

Hearings in Congress: The Crimes of HSBC

What follows are excerpts from the Congressional Quarterly transcript of the July 17, 2012 Senate Committee on Homeland Security and Governmental Affairs, Permanent Subcommittee on Investigations on U.S. Money Laundering/Terrorist Financing Vulnerabilities. Subheads have been added by EIR.

1. Senator Levin's Opening Statement

Good morning, everybody. Today's hearing will examine the money laundering, drug trafficking and terrorist financing risks created in the United States when a global bank uses its U.S. affiliate to provide U.S. dollars and access to the U.S. financial system to a network of high-risk affiliates, high-risk correspondent banks and high-risk clients. Most international banks have a U.S. affiliate. They use it in part to compete for U.S. clients and businesses, but also to provide themselves with access to the U.S. financial system.

Global banks want access to U.S. dollars because they are accepted internationally. They are the leading trade currency and they hold their value better than any other currency. They want access to U.S. wire transfer systems because they move money across international lines quickly, securely and to the farthest corners of the earth. They want to clear U.S. dollar monetary instruments like traveler's checks, bank checks and money orders.

And they want the safety, efficiency and reliability that are the hallmarks of U.S. banking. The problem here is that some international banks abuse their U.S. access. Some allow affiliates operating in countries with severe money laundering, drug trafficking or terrorist financing threats to open up U.S. dollar accounts without establishing safeguards at their U.S. affiliate. Some operate in secrecy jurisdictions. Some allow poorly managed or corrupt foreign banks to make use of an affiliate's U.S.

dollar account.

Others allow high-risk clients to use those accounts without taking adequate anti-money-laundering steps. Some even allow those affiliates to pressure their U.S. cousins to ease up on U.S. anti-money-laundering restrictions, or look the other way when they spot suspicious activity. The end result is that the U.S. affiliate can become a sinkhole of risk for an entire network of bank affiliates and their clients around the world, playing fast and loose with U.S. rules.

The consequences are the ones that you'd expect from operating a U.S. bank with inadequate safeguards against money laundering. The U.S. bank can end up aiding and abetting transactions that fund terrorists, drug cartels, corrupt dictators and tax cheats. Because all of them want access to the U.S. financial system too and for the same reasons.

Wrongdoers can use U.S. dollars and U.S. wire transfers to commit crimes, arm terror groups, produce and transport illegal drugs, loot government coffers and even pursue weapons of mass destruction. That's why our country has made combating money laundering and terrorist financing a national security imperative. For the last decade, this subcommittee has contributed to the battle against money laundering and terrorist financing by exposing problems that increase U.S. vulnerabilities to abuse.

In 2001, for example, this subcommittee released a



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Sen. Carl Levin (D-Mich.) chaired hearings of the Senate Permanent Subcommittee on Investigations on U.S. Money Laundering/Terrorist Financing Vulnerabilities, in which he interrogated executives of HSBC on the bank's multiple crimes against the people of the United States.

report showing how U.S. banks that offer accounts to foreign banks engaging in what is known as correspondent banking, can become conduits for illegal proceeds involving organized crime, drug trafficking or financial fraud. Back then, most U.S. banks opened a correspondent account for any foreign bank with a banking license. After our hearing, U.S. banks took a harder look and assessed the risks before opening a correspondent account.

In 2002, Congress cited our hearings when enacting tougher anti-money-laundering or AML laws in the PATRIOT Act, including in that act a provision making it a legal obligation for U.S. banks to conduct a due diligence review before opening an account for a foreign bank. Tougher AML, or anti-money-laundering [laws], have helped deny criminals access to the U.S. financial system. And as our report that we're releasing today shows, enormous problems remain. To illustrate those problems, today's hearing focuses on a case study involving HSBC, one of the largest banks in the world.

The Case of HSBC

Headquartered in London, HSBC has a network of over 7,200 offices in more than 80 countries, 300,000 employees and 2011 profits of nearly \$22 billion. HSBC has been among the most active banks in Asia, the Middle East and Africa. It first acquired a U.S. presence in the 1980s. Today its leading U.S. affiliate, HSBC Bank, U.S.A., sometimes called H-bus or HBUS, that HBUS affiliate has now 470 branches across the United States and four million customers here. HBUS is the key U.S. nexus for the entire HSBC worldwide network.

