
RESPONSE

A TALE OF TWO STUDIES: THE REAL STORY OF TERRORISM FINANCE

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In response to Shima Baradaran, Michael Findley, Daniel Nielson & Jason Sharman, *Funding Terror*, 162 U. PA. L. REV. 477 (2014).

INTRODUCTION

I was pleased when I saw that the *University of Pennsylvania Law Review* had published a new article on terrorism financing,¹ especially when I saw that my friend and frequent collaborator Jason Sharman was an author. But my pleasure turned to puzzlement, then to dismay, as I delved into it.

The Article, entitled *Funding Terror*, consists of three parts. The first is primarily a discussion of what we already know about terrorism financing, focusing on the use of shell companies (not easy to define, but, more or less, companies that have no independent operations, significant assets, ongoing business activities, or employees²) by terrorists,³ and on steps recently taken

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¹ See Shima Baradaran, Michael Findley, Daniel Nielson & Jason Sharman, *Funding Terror*, 162 U. PA. L. REV. 477 (2014) [hereinafter *Funding Terror*].

² EMILE VAN DER DOES DE WILLEBOIS ET AL., *STOLEN ASSET RECOVERY INITIATIVE, THE PUPPET MASTERS: HOW THE CORRUPT USE LEGAL STRUCTURES TO HIDE STOLEN ASSETS AND WHAT TO DO ABOUT IT* 37 (2011), available at <http://star.worldbank.org/star/sites/star/files/puppetmastersv1.pdf> [hereinafter *PUPPET MASTERS*]; *Funding Terror*, *supra* note 1, at 492.

³ See *Funding Terror*, *supra* note 1, at 492-95.

by countries to reduce the threat of terrorism.⁴ This first part repeatedly asserts that terrorists use shell companies to facilitate their nefarious activities⁵ and discusses how the United States and other jurisdictions have responded by trying to prevent terrorists from doing so.⁶

The second part of the Article presents an experimental study regarding the circumstances under which lawyers and certain other persons known as corporation service providers will assist different types of clients in setting up companies in different jurisdictions. The study finds that forming an anonymous shell company is not difficult, despite increased regulations following September 11—results that are “disconcerting and demonstrate that we are far from a world that is safe from terror.”⁷ While the quality of the study is excellent,⁸ its relevance to terrorism finance hinges on the accuracy of the conclusions in the first part of the Article—that terrorists use shell companies.⁹ Based on the results discussed in the second part, the third part draws conclusions about whether the jurisdictions identified in the second part are more likely to facilitate terrorism and whether domestic or international law governing the setting up of shell companies is more successful as a deterrent to the formation of those companies by terrorists.¹⁰ Again, the relevance of this third part is tied to the conclusions of the first part.

If it were true that terrorists regularly used shell companies, it might make sense to dedicate additional resources to stopping them, including

⁴ See *id.* at 495-504.

⁵ See, e.g., *id.* at 492 (“Finally, terrorists use shell companies to conceal and transfer money through bank accounts around the globe, including transfers within the United States.”); *id.* at 493 (“Terrorists, in particular, view shell companies as an attractive medium to move money anonymously around the world.”); *id.* at 494 (“Indeed, many terrorist groups have used shell companies to launder and obscure their ties to illegal funds.”).

⁶ See *id.* at 499 (noting that the United States has occasionally prosecuted individuals under 18 U.S.C. §§ 2339A-2339B, the “material support” statutes, in order to restrict the use of shell companies for terrorist financing); *id.* at 500 (listing as an example of domestic efforts to regulate money laundering the PATRIOT Act’s requirement “that broker-dealers file Suspicious Activity Reports (SARs) and that they take extra precautions when dealing with shell companies”); *id.* at 502-04 (discussing the “significant international push to stop terrorism financing through money laundering, charities, trusts, and anonymous shell companies”).

⁷ *Id.* at 478.

