

THE OIL-FOR-FOOD PROGRAM: TRACKING THE FUNDS

HEARING BEFORE THE COMMITTEE ON INTERNATIONAL RELATIONS HOUSE OF REPRESENTATIVES ONE HUNDRED EIGHTH CONGRESS

SECOND SESSION

NOVEMBER 17, 2004

Serial No. 108-157

Printed for the use of the Committee on International Relations



Available via the World Wide Web: http://www.house.gov/international_relations

U.S. GOVERNMENT PRINTING OFFICE

96-930PDF

WASHINGTON : 2005

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512-1800; DC area (202) 512-1800
Fax: (202) 512-2250 Mail: Stop SSOP, Washington, DC 20402-0001

COMMITTEE ON INTERNATIONAL RELATIONS

HENRY J. HYDE, Illinois, *Chairman*

JAMES A. LEACH, Iowa	TOM LANTOS, California
DOUG BEREUTER, Nebraska	HOWARD L. BERMAN, California
CHRISTOPHER H. SMITH, New Jersey,	GARY L. ACKERMAN, New York
<i>Vice Chairman</i>	ENI F.H. FALEOMAVAEGA, American
DAN BURTON, Indiana	Samoa
ELTON GALLEGLY, California	DONALD M. PAYNE, New Jersey
ILEANA ROS-LEHTINEN, Florida	ROBERT MENENDEZ, New Jersey
CASS BALENGER, North Carolina	SHERROD BROWN, Ohio
DANA ROHRABACHER, California	BRAD SHERMAN, California
EDWARD R. ROYCE, California	ROBERT WEXLER, Florida
PETER T. KING, New York	ELIOT L. ENGEL, New York
STEVE CHABOT, Ohio	WILLIAM D. DELAHUNT, Massachusetts
AMO HOUGHTON, New York	GREGORY W. MEEKS, New York
JOHN M. McHUGH, New York	BARBARA LEE, California
ROY BLUNT, Missouri	JOSEPH CROWLEY, New York
THOMAS G. TANCREDO, Colorado	JOSEPH M. HOEFFEL, Pennsylvania
RON PAUL, Texas	EARL BLUMENAUER, Oregon
NICK SMITH, Michigan	SHELLEY BERKLEY, Nevada
JOSEPH R. PITTS, Pennsylvania	GRACE F. NAPOLITANO, California
JEFF FLAKE, Arizona	ADAM B. SCHIFF, California
JO ANN DAVIS, Virginia	DIANE E. WATSON, California
MARK GREEN, Wisconsin	ADAM SMITH, Washington
JERRY WELLER, Illinois	BETTY MCCOLLUM, Minnesota
MIKE PENCE, Indiana	CHRIS BELL, Texas
THADDEUS G. McCOTTER, Michigan	BEN CHANDLER, Kentucky
KATHERINE HARRIS, Florida	
VACANCY	

THOMAS E. MOONEY, SR., *Staff Director/General Counsel*
ROBERT R. KING, *Democratic Staff Director*
JONATHAN R. SCHARFEN, *Chief Counsel*
GREGG RICKMAN, *Subcommittee Senior Professional Staff Member*
JEAN CARROLL, *Full Committee Hearing Coordinator*

CONTENTS

	Page
WITNESSES	
Charles A. Duelfer, Special Advisor to the Director of Central Intelligence on Iraq's Weapons of Mass Destruction, Central Intelligence Agency	6
Everett Schenk, Chief Executive Officer, BNP-Paribas North America	31
LETTERS, STATEMENTS, ETC., SUBMITTED FOR THE HEARING	
Charles A. Duelfer: Prepared statement	9
Everett Schenk: Prepared statement	35
Herbert A. Biern, Senior Associate Director, Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System: Pre- pared statement	50
APPENDIX	
The Honorable Diane E. Watson, a Representative in Congress from the State of California: Prepared statement	59
Article entitled "The Conflict in Iraq; 100 Fraud Claims Probed" from the <i>Los Angeles Times</i> , dated November 1, 2004, submitted for the record	60
The Honorable Dan Burton, a Representative in Congress from the State of Indiana, and Chairman, Subcommittee on the Western Hemisphere: Prepared statement	60

THE OIL-FOR-FOOD PROGRAM: TRACKING THE FUNDS

WEDNESDAY, NOVEMBER 17, 2004

HOUSE OF REPRESENTATIVES,
COMMITTEE ON INTERNATIONAL RELATIONS,
Washington, DC.

The Committee met, pursuant to call, at 3 o'clock p.m., in room 2172, Rayburn House Office Building, Hon. Henry J. Hyde (Chairman of the Committee) presiding.

Chairman HYDE. The Committee will come to order. Before we commence the hearing, I want to take this opportunity to congratulate and, with very mixed feelings, say goodbye to Mr. Cass Ballenger, Mr. Nick Smith, and also Amo Houghton, who is not here with us at this time. These gentlemen are finishing their congressional careers, and they have served this Committee very well over the years. And I can say from the bottom of my heart that you will be missed, all of you, and I wish you Godspeed.

Mr. LANTOS. Mr. Chairman.

Chairman HYDE. Mr. Lantos.

Mr. LANTOS. I would like to add, from the Democratic side, our great appreciation and respect to the colleagues you have indicated, and I would like to add Mr. Joe Hoeffel of Pennsylvania from the Democratic side, who also is finishing a distinguished congressional career.

Chairman HYDE. Thank you very much.

Mr. MENENDEZ. Mr. Chairman, if I may recognize as well all of the colleagues that you mentioned, but particularly, as the Ranking Democrat on the Western Hemisphere Subcommittee, I want to recognize my friend and colleague, Mr. Ballenger.

There are few of us who consider ourselves Latin Americanists, and Cass Ballenger is one of those people who has had an enormous interest for a long period of time and a stated commitment, as is exhibited by his deeds, not only in the work on the Committee but on a personal basis to Latin America. We will sorely miss him on the Committee. It has been my privilege to work with Chairman Ballenger for several years as the Ranking Democrat, and, Cass, I appreciate everything that you have done, the courtesies you have extended, and the way in which you conducted the Subcommittee's work with us. We know you will still be a Latin Americanist even after you leave this institution.

Thank you, Mr. Chairman.

Chairman HYDE. Thank you very much, Mr. Menendez. I have made the suggestion to our leadership that these gentlemen's re-

tirements require unanimous consent, so I could object, but I can't persuade the leadership to go that route.

Before beginning the hearing today, I want to take a moment to thank Sharon Hammersla, our Committee's Information Resource Manager, who is retiring at the end of next month. Today is likely to be her last Full Committee hearing after 32 years of service and dedication as a public servant. She served as Information Resource Manager under my chairmanship for both the House Committee on International Relations and the House Committee on the Judiciary. Her service has been invaluable, and we will miss her a great deal. Sharon, we wish you the best of luck and extend our fullest congratulations to you upon retirement. Thank you.

Before we begin the actual testimony, I want to announce that while Members, particularly on a subject as important as this, would like to make opening statements, we are very pressed for time. We have witnesses whose testimony is very important, and we are going to, out of necessity, not permit opening statements beyond those of myself and Mr. Lantos. They will all be made a part of the record and will give an opportunity for everybody to ask questions, and so we will do it that way.

I am beginning to believe the prevailing sentiment regarding the United Nations Oil-for-Food Program may have been "hear no evil, see no evil, and speak no evil." No one seemed to be in charge of watching Saddam Hussein while he and his government were conducting perhaps the largest financial swindle in history. The corruption Saddam and his regime sowed created scores of accomplices around the world at the expense of the Iraqi people. Far too many people looked the other way as Saddam stole billions from the program.

We must remember that the Oil-for-Food Program was designed to benefit the Iraqi people. It was imperative that they be fed and their medical needs attended to. Yet the Iraqi Government, the very government whose responsibility it was to provide that aid, deprived them of the benefits from the sale of their vast oil reserves, cynically using those funds to buy influence and weapons abroad.

Saddam Hussein corrupted every aspect of the program, and various sources indicate he may have received help from some of our allies—and you can put that in quotes—perhaps even U.S. citizens in doing so. This is why this issue has taken on a sense of urgency. We must determine to what extent Saddam's corruptive influence tainted others, and perhaps even those we trusted most, to help us to isolate and disarm him.

Following the release of the recent report by Charles Duelfer, who is here today, information has come to light as to the breadth of Saddam's actions, both at the United Nations and with our allies. On the one hand, some of our allies, eager to do business with Iraq, did all they could to facilitate business there. The commercial advantage they so eagerly sought in Iraq might well have made them susceptible to manipulations by Saddam Hussein, and influenced their relations with the United States and with Iraq. On the other hand, the United Nations, it now appears, so eager to provide humanitarian goods to Iraq, may have compounded the foreign pol-

icy challenges faced by the U.S. by overlooking Saddam's corruption.

I am eager to hear from Mr. Duelfer if, in their eagerness to sell goods to Iraq, some of our allies and other nations sold dual-use goods, and perhaps even weapons, to Iraq through the Oil-for-Food Program. We must know if these weapons were used against our own troops in Iraq.

As for Saddam, it is also important for us to determine whether the profits from his corruption were put toward terrorist purposes, as we believe may have occurred. According to information provided to this Committee, Saddam paid \$25,000 rewards to the families of Palestinian suicide bombers through the Iraqi Ambassador to Jordan out of accounts in the Rafidain Bank in Amman, which held kickback money Saddam demanded from suppliers to his regime. Evidence also points to Saddam extending the Arab League boycott against Israel, requiring companies dealing in the program to sign letters conforming to the boycott.

When we speak of the transaction of funds, we must not omit from our examination the Banque Nationale de Paris, or BNP. This was the bank that held the proceeds from Iraq's oil sales from the Oil-for-Food Program.

In the process of examining the bank's role in the Oil-for-Food Program, we looked at the bank's performance in verifying the identity of its customers, as called for under U.S. law and through the U.N. Oil-for-Food Program. There are indications that the bank may have been noncompliant in administering the Oil-for-Food Program. If true, these possible banking lapses may have facilitated Saddam Hussein's manipulation and corruption of the program.

Evidence seems to indicate that in some cases, payments in the Oil-for-Food Program were made by BNP with a lack of full proof of delivery for goods and other necessary documents contracted for in the Oil-for-Food Program. At other times, payments may have been authorized by BNP to third parties separate from the originally intended recipient of the letter of credit. These are issues I am looking forward to having our witnesses from BNP address.

We should be concerned that BNP might well have facilitated improper payments to companies that were shipping illegal goods to Iraq. With the bank administering thousands of contracts, we need to know if this occurred and, if so, how many times.

Moreover, as we understand, BNP received millions of dollars in fees over the life of the Oil-for-Food Program. This is a lot of money, and it is reasonable to ask if BNP adequately supervised its compliance programs overseeing the administration of the Oil-for-Food Program, especially in light of the widespread reports in the press of corruption within the program.

Because of the importance of these issues, I will refer the details of what we have found about BNP to the Financial Services Committee under the able direction of Chairman Mike Oxley. Questions related to the Federal Reserve's oversight, while peripheral to our jurisdiction, may be important in the process of untangling this web. Chairman Oxley and I have talked, and we agree on the need to review BNP's performance in its capacity as the bank used by the U.N. for purposes of the Oil-for-Food Program.

As we proceed with this matter, it is important for us to review the performance of the U.N. as an institution. In the future, we need to ensure that programs like Oil-for-Food, if they are deemed helpful and necessary, should proceed with greater oversight by member states, with increasing accountability and transparency. The U.N. itself must reform.

With this in mind, my friend Tom Lantos, Ranking Democratic Member of this Committee, and I are introducing legislation today that will aim to improve U.N. accountability and transparency. We need international institutions that are transparent, answerable to outside scrutiny, and beyond reproach.

We have uncovered what appears to be serious malfeasance on an international scale. The ultimate victims of Saddam's corruption have been the Iraqi people, and I believe they have already suffered enough. They are owed an accounting of the crimes of their former government. How many Iraqis were convinced that the United States was the party denying them their food and medicine, when, in fact, it was their own country's leader and his corruption that were depriving them?

We must explore the full dimensions of the corruption that plagued the Oil-for-Food Program from start to finish. To achieve this proper accounting, we will continue the search, leaving no stone unturned.

Moreover, it must be clear that if cooperation from those agencies and institutions involved in this program continues to be inadequate, we will exercise such enforcement remedies as the law makes available to us.

This inquiry is just beginning.

And now I yield to my friend and colleague, Tom Lantos, for such remarks as he chooses to make.

Mr. LANTOS. Thank you very much, Mr. Chairman.

Let me first commend you and thank you for calling this historic hearing.

For 7 months, our Committee's staff has been investigating how Saddam Hussein was able to obtain billions in illegal earnings while Iraq was under United Nations sanctions.

Mr. Chairman, I am outraged by what we have learned so far. We all knew that Saddam was doing everything in his power to evade sanctions, and I am not in the least surprised to learn the details of his schemes. But it is truly infuriating to discover the depth of the contempt and greed displayed by the governments of nations such as France, Russia, and Syria, who evidently jumped at the chance to participate in Saddam's crimes against the international community.

The rogue's gallery of profiteers ranged from a close associate of Jacques Chirac to Vladimir Putin's former right-hand man. No wonder the program needs to be redesignated as Oil-for-Fraud, not Oil-for-Food. This is not the kind of behavior that inspires confidence in the viability of international sanctions, which can be an essential diplomatic tool when they are consistently applied and properly enforced.

I am also angered at the revelations of sloppy administration and possible malfeasance of U.N. bureaucrats in managing the Oil-for-Food Program, and I am stunned at the failure of our own State

Department to use the power it had—inside and outside of the corridors of the U.N.—to put a halt to Saddam’s larceny.

I am pleased that we will have the opportunity today to hear the testimony of Mr. Charles Duelfer, who heads the Iraqi Survey Group. Mr. Duelfer’s report is the first serious investigative account, backed by documentary evidence, of how Saddam illegally financed his regime. Mr. Duelfer’s findings closely track those of our Committee’s investigation.

The Iraqi Survey Group’s work confirms all of the reports that Saddam manipulated the U.N.’s Oil-for-Food Program to gain illegal revenues and, perhaps more importantly, to win influence with governments by lavishing on them lucrative commercial contracts and bribing their officials.

Russia and France were clearly the most eager participants in this influence peddling scheme. According to the Duelfer Report, to win Russian support, Saddam granted one-third of Oil-for-Food goods contracts worth at least \$10 billion to Russian firms. He also directed bribes in the form of tradable oil vouchers to key officials, such as Putin’s former Chief of Staff, Alexander Voloshin, to the Russian Foreign Ministry, and to Russian political parties and politicians, including one of the most odious and fascistic personalities of our time, Vladimir Zhirinovsky.

French companies also received a healthy share of lucrative Oil-for-Food contracts, including almost \$2 billion worth of oil. The Duelfer Report also reveals possible direct cash payments by the Iraqi regime to French companies and officials, such as former Defense Minister Pierre Joxe.

Oil vouchers were also allotted to officials, such as former Interior Minister Charles Pasqua, and influential French citizens such as Patrick Maugein, who Mr. Duelfer says the Iraqis considered a direct conduit to President Chirac.

Mr. Chairman, in addition to these findings, the Duelfer Report has also confirmed our understanding that Saddam’s manipulation of the Oil-for-Food Program was not the primary source of his illicit income. In fact, the kickbacks Saddam extracted from the Oil-for-Food Program now appear to account for, at most, \$1.7 billion, or 15 percent of his illicit earnings.

It turns out that the lion’s share of the hard currency Saddam obtained during the period he was under sanctions came from massive illegal trade he conducted with Syria, Jordan, Turkey, and Egypt. The Duelfer Report also confirms our findings that some of these nations facilitated Iraq’s illicit revenue stream by permitting their banking systems to hold, launder, and transfer hard currency to Saddam.

Mr. Chairman, we know that while these massive trade deals clearly broke sanctions, our State Department was fully aware of them and barely raised objections. In certain cases, it actually encouraged this trade. Secretary Powell objected briefly when Syria began its own massive illegal trade with Iraq in 2001, but President Assad shrugged off United States objections and actually increased the trade as the U.S. stood by and watched.

Mr. Chairman, I am sickened that the U.N. Administrator of Oil-for-Food, Benon Sevan, appears to have had his hand in the till to the tune of \$13 million worth of oil vouchers. At the same time,

representatives of the Department of State on the Sanctions Committee ignored warnings and consistently approved the inflated Oil-for-Food contracts designed only to line the pockets of Saddam and his multifarious suppliers.

Given these findings and our specific oversight responsibilities, I believe it is imperative for our Committee to focus much greater attention than we have to date on the failings of the Department of State that contributed to Saddam's illicit earnings. To this end, Mr. Chairman, I ask you to set an early date to call in State Department officials to testify before us on these matters.

Certainly our Committee will continue to examine management failures and possible corruption at the United Nations, which contributed to Saddam's abilities to steal from the Oil-for-Food Program. In this regard, I look forward to reviewing the findings of the U.N. panel of inquiry set up by the U.N. and headed by former Federal Reserve Board Chairman Paul Volcker. In order to grasp the scope of the sordid mess, we do need to follow the money, that is true. But we also have to hold accountable the authorities who should have been in place to prevent the money from moving around to begin with. For that we have to turn our attention as far away as Moscow and Paris, and as near as Foggy Bottom.

Mr. Chairman, thank you once again for calling this important hearing. I look forward to hearing the testimony of our witnesses today.

Chairman HYDE. Thank you, Mr. Lantos, and without objection, any Member who has an opening statement may have it placed in the record at this point.

We open our testimony today with a witness from the Central Intelligence Agency. It gives me great pleasure to welcome Charles A. Duelfer, who has served as Special Advisor to the Director of Central Intelligence on Iraqi Weapons of Mass Destruction since January 2004.

Mr. Duelfer is a former Deputy Assistant Secretary of State for Arms Control and Multilateral Defense Matters. After leaving the State Department, he became a Visiting Resident Scholar at the Center for Strategic and International Studies. We are truly pleased to have you appear before the Committee today, Mr. Duelfer, and we look forward to hearing your statement.

STATEMENT OF CHARLES A. DUELFER, SPECIAL ADVISOR TO THE DIRECTOR OF CENTRAL INTELLIGENCE ON IRAQ'S WEAPONS OF MASS DESTRUCTION, CENTRAL INTELLIGENCE AGENCY

Mr. DUELFER. Thank you, Mr. Chairman. Thank you, Members. It is customary to thank the Committee for the opportunity to be here, and I do. But I do want to recognize some other individuals for my presence here.

A week ago, I was traveling in Baghdad, and our vehicles were attacked by a VVIED, which is a jargon for a suicide bomber in a car, which blew up my car and our protective detail. I would like to thank Sergeant Clinton Wisdom and Specialist Donald Clary, who gave their lives in that, and Nathan Gray, who was badly injured. Without them I would not be here.

It also underscores my appreciation for the interest of this Committee in the report that we have put together. It was not cost-free. Many people gave a lot, including their lives, to accumulate this, and there are lessons to be learned—a lot of lessons.

We accumulated a lot of information. We tried to put it together in a way that would be useful to others to dissect and to connect the dots in ways that they may choose to connect the dots. I intentionally wanted to make it unclassified, and that was not a natural act for many of the people involved in this. But we succeeded in making this body of information unclassified. So I really am very grateful for the interests of this Committee in this. It is important.

The questions of the U.N. and Oil-for-Food were only one slice of what we were interested in. But there are many lessons to be learned from this.

I am fortunate to have with me some of the experts who worked on this in the field with me. If I may take a second to introduce them: Megan Emory, on the far right, Chris Johnston on my left, and the leader of the team for this element of our work is Steve Zydick, on my immediate right.

I am going to summarize my statement. I realize brevity is valued here, so I would like my full statement entered into the record. But I want to make just a few comments by way of introduction.

