



Financial Sanctions and North Korea: In Search of the Evidence of Currency Counterfeiting and Money Laundering Part II

(A partial Chinese translation is [available](#).)

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This is the second article by John McGlynn in a series that meticulously dissects US charges of North Korean criminality, notably the forgery of US currency and money laundering, the significance of the legal instruments it has imposed on North Korea through Banco Delta Asia, and the significance of US actions for the resolution of the interrelated issues of North Korean nuclear weapons and the normalization of US-North Korean relations.

Among the important conclusions that it reaches are the following:

First, surveying the official record of charges of counterfeiting and money laundering since the early 1990s, it is difficult to understand why the US government ever identified the DPRK or Macau as currency counterfeiting concerns in the first place. Difficult to understand, that is, unless the charges are politically motivated and rest on no solid evidentiary basis.

Second, ultimately, the US Treasury's decision to impose the fifth special measure on Banco Delta Asia was not based on any regulatory, legislative or procedural shortcoming in Macau but on the "likelihood of recidivism" by BDA's owners and the "potential use of the bank for illicit purposes."

Third, US policy toward North Korea has been and remains deeply divided between approaches favored by the State Department and the Treasury, the former looking to negotiations to eliminate the North Korean nuclear threat within the framework of the six-party talks, the latter directed toward regime change in the DPRK.

The earlier articles on Japan Focus are:

- [North Korean Criminality Examined: the US Case](#)
- [Banco Delta Asia, North Korea's Frozen Funds and US Undermining of the Six-Party Talks: Obstacles to a Solution](#)

Introduction

What evidence is there to support accusations that North Korea is a money-laundering and currency counterfeiting state? The answer, at least so far as the public record is concerned, is none.

This article examines four issues:

1. The US Treasury Department's action to blacklist Banco Delta Asia (of Macau), which set the stage for a US-led international campaign of financial sanctions against the Democratic Peoples Republic of Korea (DPRK, the official name of North Korea);
2. The evidence, or lack of it, of involvement by the DPRK in money laundering and currency

counterfeiting;

3. The credibility of accusations by US government officials that the action against Banco Delta Asia is a law enforcement matter rather than an attempt to deny the DPRK access to the international banking system;
4. The apparent lack of interest among US and international authorities in the DPRK and Macau as currency counterfeiting concerns prior to the September 2005 blacklisting of Banco Delta Asia.

Since late 2005 the US government, despite its claims to the contrary, has been using its formal censure of Banco Delta Asia (BDA) as the lynchpin in a campaign of financial sanctions against the DPRK. Although US officials have repeatedly insisted on describing these sanctions as a law enforcement matter, that characterization appears incorrect and may be deliberately false. The financial sanctions in place are a product of the USA Patriot Act, a controversial law enacted in the immediate aftermath of 9-11. Section 311 of the Act gives the US government wide scope to use classified intelligence to support allegations of illicit activities by overseas financial institutions and the US Treasury Department the right to cut-off a suspected wrongdoer from the US financial system through imposition of what is called the fifth special measure. Section 311 requires the Treasury Department to consult with the US State Department, among other federal agencies, on the implications of financial sanctions for US foreign policy (such as the State Department's successful participation in the Six-Party negotiations) and national security (such as finding ways to terminate or restrict the DPRK's nuclear weapons and ballistic missile development programs). A close reading of newspapers makes it clear that whatever Section 311 consultations may have occurred, since the financial sanctions against the DPRK reached public attention in early 2006 State and Treasury have not been on the same page when it comes to US foreign policy toward the DPRK.



One of the main branches of Banco Delta Asia in Macao

US government officials have argued that financial sanctions are necessary to counteract alleged DPRK involvement in money laundering and currency counterfeiting. There is indeed evidence of wrongdoing, but it dates from 1994, or possibly over an unknown but short span of years leading up to 1998. But since the late 1990s it appears that no agency of the US government has publicly presented credible evidence.

Many who have studied the Bush administration's foreign policy toward the DPRK conclude that it suffers from a split personality. On one side is a pro-engagement faction (led by Secretary of State Condoleezza Rice, assisted by her envoy to the Six Party Talks, Christopher Hill) willing to engage in diplomatic negotiations that might someday lead to a resolution of all outstanding major differences between the two countries including dismantling of the DPRK nuclear weapons program and US-DPRK normalization of relations. On the other is a hawkish faction (led by US Vice-President Dick Cheney, assisted at one point by former United Nations ambassador John Bolton and others) which has favored a get-tough approach, basically a continuation of the standard US policy for the last 50 years:

international isolation, occasional public pronouncements about the need for regime change; and threats of war.

These two sides have been battling each other ever since the Bush administration came to office, but a key moment came in September 2005 over whether to pursue multilateral and bilateral engagement based on negotiated objectives which had been agreed during the September 13-19, 2005 Six-Party Talks (dismantlement of the DPRK's nuclear weapons program, normalization of US-DPRK relations, etc.) or to step up the pressure on North Korea and isolate it even further from the international community. The hawks won that particular round, as only became apparent several months later, by managing to stymie (but not kill) the Six-Party process through the application of financial sanctions.

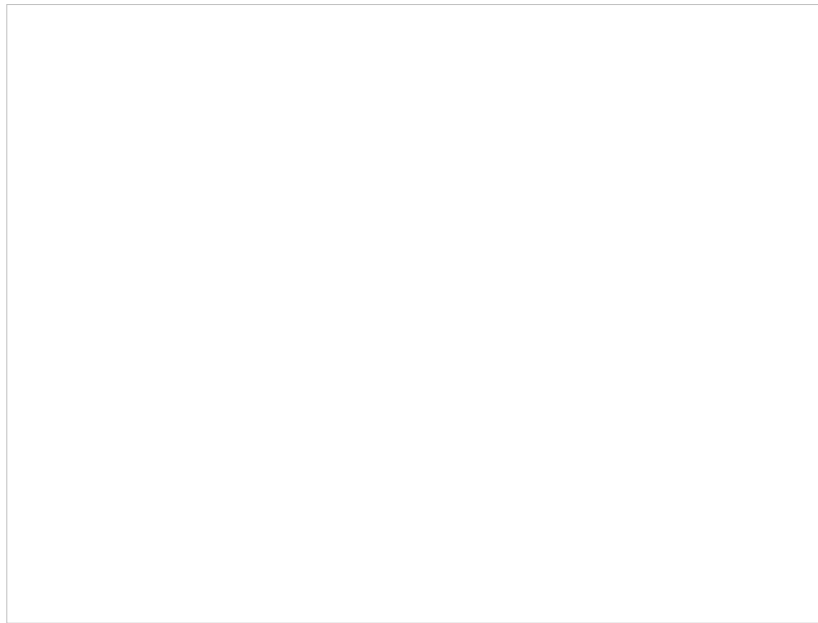
Details are sketchy, but apparently as of mid-June US and Russian banking officials, working with financial authorities in Macau, had arranged to transfer the DPRK's funds on deposit at BDA to a bank in Russia (likely to be the Far East Commercial Bank, according to the *Wall Street Journal*[1]. Because the DPRK has signaled that it agrees to the transfer, it appears the process of implementing the Six Party agreement can resume.

If this transfer does take place and if the Russian bank can get assurances from the US Treasury Department that it will not be barred from the US financial market for handling the DPRK's money, the way may be clear for the DPRK to escape from 18 months of international financial sanctions and for the Six Party diplomatic process aimed at denuclearizing the Korean Peninsula and achieving a permanent peace in Northeast Asia to resume. Such an outcome would be positive for the stability and security of the Northeast Asian region, but it leaves unclear how or when the blacklisting of BDA is to be resolved. One thing that is clear is that with the DPRK and its funds out of the picture, BDA becomes a matter strictly for US and Chinese authorities to settle.

The transfer of funds to the Russian bank is in no small degree the product of an atmosphere conducive to the resumption of Six Party talks developed over the first six months of 2007, thanks mainly to a US decision in January[2] to drop its belligerent posture toward the DPRK. It now appears that the pro-engagement faction in Washington is in charge of policy and is now focused on bringing the DPRK back into diplomatic negotiations. But the contest of wills is not over. Reaching a permanent solution to the BDA affair depends on a decision by Treasury officials to withdraw the Patriot Act Section 311 blacklisting. That will be difficult because it would mean a loss of bureaucratic face and a decision to forego use of one of the legal tools created in the wake of 9-11 to fight terrorism and other perceived threats.

I. US Treasury's Finding and Rulemaking: Setting the Stage for Financial Sanctions

Two notices published by the US Treasury Department in the US Federal Register on September 20, 2005, a Finding and a proposed "Rulemaking" (hereafter, "proposed Rule"), established the legal basis for the US government to initiate a regulatory process that in time resulted in cutting the DPRK off from the international banking system [3]. Until around December 2005, when the DPRK started to protest the legal and political significance of these notices, the public and the media had little awareness of their existence.



The US Treasury Department in Washington, DC

Both notices were prepared by the Financial Crimes Enforcement Network (FinCEN), a unit in the US Treasury Department. FinCEN describes itself as "a network, a means of bringing people and information together to fight the complex problem of money laundering", which it does by "information sharing among law enforcement agencies and its other partners in the regulatory and financial communities." [4]

In regard to investigations into counterfeiting of United States currency, FinCEN relies heavily on the work of the US Secret Service, which since its creation in 1865 has had the job of suppressing dollar forgery. In 1894 the Secret Service also began providing protection to the US president and later the vice president, their families, visiting heads of state and other designated individuals. [5]

The summary at the beginning of the Finding states the Director of FinCEN "finds that reasonable grounds exist for concluding that" BDA "is a financial institution of primary money laundering concern."

