

# The International Politics of Rogue Banking

Written by Peter Dargie

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## The International Politics of Rogue Banking

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PETER DARGIE, JAN 23 2012

Rogue Banking practices are subtle but highly consequential fiscal transactions that have tangible affects on the global economic and political landscape. These operations are established and utilized by politically alienated rogue states in order circumvent multi-lateral sanctions and to secure access to lucrative foreign markets. However, the regulatory environment of the international financial system is amorphous with governance and sanctions initiatives changing rapidly. Therefore, the clandestine systems, which rogue states such as The Democratic People's Republic of Korea (North Korea/DPRK) and The Islamic Republic of Iran, operate in order to access foreign capital markets have become increasingly sophisticated and complex in order to remain difficult to detect in any regulatory environment. As a result, multinational financial institutions have come under increasing pressure to document and profile their sources of investment and transaction cash-flow, a process which could cost the industry billions. Simultaneously a failure to adequately comply with new laws regarding international financial transactions has, and will continue, to result in widespread fines of hundreds of millions of dollars. Beyond the private sector, governmental agencies have begun to confiscate or freeze the foreign assets of rogue states in an effort to combat the proliferation of weapons of mass destruction and the funding of terrorist operations. Additionally, the assets held abroad by foreign nationals, rogue banks, and corporations of economically restricted nations are seeing increasing use as monetary bargaining chips for the purpose of diplomacy. In accordance with these developments, this paper will explore the case of frozen North Korean funds in Macau and their role in the 2005-2007 Six Party Talks. Furthermore, this expository paper seeks to equip the reader with a foundational context for understanding the rogue banking epidemic and to provide an understanding of the implications of such operations for the global economy. The analysis is organized in such a way as to describe what constitutes a rogue state; with special attention given to the contemporary cases of North Korea and Iran, and to explore the driving forces behind the establishment of rogue banking networks by using case studies of current international events involving rogue financial practices and frozen assets.

### Rogue Nations

On the international political stage there are participants who eschew normal diplomatic processes, and maintain minimalist and tenuous foreign relationships. Whether by historical hostility or ideological difference, these states find themselves unable to build the vital economic infrastructure that is an effective foreign relations presence. In order to offset this diplomatic deficit these so-called rogue states may seek the protection of a larger, politically amicable proxy power. Simultaneously or alternatively, the leadership of such nations show contempt for international norms by threatening the use of force, by way of such vehicles as WMD's and terrorist operations[i]. Strategies such as these magnify the political presence of rogues and create turbulence throughout the global community and financial system. Rogue states have existed throughout history, and their methods of operation remain strikingly unchanged. In a 2001 paper, Thomas Henriksen of the Hoover Institute at Stanford University, analyzed ancient historical nations such as the Gauls, Visigoths, Greek States and Norseman as indirect analogs of contemporary rogues. Germanic Gauls and Visigoths utilized attrition warfare and an uncharacteristic alliance with Carthage in order to claim swaths of the Roman empire, disproportionate to their numbers and technology. Other politically alienated states have taken on the role of mercenary nations whose allegiance could be purchased by the highest bid. A case example being the alliance that existed between Morocco and England during the Elizabethan era defense of Gibraltar[ii]. More recently, the cold war saw numerous states commence intelligence operations, operate undemocratic policies, and fund programs to develop nuclear weapons; all in an effort to secure their sovereignty. In doing so, Israel, South Africa, Taiwan, North Korea, and South Korea, all (for varying reasons), became pariah states in the eyes of Washington or Moscow. Accordingly, these states allied with either the United States of America or the Soviet Union, contributing

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the political polarization that engulfed the world for the majority of the 20th century. While these are isolated examples, politically marginalized nations have throughout history operated unconventional tactics in order to advance their agendas. In turn they have had a disproportionate role in the determination of history.

In 1996, from the western political paradigm there was consensus that North Korea, Iran, Libya and Iraq could be classified as rogues[iii]. The underlying commonality of these states being; documented human rights violations, WMD proliferation programs, and a hostile foreign relations program. As a result of the War on Terror and the ongoing socio-political revolutions in the middle east, Iraq and Libya have the ability to reconstruct their reputation and legitimacy abroad. In 2003 Iraq was subject to an American lead invasion which was predicated on the belief that dictator Saddam Hussein had successfully obtained chemical or nuclear WMDs. On the other hand, Libya is in the throes of a revolution which per contra is an internal uprising against the increasingly erratic despot Muammar Gaddafi. Conversely, the Democratic Peoples Republic of Korea (DPRK or North Korea), and Iran remain pariahs of the international community. It is these nations which will be profiled in this paper and used as a contextual foundation for an exploration of rogue banking practices and their role in the international financial system.