We looked at finance procurement, the oil voucher system, for a couple of reasons primarily. First, it seemed to be a logical way of bounding the problem that we had to investigate, which was weapons of mass destruction and the regime's relationship with weapons of mass destruction. Because of the sanctions and because of the oil embargo, it seemed that the resources would be bounded. So if we could understand the resources which Saddam and his regime had, and we could find out where they went, we could provide some assurance to ourselves that we knew what was going on with respect to weapons of mass destruction.

But in addition to that, as people on the Hill would know, when you fund something, that is when you really make decisions about your priorities. You can make policies and all kinds of things, but when you decide you are going to put money in back of it, that is when you make the tough decisions. I worked at OMB for a while, so maybe it is derivative of that.

But in any case, we felt it was very important we look at the intentions of the regime, not just a static point on what decisions they made with respect to weapons of mass destruction.

It is important, though, to understand that when we examined this data, it was from that perspective. It was from the perspective of Iraq and its relationship with WMD. It was not our task to investigate the improprieties that countries may have conducted or the U.N. Clearly, we identified some, but it was always from the Iraqi perspective.

That is important, because we were trying to understand how Saddam viewed the world. We wanted to make sure we understood his priorities. Where did WMD fit into his view of the future and his levers, his influence, and power?

So when you ask me questions, I may be circumscribed in what I say because our limit was the Iraqi perspective. There are others

who are conducting investigations from the other side, and I think that is very important. This Committee is, of course, one of them.

I will say a little bit about the trends we found in Iraq because I think that might be useful in establishing some context for the questioning. What we found was that in the early 1990s, from 1991 immediately after the war until 1995 or 1996, Saddam took a decision of partial compliance and partial defiance. He tried to have it two ways. He tried to negotiate. He tried to manipulate the Security Council.

He steadfastly refused to accept the predecessor resolutions to the OFF Program. The Security Council offered from the beginning, an opportunity for Iraq to sell oil as long as the proceeds would be used only for humanitarian aid.

But Saddam steadfastly refused to exercise that option because he felt that if he did, it would lift the pressure from the Security Council to lift the sanctions in their entirety.

In essence, he took his own population hostage. There was an enormous burden, and a lot of angst and guilt on people. Saddam was using a tool, the sanctions, and that had a lot of damaging effects on innocent people. The sanctions' target was the leadership in Baghdad, but largely the effects were being paid by innocent Iraqis. Saddam took advantage of that.

It was only when the effects on the Iraqi country and the population were so devastating that it became regime threatening, that Saddam decided to accept the Oil-for-Food Program as embodied in the December 1996 decision. He was surprised, and members of the regime were surprised, that there was more benefit to the program than simply providing food and humanitarian assistance to the population.

They discovered there were collateral benefits that they had not anticipated, and you have touched on many of them. The ability to exercise influence and leverage around the world through the opportunity to select who gets contracts and the ability to generate illicit revenue streams of hard currency. All of that was a bit of a surprise, and it led to a period, from 1996 to 1998, when the regime was beginning to develop techniques and tactics for exercising influence and dividing the Security Council and creating the impression that the sanctions were crumbling anyway.

In 1998, there were some crises with his cooperation with the inspectors, ultimately leading to a complete cessation of cooperation in December 1998 that was followed by the very circumscribed military action by the United States and the United Kingdom called Desert Fox—4 days of bombings—after which the Security Council was greatly divided.

I think it is fair to say that the Russian and French delegations felt this was an unauthorized use of military action. The period from December 1998 to December 1999 was a period of enormous debate in the Security Council. They finally created a new resolution with which to address the sanctions, the weapons, and so forth.

In some respects, it was a more measured or—I don't want to use the term "weaker"—but certainly the Iraqis thought of it as an easier version of a resolution. But even then, the Iraqis chose to ignore it.

As the sanctions and the Oil-for-Food Program continued, there was a developing attitude that they were winning—the Iraqis were winning. In Baghdad at that time, hotels were filled with businessmen. There was an annual Baghdad International Fair held in November of each year; it was filled with Western and other companies seeking to do business in Iraq.

There was an atmosphere of change—that Iraq was going to win, and in fact that was an attitude I heard expressed in my discussions with ministers and others in Iraq. They felt, in 2000 and very early 2001, the sanctions were in fact crumbling, and that was their strategy. They were proud of it, and they were succeeding. They were getting advice from many other countries who were participants in this, and some of these countries were active members of the Security Council.

Where Saddam had failed, and he often did fail to see the future, was after 9/11. That was when he made a very big strategic blunder from his perspective. The world changed. The Security Council changed. The attitudes around the world were no longer on his side, and he was too late in understanding that.

I think at the time of the State of the Union message in January 2002, Saddam and his top lieutenants began to understand that things might be a little bit different. There was a period of discussion and negotiation between Iraq and the Office of the Secretary General on accepting weapons inspectors again. That basically took the entire period of 2002.

But again, Saddam always sought a negotiation. He always had a dual approach of reward and punishment. He applied that approach to the international community just as he did his own people, and ultimately he failed.

Let me end my comments there and thank you again for your attention to this issue. We put a lot of work into this report, and I hope it is instructive to future policies. Thank you.

[The prepared statement of Mr. Duelfer follows:]

PREPARED STATEMENT OF CHARLES A. DUELFER, SPECIAL ADVISOR TO THE DIRECTOR OF CENTRAL INTELLIGENCE ON IRAQ'S WEAPONS OF MASS DESTRUCTION, CENTRAL INTELLIGENCE AGENCY

Thank you for the opportunity to be here and share some elements of my recent report on Iraq WMD.

The report and the supporting analysis aimed at providing a synthetic view of the former Regime's decisions and strategies as related to WMD. It was one of my objectives to describe the context within which Saddam made his decisions about WMD.

WMD did not happen in a vacuum. To understand what happened to Iraqi WMD and perhaps to learn lessons that might inform future policies, I felt it was important to examine the surrounding factors that impinged on Saddam's decisions. At different times Saddam opted to have, and then not to have, WMD. It was my hope to try to illuminate the conditions that led to these different courses.

I also tried to analyze the Regime's relationship with WMD over time. We have been wrestling with the prospect of the Iraqi nation with Saddam and WMD for almost three decades. It would have been grossly deficient simply to tally up the remnants of the WMD program. My goal was to understand the dynamics behind the decisions Saddam made.

To this end, we delved into the nature of Saddam's objectives and his perspectives on the world. A significant part of the report addresses the manner of Saddam's rule and his vision for himself and Iraq. Unlike previous reports on the Regime, we had access to primary sources—Saddam's top advisors as well as Saddam himself.

Understanding and analyzing WMD in Iraq is, in one way, simplified because the regime was basically one person—Saddam Hussein. This certainly bounded the analysis.

A second way of bounding the problem was to consider the limited amount of resources available to the regime. Sanctions and the oil embargo put strict limits on Iraq's disposable income. It struck me that if we could account for the resources available to the Regime, and examine how the regime allocated them, we could learn a great deal about its objectives and actions related to WMD.

This line of investigation quickly highlighted not just the tangible resources available to Iraq, but also the influence that the Regime accrued through the potential to allocate future resources. Examination of the resource decisions and the actions the Regime took to disperse its favors proved an excellent way of highlighting the objectives and intentions of Saddam.

We have identified several key inflection points in this history. One was in the summer following the 1991 war. The UN Security Council had taken the decision to link the lifting of sanctions and oil embargo imposed in August 1990 when Iraq invaded Kuwait, to Iraq's ridding itself of WMD.

A new inspection organization was created for this purpose. Initially, all thought it would be short-lived-Saddam amongst them. However, during the summer, early inspections proved more mettlesome than Saddam anticipated and while he made early decisions to offer partial compliance, it became obvious this would not suffice.

Saddam then established, as his top priority, to get out from the web of international sanctions. Other matters would be pursued on a non-interference basis with this prime objective. His policies, his actions, his tactics and strategies from that point—all had the objective of getting rid of sanctions.

The evolution of his approach toward the UN Security Council reflected his usual dual approach of reward and threat. In the same way he ruled at home, he dealt with the international community and the UN Security Council in particular.

Saddam offered partial compliance combined with defiance. He always wanted to bargain. He exerted pressure on the Security Council and tried to divide it. He would acquiesce to their demands only when unavoidable and usually partially. He preferred confrontation.

His lieutenants criticized this approach as having prolonged the sanctions.

Saddam's goal of getting out of sanctions was prime and shaped all his relations with the Security Council and its members.

The Security Council recognized from the start that sanctions were a penalty imposed on all Iraqis, not just the leadership. From 1991 on, the Security Council had made available the option for Iraq to sell oil under conditions that the revenues would only go for humanitarian purposes. The Council was very sensitive to accusations that their actions, imposing the sanctions, were the cause of the suffering of the Iraqi people. A pair of resolutions, UNSCR 706 and 712, first provided this option of humanitarian relief to the Regime.

Saddam understood this pressure and the leverage it conveyed to him. He understood that if he exercised the option of exporting oil under the condition that only humanitarian aid could be delivered, then it would relieve the pressure on the Council to lift sanctions in their entirety. He steadfastly refused to accept this option and at every opportunity chose to link the Security Council and the problems with the inspectors, with the deaths of thousands of Iraqi children. In essence, he held his population hostage.

Saddam sustained this position for five years during which time conditions in Iraq decayed. Infrastructure collapsed. Health care diminished. Aid agencies such as UNICEF reported the statistics of decay.

The middle class was wiped out. The value of one Iraqi dinar was over three dollars before the 1991 war. By 1996, the value was on the order of 1500 dinars to the dollar. If effect the entire savings of the middle class vanished. Jobs vanished. Iraqis tried to leave to find work elsewhere.

In mid-1995, Saddam's son-in-law, Hussein Kamal, defected to Jordan. Hussein Kamal was the key regime figure who had been in charge of the development for Saddam of all the WMD programs. When he left, the regime was forced to acknowledge it has not been fully forthcoming with the UN inspectors, and WMD documents, materials, and programs had been concealed.

The sympathy and support that had been building in the Security Council for the Iraqi position dissipated. Even Iraq's friends in the Security Council backed off. Suddenly, Baghdad realized sanctions would not soon be lifted. At the same time, their effect continued to grind down Iraq's people.

In 1995, a new resolution, UNSCR 986, was passed to offer relief to the Iraqi civilian population. This resolution, which became known as the Oil-for-Food (OFF) program, was not accepted until December 1996 and then only after several months of negotiations between the office of the Secretary General and Baghdad. Saddam accepted this program only when the damage of the sanctions on the civilian infrastructure itself became regime-threatening.

The initiation of this program turned out to have many benefits for the Regime. The program did achieve the higher objective of reducing the suffering of the Iraq population. However, it also had unanticipated collateral benefits for the regime.

First, there began a large flow of businessmen to Baghdad in search of contracts. While the UN held the checkbook, in effect, Baghdad still made the decisions on who would get the money. This provided a lever that empowered Saddam to reward or punish those seeking OFF contracts.

The flow of commerce expanded quickly to include the refurbishment of the decayed oil infrastructure. Baghdad shrewdly played various parties off against one another to win their favor. They made it clear that sanctions would not last forever, and when they were lifted, Baghdad would remember who their friends were. This attitude permeated all transactions and the attitude grew that sanctions were eroding and “everyone else” was making money. This effect was intangible, but powerful nonetheless.

The report describes the nature of income that Iraq was able to generate during this period. We broke them into largely four types:

- Protocols with neighboring countries
- Smuggling of oil products
- Kickbacks associated with OFF contracts
- Surcharges on oil exported through the OFF program

The report describes in illustrative cases how transactions occurred, estimated their magnitude, and, more to the point of the report, where the funds were directed. It is shown, for example, that the budget of the Military Industrial Commission (MIC) surged from \$7.8 million in 1998 to \$350 million in 2001. In 2003 Iraq had budgeted \$500 million for MIC. Saddam’s priorities were clear.

The process of allocating oil liftings was also instructive in terms of the strategy and tactics of Saddam regarding escaping sanctions.

We began obtaining data last winter from the Oil Ministry and the State Oil Marketing Organization (SOMO). The objective was to review the resources that were available to Iraq and determine if they led to any WMD activities. Combined with our investigations of the procurement mechanisms for sanctioned goods, we developed a fairly robust picture of the systems the Regime used. It is not an all-inclusive picture. We made no attempt to unearth all activities, but rather the illustrative examples that were supported by the testimony of Iraqis we debriefed.

It is important to emphasize that our work took, as a point of departure, the Iraqi perspective. We sought to understand what Iraq was doing. We were not investigating the countries who supplied sanctioned items to Iraq, nor were we investigating the judgments or culpability of any party.

I will note a couple of major points from this examination.

We found that there was a momentum shift in late 1998 when Iraq terminated cooperation with UN inspectors. Iraq has been pursuing two tracks to getting out of sanctions. They participated in the inspection and monitoring process at the same time they worked to erode support for that process and also the sanctions.

The decision by Baghdad to terminate cooperation and focus strictly on a policy of erosion of sanctions began in August 1998. The full cessation of cooperation with inspections provoked a limited four-day bombing campaign by the United States and United Kingdom in December 1998.

Other Council members including Russia and France were furious at what they declared to be unauthorized military action. This left the Security Council deeply divided. At the same time, the OFF program was continuing and commerce growing in Iraq. The inspectors were gone. As former Deputy Prime Minister Tariq Aziz commented, Baghdad could have sanctions with inspectors or sanctions without inspectors. They chose the latter.

Throughout 1999, the Security Council debated how to address Iraq. The sanctions remained, but were fraying and Iraq applied whatever tools it could to generate support for its position. Ultimately, the Council agreed upon a new Resolution 1284 in December 1999. This replaced the former inspection organ, UNSCOM, with a new one, UNMOVIC, and changed certain other provisions related to the prospects for lifting of sanctions based upon progressive steps of compliance by Iraq. Nevertheless, Iraq chose to ignore the resolution and did not permit inspections.

By 2000, funds from the four general revenue streams I noted earlier made life much better for the Regime. I would observe that the Jordanian protocol created in the early nineties now began to be replicated in this period. It was a model Iraq and its neighbors used to open and increase commerce.

The infusion of funding allowed Iraq to begin efforts to refurbish conventional military capabilities among other things such as palace construction. In 2000 we

found Saddam made a decision to invigorate his long-range ballistic missile programs—this was directly keyed to the availability of resources and material and expertise in spite of sanctions.

The view for Baghdad was good in 2000–2001. Businessmen filled Baghdad’s hotels. Flights were restarting to Saddam International Airport. The Baghdad International Fairs were bursting with foreign companies and representatives soliciting business with the Regime. Saddam was looking like a winner in many places.

Attention at OPEC meetings was riveted on the prospects for increased Iraqi oil production. Baghdad derived substantial international leverage from the speculation about its future decisions and their potential effect on markets. Oil analysts and traders were solicitous if not groveling with the Iraqi delegations.

It was also apparent to Baghdad that the American effort to revise sanctions with so-called “Smart Sanctions” was an indication of weakness. Baghdad was hearing from other Council members that these steps were all favorable to Iraq.

It is also important to appreciate that Baghdad was never an easy friend to its supporters. The Regime kept making more demands of its “friends” and often ignored their advice on how to relate to the Security Council.

True to form, Saddam made one last strategic blunder. He failed to grasp the effect of the attacks of September 11, 2001. He did not understand how this radically changed the international environment. Only following the January 2002 State of the Union Message, did Saddam *begin* to realize he could no longer stonewall on weapons inspections. He realized too late that his “friends” on the Security Council were limited in what they could or would do.

Yet he still insisted upon attempts to bargain. He would not simply accept inspections but rather opened a long process of negotiations with the UN. Ultimately, this worsened the conditions under which Saddam finally accepted inspectors.

During 2002 while Saddam tried to negotiate conditions for accepting inspections, the US pressed for a new resolution with tougher measures than the Council agreed previously in December 1999 in Resolution 1284. This was a reverse from the trend in the Security Council of loosening constraints on Iraq. The tougher US line found more traction in the Council following September 11. Saddam did not understand the changed environment.

In conclusion, the portion of this report devoted to OFF and the Regime’s finances is aimed at supporting assessments about WMD programs. It is also a vital indicator of the direction and intentions of the former regime. We were not conducting an investigation of OFF, the United Nations, or other nations’ actions. Our goal was to delve into the interior of a very opaque and dangerous regime. Much of what we found was ugly. The Regime depended, not on bringing out the best in people, rather on promoting the worst. It poisoned everything it touched.

Thank you.

Chairman HYDE. Thank you. Mr. Lantos.

Mr. LANTOS. Thank you very much, Mr. Chairman. This is an extremely complex subject. Let me try to get to the basics.

Saddam’s goal clearly was to divide the international community, and, specifically, the membership of the U.N. Security Council. To a very large extent he succeeded in doing so. It is self-evident from your report, Mr. Duelfer, that certainly France and Russia in a variety of ways profited from Saddam’s illegal activities, and, more importantly, they anticipated to profit dramatically once the sanctions were lifted. Saddam Hussein, as I understand it, and please correct me if I am wrong, was not just interested in siphoning off money, getting kickbacks, and using funds for bribing and illegal payments, but he also held out the hope—that is why the hotels were filled with businessmen—that once the sanctions were lifted, and we were clearly moving in that direction, he would reward the countries and the companies in those countries that played ball with him and objected to the sanctions. Those countries bought the phony line that the suffering of the Iraqi people was the result of sanctions, not Saddam Hussein’s unwillingness to devote oil revenues for the purpose of buying food and medicine for the people.

Could you comment?

Mr. DUELFER. I think you have hit some of the very key points. What our investigation showed was in 1991, Saddam established as his prime objective getting out of sanctions. Other objectives were pursued on a noninterference basis. In other words, we saw this was important to the activities we saw in WMD. But his key objective was to get out of sanctions.

The tools he applied were whatever he could gather up, and he had an exquisite sense of the use of power. He traded on the future, as you have noted and highlighted. If you want to be in on divvying up the rights for oil development, for example, in the various sections of Iraq, you had to be on his side. He traded on that.

He also was very sensitive in giving individuals and countries an economic stake in the survival of the regime. And he knew how to do that. So I think the points you have made are characteristic of his approach, exactly. I think the data showing how he allocated oil concessions and how he allocated oil vouchers strongly support that.

And he was making progress. In the behavior, as seen from Baghdad, of member states, companies and individuals, there were a lot of people trekking to Baghdad to solicit his favors.

Mr. LANTOS. If I may just pursue one more item because we are living with this daily. We now hear that Iraq's infrastructure in all of its aspects deteriorated dramatically during the last decade or so.

Is it true that the resources Saddam had, which could have been applied, for instance, to maintaining the medical infrastructure of the country, providing the Iraqi people with an opportunity to get some health care and take care of operations, was deliberately ignored, and the funds were used to bribe corrupt foreign public officials, like Zhirinovskiy of Russia, one of the most shady and sickening characters of the post-Soviet era?

And I wonder if you could comment on what basis he anticipated that sooner or later facts would become clear, people would buy the notion that a Russian—a shady Russian political figure who is viewed in Russia as a crook and a gangster—should be getting oil vouchers to the tune of millions and millions of dollars, when he has no experience in the business. He is not in selling oil. This was an outright bribe to him, as it was to the French officials and others.

Mr. DUELFER. Let me address the first part of your question. It wasn't completely the case that money was separated from proper use in its entirety. Certainly, funds were spent to bribe and to influence, and those funds could have been used to much better benefit in Iraq. There are many very honorable technocrats, even at the ministerial level, who sought to perform normal functions, health functions, education, so forth, but they found that within the regime—the leadership of the regime—funds were being siphoned off, as you suggest.