In regard to the DPRK, the principal discovery reported in the Finding was the "involvement of North Korean government agencies and front companies in a wide variety of illegal activities, including drug trafficking and counterfeiting of goods and currency," all of which "has been widely reported."

According to the Finding, BDA is the fourth smallest commercial bank operating in the Chinese territory of Macau (the Macau Monetary Authority reports 27 banks). BDA

has provided financial services for over 20 years to multiple North Korean government agencies and front companies that are engaged in illicit activities, and continues to develop these relationships. In fact, such account holders comprise a significant amount of Banco Delta Asia's business.

FinCEN's authority to conclude that a bank is a "primary money laundering concern" comes from Section 311 of the USA Patriot Act, which was passed by overwhelming votes in both houses of the US Congress and signed into law by President George H. Bush in the month following the 9-11 terrorist attacks. Section 311 grants the US Treasury Secretary the authority to make determinations that a particular foreign bank, jurisdiction, financial account or financial transaction is a "primary money laundering concern." The key law enforcement

features of Section 311 are five "special measures" that the Treasury Secretary can use "to target specific money laundering and terrorist financing." The five special measures are:

- (1) Recordkeeping and reporting of certain financial transactions;
- (2) Collection of information relating to beneficial ownership;
- (3) Collection of information relating to certain payable-through accounts;
- (4) Collection of information relating to certain correspondent accounts; and
- (5) Prohibition or conditions on the opening or maintaining of correspondent or payable-through accounts.[6]

Moreover, "Section 311 identifies factors for the [US Treasury] Secretary to consider and Federal agencies to consult before the Secretary may conclude that" a "primary money laundering concern"[7] exists. As explained below, these words came to have high significance.

To deal with BDA, Treasury applied the fifth special measure, which "authorizes the prohibition against the opening or maintaining of correspondent accounts by any [US] domestic financial institution or agency for or on behalf of a targeted financial institution." A "correspondent account" is defined as "an account established to receive deposits from, or make payments or other disbursements on behalf of, a foreign bank, or handle other financial transactions related to the foreign bank." The proposed Rule is explained across six pages of the Federal Register but these two brief excerpts provided the hook on which to hang a campaign that would mobilize the entire international private banking community to boycott BDA as well as any other financial institution that might wish to do business with the DPRK. A global financial chain reaction was triggered, as banks everywhere were quick to realize that they had to cut any financial links to the DPRK "rather than risk becoming the target of similar action" by US authorities, as the *New York Times* explained.[8]

In November 2006 Stuart Levey, the Treasury Department's Under Secretary for Terrorism and Financial Intelligence and point man for the financial sanctions campaign, described his understanding of how the banking restrictions imposed on BDA affected the DPRK:

Because of the way North Korea operates, it's very difficult for financial institutions to differentiate between its licit and illicit activities. And so, a lot of banks have decided that as long as North Korea is engaged in illicit activity, they don't want to take any chances of being associated with it. As a result, the North Koreans have had a very difficult time.[9]

Martin Hart-Landsberg and John Feffer elaborate on what this "very difficult time" actually entails: "The financial sanctions infringe upon [the DPRK's] sovereign right to engage in legal transactions, raise doubts about Washington's will to peacefully coexist, and represent steps away from normalizing relations." [10]

For a country forced to execute cash-only business transactions because of underdeveloped credit facilities, financial sanctions are potentially devastating. The US-led campaign to apply financial sanctions has therefore been more irksome to the DPRK than the sanctions mandated by the United Nations Security Council in October 2006, after the DPRK conducted its first nuclear test. As Marcus Noland, a senior fellow at the Institute for International Economics and an expert on the economy of the DPRK, put it:

North Korea is showing a more hostile reaction to the freezing of its accounts at Banco Delta Asia (BDA) in Macao than to the official sanctions by the UN. The UN sanctions are moderate and have loopholes in them, whereas the BDA measure brings about cascading effects on the external economic trade of North Korea. Moreover, financial institutions of many countries that are reluctant to be implicated in the illegal conducts of North Korea have begun to stop trade with North Korea. As a result, North Korea is facing an increasing amount of difficulties in international finance trade. This is also shown by the depreciation of the North Korean won in the black market.[11]

In the months that followed the release of Treasury's September 2005 Finding on BDA, banks around the world began to realize that undertaking any financial dealings with BDA might put their own business interests in the US financial market at risk. They also realized that since BDA's business on behalf of the DPRK was the source of its troubles, handling DPRK funds had to be avoided at all costs. In this way the US managed to strong arm the global private banking system into an informal blacklisting of both BDA and the DPRK. The formal cut off of BDA from the US financial market occurred in March 2007, when Treasury issued its Final Rule on BDA, which simultaneously served as an announcement that the fifth special measure had been imposed.[12]

II. Money Laundering and Counterfeiting Evidence: Thin Gruel

After the Bush administration arrived in office Washington stepped up its campaign to depict the DPRK as a criminal or "Soprano" state. Besides illicit financial activities there have also been accusations of drug trafficking and counterfeiting of such products as cigarettes. The main financial crime accusations are money laundering of profits generated by criminal ventures (such as drug trafficking) and the counterfeiting of \$100 "supernotes." But what is the evidence? Is it public? And how recent is it?

Two US government documents are relevant. The first and most important is the September 2005 Finding, in which Washington lays out its official justification for actions that ultimately triggered the financial sanctions against the DPRK. The second is a March 22, 2006 report issued by the Congressional Research Service (CRS) of the Library of Congress.

A. The Finding: September 2005

The word "evidence" appears only once in FinCEN's Finding:

Substantial evidence exists that North Korean governmental entities and officials launder the proceeds of narcotics trafficking, counterfeit activities, and other illegal activities through a network of front companies that use financial institutions in Macau for their operations.

But instead of "evidence," the Finding introduces "Section 311 factors", which present "reasonable grounds" for "concluding that Banco Delta Asia is a financial institution of primary money laundering concern" which has assisted the DPRK to commit financial crimes.

Those "Section 311 factors," describing suspect financial transactions between BDA and DPRK entities, are listed as follows:

1. Banco Delta Asia has provided financial services for over 20 years to multiple North Korean government agencies and front companies that are

engaged in illicit activities, and continues to develop these relationships. In fact, such account holders comprise a significant amount of Banco Delta Asia's business.

2. Banco Delta Asia has tailored its services to the DPRK's demands. For example, sources show that the DPRK pays a fee to Banco Delta Asia for financial access to the banking system with little oversight or control.

3. The bank also handles the bulk of the DPRK's precious metal sales, and helps North Korean agents conduct surreptitious, multi-million dollar cash deposits and withdrawals.

4. Banco Delta Asia's questionable relationship with the DPRK is further demonstrated by its maintenance of an uninterrupted banking relationship with one North Korean front company despite the fact that the head of the company was charged with attempting to deposit large sums of counterfeit currency into Banco Delta Asia and was expelled from Macau. Although this same person later returned to his previous leadership position at the front company, services provided by Banco Delta Asia were not discontinued.

5. Banco Delta Asia's special relationship with the DPRK has specifically facilitated the criminal activities of North Korean government agencies and front companies. For example, sources show that senior officials in Banco Delta Asia are working with DPRK officials to accept large deposits of cash, including counterfeit U.S. currency, and agreeing to place that currency into circulation.

6. It has been widely reported that one well-known North Korean front company that has been a client of Banco Delta Asia for over a decade has conducted numerous illegal activities, including distributing counterfeit currency and smuggling counterfeit tobacco products. In addition, the front company has also long been suspected of being involved in international drug trafficking.

7. Banco Delta Asia facilitated several multi-million dollar wire transfers connected with alleged criminal activity on behalf of another North Korean front company.

8. In addition to facilitating illicit activities of the DPRK, investigations have revealed that Banco Delta Asia serviced a multi-million dollar account on behalf of a known international drug trafficker.

[Note: Numbers above added by the author.]

None of these charges have been accompanied by conclusive or convincing evidence of wrongdoing. It is a list of allegations, which are by their nature almost impossible to verify since the basic factual information needed to confirm criminality, such as dates, sums of money involved and names of individuals or DPRK entities involved, is absent.

"Sources" are twice cited, but FinCEN's three formal documents on BDA – the proposed Rule, Finding and Final Rule – give no clue as to their identity. According to a spokesperson for the US Treasury Department, some are "intelligence channels."^[13] Apparently none has

ever gone on the record. In contrast to unnamed "sources" the only mention in the list of an apparent attempt by a US government agency to conduct its own direct investigation into possible illicit activities is found in factor #8, which states: "Investigations have revealed that Banco Delta Asia serviced a multi-million dollar account on behalf of a known international drug trafficker." When asked about this drug trafficker the Treasury spokesperson replied: "We declassify our statements down to every last word, and we were not able to include the name of the drug trafficker in the downgrade. I will let you know if we're permitted to disclose the nationality of the individual or even whether or not he is North Korean." [14] No additional information was received. Also, a May 2007 petition submitted to Treasury by Jones Day, counsel for Stanley Au, BDA's principal owner, and for the Delta Asia Group, BDA's majority owner, states that this drug trafficker "is not 'known' to Mr. Au or the Delta Asia Group." [15]

Leaving aside factor #4 (a 1994 incident that is discussed below) and the unnamed "sources" relied on for factors 2 and 5, everything else is "alleged," "widely reported" or "long been suspected." As such, in the words of the Jones Day petition, "it is impossible [for BDA's owners or its counsel] to formulate specific responses", because the "allegations of wrongdoing" are "often so vague and devoid of specificity." [16]

Factor #4 in the list at first seems to be incriminating, as it is the only attempt in the list of "factors" to cite a specific link between a DPRK representative and criminal activity, namely, an attempt to deposit counterfeit US currency. But here too the Finding is notably vague.

