U.S. VULNERABILITIES TO MONEY LAUNDERING, DRUGS, AND TERRORIST FINANCING: HSBC CASE HISTORY

HEARING

BEFORE THE

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS OF THE

COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS

UNITED STATES SENATE

ONE HUNDRED TWELFTH CONGRESS

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95. Transcript of 4/25/2007 telephone conversation between HBUS Claude Mandel and Mauricio Cohen (Mr. Cohen: But I can't put that, otherwise I have to declare them in the United States? I can't do that, I don't want to declare... otherwise, I have to close the accounts with you and go to Geneva.). [HSBC–PSI–PROD–0024791–795] ........................................ 1062

96. a. HSBC internal email, dated June 2007, re: Waiver Request (The two accounts are bearer shares. The client does not want neither to register nor custodize the shares, and they do not want to sign the BOL.). [OCC–PSI–00214516] ............................................................................................................................................................................. 1067

b. HSBC internal email, dated June 2007, re: Waiver Request (I would do it without going to Geneva but audit wrote up DPB on a similar situation.). [OCC–PSI–00214534] ............................................................................................................................................. 1071

97. Documents related to Peruvian Family:

a. HSBC internal email, dated June 2007, re: [redacted] Family (I spoke to Susan Wright, Group Head of AML. She is reluctant to grant the exception but will consider it.). [OCC–PSI–00214880] ................................................................. 1073

b. HSBC internal email, dated June and July, 2007, re: [redacted] Family (This is too important a family in Peru for us not to want to do business with...). [OCC–PSI–00215211] ................................................................. 1075

Documents Related to OCC—Exercising Ineffective AML Oversight:

98. HSBC internal email, dated February 2010, re: OCC Meeting (In light of the extent of our alert backlogs, Sally indicated that they will shortly be issuing a Supervisory Letter...). [HSBC OCC 3405315–316] ............... 1081

99. HSBC internal email, dated June 2009, re: GMO business reviews—LATAM (The inherent AML risk in Mexico is still very high...). [HSBC OCC 8874895] ............................................................................................................................................................................. 1083

Additional Documents:

100. Correspondence from the Comptroller of the Currency (OCC) to the Permanent Subcommittee on Investigation, September 20, 2012, on actions taken by the OCC since the Subcommittee’s July 2012 hearing. [PSI–OCC–45–0000010–016] .................................................................................................................. 1084


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102. Documents cited in footnotes to U.S. Vulnerabilities to Money Laundering, Drugs, and Terrorist Financing: HSBC Case History, the Report released in conjunction with the Subcommittee hearing on July 17, 2012. A Document Locator List provides Bates numbers and document descriptions of the documents cited in the Report. Not included are documents related to Subcommittee interviews, which are not available to the public, and widely available public documents ........................................................................... 1109
U.S. VULNERABILITIES TO MONEY LAUNDERING, DRUGS, AND TERRORIST FINANCING: HSBC CASE HISTORY

TUESDAY, JULY 17, 2012

U.S. SENATE,
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS,
OF THE COMMITTEE ON HOMELAND SECURITY
AND GOVERNMENTAL AFFAIRS,
Washington, DC.

The Subcommittee met, pursuant to notice, at 9:36 a.m., in room SD–342, Dirksen Senate Office Building, Hon. Carl Levin, Chairman of the Subcommittee, presiding.

Present: Senators Levin and Coburn.

Staff Present: Elise J. Bean, Staff Director/Chief Counsel; Mary D. Robertson, Chief Clerk; Laura E. Stuber, Senior Counsel; Robert L. Roach, Counsel and Chief Investigator; Eric Walker, Detailee; Kristin Gwin, Congressional Fellow; Christopher Barkley, Staff Director to the Minority; Keith B. Ashdown, Chief Investigator to the Minority; Adam Henderson, Professional Staff Member; Dennis Bogucz, Congressional Fellow; Brian Egger, Detailee; Beth Baltzan, Congressional Fellow; Noah Czarny, Law Clerk; Bill Gaertner, Law Clerk; Curtis Kowalk, Law Clerk; Lane Powell, Law Clerk; Arielle Woronoff, Law Clerk; Sofia Knutsson, Intern; and Jacquelyn Jones, Law Clerk.

OPENING STATEMENT OF SENATOR LEVIN

Senator LEVIN. 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 business, but also to provide themselves with 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, 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 travelers 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 (AML) steps. Some even allow their affiliates to pressure their U.S. cousins to ease up on U.S. AML 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 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, and even pursue weapons of mass destruction. That is 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 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 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 laws have helped deny criminals access to the U.S. financial system. But as our report that we are 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, sometimes called “H–BUS.” That HBUS affiliate now has 470 branches across the United States and 4 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, add on top of that, HBUS’s history of weak AML 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 (OCC) made changes, but even before the OCC lifted its 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 3-year period, to conduct AML 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 AML 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.

Let us 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 AML 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 AML standards and automatically was told to provide it with correspon-
dent banking services. HBUS did as told and 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’s dealings with an HSBC affiliate in Mexico illustrate the money laundering dangers. HSBC Mexico (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. You 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 did not.

Instead, HBUS treated HBMX as such a low-risk client bank that it did not even monitor their account activity for suspicious transactions. In addition, for 3 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, 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 into its U.S. banknotes account, completing the laundering cycle.

Over 2 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 their foreign affiliate in Mexico. Next, 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 (OFAC) has developed a list of prohibited persons which banks use to develop what is 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 pa-
perwork. An outside auditor hired by HBUS has found that, from 2001 to 2007, HSBC affiliates sent nearly 25,000 transactions involving Iran, worth 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 claim not to have known they were processing undisclosed Iranian transactions, documents show that key HBUS officials were informed early on. HBUS compliance and payment 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 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, 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 is 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.

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 September 11, 2001 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 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 2 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 4 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.

The fourth area of concern involves HBUS’s willingness to clear suspicious bulk travelers checks for foreign banks. From 2005 to 2008, on a regular basis, HBUS cleared $500,000 or more per day
in bulk travelers checks for the Hokuriku Bank of Japan. Routinely, these checks arrived in large stacks of sequentially numbered checks signed and countersigned with the same illegible signature. Forced by the Office of the Comptroller (OCC) of the Currency—to investigate, HBUS found the Japanese bank could not provide any “know your client” information or any explanation of why two dozen of its customers, supposedly in the used-car business, were often depositing $500,000 a day in U.S. dollar travelers checks purchased from the same bank in Russia. Under OCC pressure, HBUS stopped clearing the travelers checks in 2008, but kept open the correspondent account, despite the Japanese bank’s poor AML controls. In less than 4 years, HBUS provided over $290 million in U.S. dollars to a Japanese bank for the benefit of Russians, again, supposedly in the used-car business.

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 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 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 cannot do a better job policing its affiliates, we should not be providing a bank charter to their U.S. affiliate. If the U.S. affiliate cannot 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. These are all good steps, but we saw this 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 is what has been missing here.

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 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 AML problems at HBUS for 5 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 law. Anti-money laundering safeguards are not aimed at protecting bank customers; they are aimed at 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 have identified. Among the most important are the following:

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 check controls, and eliminate bearer share accounts.

HSBC should require affiliates to share information to strengthen their anti-money laundering defenses, and should 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 anti-money laundering compliance as a matter of safety and soundness of banks.

The new OCC leadership needs to get the OCC moving against money laundering by identifying statutory violations, not just identifying failures of banks as Matters Requiring Attention, in the face of significant anti-money laundering 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. I want to thank Senator Coburn for all of his support and for the work of his staff. And I now turn to him for his opening statement.

OPENING STATEMENT OF SENATOR COBURN

Senator Coburn. Thank you, Mr. Chairman. I normally submit an opening statement for the record and make a few short comments. I will not do that today because of the gravity of the problem that we face, and I want to make sure my words are heard and part of the record.

I agree with most of what we heard Senator Levin say. I want to thank him for his tireless work on this issue. He is one of my favorite bulldogs in terms of when he gets a hold of something, he really does not let go of it. I do not always agree with the number
of teeth that he loses when he grabs hold of it, but the fact is that he does grab hold of it.

I would also like to thank both the Office of the Comptroller of the Currency and HSBC Bank, and the reason I am thanking them is because in the years that I have been on this Subcommittee and this Committee, which is 8 years now, I have never seen the type of cooperation that we received both from a government agency and a private entity. OCC provided a number of people for interviews as well as essential documents about the regulatory process. HSBC Bank officials likewise sat for dozens of interviews and handed over millions of pages of documents. Some of today’s witnesses were flown in from posts around the world.

As Chairman Levin laid out in his statement, the Subcommittee’s investigation into anti-money laundering and anti-terror finance efforts at HSBC has covered quite a bit of ground. PSI examined in detail the types of vulnerabilities our Nation faces from criminals and terrorists who want to take advantage and abuse our banking system and take away our freedoms. What we learned is that the United States faces some very unique risks, both because of our post-September 11, 2001 security needs and because of the strength of our financial system, which attracts worldwide attention.

Every day, countless transactions denominated in U.S. dollars occur around the world. This is good for our economy, which benefits from a strengthened currency and increased economic activity. But criminals around the globe are also drawn to U.S. banks, which offer the attractive option of making illicit funds look legitimate. If they can pass criminal proceeds through a U.S. bank unnoticed and untouched, the funds are unlikely ever to be stopped or ever be recovered.

This hearing raises the big and important questions. Banks want to obey the law, but also grow their businesses. What happens when the two goals conflict? Banks want to know their customers, but some customers want privacy. How do we resolve this? As we write AML policy, we should look for ways to get all boats rowing in the same direction, letting banks and government each do what they do best as we all work to combat crime and terror.

At HSBC, we uncovered a number of troubling examples in which weak AML systems may have let criminal or terrorist funds pass through. In Mexico, for example, as the Chairman said, billions of U.S. dollars flowed from the HSBC affiliate in Mexico. The Mexico affiliate was the single largest exporter of U.S. dollars in Mexico to HBUS. U.S. law enforcement and the regulatory entities have concluded that because of the volume of money, it likely came from proceeds of the illegal drug trade—not a far assumption.

In another case, an Iranian bank was allowed to initiate U.S. dollar transactions that HSBC would process through the United States without explaining where they came from. At the time, however, there were severe legal restrictions on any payments coming from or going to Iran, most often meaning they would be manually inspected. HSBC’s affiliate in London coached the Iranian bank on how to get the payments through the United States without inspection and simply requested the bank send transactions that would not violate U.S. law. In effect, it relied exclusively on an Iranian
bank to comply with a law intended to catch payments from Iranian banks. The bank or the officials that made the decision were either naive or willfully blind.

This is why tough AML laws are important. If illicit funds can be tracked and stopped, there are fewer places for criminals and terrorists to hide. And while our focus has been on the problems we found at HSBC Bank, we also have to emphasize that similar problems exist at other banks. For example, Citibank, Bank of America, Wachovia, Western Union, and others have come under scrutiny for laundering drug cartel profits.

The purpose of this hearing, then, is not just to make an example of HSBC as if it were an anomaly. Rather, this hearing is to help Congress understand what kind of risks this Nation faces and what we should do to reduce them. If we can get a better handle on the risks by looking closely at the operations of a single bank, we can write better laws and achieve our true goals: Stopping crime and preventing terror.

With that in mind, I believe there are several lessons we can learn from the problems that we uncovered at HSBC Bank.

First, banks around the world operate under different laws, creating different sensitivities to money laundering. While this seems apparent, it was not clear how much this would affect a bank with worldwide affiliates until we took a closer look. In the case of HSBC, its bank in the United States operated differently even than its own affiliates in London, Mexico, and the Middle East. Failure to recognize this can lull us into thinking we can rely on foreign banks to carry out U.S. law.

Second, bank regulators are sometimes better at identifying money-laundering vulnerabilities than knowing how to fix them. Throughout this inquiry, it became clear the Office of the Comptroller of the Currency was aware of many of HSBC’s AML weaknesses, which it frequently pointed out. It was often at a loss, however, to prescribe how HSBC could eliminate the weaknesses. And so its record of enforcement at HSBC resembles a lapdog rather a watchdog that we sorely need.

We have also learned recently that investigators from Treasury’s own Office of Inspector General have cited OCC personnel for unethical practices. This, unfortunately, does not seem to be an isolated incident, and we will go into greater detail in that as we see the facts unfold. Taken together with our Subcommittee’s findings in this investigation, these conflicts are startling and suggest Congress should give closer scrutiny to the OCC’s actions.

The purpose here is to stop criminals from hiding their illicit funds and preventing terrorists from having the freedom to plot and plan. The metrics we use to measure a bank’s AML compliance need to focus less on form and more on substance. How well are we achieving our goal?

This Subcommittee has shown the kinds of vulnerabilities that we now face. Too often what we found left us very troubled, both for the risks to our Nation and for the level of effort we saw to eliminate them. HSBC made its share of mistakes, for which it is now being held accountable.

But what we must all remember is that money laundering always begins with a crime, and this ultimately is what we mean to
fight. To the extent that this hearing results in criminals and terrorists having fewer options to rob and harm the public, we will count it a success.

It may be impossible to stop all money laundering. Most of what we call money laundering in a certain context is a benign transaction in another. Buying travelers checks is innocent behavior for the tourist, but suspicious behavior when they are purchased in bulk by terrorists or drug lords. This does not mean we should not try to stop criminals from laundering their money through U.S. banks, but we need to do so wisely.

I appreciate the efforts that HSBC has made thus far to improve their AML systems, and I sincerely hope they stick. I look forward to hearing from their witnesses, as well as from the OCC, and appreciate their appearance before us today.

Thank you, Mr. Chairman.

Senator Levin. Thank you very much, Senator Coburn.

I would now like to call our first panel of witnesses for this morning’s hearing: The Hon. David S. Cohen, the Under Secretary for Terrorism and Financial Intelligence at the U.S. Department of the Treasury; and Leigh Winchell, the Assistant Director for Investigative Programs at the U.S. Immigration and Customs Enforcement (ICE). I very much appreciate both of you being with us this morning. We look forward to your testimony.

Pursuant to our Rule VI, all witnesses who testify before the Subcommittee are required to be sworn, so at this time I would ask you both to please stand and raise your right hand. Do you swear that the testimony you are about to give before this Subcommittee will be the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. Cohen. I do.

Mr. Winchell. I do.

Senator Levin. We will use a timing system today. About 1 minute before the red light comes on, you will see the lights change from green to yellow. That will give you an opportunity to conclude your remarks. Your written testimony, of course, will be printed in the record in its entirety, so please try to limit your oral testimony to 7 minutes.

Mr. Cohen, we are going to have you go first, followed by Mr. Winchell, and after we have heard your testimony, we will then turn to questions. Please proceed, Mr. Cohen.

TESTIMONY OF HON. DAVID S. COHEN, UNDER SECRETARY FOR TERRORISM AND FINANCIAL INTELLIGENCE, U.S. DEPARTMENT OF THE TREASURY

Mr. Cohen. Thank you, Chairman Levin and Senator Coburn. Thank you for inviting me to testify today. I am pleased to have the opportunity to discuss the importance of the Treasury Department’s efforts to identify and combat money laundering and terrorist financing in the U.S. banking sector.

At the outset, it is important to recognize that the United States maintains one of the strongest and most effective anti-money laundering and counter-terrorist financing regimes in the world. This is

1 The prepared statement of Mr. Cohen appears in the Appendix on page 94.
a testament to the work of the Congress, including this Subcommittee, the regulators, the enforcement agencies, and the financial institutions themselves. But the scale, efficiency, and sophistication of the United States’ financial system—particularly its banking sector—make it a prime target for those who seek to conceal and move illicit money. This involves not just money launderers, of course, but also terrorists, weapon proliferators, drug lords, and organized crime figures, who all at some point rely on the financial system to store, move, and launder the funds supporting or derived from their operations.

Treasury’s ability to protect the integrity of the U.S. financial system from abuse and to combat critical threats to our national security and foreign policy depends to a significant extent on the implementation by U.S. financial institutions of robust programs to prevent money laundering, terrorist financing, and sanctions evasion.

This morning I would like to briefly address why effective anti-money laundering, counter-terrorist financing, and sanctions compliance programs are so critical to our national security and the integrity of our financial system, as well as some of the steps we are taking, along with our partners in Congress, the Executive Branch, and internationally, to improve the effectiveness of our anti-money laundering, counter-terrorist financing, and sanctions compliance regime.