What happened was a perversion of the Iraqi system, and in our report we describe a sort of normal budgetary financial process where Iraqi bureaucrats, Iraqi technicians, tried to do what was right for their country and their people, and yet the thugs around Saddam and his cronies perverted that system.

And the second part of the question, I can only address, from my discussions with the Iraqis, the Iraqi perception of the situation. Certainly, some very senior officials, including those at the ministerial levels, understood Zhirinovsky for what he was. They also seemed——

Mr. LANTOS. Zhirinovsky, if I may interrupt, flew to Baghdad to declare his solidarity publicly with Saddam Hussein and his regime.

Mr. DUELFER. Multiple times.

Mr. LANTOS. Multiple times. And Saddam Hussein, as a bribe, gave him these oil vouchers.

Mr. DUELFER. Again, this was to pursue the strategy of erosion and collapse of sanctions. And, as you know, Russia has a permanent seat on the Security Council. Russia has a very important voice.

So, to the extent that the people in charge of Iraq's policy, including foreign policy—and I had long discussions with both the Foreign Minister and Deputy Prime Minister Tariq Aziz many times—this was natural. They were trying to affect the votes in the Security Council in a way that was to their benefit. So that was one of the tools that they exercised.

Mr. LANTOS. Thank you, Mr. Chairman.

Chairman HYDE. Mr. Leach.

Mr. LEACH. Thank you, Mr. Chairman. Perspective is very difficult to bring to issues of this nature. It strikes me that, as we as a country looked at these issues, we looked at all of those contracts principally from the point of view of trying to restrain weapons of mass destruction development. The real story, in the end, is less about weapons of mass destruction, and more about the difficulty of applying sanctions to a rogue state. Secondly, the vulnerabilities of the international system to corruption and to one of the great deadly sins, greed. In many ways the bitterest breach of public trust in the world is corruption.

It strikes me that we now have a circumstance where the U.N. has been touched; where foreign leaders have been touched; where the banking system has been touched; and where America is a little bit touched in terms of what Mr. Lantos raised. That frankly is competence. That is, the United States had the right, very unusually, to review all of these contracts in the U.N. system, and so we were really hit with a competence issue, but not a corruption issue.

I don't know what to conclude from all of this. And I am wondering from your perspective, is this an issue of endemic corruption that would exist without a sanctions approach, or do sanctions of this nature escalate the prospect of corruption? Do you have any judgment on that, having looked at this as a kind of case study?

Mr. DUELFER. Well, sir, it is a very complicated issue. Sanctions are part of it. The corruption is certainly part of it. This is a long report, and it is without an executive summary. I did that not simply to punish the reader, but because it is very complicated, and what you raise is an important part of it.

Sanctions pervert an economic system. Sanctions are a very blunt instrument, as you know, that people often point to. You are trying to affect Saddam's behavior, and one of the things about the

Iraqi regime that simplifies it is that it boils down to one guy and what goes on in his head.

The sanctions affect 23 million or 24 million Iraqis. It perverts a system. Once you put them in place, and once you then allow for selective commerce, and Iraq obviously had a lot of natural resources of enormous value to the rest of the world to sell, it allows for corruption. Particularly when one-half of the equation is controlled in a sense, or there was an attempt to control one-half. That is to say, the U.N. held the checkbook. But the blank of who gets paid with the check, in other words, who signs the contract, that authority was still with Saddam. I think that was probably one of the elements of this that contributes to the types of corruption you point to.

Mr. LEACH. Thank you, Mr. Chairman.

Chairman HYDE. Mr. Berman.

Mr. BERMAN. Mr. Duelfer, thank you for all of your, and your team's, incredible work on this. I am not yet one of the people you have punished, by virtue of my failure to yet read your full report. I have obviously read news reports about it.

There is one aspect of this I am curious about. In the context of your mission, you uncovered a lot of information about how the Oil-for-Food Program was utilized.

There is an independent inquiry committee into the United Nations Oil-for-Food Program. I believe it is chaired by Paul Volcker. To what extent have they shown an interest in your findings, your information, your sources, and your documents and pursued them? Do you have any ability at this point to give us a sense of the extent to which they are approaching their charge seriously in terms of getting to the bottom of the scandal and essentially telling the world what happened?

Mr. DUELFER. We decided early on that we wanted to find out as much as we could about the resources, so we went to the oil ministry and SOMO, the State Oil Marketing Organization. We wanted to get the records and that data. The Iraqis at the time were very helpful. I spent some time with the oil minister. Our team here, and many others, went to a lot of effort to gather that data, to copy it, and to scan it—to make sure we had those records. Those records are the basis for a lot of people's investigations, and we have spoken with the Volcker Commission. We will share with them—since the data really belongs to the Government of Iraq and others—when asked, and we have done so.

Mr. BERMAN. When asked by whom?

Mr. DUELFER. Well, by investigatory groups like the Volcker Commission. We have met on a couple of occasions just to discuss the types of information which we have identified that is available. Now, it is up to them to then get permission from the Iraqi Government to access that. Once that has happened, they do not have to duplicate the effort. We went to copy it; you kind of push a button, and they get it. But they are looking at the same set of data.

Now, again, our perspective was from the Iraqi perspective, and we were not pursuing a prosecutorial approach, but others are. And I think they have a lot to do.

Mr. BERMAN. Do you have any opinions, at this point, of the extent to which they are pursuing this aggressively, and to the extent

to which they are being constrained in any fashion? Do you have any opinion of the extent to which their investigation will tell the full story?

Mr. DUELFER. I really cannot judge. In my conversations with them, they were asking a lot of very probing questions. And they were out in Baghdad, so that is step one. I mean, they were not just living in the United States—so they are that interested.

Mr. BERMAN. One thing that may not be that important, but I am just curious to understand the thought process. In terms of who is getting these rights to buy oil, apparently Zhirinovsky was one of them, and Russia is on the Security Council. What I am missing in this connection is the extent to which Zhirinovsky had the ability or the clout at any particular point, either with Yeltsin or with Putin, to influence Russia's position in what seems to be a Russian effort to weaken and undermine the sanctions. Is there a direct connection there that you know of? Or was this simply a bribe to get positive statements from somebody with some clout in the Russian Duma?

Mr. DUELFER. Sir, what I found was, in fact, there was a debate among Iraqis on that point. They wondered if they were getting as much as they were paying for. So I think those are judgment calls which the Iraqis had to make.

Zhirinovsky, by virtue of the fact that he got a plane and flew into Baghdad at a time when planes coming into Baghdad—that was considered groundbreaking. I do not know. I am not well-positioned to answer that, but I do know that the Iraqis themselves were debating over where they get the most leverage out of these allocations.

Mr. BERMAN. You said in your opening statement that governments of Security Council members gave advice to Saddam on how to manipulate the system. Could you just lay out whom you were referring to?

Mr. DUELFER. Again, this is from the Iraqi perspective. But the Iraqis would say that they would obviously maintain close contact with as many members of the Security Council as they could, as a natural diplomatic activity.

But Tariq Aziz in particular had close contacts in Moscow and would get a sounding there from what the prospects were for the actions in the Security Council. The relationships with Paris were also instructive for the Iraqis.

It is also worth pointing out that, when you talk to some of these other council members, they would often say having Iraq as your friend is a difficult prospect. I know from my discussions with the Iraqis that they would intentionally play off some of these members to see who could produce the most for them—they would intentionally try to do that. But what I am describing is not something, which, from the Iraqi perspective, I think, would be considered normal.

The other sorts of data that we acquired underlie some of the statements in the report. We did get access to a lot of Mukhabarat documents. This is the Iraqi Intelligence Service overseas. And so we did get a sense of, from that organization, what they felt these countries were up to and what influence they were deriving from them.

Chairman HYDE. Mr. Burton.

Mr. BURTON. Thank you, Mr. Chairman.

I think the Oil-for-Food Program was a laudable objective initially, and I know that Madeline Albright was at the United Nations and was one of the people who worked on this and was an architect of it. Obviously, there were some shortcomings that led to an awful lot of this corruption that we have now come to learn of. One of the problems that I have is that—and I do not know that you are going to be able to comment on this, but I will make a comment, and take you off the hot seat for a second. From all reports I have seen, we are not getting much cooperation here in the Congress from Kofi Annan and the United Nations leadership. The United States—and I have worked with my colleague Mr. Flake on this, who has a bill on it—provides about 25 percent of the funding, which I understand is about \$10 billion a year, to the United Nations. And it seems to me, because of the gravity of this situation, it is imperative that the United Nations work with the United States to get to the bottom of this.

You do not have to comment. I know you do not want to get into international politics. But the United Nations is supposed to be the place where leaders from around the world get together to solve problems. And when this corruption and horrible kickbacks are taking place, I think it is imperative that Mr. Kofi Annan—and I hope he is listening right now—will cooperate with the Congress of the United States, because we do not want to cause any problems; we just want to get to the bottom of the situation and make sure it does not happen again.

Now, I just have a couple of questions here I would like to ask, and I hope that you are able to answer them. We know that, in your reports, you talked about bribes that were going in a one-way fashion. But can you give us any information that will lead us to believe that French officials, German officials, or Russian officials were asking for those bribes in order to get weapons in to Saddam Hussein during this period?

Mr. DUELFER. There were certainly individuals and companies who were soliciting business, but I draw a distinction between individuals, companies, and governments. What we saw were cases where marketing efforts, to use a term, were being made to sell conventional weapons, certainly. But otherwise, it tended to be Iraq exploring where they could get things. And there were a large number of countries that did in fact become suppliers for conventional munitions, and this is laid out in the report.

Mr. BURTON. Well, how did the French officials treat the sanctions? What was their attitude regarding those? And did you view, or did they view, sanctions as a nuisance, or were French officials trying to do something to circumvent them? And you can apply that to Germany and Russia, as well.

Mr. DUELFER. I have had no data showing France provided weapons in violation of the sanctions. And, in fact, the French refused to pay the oil surcharge fee which Iraq, at a certain point, was demanding on oil exports and the Oil-for-Food Program.

On the other hand, Tariq Aziz, who had his own view on France, observed in one of our discussions that it is interesting that France

was in favor of lifting sanctions while Saddam was in power, but after Saddam was gone was opposed to lifting sanctions.

Mr. BURTON. Let me interject here for just a second. What about the French-made Roland missiles? As I understand it, the missiles were getting into Iraq while the sanctions were in place, and there were covert kickbacks from the Oil-for-Food Program that allowed those weapons to get in there.

Mr. DUELFER. I may be wrong, but my memory is that the Roland missiles were there before the 1991 war. There were issues about whether they could get spare parts or maintenance on them. But so far as my recollection is, I do not think I saw—and let me check with my colleague—but I do not think I saw any case where the spare parts actually were delivered after 1991. There were discussions, and there were certainly French representatives who were trying to work that—there were contract negotiations on that point.

Mr. BURTON. What about weapons coming in from, let us say, the three that really opposed sanctions: France, Germany, and Russia? Were there any weapons that were coming in during this period in violation of the sanctions?

Mr. DUELFER. Certainly, Russia.

Mr. BURTON. Now, one more question, Mr. Chairman. Were there any kickbacks, Mr. Duelfer, associated with that? And can you give us any more details in that regard?

Mr. DUELFER. When we discussed kickbacks in this report, it was as a source of hard currency revenue. But in terms of getting a contract, an individual contract for an anti-tank weapons or a shoulder-fired surface-to-air missile, we did not get to that level of detail. We certainly found there were weapons and expertise provided, and Iraq got to count on it. They did not see the sanctions as a problem. In fact, they were designing missile systems which were entirely dependent upon receiving guidance systems from overseas. They were designing missile systems which counted on expertise in a propulsion system, which was provided by some of the countries you mentioned, in particular Russia.

Mr. BURTON. Thank you, Mr. Chairman.

Chairman HYDE. Mr. Payne.

Mr. PAYNE. Thank you very much.

I was just looking at the October 25, 2004 Iraqi newspaper, *Al Mada*, when they published, according to this report, the names of 270 individuals and entities who allegedly benefited from the illicit payment by the former regime. And on the list—I assume that in your investigation you took a look at these 270 entities—it allegedly said that some deny the charges. In your opinion, how significant is that newspaper article, and have you been able to determine whether the persons listed are indeed guilty?

Mr. DUELFER. Sir, that article, if I am remembering it correctly, is in fact the same list which we published in our report, in the annex of the recipients of the oil vouchers. Now, the data that we had is from the Iraqis. They discuss it in detail, and they have described in great detail their process for deciding who would get the vouchers and who would not. But we did not follow it beyond that. We did not pursue a case to make sure that this individual got that

particular voucher and what exactly he did with it. We took the documents as we received them from the Iraqis.

Mr. PAYNE. Were there any U.S. companies or individuals listed in the 270?

Mr. DUELFER. There are three. But because of the privacy of law, our general counsel said that we cannot print them. But in the documents provided to you, they are listed.

Mr. PAYNE. So this—

Mr. DUELFER. We cannot tell them publicly. That is why I am being a little bit—

Mr. PAYNE. Okay. That is good. Okay, I will not go there. The persons or the organizations that were involved, they get the vouchers, and then it is alleged that some of them got vouchers or were selected because there was an exchange for favors, more or less.

Mr. DUELFER. They were case by case. There was a committee headed by the Vice President of Iraq to determine to whom they would give these vouchers, and Saddam approved them personally because they did have monetary value. Some of them were perfectly acceptable and perfectly proper to go to oil companies and so forth. This was their mechanism of allocating who would lift or buy the Iraqi oil which they were permitted to sell. But they discovered that this was also a lever of influence, and they had a committee for allocating them. Often, what happened was if one received an oil voucher, and did not have an oil company, they would have to figure out what to do with it. They could then resell it to somebody who is authorized to lift. And that tended to be what happened.

Mr. PAYNE. So, evidently, this program went along without the Secretary General? Was he supposed to be the person who is responsible for making sure that everything worked correctly? And therefore, would you say that he was at fault by virtue of this program going along? Or is the U.N. so big that one individual cannot necessarily be on top of all of these? Or was it a different department of the United Nations that oversaw this specifically?

Mr. DUELFER. Sir, it is not my part to judge. But I would observe that the committee, the Sanctions Committee, and the resolution were set up by the Security Council. There was a Sanctions Committee, which is a committee of the whole, meaning that every member of the Security Council, including the United States, France, Russia, China, and the U.K., the permanent bloc, all had seats on that committee. They were the committee which was charged with monitoring and implementing the Oil-for-Food Program. The Secretary General established officers who were in charge of operating this, and there was the office of the Iraq Programme headed by Benon Sevan. But, again, I think in terms of direct responsibility, it was a Security Council program.

Mr. PAYNE. I think that is important because we find a number of things happening that we are not pleased with. And because of the misunderstanding by some members of how the U.N. operates, that the Security Council—for example, we believe that the Secretary General right now wants to do more against the Government of Sudan because of what is happening in Darfur. However, on the Security Council, especially the permanent members—China, for example, who was pumping most of the oil in Sudan,

certainly has threatened to veto any kind of serious resolution that will come before the Security Council if they deem it is going too far. So the Security Council and the way it operates many times is beyond the control of the Secretary General. I would hope that legislation—I have not seen the Burton-Flake legislation—but I would hope that we would take a look carefully at this very complicated program and, if reforms need to be made, we ought to target it as best we can to an organization like the Security Council, which is a very difficult organization to contain and control, as we all know. I appreciate your testimony. It is very interesting.

Chairman HYDE. Mr. Rohrabacher.

Mr. ROHRABACHER. Thank you very much, Mr. Chairman.

It pleases me to see that some of my colleagues now are understanding why some of us on this side of the aisle have been so hesitant about putting America's security in the hands of an organization like the United Nations. This difficult organization, as my colleague mentioned, is not something that I would trust with American security. I would now yield 1 minute of my time to Mr. Burton.

Mr. BURTON. Mr. Duelfer, I was reading through your report and recovered documents dated December 1998 and September 1999 that indicate the French company, Lura, supplied a tank carrier to the Iraqis through a man named Mr. Claude. In 1999, recovered documents show that multiple French firms displayed a willingness to supply parts for conventional Iraqi military items, mainly related to aircraft. And in 1999, al Hadr, a trade company, sent a delegation that participated in an international exhibition in Baghdad. They wanted to supply spare parts for the French Mirage, and there were several other companies as well. SOFEMA planned a visit on January 15, 2000 to seek possible trading between the two companies and on and on. Can you quickly explain this? I understand you said a while ago, there was not any of this going on, but your report seems to indicate otherwise.

Mr. DUELFER. Again, these are negotiations between marketers. Iraq had a large inventory of originally French-supplied equipment, including Mirages, Roland missiles, and their air defense system that was called Qari, which is Iraq spelled backwards, in French. French defense contractors were quite anxious to supply spare parts to refurbish the equipment.

Mr. BURTON. Who would be doing it?

Mr. DUELFER. But we did not see evidence of delivered items. You mentioned that tank carrier. That was a temporary export for the trade fair at this Baghdad International Trade Fair. I mean, we looked.

Mr. BURTON. Thank you. Mr. Rohrabacher.

Mr. ROHRABACHER. I would like to ask about the vouchers that we are talking about here, because it seems to me that we are hearing in testimony that vouchers were used as tools of bribery. These were actually the vehicle in which, if there was a crime being committed here of undue influence, the crimes were committed. Basically we are talking about how the vouchers were given in order to provide influence with people. And someone bought those vouchers back from them, did they not? And are we talking

about banks basically profiteering off of what is clearly an act of bribery? And what banks are we talking about?

Mr. DUELFER. Sir, the vouchers were unrelated to the banking issue. The vouchers were a piece of paper which gave the holder the right to purchase oil.

Mr. ROHRABACHER. I understand. And that is a negotiable commodity you might say. Other people bought those vouchers for cash at 50 percent of face value, approximately, and they went on through the system. Who is doing the buying there? Who is providing the money, then, after that point?

Mr. DUELFER. There is a range of oil lifters, and there is a list, in fact, in our annex of those who received the vouchers. There is U.N. data for every lifting of oil—who the company is and what ship actually lifted it. So you can pair those things up.

Mr. ROHRABACHER. Let me guess that there is somebody in between this. Let me guess that there is someone who bought the voucher at a certain percentage of the value and then sold it to the company that does the lifting. Who are those people?

Mr. DUELFER. Well, there is a range. Some of those are perfectly legitimate oil companies. Ultimately—

Mr. ROHRABACHER. Some of them are. Who are the others? Are you trying to tell me that there aren't some characters in there that we would know about, who knew what was going on and ended up buying the vouchers for less money than they were worth and then selling them on?

Mr. DUELFER. Sir, we did not look at all of those from that perspective.

Mr. ROHRABACHER. All right. You said the vouchers are not the only part of this, and they do not really relate to what you are charging in terms of the banks. What banks were involved in activity in this scheme that you feel were a little off base?

Mr. DUELFER. We did not look at that, sir. I mean, the Oil-for-Food Program worked for the BNP, the Banque Nationale de Paris in the New York office, and that is where the revenues went.

Mr. ROHRABACHER. Okay. So are you charging them with wrongdoing?

Mr. DUELFER. No, we did not look at that. We were looking for WMD, and we examined financing as a way of looking to see what was funded and what the intentions of the regime were. I am sorry; our level of mandate did not extend in the direction you are pointing.

Mr. ROHRABACHER. It just seems to me, whenever I have come across instances like this, that if you dig a little bit deeper, you find out that there are people in the business community who are profiteering on this type of thing and know all about it. And the only people who are left out of this equation are people who are not in the clique.

And, Mr. Chairman, I would suggest that there is probably a lot of profiteering going on here under the scenes, both in the financial community and elsewhere that we need to dig into.

Chairman HYDE. Thank you, Mr. Menendez.

Mr. MENENDEZ. Thank you, Mr. Chairman. Let me start by saying that no one on this side of the aisle seeks to cede or would cede America's security to anyone, the United Nations, NATO, OAS, or,

for that fact, even the Republican majority, because no one has a monopoly on how to best secure America.