Based on clues found in the March 22, 2006 CRS report, this incident appears to have taken place in 1994: "In 1994 . . . North Korean trading company executives, who carried diplomatic passports, were arrested for depositing \$250,000 in counterfeit notes in a Macao bank." [17] Contacted by email, a Treasury Department spokesperson confirmed that factor #4 was indeed this 1994 incident, but was unable to comment further because the US investigation into the incident was handled by the Secret Service. A Secret Service public affairs special agent would only say that this 11-year-old incident involved an "ongoing and active investigation and we are therefore unable to make any comment." [18]

Considerably more information about this 1994 incident can be found in the statement Stanley Au, BDA's principal shareholder, submitted to Treasury on May 2, 2007. As the 1994 incident is the only specific accusation of currency counterfeiting in Treasury's portfolio of "Section 311 factors" that establish "reasonable grounds" for concluding BDA is an illicit financial operation, it is worth replicating Au's account of the incident in detail:

To the best of my knowledge, there was only one incident in which a significant quantity of counterfeit U.S. dollars was deposited with the Bank by a North Korean client, and that incident was reported by Banco Delta Asia to the authorities. In mid-June 1994 the Bank received approximately US\$341,000 in cash which was paid into the accounts of three customers. Approximately \$230,000 was paid into the account of San Hap General Trading Company ("San Hap"). Approximately \$20,000 was paid into the account of Kwok Tou. San Hap and Kwok Tou were not North Korean persons or entities but both were known to have business connections with North Korea. Also in mid-June, \$91,000 was paid into the account of Korea United Development Bank (a North Korean bank) by Zokwang Trading Co Ltd ("Zokwang"). Of the overall total amount of US\$341,000, the Bank retained approximately US\$10,000. It sold approximately US\$79,000 of the

notes to DAC [Delta Asia Credit Limited] in Hong Kong and I believe the remainder of approximately \$250,000 were sold to the Hong Kong branch of Republic National Bank of New York ("Republic"), which later became part of HSBC. Republic informed the Bank on or about 20th June that approximately \$160,000 of the notes it had received were counterfeit. DAC and the Bank checked the authenticity of the notes that they were each holding and found them also to be counterfeit. The Hong Kong and Macau police authorities were then notified accordingly. The credit entries in the accounts of San Hap and Kwok Tou were reversed as a result. Since neither raised any objection to this, the Bank took this to mean that they were aware that the cash they had deposited was counterfeit. Accordingly, the Bank closed their bank accounts and terminated its relationship with them. Zokwang told the Bank that the cash paid into its account had come into its possession in China and that it had no knowledge that it was counterfeit. The Bank had no evidence to challenge this and allowed Zokwang to maintain its account but told it that if any counterfeit currency was ever paid into its bank account again, no matter what the circumstances, it would cease all business dealings . . . To the best of my knowledge, Zokwang has never since 1994 been found to be the source of counterfeit funds deposited with Banco Delta Asia.

After the Bank reported this incident to the Macau police, I was contacted by agents of the United States government. Mr. Fung Tat Ping and I subsequently met with them and they asked a number of questions about the circumstances under which the counterfeit notes came into the Bank's possession. I cordially answered the questions and asked if their preference was that we should desist from doing business with North Korean entities. They said that they would like us to continue to deal with them, as it was better that we conducted this business rather than another financial entity that may not be so cooperative with the United States. Given that the meeting took place almost 13 years ago, I cannot recall the names of the U.S. agents I met. In the next couple of years, the Bank was periodically contacted by other U.S. government agents and we cooperated in their inquiries. Since those meetings, I believed that the U.S. government knew of my willingness to cooperate with regard to the Bank's North Korean business and, indeed, to end that business if this would help prevent unlawful conduct. I have not been contacted by the U.S. government since the mid-1990's and had no reason to suspect that its views on this matter had changed.

If the CRS report is the more accurate, at most \$250,000 in counterfeit currency was involved. Yet the DPRK has been accused by US officials of putting nearly \$50 million of fake US notes into circulation since 1989[19]. Moreover, if Au's story is correct, the one known attempt to pass a tiny sum of counterfeit cash was frustrated.

Even if Stanley Au's profession of innocence is fully discounted and the 1994 incident is taken as evidence of collusion by BDA and DPRK representatives in a fake notes transaction, it is the only specific mention of a counterfeiting incident, it involves a trifling sum compared with the tens of millions the DPRK is alleged to have put into circulation, and it took place 11 years ago (prior to Treasury's September 2005 Finding).

This appears to be the only incident of a possible counterfeit currency transaction involving the DPRK that can be cross-checked against other information. If the US government has any other credible evidence of counterfeit transactions, it has not found its way into the public domain.

During a May 2006 speech about what the US was doing to protect its currency from the DPRK, Deputy Assistant Treasury Secretary Donald Glaser remarked: "Now you might ask, why am I giving this example? This is 1994 - so this is 12 years old now. Don't I have a better example? Don't I have something else that I could show you to demonstrate some sort of problem over the past 12 years?" But Glaser did not have more recent evidence; instead he argued that while it is "important to be able to pick specific instances [of money laundering] out . . . even more important are the systemic risks that Bank of Delta Asia presented to the US and to the international financial community." [20] Under Patriot Act Section 311, a simple assertion of "systemic risks" seems to be sufficient to condemn an overseas bank to exile from the international community.

Furthermore, the person charged in 1994 was a company official, not an official in the DPRK government. Yet US officials have repeatedly accused the DPRK government, including its top leadership, of using BDA for illicit purposes. True, the Finding does state:

[S]ources show that senior officials in Banco Delta Asia are working with DPRK officials to accept large deposits of cash, including counterfeit U.S. currency, and agreeing to place that currency into circulation.

and

Substantial evidence exists that North Korean governmental entities and officials launder the proceeds of narcotics trafficking, counterfeit activities, and other illegal activities through a network of front companies that use financial institutions in Macau for their operations.

But no trace of any confirmatory evidence is included in either the September 2005 Finding or the March 2007 Final Rule.

As for factors #2 and #3, there would seem to be nothing illicit, at least prima facie, in the DPRK paying a "fee for financial access to the banking system." Most banks charge for their services, and FinCEN seems to suggest that with "oversight or control" over access to the "banking system" such payments would be acceptable.

For the record, however, Stanley Au states that it is "not true" "that the DPRK or any of the North Korean customers paid the Bank a fee for special access to the Banking system 'with little oversight or control.'"

As it did in factor #3 in the Finding, in the Final Rule FinCEN again remarks on "surreptitious, multi-million dollar cash deposits and withdrawals" but then immediately adds: "In fact, [BDA] facilitated several multi-million dollar wire transfers connected to alleged criminal activity on behalf of one such company" (underline added). Moreover, the Final Rule reveals that here as well FinCEN was made aware of these "surreptitious" transactions by unnamed "sources".

In sum, the only substantive allegation is the 1994 incident.

Of course it may be that incriminating evidence of financial crimes by the DPRK exists. Footnote 4 in the Finding states: "Classified information used in support of a section 311

finding and measure(s) may be submitted by Treasury to a reviewing court *ex parte* and *in camera*." In other words, the US government claims a legal right to withhold from public scrutiny whatever real evidence it might have of DPRK financial wrongdoing.

B. Final Rule: March 2007

With the issuance of the Final Rule in March 2007 the US Treasury formally imposed the fifth special measure on BDA and closed the books on an 18-month investigation. The Final Rule contains some new or slightly fuller descriptions of allegations of illicit activities by the DPRK and BDA but goes little beyond the vague and perfunctory descriptions found in the Finding. On the other hand an entirely new problem, one not mentioned anywhere in the Finding, is introduced: a systemic lack of "due diligence."

Despite any remedial measures and regulatory changes, this historical pattern of disregard by the bank's management and primary shareholder regarding both the systemic due diligence failures at the bank and the potential use of the bank for illicit purposes, and the resultant likelihood of recidivism upon the dissolution of the administrative committee, leave us concerned about the potential for the bank to continue to be used for money laundering and other illicit purposes. Accordingly, we find that Banco Delta Asia continues to be a financial institution of primary money laundering concern.[21] (underlining added)

FinCEN's conclusion about "due diligence failures" may well be true but is mostly irrelevant to the question of whether BDA, after the end of an 18-month long FinCEN investigation, still represents a threat to the US financial system. All of its due diligence failures happened before the investigation began. The question is whether they have been in the main corrected. BDA and its counsel argued they had and pledged to aggressively enforce anti-money laundering measures in future and to abide by legislative remedies passed by the Macau government. Similar actions were adopted in a Ukrainian case and a similar pledge by authorities was enough to convince Treasury to revoke the designation of Ukraine as a primary money laundering concern.[22] FinCEN appears, however, to believe in a "likelihood of recidivism" on the part of BDA's owners, although it offers no explanation of why the owners are more likely to engage in criminality or worse crimes than any other bank owner in Macau or anywhere else.

