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**“U.S. Vulnerabilities to Money Laundering, Drugs and Terrorist Financing:
HSBC Case History”**

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 business, 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, are the leading trade currency, and 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 travelers cheques, bank cheques, 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 their affiliates to pressure their U.S. cousin 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. banking rules.

The consequences are the ones you would 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, 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 report showing how U.S. banks that offer accounts to foreign banks, engaging in what is known as correspondent banking, can become conduits for illicit 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 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 laws have helped deny criminals access to the U.S. financial system. But as the report 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. 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 is HSBC Bank USA, known as HBUS. HBUS has more than 470 branches across the United States and 4 million customers.

HBUS is the key U.S. nexus for the entire HSBC worldwide network. In 2008, it processed 600,000 wire transfers per week; in 2009, two-thirds of the U.S. dollar payments 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.

Add on top of that, HBUS' history of weak anti-money laundering controls, and you have 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 AML 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, but even before the OCC lifted the order in 2006, the bank's AML program began deteriorating. In September 2010, the OCC issued a Supervisory Letter, 31-pages long, describing a long list of severe AML deficiencies, and followed in October 2010, with a Cease and Desist order requiring HBUS to revamp its AML 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 the investigation.

The Subcommittee's work identified five key areas of vulnerability exposed by the HSBC case history. The five areas involve:

- Providing U.S. correspondent accounts to high risk HSBC affiliates without performing due diligence, including a Mexican affiliate with unreliable AML controls;
- 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;
- Providing bank accounts to overseas banks with links to terrorist financing;
- Clearing hundreds of millions of dollars in bulk U.S. dollar travelers cheques, despite suspicious circumstances; and
- Offering bearer-share accounts, a high risk account that invites wrongdoing by facilitating hidden corporate ownership.

Let's take each in turn.

High Risk Affiliate. First is 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 AML laws and oversight. Yet, until recently, HSBC's London-based parent company, known as HSBC Group, instructed its affiliates to assume that every HSBC affiliate met the group's AML standards and automatically provide it with correspondent banking services. HBUS did as told and opened U.S. correspondent accounts for more than 80 HSBC affiliates, ignoring the U.S. 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 also has a long history of severe AML deficiencies. Add all that up and the U.S. bank should have treated HBMX, the Mexican affiliate, as a high risk account for AML purposes. But it didn't.

Instead, HBUS treated HBMX 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 HBMX 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 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 casa de cambio willing to take the cash. Some of those casas de cambios had accounts at HBMX. HBMX, in turn, took all the physical dollars it got and transported them by armored car or aircraft back across the border to HBUS for deposit into its U.S. banknotes 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 financial system for suspicious cash from a foreign affiliate.

Circumventing OFAC. A 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 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 Iranian transactions as legal under a U.S. exception for so-called "U-turn" transactions, the affiliates didn't want to trigger the OFAC filter and undergo the individualized reviews required to make sure. 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, worth \$19.4 billion, through HBUS and other U.S. accounts, while concealing any link to Iran in 85% 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 claim not to have known they were processing undisclosed Iranian transactions, documents show key HBUS officials were informed early on. HBUS compliance and payments executives repeatedly told HSBC affiliates they had to use fully transparent Iranian transactions, but when faced with evidence that the affiliates were secretly circumventing the OFAC filter, no one in HBUS confronted those affiliates, brought the issue to a head, and forced the transactions to the light. Problems also arose when some HSBC affiliates tried to circumvent the OFAC filter to send potentially prohibited transactions involving other countries like Sudan or North Korea.

OFAC programs are aimed at exposing and disabling the financial dealings of some of the most dangerous persons and regimes in the world today, including terrorists, persons involved with weapons of mass destruction, drug traffickers, and rogue jurisdictions. The OFAC filter is the key to blocking prohibited transactions from polluting the U.S. financial system. Global financial institutions have a special responsibility to respect OFAC prohibitions, but that's not what happened here. While HSBC affiliates may have been aiming simply at avoiding processing delays, circumventing OFAC safeguards can also facilitate transactions undertaken by some of the world's worst wrongdoers.