⁸ In the past, my students and I worked with Professor Sharman on a preliminary version having to do with corrupt government officials rather than terrorists, see J.C. SHARMAN, *THE MONEY LAUNDRY: REGULATING CRIMINAL FINANCE IN THE GLOBAL ECONOMY* (2011), which means I am no doubt riddled with confirmation bias.

⁹ See, e.g., *Funding Terror*, *supra* note 1, at 486 (“Indeed, our results suggest that these financial regulations [concerning the formation of shell companies] may not be effective constraints on funding terrorism.”).

¹⁰ See *id.* at 527-30.

requiring corporation service providers to do a better job of detecting when their clients are really bad guys. Because, as the Article correctly notes, shell companies can be used for legitimate as well as illegitimate purposes, government must take care to fight the bad guys without overly impeding the good;¹¹ as a result, the rules must be more nuanced and therefore difficult to enforce than would be the case if shell companies were simply banned altogether. However, given that the resources to prevent bad guys from doing bad things are necessarily finite, shifting resources *to* initiatives intended to stop terrorists from setting up or using shell companies necessarily means shifting them *from* somewhere else. But if that somewhere else is actually stopping bad guys, and if the assertion that terrorists use shell companies is false, the result could actually harm antiterrorism efforts.

I don't know if existing antiterrorist financing efforts are effective or efficient, nor do I know if efforts to try to stop terrorists from using shell corporations would actually pay off—though I have my doubts.¹² But more importantly, I'm fairly sure that no one knows—except maybe the terrorists themselves. Pretending we do could result in policy changes built largely on myth, which is usually not a good idea. Unfortunately, it is a myth to claim that we know terrorists are using shell companies to finance terrorism. That this myth masquerading as truth made it into one of the nation's most respected law reviews is, in my view, unfortunate.

I. A QUESTIONABLE PREMISE

Let me provide a bit of background. On September 11, 2001, I was a senior staff member at the International Monetary Fund (IMF), specializing mostly in sovereign debt restructuring, but also overseeing the IMF's rather limited involvement in anti-money laundering policies. After the attacks, the United States government (along with some key NATO allies) decided that an essential part of the fight against terrorism would be directed toward its financing.¹³ After securing a United Nations Security Council resolution supporting that endeavor,¹⁴ these countries tasked the Financial Action Task Force (FATF)—an intergovernmental organization consisting mostly of OECD countries and set up to create and assess compliance with standards to

¹¹ See *id.* at 495.

¹² As in, serious doubts. See *infra* notes 61-67 and accompanying text.

¹³ Richard K. Gordon, *On the Use and Abuse of Standards for Law: Global Governance and Off-shore Financial Centers*, 88 N.C. L. REV. 501, 577 (2010).

¹⁴ See S.C. Res. 1373, U.N. Doc. S/RES/1373 (Sept. 28, 2001) (recognizing “the need for States to complement international cooperation by taking additional measures to prevent and suppress . . . the financing and preparation of any acts of terrorism”).

prevent money laundering¹⁵—to extend its remit to the financing of terror.¹⁶ Within a month, it had done so, adopting eight “special” recommendations (read: standards) against the financing of terrorism.¹⁷ For various reasons, including global membership, lots of staff, and plenty of financial resources, the FATF asked the IMF (and the World Bank, although at that time as a more junior partner) to help lead the charge in encouraging countries to adopt these new terrorism financing standards, as well as the preexisting anti-money laundering guidelines.¹⁸ The IMF’s Managing Director put together a select task force on combating the financing of terror, and I was named to it.¹⁹ I was the only lawyer on the task force and wound up writing much of the report, even though I knew very little about the topic. I’ve learned a bit since then.

The FATF standards on money laundering and terrorism financing (which, since 2012, have been integrated into a unified whole, and which now include antiproliferation rules) essentially fall into three categories: (1) those concerning criminal law and law enforcement;²⁰ (2) those concerning international cooperation;²¹ and (3) those designed to stop criminals from using financial institutions and certain designated nonfinancial businesses.²² The FATF refers to this third category as “preventive measures.”²³

These preventive measures require financial institutions to identify their clients, create client profiles, weed out those who from the start look like they may be bad guys or controlled by bad guys, and then monitor the account activity of accepted clients to see if that activity varies from what is expected or reflects the kind of activity that known bad guys have undertaken in the past.²⁴ Financial institutions are then supposed to look further into the questionable client activity and report to the government when they

¹⁵ See *About Us*, FATF, <http://www.fatf-gafi.org/pages/aboutus> (last visited May 10, 2014).

