

Air India Flight 182
A Canadian Tragedy

VOLUME FIVE
Terrorist Financing

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Fax: (613) 954-5779 or 1 800 565-7757
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VOLUME FIVE TERRORIST FINANCING

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Volume Five: Terrorist Financing

VOLUME FIVE

TERRORIST FINANCING

CHAPTER I: TERRORIST FINANCING – AN OVERVIEW

1.1 Introduction

The terms of reference for the *Commission of Inquiry into the Investigation of the Bombing of Air India Flight 182* require the Commissioner to make findings and recommendations with respect to "...whether Canada's existing legal framework provides adequate constraints on terrorist financing in, from or through Canada, including constraints on the use or misuse of funds from charitable organizations."¹

Addressing terrorist financing (TF) involves responding to two broad questions:

1. How do terrorists obtain the resources they need to carry out terrorist acts or support terrorist networks?
2. How can governments use this knowledge to defeat terrorists?²

1.1.1 Defining Terrorist Financing

The *United Nations International Convention for the Suppression of the Financing of Terrorism*³ refers to TF in the following terms:

Article 2.1. Any person commits an offence within the meaning of this Convention if that person by any means, directly or indirectly, unlawfully and wilfully, provides or collects funds with the intention that they should be used or in the knowledge that they are to be used, in full or in part, in order to carry out:

(a) An act which constitutes an offence within the scope of and as defined in one of the treaties listed in the annex;⁴ or

¹ Terms of Reference, P.C. 2006-293, para. b(iv).

² These two questions guided the terrorist financing-resourcing model and study prepared by John Schmidt of the Integrated Threat Assessment Centre (ITAC): see Testimony of John Schmidt, vol. 53, September 27, 2007, p. 6651.

³ Online: United Nations Treaty Collection <<http://untreaty.un.org/English/Terrorism/Conv12.pdf>> (accessed February 20, 2009).

⁴ The same treaties are referred to in the Canadian definition of "terrorist activity" and in the FATF definition of "terrorist act."

(b) Any other act intended to cause death or serious bodily injury to a civilian, or to any other person not taking an active part in the hostilities in a situation of armed conflict, when the purpose of such act, by its nature or context, is to intimidate a population, or to compel a government or an international organisation to do or to abstain from doing any act.⁵

UN Security Council Resolution 1373 (2001)⁶ defines TF as follows:

...[the] wilful provision or collection, by any means, directly or indirectly, of funds by their nationals or in their territories with the intention that the funds should be used, or in the knowledge that they are to be used, in order to carry out terrorist acts.⁷

The Financial Action Task Force (FATF), considered to be the main international body determining policy on TF and money laundering, describes TF as follows:

The term terrorist financing includes the financing of terrorist acts, and of terrorists and terrorist organisations.... Terrorist financing offences should extend to any person who wilfully provides or collects funds by any means, directly or indirectly, with the unlawful intention that they should be used or in the knowledge that they are to be used, in full or in part: (a) to carry out a terrorist act(s); (b) by a terrorist organisation; or (c) by an individual terrorist.⁸

These descriptions all support the notion that TF is essentially the collection and/or use of funds to accomplish or support terrorist acts or to support terrorist organizations.

⁵ The World Bank states that the definition in the United Nations International Convention for the Suppression of the Financing of Terrorism is the one most countries have adopted for purposes of defining terrorist financing: Reference Guide to Anti-Money Laundering and Combating the Financing of Terrorism: A Manual for Countries to Establish and Improve Their Institutional Framework, 2nd. ed. and Supp. on Special Recommendation IX (Washington D.C.: The International Bank for Reconstruction and Development/The World Bank/The International Monetary Fund, 2006), p. I-5 [The World Bank Guide to Anti-Money Laundering and Combating Terrorism Financing].

⁶ Online: United Nations <<http://daccessdds.un.org/doc/UNDOC/GEN/N01/557/43/PDF/N0155743.pdf?OpenElement>> (accessed February 13, 2009).

⁷ S. 1(b).

⁸ The Interpretative Notes to the Special Recommendations (SR) on Terrorist Financing (TF), Interpretative Note to Special Recommendation II: Criminalising the financing of terrorism and associated money laundering, paras. 2, 3, online: Financial Action Task Force <http://www.fatf-gafi.org/document/53/0,3343,en_32250379_32236947_34261877_1111,00.html> (accessed February 11, 2009).

The *Criminal Code*⁹ does not provide a definition of terrorist financing, but instead lists several offences in sections 83.02 to 83.04 under the heading “Terrorist Financing.” For example, section 83.03 makes it an offence to collect property or make available property or financial or other related services intending that they be used for the purpose of facilitating or carrying out any terrorist activity.

1.1.2 Origins of Canada’s Response to Terrorist Financing

Before 2001, no specific TF offences existed in Canadian law. Despite the enormity of the Air India tragedy in 1985, there was not much focus on TF in Canada at the turn of the millennium.¹⁰ Terrorism-related incidents that occurred before 2001 were dealt with under existing criminal law.¹¹ Discussions and groundwork leading to Canadian TF legislation were under way before the terrorist attacks of September 11, 2001 (“9/11”), but began in earnest only many years after the 1985 Air India tragedy. The current provisions concerning TF, now contained in the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act*¹² (PCMLTFA) and the *Criminal Code*, were a product of the terrorist attacks of 9/11.¹³

Blake Bromley, a Canadian lawyer practising exclusively on charities issues, wrote in a submission to the Commission that “...[i]t is noteworthy and troubling that our anti-terrorism legislation was enacted in response to the American tragedy of 2001, rather than the Canadian tragedy of 1985.”¹⁴

Canadian law enforcement authorities did not focus on TF before 2001 simply because there was no TF legislation.¹⁵ Canada’s approach to TF was not unique. Even foreign law enforcement agencies and other bodies involved in counterterrorism efforts before 2001 apparently did not focus heavily on TF activities.¹⁶ Keith Morrill, Director of the Criminal, Security and Treaty Law Division of the Department of Foreign Affairs and International Trade’s Legal Affairs Bureau, testified that TF issues had come late in the day to the international scene.¹⁷

The RCMP created a task force on terrorist-related financial matters shortly after 9/11, but even that initiative sought primarily to prevent terrorist attacks¹⁸ – an approach sometimes described as “chasing the bomber.”

⁹ R.S.C. 1985, c. C-46.

¹⁰ Testimony of Rick Reynolds, vol. 55, October 1, 2007, p. 6818.

¹¹ Testimony of Rick Reynolds, vol. 55, October 1, 2007, p. 6830.

¹² S.C. 2000, c. 17.

¹³ See, for example, Testimony of Jim Galt, vol. 55, October 1, 2007, p. 6939.

¹⁴ Blake Bromley, “Funding Terrorism and Charities,” October 26, 2007, online: Benefic Group <<http://www.beneficgroup.com/files/getPDF.php?id=120>> (accessed May 12, 2009).

¹⁵ Testimony of Rick Reynolds, vol. 55, October 1, 2007, p. 6818. But law enforcement authorities were aware that a crime might still have been committed if the behaviour could be attached to an existing criminal offence before 2001: Testimony of Rick Reynolds, vol. 55, October 1, 2007, pp. 6818, 6830.

¹⁶ Testimony of Rick Reynolds, vol. 55, October 1, 2007, p. 6818.

¹⁷ Testimony of Keith Morrill, vol. 54, September 28, 2007, pp. 6680, 6705.

¹⁸ Testimony of Rick Reynolds, vol. 55, October 1, 2007, p. 6819.

1.1.3 Objectives of Canada's Anti-Terrorist Financing Efforts

A fundamental goal of Canada's anti-TF program is to protect Canadians and the integrity of Canada's financial system and to ensure that gaps and vulnerabilities in the financial system are being addressed.¹⁹ The Government of Canada's stated objectives are to create a "hostile environment" towards TF, to respect international obligations and to be vigilant in dealing with TF.²⁰

1.2 The International System to Combat Terrorist Financing

International efforts to combat TF flowed from the intersection of existing money laundering initiatives and the need to respond to the events of 9/11. The initiative to combat money laundering itself arose because criminal activities were generating enormous amounts of cash that had to be "laundered" to avoid detection of the money's links to crime.²¹

Professor Nikos Passas of Northeastern University's College of Criminal Justice explained that the money laundering model was adapted internationally to deal with TF:

What characterized our [US] response, especially after the attacks of September 11th in the United States, was similarly an adoption of the methods that were in place against money laundering for the purpose of countering the financing of terrorism.... This was the approach adopted right after 9/11, not only in the United States, but internationally.²²

Passas testified that the money laundering model was chosen because it was familiar. As well, governments were going to apply whatever tools they had available and governments had to convey to the public the impression that they were "doing something" about terrorism.²³ He also suggested that TF measures may have been created too hastily, although they "...were not resisted particularly by those to whom they applied. The private sector or politicians didn't have any problem with that, or the general public. Everybody wanted to see something done against terrorism so whatever helps we're going to go along with."²⁴

¹⁹ Testimony of Diane Lafleur, vol. 54, September 28, 2007, pp. 6778-6779, 6753.

²⁰ Testimony of Diane Lafleur, vol. 54, September 28, 2007, pp. 6773-6774.

²¹ National Commission on Terrorist Attacks Upon the United States, *Monograph on Terrorist Financing*, p. 54, online: National Commission on Terrorist Attacks Upon the United States <http://govinfo.library.unt.edu/911/staff_statements> (accessed February 20, 2009) [National Commission Monograph on Terrorist Financing]. In many countries, provisions to counter money laundering were necessary in large part to combat the drug trade: Testimony of Keith Morrill, vol. 54, September 28, 2007, p. 6688.

²² Testimony of Nikos Passas, vol. 53, September 27, 2007, pp. 6568-6569.

²³ Testimony of Nikos Passas, vol. 53, September 27, 2007, p. 6569.

²⁴ Testimony of Nikos Passas, vol. 53, September 27, 2007, p. 6570.

In general, money laundering laws focus on the large amounts of money that are proceeds of crime – “dirty money.” In contrast, TF may involve smaller sums that are not necessarily proceeds of crime. The question remains: Did adding TF provisions to existing money laundering provisions lead to the most appropriate TF measures?

1.2.1 International Instruments and Organizations to Combat Terrorist Financing

1.2.1.1 The United Nations (UN)

Three UN instruments are important in TF matters: the *International Convention for the Suppression of the Financing of Terrorism*, *UN Security Council Resolution 1373* and *UN Security Council Resolution 1267*.

1.2.1.1.1 The International Convention for the Suppression of the Financing of Terrorism

Ratified by Canada in 2001,²⁵ the *International Convention for the Suppression of the Financing of Terrorism (Financing of Terrorism Convention)* states in its preamble that the parties to the Convention are “...deeply concerned about the worldwide escalation of acts of terrorism in all its forms and manifestations.” The Convention requires parties to criminalize TF and to provide for the freezing, seizure and forfeiture of funds used for TF.

1.2.1.1.2 UN Security Council Resolution 1373 (2001)

The UN Security Council adopted Resolution 1373 on September 28, 2001. Security Council resolutions passed under Chapter VII of the UN Charter in response to a threat to international peace and security are binding on all UN members.²⁶ Each member must then implement the resolutions in its domestic law.

Resolution 1373 imposes several obligations on member states, including the following:

- 1(a) Prevent and suppress the financing of terrorist acts;
- (b) Criminalize the wilful provision or collection, by any means, directly or indirectly, of funds by their nationals or in their

²⁵ The treaty was signed by Canada on February 10, 2000; see “Canada Signs International Convention for the Suppression of the Financing of Terrorism,” online: Foreign Affairs and International Trade Canada <http://w01.international.gc.ca/minpub/PublicationContentOnly.asp?publication_id=377482&Language=E&MODE=CONTENTONLY&Local=False> (accessed February 11, 2009).

²⁶ Exhibit P-227, Tab 3: Department of Finance Memorandum of Evidence on Terrorist Financing, February 28, 2007, paras. 3.8-3.9 [Department of Finance Memorandum of Evidence on Terrorist Financing].

territories with the intention that the funds should be used, or in the knowledge that they are to be used, in order to carry out terrorist acts;

(c) Freeze without delay funds and other financial assets or economic resources of persons who commit, or attempt to commit, terrorist acts or participate in or facilitate the commission of terrorist acts; of entities owned or controlled directly or indirectly by such persons; and of persons and entities acting on behalf of, or at the direction of such persons and entities, including funds derived or generated from property owned or controlled directly or indirectly by such persons and associated persons and entities;

(d) Prohibit their nationals or any persons and entities within their territories from making any funds, financial assets or economic resources or financial or other related services available, directly or indirectly, for the benefit of persons who commit or attempt to commit or facilitate or participate in the commission of terrorist acts, of entities owned or controlled, directly or indirectly, by such persons and of persons and entities acting on behalf of or at the direction of such persons;

2(a) Refrain from providing any form of support, active or passive, to entities or persons involved in terrorist acts, including by suppressing recruitment of members of terrorist groups and eliminating the supply of weapons to terrorists.

The UN Office on Drugs and Crime (UNODC) developed model TF legislation which countries can adopt to comply with the provisions of Resolution 1373 and the *Financing of Terrorism Convention*.²⁷

Resolution 1373 also established the UN Security Council Counter-Terrorism Committee (CTC). The CTC is composed of the 15 Security Council members. It monitors the implementation of the Resolution by member states and facilitates providing technical assistance to those states.²⁸ The Resolution calls on all states to report regularly on their progress in implementing the Resolution. Countries must perform a self-assessment of their legislation and mechanisms to combat terrorism and TF in light of the requirements of Resolution 1373. The CTC maintains a website with a directory of international best practices to help countries improve their counterterrorism infrastructures. The website also contains model legislation and related information.²⁹

²⁷ Online: International Money Laundering Information Network <<http://www.imolin.org/imolin/tfbill03.html>> (accessed February 11, 2009).

²⁸ Online: United Nations <<http://www.un.org/sc/ctc/aboutus.html>> (accessed February 11, 2009).

²⁹ The World Bank Guide to Anti-Money Laundering and Combating Terrorism Financing, p. III-7. The CTC website containing the extensive directory of best practices can be found online: <<http://www.un.org/sc/ctc/practices.html>> (accessed January 23, 2009).

1.2.1.1.3 UN Security Council Resolution 1267 (1999) and Subsequent Resolutions

Resolution 1373 was drafted following several Security Council resolutions requiring member states to freeze the assets of entities or individuals with links to Al-Qaida³⁰ and the Taliban, including entities listed by Security Council Resolution 1267 and other resolutions.³¹ A 2002 World Bank report summarized the range and scope of these resolutions:

The initial Resolution 1267 of October 15, 1999, dealt with the Taliban and was followed by 1333 of December 19, 2000, on Osama Bin Laden and Al-Qaeda. Later Resolutions established monitoring arrangements (1363 of July 30, 2001), merged the earlier lists (1390 of January 16, 2002), provided some exclusions (1452 of December 20, 2002), and measures to improve implementation (1455 of January 17, 2003).

The 1267 Committee issues the list of individuals and entities whose assets are to be frozen and has procedures in place to make additions or deletions to the list on the basis of representations by member States.³² [references to footnotes omitted.]

Collectively, these resolutions require all states to take the following measures "...in connection with any individual or entity associated with Al-Qaida, Usama bin Laden and/or the Taliban as designated by the Committee":

- freeze without delay the funds and other financial assets or economic resources of designated individuals and entities [**assets freeze**];
- prevent the entry into or transit through their territories by designated individuals [**travel ban**]; and
- prevent the direct or indirect supply, sale and transfer from their territories or by their nationals outside their territories, or using their flag vessels or aircraft, of arms and related materiel of all types, spare parts, and technical advice, assistance, or training

³⁰ Also referred to as "Al-Qaeda" or "al-Qaeda." For consistency in this volume, the names "Usama bin Laden" and "Al-Qaida" are spelled according to the Canadian spelling in the *United Nations Al-Qaida and Taliban Regulations*, S.O.R./99-444 and on the website for the United Nations Security Council Committee established pursuant to Resolution 1267, online: United Nations <<http://www.un.org/sc/committees/1267/index.shtml>> (accessed February 20, 2009).

³¹ Kevin E. Davis, "The financial war on terrorism," in Victor V. Ramraj, Michael Hor and Kent Roach, eds., *Global Anti-Terrorism Law and Policy* (Cambridge: Cambridge University Press, 2005), p. 180.