C. March 2006 Congressional Research Service Report on North Korean Currency Counterfeiting

The Congressional Research Service (CRS) serves the US Congress by providing nonpartisan and objective analysis, and its reports are highly regarded. On March 22, 2006, the CRS issued *North Korean Counterfeiting of US Currency*. It states:

The purpose of this report is to provide a summary of what is known from open sources on the DPRK's alleged counterfeiting of US currency, examine North Korean motives and methods, and discuss US interests and policy options.

Although Pyongyang denies complicity in any counterfeiting operation, estimates are that at least \$45 million in [US Federal Reserve \$100] supernotes of North Korean origin are in circulation and that the country earns from \$15 to \$25 million per year from counterfeiting. South Korean

intelligence has corroborated information on past production of forged currency — at least until 1998 — and several US court indictments indicate that certain individuals have been accused of distributing such forged currency more recently.

South Korean national intelligence is cited as an authoritative source on DPRK currency counterfeiting. But such intelligence stopped in 1998.

[P]ress reports (of February 2, 2006) cite a Uri Party Member of Parliament's account of a closed briefing by South Korea's National Intelligence Service to members of Korea's National Assembly to the effect that North Koreans were arrested abroad for counterfeiting offenses in the 1990's but that the Service had no evidence of the North making bogus currency after 1998.[23]

After 1998 evidence may have existed but been suppressed for political reasons, perhaps because of a reluctance by intelligence officials to disturb South Korea's Sunshine policy, announced in 2000, of improving relations with the DPRK.

It is unclear whether US officials were given access to any such intelligence, but it seems unlikely, because the CRS report does not discuss any grant of access and it relies primarily on US government and media sources on DPRK currency counterfeiting. It cites no evidence of DPRK counterfeiting since 1998 (when the South Korean intelligence pipeline shut down).

From the post-1998 period, the report discusses only two significant pieces of supposed evidence. The first, presented in footnote 6, reads:

In July 2004, for example, the US Secret Service reportedly uncovered a network selling counterfeit North Korean made cigarettes, pharmaceuticals, and \$100 bills. See Frederik Balfour et. al., "Fakes," *Business Week*, February 7, 2005. Criminal indictments subsequently ensued. See generally: *BBC News*, "What is a superdollar?", June 20, 2004. (underline added)

Between "reportedly" making its discovery in July 2004 and the publication of the March 2006 CRS report, the Secret Service presumably investigated this matter but none of its findings were included in the CRS report. Perhaps sources had to remain classified, but in that case the public can have no idea of what really happened.

The second significant piece of evidence is an undergraduate honors thesis written by a Stanford University student which was completed in May 2005 (available at www.nautilus.org). That honors thesis, the March 22 CRS states,

lists thirteen reported incidents since 1994 of North Korean involvement in smuggling/distributing counterfeit US currency. All of these incidents allegedly occurred in either Asia or Europe. In them, the use of DPRK diplomatic passports and the involvement of DPRK diplomats, embassy personnel, and DPRK government trading company officials connect most of these incidents to the government of North Korea in varying degrees.

A review of the sources for the listed 13 incidents[24] indicates that some apparently involved investigations by three major US government agencies: Secret Service (in 1989), Drug Enforcement Administration (1996, 1997, 1998) and the Joint Interagency Task Force West of the Department of Defense (1996). However, none of the incidents these government

agencies may have investigated are dated later than 1998. Of the remaining seven incidents mentioned in the list that occurred during the 1998-2004 period five are based on media reports and, inexplicably, two lack any sourcing at all.

If this honors thesis is to be accepted, as the CRS authors apparently do, as a reliable and comprehensive account, it demonstrates once again that the US government was unable to publicly produce any proof of DPRK involvement in the distribution of counterfeit currency after 1998 and until early 2005 when the thesis was completed.

The March 22 CRS does note several post-1998 investigations, but only on the basis of media reports, testimony before Congress and, in one case, a US government agency press release. They are qualified with circumlocutions like "the US has reportedly determined that . . . counterfeit notes seized . . . was [sic] manufactured in the DPRK", "supernotes believed to be of North Korean origin" and "believed to be DPRK government produced" (underlining added).

One investigation that seems more substantive than the others is noted in Footnote 27, which in part states: "US military sources reportedly estimated DPRK income from counterfeiting of US currency at \$15-20 million for the year 2001." Compared with other vague allegations, this one has a degree of specificity. It mentions a specific counterfeiting period and a specific sum of counterfeit money. But we learn at the end of the footnote that the information is based on second-hand (even third-hand) reporting: the *Yonhap*: a Seoul-based news agency, citing a May 2003 report in the *Yomiuri Shimbun*, a Japanese newspaper, which in turn relied on unnamed US military sources. Oddly, the March 22 CRS report, despite its thoroughness, offers no US news source for this same information. Apparently, the US military was willing to talk to a Japanese newspaper but was uninterested in passing along its findings to the US media. In the absence of any information about the research techniques used to gather the 2001 data and about the credibility of the "military sources," and in the absence of any confirmation, the *Yonhap/Yomiuri Shimbun* story appears weak.

US officials, particularly during the current Bush administration, have long held up the DPRK as a notorious counterfeiting state. But the dearth of solid evidence after 1994 (as determined by reading the Finding) or after 1998 (after reading the March 22 CRS report) is striking. That the Stanford honors thesis assumes a position of importance in the March 22 CRS report is probably attributable to its academic advisors[25] and the fact that it is one of the few recent sourced research reports on alleged DPRK financial misbehavior. But as the CRS report is an information review ("a summary of what is known from open sources on the DPRK's alleged counterfeiting of US currency") rather than a fresh and independent investigation, it is telling that its reliance on open sources indicates that since May 2000 no US government agency with investigative powers has produced and made available to the public an original and sourced analysis of possible post-1998 DPRK counterfeiting activities.

D. Why the Fuss Over BDA?

With an 18-month investigation involving review of 300,000 bank documents by Treasury officials now out of the way, it is still far from clear why BDA, out of all the financial institutions in the world, suddenly ranked in September 2005 – and, with the fifth special measure in place, continues to rank today – high up on Treasury's list of chief money laundering concerns. In the Final Rule issued after the Treasury's lengthy and vigorous investigation, only two specific sums of potentially illicit money tied to BDA are mentioned: "Many North Korean-related individuals and companies banking at Banco Delta Asia had connections to

entities involved in trade in counterfeit U.S. currency, counterfeit cigarettes, and narcotics, including several front companies suspected of laundering hundreds of millions of dollars in cash through Banco Delta Asia" and "in the absence of any credible explanation of the origin or purpose for the cash transactions . . . records from 2002 show that one North Korean-linked entity deposited the equivalent of over U.S. \$50 million."

Determining whether the former sum represents criminal profits is impossible because the front companies are not named and the time period of illegality is unmentioned (even if "hundreds of millions" represents total actual criminal gains, if the gains were laundered over, say, 10 years, how serious is this compared with South American narcotics-related money laundering through Miami or New York city banks over the same period?). Moreover, as the front companies are only "suspected," perhaps they were involved in perfectly legitimate business activities.

The latter sum of \$50 million, though smaller, may be a more serious matter. In its examination of BDA Ernst & Young found that there were certain "suspicious transactions" involving deposits of "large sums of cash and/or bullion into the BDA accounts" of North Korean "non-bank customers." For these deposits there was "a lack of tangible evidence showing that adequate KYC [Know Your Customer] due diligence had been performed." Ernst & Young conclude that BDA probably should have reported such transactions to the Monetary Authority of Macau and to the Macau police.

However, as the Ernst & Young report also notes, "when asked about the KYC procedures employed by "BDA in regard to DPRK customers, former BDA management officials "consistently responded that the justification for having large physical cash transactions was that the North Korea was a cash based economy, and that large quantities of foreign currency were sent back to the country by North Koreans working overseas, particularly in Japan" (a similar explanation was provided by Stanley Au in his May 2007 declaration to Treasury). Corroboration of the money flows to Japan comes from a Rand Corporation international economics analyst, who in November 2006 estimated that remittances from Japan to the DPRK "range from less than \$100 million to over \$300 million annually." [26] If Treasury is worried by the lack of a "credible explanation" for certain transactions and feels that it cannot trust explanations from former or current BDA officials, it appears US experts exist who can readily fill in the blanks.

But even if allegations of \$50 million in money laundering in 2002 or hundreds of million of dollars in some other time period have some basis in truth, they are small beer compared to sums uncovered in other and far better documented Treasury investigations of non-US banks which branch operations based in the US. From March 2004 to March 2005, the Israel Discount Bank of New York (a financial institution based in Israel) processed "181,000 third-party wire transfers totaling \$35.4 billion," a substantial fraction of which "exhibited characteristics and patterns commonly associated with money laundering." From August 2002 to September 2003, a North American regional clearing center under the administrative watch of the New York branch of ABN Amro (a banking institution organized under the laws of the Netherlands) processed "approximately 20,000 funds transfers – with an aggregate value of approximately \$3.2 billion – that involved 'shell companies' in the United States" that were possibly being used by criminals affiliated with "institutions in Russia or other former Republics of the Soviet Union." [27] Other institutions investigated by FinCEN for inadequate due diligence procedures that might have led to money laundering had assets in excess of \$1 billion, whereas FinCEN's September 2005 Finding reported that BDA only had total equity of

\$35 million at the end of 2003.