I want to be clear that the fact is Iraq was able to generate billions in illicit income while under U.N. sanctions. That must be thoroughly investigated.

I also think it is important to be clear that Saddam got the vast majority of those funds, not only from simply abusing the Oil-for-Food Program, but for selling oil directly to his neighbors. According to the calculations, if I am correct, in Mr. Duelfer's report, Saddam gained about 25 percent of this money through his abuse of the Oil-for-Food Program and the corrupt actions of individuals and companies complicit in that abuse, including U.N. officials. But over 75 percent of his ill-gotten gains came from oil sales and trade deals with neighboring countries. U.N. member states, including the United States, were willing to turn a blind eye to these illicit trade deals with Saddam's Iraq that willfully undermined the sanctions. We should take care to keep them separated and make sure where we deposit the appropriate blame.

I think we have to vigorously investigate the serious allegations that have been raised against officials and companies involved in the program, and certainly leaders, and U.S. and international financial institutions. I am particularly concerned about the alleged corruption that allowed Saddam Hussein to take advantage of and profit from a program specifically designed to provide humanitarian assistance to the people of Iraq. I am also concerned over the stories we have heard of humanitarian aid contracts being manipulated for personal gain and the allegations that senior U.N. personnel may have been personally involved. However, at the same time, I think we have a responsibility here in Congress, with oversight over the Executive Branch, to raise some serious concerns about the apparent lack of action on the part of the United States and other U.N. member states to stem the abuse, even when the U.N. Secretariat's Office of the Iraq Programme specifically raised concerns in multiple instances regarding inflated oil prices, surcharges, and side agreements. Saddam Hussein was blatantly manipulating the system. The 661 Committee, the committee that had oversight for this, was made up of member states on the U.N. Security Council, on which the United States was a member, never rejected a single contract based on the considerations of corruption raised by the Office of the Iraq Programme. The U.S. was unable to quickly prevail over other U.N. Security Council members to immediately stop these activities. I think those are serious concerns.

I would also like to make another important point. The Oil-for-Food Program was the humanitarian program established to confront the overwhelming medical and nutritional crisis in Iraq that had developed as a result of sanctions and that was eroding support for those sanctions. But the U.N. never had the means or the authority to be responsible for stopping illicit oil sales. That responsibility resided with U.N. member states and the U.S.-led multinational interception force.

Finally, I think Mr. Duelfer's report, while we are focused on what happened at the U.N. and what else may have happened in terms of member states not acting appropriately, found no evidence of weapons of mass destruction in Iraq. In fact, we learned from

numerous sources that our sanctions program was generally working in Iraq and that they were stopping Saddam Hussein from developing those often talked about, but never found, weapons of mass destruction.

So, Mr. Duelfer, let me ask you one question here. What went wrong when former officials from the U.N. Office of the Iraq Programme reported 71 contracts, just for the 2000 and 2001 period, including notes of concern about pricing, to the 661 Committee, that none of these warnings seem to have been investigated by the 661 Committee, including the United States? And they expected to find hundreds of additional contracts with similar problems. Why was not a single contract rejected for pricing reasons? I don't know if you covered this in your efforts. Why weren't we successful in our efforts, or why were efforts insufficient to stop Saddam from smuggling oil with other countries?

Mr. DUELFER. Sir, you have asked a question that is really better directed to another witness because, again, in our investigation, we were the Iraq survey group, we were looking at this from the Iraqi perspective. So, I apologize, but we were not looking at how the U.N. Security Council looked at this, and how the process went for allocating or deciding on these contracts.

Chairman HYDE. Mr. Royce.

Mr. ROYCE. I would just like to begin, Mr. Chairman, by pointing out it was the United States in a very tough battle in the United Nations at the end of 2001, that ended, through our reforms, the kickback-per-barrel of oil that was going back to the regime. So the United States has been taking on this issue.

I wanted to make this point. I believe that support for similar U.N.-administrated programs will be zero unless the United Nations is forthcoming with information needed to investigate this scandal. The withholding of that information is a scandal which rivals the Oil-for-Food scandal. I think we have to demand transparency from the U.N. to get at the truth, wherever that truth leads. And I would like to ask Mr. Duelfer this question: In your report, you detail the oil vouchers apparently received by Benon Sevan, Director of the United Nation's Oil-for-Food Program. You mentioned that Sevan contacted the Iraqi mission to the U.N. to nominate the Africa Middle East Petroleum Company to transport his oil. I would like to ask you if you can provide us any more details about these transactions and do you believe that Sevan might have profited from those vouchers?

Mr. DUELFER. Sir, again, our perspective on this was the Iraqi perspective. We looked at some of those cases in a bit more detail almost as an existence theorem to see how Iraq was applying its influence and to what effect. The data provided to us by Iraq showed that Mr. Sevan received oil vouchers. We then saw, again from Iraqi data, that these vouchers were exercised through the company you mentioned. It was certainly the Iraqi view that they were conveying a good to Mr. Sevan, and in conversations with Iraqis, they felt that they were getting at least good will in return.

Mr. ROYCE. Could part of that good will have been his blind eye in terms of oversight as Director of this program?

Mr. DUELFER. Sir, that is beyond my investigation.

Mr. ROYCE. You also mentioned the man who was said to have picked up Mr. Sevan's voucher is an Egyptian named Fakhrey Abdelnour. Abdelnour is the nephew of former U.N. Secretary General Boutros-Ghali and was involved in an oil scandal in South Africa. Is there anything that would indicate whether Boutros-Ghali might have recommended his nephew Abdelnour to Sevan?

Mr. DUELFER. Sir, I cannot go beyond what is in the report. I can tell you that many Iraqis discussed a lot of the approaches they had toward the U.N. Again, my mandate was to look at WMD.

Mr. ROYCE. I understand. But is there any conceivable reason why Sevan, who is the Director of the United Nations Oil-for-Food Program, would himself be receiving vouchers? I do not understand the connection of why he would be in receipt of these vouchers.

Mr. DUELFER. Again, sir, in our report we collected a lot of data. It was done for the purposes of WMD. I would be delighted if other people would carry some of these threads further forward.

Mr. ROYCE. Would more information brought forward by the United Nations assist us perhaps in deciphering the rationale for these transactions?

Mr. DUELFER. If I were charged with that, I would certainly look there. But I can tell you from experience, a great source of information are the Iraqis themselves. And they often will be very candid both in terms of discussing openly what they did as well as with documentation.

Mr. ROYCE. Let me ask you another question. In this report, you told of efforts by Iraqi intelligence to use what they called semi-diplomatic cover to recruit agents from the U.N. headquarters in New York to influence public opinion and national policy toward Iraq. Can you provide any further details regarding this effort, and were there any stories you heard from Iraqi officials you talked to of successful recruitments on their part in the United Nations?

Mr. DUELFER. We explored this to a large extent having to do with weapons inspections. Certainly, the Mukhabarat felt that they obtained people's interests and exercised some influence. We achieved that by discussions with individuals as well as documents. But I am limited because this was a public document we were creating, and because of the exact nature of the documentation and the statements which they made. I really cannot go beyond that at this point. But it certainly was a high priority for the Mukhabarat. One of the enormous advantages we had was that we had access to Mukhabarat documents, and we had access to a lot of Mukhabarat who were relatively forthcoming.

Chairman HYDE. Ms. McCollum.

Ms. MCCOLLUM. Thank you, Mr. Chairman.

Mr. Duelfer, the list of 270 individuals and entities who allegedly benefited from these illicit payments, they were all listed publicly in the Iraqi newspapers. Were they not?

Mr. DUELFER. There was one article that has been quoted to me, but we also published what the Iraqis provided to us in this report.

Ms. MCCOLLUM. Except for the American companies. So if they were—

Mr. DUELFER. The complete report is out there.

Ms. MCCOLLUM. That is my question. I just find it rather odd that the complete report is available for people searching inter-

nationally on Web sites and newspapers, and that, yet for some privacy reason you were unable to list the American companies.

Mr. DUELFER. We, the CIA, could not print them because of the Privacy Act. I was told—

Ms. MCCOLLUM. Even though it is public information?

Mr. DUELFER. I was told that Congress could happily disclose them if they wanted to.

Ms. MCCOLLUM. That is fine. It is out there for people who really want to dig in and ask questions about American companies, as well.

I spoke, the last time I was in Baghdad, with several of the reporters who were involved in writing the story, and they questioned whether all 270 people really were guilty of possible crimes. That was a real question that they had. They were not able to get second sources. They did not have collaboration on a lot of this, misspellings of names of people, and possibly, they said even using pen names or other people's names in order to get the vouchers to keep themselves sanitized. The word "alleged" is used in your report; it is used in a lot of what we have. Is that why we keep seeing the term "alleged" used over and over and over again, because a lot of this is hearsay and there isn't the full investigation that we are waiting for from the U.N.?

Mr. DUELFER. You are right in all of those questions. However, I would point out, in the charts themselves, there are those who received the allocations, and it is indicated whether oil was in fact lifted. Some of the oil allocations, there was never any oil lifted against them, and it may have been for a number of reasons. Some of those reasons are because individuals refused to pay the surcharge and so Saddam said, "Listen, if these guys refuse to pay a surcharge, we are not going to allow them to lift." So in some ways, sometimes, there is a good story.

Ms. MCCOLLUM. But their name could have still appeared on one of the documents even though they did not participate?

Mr. DUELFER. Absolutely. But if the oil were lifted, I mean, that is an indicator. And SOMO, this is the State Oil Marketing Organization, does have a lot of data on who actually exercised these. Many of those things are knowable facts, but we did not pursue that point.

Ms. MCCOLLUM. Right. My question is to what my colleague was talking about earlier, 25 percent being the Oil-for-Food, 75 percent of the illicit gains here being trade with Syria, Turkey, and Jordan. Many of these countries are allies; some countries are fair-weather friends at times. Do you think it is important that we not only get to the bottom of what the U.N.'s role was in these potential misuse of vouchers and kickbacks and corruption, but that we also have a responsibility to look at the other 75 percent, as well, to learn from that and to find out what to do in order for that not to happen again?

Mr. DUELFER. Yes. There are a lot of factors involved in it. In the case of Jordan, which was the first protocol created in 1991, people looked at it, and they said, "Well, Jordan is a country which paid an enormous price for the sanctions, trade cutoff." Of course, Turkey paid a big price when trade was ended, as well. It is interesting to me that the other three major protocols did not take place

until 2000 when there was an enormous momentum shift in terms of people accepting whittling away on sanctions. There was the Jordanian one, which stood by itself for almost a decade, and then, all of a sudden in 2000, you have Syria, Turkey, and Egypt, which follow along after that.

Ms. MCCOLLUM. Mr. Duelfer, you used the terms “Iraqi review” and “Iraqi preference.” What were they? Iraqi protocols?

Mr. DUELFER. They were protocols. These are the bilateral agreements.

Ms. MCCOLLUM. When I was in Iraq and spoke to the reporters afterwards, they brought to me their concern about the kickbacks and the new voucher program that was going on with American contracts after the war. This was quite a systemic problem within some of their ministries, and it was still continuing. Have you brought any of those conversations to the Administration’s attention?

Mr. DUELFER. I am grateful that is not my job. I mean, I have got enough problems with WMD, thank you. Not my mandate.

Ms. MCCOLLUM. Thank you, Mr. Chair.

Chairman HYDE. Mr. Tancredo.

Mr. TANCREDO. Thank you, Mr. Chairman.

Mr. Duelfer, you mentioned earlier in your testimony that, as I understood it, there were committees that would meet to review and to develop—I think you said develop the criteria. No, you said, “to look at the vouchers and determine who would get them and, also, to think about the criteria that was necessary for the award.” Did they actually spell out those criteria? Do you know exactly on what basis they made these decisions?

Mr. DUELFER. No. They did not have a consistent set of criteria. It could have been anything. It could have been a friend. It could have been because somebody did something for them in some other form. But it was the oil minister, it was Tariq Aziz, and it was the Vice President who were the key members. Then it had to be approved by Saddam. But it tended to be largely driven by influence, which is a grand term. But, again, how to fracture the system of sanctions around them, that was the over-arching theme which guided that.

Mr. TANCREDO. And there was nothing in there that would lead us to understand specifically why a person, an entity, a business, or whatever, would get a voucher? It was just assuming that it was done because of the kind of influence that could be obtained?

Mr. DUELFER. We did not recover documents that went into that, nor did we really particularly look for that. There may have been a decision document of some sort which said, “Listen, country X just helped us,” for example, “reduce the compensation committee percentage; therefore, we want to give their representative X number of dollars.” We did not find documents that linked an act to a reward.

Mr. TANCREDO. I see. How about countries like Turkey, where we knew that they were providing oil to the country—the United States was aware of it—even at the time? Do we know whether or not there was anything other than just a willing buyer and a willing seller on the part of Turkey and Iraq in terms of the oil, or did

you get any indication that there were other things that Turkey was going to provide in order to be able to obtain the oil?

Mr. DUELFER. We did not see anything explicit, but I would point out that there was a protocol, which was a government-to-government protocol, written in 2000 between Iraq and Turkey. But throughout the period, there was oil smuggling going on between Iraq and Turkey in tanker trucks and so forth. It was not through the pipeline, but there was a lot of oil going through the Kurdish areas and into Turkey.

Mr. TANCREDO. I see. All right. I have no other questions, Mr. Chairman. Thank you.

Chairman HYDE. Thank you. Mr. Paul.

Mr. PAUL. Thank you, Mr. Chairman.

I have never been a fan of sanctions, and I think you expressed some reservations or some complications that we can get when we impose sanctions, and this is certainly an example of the kind of problems we can get into through the sanctions of the 1990s. And the record is rather clear that a lot of Iraqi children suffered from our sanctions, which prompted this Oil-for-Food Program. And I think even the Administration then admitted this. But I am not a fan of sanctions—because I see sanctions as an act of war, denying vital necessities to a country. This really is a literal act of war.

So then, going to my least favorite, or one of my least favorite organizations, the United Nations, and having the United Nations manage this program, it is not a bit of a surprise to me that we have ended up with the mess that we have.

I have one or two questions, but first off, I wanted to let everybody know of something, at least the Committee here, because it has not been brought up. I know that you were not there the entire time, but to investigate the weapons of mass destruction, Congress allocated, and we spent, \$600 million, if I am not mistaken. I was just wondering, do you think the taxpayers got their money's worth spending that amount of money?

Mr. DUELFER. Well, I think we have put together a report which describes, with a great deal of detail and in a synthetic way, a problem which has vexed the world for three decades, and I am very proud of that report. It is not simple operating in Iraq right now. I had the opportunity to work with the U.N. for many years in the 1990s. And let me tell you, it is a lot harder—contrary to what you might think—to conduct investigations now. We have lost people. And when we were the U.N. going around there, it was quite different. You have to have security. I mean, there are a lot of things which drive up the cost of doing business.

Mr. PAUL. I guess the reason I ask is that I personally have not learned much, having read all 900 and some pages of the report. But listening to David Kay, who evidently did not think this was the greatest expenditure in the world, as well as individuals like Scott Ritter, it was explained pretty well what was over there. And I think he was correct about this.

But I, too, have some concerns about this idea that the American companies were not mentioned, and this does seem strange that privacy consideration means that we prevent this. But you are absolutely right, because I have the names of four American companies that are involved there, that are on the Internet. But is there

any way you can give us an idea of what percentage of all these sales involve the American companies? I mean, it is very popular now to bash the French. Is it only the French who were involved or some Americans, too, or don't we know? Or do we know that the American companies were not involved with illicit trading, or is that an unknown?

Mr. DUELFER. Sir, I would have to defer to the Treasury Department for those kinds of questions. It is clear that the United States imported a lot of Iraqi oil, but again, that really was not my mandate.

Mr. PAUL. And back on the weapons, we did not find what was suspected. There were no weapons of mass destruction. But we do know about some weapons that are pretty important, and I do not think they fall into the category of weapons of mass destruction. Those are the RDX and the HMX and the supposedly missing tons, hundreds of tons of this. Where do you think we come up short on that? Is there any advice you can give us? I mean, did we not protect that well enough? Do we not know the full story? But it seems like there is something missing there, that this stuff is very, very dangerous, and we seem to ignore it if literally hundreds of tons of this stuff disappeared and may now be in the hands of some very bad people.

Mr. DUELFER. Sir, Iraq had thousands and thousands of weapons depots. There was a system to go through them and try to consolidate them. To the extent that I have looked at the case that you referred to, which is a facility named al Qa Qaa, which is southeast of Baghdad—and we spoke with the director of that facility several weeks ago—it is not clear to me that HMX and/or the RDX are out on the street. The individual who ran the place said that it was there in June, and that that was the period of time when the U.S. Marines were there, and they were doing a lot of demolition. We sent a team out there to look at it. While I cannot tell you definitively, if I had to guess right now, I would say most of that stuff was probably destroyed by the American forces.

But your point, I think, is more general than that. That is that there were a lot of facilities in Iraq with a lot of weapons, and you would have to have hundreds of thousands of troops in Iraq if you were going to guard all those locations. There was a system to consolidate munitions. It is ongoing. There were contractors involved in destroying that material. But, again, it is a problem which is just too big to get our arms around.

Mr. PAUL. So you make the point that possibly we did not have enough troops on the ground?

Mr. DUELFER. I do not want to be quoted. What I am saying is there are a lot of sites in Iraq. I mean, it is full with weapons caches, and it would take a lot of people to guard them.

Mr. PAUL. Thank you.

Chairman HYDE. Mr. Nick Smith.

Mr. SMITH OF MICHIGAN. Thank you, Mr. Chairman.

Mr. Duelfer, do I understand you to suggest that the United Nations bureaucracy has not been totally open in the effort to investigate all of the situations and happenings with the Oil-for-Food Program?

Mr. DUELFER. Sir, I have no window into that; my mission is separate from that. You would have to talk to those who are doing an investigation of the OFF program itself at the U.N. I simply do not.

Mr. SMITH OF MICHIGAN. With your experience with the U.N., do they need additional encouragement, or are you again saying that they might or they might not?

Mr. DUELFER. Sir, I would rather confine my comments to the WMD.

Mr. SMITH OF MICHIGAN. The reason I ask is, when the appropriations bill went through for the United Nations, I had an amendment on the Floor that said we would withhold \$20 million of dues until they were fully cooperative in this investigative effort, because it seems to me, to get to the bottom of it, we need to know also what happened to the U.N.

Let me move to ask you a question on the dealings that were not totally legal in the Oil-for-Food Program that involved countries like Russia, France, and Germany. Did that involvement, and their gain in some situations from what Saddam was doing in kickbacks and paybacks, possibly have an influence on their vote at the U.N. after 9/11 and after we went for the final resolutions for going into Iraq?

Mr. DUELFER. I answer from the perspective of the Iraqis. I think the Iraqis certainly believed they had a return on their investment certainly up to 9/11. Where I think they—Saddam in particular—may have had an intelligence failure, was when he did not realize the calculus which these other countries had changed after 9/11. And whereas he felt that these other countries would be more supportive, that support, again from the Iraqi perspective, attenuated over time. Although they did feel they had promises from certain members that they would veto resolutions proposed by the United States and the Security Council against Iraq.

Mr. SMITH OF MICHIGAN. Can I translate that to understand you to say that the interaction of countries like France, Germany, and Russia in the Oil-for-Food Program may very well have, to some extent, influenced their vote on the final resolutions?

Mr. DUELFER. The Iraqis believed that they were getting influence and getting some help from those countries. But at the end of the day, Tariq Aziz and others said these guys were going to behave in terms of their own self-interests, not Iraq's.

Mr. SMITH OF MICHIGAN. Would there have been any impact or influence on the decision in Turkey to not allow the United States and British and other troops to go in through North Turkey because of their involvement in the Oil-for-Food Program?