## The Democratic Peoples Republic of Korea (North Korea)

The secretive DPRK is one of the last remnants of the global communist presence. Ideological differences stemming from the Korean War laid the groundwork for an isolated geopolitical profile. North Korea maintains the third largest standing army in the world and anti-western militarism pervades every aspect of society[iv]. In the aftermath of the war, which divided the Korean peninsula, Kim Il-sung introduced the current political and economic ideology of the nation; Juche – or self-reliance. Decades of strict state management of the economy has resulted in intense economic stagnation and famine. Leadership of the country has resorted to the use of terror and degradation to repress dissent and mitigate defection. In a bid to secure economic aid and food supplies, the DPRK authorities have used military threats, sporadic attacks, and the specter of its nuclear development program as bargaining chips with western powers[v]. In 2002 Pyongyang ordered the reactivation of a key nuclear reactor and expelled inspectors of the International Atomic Energy Agency (IAEA). By 2006 North Korea claimed to have successfully detonated a nuclear device underground, although seismological data indicates the bomb to have yielded a relatively small one-kiloton of output, the news of the test brought North Korea's voice and demands to the world. The threat of Pyongyang's emergence as a functional nuclear power succeeded in securing immense economic concessions, aid supply, and the release of some frozen assets in Macau. Tension in the region has been on the rise since 2008 when South Korean presidential incumbent Lee Myung-Bak ended the 'Sunshine Policy' of appeasement and aid which dominated the North-South relationship in the early 2000's. As a result North Korea withdrew from multilateral non proliferation negotiations and denounced the 1953 armistice between North and South. Tensions peaked in 2010 with the sinking of the ROK warship Cheonan[vi] and the bombardment of Yeonpyeong Island[vii]. In the wake of these incidents the US reinstated a series of strong economic sanctions in order to bring Kim Jong-Il and his government back to negotiations at the cyclical 'Six Party Talks'.

## Economy

Data on the economy of North Korea is largely incomplete and based on estimates, partial intelligence and projections. However, the United States Government estimates the range of the GDP of DPRK at 28[viii]-54[ix] Billion U.S. Dollars. The efforts of the centrally planned economy are allocated such that 46.9% of GDP is generated in heavy industry, with the remaining 32.1% and 20.9% coming from services and agriculture respectively[x]. The country produces products ranging from bicycles and military supplies, to tractors and textiles. However, the nation cannot survive on the output of its own agricultural industry, but must rely on aid from trading partners and relief agencies. In 2009 it was estimated that exports totaled

1.997 Billion with the majority of goods exported to China, South Korea and Singapore[xi]. As an isolationist economy, North Korea has struggled to overcome "technological obsolescence, uncompetitive exports, economic privations and a lack of foreign exchange[xii]." In order to overcome these industrial hurdles Pyongyang has begun to

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allow for limited foreign investment in domestic businesses. The majority of these investors are from mainland China or South Korea. In a stark departure from traditional Juche ideology, Kim Jong-Il has stated “[DPRK] must actively develop international activities and continuously open up new markets... and stimulate investment from other countries.” In order to remain nominally loyal to the Juche doctrine North Korea has allowed foreign investors access to the DPRK market by establishing trade and investment exceptions such as the Joint Operation Act, Foreign Investment Act, and Rason Special City – or Free Trade Zone[xiii]. Each such initiative has seen some success in attracting investment from North Korean sympathizers abroad. Additionally joint ventures between foreign firms and the DPRK have begun and are on the rise due to a new tranche of incentives including massive corporate tax cuts for foreign investors[xiv]. However, Kim Jong-Il’s government cannot expand its distribution, and financial networks abroad due to the innumerable sanctions and embargoes that have been imposed by the international community. As a result, North Korea subsidizes its weak traditional exports with illicit goods such as drugs, weapons, super-bills, and counterfeit tobacco products. In May 2003, Australian special forces boarded a DPRK vessel (the Pong-Su) in Australian territorial waters. Hidden aboard the boat was 110 pounds of pure heroin, the value of which was in excess of 50 million AUD[xv]. Additionally it is purported that North Korea earns nearly 20 million USD per year from its counterfeiting operations. It is thought that a high ranking North Korean General, O-Kuk-Ryol, has been appointed by Kim Jong-il to officially manage DPRK counterfeiting operations. The cash inflows that North Korea receives from these various sources is used to pay debt and for economic reinvestment. In order to reinvest or purchase hard capital abroad, Pyongyang manages a fund known as ‘Room 39’ and utilizes a network of rogue banks and transactions to access the more lucrative international market.