¹⁶ Gordon, *supra* note 13, at 577.

¹⁷ Richard K. Gordon, *Trusts or Terrorists? Financial Institutions and the Search for Bad Guys*, 43 WAKE FOREST L. REV. 699, 715 (2008).

¹⁸ See Gordon, *supra* note 13, at 577-78.

¹⁹ *Id.* at 577 & n.426.

²⁰ FATF, INTERNATIONAL STANDARDS ON COMBATING MONEY LAUNDERING AND THE FINANCING OF TERRORISM & PROLIFERATION: THE FATF RECOMMENDATIONS 11-13, 24-25 (2012), available at http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf (Recommendations 1-8, 29-32).

²¹ *Id.* at 27-30 (Recommendations 36-40).

²² *Id.* at 14-24 (Recommendations 9-28).

²³ *Id.* at 14.

²⁴ Richard Gordon, *Terrorism Financing Indicators for Financial Institutions in the United States*, 44 CASE W. RES. J. INT’L L. 765, 772 (2012).

suspect the client may be a criminal, including a terrorist.²⁵ Key to the process of successful activity monitoring is an understanding of what known bad guys have done in the past. Studies of these past actions are known as typologies, which can include special “red flag” indicators for particular types of nefarious activity.²⁶

The FATF and member governments had been developing money laundering typologies and red flag indicators for many years, so that while financial institutions were not originally in the business of finding criminal proceeds, they at least had years of learning how to do so.²⁷ The problem with adding terrorism financing to the list of activities that financial institutions were required to look for, and requiring them to report to the government when they suspected they saw it, was that the FATF didn’t actually know how bad guys financed terrorism.²⁸ It was one thing for governments to use their considerable investigative resources to identify terrorists or terrorist organizations and then pass those names along to financial institutions so that those institutions could verify whether they had any such clients, but yet another to ask financial institutions to identify terrorists based on their clients’ transactions alone.²⁹ In fact, at least until recently, the FATF’s and member governments’ attempts to develop terrorism financing typologies and red flags had been fitful, incomplete, and based largely on a small number of cases that were often not even relevant.³⁰

In response to this problem, the United Nations Counter-Terrorism Implementation Task Force (CTITF)³¹ approached Professor Nikos Passas of Northeastern University, the Honorable Sue Eckert of Brown University, and me in early 2008 to undertake a comprehensive study of terrorism financing. We were asked, quite simply, to examine how terrorists actually financed their activities, and to draw conclusions from those facts. We divided the task into two parts: examining terrorism cases from the United States and those from the rest of the world. I took charge of the U.S. cases, while Sue and Nikos took on everywhere else.

²⁵ *Id.* at 772-73.

²⁶ *Id.* at 780.

²⁷ *See id.* at 786-87.

²⁸ *See id.* at 786-89.

²⁹ *Id.* at 786-87.

³⁰ *Id.* at 787-88 (noting that cases cited by the FATF “dealt almost entirely with individuals or organizations identified as having terrorism connections rather than . . . terrorism financing indicators”); Gordon, *supra* note 17, at 732-735.

³¹ *See Counter-Terrorism Implementation Task Force*, UNITED NATIONS, <http://www.un.org/en/terrorism/ctitf/index.shtml> (last visited May 10, 2014) (describing the creation and role of the CTITF).

The reason for this division of labor was that we had help from the U.S. Department of Justice (DOJ) in identifying all instances where terrorism-related prosecutions had taken place—not just for terrorism financing, but for any situation where the Department thought the defendant was a terrorist. The DOJ also helped us collect information about the cases. Eventually, the Department provided us with 263 U.S. cases in which the United States had alleged that the defendant(s) may have been involved in supporting terrorism or some form of terrorist activity. This list did not include the 9/11 terrorists, who had been reviewed extensively by the U.S. 9/11 Commission and turned up no apparent terrorism financing indicators.