Although it is difficult to measure with precision, by any estimate, the total amount of dirty money moved through and concealed within the U.S. financial system is massive—in the hundreds of billions annually. The sheer volume of money moving through the banking system in particular makes banks both the most vulnerable financial institutions for money laundering and terrorist financing and the most important line of defense against money laundering and terrorist financing. Our regulatory framework, overseen by Treasury’s Financial Crimes Enforcement Network (FinCEN), along with the Federal functional regulators, was built to require financial institutions to implement risk-based anti-money laundering programs, to collect and report useful information to law enforcement and national security authorities for the purpose of combating the full range of illicit finance. This regulatory framework assists banks in identifying and managing risk and creates the foundation of financial transparency required to apply targeted financial measures, such as sanctions against specific actors or prohibitions against specific activity.

To implement targeted financial sanctions, banks must screen clients and transactions against the Specially Designated Nationals (SDN) list, maintained by the Treasury’s Office of Foreign Assets Control. This is a list of drug traffickers, weapons proliferators, terrorists, officials from rogue regimes, and other threats to our national security whose U.S. assets are frozen and who are generally forbidden from engaging in any transactions in the U.S. financial system.

Despite the importance of robust anti-money laundering and sanctions compliance programs, recent civil enforcement actions by OFAC, FinCEN, and the Federal banking regulators illustrate that sometimes financial institutions fail to implement adequate pro-
grams, exposing the U.S. financial system to significant risks of money laundering and resulting in illicit actors gaining access to the U.S. financial system.

We have seen, for example, an instance where a bank failed effectively to monitor its correspondent banking relationship with high-risk customers, resulting the processing of $420 billion in cross-border financial transactions with 13 high-risk Mexican casas de cambio from 2004 to 2007. We have also seen several cases where foreign banks stripped out the names of Iran or other sanctioned entities in wire transaction messages routed through the United States, resulting in billions of dollars of benefits to sanctioned parties.

These and other similar cases have resulted in criminal fines and forfeitures of more than $4.6 billion over the past 6 years. These cases raise important questions about vulnerabilities in the framework of anti-money laundering and counter-terrorist financing requirements that require immediate attention. As a result, Treasury is working closely with our interagency partners and the private sector to better understand the compliance challenges faced by financial institutions, clarify U.S. Government expectations of financial institutions, and strengthen the overall anti-money laundering and counter-terrorist financing regulatory structure.

In addition to continuing to impose sanctions on weapons proliferators, narcotics traffickers, transnational criminals, human rights abusers, and terrorist financiers, my office is also focused on improvements to our regulatory framework. One of our most important initiatives is to examine whether the customer due diligence rules, the foundation of financial transparency, should be improved.

Earlier this year, FinCEN issued an Advance Notice of Proposed Rulemaking suggesting ways to clarify, consolidate, and strengthen customer due diligence requirements for financial institutions, including an obligation to collect beneficial ownership information. We are also focused on combating the use of shell companies and other opaque legal structures that facilitate illicit financial activity. We strongly support legislation requiring disclosure of beneficial ownership information in the company formation process. And because strengthening anti-money laundering and counter-terrorist financing regimes internationally directly benefits the integrity of the U.S. financial system, my office works with others in the U.S. Government through the Financial Action Task Force, the International Monetary Fund, the World Bank, and the United Nations to encourage foreign jurisdictions to implement measures to combat illicit finance.

I began my testimony this morning by noting that the United States is home to one of the strongest anti-money laundering and counter-terrorist financing regimes in the world. In order to continue as the world leader in financial integrity, something we can and must do, we are obligated to push ourselves to identify where we can do better and to work tirelessly to get there. Today’s hearing is one important step on this road, and I look forward to continuing to work with this Subcommittee to achieve this critical goal. Thank you.

Senator LEVIN. Thank you very much, Mr. Cohen. Mr. Winchell.
TESTIMONY OF LEIGH H. WINCHELL, ASSISTANT DIRECTOR FOR PROGRAMS, HOMELAND SECURITY INVESTIGATIONS, U.S. IMMIGRATION AND CUSTOMS ENFORCEMENT, U.S. DEPARTMENT OF HOMELAND SECURITY

Mr. WINCHELL. Good morning, Chairman Levin and Senator Coburn. Thank you for the opportunity to appear before you today and discuss the efforts of the U.S. Immigration and Customs Enforcement to combat transnational criminal organizations and the illicit proceeds used to fund their criminal activities.

Over the past two decades, transnational organized crime has transformed in size, scope, and impact, posing a significant threat to the national and international security. While the globalization of organized crime is not new, the magnitude, pace, and violence accompanying the illicit activities is alarming.

For example, in the past 5 years, we have seen an unprecedented level of drug-related violence south of our border which has claimed over 47,000 lives since 2006.

The fight against transnational organized crime is one of the highest priorities of ICE. With the most expansive investigative authority and the largest investigative force in the Department of Homeland Security (DHS), we work closely across agency and international boundaries with our law enforcement partners, creating a united front to disrupt and dismantle transnational criminal organizations. This is aided by our expansive global footprint. With a force of nearly 7,000 special agents assigned to more than 200 U.S. cities in 71 offices in 47 countries worldwide, our domestic and international network of agents all work in concert to target transnational crime.

One of the most effective methods of dismantling a transnational criminal organization is to attack the criminal proceeds that is the lifeblood of their operations. In fiscal year 2011, Homeland Security Investigation special agents initiated nearly 4,300 financial investigations, resulting in nearly 1,800 arrests, over 1,000 criminal convictions, more than 7,700 seizures worth approximately $359 million, including $331 million in currency and monetary instruments.

In 2010, ICE initiated a financial investigative project in the State of Arizona following an increase in cash activity at financial institutions along the U.S. and Mexican international border. As a result of recent changes in Mexican financial regulations, many criminal organizations were forced to explore new ways to exploit legitimate financial systems in order to launder their proceeds. A new trend emerged, known as the repatriation of the U.S. dollar, and coupled with the Mexican black market peso exchange, has led to an increase in identified U.S. currency along the southwest border region, in the last year and a half or so, approximately two-thirds of $1 billion in the form of outbound international wires or cashier’s check purchases from border branches of U.S. financial institutions, mostly to Mexico.

In 2005, ICE initiated Operation Firewall as an effort to raise worldwide awareness of the dangers posed by the cross-border movement and smuggling of illicit funds. Operation Firewall targets methods used to move and smuggle currency by focusing on

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1 The prepared statement of Mr. Winchell appears in the Appendix on page 99.
all aspects of illicit cash movements. Since its inception, Operation Firewall has resulted in more than 5,700 arrests, totaling more than $553 million, and the arrest of 1,182 individuals. These efforts include 367 international seizures totaling nearly $258 million and 253 international arrests.

In August 2009, ICE officially launched the National Bulk Cash Smuggling Center (BCSC) as a 24/7 investigative support and operations facility. Since its inception, the BCSC initiated over 500 criminal investigations, resulting in millions of dollars seized. The center has also provided training and outreach to over 21,000 Federal, State, and local law enforcement.

ICE's interaction with the financial institutions from an anti-money laundering perspective is multilayered. Through our Cornerstone Outreach Initiative, ICE HSI special agents share lessons learned, best practices, and money-laundering typologies with the AML personnel from financial institutions throughout the world. As part of these outreach efforts, special agents show how the bank systems and processes can and are being exploited. By sharing this information, the financial institutions are better able to understand the threats, inherent vulnerabilities, and build counter measures into their training and automatic monitoring systems. These outreach presentations take place at local branch bank locations as well as through speaking engagements at AML conferences such as those hosted by the Association of Certified Anti-Money Laundering Specialists (ACAMS).

In late 2009, HSI expanded their working relationship with the private sector through ACAMS to assist bank AML specialists to better identify and monitor financial activity related to non-traditional criminal groups. This expanded working relationship allows the members to learn more about current active financial indicators related to those crimes. The members can then incorporate what they have learned into creating models and filters within their AML software to more accurately identify financial transactions indicative of those crimes. The CAMS certification, obtained through ACAMS, is the most widely recognized AML certification among compliance professionals worldwide.

Since its inception, HSI special agents have conducted over 11,800 Cornerstone presentations and trained over 243,000 participants worldwide. This outreach has resulted in the initiation of over 447 criminal investigations, led to the arrest of approximately 330 individuals, 280 indictments, and over $666 million seized.

Recognizing the magnitude of transnational organized crime, ICE will continue to work closely with our law enforcement partners as well as with the industry to identify potential vulnerabilities that could be exploited by terrorists and other criminal organizations to earn, move, and store their illicit proceeds.

I want to thank you again for the opportunity to appear before you today, and I would be pleased to answer any questions at this time.

Senator Levin. Thank you both. Let us start with a 7-minute first round.

Mr. Winchell, in your prepared testimony you talk about bulk cash, and we will be seeing a lot of discussion of that, about drug cartels smuggling U.S. dollars from the United States into Mexico,
finding a Mexican bank or a casa de cambio willing to accept the cash, after which the financial institution brings or tried to bring the dollars back to the United States.

Now, why would a drug cartel bother to smuggle U.S. dollars across the border into Mexico only to send those dollars or try to send those dollars back here again for deposit in our bank? Explain that circle. And why is it that process takes place? I tried in my opening statement to do it, but I would like to hear you try it also.

Mr. Winchell. The laws that were initiated in Mexico involving the banking industry set certain limits on the amount of U.S. currency that could go into banks in any particular period of time; $7,000 for a business and $4,000 per individual per month, I believe, are what the figures are. Bulk cash is moved south across the border as the proceeds of their illicit activity in the United States and pooled in Mexico. They are sold then to money brokers anywhere between 4 to 7 percent discounted rate. That may be casas de cambios and others that they use then to move in bulk cash back across the United States border into U.S. institutions and then wired back into Mexico and exchanged at the current rate between Mexican dollars and pesos, and in essence completing the laundering process of cleaning the money.

Senator Levin. But to put it simply, they cannot just directly deposit these drug sales money into U.S. banks because we have a Know Your Customer requirement. Is that correct?

Mr. Winchell. That would be correct, sir. They have to find someone in Mexico that would be complicit with their activity.

Senator Levin. But they want that money to be in U.S. banks, to get there and to be laundered.

Mr. Winchell. Yes, sir.

Senator Levin. So the short answer is they cannot do it directly, so they have to go through this process of sending it to a Mexican bank, if they can, and then having it returned cleansed. Is that correct?

Mr. Winchell. That is correct.

Senator Levin. Now, what is the relationship between the strength of a drug cartel and the ability of that drug cartel to launder money? Is it clear that the more it is able to launder its money, the stronger the cartel is?

Mr. Winchell. Their profits fuel their activity. The more profit they have, in other words, the more legitimate money they can appear to have, the more they can fuel their illicit activity and then diversify their criminal activity. So the larger the cartel, the richer the cartel, the more powerful they get.

Senator Levin. But also they will be more powerful if they can launder that money so that they can then diversify?

Mr. Winchell. Absolutely.

Senator Levin. All right. So that, again, we have all this huge violence on the border. We have drug cartels down in Mexico and drug groups here as well fighting for power, bringing violence to their streets and to our streets. And if they can successfully launder money, they are stronger. Is that accurate?

Mr. Winchell. That would be very accurate.
Senator Levin. OK. Mr. Cohen, would you agree that the more a terrorist can get their money through our system, the stronger a terrorist group will be?

Mr. Cohen. I would, Mr. Chairman.

Senator Levin. All right. Now, even though they have new rules down in Mexico, as you have just pointed out, I think starting in 2010, are illicit drug proceeds still being laundered into U.S. financial institutions, Mr. Cohen?

Mr. Cohen. I think there is no question that there continues to be a problem with money laundering in U.S. financial institutions coming from Mexico, from the casas de cambio and other institutions in Mexico, as well as from other sources where illicit proceeds are placed into the U.S. financial system.

Senator Levin. And, therefore, even though there have been changes in the laws, for instance, in Mexico and other efforts made to clamp down on the ability to launder money for these groups, the terrorist groups or drug cartels, it is still going on, and the efforts have continued. Can you give us some of the new efforts that are being made, the new challenges, Mr. Cohen, in this area of money laundering?

Mr. Cohen. Well, to pick up on what Mr. Winchell was discussing earlier, with respect to Mexico, obviously there is a substantial amount of legitimate trade with Mexico and a substantial amount of legitimate U.S. dollars that are spent in Mexico. And what we see is these Mexican financial institutions working with casas de cambio and then working with U.S. financial institutions to take in U.S. dollars from the Mexican economy. Dirty money is layered in with legitimate funds and placed into U.S. financial institutions. That continues to be a serious problem even after the really very important and aggressive steps that the Mexican Government has taken to restrict the ability of businesses and individuals to deposit U.S. dollars directly into Mexican financial institutions.

We have also seen some displacement of the money-laundering cycle, so instead of the drug dollars just moving into Mexico, because of the steps the Mexican Government has taken, we have seen some of these dollars move further south in coming back into the U.S. financial system from countries further into Central America.

Senator Levin. Now, when law enforcement or bank regulators see a bank in a country with drug-trafficking challenges transporting large volumes of U.S. dollars to the United States, is a red flag that illegal drug proceeds might be involved?

Mr. Cohen. I think financial institutions have in their anti-money laundering programs a whole series of factors that they look at to determine whether what is happening is normal, typical behavior or something out of the ordinary and whether it spikes in the amount of bulk cash coming in or other sort of anomalous activity. Those are the sorts of things that a well-tuned anti-money laundering program should identify and cause a financial institution to look at more carefully.

Senator Levin. OK. Senator Coburn.

Senator Coburn. Thank you.
Mr. Cohen, in your testimony, you stated that when safeguards are not stringently enforced, illicit actors are able to take advantage of the U.S. financial system. If they were all enforced 100 percent of the time, basically what I am hearing is they would still be able to take advantage of the U.S. financial system because when you blend good with bad from a legitimate organization—so what are the next steps to limit that down?

Mr. COHEN. Well, Senator Coburn, I would draw a distinction between the OFAC list, the SDN list, and anti-money laundering programs in responding to this question. A properly functioning compliance program with respect to the SDN list should prohibit anybody on that list from getting access to any U.S. financial institution because banks can run the filter, run the names, and if a transaction is coming through from someone who is on the SDN list, it should be stopped.

Preventing money laundering is a more difficult task, and the regulatory structure that we have implemented and that Congress has legislated through the Bank Secrecy Act and the PATRIOT Act and other amendments to Title 31 require a risk-based approach by financial institutions to have an anti-money laundering program that is appropriate given the risk that the bank faces across the range of its activities.

Every bank is going to approach this in a slightly different way, and every bank has a slightly different risk profile given its customer base domestically and how they interact with affiliates and non-affiliates overseas.

I do not think anyone expects to ever achieve a financial system where there is absolutely no money laundering, but it is also the case that when financial institutions do not implement robust anti-money laundering programs across the range of their activities that is appropriately tuned to the risk that they face, there is a greater opportunity for illicit acts to get access to——

Senator COBURN. So whose responsibility is it to see that the banks do just that?

Mr. COHEN. Well, I think it is all of our responsibility——

Senator COBURN. No, but it is specific to the Treasury, right?

Mr. COHEN. Sure.

Senator COBURN. It is the Treasury Department. Who in the Treasury Department is responsible for that? What agency?

Mr. COHEN. Well, my office is responsible for helping to set policy. We have obviously the OCC, which is part of the Treasury Department, that is a bank regulator. It undertakes its regulatory activities independently from the Secretary of the Treasury by statute.

Senator COBURN. Right.

Mr. COHEN. There are obviously other bank regulators as well that regulate other financial institutions.

Senator COBURN. But it is not necessarily that we do not have enough good regulations. Part of the problem is that the regulations we have are not being monitored and enforced properly. Would you agree with that statement?

Mr. COHEN. Senator, I think as we continue to work on the issue of money laundering, I think we need to look both at the regulatory structure itself and see whether there are modifications that would
be appropriate. And I also think we need to look at how effectively
the regulators are overseeing financial institutions——

Senator Coburn. Well, I think we have seen that. Our investiga-
tion is going to show a lot of lack of effectiveness. As a matter of
fact, it does show a lot of a lack of effectiveness. So the point I am
trying to get to is we can write all the rules and regulations in the
world, but if they, in fact, are not carried out by the bureaucracy
assigned to do that, it does not matter. So the whole point is: Do
we write a whole bunch more regs? Do we make it even more com-
licated?

One of the questions I had for you I am not going to ask. I will,
if I may, Mr. Chairman, send supplemental questions to both of
these witnesses. Of the people that are doing it right—and I am
going to ask HSBC this, too. What is the cost of compliance with
this as a percentage of the volume in their banks? And is there
going to become a point at which it is not worth dealing with us?
In other words, can we do it more effectively and more efficiently?
And are we doing the right things?