## Why It is Important for North Korean Funds to Access Global Markets

On an annual basis North Korea generates a trade deficit of approximately one billion USD[xvi]. The current trade deficit is estimated to stand at 12 billion USD, or 15-25% of GDP, with approximately 2/3 of the debt owed to former communist states. This means that the DPRK must service interest on trade debts or complete payments to foreign creditor nations in order to keep its already limited trade channels open. The deficit is the result of a desperate need for necessity products (food, medicine, etc.) and limited goods for export; as most of the economy’s capital is devoted to the maintenance of a three million strong standing army. However, even these exports are controlled by the military which utilizes speciality commodities such as shellfish, mushrooms and ginseng to trade for foreign currency. Such operations are under the supervision of Kim Jong-Il’s own ‘Room 39’ program[xvii]. However, without easy access to foreign currencies Pyongyang struggles to obtain the necessary funds to pay down its debt. In 2010 North Korea “offered to settle 5% of [10 Million USD] in accumulated Czech debt in ginseng... which would amount to 20 tones of the curly white root[xviii].” In principal though, it is vital that the regime obtain cash supplies through limited, and heavily sanctioned channels of access to the global financial system or alternative illegal methods. For example, The Bank of International Settlements reported that North Korea officially owed approximately 1 Billion USD, primarily in short term debt to reporting financial institutions. However, it is seems probable that unreported debts far exceed this number. G8 member nations have also provided emergency capital totaling 1.5 Billion USD, by way of the Organization for Economic Co-Operations and Development. Another major source of legal cash inflows for the DPRK is remittance payments from North Korean loyalists abroad; in 2003 it was estimated by a Japanese news agency that remittance flows of cash from ethnic North Koreans living in Japan was in the range of 200-600 Million Dollars[xix]. On aggregate the U.S. state department estimates;

“...total receipts plus remittances, aid and investment... amount to perhaps 700 million on net per year. North Korea must finance the remainder of its trade deficit- about \$300 to \$500 million – by other means. It appears these other means have included exports of military equipment and illicit activity.[xx]”

Illegal sources of income require avenues by which the obtained funds can be converted or laundered, into usable currency. On a national level this process requires complex financial transactions executed by international firms. This process of rogue banking will be examined in the core of this analysis, however an understanding of sources from which Pyongyang obtains cash, will be necessary. With extraordinary expenditures on military investment and development North Korea’s most lucrative export is military equipment. However, information and estimates regarding transactions involving DPRK’s military exports are inaccurate and difficult to obtain. Seizures of weapons trafficking vessels in international waters indicate that shipments have, and continue to made to Iran, Zimbabwe,

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Syria, and Yemen.[xxi] It is believed that in 2001 alone net receipts on missile sales exceeded 580 million USD[xxii]. Furthermore in 2009 the Wall Street Journal published an article indicating that North Korean weapon exports totaled approximately 1.5 billion USD[xxiii]. Ultimately, it is complex nature of North Korea's multi-currency transactions and the intensive labyrinth of trade and financial embargoes imposed by the west that drives the need for DPRK to access the global financial system through rogue means.

## The Islamic Republic of Iran (Iran)

In contrast to staunchly anti-religious North Korea, The Islamic republic of Iran is controlled by fanatical Islamic clerics organized beneath the supreme leader Ayatollah Khomeini. Under George W. Bush Jr. Iran was declared a part of the international "axis of evil"[xxiv]." The White House has since campaigned for the abolishment of Iran's nuclear agenda. In June 2005 newly elected president Mahmoud Ahmadinejad ordered the resumption of the Iranian nuclear program, in blatant violation of the International Nuclear Nonproliferation Treaty[xxv]. Since that time, Iran has successfully developed a Nuclear power station, and maintains claims that nuclear advancements are motivated by a need for energy. Ironically, Iran is situated atop a reservoir of oil which contains no less than nine percent of global oil supplies. Traditionally a highly conservative nation, Iran has seen extremist Islam penetrate deeper into society under president Mahmoud Ahmadinejad[xxvi]. In the spring of 2009, Ahmadinejad attacked rally's and protests held by opposition party members and reformists, in doing so he coercively solidified his position as the emerging leader of Iran. However, from within the country and abroad, Ahmadinejad has faced increasing criticism for the weakening of the Iranian economy, manipulation of oil supplies and increasing levels of investment in Iran's nuclear program.

## Economy

Iran's economy, is fueled by production of a portion of the world's largest oil reserve. However, the nation has been unable to maximize returns from the energy sector as it struggles to overcome the inherent inefficiencies of the state organized enterprises that dominate in excess of 70% of the Iranian economy. Furthermore, Iran must contend with an economic environment hampered by internal political turmoil and external political pressures including sanctions[xxvii]. Nonetheless, as a global exporter of oil and natural gas and importer of necessity products, Iran needs access to global forex markets in order to balance accounts. Iran's real GDP in 2006 was \$610.4 billion and grew to exceed \$750 billion in late 2010[xxviii]. The economy is split into three primary sectors; agriculture, industry, and services; accounting for eleven, forty-six, and forty-three percent of GDP respectively. Approximately 80% of export revenues arise from the sale of petroleum, with petrochemical products contributing significantly to supplemental exports[xxix]. Recent data suggests that Iran's crude oil production is in decline, a result of poor maintenance of infrastructure at current oil production sites, a decreasing number of new developments and an adverse political climate for foreign investment[xxx]. The United States Institute for Peace describes the Iranian production problem as follows;