In 2008, HBUS processed 600,000 wire transfers per week. In 2009, two-thirds of the U.S. dollar payments that HBUS processed came from HSBC affiliates in other countries. One HSBC executive told us that a major reason why HSBC opened its U.S. bank was to provide its overseas clients with a gateway into the U.S. financial system. Now on top of that, HBUS's history of weak anti-money-laundering controls and you've got a recipe for trouble. In 2003, the Federal Reserve and New York State Banking Department took a formal enforcement action requiring HBUS to revamp its anti-money-laundering program. HBUS which was then converting to a nationally chartered bank under the supervision of the Office of the Comptroller of the Currency, or OCC, made changes. even before the OCC lifted its order in 2006, the bank's anti-money-launder-

ing program began deteriorating. In 2010 September, the OCC issued a supervisory letter, 31 pages long, describing a long list of severe anti-money-laundering deficiencies.

And followed in October of 2010 with a cease and desist order requiring HBUS to revamp its anti-money-laundering program a second time. The OCC cited, among other problems, a massive backlog of unreviewed alerts identifying potentially suspicious activity, a failure to monitor \$60 trillion in wire transfers and account activity, a failure to examine risks at HSBC's overseas affiliates before providing them correspondent banking services and a failure over a three-year period to conduct anti-money-laundering checks on more than \$15 billion in bulk cash transactions with those same affiliates.

To examine the issues, the subcommittee issued subpoenas, reviewed more than 1.4 million documents and conducted extensive interviews with HSBC officials from around the world as well as officials at other banks and with federal regulators. HSBC has cooperated fully with our investigation. The subcommittee's work identified five key areas of vulnerability exposed by the HSBC history. The five areas involve the following; first, providing U.S. correspondent accounts to high-risk HSBC affiliates without performing due diligence, including a Mexican affiliate with unreliable anti-money-laundering controls.

Second, failing to stop deceptive conduct by HSBC affiliates to circumvent a screening device designed to block transactions by terrorists, drug kingpins and rogue nations like Iran. Third, providing bank accounts to overseas banks with links to terrorist financing. Fourth, clearing hundreds of millions of dollars in bulk U.S. dollar travelers checks despite serious suspicious circumstances. And finally offering bearer share accounts, a high-risk account that invites wrongdoing by facilitating hidden corporate ownership.

High-Risk Affiliates

Let's take each in turn. First, the issue of high-risk affiliates. HSBC operates affiliates in 80 countries including jurisdictions facing major money laundering, drug trafficking or terrorist financing challenges as well as weak anti-money-laundering laws and oversight. Yet until recently, HSBC's London-based parent company, known as the HSBC Group, instructed its affiliates to assume that every HSBC affiliate met the group's anti-money-laundering standards and automatically was

told to provide it with correspondent banking services.

HBUS did as told. It opened U.S. correspondent accounts for more than 80 HSBC affiliates, ignoring our law—the American law requiring due diligence reviews before opening U.S. accounts for foreign banks. HBUS dealings with an HSBC affiliate in Mexico illustrate the money-laundering dangers. HSBC Mexico, or HBMX, operates in a high-risk country battling drug cartels. It has had high-risk clients such as Casas de Cambios and it has offered high-risk products such as U.S. dollar accounts in the Cayman Islands, a jurisdiction known for secrecy and money laundering.

HBMX, or HB Mexico, also has a long history of severe anti-money-laundering deficiencies. You add all that up and the U.S. banks should have treated HBMX, the Mexican affiliate, as a high-risk account for anti-money laundering purposes, but it didn't.

Instead, HBUS treated HB Mexico as such a low-risk client bank that it didn't even monitor their account activity for suspicious transactions.

In addition, for three years, from mid-2006 to mid-2009, HBUS conducted no monitoring of a banknotes account used by HB Mexico to physically deposit billions of U.S. dollars from clients, even though large cash transactions are inherently risky and Mexican drug cartels launder U.S. dollars from illegal drug sales.

Because our tough AML or anti-money laundering laws in the United States have made it hard for drug cartels to find a U.S. bank willing to accept huge unexplained deposits of cash, they now smuggle U.S. dollars across the border into Mexico and look for a Mexican bank, or a casa de cambio, willing to take the cash.