³² The World Bank Guide to Anti-Money Laundering and Combating Terrorism Financing, pp. III-5-6. The most recent list of the 1267 Committee is available online: United Nations <<http://www.un.org/sc/committees/1267/consolist.shtml>> (accessed February 20, 2009). The list issued by the 1267 Committee should not be confused with Canada's own list, discussed below.

related to military activities, to designated individuals and entities [arms embargo].³³

1.2.1.2 The Financial Action Task Force on Money Laundering (FATF)

The G-7 countries established the Financial Action Task Force on Money Laundering (FATF) as an intergovernmental body in 1989. It was created informally, not by treaty.³⁴ Its current goals are to develop and promote national and international policies to combat money laundering and TF. Among other activities, the FATF works to generate the necessary political will to bring about legislative and regulatory reforms in these areas.³⁵ It is the principal group at the international level setting standards on money laundering and TF issues.

The original mandate of the FATF was to provide guidance and a practical international framework to combat money laundering. In 1990, the FATF published its first version of “The Forty Recommendations” on money laundering.³⁶ The FATF met in October 2001 to evaluate the need to take action against TF activities. The FATF’s mandate was then expanded to include TF.³⁷ Also in October 2001, the FATF published its “Eight Special Recommendations on Terrorist Financing.” A ninth was added in October 2004.³⁸ The “Nine Special Recommendations” provide guidance about combatting TF.

The FATF has described one of its fundamental goals as the “[f]ull and effective roll-out” of the “40+9” Recommendations.³⁹ However, the FATF’s responsibilities go far beyond the Recommendations. They include examining money laundering and TF techniques and trends, reviewing actions taken at the national or international levels, and recommending measures to combat money laundering and TF.⁴⁰ When its mandate was reviewed in 2008, the FATF stated that it would make efforts to respond to emerging threats created by globalization, such as “...proliferation financing and vulnerabilities in new technologies which could destabilise the international financial system.”⁴¹ As well, the FATF described the identification of, and appropriate response to, countries with severe deficiencies

³³ Online: United Nations <<http://www.un.org/sc/committees/1267/index.shtml>> (accessed February 11, 2009).

³⁴ Testimony of Keith Morrill, vol. 54, September 28, 2007, p. 6688.

³⁵ Online: Financial Action Task Force <http://www.fatf-gafi.org/pages/0,2987,en_32250379_32235720_1_1_1_1_1,00.html> (accessed February 20, 2009).

³⁶ A revision occurred in 1996, followed by a thorough review and update in 2003. The current version is available online: Financial Action Task Force <http://www.fatf-gafi.org/document/28/0,3343,en_32250379_32236930_33658140_1_1_1_1,00.html> (accessed February 11, 2009).

³⁷ Financial Action Task Force on Money Laundering, *Annual Report 2001-2002*, June 21, 2002, paras. 16-17, online: Financial Action Task Force <<http://www.fatf-gafi.org/dataoecd/13/1/34328160.pdf>> (accessed February 20, 2009).

³⁸ The current version, titled “9 Special Recommendations (SR) on Terrorist Financing (TF)” is available online: Financial Action Task Force <http://www.fatf-gafi.org/document/9/0,3343,en_32250379_32236930_34032073_1_1_1_1,00.html> (accessed February 11, 2009).

³⁹ Financial Action Task Force, *FATF Revised Mandate 2008-2012*, April 12, 2008, para. 5, online: Financial Action Task Force <<http://www.fatf-gafi.org/dataoecd/3/32/40433653.pdf>> (accessed February 11, 2009) [FATF Revised Mandate 2008-2012].

⁴⁰ “About the FATF.”

⁴¹ FATF Revised Mandate 2008-2012, para. 2.

in their money laundering and TF programs (“weak links”) as a key element of its ongoing work.⁴²

The FATF Recommendations have been endorsed by more than 170 jurisdictions around the world, as well as by the boards of the International Monetary Fund (IMF) and the World Bank.⁴³ In July 2005, the United Nations Security Council, in Resolution 1617, stated that it “...strongly urges all Member States to implement the comprehensive, international standards embodied in the Financial Action Task Force’s (FATF) Forty Recommendations on Money Laundering and the FATF Nine Special Recommendations on Terrorist Financing.”⁴⁴

The “40+9” Recommendations are not legally binding.⁴⁵ To fulfill its mandate, the FATF has established partnerships with many regional bodies and international organizations involved in combatting money laundering and TF.

In addition, the FATF has established a mutual evaluation program where experts on money laundering and TF matters examine a member state’s activities against money laundering and TF. The FATF’s 2007-08 annual report stated that, at that point, 75 countries had been evaluated.⁴⁶ Canada was evaluated in 2007-08 (the 2008 FATF Mutual Evaluation of Canada).⁴⁷ To facilitate its work, the FATF supports “FATF-style regional bodies” to raise awareness in their geographic locations and conduct mutual evaluations in partnership with the FATF or independently.⁴⁸

42 FATF Revised Mandate 2008-2012, para. 7. For instance, the FATF has recently identified Uzbekistan, Iran, Pakistan, Turkmenistan and São Tomé and Príncipe, and the northern part of Cyprus as jurisdictions with severe deficiencies on ML/TF matters: see FATF Chairman’s Summary, London Plenary, June 18-20, 2008, online: Financial Action Task Force <<http://www.fatf-gafi.org/dataoecd/50/1/40879782.pdf>> (accessed February 11, 2009) [FATF Chairman’s Summary].

43 FATF Revised Mandate 2008-2012, paras. 1, 16.

44 S. 7, online: Financial Action Task Force <<http://daccessdds.un.org/doc/UNDOC/GEN/N05/446/60/PDF/N0544660.pdf?OpenElement>> (accessed February 11, 2009).

45 Financial Action Task Force, *Annual Report 2006-2007*, June 29, 2007, para. 4, online: Financial Action Task Force <<http://www.fatf-gafi.org/dataoecd/46/1/39162982.pdf>> (accessed February 11, 2009) [FATF 2006-07 Annual Report].

46 For a complete list, see Annex 4 of the FATF *Annual Report 2007-2008*, June 30, 2008, pp. 27-28, online: Financial Action Task Force <<http://www.fatf-gafi.org/dataoecd/58/0/41141361.pdf>> (accessed February 25, 2009) [FATF 2007-08 Annual Report].

47 The results of the 2008 FATF Mutual Evaluation of Canada, and more details on the process, are discussed below.

48 The Asia/Pacific Group on Money Laundering (APG), the Caribbean Financial Action Task Force (CFATF), the Council of Europe Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL), the Grupo de Acción Financiera de Sudamérica (GAFISUD) and the Middle East and North Africa Financial Action Task Force (MENAFATF) and are Associate Members: FATF 2007-08 Annual Report, para. 8.

The membership of the FATF stands at 32 countries and territories, two regional bodies and two countries with observer status.⁴⁹ Twenty-two organizations have observer status.⁵⁰ All decisions of the FATF are taken by its members by consensus in plenary meetings. The plenary is assisted by the FATF Secretariat and chaired by the FATF President. Although the FATF Secretariat is housed at the Headquarters of the Organisation for Economic Co-operation and Development (OECD) in Paris, the FATF is a fully independent body.⁵¹

Working groups within the FATF are established to further the work of member countries and of the organization. These include the Working Group on Terrorist Financing and Money Laundering, the Working Group on Evaluations and Implementation and the Working Group on Typologies.⁵²

Delegations established by each country usually consist of government officials working in finance (in Canada's case, officials from the Department of Finance) and representatives from other government bodies, such as financial intelligence units (FIUs), law enforcement, intelligence and border control agencies, and justice and foreign affairs departments.⁵³

In February 2008, the FATF published a paper entitled "Terrorist Financing." In part, it describes various TF "typologies" (methods and trends associated with TF).⁵⁴ Previous published FATF papers often dealt with both money laundering and TF issues, but appeared to attach greater importance to money laundering.

Between 1995 and 2004, the FATF published in-depth papers on several subjects relating to money laundering and TF, including papers about precious metal/stones dealers, commercial websites and Internet payment systems, the trade system, real estate, corporate vehicles for raising funds, new payment methods and general typologies.⁵⁵ The FATF has agreed to undertake studies in several additional areas, including TF risks in the securities sector.⁵⁶ These studies can

⁴⁹ FATF Chairman's Summary, notes 3-4. As per this document the 34 members of the FATF are: Argentina; Australia; Austria; Belgium; Brazil; Canada; China; Denmark; the European Commission; Finland; France; Germany; Greece; the Gulf Co-operation Council; Hong Kong; China; Iceland; Ireland; Italy; Japan; Luxembourg; Mexico; the Kingdom of the Netherlands; New Zealand; Norway; Portugal; the Russian Federation; Singapore; South Africa; Spain; Sweden; Switzerland; Turkey; the United Kingdom; and the United States. The observer countries are India and the Republic of Korea.

⁵⁰ FATF Revised Mandate 2008-2012, para. 21.

⁵¹ FATF 2006-07 Annual Report, para. 8.

⁵² FATF 2007-08 Annual Report, paras. 10-11.

⁵³ FATF 2007-08 Annual Report, para. 7.

⁵⁴ Financial Action Task Force, *Terrorist Financing*, February 29, 2008, pp. 7-10, online: Financial Action Task Force <<http://www.fatf-gafi.org/dataoecd/28/43/40285899.pdf>> (accessed February 12, 2009) [FATF Report on Terrorist Financing].

⁵⁵ The papers can be found on the FATF website. They include: *RBA Guidance for Dealers in Precious Metal and Stones* (2008); *Money Laundering & Terrorist Financing Risk Assessment Strategies* (2008); *Money Laundering & Terrorist Financing Vulnerabilities of Commercial Websites and Internet Payment Systems* (2008); *Best Practices Paper on Trade Based Money Laundering* (2008); *Money Laundering & Terrorist Financing through the Real Estate Sector* (2007); *Laundering the Proceeds of VAT Carousel Fraud* (2007); *Trade Based Money Laundering* (2006); *The Misuse of Corporate Vehicles, Including Trust and Company Service Providers* (2006); and *Report on New Payment Methods* (2006).

⁵⁶ FATF Chairman's Summary, p. 1.

help those entities in Canada which must report financial transactions to the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC).

1.2.1.3 Other International Organizations

The World Bank and the International Monetary Fund also play important roles in fighting TF, since both normally deal with the financial sectors of countries. Both organizations assist in monitoring standards for financial institutions and in studying typologies, as well as provide assistance to countries in TF matters and in the regulation of financial institutions.⁵⁷ Other groups, such as the Basel Committee on Banking Supervision, the Wolfsberg Group of Banks, the International Association of Insurance Supervisors and the Egmont Group of Financial Intelligence Units (the Egmont Group⁵⁸), also contribute.⁵⁹

1.2.2 Differing Interpretations among Countries about TF Issues

As Professor Passas noted, approaches to TF vary widely among countries:

[T]here is no uniform legal approach to countering the financing of terrorism (CFT). Some jurisdictions mirror UN model laws, while others adopt their own methods or merely extend money laundering provisions to cover CFT. The national regimes vary with respect to the range of activities and groups covered, the types of assets or financial activities included, the origin of funds raised to finance terrorist acts, the intent or knowledge of individuals, whether an activity, act or group is financed, etc.⁶⁰

Work to counter international TF is complicated by the disagreements which may arise between countries regarding what conduct is illegal and which organizations should be pursued – a complication worsened when money flows, as it often does, between jurisdictions.

⁵⁷ For more information on the subject, see Jae-myong Koh, *Suppressing Terrorist Financing and Money Laundering* (Berlin: Springer, 2006), pp. 168-177 [Koh, *Suppressing Terrorist Financing and Money Laundering*]. The World Bank Guide to Anti-Money Laundering and Combating Terrorism Financing is of interest to all jurisdictions because it describes useful steps which can be taken to combat TF, based on international standards.

⁵⁸ The Egmont Group is the coordinating body for the international group of financial intelligence units (FIUs). It was formed in 1995 to promote and enhance international cooperation in anti-money laundering and counter-terrorist financing: The Egmont Group, Press Release, "Egmont Group Appoints Head of New Permanent Secretariat," May 17, 2007, online: The Egmont Group <<http://www.egmontgroup.org/ExecSecPR.pdf>> (accessed February 12, 2009).

⁵⁹ For more information, see Koh, *Suppressing Terrorist Financing and Money Laundering*, pp. 143-154.

⁶⁰ Nikos Passas, "Understanding Terrorism Financing" in Vol. 2 of *Research Studies: Terrorism Financing Charities and Aviation Security*, p. 28 [Passas Paper on Terrorism Financing]. Passas also described how several countries had implemented the international requirements on TF: Passas Paper on Terrorism Financing, pp. 25-27.

The Liberation Tigers of Tamil Eelam (LTTE) provides an example of the practical difficulties caused by differing definitions among countries of “terrorism” and “terrorist organization.” The LTTE was designated as a “listed entity” (meaning, in general, a prohibited group), or its equivalent, by the United Kingdom (2001),⁶¹ Australia (2001)⁶² and the European Union (May 2006).⁶³ Canada listed the LTTE as a terrorist group in April 2006.⁶⁴

Between 2001 and 2006, it would have been easier to prosecute the LTTE in the UK or Australia than in Canada because the group was not yet listed here. It was possible to prosecute an unlisted terrorist group in Canada, but the prosecution would have needed to prove that the group was terrorist; on the other hand, a group that had been listed would from that mere fact be considered terrorist, with no further proof required.⁶⁵ If Canada had listed the LTTE earlier, the group would likely have moved its fundraising activities to a country where it was still unlisted.

1.2.3 Canada’s International Involvement in Anti-Terrorist Financing Matters

Canada is active on the international scene in anti-TF matters through several organizations⁶⁶:

- the FATF: Canada is a founding member, and a former Canadian government official presided over the FATF in 2006-07. The Department of Finance is the lead Canadian department for Canada’s dealings with the FATF;⁶⁷
- the Asia/Pacific Group;
- the Caribbean Financial Action Task Force;⁶⁸
- the Egmont Group;

⁶¹ *Terrorism Act 2000 (Proscribed Organisations) (Amendment) Order 2001*, S.I. 2001/1261.

⁶² *Charter of the United Nations (Anti-terrorism – Persons and Entities) List 2001* (No. 2), online: Government of Australia, Department of Foreign Affairs and Trade <http://www.dfat.gov.au/icat/persons_entities/2_proscribed_entities_10dec2001.html> (accessed February 11, 2009).

⁶³ Declaration by the Presidency on behalf of the European Union concerning listing of the LTTE as a terrorist organisation, online: Europa <<http://europa.eu/rapid/pressReleasesAction.do?reference=PESC/06/78&format=HTML&aged=0&language=EN&guiLanguage=en>> (accessed February 11, 2009). Interestingly enough, the press release mentions that “[t]he decision of the EU to list the LTTE should come as a surprise to nobody,” since the LTTE had received several warnings.

⁶⁴ Public Safety Canada, “Currently listed entities,” online: Public Safety Canada <<http://www.publicsafety.gc.ca/prg/ns/le/cle-en.asp#ltte>> (accessed February 11, 2009).

⁶⁵ A “terrorist group” is defined in s. 83.01(1) of the *Criminal Code*, R.S.C. 1985, c. C-46 as either “an entity that has as one of its purposes or activities facilitating or carrying out any terrorist activity” or an entity on a list established by the Governor in Council under s. 83.05, and includes “an association of such entities.”

⁶⁶ For a general description of Canada’s efforts, see Testimony of Diane Lafleur, vol. 54, September 28, 2007, pp. 6767-6768.

⁶⁷ Testimony of Diane Lafleur, vol. 54, September 28, 2007, pp. 6753, 6767.

⁶⁸ Testimony of Diane Lafleur, vol. 54, September 28, 2007, p. 6767.

- the Five Eyes Group,⁶⁹ and
- the World Bank and IMF.

Because of its role and status in the FATF, Canada is an active member of a core group of countries that have taken the lead on TF matters. Canada is making strong efforts to observe its obligations under international law.⁷⁰ Evaluations of Canada's efforts are examined in Chapter IV.

Although the 2008 FATF Mutual Evaluation of Canada criticized Canada in several respects, reviews of Canada's anti-TF program show that Canada respects most of its international obligations. A lawyer who specializes in charities law, Terrance Carter, even described Canada as doing more than its obligations require against TF raised through charities, violating principles of natural justice, criminal law, and due process.⁷¹

1.3 The Concept of Terrorism

1.3.1 "Terrorism" and "Terrorist Organization"

Defining and understanding "terrorism" is necessary to develop measures to combat TF. What constitutes terrorism and, as a result, which financial activities need to be monitored, prohibited and eliminated?⁷²

The difficulty in defining terrorism helps to explain why there is no single, international approach to TF, and why it is therefore difficult to secure the international cooperation needed to deploy effective anti-TF programs.