"...the current political climate limits the amount of foreign investment in Iran's energy sector. Additionally sanctions placed on Iran could prevent future investment by IOCs... Actions by Iran's government also hinder development of the energy sector. Government spending is rising, and Iran needs oil prices to be high-around \$50 per barrel—in order to break even. The government is also dipping heavily into the Oil Stabilization Fund, which is supposed to be set aside as a reserve fund. Spending this money, combined with Iran's declining production, could have extremely negative repercussions on the economy should oil prices fall suddenly[xxxi]."

As such, Iran's economy is intrinsically dependent on perpetually rising energy prices on the international market in order to sustain its economy in the face of growing economic embargoes. As a result the Iranian economy is deeply cyclical with periods of high inflation and, as is currently the case, double digit unemployment. Figures from early 2011 appear to show an economy on the verge of contraction as annual oil exports are set to fall by nearly 16 Billion USD and key economic indicators such as imports and building permit applications fell dramatically[xxxii].

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## Why Is it Important for Iranian Funds to Access Global Markets

Iran seeks to manage funds abroad for a number of nebulous reasons related to purchasing power. An import of primary importance to the Iranian economy is refined petroleum. While this may seem counterintuitive as the Islamic state sits upon a massive reserve of crude oil, poor financial management of assets, a lack of foreign investment, and inefficient state enterprises have eroded the nation's refining capabilities. Domestic demand, both civic and industrial, for operable petroleum now far exceeds domestic production and as such Iran must supplement production with imports<sup>[xxxiii]</sup>. Iran has seen imports of refined oil rise to nearly 40% of domestic demand. However, the United States Government recently amended the 1996 Iran Sanctions Act banning the supply of refined oil or refining technologies to Iran – with similar measures being adopted throughout Europe and parts of Asia. Therefore, Iran has had to privately purchase such imports from ulterior sources which require payment in the form of unsanctioned usable currency. Traditionally Iran has tried to maintain 20% of its foreign currency reserves in American dollars<sup>[xxxiv]</sup>. However, now Iran must seek ways to obtain marketable foreign currency and generate investment income abroad in order to settle expensive and critical import debts. The second dilemma that faces Iran and the Iranian Sovereign Wealth Fund is how it can invest and spend the foreign currency it amasses through the sale of crude oil. It is currently estimated that Iran holds the equivalent of nearly 100 billion USD, in various currencies and thus must seek ways to invest these reserves in order to avoid purchasing power deterioration due to global inflation. Finally, billions of dollars worth of Iranian assets are currently frozen outside of the country in order to put pressure on the regime to become more sociopolitically amicable and to comply with nonproliferation agreements. Iran intrinsically has a vested interest in attempting to re-appropriate such reserves using whatever financial transactions are at its disposal.

## Rogue Banking

In a broad sense rogue banking practices include any financial services provided to a sanctioned member of the international community that serve to help such states circumvent the economic will of the global political majority. Such transactions may be conducted or mediated by ill informed but largely reputable financial institutions or by organizations in which rogue practices are endemic to management's business strategy. In an age of rapid communication and interconnected global trade and finance accounts the pervasiveness of illicit international financial transactions is on the rise. In parallel, the United States Treasury Department of Financial Crimes has stipulated that rogue banking practices are a growing facet of the international financial system which must be researched and better understood. As evidence of the growing prevalence of rogue banking practices, the Department of Financial Crimes recently published a congressional research paper exploring the ways in which international cash and equity flows not only fuel crime, terrorism, and weapons proliferation, but also threaten the integrity of the entire financial system<sup>[xxxv]</sup>. In his publication "Follow the Money" Wechsler notes that expansion in the financial system has been mirrored by expansion in financial abuses, and that rogue banking in conjunction with globalization creates a significant threat to democratic and free market economies<sup>[xxxvi]</sup>. Therefore, it has become increasingly necessary for National Governments, The United Nations, NATO, World Bank, and other institutions of the global community to create policies and sanctions aimed at limiting and disrupting the access of rogue states to the GFS. Multilateral organizations that seek to deter international financial crimes have also been developed and include the Financial Action Task Force and Basel Committee on Banking Supervision. These agencies request and collect information on depositors and investors from institutions domiciled in compliant nations in order to detect and disrupt financial operations which seek to circumvent sanctions programs. However, there is strong resistance to these measures in financial centers such as Switzerland and the Cayman Islands. In 2001 it was estimated that the Cayman islands had \$670 Billion in marketable foreignly owned assets (MFOA) under management with Switzerland holding \$2.7 Trillion (MFOA), with these numbers growing annually<sup>[xxxvii]</sup>. Both countries believe that depriving clients of anonymity will lower deposit rates and undermine their competitive advantage as low-tax – financially flexible investment hubs which serve clients from every state across the globe. While neither Switzerland nor the Cayman Islands are rogue banking centers it is important to understand that regionally legal transactions in both countries might be utilized by rogue states in their efforts to illegally access foreign markets.