Mr. Cohen. Well, Senator, I think we are looking at, as I said,
whether the regulatory structure needs some modification, not to
make it more complicated but to make it more effective. I think we
are looking at whether the financial institutions themselves need
to do a better job in complying with the regulations. And we are
working very closely with the bank regulators across the spectrum
of regulators, both bank regulators and the regulators in the secu-
rities industry, to talk about how we all can do a better job of over-
seeing compliance in the regulated industries.

Senator Coburn. Thank you.

Mr. Winchell, just one question. I am going to submit my ques-
tions for the record to both of you, if I might, and have you respond
to them, hopefully in a timely fashion. You talked about your out-
reach efforts have resulted in the initiation of 950 criminal inves-
tigations. Did HSI agents identify the illicit funds or did the banks?

Mr. Winchell. It was usually the banks that—I would think I
would be safe in answering that question. Our outreach efforts are
an attempt to educate them on the red flags, and then they would
bring those to our——

Senator Coburn. So you are getting some response?

Mr. Winchell. Yes, sir.

Senator Coburn. All right. And does your Trade Transparency
Unit include partnerships with countries other than Central and
South America?

Mr. Winchell. Our Trade Transparency Unit continues to grow.

Senator Coburn. But where is it now? Is it mainly Central and
South America?

Mr. Winchell. It is primarily Central and South America, but
it is expanding towards the Philippines and others, now.

Senator Coburn. And one thing I will ask you. Prepaid cards
and stored value devices seems to be a new, novel method. I would
love in the response to my questions from both of you on that, how
are we going to handle that one? That one seems even more dif-
ficult.

Mr. Winchell. That one is a bit of a challenge for us; particu-
larly as the individual crosses back and forth across the border in
bearer form, it is basically a bearer instrument. Of greater concern to us are the loadable and reloadable cards.

Senator Coburn. All right. Thank you, Mr. Chairman.

Senator Levin. Thank you very much, Senator Coburn.

I just have one more question. You touched on this in the answer to Senator Coburn’s question. Just explain for us, if you would, Mr. Cohen, very simply, what the SDN list is, what the OFAC filter is, and how the OFAC filter relates to the SDN list and why these are important.

Mr. Cohen. Sure. The SDN list is the compilation of individuals and entities that have been subject to sanctions under the range of sanctions programs that OFAC and the Treasury Department implement. These sanctions programs cover illicit actors like terrorist financiers, weapons proliferators, transnational organized criminal groups, narcotics traffickers, as well as rogue regimes—Iran, North Korea, Syria, and others. Everybody who is subject to sanctions under those sanctions programs appears on the SDN list. This is a list that is published by OFAC, available to every financial institution, and by and large, financial institutions incorporate this list into their compliance programs and screen transactions coming through their financial institutions against this list, because everybody who appears on that list is forbidden from dealing with any U.S. person, including any U.S. financial institution, and their assets are to be frozen.

It is critically important that financial institutions run the OFAC list in their filters so that our sanctions programs are effectively implemented. We rely on financial institutions to ensure that those for whom we have applied sanctions are not able to access the U.S. financial system. That makes our sanctions programs, which at root are designed to pursue our most important national security and foreign policy objectives, as effective as they can be.

Senator Levin. How effective is the OFAC filter, in your judgment?

Mr. Cohen. There are some notable examples of situations where financial institutions have taken steps to try and evade the OFAC filter. We have over the course of the last 5 or 6 years entered into a number of significant settlements with major financial institutions that all have essentially the same fact pattern, which is that the foreign financial institution was stripping information from transaction messages running through the United States as a means to evade their U.S. partners’ OFAC filter. Those are very important cases for us and I think illustrate how seriously we take this issue. But, at the same time, I think by and large, U.S. financial institutions do a good job of incorporating into their compliance programs the list of names and entities that are on the OFAC SDN list and screening transactions to prevent access to their institutions by those who are subject to sanctions.

Senator Levin. Will you put in your words now—I asked Mr. Winchell this before. Put in your words why it is that these entities we are trying to keep out of our financial system try to get into our financial system. Why is it that they make this effort, in your words?

Mr. Cohen. I think the simple answer is if you can run money through the United States, it helps to create an air of legitimacy
to those funds that makes it easier for you to then make use of those funds for whatever purpose you want to put them to. And if this is dirty money that you are trying to portray as clean funds, being able to run it try the U.S. financial system helps you achieve that objective.

Senator LEVIN. And makes you stronger.

Mr. COHEN. It helps you achieve whatever illicit objective it is that you are trying to achieve, whether it is weapons proliferation, terrorist financing, or any of the other activities that are the subject of our sanctions, all of which we are trying to combat by weakening their financial support.

Senator LEVIN. It helps you achieve the very activities that we are trying to stop.

Mr. COHEN. It does.

Senator LEVIN. Do you have any additional questions?

Senator COBURN. No, but I would make one observation. The better we get, the more they are going to want to be here. That is one. And number two is it is hard for us to know what an excellent anti-money laundering system is because we can always do better. But I would remind us that the cost of that is borne by the banks, which is ultimately the American consumer. And so efficiency in how we do this and the worry about too much—in other words, for the next regulation, what are we achieving for it? Cost-effectiveness has got to be part of our concern as we look to handle this.

Thank you, Mr. Chairman.

Senator LEVIN. Thank you very much, Senator Coburn.

There will be additional questions for the record for you both, and that will be true with all of our panelists this morning and afternoon. And talking about this afternoon, I think we have talked to your staff about it, Senator Coburn. The likelihood is that we will need to break at some point here for lunch. We will see how quickly the next panel goes.

We thank you both. We thank you and your agencies for the work that you do. It is critically important to our Nation's security, and you are excused.

Mr. COHEN. Thank you, Mr. Chairman.

Senator LEVIN. We will now call our second panel of witnesses for this morning's hearing: David Bagley, the head of Group Compliance of HSBC Holdings in London; Paul Thurston, Chief Executive for Retail Banking and Wealth Management at HSBC Holdings in Hong Kong; Michael Gallagher, the Former Executive Vice President and Head of PCM North America for HSBC Bank USA in New York; and, finally, Christopher Lok, the Former Head of Global Banknotes at HSBC Bank USA in New York.

We appreciate all of you being here this morning. We look forward to your testimony. And as you heard, we have Rule VI, which requires that all witnesses who testify before the Subcommittee are required to be sworn, so we would ask each of you to please stand and raise your right hand. Do you swear that the testimony that you are about to give will be the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. BAGLEY. I do.

Mr. THURSTON. I do.

Mr. GALLAGHER. I do.
Mr. Lok. I do.

Senator Levin. The timing system that we will be using today will give you a warning 1 minute before the red light comes on, and than it will shift from green to yellow. It will give you an opportunity to conclude your remarks. Your written testimony will be printed in the record in its entirety. Please try to limit your oral testimony to no more than 5 minutes each.

Before you start, I want to thank HSBC for their cooperation. As I said in my opening statement, HSBC was totally cooperative with this investigation. We appreciate that.

So, Mr. Bagley, I guess we are going to have you go first followed by Mr. Thurston, then Mr. Gallagher, and then Mr. Lok. And then we will turn to questions. So, Mr. Bagley, please proceed.

TESTIMONY OF DAVID B. BAGLEY, HEAD OF GROUP COMPLIANCE, HSBC HOLDINGS PLC, LONDON, ENGLAND

Mr. Bagley. Thank you. Good morning, Chairman Levin, Senator Coburn, and Members of the Subcommittee. My name is David Bagley. Thank you for the opportunity to be here today. I have submitted written testimony, but in the interest of time, I have confined my remarks to a few points.

Since 2002, I have been the head of Group Compliance at HSBC Holdings plc, which is the global parent of HSBC. Having been a compliance officer for 13 years in a bank that operates in approximately 80 jurisdictions worldwide, I have dedicated my career—not only within HSBC but through my broader industry work as well—to meeting the significant challenges that confront global banking institutions in the world we live in. I have followed the work of this Subcommittee and have seen how your work has advanced important dialogues and helped the international banking community, including HSBC, identify and address potential vulnerabilities.

My chief focus as the head of Group Compliance at HSBC has been promoting the values that we, as a bank, have set for ourselves and the values that you and our regulators, both in the United States and around the world, rightly expect from a global bank like HSBC. And while there have been successes on many compliance issues, I recognize that there have been some significant areas of failure. I have said before and I will say again: Despite the best efforts and intentions of many dedicated professionals, HSBC has fallen short of our own expectations and the expectations of our regulators. This is something that a bank seeking to conduct business in the United States and globally must acknowledge, learn from, and, most importantly, take steps to avoid in the future.

The group has always had as a core element of its compliance policy a focus on both the letter and the spirit of laws and regulations, not just what is permissible but what is prudent and responsible.

In hindsight, as I reflect on the dialogue from 2002 to 2007, and specifically the wider lessons learned out of both the OFAC and Mexico issues, I think we all sometimes allowed a focus on what was lawful and compliant to obscure what should be best practices

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1The prepared statement of Mr. Bagley appears in the Appendix on page 111.
for a global bank. Transparency is a principle that HSBC and every bank should always make a top priority, even when it is not legally required. I think that with our revised structure and approach, this is where we are today.

Indeed, we have learned a number of valuable lessons, and the bank is well along the way of converting those lessons into solutions. As I expect my colleague, Stuart Levey, to describe in some detail, HSBC is in the process of shedding the historical compliance model that the bank has outgrown. This departure from the old model is very significant. Our former compliance structure was a product of historical growth by acquisition, and it was a major factor behind some of the issues that I expect we will be discussing today.

Under the former model, my mandate was limited to advising, recommending, and reporting. My job was not to ensure that all of our global affiliates followed the group's compliance standards, and I did not have the authority, resources, support, or infrastructure to do so. Rather, final authority and decisionmaking rested with local line management in each of the bank's affiliates.

Now a major overhaul is underway. The new compliance model is a product of deep reflection and is tailored to address today's challenges as well as the inevitable challenges of tomorrow. Significantly, the Group Compliance function now for the first time has authority over the compliance departments at every one of the bank's affiliates. This is a stark break from the past. Now Group Compliance has both the mandate and the resources to ensure that affiliates are compliant. In other words, for the first time, Group Compliance is an advisory and a control function. In addition, personnel at the affiliates are now accountable to Group Compliance for their conduct.

Second, under the new model, Group Compliance oversees the bank's nearly 3,500 compliance officers worldwide and takes the lead on decisions about resource allocation, compensation, objectives, strategy, and accountability.

Last, while I do not have the time to describe all of the recent enhancements, I would like to emphasize the creation of our assurance function. In short, the authority of the head of Group Compliance and, therefore, the function as a whole is greatly increased.

As I have thought about the structural transformation of the bank's compliance function, I recommended to the group that now is the appropriate time, for me and for the bank, for someone new to serve as the head of Group Compliance. I have agreed to work with the bank's senior management towards an orderly transition of this important role.

Thank you for your time. I welcome this opportunity to answer any questions.

Senator LEVIN. Thank you very much, Mr. Bagley. Mr. Thurston.
Mr. THURSTON. Thank you and good morning, Chairman Levin, Senator Coburn, and Members of the Subcommittee. My name is Paul Thurston. I am the Chief Executive of Retail Banking and Wealth Management for the HSBC Group. I have submitted written testimony, but in the interest of time today, I will confine my comments to a few points as well.

I have worked in the banking industry for 37 years, and I have served at various roles in HSBC around the world. I was the Chief Executive of HSBC for 14 challenging and stressful months beginning in February 2007.

When I arrived in Mexico, I set out to find out the most important business issues and risks that there were in the business. I met with business heads, risk management, audit, and also with the regulators, and it became clear that a number of group systems and policies had been put in place by that time but that this was not HSBC as I knew it. There were significant weaknesses in the control infrastructure, and these weaknesses existed in Know-Your-Client (KYC) and AML management and in other areas of the bank as well, including credit risk management, card fraud prevention, technology, and management information.

As I investigated these issues and tried to assess why the problems persisted, I came to learn that they were exacerbated by a business model and a performance management system that we had inherited from the former Bital Bank that was heavily focused on business growth rather than control.

I should add that we were operating in an external environment in Mexico that was incredibly challenging. Bank employees faced very real risks of being targeted for bribery, extortion, and kidnapping. And, indeed, there were many kidnappings during my tenure, and high levels of security were required for staff working in Mexico. In addition, unlike the United States, Mexico was a data-poor environment, making it difficult to verify the identity of customers.

Some of the things I found, frankly, took my breath away. But every time I found a weakness, I tried to ensure that we took action, not just in dealing with the immediate issues but also in setting up programs to improve the infrastructure, processes, and business model for the future. I frequently requested audit and group compliance reviews to be scheduled so that I would have an independent review of progress, and I kept the board, the regional audit committee, and group management informed of everything that I saw and did. And I also ensured that we cooperated fully with the regulators, as indeed the group has done with this investigation.

Effective AML depends upon properly knowing your customers, and this was a major area of concern to me, with substandard files and KYC documentation housed across a network of 1,300 branches. I committed to invest in technology and people, to centralize the review of all files for all new and existing accounts, and to keep central records that could be used for ongoing alert man-

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1 The prepared statement of Mr. Thurston appears in the Appendix on page 116.
agement. I recognized that this would take time to develop and install, but it would give us a more robust platform, provide more reliable reports, and improve the quality and speed of remediation once implemented.

I believe that we made real progress at HSBC Mexico during my short tenure. We changed the business model, the performance management systems, and we enhanced our compliance systems. But, clearly, after only a short period of time, there was still much work to be done upon my departure in April 2008, and the scale of the remediation work alongside an escalating drug war in Mexico and ever more adept criminals continued to raise challenges and new issues.

After I left, further steps continued to be taken. Decisions were made to stop U.S. dollar cash handling in Mexico. We closed branches in areas where there was a high risk of money laundering. We are now in the process of closing all the HSBC Mexico accounts in the Caymans. We will continue to scrutinize our business in Mexico to determine how we can further mitigate compliance risk.

We know that criminals operate globally, and as an international bank, we will be a target. We have to be sure that we have the best and strongest defense in place in every business, in every market in which we operate, regardless of the local challenges, and we are committed to doing this. We know we should have done this better, sooner.

There are many learnings in our experience in Mexico for us and others, and I will be pleased to answer any questions that you have.

Senator Levin. Thank you very much, Mr. Thurston. Mr. Gallagher.

TESTIMONY OF MICHAEL GALLAGHER, FORMER EXECUTIVE VICE PRESIDENT, HEAD OF PCM NORTH AMERICA, HSBC BANK USA, N.A., NEW YORK, NEW YORK

Mr. Gallagher. Good morning, Chairman Levin, Senator Coburn, and Members of the Subcommittee, my name is Michael Gallagher, and I reside in Lincroft, New Jersey. From 2001 until last year, I was an Executive Vice President at HSBC Bank USA, also referred to as “HBUS,” and I was responsible for the Payments and Cash Management Business in North America. On November 21, 2011, I was subject to a reduction in force at the bank and, therefore, have not been a member of the bank for the past 8 months.

During my time at HSBC, PCM developed and marketed payments and cash management services to corporate middle-market clients as well as financial institutions, including HSBC-affiliated banks. While PCM generally did not manage the various operational units within PCM processing PCM products, we worked very closely with our operations colleagues to manage and maintain the expected standards of quality and control.

I understand the Subcommittee is interested in HBUS’s anti-money laundering efforts. During my tenure at HBUS, my team

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1 The prepared statement of Mr. Gallagher appears in the Appendix on page 124.
and I took compliance matters very seriously. We were active participants in the efforts of the compliance department to ensure safety and soundness. PCM assisted the compliance department operations as well as relationship managers in this regard. In instances, when PCM became aware of negative information regarding the client, PCM worked closely with the compliance department operations and the relationship managers to ensure that they received the information they needed.

PCM also made resources available to relationship managers and the compliance department to assist in any way that we could. At various times, PCM made staff available or seconded these staff to different departments to assist in various projects and problem resolution.

In summary, I would like to thank the Chairman of the Subcommittee for allowing me to speak at the hearing on these critical matters. Anti-money laundering, terrorism financing, and global access to the U.S. financial systems are issues of critical importance to the banking industry, to national security, and to me.

HSBC and the banking industry as a whole have learned many important lessons over the past decade or so. I believe that HSBC’s experience, especially in light of its uniquely global footprint, can add real value to understanding more broadly the risks and opportunities for enhance safety in this industry.

During my time at HSBC, there were steps taken to tighten anti-money laundering controls, and I understand that significant progress has been made in this regard since my departure. But with hindsight, it is clear that we did not always fully understand the risks of our businesses or the challenges of the global, cross-border nature of the business. It is clear that we could have done much more and done it more quickly.