Of these 263 cases, my students and I found only one instance where a shell company might possibly have been involved, although it may have been an active charitable trust—we couldn't confirm one way or the other.³² That was it. We did find nine instances where active charities were involved,³³ and six instances where active, otherwise legitimate companies were involved.³⁴ Sue and Nikos had far less luck in turning up information on non-U.S. cases, but found no incidents involving shell companies there either.³⁵

II. A LACK OF SUPPORT

So, one of us has made a mistake. To investigate who—the authors of *Funding Terror* or the authors of the Report to the United Nations Counter-Terrorism Implementation Task Force on Terrorism Financing Indicators³⁶—I started checking *Funding Terror*'s footnotes, which include plentiful references to the important role of shell companies in terrorism financing. The authors make the bold claim that “one of the most dangerous and accessible financial tools used by terrorists today is the anonymous shell

³² Sue Eckert, Richard Gordon & Nikos Passas, Report to the United Nations Counter-Terrorism Implementation Task Force on Terrorism Financing Indicators 29-30 (2013) (unpublished manuscript) (on file with author). While our study targeted instances where financial institutions were involved, shell companies did not turn up in any other context either.

³³ *Id.* at 29-31, 34-36, 40-44, 46.

³⁴ *Id.* at 32-37, 39-40, 46-47.

³⁵ *Id.* at 53-55.

³⁶ Our draft report to the United Nations underwent extensive peer review by the U.N. Counter-Terrorism Implementation Task Force, the U.N. Security Council Al-Qaida and Taliban Sanctions Committee, the FATF, the Egmont Group of Financial Intelligence Units, and the World Bank, among others. We also had two, day-long symposia on the draft report, one at the U.N. and another at Case Western Reserve University School of Law. No one raised any questions with respect to the quality of our case identifications or descriptions.

company,”³⁷ but at best their sources prove only that terrorists *could* use shell companies.

In footnote after footnote, the authors cite to sources that either make broad statements about shell companies generally, or merely speculate that these vehicles *might* be used by terrorists, to support their proposition that terrorists *are* using shell companies to fund their activities (and that the government needs to do more to prevent these dangerous activities). To start, the footnote supporting the statement that shell companies are “one of the most dangerous and accessible financial tools used by terrorists today”³⁸ cites to sources stating only that (1) a shell company “that is reluctant to provide information on controlling parties and underlying beneficiaries” may indicate money laundering (but *not* terrorism specifically)³⁹ and (2) shell companies *could* be misused for money laundering or to finance terrorist activities and groups.⁴⁰ As for the two sources supporting this second statement, the sources themselves are of no or nearly no probative value. Neither focuses on terrorism financing, nor do they offer any proof that terrorists *actually use* shell companies. I wouldn’t have minded if the authors of *Funding Terror* had written “according to sources that offer no evidence that what they write is correct, one of the most dangerous and accessible financial tools used by terrorists today is the anonymous shell company.” But they didn’t.

Later in the Article, the authors of *Funding Terror* assert that “terrorists use shell companies to conceal and transfer money through bank accounts around the globe, including transfers within the United States,”⁴¹ but the book they cite, *The Puppet Masters: How the Corrupt Use Legal Structures to Hide Stolen Assets and What to Do About It*, shows only that shell companies

³⁷ *Funding Terror*, *supra* note 1, at 482.

³⁸ *See id.* at 482 & n.16.

³⁹ FED. FIN. INSTS. EXAMINATION COUNCIL, BANK SECRECY ACT/ANTI-MONEY LAUNDERING EXAMINATION MANUAL app. F, at F-1 (2010), *available at* http://www.ffiec.gov/bsa_aml_infobase/documents/bsa_aml_man_2010.pdf. There is no reference to terrorism at all on that page, which lists potentially suspicious activity that may indicate money laundering. The next section, “Potentially Suspicious Activity That May Indicate Terrorist Financing,” makes no reference to shell companies. *Id.* at F-9 to -11.

