banks operating in the country. It was only over time that the usage of this term grew to refer to the newer Chinese banks founded in the early 20th century. The Bank of China, in both its structure and management drew from these outside influences, and it was the private shareholders and managerial staff that would briefly test the bank's linkage with the state. This brief period, between 1916 and the Nationalist "bank coup" of 1935 would allow the Bank of China to adopt a specific

expertise in dealing with foreign exchange that would serve as its benchmark role throughout the monobanking Maoist era.

The new Bank of China's cozy relationship with the new government hit the rocks with the coming to power of the short-lived Yuan Shikai government in 1912. In seeking to secure the title of emperor for himself, Shikai made ever-increasing demands for funds from the Bank of China, outstripping the level of bank's reserve capital. In 1916, the government ordered the bank to cease the free convertibility of bank notes to silver, and the surrender existing silver holdings to government mandate under the threat of force.¹⁸ The Bank of China, based out of its Shanghai branch, rejected the order out of fear of losing public and investor confidence, and undertook an endogenous restructuring to maintain the bank's financial integrity.¹⁹

The Bank of China's management first curtailed their own arrests through legal action, and then undertook a number of restructuring efforts to weaken the government's hand through the expansion of private ownership and raising the political stakes of outright seizure through securing loans from foreign banks and linking the Bank of China to other prominent Chinese financial institutions and lending houses. Ironically, it was the bank's conspiring with the new finance minister, Liang Qichao, who denounced Shikai's move to proclaim himself monarch, that the bank managed to reorganize itself as a more privatized institution under new internal corporate regulations.²⁰ Such new internal mandates changed the role of the Ministry of Finance within the bank, limiting

¹⁸ Linsun Cheng, *Banking in Modern China*, (Cambridge: Cambridge University Press, 2003), 55.

¹⁹ *Ibid*, 57.

²⁰ Peng, 49.

its ability to appoint senior leadership from among the existing board, and removed the formal split between government and private shares that existed since the Qing era.²¹ This influx of private capital to the bank and the government's ongoing internal war efforts and ongoing selling of shares for cash changed the ratio of private-state shares from 42% ownership in 1918 to less than 1% in 1924.²²

Two caveats are worth mentioning about this period of privatization in the Bank of China's history and its relationship to the state. First, the bank enjoyed support from the Minister of Finance, Ling Qichao, in its efforts of maintaining silver convertibility and internal reorganizing. This support, and the fractured nature of the Chinese state at the time, particularly during Shikai's unpopular fevered play at monarchy, does not reduce the argument that the Bank of China has remained virtually constant as a state-backed institution. Second, given the chaotic nature of Chinese politics at the time, it is arguable that little centralized state functioned to begin with when the bank privatized. Regardless, the breathing room that the bank enjoyed from defying Beijing's silver mandate until the state's outright takeover of the bank by Chiang Kai-Shek a few years later allowed the Bank of China to develop a specialty in conducting foreign exchange business and adopting a greater role as an international Chinese bank.

Chinese politics at the time of the Bank of China's privatization was such that political instability prevailed until the Nationalists' consolidation in the mid-1920s, thus restricting most of China's major banking activity to large cities such as Shanghai and

²¹ Peng, 49.

²² Cheng, 61.

Beijing, or in foreign-controlled enclaves along the coast.²³ Along with the new ties between the Bank of China and prominent private individuals and other private banks similarly based in big cities, the Chinese banking industry enjoyed deepening liquidity and lending until the eve of WWII.

Following Chaing Kai-Shek's coming to power and the appointment of his brother-in-law, TV Soong to the position of Finance Minister, the Bank of China received license to begin operations as an international exchange bank in late 1928. Bank of China's general manager, Zheng Jia'ao, then traveled throughout Europe, the United States, and elsewhere, establishing correspondent banking relationships, and setting up branches abroad. By 1936, Bank of China's deposits had more than doubled, and the bank's deposits with the government's new central bank accounted for 57% of the central bank's total holdings.²⁴ The state's inability to commandeer the Bank of China, as TV Soong originally hoped, and the bank's recasting as an international exchange bank, stemmed largely from the state's weakness at the time.²⁵ This is worth noting, particularly as it demonstrates the state's ongoing desire to control the Bank of China.

Bank of China's golden age of privatization proved short-lived, as the Chiang Kai-Shek regime essentially seized control of the bank in 1935. Despite the Bank of China's success at establishing a notable presence in international finance through the late 1920s and early 1930s, and in spite of the Great Depression, the bank was abruptly seized by the government in 1935 through the mandated issuing of new shares to the

²³ Cheng, 65.

²⁴ Bank of China, official website. "An Important Turning Point for Bank of China-Restructured as an International Exchange Bank (1928)", http://www.boc.cn/en/aboutboc/ab7/200809/t20080926_1601876.html, (accessed Aug. 1, 2017).

²⁵ Peng, 54.

state. This government control would characterize and dominate the bank's existence until the present.

If the government's shareholding of the Bank of China was essentially nil in 1924, its share rapidly rebounded as the state consolidated in the wake of Chaing Kai-Shek's Northern Expedition that quelled warlord resistance throughout much of the country. Perhaps drawing from the time spent in his early career in Japan and the Soviet Union, Chaing Kai-Shek set about implementing a number of fiscal and financial reforms designed to increase state control of the economy. In 1928 the government, through Chaing Kai-Shek's Finance Minister and brother-in law, TV Soong, sought to reabsorb the Bank of China as the state's central bank as it originally functioned.²⁶ The bank, due to its considerable public credibility, was able to lobby against the move, and instead limited the government to increasing its shareholding back to 20% that same year,²⁷ and reauthorizing the Ministry of Finance to select chairman of the board.²⁸

The 1930s would witness the Chinese state's increasing intervention in the financial sector, and with the Bank of China in particular in the lead-up to the 1937 Japanese invasion. In 1935, the state issued new bonds and mandated the Bank of China to increase its available shares and sell stock to the government. The proclamation of this move came from HH Kung, another brother-in law of Chiang Kai-Shek, and with the new funds from the bonds the state increased its percentage of ownership back to 50%.²⁹ On the eve of Japanese invasion, the state owned 70% of all assets within the Chinese

²⁶ Peng, 54.

²⁷ Ibid, 60.

²⁸ Cheng, 96.

²⁹ Ibid, 99.

banking industry and silver convertibility was suspended.³⁰ By 1943, the Chinese state would hold a 67% stake in the Bank of China and enjoy the appointment of the majority of directors.³¹ While the Bank of China's overseas business continued, the Bank of China would exist as an extension of the state's activity against Japanese aggression during WWII, and later after Communist takeover in 1949.

The notion that banks are loathed to take part in war is one theoretical gleaning by Kirshner's work on bankers and national security.³² The Bank of China's operations during WWII pose serious challenges to this theory, particularly as the bank proved especially aggressive in its financial efforts to undermine the Japanese presence in country and maintain business ties with friendly states. Perhaps in large part due to the bank's outright state control, the Bank of China managed to play a role in supporting the war effort. Despite the Japanese military presence, the Bank of China worked with allied banks and embassies to smuggle silver holdings, maintain republic's currency, even engaged in espionage activity against the Japanese-backed Central Reserve Bank of China that was established by the front regime of Wang Jingwei.³³

As mentioned above, it is a misconception to see the state's takeover of Chinese banks in 1949 as a uniquely Maoist phenomenon. The process of state control came to fruition just over a decade prior to the end of the Chinese civil war and just before Japanese incursion. Under Mao, rather than seek government control through

³⁰ Cheng, 100.

³¹ Peng, 60.

³² Kirshner, (2007).

³³ Bank of China, official website, "Persistent Monetary Fight Against Financial Invasion by Japanese Puppet Regime (1939-1943)", http://www.boc.cn/en/aboutboc/ab7/200809/t20080926_1601863.html, (accessed, Aug. 1, 2017).

shareholding, the state would cement itself as stakeholder of the Bank of China through the mechanisms of the People's Bank of China (PBC). If the state maintained its stakeholder status from the prior era, it would also continue its role as the purveyor of foreign exchange and overseas finance during the era of monobanking that would define the Chinese banking industry until economic reforms several decades later. Largely due to its overseas focus and its role in acting as China's financial presence abroad, the Bank of China in the postwar period must also be considered within the context of the PRC's foreign policy.

The Monobank Era

From 1949 until Deng Xiaoping's reforms that unwound China's banking sector, the PBC served as the only true bank operating within China and held all responsibilities of both central and commercial banking. The Bank of China continued to exist, largely as the world's financial window to the outside world, and did so as an extension of the PBC. In 1953, the Bank of China regained its authorized status as a foreign exchange bank, and served Chinese interests abroad. Prior to the Communist takeover, when the Ministry of Finance served as the state's tool to control the bank. Under the Maoist monobank model, the Bank of China operated as a foreign exchange specialty bureau under the PBC, the central bank.

Within the PRC's monobank structure between 1949 and 1979, the PBC directly sat beneath the State Council, which in turn oversaw both the Bank of China and the Agricultural Bank of China. Urban development was funded through either the Bank of China, or the People's Construction Bank, overseen by the Ministry of Finance. For its

part, the Bank of China serviced local PBC branches, which in turn performed financial duties for the local economy.³⁴ Standing between the State Council and both the Ministry of Finance and PBC, operated the State Planning Commission, which enjoyed all planning responsibilities for the centrally planned economy.³⁵ While the Ministry of Finance (MOF) controlled state funds and the PBC, along with the MOF, oversaw the entirety of Beijing's "banking sector" at the time, the institutional power of decision-making lay in the hands of the State Planning Commission. It is also worth noting that the relationship between local PBC branches and the state was replicated at the local level, with local state planning bodies overseeing their operations and the local governments taking their guidance from the central government via the State Council.³⁶ Nonetheless, despite total state control, the Bank of China maintained an overseas presence, effectively operating as Beijing's commercial window and presence to the outside world.

Despite the bank's function as an organ of the Communist state, the institution retained at least a veneer of its professionalism that it began to garner as an international bank prior to its prewar seizure. From its early years, the Bank of China boasted an elite managerial staff replete with Chinese elites educated abroad who leveraged their multilingual business talents for the bank's overseas operations.³⁷ The Maoist revolution, with its base in the peasantry, lacked the human capital within its base to effectively replace these elites. Indeed, for much of the Maoist period, the Chinese Communist Party (CCP) continued to rely upon experienced bureaucrats left over from KMT rule

³⁴ See, Stephen Bell and Hui Feng, *The Rise of the People's Bank of China*, (Cambridge: Harvard University Press, 2013), 56.

³⁵ *Ibid*, 57.

³⁶ *Ibid*, 58-59.

³⁷ Peng, 51-53.

since those with peasant backgrounds often lacked urban-based economic expertise.³⁸

What is notable in the case of the Bank of China is that foreign-educated multilingual bankers affiliated with the institution are mentioned meeting with representatives from international banks and foreign dignitaries at its overseas branches during the pre-reform era. With these elites operating the Bank of China abroad, the PRC used the institution as an economic window to the outside.

The *London Times* vividly describes the Bank of China's operations within the then-British enclave of Hong Kong in 1971, noting that branch manager, Li Chao-chih, held the position of "vice-minister" and operated the bank with a cadre of personnel "trained as economists in the West, and impressively at home in both English and the manners of the outside world".³⁹ It is also worth noting that despite the bank's small scale as a segment within the PRC's monobank of that era, the bank facilitated an inordinate amount of foreign exchange dealings for the state, uncorrelated with its size.⁴⁰ Based out of its Hong Kong branch, the Bank of China served as the "foreign department" of the state's central bank, the People's Bank of China.⁴¹ In acting as the state's "financing agent", the bank would buy convertible foreign currencies that could then be sent to major banking centers overseas.⁴² The bank's unique institutional position placed it as the state's negotiating agency with foreign banks seeking to finance trade

³⁸ Shiping Zheng, *Party vs. State in Post-1949 China: The Institutional Dilemma*, (Cambridge: Cambridge University Press, 1997), 42-43.

³⁹ Leo Goodstadt, "Peking Keeps in Touch", *London Times*, Sept. 10, 1971.

⁴⁰ *Ibid.*

⁴¹ YC Jao, *Banking and Currency in Hong Kong: A Study of Postwar Financing and Development*, (London: Palgrave Macmillan, 1974), 39.

⁴² *Ibid.*, 48.

with the PRC, and included settling foreign transactions in currencies other than the US dollar, largely out of Beijing's animus towards the US.⁴³

The Bank of China's unwinding from the monobank arrangement of the Maoist era to its current configuration began with the reforms instituted by Deng Xiaoping in the late 1970s. The state would remain a stakeholder in the institution, but the institution would take on a new function within China's domestic economy that added to its importance as a foreign currency window between the PRC and the outside. This new role in China's domestic economic development would cement the bank as a coalition binder for Beijing's efforts to renew political legitimacy.

At the time of Mao's death in 1976, the PRC faced a triad of domestic crises, including domestic economic rot, a crisis of legitimacy, and a struggle of succession. Economically, the PRC's potential remained bottled due an overemphasis of pure industrialization without a resulting increase in consumer demand, in part due to overly high prices on goods deemed "luxurious", and in part due to lagging levels of new employment.⁴⁴ Compounded with low levels of labor absorption in new industries,⁴⁵ and a system of managerial promotion that favored party loyalty over competence,⁴⁶ the PRC faced increasing pressures at the time of Deng Xiaoping's assuming power in 1978.

⁴³ Steven R. Stark, "An Analysis of the Foreign Trade Practices of the People's Republic of China, Including Comments on the Canadian Experience", *University of British Columbia Law Review*, Vol. 5, (1970), 181.

⁴⁴ Barry Naughton, *The Chinese Economy: Transitions and Growth*, (Cambridge: MIT Press, 2007), 80-81.

⁴⁵ *Ibid*, 82.

⁴⁶ Susan L. Shirk, *The Political Logic of Economic Reform in China*, (Berkeley: University of California Press, 1993), 33.

Reform and Continual State Control

At the microeconomic level, Deng's reforms mitigated the Maoist era problem of labor absorption through the active encouragement of private business ventures,⁴⁷ along with allowing for competition for bank financing at the local level.⁴⁸ The PRC's monobank, through which all local funds were dispersed in the form of grants prior to reform, was unwound to allow for the state's major banks to compete in making loans to localities and enterprises by the early 1980s.⁴⁹ The four state banks involved in this devolution of lending power comprise contemporary China's "Big Four", including the Bank of China.

The reorganization of the monobank model into separate state banks out from under the PBC proceeded according to sector. The Bank of China, while unwound and turned into a separate state entity, retained the specialty it held since the 1920s as a bank devoted to foreign exchange and international finance.⁵⁰ For its part, the PBC, China's central bank, was institutionally separated from the Ministry of Finance in 1978 when it was designated as its own ministry.⁵¹ The PBC would later house the PRC's Financial Intelligence Unit in the 1990s.

The financial sector's reform, and the separation of state banks into multiple entities did not in any way reduce the state's role as a stakeholder, which continues to the present. Ironically, the massive financial reforms instituted under the guidance of Zhu Rongji returned the Bank of China's form of state stakeholding into one of control by

⁴⁷ Shirk, 42.

⁴⁸ Ibid, 184.

⁴⁹ Ibid, 184.

⁵⁰ Bell and Feng, 62.

⁵¹ Bell and Feng, 62.

shareholding that predominated during the Nationalist era. In 1998 when George HW Bush asked Zhu about the progress of privatization in the PRC, he responded bluntly that China was not privatizing so much as changing the form of state ownership.⁵² Zhu's comments are telling in that they succinctly capture the nature of contemporary China's move to state control through an adoption and tailoring of international business models to Chinese needs.

The separation of the "Big Four" from the PBC functionally divided China's financial sector into distinctive realms of commercial banking in, which would be the domain of the Big Four state banks, while the PBC would serve solely as the state's central banking apparatus.⁵³ This separation in 1983 partially brought the banking sector closer to international institutional norms. By the mid-1990s, the PBC had joined the Bank of International Settlements and committed itself to the adoption of the Basel Accords (1996), cleaned the balance sheets of the Big Four through the removal of bad loans, and began seeking large foreign investors for private equity infusion into otherwise state-owned banks.⁵⁴

A number of factors in the late 1990s and early 2000s afford the PRC an appearance of moving towards normalcy in international finance. Joining the Bank of International Settlements in 1996, the possession of Hong Kong as a financial center in 1997, and PRC's membership in the World Trade Organization in 2001 portray an image of China coming into line with international best practices and liberalization. However,

⁵² Schell and Delury, 342. See also, Zhu Rongji, *Zhu Rongji Meets the Press*, (Hong Kong: Oxford University Press, 2011), 248.

⁵³ Bell and Feng, 63.

⁵⁴ *Ibid*, 271.

in preparing for issue of shares in its major banks for private ownership, China created institutional mechanisms to retain state control and oversight of the Bank of China, and create a regulatory structure that would survive the adoption of the fortified finance regime.

First, China's central bank, while now functionally separated from the PRC's commercial banking sector, remains politically tied to the State Council and senior leadership.⁵⁵ Unlike the international norm of central banks enjoying ostensible independence from political forces for the sake of financial stability, China's central bank remains a considerable outlier. This raises the question of how important the "norm" of central bank independence truly is, given that most of the largest banks in the world are supervised by central bank tied firmly to Beijing's leadership. For the AML/CTF regime, this arrangement creates the problem of state-controlled central bank effectively having to police banks owned by the state itself.

Second, in preparing the Bank of China for initial public offering (IPO) and return the state's control to the shareholding model of the Nationalist era, the government created two ownership vehicles: the Huijin Corporation in 2003, and the China Investment Corporation (CIC) in 2007. The CIC, while created four years after Huijin, houses the Huijin Corporation as a subsidiary, which in turn owns over 60% of the Bank of China.

⁵⁵ Howard Davies and David Green, *Banking on the Future: The Fall and Rise of Central Banking*, (Princeton: Princeton University Press, 2010), 220.

The Huijin Corporation, formally known as Central Huijin Investment Ltd, was founded in December 2003, the same month and year as Bank of China's IPO.⁵⁶ Huijin describes sole purpose as to "perform obligations as an investor on behalf of the State...with the goal of preserving and enhancing the value of state-owned financial assets".⁵⁷ In corporate governance, the State Council appoints all of Huijin's directors for three-year terms.⁵⁸ In the early 2000s, the PBC continually infused funds into Huijin, which in turn, invested in the Bank of China.⁵⁹ With an initial investment of \$22.5 billion, the state held a controlling share of the Bank of China at 67.6%.⁶⁰ Huijin's staff largely derives from the PBC.⁶¹

With the Bank of China's shares held by state-owned investment corporations, the bank has largely returned to the stakeholder dynamic that preceded the PRC's establishment in 1949. Interestingly, the bank's institutional arrangement has not

⁵⁶ Bell and Feng, 275. See also, Central Huijin Investment Ltd official website, http://www.huijin-inv.cn/wps/portal!/ut/p/a1/pVLBcoIwEP2VevCYyZlGxCNVqtJSZ3Q6lVwcBIQ4ENCmTvv3DejVYNU9Zee97Nu3D3O8wVzGZ5HHStQyLts3d7av4IA1WUMAofcEHgM_XNKALMORBkQaMJl5c9t9AQCbEVhMH-dTdxwCLBwj37eufLhRHpj4bO1c-QaAab5DzfyZTe_Tbxhg4PvzHv2z597575hjnkJVqAJHxac4CImEPD809UnF5RAurW0m81J8FEMQcl-fqu68ujkEApbTftEklsVRmu5pmpEE7cgoQXYSJ4i5wBCJ031GACyLMrPkdqd_WaYBPZEL0oAhMnoAOYWTMNdrxapA7c54U9RVtk3kxTGT56QH0IaiA5hS36exRwPFkXbJvenymOD1L88W3BFFcTgeuacDVUuVfSlt2h8T1VRvXVWMfgvEd87KXzGgozlfDH4AfgaezA!!/dl5/d5/L2dBISEvZ0FBIS9nQSEh/, (accessed, Aug. 1, 2017).

⁵⁷ Ibid.

⁵⁸ Ibid. See also, Huijin Corporation, "Articles of Association (Abstract)", official website, http://www.huijin-inv.cn/wps/portal!/ut/p/a1/pVLBcoIwEP2VevCYyZlGxCNVqtJSZ3Q6lVwcBIQ4ENCmTvv3DejVYNU9Zee97Nu3D3O8wVzGZ5HHStQyLts3d7av4IA1WUMAofcEHgM_XNKALH1LAYlNmMy8ue2-AIDNCCymj_OpOw4BFo6RH46ufLhRHpj4bO1c-QaAab5DzfyZTe_Tbxhg4PvzHv2z597575hjnkJVqAJHxac4CImEPD809UnF5RAurW0m81J8FEMQcl-fqu68ujkEApbTftEklsVRmu5pmpEE7cgoQXYSJ4i5wBCJ031GACyLMrPkdqd_WaYBPZEL0oAhMnoAOYWTMNdrxapA7c54U9RVtk3kxTGT56QH0IaiA5hS36exRwPFkXbJvenymOD1L88W3BFFcTgeuacDVUuVfSlt2h8T1VRvXVWMfgvEd87KXzGgozlfDH4AJk6Xfw!!/dl5/d5/L2dBISEvZ0FBIS9nQSEh/, (accessed Aug. 1, 2017).

⁵⁹ Bell and Feng, 279-280.

⁶⁰ Ibid, 279-280.

⁶¹ Ibid, 279-280.

modernized so much as returned to a previous model of state stakeholding, though government control of the bank's operations has remained virtually unchanged over the course of a century. Succinctly stated, the linkage between the Bank of China and its home state has proven both deep and resilient. If this linkage has survived multiple wars, decades of turmoil, and massive regulatory reforms, it is doubtful that the adoption of AML/CTF rules would dislodge such arrangements. The next sections address this regulatory adoption.

III. China's Fortified Finance Regime

As the Bank of China retained the state as its premier stakeholder throughout China's financial reforms, the PRC's banking industry did undertake a significant adoption of the international AML/CTF regime. In fact, most of these adoptions took place in the 1990s and in the immediate aftermath of 9/11, prior to the Bank of China's IPO and subsequent exposure to international investors. Ranging from de jure adoptions fortified finance regulations to active prosecution, China has made considerable efforts to implement changes to its banking sector to curtail crime and terrorism. Figure 2.1 outlines the steps China has taken to implement fortified finance, both in internal adoption of AML laws and membership in multilateral bodies.

Figure 2.1: Timeline of Anti-Money Laundering Regulatory Adoption in China

| Adoption | Year | Type |
|---|----------------------------|-------------------------------|
| Article 191 of Penal Code Introduced-criminalizing laundering from drugs, organized crime, terrorism (FATF) | 1997 | Domestic Law |
| Member and Founder of Asia-Pacific Group on Money Laundering (APG) | 1997 | International Membership |
| PBC Becomes China's FIU and mandates monitoring of suspicious activity | 2003 | Domestic Regulatory Adoption |
| Member and Founder of Eurasian Group (EAG) | 2004 | International Membership |
| PBC Issues New AML/CTF regulation expanding supervision and reporting mandates | 2007 | Domestic Regulatory Expansion |
| Member of Financial Action Task Force (FATF) | 2007 (Observer since 2005) | International Membership |

Two trends become noticeable upon close analysis of China's regulatory and legal changes as they pertain to fortified finance. First, China was not purely reacting to the global pushes for spreading the AML/CTF regime after 2001. Domestically, China had made money laundering and terrorist financing a criminal offense in the late 1990s, and significantly expanded its penal code to do so. Passed in 1997, Article 191 of the PRC's penal code effectively criminalized the laundering of criminally obtained funds from drugs and organized crime; notably, terrorism was included in the statute and specifically deemed the obfuscation or transfer of such funds as criminal.⁶² In April 2001, prior to 9/11 and the subsequent wave of regulation it brought, Beijing began implementing "know your customer" (KYC) requirements for depositors throughout the financial sector, mandating new account holders offer identification during the on-boarding

⁶² Financial Action Task Force, "First Mutual Evaluation Report on Anti-Money Laundering and Combating the Financing of Terrorism: People's Republic of China", (2007), 22-23.

process.⁶³ These KYC regulations were modeled on those in the US. These domestic legal changes to the PRC's criminal code place it in line with overall international AML regulatory trends at the time, and given the restructuring of Beijing's banking industry over the 1990s, indicates the country's proactivity in this arena. In June 2001, again prior to 9/11, the Bank of China formed its own internal anti-money laundering bureau,⁶⁴ thus raising the possibility that the Bank of China itself served as a test-run for Beijing establishing its national FIU two years later.

The second trend that stands out from China's adoption of threat finance regulation stands in the timing and context of the PBC's taking on the role of Beijing's financial intelligence unit (FIU). Working under the mandate of the State Council in 2003, the PBC put forth mandates for the Chinese banking sector stipulating the gathering of financial information and establishing reporting requirements for suspicious transactions. That same year the State Council also shifted the Ministry of Public Security's AML mandate to the central bank.⁶⁵ With these new mandates and capabilities, the PBC established coordination mechanisms to facilitate the production and sharing of financial intelligence related to crime and terrorism throughout the Chinese financial system.⁶⁶ In 2004, one of these tools came in the form of the PBC's AML Monitoring and Analysis Center (CAMLMAC), charged with operating as the FIU's monitoring center within the central bank.

⁶³ Song Yang, "Money Laundering in China: A Policy Analysis", *Journal of Contemporary Criminal Justice*, Vol. 18, No. 4, (Nov. 2002), pp. 370-380, 377.

⁶⁴ *Ibid*, 378.

⁶⁵ Cai Yilian, "Performing Anti-Money Laundering Obligation and Promoting Anti-Corruption Work", ABD/OECD Anti-Corruption Initiative for Asia and the Pacific, Issue Paper Workshop F, (2005), 1.

⁶⁶ Speech by Zhou Xiaochuan, Governor of the People's Bank of China, First Meeting of the Ministerial Joint Conference on Anti-Money Laundering, Beijing, Aug. 27, 2004.

As noted in the previous section, the Bank of China remains a state bank, as it has nearly since its inception with the government holding either outright control or a lion's share of ownership in the institution. Now owned by the state as a majority investor through sovereign investment funds, which are in turn financed, overseen, and staffed by the PBC, the state as effectively turned the Bank of China into an extension of its financial intelligence apparatus as of the early 2000s. While such regulatory adoptions and legal changes have occurred de jure, the question remains as to how Beijing has implemented such regulations in practice. This consideration must first be addressed before moving to consider the accusations and blocked enforcement against the Bank of China for financing terrorism.

Following the adoption of the fortified finance regime, China began centralizing monitoring of its financial system. Following the creation of CAMLMAC within the PBC in 2004, Beijing implemented a computer network that linked its banks; within a year, over 90% of Chinese banks were linked to this system.⁶⁷ Shortly after implementing these institutional capabilities and technical arrangements, reports of suspicious activity began to deluge the PBC's FIU. Between 2004-2008, CAMLMAC took in 93.62 million suspicious activity reports, with an additional 585 million large-volume transaction reports in the same period.⁶⁸ According to analysts within the PBC, 1,859 reports were sent to Chinese judicial and law enforcement from this glut of reports.⁶⁹ This resulting flow of financial intelligence moves in three directions, depending upon the nature of the

⁶⁷ Nicole Schulte-Kulkmann, "How China Fights Money Laundering: Recent Developments in Regulation and Supervision", Research Group on the Political Economy of China, Feb. 2007, p.26.

⁶⁸ Tang Xu, Shi Yongyan, and Cao Zuoyi, "The Effectiveness of China's Anti-Money Laundering Policies", Anti-Money Laundering Bureau, People's Bank of China, (2010), 8.

⁶⁹ Ibid, 8.

suspicious transaction in question. Under normal circumstances, a Chinese bank first reports the activity to its corporate headquarters, which in turn sends bulked reports to the PBC's FIU on a weekly basis.⁷⁰ If a bank branch suspects the activity pertains to a crime, it is mandated by law to send reports both horizontally and vertically by informing the nearest local branch of the PBC, local law enforcement, and its corporate headquarters.⁷¹ For its part, and as a byproduct of China's totalitarian composition, the PBC in 2004 began anti-money laundering propaganda campaigns in consort with AML trainings in order to discourage bribery while fomenting greater levels of customer due diligence.⁷² Local bank branches are also subject to inspection by PBC personnel from the central bank's nearby branches.⁷³ In 2004 alone, the PBC shuttered 155 underground banking operations and froze 460 accounts in conjunction with 274 arrests being made.⁷⁴ By the mid-2000s, the Chinese state had begun utilizing its coercive capacity in accordance with the international AML/CTF regime. It was during these years that the Bank of China became accused of harboring and transacting funds for terrorism.

In the realm of China's domestic AML/CTF financial regulations, the PBC significantly expanded its reporting requirements and best practices during the same period in which the Bank of China came under suspicion for terrorist financing. While the 2003 regulations established by the PBC mandated that banks operating in the PRC follow reporting requirements and stipulated penalties for executives found to be operating in contradiction to these regulations, the regulations taking effect in 2007 added

⁷⁰ Schulte-Kulkmann, 28.

⁷¹ Ibid, 28.

⁷² Ibid, 32-33.

⁷³ Ibid, 33.

⁷⁴ Yilian, 3.

confidentiality clauses designed to maintain secrecy in the event of a bank violating the law. Based on Article 7 of the new regulations, PBC mandated that its own personnel “shall keep all information obtained in fulfilling its anti-money laundering responsibilities confidential, and must not disclose to outsiders in violation of regulations”.⁷⁵ The new regulations also mandated that the PBC’s FIU keep confidential the identities of account holders conducting large and suspicious transactions, and warned against the sharing of these identities with “any other organization or individual”.⁷⁶ The timing of these regulatory expansions possibly relates to foreign suspicions against the Bank of China beginning in 2006.

China’s adoption and development of fortified financial regulations has largely kept pace with the outside world. In fact, it can even be argued that Beijing’s regulatory development in this area would have continued even if 9/11 and the subsequent wave of regulatory advancement had not occurred. China’s banking sector was already undergoing massive reform to increase its efficiency and attractiveness when these regulations were adopted. For Beijing to create sovereign investment vehicles to allow for its banks to sell limited levels of private equity would have been contraindicated if its state banks did not conform to some level of regulatory safeguarding that was becoming the norm in the global financial sector. Additionally, it is questionable that an authoritarian state such as China would forego the opportunity to utilize its banks as a

⁷⁵ Article 7, “The People’s Bank of China Decree No. 1”, People’s Bank of China, (2006), <http://www.pbc.gov.cn/english/130733/2897917/index.html>, (accessed Aug. 2, 2017).

⁷⁶ Ibid.

partial extension of its intelligence apparatus, particularly given the size and scope of its major banks.

IV. The Bank of China and Blocked Enforcement

In the mid-2000s, allegations began to arise that the Bank of China had financed terrorism for Palestinian terrorist groups Hamas and Islamic Jihad. The banking scandal played out as a court case between plaintiffs seeking damages against the bank in American courts for terrorist acts carried out in Israel during this period. The regulations, based in the US, became a terrain for international power politics between Israel and China. Unfolding over the course of a decade, the Bank of China, with Beijing's backing, evaded enforcement through a combination of home-state veto through bureaucratic stalling and diplomatic deflection through external pressure on a third-party state.

The increasing intensity of great power competition between China and the US is well known. What is lesser known is the role China has played in the area of terrorism and terrorist financing since the current era of international terrorism began in 2001, and the relations between Beijing and Jerusalem in this context. In Middle East politics, relations between the PRC and terrorist groups have a deep history in international affairs, and one that often pitted Israel (and the US) against Chinese designs in the region.

The PRC's foreign policy orientation of antagonism towards the US has its roots in Mao's conception of the US as the ultimate "imperialist" power after WWII; while holding at its core the Leninist notion of "imperialism as the highest form of

capitalism”.⁷⁷ After its break with the Soviet Union, Beijing’s strategy in the Middle East sought to drive a wedge between the newly independent Arab states in the region and away from a dominant reliance on Moscow in the case of those ideologically sympathetic to the PRC, as well as from the US.⁷⁸ Beijing’s stance on Israel during the Maoist era placed the two states on opposing sides of covert war, with terrorist financing serving as a main source of strategic antagonism.

During the height of the Cold War when African states were gaining their independence, Israeli covert activity in the continent followed a strategy thwarting the Chinese Secret Intelligence Service from providing money-laundering services to terrorist organizations trying to strike Israel.⁷⁹ Using Hong Kong as a base of money laundering operations in the 1960s and 1970s, the PRC used profits from drug dealing in the West, often working through Chinese gangs abroad, to finance covert operations in the developing world.⁸⁰ China’s activities in Africa included the active transport and training of students from the continent to Beijing, where they were taught practical skills relevant to conducting terrorist attacks.⁸¹ Centered in North Africa and based in Cairo, China’s covert activities in Africa actively supported insurgent groups in the continent, and provided political and logistical support to Nasser regime’s activities against Israel.⁸²

⁷⁷ Peter Van Ness, *Revolution and Chinese Foreign Policy: Peking’s Support for Wars of National Liberation*, (Berkeley: University of California Press, 1970), pp. 30-33.

⁷⁸ *Ibid*, 218-220.

⁷⁹ Gordon Thomas, *Gideon’s Spies: the Secret History of the Mossad*, (New York: St. Martin’s Press, 2005), 248.

⁸⁰ *Ibid*, 248.

⁸¹ WAC Adie, “China, Russia, and the Third World”, *The China Quarterly*, No. 11 (July-Sept, 1962), pp. 200-213, 209.

⁸² Robert A. Scalapino, “Sino-Soviet Competition in Africa”, *Foreign Affairs*, Vol. 42, No. 4, (July, 1964), pp. 640-654, 644.

With drug money going to support Beijing's proxies in Africa and the Middle East, the Israelis and Chinese fought each other through their respective intelligence services in Africa, which served as the corridor through which Beijing funded its sponsored groups. What is worth noting is that the Bank of China was the only financial institution connecting Beijing to the outside world at this time.

This antagonism between China and Israel resurfaced in the early 2000s, when suicide bombers began using explosives manufactured in China.⁸³ China's role in supporting a number of terrorist organizations came to light in 2001 with the defection of a People's Liberation Army Colonel, Xu Junping to the United States. The intelligence gained by the US through Xu's defection included networks of Chinese support to rogue states such as Iran and North Korea, terrorist groups throughout Latin America, and China's hosting of Osama bin Laden on three occasions prior to 9/11.⁸⁴ The link between regional terrorist groups operating in the Palestinian territories and Beijing was not limited to the procurement of explosives, but also services provided by the Bank of China to a PIJ operation of trade-based money laundering linking the group to its backers in Iran; and which subsequently empowered the group to carry out terrorist attacks in Israel.

In 2006, the Wultz family was the victim of a suicide bombing in Tel Aviv. Under stipulations provided by the Anti-Terrorism Act of 1990, the family sued the Bank of China, alleging that the bank funneled money to the terrorist group, Palestinian Islamic

⁸³ Scalapino, 391.

⁸⁴ Ibid, 390-391.

Jihad between 2003 and 2006.⁸⁵ The case, relying on affidavits from Israeli intelligence officials, alleged that the Bank of China knowingly conducted business on behalf a PIJ and Hamas account holder, Said al-Shurafa, at its Guangzho branch in China. More specifically, the plaintiffs in the case asserted that the Bank of China knowingly conducted this business for PIJ after multiple meetings between delegations of Israeli intelligence officials alerting them to the activities of their account holder and others, and organs of the Chinese government that included the Ministry of State Security, the People's Bank of China, the Ministry of Foreign Affairs, and others.⁸⁶ Far from an isolated meeting, the Chinese-Israeli meetings spanned a course of two years between 2005-2007.⁸⁷

According to a declaration of one of the intelligence officials, Shlomo Matalon, which was filed with the US District Court in Washington DC in 2009, PIJ and Hamas leaders transferred millions of dollars in funds to terrorist operations in West Bank and Gaza through Bank of China account numbers 4750401-0188-150882-6 and 4762307-0188-034456-6. Both accounts were held by al-Shurafa between July 2003 and early 2008.⁸⁸ The funds themselves are not inconsequential, and most are large-volume by the nature of their size and therefore would have been subjected to reporting requirements.

⁸⁵ Shira Scheindlin, Opinion and Order, *Wultz v Bank of China Ltd.*, 865 F. Supp. 2d 425 (SDNY, 2012), No. 11 Civ 1266(SAS), US District Court, New York, May 25, 2012.

⁸⁶ Respondents' Memorandum of Law in Opposition to the Petitioner's Motion to Quash, Miscellaneous No. 13-1282 (RBW), *Sheryl Wultz et al v. The State of Israel*, US District Court for the District of Columbia, Dec. 17, 2013, p. 8.

⁸⁷ *Ibid.* 8.

⁸⁸ Declaration of Shlomo Matalon, *Sheryl Wultz et al v. The Islamic Republic of Iran et al.* Civ. No. 08-01460, United States District Court for the District of Columbia, May 16, 2009. (<http://blogs.reuters.com/alison-frankel/files/2014/10/bankofchina-plaintiffsoncantor.pdf>), accessed July 10, 2018.

