

OPENING STATEMENT OF
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INVESTIGATIONS

HEARINGS ON

THE ROLE OF CORRESPONDENT BANKING IN MONEY LAUNDERING
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Today we will take an insider's look at how U.S. banks are being used by rogue and high risk foreign banks and their criminal clients to launder the proceeds of crimes such as drug trafficking, financial fraud, Internet gambling, and tax evasion.

What does it mean to launder money? It means you take the dirty money you get from selling drugs or accepting a bribe or defrauding someone and you move it through bank accounts or businesses in order to lose any link between the money and its source and then you can spend that money without anyone asking any questions. And one way you can do that is to move the money through correspondent accounts at U.S. banks.

The U.S. banking system is one of the premier banking systems in the world – it is also one of the safest and most sound. Our strong regulatory environment helps ensure that. And our dollar is the strongest currency in the world. That's why U.S. banks are so attractive.

So if criminals can move their money through U.S. banks, they can not only disguise their money, but they can also acquire the prestige of the U.S. banking system.

Here's a rather simple chart that shows how the proceeds from criminal activity and corruption makes it way into U.S. banks. [Exhibit A]. Ordinarily the dirty money from criminal activity can't get into a U.S. bank directly. U.S. banks have to report cash transactions over \$10,000 and they keep watch on the activities of their individual banking clients. But that same money can get into the same U.S. bank, by using an offshore bank that has a correspondent account at the U.S. bank. And that's what happened over and over and over again in the high risk foreign banks investigated by my staff.

For most Americans, a bank conjures up positive images of respectability and sound fiscal management. We picture a well-maintained building, a trained staff, and a prudent bank president, all operating under regulations that ensure the bank's safe, sound and lawful operation. But not all banks fit that image. Some banks in the world are quite the opposite. They operate without controls, without regulatory oversight, even without physical offices or a trained staff. Some of these high risk foreign banks are themselves engaged in criminal behavior such as financial frauds; some have clients who are engaged in criminal behavior such as drug trafficking

and political corruption; and some have such poor anti-money laundering controls that they don't know -- and some don't care -- whether or not their clients are engaged in criminal behavior.

One might suppose that these kinds of foreign banks would be unable to open accounts at U.S. banks, that U.S. banks would recognize them as posing such high money laundering risks that they would not give them entry into the U.S. financial system. But you would be wrong.

A year-long investigation by my Subcommittee staff has found that high risk foreign banks have been able to open accounts at U.S. banks, and some of these U.S. accounts have become conduits for criminal proceeds. When one bank opens an account for, and provides banking services to, another bank, it is called correspondent banking. The bank that provides the banking services is called the correspondent bank; the client that uses the services is called the respondent bank. Correspondent banking is essential to the movement of money around the world for international trade and commerce. But because many U.S. banks have failed to adequately screen and monitor foreign banks which open accounts, correspondent banking has also become a gateway into the U.S. financial system for criminals and money launderers.

Based upon its work over the past year, the staff investigation identified three categories of foreign banks that pose high money laundering risks: shell banks, offshore banks, and banks in foreign jurisdictions that do not cooperate with international anti-money laundering efforts.

"Shell bank," as we use that term, means a bank that does not have a fixed physical presence in any country. It is a bank that does not have a physical office where customers can go to conduct banking transactions or where regulators can go to inspect records and observe bank operations. Instead, these shell banks enjoy a shadowy existence, operating out of the offices of a related company, or from an undisclosed location that may be hinted at but never named. We found one shell bank that was operated out of the owner's home.

Due to their lack of visibility and presence, these shell banks have largely evaded the public spotlight, and U.S. banks opening accounts for them appear too often not to care how they operate. The staff conducted an in-depth examination of four shell banks, Caribbean American Bank, Federal Bank, Hanover Bank, and M.A. Bank. In all four cases, the investigation found the shell bank to be operating far outside the parameters of normal banking practice, without basic administrative controls, and without anti-money laundering safeguards. The investigation found that the banks had avoided regulatory oversight both in their licensing jurisdiction and in the countries where they conducted transactions. All four shell banks used accounts at U.S. banks to move millions of dollars in suspect funds across international lines, funds associated with drug trafficking, financial fraud, bribe money or other misconduct.