In short, BDA, a small bank in Macau still only vaguely accused of various irregularities despite Treasury's review of 300,000 bank documents, is a tiny fish swimming among some much larger banking whales involved in financial wrongdoing much more extensively documented by Treasury. Moreover, consider that in July 2002 Treasury issued an advisory stating that "Israel has enacted significant reforms to its counter-money laundering system . . . and has taken concrete steps to bring these reforms into effect. Because of the enactment of new laws and the beginning of effective implementation, enhanced scrutiny [by Treasury] with respect to transactions involving Israel . . . is no longer necessary." Yet as noted above, a few years later Treasury (along with New York state banking authorities) was investigating the Israel Discount Bank of New York for major violations involving "high-risk foreign accounts, such as accounts for non-bank financial institutions in Latin America" (the bank was eventually fined \$12 million in October 2006). Because of the sums involved and the existence of US-based branch operations that are conduits for direct financial flows into the United States, it might be said that Israeli banks pose a greater threat to the US financial system – and possibly national security – than banks in Macau.

III. Law Enforcement or Financial Sanctions Against the DPRK?

US officials have tried to downplay the financial sanctions issue and have rebuked the DPRK for trying to insert it into the Six-Party process. They argue that it is a simple case of law enforcement, designed to prevent alleged DPRK money laundering from harming the US financial system. During testimony before the US Senate Foreign Relations Committee subcommittee in July 2006, Christopher Hill, the US State Department's point man on North Korea and chief US envoy to the Six-Party Talks, stated:

North Korea has engaged in illicit activities for decades. The DPRK calls US law enforcement and financial regulatory measures "sanctions" and asserts they are blocking progress in the Six-Party Talks. The United States will continue to take law enforcement actions to protect our currency and our citizens from illicit activities. The measures we have taken are targeted at specific behavior. Contrary to North Korean assertions, these actions are not related to the Six-Party Talks.[28]

Later during his testimony Hill became more emphatic: "US regulatory and law enforcement measures to protect our financial system from abuse are not subject to negotiation. We will continue to guard our financial system in accordance with US law."

Hill's comments are similar to the explanation provided by Donald Glaser, a Treasury official who has played a key role in getting the world's financial institutions to distance themselves from the DPRK. In a May 2006 speech Glaser said:

There is no linkage between our right and, frankly, our obligation to protect the US financial system from abuse, which is our job at the Treasury Department, and the very important work that Ambassador Hill and others are doing in the political negotiations that they have. There is no linkage at all.[29]

During his daily press briefings US State Department spokesperson Sean McCormack has used the same line of reasoning during his daily press briefings for reporters. In December 2006, McCormack stated:

Are you going to look the other way when a country is engaged in illicit activity? We say according to our laws and regulations, no, you can't do that . . . But there comes a point in -- an irreducible point of, well, there's a problem of illicit behavior and we have to address that in certain ways [with the DPRK]. We have laws and regulations by which we have to abide.[30]



US State Department spokesman Sean McCormack

But the formal regulatory wording of the Finding indicates that Hill, Glaser and McCormack have no legal basis for arguing that financial sanctions are divorced from US foreign policy toward the DPRK (namely, the Six-Party Talks). In fact, quite the opposite. As noted earlier, the Finding states that USA Patriot Act Section 311 "identifies factors for the [US Treasury Department] Secretary to consider and Federal agencies to consult before the Secretary may conclude that a "primary money laundering concern" exists. The Treasury Secretary is required to "consult with appropriate federal agencies and other interested parties and to consider" as one specific factor "the effect of the action on the United States national security and foreign policy." The Finding further states that the Treasury Secretary "is required to consult with both the Secretary of State and the Attorney General," presumably to get their opinions about such matters.

In other words, the Finding makes absolutely clear that US national security and foreign policy concerns must by law play an important, perhaps even central, role in actions contemplated by Treasury under Section 311. As the Six-Party Talks have major implications for US foreign policy, especially with respect to Northeast Asia, and national security, it is only reasonable to conclude that the imposition of financial sanctions on the basis of the fifth special measure under Section 311 has a direct bearing on those Talks, and it is misleading for US officials to claim otherwise. That does not mean that the DPRK and the US cannot discuss the financial sanctions independently of the Six-Party Talks (they clearly can), but it does mean that the financial sanctions cannot be characterized merely as an automatic law enforcement mechanism unrelated to US foreign policy actions toward the DPRK (or for that matter, toward the other four states participating in the Six-Party Talks).

How should this apparent inconsistency in US policy be understood? On the one hand, Treasury officials have taken a hard-line approach designed to cut the DPRK adrift from the international financial system; on the other, a team of US State Department officials are supposedly making determined efforts at the Six-Party Talks to find a way to terminate the

DPRK's nuclear weapons program and work toward normalization of relations.

Combining the hard-line financial sanctions approach with the diplomatic approach might make some sense if Washington's intention was to combine carrots-and-sticks. But since the Six-Party Talks began in August 2003 no carrots have been delivered. Talks with the DPRK are not carrots, just talks. Despite the promise of carrots described in the September 2005 Six-Party statement, Washington continued in practice to employ only sticks. More carrots were promised at the conclusion of the February 2007 Six-Party Talks and, most likely, during the January 2007 meeting of US and DPRK negotiators in Berlin. Whether they will be provided will become known once BDA is eliminated as an impediment to executing Six-Part agreements.

Moreover, an important subsection in the proposed Rule explicitly states that the Section 311 action against the DPRK is being carried out with "US national security and foreign policy goals" in mind (though the goals themselves are not mentioned). The first half of this subsection states:

The exclusion from the US financial system of banks that serve as conduits for significant money laundering activity and other financial crimes enhances national security, making it more difficult for terrorists and money launderers to access the substantial resources of the US financial system. To the extent that this prevents North Korean front companies engaged in illicit activities from accessing the US financial system, the proposed action supports and upholds US national security and foreign policy goals. More generally, the imposition of the fifth special measure would complement the US Government's worldwide efforts to expose and disrupt international money laundering.[31]

Although the financial sanctions under the fifth special measure are merely described as having a complementary effect on "the US Government's worldwide efforts to expose and disrupt international money laundering," the federal rulemaking process itself strongly suggests that money laundering and counterfeiting charges against the DPRK function as pretense or at best take a backseat to more important foreign policy and national security goals, which are not identified (denuclearization? regime change? economic and political isolation from the international community?). No wonder that a dissenting senior official in the US State Department expressed alarm that the Six-Party Talks were turning "into nothing more than 'a surrender mechanism.'"[32]

In short, the US goal has been not the construction of an atmosphere conducive to negotiations but instead an international boycott of financial transactions with the DPRK. If the bureaucratic language of the two *Federal Register* notices did not make this intention clear, this plainly worded advisory issued by Treasury in December 2005 did:

This advisory warns US financial institutions that the US Department of the Treasury has concerns that the [DPRK] . . . is engaged in illicit activities and may be seeking banking services elsewhere following the finding of [BDA] to be a financial institution of "primary money laundering concern. . . . Accordingly, US financial institutions should take reasonable steps to guard against the abuse of their financial services by North Korea, which may be seeking to establish new or exploit existing account relationships for the purpose of conducting illicit activities . . . We encourage financial institutions

worldwide to take similar precautions." (underline added)

The US financial sanctions are also related to the Six-Party Talks in other ways. One has to do with the particular commitments inscribed in the Joint Statement agreed at the September 2005 Six-Party Talks. At that time the six signatories "committed to joint efforts for lasting peace and stability in northeast Asia" and "agreed to explore ways and means for promoting security cooperation in northeast Asia." In return for the DPRK's pledge to abandon its nuclear weapons programs, the DPRK and the United States made a bargain to "respect each other's sovereignty, exist peacefully together and take steps to normalize their relations subject to their respective bilateral policies." But the financial sanctions test the question of whether Washington is genuinely interested in finding "lasting peace," "stability" and "security cooperation" for the Northeast Asian region.

Moreover, the decision to publish the Finding and proposed Rule the day after the six parties issued their Joint Statement in September 2005 can reasonably be interpreted as throwing down the gauntlet. Washington faced two clear foreign policy choices, a coercive Section 311 approach or negotiation through the Six-Party Talks. That the former was chosen even as the Joint Statement was getting an almost universally positive reception around the world was a signal that the US was prepared to remain indifferent to any hope of any real mitigation of hostile relations with the DPRK. It did not take Pyongyang long to understand the meaning of that signal.

Finally, according to the September 2005 Joint Statement "the United States affirmed that it has no nuclear weapons on the Korean peninsula and has no intention to attack or invade the DPRK with nuclear or conventional weapons." There is no indication that this US commitment will not remain in force, but in some Clausewitzian sense the attacks on the DPRK's financial sovereignty represent a continuation of the same hard-line politics by other means. If the shoe were on the other foot and the DPRK had managed, in accordance with its domestic law, to find a way to take extraterritorial action to disrupt America's access to global finance, the response from Washington would not be difficult to predict.

IV. Alternatives and the Financial Sanctions Label

What alternatives were there to financial sanctions and how appropriate is that term?