Figure 2.2 outlines some of the sums involved. According to Matalon, the Bank of China continued to service the transactions despite the Israeli notification of the activity.

Figure 2.2: PIJ/Hamas transfers conducted by Bank of China (Source: Declaration by Shlomo Matalon)

| Date of Transfer | Amount |
|------------------|-----------|
| Dec. 5, 2003 | \$99,970 |
| Jan. 9, 2004 | \$99,960 |
| Feb. 18, 2004 | \$99,990 |
| March 15, 2004 | \$99,970 |
| March 19, 2004 | \$99,970 |
| April 15, 2004 | \$100,000 |
| Oct. 9, 2004 | \$200,000 |
| Oct. 24, 2004 | \$199,965 |
| Dec. 7, 2004 | \$8,000 |
| Dec. 8, 2004 | \$8,000 |
| Dec. 17, 2004 | \$8,000 |
| Jan. 28, 2005 | \$100,000 |

The terrorist financing in which Bank of China was involved consisted of a trade-based money laundering operation. Funds from the Syrian and Iranian regimes were sent to al-Shurafa's accounts at the Bank of China branch in Guangzhou. Monies from these accounts were then used by al-Shurafa to purchase innocent items such as clothing and toys that would then be sent to Gaza and the West Bank, whereupon they were subsequently sold. Last, the proceeds from the sale of these goods would be used to

facilitate terrorist operations like the one that killed and injured members of the Wultz family in 2006.⁸⁹ The damage claim made by the plaintiffs totaled \$750 million.⁹⁰

The case against the Bank of China was not isolated, nor was it even entirely the independent civil actions by the plaintiffs alone.⁹¹ Rather, the lawsuit served as an element of an Israeli strategy to use American civil law to counter the terrorist financing and blunt terrorist operations against the Jewish state. Along with the interdiction of shipping containers of Chinese origin en route to Gaza, Israel incorporated the use of lawsuits as part of a “National Policy” to counter terrorism through supporting lawsuits against banks that finance terrorism.

During the tenure of Meir Dagan as the director of Mossad (2002-2010), Israel’s foreign intelligence service and the Israeli National Security Council authorized the Terrorist Financing Task Force to begin providing information from intelligence sources on terrorist financing to lawyers and plaintiffs seeking to sue banks for funding terror.⁹² Knowing that the Bank of China held branches in the US and conducted dollar transactions, Jerusalem assured the plaintiffs that both documentary and testimonial evidence would be offered in support of the lawsuit. This testimony was meant to include that from Israeli intelligence officers present at the meetings between Israel and

⁸⁹ Respondents’ Memorandum of Law in Opposition to the Petitioner’s Motion to Quash, Miscellaneous No. 13-1282 (RBW), Sheryl Wultz et al v. The State of Israel, US District Court for the District of Columbia, Dec. 17, 2013. Pp. 6-7.

⁹⁰ Walter P. Laughlin, “Anti-Money Laundering, Anti-Terrorist Financing, and The Global Banking System: Three Anomalies”, Forum on Public Policy, 7.

⁹¹ Re: *Moriah v. Bank of China, Limited*, 12-cv-1594 (SAS)(gwg)-Subpoena on Eric Cantor. Judge Shira A. Scheindlin, SDNY, Oct. 7, 2014, (<https://blogs.reuters.com/alison-frankel/files/2014/10/bankofchina-plaintiffsoncantor.pdf>), accessed Jan. 10, 2019.

⁹² Respondents’ Memorandum of Law in Opposition to the Petitioner’s Motion to Quash, Miscellaneous No. 13-1282 (RBW), Sheryl Wultz et al v. The State of Israel, US District Court for the District of Columbia, Dec. 17, 2013, 10.

China regarding the Bank of China.⁹³ The Israelis would later retract this offer due to diplomatic pressure from Beijing.

Over the course of the suit, the Bank of China engaged in two tracks of defense in order to protect the bank. First, the bank deployed its own bureaucratic countermeasures designed to thwart discovery efforts and prevent the court from accessing valuable documentary evidence. Second, Beijing used diplomatic pressure on Jerusalem to prevent Israel from allowing its intelligence officials from providing testimony. Combined, the Bank of China managed to block enforcement.

In 2011, the plaintiffs requested that the Bank of China proffer documents related to al-Shurafa's accounts, along with documents pertaining to investigations into the bank and its dealings as they related to sanctions related to money laundering and terrorism.⁹⁴ The bank immediately turned to the PBC for guidance. Subsequently, the bank then asked the court to send discovery requests to the PBC, which the court did. Over a year passed without the court receiving a response from the Chinese FIU. Eventually, in August 2012, the court received documents, consisting largely of copies of Chinese regulation manuals.⁹⁵

On October 29, 2012 the New York district court ordered the Bank of China to produce documents related to AML/CTF investigations. The bank initially refused, stipulating that the production of such material would violate Chinese bank secrecy

⁹³ Respondents' Memorandum of Law in Opposition to the Petitioner's Motion to Quash, Miscellaneous No. 13-1282 (RBW), Sheryl Wultz et al v. The State of Israel, US District Court for the District of Columbia, Dec. 17, 2013, pp. 10-11.

⁹⁴ Opinion and Order, Wultz v. Bank of China Ltd., 910 F. Supp. 2d 548, (SDNY 2012), October 29, 2012, at 551.

⁹⁵ *Ibid*, 552.

laws.⁹⁶ Based on Chinese bank regulations that were mentioned above and instituted in 2007, the bank's arguments carried some validity. The bank refused to comply with this first order to compel the production of evidence. Initially, the court remained hesitant to grant the plaintiff's motion to compel discovery, with the presiding judge noting that for the "production of confidential documents created by the Chinese government" would "infringe on the sovereignty of the foreign state and violate principles of international comity".⁹⁷

In May 2013, two years prior to the dismissal of the case, the court again ordered the Bank of China to produce documentary evidence pertaining to four elements aspects of the suit against it. First, the motion to compel the production of evidence sought to gain documentation of communication between the Bank of China and the state regarding the al-Shurafa accounts. Second, the court sought access to reports and other information on "deficiencies" in the AML/CTF infrastructure at the Guangzhou branch and corporate headquarters. Last, the court wanted to procure evidence relating to visits between "foreign officials" and Chinese authorities related to al-Shurafa's financial activity.⁹⁸

This May 2013 order resulted in the production of a deluge of documents, 5,751 in number, totaling over 200,000 pages of material.⁹⁹ However, the plaintiffs asserted that

⁹⁶ Opinion and Order, Shira A. Sheindlin, Sheryl Wultz et al v. Bank of China Ltd, US District Court Southern District of New York, 11 Civ. 1266 (SAS). October 25, 2013, 3.

⁹⁷ Opinion and Order, Wultz v. Bank of China Ltd., 910 F. Supp. 2d 548, (SDNY 2012), October 29, 2012, at 556.

⁹⁸ Opinion and Order, Shira A. Sheindlin, Wultz v. Bank of China Ltd., 979 F. Supp. 2d 479 (SDNY 2013), No. 11 Civ. 1266 (SAS), October 25, 2013, 485.

⁹⁹ Opinion and Order, Shira A. Sheindlin, Wultz v. Bank of China Ltd., 979 F. Supp. 2d 479 (SDNY 2013), No. 11 Civ. 1266 (SAS), October 25, 2013, 485.

the corpus of documents consisted of “filler”, including publicly available material such as compliance manuals, and information already produced by the bank.¹⁰⁰

Malnourished in documentary evidence, the plaintiffs eventually turned to Israel, which first empowered the suit and others like it to progress in the first place. Among the Israeli intelligence officers who met with the Chinese government was a Mossad officer named Uzi Shaya. In February 2012, the plaintiffs wrote to Israeli Prime Minister Benjamin Netanyahu, requesting that Shaya be allowed to testify under oath about matters related to the case. In response to the letter by the Wultzes, which was hand delivered by Ileana Ros-Lehtinen, a US Congresswoman; the Prime Minister’s notified the Wultzes several months later that Shaya’s testimony could proceed.¹⁰¹

Two years prior, in 2010, the Bank of China and Beijing came to an agreement that neither the Chinese government, nor the bank would not be needed to communicate with Jerusalem, under the umbrella of “mutual trust” that the Israelis would not offer the courts any information on the meetings between the intelligence officials and the Chinese.¹⁰² On March 20, 2013, Shaya wrote to the plaintiffs’ attorneys that he was willing to testify, though under certain stipulations do to the nature of his official status and the sensitivity of the subject matter.¹⁰³ Fearing the ramifications of Shaya’s testimony, Beijing immediately began exerting diplomatic pressure on Israel.

¹⁰⁰ Sept. 3, 2013 Plaintiffs’ Memorandum of Law in Support of Plaintiffs’ Motion to Compel Production of Documents Located in China Improperly Withheld as Privileged (“P1. Mem”), at 6.

¹⁰¹ Respondents’ Memorandum of Law in Opposition to Petitioners’ Motion to Quash, Misc. No. 13-1282 (RBW), Sheryl Wultz et al v. the State of Israel, Dec. 17, 2013, 23.

¹⁰² Ibid, 15.

¹⁰³ Uzi Shaya, “Re: Wultz v. Bank of China; Elmaliach et al v. Bank of China; Rot v. Bank of China, Mor v. Bank of China”, March 20, 2013.

In April 2013, the Chinese summoned the Israeli ambassador in Beijing, Matan Vilnai, threatening to cancel Netanyahu's May 2013 trip to China.¹⁰⁴ Between the Shaya letter and Netanyahu's visit, the Israelis assured Beijing that the Israeli intelligence officers privy to information in terrorist financing meetings would not testify in the United States.¹⁰⁵ Netanyahu did travel to China in May that year. Meeting with the Chinese in order to increase trade from \$8 billion to \$10 billion in three years, pen free trade negotiations, and cement new ties with Xi Jinping.¹⁰⁶ It is worth noting that the diplomatic stakes for Israel were high during this time. Cooling relations between the Netanyahu government and the US Obama administration, and ongoing negotiations with Iran over its nuclear program, to which China was one permanent negotiating party, provide some context for Israel's decision to retract the offer to allow Shaya to testify.

In reaction to the Israeli reversal, both the plaintiffs and US officials pressured Israel to recommit to its promise to allow testimony. A month after Netanyahu's China trip, Wultz, one of the plaintiffs, spoke with Israeli General Yaacov Amidror about the Bank of China case. Amidror did mention to Wultz that the Bank of China had promised to cease financing terrorism in the future, though it did so willingly in the period up to the suicide bombings in the mid-2000s. Furthermore, Amidror urged the plaintiff to recognize that the bank to reversed its policy as a result of legal assault waged against it

¹⁰⁴ Respondents' Memorandum of Law in Opposition to Petitioners' Motion to Quash, Misc. No. 13-1282 (RBW), Sheryl Wultz et al v. the State of Israel, Dec. 17, 2013, 16.

¹⁰⁵ Ibid, 16.

¹⁰⁶ Israeli Ministry of Foreign Affairs, "PM Netanyahu to China-May 2013", May 5, 2013. <http://mfa.gov.il/MFA/PressRoom/2013/Pages/PM-Netanyahu-to-visit-China-May-2013.aspx> (accessed Aug. 2, 2017).

in court.¹⁰⁷ With China increasing its financial status, and the Bank of China in particular growing in stature in the banking industry, such a change in course as easily could have resulted from adopting regulatory institutions organically as it could be the result of legal warfare. Despite additional pressure from US Congresswoman Ros-Lehtinen, the Netanyahu government refused to allow Shaya's testimony. In late 2013, the Israeli government moved to quash. In August 2015, the case was dismissed.

V. Analysis

The Bank of China developed and maintained deep institutional linkages with the Chinese state throughout its history. Since it opened at the turn of the 20th century, the bank has held the same relationship with the state, with the latter remaining the premier stakeholder in bank ownership over the course of multiple state regime types. This state ownership began during the Qing era, and expanded drastically under the Nationalist government, well before the Communist takeover in 1949. Serving as a financial extension of Beijing, the bank allowed the PRC to maintain a foreign exchange window to the outside world. Under subsequent restructuring beginning with Deng Xiaoping, the bank maintained this same status, with the state conserving its premier stakeholder status while absorbing private capital and increasing the scope of its operations.

Such institutional linkage between bank and state not only survived political turmoil in China, it also survived the regulatory adoption of the international threat finance regime. China began adopting the international AML/CTF regulations prior to 9/11 and the subsequent flood of regulatory adoptions around the world. Even in the

¹⁰⁷ Respondents' Memorandum of Law in Opposition to Petitioners' Motion to Quash, Misc. No. 13-1282 (RBW), Sheryl Wultz et al v. the State of Israel, Dec. 17, 2013, 17.

midst of enforcement attempts, the threat finance regime continued to mature, with the PRC joining the FATF in 2007. However, the Bank of China's deep relationship with the state was not altered when the fortified finance regime was adopted. Rather, the AML/CTF regime simply grew around this preceding structural configuration.

The Bank of China case encapsulates the moral hazard risk posed by a state seeking to effectively regulate a bank it itself owns. The PRC had a vested interest in defending the Bank of China from regulatory sanction throughout the course of the lawsuit filed against it. Not only did the Bank of China and its overseer the PBC bureaucratically choke off the production of evidence in the course of discovery, the PRC government also employed diplomatic pressure to coerce Israel into withholding testimony vital to the enforcement attempt carried out in US courts. This combination of diplomatic deflection and bureaucratic foot-dragging was sufficient to block enforcement against the bank.

This particular case not only offers an example of blocked enforcement, but also underscores how the financial system comprises a strategic terrain in its own right. In the case of the Bank of China, Israel and the PRC engaged in a legal fight over regulatory malfeasance in a third country's legal system. Furthermore, the entire encounter was the result of a state using the adversarial legal system of the US to pursue geopolitical goals against a terrorist group. Of all of the positive cases, the Bank of China arguably comprises the "easiest" case, as the bank itself was essentially a longstanding possession of the state. The Bank of China case also highlights the centrality of the American financial and legal system to the regulatory system of fortified finance. Not only did

Israel consciously approach the American legal system as a strategic terrain through which to pursue its security policy goals, but China leveraged its own status as a rising great power against Israel to dissuade it from using this American legal arena for this purpose.

Chapter 3: Al Rajhi Bank in Saudi Arabia

I. Introduction

Saudi Arabia's volte-face relationship with Sunni jihadist groups comprises an open secret in international affairs. Fifteen of the nineteen hijackers in the 2001 attack on New York and the Washington DC were from Saudi Arabia, and significant amounts of terrorist financing have flowed through the kingdom despite Riyadh's close relationship with the West. The 9/11 hijackers received funds from an Al Qaeda financier in Europe named Muhammad Galeb Kalaje Zouaydi.¹ Zouaydi transferred funds to the terrorists from an account at the Saudi financial institution, Al Rajhi Bank.² Al Rajhi Bank has yet to face regulatory or judicial penalty for financing terrorism, despite facing multiple attempts by plaintiffs in civil suits and American regulatory action.

First, this chapter traces the deep roots of the Al Rajhi Bank, and its close institutional intertwining with the Saudi monarchy and royal family. In addition to this connection, the bank's relationship to the Saudi regulatory regime will be explored prior to the importation of the fortified finance regime. Next, the bank's suspected involvement in terrorism will be outlined, along with Riyadh's adoption of greater regulatory capacity. Last, the blocked enforcement phase will be discussed.

¹ Rachel Ehrenfeld, *Funding Evil*, (Chicago: Bonus Books, 2003), 45.

² Ibid, 45.

³ Louis Gordon and Ian Oxnevad, *Middle East Politics for the New Millennium: A Constructivist Approach*, (London: Lexington Books, 2016), 158.

⁴ Kristian Coates Ulrichsen, "Saudi Arabia", in *Power and Politics in the Persian Gulf Monarchies*, edited by Christopher Davidson, (New York: Columbia University Press, 2011), pp. 63-88, 63-64.

II. Al Rajhi Bank, Legitimacy, and Regime Binding

The bank's institutional position within the kingdom dates deep into Saudi Arabia's past, with the Al Rajhi family to whom the bank belongs enjoying close relations with the monarchy. The Al Rajhi history illustrates a relationship in which the monarchy has proven incapable of regulating a financial institution due the bank's position as a coalition binder for the ruling family. The Al Rajhi family's supposedly close ties with jihadist elements in the kingdom, and the monarchy's reliance on both the banking family and its relationship to religious authorities effectively render the bank institutionally untouchable by the Saudi authorities due to the banking family's importance to the Saudi regime's stability.

In order to understand the nature of the relationship between the Saudi monarchy and the Al Rajhi Bank, it is necessary to understand the bank's unique history and its role in the Saudi economy. Unlike modern Western banks, or banks elsewhere that follow a Western business model, the Al Rajhi Bank's origins lay in Saudi Arabia's deep past as a money dealing network that only emerged in its first incarnation as a modern bank in 1957. The monarchy, the bank and the money network that preceded it, and religious radicalism lie deeply intertwined with the origins of the Saudi state and the state's composition as a tribal monarchy that relies heavily upon religious legitimacy.

The Saudi monarchy's reliance on religious influence dates to the mid-18th century. Unlike other areas of the Middle East, the interior of the Arabian Peninsula in which the monarchy originates never experienced colonization. Both regional and global powers never fully penetrated into the peninsula's harsh interior. Effectively isolated

from much of the outside world, today's ruling Saudi monarchy developed a unique relationship with religious authority that would shape its banking and governing institutions.

The fusion of the Saudi royal family's temporal authority with the religious zeal of the Hanbali Islamic juridical tradition traces to the 1740s, when the sheikh of the Rwala tribe, Muhammad Ibn Saud brokered a marriage between his son and the daughter of Muhammad Ibn 'Abd al-Wahhab.³ The Hanbali tradition of Islamic jurisprudence, with its offshoots of Salafism and Wahhabism, serves as the religious basis for Sunni terrorist jihadist movements around the world. In foreign relations, the binding of the Saudi monarchy with Wahhabism allows the kingdom to leverage considerable soft power in the Sunni world as a result of oil revenue and the presence of Mecca and Medina within its borders. Domestically, Wahhabism directly contributed to the consolidation of Saudi power within the Arabian Peninsula while also serving as a threat to the monarchy's security over the course of its modern history. Wahhabist groups' activity within the kingdom has intermittently threatened the monarchy's overthrow, while Wahhabist jihadist groups have undermined the kingdom's relationships with outside powers.

Wahhabi influence played a significant role in the kingdom's legal and institutional development, often leading to tensions between religiously motivated traditionalists and ambitious modernizers. The contemporary Saudi state only came into being in 1932, after nearly a century of fluctuating Saudi tribal rule based in the Nejd, in

³ Louis Gordon and Ian Oxnevad, *Middle East Politics for the New Millennium: A Constructivist Approach*, (Lanham: Lexington Books, 2016), 158.

the heart of the peninsula. The *Ikhwan*, the Wahhabi militia that helped the Saudi family consolidate its rule during the 1920s, had to be defeated by forces led by Abdul Aziz Ibn Saud in 1930 before the monarchy could effectively exert royal authority over the religious elements in its midst.⁴ Since 1932, the monarchy has engaged in uneasy political balancing with Wahhabi radicals in the kingdom. As the state matured in the 1940s and 1950s, schisms over the establishment of economic institutions would become a focal point of tension between the forward-looking monarchy and religious traditionalists.

Economically, Saudi Arabia relied upon localized agriculture, pastoralism, and small commerce into the 1940s.⁵ From the death of Abdul Aziz in 1953 until the oil boom twenty years later, the Saudi political economy witnessed an enmeshing of relationships between the monarchy and the banking industry that would later shape the kingdom's inability to effectively regulate the lion's share of its financial sector. During the 1950s and 1960s, regional dynamics driven by political events elsewhere in the Arab world shook the Saudi socio-political landscape. Saudi workers trained in Egypt and Lebanon brought secular political mores back to the kingdom, while the proliferation of print periodicals and the introduction of radio and television prompted a backlash by conservative Wahhabis.⁶

Threatened by secularizing influences brought from Arab Nationalist Egypt via modern media, and engaged in a proxy war with Cairo in Yemen, Wahhabi clerics during

⁴ Kristian Coates Ulrichsen, "Saudi Arabia", in *Power and Politics in the Persian Gulf Monarchies*, edited by Christopher Davidson, (New York: Columbia University Press, 2011), pp. 63-88, 63-64.

⁵ Ulrichsen, 64.

⁶ David Commins, *The Wahhabi Mission and Saudi Arabia*, (New York: IB Tauris, 2006), 108-110.

this era pushed for the development of institutions that would provide modern mechanisms for the propagation and preservation of Wahhabi power. Such institutional developments would include the formation of religious universities, the establishment of the World Muslim League, and a parallel and often contentious relationship between religious and state-based authority in the kingdom's legal system.⁷ This legal double helix within Saudi Arabia led to Wahhabi considerations taking precedent in matters of commercial law. In business, legal developments took place in a competitive growth between secular administrative bodies and religious authorities in the court system.

Until the foundation of the modern state, the west coast of the Arabian Peninsula, the Hejaz, remained outwardly oriented and cosmopolitan due to its access to foreign trade along the Red Sea and exposure to outside influences during annual *Hajj* pilgrimage. The cosmopolitanism of the Hejaz stood in stark contrast with the ultraconservative Nejd in the center of the country, and in which the Saudi-Wahhabi alliance originated. From 1926 until 1955, the Hejaz enjoyed a commercial legal domain largely beyond the purview of religious authorities. However, in the mid-1950s, religious jurists succeeded in gaining control of commercial adjudication in the region, until a decade later when the monarchy re-established secular oversight in the form of the Ministry of Commerce.⁸ Within the commercial courts of the ministry, three secular judges oversaw the adjudication of business disputes. By the late 1960s, Wahhabi clerics reasserted institutional control by placing two religious judges to one secular regulator in

⁷ Commins, 117.

⁸ Ibid, 119-120.

each panel.⁹ Al Rajhi Bank's origins in the Hejazi city of Jeddah date to this period of competition between royal technocrats and Wahhabi religious authorities during Saudi modernization in the mid-20th century.

While the Al Rajhi family's parent holding firm, Al Rajhi Holding Group was founded in 1936, the first modern Al Rajhi Bank began in the 1960s as a money changing business in the traditional street market in Jeddah, with the founder, Suleiman Al Rajhi supplying paper cash to other money dealers in the city from a suitcase.¹⁰ Unlike the cosmopolitan business class of the Hejaz, the Al Rajhi family traces its origins to the Nejd in the conservative interior of the country. The Al Rajhi family enjoyed a close relationship with the founding monarch of the modern state, Abdul Aziz Ibn Saud. This interpersonal relationship between the king and the Al Rajhi family was reinforced by land grants offered to the family and Al Rajhi's oversight of much of the king's personal business dealings.¹¹ The relationship between bank and monarchy within the kingdom's political economy was already in place by the time the Saudi economy began to grow the institutions necessary for modern economic development. Additionally, due to the personal ties between the ruling family and the Al Rajhis, as well as the position of the latter within the financial sector later on, the monarchy has held little institutional leverage over the bank's alleged involvement in financing terrorism.

Tribal wars during the 1920s, during which the Wahhabi *Ikhwan* routinely raided commercial centers on the coast, left a mutual suspicion between the new Saudi state and

⁹ Commins, 120.

¹⁰ Rodney Wilson, *Banking and Finance in the Middle East*, (New York: St. Martin's Press, 1983), 12.

¹¹ *Ibid*, 13.

Hejazi merchants. Both Ibn Saud and his Wahhabi base of support were openly hostile to the Hejazi moneychangers and foreign banks around Mecca.¹² This hostility lay rooted not only in the tribal conflict that lingered in the kingdom's political memory, but also due to many traditional money changing houses and foreign banks engaging in practices related to *riba*, or the charging of interest and participating in other business practices forbidden by Islamic law. Due to its traditional financial practices grounded in religious consideration, Ibn Saud favored the Al Rajhi network.¹³ Indeed, despite the centuries-old financial position of Hejazi commercial families, the wealthiest families of today's Gulf States do not originate on the Red Sea coast, but from the conservative desert region of the Nejd.¹⁴

Distrust of foreign banks and a steadily increasing supply of foreign currency from the 1940s onwards pressured Ibn Saud to look for alternatives to relying on Egyptian and British banking interests seeking to establish a greater presence in the kingdom. In the early 1950s, Finance Minister, Sheikh Abd Allah Suleiman turned to American financial expertise to formulate a solution to the kingdom's currency convertibility crisis. This solution encompassed the creation of the kingdom's central bank, the Saudi Arabian Monetary Agency (SAMA) that opened in 1952 a year before Ibn Saud's death.¹⁵

¹² Rodney Wilson, Abdullah Al-Salamah, Monica Malik, and Ahmed Al-Rajhi, *Economic Development in Saudi Arabia*, (Abingdon: Routledge, 2004), 57.

¹³ Wilson, (1983), 13.

¹⁴ Michael Field, *The Merchants: The Big Business Families of Saudi Arabia and the Gulf States*, (Woodstock: The Overlook Press, 1985), 73.

¹⁵ Wilson et al (2004), 58.

III. Al Rajhi Bank and the Saudi Regulatory System

Suleiman arranged the creation of the regulatory agency to avoid business practices based on interest, and Article 3.7 of the agency's charter stipulates the prohibition of interest of interest payments in the kingdom's financial sector.¹⁶ The timing of SAMA's founding and its initial institutional tasks had implications for the royals' relationship with the Al Rajhi family, particularly as SAMA embodied potential competition to the Al Rajhi network for the handling of kingdom's royal funds.¹⁷ Unlike Al Rajhi's traditional orientation, SAMA embodied technocratic modernity. With its revenues based upon charging the state fees for its activities, SAMA enjoyed considerable autonomy through operating beyond the purview of the Ministry of Finance and by employing its own recruitment programs outside of the civil service.¹⁸ Additionally, the agency's early years instilled a professionalism through early careerists consisting of American and Lebanese financial experts and a board of governors subject to royal decree.¹⁹

Al Rajhi Bank, the largest Islamic bank in the world by the mid-2000s,²⁰ was founded first as a money dealer in the traditional *souk* of Jeddah in 1957, and then as a modern *sharia* compliant bank in 1987. The bank's growth from a street-based money dealing operation to a multinational bank can only be understood through examining the organization's role in the Saudi economy. Unlike banks following a Western business

¹⁶ Wilson (2004), 59.

¹⁷ David Holden and Richard Johns, *The House of Saud*, (London: Pan Books, 1981), 166-167.

¹⁸ Steffen Hertog, *Princes, Brokers, and Bureaucrats*, (Ithaca: Cornell University Press, 2010), 57.

¹⁹ *Ibid*, 57.

²⁰ Rodney Wilson, "Islam and Business", *Thunderbird International Business Review*, Vol. 48, No. 1, (2006), pp. 109-123. See also, "Top Islamic Financial Institutions", *The Banker*, Nov. 2015.

model, traditional moneylenders in the Gulf remain tied to specific industries and often directly participate in the non-banking operations of these industries themselves.²¹ Additionally, lending is often predicated upon the requirement that the debtor spends the loaned cash with businesses affiliated with the bank through family and personal ties.²² As a moneychanger, Al Rajhi Bank enjoyed a comfortable position through close social proximity to the royal family and serving as the preferred financial institution facilitating remittances for foreign workers in Saudi Arabia from across the Muslim world. Even as its financial status grew, the bank maintained traditional business practices to the point that individual cash couriers frequently traveled to Europe to exchange notes for gold and other currencies in order to replenish their individual Saudi branches.²³ Al Rajhi Bank's status as a *sharia*-compliant financial institution eventually clashed with the kingdom's own regulatory stance in the 1980s, when the bank's lobbying ability allowed it override SAMA's opposition to the religious nature of the bank's business practices.

As noted above, the kingdom's political economy historically balanced a fine line between establishing regulatory institutions oriented based upon modern technocratic expertise and religious considerations. While SAMA was prohibited from conducting business in interest, thereby avoiding violations of Islamic business practices, the agency itself largely opposed the promotion of Islamic banking in the kingdom and instead focused on regulating banks' levels of reserve capital and providing financial advice to

²¹ Wilson (1983), 16.

²² Ibid, 16.

²³ Wilson (1983), 18.

the state.²⁴ Even as oil revenues flushed the kingdom with capital in the 1970s, the increased need for financial institutions was met through an increased presence of foreign banks, regulated by SAMA.²⁵ Traditional banking remained the domain of the informal sector, based in the street market.

The fact that Al Rajhi Bank managed to lobby the Saudi state into allowing it to become a modern sharia-compliant bank is noteworthy for two reasons. The first is due to the institutional status of SAMA within the kingdom Al Rajhi's ability to lobby and overcome the central bank's opposition to its modernization. Unlike other countries in the Middle East, SAMA has kept an institutional distance between itself and the members of the royal family by never having royals on its board.²⁶ The second is the fact that SAMA also operates as the manager of the kingdom's sovereign wealth fund. Yet, despite SAMA's technocratic acumen and institutional distance, Al Rajhi managed to override the agency's opposition to its modernization. Al Rajhi's prominence in the kingdom has only increased after its modernization, and this prominence came to the forefront of a 2010 IMF assessment that noted the kingdom's highly concentrated banking sector.²⁷ As of 2016, Al Rajhi alone held 16% of the kingdom's banking industry market share.²⁸

While the early 1970s and the aftermath of the Yom Kippur War catapulted capital into the Persian Gulf in the form of oil revenue, 1979 marked another geopolitical

²⁴ Wilson et al, (2004), 59.

²⁵ Ibid, 60.

²⁶ Sara Bazoobandi, *The Political Economy of the Gulf Sovereign Wealth Funds*, (Abingdon: Routledge, 2013), 68.

²⁷ Ahmed Banafe and Rory MacLeod, *The Saudi Arabian Monetary Agency: 1952-2016*, New York: Springer 2017), 153.

²⁸ Ibid, 268.

turning point for Sunni monarchies in the region, and for Saudi Arabia in particular. The Iranian Revolution brought to power a regime openly hostile to Riyadh, and one that could rival Saudi Arabia's position as a geopolitical representative for Islam; meanwhile, that same year the Soviet Union invaded Afghanistan. Domestically the Saudis experienced their most dire security threat since eradicating the *Ikhwan* decades before, when Mecca's Grand Mosque was seized by terrorist led by Juhayman al-Otaybi, the grandson of one of the *Ikhwan*'s commanders. The need to harness Islamic legitimacy in order to maintain security at home and project power abroad to counter Iranian and Soviet threats would impact the Saudi banking sector through the official introduction of Islamic banking.

The institutional changes brought about by the 1970s in the kingdom cannot be overstated. While the Gulf was flooded with oil wealth, the technocratic elements within Saudi bureaucracy began to lose ground to religious-minded traditionalists. The assassination of King Faisal in 1975 at the hands of Faisal bin Musaid had led to a new era of caution on the part of the monarchy regarding religious elements in the kingdom. Many believe Faisal's assassin acted out of revenge for the 1965 police killing of the traditionalist prince, Khalid bin Musaid, over his opposition to the modernization of Saudi life.²⁹ Following Faisal's death, King Fahd allowed greater concessions to Wahhabism in the form of allocating greater funds to religious schools and universities, despite declining state budgets through the early 1980s.³⁰ The SAMA, with the monarchy following greater caution over religious affairs and facing pushback from other

²⁹ Commins, 110.

³⁰ Hertog, 126.

ministries over the resolution of commercial disputes, began to lose institutional predictability on issues in its purview.³¹

In the early 1980s the Al Rajhi family operated Saudi Arabia's largest money dealing and remittance service. However, after one branch of the family's banking network nearly collapsed as a result of silver bullion speculation in 1982, the SAMA stepped in to regulate the informal banking sector by mandating registration and conversion of traditional moneylending operations into modern commercial banks.³² Traditional money dealers were mandated to convert their institutions by the end of 1983 if they were to stay in business.

While Al Rajhi sought to morph into a commercial bank, its traditional religious mores stipulated that the bank would be Islamic in nature and follow *sharia*-compliant business practices. SAMA was not only hostile to the notion, but did not acquiesce to the Al Rajhi's pleas until 1988.³³ SAMA's director at the time, Hamad Al Sayari, proved a strict regulator in keeping with the professionalism of the agency's institutional legacy; however, monarchic mandates determined final decisions regarding regulatory outcomes.³⁴ After an aggressive campaign to convince the state to allow it a banking license, the Al Rajhi Banking and Investment Corporation came into being.³⁵ The bank was allowed to provide Islamic financial services, provided that "Islamic" did not appear

³¹ Hertog, 127.

³² Wilson, (1983), 171.

³³ Wilson et al (2004), 61.

³⁴ J. Millard Burr and Robert O. Collins, *Alms for Jihad*, (Cambridge: Cambridge University Press, 2006), 56-57.

³⁵ Wilson et al (2004), 61.

in the bank's name.³⁶ While the SAMA's stance opposed the introduction of overt Islamic banking within the kingdom, Riyadh has openly supported the spread of Islamic financial institutions elsewhere in the world.³⁷ In Saudi Arabia itself, Al Rajhi stands as the only bank of a primarily Islamic orientation; other banks in the kingdom largely focus on conventional financial services.³⁸ As for why the state forbade Al Rajhi from holding an overtly Islamic moniker, the bank was barred from carrying the title over concerns that having an outwardly "Islamic" bank would implicate other financial institutions as somehow un-Islamic in their business practices.³⁹ As the bank grew, the Al Rajhi conglomerate expanded its non-banking activities into the fields of construction and philanthropic activities. This combination supposedly placed it at the social nexus for working with Al Qaeda over the course of the 1980s and 1990s. SAMA, one of the regulatory bodies that would serve to thwart money laundering and terrorist financing began collecting suspicious activity reports (SARs) in the 1970s. SAMA's weakness in the face of Al Rajhi's influence in the kingdom would serve as a lasting institutional condition.

As for how the bank survived transitioning from a traditional money dealing network to a modern bank, the bank itself operated as but one of many ventures overseen by the Al Rajhi family. These ventures spanned from banking and construction, to the poultry business and non-profit sectors. In 1978 these ventures formally melded together

³⁶ Wilson et al. (2004), 61.

³⁷ Ibid, 61-62.

³⁸ Rodney Wilson, (2006), 119.

³⁹ Wilson, (2004), 61.

into the Al Rajhi Trading and Exchange Company.⁴⁰ After its full conversion to a modern joint-stock banking venture in 1987, majority shareholders remained with the Al Rajhi family. As the bank and its affiliated businesses expanded, its connections with the Saudi state expanded in the form of contracts for infrastructure projects.⁴¹ Al Rajhi wealth was prominent enough warrant mention in a US diplomatic cable in 1996, which noted the family's wealth dwarfed that of most of the members of the Saudi royal family.⁴²

At the time of its transition from traditional money dealer into modern bank, the Al Rajhi Company for Currency Exchange and Commerce was already worth \$7 billion; while its founder Suleiman Abdul-Aziz Al Rajhi was the richest man in the kingdom outside of the royal family.⁴³ Yet, despite its wealth, the Al Rajhi's religious mores continued to guide its business. Unlike other burgeoning Saudi billionaires who began utilizing private jets and buying holiday homes in Europe and elsewhere in the 1980s, the Al Rajhis maintained austere business premises and remained close to their traditional Bedouin roots.⁴⁴ Socially embedded within the religious segments of Saudi society, Al Rajhi Bank patronized numerous religious charitable causes in the kingdom. Taking place in a domestic environment where emboldened Wahhabism began to enjoy greater leeway given by the Saudi state, some of Al Rajhi bank's charitable causes allegedly financed terrorism.

⁴⁰ "US Vulnerabilities to Money Laundering, Drugs, and Terrorist Financing: HSBC Case History", US Senate Permanent Subcommittee on Investigations, July 17, 2012, 190.

⁴¹ Wilson, (2004), 61.

⁴² Saudi Royal Wealth: Where do they get all that money?, Nov. 30, 1996. Canonical ID; 96Riyadh4784_a, Wikileaks, https://wikileaks.org/plusd/cables/96RIYADH4784_a.html, (accessed Jan. 16, 2018).

⁴³ Field, 120.

⁴⁴ Ibid, 85-86.

IV. Counter-Terrorist Financing and Al Rajhi Bank

If Saudi Arabia comprises a strong state, it also lacks institutional standardization. Laws and major bureaucratic decisions rest on royal decree and the monarchy's negotiation of power dynamics between the *ulema*, factions within the royal family, and changes in the Middle Eastern geopolitical landscape. While monarchic mandate remains the ultimate arbiter of state decisions in the kingdom, the legal realm relies on traditional *sharia* law. The ultraconservative Hanbali tradition of Islamic jurisprudence, from which Wahhabism derives, is the official juridical orientation of the kingdom. In order to understand the Saudi legal approaches to terrorism and terrorist financing, the tensions between royal decree and Hanbali legal code must be taken into account. Additionally, while Western *de jure* notions of CTF regulation are relatively new and date to the early 2000s, Saudi surveillance of the financial system dates to the mid-1970s.