In his paper for the Commission, Professor Passas highlighted the challenges of defining terrorism, and of identifying certain groups as terrorist entities:

Rebels, insurgents, resisters, guerrillas, militants, militias, independence movements, nationalists etc. come in different sizes, operate in diverse contexts, enjoy differential popular (or state) support, antagonize different social actors and represent high or low priorities of domestic, regional and international controllers. Placing them all in the same category and discussing this in general terms as 'terrorist finance and its control' obscures more issues than it clarifies. Inevitably, the label 'terrorist' is a blanket political and polemical concept

⁶⁹ See Chapter III for a description of the Five Eyes Group.

⁷⁰ See Testimony of Diane Lafleur, vol. 54, September 28, 2007, pp. 6768-6772 and Exhibit P-227, Tab 2: Presentation of Diane Lafleur, September 28, 2007, Slides 7-10 for a general overview of Canada's compliance efforts with the FATF's 9 Special Recommendations on TF.

⁷¹ Terrance S. Carter, "The Impact of Anti-terrorism Legislation on Charities in Canada: The Need For an Appropriate Balance," October 26, 2007, p. 13, online: Carters Professional Corporation <<http://www.carters.ca/pub/article/charity/2007/tsc1026.pdf>> (accessed May 12, 2009).

⁷² Testimony of Keith Morrill, vol. 54, September 28, 2007, p. 6690.

that varies from one legal system to another. As a result, any discussion of 'terrorist finance' is directly affected and infected by the problem of defining terrorism.⁷³

A 2002 World Bank report stated that terrorism financing was a fundamentally simple concept, but that terrorism was more difficult to define:

Not all of the countries that have adopted the [*International Convention for the Suppression of the Financing of Terrorism*] agree on specifically what actions constitute terrorism. The meaning of terrorism is not universally accepted due to significant political, religious and national implications that differ from country to country.⁷⁴

The organization known as "Hamas" provides a case in point. Considered terrorist by several nations,⁷⁵ Hamas was elected to the government in Palestine and thereby gained a degree of legitimacy in some eyes.

In other cases, one arm of a terrorist group may be involved in humanitarian aid efforts while another arm conducts terrorist operations. Hamas may again serve as an example. Public Safety Canada's website provided the following information from Israeli intelligence officials about the alleged dual activities of Hamas:

In March 1996, Israeli intelligence officials estimated that roughly 95 per cent of the estimated \$70-million a year that it [Hamas] collected went into such charities as hospitals, clinics and schools, with only a small portion siphoned off to pay for weapons and military operations. While some funds supposedly raised for charity go directly to the military wing, some of the charity funds intended for activists, families, and institutions are "leaked" to the terrorist apparatus and are used for terrorist activities.⁷⁶

1.3.1.1 International Efforts to Develop a Universal Definition of "Terrorism"

The United Nations continues to struggle with defining terrorism. In 1996, UN General Assembly Resolution 51/210 established an ad hoc committee to negotiate, along with the UN Sixth (Legal) Committee, the *Draft Comprehensive*

⁷³ Passas Paper on Terrorism Financing, p. 21.

⁷⁴ The World Bank Guide to Anti-Money Laundering and Combating Terrorism Financing, p. I-4.

⁷⁵ Hamas, or Harakat Al-Muqawama Al-Islamiya, has been a "listed entity" in Canada since 2002: see Public Safety Canada, "Currently listed entities," online: Public Safety Canada <<http://www.publicsafety.gc.ca/prg/ns/le/cle-eng.aspx#hhi18>> (accessed February 11, 2009).

⁷⁶ Public Safety Canada, "Currently listed entities," online: Public Safety Canada <<http://www.publicsafety.gc.ca/prg/ns/le/cle-en.asp#hhi18>> (accessed July 28, 2008).

Convention on Terrorism.⁷⁷ That process is ongoing. DFAIT witness Keith Morrill testified that defining terrorism “has proved and will continue to prove, I think, extraordinarily difficult.”⁷⁸ In the end, there is no universally accepted definition, adding to the challenges of the international fight against both terrorism and TF.

In the meantime, the international community has been dealing with terrorism by using what Morrill described as a “piecemeal” approach.⁷⁹ The international community responds to very specific and defined actions when they occur and as they have impact on world affairs. Morrill further explained that, “[i]f you can’t get people to agree on what terrorism is, you can perhaps get them to agree that it is always wrong to blow up an aircraft.”⁸⁰ This latter approach to terrorism began with the 1963 *Convention on Offences and Certain Other Acts Committed on Board Aircraft* (the “Tokyo Convention”).⁸¹

As Morrill explained, the international community reacts to a situation by adopting an appropriate convention that can then be ratified by individual countries. These countries are then responsible for implementing the convention’s obligations in their domestic law.

Morrill testified that these conventions are not created in a vacuum. Canadian officials participate in their negotiation and are vocal about Canada’s views. The collective views of all participants ultimately form part of the conventions.⁸²

1.3.1.2 The Life Cycle of a Terrorist Organization

The structure and operations of terrorist organizations change over time. Understanding these changes is important because they may in turn lead

⁷⁷ For more information, see C.L. Lim, “The question of a generic definition of terrorism under general international law” in Victor V. Ramraj, Michael Hor and Kent Roach, eds., *Global Anti-Terrorism Law and Policy* (Cambridge: Cambridge University Press, 2005), p. 37; Antonio Maria Costa, “Drugs, Crime and Terrorist Financing: Breaking the Links,” Speech delivered at the Conference on Combating Terrorist Financing, Vienna, November 9, 2005, online: United Nations <<http://www.unodc.org/pdf/ED%20speech%20to%20OSCE.pdf>> (accessed February 24, 2009).

⁷⁸ Testimony of Keith Morrill, vol. 54, September 28, 2007, p. 6682.

⁷⁹ Testimony of Keith Morrill, vol. 54, September 28, 2007, p. 6684.

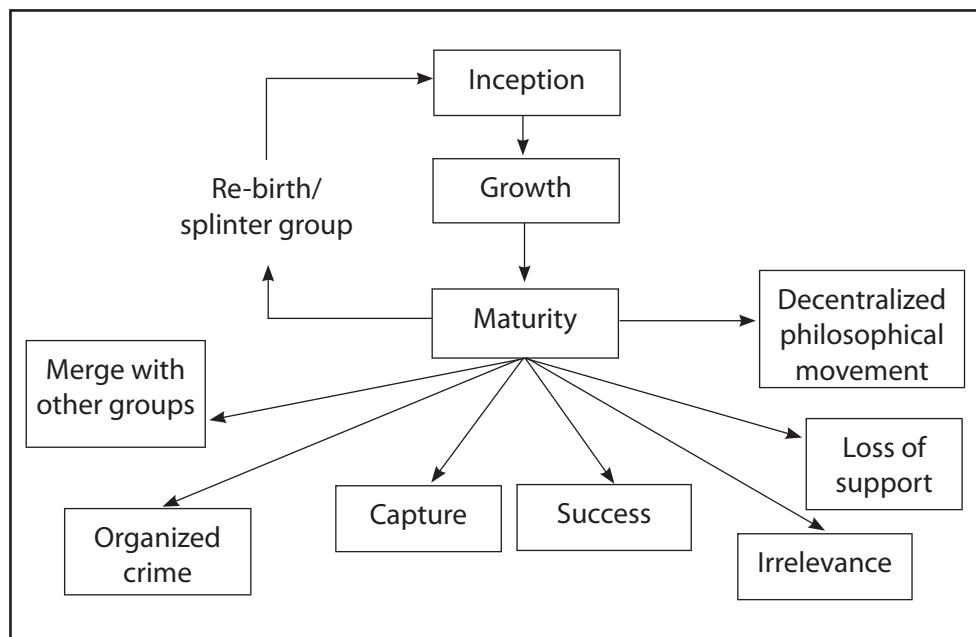
⁸⁰ Testimony of Keith Morrill, vol. 54, September 28, 2007, p. 6683.

⁸¹ See the United Nations Treaty Collection, Conventions on Terrorism, online: United Nations <<http://untreaty.un.org/English/Terrorism.asp>> (accessed February 24, 2009); Exhibit P-226, Tab 2: Presentation of Keith Morrill, September 27, 2007. Other such conventions include: *Convention for the Suppression of Unlawful Seizure of Aircraft* (1970); *Convention for the Suppression of Unlawful Acts against the Safety of Civil Aviation* (1971); *Convention on the Prevention and Punishment of Crimes against Internationally Protected Persons, including Diplomatic Agents* (1973); *International Convention against the Taking of Hostages* (1979); *Convention on the Physical Protection of Nuclear Material* (1980); *Protocol on the Suppression of Unlawful Acts of Violence at Airports Serving International Civil Aviation, supplementary to the Convention for the Suppression of Unlawful Acts against the Safety of Civil Aviation* (1988); *Convention for the Suppression of Unlawful Acts against the Safety of Maritime Navigation* (1988); *Protocol for the Suppression of Unlawful Acts against the Safety of Fixed Platforms Located on the Continental Shelf* (1988); *Convention on the Marking of Plastic Explosives for the Purpose of Detection* (1991); *International Convention for the Suppression of Terrorist Bombings* (1997); *International Convention for the Suppression of the Financing of Terrorism* (1999) and *International Convention for the Suppression of Acts of Nuclear Terrorism* (2005).

⁸² Testimony of Keith Morrill, vol. 54, September 28, 2007, p. 6746.

to changes in financing requirements and the methods used to raise and move funds. Law enforcement and security intelligence authorities need to understand where in its life cycle a given organization stands. For example, if a “mature” terrorist group is preparing an immediate attack, the authorities may, by monitoring the movement of funds, identify those who are likely to carry out the strike.

The stages in the life of a terrorist organization are shown in the following chart, and the main stages are described below.



1.3.1.2.1 Inception

In their initial stages, terrorist groups often have relatively few members. They may devote resources to raising their profile, possibly through violent acts and propaganda. Raising a group’s profile may in turn lead to an increase in resources.

This stage in which resources are still meagre may be the most vulnerable stage in the life of a terrorist organization. Professor Bruce Hoffman, a terrorism expert from Georgetown University in Washington, DC, cited an estimate that at least 90 per cent of all such organizations die out within a year.⁸³

⁸³ Bruce Hoffman, *Inside Terrorism*, revised and expanded edition (New York: Columbia University Press, 2006), p. 241 [Hoffman, *Inside Terrorism*].

1.3.1.2.2 Growth

During its growth phase, a terrorist group usually gains recruits and establishes a support base. This growth leads to the group's increased influence as it acquires financial and other resources. This in turn results in an increase in activities, often violent, which may yield a further increase in size and influence.

As Hoffman noted, "...a terrorist movement's longevity ultimately depends upon its ability to recruit new members as well as appeal to an expanding pool of both active supporters and passive sympathizers."⁸⁴

A tension exists between the size of an organization (and the corresponding influence it exerts) and its ability to maintain its own security. The larger it becomes, the more resources (human and material) it has at its disposal and the more influence it can exert through terrorist and other measures. However, the larger it becomes, the more difficulty it faces operating "underground," maintaining its own security and keeping its plans secret.

As a group grows, it may face challenges that require additional resources. These challenges commonly include the following:

- organizational challenges requiring a more formal structure for managing and coordinating the group's operational and support functions, while ensuring its own security;
- political challenges, such as the need to refine and clarify the group's objectives, beliefs and principles to maintain or increase support;
- identifying ever better targets for violent actions to maintain or increase the group's profile; and
- for those organizations initially supported by nation states, the need to identify new, more independent sources of financial support.

1.3.1.2.3 Maturity

A mature terrorist organization is well-established in terms of membership, support and objectives. It is concerned with maintaining the momentum for its cause and, in some cases, seeking out realistic options for achieving its goals.

After it reaches maturity, the evolution of a terrorist organization may proceed in one or more of several directions:

- Faced with dissatisfaction with the state of the organization (which may have become an inefficient and possibly corrupt bureaucracy),

⁸⁴ Hoffman, *Inside Terrorism*, p. 225.

or with its methods (which may have become less violent), smaller and more violent splinter groups may emerge;⁸⁵

- The organization may merge with, or establish a network of, affiliated terrorist organizations with similar or complementary objectives and aspirations;⁸⁶
- It may evolve into a criminal organization that is concerned only with the accumulation of wealth;⁸⁷
- Key members and resources, or both, may be captured or destroyed, effectively ending operations or returning the group to an earlier stage in the life cycle.⁸⁸
- The organization may lose support because its objectives become stale or its tactics alienate its core support groups (for example, by engaging in excessively violent actions);⁸⁹
- It may succeed in achieving its goals and gain legitimacy as a political party or even as the government; and
- It may become irrelevant if its objectives and environment change.⁹⁰

1.3.2 Kinds of Terrorist Groups

Professor Passas underlined the importance of understanding how terrorist groups operate in order to undermine their TF activities. Understanding the structure and organizational methods of a group will often provide direct insight into its fundraising mechanisms and make it more vulnerable to law enforcement and surveillance efforts.

Professor Passas identified three types of terrorist groups:

- Large and popular groups that control some geographical areas and engage in providing *de facto* government services,

⁸⁵ MIPT Terrorism Knowledge Base, "Group Profile: Real Irish Republican Army (RIRA)," online: <<http://www.tkb.org/Group.jsp?groupID=91>> (accessed February 14, 2007). See also MIPT Terrorism Knowledge Base, "Group Profile: Continuity Irish Republican Army (CIRA)," online: <<http://www.tkb.org/Group.jsp?groupID=37>> (accessed February 14, 2007).

⁸⁶ MIPT Terrorism Knowledge Base, "Group Profile: Bersatu," online: <<http://www.tkb.org/Group.jsp?groupID=3569>> (accessed February 14, 2007).

⁸⁷ MIPT Terrorism Knowledge Base, "Group Profile: Ulster Volunteer Force (UVF)," online: <<http://www.tkb.org/Group.jsp?groupID=124>> (accessed February 14, 2007).

⁸⁸ MIPT Terrorism Knowledge Base, "Group Profile: Babbar Khalsa International (BKI)," online: <<http://www.tkb.org/Group.jsp?groupID=4568>> (accessed February 14, 2007).

⁸⁹ Hoffman notes that "...[t]he more successful ethno-nationalist/separatist terrorist organization will be able to determine an effective level of violence that is at once 'tolerable' for the local populace, tacitly acceptable to international opinion, and sufficiently modulated not to provoke massive governmental crackdown and reaction... For some terrorists, however, the desire for action can lead to an obsession with violence itself." Hoffman, *Inside Terrorism*, pp. 233, 246.

⁹⁰ MIPT Terrorism Knowledge Base, "Group Profile: Contras," online: <<http://www.tkb.org/Group.jsp?groupID=250>> (accessed February 14, 2007). For more details on the decline of terrorist groups, see Steven Hutchinson and Pat O'Malley, "How Terrorist Groups Decline," ITAC Presents, Trends in Terrorism Series, Vol. 2007-1, online: Integrated Threat Assessment Centre <http://www.itac-ciem.gc.ca/pblctns/tc_prsnts/2007-1-eng.asp> (accessed February 24, 2009).

as well as militant activities (John Schmidt, a senior financial intelligence analyst seconded from FINTRAC to the Integrated Threat Assessment Centre (ITAC), referred to these as “large international hierarchical organizations⁹¹); Passas testified that current anti-TF regulatory programs appear most effective against this type of group;⁹²

- Small and isolated groups that act independently, even though they may be inspired by other groups (the fully autonomous “lone wolves,” as Schmidt described them⁹³); and
- Small groups operating on their own but interacting with wider networks.⁹⁴

In testimony, Schmidt added to these categories other groups or individuals whose role consists solely of funding and directing others to carry out terrorist acts as surrogates.⁹⁵

Many terrorist groups have a regional or local focus:

- The terrorist activities of the Euskadi Ta Askatasuna (ETA) are largely contained within Spain and France. ETA’s fundraising activities focus on the Basque population of the region, and tend to support criminal activities;⁹⁶
- The Liberation Tigers of Tamil Eelam (LTTE) are also regionally focused in that terrorist acts are directed at Sri Lanka and India.⁹⁷ Despite having only regional objectives, the LTTE raises funds abroad through Tamil communities in North America, Europe and Asia.⁹⁸

Other terrorist groups may have an international focus. Al-Qaida is the most notorious example:

Al-Qaeda acts in part to fend off perceived attacks on Muslims, to replace ‘un-Islamic regimes’ that oppress Muslim citizens with true Islamic governments, expel U.S. soldiers and Western influence from the Gulf and Iraq and to take control of Jerusalem as a Muslim city.⁹⁹

91 Testimony of John Schmidt, vol. 53, September 27, 2007, p. 6655.

92 Testimony of Nikos Passas, vol. 53, September 27, 2007, p. 6572.

93 Testimony of John Schmidt, vol. 53, September 27, 2007, p. 6655.

94 Passas Paper on Terrorism Financing, pp. 56-57.

95 Testimony of John Schmidt, vol. 53, September 27, 2007, p. 6655.

96 Loretta Napoleoni, *Terror Incorporated: Tracing the Dollars Behind the Terror Networks* (New York: Seven Stories Press, 2005), p. 38 [Napoleoni, *Terror Incorporated*]. ETA is a Basque nationalist and separatist organization, known also by its English name, “Basque Homeland and Freedom.”