I appreciate the opportunity to provide this information to the Subcommittee, and I am prepared to answer any additional questions that the Subcommittee may have at this hearing. Thank you.

Senator Levin. Thank you very much, Mr. Gallagher. Mr. Lok.

TESTIMONY OF CHIU HON “CHRISTOPHER” LOK, FORMER HEAD OF GLOBAL BANKNOTES, HSBC BANK USA, N.A., NEW YORK, NEW YORK

Mr. Lok. Good morning. Chairman Levin, Senator Coburn, and Members of the Subcommittee, I appreciate the opportunity to be here today. My name is Christopher Lok, and from 2001 until 2010 I served as the global head of the banknotes business at HSBC.

In my statement today, I will cover three topics. First, I will provide my background. Second, I will provide an overview of the banknotes business at HSBC. And, third, I will address some of the specific problems and issues that I believe the Subcommittee is interested in.

For me, it is painful and embarrassing to talk about the areas where, in hindsight, we fell short. At the same time, it is valuable to do so in order to find constructive solutions and so that others do not make the same mistakes going forward.

1The prepared statement of Mr. Lok appears in the Appendix on page 127.
I was born and raised in Hong Kong. In 1981, I started working in the banknotes business, and that is what I did for 29 years. During the entire time from 1981 through 2010, I worked for HSBC or a predecessor institution. For most of my career I was based in Asia, but I was privileged to have lived and worked in New York for a brief period in the 1990s and again from 2001 until 2010. Even though I am not a U.S. citizen, I had a wonderful experience living and working in this country, and I have a great admiration and affection for the United States.

I would like to provide a brief overview of the banknotes business. In essence, the business is about the buying and selling of physical currency at the wholesale level. Our clients were banks and other financial institutions around the world. We employed about 275 people, including traders, back office staff, and people who focused on operations and logistics. We dealt with approximately 800 customers in over 100 countries, and we transacted in about 75 different currencies. These customers have natural demand for and supply of currency banknotes, driven by various economic activities. To them, HSBC was a safe and reliable counterparty, and I believe that we provided them with a valuable service.

I understand that the Subcommittee is focused on some of the compliance challenges that we faced in the banknotes business. Let me start by emphasizing that compliance was a critical part of the HSBC banknotes business. Over a period of years, there were some occasions when I communicated with my colleagues in compliance in a manner that was unnecessarily aggressive and harsh. These communications were unprofessional, and I deeply regret them.

In reality, the business line and compliance shared the same objective: To avoid the bank being used by inappropriate people for improper transactions. Despite my overly critical emails, I believe banknotes business and compliance people actually had a good working partnership. While I did not always communicate this, I had great respect for my colleagues in compliance, and I valued their work.

With respect to banknotes transactions with customers in Mexico, up until December 2008 I was under the impression that HSBC’s Mexican affiliate, HBMX, was operating under HSBC group standards. In December 2008, HBMX announced that it would no longer be accepting U.S. currency in Mexico. I was surprised by this announcement, and I tried to find out what was the reason behind it. It was not until early 2009 that I learned, as a result of my own inquiries, that HBMX had gotten into problems because their anti-money laundering controls were seriously compromised. I was surprised and concerned about this news. I was not previously aware of the AML problems at HBMX. If we had known of these problems, I am certain that we, in the banknotes business, would have done things differently.

As time went by, some questions were raised about the banknotes business in Mexico. In retrospect, we did not adequately appreciate the concerns being raised about the business environment in Mexico. While we did our best to deal with these inquiries, I am sorry to say that I did not understand what later became apparent.
With the benefit of hindsight, it is now clear that we did not perceive the extent of the anti-money laundering deficiencies and the risks present in Mexico. Thank you very much.

Senator Levin. Thank you very much, Mr. Lok.

Let us have a 10-minute first round, if that is all right. Does that give you enough time?

Senator Coburn. Yes.

Senator Levin. Because we will have more than one round.

Mr. Thurston, HBMX was a bank that had a longstanding severe money-laundering problem, and we describe this at length in our report. The bank was purchased in 2002. You did not arrive until 2007. Take a look, if you would, at the exhibit book, Mr. Thurston, in front of you there, Exhibit 1b.1 What we have done here is we have put together a chart summarizing some of the exhibits. Just a few highlights from those exhibits, which are really a litany of money-laundering deficiencies at HBMX from 2002 to 2009.

The first reference is to 2002 in this exhibit. Here is what the audit found: “There is no recognizable compliance or money laundering function” at Bital. That is the bank that you bought. That is 2002.

Then in 2005, 3 years later now, “senior persons within the compliance function fabricated records of certain mandatory anti-money laundering meetings.” This quote is taken from Exhibit 12,2 but we put together these quotes on this Exhibit 1b.

Now, the fabrications were ordered by the head of the anti-money laundering compliance program who was asked then to leave the bank. This email was sent by Mr. Bagley to Stephen Green, who was then CEO of the HSBC Group.

Next, 2007. This is a quote from a July 7, 2007, email from a senior compliance person at HSBC Group, John Root. It is taken from Exhibit 19.3 It is an email to the head of HBMX compliance after finding out that the anti-money laundering committee allowed three different high-risk accounts with suspected illegal drug proceeds to stay open, and he writes, “What is this, the School of Low Expectations banking?”

Then in 2008, this is a statement from HBMX’s own AML director who was leaving that Mexican affiliate, and he was participating in an exit interview with Mr. Bagley, and he said the following: That there were allegations of 60 percent to 70 percent of laundered proceeds in Mexico going through HBMX. He also stated that HBMX executives did not care about AML controls. That comes from Exhibit 30.4 This is 2008.

And then another quote from Mr. Bagley in 2008: “What I find most frustrating is the way in which new issues constantly emerged, however much time is spent with HBMX.”

In 2009, a statement from an email from Mr. Bagley to the CEO of HSBC Latin America, Mr. Alonso: “The inherent anti-money laundering risk in Mexico is still very high.”

So this had been going on for 7 years, money-laundering problems at the HBMX bank, the Mexican affiliate.

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1 See Exhibit No. 1b, which appears in the Appendix on page 576.
2 See Exhibit No. 12, which appears in the Appendix on page 634.
3 See Exhibit No. 19, which appears in the Appendix on page 673.
4 See Exhibit No. 30, which appears in the Appendix on page 703.
So, Mr. Thurston, when you arrived in 2008, you began immediately making some changes. The problems that you faced had been longstanding. They were not corrected before you got there, and some of them, plenty of them, were not corrected until you got there, and then some remained and they were corrected, some of them, after you left.

Why did you discover that these had festered for so many years? What was there about that bank, that culture that you discovered that allowed these things to go on and on and on? These are not thing which were discovered later. These were known at the time. Emails show that they were known at the time. A number of you have talked about hindsight. These are contemporaneous emails. This is not something discovered in hindsight or learned in hindsight. This is something that people knew was going on at that bank. Why was it allowed to continue? What did you find when you got there?

Mr. THURSTON. Thank you, Mr. Chairman. My assessment was that starting from before the acquisition, this bank had been a fast-growth bank. In fact, that was the reason why it got into trouble, and that was the reason that we were able to acquire it. It grew fast, but it had no controls. The business model was completely decentralized. All the files, all the decisions were taken in a distributed branch network. It was very difficult from the center to get controls, and there was a very strong incentive scheme that backed continued volume growth rather than quality of controls.

A number of steps were taken to install group processes and group systems, but if you are confronted with that, as I said in my opening remarks, you need to address the business model that is underneath it and put something systemic in. So one of the steps that I took was to create this centralized platform where, instead of relying on 1,300 branches to do the KYC, we would have all of those papers imaged to a central site where we could check and see that we had all the documents, that we had all the papers, and if we did not, then we would not open the accounts.

But that kind of investment takes time, and there was a significant remediation task to be done to put right the files from the past. So there were multiple problems that existed in the bank, as I saw it when I was there.

Senator LEVIN. These were problems which were known for years. This is not something which was looking back. This is something which year after year after year, starting in 2002, was known by this bank. And yet these problems festered for years.

Here is another email, Exhibit 36.¹ This was an HSBC Group deputy head of compliance, a 2008 email. Now, he had been sent to Mexico to try to get a handle on money-laundering problems there. One of the problems discussed was a backlog of 3,600 accounts that were supposed to be closed but were not, including 675 which had been identified as potentially involving money laundering that had been ordered closed by HBMX’s anti-money laundering committee, known as CCC, or Triple C. Here is what the email noted, and this is Exhibit 36: That of the 675 accounts, 16

¹ See Exhibit No. 36, which appears in the Appendix on page 726.
had been ordered closed in 2005, 130 in 2006, 172 in 2007, 309 in 2008. So it took 3 or 4 years to close a suspicious account.

Now, is there any way that should have been allowed to have happened at the time? Forget the business case and anything else.

Mr. THURSTON. No, Senator.

Senator LEVIN. Now, another problem involving HBMX was the committee at the bank which was mandated under Mexican law and is composed of both business and compliance personnel charged with resolving anti-money laundering issues, such as what accounts should be closed.

In July 2008, after the CCC committee decided to allow several suspect accounts to remain open, a senior compliance official at HSBC Group, John Root—so now this is the group now—sends a blistering letter to HBMX compliance head, Mr. Garcia, at Exhibit 19.1 I am going to read from this exhibit. “A number of items jump out from your most recent weekly report . . . but everything pales in comparison with the [money-laundering] items on page 4,” he writes. “It looks like the business is still retaining unacceptable risks and the AML committee is going along after some initial hemming and hawing. I am quite concerned that the committee is not functioning properly. Alarmed, even. I am close to picking up the phone to your CEO.”

“What on earth is an ‘assumption responsibility letter’ and how would it protect the bank if the client is a money launderer? Please note,” he writes, “that you can dress up the USD 10 million to be paid . . . to the U.S. authorities as an ‘economic penalty’ if you wish but a fine is a fine is a fine, and a hefty one at that. What is this, the School of Low Expectations Banking? (‘We didn’t go to jail! We merely signed a settlement with the Feds for $10 million!’)”

“So,” he said, one problem was “strike one.” Another is “strike two. Let’s now look at strike three,” he writes. “(I hope you like baseball.)”

“The same person who is giving”—this is his writing—“the sacrosanct ‘assumption responsibility letter’ . . . is being asked by the CEO to explain why he retained Casa de Cambio Puebla relationship after USD 11 million was seized by the authorities in Puebla in an account with Wachovia in Miami. What?! The business was OK with this?”

And then he says, “The [anti-money laundering] committee just can’t keep rubber-stamping unacceptable risks merely because someone on the business side writes a nice letter. It needs to take a firmer stand. It needs some cojones. We have seen this movie before, and it ends badly.”

Why is it that the bank—the bank that is the group bank—that sees these kind of problems just does not flat out hold some folks accountable and fire some folks? I mean, they can write this kind of a letter, and they did, and we dug this out of the emails. Why, if the folks running this bank are so bad, why isn’t action taken against them by the parent bank?

Mr. THURSTON. Mr. Chairman, in the time that I was in Mexico, we were very firm on discipline. We took strict disciplinary action

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1 See Exhibit No. 19, which appears in the Appendix on page 673.
against many members of staff, even at senior management levels, including dismissals. So we were certainly taking it seriously within Mexico.

Senator Levin. My time is up. Thank you. Senator Coburn.

Senator Coburn. I want to go to Mr. Bagley for a moment, if I might. I think your testimony was that you were in charge of compliance, but you had no essential line authority to enforce that compliance. Is that correct?

Mr. Bagley. That is right. The core responsibility of Group Compliance was to set policy, to report, to escalate issues when they were reported to us, but we did not manage and control the individual compliance departments in each one of the affiliates or subsidiaries.

Senator Coburn. Those individual compliance departments in those subsidiaries reported to the head of whatever that subsidiary was, correct?

Mr. Bagley. There were two reporting lines: One to the Group Compliance team for reporting and other reasons, and then another line to the local CEO or business head.

Senator Coburn. And I think it was also your testimony that had now been changed and that there is a line function for compliance from corporate HSBC all the way down to every bank. Is that correct?

Mr. Bagley. It has fundamentally changed in that the hardest line of reporting is now through the function, so I am accountable, responsible, and have authority over the whole function globally, 3,500 people across the group, and that means I control resource, allocation, budget, remuneration, the performance and the function, and can ensure that the adequate resources, the right amount of money is spent on this effort. It is a radical shift, a significant change.

Senator Coburn. There is the answer to the question you asked. In other words, there is no line authority—you can have a compliance officer all you want. If they have no line authority to cause people to change actions and the same people they are guiding have a line authority that says here is your profit, how well our affiliate or our subsidiary does, one of those is going to have more power than the other. Thank you.

Mr. Gallagher, you said in your testimony, “But with hindsight, it is clear that we did not always fully understand the risks of our businesses” and “that we could have done much more and done it more quickly.”

Looking at the whole of this, that to me is almost an unbelievable statement when you have things going on in Mexico, things going on elsewhere. It is almost like you were not aware that these things were happening?

Mr. Gallagher. It is a fact that there are certain things that we were not aware were happening. Within certain entities that is true.

Senator Coburn. What were the efforts made to try to become aware of what was happening? My natural inclination is to say you were not—did not fully understand the risk or you ignored reality, based on the testimony and the data that we have collected from
inside your own operations. Would you just expand on that a little bit so I can gain a clearer understanding?

Mr. GALLAGHER. Yes, I appreciate the question, and I share your concern on this matter. One of the lessons we have certainly learned is the sharing of information not only throughout the organization across various operations and silos, as it were, but across geography is something that requires significant improvement. I am led to believe that has improved significantly since I left, and even during my time there, there was improvement in the process. But heretofore it was not easy to move information across organizations and to filter it down to the appropriate levels to get action.

Compliance and monitoring was our first level of finding issues and looking after them, and whenever we found issues, in my experience, I believe we inquired, we reacted, and we pursued. So I think we did a lot at the time, but as has been said by others this morning, we have learned a lot as we have gone along.

Senator COBURN. OK. Thank you.

Mr. Thurston, in early 2007, right when you started, one of HBMX’s clients was Zhenli Ye Gon, a reported drug lord who got caught selling precursor chemicals for methamphetamine production for La Familia and the Sinaloa cartels. When you learned that Mr. Ye Gon was a client of HBMX, what was your reaction? What did you do?

Mr. THURSTON. Well, I was horrified by the case, and this really exposed a whole series of weaknesses within the bank. So I personally conducted an investigation. I brought in the audit team. I brought in the security and fraud team. I brought in the compliance team. And we made a number of changes. This is where I found, for example, the business heads were overriding the people in the Compliance Department on decisions on accounts. So I put up an escalation process so that Compliance had a route to the chief operating officer and then to me if they were not comfortable with the decisions that were being made through that legal committee.

I looked at the fact that we had here a business account that was being managed in the personal consumer part of the bank, which would make it very hard for people then to spot the underlying activity and compare it with normal activity. So we made a number of changes about that, and that is where we started to—we dismissed a number of people who had falsified visit records, not been to visit the premises when they said they had. That is when I realized that practice existed.

We looked to see if there was any sign whatsoever of any collusion. We investigated all the staff’s accounts. And as a result of that, we found some incidents of staff lending to each other, so we created policies on that.

So there were a whole series of actions that stemmed out of finding that incident.

Senator COBURN. There was, in fact, significant attention from the compliance officer at that time, correct? Prior to your knowledge of it, that had been raised as an issue.

Mr. THURSTON. That is correct, Senator Coburn.

Senator COBURN. All right. Thank you.
During your tenure at HBMX, I understand that law enforcement in Mexico raised concerns about high-risk money laundering at HBMX. Why was it that the Mexican legal authorities think now today that your record was worse than any other bank in Mexico? Is it a fact or is there some assumptions there that the Subcommittee should know about?

Mr. Thurston. They found that whenever they wanted information from the banks, HSBC was one of the slowest to respond. So when they were conducting investigations, HSBC took longer to produce documents and had more challenges producing documents than most of the other banks. When we investigated that, again, we looked to see is this collusion, is this people deliberately trying to hold information from the authorities, and we found no sign of that whatsoever. But what we did find was a process where these things would go out to branches. Because all the files were held out in all the branches around the country and the quality was so poor, it would take a long time to collate effective information and get it back, and there were things that were missing, which is why the centralized program we had was so important. But we were also swamped with information requests. We had on average 1,000 a week coming from the regulators, not distinguishing between different types.

So we then set up a direct line with the financial intelligence unit within Mexico so that where they were conducting urgent investigations, they could come through straight to the bank so that we could respond more quickly.