Characteristics of the Saudi legal system place the monarchy in a precarious position in relation to religious authorities in the *ulema*. The kingdom's legal system consists of *sharia*, with the king serving as the final point of appeal for legal decisions. During the late 1980s and early 1990s, during the same period in which Al Rajhi reinvented itself as a modern bank, religious authorities and business groups began advocating for a reassertion of Islamic religious mores in the kingdom.⁴⁵ Elements of this reassertion included King Fahd's issuance of decrees explicitly stating that royal authority drew legitimacy from the Quran and Prophetic tradition.⁴⁶ In the legal realm,

⁴⁵ Ulrichsen, 69.

⁴⁶ Ibid, 69.

judges were still to be appointed by royal fiat.⁴⁷ However, with the sharia judicial system overseeing all aspects of both civil and criminal law, this would place any royal override of legal decisions potentially at odds with religious bases of power in the kingdom. Understanding this balancing act is key to comprehending how the Saudi state, with its collection of SARs since the 1970s, could overlook the suspected funding of terrorism by Al Rajhi Bank.

The early 1990s reforms enacted by Fahd's decrees culminated in the Basic Ordinance of Saudi Arabia in 1992. While the king is considered above the ostensibly separate legislative and judicial powers within the kingdom, Article 67 stipulates that the monarchy has regulatory purview in areas in which sharia law has no specific answer.⁴⁸ Despite the supposed urbanity of commerce, to which this royal prerogative is most applicable, the monarchy's actions are curtailed by theories from sharia law.⁴⁹ Royal oversight of regulatory mandates is bound by legal theory from the medieval scholar Ibn Taymiyya, whose theories stipulate that the regulations issued cannot fly in the face of sharia dictates.⁵⁰ In the case of Saudi Arabia, it is not inconsequential that Ibn Taymiyya's theories outline the range of the monarchy's royal authority in the regulatory sphere. Ibn Taymiyya's interpretation of sharia law is the legal justification drawn upon by Sunni terrorist groups such as the Islamic State and Al Qaeda.

The intellectual founders of Sunni jihadist groups, Abd al-Wahhab, Sayyid Qutb, and Ibn Taymiyya were all Hanbali juridical thinkers. For the Saudi monarchy, it is

⁴⁷ Ulrichsen, 70.

⁴⁸ Esther van Eijk, "Sharia and National Law in Saudi Arabia", in *Sharia Incorporated*, (Leiden: Leiden University Press, 2010), edited by Jan Michiel Otto, pp. 139-180, 156.

⁴⁹ *Ibid*, 156.

⁵⁰ *Ibid*, 156.

ironic that during the 1990s, Sunni jihadists would draw upon Ibn Taymiyya's philosophy and juridical decisions to advocate for the overthrow of the royal family.⁵¹ In the regulatory realm, the kingdom is institutionally at an impasse with its own religious legitimacy. Within Saudi law, both terrorism and terrorist financing fall under the same category of crime, which draws from sharia law. Specifically, both terrorism and terrorist financing are considered *hiraba*, or the "killing and terrorization of innocent people, spreading evil on the earth, theft, looting, and highway robbery".⁵²

Regarding the prevention of terrorism and terrorist financing, both legal frameworks were present by the time the modern Al Rajhi bank is suspected to have begun serious involvement in funding groups such as Al Qaeda. The presence of sharia law since the beginning of the kingdom indicates that whatever action or inaction taken by the Saudi state regarding terrorism had a legal basis upon which to draw in order to counter terrorism. In terms of banking supervision, SAMA began operating a surveillance system in the mid-1970s. In 1975, Saudi Arabia began mandating the collection of suspicious activity reports (SARs).

SAMA was the prime agency concerned with collecting financial surveillance in the kingdom. SARs were to be collected by financial institutions and then reported to law enforcement and the central bank. The original purpose for such collection of

⁵¹ Gilles Kepel, *Jihad: the Trail of Political Islam*, (Cambridge: Harvard University Press, 2002), 72. See also, Jessica Stern and JM Berger, *ISIS: The State of Terror*, (New York: Harper Collins, 2015), 265-269.

⁵² Report of the Kingdom of Saudi Arabia Submitted Pursuant to Paragraph 6 of Security Council Resolution 1373 (2001) Concerning Counter-Terrorism, at 5, UN Doc. S/2001/1294 (Dec. 26, 2001), <http://www.un.org/en/sc/ctc/resources/1373>. See also, Report of the Kingdom of Saudi Arabia in Response to the Comments Contained in the Letter Dated 18 April 2002 from the Chairman of the Security Council Committee Established Pursuant to Resolution 1373 (2001) Concerning Counter-terrorism, at 4, U.N. Doc. S/2002/869 (July 10, 2002), <http://www.un.org/en/sc/ctc/resources/1373.html>.

financial intelligence was the crackdown on illegal remittance systems in the kingdom, and underground banking overall.⁵³ Institutionally, the original design of such financial organization was intended to monitor and sanction financial services precisely like Al Rajhi Bank prior to its modern reinvention as an Islamic bank in the 1980s. It must be noted that these regulatory arrangements began well before 1979 when kingdom faced an international motivation to turn a blind eye to terrorist activity abroad. Instead, such surveillance was domestically motivated in order to help modernize the Saudi financial system and increase its efficiency. This surveillance began prior to the lobbying by Al Rajhi to pressure the kingdom into letting it become a modern bank. In other words, the Saudi regulatory apparatus for financial surveillance was partly in place by the time Al Rajhi supposedly began supporting terrorism in the 1990s.

The beginnings of Saudi efforts to surveil their financial system in the 1970s coincided with a marked increase in the kingdom's efforts to use the soft power of religion and promote Sunni Islam around the world. One loophole in the Saudi financial intelligence system consisted of limiting royal regulatory purview to legal areas in which sharia law is uncertain, the second is linked to the kingdom's approach to regulating *zakat*, or Islamic charity. Unlike in the West, where taxes and charity are conceptually separate types of financial activity, Islamic thought holds little differentiation between the two. The regulation of Saudi taxes and charity are inextricably linked for Saudi citizens and enterprises, since *zakat* taxes are levied on all Saudi interests, and both are regulated by the Department of Zakat and Income Taxes (DZIT). In order to meet these

⁵³ Anti-Money Laundering and Combating the Financing of Terrorism: Kingdom of Saudi Arabia, Middle East and North Africa Financial Action Task Force, June 25, 2010, 146.

requirements, regulated by DZIT since 1950, Saudi entities often have special committees to facilitate paying such fees.⁵⁴ Despite regulatory attempts to increase the transparency as to where such charity funds were destined, the chief regulator of SAMA lamented that many payments go abroad for unknown uses.⁵⁵ One primary function of Islamic banking institutions is the facilitation and oversight of zakat for its clients.⁵⁶ In the case of Al Rajhi Bank and other suspected terrorist financiers, it was through charitable foundations that finance moved from the bank to terrorism.

In Western states, most governments developed aspects of welfare institutions beginning in the late 19th century. In the West, private charity and government-backed social assistance are separate economic phenomena that both contribute to social causes. In Islamic economic thought charity, whether from private actors or from the state, is the same. Charitable foundations provide the lion's share of social welfare, and the state has historically supported such foundations in Islamic countries through the form of *zakat* taxation. In the case of Saudi Arabia, it is charities that have served as the conduit for terrorist funds to transmit from backers to fighters.

Al Rajhi Bank was one of several banks that supposedly transmitted such funds. The 9/11 hijackers from the Hamburg Al Qaeda cell received money through Al Rajhi accounts held by Mahmoud Darkazanli and Abdul Fattah Zammar, who provided the cell with logistical support.⁵⁷ Muhamma Galeb Kalaje Zouaydi transferred funds directly from Al Rajhi Bank to terrorists involved with 9/11, the Bali bombing in 2002 that killed

⁵⁴ Jean-Charles Brisard, "Terrorism Financing: Roots and Trends of Saudi Terrorism Financing", Prepared for the President of the Security Council, United Nations, New York, Dec. 19, 2002, 16.

⁵⁵ Ibid, 17.

⁵⁶ Ibid, 20.

⁵⁷ Brisard, 24.

204 people, and the 2004 Madrid attack that killed 192.⁵⁸ In addition to holding an account of a premier Al Qaeda financier, Al Rajhi Bank provided extensive financial support for the Al-Haramain Islamic Foundation, and the SAAR Foundation.⁵⁹ Each non-profit provided financial support for Al Qaeda. In 1999, US representatives from National Security Council and the Office of Foreign Asset Control went to Saudi Arabia to warn both Al Rajhi Bank and SAMA about the financial institution's ties to jihadist groups, and Al Qaeda in particular.⁶⁰ Securing Riyadh's cooperation in counter-terrorist financing efforts would prove a perennial struggle for the US until the kingdom's own security interests aligned with those of Washington.

The Al Haramain Islamic Foundation (AHIF) came into being during the late 1980s, with the purpose of supporting Wahhabi social action around the world. In 1997, the AHIF opened its own headquarters in Ashland, Oregon. At its height, AHIF had operations in 50 countries, and disbursed between \$30-80 million in its charitable work until its closure in 2004.⁶¹ US intelligence sources discovered that Al Haramain supported the Makhtab al-Khidemat (MAK) in Afghanistan, and even opened its own presence in Albania with the backing of Osama bin Laden.⁶² During the 1980s and 1990s, Al Qaeda's financial apparatus lay intertwined with MAK, or the Afghan Services

⁵⁸ Steve Barber, "The "New Economy of Terror:" The Financing of Islamist Terrorism", *Global Security Studies*, Vol. 2, No. 1, (2011), 5-6.

⁵⁹ *Ibid*, 5-6.

⁶⁰ *IN RE TERRORIST ATTACKS ON SEPTEMBER 11, 2001*, 349 F. Supp. 2d 765 (S.D.N.Y. 2005). Jan. 18, 2005, section 832.

⁶¹ Jimmy Gurule, *Unfunding Terror: The Legal Response to the Financing of Global Terrorism*, (Cheltenham: Edward Elgar: 2008), 126.

⁶² Press release, "Additional Al-Haramain Branches, Former Leader Designated by Treasury as Al Qaida Supporters Marks Latest Action in Joint Designation with Saudi Arabia", Office of Public Affairs, Dept. of the Treasury, June 2, 2004. <https://www.treasury.gov/press-center/press-releases/Pages/js1703.aspx> (accessed Dec. 28, 2017).

Bureau, that actively recruited Al Qaeda members, published propaganda, and boasted over thirty offices in the United States alone.⁶³ A 2003 cable by then Secretary of State, Colin Powell notes that AHIF's support was so widespread that Al Qaeda received support from roughly 20 of the NGO's branches, including those within Saudi Arabia.⁶⁴

In 1999, AHIF's involvement with Al Qaeda was shown to be even more direct. That year, an Al Haramain representative deployed a Bangladeshi terrorist to scout American consulates in India.⁶⁵ Upon his arrest by Indian authorities, where he was found with bomb-making material, he confessed that the planning of the foiled attacks on US targets in India was conducted on AHIF premises in Bangladesh.⁶⁶ AHIF also assisted Al Qaeda conduct attacks on US embassies in Kenya and Tanzania.⁶⁷

The US had advanced warning of Al Qaeda's presence in Kenya before the 1998 Nairobi attack. In 1997, Kenyan police raided the Nairobi home of Wadih el-Hage, a Lebanese-American who served as Osama bin Laden's secretary.⁶⁸ Due to evidence produced by the raid, officials suspected that the banker, Saleh Abdul-Aziz Al-Rajhi, had been supporting Al Qaeda.⁶⁹ El-Hage's personal affiliation with bin Laden began in 1986, while working in a MAK office in Quetta, Pakistan.⁷⁰ In the early 1990s, El-Hage's

⁶³ Rohan Gunaratna, *Inside Al Qaeda*, (New York: Berkely Books, 2002), 5.

⁶⁴ Terrorist Financing-Updated Nonpaper on Al Haramain, Jan. 28, 2003, Canonical ID: 03State23994_a, Wikileaks, https://wikileaks.org/plusd/cables/03STATE23994_a.html, (accessed Jan. 15, 2018).

⁶⁵ Treasury press release, June 2, 2004.

⁶⁶ Ibid.

⁶⁷ John B. Taylor, *Global Financial Warriors*, (New York: WW Norton and Company, 2007), 22.

⁶⁸ "US knew of bin Laden Kenya cell", NBC News, Oct. 24, 2003.

<http://www.nbcnews.com/id/3340668/t/us-knew-bin-laden-kenya-cell/#.WnAozBS6hFI>, (accessed Dec. 26, 2017).

⁶⁹ Ehrenfeld, 46.

⁷⁰ Burr and Collins, 98.

tenure in Nairobi included involvement in the illicit diamond trade,⁷¹ and forging documents for Al Qaeda members involved in the Nairobi attack.⁷² In 2002, the US and Saudi Arabia jointly began designating AHIF branches as supporters of terrorism, while the UN listed the foundation as a supporter of terrorism in 2004. El Hage was tried in the US and sentenced to life without parole in 2001.

Former Assistant Secretary to the Treasury, Juan Zarate notes that Al Rajhi's suspected involvement in Al Qaeda surfaced again in 2002, when Bosnian officials raided an Al Qaeda property in Sarajevo. Among the seized evidence were documents linking Al Qaeda to another Saudi charity, the Benevolence International Society. After the FBI raided the charity's Chicago offices, Treasury discovered a list of major backers who were allegedly involved in supporting Al Qaeda; this list included the founder of Al Rajhi Bank, Suleiman Al-Rajhi.⁷³ In a 2003 CIA report that became public knowledge in 2007, Suleiman Al-Rajhi was a member of prominent financiers known as the "Golden Chain". Al-Rajhi was allegedly not only a financier, but played an additional role in helping Al Qaeda front charities disguise their financial activity and avoid arousing a regulatory crackdown by Riyadh.⁷⁴ Concurrent to the Bosnian raid, US authorities began Operation Green Quest. Operation Green Quest would focus in part on the SAAR Foundation and the Safa Group. Both entities were supposedly intertwined with Al Rajhi Bank.

⁷¹ Douglas Farrah, *Blood from Stones: The Secret Financial Network of Terror*, (New York: Broadway Books, 2004), Chapter 4.

⁷² Burr and Collins, 98.

⁷³ Juan Zarate, *Treasury's War*, (New York: Public Affairs, 2013), 80.

⁷⁴ Matt Taibbi, "Gangster Bankers: Too Big to Jail", *Rolling Stone*, Feb. 22, 2013, 3.

One of the first responses the US took after 9/11 was to undertake renewed regulatory action against terrorist financing. Beginning in October 2001 and running through June 2003, a basket of US intelligence and regulatory agencies conducted “Operation Green Quest” in order to uncover and rectify terrorist financing vulnerabilities in the American financial system. By the time of its completion, Green Quest had frozen \$33 million and issued 70 indictments.⁷⁵ Much of the operation focused on an Al Rajhi-backed front for terrorist financing called the SAAR Foundation.

Yaqub Mirza founded the SAAR Foundation in 1984 with financial infusions from Suleiman Al Rajhi. Named after Suleiman Abdul-Aziz Al Rajhi,⁷⁶ the organization sought to expand Islam through the founding of over one hundred branch offices and non-profits based in Herndon, Virginia.⁷⁷ While SAAR itself closed in December 2000, it was replaced by Safa Group and operated with the same individuals. While tasked with promoting Islam, the foundation actually did little to win converts, but instead invested in Virginia real estate and agricultural businesses in the US and South America.⁷⁸ Virtually all of the organization’s 130 subsidiary groups functioned out of the same 555 Grove Street address in Herndon, and managed to avoid outright intervention from the US government due to the close relationship that Suleiman Al Rajhi enjoyed with the Saudi

⁷⁵ Steven Emerson, *Jihad Incorporated*, (New York: Prometheus Books, 2006), Ch. 10, location 4580.

⁷⁶ Burr and Collins, 279.

⁷⁷ *Ibid*, 280.

⁷⁸ *Ibid*, 281.

royal family.⁷⁹ Over the course of the late 1990s, it enjoyed significant donations, raking in \$1.7 billion alone in 1998.⁸⁰

A 2002 investigative piece by the *Washington Post*, citing both American and European investigators, noted that SAAR transferred \$20 million in funds to both Youssef Nada and Ahmed Idris Nasreddin.⁸¹ Authorities raided the bank used by Nada, Al Taqwa Bank, based in Switzerland and the Bahamas, in 2001. Al Taqwa boasted shareholders that included two members of the bin Laden family, and counted Nasreddin and Nada on its board.⁸² The bank was only able to establish itself in Switzerland due to the presence of Albert FA Huber, an outspoken Nazi, on its board of directors.⁸³ Al Taqwa Bank, Nada, and Huber were designated as supporting terrorism by the US Treasury Department in November 2001.⁸⁴ According to the investigative piece by the *Washington Post*, Nada and Suleiman Al Rajhi met through their mutual involvement with the Muslim Brotherhood.⁸⁵ The FBI met with SAAR representatives multiple times prior to 2001.⁸⁶

⁷⁹ Burr and Collins, 281.

⁸⁰ Stephen Schwartz, *The Two Faces of Islam: Saudi Fundamentalism and Its Role in Terrorism*, (New York: Anchor Books, 2003), LOC 4951.

⁸¹ Douglas Farah and John Mintz, "US Trails Va. Muslim Money Ties", *Washington Post*, Oct. 7, 2002, https://www.washingtonpost.com/archive/politics/2002/10/07/us-trails-va-muslim-money-ties/11fed21c-9928-40a4-845e-78b60c37f645/?utm_term=.b3def286f57c (accessed Jan. 15, 2018).

⁸² Mark Hosenball, "Attacking the Money Machine", *Newsweek*, Nov. 6, 2001, <http://www.newsweek.com/attacking-money-machine-149693>, (accessed Jan. 15, 2018).

⁸³ Hosenball, "Attacking the Money Machine", *Newsweek*.

⁸⁴ Recent OFAC Actions, US Dept. of the Treasury, Nov. 7, 2001, <https://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Pages/20011107.aspx>, (accessed Jan. 15, 2018).

⁸⁵ Farah and Mintz, *Washington Post*, Oct. 7, 2002.

⁸⁶ *Ibid.*

V. Blocked Enforcement

While Al Rajhi came under massive scrutiny from a number of sources, ranging from damning media reports to investigative journalism, and governmental agencies from several countries, the bank has enjoyed blocked regulatory enforcement from its home state. Indeed, this blockage has come in the form of Saudi-US diplomatic action and the shielding of the bank from civil lawsuits originating in American courts. First, the diplomatic activity will be analyzed, after which the civil suits will be examined. While the kingdom and Al Rajhi Bank have endeavored to build regulatory capacity to counter terrorist financing, the bank has yet to face penalization for its alleged prior activities. Instead, Saudi Arabia's development of increased regulatory capacity included Al Rajhi in its development and included bureaucratic reshuffling in the arenas of banking and charitable organizations.

Shortly after September 11, 2001, the United States began pushing for greater Saudi action against terrorist financing in the kingdom. Suspicion about Saudi knowledge and involvement ran high in the US, and led to strains in diplomatic ties between the two countries over issues related to terrorist financing. However, due to the precarious situation of the Saudi monarchy regarding the religious radicalism in its borders, the US opted for a cautious strategy in working with Riyadh to curtail terrorist financing. On September 24, 2001, President Bush, along with Secretary of State Colin Powell, and Secretary of the Treasury, Paul O'Neill complimented the Saudis on their cooperation with curtailing terrorist financing.⁸⁷ Yet, according to current and former

⁸⁷ Craig Unger, *House of Bush, House of Saud*, (New York: Scribner, 2004), 260.

intelligence and foreign policy officials at the time, the Saudis were mostly reluctant to cooperate too intensely on security issues related to terrorism.⁸⁸

In 2002, the Council on Foreign Relations singled out Saudi Arabia and its charities as conduits for terrorist funds. According to the Council, not only was Saudi Arabia dragging its feet through slow cooperation with the US, but also that the Bush administration was defending Riyadh by claiming cooperation on the part of the kingdom.⁸⁹ Additionally, the National Security Council advised the administration to push the Saudis to “punish” terrorist financiers within three-month period by ultimatum, or the US would take unilateral action against the financiers.⁹⁰ Prince Bandar, Saudi ambassador to the US at the time, noted that the kingdom would have to change carefully and slowly due to the religious conservatism of the Saudi population.⁹¹ In other words, a poorly planned monarchy-led crackdown on the kingdom’s socio-religious institutions, many of which relied on Al Rajhi Bank for financial support, could trigger a potentially destabilizing backlash.

From 2001 through 2005, Saudi Arabia implemented changes in an effort to cleanse its financial system of terrorist funds. However, it was only with an ongoing discreet US push and an increased terror threat within the kingdom that allowed these to take place. These measures were largely de jure in nature, and included the kingdom’s entering into greater involvement with the Financial Action Task Force, adopting UN

⁸⁸ Unger, 261.

⁸⁹ Naif bin Hethlain, *Saudi Arabia and the US Since 1962*, (London: SAQI, 2010), 279. See also, Council on Foreign Relations, Task Force Report, *Terrorist Financing*, 2002, p. 8.

⁹⁰ *Ibid*, 280.

⁹¹ William Simpson, *The Prince: The Secret of the World’s Most Intriguing Royal*, (New York: Harper Collins, 2006), 332.

resolutions, and developing domestic fortified finance capability. In October 2001, Saudi Arabia took initial action by adopting UN Security Council Resolution 1373 that mandates the freezing and seizing of terrorist assets in the financial system.⁹² Additionally, the kingdom established a full-fledged FIU in 2005. Al Rajhi Bank was present and involved in the development of the domestic regulations.

In March 2002, an American delegation from the Department of the Treasury traveled to Saudi Arabia to secure the kingdom's cooperation against Al Qaeda and its financial network. One of the goals of the meeting consisted of fostering joint action against the Al Haramain Foundation, and both the US and the kingdom jointly designated the organization as a financier of terrorism on March 11, 2002.⁹³ According to then-Assistant Secretary of the Treasury, Juan Zarate, the Saudis stepped up their crackdown on Al Qaeda's financial network in May 2003 after the outbreak of a number of terrorist attacks in the kingdom.⁹⁴ This critical juncture for Saudi domestic security vis-à-vis Al Qaeda, may have led Al Rajhi even closer to the monarchy and the organs of the Saudi state. However, despite increased cooperation, the financing of terrorism from within the kingdom led to ongoing aggravation for the Saudis due to the reticence of captured Al Qaeda members and skepticism within intelligence circles as to whether or not wealthy donors, such as those mentioned in the "Golden Chain", were actual contributors.⁹⁵ In

⁹² Alfred B. Prados and Christopher M. Blanchard, "Saudi Arabia: Current Issues and US Relations", Congressional Research Service, (July 11, 2006), 6.

⁹³ Zarate, 76.

⁹⁴ Zarate, 76.

⁹⁵ Ibid, 82.

total, the combined wealth of those individuals involved in the Golden Chain amounted to over \$85 billion, or 42% of Saudi Arabia's gross national product.⁹⁶

It must be noted that the relationship between the Saudi state and Al Rajhi Bank is not necessarily simpatico, nor simple. The Al Rajhi affiliation with the kingdom's conservative base, upon which the monarchy relies for its legitimacy is what drives Saudi caution in dealing with issues related to terrorist financing. According to an investigative piece by *The Wall Street Journal*, American intelligence agencies contemplated implementing covert action in order to sabotage and infiltrate Al Rajhi Bank.⁹⁷ Another strategy would have been to pressure other countries to more heavily regulate Al Rajhi's activities within their own jurisdictions; however, the Bush administration opted for a plan of action centered on closely and quietly lobbying the Saudi government.⁹⁸ Indeed, due to SAMA's technocratic acumen and surveillance apparatus being in place since 1975, the Saudi state may have proven incapable of curtailing the bank's activities due to its societal position in the kingdom's economy.

Diplomatic cables from 2004 indicate that there was particular concern over Al Rajhi Bank's involvement in funding terrorism. According to correspondence to the US Secretary of State, Zarate met with Ali Al Gaith, then Director of Banking Inspection, Insurance and Financial Leasing at SAMA. During the meeting, Al Gaith argued that public suspicion of Al Rajhi Bank was unfounded, and that the bank had received a clean bill of health following an August 2003 audit conducted by Ernst & Young. Zarate

⁹⁶ Gerald Posner, *Secrets of the Kingdom: The Inside Story of the US-Saudi Connection*, (New York: Random House, 2005), 171.

⁹⁷ Glenn R. Simpson, "US Tracks Saudi Bank Favored by Extremists", *The Wall Street Journal*, July 26, 2007, <https://www.wsj.com/articles/SB118530038250476405> (accessed Jan. 30, 2018).

⁹⁸ *Ibid.*

mentioned “particular accounts of concern” to Al Gaith that were connected to Al Rajhi Bank, and that the institution’s regulatory capacity warranted a review in addition to the conduct of an investigation regarding particular accounts. What is notable in the cable is that Al Gaith was “fed up” with American suspicion into Al Rajhi’s purported terrorist financing.⁹⁹

The regulatory and diplomatic tension extended into late 2004 when both American and Saudi officials conducted a joint on site examination into Al Rajhi Bank’s CTF capabilities. In a November 2004 diplomatic cable, Colin Powell notes that the Saudi CTF regime was robust in its ability to prevent its financial system from being used for terrorist financing. Pertaining to Al Rajhi Bank in particular, Powell mentions that the US provided Riyadh with evidence regarding a number of terrorist affiliated accounts, and that “the US and Saudi governments have agreed to work together to meet a mutual goal of ensuring Al Rajhi Bank is fully equipped to monitor and note suspicious patterns and trends in account activity, so as to create a preventative system within the institution”.¹⁰⁰ Powell notes that the reason for a joint review of the bank was to “work collectively with Al Rajhi Bank” in implementing measures designed to prevent future malfeasance.¹⁰¹ During the review, SAMA personnel would be present at “all meetings”

⁹⁹ Diplomatic cable, “Terrorist Financing: Al Rajhi Bank”, Canonical ID: 04Riyadh5103_a, Sept. 27, 2004, Wikileaks, https://wikileaks.org/plusd/cables/04RIYADH5103_a.html (accessed Feb. 1, 2018).

¹⁰⁰ Diplomatic cable, “Joint Examination of Al Rajhi Bank Through the Joint Terrorist Financing Task Force”, Canonical ID: 04State251768_a, November 25, 2004, Wikileaks, https://wikileaks.org/plusd/cables/04STATE251768_a.html (accessed Feb. 1, 2018).

¹⁰¹ Ibid.

with the bank's personnel, and the review would include meetings with specific managers who oversaw the relevant accounts.¹⁰²

While it is not publicly known if bank officials faced any arrest or other penalties in Saudi Arabia, the bank's relationship to terrorism is not one-dimensional. Not only did the bank have accounts used by terrorists directly, the bank's founder and head supposedly contributed to terrorist groups through charitable foundations, who in turn supposedly supported terrorist groups on an logistical level. The bank's relationship to the Saudi state would remain close as Riyadh engaged in bureaucratic reshuffling later in the decade in order to regulate charities and develop its FIU.

In the mid-late 2000s, the British bank, HSBC came under increasing scrutiny for nefarious financial practices ranging from aiding in tax evasion to laundering money for drug cartels and financing terrorism. Investigations into the bank from across multiple countries exacted a number of penalties against the institution, including a 2012 fine for \$1.92 billion, the largest financial penalty ever levied against a bank.¹⁰³ HSBC also had ties to Al Rajhi Bank. A 2012 report by the US Senate's Permanent Subcommittee on Investigations details a number of HSBC's internal emails debating the value of maintaining ties with Al Rajhi over the latter's financial relationships.¹⁰⁴

¹⁰² Diplomatic cable, "Joint Examination of Al Rajhi Bank Through the Joint Terrorist Financing Task Force", Canonical ID: 04State251768_a, November 25, 2004, Wikileaks, https://wikileaks.org/plusd/cables/04STATE251768_a.html (accessed Feb. 1, 2018).

¹⁰³ "HSBC to pay record \$1.9-billion fine in US money laundering case", Reuters, Dec. 11, 2012, <https://www.theglobeandmail.com/report-on-business/international-business/hsbc-to-pay-record-19-billion-fine-in-us-money-laundering-case/article6189108/> (accessed Feb. 1, 2018).

¹⁰⁴ "Hearing on US Vulnerabilities to Money Laundering, Drugs, and Terrorist Financing: HSBC Case History", US Senate Permanent Subcommittee on Investigations, Committee on Homeland Security and Governmental Affairs, July 17, 2012.

Senator Carl Levin notes that 2005 marked a year of confusion for HSBC regarding Al Rajhi, and that the British bank instructed its affiliated branches to cut all ties with Al Rajhi Bank outside of the Middle East over concerns related to terrorism. Yet, later that year, HSBC retracted its instructions to its affiliates and allowed every country branch to determine its own interactions with Al Rajhi. That following year, following threats by Al Rajhi Bank, HSBC relinquished and supplied the Saudi bank with \$1 billion in US currency.¹⁰⁵ HSBC's financial confusion regarding Al Rajhi and its financial ties is not solely due to overall mismanagement on its part, particularly as the Saudi bank worked closely with the Riyadh and the US in order to develop the kingdom's financial surveillance apparatus.

HSBC's confusion is notable, since 2005 marked a turning point in US-Saudi relations as President Bush and Crown Prince Abdullah met in April of that year to rebuild ties. Facing ongoing threats from Al Qaeda within its own borders, the Saudi state began to take a more overt stance against terrorism alongside the US.¹⁰⁶ While heads of state schmoozed diplomatically, the two countries were involved in further developing the Saudi regime of fortified finance.

Between 2005-2006, the kingdom was developing its FIU system in order to secure membership in the Egmont Group. Egmont Group, the international organization of states' respective FIUs, officially recognized the year of kingdom's founding of an

¹⁰⁵ Press release, "Opening Statement of Sen. Carl Levin: US Vulnerabilities to Money Laundering, Drugs, and Terrorist Financing: HSBC Case History", US Senate Permanent Subcommittee on Investigations, July 17, 2012, 4-5.

¹⁰⁶ Bin Hethlain, 306.

FIU despite the SAMA's beginning SAR collection in the 1970s.¹⁰⁷ The Saudi FIU was only officially admitted in May 2009. Al Rajhi Bank's position in the late 2000s was one of a gray area, but one in which it enjoyed a comfortable relationship with its home state.

Officially, the Saudi FIU began operations the day before the fourth anniversary of 9/11 on Sept. 10, 2005, and took place with the assistance from the United States and the involvement of Al Rajhi Bank. Indeed, between 9/11 and 2005, the Saudis froze 41 bank accounts at a total of \$5,697,400, or a paltry 4% of estimated global terrorist funds at the time.¹⁰⁸ Diplomatic cables from 2006 describe meetings in Riyadh between US Treasury officials and Saudi representatives from SAMA and its FIU, along with representatives from Al Rajhi Bank in order to help facilitate the kingdom's entry into the Egmont Group as a full member.¹⁰⁹ While the Saudis made institutional improvements in the areas of reporting and regulating charities, the cable describes bank officials as reluctant to discuss their relationships with the Saudi FIU or to talk about their monitoring practices.¹¹⁰

In 2009 a diplomatic cable disseminated through the American intelligence community describes US efforts to assist Saudi Arabia develop its fortified finance regime. In mid-May 2009, coinciding with the official Saudi membership date of the

¹⁰⁷ Egmont Group, Saudi Arabia Financial Intelligence Unit (SAFIU), Official Commencement Date, Sept. 10, 2005, <https://egmontgroup.org/en/content/saudi-arabia-saudi-arabia-financial-investigation-unit>, (accessed Feb. 2, 2018).

¹⁰⁸ Posner, 181.

¹⁰⁹ Diplomatic Cable, "The Saudi Financial Intelligence Unit I: Stab at 2007 Egmont Membership", Canonical ID: 06Riyadh8401_a, Wikileaks, https://wikileaks.org/plusd/cables/06RIYADH8401_a.html, (accessed Feb. 2, 2018).

¹¹⁰ Diplomatic Cable, "The Saudi Financial Intelligence Unit II: Power Struggle with SAMA", Canonical ID: 06Riyadh8404_a, Wikileaks, https://wikileaks.org/plusd/cables/06RIYADH8404_a.html, (accessed Feb. 2, 2018).

Egmont Group, Treasury Deputy Assistant Secretary Daniel Glaser traveled to Riyadh to enhance cooperation with Saudi Arabia in the area of threat finance.¹¹¹ The meeting itself is noteworthy due to its attendees. Aside from Glaser, the only Saudi attendees were governmental officials and the heads of two banks, Riyadh Bank chairman Rashed Al Rashed, and Al Rajhi Bank CEO Suleiman Al Rajhi. Al Rajhi Bank was the only private bank in attendance, as Riyadh Bank is state-owned. The fact that Al Rajhi was the only non-state commercial bank present highlights the unique relationship between the Saudi government and Al Rajhi.

During the meeting, which covered CTF issues and financial strategies to isolate Iran over its nuclear program, Suleiman Al Rajhi discussed his bank's efforts to increase CTF reporting. Al Rajhi himself claimed, "Things are better now as the Kingdom of Saudi Arabia had suffered from terrorism so institutions know that these systems are for the good".¹¹² Al Rajhi described that his bank had augmented compliance training and reporting suspicious activity. As for charities, Al Rajhi described how Saudi banks were barred from transferring charitable funds unless the charity in question held the requisite state license. When certain charities endeavored to circumvent the ban, Al Rajhi worked with SAMA to track or curtail the transfer of the funds.¹¹³ Uncertainty over the legality of the bank's dealings and its standing was strong enough to cause confusion over its commercial partners such as HSBC.

¹¹¹ Diplomatic cable, "Treasury DAS Presses Terror Finance Cooperation in Riyadh", Canonical ID: 09Riyadh828_a, Wikileaks, https://wikileaks.org/plusd/cables/09RIYADH828_a.html (accessed Feb. 2, 2018).

¹¹² Ibid.

¹¹³ Diplomatic cable, "Treasury DAS Presses Terror Finance Cooperation in Riyadh", Canonical ID: 09Riyadh828_a, Wikileaks, https://wikileaks.org/plusd/cables/09RIYADH828_a.html (accessed Feb. 2, 2018).

While Al Rajhi Bank enjoyed the luxury of assisting the US and Saudi Arabia regulate its own activities, US officials assisted the bank by helping shield it from lawsuits and investigations originating in the United States. Throughout the 2000s, survivors of the 9/11 attacks sought to bring lawsuits under the 1992 Anti-Terrorism Act against entities that supported Al Qaeda. Defendants attacked in the suits included Saudi royals and banking interests, including Al Rajhi Bank that in turn, accused the US seeking to “extort Saudi money” and “meddle in the region”.¹¹⁴ However, these efforts were stymied due to the diplomatic connection between Saudi Arabia and the US. Repeated attempts to sue Al Rajhi Bank by survivors, insurance companies and others have been summarily dismissed in US courts.

VI. Analysis

While it cannot fully be known if Al Rajhi Bank knowingly and actively supported terrorism, its relationship to the Saudi state is certain. The bank developed in the same sociopolitical circles as the royal family, with both families deriving from the hyper-conservative Wahhabi interior of the Nejd, in the Arabian Peninsula. Indeed, during the founding period of the Saudi monarchy, the early royal family relied on the Al Rajhi financial network for assisting in caretaking its financial affairs. Due to the split between the new Nejdi rulers and the established Hejazi banks at the time, this social affinity between the Al Rajhi Bank and the monarchy persisted into the contemporary era, strained as it might be due to diverging interests.

¹¹⁴ “Saudi threat to withdraw billions in US investments”, *The Telegraph*, Aug. 20, 2002, <http://www.telegraph.co.uk/news/worldnews/middleeast/saudiarabia/1404928/Saudi-threat-to-withdraw-billions-in-US-investments.html>, (accessed Jan. 30, 2018).

It is highly possible that the Al Rajhi Bank financed terrorist activity, particularly due to its position in the kingdom as the only bank operating openly as an Islamic bank in the country. The particularities of the Saudi tax system, with both the state and private corporations developing a deep institutional network of Islamic charities through *zakat* provided ample potential sources of logistical and economic support for groups such as Al Qaeda and other jihadist groups reliant on donations from within the kingdom.

Data indicates that Al Rajhi Bank had multiple ties with charitable organizations suspected of links to Al Qaeda, beginning shortly after the bank's evolution into a modern commercial bank in the 1980s. This period, during which the Saudis were engaged on two fronts against Soviet encroachment and a revolutionary Iranian regime provided an additional motive to promote Sunni jihadist groups such as Al Qaeda. Furthermore, there is little likelihood of the bank being ignorant of the activities of its account holders. Not only was the Saudi state capable of knowing the financial dealings taking place within its territory through its central bank, SAMA, but Al Rajhi held suspected ties to extremist groups at multiple levels that coincided with its close social proximity to the Saudi state. These levels included the personal charitable work of its founder, Suleiman Al Rajhi, the charities it helped establish, and the multiple accounts held by individual terrorists and terror-connected banking affiliates.