Mr. DUELFER. I saw no evidence of that, and it really was not a particular area of our examination.

Mr. SMITH OF MICHIGAN. Thank you. Mr. Chairman, I have no further questions.

Mr. ROYCE [presiding]. Mr. Smith.

Mr. SMITH OF NEW JERSEY. Thank you very much, Mr. Chairman.

Mr. Duelfer, as you know, the *9/11 Commission Report* noted that, to date, the United States Government has been unable to determine how much money al-Qaeda raises, from whom, and how it spends the money. It is, I think you would admit, entirely plausible

that at least some of the \$23 billion Saddam Hussein is alleged to have diverted from the Oil-for-Food Program went to al-Qaeda. What do we know, if anything, about links between the Oil-for-Food Program and al-Qaeda? And, secondly, in your investigation regarding Iraq's weapons of mass destruction program, even though it was not the Iraq Survey's mandate to investigate allegations of illicit financial dealings, did you find any indication that the World Trade Center bombers were financed by illicit proceeds from the Oil-for-Food Program?

Finally, on the issue of human trafficking, this is an issue that many Members of this Committee have taken very seriously. It is a transnational crime. After drugs and weapons, it is the third largest money-maker for organized crime. Did your group investigate or uncover any documentation of links between human trafficking and terrorism?

Mr. DUELFER. Sir, the answer to all three of your questions is, we have no evidence that we came across. What I would say, though, is we, the United States, the coalition, recovered a lot of documents which are being examined in Qatar. There is a facility there, a document exploitation facility, and there are literally millions and millions of pages of documents. Many people will be examining that resource to look at a number of questions. I think the ones which you have suggested also could be looked at.

Mr. SMITH OF NEW JERSEY. Could you give any indication what the timeline might be regarding an investigation into whether the Oil-for-Food money that was derived illegally from that program is linked to al-Qaeda? Is there any kind of prioritization to find out if there was such a link? I mean, it is an enormous amount of money. This was not all financed by the fortune that the head of al-Qaeda purportedly has.

Mr. DUELFER. I simply do not know. That was not what we were looking for. We did not incidentally find anything like that. Others may be examining that question, but I cannot comment.

Mr. SMITH OF NEW JERSEY. Understood. Thank you. I yield back.

Mr. ROYCE. Mrs. Davis, we will go to you.

Mrs. DAVIS OF VIRGINIA. Thank you, Mr. Chairman.

Mr. Duelfer, I was in Baghdad last week when the unfortunate incident happened with you, and I really appreciate you honoring those two gentlemen. Their same unit carted us around, and they definitely are brave men and heroes, and I appreciate you honoring them today.

Could you tell us what role, if any, you think Syria may have played in aiding Saddam and trying to evade the sanctions? And, second, I do not know if you investigated this or not, but do you believe that BNP was ill-suited and ill-equipped to handle the Oil-for-Food Program? And, if so, why would the U.N. have chosen them?

Mr. DUELFER. On your second question, I am really not the one to ask. You will have to ask another witness.

On the first, Syria was key. There were close relations at a government-to-government level. There were companies who facilitated the acquisition and transport of weapons into Iraq. Syria provided false end-user certificates so that companies and countries

that wanted to ship to Iraq could ship to an end-user nominally in Syria. The Syrian protocol provided a substantial avenue of finance. I think we have laid out a pretty detailed case in the report on this. But Syria is one of the key actors in this.

Mrs. DAVIS OF VIRGINIA. Given that you said the reason you did not answer some of these other questions was because your mandate was to look into weapons of mass destruction, is there any evidence whatsoever that Saddam Hussein may have transported any of the WMDs over to Syria? Have you looked into that as of yet?

Mr. DUELFER. It is still an open question. We have been looking very carefully at that. It is difficult to investigate because one of the things we would like to do, and have not been able to do, is to go up to the border area and talk to some of the Mukhabarat people and so forth. It turns out that is a pretty dangerous area right now. We certainly have seen reports. I cannot confirm anything one way or the other.

What we do know is that a lot of stuff was crossing the border before the war such as trucks. But we do not know what was in them. So I would like to be able to state definitively one way or the other an answer to that; I am not sure I am going to be able to.

Mrs. DAVIS OF VIRGINIA. Thank you, Mr. Duelfer.

Mr. Chairman, I yield back.

Mr. ROYCE. Thank you. We are going to have to go to our third panel at this time. I want to thank the witnesses here today. We need to hear from our witnesses from BNP-Paribas North America.

I am going to ask Mr. Everett Schenk, who serves as the Chief Executive Officer, if he would come forward to be on this next panel. And I am going to ask Mr. Nicholas Farachi, who was formerly the Compliance Officer for BNP-Paribas. We are going to switch our third and second panels so that we can have a chance to hear from these two gentlemen at this time. Let me welcome them both to the House International Relations Committee.

We will be hearing from Mr. Everett Schenk. As I mentioned, he is the Chief Executive Officer of BNP-Paribas. We have a copy of his written testimony. If you could make your comments within the designated 5 minutes, that will give us a chance to ask questions.

**STATEMENT OF EVERETT SCHENK, CHIEF EXECUTIVE
OFFICER, BNP-PARIBAS NORTH AMERICA**

Mr. SCHENK. Mr. Royce, Members of the Committee, my name is Everett Schenk, and to my left is Nick Farachi, who is the former FHC and Banking Compliance Officer within BNP-Paribas.

You mentioned 5 minutes, Mr. Chairman. I had prepared a few remarks a little bit longer than that. Given the recent releases in the press over the last 24 hours, I thought it would be appropriate, if you don't object, that I take a little bit more time than that. Thank you very much.

Since May 2000, I have served as CEO of North American Corporate Investment Banking Operations for BNP-Paribas. In its entirety, the bank has over 10,000 employees in the United States. In my capacity as CEO since May 2000, I have been responsible, among other things, for overseeing the operations of the New York branch of the bank, which provided certain banking services to the

United Nations in connection with the U.N. Oil-for-Food Program. These services were provided under a written agreement for banking services between the United Nations and the bank.

At the outset, let me say that the bank is deeply disturbed by reports in today's media, apparently based on statements from this Committee, that the bank may have paid letters of credit with funds from the U.N. Iraq account without having received confirmations from the U.N. that the goods had arrived in Iraq. Those statements evidently were prompted by a document obtained by the Committee from the bank's regulator, which raised questions regarding such confirmations of arrival in connection with a number of letter of credit payments, as well as other issues, all of which we believe have been satisfactorily resolved.

The bank has never been asked by this Committee or its staff to provide even a single letter of credit file, much less to address the particular issue before these reports appeared in the media. Obviously, it is impossible for me, sitting here today, to discuss the details of highly complex letter of credit transactions that I have not personally had an opportunity to review.

But I am advised by bank staff that the bank received confirmations of arrival for each of the payments in question. The bank would be happy to make its staff available to meet with the Committee staff and take them through each of these multifaceted transactions one step at a time to ensure that they understand how each of these transactions was processed.

An issue has also been aired in today's media, again based upon a document I referred to earlier, about possible letter of credit payments by the bank to persons other than those designated as the suppliers of specified goods to Iraq. That document identifies a single letter of credit issued in 2001, under which approximately 40 percent of the amount due was paid to one trading company at the request of another that was the designated supplier of the goods.

This was not consistent with the procedures followed by the bank under the Oil-for-Food Program, which limited payments to a designated supplier or to a financial institution providing financing for the transaction. It appears to have been authorized as an exception to those procedures, and as yet we have not been able to ascertain the reasoning behind the action.

I am, however, unaware of any other such exception having been identified as a result of any other internal or external reviews that have been conducted of the bank's performance of services in connection with the Oil-for-Food Program. I do not believe in any way that it is characteristic of the bank's handling of the more than 50,000 payments it has made on letters of credit under the program.

I also believe that the name of the recipient of the payments in question, along with the designated supplier of the credits, would have been checked against the list of designated nationals published by the U.S. Department of Treasury Office of Foreign Asset Control, and I have been advised that the recipient of the payments in question is not among the list of suspected front companies identified in the Duelfer report.

In short, we believe it is unfair to characterize the bank's performance under its agreement to provide banking services to the

U.N. based upon this isolated incident which bears no relationship to the evidence of improper payments that was unearthed by Mr. Duelfer during his recent mission to Iraq on behalf of the Director of Central Intelligence.

I would also like to address the suggestions in today's media emanating from the Committee that raises issues by the bank's regulators with respect to its anti-money-laundering procedures and how they may have somehow impacted the Oil-for-Food Program. This simply is not the case.

The bank had only one customer under its agreement to provide banking services to the U.N. in connection with the Oil-for-Food Program, and that was the U.N. itself. Under the agreement, only one account was opened at the bank, and that was the U.N. Iraq account. With the exception of OFAC filtering, to which I have referred earlier, which was performed on all names associated with all letter of credit transactions processed by the bank, the anti-money-laundering procedures at issue had no applicability in the bank's processing of these transactions.

The bank believes that the standards and procedures that were applied in processing its letters of credit under the Oil-for-Food Program comported with all applicable legal and regulatory requirements, and that the improprieties that have been identified in the Duelfer report could not have been detected through any greater diligence by the bank in processing these transactions.

Moreover, the bank reasonably took comfort that the Security Council had reauthorized the program on 13 occasions; that the Sanctions Committee of the Security Council had implemented procedures to ensure the integrity of the program; and that the Sanctions Committee had authorized all of the transactions under the program.

The bank understands that in approving those transactions, the Sanctions Committee operated by consensus, and that any member of that committee, including the United States, was able to withhold approval for any transaction under the program.

The bank further understands that at times approvals were withheld, including when there were concerns that contracts proposed for the sale of goods to Iraq involved items that might be converted to military use, despite their ostensible civilian purpose.

We make these observations to underscore the fact that in performing its obligations under its contract with the U.N., the bank could not have uncovered the information that Mr. Duelfer has been able to discover only by following an intensive and thorough investigation with access to previously unknown documents maintained in secrecy by former members of the Iraq regime.

Again, the bank believes it performed its obligations under its contract with the U.N. with appropriate diligence and with the knowledge that the Oil-for-Food Program itself, and all transactions thereunder, had the authorization of the U.N. Security Council and the committee that was chartered by the Security Council to oversee enforcement of the sanctions against Iraq.

In order to properly evaluate the bank's performance under the agreement to provide banking services to the U.N., we think it is important that the Committee understands the role of that agreement. The bank was retained by the U.N. to provide nondis-

cretionary banking services in connection with the Oil-for-Food Program. Generally, on the oil side of the program, the bank services involved confirmation of letters of credit issued on behalf of U.N.-approved purchasers of Iraqi oil. Those letters of credit were issued by various banks for the benefit of the U.N. Iraq account, an account that was opened by the U.N. at the bank's New York branch at the inception of the Oil-for-Food Program. When a bank confirms a letter of credit, it takes upon itself the obligation of the issuing bank to pay the beneficiary, in this case the U.N. The bank's confirmation of each of the oil letters of credit was done at the direction of the U.N.

The processing of oil letters of credit under the Oil-for-Food Program conformed with standard practices governing letters of credit with the following additional controls. First, each contract between the Iraqi State Oil Marketing Organization, SOMO, and a buyer had to be approved by the U.N. Second, the price of oil was established by a process approved by the U.N. Third, the loading of the oil was supervised by an independent company appointed by the U.N. to ensure that the correct volume and grade of oil was loaded. And, finally, at the payment stage, all shipping documents were presented to the bank by the U.N.

On the humanitarian side of the Oil-for-Food Program, the banking services under the contract with the U.N. have involved the issuance of letters of credit at the direction of the U.N. for the benefit of U.N.-approved suppliers of goods to Iraq. Those letters of credit provided the necessary assurance to suppliers that they would, in fact, receive payment for their goods once they had been delivered to Iraq in accordance with their contractual obligations. The processing by the bank of those letters of credit was performed in accordance with standard letter of credit practice, with the additional safeguard that, prior to payment, the U.N. was required to provide the bank with a certificate confirming the arrival of the goods in Iraq based upon an independent inspector's report.

Significantly, the bank had no discretion over how money was spent or invested under the U.N. Oil-for-Food Program. The bank did not select the buyers of the oil or the sellers of the goods. It did not establish the volume or price of the oil to be sold by Iraq, and it did not determine the goods to be supplied or the price to be paid for them.

In sum, the bank provided nondiscretionary banking services to the U.N. under the banking services agreement. Its role has been to confirm oil letters of credit, ensuring that the U.N. Iraq account received all of the proceeds from the U.N.-approved sales of Iraqi oil; to credit the U.N. Iraq account with the proceeds from U.N. oil sales; to transfer certain of those funds, pursuant to U.N. instructions; to invest the balance pursuant to U.N. directives; and to issue, process and pay humanitarian letters of credit at the direction of the U.N., all in accordance with traditional trade finance practice, OFAC filtering requirements, and the specified protections of the Oil-for-Food Program.

The bank reasonably relied on the Sanctions Committee for its authorization of all of the oil and humanitarian transactions under the program. Aside from temporary backlog and other administrative matters that did not affect the integrity of the program, the

bank believes it properly fulfilled all of its responsibilities under its banking services agreement in accordance with applicable law and regulatory requirements.

I would be pleased to answer any questions the Committee may have, and I respectfully request that my written statement be submitted for the record. Thank you.

Mr. ROYCE. Certainly, Mr. Schenk, we will put that, without objection, into the record.

[The prepared statement of Mr. Schenk follows:]

STATEMENT OF EVERETT SCHENK BEFORE
THE HOUSE INTERNATIONAL RELATIONS COMMITTEE
ON BEHALF OF BNP PARIBAS

My name is Everett Schenk. Since May 2000, I have served as CEO of the North American corporate and investment banking operations of BNP Paribas. In its entirety, the Bank currently has over 10,000 employees in the United States. In my capacity as CEO and since May 2000, I have been responsible, among other things, for overseeing the operations of the New York branch of the Bank, which provided certain banking services for the United Nations in connection with the UN's Oil-for-Food Program. These banking services were provided under a written Agreement for Banking Services between the United Nations and the Bank.

In order to understand the Bank's role in connection with the Oil-for-Food Program, it is important to observe two essential points. First, the Bank's sole customer under its Banking Services Agreement with the UN has been the UN itself. Second, at the outset of the Oil-for-Food Program, the Sanctions Committee of the UN Security Council, also known as the 661 Committee, whose members included all members of the Security Council, implemented detailed procedures for the review and approval of all the oil and humanitarian goods transactions under the Program. The Bank was aware of those controls from the beginning, and throughout has processed such transactions only when they had been authorized by the Sanctions Committee.

The role of the Bank under the Banking Services Agreement has consisted of delivering non-discretionary banking services to its customer, the UN. Generally, on the oil side of the Program, the Bank's services have involved the confirmation of letters of credit issued on behalf of UN-approved purchasers of Iraqi oil. Those letters of credit were issued by various banks for the benefit of the UN Iraq Account -- an account that

was opened by the UN at the Bank's New York branch at the inception of the Oil-for-Food Program. When a bank confirms a letter of credit, it takes upon itself the obligation of the issuing bank to pay the beneficiary, here the UN. The Bank's confirmation of each of the oil letters of credit was done at the direction of the UN.

The processing of oil letters of credit under the Oil-for-Food Program conformed with standard practices governing letters of credit, with the following additional controls imposed by the UN: (i) each contract between the Iraqi State Oil Marketing Organization, or "SOMO," and a buyer had to be approved by the UN; (ii) the price of the oil was established by a process approved by the UN; and (iii) the loading of the oil was supervised by an independent company appointed by the UN to ensure that the correct volume and grade of oil was loaded. At the payment stage, all shipping documents were presented to the Bank by the UN.

On the humanitarian side of the Oil-for-Food Program, the Bank's services under its contract with the UN have involved the issuance of letters of credit at the direction of the UN for the benefit of UN-approved suppliers of goods to Iraq. Those letters of credit provided the necessary assurance to suppliers that they would receive payment for their goods once they had been delivered to Iraq in accordance with their contractual obligations. The processing by the Bank of those letters of credit was performed in accordance with standard letter of credit practice, with the additional safeguard that, prior to payment, the UN was required to provide the Bank with a certificate confirming the arrival of the goods in Iraq based upon an independent inspector's report.

Significantly, the Bank has had no discretion over how money has been spent or invested under the Oil-for-Food Program. The Bank did not select the buyers of the oil or the sellers of the goods; it did not establish the volume or price of the oil to be

sold by Iraq; and it did not determine the goods to be supplied or the price to be paid for them.

It is important to point out that the Bank is not the only institution that has held funds for the Oil-for-Food Program. Other banks have been involved in holding such funds from the outset of the Program. Although 100% of the proceeds from the sale of oil initially were credited to the UN Iraq Account at the Bank, only 59% of those proceeds remained in that Account. The balance of those proceeds immediately were transferred to a UN account at JP Morgan Chase pursuant to instructions from the UN: 13% of the funds to be used by the UN to provide relief to the Kurdish provinces in Northern Iraq; 25% to be used by the UN to provide compensation to victims of the first Gulf War; and 3% to be used by the UN for weapons inspection and to defray the costs of administering the Program.

In short, the Bank's role under the Banking Services Agreement has been to confirm oil letters of credit, ensuring that the UN Iraq Account received all of the proceeds from the UN-approved sales of Iraq oil; to credit the UN Iraq account with the proceeds from UN-approved oil sales; to transfer certain of those funds pursuant to UN instructions; to invest the balance pursuant to UN directives; and to issue, process and pay humanitarian letters of credit at the direction of the UN, all in accordance with traditional trade finance practice and the specified protections of the Oil-for-Food Program.

The Bank's provision of services pursuant to the Banking Services Agreement was licensed by the United States Department of Treasury Office for Foreign Asset Control, or "OFAC." Moreover, all services provided by the Bank under the Banking Services Agreement were performed within a framework designed by the UN. In addition, to continue the Oil-for-Food Program, which was conducted in six-month phases, the UN Security Council needed periodically to authorize the Program's renewal.

In fact, the Security Council approved the renewal of the Program on 13 occasions during the course of the Program.

All letters of credit confirmed or issued by the Bank under the Banking Services Agreement also were governed by the Uniform Customs and Practices for Documentary Credits, a set of detailed procedures for letters of credit published by the International Chamber of Commerce. Program transactions also were subject to U.S. regulatory requirements, including in particular, the screening of any Program participant against lists of specially designated nationals published by OFAC.

In sum, under the Banking Services Agreement, the UN was the Bank's sole customer. The role of the Bank under that Agreement was clearly defined and circumscribed. The responsibilities of the Bank thereunder were non-discretionary banking services related to the processing of letters of credit that were designed to facilitate transactions for the UN-approved sale of oil and purchase of goods by Iraq. The Bank reasonably relied upon the Sanctions Committee for its authorization of all of the oil and humanitarian transactions under the Program. Aside from temporary backlogs and other administrative matters that did not affect the integrity of the Program, the Bank believes it properly fulfilled all of its responsibilities under its Banking Services Agreement in accordance with all applicable legal and regulatory requirements.

Mr. ROYCE. Let me explain some of the differences of opinion on this issue. Regulators looked at 80 transactions. Of those 80 transactions, they report that they found three transactions with East Star Trading Company where you have third-party assignments of letters of credit without authorization.

Now, members of the staff of the House International Relations Committee have been informed by State Department officials that the United Nations has found no record authorizing your bank to make third-party payments to the East Star Trading Company on

March 23rd, or April 12th, or May 3rd. Those sums were in the amounts of \$2,224,000 in the first instance, \$3,609,000 in the second, and \$3,055,000 in the third.

I understand your position that you received authorization to make these third-party payments, but the U.N. reports that their records indicate they ordered the bank to make the payment to the named party on the letters of credit on these dates, and that is Al-Riyadh International Flower Company's group.