Senator Coburn. OK. Thank you. I will yield back for right now.

Senator Levin. Thank you.

Mr. Thurston, you were at the bank there for a year, you have testified, and while there, you made some improvements. But the problems continued, and part of the reason was the nature of high-risk products and clients that the bank had, 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 the Caymans was run by HBMX itself using its own employees in Mexico. Any 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 have 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 pose significant money-laundering problems, and they do it as soon as they are organized because nobody knows who is behind those corporations. And here are 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 email by Mr. Root saying that “15 percent of the customers there did not even have a file.”

“Fixing the Cayman accounts will be a huge struggle.” He says, “How do you locate clients when there is no file?”

Exhibit 32 is a July 2008 email 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 to drug cartels.”

A later email, 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?

Mr. Thurston. It is what is called a cat B license, I believe.

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

Mr. Thurston. I know now, sir.

Senator Levin. And did you know about the problems at the Cayman accounts that I have just read?

Mr. Thurston. Mr. Chairman, no, I did not during the time that I was there, and on reading your report, I was really angry to find there had been an audit report on these in the previous year, but that it had been closed off with no action. 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.

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

Mr. Thurston. Correct, sir.

Senator Levin. Now, Mr. Bagley, you indicated to the Subcommittee during an interview that although you were aware of the accounts since 2002, the Cayman accounts, you focused on them only after a July 2008 incident involving funds going to buy planes for drug cartels. Now, I do not know, given the history here, how you could possibly not know of the severity of the problems involving the Caymans until that time, but in any event, after that incident, the new head of HBMX decided—and this is, I think, 2008 now—Mr. Pena decided to suspend opening new Cayman Island accounts.

So under Mr. Pena, HBMX initiated a review of the accounts, eventually closed 9,000 of them. But as of the beginning of 2012, there were still about 20,000 accounts with $670 million in assets. So two-thirds of the money-laundering risk continues.

So, Mr. Bagley, this Subcommittee really has found out that these kind of shell corporations in the Caymans and other places create all kinds of tax avoidance problems, but this is a different kind of an issue here. This is a money-laundering issue, and we

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1 See Exhibit No. 9, which appears in the Appendix on page 607.
2 See Exhibit No. 31, which appears in the Appendix on page 708.
3 See Exhibit No. 32, which appears in the Appendix on page 711.
4 See Exhibit No. 34, which appears in the Appendix on page 720.
have now two-thirds of those accounts which were in the Caymans, with that many assets apparently still sitting there. What are you going to do about it?

Mr. 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, revised and refreshed the KYC 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 are holding.

Senator Levin. Does that mean 20,000 accounts now that you are going to keep there?

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

Senator Levin. “No.” Well, that is the short answer, a very welcome answer, and particularly I think this Subcommittee can really look at its work as contributing to this kind of pressure on you to do the right thing.

Mr. 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 all be closed.

Senator Levin. That is good news.

Now, HBMX did not inform HBUS about the Cayman U.S. dollar accounts for many years. Is that correct, Mr. Gallagher?

Mr. Gallagher. Yes, sir, that is correct.

Senator Levin. So these transactions were run through the U.S. dollar correspondent account that HBMX had at HBUS. Would HBUS have wanted to know about these high-risk accounts in a secrecy jurisdiction? Would you have wanted to know that?

Mr. Gallagher. Absolutely.

Senator Levin. Do you know why you were not informed?

Mr. Gallagher. No, sir, I cannot answer that question.

Senator Levin. Maybe Mr. Bagley or Mr. Thurston. Why wouldn’t HBUS have been informed of those accounts?

Mr. Bagley. It is a very appropriate question. I think there are two or three reasons. One is that at that stage neither HBUS, as your report reflects, was conducting affiliate due diligence. Second, we at that time did not do affiliate due diligence across the rest of the group. And as a consequence, the questions that you would normally expect to be asked by one affiliate of another, one correspondent bank of another, were not asked. They are now.

Senator Levin. Under your new rules now, you are going to be notifying each of the affiliates of this kind of action?

Mr. Bagley. What we are doing and have introduced and are in the process of rolling out is affiliate due diligence across the whole group, so every affiliate will do due diligence on its own affiliates. That will be to the same standard as we apply to an entirely independent third party.

In addition, we have put in place a process that ensures that if there is a material AML deficiency or issue or risk in one affiliate,
See Exhibit No. 40, which appears in the Appendix on page 755.

That will be reported on a mandatory basis across the group and will automatically go to the head of compliance for each region. So what that will mean, when that work is complete, is that each affiliate will treat its affiliates at arm’s length, will ask all of the appropriate questions, will know everything that it needs to know about the risk profile that one affiliate presents to another.

Senator Levin. And when will this be put in place? You said it is being put in place. When will this be accomplished?

Mr. Bagley. We are rolling out—it will take a while, obviously, to complete those due diligence profiles. We will use the ones we have already completed for the United States in response to the cease and desist orders. We will do it as fast as we can. We have already put in place the mandatory reporting of AML deficiencies, and we have that up and running as a process.

Senator Levin. When will it be completed, do you know?

Mr. Bagley. I do not know exactly when it will be completed, but we will do the highest risk as quickly as we can.

Senator Levin. All right. Will you let the Subcommittee know when it is completed?

Mr. Bagley. I would be very happy to.

Senator Levin. Thank you very much. Senator Coburn.

Senator Coburn. Mr. Gallagher, if you would turn to Exhibit 40.1 The Bank Melli in Iran, prior to September 11, 2001, HSBC had a relationship with this bank in Iran which, because of its home country, would get more scrutiny in the United States. HSBC in Europe helped coach Bank Melli to send payments through the United States without getting slowed down.

Why was HSBC interested in doing business with this bank?

Mr. Gallagher. I cannot speak specifically for all of the reasons. The business desire was coming out of Europe and the Middle East, not coming out of the United States. There was a memo that described some opportunities that they saw for growth in business generally, but HBUS was not driving that business decision.

Senator Coburn. What was it exactly that made you say in this email, “I wish to be on the record as not comfortable with this piece of business”?

Mr. Gallagher. Yes, thank you. That is a very important question. I was very concerned about the lack of transparency in the proposal that had been put forward that described how the payments would flow. So in this particular case, there seemed to be an inability for the bank—that is to say, Melli—to describe in advance who its primary beneficiaries would be. That caused me to say we should not want to engage in business with a client who cannot provide that level of transparency to our system.

Senator Coburn. And so what was the response to that?

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1 See Exhibit No. 40, which appears in the Appendix on page 755.
Mr. GALLAGHER. Well, ultimately the transaction never was approved.

Senator COBURN. And do you know why?

Mr. GALLAGHER. Discussion went on for some time back and forth across the regions and the world. I do not recall the specific reason, but I was delighted to know that my recommendation was part of the solution.

Senator COBURN. Did you raise other concerns other than in this email that we have documented under Exhibit 40?¹

Mr. GALLAGHER. About Bank Melli specifically?

Senator COBURN. Yes.

Mr. GALLAGHER. I do not recall.

Senator COBURN. OK. If you would turn to Exhibit 57,² Iranian U-turn payments, in November 2004. This email suggests that some inside HSBC thought that all Iranian payments through the United States should be fully disclosed. Nonetheless, many payments still went through without full transparency, sometimes because information was removed by HBEU. This email says, “HBEU would be advised to not alter the payment details in any way.”

Was it well understood within HSBC that information was being removed from payments before they arrived in the United States?

Mr. GALLAGHER. I do not know how well understood it was, and I do not recall specifically some of these exchanges. But if I had to speculate, consistent with my earlier position, which was unchanged, regarding the importance of transparency in these messages, I am quite comfortable that the proper people were alerted and it was in the proper hands for resolution. But specific details on this I do not recall.

Senator COBURN. But the decision went really against your advice?

Mr. GALLAGHER. Yes.

Senator COBURN. Because, in fact, they were altered, correct?

Mr. GALLAGHER. It would seem so, yes.

Senator COBURN. OK. Do you have any idea how HSBC intended to make sure all these payments complied with U.S. law?

Mr. GALLAGHER. There was a view at the time that the team in London and/or subsequently elsewhere was going to ensure that the payments were going to be U-turn compliant before they got to the United States.

Senator COBURN. Do you think they were?

Mr. GALLAGHER. I do not honestly know specifically that they were not. Some of this information is slightly new to me in being involved in this investigation and catching up. So I do not know the specific answer to that question.

Senator COBURN. Who would know the answer to that question?

Mr. GALLAGHER. I would suggest either operational staff doing the work on the other side and/or possibly somebody in Compliance.

Senator COBURN. Should they have relied on people in Iran to do that?

¹ See Exhibit No. 40, which appears in the Appendix on page 755.
² See Exhibit No. 57, which appears in the Appendix on page 844.
Mr. GALLAGHER. No. Certainly, in retrospect, we should not have relied on anybody but ourselves to ensure the soundness of the payments coming into our system.

Senator COBURN. Mr. Lok, in your testimony, you said compliance was a critical part of the HSBC banknotes business.

Mr. Lok. Correct, sir.

Senator COBURN. Can you explain to me exactly what you mean by this? And tell me what it looked like.

Mr. Lok. We have a system in place whereby customers are risk-rated, and they are rated according to different categories, and then, therefore, the high-risk customers, we need to make sure that there is a process in place whereby the information about a client is laid out in the open so that people can come in, including the relationship managers, the business people, as well as compliance, so that we can evaluate the risk. And, finally, compliance has to be the final sign-off so that we can do business with these people. In other words, we consider compliance a very important partner in our business.

Senator COBURN. Did you recognize certain vulnerabilities in your compliance strategy in the banknote business?

Mr. Lok. At that moment, honestly, no.

Senator COBURN. You would agree that there were, though, in hindsight?

Mr. Lok. In hindsight, yes. Looking at all these documents, yes. The answer is definitely yes.

Senator COBURN. Just for our educational purposes and given your broad experience, are there certain challenges that are different in the banknote business related to specific currencies over other currencies?

Mr. Lok. I am sorry. Can you repeat the question?

Senator COBURN. Are there specific challenges in the banknote business in terms of compliance related to one currency over another, not necessarily in terms of geographic location, but, for example, is it easier to run a scam or play the game with the U.S. dollar, the British pound, the euro, the Japanese yen, the renminbi? In other words, does the same compliance vulnerabilities that you see now in hindsight apply differently to different currencies and different geographic locations?

Mr. Lok. At that moment, no, it did not strike me that there is a difference in terms of compliance risk because the policy itself spells out exactly how we run it, analyzing the risk. No, we were not—no. The answer is no.

Senator COBURN. All right. I will yield back.

Senator LEVIN. Let me ask some questions about the Sigue Corporation, which was a U.S. money service business that transmitted funds from U.S. clients to Mexico and Latin America. The Drug Enforcement Association undertook a sting operation in 2007 in which its agents told Sigue's operators that they wanted to send drug proceeds to Mexico, and more than two dozen of those Sigue operators obliged.

In January 2008, Sigue entered into a deferred prosecution agreement with the U.S. Department of Justice, admitting the facts, for failing to have adequate money-laundering programs. HBUS determined that in 2007 alone it had processed 159 U.S. dol-
lar wire transfers for Sigue involving about half a billion dollars, and they were all sent through the HBMX correspondent account with HBUS.

Then if you would look at Exhibit 18a, Mr. Gallagher, this was a memo that was prepared by HBUS after a 2008 Wall Street Journal article on the Wachovia case. It talks about the Sigue case and its use of the HBMX account, but it also notes that Sigue was not added to the HBUS filter so that it could be subjected to enhanced anti-money laundering to identify suspicious activity.

Now, you were the head of PCM at that time, Mr. Gallagher, and that handles wire monitoring. Do you know why HBUS did not subject Sigue to enhanced monitoring after the 2008 deferred prosecution agreement?

Mr. Gallagher. No, Mr. Chairman, I do not know. Looking at the memo, I note that I am not addressed on the memo. I cannot honestly recall if I saw the memo. But the decision as to whether or not to add any name to enhanced monitoring or to a filter, etc., is a decision that would be taken in Compliance, not in PCM.

Senator Levin. But you do not know why. You are saying it is not your department, but you just do not know why it was not added. Should it have been added?

Mr. Gallagher. Seemingly, absolutely it should have been added. I do not know why it was not.

Senator Levin. OK. In 2007—this is Exhibit 30—a man named Mr. Barroso, who was head of the HBMX anti-money laundering program, was leaving the bank. He had an exit meeting with you, Mr. Bagley, I believe, and according to a meeting summary that you wrote, Mr. Barroso told you that there were allegations that “60 to 70 percent of laundered proceeds in Mexico went through HBMX,” and he did not think that senior management had any commitment to robust anti-money laundering controls.

That memo, I believe, Exhibit 30, was written to you, Mr. Thurston, if I have that correct.

Mr. Thurston. That is correct, Chairman.

Senator Levin. What was your reaction when you got that memo?

Mr. Thurston. Mr. Chairman, I was incredibly distressed. I do not think anybody wants to hear those sorts of things coming through, so we made sure that we investigated. We made sure that we took the points that were there. We had recently had discussion with the regulators in Mexico, and we made sure that we took account of those points within the remediation program that we were looking at in Mexico to make sure there was nothing new that we had missed. It also caused us to question whether our head of compliance was sufficiently good for the role as well.

Senator Levin. All right. Let me now turn to the Iranian issue, which Senator Coburn asked some questions about as well.

Now, Iran had been subject to sanctions in the United States for a long time as a rogue nation. It had long been on the U.S. SDN list, as we heard about this morning, as a prohibited country. Our laws consistently prohibited U.S. persons from doing business di-

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1 See Exhibit No. 18a, which appears in the Appendix on page 654.
2 See Exhibit No. 30, which appears in the Appendix on page 703.
rectly with Iran, but until 2008, U.S. banks were allowed to process transactions that might involve Iran but which were sent to the United States by foreign banks located outside of Iran. Now, those transactions were called “U-turns” because they went from Iran to a non-Iranian bank, a foreign bank, then to a U.S. bank and then back to a different non-Iranian foreign bank and then to the final party. So there was a U-turn that was made through the U.S. bank.

The issue with HBUS is that the HSBC affiliates in Europe and the Middle East wanted to send U-turn transactions through their accounts at HBUS without triggering that OFAC filter or an individualized review to make sure that they were permissive U-turns. They wanted to remove any reference to Iran and to go through the HBUS systems without any manual or more detailed review. So this was a battle over transparency.

The United States wanted full transparency so that it knew it was dealing with an Iranian U-turn and could make sure it complied with U.S. law. The affiliates did not want to trigger these reviews or to take the time for those reviews. So HBUS and the affiliates fought over this issue for 3 years, from 2001 to 2004. But while they were arguing, the overseas HSBC affiliates were sending undisclosed Iranian U-turns through their HBUS accounts, anyway. And to do that, the HSBC affiliate in Europe, HBEU, stripped out the references to Iran. Senior employees at HBEU protested in 2003 and 2004—and I believe one of these protests was read by Senator Coburn—that they did not want to be altering wire transfer documents for Iran. They even set two deadlines in 2004 when they said that they would stop doing it, but both deadlines were ignored.

HSBC issued group-wide policy statements on Iran in 2005 and 2006, but neither resolved the U-turn issue. The issue was resolved only in 2007 when HSBC made a global decision to exit Iran.

Now, I believe that Exhibit 41 was referred to by Senator Coburn, and if so, I will not read it again.

Senator COBURN. I did Exhibit 40.

Senator LEVIN. OK. So Exhibit 40 was read by Senator Coburn, which made reference to the statement about, “I wish to be on record as not comfortable with this piece of business.”

Exhibit 41 was, “With the amount of smoke coming off of this gun, remind me again why we think we should be supporting this business?” So that is another HBUS employee describing the Iranian business. But at HBEU, the Europe branch, they were stripping payment information, so the United States was unaware of these Iranian payments.

Senior officials at HSBC, at the headquarters in London from 2001 to 2007, knew that affiliates in England and the Middle East, the HBEU and HBME, were sending undisclosed payments through their HBUS accounts but did not stop them or inform HBUS of the extent of the activity. So they knew that their affiliates were hiding key information from each other.

Now, at HBUS, senior compliance officials were on notice as early as 2001 that this stripping was occurring but took no decisive

1 See Exhibit No. 41, which appears in the Appendix on page 760.
action to stop it. They stopped occasional wire transfers from Iran with the words, “Do not use our name in New York.”

So, first, Mr. Bagley, didn’t the European and Middle East affiliates—why weren’t those affiliates told, why wasn’t HBUS told, what possible justification is there for not telling an affiliate that key information to them so that they can comply with their own laws has been removed?