While the proximity and importance of Al Rajhi Bank to the Saudi monarchy is fairly straight forward, what is less certain is the motivation behind the bank's suspected activities. It can easily be argued that the bank held greater loyalty to the monarchy than to causes such as that held by Al Qaeda. The bank came under intense scrutiny from the

US, both in the court system, the media, and from American law enforcement and intelligence agencies. Additionally, the bank appeared to have been intimately and elaborately connected to financial networks connected to jihadist groups. However, the blockage of enforcement against the bank and the way it occurred raises several possibilities as to the bank's close relationship to the state. The first possibility is that the bank was simply too politically important for the Saudi state to crack down directly on its activities. The more likely possibility is that the bank's activities were guided by a notion of supporting Wahhabi terrorist groups under the assumption that it was helping the monarchy's interests. Promoting its religious agenda through its charitable work parallels both motivations.

Regardless, the bank's close involvement in Saudi Arabia's building regulatory capacity after 9/11 indicates that the bank enjoys a privileged position in Saudi politics. The bank was present at multiple meetings between US financial officials and those of Saudi Arabia; indeed, it was often the only private banking institution heavily involved. Furthermore, while it is unclear if the monarchy turned to the Al Rajhi Bank for help in developing its financial surveillance capability, or if involving the bank was an emulation of the adage to keep one's enemies closer than one's friends, Al Rajhi's involvement in assisting develop the apparatus that would police its activities is thoroughly documented.

The most striking aspect of the Al Rajhi Bank case is the nature in which it was included in its own enforcement efforts. As the US investigated Saudi financial networks and their ties through charities to terrorism, it actively assisted both the Saudi state and Al Rajhi Bank despite the role that the latter purportedly played in financing terrorism.

While the bank was involved in Saudi Arabia's regulatory reshuffling, it also has also never been successfully sued, nor faced fines for its activities. On a deeper theoretical level, the case of Al Rajhi Bank indicates that security interests supersede those of regulatory harmonization or elegance. Indeed, these regulations designed to fortify finance are a product of states seeking their own security, and any efforts to build regulatory capacity in this arena derives from such a goal.

Chapter 4: Halk Bank of Turkey

I. Introduction

In the mid-2000s, Halk Bank, one of Turkey's remaining state-owned banks came under international scrutiny for assisting Iran with circumventing economic sanctions in what comprised one of the largest money-laundering and terrorist financing schemes in history. The scandal over the bank's activities placed increasing strain on Ankara's long-time relationship with the West, and heralded a renewal of Turkish interest in influencing Middle Eastern geopolitics. This chapter first examines Halk Bank's history of development and ownership by the state in the wider Turkish political economy. Specifically, the bank's role as an instrument of foreign policy and domestic political coalition binding will be explored. Next, this chapter discusses Ankara's adoption of fortified financial regulations and the development of Turkey's secret laundering activity with Iran. Last, the chapter will discuss efforts by the Turkish state to defend Halk Bank and the leading regime under Turkey's Justice and Development Party (AKP) after it came under enforcement pressures for violating international sanctions.

Turkish politics encompass a cluster of contradictions. Aside from serving as a bridge between Europe and the Middle East since ancient times, modern Turkey has oscillated between varying degrees of authoritarian and democratic rule. One near-constant characteristic of Turkey's political institutions is statism in its political economy and high concentration of ownership in its financial industry. Since becoming a modern republic in 1923, the Turkish economy has retained this characteristic despite engaging in

liberalization efforts in 1980s in an effort to prepare for economic integration into Europe. State-owned banks, including Halk Bank, remain an integral institutional component of the Turkish political economy. This institutional binding, along with its tight managerial proximity to the government, places it at the service of both domestic economic policy and foreign policy initiatives. Combined, this close proximity provides a ready environment for political corruption while positioning the state to insulate the bank from regulatory penalty.

II. Halk Bank and Statist Legacies

The modern Turkish republic emerged out of the remnants of the Ottoman Empire in the aftermath of WWI. Forming in 1923 after Turkish nationalists repelled European attempts at colonization, the early Turkish state was birthed in regional and international environments rife with statist approaches to economic affairs. This environment, and early ideological currents in the Turkish nationalist movement influenced the circumstances into which Halk Bank was founded in 1938. In the spring of 1923, in the midst of the proto-republic's negotiations with European powers over Ottoman-era capitulations, foreign debts, and national boundaries, the Economic Congress in Izmir laid a nationalist groundwork for the modern Turkish economy.

Reminiscent of statist thinking in Republican China and popular in European states at the time, Turkish nationalists placed economic prowess at the forefront of securing political independence and national security. At the 1923 Economic Conference, Mustafa Kemal Ataturk stated that, "national sovereignty should be

supported by financial sovereignty”.¹ The rest of the 1920s witnessed a holdover of Ottoman-era institutional arrangements characterized by foreign capital remaining dominant in a number of industries in what remained a heavily agricultural political economy. After six years of laying institutional groundwork, the economic downturn of 1929 ironically pushed Turkey into the early stages of creating its own modern indigenous banking sector.

In 1926, the new republic adopted a number of legal institutions from Europe. That year, Ankara adopted a largely Swiss legal system in conjunction with a mixture of Italian and German commercial codes.² Due to its wariness from late Ottoman-era economic privileges extended to European interests, the new republic sought ways to limit foreign competition in its financial sector. It is worth noting here that Turkey, neutral through WWII, imported institutional economic influences from Fascist Italy, Germany, and the Soviet Union throughout the 1920s and 1930s. Germany’s banking industry under Nazi rule shifted abruptly between the early and late 1930s, with nationalization predominating in the early parts of the decade and increased privatization predominating later on.³ Turkey’s creation of Halk Bank in 1933 reflected the nationalization in Nazi Germany’s banking sector in the early 1930s.

The early 1930s saw the crystallization of statism as a basis of Turkish economic orientation. In 1931, Ataturk formally declared, “Our people are certainly statist because

¹ Abdullah Takim and Ensar Yilmaz, “Economic policy during Ataturk’s era in Turkey”, *African Journal of Business Management*, Vol. 4, no. 4, pp. 549-554, 551.

² Dilek Barlas, *Etatism and Diplomacy in Turkey: Economic and Foreign Policies in an Uncertain World, 1929-1939*, (Leiden: Brill, 1998), 42.

³ Germa Bel, “Against the mainstream: Nazi privatization in 1930s Germany”, *The Economic History Review* 63, no. 1 (2010) pp. 34-55.

they naturally demand that their needs be satisfied by the state. Considering that point, there is complete conformity between the program of our party and the nature of our people”.⁴ While such statist orientation was also designed to help withstand the effects of the Great Depression, it would also play a role in the establishing of state-owned banks. Halk Bank, with its focus on the financing of small and medium enterprises serving as its specialty, was uniquely placed in within the political economy. This focus on small and medium enterprises would not only make the bank elemental in helping Turkish political parties maintain constituencies, it also created political liabilities in the event that serious privatization was ever considered. Functioning as a state bank devoted to small businesses and what would constitute the Turkish middle class, the domestic positioning of the bank would serve as a pillar for regime binding and political clientelism. Additionally, Halk Bank’s focus on small and medium-sized enterprises, as opposed to a specific industry, placed it in a durable position in Turkey’s political economy.

In 1933, Halk Bank was incorporated with a specific focus of fostering “favorable conditions to tradesmen, artisans and small business owners and triggering capital accumulation; for both long-lasting economic development and for preserving social equilibrium”.⁵ Unlike the Soviet Union, Turkey’s Kemalist-era state-owned banks were not solely focused on state-owned enterprises. Rather, Ankara opened state-owned banks with the purpose of supporting critical sectors of the capitalist economy and to support

⁴ Barlas, 62. See also, *Atatürk’ün Söylev ve Demeçleri I-III* (Ankara: Türk Tarih Kurumu Basımevi, 1989), 295.

⁵ Halk Bank, official website, “1918-1933: The young Turkish Republic was established”, <https://www.halkbank.com.tr/en/about-halkbank/3158/about-halkbank>, (accessed Feb. 15, 2018).

Turkish nationalism.⁶ Indeed, Atatürk highlighted and condoned individual entrepreneurship and profit-seeking when it came to Halk Bank's client base, "You artisans, when the day comes that I witness great factories being built in the place of your small shops, I'll be elated to the highest degree".⁷

After it began open operations in 1938, Halk Bank expanded over the course of decades through opening branches and serving as a conduit of state funds to its small business client base. From 1938 until 1950, Halk Bank provided capital to small and medium enterprises through public funds directly from the state. In 1950, this "People's Fund" took on bureaucratic and institutional characteristics more reminiscent of a conventional bank when it opened branches and offering business loans to small businesses.⁸ Coming to power in 1950, Turkey's Democratic Party broke with the hardline statist policy legacies of Republican People's Party (CHP) and instituted a number of modest reforms to privatize state-owned enterprises. While Halk Bank remained state-owned, its operations were reformed from functioning as a direct activity of the state to that of a bank owned by the state. During this era, Halk Bank remained part of an overall economic strategy by Ankara to insulate the Turkish economy from external market forces and foreign competition. Until the 1980s, when Turkey undertook aggressive liberalization reforms, Halk Bank steadily expanded its presence throughout the country through opening additional branches and increasing its lending capacity.

⁶ Thomas Marois, "The Lost Logic of State-Owned Banks: Mexico, Turkey, and Neoliberalism", Conference Paper, Canadian Political Science Association, May 31, 2007, 7.

⁷ Halk Bank, official website, "1918-1933: The young Turkish Republic was established", <https://www.halkbank.com.tr/en/about-halkbank/3158/about-halkbank>, (accessed Feb. 15, 2018).

⁸ Halk Bank, official website, "History", <https://www.halkbank.com.tr/en/about-halkbank/97/history>, (accessed Feb. 20, 2018).

While its organizational infrastructure matured and expanded, it remained a state-owned bank.

If Halk Bank's history can be summarized into a single characteristic it is that of ongoing institutional linkage with the state despite phases of attempted liberalization of the Turkish economy. Under Democratic Party rule in the 1950s, Ankara relied on access to capital through the Marshall Plan in its attempt to liberalize trade and allow free capital flows while trying to sell state-owned enterprises. These efforts were cut short due to inflationary pressures and a rising trade deficit.⁹ Through periods of intermittent military and civilian rule from the 1960 coup until the 1983 election of Turgut Özal, Turkey's economy remained introspectively oriented and reliant on import substitution and protectionism. It was under Özal that Halk Bank not only bypassed planned "privatization" while remaining a state-owned bank, but also when the bank morphed into its current incarnation.

III. Partial Liberalization and Domestic Coalition-Binding

The 1980s witnessed a move towards neoliberalism in economies around the world. Turkey, along with other countries with statist economic legacies, undertook structural reforms in order to check rising inflation and high unemployment resulting from increasing oil prices. As a political figure, Özal is notable in that his career spanned involvement in both military and civilian governments. Under military rule, Özal held the post of Deputy Prime Minister of Economic Affairs prior to his taking power as prime minister in 1983. As a power broker, Özal was uniquely pedigreed, combining liberal

⁹ Introduction, *Liberalization and the Turkish Economy*, Ed. Tefik F. Nas and Mehmet Odekon, (New York: Greenwood Press, 1988), 2.

technocratic economic institutional experience with Islamist credentials and comfort around Turkey's authoritarian military elite.¹⁰ Notably, the manner in which he carried out liberalization and privatization followed a trajectory of neoliberal populism that combined these contradictory characteristics. It was neoliberal populism that not only created the institutional environment that Halk Bank currently inhabits, but also links the economic orientation of Özal's legacy with that of the current authoritarian government under the Justice and Development Party (AKP).

Common under hybrid regimes of semi-democracies, neoliberal populism seeks to install policies designed to facilitate economic efficiency and disincentivize rent seeking in concert with intervention by the state.¹¹ Neoliberal populist policy is also often affiliated with a charismatic leader and a "shallow" democratic environment.¹² Despite Özal's admiration for Thatcherism and privatization, the process of privatizing state-owned banks and other enterprises that began in the mid-1980s was slow moving and never fully matured.¹³ Indeed, for many state-owned enterprises, Halk Bank included, the process was never completed.

After taking power as prime minister in 1983, Özal initiated privatization policies aimed at liberalizing sectors of the Turkish economy in 1985. Two goals of state-owned bank privatization centered upon the desire to expand share ownership and to increase

10 Ziya Öniş, "Turgut Özal and His Economic Legacy: Turkish Neo-Liberalism in Critical Perspective", *Middle Eastern Studies*, Vol. 40, No. 4 (July 2004), pp. 113-134, 117. See also, "The Motherland Party: The Challenge of Institutionalization in a Charismatic Leader Party", *Turkish Studies*, Vol. 3, No. 1 (Spring 2002), pp. 41-61.

¹¹ Öniş, 126.

¹² *Ibid*, 126.

¹³ Çağa Ökten, "Privatization: What has been achieved?", in *The Turkish Economy: The Real Economy, Corporate Governance and Reform*, Edited by Sumru Altuğ and Alpay Filiztekin, (Abingdon: Routledge, 2006), pp. 227-251, 232.

revenues for the state through the sale of state shares.¹⁴ Specifically, 32 state-owned companies were targeted for privatization through block sales, public sales and direct sales of assets and subsidiaries.¹⁵ Instituted by Privatization Law No. 4046, the Privatization High Council in concert with the Privatization Administration oversees the privatization of state enterprises. The Prime Minister sits on the Privatization High Council and recommends entities for privatization while also overseeing the Privatization Administration.¹⁶ The legal positioning of the Prime Minister in the privatization process combined with the failed privatization of Halk Bank would uniquely position the bank as a means of kleptocracy and money laundering.

Turkey's domestic politics of the Özal era marked an ideological shift in Turkish politics that laid the foundations for later Islamist movements under Erbakan and Erdoğan. Unlike the secularist military rulers that preceded Özal's rise to power, Özal's ideological orientation combined aspects of Islamism and Turkish nationalism with a highly technocratic Western liberalism. Breaking from Turkey's staunchly secular Kemalist orientation, Özal drew domestic support from small business interests in the Anatolian interior of the country, and from social and religious conservatives.¹⁷ Despite his drives for economic liberalization, Özal's domestic orientation was that of soft neo-Ottoman outlook. At his funeral, mourners even walked through Istanbul shouting Islamist slogans.¹⁸ As noted at the beginning of this chapter, it was small businesses and

¹⁴ Ökten, 240-241.

¹⁵ Marc C. Palmer, "The Turkish Privatization Experience, 1984-2009", (2010). *Turkey: bridging two worlds*, Paper 9, 80.

¹⁶ Palmer, 83-84.

¹⁷ Ataman, 127.

¹⁸ Ataman, 127.

the lower middle class that served as Halk Bank's prescribed primary customer base. It was this same consumer demographic to which Özal appealed. Not coincidentally, later Islamists Erbakan, and Erdoğan would appeal for political support from this same constituency.

The number of Turkish state-owned banks and the scope of state ownership did contract under privatization reforms in the 1990s. Özal's reform attempts remained uncompleted, but privatization of the banking sector advanced under later prime ministers Tansu Çiller and Mesut Yılmaz in the late 1990s. Four state banks: Etibank, Sumerbank, AnadoluBank, and Denizbank were all fully privatized through the total block sale of the banks' shares to single buyers.¹⁹ Halk Bank had not previously been a premier state-owned bank, but did take on greater importance while the state maintained ownership despite privatization of other banks. Its capital increased as a result of private investment infusions through the sale of minority shares while also growing in size as a result of absorbing other banks. Through the 1990s, Halk Bank absorbed Töbank, a bank owned by Turkish schoolteachers, Sumerbank, and all assets and liabilities of Etibank.²⁰ In 2001, Halk Bank absorbed the branches of the state-owned Emlakbank. All three of Turkey's remaining state-owned banks are among the top seven Turkish banks ranked by total assets.²¹

Ownership within Turkey's banking sector is not only highly concentrated, but is also politicized and prone to corruption. With its failed privatization through the sale of

¹⁹ Ökten, 234.

²⁰ Halk Bank Official Website, <https://www.halkbank.com.tr/en/international-banking/97/history>, (accessed April 10, 2018).

²¹ Banks in Turkey: 2016, Turkish Banks Association, Publication No: 322, June 2017, II-242.

minority shares to private investors, Halk Bank's position in Turkey's political economy became uniquely reconfigured in a manner conducive to political cronyism and money laundering. It was this positioning that would enable the bank to be used in laundering Iranian money under sanction for terrorism.

As a result of financial crises in 1994 and 2001, Turkey's banking sector reoriented in favor of state-owned banks. Turkey passed a law by decree in 1994 designed to clarify previously incoherent and contradictory laws pertaining to the privatization of state-owned enterprises.²² This 1994 law allowed the government to levy privatization laws by fiat, and was overturned by Turkey's Constitutional Court in the aftermath of 1994 Turkish currency crisis. Turkish elites committed to the country's legacy of statism drove the effort to strike down the privatization law, which was replaced with Privatization Law no. 4046.²³ This statist legacy, combined with the unique legal positioning of the Prime Minister in matters of privatization contributed to the politicization of state-owned banks like Halk Bank. A politically driven financial crisis in 2001 would result in solidifying state-owned banks in an advantaged position vis-à-vis their private counterparts.

State-owned Turkish banks hold a number of institutional advantages over private banks in the country. State bank operations are highly politicized and offer a means of political elites to distribute rents to important constituencies and allies.²⁴ This dynamic

²² Izak Atiyas, "Recent Privatization of Turkey-A Reappraisal", August, 2009, 6.

²³ Ibid, 6.

²⁴ Yener Altunbaş, Alper Kara, and Özlem Olgu, *Turkish Banking: Banking Under Political Instability and Chronic High Inflation*, (Hampshire: Palgrave, 2009), 54. See also, CE Alper and Z. Öniş, "Financial Globalization, the Democratic Deficit and Recurrent Crises in Emerging Markets: The Turkish Experience

creates a moral hazard by which state-banks can provision loans based on political connection rather than potential profitability or the ability of debtors to service the debt. Halk Bank, along with Ankara's other banks, issues more loans than their private counterparts as a result. Indeed, the opacity of this politicized lending scheme leads to an inability to accurately gauge the efficiency of Turkish state-owned banks.²⁵ When this politicized lending dynamic is put into context with Turkey's structure for privatization, it becomes clearer as to why Halk Bank failed to fully privatize.

In efforts to raise revenues and stabilize the financial system through the wake of the 1994 crisis, Turkey sold minority shares to their state banks. However, through consolidation, Halk Bank grew in size throughout the 2000s. After absorbing Emlakbank in 2001, Halk Bank acquired Pamukbank in 2004. This growth occurred during a critical juncture of Halk Bank's history, as in November 2001, the state planned to sell the entirety of the bank under Privatization Law No. 4603. Article 16 of law places all of Halk Bank's operations under the auspices of the General Manager, who in turn is appointed by the Prime Minister. This structural arrangement was intended as temporary until privatization; however, the government scrapped the planned sale of the bank in 2006. This new arrangement placed the bank's operations effectively under the oversight of the Prime Minister through the mechanism of the General Manager. As noted in Figure 4.1, Halk Bank's politicized lending was enabled through this institutional

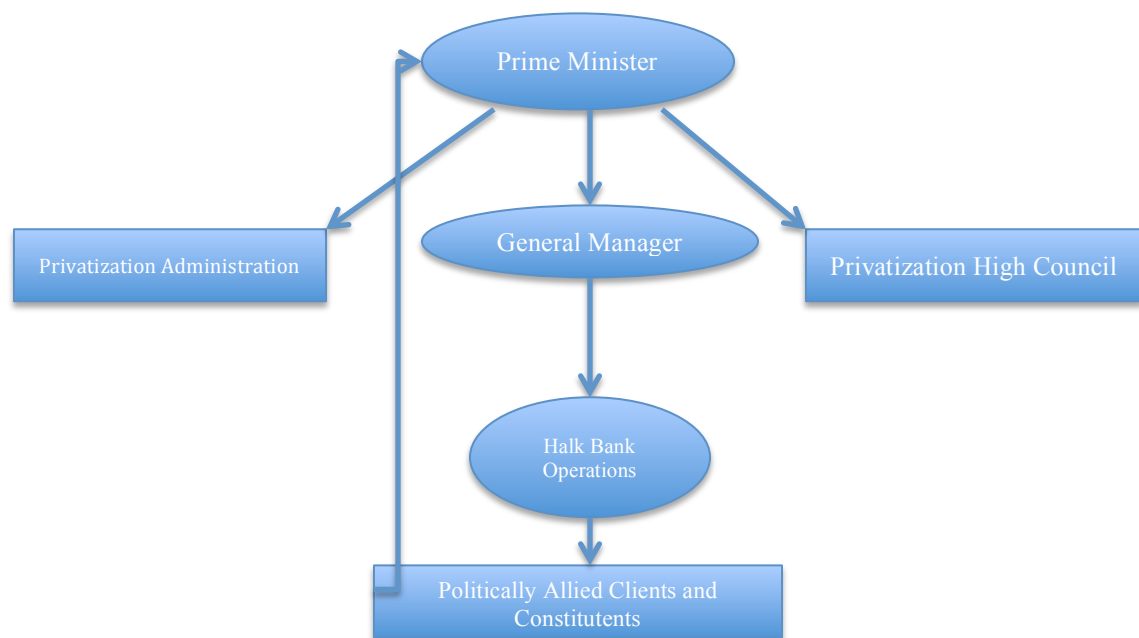
in the Aftermath of Capital Account Liberalization", *Emerging Markets, Finance, and Trade*, (2003), Vol. 39, no. 3: pp. 5-26.

²⁵ Altunbaş et al, 138.

mechanism and placed the bank in a position uniquely conducive to a cycle of corruption and financing politically motivated activity.

While the Turkish government under Recep Tayyip Erdoğan cancelled plans to fully privatize Halk Bank in 2006, the government did offer the sale of minority shares in the late 2000s. In 2007 the bank offered 25% its shares in an initial public offering, followed by a second offering of 23.92% on Nov. 16, 2012.²⁶ In sum, the Turkish state retains ownership of 51.1% of the bank. As of 2016, Ankara owns Halk Bank through its sovereign wealth fund, the Turkey Wealth Fund.

Figure 4.1: Turkish Prime Minister's Relationship to Halk Bank and its Operations



Since the turn of the millennium, Turkish politics has followed an increasingly authoritarian trajectory under the Justice and Development Party (AKP) under Recep Tayyip Erdoğan. Halk Bank's primary customer base of small enterprises, artisans and

²⁶ Halk Bank, Official Website, Investor Relations-Milestones, <https://www.halkbank.com.tr/en/investor-relations/55/milestones>, (accessed April 10, 2018).

other small borrowers significantly overlaps with the AKP's constituency. While Halk Bank was founded with the intent of serving entrepreneurial clients from Turkey's lower middle class and small businesses, the bank retains this orientation into the 21st century. Halk Bank explicitly maintains a financial strategy focused upon Turkey's small-scale borrowers and artisans. In a 2014 prospectus memo aimed at luring limited private shareholders, the bank stated a strategy calling for increasing and deepening the institution's penetration of the small and medium enterprise market.²⁷ This focus upon local artisans, small business groups, and local unions of independent tradespeople remains the focus of Halk Bank's plans for long-term growth and profitability.²⁸ This segment of Turkey's political economy is also one of the bedrocks of AKP's voter base.

The 2002 Turkish election demarcates a profound shift in the country's political landscape in that over half of the Turkish electorate voted for an alternative party than who they voted for in 1999.²⁹ Drawn by the AKP's combination of conservatism and its economic performance at the local level, the party founded by Erdoğan absorbed disillusioned voters from other parties. The Motherland Party (ANAP) that brought Turgut Özal to power with his combination of neoliberal economics and Islamist sentiments in the 1980s served as a main source of AKP's voters in 2002. Erdoğan's AKP absorbed half of ANAP's voters, along virtually absorbing the Islamist Virtue Party.³⁰ Indeed, Özbudun notes that the nascent AKP in 2002 managed to recreate Özal's

²⁷ Halk Bank Offering Memorandum, May 29, 2014, http://www.ise.ie/debt_documents/Prospectus%20-%20Standalone_bf28fe49-51f6-4fcf-ac89-7a803aede994.PDF (accessed April 29, 2018), 82.

²⁸ Halk Bank Offering Memorandum, May 29, 2014, 4-5.

²⁹ Cem Baslevant and Akarca, Ali, Micro Evidence on Inter-Party Vote Movements in Turkey: Who Voted for AKP in 2002? (November 20, 2008), 2.

³⁰ Baslevant and Akarca, 10.

voting coalition of urban tradesmen and artisans in concert with rural conservatives.³¹

Halk Bank's most important customer base proved to be the same base of support for Erdoğan's AKP. The AKP's middle class voters, characterized as socially conservative and neoliberal, consisted of the "small and midrange enterprisers" of Turkey's cities who were alienated from traditional Republicanism.³² Additionally, the AKP's platform placed small and medium-sized enterprises at the center of its strategy for Turkey's economic growth.³³ It is not coincidental that Halk Bank's long-term strategic plan for deepening its market penetration of small and medium enterprises overlaps with that of the AKP. Rather, the bank is in part a useful tool for the AKP to assist in maintaining its electoral coalition. Furthermore, given the position of the Prime Minister in overseeing the bank's organizational structure, it becomes clear how the financial institution serves as a coalition binder for Erdoğan's party. Ankara's adoption of the fortified finance regime has done little to displace this institutional linkage between state, bank, and the ruling party's primary economic voting base.

IV. Fortified Finance in Turkey

Turkey's perennial geopolitical goal has historically centered upon joining the West despite its position as a regional Middle Eastern power. Since the early Cold War, the modern Turkish republic's unique geographic location placed it as a major player in

³¹ Ergun Özbudun, "From Political Islam to Conservative Democracy: The Case of the Justice and Development Party in Turkey", *South European Society and Politics*, Vol. 11, nos. 3-4, pp. 543-557, 547.

³² Ahmet Insel, "The AKP and Normalizing Democracy in Turkey", *South Atlantic Quarterly*, Vol. 102, no. 2-3, pp. 293-308, 298-299.

³³ *Ibid*, 298.

Western security planning through its membership in NATO. Economically, Ankara has spent years seeking inclusion into Europe since 1999 when Turkey was mentioned as potential member of the European Union.³⁴ Economic melding with Europe has thus far proven elusive, in part due to the qualitative regulatory challenges posed by its financial system. Concerns over corruption and the banking system's integrity are one area that Ankara has sought to rectify through the adoption of fortified financial regulations. Despite proving an early adopter of fortified finance regulations and institutions, none of these adoptions managed to disrupt the deepening connections between Halk Bank and the Turkish state over the same period.

As mentioned in the introduction, the internationalization of the fortified financial regime to counter money laundering and terrorist financing began with the founding of the Financial Action Task Force (FATF) in 1989. Turkey joined the FATF in 1991, only a year after most Western states joined the organization after beginning its functions in 1990. Indeed, Turkey's joining the AML/CTF regime coincided with Ankara's efforts to adopt overall neoliberal reforms initiated under the Özal administration. Domestically, Turkey outlawed money laundering in November 1996 under Law no. 4208, and established MASAK, its own financial intelligence unit (FIU) a few months later in February 1997. In 1998, Ankara joined the Egmont Group of FIUs.

Despite having a long experience with terrorism, much of it related to the threat posed by Kurdish separatists in the country's southeast, Turkey's terrorism laws originate

³⁴ Atila Eralp, "Turkey and the European Union in the Post-Cold War Era", in *Turkey's New World*, ed. Alan Makovsky and Sabri Sayari, (Washington DC: Washington Institute for Near East Policy, 2000), pp. 173-188, 173.

in parallel with the beginning of its adoption of the AML/CTF regime. Turkey's 1991 anti-terrorism law, Act No. 3713, is profoundly broad and defines terrorism as any act "with the aim of changing the characteristics of the Republic", "seizing the authority of the state", or altering its sociopolitical order.³⁵ Notably, as Turkey's AML/CTF regime expanded, Ankara's Anti-Terrorism Law underwent five amendments between 1995 and 2010. It was also over this period that Turkey began moving towards authoritarianism under the AKP where the law would prove useful in neutralizing political opposition.

The central component of any country's regulatory apparatus to counter terrorist financing is the FIU. Turkey's FIU, Mali Suçları Araştırma Kurulu (MASAK) was instituted in 1997 and was placed under the supervision of the Ministry of Finance. MASAK's responsibilities under law no. 5549 include the collection of suspicious activity reports (SARs) from banks and report suspicions of financial malfeasance to the Public Prosecutor for potential prosecution.³⁶ Article 2 of law no. 5549 passed in 2006 stipulates mandatory reporting of suspicious activities on the part of banks, pension funds, jewelers, money dealers and most businesses affiliated with high-end transactions.³⁷ Chapter 4, Article 19 of the law includes the tracking and collection of data related to terrorist financing as one MASAK's tasks. Even prior to the implementation of the 2006 law, the filing of SARs increased over 300% in the early 2000s from the 1990s.³⁸

³⁵ Article 1: Anti-Terror Law Act No. 3713: Law to Fight Terrorism, Official Gazette, April 12, 1991.

³⁶ MASAK, Official Website, Duties and Powers, (<http://www.masak.gov.tr/en/content/duties-and-powers/148>), accessed April 10, 2018.

³⁷ Article 2, Prevention of Laundering the Proceeds of Crime Law, Law No. 5549, 2006.

³⁸ Section 17, Summary of the Third Mutual Evaluation Report on Anti-Money Laundering and Combating the Financing of Terrorism: Turkey, FATF, Feb. 23, 2007.

Over the course of the 2000s, Turkey deepened its involvement in the international AML/CTF regime through the joining of treaties designed to counter corruption, terrorist financing, and organized crime. In December 2000, Turkey became a signatory to the United Nations Convention Against Transnational Crime and would ratify it in 2006. Regarding terrorist financing, Turkey joined the UN Convention for the Suppression of the Financing of Terrorism in September 2001. By 2006, Ankara implemented its own law, the Prevention of Laundering Proceeds of Crime Law No. 5549, and signed the Council of Europe's Convention on Laundering the Proceeds of Crime and Financing of Terrorism in 2007.³⁹ Given Turkey's desire to join the European Union and Eurozone, Ankara's regulatory adoptions do comprise more than simple juridical theater. Rather, they represent part of a greater yet haphazard Turkish economic effort to join Europe during the 1990s and 2000s. Furthermore, this regulatory adoption of the fortified finance regime coincided with overall Turkish efforts to liberalize and privatize sectors of the country's economy. Notably, the growth of Turkey's CTF regulations grew alongside its terrorism laws.

The turn of the millennium provided a turning point for Turkey in seeking to adhere to international standards of financial regulation. While Turkey initiated its adoption of the fortified finance regime by joining of the FATF in 1991 and establishing MASAK in 1997, it was the involvement of the EU and the IMF in the aftermath of Turkey's 2001 financial crisis that helped promote Ankara's regulatory adoption of

³⁹ MASAK, Official Website, Chronology, (<http://www.masak.gov.tr/en/content/chronology/173>), accessed April 10, 2018.

international standards in the 2000s.⁴⁰ However, despite Turkey's formidable de jure adoption of threat finance laws and regulations, the FATF issued a number of reports of concern pertaining to actual enforcement despite Turkey's high legal and regulatory capability.

In the mid-2000s, FATF issued a number of evaluations of Turkey's adherence to the FATF's forty-one recommendations pertaining to countering money laundering and terrorist financing. In 2007, the FATF noted that Turkey's banks served as the primary means of laundering and financing terrorism within the country's financial system.⁴¹ Despite the low ratio of SARs filed given the size of the Turkish financial sector, Turkey's banks provided a steadily increasing number of reports.⁴² In terms of funds related to terrorism outside of Turkey, a number of FATF's recommendations remained unimplemented in 2007. Throughout the decade, Turkey implemented significant improvements in its threat finance regime over issues related to terrorism.

The 2007 FATF report noted that Ankara was noncompliant or only partially compliant in areas of customer due diligence, politically exposed clients, transactions to and from high-risk jurisdictions, and in mandates to file SARs related to terrorist financing. In 2014, the FATF noted that multiple improvements in the state's capacity to counter terrorist financing. Legally, Turkey's National Assembly implemented Terrorist Financing Law No. 6415 in 2013. The law effectively harmonized Turkey with the 1999

⁴⁰ See Ziya Öniş and Caner Bakır, "Turkey's Political Economy in the Age of Financial Globalization: The Significance of the EU Anchor", *South European Society and Politics*, Vol. 12, No. 2, June 2007, pp. 147-164.

⁴¹ Section 7, Summary of the Third Mutual Evaluation Report on Anti-Money Laundering and Combating the Financing of Terrorism: Turkey, FATF, Feb. 23, 2007.

⁴² Section 5, Summary of the Third Mutual Evaluation Report on Anti-Money Laundering and Combating the Financing of Terrorism: Turkey, FATF, Feb. 23, 2007.

UN Convention for the Suppression of Financing Terrorism. Notably, Article 3 of the law defines terrorism along mainstream international standards, declaring terrorism to be “acts intended to cause death or serious bodily injury for the purpose of intimidating or suppressing a population or compelling a government or an international organization to do or abstain from doing any act”.⁴³ In terms of terrorist financing, the law stipulates in Article 4 that terrorist financing includes the “collection of funds for a terrorist or terrorist organizations”.

Turkey’s de jure declaration of international cooperation also improved. Importantly, the law mandates that Turkey would freeze the funds of organizations designated under the UN Security Council Resolutions 1267, 1988, and 1989 “without delay”.⁴⁴ Additionally, the law mandates that that Turkey attempt to comply with asset seizure requests made by foreign states under a principle of reciprocity.⁴⁵ The law stipulates that the foreign power make requests either to the Foreign Ministry, MASAK, or directly to the Ministry of Justice.⁴⁶ In the case that a foreign country makes a request for Turkey to freeze or seize criminal or terrorist assets, the ultimate decision to follow through falls under the authority of the Council of Ministers.⁴⁷ The Council of Ministers, or Turkey’s cabinet, is filled with presidential appointees under the guidance of the Prime Minister.

The Financial Action Task Force conducted a follow-up evaluation of Turkey’s CTF regime in 2014. The FATF noted multiple improvements in terms of Ankara’s

⁴³ Article 3, Item A. Law No. 6415 on the Prevention of the Financing of Terrorism, Passed Feb. 7, 2013.

⁴⁴ Article 5, Law No. 6415.

⁴⁵ Article 6, Law No. 6415.

⁴⁶ Article 6, Section 2, Law No. 6415.

⁴⁷ Article 6, Law No. 6415.

compliance with international standards. However, the FATF recorded lacking compliance in the key areas of politically exposed clients, dealing with risky jurisdictions, and in the full vetting of “unusual large transactions”.⁴⁸ Additionally, the FATF discovered that Turkey lacked a cohesive mechanism for seizing and freezing terrorist funds.⁴⁹ All three of these key areas of concern are highlighted in case of Halk Bank’s gold-based scheme for laundering money for Iran and in Ankara’s assisting Tehran avoid sanctions.

The international CTF regime takes into account the potential risks that politically exposed persons (PEPs) and risky jurisdictions pose for the threat of money laundering. The FATF defines PEPs as either foreign or domestic individuals who are “entrusted with prominent public functions”.⁵⁰ The primary fear of PEPs in relation to money laundering and terrorist financing is that such foreign individuals may have the luxury of diplomatic immunity that can enable them to avoid prosecution.⁵¹ Similarly, key figures of domestic political stature may enjoy the ability to circumvent prosecution or arrest due to the abuse of their positions. Indeed, a key FATF concern regarding PEPs is that such individuals may “capture” financial institutions through shareholding, management or other means that can allow them to launder money or finance terrorism.⁵² The capturing of a financial institution about which the FATF is concerned effectively enables politically powerful persons to manipulate banks for their own corrupt or criminal enterprises. Coincidentally,

⁴⁸ Mutual Evaluation of Turkey: 15th Follow Up Report, Financial Action Task Force, October 2014, 26.

⁴⁹ Mutual Evaluation of Turkey: 15th Follow Up Report, Financial Action Task Force, October 2014, 26, 24.

⁵⁰ Politically Exposed Persons (Recommendations 12 and 22), Financial Action Task Force, June 2013, 4-5.

⁵¹ Politically Exposed Persons (Recommendations 12 and 22), Financial Action Task Force, June 2013, 24.

⁵² Ibid, 24.

once Halk Bank came under international scrutiny over its accused laundering of terrorist funds for Iran, it centered upon key personalities of Turkish and Iranian governments.

A number of countries around the world are considered problematic jurisdictions for money laundering and terrorist financing by major economic centers and the FATF. The FATF considers only two states, Iran and North Korea, as being wholly non-compliant and extremely high-risk jurisdictions.⁵³ Other jurisdictions are considered potential risks due to their conditions as war zones or other failed states. FATF's designation of high-risk jurisdictions relies upon a number of sources, ranging from countries listed under international sanctions from bodies such as the UN and the lack or level of involvement in AML/CTF institutions, to information provided by member states.

