June 26, 2014
SNAPSHOT

Breaking the Banks
The Financial Consequences of Counterterrorism

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Last summer, the British banking giant Barclays sent account closure notices to some 250 clients in the United Kingdom, giving them 60 days to find a new home for their cash. Most of the customers were small remittance companies -- so-called money services businesses -- that served the country’s large diaspora communities. Since big international banks don’t typically have branches in Somalia and Bangladesh, such money transfer firms are the main pipeline through which immigrants send money to family members back home. Increasingly concerned about complying with government regulations to combat terrorist financing, however, the banks wanted to clear their books of any excess risk.

Condemnation came swiftly, and a coalition of nonprofits, politicians, and sports stars mobilized to fight the Barclays decision. The account closures, they said, constituted the severing of a “financial lifeline” for fragile, poverty-stricken states. Somalia, for example, receives more money [2] from remittances than it does development aid, and according to the World Bank, developing countries receive over $400 billion in remittances annually. In response to the uproar, the British parliament held debates, set up an action group, and commissioned a report (to which I contributed). Barclays managed to close most of the accounts anyway.

In its defense, Barclays argued that the high costs of complying with counterterrorism regulations meant that it was no longer “commercially viable for [the bank] to continue to provide services to any customer representing less than £100,000 in annual revenue.” That argument -- particularly as it applies to banks providing high-risk, low-return services to clients such as money services companies -- has now become a common refrain. A host of other banks, ranging from HSBC to the Merchants Bank of California, have used the same logic to justify similar account closures in Europe and the United States. Their caution,
moreover, is symptomatic of a larger trend reflected by the Barclays episode: the restricting of the global financial system to support the international community’s war on terrorism.

In the aftermath of the September 11 attacks, U.S. officials singled out the government’s failure to combat terrorist finance networks as a key factor that had allowed al Qaeda to grow and thrive. As former White House counterterrorism chief Richard Clarke put it in his 2004 memoir, “the departments were doing a lousy job of tracking and disrupting international criminal financial networks and had done little or nothing against terrorist-financing.” One of U.S. President George W. Bush’s first shots in the new global war on terror was Executive Order 13224, which called for “a strike on the financial foundation of the global terror network,” meant to “starve the terrorists of funding.”

Washington’s focus on securing financial borders has since been intense, resulting in a blizzard of new rules, practices, and penalties for the banking sector. There is scant evidence that such tactics have actually starved the terrorists of funding. What is clear is that, having been delegated prime responsibility for securing the national and international financial borders, banks have abandoned operations and clients that might expose them to any form of illicit financial activity, restricting financial access.

Money services businesses have not been the only ones to feel the heat. Many nongovernmental organizations, particularly those that operate in risky locales, have seen their access to basic financial services diminish. So, too, have a diverse collection of individuals, ranging from so-called politically exposed persons, those who occupy a formal position that can be abused for criminal purposes, to adult-film stars, whose accounts are often thought to be financed by funds from unsavory sources. Banks are also cutting services in which they transact on behalf of the clients of other banks seeking to transfer funds internationally.

Driving such decisions is a desire to minimize risk -- a warranted goal. In the past two years, U.S. regulators have slapped such banks as HSBC, ING, and Standard Chartered with huge penalties. In 2012, for example, HSBC paid the U.S. government a fine of $1.9 billion for facilitating money-laundering and sanctions breaches by its clients. But such fines will be dwarfed by the crippling, $8 billion to $9 billion penalty rumored to be awaiting French bank BNP Paribas for its alleged breaches of sanctions against Sudan -- a sum that would amount to double the total combined sanctions-related fines levied on all banks since U.S. President Barack Obama took office.

Following 9/11, banking standards certainly needed to improve. But so long as fear governs the relationship between the regulatory authorities and the banking sector, and until banks feel that they are partners in the drive to track criminals and terrorists through the financial system, they will continue to operate conservatively, shedding clients and restricting services where possible. That won’t secure financial borders. Money always finds a way to its intended recipient. Restrictive regulations have simply pushed large pools of funds outside formal channels -- encouraging criminals and terrorists to finance their activities in the shadows.

At a recent conference held in London, David Cohen, the U.S. Treasury Department’s Undersecretary for Terrorism and Financial Intelligence, acknowledged the importance of collaboration between financial institutions and law enforcement. By keeping account holders within the formal financial system, banks could have access to a vast and potentially enlightening trove of financial data that could prove invaluable...
in the hunt for terrorists. But whatever the value of such intelligence, the banks currently have a much stronger incentive to wash their hands of risky clients altogether. And as long as the fines rain down, de-risking will continue, financial access will be reduced, and more cash will be exchanged outside the global banking system. Financial borders, in other words, will become less secure.

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