A. Alternatives to the Fifth Special Measure

Section 311 was written at a time when Americans were especially sensitive to the threat of terrorism, right after 9-11. The new law's extraterritorial provisions were seen as providing a way for the US to disrupt terrorist financing or squeeze the financial system of any country considered hostile in the eyes of the US government. However, as noted earlier, Section 311 provides Treasury with five special measure options. The choice made was application of the fifth special measure, which entails cutting off any financial institution from the US financial system that wishes to do business with the DPRK. In contrast, special measures one through four are less harsh in that they only impose record-keeping, reporting and information-gathering "due diligence" requirements on America's financial institutions. The US could have registered its concern for the DPRK's alleged illicit financial activities by selecting one of these other four measures, any one of which would have facilitated the collection of data, which, if incriminating, could have been used in some way to dissuade the DPRK from remaining involved in financial crimes.

B. Financial Sanctions?

Does the term "financial sanctions" appropriately describe the Section 311 action of the US government against the DPRK? The question is of some importance given the way some top US officials have interpreted their own actions. According to Treasury official Donald Glaser:

Section 311 is not a sanction. Almost universally, when I read the newspaper and see discussions about Section 311 it is referred to as a sanction. The Treasury Department does administer US sanctions so we are quite familiar with the characteristics of a sanction. Section 311 is not a sanction. We refer to Section 311 as a defensive measure.[33]

Compare this with the opposite view of David Asher, the US State Department's point man on the DPRK until July 2005 and a leading advocate of sanctions against the regime:

[The DPRK is] not coming back because they want to give up nuclear weapons. They are feeling the financial pressure and the cutoff from the international financial system, so they are trying to make nice . . . Banco Delta was just a thumbtack against their skin. We knew that behind the skin was a central artery. When we pricked it, blood was going to start coming out fast.[34]

A "defensive measure" or a coercive global campaign of sanctions? Early in 2006, Asher said: "[T]he beauty of this approach is it is not full-bore sanctions." [35] The "full-bore" variety presumably would involve an act of Congress targeting a specific country (for example, the Iran-Libya Sanctions Act of 1996) or perhaps military enforcement. In contrast, as the DPRK case demonstrates, the most onerous penalty of Section 311 – the fifth special measure – can be applied virtually at will by the US Treasury Department acting in consultation with the State Department and other government agencies.

Based on interviews with current and former US government officials, in November 2006 the *Los Angeles Times* concluded that "[t]he Treasury action created a run on Banco Delta, which lost a third of its deposits in six days, and forced the government [i.e., Macau monetary authorities] to seize control, sending an unmistakable message to bankers about the consequences of dealing with the North Koreans." [36] Another issue of importance, not least to those in Pyongyang trying to understand US behavior, is how Washington chooses to give Section 311 legal force. Section 311's legal implementation appears to be in part modeled on formal procedures the US government has in place to execute economic sanctions against countries officially identified as enemy states.

Glaser and other US officials may prefer the "defensive measure" locution, but an economic sanctions logic lies behind the measures selected. A country can hardly be said to be acting defensively when it causes another country to feel economic pain and does so without fear of reprisal.

The economic sanctions logic is found in the proposed Rule. Treasury suggests that US financial institutions take advantage of "commercially available software programs used to comply with the economic sanctions programs administered by OFAC [the Treasury Department's Office of Foreign Assets Control]" as a "screening mechanism" to identify financial transactions connected to BDA.[37]

The kinds of software programs Treasury has in mind are used to achieve compliance with economic sanctions directives of the US government administered by the OFAC. The OFAC

describes itself as

an office of the US Treasury that administers and enforces economic and trade sanctions based on US foreign policy and national security goals against entities such as targeted foreign countries, terrorists, international narcotics traffickers, and those engaged in activities related to the proliferation of weapons of mass destruction.

OFAC acts under Presidential wartime and national emergency powers, as well as authority granted by specific legislation, to impose controls on transactions and to freeze assets under US jurisdiction. . .OFAC has been delegated responsibility by the Secretary of the Treasury for developing, promulgating, and administering US sanctions programs.
[38]

These sanctions programs are based on such powerful and in some cases longstanding US legal instruments as the Trading With the Enemy Act, the International Emergency Economic Powers Act and the Iraqi Sanctions Act.

The regulatory language quoted above comes from open-source material. An analyst of US foreign policy working in Pyongyang could be forgiven for being unable to distinguish the "defensive measure" mentioned by Glaser and the economic sanctions administered by the OFAC. A military analyst in Pyongyang would likewise have difficulty distinguishing between the "Presidential wartime and national emergency powers" language and the objectives of a Section 311 action. Military alarm bells did indeed ring in Pyongyang. At the end of 2006, Kim Young-chun, deputy marshal of the Korean People's Army of the DPRK, warned: "If hostile forces continuously step up maneuvers for sanctions and pressure, we will cope resolutely by using more powerful countermeasures." [39]

The term "financial sanctions" does not appear in the Finding, the proposed Rule or USA Patriot Act Section 311. But if there is any doubt that Washington viewed its actions against the DPRK as financial sanctions rather than a defensive reaction, those doubts were put to rest in June 2007 by Treasury Secretary Henry Paulson, who told the Council on Foreign Relations:

[W]e have used targeted financial measures to help protect the U.S. financial system from the DPRK's illicit financial conduct . . . The result is North Korea's virtual isolation from the global financial system. The effect on North Korea has been significant, because even the most reclusive regime depends on access to the international financial system. [40]



US Treasury Department Secretary Henry Paulson

V. The US Did Not Consider North Korea and Macau Official Money Laundering or Counterfeiting Threats Until September 2005

Until BDA was named in September 2005 as a "primary money laundering concern", several US government agencies and at least two key anti-money laundering international bodies which count the US as an important member had multiple opportunities between 1999 and 2005 to formally register concerns about the DPRK and Macau as possible centers of financial criminality. But as described below, no such concerns were expressed.

In September 2006 the US Treasury, the Federal Reserve System, and the U.S. Secret Service jointly issued the last of three reports that ended a 10-year study of "U.S. currency holdings and counterfeit activity abroad." Among the findings in the 2006 report[41] were:

-- "Colombia registers first on the counterfeiting threat list because it has been the chief supplier of counterfeit notes to the U.S. market. Relatively high-quality Colombian counterfeit U.S. banknotes have been successfully imported into the United States for several decades."

-- "Full or partial dollarization [the use of the dollar as the unit of account for financial transactions in the economy] in Latin America, along with a relatively low threat of prosecution, has made this region an attractive target for counterfeit U.S. currency."

-- "Out of the approximately \$760 billion in U.S. banknotes in circulation by the end of 2005, the U.S. Secret Service reported that about \$61 million in counterfeit currency was passed on to the public worldwide, or about \$1 for every \$12,400 in circulation. Of that \$61 million, the vast majority (\$55.2 million) was passed in the United States, with the remainder passed abroad."

The 2006 report updated prior reports issued in 2000 and 2003. After 10 years of study what currency counterfeiting concerns did the three US federal agencies have with regard to the DPRK? In 2000 and 2003, none. The first mention of the DPRK is in the 2006 report in this strongly worded statement:

Since 1989, the U.S. Secret Service has led a counterfeit investigation involving the trafficking and production of highly deceptive counterfeit notes known as supernotes. The supernote investigation has been an ongoing strategic case with national security implications for the U.S. Secret Service since the note's first detection in 1989. The U.S. Secret Service has determined through investigative and forensic analysis that these highly deceptive counterfeit notes are linked to the Democratic People's Republic of Korea (DPRK) and are produced and distributed with the full consent and control of the North Korean government. (underline added)

However, as far as this author knows the Secret Service has never issued a publicly available report on the DPRK and currency counterfeiting. Thus, the exact meaning of "linked" and the way in which the Secret Service learned that forged notes "are produced and distributed with the full consent and control of the North Korean government" are not known. Phone calls to the Secret Service to request more information, particularly from Michael Merritt, the Deputy Assistant Director Office of Investigations whose knowledge of the DPRK's alleged involvement in counterfeiting has led him to testify before the US Congress, were not returned.

As for Macau, no currency counterfeiting concerns were raised in the reports in any of the

three years.

Among the key countries and regions where counterfeiting was found to have taken place (such as Latin America, Bulgaria and Russia) only the DPRK is viewed as a "national security" concern. Why this concern does not exist in the case of Russia, a country with far greater technological resources which has been plagued by high-profile incidents of organized crime, or in the case of Colombia, "first on the counterfeiting threat list" and cited by the Clinton administration in 2000 as needing a special anti-drug trafficking aid package for national security reasons[42], is not explained.

What is the evidence against the DPRK in the 2006 report?

Over the course of [the Secret Service's] sixteen-year investigation, approximately \$22 million in supernotes has been passed to the public (table 6.5), and approximately \$50 million in supernotes has been seized by the U.S. Secret Service.

This insertion of information about supernotes in the report's entry on the DPRK is confusing at best and misleading at worst.

First, Table 6.5 appears in the report prior to the entry on the DPRK. It presents "data on the highly deceptive 'supernotes'" passed to the public from 1996 to 2005. These "highly deceptive 'supernotes'" were printed using the intaglio method, the same sophisticated method used by the US Bureau of Engraving and Printing to print genuine currency notes. In the report the only country specifically associated with the passing of supernotes is Peru, not the DPRK:

In March 2005, the U.S. Secret Service learned that the Federal Reserve Bank cash office in Miami had received a large quantity of highly deceptive \$100 supernotes in deposits from financial institutions in Peru.