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Ultimately, both Iran and North Korea maintain anti western governments, have nuclear ambitions, and recurrently violate basic human rights. Accordingly various embargoes and sanctions have been put in place in an attempt to curb the behavior of each state. However, a consensus amongst western powers did and does not exist about the extent to which the economic sanctions were/are to be applied. In particular the Iranian threat is felt to be much stronger in the United states than it is in Europe. Therefore the sanctions and embargoes in place are rapidly changing and malleable in interpretation depending on the region in which they are enacted. However, the purpose of this paper is not to develop an extensive exploration of the sanctions programs currently in place against North Korea and Iran as this is an extremely well documented body of public information. For the so inclined, complete lists can be obtained through Congressional Research Services, The World Bank and other political agencies. Rather, this analysis will proceed by examining historical and contemporary cases of verifiable rogue banking activity involving each state.

## Bank of Credit and Commerce International

Founded in 1972 by Agha Hasan Abedi, the Bank of Credit and Commerce International (BCCI), was at one time the seventh largest private financial institution in the world. In less than twenty years the bank (domiciled in Luxembourg) became one of the most powerful financial firms on the planet and then suddenly collapsed amid a storm inter-governmental litigation. Since that time the unimaginable complexity, profitability and political influence of BCCI has come to light, leading it to be dubbed “The Dirtiest Bank of All.[xxxviii]” The sheer scale and potency of BCCI’s perpetrations is difficult to comprehend, but it involves more than seventy-five countries and international financial and political elite including the Shah of Iran, the Ayatollah Khomeini, Ferdinand Marcos, Saddam Hussein, Manuel Antonio Noriega and the terrorist Abu Nidal. In 1991 Times Magazine broke the story around the world with the description;

“Bank-fraud cases are usually dry, tedious affairs. Not this one. Nothing in the history of modern financial scandals rivals the unfolding saga of the Bank of Credit & Commerce International, the \$20 billion rogue empire that regulators in 62 countries shut down early this month in a stunning global sweep. Never has a single scandal involved so much money, so many nations or so many prominent people[xxxix].”

BCCI finds its roots in the Pakistani banking world, it was formed and operated by Abedi and his previous associates from the Pakistani United Bank (founded in 1958). United Bank (UB), was granted its operational license and rapidly grew into an opulent and modern financial institution which catered primarily to high net worth individuals (although it was later nationalized by Pakistani socialist Bhutto)[xl]. As CEO of the firm Abedi quickly realized that it was possible to attain favorable settlements and legal rights by connecting with diplomats and making ‘courtesy’ payments to high ranking government officials. In order to further solidify the firms influence within Pakistan

“Abedi appointed as chairman of its board I. I. Chundrigar, the former Prime Minister of Pakistan, who was a close confidante of Pakistani’s then current prime minister, Ayub Khan.[xli]”

The bank perpetuated similar patterns of hiring in other nations and quickly increased the number of political officials on its clandestine payroll. However, Abedi showed little loyalty to any particular regime, rapidly altering his allegiance in cases such as Bhutto-Zia conflict. Eventually the global reach of the bank necessitated a move to an international financial hub. Thus it was that in 1972 Abedi abandoned United Bank and lured other UB employees to assist in launching BCCI in the tax haven of Luxembourg. In order to do so initial deposits and bank assets were almost exclusively funded by the Royal Family of Abu Dhabi and in particular the Sheikh Zayed (Who had been a patron of Abedi’s at UB). Throughout the late 1970s BCCI accelerated its global expansion – and recruited new members into an organization structured ever more similarly to Casa Nostra. In 1974 BCCI opened two new franchises; BCCI Holdings (which conducted the banks business in the Middle East and Europe) and BCCI Overseas which maintained an office in Grand Cayman (which managed BCCI affairs throughout the third world). Moving forward in time, the bank developed a labyrinthine network of impenetrable holding companies, partnerships, subsidiaries, investment accounts, word of mouth agreements, and nominee relationships[xlii]. Throughout the 70’s and 80’s BCCI chose to relentlessly expand its core asset base rather than increase profit margins. In a sense the firm had no choice due to an “underlying lack of working capital and BCCI’s high-start up costs[xliii].” Abedi’s plan was to keep losses

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off the books by manipulating financial statements until additional profits could be realized by way of commissions on the cash-flows throughout its large asset base. However, this plan quickly began to spiral into a 'ponzi-esque' operation in which retained capital was entirely employed as collateral against billions of dollars worth of new assets[xliv]. It would seem likely that at this point BCCI sought ways to realize quick and high-margin-profits in order to build fiscal provisions against a decline in its asset prices and a resultant unraveling of its entire financial structure. Those familiar with the BCCI story will likely realize the above description gives only a brief, simplified and high level description of the bank's origins. However it is not the purpose of this analysis to explore BCCI's origins but rather the services which it provided to despots, militants, juntas, and dictators around the world.