97 Napoleoni, *Terror Incorporated*, p. 242.

98 This is the designation given to the LTTE by MIPT Terrorism Knowledge Base: MIPT Terrorism Knowledge Base, “Group Profile: Liberation Tigers of Tamil Eelam (LTTE),” online: <<http://www.tkb.org/Group.jsp?groupID=3623>> (accessed February 14, 2007).

99 MIPT Terrorism Knowledge Base, “Group Profile: Al-Qaeda,” online: <<http://www.tkb.org/Group.jsp?groupID=6>> (accessed February 14, 2007).

Al-Qaida operations are pursued internationally and so is its fundraising.¹⁰⁰ Other groups with international goals may have narrower objectives. Hamas, for example, is said to aim for broad social, moral and political reform based on Islamic principles, as well as to destroy Israel and create a Palestinian Islamic state.¹⁰¹

In general, groups with differing ideologies have differing objectives, targets and methods. As a result, the sources and uses of financing will also differ. Recognizing the differences among groups is important. An anti-TF measure that targets funds flowing to a large regional terrorist organization may not be successful with a smaller, isolated group. Still other measures may be needed to suppress the flow of funds to international terrorist networks.

1.3.3 Costs Flowing from Terrorism

Governments and terrorist groups each want to deprive the other of funds. Terrorists know that government money spent on anti-TF measures cannot be spent on other programs, while governments know that money seized from terrorist groups cannot be used for their organizational and operational needs.

Terrorist acts impose both direct and indirect costs on the general public:

- Direct costs include the loss of human life and health and the loss of physical capital due to the physical destructiveness of a terrorist attack;
- Indirect costs are those incurred by society as terrorist acts raise the level of fear in the population.

The cost of losing physical capital is relatively easy to estimate. That, however, is less true of other direct and indirect costs.

1.3.3.1 Direct Costs

The physical costs of many terrorist attacks are small relative to the value of national or local economies. For example, the cost when an aircraft is destroyed, while significant in absolute dollar terms, is small in terms of the overall economy of a country. The physical cost of the 9/11 attacks, including property damage and clean-up costs, is estimated at US\$21.8 billion,¹⁰² only a tiny proportion of the US Gross Domestic Product.

¹⁰⁰ This is the designation given to Al-Qaida by MIPT Terrorism Knowledge Base: MIPT Terrorism Knowledge Base, "Group Profile: Al-Qaeda," online: <<http://www.tkb.org/Group.jsp?groupID=6>> (accessed February 14, 2007).

¹⁰¹ MIPT Terrorism Knowledge Base, "Group Profile: Hamas," online: <<http://www.tkb.org/Group.jsp?groupID=49>> (accessed February 14, 2007).

¹⁰² William C. Thompson, Jr., Comptroller, City of New York, *One Year Later: The Fiscal Impact of 9/11 on New York City*, September 4, 2002, p. 2 [New York Comptroller Report on Fiscal Impact of 9/11].

The human cost is impossible to quantify. Even if it were possible, no figure would reflect the enormity of the trauma suffered by victims and their families. One option, looking at “human capital” very clinically, is to estimate the lost earnings of terrorist victims. The Comptroller for the City of New York estimated that the present value of the total loss in future earnings of those killed during the 9/11 terrorist attacks was about US\$8.7 billion.¹⁰³

In the Air India bombing, the value of the destroyed Air India aircraft was about US\$260 million. In addition, the loss of 329 individuals carried substantial financial consequences for their families. All this, it bears emphasizing, was dwarfed by the unquantifiable and devastating emotional trauma. As detailed in the Commission’s first report, there was “...an enormous loss of human potential” on June 23, 1985, and many most promising lives were extinguished in the bombing – “[p]arents and children, scholars, scientists, doctors, social workers, business people, artists, humanitarians and students...”¹⁰⁴ The victims included leaders in many fields.¹⁰⁵

Most terrorist attacks to date have inflicted smaller direct costs than did the 9/11 or Air India attacks.

1.3.3.2 Indirect Costs

Terrorist acts are often designed to intimidate and disrupt in a manner that makes the indirect costs far exceed the direct costs. Following a terrorist incident, citizens and governments, savaged by fear, take many actions to avoid a repetition. Both governments and the private sector will step up their counterterrorism efforts. Many individuals, seeking to avoid becoming victims, will change their behaviour in ways that carry costs both for them and for society. Examples include the following:

- because of fears about air travel, an individual might avoid travel by airplane, causing the longer travel times that other transportation modes require; might use more dangerous transport (automobiles, for example); or might forego travel altogether if a good substitute for air travel is not available;
- an individual might choose to locate business and personal activities in locations where terrorism is less likely, but where economic opportunities may also be less attractive; and
- some insurance costs might increase, and, if insurance coverage were reduced or denied for damage or death caused by terrorism, the individual might bear a greater level of risk.

¹⁰³ New York Comptroller Report on Fiscal Impact of 9/11, p. 1.

¹⁰⁴ Commission of Inquiry into the Investigation of the Bombing of Air India Flight 182, *The Families Remember* (Ottawa: Public Works and Government Services Canada, 2007), p. 9 [*The Families Remember*].

¹⁰⁵ *The Families Remember*, p. 49.

1.3.3.3 Costs of Counterterrorism Policies

1.3.3.3.1 Public Costs

Counterterrorism efforts by governments can be expensive, involving airport security and border control measures, the monitoring of the financial system, and even military operations. Apart from the benefits to security industries and to those employed by government to deal with terrorism issues, these efforts drain resources from economically productive activities.

Increased security expenditures by government may be one response to terrorism. However, terrorism may also create a political climate for governments to introduce intrusive and expensive security measures and surveillance that the public would not otherwise tolerate. In both cases, there is an increased cost to government and a redirection of limited government resources.

1.3.3.3.2 Private Costs

Examples of costs imposed on the private sector by counterterrorism policies include:

- direct financial costs borne by individuals and businesses to comply with enhanced counterterrorism laws and policies (such as the additional costs incurred by private sector financial institutions to comply with reporting requirements under the *PCMLTFA*);
- reduced economic activity caused by greater costs to individuals and businesses (such as higher taxes to support counterterrorism efforts); and
- the non-monetary cost of the loss of civil liberties and other freedoms because of counterterrorism laws and policies.

1.3.3.3.3 Economics of Terrorism and Terrorist Financing

Terrorist groups must be selective, choosing the attacks and other activities that will best help them reach their objectives. Financial constraints limit both the number and the type of terrorist acts that a group can carry out. In addition, financial constraints limit the supporting activities (such as propaganda, recruiting and fundraising) that a group can pursue.

A “substitution effect” occurs when the costs of terrorist activities change. In general, terrorist groups will limit costly activities and substitute activities that are less costly. For example, metal detectors began to be installed at airports in the 1970s. This did not deplete terrorist resources, but it did raise the cost of carrying out a successful “skyjacking.” As a result, terrorists moved away from skyjackings but increased the taking of hostages.¹⁰⁶

¹⁰⁶ Walter Enders and Todd Sandler, *The Political Economy of Terrorism* (New York: Cambridge University Press, 2006), pp. 127-128.

1.4 The Terrorist Financing Concept

1.4.1 The Extent of Terrorist Financing

Much terrorist activity, including TF, is covert. As a result, the value of the funds and property involved is difficult to estimate.¹⁰⁷ Differing definitions among countries of what constitutes terrorism and, by extension, what constitutes TF further complicate valuations.¹⁰⁸

No witness who appeared before this Commission felt it possible to estimate the dollar value of TF activity, whether in Canada or globally. In short, anti-TF measures must seek to contain an activity of unknown value.

In Canada, the sums identified in disclosures by FINTRAC to law enforcement agencies and CSIS are often used to estimate the value of funds involved in TF.¹⁰⁹ In 2006, FINTRAC reported \$256 million in disclosures related to *suspected* TF and other threats to the security of Canada.¹¹⁰ In 2007, the corresponding figure was \$208 million.¹¹¹ However, witnesses before the Commission raised doubts about using these figures as indicators of the value of TF in Canada. Mark Potter, Assistant Director for Government Relationships at FINTRAC, testified that, at best, these numbers provide raw intelligence that requires further analysis to make it useful.¹¹² RCMP Superintendent Rick Reynolds indicated that the amounts reported by FINTRAC as being connected to TF seemed high in light of the RCMP's own observations.¹¹³

Other jurisdictions have similar problems in determining the value of funds involved in TF.

1.4.2 Understanding the TF Process

The purposes for which terrorists use funds are commonly described as operational or organizational.¹¹⁴ Acts of terrorism themselves may cost relatively little, while maintaining the groups and networks behind those acts generally costs more.

¹⁰⁷ The World Bank Guide to Anti-Money Laundering and Combating Terrorism Financing, p. I-6; Testimony of Rick Reynolds, vol. 55, October 1, 2007, p. 6826.

¹⁰⁸ Martin Rudner, "Using Financial Intelligence Against the Funding of Terrorism" (2006) 19(1) *International Journal of Intelligence and Counterintelligence* 32 at 45 [Rudner Article on Using Financial Intelligence].

¹⁰⁹ A review of several media reports and analyses has shown that these numbers are often cited.

¹¹⁰ Financial Transactions and Reports Analysis Centre of Canada, *FINTRAC 2006 Annual Report*, p. 8, online: Financial Transactions and Reports Analysis Centre of Canada <<http://www.fintrac.gc.ca/publications/ar/2006/AR-eng.pdf>> (accessed February 12, 2009).

¹¹¹ Exhibit P-440, Tab 7: FINTRAC Response to Outstanding Questions related to Terrorist Financing, Question 2(e).

¹¹² Testimony of Mark Potter, vol. 56, October 2, 2007, pp. 6952-6953.

¹¹³ Testimony of Rick Reynolds, vol. 55, October 1, 2007, p. 6868.

¹¹⁴ See, for example, the FATF Report on Terrorist Financing.

1.4.2.1 Operational Funding

Operational funding usually includes the cost of an attack, salaries, communications, travel and training.¹¹⁵ All these expenditures relate to a specific terrorist operation. Professor Passas gave the Commission estimates of the operational costs of several terrorist attacks:

Operational Costs of Terror
Madrid 2004 bombings – about €15,000 (in addition to these operational costs, explosives were acquired in a barter deal for illicit drugs with a street value of about €35,000)
Bali nightclub bombings – about \$20,000
US embassy bombings in Kenya and Tanzania – about \$10,000
Attacks in Istanbul – less than \$40,000
9/11 attacks – about \$320,000 for 19 hijackers over about two years
Paris bombs – a few hundred euros
USS Cole 2000 attack in Aden – less than \$10,000
Bishopsgate IRA attack – £3000
London 2005 attacks – a few hundred British pounds Jakarta 2003 Marriott Hotel bombing – about \$30,000
Chechnya: \$4,000 to down the airplanes; \$7,000 for bomb attacks on Kashirskoye Highway and near metro station.
Nord-West operation in Beslan – \$9,500
Germany Planned 2006 train bomb attempt – less than €200 Cologne bomb – \$241
Air India bombings – \$3000 CAD
Planned Amman, Jordan chemical attack – \$170,000 ¹¹⁶

¹¹⁵ FATF Report on Terrorist Financing, pp. 7-8.

¹¹⁶ Passas Paper on Terrorism Financing, p. 55. Passas states the following as the sources for this information: "Personal interviews with investigators and prosecutors from the US, UK, France, Germany, Spain, Turkey, FBI; UN Monitoring Team reports; on Jordan: Air Security International; on Chechnya: Shamil Basaev statement; on US East Africa embassy and Bali bombings, 9/11 Commission Staff report: 27-28. It should be noted that an official inquiry into the London bombings in 2005 estimated the total cost of overseas and UK trips, bomb-making equipment, rent, car hire, to less than £8,000. This was funded through defaulted loans, account overdrafts and cheques that eventually bounced.": pp. 55-56. See also Testimony of Nikos Passas, vol. 53, September 27, 2007, p. 6610.

Passas testified about the difficulties in estimating the value of actual terrorist operations: "Everybody is going to have a different counting method and this is why we have a very wide range of estimates in all of these cases."¹¹⁷ However, it is striking that relatively small sums are needed to fund actual terrorist operations.

1.4.2.2 Organizational Funding

Terrorist groups need money for organizational matters such as recruitment, planning and infrastructure support.¹¹⁸ As noted, it is significantly more costly to support terrorist organizations and networks than to carry out terrorist acts.¹¹⁹

1.4.3 Terrorist Financing in Practice¹²⁰

Some methods of TF are widely used, while others are closely identified with specific groups.¹²¹ One TF method might be more suited to a particular group than to another, and one group may use several fundraising methods. The methods (though not the planned uses of the funds) may be legal¹²² or illegal.

One ITAC intelligence assessment stated, for example, that with Al-Qaida, "... [i]n the absence of a central command to allocate expenditure, the locally compartmentalized cells have increasingly resorted to raising funds through whatever local or regional means are available."¹²³

The reasons for forming a terrorist group, its location, its means, its members and its objectives all play a role in the way funds are raised and moved.¹²⁴ To combat TF, intelligence and law enforcement agencies must acquire an understanding of how these differences among terrorist groups influence their fundraising methods.

In his evidence before the Commission, Detective Inspector Paul Newham of the United Kingdom's National Terrorist Financial Investigations Unit discussed the variety of TF methods used in the UK: "Terrorist financing is quite a complex

¹¹⁷ See also Testimony of Nikos Passas, vol. 53, September 27, 2007, p. 6610.

¹¹⁸ Rudner Article on Using Financial Intelligence, p. 35.

¹¹⁹ See, for example, the FATF Report on Terrorist Financing, p. 10: "...[A]lthough individual terrorist attacks can yield great damage at low financial cost, a significant infrastructure (even if relatively loosely organised) is required to sustain international terrorist networks and promote their goals over time."

¹²⁰ For an in-depth analysis of the phenomenon, see Passas Paper on Terrorism Financing.

¹²¹ See Testimony of John Schmidt, vol. 53, September 27, 2007, pp. 6656-6657, for a general description of fundraising activities, both legitimate and illegitimate.

¹²² These may be "significant amounts": Passas Paper on Terrorism Financing, p. 34.

¹²³ Exhibit P-223, Tab 2: Integrated Threat Assessment Centre Intelligence Assessment, "Terrorist Financing: How it is Done, and How it is Countered," March 24, 2006, para. 2 [ITAC Intelligence Assessment on Terrorist Financing].

¹²⁴ The Passas Paper on Terrorism Financing offers a tentative general typology of why certain terrorists groups would choose one fundraising/transfer method over others at pp. 56-57. See also Testimony of Nikos Passas, vol. 53, September 27, 2007, p. 6567.

picture [in the United Kingdom]. It varies regionally. It varies from organization to organization in terms of terrorist groupings. So there is no one single method of terrorist financing."¹²⁵

John Schmidt from ITAC also spoke about the variety of TF methods: "...[T]errorist activities can range from being highly specific, planned and organized to being essentially random and opportunistic and these differences result in different resourcing needs, capabilities and mechanisms."¹²⁶ He said that TF methods were constantly evolving.¹²⁷ Professor Passas wrote about the variety of fundraising methods: "One aspect of terrorist finance is clear and undisputed: there is a wide range of fund-raising methods and sources, some of which are particular to specific groups or contexts, while others are quite common across the board."¹²⁸

One ITAC intelligence assessment spoke of the "...great variety of relatively anonymous methods for raising and moving money" and stated that "...terrorists have proven resilient in circumventing restrictions and shifting their reliance among the many conventional and unconventional financial transaction options."¹²⁹

However, Passas warned that "...trivialized conclusions to the effect that 'everything funds terrorism' and 'all channels are used for fund transfers' ... would not be particularly helpful to strategic planning, prioritization and focus of limited resources."¹³⁰

Those involved in TF go to great lengths to avoid detection by the authorities. Professor Passas testified that UK police had discovered a manual attributed to Al-Qaida. The manual discussed the following:

...how to not put all their eggs in the same basket; to have operational funds in multiple places; not tell other members of the group where the funds are; take precautions when carrying amounts of money; to keep it at lower amounts; and also, using non-members for the facilitation of their transactions.¹³¹

¹²⁵ Testimony of Paul Newham, vol. 58, October 4, 2007, pp. 7227-7228.