Offshore banks are banks whose licenses bar them from transacting banking activities with the citizens of their home jurisdiction, but empower them to transact business "offshore" with the citizens of other countries. In other words, the countries that create these banks protect their own citizens from them, but unleash them on the rest of the international community. One might ask why any U.S. bank would want to do business with a bank barred from transacting business in its

home jurisdiction, but they do. Major U.S. banks have opened accounts for hundreds, if not thousands, of offshore banks.

About 4,000 offshore banks now hold licenses from about 60 countries around the world, and control almost \$5 trillion in assets. About half of these offshore banks are thought to be located in the Caribbean and Latin America, with the rest in Europe, Asia, Africa and the Middle East. The offshore banking sector continues to grow, even as the international outcry over their association with crime and corruption is also increasing.

One reason offshore banks pose high money laundering risks is that the country licensing the bank has less incentive to police it, since it is barred from doing business with the country's own citizenry. Another is that offshore banking is a money-making enterprise for the governments of small countries which license them, and the less demands made by the government on bank owners, the more attractive the country becomes as a licensing locale. Offshore banks often rely on these disincentives to minimize regulatory oversight of their operations, increasing the risk that some will become vehicles for money laundering, tax evasion and other crimes.

The third category of high risk foreign banks are banks licensed by jurisdictions that do not cooperate with international anti-money laundering efforts. In June 2000, the Financial Action Task Force on Money Laundering, which is the leading international body fighting money laundering, issued a list of 15 countries determined to be "non-cooperative" with international anti-money laundering efforts. Together, these 15 jurisdictions have licensed hundreds and perhaps thousands of banks, all of which introduce money laundering risks into international correspondent banking. In July 2000, U.S. banking regulators issued advisories warning U.S. banks against doing business with banks in the listed jurisdictions. But if you thought that these advisories caused U.S. banks to stop doing business with these banks, think again.

Why do U.S. banks open correspondent accounts for these high risk banks? For some banks, correspondent accounts are easy money. When a U.S. bank isn't extending credit, correspondent accounts carry no monetary risk to the U.S. bank, they provide income through the fees charged for the services received, and the attitude has been that "a bank is a bank is a bank." We know that's not true. Some U.S. banks are apparently unaware of the money laundering involved; others seem to assume their systems will catch specific problems. But too often U.S. banks have failed to conduct the initial and ongoing due diligence needed to get a clear picture of the foreign banks using their services. And when negative press reports or information regarding suspicious activity did come to the attention of the U.S. banks, in too many cases the information did not result in a serious review of the foreign banks involved or in concrete actions to prevent money laundering.

The result is that U.S. banks through their correspondent account services, become aiders and abettors, unwittingly, of laundering the proceeds from drug trafficking, financial fraud, tax evasion, Internet gambling and other illegal acts. We can't spend billions of taxpayer dollars to interdict drugs and eradicate coca farms and at the same time let drug lords deposit illegal drug profits in foreign banks with U.S. correspondent accounts. We can't be consistent if we condemn

corruption in foreign business practices and make illegal the payment of bribes by our business leaders to foreign government officials, and then let bribe money be deposited in U.S. bank accounts earning interest. We can't fight for human rights in all parts of the globe, and then let corrupt public officials steal from their own people and place corrupt funds in U.S. bank accounts to enjoy the safety and soundness of the U.S. banking system. Money laundering not only finances crime, it pollutes international banking systems, impedes the international fight against corruption, distorts economies, and undermines honest government.

The Subcommittee is devoting three days of hearings to the money laundering problems posed by high risk foreign banks' opening correspondent accounts at U.S. banks. I want to thank the Subcommittee Chairman, Susan Collins, for her support of this investigation and for allocating these three days of hearings to this subject.