Some of those casas de cambios had accounts at HB-Mexico, which in turn took all the physical dollars that it got, transported them by armored car or aircraft back across the border to HBUS for deposit in its U.S. bank notes account, completing the laundering cycle.

Over two years, from 2007 to 2008, HBMX shipped \$7 billion in physical U.S. dollars to HBUS. That was more than any other Mexican bank, even one twice HBMX's size.

When law enforcement and bank regulators in Mexico and the United States got wind of the banknotes transactions, they warned HBMX and HBUS that such large dollar volumes were red flags for drug proceeds moving through the HSBC network.

In 2008, after warnings from regulators, HBMX stopped taking large deposits of U.S. dollars. But for years HBUS provided an easy gateway into our finan-

cial system for suspicious cash from their foreign affiliate in Mexico.

Circumventing U.S. Bans

Next, the second problem involves actions taken by some HSBC affiliates to circumvent a U.S. ban on bank transactions involving designated drug traffickers, terrorists, or rogue regimes such as Iran.

To enforce that ban, the U.S. Treasury Department's Office of Foreign Assets Control, or OFAC, has developed a list of prohibited persons which banks use to develop what's known as an OFAC filter, to identify and stop prohibited or suspicious transactions.

The subcommittee found that for years HSBC affiliates in Europe and the Middle East acted to circumvent the OFAC filter when sending U.S. dollar transactions involving Iran through their accounts at HBUS.

Although they viewed these transactions as legal, under a U.S. exception for so-called U-turn transactions, the affiliates did not want to trigger the OFAC filter and undergo the individualized reviews required to make sure that they were legal.

So they stripped out or omitted any reference to Iran from the paperwork. An outside auditor hired by HBUS has found that from 2001 to 2007 HSBC affiliates sent nearly 25,000 transactions involving Iran, with over \$19 billion through HBUS and other U.S. accounts, while concealing any link to Iran in 85 percent of the transactions.

HSBC's chief compliance officer and other senior executives in London knew what was going on but allowed the deceptive conduct to continue.

While some HBUS officials in the United States claimed not to have known they were processing undisclosed Iranian transactions, documents show that key HBUS officials were informed early on.

HBUS compliance and payments executives repeatedly told HSBC affiliates that they had to use fully transparent Iranian transactions. But when faced with evidence that the affiliates were secretly circumventing the OFAC filter, nobody at HBUS confronted those affiliates, brought the issue to a head and forced the transactions to light. . . .

Links to Terrorist Financing

A third issue involves the fact that HSBC is active in regions of the world with significant terrorism challenges, while demonstrating a worrisome willingness to do business with banks that have links to terrorist fi-

nancing. One example involves Al Rajhi Bank, the largest private bank in Saudi Arabia. After the 9/11 terrorist attack on the United States, evidence emerged that the bank's key founder was an early financial benefactor of Al Qaida and that it provided accounts to suspicious clients.

In 2005 HSBC Group told its affiliates to sever ties with that bank. But they made an exception for HSBC Middle East. Four months later, without explaining why, HSBC Group reversed itself and said that all of its affiliates could decide whether to do business with Al Rajhi Bank.

HBUS chose to close its Al Rajhi accounts. Over the next two years however, its own bankers and bankers from other HSBC affiliates pressed HBUS to resume ties with Al Rajhi Bank and in 2006, after Al Rajhi Bank threatened to pull all of its business from HSBC unless HBUS reinstated its U.S. dollar banknotes account, HSBC gave in.

And over the next four years HBUS supplied Al Rajhi bank with nearly \$1 billion, U.S. dollars, stopping only when HSBC made a global decision to exit the banknotes business altogether.

Bulk Traveler's Checks

The fourth area of concern involves HBUS' willingness to clear suspicious bulk traveler's checks for foreign banks. From 2005 to 2008 on a regular basis HBUS cleared \$500,000 or more per day in bulk traveler's checks from the Hokuriku Bank of Japan. . . .

Bearer-Share Corporations

Finally, there is HBUS' willingness to offer accounts to bearer-share corporations. These corporations are prime vehicles for money laundering and other illicit activity by providing anonymity through assigning legal ownership of the corporation to whoever has physical possession of its shares.

Over a decade HBUS opened accounts for 2,000 such corporations, despite warnings by internal auditors and outside regulators that the accounts posed high money laundering risks.