¹²⁶ Testimony of John Schmidt, vol. 53, September 27, 2007, p. 6655.

¹²⁷ Testimony of John Schmidt, vol. 53, September 27, 2007, p. 6655.

¹²⁸ Passas Paper on Terrorism Financing, p. 30. See also Testimony of Nikos Passas, vol. 53, September 27, 2007, pp. 6564-6565.

¹²⁹ ITAC Intelligence Assessment on Terrorist Financing, para. 1. This document encompasses the kind of work ITAC does, but it is not an example of a standard threat assessment. The document attempts to give an overview, which John Schmidt qualifies as "good." The document and model are exceptions to the work of ITAC because they focus on methodology instead of a specific threat: Testimony of John Schmidt, vol. 53, September 27, 2007, pp. 6646-6648.

¹³⁰ Passas Paper on Terrorism Financing, p. 23.

¹³¹ Testimony of Nikos Passas, vol. 53, September 27, 2007, p. 6578.

1.4.3.1 Raising Funds

1.4.3.1.1 State Support

A Department of Finance Memorandum of Evidence on Terrorist Financing provided to the Commission explained that there are two primary sources of funding: state sponsors and “revenue-generating” activities. The Memorandum placed wealthy donors in the same category as state sponsors.¹³² Revenue-generating activities may involve legal or illegal sources.

State support for terrorism is not new. During the Cold War, for example, superpowers sponsored militant groups around the globe.¹³³ Examples include state support for extremist Irish, Palestinian, Central and South American, Angolan and South African groups.¹³⁴

Even after the Cold War, state sponsorship continued, though in a different context and for different purposes. The U.S. Department of State currently designates the following countries as sponsors of terrorism: Cuba, Iran, Sudan and Syria.¹³⁵ Professor Passas identified Hamas, Hezbollah, Hizbul Mujahideen, the Islamic Militant Union (IMU), Islamic Jihad, Lashkar e Taiba (LeT), Jaish-e-Mohammad (JeM) and Sipah-e-Sahiba (SSP) as among the groups sponsored by states.¹³⁶

Professor Hoffman argued that direct state sponsorship of terrorism is used by some countries “...as a deliberate instrument of foreign policy: a cost-effective means of waging war covertly, through the use of surrogate warriors or ‘guns for hire’ – terrorists.”¹³⁷

However, dependence on states for funding also means that such groups may become beholden to the wishes of those states. As a result, some terrorist groups try to reduce their dependence on state sponsorship. Beginning in the early 1960s, the Palestine Liberation Organization (PLO) took steps to become independent of state sponsorship, especially that of Egypt and Syria. The PLO feared that the flow of funds depended on the perceived usefulness of the group to the domestic politics of the sponsoring states.¹³⁸

Professor Passas wrote that state sponsorship may include “turning of blind eyes” to questionable activities rather than providing direct state funding.¹³⁹ This might mean a loose application by states of rules governing financial transactions or charitable organizations. Such states are referred to in this volume as the “weak links” in the anti-TF process.

¹³² Department of Finance Memorandum of Evidence on Terrorist Financing, para. 2.2.

¹³³ Passas Paper on Terrorism Financing, p. 31.

¹³⁴ Passas Paper on Terrorism Financing, p. 31.

¹³⁵ Office of the Coordinator for Counterterrorism, “State Sponsors of Terrorism,” online: U.S. Department of State <<http://www.state.gov/s/ct/c14151.htm>> (accessed February 12, 2009).

¹³⁶ Passas Paper on Terrorism Financing, p. 31.

¹³⁷ Hoffman, *Inside Terrorism*, p. 258.

¹³⁸ Napoleoni, *Terror Incorporated*, p. 45.

¹³⁹ Passas Paper on Terrorism Financing, p. 19.

Besides the desire of some terrorist groups to end reliance on state support, international pressures may have played a role in the decline of state sponsorship.¹⁴⁰ As state sponsorship diminishes, terrorist groups must find other ways to raise funds. Still, state sponsorship remains an important component of TF. Passas noted that "...[e]ven though virtually everyone agrees that state sponsorship is in decline, the phenomenon has not disappeared."¹⁴¹

1.4.3.1.2 "Legitimate" Sources of Funds

Employment and Business Income

One relatively simple way to raise money for terrorism purposes is to use money gained by legitimate means.¹⁴² The owner of a legal business could use its profits to subsidize terrorist activities. The profits would be legitimate, but giving them to a terrorist group would violate the *Criminal Code*. In other cases, a terrorist organization itself controls a business. It can both use the profits and rely on any "synergy" between the business and the objectives of the organization, as in the following situations:

- The business provides goods or services that the terrorist organization can use in its own operations; or
- The business provides goods or services that a community needs but cannot otherwise obtain, generating goodwill among the community members whose support the terrorist organization is seeking.

In his report, Professor Passas stated that the most resilient and well-organized groups were diversifying into legitimate businesses. These included the Abu Nidal Organisation, LeT, LTTE, the Fuerzas Armadas Revolucionarias de Colombia (FARC), Hezbollah, the Irish Republican Army (IRA) and Jemaah Islamiya.¹⁴³

One oft-cited, but controversial, example of a legitimate business that was reportedly controlled by a terrorist entity and that may have financed terrorism is the Gum Arabic Company Ltd. Napoleoni wrote that Usama bin Laden had acquired the company and that it had a near monopoly in the Arabic gum market.¹⁴⁴ The controversy arises about whether the company was actually used to finance terrorist activity. The U.S. 9/11 Commission, for example, concluded that Al Qaida did not benefit from businesses belonging to bin Laden or from his personal fortune.¹⁴⁵ Whether or not the business was used to fund terrorist activity, the Gum Arabic Company stands as a possible example of how a legitimate business could be controlled by a terrorist organization and used to facilitate TF.

¹⁴⁰ FATF Report on Terrorist Financing, p. 15.

¹⁴¹ Passas Paper on Terrorism Financing, p. 31.

¹⁴² Testimony of Nikos Passas, vol. 53, September 27, 2007, p. 6564.

¹⁴³ Passas Paper on Terrorism Financing, p. 34.

¹⁴⁴ See, for example, Napoleoni, *Terror Incorporated*, p. 167.

¹⁴⁵ National Commission Monograph on Terrorist Financing, pp. 17, 20.

Self-funding through a business or the personal finances of members of an organization is ideal for financing smaller attacks,¹⁴⁶ and where the group's operating costs are not great.

Charitable Organizations¹⁴⁷

The 2006 ITAC Intelligence Assessment, *Terrorist Financing: How it is Done, and How it is Countered*, states that "...[c]harities constitute, wittingly or not, a significant source of financing."¹⁴⁸ Professor Passas wrote that "...[w]ith respect to charities, a distinction can be drawn between those that have had their funds unknowingly diverted and those that have been corrupted and act as fronts."¹⁴⁹ The funds provided to charities by well-meaning contributors can be diverted "on the ground."¹⁵⁰ As Professor Rudner, Professor Emeritus and distinguished research professor at Carleton University, wrote, "...[e]xtremist clerics, corrupt officials, and well-placed facilitators have functioned as critical enablers for that redirection of funds from religious institutions and humanitarian organizations to terrorist activities and operations."¹⁵¹ In some cases individuals knowingly contribute to charities that are "fronts" for terrorist organizations.

The FATF noted that, because of the large volume of funds and assets handled by the charitable sector, even a small part of those funds ending up in terrorist hands would pose a serious problem.¹⁵²

An extensive discussion of the role of charities in TF, and particularly the role of Canadian charities, appears in Chapter VI.

1.4.3.1.3 Illegal Sources of Funds

The relationship between terrorism and other types of crimes is complex.¹⁵³ Criminal activity can provide funds for terrorist groups, although criminals may not work in the same ways as terrorist groups to raise funds. Professor Passas noted that "...criminal groups for-profit have very different motives and often

¹⁴⁶ FATF Report on Terrorist Financing, p. 14.

¹⁴⁷ See also Testimony of Nikos Passas, vol. 53, September 27, 2007, pp. 6578-6588.

¹⁴⁸ ITAC Intelligence Assessment on Terrorist Financing, para. 5.

¹⁴⁹ Passas Paper on Terrorism Financing, p. 34. For examples of fronts, see Rudner Article on Using Financial Intelligence, p. 44.

¹⁵⁰ Testimony of Nikos Passas, vol. 53, September 27, 2007, p. 6565.

¹⁵¹ Rudner Article on Using Financial Intelligence, p. 44.

¹⁵² FATF Report on Terrorist Financing, p. 25.

¹⁵³ See passages in the Passas Paper on Terrorism Financing, pp. 35-42; Testimony of Nikos Passas, vol. 53, September 27, 2007, pp. 6565-6666; Yvon Dandurand and Vivienne Chin, "Links Between Terrorism and Other Forms of Crime" (2004), Report to Foreign Affairs Canada and The United Nations Office on Drugs and Crime, online: International Centre for Criminal Law Reform and Criminal Justice Policy <http://www.icclr.law.ubc.ca/Publications/Reports/TNOC_LINKS_STUDY_REPORT.pdf> (accessed February 24, 2009); and Pat O'Malley and Steven Hutchinson, "Actual and Potential Links Between Terrorism and Criminality," ITAC Presents, Trends in Terrorism Series, Vol. 2006-5, online: Integrated Threat Assessment Centre <http://www.itac-ciem.gc.ca/pblctns/tc_prsnts/2006-5-eng.asp> (accessed February 24, 2009) [O'Malley and Hutchinson Article on Links Between Terrorism and Criminality], among many others.

different methods, different objectives, than militant ideologically motivated groups.”¹⁵⁴ As a result, security intelligence and law enforcement authorities must be alert to numerous criminal fundraising options when developing anti-TF measures.

An ITAC intelligence assessment described the shift towards criminal activity to provide TF:

As a result of the crackdown on charities and front companies, some experts believe terrorist reliance on illegal money has increased exponentially....Criminal activity associated with terrorists includes the drug trade, smuggling of weapons and other goods, fraud, kidnapping, extortion, credit card and bank account fraud and manipulation, and simple robbery.¹⁵⁵

The range of criminal activity that can be used to raise funds is broad. Passas identified robberies, extortion, kidnapping, hijacking, informal taxation of both legal and criminal enterprises, blackmail, protection rackets, fraud, counterfeiting, drug trafficking and smuggling.¹⁵⁶ The FATF noted that some terrorist groups might move from one type of criminal activity to another as the situation requires.¹⁵⁷

The extortion of members of expatriate communities is an oft-used and effective TF technique, especially where there are substantial expatriate communities originating from current or former conflict zones. The extortion may involve the unofficial “taxation” of the legitimate earnings, savings or businesses of community members.¹⁵⁸ They often cooperate out of fear of retribution against themselves or their families in Canada or abroad.¹⁵⁹

In Canada, two groups have been exposed for their alleged extortion – the LTTE and the World Tamil Movement (WTM). Both target the sizeable Tamil community in Canada. One RCMP affidavit in a case involving the LTTE stated that its investigation of the LTTE revealed that the World Tamil Movement and the LTTE “...have been demonstrated to utilize pressure tactics to elicit

¹⁵⁴ Testimony of Nikos Passas, vol. 53, September 27, 2007, p. 6565.

¹⁵⁵ ITAC Intelligence Assessment on Terrorist Financing, para. 11. The ITAC document also discusses the North Carolina case and similar examples in Europe at paras. 12-13.

¹⁵⁶ Passas Paper on Terrorism Financing, pp. 35-36; Testimony of Nikos Passas, vol. 53, September 27, 2007, p. 6565.

¹⁵⁷ FATF Report on Terrorist Financing, p. 19.

¹⁵⁸ FATF Report on Terrorist Financing, p. 18.

¹⁵⁹ FATF Report on Terrorist Financing, p. 18.

funds and donations as well as to participate in veiled threats.”¹⁶⁰ The same affidavit presented many examples of alleged TF activities, and stated that “[f]undraising activities were being conducted aggressively by WTM members in the Montreal area. The WTM members were visiting families and businesses in the Tamil community, demanding amounts which ranged from \$2500 to \$30,000.”¹⁶¹

The profit generated by criminal activity can be much greater than that of legitimate businesses. This is because criminal activity typically involves either appropriation from others or the enormous profits that criminals make in illicit (“black”) markets, such as those created by drug prohibition, excessive or differential tax rates on alcohol and tobacco, high import duties and other trade barriers.¹⁶² In a black market, criminal organizations, often using physical intimidation, can assert monopoly control, charging exorbitant prices and bringing in correspondingly large profits.

Smuggling and selling contraband on the black market is not restricted to developing countries. The trade in illegal drugs is one example of an illegal market that thrives even in wealthy countries. Hezbollah is known to have benefited from smuggling cigarettes between North Carolina and Michigan, exploiting the differences in sales taxes between the two states.¹⁶³

Because of the black market created by their prohibition, illegal drugs are a major source of income for some terrorist and insurgent groups. Law enforcement and security intelligence authorities have observed a recurring link between drugs and terrorism.¹⁶⁴ The 9/11 Commission’s monograph on TF stated that drugs were an important source of income for the Taliban. However, the Commission found no substantial evidence of links, before or after 9/11, between Al-Qaida and the drug trade.¹⁶⁵

¹⁶⁰ Affidavit of Shirley Davermann, April 1, 2008, para. 3 [Affidavit of Shirley Davermann]. The LTTE also apparently benefited from pre-authorized payment plans. For an interesting read on the LTTE in Canada (and other groups), see Stewart Bell, *Cold Terror: How Canada Nurtures and Exports Terrorism Around the World* (John Wiley & Sons Canada, Ltd., 2007). Bell quotes a leading world expert on the LTTE as stating that Canada is the bank of the LTTE. Bell also notes estimates that the LTTE was raising millions of dollars per year in Canada: pp. 49-50. He gives examples of alleged trade-business fraud and fraud companies (p. 68), false charitable donations (p. 66), collection jars and the sale of paraphernalia (pp. 52-65) and government grants (pp. 59-61). Furthermore, according to Bell, one reason for the significant LTTE presence in Canada is the relative speed with which the organization was designated in the U.S. (in contrast to Canada): p. 79.

¹⁶¹ Affidavit of Shirley Davermann, para. 239.

¹⁶² Napoleoni, *Terror Incorporated*, p. 202.

¹⁶³ For more information, see O’Malley and Hutchinson Article on Links Between Terrorism and Criminality, p. 4.

¹⁶⁴ FATF Report on Terrorist Financing, p. 15. In his paper, Passas warned the Commission that links between drugs and terrorism should not be made too hastily: “Even though such links are not surprising, it must be impressed that there are very good reasons why any alliances between terrorists and drug traffickers *cannot* last for very long, due to fundamental incompatibilities of objectives and outlook as well as attitudes toward the State.”: Passas Paper on Terrorism Financing, p. 38.

¹⁶⁵ National Commission Monograph on Terrorist Financing, pp. 22-23.

1.4.3.1.4 Other Sources of Funds

Professor Rudner observed that "...[m]ilitant groups have also raised substantial funds through the sale of inspirational tracts, advocacy literature, audio cassettes, videos and CDs, and other iconic paraphernalia."¹⁶⁶ Some sales would be legitimate, but others could be illegal, such as sales of material promoting hatred.

1.4.3.2 Movement of Funds

Raising funds is the first major component of TF. The second is moving the funds after they are raised. Funds may need to leave Canada to fund a terrorist attack or terrorist organization abroad, or they may be sent to Canada to fund an organization or attack here. Because funds may be more "exposed" while they are being moved, authorities can sometimes use these movements to help identify terrorists and TF. FINTRAC and most of the world's FIUs are set up mainly to detect movements of money through reports of suspicious transactions. FINTRAC receives such reports as well as information about other financial transactions, including international wire transfers. The fundraising mechanisms themselves, rather than movements of funds, are easier to combat through CSIS or RCMP operations or, in the case of charities, through monitoring by the CRA.