Today we will look at how high risk banks work and how U.S. banks respond to them. Tomorrow's hearing will focus on the special problems posed by foreign offshore shell banks. And the third day of hearings, next Tuesday, will focus on what can and should be done to strengthen anti-money laundering safeguards in U.S. correspondent banking. Based upon the testimony and recommendations received, I will be introducing legislation in the near future to try to strengthen U.S. law in this area, in order to close the net around criminals using accounts of high risk foreign banks in U.S. banks to launder money.

Today we will hear first from a U.S. citizen, John Mathewson, who used to own and manage an offshore bank in the Caribbean called Guardian Bank and Trust. After ten years at the bank, Mr. Mathewson was arrested in the United States for tax evasion and money laundering. He pled guilty to the charges and agreed to cooperate with U.S. law enforcement. One action he took, which was the first and so far the only time in U.S. law enforcement history it has happened, Mr. Mathewson turned over a year's worth of offshore banking records for inspection and review. These records not only provided invaluable information about how an offshore bank operates, but also enabled U.S. law enforcement to initiate prosecutions of numerous of his bank's clients for tax evasion and other misconduct. Mr. Mathewson has since provided invaluable testimony in many of these prosecutions. Today, he has agreed to provide testimony about how an offshore bank and its clients use U.S. bank accounts to launder funds. He will also explain how dependent offshore banks are on other banks to conduct their operations, and how U.S. banks hold tremendous power in their hands to decide which offshore banks will gain access to the U.S. banking system.

We will also hear from two U.S. banks, Bank of America and Chase Manhattan Bank, that opened correspondent accounts for offshore banks. One case involves American International Bank, an offshore bank that was able to open accounts at these as well as other U.S. banks, despite having a bad local reputation, its own correspondent accounts for rogue banks, and increasing evidence that the bank's accounts held suspect funds related to major financial frauds. Another offshore bank, Swiss American Bank, opened accounts at both banks. It maintained these accounts for years, despite mounting evidence that the bank's accounts were repositories for funds associated with drug trafficking, financial frauds, Internet gambling, or other illicit

activities. In the face of repeated evidence of questionable activities, the U.S. banks kept open the Swiss American Bank accounts. Today we will find out how could that happen.

Last year, U.S. taxpayers spent over \$600 million in the fight against money laundering. U.S. banks are required by law to join in this fight by operating anti-money laundering programs designed to detect and stop criminals from washing their dirty money through U.S. banks. We can't condemn jurisdictions with weak anti-money laundering controls, weak banking oversight, and unregulated offshore sectors, and then tolerate U.S. banks doing business with the very banks these jurisdictions license and unleash on the world.

Since the report was issued last month, we have already seen some results. With respect to the high risk foreign banks that were the subject of the case histories, the Governments of Antigua-Barbuda, the Bahamas, Cayman Islands and Dominica have revoked or suspended the license of four of the banks. The Cayman Islands also announced that by the end of this year, all of its offshore banks that are not branches or units of other banks, of which there are 62, will have to enhance their physical presence on the island, by opening an office with bank records and a resident manager. In the United States, the New York Clearing House Association, which is composed of a dozen of the largest correspondent banks in the United States, has announced its intention to develop a code of best practices for the industry. We have also been told by banks like Chase Manhattan that they have begun top-to-bottom reviews of their correspondent accounts. These are encouraging signs, although more must be done.

U.S. banks are the gatekeepers through which foreign banks and their clients have to pass to get access to U.S. dollars; U.S. banking services such as wire transfers, investments, and credit; and the U.S. banking system which is one of the best in the world. When it comes to high risk foreign banks, U.S. banks have not lived up to their gatekeeping role. They need to do a better job in screening and monitoring the high risk foreign banks that want access to our banking system. Only then will we end the money laundering activities and help ensure that crime doesn't pay.

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