Documents show that the actual account owners deliberately pressured the bank to help hide their identities. One such account was used by a father-son team of Miami Beach hotel developers who were later convicted of tax fraud for hiding \$150 million in assets.

Bearer-share accounts, suspicious traveler's checks, banks with terrorist financing links, hidden

transactions, dodging OFAC safeguards and Mexican drug money, none of them represent the types of transactions we want in a U.S. bank.

If the parent corporation of a global bank can't do a better job policing its affiliates, we shouldn't be providing a bank charter to their U.S. affiliate. If the U.S. affiliate can't do a better job of standing up to affiliate pressures and safeguarding the U.S. financial system, federal regulators should consider whether to pull its charter [emphasis added].

HSBC Group recently issued a policy statement declaring that all of its affiliates would be subject to the highest anti-money-laundering standards among them, that its affiliates would start sharing information to strengthen their anti-money-laundering defenses, and that all affiliates would be subject to diligence reviews.

HBUS has more than doubled the size of its anti-money-laundering compliance department, put in a new anti-money-laundering monitoring system, and closed over 395 high-risk correspondent accounts. These are all good steps, but we saw that movie before in 2003.

The recent commitments are welcome. Apologies and commitments to improve are also welcome. *But accountability for past conduct is essential. And that's what's been missing here [emphasis added].*

Where Were the Regulators?

It's bad enough that a single bank, such as HSBC, exposes the U.S. financial system to multiple money-laundering risks. It's made worse when there's a failure of anti-money-laundering oversight by the regulator, which is supposed to oversee our biggest banks, the OCC.

It is of great concern to the subcommittee, and it should be of great concern to every American that the OCC tolerated the mounting anti-money-laundering problems at HBUS for five years without taking any formal or informal enforcement action.

In addition, when the OCC decided the problems had gone far enough, it lowered HBUS's consumer compliance rating instead of its safety and soundness rating. Every other federal banking agency treats anti-money-laundering deficiencies as a matter of safety and soundness of the bank.

Only the OCC treats anti-money-laundering deficiencies as if they were a matter of consumer protection. Anti-money-laundering safeguards aren't aimed at protecting bank customers. They are aimed at pro-



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The Levin hearings zeroed in on the use by HSBC of the infamous British offshore banking center in the Cayman Islands, grilling top HSBC executives David Bagley (far left), Paul Thurston (center), and others. Here, they are sworn in before testifying.

protecting the entire American public from wrongdoers seeking to misuse the U.S. financial system.

The new leadership at the OCC needs to move swiftly to correct the previous oversight shortfalls, and to assure that promised changes at HSBC are implemented promptly and effectively. Our report contains many recommendations to address the abuses that we've identified....

Global banks have caused the world a lot of heartache. Our focus today is on one global bank that failed to comply with rules aimed at combating terrorism, drug trafficking, and the money laundering that fuels so much of what threatens the global community....

2. The Cayman Island Accounts

The following are excerpts from the hearing discussions which zeroed in on the use by HSBC of the infamous British offshore banking center in the Cayman Islands, from Panel II, featuring HSBC witnesses David Bagley, head of Group Compliance, HSBC Holdings PLC; and Paul Thurston, Chief Executive, Retail Bank-

ing and Wealth Management, HSBC Holdings PLC.

Levin: And I want to get to some of that issue by discussing with you the Cayman accounts. Now, when you bought the Mexican bank, when HSBC bought the Mexican bank, it found that HBMX kept open a so-called branch office in the Cayman Islands.

Now, I say so-called branch office because my understanding is there was [no] actual building, no office, no employees. It was just a shell operation that offered U.S. dollar accounts.

The branch, so-called, in Caymans was run by HBMX itself using its own employees in Mexico. And HBMX branch could open a U.S. dollar account for a client.

And at one point, 50,000 clients had these Cayman accounts, holding \$2.1 billion in assets.

Now, we've spent a lot of time on this subcommittee raising questions about Caymans, and other tax havens for tax-avoidance purposes. But this is a little bit different.

And this subcommittee has a lot of interest in these issues involving the Caymans, because they are shell corporations, and they possess and pose significant money-laundering problems. And they do it as soon as they're organized, because nobody knows who's behind those corporations.