BCCI's criminality included a plethora of different practices including laundering for the drug trade, facilitation of arms transport, financing for mass prostitution and even the assassination of innumerable persons from across the world. However, on a financial level, the majority of BCCI's illicit activities occurred in the creation and operation of accounts for non-democratic national governments and for corruption funds of high ranking diplomats. One of the primary difficulties which faced authorities investigating BCCI was the method by which the bank stripped or encoded the identification of its depositors. For large account holders BCCI employed a system known as 'managers ledgers.' This numerical system permitted high-net-worth individuals to hold accounts at BCCI with their identities known only to a personal concierge-banker. In many cases these accounts were opened by officials or state agencies from heavily sanctioned countries which used the rogue network of BCCI to access markets around the world. In his 1992 indictment of the BCCI management team, District Attorney Robert Morgenthau stated;

"...members of the BCCI Group, acting to further the conduct and affairs of the criminal enterprise, assisted various nations, including Pakistan, Senegal, Zambia and Nigeria, to evade fiscal restraints placed on them by such world institutions as the World Bank and the International Monetary Fund...[xlv]"

Furthermore, the bank itself facilitated and in some cases brokered deals for the illicit sale of arms from one nation to another. In an interview with TIME Magazine a former BCCI official alleged that the bank "...financed and brokered, Silkorm missiles that went to Saudi Arabia... equipped with sophisticated Israeli guidance systems. When you couldn't use direct government transfers or national banks, BCCI was there to hot-wire connections between [countries such as] Saudi Arabia, China and Israel[xlvi]."

It has also come to light that BCCI orchestrated the North Korea sale of Scud-B missiles to Syria, and then utilized a series of rogue transactions both internally and externally in order to transfer funds back to Kim Il-Sung's government. Even more conspicuously, rogue transactions were conducted by BCCI on behalf of western powers, the most notable example being the infamous Iran-Contra Scandal (ICS). The ICS developed in 1986 when the CIA (and other unconfirmed U.S. Gov. agencies) used the BCCI network in order to facilitate the sale of arms to Iran, in exchange for the release of political prisoners. The CIA employed the rogue BCCI network as at that time Iran was subject to a multi-national embargo which barred the sale of weapons systems to the Islamic nation. Upon completion of the transaction, the money from the sale was then deposited with BCCI in order for it to be transferred to the Nicaraguan Contras. Since the dissolution of BCCI in the early 90's former CIA officials have confirmed that the Iran-Contra affair was not an isolated interaction between the United States and BCCI. It is claimed that accounts within BCCI were also utilized as slush funds for the financing of unauthorized operations abroad.

The liquidation of BCCI holdings and litigation against complicit individuals continues to this day, more than 20 years later. However, the BCCI scandal provided a valuable insight into the capabilities and operations of a rogue bank. For the interested reader there exist numerous books which deal with an overwhelming number of high value rogue transactions undertaken by BCCI.

## Banco Delta Asia – North Korea

Banco Delta Asia (BDA) is a midsize, full service bank based in the Macau Special Administration Region of China (Macau). In 2007 the United States Treasury Department designated BDA as an institution of "primary money laundering concern.[xlvii]" Officials within the United States government asserted that BDA accepted large deposits of foreign currencies, counterfeit U.S. dollars and precious metals from North Korean officials[xlviii]. After laundering

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the money via murky fiscal transactions and investments, senior bank officials allowed the government of the DPRK to access the financial system vicariously through BDA with minimal control or oversight[xlix]. Furthermore, it was alleged that BDA willingly and knowingly executed transactions on behalf of North Korean businesses reputed as fronts for drug and weapons smuggling. Later in 2007 the Financial Crimes Enforcement Network (US treasury dept.) announced that its investigation of BDA had uncovered details of a 20 year relationship between North Korean government agencies and BDA management[l]. When the news broke customers of the bank withdrew \$133 million dollars in a bank-run equivalent to a third of the total cash deposits at the firm[li]. Soon after, Washington invoked the newly formed U.S. Patriot Act against BDA and in doing so made it illegal for American companies to do business with the bank. The Monetary Authority of Macau feared that the Patriot Act would be applied more generally (as nearly all banks in Macau handled North Korean transactions at that time) and as a result restructured the firm's management and froze approximately \$25 million of North Korean assets. The power and implications of the patriot act became apparent through the BDA affair and as a result global firms began to wind down operations servicing entities with possible North Korean connections[lai]. Marcus Noland, an economist specializing in North Korean issues, of the Petersen Institute for International Economics described the effects of the treasuries move as highly successful because;

“Not only did North Korea lose access to this particular financial institution, other financial institutions began severing their ties with North Korea, not wanting to risk entanglement in North Korean illicit activities and possible expulsion from U.S. financial markets. As a consequence of both these direct and indirect effects, North Korea has encountered increasing difficulty executing international financial transactions[laii].”