One of the questions I'd like to ask you is whether you know who the East Star Trading Company is? U.N. records don't indicate that particular entity, and I was wondering if your records might indicate this.

Mr. SCHENK. A couple of comments. First of all, the specific subject you raise came to our attention late in the day yesterday through the media. And I would offer up to this Committee that we would be more than pleased to sit down and review with staff of this Committee the details that we have on that file or other files which are in our possession. As the Committee had not really requested that information, I must say that today I am not prepared to comment on the complexity of a number of these situations.

We did, however, have a chance, over the evening, to review and can at least validate to this Committee that for the payments that were made, we did have certificates of arrival in all of the situations that you referred to.

Mr. ROYCE. Well, I understand. But the regulators did raise this issue with your bank. Part of the question is the failure to respond, I believe, to the concerns of the regulators. I mean, this is how we got to this point.

If we recognize that the act of the regulators calling it to your attention puts you on notice as to the nature of the problem, and today you are indicating with respect to the one instance you did cite that you didn't have explanation of how the payment was made, how the third-party assignment occurred. It does bring to our minds the question of whether the letter of credit operation in your bank was compliant with the banking laws and regulations, including the USA PATRIOT Act. That is one of the questions we have.

It is my further understanding that increased attention to operational risk within the banking community may be causing banks to further tighten their internal standards for whom they choose to do business with in order to check out these types of situations. Is that correct, in your opinion?

Mr. SCHENK. Again, if I can—I appreciate the breadth of the comments you just made. First, with specific reference to comments that the regulators have made to us, I certainly appreciate that you understand and are aware that, by law and regulation, the information contained in any examination reports or any communications with our regulators is considered confidential supervisory information. The bank is really not permitted to disclose that information without prior authorization from the regulators.

Prior to this hearing, the bank consulted with its regulators for guidance on how the bank should answer questions such as you have posed with reference to regulatory discussions. We were ad-

vised that the regulators have discussed this matter with the Committee and indicated they would not permit disclosure by us of confidential supervisory information in a public hearing.

To address any questions specifically related to regulatory confidential supervisory information, we would be willing, and our regulators would permit us, to sit in a private session with the Committee. We will make every effort today to be responsive to your questions, but I put my response in the context of that qualification.

I can say that at various points in time we have received inquiries about the status of various programs, and people have visited the subject from a regulatory perspective.

My remarks at the beginning implied, and I would like to repeat them, to say that all of the concerns that we are aware of, we believe have been satisfactorily resolved. I don't have the benefit of all of the information that you may have available to you, but, again, we would be happy to discuss this in more detail in a private session.

You made further reference to the bank's compliance with the USA PATRIOT Act. And the bank, as all financial institutions, I suspect, has taken particular care to review its own internal procedures to ensure compliance with the USA PATRIOT Act. There is nothing in our approach to the administration of the Oil-for-Food Program which in any way is not compliant with the USA PATRIOT Act. In fact, we find the procedures present in the Oil-for-Food Program to be at least, if not stronger, than what is implied in the Know Your Customer applications and enhanced due diligence required under the USA PATRIOT Act.

With reference to your comments about operational risk, it is true that it has been a significant focus for all institutions these days, and one which we take very seriously and are actively pursuing in our own operations.

Mr. ROYCE. Well, again, we had three payments assigned. I think that was in July 2003 that issue was uncovered, and it has been over a year since that initial discovery. I think resolving this goes to the heart of the issue of compliance in the Oil-for-Food Program. And it has been called to our attention. That is why we press the issue today.

If I may ask, your contract with the U.N., was that priced and identified as being high risk for internal risk management purposes at any time during this contact period? Also, what kinds of internal controls exist at the bank regarding high-risk customers and transactions?

Mr. SCHENK. In the context of a risk-grading system for purposes of assessing a client's suitability for the banks, if it is in the context of that, our client for the Oil-for-Food Program is the U.N. The U.N. is a large multinational organization, and as such carries a low-risk grading for us internally as part of our rating system because, if you recall under the U.N. Oil-for-Food Program, our client is the U.N. We have one account, the U.N. Iraq account at the bank.

Our procedure today, as it exists for handling clients and new clients, consistent with the PATRIOT Act, involves very deliberate and specific processes for opening new accounts. These accounts in-

volve a preparation of detailed background information on the client and the preparation of an account profile, which indicates the kind of activity that the bank will engage in with that client.

That information is then presented to a client acceptance review department, which validates it. This is an independent group, part of our banking operations. If, in the process of that customer validation process, it is deemed to be high risk, high risk by the nature of its business or high risk by the nature of its company origin, we submit that to a client acceptance committee.

That client acceptance committee includes not only myself, but representatives of our audit, legal, and compliance areas in order to validate whether the risk associated with that client is determined to be one acceptable to the bank.

Mr. ROYCE. But after 2001, you had widespread allegations of fraud, corruption, and, frankly, of worse, routinely in the press, connected with this Oil-for-Food Program. Why would you not consider these accounts to be high risk when you began seeing third-party assignments and documentation problems that were expressly not permitted by the U.N. program? That is the question.

Mr. SCHENK. Okay. With reference to third-party payments, at this point in time, of the various independent internal and external examinations associated with the Oil-for-Food Program, we are—and I am—only aware of the one instance with a third-party payment which was not approved in accordance with the procedures which governed the Oil-for-Food Program.

Mr. ROYCE. I understand your assertion. The inspections report that we have identified 3 out of 80 such third-party payments.

Mr. SCHENK. I was speaking in particular about one client who was under, I think, one contract. So I realize there were seven or eight payments related to that contract. So I generalize to one contract, yes, sir.

Mr. ROYCE. Was anyone in management ever concerned that a customer might be criminally diverting funds away from the people of Iraq? Did that flag ever go up? If you were concerned, what internal control mechanisms might you have put in place to protect the bank from becoming an unwitting tool in what we look at today, as we examine the overall picture of the Oil-for-Food Program, as sort of a broad international web of corruption? That is something, frankly, that undermines not only, in my mind, the legitimacy of the United Nations itself, but it could undermine an institution. Did that flag ever go up?

Mr. SCHENK. Well, I guess, for the record, we had one customer, and that customer was the U.N. As it relates to our procedures, all incoming requests and outgoing moneys were run through various filters, especially OFAC filters, so that we did not deviate in any way from standard practice of monitoring requests. It wasn't just the money, but the names involved in the specific requests were also run through our filters, and such that we didn't perceive those to be clients of the bank. They were, in fact, run through the various filters available to us such that it gave us comfort that we were not doing acts as you suggest.

Mr. ROYCE. What did you do in response to the violation notices you received regarding East Star Trading Company?

Mr. SCHENK. It is a question of characterization. I am not familiar with the expression "violation notices." What I said was we have, first of all, some aspects of that particular review, and it was a regulatory review, so I am somewhat restricted in my comments in terms. But we have engaged in a review of specific transactions. The specific transactions have involved ongoing discussions.

I don't have the benefit today of the material that you and the Committee have, so all I can say is we believe that any review done by internal or external parties has been successfully resolved. I again reiterate on that particular transaction, I am personally not equipped to discuss it in detail today. I just haven't had the time. It surfaced yesterday as a comment. We would be happy to sit down with the Committee, and we would be happy to go over all of the information we have on that file.

But as we understand it today, any issues that have been raised have been satisfactorily resolved.

Mr. ROYCE. The last question I am going to ask you is, independent of the bank's responsibilities under the contract, and independent of your responsibilities, since you are operating in the United States under U.S. law. There is the issue of responsibility to implement strong internal risk management procedures to protect shareholders and depositors from becoming unwitting tools of corrupt Iraqi officials.

Is it your testimony that management at BNP chose merely to comply with the terms of the contract and the strict letter of the law without any additional internal risk management overlay? Does the bank normally defer to external judgment when assessing the risk of a client or counterparty without undertaking further due diligence? And if not, why would you choose to defer risk assessment to the U.N., as you have commented in this instance, when in the newspapers, as I mentioned, there was evidence of all of the concerns about the Oil-for-Food Program? There was growing concern worldwide about the possibility and the allegations of corruption at the U.N. involved in this program.

I am referring to 2001 on, not prior to the surfacing of that dialogue.

Mr. SCHENK. You suggest by your question that we deferred to the U.N. While the U.N. is our customer in this instance, we took enormous comfort from the fact that every oil contract and every contract for humanitarian aid was approved and validated by the 661 Committee. This includes all of the members of the Security Council.

So we are not relying exclusively on some body called the United Nations, but we, in fact, are looking through that to an organization which includes substantial representation of meaningful countries, including the United States. And we took great comfort from that.

That external validation, if you will, of qualified purchasers of oil, qualified vendors of services or providers of supplies, humanitarian contracts to Iraq, is more than we get in traditional banking services. That validation by a number of independent people represents a level of due diligence that is beyond normal banking practice.

Mr. ROYCE. But the bottom line here, the reason we ask the questions, is the United Nations indicated that their records indicated that they ordered the bank to pay the named party on the letters of credit. That named party was Riyadh International Flower Company; it was not East Star Trading. So hence we get to this point of questioning about due diligence.

Mr. SCHENK. And in my remarks, I suggested that the process calls for payments to be made to a designated supplier or to a financial institution that is providing financing for the transaction.

In the instance that you have cited, we continue to investigate and ascertain the reasons. But I will also say, once again, that in both our own external and internal evaluations at this moment is the only instance that our staff has made known to me where, in fact, we do not have external—I mean, we don't have appropriate support for that.

I think we just have to sit down and go through this with the Committee staff.

Mr. ROYCE. Thank you, Mr. Schenk.

We are going to go to Mr. Payne of New Jersey.

Mr. PAYNE. Thank you very much. I certainly commend the acting Chairman for the detail of his questioning.

I just wanted to mention very quickly, though, that my colleague, Mr. Smith, had asked the question before about al-Qaeda and profiting from the Oil-for-Food Program, and whether the hijackers, they felt, profited from the Oil-for-Food Program or any of that money had gotten to them.

I wanted to indicate that I think it was made pretty clear that al-Qaeda was responsible for 9/11, and according to all that we have been able to ascertain, there was actually no relationship between al-Qaeda and the Government of Iraq and Saddam Hussein.

They are both very horrible entities, but I think to continue to try to make a connection between al-Qaeda and Saddam Hussein and the lack of weapons of mass destruction continues to cloud the line between two separate, distinct issues. Al-Qaeda, as a matter of fact, was unwelcomed in Iraq because Saddam Hussein wanted the money; he wanted to behave in a way that the head of al-Qaeda despised. Saddam Hussein was called an infidel by Osama bin Laden. So I think that continually trying to make the connection between the two keeps our focus away from these separate incidents.

Maybe you can answer yes or no. Did BNP have a problem complying with the antilaundrying section of the PATRIOT Act known as the Know Your Client requirement? Did you feel that that was a nuisance or was something burdening? Did you feel it was something the bank did not feel it needed to comply with?

Mr. SCHENK. Well, the bank has to comply with the USA PATRIOT Act. Every bank has to comply with the USA PATRIOT Act. The enhanced due diligence embedded in the USA PATRIOT Act specifically related to Know Your Customer is something that every bank is putting in place actively or has already put in place.

We have put in place a significant new account opening process which we believe is consistent with the rules embedded in the requirements of the USA PATRIOT Act.

Mr. PAYNE. What about the automated computer system that is supposed to be in place? Is that a part of that supposed list of suspected terrorists and front companies? Has your bank moved into that system yet?

Mr. SCHENK. Well, we are in the process. We have automated solutions associated with our monitoring activity. Our compliance function today has a monitoring group within it. That monitoring group would use account profiles that are provided to identify any behavior that looks to be outside of the normal course of behavior we anticipated from a client.

We have an inquiry-based tool today that allows us to make inquiries. And I think the best current practice implied among banks is that there would be a more automated inquiry and artificial intelligence-based automation system, which would lift out and try and make connections that perhaps human intervention might not be able to see. And we are in the process of installing such a system.

So that system is not in place today, but we have an automated system in place for lifting up any behavior which is inconsistent with the behavior that we expected to see from our current client.

Mr. PAYNE. Thirty years ago, the Congress passed the Currency and Foreign Transactions Reporting Act, known as the Bank Secrecy Act, trying to deal, at that time, with drug money and money laundering. And one of the things—although I guess this is more for the Banking Committee—one of the problems that I have had in general with the banking industry—and I realize that you just happen to be with a bank, but since you are here, I might as well get it out; I may never have the opportunity since I am not on the Banking Committee. I think one of the problems that I have seen with illegal activities is really the cooperation of the banking industry in general.

It seems to me like banks are in a position of saying, "All our job is, is to take the money, invest it, hold it, give the interest rate, and send a check to whomever the person sends the check to," and no one investigates anything.

You might tell me, since I am so far removed from banking, and I have just been trying to keep my little account straight—I know the philosophy of a bank is that it is not a social agency. There are social agencies, but I guess bankers would say that is for someone else to do. I think that a lot of misery in this world really could have been avoided if there was some semblance, just a little bit of semblance, of integrity in the banking department. You take a person like Mobutu from Zaire, a country where at the time he was in power the average person lived on 50 cents a week, and Mobutu put money in banks in France; he had villas, and they said he had 25 billion in banks. But when the money came to the bank, no one ever wondered, "Wow, this guy is making a lot of money in his job as President of Zaire."?

We can go from the Shah of Iran to Marcos in the Philippines, and on and on. The drug dealers and the cartels used to load the money up in banks—U.S. banks, offshore banks, European banks—and no one would ever question where all of this money came from. As a matter of fact, if they don't want their name on it, the bank will give them a number.

And so I think it is just sad that such an important entity and the way that the world works has resulted in every agency having to be regulated. Nothing is done without a law passed, to comply with this or comply with that. And, like I said, it has been something that has bothered me for a long time. It seems like the dirtiest of criminals, blood on the hands of people for decades, it just seems like the industry—and like I say, I don't know you, so don't take this personally—is almost like a misguided missile.

I don't have any question. I just had a little statement that I wanted to make. Thank you, Mr. Chairman.

Mr. ROYCE. Well, I think Don makes a good point. That is why we have passed the Know Your Customer law. But we passed that predating the passage of the PATRIOT Act, and I think in these circumstances, Know Your Customer becomes a very important law for everyone to follow.

I am going to go to Mr. Rohrabacher and then to Mr. Leach.

Mr. ROHRABACHER. Well, thank you very much.

First of all, just for the record, let me ask you, at any time did you, or any other member of your banking team—or were you requested—by a compliance officer at your bank, to discuss the efforts within the bank to examine the bank's position on this Oil-for-Food Program or letter of credit program?

Mr. SCHENK. The way you phrased the question—

Mr. ROHRABACHER. Well, did BNP compliance officials ever ask for, but were denied access—

Mr. SCHENK. Absolutely not.

Mr. ROHRABACHER [continuing]. To the Oil-for-Food Program?

Mr. SCHENK. Absolutely not. You have to understand the way that compliance works today in a bank. It is not a department that sits off in the corner and is uninvolved in the business. It is a day-to-day business.

Mr. ROHRABACHER. But you have compliance officials in the bank who work for you. You are saying absolutely not. No one ever requested—

Mr. SCHENK. No. No. I thought you said were they ever denied access. To that question the answer is no. The compliance department is actively and intimately involved in all aspects of our business and has access to every operation that we have. And it is such an active, regular process embedded in our day-to-day lives, it is not a question of an inquiry today or tomorrow. It is a constant.

Mr. ROHRABACHER. So it would never happen that someone would come up with a letter that says, "Please let us in to look at this program, we think there are some problems," and you would get another memo back that says, "Denied"? That would never—that could not have occurred in your—

Mr. SCHENK. Typically, if someone felt there were any activities—and let's just step away from the Oil-for-Food Program for a minute—that were suspect, they have a number of avenues to raise those issues.

Normally, we would involve our audit department to investigate those situations and surface any. And, in fact, back to the Oil-for-Food Program, in the normal course of its activities, certain activities we schedule for audits on a certain regulated basis. And our independent audit, internal audit department, did examinations on

seven different occasions specifically addressing issues of compliance to regulations process, to procedures within the Oil-for-Food department, with no significant findings.

Mr. ROHRABACHER. All right. Thank you.

Mr. Payne's comments were interesting to me. I was wondering what kind of clients—when you talk about clients, now, do you have other oil clients? What other countries do you represent?

Mr. SCHENK. Well, BNP itself is a large international organization with operations around the world.

Mr. ROHRABACHER. Did you deal with Saddam Hussein before 1990, for example?

Mr. SCHENK. I personally don't—I can't comment—I don't have—

Mr. ROHRABACHER. Did your bank deal with Saddam Hussein before 1990?

Mr. SCHENK. I am not in a position to respond. I don't recall. I joined Paribas, for the record, in 1989, and Paribas merged with BNP in 2000. I cannot speak prior to 2000 for anything associated with BNP. I just don't have that kind of knowledge. And I honestly didn't know the answer to that question.

Mr. ROHRABACHER. Well, that is astounding that you don't know the answer to that question. This is huge. This huge contract that your bank has, and you don't even know the history of your bank's association with Saddam Hussein.

Mr. SCHENK. It was a very specific question. I provided a specific answer. I arrived at BNP-Paribas—

Mr. ROHRABACHER. You can read your historic background of your bank. You can review the history of your bank. This is a multi-billion-dollar contract. You are telling me you didn't even review it enough to know whether your bank had had activities with Saddam Hussein's regime before 1990?

Mr. SCHENK. I am not completely comfortable with your characterization here. Understand the nature of our business: BNP won a contract through a competitive bid in 1996 with an RFP. And there were a short-listed group of banks based on a number of criteria that were provided, and we won that.

Mr. ROHRABACHER. You won that. And we are talking about a multi-billion-dollar endeavor, and you are not aware of the history of the bank's relationship with the country that is in the center of that multi-billion-dollar business deal?

Mr. SCHENK. First of all, my experience with the bank is in the U.S. I just don't—I do not have that kind of—

Mr. ROHRABACHER. It would seem to me that if you came here to testify, you would know that, frankly. That is my opinion, and we will move on to something else.

Let's talk about some of your other clients who you may know about. First of all, does the bank differentiate between democratic governments and nondemocratic governments in relationship to the people it takes on as clients?

Mr. SCHENK. I can speak with reference to our North American operations, and in North America we have several government-related entities as clients: Fannie Mae, Ginnie Mae, people like that. And we deal with the U.N., and we deal with U.S. corporate relationships.

I really am not in a position to comment on any standard globally for the bank as you posed the question. We look at every client on an individual basis in accordance with procedures we have, which tend to judge a number of criteria. Credit worthiness obviously is one.

Mr. ROHRABACHER. Mr. Payne's criticism may well be justified then, right. You are trying to tell me you can't answer whether or not your bank is willing to take on, let's say, some wondrous and noteworthy regime, some praiseworthy regime the likes of Burma or some country like that?

Mr. SCHENK. The bank has criteria for dealing with its clients and would view each client—

Mr. ROHRABACHER. It is reported that Yasser Arafat has stored bundles of money in various places. Is it possible that some of that money is stored in your bank?

Mr. SCHENK. I am not in a position to comment.

Mr. ROHRABACHER. Let me note for the record, and from my perspective—look, I am a former journalist. I am a writer by profession; I am not a lawyer. I know there a lot of lawyers who will just take answers like that as, "Well, that is all we legally have to say," or "This is how legally we would say something to don't get ourselves in trouble." It is just not good enough. I mean, it is just not good enough. You are here before the United States Congress. And I think Mr. Payne's heartfelt comments are something that I pay attention to, and we are talking about some horrible people around the world who are gangsters who run countries. And it seems like there are financial institutions that are, frankly, making their profit, at least in part, by doing the bidding of these gangster regimes. And you have said nothing—nothing—that would make me feel any more comfortable that your bank isn't, and that you personally because of your association with the bank, are not engaged in that type of, what I consider to be, immoral activity.