And here's a few of the highlights relative to the Caymans. Exhibit 9 is a 2002 audit of HBMX. And that audit notes that 41 percent of the accounts in the Cayman Islands had no client information.

Exhibit 31 is a 2008 e-mail by Mr. Rue [phonetic] saying that 15 percent of the customers there didn't even have a file. Fixing the Cayman accounts will be a huge struggle. He says, "How do you locate clients when there's no file?"

Exhibit 32 is a July 2008 e-mail noting that HBMX has discovered, "significant U.S. dollar remittances

being made by a number of HBMX Cayman customers to a U.S. company alleged to be involved in the supply of aircraft of drug cartels.” That’s exhibit 32.

Later e-mail, November 2008, which is Exhibit 34, describes the Cayman accounts as having been frozen, “due to massive misuse of them by organized crime.”

So Mr. Thurston, first of all, did you know that the Cayman branch was fictitious, just a shell?

Thurston: It’s what’s called a “Cat-B” license, I believe.

Levin: But did you know that it was just a shell company? There [were] no employees there, no office. Were you aware of that?

Thurston: I know that, sir.

Levin: And did you know about the problems at the Cayman accounts that I’ve just read?

Thurston: Mr. Chairman, no, I didn’t during the time that I was there. And I, on reading your report, I was really angry to find there had been an audit report on these in the previous year. But that has been closed off with no actions. So when I got there and went through what are the top risks and the big-audit outstanding items, these were nowhere to be seen.

Levin: All right. So you were unaware the Cayman accounts at the time that you were head of that office?

Thurston: Correct, sir. . . .

Bagley: Thank you. The point is that when we became aware of those Cayman accounts, the ones that remain have all been fully remediated.

So when we became aware and focused on the Cayman accounts themselves, what we did as a group, what HBMX did, was work through each and every one of those accounts, revise and refresh the KYC [Know Your Client—ed.] to satisfy ourselves that there was an explanation for the monies, and that we were satisfied with the source of the funds. And therefore, what is left has been subject to revised and enhanced due diligence, and a refreshment of all of the information that we’re holding.

Levin: Does that mean 20,000 accounts now that you’re going to keep there?

Bagley: Well, actually, the group has recently arrived at a decision which I support, which is to actually close all of those Cayman accounts.

Levin: Well, that’s the short answer, very welcome answer. Particularly, I think this subcommittee is really—looks at its work as contributing to this kind of pressure on you to do the right thing.

Bagley: Sorry to interrupt. I should just be very clear that we are in the process of closing those accounts. They are not yet closed, but they will be closed. . . .

From Panel Three, featuring Stuart A. Levey, Chief Legal Officer, HSBC Holdings PLC. Senator Levin is questioning Levey on legal compliance with the Office of Foreign Assets Control, which has a filter to identify and stop prohibited or suspicious transactions.

Levin: My question though is . . . if one bank knows that information is being sought by OFAC, will it make sure that that information is provided? That’s my question.

Levey: My—again, my—my view on this would be that we would give to any government as much information as we’re legally permitted to do when we get a valid request. So what I—I can’t tell you whether there would be some legal restriction, but we would do everything we could to get them the information.

Levin: Well you say what you’re legally permitted to do, were you legally permitted by the Caymans’, by their law, to provide this? Do you know Cayman law won’t allow this? They’re a secrecy jurisdiction.

Levey: I don’t—I don’t know, Senator.

Levin: Well, but you need to find out.

Levey: Pardon me? Well, if I. . .

Levin: Are you going to be bound by a secrecy jurisdiction’s law that says you can’t share that information, or are you going to be carrying out your commitment here that you’re going to treat all of your affiliates as though they’re one place globally and you’re going to respond to law enforcement with their request?

And if you’re going to say, if legally permitted by the Caymans or by any other country, you’ve got tax havens and so forth with secrecy jurisdictions, Caymans being one of them. Are you bound by that? Are you going to work with law enforcement or are you going to be bound by Caymans?

Levey: We’re going to do everything we can to cooperate with law enforcement.

Levin: But you say though that you’re—if it’s legally permitted, that’s your hedge word, U.S. law binds you to report to OFAC; what are you going to do, live up to Cayman law or U.S. law?

Levey: We would—I don’t know if there would be a conflict there. . .

Levin: There is. Assume there is. . . .