⁴⁰ *See* FIN. CRIMES ENFORCEMENT NETWORK, THE ROLE OF DOMESTIC SHELL COMPANIES IN FINANCIAL CRIME AND MONEY LAUNDERING: LIMITED LIABILITY COMPANIES 13 (2006) (“In effect, the domestic shell company could be a vehicle to launder money, move money derived from crime, or finance terrorist activities and groups, all completely anonymously.”); *They Sell Sea Shells*, *ECONOMIST*, Apr. 7, 2012, at 69, 69 (noting that shell companies have legitimate uses but “can also be misused—for tax evasion, money laundering, sanctions-busting or terrorism”).

⁴¹ *Funding Terror*, *supra* note 1, at 492.

can be used to conceal ownership information.⁴² There is not a word about terrorism or terrorists. And, in support of their contention that “many terrorist groups have used shell companies to launder and obscure their ties to illegal funds,”⁴³ the authors provide nothing more than a vague reference to an unidentified FBI prosecution. The supporting footnote quotes a *Forbes* article as stating that “individuals associated with al-Qaeda have used shell companies in Utah and California ‘to commit bank fraud and money laundering and possibly to fund terrorist activities in the Middle East.’”⁴⁴ But in reality, this quote is a reference to a statement by an unidentified FBI agent that a certain, unnamed prosecution that I can’t identify involves shell companies that may, and I quote, “possibly” involve terrorism. This is a far cry from the claim that “many terrorist groups have used shell companies.”⁴⁵

While shell companies’ potential for abuse might be particularly worrisome if it were true that “[t]errorists, in particular, view shell companies as an attractive medium to move money anonymously around the world,”⁴⁶ the authors provide no proof that terrorists do indeed view them in this light. In support of their statement, the authors cite to a *Wall Street Journal* article, *Tax Report: IRS Cracks Down on Dodgers Who Use Onshore Tax Havens*.⁴⁷ The sole reference to terrorism in that article is a quote from Senator Norm Coleman (R–Minnesota), who said, “[t]he absence of ownership disclosure requirements and lax regulatory regimes in many of our states make U.S. shell companies attractive vehicles for those seeking to launder money, evade taxes, finance terrorism, or conduct other illicit activity anonymously.”⁴⁸ So, it’s not terrorists “in particular” that view shell companies as attractive; in fact, terrorism is only one of several enumerated types of

⁴² PUPPET MASTERS, *supra* note 2, at 37. The *Funding Terror* authors also cite *Puppet Masters* earlier in their Article to make the leap from the book’s description of shell companies as “hollow” (again, without reference to terrorism or terrorists) to the claim that this feature makes shell companies “commonly used” for terrorism. See *Funding Terror*, *supra* note 1, at 483 & n.18 (citing PUPPET MASTERS, *supra* note 2, at 35).

⁴³ *Funding Terror*, *supra* note 1, at 494.

⁴⁴ *Id.* at n.84 (quoting Elizabeth MacDonald, *Shell Games*, FORBES, Feb. 12, 2007, at 96, 96).

⁴⁵ The second part of the footnote reads “see also Glenn R. Simpson, *Palestinian Bank Faces U.S. Probe on Laundering*, WALL ST. J., Feb. 2, 2005, at B3 (describing a ‘major crackdown’ on the use of shell companies to fund terrorism).” *Funding Terror*, *supra* note 1, at 494 n.84. In reality, the Simpson article’s use of the phrase “major crackdown” actually references a crackdown on banks for failing to implement anti–money laundering laws. Simpson, *supra*. There is no reference to shell companies anywhere in the article, although there is mention of active charities. *Id.* In other words, the footnote is simply wrong.

⁴⁶ *Funding Terror*, *supra* note 1, at 493.

⁴⁷ *Id.* at 493 n.82 (citing Tom Herman, *Tax Report: IRS Cracks Down on Dodgers Who Use Onshore Tax Havens*, WALL ST. J., Dec. 6, 2006, at D2).