Mr. Bagley. It is a very fair question, Senator. My understanding of the position was that HBEU was checking each one of those transactions to ensure that they were U-turn compliant, that I was always advised that they were U-turn compliant. When I first focused on this issue, which was, I think, in mid-2003, although there were indications in emails before that, I emphasized and recommended that there should be full transparency given to HBUS so that they could check the U-turn compliance—compliance with the U-turn themselves.

Senator Levin. Was it?

Mr. Bagley. It was not.

Senator Levin. So as Exhibit 55 says so simply and eloquently and dramatically, your own people “were being asked to ‘fudge’ the nature of the payments to avoid the U.S. embargo and seizure.” That is Exhibit 55.1

Then you were not the only one that was uncomfortable, Mr. Gallagher, with this piece of business. People in this bank, this global bank, were being asked to fudge the nature of the payments to avoid the U.S. embargo and seizure. And it is pretty shocking stuff.

Now, in 2002 and 2003, HSBC affiliates continued to send thousands of these undisclosed Iranian transactions through HBUS. Exhibit 1c2 is a chart that shows the numbers. So even though the HSBC Group was on notice as early as 2001 that HSBC affiliates were sending these hidden Iranian transactions through their accounts in the United States, nobody did anything to stop it for years.

Mr. Bagley, in 2003, you had recently become head of compliance for the entire HSBC Group. Earlier that month, the Middle East affiliate, HBME, sent HBUS a memo laying out the business case for it to process Iranian transactions. Why were they processing them? Because there was a substantial income opportunity, and here is what you wrote in 2003, Exhibit 45:3 “The business case includes a number of express references to practices which may constitute a breach of U.S. sanctions.” But then in October 2003—and this is Exhibit 484—one of your attorneys in Group Compliance, John Root, wrote to you that six banks were processing U.S. dollar payments and that these payments were being altered by HBEU before going to HBUS. He said HBEU was removing the remitter’s name. Breaching these U.S. sanctions is a serious matter, and as the head of Compliance, you were making that point.

When you learned that HBEU was removing the names of Iranian banks, why was not the practice simply stopped right then? Why did it take so long to fix?

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1 See Exhibit No. 55, which appears in the Appendix on page 840.
2 See Exhibit No. 1c, which appears in the Appendix on page 577.
3 See Exhibit No. 45, which appears in the Appendix on page 784.
4 See Exhibit No. 48, which appears in the Appendix on page 801.
Mr. Bagley. Mr. Chairman, that is an absolutely appropriate question, and with the absolute benefit of hindsight, this clearly took far too long to resolve.

What I can say is that when it came to my attention, I very clearly recommended that all transactions should be compliant, should be transparent, and should be made in a way which HBUS was comfortable with, and that recommendation went to the relevant parts of the group and ultimately was escalated to senior management within the group.

Senator Levin. How long did it take?

Mr. Bagley. I think as you have indicated, there were then various discussions between different parts of the group, and I think we progressively started to introduce transparency into the payments in 2006.

Senator Levin. So that would be about what, 3 years?

Mr. Bagley. Far too long.

Senator Levin. But about 3 years?

Mr. Bagley. Yes.

Senator Levin. Senator Coburn.

Senator Coburn. If a U-turn transaction is fully compliant and fully transparent, I would make the point it is legal, and nobody here is claiming illegality. But if one of these—and this is for you, Mr. Bagley. If one of these U-turn payments was not compliant with U.S. law, who is responsible?

Mr. Bagley. Ultimately I anticipate that the transaction passing through the U.S. bank may expose the U.S. bank to risk. And if there was malign intent, then it could expose somebody else to risk as well.

Senator Coburn. So in this great big organization called HSBC, is it fair for one profit center to put another profit center at that kind of risk? Not only is it fair, is it the right thing to do?

Mr. Bagley. I neither think it is fair nor the right thing to do, which is why I urged transparency so that HBUS could satisfy itself. But I would like to stress that at all times we were told and believed that those transactions were compliant and lawful and that there was a process where people seriously tried to ensure within HBEU that the transactions that were sent were compliant.

Senator Coburn. So it is your feeling—and you cannot know this for a fact because you have not looked at all of them. But it is your feeling that none of these transactions that HBUS saw no transparency on, it is your testimony that you feel that they all met the intent that our government says if you are going to run it through U.S. dollar banks, that you actually met that expectation?

Mr. Bagley. I do not think I can say that all of those transactions were. What I was always told was that people were seeking to ensure they were compliant——

Senator Coburn. Who are those people?

Mr. Bagley. The processing unit within HBEU.

Senator Coburn. And who are those? Who is the head of the processing unit at HBEU?

Mr. Bagley. I cannot recall the name.

Senator Coburn. Who could recall the name?

Mr. Bagley. I am sure we could find that name.
Senator COBURN. Would you do that for the Subcommittee, please?

Mr. BAGLEY. Absolutely.

Senator COBURN. I would love to have that name during our questioning this afternoon because that is a key point. Either they were legitimate U-turns or they were not.

Mr. BAGLEY. I believe that the results of the lookback that has been conducted by Deloitte indicates that most, if not all, of those transactions were compliant, or a significant number, I believe. That is not a report I have seen, but that is my understanding.

Senator COBURN. OK. And who has that report?

Mr. BAGLEY. I believe the results of that report have been disclosed to the Subcommittee.

Senator COBURN. OK. Thank you.

Mr. Lok, on Al Rajhi Bank, Exhibit 78, if you would take a look at that. You were interested in carrying on a business relationship with this bank to sell it banknotes, as this email shows. Page 2 of the email also shows that one of your compliance people wrote, “I am not trying to be difficult,” but that she did not want to approve the business.

What was your impression at the time why she would be concerned about being difficult?

Mr. Lok. The way I read her message, “difficult” refers to her reluctance to sign off the profile, and she is saying here that she is not comfortable signing it because she does not know the client.

Senator COBURN. Did she feel like she was being difficult because somebody was pressing her to approve something that she did not feel comfortable with?

Mr. Lok. No, that is not my interpretation. It is just because she was asked, and then she turned it down. That could be interpreted as difficult. I think that is what she is referring to.

Senator COBURN. All right. She also states, “I cannot answer questions if/when the Al Rajhi name appears in the U.S. media.” What kind of concerns were you aware of that would rise to that level?

Mr. Lok. I know that this name had appeared numerous times in the papers, negative reports about the family members, and all sorts of allegations. So it is a very controversial name.

Senator COBURN. All right. You also, on page 1 of this email, wrote it is compliance that is the key. Were you suggesting that you needed to convince somebody in compliance to approve the deal or that you were willing to submit to whatever compliance said?

Mr. Lok. Because this is a very difficult case, it is not simple at all. When it was passed on to me by my colleague, on the one hand, there were these negative news in the paper, etc. But, on the other hand, there was this very supportive report coming out from the RMs based in Saudi Arabia. And at the same time, the Group Compliance had actually reversed its decision saying that they were happy to let individual entities resume doing business.

So, to me, it is a balancing act where you have some very bad news, but, on the other hand, you cannot ignore the news that appeared to be favorable. So that is why I presented this to the com-

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1 See Exhibit No. 78, which appears in the Appendix on page 937.
See Exhibit No. 50a, which appears in the Appendix on page 807.

Senator COBURN. And ultimately you did not do this deal? Is that correct?

Mr. LOK. I am sorry. No. I think after a very long period of time, New York Compliance had agreed to letting us resume the relationship. I mean the U.S. side. But it took a long time, because I had read this file before coming here, the dialogue first started in May, and then a decision was made in New York that we could resume for trading, that this was in December 2006.

Senator COBURN. OK. Thank you.

Senator LEVIN. Thank you.

Mr. Gallagher, take a look at Exhibit 50a, if you would, when Denise Reilly of HBUS writes to Teresa Pesce at HBUS, anti-money laundering director, that the so-called Eastwood memo, which was referring to alterations to remove references to Iran, that the memo was discussed at a meeting with you, Mr. Gallagher.

This is dated December 17, 2003, so the question is—when you learned that HBEU was sending these hidden Iranian payments through their HBUS account, you saw it as a problem, you said so, and the real question is: What steps did you take to stop the practice? You objected to it. But what did you do beyond that?

Mr. GALLAGHER. Yes, thank you for that. I have reread these documents as well, and while I do not recall the specific meeting that is discussed there, mentioned there, I feel very comfortable about two things: First, that my position on this with respect to the necessity for transparency and full compliance was unchanged throughout the process; and, second, that this was really in the right hands. Denise Reilly at the time was in Compliance, I believe already, and Terry Pesce was the head of AML Compliance. So all the right hands from an HSBC Bank USA perspective into which this needed to be elevated were, in fact, contained in this memo. I do not recall my specific discussions here, but I would have to speculate they would be consistent with my prior positions, which is an abundance of caution.

Senator LEVIN. So you objected in 2001 to the practice. By 2003, you were the head of the HBUS's Payments and Cash Management Division. Why not just pick up the phone in 2003, call the CEO of HBUS or somebody in the HSBC Group and just raise hell? Why not do that?

Mr. GALLAGHER. Well, certainly with——

Senator LEVIN. I think you knew whoever was supposed to be taking care of it was not taking care of it.

Mr. GALLAGHER. Yes. With the benefit of hindsight, that is exactly what I should have done, and I think we have all learned the lesson that we should have been louder sooner and more broadly in the organization.

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1 See Exhibit No. 50a, which appears in the Appendix on page 807.
Senator Levin. Mr. Lok, let me ask you about Exhibit 84b.1 You were the head of HBUS's global banknotes business that supplied physical U.S. dollars to financial institutions around the world. Some of your clients, to put it mildly, did not inspire confidence and were either opposed by HBUS's Compliance, the division there, or they sought to subject them to special anti-money laundering monitoring. But you often opposed those recommendations, and here are a few examples, 84b is one.

This is an email exchange in 2005. This was about whether to classify a particular HBUS banknotes client as a special category client (SCC), which means that is a high-risk client that undergoes additional scrutiny.

HBUS Compliance described the foreign bank as one in which, “the bank’s senior management and employees have been involved in numerous significant instances of corruption, fraud, and embezzlement over the past few years,” and recommended that it be classified as a SCC.

You responded as follows: “Yes, corruption can be rampant in this bank, but it is not unique” to that bank. So you opposed the SCC designation.

Now, the HBUS compliance officer for banknotes, Daniel Jack, described a bank as “government-owned, in a high-risk country with a politically exposed person,” which is someone who requires enhanced due diligence, “and reputational risk due to corruption, etc.” This is now Exhibit 84a.2 And he recommended an SCC designation, and your response: “. . . this is such a large bank hence malfeasance is expected.”

“However,” you wrote, “I do not agree that just on these numerous breaches that the bank should be classified.”

So your position was that malfeasance is to be expected at a large bank so do not even bother to do additional anti-money laundering monitoring.

And then Exhibit 82 3—this is from 2007—in this email chain, an HBUS banknotes colleague asks if you—and, Mr. Lok, we are referring to you—would be willing to help open a banknotes account for Islami Bank Bangladesh, which was partly owned by Al Rajhi Bank, a Saudi Arabian bank whose account was closed by HBUS in 2005 for terrorist-financing reasons, although in part in 2007, because of your urging, HBUS reopened that account.

Here is what you wrote: “I am happy to be the relationship manager if this is an account worth chasing. How much money can you expect to make from this name?”

And then when you were told the account would produce about $75,000 in revenues per year, you wrote: “One, the money is there, and we should go for this account. Two, I will jump in and wear the [global relationship manager] hat.”

So your test, apparently, for opening an account was, first, how much revenue it would produce, but what about the second test, Mr. Lok? What about a test is the bank involved in wrongdoing, whether it is terrorist financing, corruption, or malfeasance? Why

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1 See Exhibit No. 84b, which appears in the Appendix on page 964.
2 See Exhibit No. 84a, which appears in the Appendix on page 968.
3 See Exhibit No. 82, which appears in the Appendix on page 949.
weren't those factors enough for you to say we are not going to do it?

Mr. LOK. Mr. Chairman, let me try to explain what had happened. Exhibit 84b,\(^1\) that was about classifying that particular client in China as a SCC. The thinking was China is a different country from a lot of other countries. It has its own characteristics. And this bank actually shared the same characteristics of the other big banks as well. So it is not one just on this particular bank. So my point at that time was if FIG, which is a unit within Compliance, wants to say that this should be SCC, that means the other banks should also be subject to the same rating.

Senator LEVIN. Well, why not all banks that, in your words, where corruption is rampant? Why shouldn't they all be subject to that rating?

Mr. LOK. First of all, I have to apologize the colorful words I used that. It was not the appropriate——

Senator LEVIN. Apologize to whom?

Mr. LOK. Well, that email give the impression that I was very tolerant of this malfeasance. That is why I said that the word itself is not the right word to use.

Senator LEVIN. I am afraid it was the right word to use if you believed it. Corruption was rampant at that bank. Did you believe it was rampant?

Mr. LOK. Well, it is a very large organization. I think just like other organizations, when you have such a large bank, yes, there are bound to be cases of malfeasance.

Senator LEVIN. You did not really mean what you said, that it was rampant? Is that what you are saying? At the time you wrote it was rampant and that it was not unique to that bank. So were you inaccurate in your email? Did you express what you believed at the time?

Mr. LOK. At that time, yes, but I need to qualify that statement, which is the email came forward, I was overwhelmed by this feeling that if this bank were to have been SCC, that means the other banks need to be SCC. And at that time China was a country that the group itself looked at as a very important market. So I wanted to elevate the issue. That is why I copied my colleagues in London, bring in Group Compliance, take a look at this. That was what I was trying to do at that time.

Senator LEVIN. What about your Exhibit 84a?\(^2\) Here you are recommending you proceed despite the fact that the compliance officer for banknotes, Daniel Jack, described this as a government-owned bank in a high-risk country with politically exposed persons that require enhanced due diligence and a reputational risk—that is to you, to your bank—due to corruption. And your recommendation was go ahead anyway. “It is a large bank. Hence”—your word—“malfeasance is expected. I do not agree,” you said, “that just on these numerous breaches the bank should be classified”—in other words, given enhanced review.

Did that reflect your view at the time? Did you believe what you wrote at that time?

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\(^1\)See Exhibit No. 84b, which appears in the Appendix on page 964.

\(^2\)See Exhibit No. 84a, which appears in the Appendix on page 958.
Mr. Lok. At that moment, yes.

Senator Levin. OK. What about this Bangladeshi bank? When you said—all you seemed to be interested in is how much money will it make for us, how much money can we expect. Then $75,000 in revenues. And then you say, “We ought to go for it.” You will be happy to wear the hat, the global relationship hat.

You are head of the Banknotes Department, and when your employees see those kinds of remarks in your emails from their boss, what kind of an impact do you think it has on their willingness to consider compliance issues when deciding whether to open an account for a potentially lucrative but a high-risk client? What do you think the effect of those words are on your employees?

Mr. Lok. Mr. Chairman, I agree that this is not portraying a right image, not giving the right message, looking at the message right now.

Senator Levin. Senator Coburn.

Senator Coburn. Just for the record, the email that Mr. Lok sent did not say it was rampant. It actually said “can be rampant.” And some of the realism of the world we live in in global commerce, if you take this particular bank—and this is not a defense, but if you look at their own bank in Mexico, I would tell you it looked like it could be rampant there as well. And I think that Mr. Thurston certainly found that, that corruption could be rampant in that.

I think we have a better understanding, Mr. Chairman, of what went on. Someone taught me a long time ago that greed tends to conquer all technologic difficulties, and so we are about anti-money laundering. That is what this hearing is about. And it is not the accusation of illegality. It is the accusation of poor judgment and mistakes and not good line authority inside a very large and very successful organization.

I would just say, one, I appreciate the candor of the witnesses today. It is a very difficult issue. I am still concerned even though Deloitte said there are 79 accounts they could not account for in terms of U-turns. I still think it is a difficult issue when the world is dealing with a terrorist state like Iran and we are allowing them the flexibility. So my hope is that we can learn some things, and I know HSBC certainly has, and I appreciate our witnesses’ testimony.

Senator Levin. Thank you, Senator Coburn. I think I read the email correctly. I will read it again. “Yes, corruption can be rampant in this bank, but it is not unique to the bank.” And so I think it speaks for itself. If I at one point said that he said it is rampant instead of, “Yes, it can be rampant” and “it is not unique,” then your quote is exactly right, and the one I just read I think is also exactly right. But there is not much difference between “it can be rampant” and “it is not unique” to what the point was of this question and Mr. Lok’s answer.