In his paper, Passas argued that "...one can hardly find a method that has not been used by one group or another to make payments or transfer funds and value."¹⁶⁷ In his testimony, he added that "...the range...is only limited by your imagination."¹⁶⁸ The FATF reached a similar conclusion: "[E]xperience suggests that *all* of the mechanisms that exist to move money around the globe are to some extent at risk" of being used for TF.¹⁶⁹

A terrorist group involved in "self-funding" through a business or through the personal finances of its members might not have to move the funds, making it much easier to avoid notice by agencies such as FINTRAC and the entities that report to it.

1.4.3.2.1 Traditional Banking and Financial Systems

Terrorist groups, like most organizations, use formal banking and financial systems in Canada and abroad to transfer and store money. They may hold accounts in the names of individuals, businesses, charities and other entities. In addition, terrorist groups may use traditional fund transfer methods such as cheques and electronic funds (wire) transfers. They may also use money laundering methods to disguise the source and intended use of funds, including the following:

¹⁶⁶ Martin Rudner, "Building Canada's Counter-Terrorism Capacity: A Proactive All-of-Government Approach to Intelligence-Led Counter-Terrorism" in Vol. 1 of Research Studies: Threat Assessment RCMP/CSIS Co-operation, p. 120 [Rudner Paper on Building Counter-Terrorism Capacity].

¹⁶⁷ Passas Paper on Terrorism Financing, p. 42.

¹⁶⁸ Testimony of Nikos Passas, vol. 53, September 27, 2007, p. 6566.

¹⁶⁹ FATF Report on Terrorist Financing, p. 21.

- opening numerous banking accounts containing relatively small amounts, to create complex paper trails;
- using “front” businesses to reintegrate funds into the financial system and make the funds appear to have come from legitimate sources; and
- placing funds in off-shore tax havens.

In Western countries, financial systems are well developed and involve extensive electronic records. However, most accounts held with banks in these countries and the transactions which terrorist organizations conduct through them are sufficiently small that it is extremely difficult, if not impossible, for authorities to distinguish these transactions from ordinary banking activity.¹⁷⁰

The funds needed to support terrorist groups and acts amount to only a tiny fraction of the hundreds of millions of dollars of transactions processed by the Canadian banking system daily, and the billions processed in the United States. Because transactions linked to terrorism do not have unique characteristics that allow them to be singled out by electronic searches or the monitoring of transaction records, it is impossible to identify all flows of funds that could relate to terrorism.

Financial institutions also have little incentive to monitor flows of funds relating to terrorism, unless obliged by law to do so. However, most financial institutions in developed countries likely see value in being good corporate citizens and would not want to be seen as facilitating or being complicit in TF. However, would-be good corporate citizens face a cost disincentive since they must bear the full cost of their monitoring systems.

1.4.3.2 Informal and Unregulated Channels for Moving Funds

The focus of anti-TF measures on the conventional banking system may have led terrorist financiers to shift to methods of moving funds that are more difficult for authorities to monitor. A 2006 ITAC intelligence assessment observed that, “...[d]eprived of safe access to conventional banking, terrorists have turned to harder-to-detect remittance methods, such as hawalas and couriers.”¹⁷¹

Much has been said and written about the use of informal channels to move terrorist funds, especially hawala,¹⁷² an informal value transfer system (IVTS). Through international migration and the Internet, hawala has spread around

¹⁷⁰ See, for example, Ilias Bantekas, “The International Law of Terrorist Financing” (2003) 97(2) *American Journal of International Law* 315.

¹⁷¹ ITAC Intelligence Assessment on Terrorist Financing, para. 16.

¹⁷² For a history and explanation of hawala, see Nikos Passas, “Demystifying Hawala: A Look Into Its Social Organisation and Mechanics” (2006) 7(1) *Journal of Scandinavian Studies in Criminology and Crime Prevention* 46 [Passas Article on Hawala]; Passas Paper on Terrorism Financing, pp. 44-45; Testimony of Nikos Passas, vol. 53, September 27, 2007, pp. 6589-6599. INTERPOL also describes hawala on its website, online: <<http://www.interpol.int/Public/FinancialCrime/MoneyLaundering/hawala/default.asp>> (accessed February 24, 2009).

the world, although it is most popular in the Middle East and Asia and within immigrant communities in the West.

At a minimum, hawala involves a remitter, a recipient and two hawala operators, one working in each country with the remitter and recipient respectively. Hawala has two main elements: 1) the sending and receiving of money (this involves a hawala operator (*hawaladar*) and the client), and 2) the settlement process (this involves intermediaries and agents who play a role in the transaction). According to Passas, the first element is relatively straightforward, while the settlement process can be much more complex.¹⁷³

In 2006, the Canadian Centre for Intelligence and Security Studies described a transfer of funds using hawala as follows:

Hawala transfers money from one country to another without actually moving it, and the system is based on trust, to move funds and settle accounts with almost no paper trail. The transfer takes place as follows. Person A from country X wants to send money to person B in country Y. Person A gives the money to a broker (*Hawaladar*) in country X, who charges her a relatively low fee together with a more favorable exchange rate than what is offered by the bank. The broker then contacts another broker in country Y by phone, fax or email, who gives the money to person B based on a prearranged code word or number. To settle accounts with each other, the broker in country X can either reduce the debt owed by her to the broker in country Y, or else, expect a remittance from the latter.¹⁷⁴

In his paper, Passas identified several other informal value transfer systems:

Hawala, Hundi, Black market peso exchange networks, Fei chien (door-to-door and other Asian varieties), Invoice manipulation schemes, In-kind transfers, Trade diversion schemes, Courier services and physical transfer methods, Corresponding banking accounts, Charities, Gift and money transfer services overseas via special vouchers and internet web sites, Digital/Internet based transfers, Stored value (such as pre-paid telephone cards) and finally, Debit and credit cards used by multiple individuals.¹⁷⁵

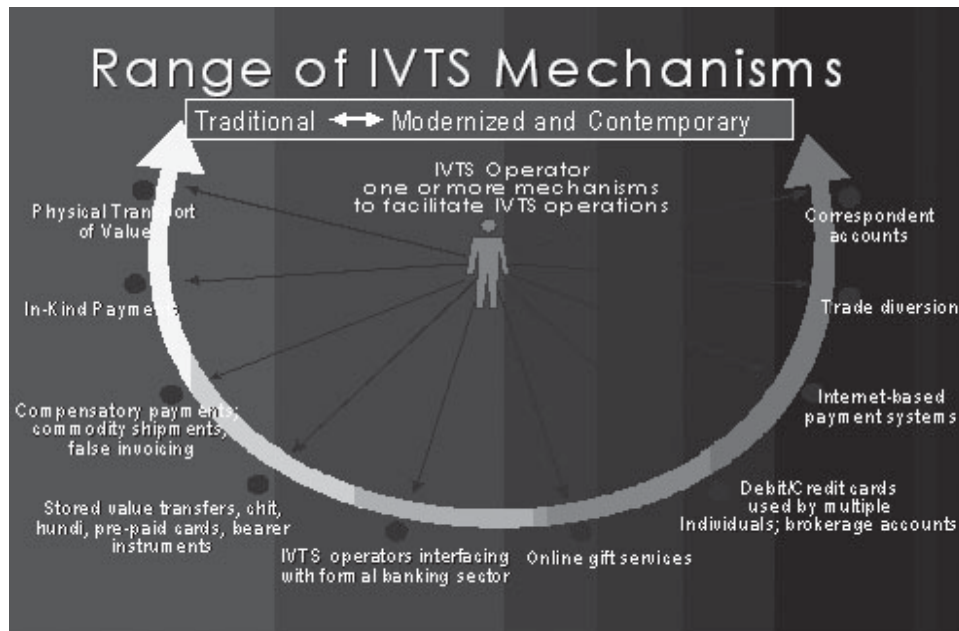
¹⁷³ Passas Article on Hawala, p. 50; Testimony of Nikos Passas, vol. 53, September 27, 2007, pp. 6589-6599.

¹⁷⁴ Canadian Centre for Intelligence and Security Studies, "Terrorism Financing and Financial System Vulnerabilities: Issues and Challenges," Vol. 2006-3, pp. 7-8, online: Integrated Threat Assessment Centre <http://www.itac-ciem.gc.ca/pblctns/tc_prsnts/2006-3-eng.pdf> (accessed February 12, 2009) [CCISS Paper on Terrorism Financing].

¹⁷⁵ Passas Paper on Terrorism Financing, p. 43. As can be seen from the list, Passas believed that using charities, for example, to move money is an informal channel.

There may be other, lesser known, informal transfer methods, and additional methods will emerge over time.

The chart below illustrates numerous types of informal value transfer mechanisms, ranging from physical transport using couriers to more sophisticated means that include brokerage accounts and Internet payment systems.¹⁷⁶



Source: Passas Paper on Terrorism Financing, p. 43.

Passas stated in his paper for the Commission that informal value transfer systems, especially hawala, became the target of aggressive policy-making "... after the word was uttered during a US Congressional hearing suggesting that this was the preferred method for al Qaeda and similar Islamist groups."¹⁷⁷ The international community views IVTS as a weakness in global anti-TF efforts. As well, these systems are not always fully understood by Western government authorities.¹⁷⁸ In addition, some see IVTS as a vulnerable point in anti-TF efforts because they believe that the systems leave a less substantial paper trail than formal transfer mechanisms. However, in his testimony, Passas criticized the "absence of paper trail" argument, at least as it related to hawala, stating that it was a "...myth that [hawala] is something without trails." He gave several examples of the types of records that hawala produces. He added, "...instead of talking about paperless [transactions], lack of trail and so on, sometimes there's just too much of it."¹⁷⁹

¹⁷⁶ Passas Paper on Terrorism Financing, p. 43.

¹⁷⁷ Passas Paper on Terrorism Financing, p. 44.

¹⁷⁸ See CCISS Paper on Terrorism Financing, p. 7.

¹⁷⁹ Testimony of Nikos Passas, vol. 53, September 27, 2007, pp. 6591-6594.

The FATF responded to concerns about the use of IVTS in its Special Recommendation VI:

Each country should take measures to ensure that persons or legal entities, including agents, that provide a service for the transmission of money or value, including transmission through an informal money or value transfer system or network, should be licensed or registered and subject to all the FATF Recommendations that apply to banks and non-bank financial institutions. Each country should ensure that persons or legal entities that carry out this service illegally are subject to administrative, civil or criminal sanctions.

Passas warned the Commission to be cautious about demonizing some mechanisms, especially hawala. He stated that "...there are very legitimate reasons why this [hawala] is happening." Pointing during his testimony to a graphic photo of desolation to show that, in some places "...there is no ATM machine," he added, "...[i]f we misapply financial controls and take out useful services to these regions, they are the victims of misapplied law enforcement actions – innocent people who rely on Hawala in order to get the means of survival for them today."¹⁸⁰

Professor Rudner also acknowledged that a system such as hawala might be used to move money for TF. However, he also cautioned against disproportionate concern about hawala:

Although terrorism finance may in fact flow through informal value-transfer systems, little evidence suggests that traditional hawala-type mechanisms represent terrorists' preferred vehicle for financial transfers, or that these informal systems are more prone to terrorist exploitation than the formal, regulated financial sector.¹⁸¹

Hawala and other informal value transfer systems can be used for TF. However, they are not instruments of TF *per se* – an important distinction. In the end, hawala is simply one of many ways to move money for TF.¹⁸² As Passas testified, "It is...recognized widely that the overwhelming majority of Hawala customers are legitimate people sending honestly earned money overseas. But it is also confirmed that it is subject to abuse just as is any other financial institution you can think of."¹⁸³

¹⁸⁰ Testimony of Nikos Passas, vol. 53, September 27, 2007, p. 6660.

¹⁸¹ Rudner Article on Using Financial Intelligence, p. 46. Rudner cited a report from the Netherlands Ministry of Justice Research and Document Centre that came to the same conclusion.

¹⁸² Testimony of Nikos Passas, vol. 53, September 27, 2007, p. 6609.

¹⁸³ Testimony of Nikos Passas, vol. 53, September 27, 2007, p. 6609.

1.4.3.2.3 Couriers

FATF Special Recommendation IX calls for countries to have measures in place "...to detect the physical cross-border transportation of currency and bearer negotiable instruments, including a declaration system or other disclosure obligation." The FATF noted that the movement of cash across borders is prevalent and that couriers were one means of doing this.¹⁸⁴ Couriers might be more expensive than ordinary wire transfers, but less likely to leave an audit trail.¹⁸⁵

A 2006 ITAC intelligence assessment reported that since 9/11 "...major terrorist cash transfers are also done by trusted couriers or, for added security, by the main operatives themselves."¹⁸⁶

1.4.3.2.4 Trade Diversion

Passas identified commercial trade transactions as being vulnerable to TF and money laundering.¹⁸⁷

Literally volumes can be written about the vulnerabilities to abuse of trade transactions, which constitute a weak link (possibly the weakest and riskiest link) in AML/CFT [anti-money laundering/countering the financing of terrorism] efforts and other regulatory regimes....¹⁸⁸

With trillions of dollars changing hands worldwide daily, it is almost impossible to escape the conclusion that trade transactions provide a "sea of possibilities" for TF.¹⁸⁹

John Schmidt of ITAC agreed with the concerns of Passas about the trade sector.¹⁹⁰ The FATF recently observed that the trade sector is vulnerable¹⁹¹ (and published a 40-page paper on the subject in 2006¹⁹²), but it has not made specific recommendations relating to trade transactions. However, the international community has addressed some aspects of the trade issue, such as trading in diamonds produced in conflict zones ("conflict diamonds").¹⁹³

¹⁸⁴ FATF Report on Terrorist Financing, p. 23.

¹⁸⁵ FATF Report on Terrorist Financing, p. 24.

¹⁸⁶ ITAC Intelligence Assessment on Terrorist Financing, para. 18. Passas reached a similar conclusion: Passas Paper on Terrorism Financing, p. 45.

¹⁸⁷ For a general study of the commercial trade area as it relates to TF, see Testimony of Nikos Passas, vol. 53, September 27, 2007, pp. 6614-6622.

¹⁸⁸ Passas Paper on Terrorism Financing, p. 46.

¹⁸⁹ Testimony of Nikos Passas, vol. 53, September 27, 2007, p. 6614.

¹⁹⁰ Testimony of John Schmidt, vol. 53, September 27, 2007, p. 6658.

¹⁹¹ FATF Report on Terrorist Financing, p. 23.

¹⁹² Financial Action Task Force, *Trade Based Money Laundering*, June 23, 2006, online: Financial Action Task Force <<http://www.fatf-gafi.org/dataoecd/60/25/37038272.pdf>> (accessed February 12, 2009).

¹⁹³ Passas also testified that the gold trade has been used to support terrorism in Colombia. For more information on gold and the conflict diamonds as they concern TF, see Testimony of Nikos Passas, vol. 53, September 27, 2007, pp. 6614-6618.

1.4.3.3 Terrorist Financing “Typologies” (Trends and Methods)

The methods and trends associated with a given phenomenon are known as “typologies.”¹⁹⁴ Typologies can help officials to understand a phenomenon and develop better responses to it.

Several international organizations have identified typologies in money laundering and TF matters. The FATF considers developing typologies a key component of its work and has published several documents showing the typologies of money laundering and TF cases.¹⁹⁵ A quick review of these documents shows that the FATF focuses primarily on money laundering, but recognizes that there is some similarity between TF and money laundering typologies. Several FIUs throughout the world, including FINTRAC, provide typologies to the FATF.

Several of the TF typologies published by the FATF are set out below.

Case study: Diversion of funds from legitimate business

The personal bank account of Person A (a restaurant manager) regularly received cheques drawn from wooden pallet Company B, as well as significant cash deposits. The account did not show any “normal” financial activity such as payment for food, travel, etc. The bank account of Company B also showed significant cash withdrawals of between EUR 500000 and EUR 1 million.

The bank where A’s account was held became suspicious because of the inconsistency between Person A’s profession and the nature of Company B’s business and submitted a suspicious transaction report to the financial intelligence unit. FIU analysis revealed that the individuals concerned were linked to Salafist movements, and the case was referred to prosecutors for wider investigation.

Source: France

¹⁹⁴ Financial Action Task Force, *Money Laundering & Terrorist Financing Typologies 2004-2005*, June 10, 2005, p. 1, online: Financial Action Task Force <<http://www.fatf-gafi.org/dataoecd/16/8/35003256.pdf>> (accessed February 17, 2009) [FATF 2004-05 Typologies].