⁴⁸ Herman, *supra* note 47.

illegal activity that shell companies could theoretically facilitate. Also, the *Wall Street Journal* article indicates no actual proof that the Senator knows what he's talking about. The authors of *Funding Terror* leave us with a *conclusion* that terrorists, *in particular*, view shell companies as an attractive medium, while the source demonstrates only that Senator Coleman has a view—based on what, we do not know—that, terrorists, *among others*, view shell companies as such.

Funding Terror's assertion that the United States and other jurisdictions have responded to terrorists' abuse of shell companies by trying to prevent that abuse is also unsupported by the sources they cite. The authors claim that the United States "has occasionally enforced the material support statutes" in order "to restrict the use of shell companies for terrorist financing,"⁴⁹ but the corresponding footnote cross-references footnotes whose sources do not even mention shell companies.⁵⁰ Likewise, their statement that the PATRIOT Act requires broker-dealers to "take extra precautions when dealing with shell companies" finds no support in a reference to an article that includes no discussion of shell companies.⁵¹

III. NEGLIGIBLE FUTURE RISK

Speaking personally, I believe terrorists haven't been using shell companies to finance terrorism because they haven't had to; setting up shell companies is a step they just don't need to take.⁵² I have a few hypotheses about this, which I will outline briefly.

⁴⁹ *Funding Terror*, *supra* note 1, at 499.

⁵⁰ *See id.* at n.116; *id.* at 497 nn.105-06 (citing Robert M. Chesney, *The Sleeper Scenario: Terrorism-Support Laws and the Demands of Prevention*, 42 HARV. J. ON LEGIS. 1 (2005), and Andrew Peterson, *Addressing Tomorrow's Terrorists*, 2 J. NAT'L SEC. L. & POL'Y 297 (2008)).

⁵¹ *See id.* at 500 & n.119 (citing Alan E. Sorcher, *Lost in Implementation: Financial Institutions Face Challenges Complying With Anti-Money Laundering Laws*, 18 TRANSNAT'L LAW. 395 (2005)). Although *Lost in Implementation* discusses "shell banks," these are quite different from shell companies—though both confusingly use the same adjective. Shell banks are licensed financial institutions that have no physical presence in the country in which they are incorporated and licensed, making it difficult to collect information during the supervisory examination process. *See Glossary of the FATF Recommendations: "Shell Bank,"* FATF, <http://www.fatf-gafi.org/pages/glossary/s-t> (last visited May 10, 2014). Shell banks are also unaffiliated with a regulated financial group and are therefore not subject to effective consolidated supervision. *See id.*

⁵² It is possible that terrorists have tried to create shell companies but have failed, perhaps because corporation service providers have refused to assist them. There is, however, no evidence to suggest this. Even the authors of *Funding Terror* acknowledge that "the terrorism condition findings show that relying on [corporation service providers] to decline customers that pose a terrorism risk may not adequately deter terrorism financiers. . . . In many cases, [corporation service providers] did not even require identifying information from customers posing an obvious risk of terrorism." *Funding Terror*, *supra* note 1, at 523.

There are many proven instances where, to further their criminal activities, money launderers have utilized companies—both shell companies and operational companies used as fronts⁵³—or other legal persons like charities. As I see it, these instances are all due to the fact that for some time, anti-money laundering rules have required banks and other financial institutions, including money services businesses, to identify their customers, maintain customer records, and report suspicious transactions.⁵⁴

If you are a known crook, you obviously don't want to identify yourself to a financial institution, and if you are an as-yet-unknown crook, divulging your name might allow some investigator to later find and question you. If you set up a company or other legal entity, however, the company will be the account holder, not you. And, if you can hide your ownership of or control over the account—and mind you, financial institutions are supposed to make this difficult⁵⁵—it becomes easier to keep your name from the bank or other financial institution, or from criminal investigators.⁵⁶