Given Turkey's neighboring Iran, and Turkey serving as the logical transit country between Iran and most of its potential export destinations, Turkey would naturally have a difficult time coming into full compliance with FATF's threat finance mandates. In terms of Halk Bank's suspected laundering of terrorist funds for Iran throughout the 2000s, the ensuing banking scandal involved all three of Turkey's compliance deficiencies: politically exposed persons, business involving high risk jurisdictions, and large suspicious sums. Combined, these weak links in Ankara's fortified finance regime would facilitate one of the largest money laundering operations in history. Halk Bank's unique institutional linkage with the state would also assist in helping the bank escape regulatory enforcement. Not only was the state the majority

⁵³ High Risk and Other Monitored Jurisdictions, Financial Action Task Force, Official Website, (<http://www.fatf-gafi.org/countries/#high-risk>), accessed April 10, 2018.

shareholder in the bank at the time of the accused laundering, but the Prime Minister also constituted a politically exposed person who assisted in overseeing the regulatory escape.

V. Halk Bank, Iran, and Blocked Enforcement

The end of the Cold War substantially expanded Turkey's geopolitical influence. The expansion of the European Union and Eurozone brought with it the enticing prospect of Ankara's ascension as a member state. To its east and south, the Middle East and Central Asia offered new possibilities for Turkish interests. Former Soviet republics in Central Asia offered Turkey to expand its influence to Turkic speakers across Eurasia. Economically, the collapse of the Soviet Union also afforded Ankara the possibility of accessing the region's lucrative natural gas and oil deposits, and to leverage its own geographic location as a transit country between Central Asia's energy production and European markets.

Domestically, Turkey has evolved into an increasingly authoritarian regime since the election of the Justice and Development Party (AKP) into power in 2002. Coincidentally over the same period, Halk Bank underwent partial privatization while Ankara progressively adopted increasing amounts of the international fortified finance regime. In 2012, allegations emerged that Halk Bank assisted Iran in laundering \$20 billion of oil and natural gas for its equivalent amount in gold.⁵⁴ Institutionally, the linkage of Halk Bank to the Turkish state and the position of Prime Minister created a

⁵⁴ Benjamin Weinthal, "Iran secured as much as \$20 billion from Turkey breaking sanctions", *Jerusalem Post*, July 24, 2015, (<https://www.jpost.com/Middle-East/Iran/Iran-secured-as-much-as-20b-from-Turkey-breaking-sanctions-410057>), accessed March 2, 2018.

perfect storm in which the bank's ownership and management by the state effectively insulated it from regulatory enforcement.

Turkey's relationship with Iran must be understood in light of its centuries' old legacy of competition, rather than amicability or outright animosity. While the Middle East reeled with the implications and aftermath the Iranian revolution of 1979, Turkey avoided an outright alliance with Sunni states against Tehran. Indeed, Turkey was one of the first states to recognize the post-revolution Iranian government.⁵⁵ After the transition to civilian rule, the Turkish government under Turgut Özal opted for a stance of "positive neutrality" towards both Baghdad and Tehran during the Iran-Iraq war.⁵⁶ Özal's strategy was diplomatically successful, as evidenced by both Iran and Iraq utilizing Ankara as an intermediary. Aside from direct security concerns, Özal leveraged Turkey's position for purposes of economic statecraft.

Structurally, Özal consolidated foreign policymaking power through weakening the Foreign Ministry through tasking foreign trade relations away from the ministry and placing such functions directly under that of the Prime Minister.⁵⁷ Özal sought to move beyond Turkey's Kemalist legacy in foreign policy and rekindle relations with the Middle East. Prior to his taking office, Özal stated that Turkey's neighbors afforded potential "natural trading partners" and that Turkey should resume its "proper place" as the

⁵⁵ Nihat Ali Özcan and Özgür Özdamar, "Uneasy Neighbors: Turkish-Iranian Relations Since the 1979 Islamic Revolution", *Middle East Policy*, Vol. 17, No. 3, 2010, pp. 101-117, 105.

⁵⁶ Philip Robins, *Suits and Uniforms: Turkish Foreign Policy Since the Cold War*, (Seattle: University of Washington Press, 2003), 57.

⁵⁷ Muhittin Ataman, "Leadership Change: Özal Leadership and Restructuring in Turkish Foreign Policy", *Alternatives: Turkish Journal of International Relations*, Vol. 1, No. 1, (Spring 2002), pp. 120-153, 124.

historical link between the Middle East and Europe.⁵⁸ Indeed, it was Turkey that brought Iran together with itself and Pakistan in the creation of the Economic Cooperation Organization in 1988.⁵⁹

Özal pursued a path of liberalization and privatization throughout the 1980s in order to make Turkey more competitive. However, Özal also followed an economic foreign policy of seeking to increase Iraqi and Iranian dependence on Turkey.⁶⁰ Iran's position being surrounded by mostly hostile Arab states placed Ankara in the advantageous position of offering Tehran an outlet to the wider economic world. Turkey would emerge in the 1980s as a key market for Iranian exports.⁶¹ In the area of oil and gas, Turkey's longtime skepticism of Russian encroachment in the Middle East makes Iran an attractive source of for Ankara's energy imports. Because of international sanctions against Iran, Turkey enjoys the position of serving as one of Tehran's only outlets for exporting oil and gas. Today, Turkey remains dependent on energy imports.⁶²

Despite its proximity to the energy riches of the Middle East and Eurasia, Turkey is naturally impoverished in terms of its own energy sources. Additionally, Turkey has little ability to store what natural gas it needs, thereby making it dependent upon a constant flow of imported energy⁶³ Given that a Turkish reduction of Iranian energy imports would increase Ankara's reliance upon Russian oil and gas, and such reliance

⁵⁸ Ataman, 136.

⁵⁹ Ibid, 138.

⁶⁰ Robins, 57.

⁶¹ Ibid, 58.

⁶² Nader Habibi, "Turkey and Iran: Growing Economic Relations Despite Western Sanctions", Middle East Brief, No. 62, Brandeis University, May 2012, 4.

⁶³ "Natural Gas Exports from Iran: A report required by section 505(a) of the Iran Threat Reduction and Syria Human Rights Act of 2012", US Department of Energy, October 2012, 7.

upon Russia would jeopardize Turkey's position among Central Asian republics, a stable Iranian flow of energy is a paramount security and economic concern for the country. Indeed, over 90% of Iranian gas exports are destined for Turkey.⁶⁴ Iran's unique position with Turkey brought Tehran roughly \$10.5 million per day from natural gas alone.⁶⁵ With Tehran under sanctions for issues pertaining to both terrorism and its nuclear program, much of Iran's Turkey-borne energy revenue mandates some form of laundering.

With Turkey dependent upon Iranian energy, and Turkey offering Iran an economic export market, a symbiosis developed under Özal that would characterize foreign economic policy between the two states under future administrations. Turkey's strategy of economically leveraging Iran would continue in the 1990s and mature in the 2000s as increasing Islamism in Turkey's political landscape warmed relations between the two countries in an otherwise turbulent region. Halk Bank's laundering of Iranian funds under thus follows a longstanding Turkish strategy of using economic statecraft on its Persian neighbor for purposes of resource acquisition and securing influence.

Since the Iranian revolution in 1979, Tehran has pursued a path towards becoming a regional power. Religiously Shi'a and ideologically revisionist in areas of the Middle East with significant Shi'a populations, post-revolution Iran holds longstanding animosity towards secular Arab regimes, Israel, and conservative Sunni monarchies in the Persian Gulf. Iran's pursuit of regional influence has long included

⁶⁴ "Natural Gas Exports from Iran: A report required by section 505(a) of the Iran Threat Reduction and Syria Human Rights Act of 2012", US Department of Energy, October 2012, 1.

⁶⁵ Ibid, 1.

support of Shi'a militias and terrorist groups and rebel proxies in the both the Middle East and beyond. Since taking power in 1979, Iran's support of terrorism and in pursuing its nuclear program led to levying of multiple sanctions against Tehran. It was precisely when such Iran was the most isolated due to mobilized threat finance regulations that Ankara laundered money for Tehran.

Iranian financial support for terrorism in the Middle East and elsewhere comprises a longstanding facet of Tehran's geopolitical strategy. In 1982, during the height of both the Iran-Iraq War the Lebanese civil war, a contingent of 1,500 soldiers from the Iranian Revolutionary Guard Corps set up training camps in Lebanon's Bekaa Valley with the stated purpose of exporting the Iranian revolution across the Arab world.⁶⁶ Three years later, Hezbollah stated its own ideological platform that effectively placed it directly under the guidance of the Iran and declared the Tehran government as "the vanguard and new nucleus of the leading Islamic State in the world".⁶⁷ Logistically, the Shi'a group required all Hezbollah members to go through Iran's Bekaa Valley training camps and enjoys between \$200-\$350 million per year in Iranian largesse.⁶⁸ Iran retains a permanent contingent of roughly 500 personnel in Lebanon for purposes of training Hezbollah, and provides funding for Hezbollah-affiliated social services.⁶⁹ It is worth mentioning that no organizational separation exists between the group's social services wing and Hezbollah's terrorist activity. In 2000, Hezbollah's deputy secretary

⁶⁶ Matthew Levitt, *Hezbollah: The Global Footprint of Lebanon's Party of God*, (Washington DC: Georgetown University Press, 2013), 12.

⁶⁷ *Ibid*, 12.

⁶⁸ Levitt, 12.

⁶⁹ Daniel Byman, *Deadly Connections: States that Sponsor Terrorism*, (Cambridge: Cambridge University Press, 2005), 87-88.

general, Maim Qassem noted that the group's secretary general oversees both sides of the group's operations.⁷⁰ While Hezbollah's self-funding activities have matured since the 1980s, the group still receives Iranian support estimated around \$100 million in value per year.⁷¹

Iranian support of Hezbollah is not limited to the Middle East, nor do its attacks avoid civilian targets. After its 1983 attacks on the US embassy and Marine Corps barracks in Beirut, Hezbollah expanded its reach and scope with the help of Iranian support. In 1994, Hezbollah bombed the Argentine Israelite Mutual Association, a Jewish community center in Buenos Aires. The attack left 85 dead and hundreds injured. The Iranian embassy in Argentina provided a base of support for the attack, and for a previous bombing at the Israeli embassy in Buenos Aires in 1992.⁷² In 2003 an Argentine judge issued arrest four warrants for four Iranian officials for assisting in carrying out the attack. Prosecutors in the case recommended twelve warrants for prominent Iranian officials, including Ayatollah Ali Khamenei.⁷³ Ali Fallahian, Iranian former minister of security and intelligence, was included in the arrest warrants.⁷⁴

Tehran's support of terrorism includes reliance on Hezbollah for the assassination of Iranian dissidents abroad, the setting up of banking institutions abroad to support Islamist recruitment, and the establishment of money laundering fronts in form of local businesses in multiple countries. Throughout the 1990s, Iran assisted proxies around the

⁷⁰ Levitt, 14.

⁷¹ Byman, 87-88.

⁷² Ibid, 87-88.

⁷³ "Argentine Judge Indicts 4 Iranian Officials in 1994 Bombing of Jewish Center", New York Times, March 10, 2003, (<https://www.nytimes.com/2003/03/10/world/argentine-judge-indicts-4-iranian-officials-in-1994-bombing-of-jewish-center.html>), accessed April 28, 2018.

⁷⁴ Ibid.

world establish a presence for purposes of advancing Tehran's interests. In the 1997, Iran established bank branches in Albania as a means of promoting militant networks in Europe.⁷⁵ In expanding its influence in Europe, Iranian Central Bank governor, Mohsen Nurbakan, oversaw investment operations in the region to promote Iranian-backed Islamist groups in the Balkans.⁷⁶ In 2013, Bulgarian Interior Minister Tsvetan Tsvetanov attributed a bus bombing to Hezbollah that occurred in the coastal city of Burgas a year prior. The attack killed 7 and wounded 32 people.⁷⁷

Iranian support for the group also extends to Africa, where Tehran actively supports Islamist militant activity on the continent. In seeking to compete with more successful Saudi-backed Sunni networks, Iran established a number of mosques and schools in sub-Saharan Africa aimed at expanding the number of Shia adherents beyond Lebanese expatriate communities.⁷⁸ Financed out of Iranian embassies in the region, Iran has established a number of cultural centers for the means of recruiting for Hezbollah-affiliated activity related to intelligence gathering for potential attacks on Western targets.⁷⁹

At varying levels of intensity, tensions between Tehran and the West remain a constant factor of Middle East politics since 1979. US-led international sanctions against Iran parallel Tehran's support of terrorism and its pursuit of nuclear weapons. While the US is the epicenter for the sanctions levied against the Iranian regime, these sanctions

⁷⁵ Loretta Napoleoni, *Terror Incorporated*, (New York: Seven Stories Press, 2005), 114-115.

⁷⁶ *Ibid*, 115.

⁷⁷ "Hezbollah linked to Burgas bus bombing in Bulgaria", BBC News, Feb. 5, 2013, (<http://www.bbc.com/news/world-europe-21342192>), accessed April 28, 2018.

⁷⁸ Levitt, 265.

⁷⁹ *Ibid*, 265-266.

became nearly all encompassing for the Iranian economy. By the late 2000s, Iran's economy was nearly strangled through a combined focus of sanctions on key members of the Iranian government, the country's energy sector, and its currency. While Tehran would suffer multiple sanctions from the UN, European Union, and would remain on the FATF blacklist, the multilateral economic efforts to curtail Iran's terrorist activity and its nuclear program originated in the United States.

In the mid-1980s, US-led sanctions on Iran focused on curtailing Tehran's ability to access arms from abroad. In 1984, Iran was designated a state sponsor of terrorism, which economically severed Iran from most of the American economy. In 1987, the US outlawed the import of Iranian goods. The Clinton administration expanded the sanctions regime by increasing its multilateral reach through using diplomatic and economic leverage against Iran through blocking bank loans and by penalizing companies doing business with the Iranian energy sector.⁸⁰ The 1996 Iran and Libya Sanctions Act not only limited potential investment in Iranian oil resources, and effectively placed companies from US allies on notice for potential sanction should they do business with Tehran.⁸¹

Even prior to the post-9/11 expansion of the international fortified finance regime, US pressure on Iran was successful in curtailing international lending to Tehran. The US effectively thwarted loans to the Iranian government from both the International Monetary Fund and the World Bank over the course of the 1990s.⁸² In the 2000s,

⁸⁰ Byman, 107-108.

⁸¹ See Sections 4 and 5 of HR 3107, Iran and Libya Sanctions Act of 1996.

⁸² Byman, 109.

American economic statecraft nearly crippled the Iranian economy through entirely financial means.

In the 2000s, while Turkey progressively and haphazardly adopted the fortified finance regime into its domestic political economy, Iran came under economic increasing pressure over its support for terrorism and its nuclear weapons program. In 2005, the Bush administration cut Iran off from most of the world's financial markets through banning Iranian banks from the American financial system.⁸³ Through penalizing third parties doing business with Iran, most Iranian financial assets essentially froze.⁸⁴ In 2010, the US Senate passed the Comprehensive Iran Sanctions and Divestment Act that mandated the sanctioning of any foreign bank that conducted transactions with Iran.⁸⁵ In 2012, the US pressured Iran through threatening to sever foreign banks from the ability to conduct dollar transactions if they also conducted business with the Central Bank of Iran.⁸⁶

Shortly after 9/11, US Secretary of the Treasury Paul O'Neill and General Counsel to the Treasury David Aufhauser traveled to Brussels to pressure the Belgian-based Society for Worldwide Interbank Financial Telecommunications (SWIFT) for access to financial intelligence.⁸⁷ SWIFT, overseen by the National Bank of Belgium and governed by the top executives of the world's major banks, serves as the international

⁸³ Alireza Nader, "Influencing Iran's Nuclear Program", in *Sanctions, Statecraft and Nuclear Proliferation*, ed. Etel Solingen, (Cambridge: Cambridge University Press, 2012), pp. 211-231, 214.

⁸⁴ *Ibid*, 214.

⁸⁵ Juan Zarate, *Treasury's War*, (New York: Public Affairs, 2013), 336.

⁸⁶ James Rickards, *Currency Wars: the Making of the Next Global Crisis*, (New York: Portfolio/Penguin, 2011), 261.

⁸⁷ Zarate, 48-60.

clearinghouse for all financial transactions of formal high finance.⁸⁸ While the US-SWIFT intelligence relationship remained uneasy after 9/11, it offered Washington an alternative mechanism to pressure Iran aside from pure intelligence collection. In early 2012, the US effectively pressured SWIFT into excluding Iran from conducting dollar transactions. Furthermore, American pressure succeeded in dissuading SWIFT from conducting Iranian transactions related to its energy sector.⁸⁹

With the US dollar serving as the premier reserve currency around the world, the US threat to bar banks from conducting any business with Iranian currency decisively lowered its value. As a result, bank runs ensued in Iran as the value of the Iranian rial fell by 40% and consumer prices nearly doubled.⁹⁰ Without an ability to access hard currency, Iran had to discover a way to launder revenues from its oil and gas exports, and change hydrocarbons into cash. Turkey's Halk Bank assisted in providing this service.

As mentioned in the introduction, money laundering at its core comprises the "transfer of value" from one asset to another.⁹¹ In order to obfuscate the laundered from its nefarious origins or destination, the transfer of value must occur in a way that evades detection from interested authorities. Gold, due to its widely accepted value around the world, provides an optimal vehicle to transfer value. Halk Bank and Iran would exploit this golden loophole to exchange gas for gold, so that Iran could then access hard currencies in exchange.

⁸⁸ Zarate, 49-50.

⁸⁹ Rickards, 261-262.

⁹⁰ Ibid, 261-262.

⁹¹ See Wittig (2011), 10.

In December 2013, Turkish police stormed apartments across Istanbul as part of a crackdown on suspected financial corruption. Halk Bank's General Manager, Suleyman Aslan, was arrested along with Reza Zarrab, a businessman and former associate of Iranian president Mahmoud Ahmadinejad. Also arrested were the sons of Turkey's economy, urban development and interior ministers along with an AKP affiliated mayor.⁹² Aslan began his financial career at Ziraat Bank, Turkey's oldest state-owned bank in the early 1990s, and became General Manager of Halk Bank in 2011.⁹³ As the scandal unfolded, Halk Bank emerged as the centerpiece to a massive money-laundering scheme between Iran and Turkey.

As early as 2008, concerns emerged over Halk Bank's role in Iranian business dealings. On January 28 of that year, US Treasury Undersecretary Stuart Levey met with the Turkish Foreign Ministry in concert with the Turkish Ministry of Finance, Treasury and officials from Halk Bank to address international concerns over the bank's dealings with Iran.⁹⁴ Halk Bank General Manager at the time, Halil Celik, along with the bank's chief compliance officer declared that their institution closely followed the best practices of the fortified finance regime, such as monitoring transactions and keeping close familiarity with the nature of their clients.⁹⁵ In terms of its Iranian clients, Halk Bank

⁹² "Turkey's politicians, gold dealer, and the pop star", The Telegraph, Dec. 29, 2013, (<https://www.telegraph.co.uk/news/worldnews/europe/turkey/10540423/Turkeys-politicians-gold-dealer-and-the-pop-star.html>), April 10, 2018.

⁹³ "All About SMEs", Interview with Suleyman Aslan, 2012, (<https://www.thebusinessyear.com/turkey-2012/all-about-smes/interview>), April, 10, 2018.

⁹⁴ Diplomatic cable, "Turkey: U/S Levey on the Dangers of Doing Business with Iran", Canonical ID: 08Ankara379_a, Feb. 27, 2008, Wikileaks, (https://wikileaks.org/plusd/cables/08ANKARA379_a.html), accessed April 2, 2018.

⁹⁵ Ibid.

officials noted that their institution held “long-dormant correspondent accounts” acquired via Halk Bank’s acquisition of Pamukbank in 2004.⁹⁶

Duran Uğur, Halk Bank’s designated compliance officer issued an official statement regarding the bank’s commitment to implementing fortified finance practices within the bank. Halk Bank declared that its internal policies reflected not only Turkish counter-terrorism laws, but also FATF recommendations through its cooperation with MASAK and Turkey’s Banking Regulation and Supervision Agency (BRSA).⁹⁷ Notably, the bank stipulated that it mandated anti-money laundering, terrorist financing and know-your-customer training to all of its employees in order to comply with best practices from the FATF and to comply with US-led sanctions.⁹⁸ As mentioned in the previous section, Turkey became a FATF member in 1991.

According to Wikileaks, in 2009 US Treasury Assistant Secretary for Terrorist Financing and Financial Crimes David Cohen, met with both Halk Bank and Turkey’s BRSA. In the meeting, the BRSA assured Cohen that the agency collected all relevant financial intelligence from Turkey’s banks. Halk Bank declared that “no deals are financed on a cash-for-goods basis” in the bank’s dealings with Iran.⁹⁹ Despite this assertion, this is precisely the business that Halk Bank conducted.

⁹⁶ Diplomatic cable, “Turkey: U/S Levey on the Dangers of Doing Business with Iran”, Canonical ID: 08Ankara379_a, Feb. 27, 2008, Wikileaks, (https://wikileaks.org/plusd/cables/08ANKARA379_a.html), accessed April 2, 2018.

⁹⁷ Duran Uğur, Anti-Money Laundering, Anti-Terrorist Financing and Know Your Customer Statement, Halk Bank, 2008.

⁹⁸ Ibid.

⁹⁹ Diplomatic cable, “Treasury Official on Fight Against Terrorist Financing”, Canonical ID: 09Ankara1725_a, December 4, 2009, Wikileaks, (https://wikileaks.org/plusd/cables/09ANKARA1725_a.html), accessed April 2, 2018.

At the arrest of Halk Bank's CEO and other suspects, police discovered caches of cash valued in the millions stashed at their various Istanbul apartments. The cash functioned as part of laundering plan developed by Reza Zarrab in which Turkish lira would be converted to gold, shipped to Dubai, and then sent to Iran as payment for Turkey's importation of Iranian oil and gas. The laundering was massive, and amounted to 36 metric tons of gold shipped from Turkey to Iran in August 2012 alone.¹⁰⁰ Zarrab, the Iranian middleman allegedly paid millions of dollars to Halk Bank's CEO along with payments to Turkey's economic minister.¹⁰¹ From 2012-2013, as Iran struggled to obtain hard currencies due to sanctions, Turkey sent roughly \$13 billion in gold to Tehran; this gold exportation dropped to nothing by January 2014 following the arrest of Halk Bank's CEO.¹⁰²

State ownership of Halk Bank, along with the AKP affiliation of the Istanbul mayor and the ministers whose sons were arrested in the raid, brought political as well as economic scandal to Ankara. Shortly after the arrests, as Halk Bank's stock prices fell under the shadow of the Iranian gold dealings, Prime Minister Erdoğan and the Turkish government quickly enacted countermeasures to protect the bank. Using a combination of diplomatic pressure, domestic political intimidation, and bureaucratic reshuffling, the government succeeded in protecting the bank from penalty.

¹⁰⁰ "Turkey's politicians, gold dealer, and the pop star", The Telegraph, Dec. 29, 2013, (<https://www.telegraph.co.uk/news/worldnews/europe/turkey/10540423/Turkeys-politicians-gold-dealer-and-the-pop-star.html>), April 10, 2018.

¹⁰¹ Ibid.

¹⁰² Jonathan Schanzer and Rachel Zeimba, "The Anatomy of Turkey's "Gas-for-Gold" Scheme with Iran", Foundation for the Defense of Democracy Policy Brief, June 14, 2014, (<http://www.defenddemocracy.org/media-hit/the-anatomy-of-turkeys-gas-for-gold-scheme-with-iran/>), accessed April 10, 2018.

Within days of the raid in Istanbul, police officers connected to the laundering investigation were either dismissed or fired from the force. Huseyin Capkin, the head of Istanbul's police, resigned on Dec. 19, only two days after the raid on Halk Bank's CEO.¹⁰³ Amid the purging of over 30 senior police officials in Istanbul's police force was the firing and reassigning of 350 police officers in Ankara the following month, over what Prime Minister Erdoğan claimed was a "dirty plot" on the part of Turkey's judiciary in consort with the police.¹⁰⁴ As the purges took place, Erdoğan declared in a speech that the police force itself was "tainted" while simultaneously assuring a zero tolerance approach to corruption.¹⁰⁵ As for Halk Bank, Erdoğan decried the scandal as part and parcel of a "plot by Turkey's enemies", such as his political archrival Fethullah Gulen.¹⁰⁶

In early 2014, the AKP-controlled government implemented a law aimed at curtailing the powers of Turkey's judiciary. During open debate prior to the law's implementation, physical fighting erupted in parliament. The new law mandated that the Ministry of Justice would dictate judicial appointments, as opposed to the separate and independent High Council of Judges and Prosecutors.¹⁰⁷ Judicial officials involved with the Halk Bank case were summarily dismissed or reassigned as part of a massive shuffle

¹⁰³ "Turkey Corruption Inquiry: More Senior Police 'Fired'", BBC News, Dec. 20, 2013, (<http://www.bbc.com/news/world-europe-25462121>), accessed April 12, 2018.

¹⁰⁴ "Hundreds of Turkish Police Officers Dismissed", BBC News, Jan. 7, 2014, (<http://www.bbc.com/news/world-europe-25634542>), accessed April 12, 2018.

¹⁰⁵ "Hit by scandal and resignations, Turk PM names new ministers", Reuters, Dec. 24, 2013, (<https://www.reuters.com/article/us-turkey-corruption/hit-by-scandal-and-resignations-turk-pm-names-new-ministers-idUSBRE9BN0D720131225>), accessed April 12, 2018.

¹⁰⁶ "Turkey's Business Sector Hit by Scandal Fallout", Financial Times, Dec. 23, 2013, (<https://www.ft.com/content/b4bda6de-6bee-11e3-85b1-00144feabdc0>), accessed April 10, 2018.

¹⁰⁷ "Turkish president signs off on new controls over judiciary", BBC News, Feb. 26, 2014, (<http://www.bbc.com/news/world-europe-26351258>), accessed April 10, 2018.

of nearly 120 judges and prosecutors.¹⁰⁸ Since the outbreak of the scandal with the arrests a month prior, thousands of police had also been reassigned or dismissed.¹⁰⁹ Murat Arlsan, head of Turkey's YARSAV association of prosecutors and judges declared the entirety of the bureaucratic shuffle to be politically motivated, stating that Erdoğan's desire was to insulate himself and those affiliated with the AKP.¹¹⁰ As for Turkey's banking authority, the BRSA, Erdoğan declared in an interview with Al Jazeera that the regulatory body conducted a full audit of Halk Bank and its CEO's affairs. According to the Prime Minister and the banking authority, there was "no trouble" to be found.¹¹¹

Reza Zarrab, the Iranian at the center of the laundering scandal, enjoyed special protections provided by Erdoğan. Erdoğan advocated for Zarrab's integrity and described him as a charitable figure.¹¹² Zarrab's charitable activity included multiple donations to the Social Development Center for Education and Social Solidarity, a charity founded by Ermine Erdoğan, the Prime Minister's wife.¹¹³ Zarrab also provided gifts to Halk Bank CEO Suleyman Aslan, including a \$37,000 piano, a luxury watch valued at \$350,000, and millions of dollars in currency.¹¹⁴

¹⁰⁸ "Turkish judicial purge brings corruption investigation to halt", Reuters, Jan. 22, 2014, (<https://www.reuters.com/article/us-turkey-corruption/turkish-judicial-purge-brings-corruption-investigation-to-halt-idUSBREA0L1G220140122>), accessed April 11, 2018.

¹⁰⁹ "Turkish judicial purge brings corruption investigation to halt", Reuters, Jan. 22, 2014, (<https://www.reuters.com/article/us-turkey-corruption/turkish-judicial-purge-brings-corruption-investigation-to-halt-idUSBREA0L1G220140122>), accessed April 11, 2018.

¹¹⁰ Ibid.

¹¹¹ "Cash found in shoeboxes at Halkbank ex-manager's home not bank's money: Turkish PM", Hurriyet Daily News, Feb. 11, 2014, (<http://www.hurriyetdailynews.com/cash-found-in-shoeboxes-at-halkbank-ex-managers-home-not-banks-money-turkish-pm-62314>), accessed April 10, 2018.

¹¹² David L. Philips, *An Uncertain Ally*, (Abingdon: Routledge, 2017), 49.

¹¹³ Ibid, 49.

¹¹⁴ Philips, 50.

The AKP's countermeasures effectively insulated the bank and its General Manager along with others suspected of laundering money for Iran. In October 2014, prosecutors in Istanbul opted to drop all charges. Ekrem Aydiner, the only Istanbul prosecutor for anti-terrorism and organized crime remaining with the case, announced that the case could not advance due to a combine lack of grounds and deficient evidence regarding any conspiracy.¹¹⁵ On October 17, the primary investigation against Suleyman Aslan was dropped.¹¹⁶

The Turkish state effectively deflected any threat finance enforcement on the domestic level. If anything, Ankara's domestic blockage of enforcement deepened the ruling AKP's political grip on power and increased authoritarianism in the country. Internationally, the case would revive in the United States with the arrest of Halk Bank Deputy General Manager Hakan Atilla. Reza Zarrab, the Iranian financier behind much of the laundering scheme would later resurface in the United States where the Turkish government would once again seek to protect its bank. One police official involved in the investigation who purged in the wake of Ankara's bureaucratic reshuffle fled Turkey to the United States, whereupon he handed it to American authorities.¹¹⁷

Halk Bank's Iranian middleman, Reza Zarrab, was arrested in Miami on March 19, 2016 while attempting a vacation trip.¹¹⁸ Halk Bank official Hakan Atilla was

¹¹⁵ "Turkey's massive corruption case dropped by prosecutor", Hurriyet Daily News, October, 17, 2014, (<http://www.hurriyetdailynews.com/turkeys-massive-corruption-case-dropped-by-prosecutor-73149>), accessed April 12, 2018.

¹¹⁶ Ibid.

¹¹⁷¹¹⁷ "Turkish banker Hakan Atilla convicted in US sanctions case", NBC News, Jan. 3, 2018, (<https://www.nbcnews.com/news/us-news/turkish-banker-hakan-atilla-convicted-u-s-sanctions-case-n832181>), accessed April 10, 2018.

¹¹⁸ Philips, 50.

arrested on charges of sanctions evasion while traveling to New York on business.¹¹⁹ The US indictment against Zarrab and Atila included charges of fraud, money laundering, and conspiracy. While the charges largely focused on sanctions evasion pertaining to Iranian state entities assisted by Halk Bank, it also included allegations that the Turkish bank facilitated transactions for a company called Mahan Air.¹²⁰ As a commercial airline, the US Office of Foreign Asset Control blacklisted Mahan Air in October 2011 for supporting the Iranian Revolutionary Guards Corps-Quds Force (IRGC-QF).¹²¹ The IRGC-QF is the arm of the Iranian military that helped form and continues to provide support for Hezbollah.¹²² Mahan Air supported the IRGC-QF through offering “covert travel” for personnel, weapons, and cash.¹²³ Shortly after Mahan Air was designated as an entity supporting terrorism, Reza Zarrab wrote to Iran’s Central Bank governor offering his services for “economic jihad”.¹²⁴

At the height of the arrests, Halk Bank issued a statement in 2016 that highlighted its purported compliance with the international fortified finance regime. It stated that the bank not only followed all AML/CTF regulations through its cooperation with Turkey’s

¹¹⁹ “US Arrests Top Turkish Banker in Iran Sanctions Probe”, Bloomberg, March 23, 2017, (<https://www.bloomberg.com/news/articles/2017-03-28/halkbank-deputy-g-m-arrested-in-u-s-in-iran-financing-probe>), accessed April 13, 2018.

¹²⁰ United States District Court Southern District of New York, Superseding Indictment, S4 15 Cr. 867, RMB, 35-40.

¹²¹ Treasury Designates Iranian Commercial Airline Linked to Iran’s Support for Terrorism, US Treasury Department, October 12, 2011, (<https://www.treasury.gov/press-center/press-releases/Pages/tg1322.aspx>), accessed April 8, 2018.

¹²² Assaf Moghadam, *Militancy and Political Violence in Shiism: Trends and Patterns*, (Abingdon: Routledge, 2011), 87. See also, Levitt, 9.

¹²³ Treasury Designates Iranian Commercial Airline Linked to Iran’s Support for Terrorism, US Treasury Department, October 12, 2011, (<https://www.treasury.gov/press-center/press-releases/Pages/tg1322.aspx>), accessed April 8, 2018.

¹²⁴ Philips, 52.

regulatory body, but also in “jurisdictions where the foreign branch is located”.¹²⁵

Moreover, it specifically claims that it complied with all sanctions, including those stated by the US Treasury’s Office of Foreign Asset Control.¹²⁶

Notably, Zarrab became the primary witness against Atilla after striking a deal with prosecutors and agreeing to testify in how the bank was involved in laundering. After testifying that then-Prime Minister Erdoğan oversaw the use of Halk Bank to channel funds to Iran, Turkey seized assets of Zarrab and his family in the country.¹²⁷ Despite Zarrab’s testimony, Atilla was acquitted of money laundering while being convicted of conspiracy and fraud.¹²⁸

Shortly after Atilla’s conviction, the Turkish state indicated its willingness to defend its bank should the US seek to penalize the institution. Turkey’s Deputy Prime Minister, Mehmet Simsek declared that Ankara would do “whatever is necessary” to assist banks threatened as a result of Atilla’s trial.¹²⁹ Simsek’s verbal rebuttal to the New York trial also contained the telling contradiction when he stated that Halk Bank itself, rather than the Turkish government would pay any levied fines.¹³⁰ Halk Bank serving as a

¹²⁵ “Statement of Anti-Money Laundering and Counter Terrorist Financing and Anti-Bribery-Corruption and Sanctions”, Halk Bank, 2016, 1.

¹²⁶ Ibid, 2.

¹²⁷ “Jailed police chiefs who led 2013 corruption ops taken to police HQ”, Turkish Minute, Jan. 14, 2018, (<https://www.turkishminute.com/2018/01/14/jailed-police-chiefs-who-led-2013-corruption-ops-taken-to-police-hq/>), accessed April 10, 2018.

¹²⁸ “Halkbank in clear in Turkish banker Atilla case in US”, Anadolu News Agency, Jan. 4, 2018, (<https://www.aa.com.tr/en/economy/halkbank-in-clear-in-turkish-banker-atilla-case-in-us/1022288>), accessed April 10, 2018.

¹²⁹ “Halkbank not Turkey will pay any US fine, deputy PM says”, Reuters, Jan. 11, 2018, (<https://www.reuters.com/article/us-turkey-halkbank/halkbank-not-turkey-will-pay-any-u-s-fine-deputy-pm-says-idUSKBN1F10IZ>), accessed April 10, 2018.

¹³⁰ “Halkbank not Turkey will pay any US fine, deputy PM says”, Reuters, Jan. 11, 2018, (<https://www.reuters.com/article/us-turkey-halkbank/halkbank-not-turkey-will-pay-any-u-s-fine-deputy-pm-says-idUSKBN1F10IZ>), accessed April 10, 2018.

state-owned bank warrants the government's negation of any fine through bailouts or subsidy. The Turkish foreign ministry similarly stood firm in dismissing the US conviction of "any legal value".¹³¹ After American prosecutors requested a sentence of prison time for Atilla, Halk Bank's shares paradoxically rose, rather than fell.¹³² As for whether Halk Bank directly faces any financial punishment from the US, either in the form of fines or being blacklisting and severed from dollar transactions, the bank has yet to face financial penalties for its activities.

VI. Analysis

The Halk Bank case clearly illustrates a financial firm with deep institutional linkage to its state escaping enforcement for laundering money for terrorism. This Turkish case is unique in that it involves a state-sponsor of terrorism as opposed to simply a terrorist group using the financial system of another country. Furthermore, this case is one involving overlapping sanctions against the state sponsor of terrorism for other issues than terrorism alone. In their various manifestations, sanctions against Iran cover concerns over Tehran's nuclear program and engagement in interstate war along with its support for groups such as Hezbollah. Regarding the fortified finance regime, what is less explicable is how Ankara's state-owned bank knowingly assisted Tehran in circumventing these sanctions while Turkey simultaneously deepened its adoption of AML/CTF regulations. The only feasible explanation is that states defend banks that are extensions of the state themselves.

¹³¹ "Turkey anger as US convicts banker Atilla over Iran sanctions case", BBC News, Jan. 4, 2018, (<http://www.bbc.com/news/world-europe-42564833>), accessed April 10, 2018.

¹³² "RPT-Update 2-Halkbank shares surge after US seeks jail term for banker", Reuters, April 5, 2018, (<https://www.reuters.com/article/usa-turkey-zarrab-spokesman/rpt-update-2-halkbank-shares-surge-after-us-seeks-jail-term-for-banker-idUSL5N1RI4GD>), accessed April 12, 2018.