[Pause.]

Senator Levin. We thank our witnesses, and, again, we appreciate the cooperation with this investigation of your bank.

We are going to recess now until 2 o’clock. We thank our witnesses, and you are discharged.

[Whereupon, at 12:34 p.m., the Subcommittee was recessed, to reconvene at 2 p.m., this same day.]
The prepared statement of Ms. Dorner appears in the Appendix on page 130.

Senator LEVIN. The Subcommittee will now come back to order. I would like to call our third panel of witnesses for this hearing, Irene Dorner, the President and Chief Executive Officer of HSBC Bank USA and HSBC North America Holdings in New York; and Stuart Levey, the Chief Legal Officer of HSBC Holdings in London.

We welcome you both. We appreciate both of you being with us this morning. We look forward to your testimony, and we also want to tell you that we appreciate the cooperation of your bank. It has been consistently cooperative with us and we are grateful for that.

Pursuant to Rule VI, all witnesses who testify before the Subcommittee are required to be sworn, so I would ask you both to please stand and raise your right hand.

Do you swear that the testimony you will give before this Subcommittee will be the truth, the whole truth, and nothing but the truth, so help you, God?

Ms. DORNER. I do.

Mr. LEVEY. I do.

Senator LEVIN. The timing system that we have will give you a red light after 5 minutes, but a minute before that it will shift from green to yellow to give you an opportunity to conclude your remarks. Your entire written testimony will be printed in the record. And we would, again, appreciate that you attempt to limit your oral testimony to 5 minutes each.

Ms. Dorner, we will have you go first, followed by Mr. Levey, and then we will proceed to questions. But first, let me turn to Senator Coburn.

Senator COBURN. Thank you. I privately greeted our witnesses and I would apologize. This afternoon, I will be in and out, but I will be here to ask my share of the questions. So if you are in the midst of your testimony and I leave, please forgive me.

Senator LEVIN. Thank you very much, Senator Coburn. Ms. Dorner.

TESTIMONY OF IRENE DORNER,1 PRESIDENT AND CHIEF EXECUTIVE OFFICER, HSBC BANK USA AND HSBC NORTH AMERICA HOLDINGS, INC., NEW YORK, NEW YORK

Ms. DORNER. Thank you, Chairman Levin and Senator Coburn. My name is Irene Dorner and I serve as President and CEO of HSBC Bank USA and HSBC North America Holdings, Inc. I have led the bank in the United States since January 2010.

I fully appreciate why we are here and believe that the discussion about controls at global banks is an important one to have. We deeply regret and apologize for the fact that HSBC did not live up to our own expectations, the expectations of our regulators, our customers, our employees, and the general public.

HSBC’s compliance history as examined today is unacceptable. HSBC has learned some very hard lessons from the experience of the past few years, but we have taken very substantial steps to address the problems that we, our regulators, and this Subcommittee have identified. We have made fundamental changes in governance, culture, training, and funding to ensure that we can effectively deter illicit use of our bank in a manner that will be embed-

1The prepared statement of Ms. Dorner appears in the Appendix on page 130.
ded and sustained going forward. The process is ongoing and requires vigilance. As you know, these issues and challenges do not end at the water’s edge, so we are combining our efforts with reforms that apply throughout HSBC’s global businesses, and I am joined today by our new Chief Legal Officer, Stuart Levey, who is here on behalf of the HSBC group, and who will describe HSBC’s global compliance commitment.

Given my experience working for HSBC in other parts of the world, I am cognizant of the risks and obligations that come with serving our customers who have a need for global banking services, and at an absolute minimum, we must have the proper controls and systems in place to ensure that we are doing the right business in the right places with the right customers and that our customers’ transactions are properly monitored. If, for any reason, a transaction appears to be unlawful or suspicious, then we scrutinize the customer and report this information to the authorities in a timely manner.

As the Subcommittee has documented, we have fallen short in a number of serious ways. In October 2010, the U.S. bank entered into a consent order with the OCC. With the full support of our board and of the HSBC group, I took the lead in overseeing our remediation efforts and we have taken significant steps.

First, we have worked hard to foster a new culture that values and rewards effective compliance and that starts at the top. By the end of 2010, we had a new U.S. senior management team in place. We overhauled our AML compliance function, improving the quality, coverage, and strength of our AML program through additional staffing and training. We have increased spending in AML compliance nine-fold from 2009 to 2011. And today, we have 892 full-time AML compliance professionals.

Second, we have undertaken an enterprise-wide risk assessment and have exited customer relationships and businesses that do not represent acceptable manageable risks. This is an ongoing process and we continue to do a formal risk assessment twice a year.

Third, we have made changes to our “know your customer” policies because proper KYC must be robust to be effective. We must know a significant amount about our customers to be satisfied that we want their business. Our new KYC policy delivers a critical look at each customer, including our own HSBC affiliates. We have also implemented a new customer risk rating methodology which takes a holistic view of customer risk. I chair the project to apply our new KYC standards to our entire customer base. Many of the changes we are making are being adopted as HSBC Global best practices.

And finally, we have made significant investments in technology and we have built better controls around our automated monitoring system, although we recognize that there is more to be done. The intended consequence of these changes is to embed a new culture of responsibility, accountability, and deterrence within our U.S. bank. It has been my mission and the mission of my new senior team to make sure that compliance is on every employee’s mind at every level in the organization.

In closing, let me say that I do appreciate this Subcommittee’s efforts to examine and improve the steps taken by industry and
government to address these challenges and the recommendations you have made. We are committed to fulfilling our responsibilities in an effective and sustained manner.

Thank you, and I am happy to address any questions.

Senator LEVIN. Thank you very much, Ms. Dorner. Now, Mr. Levey.

TESTIMONY OF STUART A. LEVEY, CHIEF LEGAL OFFICER, HSBC HOLDINGS PLC, LONDON, ENGLAND

Mr. LEVEY. Thank you, Mr. Chairman and Senator Coburn. My name is Stuart Levey. I am the Chief Legal Officer of HSBC, a position I have held for the past 6 months. I am pleased to be here at the Subcommittee's request to participate in today's hearing, and I would also like to express the appreciation to the Subcommittee staff for its hard work and professionalism.

Some of the information discussed earlier today and in the Subcommittee's report is sobering. It highlights serious historical problems at HSBC, and we have not shied away from that. In fact, we have gone to great lengths to cooperate, not only to be helpful to you, but to help us diagnose the problems and identify solutions. We obviously have a great deal of work to do.

I know from experience that it is critically important to our safety and security to stop illicit actors from gaining access to the financial system. At HSBC, we must do everything in our power to prevent that access through our bank and we embrace that responsibility. That is why we are taking action not only to address the specific deficiencies the Subcommittee identified, but also to implement a global strategy to tackle their root causes. This is a complex undertaking, given the scale of our institution and our multinational footprint. But if we get this right, it will make a difference.

At the beginning of 2011, there was a transition at HSBC to a new CEO, Stuart Gulliver, and our new Chairman, Douglas Flint. Our new leadership team understands these challenges and they approached me to join them to help drive the necessary changes. My views on these issues were public and well known and HSBC’s leadership wanted me to bring my experience and commitment to bear on their challenges.

I would like to outline for you the path that we are on. First, beginning in January 2011, we have reorganized HSBC around four global businesses and 10 global functions. This means for the first time that the global head of a function, like myself, has authority over the operations and personnel of that function wherever we operate. This makes it easier to manage our risk globally. The historical decentralized corporate structure that concentrated authority on country heads has been replaced.

Second, we have simplified our business model to make HSBC easier to manage. We are reducing our footprint and product lines. We have focused on selling and exiting non-core businesses, such as our global banknotes business. Over the past 18 months, we have sold or exited 31 businesses and are already withdrawing from nine countries.

1 The prepared statement of Mr. Levey appears in the Appendix on page 137.
Third, we have elevated and strengthened the role of group compliance so it is now in power to set standards across the organization and has the necessary authority to ensure that those standards are enforced. Our new Chief Risk Officer, Marc Moses, is also providing fresh leadership in this area.

Fourth, on April 30 of this year, our CEO issued a directive to the entire bank requiring adoption of high uniform standards across the firm. We are adopting a highest common denominator approach, applying everywhere the highest standard that we must apply anywhere. That will most often mean that we will be applying U.S. standards globally. This means that instead of the United States taking on risk from abroad, as you discussed in your opening statement, Mr. Chairman, instead, high U.S. standards will be exported globally, thereby promoting the integrity of the financial system.

Among other things, that directive, or group circular letter, also requires that we maximize information sharing for risk management purposes and that we apply a globally consistent approach to knowing and retaining our customers. The CEO has also directed the Chief Risk Officer and me to co-chair a steering committee, on which Ms. Dorner also sits, to drive implementation of this new approach.

We have already begun our work. For example, we adopted a new global sanctions policy. We ordered global application of the obligation to conduct affiliate due diligence. And we adopted a new risk filter to reduce and better control the business we do in any high-risk country where we operate. This is the process under which we decided to close the Mexican Cayman accounts that were discussed this morning.

This is the beginning of the journey and we have a long way to go, and we agree with you, as you say in your report, that the burden of proof is on HSBC to demonstrate progress on these reforms.

In addition, in 2011, our CEO introduced a new values program under which all senior executives are evaluated on whether they adhere to the bank’s core values, including respect for compliance.

In the end, sustainability of these reforms depends critically on the commitment of HSBC’s top leadership. I have confidence because I know our board and senior leadership are committed to seeing these reforms through. We understand that this is something that absolutely must be done for the long-term success of the bank.

I appreciate the opportunity to speak to you today and I look forward to answering your questions.

Senator Levin. Thank you very much, Mr. Levey.

Let me start. We will have, I think, a 10-minute round.

Senator Coburn. You may go 20 minutes.

Senator Levin. OK. In 2003, HBUS was the subject of a formal enforcement order by its regulators at the time, the Federal Reserve of New York and the New York State Banking Department, and it required the bank to revise and revamp its AML program due to some very serious deficiencies. HBUS made a commitment at that time to correct the problems. And after 3 years, in 2006, the Office of the Comptroller of the Currency (OCC), lifted the enforcement action despite a host of unresolved issues.
Four years later, in 2010, the bank was right back in the soup, the subject of another enforcement action by its regulator, this time the OCC, requiring the bank to revamp its AML program due to severe deficiencies. And many of those were similar to the problems that had been identified in 2003, including many violations of Federal AML law, a backlog of over 17,000 un-reviewed alerts regarding possible suspicious activity, failure to conduct any anti-money laundering monitoring of $60 trillion annually in wire transfer activity by customers domiciled in countries rated by HBUS as lower risk, and failure to conduct any due diligence of HSBC affiliates.

Now, on April 30 of this year, the HSBC group, as you have testified, issued a new group-wide policy that applies to all of its affiliates around the world, and that is Exhibit 2b. Now, this group circular letter requires all HSBC affiliates to meet the most stringent standards anywhere in the group, and it states that, “The bank and its affiliates will adopt and enforce the adherence to a single standard globally that is determined by the highest standard that we must apply anywhere. Often, this will mean adhering globally to U.S. regulatory standards. But to the extent another jurisdiction requires higher standards, then that jurisdiction’s requirements must shape our global standard.”

That new policy statement could be a groundbreaking commitment that will force the entire HSBC network to improve, and I hope it does. I understand, Mr. Levey, that you are co-chairing a committee—you have just testified about that—aimed at implementing the new group circular letter.

But here is what HSBC said in 1993. “Group members should comply with both the letter and spirit of all relevant laws, codes, rules, regulations, and standards of good market practice in each jurisdiction around the world where they conduct business.”

The 2012 and the 1993 compliance policy statement have good sentiments and they sound very similar in a lot of regards. They promise the bank will adhere to high standards, and as I have said before, commitments and promises are welcome. But accountability for previous failures and conduct that has already taken place is essential as a deterrent, and it is that accountability that has been missing.

My first question is the following, and either one of you can answer. Let me try you first, Ms. Dorner. Do you agree that given past commitments that have not been kept that the bank has a heavy burden of proof that they mean what they say, or you mean what you say, both as to changing behavior and as to changing the culture?

Ms. Dorner. Thank you, Mr. Chairman. I can entirely understand these concerns. It is quite clear that we have had failures in the past, which we deeply regret, and I would agree that we have some way to go to regain the trust of our regulators and of yourselves on this Subcommittee.

Senator Levin. Thank you.

Exhibit 71d is a chart which was prepared by an outside auditor at HBUS’s request. It lists accounts that are held by HSBC af-
filiates in the United Kingdom and Hong Kong for banks in rogue regimes subject to U.S. sanctions, such as Iran, Iraq, North Korea, and Sudan, a total of 55 suspect banks with U.S. dollar accounts made possible by the HSBC affiliates’ correspondent accounts at HBUS.

Basically, how could HSBC affiliates accept such clients and do you know whether HSBC told HBUS that it was servicing these type of clients?

Ms. DORNER. Mr. Chairman, clearly, this predates my tenure of being in the United States and so I cannot comment specifically on this. I can tell you now that HBUS does not hold accounts for any of these names.

Senator LEVIN. Thank you.

One of the accounts that was in an HSBC affiliate is a U.S. dollar account for an Afghan bank on the SDN list from October of 1999 through February 2002. It was on the SDN list because of its ties to the Taliban. It is incredible to me that an affiliate of HSBC, an affiliate which is located in the United Kingdom, could even consider owning an account for a Taliban-affiliated organization and continue the relationship after the September 11, 2001 attack.

Now, there is another extraordinary example here, as well, and that is Exhibit 50d. That is an exchange of emails in 2008 between HSBC employees in the U.S. and the Cayman Islands. An AML compliance officer at HBUS received an inquiry from OFAC regarding a trust account in the HSBC Cayman affiliate which was administered by HSBC Geneva and which had been established to benefit a well-known international terrorist named Rami Makhlouf. He is from Syria. The exchange is stunning, if you will take a look at this one.

The Internal Control Officer for Compliance in the Cayman Islands admits that the trust for Makhlouf exists and the Cayman affiliate is the trustee. In a subsequent email, she informs the HBUS AML officer that a year earlier, in 2007, concerns about this client were raised and the relationship was viewed at the group level, which decided to maintain it. In other words, people at HSBC headquarters made a conscious, knowing decision to maintain the account for the benefit of an international terrorist.

So how is it that HSBC Geneva or its Cayman affiliate, or any affiliate in the HSBC system, could have maintained a trust benefitting a terrorist or gotten permission from group headquarters to service such an individual, and if you wish to comment, as well, on that account that was being held for a Taliban-affiliated organization, you can do so at the same time. Ms. Dorner.

Ms. DORNER. Mr. Chairman, I am afraid I am not able to assist you on the account for Mr. Makhlouf because he is not a customer of HBUS and I am not acquainted with this chain of events.

Senator LEVIN. Could you become acquainted and then give us your comment for the record?

Ms. DORNER. I can look at the chain of emails, yes.

Senator LEVIN. Will you do that?

Ms. DORNER. I can do that.

Senator LEVIN. OK. Mr. Levey, do you have a comment?

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1 See Exhibit No. 50d, which appears in the Appendix on page 823.
Mr. LEVEY. Naturally, this is long before my tenure. I do know who this individual is. He is someone that we designated when I was in the government. He was designated in 2008, I am pretty sure, under the sanctions program by the United States. I do not think this is the kind of thing that we need to change. I do think this is the kind of thing that we need to change.

Senator LEVIN. You made reference to your service with the U.S. Government. If I remember, you were the Under Secretary of the Treasury for Terrorism and Financial Intelligence. Do I have it right?

Mr. LEVEY. Yes, sir.

Senator LEVIN. How would you have reacted if you knew that HSBC was engaged in such a practice and that an HSBC affiliate knew of the HSBC account and did not report it?

Mr. LEVEY. I think that would be unacceptable.

Senator LEVIN. Would it not be even stunningly unacceptable? I mean, a lot of things are unacceptable. But on degrees of acceptability, is this not kind of shocking?

Mr. LEVEY. I am not going to quarrel with you, Senator. Of course, this is exactly the kind of thing, I should say, that we are trying to change, where we are trying to make important compliance information mandatorily shared to compliance officers around the world. This would be the kind of thing that would, in my view, fall into that category.

Senator LEVIN. Senator Coburn.

Senator COBURN. Thank you.

Ms. Dorner, as I understand from the report, you arrived to run the U.S. affiliate or the U.S. organization in 2010 and were handed a pretty good sized mess. But why, irrespective of these challenges, does HSBC choose to have a presence in the United States in the first place? I mean, what is the value to HSBC? You are in all these countries. You are worldwide. What is the value? Why are you here?