Also, Table 6.5 is situated in the report's central discussion of \$100 note counterfeit detection by several Federal Reserve cash offices that process shipments of currency arriving in the United States. These \$100 notes include both the highly deceptive intaglio supernotes and notes produced using less sophisticated means, such as laser printers. Nowhere in this discussion is the DPRK mentioned. The only country that is mentioned is Peru, which in 2005 experienced an increase in deposits of fake \$100 notes into domestic bank accounts.

Second, the 2006 report nowhere discusses whether Secret Service seizures of approximately \$50 million in supernotes had anything to do with the DPRK.

It is possible that China's administrative and political control of Macau and its proximity to the DPRK might make China a concern, but as stated in the 2006 report, "[China] is not currently an area of major concern for counterfeiting of U.S. currency." Moreover, "[t]he U.S. Secret Service has a resident office in Hong Kong whose are [sic] of responsibility includes mainland China."

If a particular region or country did become a concern, the 2006 report describes vigorous responses from the Secret Service. For example:

Peru: "In March 2005, the U.S. Secret Service learned that the Federal Reserve Bank cash office in Miami had received a large quantity of highly deceptive \$100 supernotes in deposits from financial institutions in Peru. . . [T]he U.S. Secret Service sent agents and counterfeit

specialists to Peru to meet with and provide counterfeit detection training to representatives of foreign law enforcement, the Peruvian Central Bank, and other financial institutions within Peru."

Bulgaria: "In March 2002, the U.S. Secret Service formally joined forces with the Bulgarian National Service for Combating Organized Crime to form the Bulgarian Counterfeit Task Force."

The Russian Caucasus: "The U.S. Secret Service is currently investigating a scheme with ties to suspects in Israel, Russia, and the Republic of Georgia to produce counterfeit U.S. currency" and "U.S. Secret Service agents are currently working closely with the Israeli National Police, Georgian Ministry of Internal Affairs, and Russian National Police/Ministry of Internal Affairs in an effort to identify investigative leads and to continue the progress in this case."

Missing is Macau. It does not even enter the picture as a counterfeiting concern. In contrast to the alarming picture presented today by Treasury, none of the three reports issued over the study's 10-year period mentions the Secret Service as having an interest in conducting a local investigation in Macau or in establishing a "resident office" as it did in Hong Kong.

Another peculiarity is that the 2006 report never mentions the Macau territory, even though 12 months earlier Treasury formally designated Macau-based BDA as a "primary money laundering concern" and raised the possibility of illicit activities at other banks in the territory. For whatever reason none of the information known about Macau in September 2005 or learned later once Treasury's FinCEN launched its investigation of BDA managed to find its way into the US government's most recent authoritative report on overseas counterfeiting.

Information elsewhere in the 2006 report flies in the face of allegations of involvement by BDA and the DPRK in counterfeiting. For example, the report found that "on average, international banks appear to check their U.S. currency shipments more carefully for counterfeits than do U.S. banks, partly because labor costs are so much lower in many foreign countries with heavy U.S. currency traffic." The implication is that labor-intensive operations result in greater counterfeit detection. As the fourth smallest bank of 27 banks in Macau, BDA is probably more labor intensive than most of its local and larger competitors. In fact, the kind of protection a small bank like BDA can potentially offer to the US financial system is underscored by this comment in the 2006 report: "[H]and examination of the notes is the most common and effective method used by clerks at commercial banks and money exchanges and enables them to detect even high-quality counterfeit U.S. currency." [43]

As for large-size cash deposits that are more difficult for BDA bank clerks to handle, a review of BDA records conducted by the international audit firm Ernst & Young following Treasury's September 2005 designation of BDA reached this conclusion:

From our investigations it is apparent that the procedures in place at the Bank for handling large value (wholesale) deposits of U.S. currency notes ensured that, to a material degree, the Bank did not introduce counterfeit U.S. currency notes into circulation. [44]

The 2006 report states that "based on counterfeit data collected by Federal Reserve and the U.S. Secret Service", the "value of counterfeits in circulation is most likely around \$70 million, or fewer than one in 10,000 notes, with about 60 percent of these held abroad. The upper bound is estimated to be about \$200 million, or about 2.5 in 10,000 notes." Using the 60

percent guideline, most likely \$43 million in counterfeit cash is in circulation outside the US (or an upper bound of \$180 million). Given the report's extensive discussions about Secret Service investigations into major counterfeiting operations generating large sums of fake notes in such places as Colombia (\$162.5 million seized from May 2001 to February 2006), Peru and the Russian Caucasus (more than \$23 million passed or seized from 1999 to 2005) and zero mention of any investigations into possible counterfeiting activities in the DPRK or Macau, it is difficult to understand why the US government ever identified the DPRK or Macau as currency counterfeiting concerns in the first place.

Finally, accusations that the DPRK (or any country) is producing sophisticated \$100 supernotes in any quantity is effectively rebutted by this comment in the 2006 report:

[A] number of news stories suggested that there might be significant international counterfeiting of U.S. banknotes. Since the release of the NCD [New Currency Design] \$100 note in March 1996, however, the U.S. Secret Service has found no evidence to support the claims of large volumes of counterfeits in circulation.[45]

A. International Anti-Money Laundering Bodies: The FATF and APG

In 1989 the G-7 established the Financial Action Task Force on Money Laundering (FATF) to address rising concerns over money laundering. According to the FATF website,

The Task Force was given the responsibility of examining money laundering techniques and trends, reviewing the action which had already been taken at a national or international level, and setting out the measures that still needed to be taken to combat money laundering. In April 1990, less than one year after its creation, the FATF issued a report containing a set of Forty Recommendations, which provide a comprehensive plan of action needed to fight against money laundering.
[46]

The FATF has 31 members, including Germany, Italy, Japan, New Zealand, the United Kingdom, Hong Kong and the US. There are also several FATF associate members, one of which is The Asia/Pacific Group on Money Laundering (APG), to which Macau and the US both belong. APG describes itself as an autonomous body which closely follows "the international standards for anti-money laundering and combating the financing of terrorism" established by FATF.[47]

In testimony presented to Congress in April 2007 FinCEN's Daniel Glaser described the importance of FATF to US efforts to combat global financial crime:

The FATF sets the global standard for combating terrorist financing and money laundering and provides us with a unique opportunity to engage our international counterparts in this effort. Treasury – along with our partners at State, Justice, Homeland Security, the Federal Reserve Board, and the Securities Exchange Commission – continues to assume an active leadership role in the FATF, which articulates standards in the form of recommendations, guidelines, and best practices. These standards aid countries in developing their own specific anti-money laundering and counter-terrorist financing laws and regulations that protect the international financial system from abuse.

[The] standard-setting efforts at the FATF create an international obligation and framework for countries to implement AML/CFT [Anti-Money Laundering/Counter-Terrorist Financing] regimes that promote transparency and effectively protect the international financial system from various forms of illicit finance, including terrorist financing and WMD proliferation finance.[48]

Since 1999 the FATF has issued annual lists of Non-Cooperative Countries and Territories (NCCTs) to identify countries or regions which have failed to implement adequate anti-money laundering protections. Over the years these lists have named such jurisdictions as Cook Islands, Dominica, Egypt, Guatemala, Israel, Lebanon, Marshall Islands, Nigeria and Russia. In the most recent list issued in June 2006 only one jurisdiction was named: Myanmar.

In seven years of issuing annual NCCT lists the FATF has not once listed Macau. While Macau was not an FATF member, many other non-members have been listed. If the US had money laundering concerns which it was unable to raise with Macau due to its non-membership in FATF, these concerns could have been taken up more directly with Macau within the APG. Also, Hong Kong, which has both FATF and APG membership and is familiar with Macau banking practices through the branch networks of Chinese banks existing in both territories, was in a position to note any inadequacies in money laundering safeguards. Nevertheless, a review of the documentation available at the APG website indicates that Macau has not been a concern for any member of APG.

The Forty Recommendations mentioned above represent, as described by FATF, "a complete set of counter-measures against money laundering (ML) covering the criminal justice system and law enforcement, the financial system and its regulation, and international co-operation." They were initially developed in 1990 but later underwent revision, most recently in 2003. As explained by Glaser during his April 2007 Congressional testimony, the US supports strengthening the Forty Recommendations to assure their status as the "the global standard for combating terrorist financing and money laundering."

In the September 2005 Finding, FinCEN criticized Macau for failing to adopt money laundering legislation that was based on FATF's 2003 revisions to the Forty Recommendations. An older version of the Forty Recommendations on the law books apparently leaves Macau with "significant vulnerabilities", a conclusion reached in a 2004 IMF study that is noted in the Finding.

In the March 2007 Final Rule, Macau is described as "historically . . . known to be vulnerable to financial crime, due in large part to an under-developed anti-money laundering regime." Gone, apparently, are the IMF-identified vulnerabilities. Even more to the good is that Macau "has begun to take important steps to address [the] systemic concerns" about its financial system. Macanese authorities are described as having "taken a number of additional important steps" since Treasury proposed applying the Section 311 special measure that would cut off BDA from the US financial market. These steps are then described in detail and receive words of praise from FinCEN. At least some of these steps appear designed to address FinCEN's displeasure at Macau's failure to adopt the revised Forty Recommendations.

Surprisingly, however, FinCEN skips over any discussion of the Forty Recommendations in the Final Rule. Macau's progress toward meeting a "global standard for combating terrorist financing and money laundering" now appears unimportant, a disturbing omission that

suggests FinCEN's 2005 criticism was, in the words of BDA's lawyers, "arbitrary and capricious."