Halk Bank fits the dependent variable of holding institutional linkage to its home state. Aside from lasting state-majority ownership and failed privatization, the bank's governance remains linked to the Turkish executive through its managerial structure. Furthermore, the bank's primary client base places the bank in a unique position as a coalition binder for the political party in power. Indeed, Halk Bank's main client base coincides with primary voting demographic for Turkey's Islamists under the AKP.

Critics of the Turkish case may point out that significant international disagreement over Iranian sanctions make the case excessively American, and that rather than breach the international fortified finance regime, Ankara simply disregarded US interests. However, Ankara opted into the fortified finance regime through its entry into the FATF in 1991, long prior to the depth that Iranian sanctions took on as a result of its nuclear ambitions. Similarly, while the FATF had concerns over Turkey's implementation of AML/CTF regulations, Ankara progressively adopted more international standards throughout the 2000s. Turkey adopted financial regulations and the capacity to follow them through implementing know-your-customer rules and the monitoring of suspicious activity. Indeed, the rules were effective, as evidenced by the government's attempted crackdown in December 2013 when multiple arrests took place in Istanbul. If the financial regulations were not present, no such enforcement attempt should have occurred. Turkey's judicial and law enforcement bureaucracy did not fail to act so much as be thwarted by the state itself through bureaucratic reshuffling and political intimidation.

As for the regulatory adoptions and legal changes that Turkey underwent to come under de jure compliance, none of these changes displaced Turkey's statist legacy or its structural relationship with its bank. Preexisting institutional arrangements between the Turkish state and Halk Bank remained intact despite deepening involvement with the fortified finance regime. Furthermore, Turkey's fortified finance regime did not disrupt Turkey's economic reliance upon Iranian energy imports.

Halk Bank has thus far escaped any regulatory enforcement. Domestically, the AKP under Erdoğan restructured Turkey's judicial and law enforcement apparatus through bureaucratic reshuffling in combination with political intimidation. The layoffs and reassignment of hundreds of judges, police, and prosecutors effectively thwarted any domestic charges against Halk Bank officials and others affiliated with the laundering. Internationally, the conviction of Hakan Atilla comprises the single punishment faced by Halk Bank or any of its personnel. US prosecutors tried other individuals in absentia; however, only Atilla was arrested and convicted.

Institutionally, Halk Bank remains free of any penalty. Should the US advance any fines against the bank, similar to what occurred against European banks engaged in similar activity, Ankara's statements indicate the state will negate any levied penalty. A massive American fine against Halk Bank, severing it from dollar transactions, or SWIFT access would deliver a massive blow to Turkey's economy while straining Ankara's position in NATO and its involvement in Syria. If any fine is levied, Halk Bank's position as a state-owned bank places Ankara's government as well as its financial sector

in the crosshairs of American economic statecraft. Out of pure necessity, the Turkish government would be forced to thwart any further enforcement against its bank.

Halk Bank's figure at the center of the case, Hakan Atilla, received a sentence of 32 months in prison as opposed to the 20-year sentence sought by prosecutors.¹³³ Presiding judge Richard M. Berman declared that Atilla served as the "cog in the wheel" rather than the "mastermind" at the center of the operation.¹³⁴ Indeed, judge Berman stated that Atilla was only "following orders" from Halk Bank's CEO, Suleyman Aslan.¹³⁵ Institutionally, the Turkish state has moved to protect its bank through high-level diplomacy and economic statecraft. Both Halk Bank and Turkey's economy and foreign ministers took part in defending the bank. Foreign Minister, Mevlut Cavusoglu declared in a statement to the *Financial Times*, that the state was working with the US to resolve the issue. Furthermore, the Turkish state indicated it would step in if necessary financially negate any fallout from US regulatory fines.¹³⁶

In the realm of economic statecraft, Ankara moved to defend its bank and the Turkish lira from American action a month prior to the Atilla conviction. In April 2018, Ankara withdrew 28.6 tons of Turkish gold being held at the Federal Reserve and re-deposited the holdings at the Bank of England the Bank of International Settlements.¹³⁷

¹³³ "Turkish Banker in Iran Sanctions-Busting Case Sentenced to 32 Months", *New York Times*, May 16, 2018, (<https://www.nytimes.com/2018/05/16/world/turkish-iran-sanctions-trial.html>), accessed May 16, 2018.

¹³⁴ Ibid.

¹³⁵ "Turkish Banker Sentenced in US Court Over Iran Sanctions Violations", *Financial Times*, May 16, 2018, (<https://www.google.com/amp/s/amp.ft.com/content/a0b6ac1c-593d-11e8-b8b2-d6ceb45fa9d0>), accessed May 16, 2018.

¹³⁶ Ibid.

¹³⁷ "Turkey withdrew gold from Fed amid crisis-analysis", Ahval News Service, April 17, 2018, (<https://ahvalnews.com/us-turkey/turkey-withdrew-gold-fed-amid-crisis-analysis>), accessed April 18, 2018.

Domestically, Turkish banks also changed the makeup of their reserves with Turkey's central bank, replacing foreign currency holdings with gold.¹³⁸ Turkey also drew down its holdings of US bonds beginning in November 2017.¹³⁹

Given the US and Turkey form part of an international conflagration of powers militarily involved in Syria, any American economic action against Halk Bank could have kinetic consequences for the Syrian civil war and the Middle East as a whole. The Turkish state indicated it would defend its bank against regulatory attack, thereby negating any damage to the institution or even the linkage between the government and the bank. Turkey's withdrawal from US assets and from exposure to unilateral American seizure of Turkish gold offers little indication of Ankara's willingness to surrender on behalf of its bank.

¹³⁸ "Turkey withdrew gold from Fed amid crisis-analysis", Ahval News Service, April 17, 2018, (<https://ahvalnews.com/us-turkey/turkey-withdrew-gold-fed-amid-crisis-analysis>), accessed April 18, 2018.

¹³⁹ "Early elections and reserves held in the US", *Hurriyet Daily News*, April 21, 2018, (<http://www.hurriyetdailynews.com/opinion/ugur-gurses/early-elections-and-reserves-held-in-the-us-130648>), accessed April 22, 2018.

Chapter 5: Institutional Independence and Regulatory Enforcement

I. Introduction

The positive cases of blocked enforcement all occurred where institutional connections with their home states placed them in positions of critical importance to the security and stability of the state in which they are embedded. In these instances, the home state came to the defense of banks in order to deflect or defuse the attempt in order to protect the integrity of the bank being targeted. However, some banks do indeed succumb to enforcement measures without any meaningful protections from their home states. This chapter explores why and how enforcement succeeds in the absence of such bank-state linkages, and to address potential rival explanations for enforcement outcomes such as regulatory presence, rule of law, and authoritarianism. To account for these rival explanations, and to examine why fortified financial regulations are weak in enforcement, I explore the cases of the Bank of Credit and Commerce International (BCCI), and Jordan's Arab Bank.

The cases of both BCCI and Arab Bank display institutional independence from their home state regimes. The case of BCCI operated out of the offshore tax havens of Luxembourg and the Cayman Islands. Contrary to popular conceptions of offshore tax havens as being rogue financial jurisdictions that actively promote and attract illicit funds and protect them in the face of international pressure, both offshore tax havens took active roles in closing BCCI's operations once it came under regulatory scrutiny for

financing terrorism and conducting other nefarious business activities. In the early 1990s, BCCI was forcibly closed by multilateral law enforcement and regulatory action.

Arab Bank, which came under regulatory penalty through the form of administrative fines and civil suits based in the United States, paid fines without any blockage from the Jordanian government. Arab Bank, a financial institution laudable for its ability to survive multiple wars, decolonization and population shifts in the Middle East, followed an American model of business drawing upon financial structural model from the United States. When both banks came under regulatory scrutiny for financing terrorism, this lack of institutional linkage left them exposed to regulatory crackdown

II. Enforcement Against the Bank of Commerce and Credit International (BCCI)

The history of the fortified finance regime is marked by a number of spectacular cases involving high-profile arrests, asset seizures, and publicized lawsuits. BCCI met a rapid regulatory demise in the early 1990s following multilateral investigations into the bank's laundering proceeds from numerous crimes and for financing terrorism. While BCCI held a notable presence around the world, it was based in the tax havens of Luxembourg and the Cayman Islands. Paradoxically, its legal grounding in offshore political economies did little to protect it from regulatory enforcement.

BCCI was founded in the backdrop of bank nationalization in Pakistan, and its founder's desire to avoid state interference in financial affairs. Founded in 1972, BCCI was deliberately established as a legal presence in Luxembourg in order to avoid significant financial regulation and to become the root of a multinational bank devoted to

the developing world.¹ BCCI's founder, Agha Hasan Abedi, described the envisioned bank as a "world bank, a global bank for the third World".²

In seeking to avoid regulatory scrutiny, BCCI developed a two-pronged strategy of basing a legal presence in two offshore tax havens while basing its operational headquarters in London. Its first legal founding in Luxembourg in 1972 was replicated by reflecting its legal registration in the Cayman Islands in 1975. Additionally, its Cayman Islands office was registered as an offshore subsidiary of its Luxembourg entity, BCCI Holdings SA.³ BCCI's founding structure was designed to preclude any state meddling through aggressive regulation or bank nationalization. Abedi, sensing Islamabad's coming nationalization of Pakistan's banking industry in 1974, organized the new bank specifically to inhibit regulatory oversight and state linkage.

Prior to BCCI, Abedi founded a Pakistani bank named United Bank Ltd in 1959. However, Prime Minister Zulfikar Ali Bhutto's suspicion of United Bank's association with Pakistani military led the Bhutto regime to place Abedi under house arrest prior to Islamabad's 1974 nationalization of the country's banking industry.⁴ While United Bank would eventually reprivatize in 2002, Abedi drew his past experience to design BCCI's structure as a private bank beyond the reach of state authorities. Notably, cultural connection between BCCI and Pakistan would remain close. The Islamabad government

¹ MB Malik, *Double Standards: The Forced Closure of BCCI*, (Leicestershire: Matator-Troubador Books, 2016), 12.

² Peter Truell and Larry Gurwin, *False Profits: The Inside Story of BCCI, the World's Most Corrupt Financial Empire*, (New York: Houghton Mifflin Co., 1992), 11.

³ James Ring Adams and Douglas Frantz, *A Full Service Bank: How BCCI Stole Billions around the World*, (New York: Pocket Books, 1992), 29.

⁴ Truell and Gurwin, 2.

under Muhammad Zia-ul-Haq would provide political support for BCCI's political activities despite the private bank's registration in offshore tax havens.

BCCI's legal homes in Luxembourg and the Cayman Islands provided a jurisdictional grounding to help prevent any home state interference. This institutional separation between bank and state not only assisted the bank in facilitating a number of money laundering crimes and financing terrorism, but also paradoxically enfeebled the bank's position within the political economies it was embedded. While tax havens provide an illusion of corporate freedom from the reach of regular states, tax havens also serve to lose little should a bank or other company face closure. Not only did the Cayman Islands and Luxembourg both eventually assist American and European authorities in shutting down BCCI, they were also both early entrants into the emerging fortified finance regime. Additionally, the closure of BCCI coincided with the founding of the Financial Action Task Force.

Popular depictions of tax havens conjure images of shadowy business people affiliated with the world's wealthy engaged in tax evasion, drug dealing, and other activities. Such activity exists; however, tax havens are not entirely independent from the sway of powerful states seeking access to their financial systems. Many tax havens hold affiliations with old established states through colonial legacies. Similarly, despite the BCCI founder's planned structure of the bank, the "global" corporate entity does not exist. Every bank and corporation must be institutionally based in some legal framework

somewhere in order to effectively operate.⁵ In seeking insulation from state linkages, BCCI paradoxically left itself vulnerable to regulatory attack after it came under scrutiny.

Through its main London office and its Cayman Islands base, BCCI's operations and the bulk of its legal presence rested within Britain's financial arena. While the UK was one of the early promoters of counter-terrorist financing regulations, the City of London paradoxically lay at the center of its own offshore financial network that included the Caymans and other pseudo-colonial holdings in its domain. BCCI's "global" structure was a façade that otherwise rested on Britain's strategic legacy of competing with the United States as a financial center. The idea behind offshore havens such as the Caymans, and indeed the City of London, was to offer a veneer of light and laissez-faire regulation.

BCCI's first legal residency of Luxembourg emerged as a proto-tax haven as early as 1929, through the introduction of holding company laws that allowed nonresidents to enjoy a special status of tax exemption.⁶ In the 1970s, the city-state sprung forth as a major tax haven in parallel to the reorientation of the international financial system to monetarism. In 1981, through its competition with Switzerland, it augmented its laws to increase bank secrecy.⁷ Not coincidentally, BCCI's growth coincided with Luxembourg's legal changes.

The Cayman Islands' function as a tax haven derives from the island's legacy as an otherwise innocuous holding of the British Empire. Nicholas Shaxson notes that the

⁵ See Paul N. Doremus, William W. Keller, Louis W. Pauly, and Simon Reich, *The Myth of the Global Corporation* (Princeton: Princeton University Press, 1998).

⁶ Ronen Palan, Richard Murphy, and Christian Chavagneux, *Tax Havens: How Globalization Really Works*, (Ithaca: Cornell University Press, 2010), 119.

⁷ Palan et al, (2011), 119.

City of London rests at the center of a financial empire that encompasses otherwise unimportant island jurisdictions around the world. Britain's island pseudo colonies include several "Crown Dependencies" around the UK itself, and 14 other jurisdictions that only boast a combined population of 250,000 people while offering a home to much of the world's hidden financial wealth.⁸ Contrary to BCCI's calculations, these tax havens only comprise an appearance of statelessness. In reality, the UK cultivated the City of London, the Caymans, and other offshores as lightly regulated arena where financial sector could operate with the state looming in the background.

BCCI's founding in the 1970s coincided both with the international monetary system's shift towards monetarism and with the emergence of offshore finance havens. In 1962 the Bank of England began allowing the issuance of securities denominated in foreign currencies, thus augmenting the embryonic Eurodollar market in an effort to regain the City's position as a major financial center.⁹ As noted by Eric Helleiner, the Euromarket effectively created an arena that was "offshore" and ostensibly "separate" from the rest of the British financial sector.¹⁰ As the then chief British regulatory body, the Bank of England actively promoted this arena of light regulation.¹¹ As noted by Gary Burn, the City's Euromarket "punctured a hole" in the regulatory system of the banking

⁸ Nicholas Shaxson, *Treasure Islands: Uncovering the Damage of Offshore Banking and Tax Havens*, (New York: Palgrave Macmillan, 2011), 16-17.

⁹ Peter Hall, *Governing the Economy: The Politics of State Intervention in Britain and France*, (Oxford: Oxford University Press, 1986), 77.

¹⁰ Eric Helleiner, *States and the Reemergence of Global Finance*, (Ithaca: Cornell University Press, 1996), 84.

¹¹ Helleiner, 84.

industry.¹² This British regulatory reorganization also coincided with an approach to decolonization through the means of financial statecraft. The City's creating itself as an epicenter of offshore finance extended to the UK's dependencies and pseudo-colonies.

The 1960s witnessed a surge in independence movements that virtually eliminated what remained of European colonialism. However, not all colonies proved determined or able to free themselves from colonial rule. In the Caribbean, the Bahamas under British rule attracted the financial activities the American mafia. In 1961, the mafia's financial networks under Meyer Lansky began serious operations in the islands, having bribed the British Bahamas' finance minister.¹³ The Bahamas' burgeoning illicit finance contributed to the election of independence-minded populists in 1967, and eventual independence in 1973. As a result, the Bahamas' offshore finance moved to the Caymans.¹⁴

The Caymans' forgoing independence while implementing the colony as an offshore tax haven was the product of commercial aristocracy in the islands seeking to retain the territory's dependency on the one hand, and London's state bureaucracies battling over how closely to regulate and revamp the island. When Jamaica achieved independence in 1962, the Caymans opted for continued association with the UK as a colonial holding. The UK remains responsible for its Caymanian holding's executive functions.

As offshore funds already stashed in the Caribbean flowed to the Caymans, London's bureaucracies stood divided over the emerging tax haven. From 1966-1979,

¹² Gary Burn, "The state, the City, and the Euromarkets", *Review of International Political Economy*, Vol. 6, No. 2, (1999), pp. 225-261, 226.

¹³ Shaxson, 89.

¹⁴ *Ibid*, 90.

the Caymans established a number of legal changes to attract unregulated finance. Notably, these laws coincided with the introduction of what would evolve into the AML/CTF regime, with the passage of the Bank Secrecy Act in the United States in 1970. These legal changes served to flush greater capital to the emerging Caymanian offshore from the United States. In 1976, the Caymans implemented legal privacy coverage for the offshore corporations and funds placed on its shores via the Confidential Relationships Law.¹⁵ The Caymans' enforcement of the Confidential Relationships Law is overseen by the Caymans Protection Board that not only oversees enforcing privacy, but also controls Caymanian citizenship and visa processes.¹⁶

British bureaucracies clashed over the Caymans' emergence as a tax haven, with the Bank of England and the British Overseas Development Ministry supporting its development, and the British Treasury and the British Foreign Office opposing it.¹⁷ Tellingly, the Bank of England expressed little concern over the influx of illicit funds, but expressed greater concerns over maintaining the Sterling Area. Palan notes that in a 1969 letter, the Bank of England declared "no objection to providing bolt holes for nonresidents", but did express concern over the Cayman's possibility of becoming a haven for sterling.¹⁸ In 1972 London restricted the Sterling Area to the British Isles, while the Caymans adopted their own currency pegged to the dollar to increase the attraction of illicit financial holdings from the US and Latin America.¹⁹

¹⁵ Palan et al (2010), 137.

¹⁶ Jonathan Beaty and SC Gwynne, *The Outlaw Bank: A Wild Ride into the Secret Heart of BCCI*, (New York: Randomhouse, 1993), 113-114.

¹⁷ Shaxson, 90.

¹⁸ Ibid, 91-92.

¹⁹ Shaxson, 92.

Despite ongoing protests from other organs of the British state, the Bank of England's fostering of the Caymans into a Caribbean tax haven continued.²⁰ Tellingly, the Bank of England's regulatory authority over illicit finance regulation was effectively replaced with the Financial Services Authority in 2000.²¹ The primary British bureaucracy responsible for overseeing the fortified finance regime that would later emerge in this era was the same British Treasury that opposed the Bank of England's attempts to develop the Caymans as an offshore tax haven.²² Far from being unsupervised, the main stage of BCCI's activities were deliberately created arena's where the state was not so much absent as willfully aloof in a regulatory capacity. As will be shown later, not only was the Bank of England knowledgeable of BCCI's activities, it assisted in their obfuscation.

The Caymans proved central to BCCI's activities, and housed a virtual "bank within a bank" that cleared nefarious transactions and housed dubious accounts.²³ The Caymans' Confidential Relationship Law of 1976 afforded BCCI the ability to establish a subsidiary that kept much of its activities ostensibly secret. BCCI established its subsidiary, ICIC Overseas in 1976 in the Caymans. In an incestuous shareholding scheme, ICIC owned 41% of BCCI's own official legal home entity in Luxembourg.²⁴ BCCI's Caymanian presence allowed it to book transactions in the tax haven, even if funds were not housed in the jurisdiction. Furthermore, BCCI's reluctance to

²⁰ Shaxson, 93.

²¹ Nicholas Ryder, *Money Laundering-An Endless Cycle? A Comparative Analysis of the Anti-Money Laundering Policies in the United States of America, the United Kingdom, Australia, and Canada*, (Abingdon: Routledge, 2012), 80.

²² Ryder, 79.

²³ Beaty and Gwynne, 114.

²⁴ *Ibid*, 113.

computerize its operations and stubborn insistence upon maintaining handwritten ledgers and memos in Urdu effectively placed much of the bank's \$20 billion in assets within a black box.²⁵ As early as 1978 alarm bells began to sound among banking circles over BCCI's activities.

The bank's original backing came from newly oil-rich monarchies in the Persian Gulf. Sheikh Zayed bin Sultan Al-Nahayan of Abu Dhabi proved a perennial political and financial backer for BCCI, despite the bank's locating offshore and basing its primary headquarters in London. Notably, Al-Nahayan came to power via a coup backed by British intelligence services.²⁶ It was also Al-Nahayan to whom the Bank of England turned in an effort to forestall BCCI's collapse. Despite its support from the Gulf, BCCI secured support from Bank of America to increase the bank's profile and legitimacy. Bank of America even became a significant shareholder. While Bank of America's support was initially significant, it was also the first to cast doubt upon BCCI's legality and long-term health. Bank of America jointly founded and invested in National Bank of Oman with BCCI in order increase its access to the Gulf.²⁷

As early as 1977, concerns arose at Bank of America about BCCI's viability due to the offshore bank's lending practices. BCCI's lending included the issuing of unsecured loans, lending to major shareholders, and lending over 10% of its capital to a single borrower.²⁸ Indeed, Bank of America's own documents outlining its concern about

²⁵ Beaty and Gwynne, 114-115.

²⁶ Adams and Franz, 14.

²⁷ Truell and Gurwin, 18.

²⁸ Ibid, 29.

BCCI revolved around the offshore bank's lending to "insiders".²⁹ A number of high-end loans on BCCI's balance sheet were for real estate in the Persian Gulf, often to political figures who offered no security and went mostly unpaid. Such borrowers included Saudi Arabia's intelligence chief at the time, Kamal Adham. Adham not only took out real estate loans for unvalued property, he also borrowed from BCCI in order to reinvest the loan in the bank itself.³⁰ By 1978, Bank of America issued a press release announcing its planned selloff of all of its BCCI shares by 1980.³¹

Across the Atlantic, the Bank of England took measures to curtail the bank's rapid growth in the UK, but did nothing to regulate its activities. In 1978 the Bank of England froze the number of BCCI's allowed branches in the country at 45, and a year later refused to issue the bank a license as a "recognized bank".³² The UK's 1979 Banking Act formulated two allowable forms of British financial institutions, and stipulated that a bank must either function as a "recognized bank" or a "licensed deposit taker" with the latter enjoying less status than the former. The Bank of England relegated BCCI to the status of the latter.³³ Despite concerns and knowledge of BCCI's lending activities and its involvement in terrorism and money laundering, the Bank of England did nothing to reign in the institution until 1991.

While BCCI lacked any institutional linkage with what could be considered a home state in the Caymans or Luxembourg, it did everything it could to immerse itself in political affairs and foster relationships with political figures. Ranging from arms

²⁹ Truell and Gurwin, 48.

³⁰ Adams and Franz, 42-43.

³¹ Truell and Gurwin, 30.

³² Ibid, 29.

³³ Ibid, 28.

financing to laundering drug money and financing terrorism, BCCI's list of high profile political allies and acquaintances offers an idea of how it managed to operate for over a decade after concerns over its practices emerged. BCCI's catalogue of political friends and relations consists of little less than the geography of a shadow world filled with the darker aspects of international crime and statecraft.

Meeting immediately after Jimmy Carter left office, BCCI's founder, Agha Hasan Abedi met the former president and cultivated a relationship based upon the bank's support for Carter's presidential library and humanitarian work.³⁴ One of BCCI's major account holders, a Saudi arms dealer named Adnan Khashoggi, helped fundraise for the library.³⁵ Through the bank's relationship with Carter, BCCI made political relationships in the West that included former British Prime Ministers James Callaghan and Margaret Thatcher.³⁶ Along with its Gulf connections, BCCI had a number of high profile political figures as either allies or clients. BCCI provided financial assistance to Manuel Noriega's regime in Panama, financed both sides of Nicaragua's civil war, laundering Columbian drug proceeds, and providing banking services to a number of different intelligence agencies.³⁷ In Zimbabwe, BCCI was initially the only bank allowed into the country in 1980, due to the bank's longtime support for Robert Mugabe.³⁸ In Pakistan in the late 1980s, BCCI's charitable activities included funneling money through its BCC Foundation to the Ghulam Ishaq Khan Institute of Engineering Sciences and Technology. The institute's director at the time, Abdul Qadeer Khan, was the mastermind behind

³⁴ Truell and Gurwin, 84.

³⁵ Ibid, 84.

³⁶ Ibid, 87.

³⁷ Beaty and Gwynne, 89-90.

³⁸ Truell and Gurwin, 93.

Pakistan's nuclear weapons program.³⁹ In the Middle East and Afghanistan, BCCI's activities would include the financing of terrorism and would even provide the initial financial rubric for Al Qaeda.

In the mid-1980s BCCI's primary Gulf backer, Sheikh Zayed, began financing the Palestinian Abu Nidal terrorist organization as part a means of placating the group and preventing it from attacking Gulf interests.⁴⁰ Following the bank's closure, regulators discovered that BCCI's London headquarters served as an intermittent office for Abu Nidal, where the terrorist organization also held an account.⁴¹ In return for BCCI's services, Abu Nidal occasionally assisted in coercing specific clients on behalf of the bank.⁴² The attacks carried out by Abu Nidal's organization include bombings, assassinations, and kidnappings of citizens and officials from multiple countries.

The Palestine Liberation Organization (PLO), one terrorist group demonstrating astute long-term financial planning, used BCCI extensively to finance its investments. In 1981, the PLO lent the Nicaraguan government \$12 million via BCCI, and used funds in BCCI accounts to purchase holdings in airline companies and access to duty free airport space across the developing world.⁴³ Iran-backed Hezbollah oversaw the activities of its Europe-based fighters through BCCI's London infrastructure.⁴⁴ Other terrorist groups who used BCCI's services included Peru's Shining Path, which used the bank to

³⁹ Beaty and Gwyne, 290-291.

⁴⁰ Truell and Gurwin, 101.

⁴¹ Ibid, 328.

⁴² Ehrenfeld, Rachel, *Evil Money*, (New York: Harper Collins, 1992), 172.

⁴³ Ehrenfeld (1992), 194.

⁴⁴ Ibid, 199.

institutionalize routine payment mechanisms for cartels seeking access to drug shipments.⁴⁵

The CIA, which itself used BCCI's services to channel funds to anti-Soviet fighters in Afghanistan, claimed to begin looking into the bank's financing of terrorism as early as 1983 and that it was informing other intelligence and law enforcement agencies about the bank's activities; however, other organs of the US intelligence community denied ever receiving the information.⁴⁶ In the regulatory aftermath of BCCI's closure, it was found that Ghassan Qassem, the bank's primary London manager, worked as a paid informant for American and British intelligence services in order to provide information related to some of the bank's dealings with terrorism.⁴⁷

The 1980s witnessed a multinational increase in outside support for Afghan fighters against the Soviet Union. The US and Saudi Arabia worked with Pakistan under Zia ul-Haq to provide the Afghan mujahedeen with needed materiel, financing, and training. BCCI's longstanding relationship with Sunni Gulf monarchies and the Islamabad government placed it in a unique relational position to assist, while its hyper-cloaked regulatory homes offered an easy means by which intelligence services could channel money to the war effort. Al Qaeda, one of the terrorist groups to emerge out of the Soviet-Afghan war, utilized BCCI as both a model for money laundering and secrecy and

⁴⁵ Ehrenfeld (1992), 204-206.

⁴⁶ Ibid, 177-178.

⁴⁷The BCCI Affair: Report to the Committee on Foreign Relations, US Senate, prepared by Senators John Kerry and Hank Brown, December 1992, 76.

likely relied upon the bank's former employees to establish its financial networks in the 1990s.⁴⁸

After BCCI's closure, one area the bank's operations that proved difficult for the Senate Committee on Foreign Relations to decipher was the bank's relationship with the CIA. Bureaucratically, an image emerged that pitted the Federal Reserve against the intelligence community over the central bank's attempts to discover the CIA's relationship with the bank. The Fed, which worked in close consort with the Manhattan District Attorney to crack down on the bank, received not only pushback from Langley, but also from the Bank of England. In both cases, both the UK and the US had ample awareness of the bank's activities and tried to obfuscate relevant investigations prior to its collapse.

New York congressman Charles Schumer noted that as early 1983, the Federal government had extensive awareness of BCCI's activities.⁴⁹ In 1984, Senator Paula Hawkins met with Zia ul-Haq as part of a congressional delegation in which she queried him over a "Pakistani bank's" involvement in money laundering through the Cayman Islands.⁵⁰ Indeed, former CIA deputy director Richard Kerr claimed that the CIA claimed that agency began reporting on BCCI's activities that same year.⁵¹ However, the agency had in fact begun reporting to the US Treasury, the Federal Reserve, the FBI and other

⁴⁸ Rohan Gunaratna, *Inside Al Qaeda*, (New York: Berkeley Books, 2003), 17. See also, Rachel Ehrenfeld, *Funding Evil*, (Chicago: Bonus Books, 2005), 58.

⁴⁹ House Judiciary Committee's Subcommittee on Crime and Criminal Justice, Rep. Charles Schumer, Chair, *Subcommittee Staff Report Regarding Federal Law Enforcement's Handling of Allegations Involving the Bank of Credit and Commerce International*, September 5, 1991.

⁵⁰ Beaty and Gwynne, 324.

⁵¹ *Ibid*, 325.

intelligence agencies about the bank's money laundering activities beginning in 1983.⁵² Despite such reporting, the CIA pled ignorance over much of BCCI's activities related to intelligence operations financed by the bank and activities of many of the bank's shareholders. The CIA feigned ignorance over the bank's secret control of First American Bank, and the bank's activities pertaining to the Iran-Contra affair and its use by other intelligence services.⁵³ The bank would only suffer a regulatory coup de grace in 1991 at the hands of the Fed and the Manhattan District Attorney. The US Treasury's FIU, the Financial Crimes Enforcement Network (FinCEN), would come into being in 1990.

Across the Atlantic, the British government also had longstanding knowledge of the bank's activities in London and the Caymans. However, London only opted to take action as the result of intense American regulatory pressure. What becomes clear in the Bank of England's defense of BCCI is that the UK sought not to defend the bank itself so much as preserve the reputation of its own central bank and integrity of its offshore arena.

Findings from Senator John Kerry's report to the Committee on Foreign Relations claimed that the Bank of England only had partial regulatory oversight BCCI's operations due to the bank's offshoring in Luxembourg and the Caymans.⁵⁴ The Bank of England, considering those jurisdictions to be "lead regulators" overlooks the fact that the Caymans was not a separate jurisdiction from the UK. As noted earlier, the Bank of England actively cultivated its island holding into an offshore tax haven following its

⁵² Beaty and Gurwin, 325.

⁵³ Kerry, 320-321.

⁵⁴ Ibid, 353.

decision to effectively remain a British colony. The Caymans not only provide a playground for secretive financial dealings, but also serves as a hub of British intelligence activity, with MI6 enjoying a major presence on the islands.⁵⁵

For their part, Luxembourg also knew of BCCI's activities and in 1985 sought to have the bank relocate its legal home to the UK in order for the Bank of England to become its lead regulator. The Bank of England refused.⁵⁶ Luxembourg continued to spread around the regulatory liability that BCCI posed through its push for the formulation of a College of Regulators under a 1983 Basle agreement that offered such a mechanism as a means of regulating renegade banks.⁵⁷ Luxembourg complained that only 2% of BCCI's activities occurred within its jurisdiction, thus warranting such collaboration.⁵⁸ Eventually, the group did meet in 1988; however, despite multiple audits outlining malfeasance, the regulators recommended no specific action.⁵⁹

In the late 1980s, the Bank of England sought to conceal audits of BCCI, even to the point of eventually seeking to broker a deal with Abu Dhabi to cover the exposure of British depositors to the bank's malfeasance. In 1987, the Bank of England undertook a half-baked audit of BCCI's ledgers using the bank's own auditors, which found nothing amiss with the bank's dealings.⁶⁰

After conducting a future audit of the bank in 1990, the accounting firm Price Waterhouse described magnitude of BCCI's nefarious affairs and bad balance sheets to

⁵⁵ Shaxson, 17-18.

⁵⁶ Kerry, 354.

⁵⁷ Ibid, 355.

⁵⁸ Ibid, 355.

⁵⁹ Ibid, 356.

⁶⁰ Beaty and Gwynne, 105.

the Bank of England; whereupon the British central bank began to lobby Abu Dhabi for assistance in letting Sheikh Zayed move the bank to the emirate from London.⁶¹ The UK was hesitant to close the bank over concerns of the ensuing financial scandal that would ensue due to the foreseen losses on the part of the bank's 120,000 British depositors.⁶² Individual British depositors stood to lose nearly \$404 million, while deposits from local British municipal governments stood to lose nearly \$160 million.⁶³ Bank of England's governor, Robin Pemberton, flew to Abu Dhabi in an effort to lobby Sheikh Zayed for cash infusions into the bank and for the possibility of moving the bank's home of operations to the emirate.⁶⁴ The Abu Dhabi government agreed to the move, and flushed the bank with \$1.2 billion in addition to promising London to cover the bank's potential losses.⁶⁵

In his testimony before the House of Commons Treasury and Civil Service Committee, Pemberton defended the move, and declared that "it was a matter of realism that we do have occasions of fraud in banks, but that if we close down a bank every time we find an individual act or two of fraud we would have rather fewer banks than we do at the moment".⁶⁶ From Pemberton's statement, it becomes clear that the motive behind the UK's defense of BCCI lay in an effort to secure the integrity of its financial sector and diffuse blame across multiple jurisdictions. This is in sharp contrast to an effort designed to defend a bank in which the London held an institutional linkage.

⁶¹ Beaty and Gwynne, 105-106.

⁶² Adams and Franz, 295.

⁶³ Beaty and Gwynne, 98.

⁶⁴ Ibid, 107.

⁶⁵ Kerry, 357.

⁶⁶ Minutes of Evidence Taken Before The House of Commons Committee on Treasury and Civil Service, July 23, 1991, Fourth Report, Banking Supervision and BCCI, printed March 4, 1992, 104.

In Britain, the Parliamentary record in the aftermath of BCCI's closure indicates how the Bank of England's feigned ignorance of BCCI's attempts to avoid a jurisdictional base. British MPs described the Bank of England as having created a "culture of the 1980s, when a nod and a wink were given in the direction of regulation", but otherwise followed a laissez faire attitude regarding how much of British banking took place.⁶⁷ In 1992 parliamentary debates, it was noted that BCCI was the only bank to have ever faced attempted regulation via a "college of regulators".⁶⁸

On both sides of the Atlantic, BCCI was discussed as if it was structured much as Abedi originally intended; namely, as a "global" bank without a state. However, the bank was not so much a stateless financial entity as one for which no state wanted ultimate responsibility. The scope of BCCI's criminality may never fully be known, but what is more apparent is the bank's involvement in a wide array of political circles that included current and former heads of state, revolutionaries, drug cartels, terrorists, and multiple intelligence services. Any ostensive quality of "statelessness" the bank sought to obtain by locating in two tax havens was a veneer at best. While Luxembourg may have had limited comprehension of the bank's activities, the UK did not. The Caymans was actively cultivated as an offshore tax haven by the UK, and the Bank of England in particular acted as a bureaucratic driving force behind this cultivation. The fact is that the Bank of England eventually had to face a financial monster that was the product of a regulatory environment it created, and one about which it had prior knowledge.

⁶⁷ BCCI (Bingham Report), Deb. Nov. 6, 1992, vol. 213 cc.523-94, Paragraph 544-555.

⁶⁸ Ibid, Paragraph 544-555, Paragraph 547-548.

In 1990, as British authorities worked with Abu Dhabi in an effort to remove BCCI as a financial liability through Gulf-backed bailouts and relocating the bank, regulatory pressures were building across the Atlantic. In the US, Jack Blum, a lawyer working for the Senate subcommittee on terrorism and drugs, reported BCCI's activities to the Manhattan District Attorney at the time, Robert Morgenthau. After relating to the prosecutor his knowledge of BCCI's array of criminal and terrorist activities, the New York DA commenced pressuring actions against the bank.⁶⁹ After bureaucratic resistance from Price Waterhouse and government agencies in the US and the UK, Manhattan prosecutors secured needed audit results. The Federal Reserve, after obtaining information from Morgenthau's office, began exerting pressure against the Bank of England for action.⁷⁰

July 5, 1991 witnessed a multinational crackdown on BCCI's operations. British police raided the bank's UK offices, while the Bank of England contacted regulatory authorities in over sixty countries to ask for cooperation in closing the bank.⁷¹ The British governor of the Caymans placed the bank's three divisions stationed in the country under receivership, and froze the assets of eight corporations linked to the bank. Luxembourg and other European jurisdictions followed suit.⁷² Later that year in the US, the State Department confirmed BCCI's involvement with Abu Nidal, other terrorist groups, and

⁶⁹ Truell and Gurwin, 283-284.

⁷⁰ Kerry, 358-359.

⁷¹ Truell and Gurwin, 311.