This informal embargo seriously hampered Pyongyang's ability to conduct business abroad and was a catalyst for the return of North Korea to the '6 party Talks'. In Spring 2007 DPRK demanded that 25 million, of funds frozen by Macanese authorities (not the U.S.) be transferred to another institution. However, the only way this transfer could occur, due to the economic isolation imposed upon the nation by the financial system, was through the U.S. federal reserve, who used the funds as an additional bargaining chip in demilitarization negotiations.

## Lloyds – Iran

In the late nineties a lack of multilateral political agreement led to to the implementation of poorly understood sanctions programs which were open to a high degree of interpretive flexibility. When such programs were enacted against Iran, many European banks and firms assisted Iran in circumnavigating the international economic sanctions programs, both directly and inadvertently. In particular a largely misunderstood anti-terrorism sanction was put in place in an effort to combat the Iranian nuclear program[liv]. These sanctions stipulated that transactions involving sums greater than 40,000 euro and stemming from entities or individuals with an Iranian connection must be approved by legal authorities. However, the financial costs of these sanctions were carried primarily by international financial institutions who were tasked with enforcing the restrictions by freezing assets of implicated entities and reporting such transactions to international authorities. In 2009, Lloyds Banking Group which is domiciled in the United Kingdom was fined 231 Million Pounds by the US Department of Justice on allegations of wire fraud. The American government asserted that from 1995 to 2002 Lloyds “falsified wire transfers involving countries or individuals on the U.S. sanctions list[lv].” The District Attorney for Manhattan, Robert Morgenthau went on record as saying “The Iranian banks have money on deposit in London with Lloyds. They were having Lloyds send the money to the US and beyond and stripping the identification[lvi].” The actions of Lloyds staff permitted Iran to access nearly 300 Million USD in the barred American financial system. These funds were classified as having a high probability of being used in the financing of weapons technology programs or terrorist operations[lvii]. The most interesting part of these particular rogue banking transactions is the fact that they occurred within a reputable and otherwise compliant financial institution. For example, the insurance arm of Lloyds banking group had months earlier elected to refuse the sale of maritime insurance for vessels transporting petroleum to Iran in order to comply with a newly instituted energy embargo[lviii].

## Credit Suisse – Iran

In 2009 the United States Justice Department, Federal Reserve and Manhattan District Attorney Office announced



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the investigation of Credit Suisse Aktiengesellschaft[l ix] on allegations of wire transaction manipulations and other rogue banking practices. The transactions in question occurred during a six year period (2002-2007) and totaled in excess of \$1.8 billion[l x]. However, the investigation and subsequent 586 million dollar fine centered on 7000 particular transactions involving \$700 million which primarily stemmed from Iran (other nations serviced include Burma, Cuba, Libya and Sudan[l xi]). The residual transfers totaling \$1.1 billion were found to be manipulated but not in violation of international sanctions programs. The District Attorney Office of Robert Morgenthau alleged that when Lloyds began to decline service to Iranian entities, officials in Iran opened accounts with Credit Suisse. It was alleged that beginning at this time "Credit Suisse's internal communications showed a continuous dialogue about evading US sanctions spanning approximately a decade[l xii]." During a state news conference Attorney General Eric. H. Holder Jr. went on record saying that;

"Rather than adhere to the law and decline to serve these customers, Credit Suisse established a business model to allow these rogue players access to U.S. dollars... At one point, the company even developed a pamphlet for its Iranian clients, explaining how to fill out payment messages so as not to trigger U.S. filters. They created a how-to book on committing a crime – and it worked well for years[l xiii]."