But there is at least one other key reason to operate through a company rather than as an individual. Anti-money laundering rules require that financial institutions learn about their customers, including the nature of their businesses and, where necessary (as in, where there are doubts about a customer⁵⁷), the sources of funds for customers' accounts.⁵⁸ If a customer does not present a convincing argument that its activities are legitimate, the bank might decline to open the account and might even file a report with the government.⁵⁹ If, however, an individual forms a company, he can build and provide the financial institution with a backstory that paints the company as a real business generating legitimate funds. This is often much easier than creating a backstory for a physical person, especially when a lot

⁵³ See PUPPET MASTERS, *supra* note 2, at 39 (“Operational entities have inflows and outflows of assets, which enables streams of illicit assets to be mingled with legitimate funds and thereby laundered. Thus, substantial amounts of money can be transferred without raising suspicion.”).

⁵⁴ I have described the system in detail in previous work. See Gordon, *supra* note 24, at 772-81.

⁵⁵ See *id.* at 774 (noting that the FATF requires that financial institutions take “reasonable measures to identify the physical persons who own or control” the company or other legal person (internal quotation marks omitted)).

⁵⁶ See OECD, BEHIND THE CORPORATE VEIL: USING CORPORATE ENTITIES FOR ILLICIT PURPOSES 13 (2001), available at <http://www.oecd.org/daf/ca/43703185.pdf>.

⁵⁷ See FED. FIN. INSTS. EXAMINATION COUNCIL, *supra* note 39, at 64-65 (explaining that a bank “may determine that a customer poses a higher risk because of the customer’s business activity, ownership structure, [or] anticipated or actual volume and types of transactions, including those transactions involving higher-risk jurisdictions”).

⁵⁸ Gordon, *supra* note 24, at 775.

⁵⁹ *Id.* at 775, 777.

of money is involved and the launderer isn't known as a business or financial genius.⁶⁰

The advantage of using a front or otherwise legitimate company is that much of the backstory is built in, although it may require a little tweaking to explain why business has been so good lately. The disadvantage of using a front is that you either have to build one from scratch or take over another one, which in either case requires recruiting a fair number of confederates who are not otherwise necessary in the criminal undertaking. That can be difficult or even dangerous, in that one of these confederates may make a revealing mistake or simply decide to turn you in. The advantage of using a shell company is that you need no confederates (other than maybe a corporation service provider), but the tradeoff is that it will be much harder to develop a convincing backstory.

So why might terrorists not turn to shell companies? The reasons seem to be twofold, though so far, I haven't been able to interview any terrorists to confirm.⁶¹ As noted above, Sue Eckert, Nikos Passas, and I discovered fourteen cases where terrorists used otherwise legitimate front companies or active charities to facilitate their illegal acts.⁶² While we found that criminal proceeds were used to finance terror in only six cases,⁶³ in all cases the financial institution should have inquired as to the purpose of the account and looked at any unusual transactions that took place;⁶⁴ this inquiry occurred in a minimum of twelve cases.⁶⁵ If the only drawback to a front company is the risk of being ratted out, terrorists may opt to use them

⁶⁰ Other reasons that companies might be appealing vehicles through which to engage in criminal activities include the ease with which multiple legal persons can be set up in multiple jurisdictions, thereby making it more difficult for investigators to operate across many different countries, laws, and legal systems. OECD, *supra* note 56, at 15.

⁶¹ I have tried.

⁶² See *supra* notes 33-34 and accompanying text. One of the identified cases involved both a front company and an active charity.

⁶³ See Eckert, Gordon & Passas, *supra* note 32, at 30-31, 37-39, 44-45, 47, 51-52.