⁷² Ibid, 311.

terrorist financing's symbiosis with drug dealing.⁷³ By the end of that July, BCCI's offices were closed in forty-four separate states.⁷⁴

In the end, BCCI was not institutionally linked to any particular state. No state in which BCCI was legally rooted carried any ownership stake in the bank. Certainly, the history of the bank's activities illustrates a financial institution instrumental to the shadowy dealings of a number of states and non-state actors alike. However, the bank was not the going concern of any specific state so much as one that provided a variety of services to state clients engaged in covert activity. The Caymans and Luxembourg continue to function as offshore tax havens, and so long as have the need to conduct business dealings beyond the view of their constituencies, banks such as BCCI have the potential to resurface in the future.

Unlike Abedi's considerations to the contrary, BCCI was not a bank without a state home, was one without state linkage. In its home jurisdictions of the Cayman Islands and Luxembourg, both financial arenas remained the purview of state power. The Cayman Islands was actively cultivated to serve as an offshore by its colonial masters in the UK, even contrary to the recommendation of a number of bureaucracies in the British government. Even geographically minute Luxembourg demanded in 1990 that BCCI relocate out of the city-state within a year.⁷⁵ The two locales that might have proven durable state backers of BCCI, Abu Dhabi and Pakistan, were not BCCI's home

⁷³ Ehrenfeld (1992), 201-202.

⁷⁴ Raj K. Bhala, *Foreign Bank Regulation After BCCI*, (Durham: Carolina Academic Press, 1994), 9.

⁷⁵ Bhala, 134-135. See also, The Right Honorable Lord Justice Bingham, "Inquiry into the Supervision of the Bank of Credit and Commerce International", Prepared for The Right Honorable Norman Lamont, MP Chancellor of the Exchequer and the Right Honorable Robin Leigh-Pemberton, Governor of the Bank of England, (October 22, 1992), Parliament, paragraphs 2.213-.215.

jurisdictions. Both the emirate under Abu Zayed and Pakistan under Zia ul-Haq provided political and financial backing to the criminal bank, but neither Abu Dhabi nor Pakistan proved capable of safeguarding BCCI from its multilateral closure in its primary jurisdictions in Europe. Abedi established the bank in offshores in order to avoid the fate of a state takeover of the bank, such as that which occurred to his previous bank in Pakistan. As for Abu Dhabi, the UK actively sought out support from the emirate in an effort to forestall the deterioration of the bank's balance sheets. If BCCI had been linked to a home state, a situation it sought to avoid, the bank would have enjoyed protections in the face of regulatory crackdown. During the fated attempt by the ad hoc "college of regulators" to restructure the bank, the Bank of England, Luxembourg, and the Caymans sought to have BCCI relocate to Abu Dhabi where the emirate held a stake in the bank.⁷⁶ In the end, the emirate was given no advanced notification when regulators around the world commenced closing BCCI.

Concurrent with the collapse of BCCI was the emergence of the international lynchpin of the fortified finance regime. In 1989, the Financial Action Task Force was formulated by the G-7. In the United States in 1990 created the prototypical financial intelligence unit in the Treasury Department's Financial Crimes Enforcement Network. That same year, Congress passed the Anti-Terrorism Act of 1990, opening terrorist financiers to civil litigation. While the UK's fortified finance apparatus would continue evolving, the Bank of England eventually lost its premier status as the country's financial regulator.

⁷⁶ Bhala, 134-135.

Contrary to notions that the UK could not regulate an otherwise “global” bank, the UK actively chose to selectively regulate BCCI. The British government facilitated the growth of the Caymans as a financial colonial holding designed to attract banks like BCCI. Furthermore, if the Bank of England proved incapable of regulating it, the UK would not have proved able to limit BCCI’s growth in the country in 1978 and relegate the bank to a second tier status in 1979. Rather than regulate the bank in the face of multiple audits in the 1980s, the Bank of England engaged in financial geopolitical diplomacy in an attempt to shift the problem abroad.

II. Enforcement Against the Arab Bank of Jordan

Little research exists on how banks manage to survive political upheaval of the states in which they operate. However, Arab Bank of Jordan is one such financial survivalist. Headquartered in Amman, Jordan, the bank survived decolonization, shifting borders, and multiple wars between Arab states and Israel. However, despite its adeptness at surviving Middle East turmoil the bank came under regulatory penalty for financing terrorism in 2005 when the bank faced a \$24 million penalty over its ties to Hamas. Over the course of ensuing years, Arab Bank faced multiple civil lawsuits in US courts for violations of the 1990 Anti-Terrorism Act. Unlike many longstanding banks in the Middle East, Arab Bank was founded following an American model that maintained the privatized integrity of the bank. Additionally, the era of the bank’s founding and growth precluded any attachment to a burgeoning state.

Outside of Egypt, localized modern banking in the Arab Middle East did not take root until the 1930s. Many locally developed banks in the region faced a number of

institutional hurdles in modernizing traditional lending and bookkeeping practices. Additionally, political uncertainty due to remnants of Ottoman institutions intermingling with the abrupt entry of European administration and nascent nationalist movements hindered effective overall economic growth.

Arab Bank, now the largest indigenous Middle East bank not based out of the Gulf, was founded in Jerusalem in 1930 following American banking models. The founder, Abdul Hameed Shoman, drew upon his exposure to Wall Street banking in the 1920s.⁷⁷ Arab Bank would emerge closely intertwined with Palestinians in the following decades, while remaining at arm's length from the Jordanian monarchy and other state governments in the region.

Palestinian businessman Abdul Hameed Shoman came to the US in 1911, whereupon he commenced a successful career in the textile industry and sales. Driven by a combined admiration for the manner in which American banks worked with their clients, Arab nationalism, and rabid anti-Semitism, Shoman desired to create a bank that could serve the political motivation of decreasing Arabs' reliance on European banks, and those run by Jews. In his memoirs Shoman argues that the Arabs "must gather strength by creating their own national institutions, for they would be their best buttress against the encroaching power of Zionism, the Mandate and colonialism".⁷⁸ Notably, one primary aspect of Shoman's desire for creating Arab Bank was his anti-Semitism.

Shoman declared in his memoirs that, "all business dealings with the Jews-buying, selling

⁷⁷ Rodney Wilson, *Banking and Finance in the Arab Middle East*, (New York: St. Martins Press, 1983), 44.

⁷⁸ Arab Bank, *The Indomitable Arab: The Life and Times of Abdulhameed Shoman (1890-1974)*, (London: Third World Publishing Center, 1984), 142. (Hereafter referred to as Shoman Memoirs).

or banking transactions-are damaging to our country's self-interests", and that there was "no need to fear any other group".⁷⁹

Arab Bank opened in Jerusalem in 1930, and from its opening Shoman went out of his way to secure private deposit holders and clients. Initially going "door to door" himself, Shoman actively engaged local shopkeepers and merchants among the Arab population of British Mandate Palestine.⁸⁰ As he gathered clients, Shoman argued for the benefits that such a modern bank could provide, and even developed interest-free savings accounts in order to secure clients wary of the Islamic prohibition of interest.⁸¹ Both within British Mandate Palestine and beyond, Arab nationalism emerged as a constant theme of Shoman's business motivations, and those of the bank he founded. This motivation animated the bank's efforts to open branches elsewhere in the Levant, North Africa, and the Gulf.

While statism served as the primary feature for a number of banks opening in this era, particularly those in areas seeking independence, Arab Bank's ownership structure was private in nature, and paradoxically tied to Arab Nationalism. In describing the bank's logo, Shoman emphasized that the bank was not intended as a national bank. Shoman declared that Arab Bank was not "backed by any government or central bank".⁸² Instead, Shoman declared that "God is our only refuge" when describing the solvency of the bank in times of crisis.⁸³

⁷⁹ Shoman memoirs, 119, 67.

⁸⁰ Ibid, 154.

⁸¹ Ibid, 149.

⁸² Ibid, 309.

⁸³ Ibid, 309.

When the bank expanded its capital through increasing its issuance of shares, the bank's board discussed the importance of issuing ownership throughout the Arab world rather than one state. The bank's board decided for "a new issue of shares which Arab nationals of any part of the Arab World served by the Arab Bank shall be permitted to purchase".⁸⁴ While the bank was founded, and for a time headquartered in British Mandate Palestine, Arab Bank deliberately sought to keep itself from becoming simply a Palestinian bank. Shoman himself declared that the bank "is not a Shoman property" and that it "does not belong simply to the people of Jerusalem, nor even to the people of Palestine but to the entire Arab nation".⁸⁵

At the time of its founding, and continuing through much of the 20th century, Arab Bank's competition has largely been with national banks. When Arab Bank opened its Jordanian branch in Amman in 1934; Ottoman Bank conducted most banking in the immediate region. Founded in 1856, Ottoman Bank was a joint venture between the Ottoman Empire and European imperial interests in the Middle East.⁸⁶ While Ottoman Bank's original purpose was to help safeguard British and French financial interests in the Ottoman Empire and to ensure the security of long-term Turkish debt, the bank in Transjordan became the purview of the British administration following WWI. Banking in Transjordan under British administration was dominated by a combination of foreign

⁸⁴ Shoman memoirs, 220.

⁸⁵ Ibid, 220.

⁸⁶ Herbert Feis, *Europe the World's Banker: 1870-1914*, (New Haven: Yale University Press, 1930), 320-330.

banks with “little interest” in providing financial services for local businesses.⁸⁷ Local Arab merchants were precisely those sought by Shoman in expanding Arab Bank.

As Arab Bank expanded across what would become multiple countries after decolonization, Transjordan remained overly reliant upon British subsidized aid and most Mandate spending focused on administrative infrastructure rather than the local economy.⁸⁸ With Arab Bank’s drive to secure clients among local indigenous small businesses and the detachment of Shoman’s sentimentality to any specific area of the Arab world, the Jordanian monarchy agreed to allowing the bank to open presence in Amman. In both 1934 when Arab Bank was established in Transjordan and in 1944 when it expanded its shares, both the British administration and monarchy were suspicious of its intent. For their part, British authorities were skeptical of potential competition with Ottoman Bank’s position in the country while Prince Abdullah was concerned with rumors at the time regarding the possibility of the bank disrupting political stability.⁸⁹ In 1944 at a meeting with Prince Abdallah, Shoman assured him that “none of the bank’s people will interfere in any activity of a political nature”.⁹⁰

The late 1940s and early 1950s proved pivotal for Arab Banks’s standing in the political economy of the region, and set the stage for its position for the remainder of the 20th century into the present. In 1948 with the Israeli war for independence, Arab Bank

⁸⁷ Raymond F. Mikesell, “Sterling Area Currencies of the Middle East”, *Middle East Journal*, Vol. 2, No. 2 (1948), pp. 160-174, 167.

⁸⁸ Tariq Moraiwed Tell, *The Social and Economic Origins of Monarchy in Jordan*, (New York: Palgrave Macmillan, 2013), 77-78.

⁸⁹ Shoman memoirs, 173, 233.

⁹⁰ *Ibid*, 234.

relocated its headquarters to its Amman branch.⁹¹ The founding of Israel in combination with the rise of Arab socialism led to a number of branch losses for the bank that undermined its position in the Middle East and North Africa. From 1948-1970 Arab Bank lost 34 branches entirely due to political risk from either wars between Arab states and Israel, or from nationalization under dictatorships in Yemen, Libya, Iraq, Syria, Egypt, and elsewhere.⁹² Tellingly, Arab Bank opened branches in Switzerland in 1961 and a Swiss subsidiary in 1962.⁹³

Unlike the bureaucratic authoritarian dictatorships in Arab countries around Jordan, the Hashemite kingdom remained a steadfast Western ally throughout the Cold War and into the 21st century. Additionally, Jordan managed to sidestep the internal tumult that characterizes modern Middle East history. In contrast to other Arab states in the region, Jordan's relationship with Israel displays a nuance in which Amman played an intermediary role between otherwise hostile states. Similarly, Jordan's affiliation with the UK and the US remained a constant factor in its foreign policy while other states in the region engaged in decades of hostility with the West under the sway of Gamal Nasser's socialism or Baathism in Syria. Similarly, Jordan has thus far remained a stable state despite multiple jihadist groups and Palestinian groups operating in the kingdom and against the Jordanian government. Such diplomatic and domestic political acumen on the part of Jordan's monarchy also impact the kingdom's political economy, where Arab

⁹¹ Arab Bank official website, "Our History", (<http://www.arabbank.jo/en/history.aspx>), accessed May 28, 2018.

⁹² Shoman memoirs, 354.

⁹³ Arab Bank official website, "Our History", (<http://www.arabbank.jo/en/history.aspx>), accessed May 28, 2018.

Bank not only never faced nationalization, but was also allowed to function as the American-style bank envisioned by its founder.

Jordan's fortunate record of political stability is not coincidental. Over the course of the 20th century and into the 21st, Jordan became a safe haven for multiple waves of refugees and political migrants from surrounding states in the region. Shortly after its independence in 1946, Jordan faced its first major geopolitical crisis in the context of Israel's 1948 war for independence. After reluctantly entering into the war against Israel, Jordan would come to occupy and eventually annex one-fifth of what encompassed British Mandate Palestine.⁹⁴ Between its annexation of East Jerusalem and the West Bank, along with Palestinian refugees flooding into the kingdom, much of Jordan's population is of Palestinian origin. This influx of Palestinian refugees permanently altered the kingdom's demography and political economy in a way that was conducive to Arab Bank's expansion. At the same time, Jordan's conservatism prevented both the full political enfranchisement of the kingdom's Palestinian population while its Western alignment served to keep banks privatized.

The influx of Palestinian refugees into Jordan created a unique problem in the kingdom's political economy. On the one hand, the new Palestinian population created a bourgeoisie in the kingdom due to their high caliber of human capital and wealth relative to the indigenous Transjordanians. Indeed, the influx of Palestinians' wealth significantly increased the kingdom's money supply while the Palestinians' business

⁹⁴ Curtis R. Ryan, "Hashemite Kingdom of Jordan", in *The Government and Politics of the Middle East and North Africa*, 6th edition, eds. David E. Long, Bernard Reich, and Mark Gasiorowski, (Boulder: Westview Press, 2011), pp. 297-320, 301.

activity created the core of Jordan's skilled middle class.⁹⁵ On the other, the new Palestinian population created an imbalance of economic power in relation to the kingdom's indigenous subjects. In order to safeguard power the kingdom restricted Palestinian political activity and sought to empower Jordanian Bedouins and rural areas deemed loyal to the monarchy.⁹⁶

While other Middle East states experimented with nationalizing banks and certain industries, Jordan's political economy commenced private sector development. As early as 1949, Jordan implemented Law No. 41 that established the legal basis for the country's Chamber of Commerce⁹⁷ The structure of Jordan's private sector deepened its autonomy vis-à-vis the state over the course of ensuing decades, with the formation of Jordan's Chamber of Industry in 1964 and the Association of Bankers in 1978.⁹⁸ The Association of Bankers, along with the other business organizations, effectively acts as a legal interest group that can lobby the state on behalf of its members.⁹⁹ The General Assembly for Association of Bankers not only represents Jordanian banks in the kingdom, but also foreign banks operating in the country.¹⁰⁰ Arab Bank is the oldest bank in the group. Aside from state funding for government-backed projects in the agricultural and housing sectors, Amman's liberal banking sector remains devoted to commercial lending,

⁹⁵ Timothy J. Piro, *The Political Economy of Market Reform in Jordan*, (Lanham: Rowman and Littlefield 1998), 27-29.

⁹⁶ *Ibid*, 29, 31.

⁹⁷ Zayd Sha'sha, "The Role of the Private Sector in Jordan's Economy", in *Politics and the Economy in Jordan*, ed. Rodney Wilson, (London: Routledge, 1991), pp. 71-79, 71.

⁹⁸ *Ibid*, 73-74.

⁹⁹ *Ibid*, 74.

¹⁰⁰ The Association of Banks in Jordan, Official Website, "The Association's Organizational Structure: General Assembly", (<http://abj.org.jo/en-us/The-Associations-Organizational-Structure>), accessed May 28, 2018.

remittances, and the financial activity of private actors.¹⁰¹ For its part, the state's direct involvement in specific industries is restricted to such areas as phosphate mining, oil, fertilizer, and cement.¹⁰² Banking in Jordan is a private sector affair.

The Shoman family that founded the bank remains the predominant governing element in the bank's shareholding and on the bank's corporate board. When Arab Bank came under regulatory scrutiny for financing terrorism, the Shoman family alone controlled 35% of the bank while other prominent shareholders include the government of Saudi Arabia (17%), former Lebanese Prime Minister Rafiq Hariri, influential Palestinian-Jordanian families, and a share from the Jordanian Social Security Corporation.¹⁰³ Along with the Shoman family presence on Arab Bank's board of directors, all members but the one representing the Hariri family support the Shoman's guidance of the bank.¹⁰⁴

While the Jordanian state has influence on Arab Bank through the involvement of the Jordanian Social Security Corporation in the bank's affairs, the bank's majority shareholders are private. Additionally, the majority of its board members are either private economic actors or politically connected to states other than Jordan. Indeed, when then-Lebanese Prime Minister, Rafiq Hariri sought to increase his ownership share of the bank, Jordan's King Abdullah intervened to preserve the bank's control by the Shoman

¹⁰¹ Sha'sha, 78, see also Rodney Wilson, "Islamic Banking-the Jordanian Experience", in *Politics and the Economy in Jordan*, (London: Routledge, 1991), pp. 115-138, 115.

¹⁰² Piro, 37-58.

¹⁰³ Diplomatic cable, "The Arab Bank's Place in Jordan and the Region", Canonical ID: 02Amman6852_a, November 24, 2002, Wikileaks, (https://wikileaks.org/plusd/cables/02AMMAN6852_a.html), accessed May 28, 2018, paragraph 5.

¹⁰⁴ Ibid, paragraph 6.

family.¹⁰⁵ In this instance, the Jordanian state sought to preserve the bank's integrity as a private financial concern legally based within its borders.

Due to its absorption of Palestinians in 1948, roughly 40% of Jordan's population is of Palestinian origin.¹⁰⁶ The kingdom's political economy and political system place its Palestinian population in a nebulous position. Jordan's Palestinian demographic is kept at a distance in the country's political system, with occasional tensions arising with the state. Amman's challenges with the kingdom's Muslim Brotherhood and Hamas relate to these sociopolitical tensions. Jordan's Palestinians outside of refugee camps are not economically disadvantaged. Palestinians dominate the top echelons of the kingdom's private sector, while indigenous Jordanians of old Bedouin extraction dominate state bureaucracies.¹⁰⁷

The Palestinian dominance in the country's private sector is profound, with 60% of Jordan's top 500 companies being owned by Palestinians and Palestinian capital comprising 87% of the kingdom's GNP.¹⁰⁸ Palestinian dominance of Jordan's banking sector is even stronger, with Palestinian-owned banks comprising 92% market capitalization of the kingdom's banking industry.¹⁰⁹ Arab Bank dwarfs its rivals in the country, where it alone encompasses 62% of the country's market capitalization.¹¹⁰

Regarding questions of how a bank's size in its home state influences enforcement

¹⁰⁵ Diplomatic cable, "The Arab Bank's Place in Jordan and the Region", Canonical ID: 02Amman6852_a, November 24, 2002, Wikileaks, (https://wikileaks.org/plusd/cables/02AMMAN6852_a.html), accessed May 28, 2018, paragraph 4.

¹⁰⁶ Ryan, 323.

¹⁰⁷ Ibid, 325.

¹⁰⁸ Yitzhak Reiter, "The Palestinian-Transjordanian Rift: Economic Might and Political Power in Jordan", *Middle East Journal*, Vol. 58, No. 1 (2004), pp. 72-92, 78.

¹⁰⁹ Ibid, 79.

¹¹⁰ Ibid, 79.

outcomes for terrorist financing, it is worth noting that Arab Bank's behemoth presence in Jordan did not preclude enforcement from occurring. Additionally, the political divide between the Jordanian state and the Palestinians assists in partially explaining why no institutional linkage developed between it and Arab Bank.

Despite Palestinian business dominance, Jordan's political system diminishes the influence of the Palestinian demographic while magnifying the political power of the kingdom's rural Bedouin base and other indigenous segments of the kingdom's population. This divide has grown in recent decades with political reforms in Jordan's bureaucracies and increased opposition activity on the part of segments of the Palestinian population.

Since the late 1940s, Jordan's population lays divided along a cleavage of native Jordanians on the one hand and those of Palestinian extraction on the other. While Palestinians would come to dominate the kingdom's private sector, the Jordanian state remained dominated by indigenous Jordanians based along old rural and tribal lines. As the Jordanian state expanded, the monarchy considered the indigenous population to hold greater loyalties to the crown than the incoming Palestinians and drew from the kingdom's tribal structure to fill the ranks of the military and state agencies.¹¹¹ Indeed, "Jordanian" identity in the kingdom is often affiliated with work and affiliation with working in the public sector.¹¹²

¹¹¹ Laurie A. Brand, "Palestinians and Jordanians: A Crisis of Identity", *Journal of Palestine Studies*, Vol. 24, No. 4, (1995), pp. 46-61, 48.

¹¹² *Ibid*, 48.

Politically, Palestinians in Jordan have always remained partially disenfranchised from the state, despite their economic prowess. This virtual lockout from a meaningful presence in the state apparatus, in combination with power and influence concentrated in the monarchy and tribal affiliations, placed the Palestinians in a position of active involvement in the kingdom's political opposition. Participation in the opposition among segments of the Palestinian population placed in a unique position when groups such the Muslim Brotherhood and Hamas began operations in Jordan.

The security of the Jordanian state has long interlocked with Western security interests in the Middle East, and this interlocking has involved the kingdom's thwarting domestic opposition to the monarchy. Jordan is situated in the midst of the Israeli-Palestinian conflict, and yet managed to maintain continuous rule despite being surrounded by Arab nationalist dictatorships, jihadist movements, and state collapse in neighboring states. The 1967 war with Israel brought an end to Jordanian control of the West Bank, and introduced a second wave of Palestinians into the kingdom. The resulting year long Jordanian civil war brought a permanent rift between Palestinian political organizations in the country and the monarchy. The secular nationalist Palestine Liberation Organization (PLO) lost against the short conflict against Jordanian troops and was driven out of Jordan.¹¹³ On the macro political scale, the civil war in Jordan crystalized "Jordanian" as opposed to "Palestinian" identity while religious Palestinian groups grew in the ensuing years. Hamas, the terrorist group involved with Arab Bank's laundering, was one such group.

¹¹³ Ryan, 302.

Although Hamas' origins date to 1987, the group's roots in Jordan trace to the Muslim Brotherhood's presence in the country. Unlike secular Palestinian nationalists, Jordan did not initially consider religious groups as potentially threatening to the state. Indeed, in the 1950s, the Muslim Brotherhood in Jordan cooperated with the monarchy against secular nationalist groups.¹¹⁴ When the Muslim Brotherhood helped create Hamas, the new organization's structure included a formidable apparatus that included administration, charity, public relations, and political activity alongside its paramilitary operations.¹¹⁵ In Jordan, Hamas not only refrained from seeking a linkage with the state, it actively supported political liberalization and democratization movements in the country.¹¹⁶

The 1980s catalyzed Jordanian experiments with political liberalization that would culminate with the monarchy's expulsion of Hamas from the country in 1999. As the oil boom subsided in the 1980s, Jordan experienced an exodus of Palestinian capital from the kingdom's private sector as the country's economy entered a downturn.¹¹⁷ As the Jordanian monarchy detached itself from claims to the West Bank in 1989, the state introduced political reforms as a means of increasing the throne's legitimacy.¹¹⁸ Such reforms included the holding of full parliamentary elections, the legalization of political

¹¹⁴ Matthew Levitt, *Hamas: Politics, Charity, and Terrorism in the Service of Jihad*, (New Haven: Yale University Press, 2006), 20.

¹¹⁵ Muhammad Muslih, *The Foreign Policy of Hamas*, (New York: Council on Foreign Relations, 1999), 15.

¹¹⁶ Muslih, 17.

¹¹⁷ Russell E. Lucas, "Democratization in Jordan", *Journal of Democracy*, Vol. 14, No. 1, (2003), pp. 137-144, 138.

¹¹⁸ Ali E. Hillal Dessouki and Karen Abul Kheir, "Foreign Policy as a Strategic National Asset: The Case of Jordan", in *The Foreign Policies of Arab States* eds. Bahgat Korany and Ali E. Hillal Dessouki, (Cairo: American University of Cairo Press, 2008), pp. 253-282, 264.

parties, an easing of press censorship, and the ending of martial law in 1991.¹¹⁹ The reforms favored indigenous Jordanians and the social loci of the monarchy's historical powerbase, such as Transjordanian-dominated bureaucracies, Bedouin tribal groups, and the military.¹²⁰ Jordan's political liberalization coincided with economic adjustments that bolstered segments of the opposition. In the 1989 election, the Muslim Brotherhood won the largest share of parliamentary seats.¹²¹

In the 1990s, relations between Jordan and Israel brought Amman's tolerance of Hamas to a breaking point. A serious Hamas presence in Jordan formed in 1990, only a year after the Muslim Brotherhood's influential entry into the kingdom's limited system of representation. Khaled Mishal, the Hamas leader who became the chair of the group's political wing in 1996, relocated to Jordan in 1990 after his expulsion from Kuwait.¹²² In 1997, Israel's botched attempt to poison Mishal in Jordan opened a rift between Amman and Jerusalem that emboldened the group within the country.¹²³ While Jordanian diplomatic pressure helped secure the antidote to the Mishal's poisoning, Hamas operations designed to undermine Middle East peace negotiations brought pressure to its presence in the kingdom. Hamas interpreted Amman's response to the Israeli assassination attempt as the monarchy offering full political backing to its activities.¹²⁴ In 1999, Jordanian security forces closed Hamas offices in the capital and charged Mishal

¹¹⁹ Lucas, 139.

¹²⁰ Glenn E. Robinson, "Defensive Democratization in Jordan", *International Journal of Middle East Studies*, Vol. 30, No. 3 (Aug. 1998), pp. 387-410, 387.

¹²¹ Lucas 139.

¹²² Levitt, 44.

¹²³ Ibid, 44.

¹²⁴ Ibid, 45-46.

and other Hamas figures with illegal weapons' possession, fraud, and "raising funds for a non-authorized association".¹²⁵

Jordan severed ties with Hamas in 1999, despite the surging of Islamist influence in other countries in the Middle East in early 2000s. Unlike the Muslim Brotherhood in Jordan, Hamas is a primarily Palestinian and urban phenomenon.¹²⁶ The Muslim Brotherhood in Jordan enjoys genuinely Transjordanian roots in the country, where it was founded in 1942 prior to the arrival of the Palestinians.¹²⁷ Additionally, the Brotherhood in Jordan has enjoyed an overall easier relationship with the monarchy through its provision of social services alongside royal-run charities and its close ties with the business community.¹²⁸ However, the late 1990s rift between the monarchy and pro-liberalization opposition movements brought even the Brotherhood to abstain from the 1997 Jordanian elections.¹²⁹

When Jordan banned Hamas activity in 1999, Prime Minister Abdel Rauef al-Rawabdeh deemed the organization a threat to the country's stability.¹³⁰ Indeed, Jordanian intelligence officials discovered a weapons smuggling and paramilitary training scheme that linked Hamas to Hezbollah in Syria, and included ongoing Hamas intelligence gathering operations on the Jordanian state.¹³¹ The early 2000s marked a shift in Jordan's stance towards Hamas and its dealings with Arab Bank, such that

¹²⁵ Levitt, 45.

¹²⁶ Glenn E. Robinson, "Hamas as a Social Movement", in *Islamic Activism: A Social Movement Theory Approach*, ed. Quintan Wiktorowicz, (Bloomington: Indiana University pp. 112-139, 117.

¹²⁷ Neven Bondokji, "The Muslim Brotherhood in Jordan: Time to Reform", Brookings Institute (2015), 2.

¹²⁸ Gilles Kepel, *Jihad: The Trail of Political Islam*, (Cambridge: Belknap-Harvard, 2002), 336-337.

¹²⁹ Ibid, 338.

¹³⁰ Levitt, 49.

¹³¹ Ibid, 49.

Amman's monitoring of the terrorist group would align with increasing animosity the group faced from the secularist Palestinian Fatah faction of the PLO. The acrimony Hamas faced from secular Palestinian factions and Jordan combined with increased Israeli scrutiny of the Arab Bank's activities. In 2005, Arab Bank's lack of institutional linkage with Jordan left it exposed to administrative penalties and civil suits emanating from the United States.

The US designated Hamas as a terrorist group in 1997 and began designating entities as its financiers in the early 2000s.¹³² In 2003 the US designated Hamas-affiliated charities in Europe as financiers of terrorism.¹³³ Through a network of charities in the West, money funneled from abroad to Hamas' local charities via Arab Bank.¹³⁴ Security services with the Palestinian Authority noted as early as 2000 that Hamas routinely reallocated funds meant for social projects to the group's combatant arm and often transferred monies raised from Gulf through Arab Bank.¹³⁵

In 2004 during the height of the Second Intifada, the Israeli military raided Arab Bank's Ramallah offices under suspicion that it was financing terrorism for Hamas, Islamic Jihad, and the Al Aqsa Martyrs Brigade.¹³⁶ In 2009 the Israelis later declared the bank to be in the clear of financing terrorism.¹³⁷ However, the early 2000s witnessed

¹³² Designation of Foreign Terrorist Organizations, US Department of State, Public Notice 2612, Federal Register, Vol. 62, No. 195, Oct. 8, 1997.

¹³³ Levitt, 157.

¹³⁴ Ibid, 158.

¹³⁵ Ibid, 68-69.

¹³⁶ "IDF Clears Ramallah Bank of Terror Involvement", *Haaretz*, April 13, 2010, (<https://www.haaretz.com/1.5101503>), accessed May 21, 2018.

¹³⁷ Ibid.

penalizations against the bank in the form of American fines in 2005 and civil suits in US courts that commenced in 2004.

Zarate notes that one year after the raid, on August 17, 2005, the US Comptroller of the Currency and the Treasury Department's Financial Crimes Enforcement Network (FinCEN) levied a \$24 million fine against Arab Bank for failure to comply with the Bank Secrecy Act.¹³⁸ The US accused the bank of conducting "willfully blind" business and facilitating suspicious transactions through its New York branch for terrorism.¹³⁹ The American regulatory order also reduced Arab Bank's New York branch into an "uninsured administrative office" without a real ability to conduct transactions.¹⁴⁰ The Financial Crimes Enforcement Network found that Arab Bank conducted no monitoring of transactions through its New York office before June 2002.¹⁴¹ American regulators discovered that Arab Bank failed to submit adequate suspicious activity reports (SARs) on transactions through its New York branch despite most of its funds dealing with jurisdictions with high risk of terrorism and terrorist financing.¹⁴² These regulatory penalties served as the first salvo in enforcing the fortified finance regime against Arab Bank. Shortly after the levying of regulatory fines, survivors of terrorism commenced pursuing further enforcement against the bank in the form of civil lawsuits.

¹³⁸ Karen Krebsbach, "Arab Bank's \$24 Million Lesson: Your Clients' Clients are Yours, Too", *American Banker*, Dec. 2, 2013. See also Zarate (2013).

¹³⁹ Juan Zarate, *Treasury's War: Unleashing of a New Era of Financial Warfare*, (New York: Public Affairs, 2013), 148.

¹⁴⁰ Zarate, 148.

¹⁴¹ Assessment of Civil Money Penalty, US Department of the Treasury-Financial Crimes Enforcement Network, Nov. 2005, 4.

¹⁴² *Ibid*, 6-7.

While FinCEN's penalty against Arab Bank was levied in November 2005, the Jordanian government was already in dialogue with US officials regarding penalizing the bank for financing terrorism. In February 2005, a US delegation that included the Treasury Department's Undersecretary of Terrorism and Financial Intelligence traveled to Jordan to address concerns over Arab Bank's terrorist financing.¹⁴³ The US delegation met with the Central Bank of Jordan, the Ministry of Finance, and Arab Bank's CEO, Abdulhameed Shoman.¹⁴⁴ In 2000, Shoman personally contributed to terrorism, while his staff contributed 5% of their own salaries to terrorist operations during the Second Intifada.¹⁴⁵

While Jordan stressed Arab Bank's importance to American regulators from the Office of the Comptroller of the Currency, the Jordanian government declared it would support regulatory penalty "as long as Arab Bank received due process".¹⁴⁶ Regarding Jordan's regulatory capacity, the American delegation lamented "significant systemic problems" with the country's fortified finance structure, while both American and Jordanian officials discussed the difficulty of effectively policing terrorist financing due to the lack of any significant regulatory capacity within Arab Bank and in the

¹⁴³ Diplomatic cable, "U/S Levey Bilats Address Arab Bank and AML Law", Canonical ID: 05Amman1356_a, Feb. 17, 2005, Wikileaks, (https://wikileaks.org/plusd/cables/05AMMAN1356_a.html), accessed May 29, 2018.

¹⁴⁴ Ibid.

¹⁴⁵ Civil Action Number 3251, Case 1:08-cv-03251-NG-VVP, US District Court, Eastern District of New York, Filed Aug. 11, 2008, 47-48.

¹⁴⁶ Paragraph 3, Diplomatic cable, "U/S Levey Bilats Address Arab Bank and AML Law", Canonical ID: 05Amman1356_a, Feb. 17, 2005, Wikileaks, (https://wikileaks.org/plusd/cables/05AMMAN1356_a.html), accessed May 29, 2018.

neighboring Palestinian Authority.¹⁴⁷ Jordan expressed that it was seeking Cypriot or Lebanese sponsorship into the Egmont Group, and that planning was already underway for its own enforcement body under the auspices of the Central Bank.¹⁴⁸ Jordanian Prime Minister Faisal al-Fayez agreed with Treasury Undersecretary Levey over the need for the kingdom to adopt its own fortified finance regime.¹⁴⁹

The meeting between US officials and Arab Bank in Jordan illustrate the bank's earliest attempts at defending itself. Arab Bank administrators declared that had the Office of the Comptroller of the Currency given additional prior warning that the bank would have acted upon any noncompliant branch with the "wrath of God", and that the bank itself was offered "no time" in responding to regulatory charges.¹⁵⁰ Arab Bank stated its intent to officials that it was seeking to end all individual account transactions through New York and instead focus on "corporate credit and finance", ostensibly in an effort to decrease risk of money laundering and terrorist financing.¹⁵¹ Despite repeated concerns from both Arab Bank and various organs of the Jordanian state about the effect a scandal would have on the country's financial system, Amman made no attempt to block American regulatory actions against the bank.

Meanwhile, in 2004 lawyers representing victims of terrorism during the Second Intifada began bringing suits against the bank in the Eastern District Court of New York

¹⁴⁷ Diplomatic cable, "U/S Levey Bilats Address Arab Bank and AML Law", Canonical ID: 05Amman1356_a, Feb. 17, 2005, Wikileaks, (https://wikileaks.org/plusd/cables/05AMMAN1356_a.html), accessed May 29, 2018., paragraph 4.

¹⁴⁸ Ibid, paragraph 5.

¹⁴⁹ Ibid, paragraph 13.

¹⁵⁰ Ibid, paragraph 6.

¹⁵¹ Diplomatic cable, "U/S Levey Bilats Address Arab Bank and AML Law", Canonical ID: 05Amman1356_a, Feb. 17, 2005, Wikileaks, (https://wikileaks.org/plusd/cables/05AMMAN1356_a.html), accessed May 29, 2018 paragraph 7.

for knowingly financing Hamas and other Palestinian terrorist groups between 1995 and 2004 (See Figure 5.1 below). However, the civil case was stalled due to Arab Bank's refusal to produce court-ordered documents during the discovery process of the trial. Arab Bank refused to produce relevant documents to the court on the grounds doing so would violate multiple laws and regulations pertaining to bank secrecy in Europe and the Middle East.¹⁵² On December 13, 2006, Judge Nina Gershon of the Eastern District of New York ordered Arab Bank to produce the documents it had earlier proffered to FinCEN and the Office of the Comptroller of the Currency.¹⁵³ In 2010, the court initiated sanctions on the bank for continual failure to produce discovery documents on the grounds of violating bank secrecy laws.¹⁵⁴ During the bank's attempt to stall, the bank attempted to obfuscate its previous activities while Jordanian authorities were working with American officials to bring greater regulatory policing to both Arab Bank and the Jordanian banking sector.

¹⁵² Brief for Respondent, *Joseph Jesner et al. v. Arab Bank, PLC*, No. 16-499, Supreme Court of the United States, Aug. 21, 2017, 49-50.

¹⁵³ *Linde v. Arab Bank, PLC*, US District Court for the Eastern District of New York, July 12, 2010, Decided, 04 CV 2799, 4.

¹⁵⁴ *Opinion and Order, Courtney Linde et al v Arab Bank, PLC*, US District Court, Eastern District of New York, Case 1:04-cv-02799-NG-VVP, July 12, 2010.