Records from the period spanning from 2002 to 2005, demonstrated that Credit Suisse quadrupled the number of transactions executed on behalf of Iranian state corporations. However, it was acknowledged by U.S. prosecutors that as the legislative environment surrounding Iranian sanctions programs became more certain in 2006, Credit Suisse autonomously began to curb its practices in accordance with international laws. However, it is particularly noteworthy that financial firms in general operate in close accord with the legal interpretation of the nations in which they are incorporated and headquartered. In the case of Credit Suisse, the liberal and neutral attitude of the Swiss government to foreign relations was reflected in the practices of financiers within the international banking department of the firm. Nonetheless, in early 2006 Credit Suisse shut its representative office in Tehran, froze assets in suspected accounts and terminated all business agreements with Iranian entities sanctioned by the United States Office of Foreign Assets Control (OFAC)[l xiv]. What made the Credit Suisse case unique from other litigation levied against financial institutions on the basis of rogue banking practices was the peripheral documentation which surfaced. In particular it was found that Credit Suisse had conducted transactions on behalf of two heavily sanctioned Iranian state banks; Bank Saderat and Bank Mellī. Additionally the bank orchestrated transfers from the Atomic Energy Organization of Iran and the Aerospace Industries Organization of Iran. Each entity has been officially designated as an agency for the proliferation of weapons of mass destruction by OFAC – and are thus barred from doing business with the United States. However, the case of Credit Suisse's facilitation of transactions of Iranian origination is similar to that of Lloyds PLC. Each financial institution is on aggregate a respected member of the international financial system with management structures which seek to maximize revenues while generally complying with international law. Furthermore, in each case, the prosecution established that it was the private bankers servicing the implicated accounts, that directly evaded international finance protocols. While this is verifiably true, it seems implausible that senior management could have been entirely oblivious to the transactions given their magnitude and frequency. Nonetheless, as part of a resolution for the suit lodged against the firm, Credit Suisse declared in a December 2009 press release that it would enhance

"...its global compliance program by, among other things, appointing a global sanctions compliance officer, establishing competency centres and designating individuals responsible for coordinating and monitoring compliance with sanctions programs and enhancing its global policies, procedures and employee training programs, which will continue to be regularly reviewed for effectiveness [as well as imposing] enhanced sanctions filters screening designed to cover incoming and outgoing transactions[l xv]."

## Conclusions

As the process of globalization continues and global financial markets correspondingly expand, rogue banking practices will see parallel growth. This is cause for concern throughout the public and private sector as these transactions violate international law, weaken the intended political affects of costly sanctions initiatives and are detrimental to the fiscal integrity and reputability of implicated firms. Furthermore as the international economic system contains to roil in a storm of obdurate economic discord the value of credibility is at a premium for financial

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firms. Therefore an examination of these malignant financial fissures should be of high priority to academics, government and the banking community alike.

The analysis performed indicates that infringements appear to occur under two scenarios – the first being rogue transactions within otherwise reputable firms, the second being transactions within financial businesses which expressly market illegal services to rogue states. The preceding analysis demonstrates that the recent fines levied against Lloyds and Credit Suisse are the result of a series of transactions which constitute violations of the former type. To be precise, particular bankers at both Lloyds and Credit Suisse chose to turn a blind eye, or to operate in accord with only the most liberal interpretation of global financial regulations. Conversely, BCCI and Banco Delta Asia are quintessential examples of rogue banking institutions – and the transactions undertaken by their management and employees constitute violations of the latter type. It is important that regulators develop a clear and academic appreciation for this contradistinction in order to re-evaluate the efficacy of current and planned sanctions programs. On the one hand, the rules of banking for generally compliant multinational banking firms, which partake in western markets, must be clarified and applied uniformly. For example, Swiss banks such as the United Bank of Switzerland and Credit Suisse which have access to innumerable foreign economies must impose sanctions in accordance with the interpretation of international law rather than in accord with traditional Swiss views on neutrality and anonymity. However, while such international laws of banking may be successfully established and willingly enforced by the management of most banks – it is crucial to note that the core strategies of some financial institutions involve willful violation of international sanctions, embargoes and law. Individually targeting such firms for investigation seems to be a high cost, cumbersome and futile tactic for staunching the flow of illicit capital from rogue nations.

However, as demonstrated by the effective application of the U.S. Patriot Act against BDA, it is possible to isolate rogue banks from interfacing with less nefarious members of the global financial system. Furthermore it would be prudent for regulatory bodies to collaborate with senior financial managers in order to develop a concrete code of international financial services. Such a document would explicitly delineate the services and intents, which constitute a rogue banking practice. Firms operating in international markets would likely feel compelled to adopt such a set of ethical standards as it would limit their exposure to the liabilities associated with deals involving rogue firms. In conclusion, it seems that overarching economic sanctions, enacted by regulators who fail to engage in a dialogue between themselves and private financial institutions, cannot be successful in curbing the behavior of rogue states and the firms which serve them abroad. However, by placing restrictions on key institutions and sharing financial intelligence with intercontinental firms, global governing bodies such as the UN, IMF, and World Bank can align the international political agenda, with the interests of free enterprise. In this way, it would be possible to dramatically increase the financial cost of being a pariah state.

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*Written by: Peter Dargie*  
*Written at: Mount Allison University*  
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