⁶⁴ One "red flag" indicating potential money laundering or terrorism financing is a funds transfer to "a higher-risk geographic location without an apparent business reason." FED. FIN. INSTS. EXAMINATION COUNCIL, *supra* note 39, at F-2. High-risk geographic locations are determined by financial institutions based on five criteria. See *Bank Secrecy Act (BSA): High-Risk Entities Identifying Worksheets*, BANKERSONLINE, http://www.bankersonline.com/tools/operational/mr_highriskentities.pdf (last visited May 10, 2014) (describing high-risk countries as (1) those "in which the production or transportation of illegal drugs may be taking place"; (2) "[b]ank secrecy havens"; (3) "[e]merging countries that may be seeking hard currency investments"; (4) "[c]ountries identified in FinCEN advisories"; and (5) "[m]ajor money laundering countries and jurisdictions"). Using that calculus, we found evidence of transactions to potentially higher-risk locations in twelve cases. See Eckert, Gordon & Passas, *supra* note 32, at 33-35, 38-40, 43-46, 47-48, 52-53.

⁶⁵ See Eckert, Gordon & Passas, *supra* note 32, at 33-36, 38-40, 43-48, 52.

because it's easier to find loyal, ideological recruits than it is to set up a shell company and construct a believable backstory.

Sometimes terrorists might not even require the aid of a front company. In two cases covered in our report, the amount of money involved was so small that there was no need to open multiple accounts or start a company to build a backstory,⁶⁶ while in two other cases where the amount was big, the terrorists used multiple individuals to open multiple accounts.⁶⁷ While in each of these instances the account holders risked having their names turn up in a future investigation, as not-yet-known terrorists or confederates, they were unlikely to prompt a financial institution to ask too many questions or to file a suspicious transaction report. Maybe the individuals were innocent dupes, didn't think they'd get investigated, didn't care, or even looked forward to it. After all, they were probably either stooges or true believers.

If I'm correct, making it more difficult to create shell companies neither would have stopped terrorists in the past nor will it stop them in the future.

There is another problem. While the authors of *Funding Terror* have demonstrated quite convincingly that the rules on customer due diligence are not well enforced by corporation service providers, they do not present evidence suggesting that strategies to keep bad guys from using such providers can be effectively implemented. As the known cases of terrorism financing have demonstrated, there appear to be enough dupes or true-believing confederates around to aid determined terrorists. I find it difficult to believe that plain vanilla money launderers won't be able to persuade—through fraud, threat, or compensation—people who appear honest to approach service providers to set up and “own” companies, whether shell or otherwise, on behalf of the bad guys. While investigators would find it useful for corporation service providers to record the identity of the physical person who sets up a company (thereby providing someone for investigators to question as to who directed the formation of the company), I think efforts are better made at the level of the financial institution, via a shift from identifying who controls the corporate account to judging whether the corporate client and its transactions seem dodgy. Anything else could be an expensive waste of time.

But all this is just a guess, albeit an educated one.

⁶⁶ See *id.* at 40-42.

⁶⁷ See *id.* at 41-42, 44-45.

CONCLUSION

So, if there is no groundswell of evidence that terrorists actually use shell companies, why base a study of corporation service providers on such a premise? Clearly there is plenty of evidence that shell companies are used for money laundering.⁶⁸ In fact, a recent book, *Global Shell Games: Experiments in Transnational Relations, Crime, and Terrorism*⁶⁹—coincidentally written by Jason Sharman, Michael Findley, and Daniel Nielson, three of the four authors of *Funding Terror*—uses an experimental technique similar to that found in the second part of that Article, but focuses less on terrorism than on corruption and money laundering. While shifting the focus to terrorism may have increased interest in the *Funding Terror* study, it unfortunately also decreased its relevance.

Funding Terror asserts, and quite firmly, that the use by terrorists of shell companies is a known fact, and that policymakers should address this danger by expending resources directed at stopping it. The assertion, however, is not supportable, and the recommendation is therefore dubious. That it was presented in such a manner by one of the nation's top law reviews is unfortunate and highlights the need for some aspect of peer review in the editing process—at least for specialized topics like terrorism financing.

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⁶⁸ See, e.g., PUPPET MASTERS, *supra* note 2.

⁶⁹ MICHAEL G. FINDLEY, DANIEL L. NIELSON & J.C. SHARMAN, *GLOBAL SHELL GAMES: EXPERIMENTS IN TRANSNATIONAL RELATIONS, CRIME, AND TERRORISM* (2014).