Disregarding 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 financing. 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 Qaeda and that it provided accounts to suspect clients.

In 2005, HSBC Group told its affiliates to sever ties with the bank, while making an exception for HSBC Middle East. Four months later, without explaining why, HSBC Group reversed itself and said 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. 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. Over the next four years, HBUS supplied Al Rajhi Bank with nearly \$1 billion in U.S. dollars, stopping only when HSBC made a global decision to exit the banknotes business altogether.

Clearing Suspicious Bulk Travelers Cheques. The fourth area of concern involves HBUS's willingness to clear suspicious bulk travelers cheques for foreign banks. From 2005 to 2008, on a regular basis, HBUS cleared \$500,000 or more per day in bulk travelers cheques for Hokuriku Bank of Japan. Routinely, these cheques arrived in large stacks of sequentially numbered cheques signed and countersigned with the same illegible signature. Forced by the OCC to investigate, HBUS found the Japanese bank could not provide any "know your client" information or explanation why two dozen of its customers, supposedly in the used car business, were often depositing \$500,000 a day in U.S. dollar travelers cheques purchased from the same bank in Russia. Under OCC pressure, HBUS stopped clearing the travelers cheques in 2008, but kept open the correspondent account, despite the Japanese bank's poor AML controls. In less than four years, HBUS provided over \$290 million in U.S. dollars to a Japanese bank for the benefit of Russians supposedly in the used car business.

Offering Bearer Share Accounts. Finally, there is HBUS's 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 whomever 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 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 travelers 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.

HSBC Group recently issued a policy statement declaring that all of its affiliates would be subject to the highest AML standards among them; that its affiliates would start sharing information to strengthen their AML defenses; and that all affiliates would be subject to diligence reviews. HBUS has more than doubled the size of its AML compliance department, put in a new AML monitoring system, and closed over 395 high risk correspondent accounts. All good steps, but we saw this movie before in 2003. The recent commitments are surely welcome. Apologies and promises to improve are also welcome. But accountability for past conduct is essential, and that's what's been missing here.

Exercising Ineffective AML Oversight. It is bad enough that a single bank such as HSBC exposes the U.S. financial system to multiple money laundering risks. It is made worse when there is a failure of AML oversight by the OCC which is supposed to oversee our biggest banks. It is of great concern to the Subcommittee, and should be of great concern to every American, that the OCC tolerated the mounting AML 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' consumer compliance rating instead of its safety and soundness rating. Every other federal banking agency treats AML deficiencies as a matter of safety and soundness; only the OCC treats AML deficiencies as if they were a matter of consumer protection law. AML safeguards aren't aimed at protecting bank customers, but rather the entire American public from wrongdoers seeking to misuse the U.S. financial system.

The OCC's new leadership needs to move swiftly to correct the previous oversight shortfalls and assure that promised changes at HSBC are implemented promptly and effectively.

Our report contains ten recommendations to address the abuses we've identified. Among the most important:

- HBUS should identify which of its sister affiliates are high risk, subject them to enhanced monitoring, and in particular review whether it should close the account of HSBC's Mexican affiliate.
- HBUS should beef up its OFAC compliance program by auditing affiliate transactions to see if they are circumventing the safeguards that protect our country and other countries from terrorists, drug traffickers, and rogue jurisdictions.
- HBUS should close accounts with banks suspected of involvement in terrorist financing, revamp its travelers cheque controls, and eliminate bearer share accounts.
- HSBC should require affiliates to share information to strengthen their AML defenses, and continue to beef up its compliance program which was given short shrift in the past.
- At the OCC, the agency should follow the lead of other regulators and treat AML compliance as a matter of safety and soundness.
- The new OCC leadership needs to get the OCC moving against money laundering by citing statutory violations, not just identifying failures as Matters Requiring Attention, in the face of AML deficiencies.

Global banks have caused the world a lot of heartache. Our focus today is 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. I want to thank my staff for their extraordinary work, Ranking Republican Senator Coburn for all his support and the work of his staff, and turn to him now for his opening statement.