Drexel Hamilton

A Service-Disabled Veteran Owned & Operated Business

Outside The Wire
The Treasury Department and National Defense

A view of the North entrance of the U.S. Treasury Building in Washington D.C.
Image: Wikipedia

Throughout the 20th century, the U.S. has used its financial strength as a means of influencing foreign policy. Historically this has included sanctions against regimes like Iraq and Iran, and a trade embargo against Cuba. Additionally, during the Cold War, the U.S. engaged in a very limited amount of trading activity with the Soviet Union (largely tied to grain exports) and discouraged its allies and trading partners from doing so as well.

However, in the 21st Century, the United States has accelerated its use of financial leverage to achieve national security objectives. As a byproduct of globalized trade and an interconnected banking sector, U.S. institutions such as the Treasury Department recognized that they could play a more essential role in national defense policy specifically after September 11, 2001 and the U.S.-led Global War on Terror.

In the wake of the 9/11 attacks, the Bush Administration created the Department of Homeland Security. In doing so, the Treasury Department lost some of its law enforcement capabilities which included the Bureau of Alcohol, Tobacco, and Firearms (ATF). Nevertheless, the Treasury quickly adapted and built new capabilities to be a relevant player.

One example was the creation of the Terrorist Finance Tracking Program (TFTP) under the Office of Terrorism Financial Intelligence (TFI). Shortly after 9/11, the TFTP collaborated with the Society for Worldwide Interbank Financial Telecommunication (SWIFT). SWIFT is a Belgium-based company that is used as a global messaging service for financial transactions. The Treasury and SWIFT agreed that the TFTP could issue subpoenas against certain individuals and entities. This gave them the legal authority and ability to access specific data sets in SWIFT tied to suspected terrorists. The goal was to follow the money of terrorist financing and develop financial intelligence to help prevent a future terrorist attack. The program operated for years with little scrutiny until June 23, 2006 when the *New York Times* published a tell-all story about the program.

SWIFT logo: www.swift.com

Several other tools that the Treasury Department began to leverage included Section 311 of the USA PATRIOT Act. Under this provision the Treasury Department had the ability to "designate a foreign jurisdiction, financial institution, class of transactions, or type of account as being of 'primary money laundering concern.'" One of the first and most prominent examples of the use of Section 311 took place when the Treasury Department put the Macau-based Banco Delta Asia (BDA) on a list of designated entities for their dealings with North Korea. At the time, North Korea was able to use banks like BDA to access the global banking system and maintain accounts that were tied to their illicit activity worldwide which included drug trafficking, cigarette smuggling, and counterfeiting the U.S. one-hundred-dollar bill with "supernotes."

When the BDA was designated, the Treasury Department was able to cut North Korea off from the global financial system. It was a warning to entities that doing business with a bad bank tied to a rogue regime would have severe consequences. In effect, the Treasury's decision caused a ripple effect across the market and forced many into a choice of transactions with banks like BDA or the United States. As an overwhelming majority of market participants chose the latter, other banks were forced to evaluate their relationship with North Korea too. Thus, the designation of the BDA damaged North Korea financially and eventually brought them back to the table for diplomatic negotiations.

After 9/11, President Bush signed Executive Order 13224, which gave the U.S. government broad powers to go after terrorist funding. Through the Office of Foreign Asset Control (OFAC), individuals and entities could be designated and cut off from access to the U.S. financial system. This list is currently over 1500 pages and in small print.

OFAC logo: Department of the Treasury

The previously mentioned BDA case is important because it was one of the first times that the Treasury leveraged its power beyond a specific bad actor and targeted an entity with ties to that bad actor. In subsequent years, this type of action would be used against Iran to pressure them into ending their nuclear weapons program. The U.S. effort to cut off Iran from the global banking system often put it at odds with European nations and European banks. But, the Treasury Department remained steadfast in their enforcement. In one case, the British Bank HSBC was fined nearly $2 billion for sanctions violations related to business with Iran.

To this day, the Treasury Department provides updates on its enforcement actions. Specifically, as companies settle civil penalties related to their disclosure of business activities that they discover had been tied to OFAC designated entities. One of the more recent enforcement actions was a $4.1 million settlement with Berkshire Hathaway that came from their disclosure of a Turkish-based subsidiary doing business with a prohibited Iranian entity from 2012- 2016.

How do we think about these issues moving forward?

We are watching several developments. First, national security is becoming a catch-all term for certain challenges such as climate change. We are not going to debate the validity of this claim. However, consider a scenario in which the U.S. government decides to use some of the same tools that have been used to fight terrorism to fight climate change. This could include designating entities that are involved in carbon emissions or other forms of waste and pollution outside of the U.S.

We think that this is something investors should be considering. Investors are already starting to pay attention to ESG and impact investing. How much more quickly could this trend accelerate if the U.S. government were to begin designating individuals and entities that are accused of hurting the climate and thereby endangering national security? Our suggestion is that this tool has been used in the past in the name of national security, so there is precedent for it to be used again.

Additionally, the same tools will continue to be used to go after individuals that the U.S. determines are engaged in bad actions abroad. We saw this as the U.S. recently moved to designate individuals tied to the murder of journalist Jamal Khashoggi after a report from the Office of the Director of National Intelligence placed the blame for the journalist's death on the Saudi Crown Prince Muhammad bin Salman. Although as of this writing, no designation has been placed directly on the Saudi Crown Prince.

We will continue to track the ways in which the Treasury Department uses its power to achieve U.S. foreign policy objectives. The close ties between the financial world and national strategy remain strong and will grow stronger with time. As it shapes and evolves, we believe that investors and capital markets participants need to pay attention and take a hard look at their customers and counterparty relationships to avoid possible fines and regulatory scrutiny. Furthermore, as veterans of the U.S. military, we believe that businesses and investors should ask whether their investments and business dealings are aligned with national security objectives.

Photo Illustration: Dreamstime.com