Mr. SCHENK. Well, I think it is a terribly unfair characterization. And in response to the questions about BSA and AML, recall that my responsibilities reside in North America, and in that context, and as oversight over the program, the U.N. Oil-for-Food Program is administered out of our New York operation.

Mr. ROHRABACHER. Well, let's be specific. Your bank was the correspondent bank for the Central Bank of Iraq when Saddam Hussein was in power before 1990; was it not? Okay.

Mr. SCHENK. I honestly am not in a position—I just—

Mr. ROHRABACHER. We are in a situation right now where we are trying to find out about how—what you call letters of credit, or what became vouchers in some way—were transmitted from one person to another person in a way that was detrimental to the people of Iraq and the people of the world.

And some of us believe that some people have been profiteering off this type of activity and that morality didn't come into play. Well, it seems to me that you have done nothing to convince me that your bank wouldn't be interested in taking a look at such opportunities.

Mr. SCHENK. Well, I am disappointed to hear you say that. The procedures in place today for working on the Oil-for-Food Program have processes in place that ensure that we are not dealing with

bad people. When bad people arrive, they enter into our filtering systems, and they are filtered out.

Mr. ROHRABACHER. But when they start talking about vouchers, isn't it some kind of an indication that when you have some new mechanism for transferring wealth, that all of a sudden there should be an alarm bell that goes off, and they say, "We should really look into this a little bit deeper."?

Mr. SCHENK. Well, I am not the expert on this side of it. There are a couple of people in our bank that may be able to better respond to this. But the notion of vouchers arrived sometime earlier. It is within the last year or so that this thing came to light. When those names appeared, we did review all of the transactions, and we reported those transactions that may have involved names that were on the famous list of 270. We didn't sit idly by.

Mr. ROHRABACHER. Because it was required by the PATRIOT Act, correct?

Mr. SCHENK. I am not so sure. It wasn't a legal list. Even today, there is no legal list that you can run against that. I think we did that of our own volition. If it is required literally by the PATRIOT Act, we would do it. We did it.

Mr. ROYCE. Thank you very much.

Mr. ROYCE. We are going to go to Mr. Leach of Iowa.

Mr. LEACH. You head the division of the bank in New York that is a traditional commercial bank; is that correct?

Mr. SCHENK. We have both a corporate banking business as well as a broker-dealer operation. So we actually have a corporate and investment banking operation.

Mr. LEACH. Do you trade in products?

Mr. SCHENK. Yes.

Mr. LEACH. Do you trade in oil?

Mr. SCHENK. Yes.

Mr. LEACH. In your trading function, did anyone bring vouchers to your bank?

Mr. SCHENK. Not to my knowledge.

Mr. LEACH. So not one of those 270 recipients of vouchers came to your bank to trade?

Mr. SCHENK. I have never heard anything about that. I would be absolutely amazed if it happened.

Mr. LEACH. One of the revelations is that as much as 10 percent of contracts were kickbacks. When you transferred money, would you at any time reserve 10 percent for one function?

Mr. SCHENK. No, sir.

Mr. LEACH. Okay. Do you have any relationship with the Rafidain Bank in Amman?

Mr. SCHENK. I don't know.

Mr. LEACH. In terms of profitability in this whole process, how does your bank make money?

Mr. SCHENK. It specifically is related to the Oil-for-Food Program. We have a process by which we make confirmation fees and issuance fees on letters of credit and amendment fees associated with transactions. There were some 20,000 plus letters of credit, and an additional 30,000 amendments to those letters of credit over the life of the program.

Mr. LEACH. And presumably you would have deposit interest as well?

Mr. SCHENCK. No. We keep deposits. The oil money comes into the bank. Certain money then is forwarded onto the U.N. for other programs, such as relief, the northern provinces. We retained 51 percent of the proceeds from the oil sales. They were kept in an account by the U.N. Those moneys were there to collateralize the LCs that were issued on behalf of providers of services or products to Iraq, and that we issued letters of credit to collateralize.

Mr. LEACH. Would you receive interest on these?

Mr. SCHENCK. No, we did not. The U.N. received interest on that account. We did not profit from the deposits made at the bank.

Mr. LEACH. How much profit do you think your bank made on your involvement with Oil-for-Food?

Mr. SCHENCK. We estimate that over the 8 years of the program, we made, pretax, approximately \$90 million.

Mr. LEACH. I want to go to a question that my colleague raised just because your answer, I want to be very definite about it. He asked if—and let me broaden it—did Yasser Arafat or his family ever have an account with your bank? And you said you are not in a position to comment. Does that mean you don't know?

Mr. SCHENCK. I am sorry, I don't know.

Mr. LEACH. You don't know?

Mr. SCHENCK. I just don't know.

Mr. LEACH. Your colleague here, Mr. Farachi, would you know?

Mr. FARACHI. I don't know.

Mr. SCHENCK. Excuse me. My good counsel, Mr. Bennett, reminds me that I can at least speak to what I know as it relates to New York, and the answer is, in the United States we do not have an account.

Mr. LEACH. Thank you. Do either of you have a personal judgment that your bank did anything that would be in violation of law, or unethical? Would you, sir, Mr. Schenck?

Mr. SCHENCK. With reference to the Oil-for-Food Program?

Mr. LEACH. Yes.

Mr. SCHENCK. To my knowledge, based on my knowledge of that program, the systems we have in place and the procedures that we have employed, I am not personally aware of anything that would constitute—remotely constitute—a violation of law.

Mr. LEACH. Or unethical?

Mr. SCHENCK. Or unethical.

Mr. LEACH. Mr. Farachi, would you—

Mr. FARACHI. I will agree with that statement made by Mr. Schenck.

Mr. LEACH. Thank you, Mr. Chairman.

Mr. ROYCE. Thank you, Mr. Leach.

I want to thank our witnesses for testifying today. It is my understanding that the Financial Services Committee will be following up on these issues both with BNP and with the Federal Reserve Board after we reconvene in January. And, again, I want to thank the Members for their participation today as well. This hearing stands adjourned.

[The prepared statement of Mr. Biern follows:]

PREPARED STATEMENT OF HERBERT A. BIERN, SENIOR ASSOCIATE DIRECTOR, DIVISION OF BANKING SUPERVISION AND REGULATION, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

INTRODUCTION

Mr. Chairman, thank you for the opportunity to appear before the Committee on International Relations to discuss the obligations of banking organizations under the Bank Secrecy Act (BSA) and the USA Patriot Act and the activities of bank supervisors in this important area. Money laundering and terrorist financing can, if not properly controlled, pose significant threats to our financial system and nation. Due to these risks, the Federal Reserve and the other bank supervisory agencies work to ensure that banking organizations have the appropriate anti-money laundering (AML) compliance programs in place.

As the Committee requested, in my testimony today I will provide:

- a brief “primer” on money laundering and terrorist financing;
- an outline of BSA/AML statutory and regulatory requirements (in particular, I will address a few key requirements with which banking organizations must comply, such as suspicious activity reporting requirements and customer due diligence standards);
- a description of the roles of the Federal Reserve and other banking and government agencies with regard to BSA/AML; and
- a summary of the Federal Reserve’s BSA/AML supervisory program (including a description of the examination process, related enforcement and applications programs, and a few key interagency initiatives) in order to illustrate how bank supervisors carry out their responsibilities.

As we discussed with the staff of the Committee in advance of today’s hearing, this afternoon I will not be discussing the BSA/AML practices of any particular banking organization supervised by the Federal Reserve or the results of any supervisory efforts that were undertaken to determine compliance with applicable anti-money laundering statutes and rules at any specific institution.

Banking organizations today are responsible for complying with a number of laws and regulations to combat money laundering and terrorist financing. These obligations span a number of statutes and regulations including the BSA, rules issued by the U.S. Department of the Treasury and the banking agencies, and the legislation and regulations that enact the various sanction programs administered by Treasury’s Office of Foreign Assets Control—or OFAC. To ensure that banking organizations have the programs in place to fully comply with all of their legal obligations and to effectively identify and manage all of the risks associated with their business operations, the Federal Reserve has long included a review of banking organizations’ anti-money laundering compliance programs as part of our safety and soundness examinations. In addition, we and the other banking agencies have developed guidance designed to help banking organizations understand applicable statutory and regulatory requirements and our compliance expectations.

MONEY LAUNDERING AND TERRORIST FINANCING

The central purpose of the Bank Secrecy Act is to help identify situations when the U.S. financial system and the institutions that comprise that system may be used to facilitate money laundering, terrorist financing and other illicit financing activities. In both money laundering and terrorist financing, criminals are able to exploit the openness of our financial system to launder criminal proceeds, or to support terrorist activity, and ultimately, to hide their true purpose.

Money laundering is the criminal practice of filtering ill-gotten gains or “dirty” money through a maze or series of transactions, so the funds are “cleaned” to look like proceeds from legal activities. Although money laundering can be diverse and complex, it basically involves three independent steps that can occur simultaneously: the “placement” of the unlawful proceeds into the financial system in an effort to avoid attracting the attention of law enforcement; the “layering” of the proceeds through a series of transactions to create confusion about the origin and true owner of the funds, and complicate the paper trail; and the “integration” of the proceeds wherein the launderers seek to create the appearance of legitimacy through additional transactions.

In contrast with money laundering, the motivation behind terrorist financing is ideological rather than profit-based. Typically, terrorist financing includes the use of both clandestine and legitimate sources of financing, which is a key difference from traditional money laundering. However, terrorists and their support organiza-

tions have been found to use the same methods as other criminal groups to launder funds. For example, law enforcement reports that terrorist financiers use currency smuggling; structured deposits to, or withdrawals from, bank accounts; purchases of various types of monetary instruments; and circuitous funds transfers in order to hide financial support. Terrorist financing is generally more difficult for banking organizations to identify. Funding for terrorist attacks does not always require large sums of money, and the associated transactions may not be complex. The movement of small sums of money for laundering or terrorist purposes can be a challenge for a banking organization to identify with no other information.

STATUTORY AND REGULATORY REQUIREMENTS OF BANKING ORGANIZATIONS

With that brief explanation of money laundering and terrorist financing, I will now outline a brief history of the statutory and regulatory framework in the United States to combat these crimes and then describe a few of the key BSA/AML requirements placed on banking organizations today.

First and foremost, in 1970, Congress passed the Currency and Foreign Transactions Reporting Act otherwise known as the “Bank Secrecy Act” that established requirements for recordkeeping and reporting by banks and other financial institutions. The BSA was designed to help identify the source, volume, and movement of currency and other monetary instruments into or out of the United States or U.S. financial institutions. The statute sought to achieve that objective by requiring individuals, banks, and other financial institutions to create a paper trail by keeping records and filing reports determined to have—quoting from the law—a “high degree of usefulness in criminal, tax and regulatory investigations and proceedings.” Part of the paper trail was the filing of Currency Transaction Reports, or CTRs, for currency transactions in excess of \$10,000. CTRs and other reports enable law enforcement and regulatory agencies to pursue investigations of criminal, tax and regulatory violations.

The next significant development was the enactment of the Money Laundering Control Act of 1986 that sought to preclude circumvention of the BSA requirements by imposing criminal liability for an institution or person that knowingly assists in the laundering of money, or who structures transactions to avoid reporting. It also directed banks to establish and maintain procedures reasonably designed to assure and monitor compliance with the reporting and recordkeeping requirements of the BSA. In January 1987, all federal banking agencies issued essentially similar regulations requiring banks to develop procedures for complying with the BSA and other AML requirements. For the Federal Reserve, the anti-money laundering program rule is set forth in Regulation H (12 C.F.R. 208.63).

The 1992 Annunzio-Wylie Anti-Money Laundering Act strengthened the sanctions for BSA violations and the role of the Treasury Department. Two years later, Congress passed the Money Laundering Suppression Act that primarily addressed Treasury’s role in combating money laundering.

More recently, in response to the terror attacks of September 11th, Congress passed the Patriot Act, more formally known as the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001. Title III of the Patriot Act is the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001. The Patriot Act is arguably the single most significant AML law that Congress has passed since the BSA itself. Among other things, the Patriot Act criminalized the financing of terrorism and augmented the existing BSA framework by strengthening customer identification requirements for banks and other financial institutions, prohibiting banks from engaging in business with foreign shell banks, requiring banks to enhance their due diligence procedures concerning foreign correspondent and private banking accounts, and improving information sharing between banks and with the U.S. government.

The Patriot Act and its implementing regulations also:

- expanded the AML compliance program requirements to all financial institutions, including broker-dealers and casinos;
- increased the civil and criminal penalties for money laundering;
- facilitated access to records and required banks to respond to requests for information within 120 hours;
- required regulatory agencies to evaluate an institution’s AML record when considering bank mergers, acquisitions, and other applications for business combinations; and
- provided the Secretary of the Treasury with the authority to impose “Special Measures” on jurisdictions, institutions, or transactions that are of “primary money-laundering concern.”

Most of the rulemaking under the Patriot Act is now completed, and banking organizations have made significant investments to ensure compliance with these requirements.

ROLE OF GOVERNMENT AGENCIES

To effectively oversee compliance with the BSA/AML requirements in banking organizations, Treasury and the federal banking agencies have had an important partnership for a number of years. To help you understand the roles we play, I will briefly describe the functions of a few of the key agencies engaged in BSA/AML oversight.

A number of government agencies play a critical role in promulgating BSA regulations, developing examination guidance, and ensuring compliance with and enforcing the BSA. With respect to banks, these agencies include the U.S. Department of the Treasury, Treasury's Financial Crimes Enforcement Network (FinCEN), and the federal banking agencies (Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, Office of the Comptroller of the Currency, and Office of Thrift Supervision). The Department of Justice administers any prosecutions for money laundering or for criminal violations of the BSA. Finally, Treasury also administers the foreign sanctions program through OFAC.

U.S. Department of the Treasury

The U.S. Department of the Treasury has statutory authority to administer the BSA, and has delegated this authority to FinCEN, one of the department's bureaus. In this capacity, FinCEN promulgates regulations, provides outreach and guidance to the regulated industries, and pursues civil enforcement actions in certain circumstances. FinCEN has authority to examine institutions for compliance with the BSA, but has delegated this examination authority to other federal agencies—including the Federal Reserve—for institutions within their respective jurisdictions. As we explain below, the bank supervisory agencies use their own examination authority to assess compliance with the Bank Secrecy Act by organizations within their jurisdiction.

While Treasury has delegated its examination authority, it remains the overall administrator of the BSA. The role has become all the more important as BSA requirements have expanded beyond traditional financial service providers to include not only other federally functionally related financial services providers, but also casinos, money services businesses, insurance providers, and others. To enhance coordination of the administration of the BSA across industry sectors, FinCEN has entered into, or is in the process of entering into, memoranda of understanding for information sharing with each of the federal agencies that examine for BSA compliance—that is, the federal banking agencies, the U.S. Securities and Exchange Commission, the Commodity Futures Trading Commission, and the Internal Revenue Service. The MOU with the banking agencies, which was executed in September, details the types of information that will now be shared among the banking agencies and FinCEN with the goal of assisting FinCEN to fulfill its role as administrator of the BSA and to enhance the banking agencies' examination efforts in this area. (I should note in this regard that well before the execution of the recent MOU, the Federal Reserve routinely shared critical information concerning BSA compliance with FinCEN on a case-by-case basis.)

Federal Banking Agencies

The federal banking agencies expect the banking organizations they supervise to take reasonable and prudent steps to combat money laundering and terrorist financing in order to minimize their vulnerability to such activities. The agencies require banking organizations under their supervision to establish and maintain an anti-money laundering compliance program that addresses the risks presented by the nature, extent, and complexity of the banking products and services offered, by an organization's customer base, and other factors. Today, it is abundantly clear that banking organizations face legal, reputational, and operational risks when they do not perform appropriate due diligence and safeguard their institutions with adequate internal controls to mitigate risks. For this reason, the commitment of the federal banking agencies to ensuring compliance with the BSA continues to be a high supervisory priority.

The federal banking agencies work to ensure that the banking organizations they supervise understand the importance of having in place effective AML compliance programs. This obligation is "dynamic"—that is, a bank's policies and procedures must reflect any expansion of business operations and new products and services. An organization's AML program should also take into account developments within

the industry, as new regulatory standards are introduced, as industry best practices evolve to better manage risks, as law enforcement authorities provide feedback about laundering and terrorist funding schemes, and as improved systems and software become available to enhance compliance.

Office of Foreign Assets Control

Treasury's OFAC administers and enforces economic and trade sanctions against targeted foreign countries, terrorism-sponsoring jurisdictions and organizations, and international narcotics traffickers based on U.S. foreign policy and national security goals. OFAC acts under presidential wartime and national emergency powers and authority granted by specific legislation to impose controls on transactions and freeze foreign assets under U.S. jurisdiction. Acting under authority delegated from the Secretary of the Treasury, OFAC promulgates, develops, and administers the sanctions under its statutes and executive orders.

OFAC requirements are separate and distinct from the BSA, but both OFAC requirements and the BSA share a common national security goal. Because institutions and regulators view compliance with OFAC sanctions as related to BSA compliance obligations, supervisory examination for OFAC compliance is typically connected to examination of an institution's BSA compliance. Examiners focus on a banking organization's compliance processes and evaluate the sufficiency of a banking organization's implementation of policies, procedures and systems to ensure compliance with OFAC regulations.

KEY BSA/AML REQUIREMENTS

Before going forward, it is worth taking some time to outline a few of the most significant BSA/AML requirements placed on banking organizations. These requirements serve as the framework for BSA/AML examinations as they are the core of a banking organization's BSA/AML responsibilities: the anti-money laundering compliance program, the customer identification program, and suspicious activity reporting requirements and the customer due diligence program.

Anti-Money Laundering Programs

Under the Bank Secrecy Act, all financial institutions must develop, administer, and maintain a program that ensures compliance with the BSA and its implementing regulations, including reporting and recordkeeping requirements, and each federal banking agency, including the Federal Reserve, has specific rules requiring such programs. A strong anti-money laundering compliance program that is tailored to a bank's business operations and risks, and rigorously followed by bank personnel, should ensure full compliance with all legal requirements, as well as effective risk management.

At a minimum, a banking organization's anti-money laundering compliance program must be documented in writing, approved by the board of directors (or its equivalent), and noted in the minutes of board meetings. By law, the program must include the following four components:

- a system of internal controls to assure ongoing compliance with the BSA;
- independent testing of the banking organization's compliance with the BSA;
- the designation of an individual responsible for coordinating and monitoring day-to-day compliance with the BSA; and
- training for appropriate personnel.

Customer Identification Program

Under the BSA, as amended by the Patriot Act, every financial institution must implement a written Customer Identification Program (CIP) appropriate for its size, location, and type of business. The CIP must be incorporated into the institution's anti-money laundering compliance program and must be approved by the institution's board of directors. The CIP must include account-opening procedures that specify the identifying information that will be obtained from each customer, and it must include reasonable and practical risk-based procedures for verifying the customer's identity. These procedures must enable the institution to form a reasonable belief that it knows the true identity of each customer.

Suspicious Activity Reporting Requirements and Customer Due Diligence

Under the Bank Secrecy Act and the suspicious activity reporting rules promulgated by the Federal Reserve, the other federal banking agencies, and Treasury in 1995, banking organizations are required to report to the government any instances of known or suspected criminal or suspicious activity by filing a Suspicious Activity Report, or SAR. To ensure that it will be able to identify suspicious activity, a bank-

ing organization should have in place a customer due diligence (CDD) program under which the organization (1) assesses the risks associated with a customer account or transaction, and (2) gathers sufficient information to evaluate whether a particular transaction warrants the filing of a SAR. In addition, appropriate systems, processes, and controls should be in place to monitor and identify suspicious or unusual activity. Common processes include employee referrals, manual systems, automated systems, or any combination, which vary based on the risk and size of the banking organization.