Whether FinCEN officials were ever truly worried by Macau's failure to incorporate the newest version of the Forty Recommendations into law remains a mystery. As indicated in the Final Rule, FinCEN seems satisfied with the substantive nature of the new anti-money laundering and counterfeiting measures Macau authorities have adopted since 2005, noting only that "full and comprehensive implementation" now awaits. Ultimately, FinCEN's decision to impose the fifth special measure on BDA was not based on any regulatory, legislative or procedural shortcoming in Macau but on the "likelihood of recidivism" by BDA's owners and the "potential use of the bank for illicit purposes."

VI. Conclusion

If media reports of the transfer of the DPRK's funds from BDA to the Russian bank are correct, the BDA affair is about to split in two. On the one hand, the DPRK may be on the verge of escaping from 18 months of US-led financial sanctions that effectively prevented it from transferring funds from BDA. How that will happen in practice remains unclear. The *Washington Times* reported on June 13 that Treasury is set to provide "assurances"[49] in the form of a "no action" letter that promises not to take any USA Patriot Act Section 311 action against whatever bank agrees to accept a transfer of DPRK funds from BDA. Whether any such assurances have in fact been offered and what this implies for the DPRK's access to banks other than this single one in Russia's Far East will no doubt be revealed in time.

On the other hand, if BDA owner Stanley Au, a man who has resources and determination, and his team of lawyers continue to contest Treasury's blacklisting, BDA could very well develop into any even more unpleasant diplomatic, legal and financial dispute, but one that now pits the US against China. Whether this has any implications for the Six Party diplomatic process, which at the moment is the key to negotiating a more stable peace in Northeast Asia, the budding "strategic economic dialogue" between China and the US, and the intensifying Asia-Pacific arms race – again, time will tell. But the potential for BDA to again play a spoiler role cannot be ruled out.

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This article was completed near the end of June 2007 when reports appeared of US and Russian officials working together to transfer North Korea's long inactive funds out of its accounts at Macau-based Banco Delta Asia (BDA) to different North Korean accounts via a bank in Russia's far east. With the transfer North Korea appears to have concluded that its 21-month dispute with the US over its BDA funds has ended and it may now begin to work with the United States and other countries in Northeast Asia to implement the Six-Party agreement on denuclearization and normalization of relations. Meanwhile the US Treasury Department's official barring of BDA from the US financial market remains in place. Posted on Japan Focus, July 7, 2007.

Notes:

1. Jay Solomon & Gregory L. White, "Russia to Move North Korea Funds --- U.S. Hopes Resolution Resumes Stalled Talks On Nuclear Program," *The Wall Street Journal*, June 11, 2007.

2. Since Chris Hill and his DPRK counterpart at the Six Party Talks, Kim Kye-Gwan, met in Berlin last January for closed-door talks approved by Condoleezza Rice and later blessed by President George Bush the pro-engagement faction has appeared to have the upper hand.
3. [The Finding and the "Rulemaking" notice can be read at the website of the Financial Crimes Enforcement Network \(FinCEN\).](#)
4. [About FinCEN, Financial Crimes Enforcement Network website.](#)
5. [Secret Service History, United States Secret Service website.](#)
6. As described in the Finding and the proposed Rule.
7. Final Rule, page 55214.
8. David Lague, ["U.S. Negotiator Urges North Korea to End Standoff on Financial Curbs,"](#) *New York Times*, December 22, 2006.
9. Los Angeles Times, November 2006.
10. Martin Hart-Landsberg and John Feffer, ["Sanctions and the Road to War in Korea,"](#) Japan Focus website, January 18, 2007
11. The Dong-A Ilbo, ["U.S. Sanctions Hurting North: Expert,"](#) January 4, 2007.
12. [The Final Rule can also be found at FinCEN's website.](#)
13. February 7, 2007 email from the US Treasury Department.
14. February 6, 2007 email from the US Treasury Department.
15. In the Matter of the Imposition of Special Measure Five Against Banco Delta Asia S.A.R.L., Petition of Mr. Stanley Au and Delta Asia Group (Holdings) Ltd. to Rescind Final Rule, May 3, 2007, Footnote 6.
16. Petition of Mr. Stanley Au and Delta Asia Group, page 4.
17. Raphael F. Perl and Dick K. Nanto, *North Korean Counterfeiting of U.S. Currency*, Congressional Research Service, March 22, 2006, p. 4, quoting May 23, 2003 Senate testimony by William Bach, Director of the Office of African, Asian and European Affairs in the Bureau for International Narcotics and Law Enforcement Affairs of the U.S. Department of State.
18. The communications with Treasury and the Secret Service took place by phone and email during February 7-9, 2007.
19. Raphael F. Perl and Dick K. Nanto, p. 8 and footnote 26.
20. Donald L. Glaser, [Protecting United States Currency: The Case of North Korea](#), ICAS Spring Symposium, Institute for Korean-American Studies, May 22, 2006.
21. Final Rule, 12735.
22. Department of the Treasury, Revocation of Designation of Ukraine as Primary Money Laundering Concern, Federal Register/Vol. 68, No. 74/Thursday, April 17, 2003/Notices. See [FinCEN's website.](#)

23. CRS, 8.

24 Sheena E. Chestnut, [The "Sopranos State"? North Korean Involvement in Criminal Activity and Implications for International Security](#), Honors Program for International Security Studies, Center for International Security and Cooperation, May 20, 2005.

25. The thesis advisors were former Secretary of Defense William Perry and Dr. Scott Sagan, authors of works on how the DPRK endangers US interests. "Inspiration" for the thesis was received from Dr. David Asher, the former Coordinator for the North Korea Working Group in the U.S. State Department (now with the Heritage Foundation).

26. Charles Wolf, Jr., "[Tokyo's Leverage Over Pyongyang](#)," commentary originally appearing in the *Asian Wall Street Journal*, November 21, 2006, Rand Corporation.

27. The information about these banks be found at FinCEN's Regulatory Enforcement Actions [website](#).

28. Christopher R. Hill, US State Department Assistant Secretary for East Asian and Pacific Affairs, "[Recent Developments in U.S.-Democratic People's Republic of Korea Relations](#)," Statement before the US Senate Foreign Relations Committee, Subcommittee on East Asian and Pacific Affairs, July 20, 2006,

29. Donald Glaser, US Treasury Department Deputy Assistant Secretary for Terrorist Financing and Financial Crimes, "[Protecting United States Currency: The Case of North Korea](#)," (transcript of remarks) Institute for Korean-American Studies Spring Symposium, May 22, 2006.

30. Sean McCormack, US State Department spokesperson, [Daily Press Briefing at the US State Department, December 21, 2006](#).

31. Proposed Rule, Section II.4 in the "Rulemaking" notice ("The Effect of the Proposed Action on United States National Security and Foreign Policy")

32. Joel Brinkley, [U.S. Squeezes North Korea's Money Flow](#), *New York Times*, March 10, 2006.

33. "Protecting United States Currency: The Case of North Korea," (transcript of remarks) Institute for Korean-American Studies Spring Symposium, May 22, 2006.

34. Josh Meyer, "[Squeeze on North Korea's money supply yields results](#)," *Los Angeles Times*, November 2, 2006.

35. "U.S. Squeezes North Korea's Money Flow," *New York Times*, March 10, 2006.

36. "Squeeze on North Korea's money supply yields results," *Los Angeles Times*, November 2, 2006

37. Federal Register/Vol. 70, No. 181, September 20, 2005, Proposed Rules, 31 CFR Part 103

RIN 1506–A83, Financial Crimes Enforcement Network; Amendment to the Bank Secrecy Act Regulations—Imposition

of Special Measure Against Banco Delta Asia SARL

38. [Excerpts from the Federal Financial Institutions Examination Council's Bank Secrecy Act/Anti-Money Laundering Examination Manual](#) - July 2006.
39. *Hankyoreh*, December 31, 2006
40. [Remarks by Treasury Secretary Henry Paulson before the Council on Foreign Relations on the Treasury Department's role in national security, June 14, 2007.](#)
41. *The Use and Counterfeiting of United States Currency Abroad*, a September 2006 report jointly prepared by the U.S. Treasury, the Federal Reserve, and the U.S. Secret Service. [All three reports](#) are available through the US Treasury Department's website. (scroll to the bottom of Treasury's press release to find the links to each report).
42. Ellen Nakashima and Matthew Vita, "[Clinton Clears Aid Package For Colombia](#)," *Washington Post*, August 23, 2000.
43. *The Use and Counterfeiting of United States Currency Abroad*, ix.
44. Banco Delta Asia S.A.R.L., [Report to The Administrative Committee](#) (redacted), Ernst & Young, December 16, 2005, page 35.
45. *The Use and Counterfeiting of United States Currency Abroad*, 83.
46. Financial Action Task Force [website](#).
47. Relation to the FATF, Asia/Pacific Group on Money Laundering [website](#).
48. [Joint Testimony](#) by Daniel Glaser, Deputy Assistant Secretary for Terrorist Financing and Financial Crimes, and Adam J. Szubin, Director of the Office of Foreign Assets Control, before the Foreign Affairs Subcommittee on Terrorism, Nonproliferation, and Trade and the Financial Services Subcommittee on Domestic and International Monetary Policy, Trade, and Technology in the U.S. House of Representatives, April 18, 2007.
49. Bill Gertz, "[U.S. seeks data on N. Korea centrifuges.](#)" *The Washington Times*, June 3, 2007.