¹⁹⁵ FATF 2004-05 Typologies, p. 1.

Case study: Small, self-funding network plans attack

In July 2006, rail employees found two unattended suitcases on two German regional trains. Improvised explosive and incendiary devices were discovered in each suitcase consisting of a propane tank, an alarm clock as a timer, batteries for energy supply, various detonating agents as well as a plastic bottle filled with petrol. The instructions for building an explosive device were taken from an al-Qaeda-linked website, with components purchased in ordinary shops, costing no more than EUR 250.

No suspicious funding from abroad was required, and the suspect's primary source of funding during this period was from family members to pay for his education. The only transactions that appear to have been linked to the planned attack were for plastic bottles, which when filled with petrol and linked to propane tanks would have made an improvised explosive device.

Source: Germany

Case study: Terrorist organisation extorts money from drug traffickers

An investigation and prosecution carried out by Turkish authorities revealed that drug trafficking is the principal source of funds for a terrorist organisation. Drugs are grown in Pakistan, Afghanistan and Iran; and sent from there to Europe, both through known members of the organisation, and through their associates and other non-designated militants.

In 2007, more than 10 members of the organisation terrorist group were arrested and large amounts of money seized. Investigation and testimony by these members revealed that the organisation extorts money from smugglers at points of entry in the North of Iraq in the form of "taxes" worth around 7% of the value of smuggled items. The groups also collect money for each person or each car crossing their 'customs points.' One such "customs point" earns USD 20,000 - 30 000 per week. One member of the group stated that the most important income for the group is the money collected from drug traffickers as 'taxation'.

Source: Turkey

Case study: Extortion of a commercial organisation

In September 2007, Company C was sentenced to pay a USD 25 million criminal fine, placed on five years of corporate probation and ordered to implement and maintain an effective compliance and ethics program. Earlier in the year, Company C pleaded guilty to one count of engaging in transactions with a Specially Designated Global Terrorist (SDGT) in that, from 1997 through 2004, the company made payments to a terrorist group. The payments, demanded by the group, were made nearly every month and totalled over USD 1.7 million. The group was designated as a Foreign Terrorist Organisation in September 2001, and listed as an SDGT in October 2001.

Source: United States

Case Study: Terrorist organization uses MVT mechanisms to move money

Person D, a leader of a terrorist organization based in Country C and once a resident in Country A, was in hiding in Country B. The FIU in Country A found out through investigations that persons in Country A were sending money through money transfers to D's friends in Country B to financially support him. The money flow was detected because the transfers were made by nationals of Country C — which was unusual in Country A. Person D was later arrested in Country B on suspicion of terrorism. Money transfers from Country A to Country B were presented in court as supporting evidence of terrorist financing.

Source: The Netherlands

The Egmont Group of Financial Intelligence Units (Egmont Group) has published a review of 100 "sanitized" cases relating to money laundering.¹⁹⁶ Relatively few deal with TF.¹⁹⁷

1.4.3.3.1 The "Terrorism Operational Cycle"

In his testimony and in a related paper, Professor Rudner described his model of a "terrorism operational cycle." He developed the model by looking at case studies of terrorism and "...breaking terrorism down into its functional and enabling activities."

¹⁹⁶ The Egmont Group, *FIU's in action: 100 cases from the Egmont Group*, online: The Egmont Group <http://www.egmontgroup.org/files/library_sanitized_cases/100casesgb.pdf> (accessed February 12, 2009).

¹⁹⁷ These can be accessed online: The Egmont Group <http://www.egmontgroup.org/library_sanitized_cases.html> (accessed February 12, 2009).

Rudner identified 11 stages of the cycle. Each stage consisted of a set of activities which enabled terrorism to proceed.¹⁹⁸ Rudner testified that the model could apply to any terrorist phenomenon.¹⁹⁹

Rudner described the 11 stages of the cycle as follows:²⁰⁰

- strategic planning;
- recruitment;
- training;
- communication;
- financing;
- procurement;
- infrastructure;
- tactical preparations;
- propaganda;
- reconnaissance; and
- terrorist assaults.²⁰¹

It appears that money plays a role in most, if not all, of the 11 stages of the cycle, not merely in the “financing” and “procurement” stages. Rudner considered the financing and procurement stages as among the most sensitive in a democratic context because of the intrusive legal measures usually required to investigate the activities involved.²⁰²

1.4.3.3.2 The Schmidt “Terrorist Resourcing Model”

John Schmidt of ITAC testified about a model he had developed of the TF process – the “Terrorist Resourcing Model.”²⁰³ Schmidt started developing the model while at FINTRAC, and eventually enhanced it with information gathered after he was seconded to ITAC.²⁰⁴ It appears to be the only model of its kind,²⁰⁵ and has been well received by both domestic and international partners.²⁰⁶ Professor Rudner’s model of a “terrorism operational cycle,” discussed above, breaks “terrorism” into its functional and enabling activities, including financing and procurement; the Schmidt model focuses solely on TF.

¹⁹⁸ Testimony of Martin Rudner, vol. 92, December 10, 2007, p. 12211.

¹⁹⁹ Testimony of Martin Rudner, vol. 92, December 10, 2007, pp. 12211-12240.

²⁰⁰ Rudner Paper on Building Counter-Terrorism Capacity, pp. 114-125. Rudner’s testimony and paper differ slightly in the description of the stages. The Commission is using the description of the stages from his testimony.

²⁰¹ In his paper, Rudner uses the term “penetrating sensitive government departments, agencies and institutions” as the 9th of 12 steps.

²⁰² Testimony of Martin Rudner, vol. 92, December 10, 2007, pp. 12232-12233.

²⁰³ The model was first explained to Commission counsel when Schmidt presented it at a seminar on TF issues in Montreal.

²⁰⁴ Testimony of John Schmidt, vol. 53, September 27, 2007, p. 6651.

²⁰⁵ Testimony of John Schmidt, vol. 53, September 27, 2007, pp. 6661-6662.

²⁰⁶ Testimony of John Schmidt, vol. 53, September 27, 2007, p. 6663.

Schmidt named his model the “Terrorist Resourcing Model” rather than the “Terrorist Financing Model” because, in his view, TF does not necessarily involve money. It can consist of an exchange of goods and, even if money is used, it may not reach the operating cell if it is exchanged before then for goods.²⁰⁷

Both classified and open-source information were used to build Schmidt’s model, and it was reviewed by several experts before its description was published.²⁰⁸ One goal of the model is to inform those working on TF matters,²⁰⁹ and it may also help to identify gaps in efforts to counter TF.²¹⁰ ITAC and FINTRAC are cooperating to find ways to test the model.²¹¹

The model identifies five stages of TF. The stages need not always occur in the same order and may not be present in every case. They are summarized below:²¹²

First Stage: Acquisition

Acquisition activities are fundraising activities. Acquisition can also consist of the direct contribution or receipt of goods or services – for example, weapons, vehicles, explosives or food.

Second Stage: Aggregation

This stage consists of pooling resources, either in a few financial institutions (for money) or in a few physical locations (for goods). In some cases, the aggregation stage is bypassed completely.

Third Stage: Transmission to a Terrorist Organization

Here, the funds or goods are moved. Schmidt testified that this stage often involves at least one international movement of the funds or goods. The movement might occur in several steps.

Fourth Stage: Transmission to a Terrorist Cell (Allocation or Disaggregation)

The terrorist organization allocates funds or goods to the appropriate cell in charge of a given activity. In the model, “activity” means much more than attacks, and includes matters such as direct support, propaganda, intelligence gathering, recruitment and radicalization. If funds are allocated rather than converted into goods, this will be the last stage of the process.

²⁰⁷ Testimony of John Schmidt, vol. 53, September 27, 2007, p. 6654. For consistency, this chapter continues to use the term “terrorist financing.”

²⁰⁸ Testimony of John Schmidt, vol. 53, September 27, 2007, p. 6651.

²⁰⁹ Testimony of John Schmidt, vol. 53, September 27, 2007, pp. 6651-6652.

²¹⁰ Testimony of John Schmidt, vol. 53, September 27, 2007, p. 6652.

²¹¹ Testimony of John Schmidt, vol. 53, September 27, 2007, p. 6661.

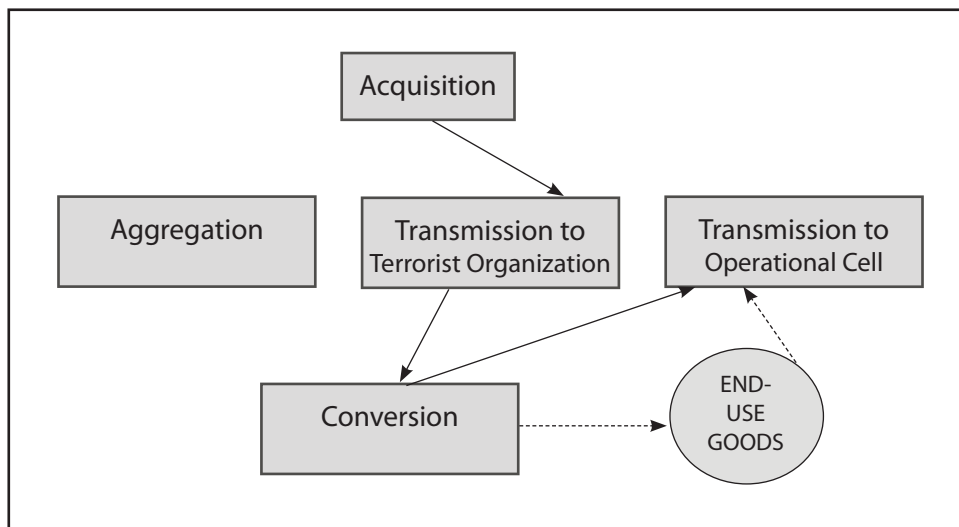
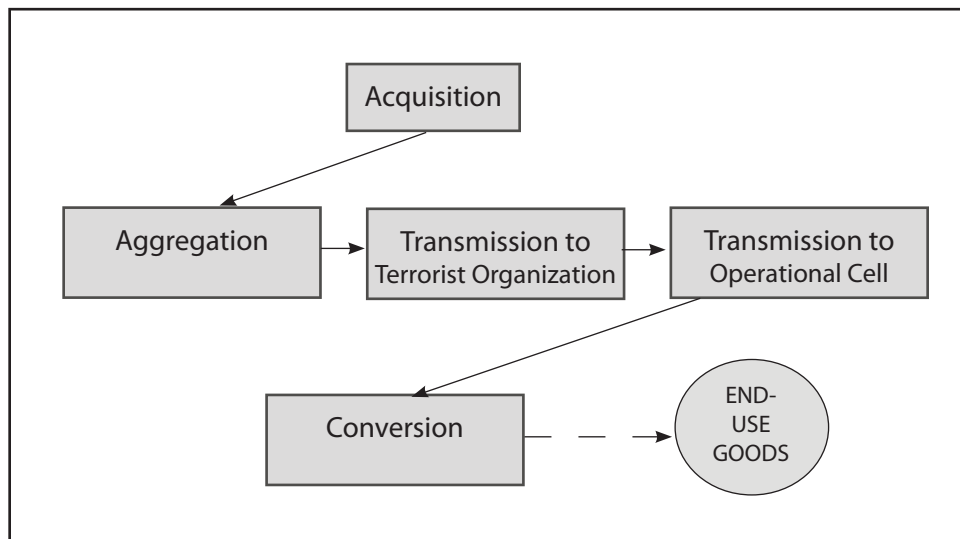
²¹² Testimony of John Schmidt, vol. 53, September 27, 2007, pp. 6657-6659.

Fifth Stage: Conversion

This stage consists of exchanging funds or goods for end-use goods. For example, money may be used to buy a vehicle.²¹³

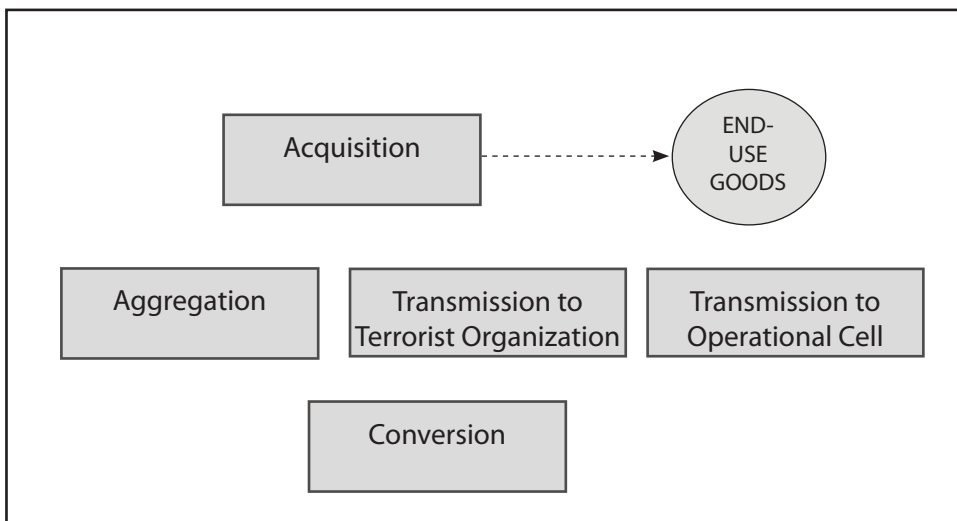
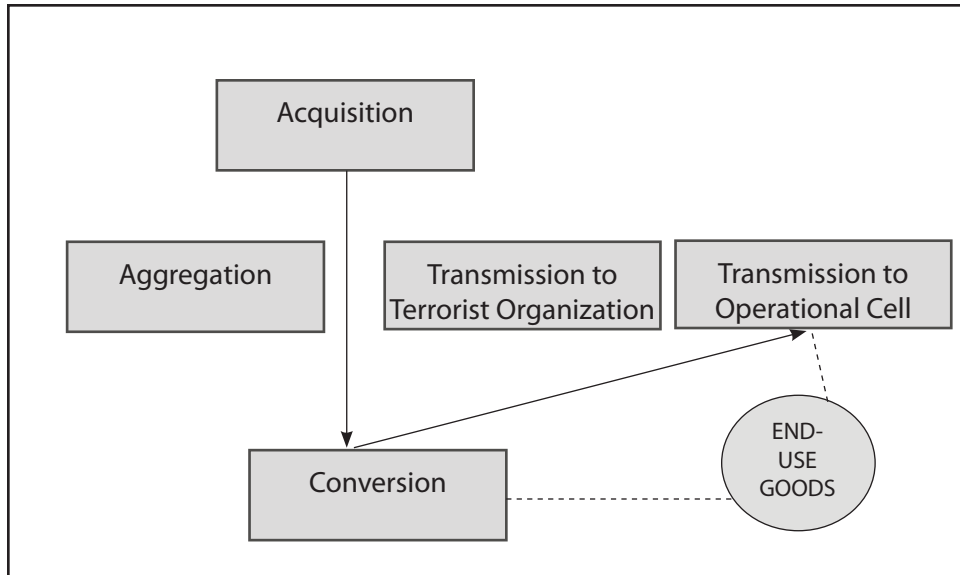
1.4.3.3 Possible Sequences in the Terrorist Financing Process

The order of the stages in Schmidt's model may vary and some stages may also be omitted. Below are examples of possible variations.²¹⁴



²¹³ Testimony of John Schmidt, vol. 53, September 27, 2007, pp. 6657-6659.

²¹⁴ Exhibit P-223, Tab 4: John Schmidt, "A Terrorist Financing/Resourcing Model," August 2007, pp. 18-21 [Schmidt Terrorist Financing Model].



1.4.3.3.4 Similarities between the Rudner and Schmidt Models

In Professor Rudner’s model of a “terrorism operational cycle,” which involved eleven stages, the fifth stage was “financing.”²¹⁵ Financing involved the following:

²¹⁵ Testimony of Martin Rudner, vol. 92, December 10, 2007, pp. 12211-12212.

- raising funds;
- remitting them to a safe place; and
- transferring them to their final destination.²¹⁶

Rudner and Schmidt described the TF process in similar ways. Rudner spoke of raising funds, remitting them to a safe place and transferring them to their destination. Schmidt spoke of acquisition, aggregation and transmission.

1.4.3.4 Relationship between Terrorist Financing and Money Laundering

Up to this point, this chapter has discussed two models of how TF works in practice. It is also useful to understand the relationship between TF and money laundering to determine whether the techniques used to combat money laundering are suitable for pursuing TF.