The concept of CDD incorporates and builds upon the CIP requirements for identifying and verifying customer identification. The goal of a CDD program is to conduct a risk assessment to develop and maintain an awareness of the unique financial details of the banking organization's customers joined with an ability to generally predict the type and frequency of transactions in which its customers are likely to engage. In doing so, banking organizations can better identify, research, and report suspicious activity as required by the BSA and the agencies' regulations. It is essential that CDD programs be tailored to each institution's BSA/AML risk profile and that they include monitoring systems and procedures for identifying transactions or activities inconsistent with a customer's normal or expected banking activity.

It is important to note that sound practices in the banking industry and statutory and regulatory standards for specific CDD protocols vary depending on the activities associated with different types and volumes of banking transactions and their risk. For example, a bank's CDD procedures for its large, publicly held corporate account holders such as General Motors and IBM will be very different than a U.S. bank's customer due diligence procedures associated with its foreign correspondent banking activities. In the former, it is easier to understand the nature of the transactions undertaken by General Motors or IBM and identify what may be suspicious—for example, new requests for loans to fund transactions that are inconsistent with the normal, routine business activities of the customer. With respect to the foreign correspondent banking business, given the special risks associated with this activity it is expected that the U.S. bank's customer due diligence procedures include a review of the nature of the business of its foreign respondent bank. In higher risk cases, U.S. banking organizations may also now be expected to look at what banks and other entities do business with the foreign respondent bank and review the types of transactions that will be undertaken by the respondent bank and its customers—an evolving “know your customer's customer” standard in a limited area of a bank's correspondent banking activities.

THE FEDERAL RESERVE'S BSA/AML SUPERVISORY PROGRAM

Understanding how the Federal Reserve conducts its BSA/AML examination program and related functions should be instructive to the Committee because it will illustrate what bank regulators do in this important area.

The Federal Reserve's BSA/AML role is multifaceted. It includes work in the areas of bank supervision, enforcement, applications, investigations, and coordination with the law enforcement and intelligence communities. This afternoon, I will touch on some of these aspects of the Federal Reserve's anti-money laundering program, but will concentrate on bank supervision efforts and our enforcement and applications approaches. The other federal banking agencies work in similar ways.

Our examinations are conducted at the state member banks, bank holding companies, Edge Act corporations, and U.S. branches and agencies of foreign banks supervised by the Federal Reserve. Each of the twelve Federal Reserve Banks has BSA/AML specialists and coordinators on its staff, and, since the late 1980s, the Board has had an anti-money laundering program in its supervision division overseen by a senior official.

The Federal Reserve supervision process includes both on-site examinations and off-site surveillance and monitoring. On-site examinations of banks generally occur once every twelve to eighteen months, and, at each examination, examiners review the institution's anti-money laundering procedures and its compliance with the BSA, as amended by the Patriot Act and recent Treasury regulations. Banking organizations with problems generally are examined more frequently. For large, complex banking organizations, safety and soundness examination is a continuous process, and anti-money laundering and BSA compliance is incorporated into examinations conducted throughout the year.

A key component of anti-money laundering examinations is the banking organization's compliance with the anti-money laundering program rule that was already described. When a Reserve Bank conducts a BSA/AML examination of a banking organization under its supervision, the four components of the program establish the framework for the examination. To properly evaluate the effectiveness of a banking

organization's anti-money laundering compliance program, the Federal Reserve has developed comprehensive examination procedures and manuals, and regularly provides training for its examiners.

Examiners first determine whether the institution has included BSA/AML procedures in all of its operational areas, including retail operations, credit, private banking, and trust, and has adequate internal audit procedures to detect, deter and report money laundering activities, as well as other potential financial crimes. As part of such an examination, bank examiners also review a banking organization's fraud detection and prevention capabilities, and its policies and procedures for cooperating with law enforcement (whether through responding to subpoenas, acting on information requests under the Patriot Act, or otherwise). Examiners also conduct a review of the databases of SARs and Currency Transaction Reports to determine if the banking organization that is about to be examined has filed such reports and that they appear complete and timely. Testing of sample transactions is generally conducted to verify these procedures and systems.

In those instances where there are deficiencies in the anti-money laundering program, including failures to adequately document self-testing or training, obvious breakdowns in operating systems, or failures to implement adequate internal controls, examiners conduct a more intensified second-stage examination that would include the review of source documents and expanded transaction testing, among other steps.

Enforcement

Federal Reserve supervisory staff makes every effort to assist banking organizations to identify and address anti-money laundering deficiencies as early as possible. The Federal Reserve focuses significant resources on the prevention and early resolution of deficiencies within the supervisory framework. When problems are identified at a banking organization, they are communicated to the management and directors. The management and directors are requested to address identified problems voluntarily and to take measures to ensure that the problems are corrected and will not recur. Most problems are resolved promptly after they are brought to the attention of a banking organization's management and directors.

In the event that anti-money laundering problems are pervasive, repeated, unresolved by management, or otherwise of serious concern, the Federal Reserve may exercise its enforcement authority by taking an action against a supervised institution. The federal enforcement statutes associated with actions based on BSA/AML-related problems and violations are the same for all of the federal banking agencies. In general, problems that give rise to enforcement actions relate to compliance with the four-part anti-money laundering program rule and with suspicious activity reporting requirements. The provisions of each action are tailored to the organization to address particular violations and weaknesses identified by examiners. Actions may also require forensic reviews of past transactions to ensure that the organization has properly complied with all filing obligations. As a general rule, banking organizations consent to the issuance of supervisory actions and move quickly to take required remedial actions.

In the case of some deficiencies, informal, non-public supervisory action is sufficient to resolve a problem. Such action could include requiring the adoption of a resolution by an institution's board of directors or the execution of a memorandum of understanding between an institution and the appropriate Reserve Bank. These actions are incorporated into the supervisory process, trigger periodic status reports from the institution, and guide the banking organization in making the required improvements.

Where informal action is insufficient to address problems or the problems are egregious, the Federal Reserve may exercise its statutory enforcement authority to issue formal action against an institution. Such action includes written agreements, cease and desist orders, and civil money penalties. By law, the Federal Reserve must make these actions public, and they are posted on the Board's website. Because these actions are public, they can have a significant impact on a banking organization, particularly one that is a public company. In determining whether formal action is appropriate, Federal Reserve staff considers all relevant factors, including the nature, severity, and duration of the problem, the anticipated resources and actions necessary to resolve the problem, and the responsiveness of the directors and management.

In cases where examiners have identified a violation of the four-part anti-money laundering compliance program requirement, the federal banking agencies are required by law to take formal enforcement action. The same law requiring the banking agencies to promulgate rules requiring the compliance program provides that if an institution fails to establish and maintain the required procedures, or if it has

failed to correct any previously identified problem with the procedures, then the agency *must* issue a formal action requiring the institution to correct the problem. The Federal Reserve takes this responsibility very seriously and has issued a number of public actions against banking organizations in fulfillment of this statutory mandate.

Over the past three years, the Federal Reserve has taken approximately twenty-five formal, public enforcement actions addressing anti-money laundering compliance at a wide variety of institutions. The banking organizations subject to action have been large, small, domestic, and foreign. In each case, the examination process identified regulatory violations in the organization's compliance programs that, under the law, mandated the action.

The cases in which the Federal Reserve takes action for anti-money laundering problems are also brought to the attention of Treasury's FinCEN when they involve serious BSA problems, so that FinCEN may itself consider assessing a penalty for violations of the BSA. The recent MOU among the federal banking regulators and FinCEN provides that FinCEN will be notified of all significant BSA deficiencies and violations by federal and state bank supervisory authorities.

In recent cases, FinCEN has taken coordinated actions with federal banking agencies. For example, the Office of the Comptroller of the Currency, FinCEN, and the Federal Reserve coordinated their recent enforcement actions against Riggs Bank, N.A., Riggs National Corporation, and Riggs International Banking Corporation, the bank's Edge Act subsidiary, to ensure consistency and to ensure concurrent resolution of open issues. FinCEN and the Federal Reserve recently coordinated a concurrent penalty against AmSouth Bank, which was issued together with a joint Federal Reserve and State of Alabama order for remedial action. In that case, the Department of Justice also coordinated the issuance of a deferred prosecution agreement and forfeiture against the bank.

The Federal Reserve regularly coordinates enforcement actions with state banking supervisors, and enforcement actions involving U.S. operations of foreign banking organizations are also resolved in cooperation with supervisors abroad.

The Applications Process

To fully gauge the importance of a banking organization having a sound anti-money laundering compliance program, it is also essential that I mention another important component of the anti-money laundering supervisory process—the processing of applications and notices filed with the Board.

The Federal Reserve has had a longstanding practice of considering an applicant's compliance with federal law, including anti-money laundering laws and regulations, in evaluating various applications, including applications for bank mergers and acquisitions of insured depositories by bank holding companies as well as applications filed by foreign banks to establish U.S. banking offices under the Foreign Bank Supervision Enhancement Act. The Patriot Act memorialized our practice in the application area and required the Board to take into account the effectiveness of an applicant's anti-money laundering compliance program when it considers applications under various laws.

Under our existing protocols as well as the new law, every application matter considered by the Federal Reserve includes a BSA/AML compliance-related component. While I cannot of course comment on specific cases, I can report to you that Board staff has on some recent occasions advised banking organizations considering expansion or other activities requiring the filing of applications with the Federal Reserve to concentrate instead on enhancing their anti-money laundering or other federal law compliance programs. While not the full equivalent of an enforcement action, I am sure that you can appreciate that every banking organization that is seeking or planning on seeking Federal Reserve approval of an application makes every effort possible to ensure that its anti-money laundering program is considered to be fully satisfactory by examiners and that any deficiencies that may be identified are addressed as expeditiously as possible.

OTHER INITIATIVES

Interagency BSA/AML Examination Procedures

Since July 2004, the federal banking agencies, FinCEN, and state bank supervisors have been collaborating to develop a single set of BSA/AML examination procedures. This is broadly viewed as a critical initiative in the area of safety and soundness examination. We expect that the interagency examination procedures will go a long way to ensure consistency in the interpretation of BSA and AML requirements among the agencies.

The new procedures will have two important components: a “core” section will be used as the term implies, as the platform for the BSA/AML examination, or perhaps the entire BSA/AML examination for a very low-risk organization; and “expanded” procedures will be used by examiners to address specific lines of business or products that may be more vulnerable to money laundering or terrorist financing. This format will allow examiners to tailor the examination scope to the specific profile of a banking organization. We expect to release the new examination procedures in the second quarter of 2005.

To support this important work and to provide a forum for the federal banking supervisors to discuss matters related to BSA/AML examination and training, a BSA Working Group was recently formed under the Federal Financial Institutions Examination Council. The working group includes FinCEN and state bank regulators. This new working group complements the work of other, already existing interagency and international efforts, such as the Bank Secrecy Act Working Group, the Bank Fraud Working Group, the Financial Action Task Force and various Basel supervisors committees.

Guidance to Banking Organizations

The Federal Reserve and the other bank regulators view their supervisory roles as including initiatives to enhance awareness and understanding by examiners, by banking organizations under the agencies’ supervision, and by the financial industry at large. To promote a full understanding of BSA and anti-money laundering requirements, for example, we issue Supervision and Regulation letters (commonly referred to as SR letters) that are used to advise Reserve Bank supervisory staff, supervised institutions, and the banking industry about policy matters; provide ongoing training to examiners; speak regularly before the financial industry; and issue guidance. This is often done in conjunction with other regulators and Treasury. A good example of this was the recently issued interagency guidance on the embassy banking business, which addressed sound practices and risk management policies arising out of the Riggs matter. These initiatives are meant to respond to or anticipate questions that arise regarding anti-money laundering requirements.

CONCLUSION

Banking organizations that operate in this country are subject to a wide variety of laws and regulations requiring them to address money laundering and terrorist funding activities through the establishment of compliance programs, monitoring systems, and reporting protocols. Regulators believe that banking organizations have to take reasonable and prudent steps to combat illicit financial activities such as money laundering and terrorist financing, and to minimize their vulnerability to risks associated with such activity by taking conscious and well considered steps to comply with their legal obligations.

Thank you again for inviting me today to explain the laws and rules relating to countering money laundering and terrorist financing and the obligations of banking organizations under them, as well as the bank supervisors’ work in this critical area. I will be pleased to respond to any questions.

[Whereupon, at 5:58 p.m., the Committee was adjourned.]

A P P E N D I X

MATERIAL SUBMITTED FOR THE HEARING RECORD

PREPARED STATEMENT OF THE HONORABLE DIANE E. WATSON, A REPRESENTATIVE IN
CONGRESS FROM THE STATE OF CALIFORNIA

Mr. Chairman, I think it is critical for Congress to address the serious questions surrounding the UN's mismanagement of the Iraq "Oil for Food" program. The very idea that a program designed to feed people starving under the tyranny of Saddam Hussein was manipulated to enrich him and his cronies is repulsive. I am happy that this committee is taking action to ensure that we can hold the responsible parties accountable.

But we also need to take action to make sure that this sort of thing does not happen again. So far, Congress is failing in that mission. We have failed to look into the Bush Administration's poor management of Iraqi oil proceeds in the Development Fund for Iraq.

The Bush Administration has now managed to lose close to nine billion dollars of Iraqi oil money. That is scandalous. We should be embarrassed. But it is more than just embarrassing. This scandal pulls the rug out from under our mission in Iraq and the world at large.

Mr. Chairman, how can we lecture Iraqis on democracy and accountability when we've lost nine billion dollars of their money to waste, fraud and abuse? What makes us think Iraqis won't notice when we take nine billion dollars that should be spent on hospitals and schools and let it drift into the pockets of thieves?

At a time when we are trying to win Iraqi hearts and minds—at a time when we are trying to convince the Iraqi people that the U.S. presence in their country will bring democracy and transparency—the United States cannot afford to so blatantly fail to live up to that standard.

The CPA's own Inspector General's office has issued a report that is extremely critical of the Administration's management of Iraqi funds in the Development Fund for Iraq. In particular, the Inspector General's report criticizes actions by the Administration's "Contracting Activity" office in Iraq. Among the allegations in this report:

- The CPA failed to issue standard operating procedures or develop an effective review, tracking, and monitoring system.
- Contract files were missing or incomplete.
- The CPA did not always ensure that prices were fair and reasonable, that contractors could meet delivery schedules, or that payments were made on time and in full.
- The CPA did not provide adequate supervision over the actions of procuring contracting officers as required.

In addition, the Inspector General's report found that, of the contracts they analyzed, "67 percent . . . had incomplete or missing documentation."

67%, Mr. Chairman! TWO THIRDS. That number itself is a scandal.

I would like to insert into the record this recent Los Angeles Times article concerning abuse of Iraq development funds.

I hope this committee can help get to the bottom of the UN's "Oil for Food" scandal. But we must also make sure that the United States Government is not permitting a similar such scandal to unfold under our watch. This committee should perform our oversight responsibility by holding hearings on the Administration's management of the Development Fund for Iraq.

MATERIAL SUBMITTED FOR THE RECORD BY THE HONORABLE DIANE E. WATSON, A
REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Main News; Foreign Desk
The Conflict in Iraq; 100 Fraud Claims Probed

From Reuters
231 words
1 November 2004
Los Angeles Times
Home Edition
A-5
English
Copyright 2004 The Los Angeles Times

WASHINGTON

U.S. investigators have opened more than 100 cases this year into alleged abuse involving the billions of dollars in U.S. and Iraqi funding to rebuild Iraq, says an auditors' report that is to be released today.

The report says most allegations involve fraud, waste and abuse of funds, and 40% are linked to reprisals, theft and other issues. It says 75 cases have been closed or referred to other U.S. agencies and 38 remain open.

The report was prepared for Congress by the inspector-general's office of the Coalition Provisional Authority, the U.S. occupying power dissolved in June.

The inspector-general's office said it expected to release an audit this month on the CPA's handling of money from the Development Fund for Iraq.

The fund includes proceeds from Iraqi oil sales, frozen assets from foreign governments and surplus money from the U.N. "oil-for-food" program.

A leaked draft of that audit says at least \$8.8 billion in Iraqi funds given to Iraqi ministries by the CPA cannot be accounted for.

In addition to the CPA investigations, the FBI has at least five open and pending cases involving Iraq, with two recent ones focusing on public corruption and government fraud, the report says. It gives no details.

PREPARED STATEMENT OF THE HONORABLE DAN BURTON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF INDIANA, AND CHAIRMAN, SUBCOMMITTEE ON THE WESTERN HEMISPHERE

Mr. Chairman, A dark shadow has been cast over the United Nations. The abuse of the Oil-for-Food program was the result of a staggering management failure and has raised troubling questions about the credibility of the UN.

Earlier this week, the Senate Permanent Subcommittee on Investigations estimated that Saddam Hussein amassed \$21.3 billion by manipulating UN Security Council sanctions after the first Gulf War. The ruthless and greedy tyrant continued to enrich his regime and fuel his evil ambitions through the Oil-for-Food framework after it was introduced in 1996.

I am a principal co-sponsor of H.R. 4284 introduced by Congressman Jeff Flake last spring. H.R. 4284 requires the withholding of DS contributions to the UN until the President certifies that the UN is cooperating in the investigation of the Oil-for-Food program. I am a co-sponsor of this bill because I believe so much more could have been achieved had the Oil-for-Food Program been implemented honestly. Now it is necessary to withhold payments to the UN until there is a full and transparent accounting with full cooperation from the UN. I urge colleagues who have yet to sponsor this bill to do so.

Overall responsibility for the Oil for Food program's failure—and this was one of the biggest financial scandals of modern times—should lie with UN Secretary General Kofi Annan. The UN's inability to successfully manage the Oil-for-Food program represents a spectacular failure of leadership on the part of Mr. Annan.

The \$67 billion in UN Oil for Food was designed to provide humanitarian relief for the people of Iraq. The program required the UN to oversee approximately \$15 billion a year, by far the largest program it had administered. In fact, it was more than five times the UN's annual core budget. Internal audits of the program were not made available to member states. Fifty-five audits prepared by the UN office of internal oversight services were not shared with members of the so-called "661 Committee of Oversight." Repeated requests for access to the internal audits have been denied by the UN.

A growing body of evidence suggests that proceeds from smuggled oil and manipulation of the Oil for Food program may be financing the current insurgency in Iraq,

where radicals are killing Coalition and Iraqi troops and civilians alike. Car bombings, abductions, and beheadings are a familiar part of this campaign to derail efforts to stabilize and secure the transition from tyranny to freedom. We absolutely need to know where ill-begotten proceeds of the Oil for Food program went, and if in fact these proceeds are fueling the insurgency.

The Volcker Commission must operate in an open, transparent manner. Congressional leaders and the Bush Administration should demand full access to all UN documents relating to Oil-for-Food.

The UN should provide a full list of documents currently in its possession that relate to Oil for Food. Federal and Congressional investigators should be able to question UN officials under investigation by the Volcker Commission. The Volcker Commission should be open to public scrutiny and should include third-party representatives seconded from bodies such as the FBI and Interpol. All members of the UN Security Council should be furnished with regular updates on the investigation and a firm date for publication of the Volcker Report should be announced.

We are watching the Volcker Commission closely and we expect nothing short of a full and transparent investigation. We expect full access both to the U.N. Oil-for-Food records and the documents in Baghdad. We must continue to conduct a systematic look at whether Saddam robbed his people of the humanitarian aid they so desperately needed in order to fund his extravagant lifestyle and his campaign of hate and terror. We must ascertain whether the Oil for Food proceeds were diverted to *ihadists* like Al Qaeda, other extremists, and the insurgency fighting to destabilize Iraq and prevent democratization there today. Thank you.