Figure 5.1: Sample of Hamas Members and Arab Bank Accounts (Source: Osen Attorneys at Law, LLC)¹⁵⁵

| Hamas Member | Role | Account Number(s) | Amount | Date Range | Arab Bank Branch |
|------------------------|--|----------------------|-----------|------------------------------|------------------|
| Ghazi Ahmed Hamad | Hamas spokesman: 2006-2007 Hamas Editor: (Al-Watan, Al-Risala) | 1170465510 706785 | \$152,986 | July 2000-Jan. 2002 | Gaza |
| Jamal Salim | Senior Hamas W. Bank leader | 4033906500 | \$13,500 | Dec. 2000-March 2001 | Nablus |
| Ismail Abu Shanab | Qassam Brigades Commander, Sheikh Yassin Deputy | 236519510 | \$173,172 | Aug. 2000-Aug. 2001 | Gaza |
| Ismail Haniyeh | Hamas Party Leader | 63517500 | \$409,400 | July 2000-Sept. 2001 | Gaza |
| Muhammad Hasan Shama'a | Hamas Co-Founder | 513636510 | \$144,000 | Jan. 2001-Dec. 2001 | Gaza |
| Jamal and Muna Mansur | Jamal Mansur: Founder-Hamas Research Institute, W. Bank Spokesman Muna Mansur: Palestinian Legislative Council Member for Hamas | 4064788500 | \$85,000 | Dec. 2000-Sept. 2001 | Nablus |
| Salah al-Din Darwazah | Qassam Brigades Commander, Hamas leader in Nablus | 4286871510 | \$302,000 | July 2000-July 2001 | Nablus |
| Sheikh Ahmed Yassin | Hamas founder and Spiritual Figurehead | 36444 | \$60,000 | May 5, 2001 (single payment) | Gaza |

During the period in which the bank was pressed by US courts to produce evidence pertaining to discovery, the bank was taking actions to clean up its own account records and obfuscate its involvement with terrorist financing. During a meeting in February 2005, Treasury Undersecretary met with Israeli Counterterrorism Director,

¹⁵⁵ Payments to Hamas Leaders, Osen Attorneys at Law, LLC, (<https://www.osenlaw.com/content/payments-hamas-leaders>), accessed May 10, 2018.

General Danny Arditi to discuss terrorist financing and Arab Bank in particular.¹⁵⁶ In the briefing of US Treasury officials, the Israelis informed them that while Arab Bank ceased financing terrorism after the filing of civil suits, the bank was “playing with evidence, cleaning the records, and deleting accounts”.¹⁵⁷ While the bank purportedly took measures to destroy the evidence of its financing terrorism, Jordan worked with US regulators in their efforts to foster and strengthen the fortified finance regime in the kingdom.

Throughout 2005, diplomatic meetings between the US and Jordan indicate that kingdom’s efforts related to countering terrorist financing were hampered by the immaturity of the regulatory regime rather than home-state efforts to protect Arab Bank. In July 2005, American Treasury officials met again with Jordan’s central bank governor and Minister of Finance to call on the kingdom to institute AML and CTF regulations for its banking system.¹⁵⁸ Jordan’s central bank chairman, Umayya Touqan, noted that the fortified finance regulations of customer due diligence were already practiced by banks in Jordan, aside from Arab Bank.¹⁵⁹ Two months later in meetings between US and Jordanian officials regarding implementing counter-terrorist financing controls, the Deputy Governor of the Central Bank of Jordan noted that the Amman government was

¹⁵⁶ Diplomatic cable, “Israelis Brief U/S Levey on Terror a Hamas and Hizballah and Views on PA Welfare Reform”, Canonical ID: 05TelAviv1013_a, Feb. 18, 2005, Wikileaks, (https://wikileaks.org/plusd/cables/05TELAIVIV1013_a.html), accessed May 22, 2018.

¹⁵⁷ Diplomatic cable, “Israelis Brief U/S Levey on Terror a Hamas and Hizballah and Views on PA Welfare Reform”, Canonical ID: 05TelAviv1013_a, Feb. 18, 2005, Wikileaks, (https://wikileaks.org/plusd/cables/05TELAIVIV1013_a.html), accessed May 22, 2018. Paragraphs 7-8.

¹⁵⁸ Diplomatic cable, “Assistant Secretary Wayne’s July 10 Meetings with Jordan’s Central Bank Governor Touqan and Finance Minister Al-Kodah”, Canonical ID: 05Amman5725_a, July 19, 2005, Wikileaks, (https://wikileaks.org/plusd/cables/05AMMAN5725_a.html), accessed May 29, 2018.

¹⁵⁹ Ibid, paragraph 4.

“pressing the bank hard to comply fully and expeditiously with all US regulatory requirements”.¹⁶⁰ Jordanian officials noted that they believed their intermediate regulatory efforts should have prevented Arab Bank’s terrorist activity.¹⁶¹ Previous Jordanian efforts to counter terrorist financing relied heavily upon its intelligence services.¹⁶² Indeed, the kingdom began implementing aspects of the fortified finance regime in 2000.

At the turn of the millennium, Jordan sought to counter the financing of terrorism in its banking system. Article 93 of the Jordan’s 2000 Banking Law mandates that banks report suspicious activities to the Central Bank if such activities were suspected of being linked to a crime.¹⁶³ Jordan’s Central Bank Regulation No. 10, implemented in 2001, specifies money laundering as a primary concern.¹⁶⁴ Bank Regulation No. 10 was implemented in conjunction with the kingdom’s more generic Banking Law No. 28 that compels banks to report suspicious activity to the Central Bank, and frees the reporting banks from any potential legal liabilities pertaining to the violation of privacy.¹⁶⁵

Regarding Hamas in particular, the Central Bank of Jordan mandated that all banks in the

¹⁶⁰ Diplomatic cable, “Scene Setter for Visit of Treasury Acting A/S Glaser to Amman”, Canonical ID: 05Amman7547_a, Sept. 21, 2005, Wikileaks, (https://wikileaks.org/plusd/cables/05AMMAN7547_a.html), accessed May 22, 2018, paragraphs 6-7.

¹⁶¹ Diplomatic cable, “Scene Setter for Visit of Treasury Acting A/S Glaser to Amman”, Canonical ID: 05Amman7547_a, Sept. 21, 2005, Wikileaks, (https://wikileaks.org/plusd/cables/05AMMAN7547_a.html), accessed May 22, 2018, paragraph 7.

¹⁶² Diplomatic cable, “Scene Setter for Visit of Treasury Acting A/S Glaser to Amman”, Canonical ID: 05Amman7547_a, Sept. 21, 2005, Wikileaks, (https://wikileaks.org/plusd/cables/05AMMAN7547_a.html), accessed May 22, 2018, Paragraph 1.

¹⁶³ Lu’ayy Minwer Al-Rimawi, “Money Laundering in Jordan: a positive example of Middle Eastern country earnest about catching up with international financial standards”, *Journal of Money Laundering Control*, (2004), Vol. 7, No. 1, pp. 15-17.

¹⁶⁴ *Ibid*, 15-17.

¹⁶⁵ Ahmed Adnan Al-Nuemat, “Money Laundering and Banking Secrecy in the Jordanian Legislation”, *Journal of International Commercial Law and Technology*, Vol. 9, No. 2, (2014), pp. 117-126, 121.

kingdom “freeze any dealings” with Hamas and its charity affiliates in 2003.¹⁶⁶ Building off of its Penal Code No. 16 of 1960, Jordan implemented a number of laws designed to counter terrorism and terrorist financing in the years prior to the arrival of US regulators in 2005.¹⁶⁷ Amman’s assurances to implement terrorist financing and money laundering regulations came to full fruition in 2007 with Law No. 46 that established the country’s financial intelligence unit within the central bank.

The numerous civil cases against Arab Bank brought mixed levels of punishment against the bank. In one case, *Linde v. Arab Bank*, a jury found the bank liable for financing terrorism in 2014. While the verdict was vacated upon a technicality, an undisclosed settlement was reached between the plaintiffs and the bank in 2015.¹⁶⁸ The bank stated in 2016 that it had amassed \$1 billion to cover settlement obligations.¹⁶⁹ The undisclosed settlement covered all of the more than 500 plaintiffs in the case.¹⁷⁰ Notably, the bank stated in its Annual Report of 2015, that the settlement was “in the best interest of the Bank, and it has been entered into upon acceptable and satisfactory terms and

¹⁶⁶ Congressional Research Service Report for Congress, Report RL32499: Saudi Arabia: Terrorist Financing Issues, Sept. 14, 2007, Wikileaks, (<https://wikileaks.org/wiki/CRS: Saudi Arabia: Terrorist Financing Issues, September 14, 2007>), accessed May 20, 2018, 6.

¹⁶⁷ Brief for Respondent, *Joseph Jesner et al. v. Arab Bank, PLC*, No. 16-499, Supreme Court of the United States, Aug. 21, 2017, 6.

¹⁶⁸ Arab Bank Litigation, Motley-Rice, LLC, (<https://www.motleyrice.com/anti-terrorism/arab-bank-litigation>), accessed May 22, 2018.

¹⁶⁹ “Arab Bank Settlement Over Israel Attacks May Hit Snag in US Appeals Court”, *Jerusalem Post*, May 17, 2017, (<https://www.jpost.com/Middle-East/Arab-Bank-settlement-over-Israel-attacks-may-hit-snag-in-US-appeals-court-490976>), accessed May 24, 2018.

¹⁷⁰ “Arab Bank Reaches Settlement in Suit Accusing it of Financing Terrorism”, *New York Times*, Aug. 14, 2015, (<https://www.nytimes.com/2015/08/15/nyregion/arab-bank-reaches-settlement-in-suit-accusing-it-of-financing-terrorism.html>), accessed May 24, 2017.

without admission of liability of any wrongdoing by the Bank”.¹⁷¹ Additionally, the bank noted that it had “sufficient provisions to cover the expected financial obligations under this agreement”.¹⁷² Litigation for the nearly 6,000 foreign nationals brought against the bank under the Alien Torts Statute (ATS) of 1789 was dismissed in 2018.¹⁷³

In the course of the civil suits against the bank, Jordan did protest what it viewed as excessive efforts to penalize the bank. In August 2017, Jordan filed an *amicus curia* brief that argued for the dismissal of civil suits against Arab Bank that had been sought under the Alien Torts Statute Act. The ATS, the 18th century law that allows non-US nationals to sue in American courts, was the legal basis for the thousands of plaintiffs seeking damages against Arab Bank. Unlike *Linde v Arab Bank*, where the plaintiffs were both American and smaller in number, civil penalties for the 6,000 foreign nationals under the ATS carried the possibility of undermining the very integrity of Arab Bank and destabilizing the Middle East. The Jordanians noted that aside from the ATS action comprising infringement on sovereignty, Arab Bank was the financial institution through which US aid to the kingdom was processed.¹⁷⁴ Additionally, Jordan argued that since Arab Bank alone encompasses between 20%-33% of the value of the country’s stock exchange, a massive shock in civil penalties would potentially lead to the kingdom’s

¹⁷¹ Arab Bank Group, *Annual Report 2015*, (<https://www.arabbank.com/docs/default-source/annual-reports/arab-bank-group-annual-report-2015>), accessed May 10, 2018, 5.

¹⁷² *Ibid.*, 5.

¹⁷³ “US Supreme Court ends second Arab Bank case”, *Jerusalem Post*, April 24, 2018, (<https://www.jpost.com/Arab-Israeli-Conflict/US-Supreme-Court-ends-second-Arab-Bank-case-552643>), accessed May 10, 2018.

¹⁷⁴ Brief for the Hashemite Kingdom of Jordan as *Amicus Curiae* Supporting Respondent, *Joseph Jesner, et al., v. Arab Bank PLC*, Supreme Court of the United States, No. 16-499, Aug. 2017, 8.

economic collapse.¹⁷⁵ Jordan receives on average over \$1 billion in American aid per, with \$6.375 billion pledged in US aid from 2018-2022.¹⁷⁶ With the Middle East facing anemic reconstruction in Iraq, growing tensions between Gulf states, Israel, and Iran, and unfolding state failure in Syria, Jordan's stability comprised a lynchpin of US interest in the region while Arab Bank was one conduit for maintaining such stability.

While the civil suits filed under of the ATS were dismissed in 2018, Arab Bank did face regulatory enforcement for violating the fortified finance regime. The first penalty came as a \$24 million fine in 2005 from the Office of the Comptroller of the Currency and FinCEN, while the second litigious penalty was settled out of court for the case of *Linde v. Arab Bank Bank* for up to \$1 billion a decade later in 2015. Throughout the enforcement period, the Jordanian state did not act to block enforcement efforts from the United States; rather, Amman continued to work with American officials in implementing the fortified finance regime in its banking system while building off of unilateral efforts from the preceding years.

IV. Analysis

The cases of BCCI and Arab Bank demonstrate banks being penalized for financing terrorism. In each case the bank involved operated as a private bank without a linkage that tied the financial institution to the regime of its own state. Furthermore, the arrangements between the banks and their home states were characterized by reluctance

¹⁷⁵ Brief for the Hashemite Kingdom of Jordan as *Amicus Curiae* Supporting Respondent, *Joseph Jesner, et al., v. Arab Bank PLC*, Supreme Court of the United States, No. 16-499, Aug. 2017, 8.

¹⁷⁶ "US plans to boost aid to Jordan to \$1 billion per year", Reuters, Feb. 3, 2015, (<https://www.reuters.com/article/us-jordan-aid-idUSKBN0L72ET20150203>), accessed May 19, 2018. See also, Jeremy M. Sharp, "Jordan: Background and US Relations", Congressional Research Service, Feb. 16, 2018, 9-10.

of the banks to have significant government control or stake holding. In terms of enforcement befalling the banks for their illegal activities, enforcement occurred either in the absence of the fortified finance regime or as it deepened and integrated into the domestic political economy in which the bank was legally based.

One of the stereotypes of terrorist financing and money laundering is that such activities are the natural byproduct of jurisdictions with bank secrecy and tax havens. Certainly, terrorist groups, fraudsters, and criminals launder money through such countries; however, in order to understand why such jurisdictions exist, it must be understood that they are the products of the states that create them. BCCI's structure was designed to avoid significant state oversight through legally basing itself in mutual tax havens in an effort to avoid truly having a home state. Both BCCI and Arab Bank sought institutional arrangements in their founding and growth that allowed them to avoid politics. Abedi's placing BCCI in tax havens and Shoman's promise to the Jordanian monarchy to avoid meddling in political affairs illustrate this fact.

Based on Abedi's experience with Pakistan where his previous bank was nationalized, Abedi legally grounded BCCI in the Cayman Islands and Luxembourg. While Luxembourg was not indifferent to the bank's activities, most of its transactions were based out of the Cayman Islands. The Cayman Islands was cultivated as an offshore tax haven in the 1960s while remaining a British domain. Promoted as a haven by the Bank of England, the Cayman Islands offered the appearance of a regulation-free domain where innumerable financial dealings of questionable legality could occur. This state-created laissez-faire environment allowed BCCI to engage with numerous high

profile political leaders around the world, terrorist groups, intelligence agencies, and drug cartels. Despite doing business with such politically powerful actors, including states, the bank did not enjoy protection from its largest backers. If the bank had been based in Abu Dhabi, where the UK endeavored to have BCCI relocate, it could have enjoyed the protection and backing from the state that provided its greatest largesse. However, BCCI succeeded in precluding the formation of any state linkage that would have protected it from enforcement.

Because of Arab Bank's headquartering in Jordan, the bank managed to avoid the formation of any significant institutional linkage with its home state. Much of this political economic luck is purely circumstantial due to the fact that there was almost no independent state in the Arab world at the time to which the bank could have formed a linkage at the time. In 1930, Egypt served as the only fully independent Arab state in the region. Indeed, in establishing Arab Bank in British Mandate Palestine, the bank's founder avoided facilitating any linkage with the Cairo government. Similarly, unlike Al Rajhi Bank in Saudi Arabia, where tribal and familial connections tied the Saudi monarchy to the bank, Arab Bank's modernist orientation and Western structure at the time of its founding and formation precluded any pre-independence linkages between ruling families and the bank itself.

The bank's expansion beginning throughout the 1930s and 1940s across what would become multiple Arab independent states similarly kept the bank from forming any linkage with a single state where the bank remained private and independent. Certainly, multiple wars and bank nationalization programs across the region dealt Arab

Bank a number of geopolitical blows. However, Jordan, where Arab Bank has been legally based since 1948, refrained from nationalizing it or instituting a majority ownership stake. Thus, once Arab states commenced nationalizing Arab Bank's presence in other countries, the institution's early multinational expansion afforded it the flexibility to maintain its operation as a private bank.

When facing enforcement from US civil suits, Jordan did apply pressure to help safeguard the bank's survival. After facing administrative fines from the US in 2005 and a negotiating a settlement with the first wave of civil suits against it under the Anti-Terrorism Act, the bank faced potential collapse under the weight of potential penalties under the Alien Torts Act. When Jordan sought to have this third wave of enforcement dismissed, Amman did note that its Social Security Corporation owned roughly 15%.¹⁷⁷ However, the bank has remained a privately owned concern throughout its existence. Geopolitically, the Arab Bank case illustrates Jordan's precarious position vis-à-vis the bank since it processes critical US aid for the kingdom while also serving as the premier financial organ for the country's political economy. Despite such importance, the Arab Bank remains much as it was established; namely, a private bank based upon an American model.

One of the highlights both the BCCI and Arab Bank cases is what the cases demonstrate regarding the efficacy of the fortified finance regime. In both cases, enforcement occurred either in the near-absence of AML/CTF regulations, or occurred while they matured within their home state. BCCI faced simultaneous crackdown in

¹⁷⁷ Brief for the Hashemite Kingdom of Jordan as *Amicus Curiae* Supporting Respondent, *Joseph Jesner, et al., v. Arab Bank PLC*, Supreme Court of the United States, No. 16-499, Aug. 2017, 8.

jurisdictions around the world in 1991 over its operations that long predated the establishment of the Financial Action Task Force. Indeed, the global shutdown of BCCI in the earliest phases of the fortified finance regime becoming truly international begs the question as to whether or not the regime is effective at all. Certainly, BCCI's structure of apparent "statelessness" and its lack of state linkage offered it no means of political protection when the crackdown commenced. Additionally, its unique structure provided no pre-existing relationship between bank and state that needed to be disrupted by the arrival of the fortified finance regime. When enforcement commenced in 1991, the bank had now linkage to call upon for political assistance.

In the case of Arab Bank, the fortified finance regime was already present when American regulators implemented initiated the first wave of enforcement against the bank. However, Jordan's domestic laws were not yet fully developed. As early as 2000, the kingdom began implementing the legal groundwork for criminalizing money laundering, and domestic laws grew over the course of the early 2000s until their culmination in 2007 with the establishment of a financial intelligence unit for the kingdom. Notably, when US regulators arrived in 2005 to discuss the kingdom's adoption of the fortified finance regime and to discuss Arab Bank's financing of terrorism, the Jordanian state did not attempt to block the enforcement mechanism. Even when faced with civil penalties under the Anti-Terrorism Act, Jordan did not block enforcement efforts, and the bank defended itself through negotiated settlements with the American plaintiffs involved. Only in the prospect of the bank being entirely shut down

due to facing the prospect of payouts to 6,000 plaintiffs did the Jordanian state step in to diplomatically pressure US courts to safeguard the bank's existence.

While BCCI had no home state stakeholder to call upon for assistance when facing enforcement, the obvious question arises as to how BCCI managed to conduct so many illegal financial activities in a British domain. Certainly, London designed the Caymans to provide a venue for bank secrecy and tax evasion. However, with its primary base of operations in London and its legal home in the Caymans, the question arises as to how the UK, with its sophisticated centuries-old banking sector, allowed BCCI's laundering and terrorist financing to take place.

One theory disproven by the cases of BCCI and Arab Bank is the fact that both cases illustrate enforcement against banks for financing terrorism despite illustrating massive disparities in GDP, regulatory presence, and corruption. Additionally, with Jordan's being an authoritarian monarchy and the UK's existence as a parliamentary democracy, the fact that both cases demonstrate enforcement outcomes for banks financing terrorism is counterintuitive. In both cases, enforcement was carried out, despite the unpleasantness that enforcement actions carried for London and Amman. Similar enforcement outcomes indicate that regulatory capacity and a country's political system may be irrelevant to ascertaining whether or not enforcement will occur against banks that finance terrorism. Rather, the cases indicate that a bank's relationship to its home state regime play the causal role in determining enforcement outcomes while a state's regime type and the bank's regulatory environment play marginal secondary roles.

Chapter 6: Conclusion

The central theoretical and normative concern in literature on the fortified finance regime is whether or not AML/CTF regulations work. Financial regulations meant to combat money laundering and terrorist financing have proliferated and deepened in states around the world since the US passing of the Bank Secrecy Act in 1970. However, the effectiveness of these regulations remains suspect. This research helps answer this question through addressing trajectories of enforcement, and under what circumstances enforcement leads to penalties against the bank as opposed to when enforcement is blocked.

The guiding theory of this research is that when a bank is institutionally linked to the state in which it based, enforcement will be blocked by its home state. This research tests this theory by hypothesizing that institutional linkage is sufficient to thwart attempted enforcement. Using comparative cases to control for the possibility of rival causes, this research tests this hypothesis of sufficiency by tracing the history of banks suspected of financing terrorism and their relationships with the states in which they are embedded.

This theory posits that when a bank enjoys a structural institutional linkage with its home state, then that state will come to its defense at home and abroad. At first glance, this phenomenon would seem confined entirely to state-owned banks. However, state linkages are not confined to such majority state-owned enterprises. A state's relationship to the banks within it is determined by the unique institutional characteristics of the country's political economy that country's financial sector. Furthermore, a

relationship between a state and banks within it may extend from deep institutional legacies that the fortified finance regime will not succeed in displacing.

Using comparative case studies, I tested how state-bank linkages affect enforcement outcomes for banks coming under penalty for financing terrorism. First, I demonstrated the institutional linkages of banks to their home state, and how these banks evolved alongside the states in which they developed until the attempted enforcement took place. I also accounted for the presence of the fortified finance regime within the state in question, and how its presence impacted the bank that financed terrorism. Using qualitative data in the form of court and governmental documents, journalistic accounts, and communiqués from Wikileaks, I established the bank's actual financing of terrorism whenever possible using account numbers gleaned from the data. Then, using the same documentary data, I traced how enforcement was blocked or allowed to proceed. Contrary to popular belief, this shadowy world of threat finance is not obfuscated due to lack of data.

The Bank of China and Turkey's Halk Bank both fit the classic model of state-owned enterprises. In both cases, the banks were formed to be of service to the state and help financially safeguard national interests in the lingering threat of foreign financial dependence. The Bank of China survived multiple upheavals as China moved from various forms of authoritarianism and multiple wars. Throughout the tumult, the bank operated as an extension of Beijing's respective governments without any structural severance between it and China's ruling regimes. Similar to the Bank of China, Halk Bank formed in the earliest phases of Turkey's state development, and formed as a means

of fostering the growth of a Turkish middle class with the assistance of the state. Unlike Bank of China, Halk Bank underwent genuine efforts of partial privatization; however, the state's majority ownership remained a constant throughout its history.

Unlike the total state ownership of the Bank of China case, Halk Bank's role in Turkish politics was one of semi-democratic coalition binding. The bank's specific focus on small and medium-sized enterprises helped create a durable socioeconomic political coalition for emerging Islamist parties based in the working and middle classes. Domestic coalition binding aside, Halk Bank also served as an instrument of Turkish foreign policy in reengaging with the Middle East and exercising leverage over Iran as its historical competitor.

Unlike Halk Bank and the Bank of China, Al Rajhi Bank was never a state-owned concern. The private bank emerged as a family business originating in the pre-modern Arabian economy, and developed into a modern bank in conjunction the development of the Saudi state. Due to the bank's involvement with the Saudi *ulema* and its support of religious institutions, the bank's operations became vital to the Saudi monarchy. Like European monarchies of the distant past, Saudi Arabia's monarchy relies heavily upon religious legitimacy as well as economic vibrancy for its survival. Because of Al Rajhi's linkages with both the royal family and the religious pillar of the country's historic ruling elite, any capitulation on the part of the state to enforcing the fortified finance regime places the integrity of the state at risk.

While the fortified finance regime has spread around the world, it remains questionable as to whether or not such regulations have displaced pre-existing

relationships between banks and the states in which they are based. In the cases of blocked enforcement, every state in question exhibited some level of a fortified finance regime at the time that enforcement efforts ensued. It is also worth noting that any imported financial regulations from abroad pertaining to terrorism layered onto existing regulatory efforts that began domestically.

This research controls for potential rival causes such as authoritarianism and state capacity. Every state in which enforcement was blocked comprises an example of a strong state with more than enough capacity to control and surveil its financial system. Additionally, every state that blocked enforcement was at least partly authoritarian, and the linkage of each bank to its home state virtually ensures that the bank's home state exercised some oversight of the bank's affairs. The fact that Arab Bank suffered penalties for financing terrorism indicates that authoritarianism itself is not sufficient to block enforcement.

Both China and Turkey had formidable surveillance and enforcement capacities in place at the time enforcement was attempted against their banks. China's surveillance apparatus in its financial system, and its adoption of the fortified finance regime pre-dates the enforcement attempts made against the Bank of China for financing Hamas and Palestinian Islamic Jihad. The Turkish attempt at enforcement is unique in that enforcement actions were attempted by the state's own bureaucracies, at the hands of the country's own police and judiciary. The manner in which enforcement was attempted in Turkey indicates that Ankara's fortified finance regime was indeed working at the time that enforcement was initiated. While the Chinese case demonstrates a state protecting its

bank from a foreign state's punishment through diplomatic pressure, Turkey's massive bureaucratic reshuffling and the firing of key judicial and police officials illustrates the regime enacting a veto against its own enforcement apparatus in order to protect the integrity of its bank.

The case of Saudi Arabia's Al Rajhi Bank demonstrates a functioning and capable surveillance apparatus within the kingdom's financial sector overseeing a bank that influences Saudi financial regulatory policy. The Saudi central bank that regulates the kingdom's financial sector was not only in place when Al Rajhi's became suspected of financing terrorism, but the bank itself assisted the kingdom in developing the state's fortified finance regime. The structural braiding of Al Rajhi Bank with the monarchy on the one hand, and the *ulema* on the other existed prior to the development of the Saudi financial surveillance system. Furthermore, this system was not displaced when this system deepened at the behest of the US.

The Jordanian case of executed enforcement juxtaposes with that of Saudi Arabia. Both states are conservative Sunni tribal monarchies originating in the same era, and both states share a number of similar characteristics across their political economies. However, unlike Al Rajhi's coalition binding function in Saudi Arabia, Arab Bank was founded as a Western-style bank with an arm's length structural relationship to the state. In contrast to the familial ties linking the Al Rajhi Bank family with Saudi monarchy and the *ulema*, Arab Bank is embedded in the economy of the Palestinian middle class. While the Palestinians and their political activities carry consequences for the Jordanian state, Amman developed policies aimed at binding the Hashemite monarchy to the

kingdom's non-Palestinian Bedouin population. Indeed, the orientation of Jordan's political economy heavily focuses upon linking state bureaucracies with the kingdom's rural Transjordanian base that pre-dated later waves of Palestinian settlement. Unlike most of the monarchies of the modern Middle East, Jordan's financial system demonstrates a legacy of private banking without any significant royal largesse. This institutional distance did not preclude Arab Bank from suffering administrative fines and settlements from civil suits brought against it.

In every case of blocked enforcement, the institutional structural relationships between states and their banks remained intact despite the arrival and adoption of AML/CTF regulations. The implications of this study are multifarious for questions pertaining to the international financial system and how it relates to international affairs. For institutional theory, the findings should not be surprising. Namely, deep institutional configurations within a country's political economy are not likely to be dislodged by the importation of institutional paradigms from the outside. Rather, the institutional imports are likely to simply overlay on top of pre-existing configurations. Furthermore, a state's adoption of institutions from outside is no indication that they will correctly work in their new environment. As noted by other scholars of terrorist financing, one of the drawbacks to the entire regime is that they are ill suited for many of the environments where they are most needed. The second institutional finding is also not surprising, given that a moral hazard exists for states seeking to enforce CTF regulations upon banks to which they are linked.

The fortified finance regime emerged and matured in liberal Western political economies where banking is a regulated, yet private affair. Regulations designed to counter terrorist financing and money laundering, complete with the surveillance of bank customers and of the banks themselves, effectively deputize banks to act as an extension of the state's security and intelligence apparatus. Designed for commercial private banks in developed economies, these regulations are ill suited to monitor state-owned banks, or financial systems based upon pre-modern relationships between the state and banks. In such structural configurations, such regulations place the state in the morally hazardous situation of having to monitor their own affairs and those of politically critical allies within their own political economies. In these cases, it is not surprising that enforcement misfires due to diplomatic pushback, bureaucratic shuffling, intimidation, or some other manifestation of state power.

A second implication of this research pertains to power politics and should come as no surprise; namely, states will defend their interests. The financial sector is not typically viewed as a strategic terrain in international relations, despite the fact that it is such. As actors, banks are involved in geopolitics and security, whether they choose to be or not. Terrorists deposit their money in bank accounts, while bankers and regulators now act as spies. Despite states, bankers, regulators, terrorists, and intelligence agencies inhabiting the same political economic universe, this motley crew of actors is rarely theorized in political science as interacting within the same environment. Yet, these actors not only interact in ways that are often out of sight of scholars, they are intimately intertwined.

Normatively, the implications are somewhat chilling. Terrorists' use of banks should come as no surprise. Banks offer incredible efficiency and ease of use when compared to alternatives, and terrorists must pay for gasoline and groceries as much as they must pay for bullets and publishing propaganda. The normatively disconcerting implication of this research is that states are intimately aware of the malfeasance that takes place in bank branches and recorded in ledgers all over the world. With the possible but doubtful exception of Jordan, every state in this study had knowledge of the terrorist financing taking place in banks within their territories. In cases of institutional linkage, banks escaped punishment and remained in positions to finance terrorism in the future.

Even in the cases where enforcement occurred, banks' home states did not want to take enforcement action against the targeted banks. Rather, for both BCCI and Arab Bank, officials only made moves against the banks due to pressure from the United States. While Jordan did not stand in the way of administrative penalties or the first salvo of lawsuits against Arab Bank, none of the data indicates that Amman was eager to penalize the bank. Instead, the state in this case allowed enforcement to proceed, and only intervened in order to maintain the integrity of the bank as a financial institution.

The case of BCCI and the Bank of England is even more nefarious. Not only did the Bank of England cultivate the offshore financial realm in the Caymans that allowed BCCI to thrive, it also sought to save the bank through assisting its relocation to Abu Dhabi. BCCI did business with dictators, terrorist groups, drug cartels, and even assisted Pakistan with the smuggling of nuclear materials. When BCCI's activities are taken into

account, the Bank of England's treatment of the case moves beyond the realm of simple regulatory corruption to one with real kinetic consequences for geopolitical stability and public safety. In light of the global crackdown on BCCI, the UK's actions indicate a desire to safeguard the offshore system rather than only one bank of many that thrived within it. In short, even though the UK did not own BCCI, it sought to preserve the environment in which it thrived due to its own interests.

Building off of the fact that states have so much knowledge of bank's activities related to money laundering and terrorist financing, a deeper possibility arises as to the implications of this study for how states and banks interact within their shared institutional universe. The implications of conscious regulatory failure travel far beyond issues of terrorism. Given that governments carry such deep awareness of what takes place regarding threat finance, questions arise as to whether states can similarly surveil coming financial crises and the financial activities that catalyze them.

The fortified finance regime was well implemented in major economies around the world by the time of the financial crisis of 2008. With such a surveillance apparatus in place inside of banks around the world, the dark question arises as to how states missed the subprime mortgage crisis, the Eurozone crisis, and other economic crises surrounding 2008. Contrary to urbane notions that banking and the financial system is somehow above political affairs, the world of threat finance indicates that ballots, bombs, and bankers are more interconnected than mainstream political science subfields would care to admit. Murky as it is, this area offers a number of sordidly fruitful avenues for future research.

The policy implications of this study are straightforward. While state-bank linkages are sufficient to thwart enforcement, the presence of these regulations in a given country offers leverage for potential enforcers. Given the international scope of the banking system, banks seldom hold all assets within the confines of their home jurisdictions. This multinational presence of banks' assets allows for states seeking enforcement to target these assets beyond the borders of the bank's home state. Additionally, instead of seeking to simply deepen the fortified finance regime, it may prove more effective to target specific banks through fines and disallowing such banks from engaging in specific currency transactions. This unit-specific targeting could provide ample disincentive for banks to finance terrorism.

If a bank financing terrorism is linked to its home state, it may also prove more effective to target the home state itself, rather than simply the bank. Currency prohibitions, and sanctions against state officials or governmental entities may be more effective in curtailing banks from financing terrorism. Instead of targeting a bank linked to its state, potential enforcers may enjoy greater success in curtailing terrorist financing by targeting the enabling state beyond the confines of the bank in question. From the standpoint of economic statecraft, this expands the range of potential opportunities for those states seeking to stop terrorists from using banks to finance their operations.

Regarding terrorists themselves, there is little scholarship regarding how they choose to finance their activities. While banks provide an incredibly efficient means of moving funds and integrating them into the financial system, not all banks are equal. While most economic actors should hypothetically entrust their money to the most

efficient banks for transactions and investment, these same banks may not offer the requisite security that a terrorist group needs. Terrorist groups may seek to entrust their funds with state-linked banks, and may do so with the knowledge that the state in such cases will assist in safeguarding the terrorists' bank of choice from outsiders. While terrorist groups may prove to be identical to other economic actors in that they seek maximum efficiency, further research is needed to determine how terrorists choose their banks and other aspects of their financial operations.

At the banking level, further research is needed to answer questions of corporate governance, corruption, and how financial institutions choose to engage in illicit activity. Regulations assume that a bank's financial intelligence unit will pass relevant information along to higher management levels within the bank, and to government officials. However, communication and cooperation within the bank itself may not efficiently work. Some personnel in the bank may be the subjects of bribes or coercion, while other departments are unaware or negligent. Similarly, a bank's FIU may clash with the bank's sales department and other offices within the bank, whereupon higher management is placed in the position of choosing between following the law and following their business interest. At the bank level, greater research into the corporate governance of illicit activity is needed to answer these questions.

Similarly, as this study illustrates, the unitary actor assumption pertaining to states must be relaxed in order to answer a number of questions related to threat finance. States are not monoliths with uniform interests. Different bureaucracies may have diverging interests and differing professional cultures that dictate how they approach affairs of this

nature. Clearly, as illustrated in the case of BCCI and Halk Bank, different organs within the state may conflict over issues related to terrorist financing and money laundering. In the BCCI case, the Bank of England was in clear conflict with other elements of the British government over its transformation of the Cayman Islands into an offshore financial center. Similarly, Turkey's judiciary and law enforcement apparatus did attempt domestic enforcement against Halk Bank's activities, despite later being thwarted by the government in power through mass firings and bureaucratic shuffling. Further research is needed in order to explore how and when certain bureaucracies and state organs conflict over areas of financial regulation and enforcement.

At the level of the international financial system, there is no research exploring the possibility that states may have foreknowledge of malfeasance in the banking system in areas aside from terrorism. If states know of terrorism being financed through the mainstream financial system and refrain from overt regulatory action, states may similarly know of other indecent practices such as risky lending, the laundering of criminal funds, political corruption, and other types of illicit economic activity detrimental to growth and geopolitical stability. Often in studies of financial regulation or political economy, it is generally assumed that relationships between banks and states are formal and cordial. As shown in this study, interactions between banks and governments may be informal, messy, conflictual, and not intended for widespread public knowledge.

Another international aspect of this phenomenon is one of American hegemony. In some form, the US is present at some level in every case of this study. Certainly, the

US is the state seeking enforcement against banks financing terrorism in the cases of BCCI, Arab Bank, Halk Bank, and Al Rajhi Bank. However, even when the US government is not directly seeking action against banks, the American legal system is often the venue for private actors seeking restitution against banks financing terrorism. In a number of cases, private actors were either spearheading enforcement efforts, or involved in additional enforcement moves in conjunction with administrative action by the US government. The fact that the American legal system is so prevalent in enforcement attempts, even when the government is not the primary actor, indicates a form of judicial hegemony in the financial realm. This prevalence of the American judicial system raises questions of judicial autonomy and geopolitical interference.

In the negative cases of BCCI and Arab Bank, the American legal system impacted political economies far-removed from the United States. Similarly, in the case of Halk Bank, American courts offered a secondary enforcement mechanism after domestic enforcement attempts within Turkey were thwarted by the AKP. With the Bank of China, ongoing lawsuits were effectively stillborn due to the actions of outside states, with Israel and China both taking action to prevent requisite testimony from occurring. The fact that such geopolitical jockeying is occurring in the American legal system underscores an aspect of US hegemony not often discussed in political science, despite its impact.

The complexity of this phenomenon combines substantive focuses from security studies, comparative political economy, international law, and financial regulation. Because of this complexity and substantive overlap, there is little theoretical development

about terrorist financing and money laundering in political science. Literature about regulatory development and expansion does not address studies about terrorist groups, while studies about terrorist groups and financing do not connect with those about great power politics and the financial system. This study offers a first foray into the crevasse between the existing literatures.

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