1.4.3.4.1 Historically

The concept of money laundering was first introduced into the international community in the *United Nations Convention against Illicit Traffic in Narcotic Drugs and Psychotropic Substances, 1988*.²¹⁷ The Convention required parties to establish criminal offences relating to money laundering.

Immediately after 9/11, countries called for measures to fight TF. In an effort to respond quickly, the money laundering model was chosen.²¹⁸

UN Security Council Resolution 1373 (2001) spoke of a connection between international terrorism and money laundering:

[The Security Council] [n]otes with concern the close connection between *international terrorism* and transnational organized crime, illicit drugs, *money-laundering*, illegal arms-trafficking, and illegal movement of nuclear, chemical, biological and other potentially deadly materials, and in this regard *emphasizes* the need to enhance coordination of efforts on national, subregional, regional and international levels in order to strengthen a global response to this serious challenge and threat to international security."²¹⁹ [Emphasis added.]

Similarly, a 2006 ITAC intelligence assessment stated that "...[m]ost of the methods used by terrorist groups to 'process' their funds (that is, move them from the source to where they will be used) have also long been used by non-terrorist criminal groups to launder funds."²²⁰

²¹⁶ Testimony of Martin Rudner, vol. 92, December 10, 2007, p. 12229.

²¹⁷ Testimony of Keith Morrill, vol. 54, September 28, 2007, p. 6686.

²¹⁸ Testimony of Nikos Passas, vol. 53, September 27, 2007, pp. 6568-6569.

²¹⁹ S. 4, online: United Nations <<http://daccessdds.un.org/doc/UNDOC/GEN/N01/557/43/PDF/N0155743.pdf?OpenElement>> (accessed February 13, 2009).

²²⁰ ITAC Intelligence Assessment on Terrorist Financing, para. 4.

The same international body, the FATF, oversees both anti-money laundering and anti-TF efforts. In October 2001, the FATF added special recommendations about TF to its existing recommendations about money laundering.²²¹

As well, some of the techniques used to deter and detect money laundering operations (for example, those described in the FATF Forty Recommendations) have been applied by entities obliged to report to FINTRAC to combat TF.

The Department of Finance Memorandum of Evidence on Terrorist Financing states that, "...[t]o the extent that funds for financing terrorism are derived from illegal sources, the same anti-money laundering techniques and legal framework used to combat the financing of organized crime can be used to combat terrorist financing."²²² Professor Passas also testified that anti-money laundering methods can be effective in countering TF.²²³ In addition, several officials and experts concluded that money can eventually be laundered in the TF process and that there is a convergence between the two activities.²²⁴

1.4.3.4.2 Differences between Money Laundering and Terrorist Financing

The main objectives of money laundering and TF differ. Money laundering generally involves organized criminal groups trying to disguise the origins of money obtained through crime.²²⁵ The goal is to have the money appear "clean" so that it can be spent in the legal economy without drawing suspicion towards those spending it. In contrast, TF is not necessarily about laundering "dirty" money so that it can be spent in the legal economy.

Schmidt testified that money laundering and TF do "intersect" on many occasions and share many of the same techniques, but that TF is not the same as money laundering. As a result, the money laundering model does not effectively represent the TF process.²²⁶

TF may involve a complex web of activities that differ significantly from those used to launder money. Schmidt stated that, unlike TF, which generally occurs in five stages, money laundering occurs in three main stages – placement, layering

221 The FATF's Nine Special Recommendations on TF must be read in conjuncture with The Forty Recommendations to adequately understand the whole regime: "The revised Forty Recommendations now apply not only to money laundering but also to terrorist financing, and when combined with the Eight [now Nine] Special Recommendations, they provide a set of enhanced measures that will help countries to prevent terrorism.": Financial Action Task Force on Money Laundering, Annual Report 2002-2003, June 20, 2003, para. 20, online: Financial Action Task Force <<http://www.fatf-gafi.org/dataoecd/13/0/34328221.pdf>> (accessed February 18, 2009). See also Koh, *Suppressing Terrorist Financing and Money Laundering*, p. 125.

222 Department of Finance Memorandum of Evidence on Terrorist Financing, para. 2.3.

223 Testimony of Nikos Passas, vol. 53, September 27, 2007, p. 6575.

224 Testimony of John Schmidt, vol. 53, September 27, 2007, p. 6654; Schmidt Terrorist Financing Model; Testimony of Mark Potter, vol. 56, October 2, 2007, p. 7008; Department of Finance Memorandum of Evidence on Terrorist Financing, para. 2.5; Testimony of Nikos Passas, vol. 53, September 27, 2007, p. 6574.

225 Testimony of Keith Morrill, vol. 54, September 28, 2007, pp. 6685-6687.

226 Testimony of John Schmidt, vol. 53, September 27, 2007, p. 6653.

and integration. The placement stage is basically the movement of funds (the proceeds of crime) into banking or related systems. The layering stage is the “cover” stage, where the individual or organization tries to move the proceeds of crime, in whatever form they take at that point, to distance the funds from their origins. This second stage is often characterized by numerous movements of the funds. The third stage, integration, occurs when the funds are integrated into the legitimate marketplace.²²⁷

The money laundering model puts great emphasis on the “placement” stage (the movement of criminal proceeds into the financial system),²²⁸ which is not the case in most TF activities, where the focus is more on how funds are transmitted to terrorists.

Detective Inspector Paul Newham, Deputy Head of the National Terrorist Financial Investigations Unit of the Metropolitan Police Service in the UK, testified that the TF and money laundering phenomena were very different in several ways:²²⁹

With money laundering, you have a crime and then you have the proceeds of that crime flowing through a variety of sophisticated mechanisms. The situation you’ve described as placement, layering and then integration within the financial system to actually launder the money.

In terms of terrorist financing, there is no predicate offence. This is – often there is no criminal money. It can be legitimate donations.

Another distinction would be that in money laundering, you see large vast sums of money being moved in a variety of ways. In terms of terrorist financing, we see [in most cases] very small amounts or relatively small amounts compared to money laundering.

So, in essence, the distinction with money laundering is we have a post-criminal act. In terms of terrorist financing, we have money, either a mixture of donations or potential low-level frauds, being used for an intended terrorist activity in the future which, again, brings its own problems when it comes to the actual prosecution of terrorist financing.²³⁰

227 Testimony of John Schmidt, vol. 53, September 27, 2007, p. 6652.

228 Testimony of John Schmidt, vol. 53, September 27, 2007, p. 6653.

229 Testimony of Paul Newham, vol. 58, October 4, 2007, p. 7232.

230 Testimony of Paul Newham, vol. 58, October 4, 2007, p. 7232.

As well, in money laundering operations, the money is “in hand” whereas in TF, the money must first be acquired.²³¹

Keith Morrill of DFAIT stated that “...the impetus of the money laundering approach internationally” was recognition of the “huge” amounts of money involved.²³² Money laundering has been identified in Canada alone as “a multi-billion dollar problem.”²³³ The large sums known to be involved in money laundering cases – for example, laundering the proceeds of drug crimes – dwarf the amounts involved in financing even major terrorist attacks or in sustaining operating cells, or even larger organizations, such as Al Qaida. Techniques that might help to identify money laundering, such as a focus on cash transactions over \$10,000, might completely miss many transactions related to TF.

1.4.4 The Need for an Anti-Terrorist Financing Program in Canada

Professor Passas asked this important question in his testimony:

...[C]an terrorist finance be stopped? And it is more or less a rhetorical question. Unless you seriously disrupt legitimate trade or you have a police state, you can't do it.²³⁴

Like the crimes of murder or fraud, TF cannot be completely eradicated. RCMP Superintendent Reynolds testified, however, that authorities can try to make it more difficult.²³⁵

The alleged cost of the actual bombing of Air India flight 182 was under \$10,000.²³⁶ That excludes the cost of maintaining the organization and individuals involved in its planning and execution. Money was likely not a factor in the decision to proceed with the bombing. Still, several reasons have been advanced for Canada to have an anti-TF program.

1.4.4.1 The Reality of Terrorism

Canadians have their own interests at stake in international efforts to combat terrorism and terrorism financing.²³⁷ In addition, as Keith Morrill of DFAIT testified, the international community would not go through the difficult process of adopting treaties and resolutions if an issue were not sufficiently serious.²³⁸

²³¹ Schmidt Terrorist Financing Model, p. 7.

²³² Testimony of Keith Morrill, vol. 54, September 28, 2007, p. 6690.

²³³ *Royal Canadian Mounted Police Departmental Performance Report for the period ending March 31, 2007*, p. 76, online: Treasury Board of Canada Secretariat <<http://www.tbs-sct.gc.ca/dpr-rmr/2006-2007/inst/rcm/rcm-eng.pdf>> (accessed May 13, 2009).

²³⁴ Testimony of Nikos Passas, vol. 53, September 27, 2007, p. 6567.

²³⁵ Testimony of Rick Reynolds, vol. 55, October 1, 2007, p. 6878.

²³⁶ Passas Paper on Terrorism Financing, p. 55.

²³⁷ Keith Morrill of DFAIT appeared to hold a similar view: Testimony of Keith Morrill, vol. 54, September 28, 2007, p. 6681.

²³⁸ Testimony of Keith Morrill, vol. 54, September 28, 2007, p. 6719.

RCMP Superintendent Reynolds testified that Canada had long been considered fertile ground for TF and for the procurement of terrorism-related materials, but it was not seen as a country from which terrorist attacks themselves were being launched. However, the situation has evolved.²³⁹ Canada is not immune to direct terrorist attacks, and terrorist groups operate in Canada.²⁴⁰

The RCMP Departmental Performance Report for the period ending March 31, 2006 noted that, "...[i]f the RCMP is unable to address terrorist financing issues in an appropriate manner, Canadians and our allies would be in an environment of elevated risk."²⁴¹ Terrorist financiers could focus on Canada as an operating base, which could undermine the integrity of Canada's financial system²⁴² and its reputation abroad.²⁴³ Failure to pursue TF might also put members of some communities at greater risk of being exploited.

1.4.4.2 Canada's International Obligations

Morrill testified that Canada has now signed several international instruments aimed at combatting TF, and that it must follow through domestically and internationally on its commitments.²⁴⁴ Like many other countries, Canada is bound by UN Security Council Resolutions 1373 and 1267 and by the *International Convention for the Suppression of the Financing of Terrorism*. Morrill stated that Canada takes its international obligations "very, very seriously."²⁴⁵

Canada also is under strong pressure to honour the FATF Recommendations.²⁴⁶ As a founding member, Canada committed itself to their implementation.²⁴⁷ As well, Recommendation 26 requires member states to have a functioning FIU, and Special Recommendations I and II require ratifying and implementing the Convention and criminalizing TF.

Countries that do not follow the "40+9" Recommendations face the real possibility of being blacklisted by the FATF.²⁴⁸ Until recently, the FATF maintained a list of countries identified as Non-Cooperative Countries and Territories (NCCT). In 2006, the FATF introduced a new surveillance process – the International Co-

239 Testimony of Rick Reynolds, vol. 55, October 1, 2007, pp. 6826-6827.

240 Testimony of Rick Reynolds, vol. 55, October 1, 2007, pp. 6828-6829.

241 *Royal Canadian Mounted Police Departmental Performance Report for the period ending March 31, 2006*, p. 62, online: Treasury Board of Canada Secretariat <<http://www.tbs-sct.gc.ca/dpr-rmr/2005-2006/rcmp-grc/rcmp-grc-eng.pdf>> (accessed May 13, 2009) [2005-06 RCMP Departmental Performance Report].

242 Testimony of Diane Lafleur, vol. 54, September 28, 2007, p. 6773; 2005-06 RCMP Departmental Performance Report, p. 62.

243 One can imagine the outcry if a terrorist attack occurring elsewhere were financed from Canada while Canada had failed to put TF measures in place. Keith Morrill believed Canada would hear criticism from the international community if it were not meeting its commitments in this regard: Testimony of Keith Morrill, vol. 54, September 28, 2007, p. 6721.

244 Testimony of Keith Morrill, vol. 54, September 28, 2007, pp. 6697-6698.

245 Testimony of Keith Morrill, vol. 54, September 28, 2007, p. 6711.

246 Testimony of Keith Morrill, vol. 54, September 28, 2007, pp. 6701-6702.

247 Testimony of Diane Lafleur, vol. 54, September 28, 2007, p. 6767.

248 Testimony of Diane Lafleur, vol. 54, September 28, 2007, p. 6774.

operation Review Group – “to identify, examine and engage with vulnerable jurisdictions that are failing to implement effective AML/CFT systems.”²⁴⁹

1.4.4.3 Role of Anti-Terrorist Financing Efforts in Combatting Terrorism

John Schmidt of ITAC testified that financial intelligence was a useful component of the fight against terrorism as a whole: “[T]he financial intelligence can and does go a long way to help identify criminal or terrorist networks and relationships and is very important in the overall process...[U]nderstanding terrorist resourcing goes a long way to helping us understand, anticipate, the overall terrorist activity; how they work together, how their networks operate and...the [change] that is going on in the nature of many terrorist organizations and their activities.”²⁵⁰

Financial intelligence can often help law enforcement and related agencies understand the networks and relationships much better than can other sources of information.²⁵¹ Terrorism financing prosecutions have the potential to disrupt groups that may be accumulating funds for terrorist purposes but have not yet decided to commit any terrorist act.

In his testimony, Passas gave several reasons why financial controls were a vital part of all counterterrorism efforts:

- If the would-be terrorists have less money, the harm might be reduced. Passas cited the example of those involved in the first World Trade Centre attacks who complained that they didn’t have more than \$19,000 to pack explosives into the rental truck that they exploded in the parking garage: “They didn’t have more money so when you limit the resources the harm is reduced”;
- The intelligence that can be gathered in anti-TF operations is essential to make links and reconstruct events: “Monitoring what the militant groups are doing is much more important than seizing and freezing their assets”; and
- If terrorists believe that they are being tracked, it forces them to “... speak to each other, to communicate, to change methods, to move things around, to move to low-tech hand-carried kinds of options, and that generates additional intelligence-gathering opportunities.”²⁵²

Passas warned, however, that controls may produce negative results. Among his examples were the following:

²⁴⁹ FATF Revised Mandate 2008-2012, para. 8.

²⁵⁰ Testimony of John Schmidt, vol. 53, September 27, 2007, pp. 6660-6662.

²⁵¹ Testimony of John Schmidt, vol. 53, September 27, 2007, pp. 6663-6664.

²⁵² Testimony of Nikos Passas, vol. 53, September 27, 2007, p. 6623.

- The controls may drive terrorists networks underground and create organizations that are more difficult to monitor and detect;
- Innocent parties could suffer “significant collateral damage”;
- Legitimate trade could be disrupted;
- Ethnic groups that otherwise would serve as allies in counterterrorism matters might be alienated; and
- Other countries that are forced to implement measures that they do not support may simply pass laws that are not enforced. This “window dressing” would give the appearance of progress even though none was occurring.²⁵³

Detective Inspector Newham of the Metropolitan Police Service in the UK estimated in his testimony that there was more information and intelligence on individuals within the financial systems of developed Western economies than in any other database.²⁵⁴ He spoke of the value of this information:

It’s one of the tools where we can quickly locate individuals; we can quickly identify trouble patterns; we can identify spending, procurement activity associations, and we use a number of covert and overt techniques to actually model behaviours of individuals and what connectivity they have, again, abroad.²⁵⁵

1.5 Conclusion

It is impossible to obtain a clear picture of the extent of TF. It is clear, however, that the TF phenomenon is complex. TF can take on innumerable forms²⁵⁶ and can span many borders.

Several witnesses spoke of the importance in combatting terrorism of the financial intelligence acquired through anti-TF programs. Fighting TF can generate leads and serve as an investigative or intelligence-gathering tool. Anti-TF efforts are therefore one element of a larger process: preventing terrorist incidents.

²⁵³ Testimony of Nikos Passas, vol. 53, September 27, 2007, pp. 6623-6624.

²⁵⁴ Testimony of Paul Newham, vol. 58, October 4, 2007, p. 7228. The Egmont Group also stated that “[i]t became apparent over the years that banks and other financial institutions were an important source for information about money laundering and other financial crimes being investigated by law enforcement.”: “Financial Intelligence Units (FIUs),” online: The Egmont Group <http://www.egmontgroup.org/about_egmont.pdf> (accessed February 20, 2009).

²⁵⁵ Testimony of Paul Newham, vol. 58, October 4, 2007, p. 7238.

²⁵⁶ Testimony of Rick Reynolds, vol. 55, October 1, 2007, p. 6842, agreeing with a description by the Commissioner.