Ms. DORNER. Senator, that is a great question. This is a terrific place to do business. There are more than 10,000 U.S. headquarters of international companies based here in the United States. We, as an international bank, it is our business to help our customers realize their aspirations. And so we have many United States companies who want to grow internationally and they use us and we help them to do that. We connect them with international business.

And then there is incoming business, and, of course, as you know, we do have businesses in other parts of the world, and I am thinking particularly here of Asia and emerging markets, where many companies wish to do business and wish to invest in the United States. And it is the role of HSBC as an international bank to facilitate that. The United States is the biggest trading Nation in the world. It is a massive opportunity.

Senator COBURN. So given the mess you have had and what you have seen, the consequences, both financial and from a business standpoint, as a result of the consent order with OCC, would you outline what the impacts have been on your organization, the latest consent order?
Ms. DORNER. The latest consent order has had a massive impact. Clearly, it happened just after I arrived, and I can tell you that what we have done is that we have changed the senior management here in the United States. We have changed our General Counsel. We have changed our Head of Compliance. We changed our AML Director. We have had a top-to-bottom overhaul of the way that we actually do AML compliance. We are burning the bridges to make sure nobody can get back to the way it was before. We have new governance in place. We have new structures. We have new policies.

But actually, the processes and the policies are never enough. This is actually about the people. And so it is my job to make sure that the right way down the whole organization, the DNA of HBUS, we actually get compliance on the front foot in everybody's mind.

And in terms of fixing it, that is what CEOs do. I am clearly absolutely committed to fixing this. But the reality is, the change that will take place and is taking place is that this has to be fixed for the future. This has got to be BAU. So business as usual is not just about fixing the consent order. It is driving this through into the future as a full-scale remediation that will last.

Senator COBURN. So you put all these steps forward and all these changes, but the real thing that you have to change is the culture.

Ms. DORNER. That is correct, Senator.

Senator COBURN. So how are you doing that? I mean, you have outlined the steps, but where is the leadership that is going to change the culture? Where is the example so far since you have been there changing the culture? When somebody has violated some of these policies, what has been the consequence? The only way you change a culture is if everybody in the organization sees when you violate the core values of the institution that there is a consequence.

Ms. DORNER. Senator, I can tell you unequivocally since I have been here that I have fired people for not complying, that I have clawed back in terms of future remuneration, and I have reduced compensation. Of course, that is the negative side of things. Equally, we have celebrated success. We have examples of compliance officers who have been put onto our Internet to show people that this is where it is at that they should be looking at, these kind of standards to drive the way that we do business. It is quite clear that we need to make further changes. There is never enough done. We can always improve. But this has got to be on everybody's lips, from top to bottom of the organization.

And I would just say that one of the big changes that has helped me in this is that this group has changed in terms of how it wishes compliance to be viewed, and compliance now has a control function role within the whole group. And so I am totally supported by the HSBC group in this and by the HSBC group's senior management.

Senator COBURN. OK. I just have one more question for you. You mentioned the changes you made to “Know Your Customer” policies have enabled you to make better decisions about whether a customer fits your risk appetite. Would you describe what your risk appetite is at HSBC or HBUS?
Ms. DORNER. I can do that. I think that the thing about risk is it has to be taken at the highest level. You are trying to find the right customer, and so it is about understanding customers’ business, where they do business, why they do business, and what they want to do with us. And, therefore, when you put a KYC process in place, those are the things that you are looking for throughout, and not only are we looking for that in our future customers, we are actually remediating the existing customer base we have to make sure that the customers that we already have fit within the risk appetite that we have. And I can tell you now that we have exited, as a result of rolling out this remediation, in the order of 14,000 customers because they simply did not fit our risk appetite.

Senator COBURN. OK. Thank you.

Mr. Levey, this was a 300,000 person organization. You have an impressive resume, but there is just one of you. And you have entered into an organization that has an admittedly poor record and presumably a poor culture for compliance to match that poor record. When you leave here today and resume business as usual, go back, what is going to be the impact of a hearing like this or a meeting with the government like this in terms of how it affects the bank, the bank operations, the structure, and the culture?

Mr. LEVEY. Well, Senator, I can assure you that the top leadership of this company is very focused on your report, on this hearing, on all the information that has been developed in the course of this investigation. In fact, it was not just when the report was issued or we were coming to testify today that there was engagement from the top. As I said, the change began when the new CEO took office at the beginning of 2011 and they reached out to me soon thereafter to ask if I would come and help drive the change that they were pursuing.

I believe that the culture and the tone at the top is excellent. We have risk management meetings where the top executives of the firm sit around the table and we share the information in ways that apparently did not happen as robustly before and make the kinds of decisions that are necessary for controlling these sorts of risks.

I believe that this whole experience is one in which, as our CEO has said, we are going to be judged by how we respond to this sort of adversity, and he is absolutely committed to getting this right—in large part, because we think it is critical to our success. If we are going to be a successful, the leading international bank, which is our aspiration, we have to be successful at this. We have to lead in this area, as well.

Senator COBURN. Is there a conflict within your board to—I am trying to think of the best way to phrase this—compliance here does not necessarily have to be difficult, but it has to be right, and there are some variables that affect that. How well do the regulators do? Are they fair? But are they trying to do the right thing, not just be right? Is there a conflict or tension between the potential, as Ms. Dorner outlined, of being a global bank with a large number of multinational countries here, and the cost of compliance, because I actually see that is where things really went awry. How do you manage that tension so that when they are looking—if this is a great business opportunity for HSBC, is this too much of a
compliance hurdle or cost given the potential capital appreciation opportunities for your organization?

Mr. Levey. Senator, I do not believe we view this as a tension or a tough call. We are going to have to get this right, whatever it takes to get this compliance in order. I do not think there is any ambivalence about that on our board. And we view it as our responsibility—quite aside from the regulators, candidly—it is our responsibility to get this right and we appreciate the help we have had from the Subcommittee and the recommendations, but we have—it is our responsibility to look at those and improve and also identify the improvements ourselves that we need to make.

Senator Coburn. With the changes that Ms. Dorner has put in and with your expertise, is it your opinion that not only will you be better in terms of compliance, but you will be a better organization and a more profitable organization as a result of it?

Mr. Levey. I agree with that entirely, Senator. I think that there is no conflict in the long run between those two things. Being compliant, having the right controls in place, is in our long-term financial interest.

Senator Coburn. Thank you, Mr. Chairman.

Senator Levin. I want to go back just for a moment to that situation with the Syrian terrorist. There was an inquiry from OFAC. We want to start with that. It was an inquiry regarding a trust account in the HSBC Cayman affiliate that was administered by HSBC Geneva. What happened then is that an AML officer at HBUS—and this, again, is Exhibit 50d1—an AML officer at HBUS wrote the following, “that we have determined that accounts held in HSBC Cayman are not in the jurisdiction of and are not housed on any systems in the United States. Therefore, we will not be reporting this match to OFAC.”

So HBUS knew the account existed, knew that there had been a request about this account from OFAC, knew that an HSBC affiliate maintained it, but was not going to get that information to OFAC based on this jurisdictional line. In effect, what the AML official decided to do is to use the affiliates’ separate entity status as a reason to not report a Syrian terrorist’s HSBC account to OFAC.

So we have HSBC crossing international lines to establish and service the trust, to protect its assets, and to facilitate Makhlouf’s transactions. And this is 2008, by the way. And yet they rely on that technicality not to report the information to OFAC.

And so my question to you folks is, if this same thing happened today, would you get that information to OFAC?

Mr. Levey. Mr. Chairman, I am—obviously, this is, again, several years before I arrived. I do not know the details of what happened here. What I can tell you is that one thing we have done that would handle this kind of situation is that we have now adopted a global sanctions policy so that anyone who is designated by OFAC will be—we will search across the entire bank in all jurisdictions and all currencies to ensure that we catch all those situations and either freeze accounts if we are permitted to, because in some—if it is a U.S.-only designation, we may not be able to freeze

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1 See Exhibit No. 50d, which appears in the Appendix on page 823.
the account—or exit or reject transactions. I am not in a position
to go into the details of transaction.

Senator Levin. Well, I think you have answered the question,
without going into details. You are saying that, first of all, every
affiliate is going to apply the same catch mechanism. So, presum-
ably, they would have caught this.

Mr. Levey. Yes. What I do not know——

Senator Levin. If it would have been caught by HBUS, it would
have been caught by Cayman.

Mr. Levey. Right.


Mr. Levey. Presumably, yes.

Senator Levin. It should be.

Mr. Levey. What I do not know is when Rami Makhlouf was ac-
tually designated. I do not have the date in my head.

Senator Levin. Well, putting aside that, the question is, presum-
ably, it will be caught by the same mechanism being applied in
every one of your banks, wherever they are located. My question,
though, is if for some reason it fails and if one bank knows that
information is being sought by OFAC, will it make sure that the
information is provided?

Mr. Levey. Again, my view on this would be that we would give
to any government as much information as we are legally per-
mitted to do when we had a valid request. So I cannot tell you
whether there will be some legal restriction, but we would do ev-
everything we could to get them the information.

Senator Levin. Well, when you say what you are legally per-
mitted to do, were you legally permitted by the Caymans, by their
law, to provide this? Do you know, Cayman law will not allow this.

They are a secrecy jurisdiction.

Mr. Levey. I do not know, Senator.

Senator Levin. Well, but you need to find out.

Mr. Levey. Will I find out?

Senator Levin. Are you going to be bound by a secrecy jurisdic-
tion’s law that says you cannot share that information, or are you
going to be carrying out your commitment here that you are going
to treat all of your affiliates as though they are in one place glo-
ally and you are going to respond to law enforcement with their re-
quest? I mean, if you are going to say, if legally permitted by the
Caymans or by any other country, you have 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?

Mr. Levey. We are going to do everything we can to cooperate
with law enforcement.

Senator Levin. Well, you say, though, that if it is legally per-
mitted. That is 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.

Mr. Levey. I do not know if there would be a conflict there.

Senator Levin. There is. Assume there is.

Mr. Levey. If there is, we do everything we can to get it to
OFAC.

Senator Levin. To comply with U.S. law?
Mr. Levey. Yes.

Senator Levin. Now, sharing information across international lines is not just an ancient problem at HSBC, it is still a current problem, and I am going to give you what has happened recently involving this Subcommittee. In 2010, in a hearing before this Subcommittee, we reviewed an incident in which an HSBC affiliate in the Bahamas was asked to open an account for the Central Bank of Angola. Email exchanges obtained by the Subcommittee made it clear at that time that the Angolan Central Bank wanted to use an offshore secrecy jurisdiction—that is the Bahamas—to hold its funds in order to avoid court orders that might lead to a freezing of its funds. At the 2010 Subcommittee hearing, I asked HSBC if the account was ever opened, and not surprisingly, HSBC refused to answer, citing jurisdictional constraints.

Last week, HSBC informed us that the account had been opened and was opened at the time of our 2010 hearing, but that it was closed 45 days ago. HSBC also revealed that the only reason it could provide that information to the Subcommittee was because HSBC had received permission from the Central Bank of Angola. HSBC Bahamas could not release it to HBUS without the client’s permission, so that is the problem with what you are telling us today. It is the problem with HSBC’s word, the subject of being legally permitted, that description, which is a real big loophole, and it is a problem with other international banks.

The international banking system established a financial system that enables them to facilitate financial transactions and move around the globe across jurisdictional lines in a matter of seconds, but when it comes time to sharing critical information with U.S. authorities about clients and their accounts and transactions, then things begin to grind to a halt and banks point to jurisdictional rules and local laws, sometimes using that argument disingenuously. But putting that aside, that is the reason given by HSBC not to share that information.

Now, in the most recent group-wide policy, your GCL, on April 30, you say that you will “maximize the sharing of information for risk management purposes amongst group companies and amongst global businesses and functions.” You have noted that HSBC is going to maximize the sharing of information to “the extent permitted by laws.” And that, again, is the rub.

What policies are you going to enact or implement to ensure that you provide law enforcement and governmental officials in this country which has given HBUS a charter—rather than using jurisdictional constraints as the excuse to avoid sharing information, what are you going to do with your new rules and regulations to make sure that this government and the proper authorities are given information upon request?

Mr. Levey. Mr. Chairman, as you indicate, we have committed within the company in the GCL to maximize the sharing of information for risk management purposes amongst our companies and functions. We have decided that is the value that we are going to pursue, which is that we need to share information. I think your report highlights the serious consequences that occur when we do not.
We have also decided through this policy that when there is—we are going to do everything we can to share information across borders. We have found, as you indicated in your question, that sometimes the secrecy jurisdiction was being used as a comfort, in a way. Well, no, we cannot share the information because of the jurisdictional rules.

It is my job as the Chief Legal Officer to look at that, right, and to try to work that out and make sure that we are not using it as an excuse. But in the end, of course, we have to abide by the law wherever we operate. That is true of any multinational company. All we can commit to do is—whenever there is any discretion, to exercise it in favor of sharing information. I do not know that we can do more than that or that any multinational organization can do more than that.

Senator Levin. Senator Coburn.

Senator Coburn. Ms. Dorner, in how many locales does HSBC now have operations that have such agreements as the Bahamas? In other words, what percentage of HSBC’s locations throughout the world are tax havens or isolated places where jurisdictional differences preclude the sharing of information?

Ms. Dorner. I am sorry, Senator. I cannot actually put a number on that for you.

Senator Coburn. We have seen changes in Liechtenstein, for example, from pressure from this Subcommittee and others, where they have actually changed their laws. But could you get that to us?

Ms. Dorner. I am sure that we could. I think it is fair to say that all countries have privacy rules of one sort or another.

Senator Coburn. I understand, but we are talking about those countries that have privacy rules intended to not be transparent in the commission or the suppression of information that may or may not be, in fact, in the best interest of the global economy as a whole and may be associated with illicit activity.

Ms. Dorner. I understand. I am sure we could do that.

Senator Coburn. Thank you.

Do you know of any history in your experience where a bank charter has been pulled for cross-jurisdictional violations or what was perceived as a violation, but what was also perceived as in the best interest of your company as a whole or in the best interest of transparency in terms of fighting illicit activity?

Ms. Dorner. I am not aware of any.

Senator Coburn. OK. Thank you.

Back to Mr. Levey just for a minute. Do you believe there is sufficient oversight of the affiliates that make up the group compliance right now in your organization?

Mr. Levey. I think we are on the path to getting there, Senator, but I do not think I can sit here today and tell you that we are at the end of the road. I think we are at the beginning of the journey and we do have our work cut out for us, but we are on the right path.

Senator Coburn. As I said, I believe you have the best of intentions. This is not to question the new management at all, but I think some questions need to be asked. Do you know of any affiliates now that are not complying with the set standards?
Mr. LEVEY. Senator, I do not have knowledge of such a thing, but I also cannot sit here and tell you I am comfortable with the scope of this whole——

Senator COBURN. One further question along that line. If today you found out an affiliate that was not in compliance, what are the consequences?

Mr. LEVEY. The consequence is they would have to improve immediately, and the new thing, though, is that information would be shared with all other affiliates so that Ms. Dorner here in the United States would not be blind to it in the ways that we saw in the examples in the report.

Senator COBURN. You have powerful experience in the government and now applying that in the private sector. Do you have a recommendation for Senator Levin and I in terms of what we could do to make us both more effective, less burdensome, and more efficient as—even though you stated it is in your own best interest to be compliant, the point is, are there ways that we can help do that in a more efficient way that gets a better result.

Mr. LEVEY. I have to say, that sounds like a dangerous question. I did not come here to give you recommendations.

Senator COBURN. I have a reputation of being a straight shooter. I am asking that because I really want to know. I actually like to try to fix what is wrong with government rather than pile on another program that is supposed to do the same thing that is going to fail again. So if you would like to think about that and shoot me a short note, I would love to hear from you, but that was not meant in jest or as a trap——

Mr. LEVEY. No, I did not intend that.

Senator COBURN. It is my intent to try to make government work, and too often, it does not. Having been on both sides of the wall, you have a perspective that not many people have and I think you could offer us lots of suggestions on how we might be better at what we are doing, much like we have made recommendations in our report.

Mr. LEVEY. Well, I appreciate that, Senator. Of course, we have a lot to do to fix ourselves, but I do think that there are ways in which the sharing of information, which is the key here, right? The sharing of information is the key to these kinds of controls being effective and there are ways to improve that. There are changes that can be made in the way governments share information with the private sector and in which the private sector shares information amongst itself. That is ultimately what needs to be done. If we are going to really get these illicit actors, we are going to have to have better visibility. But I would be happy to try to follow up.

Senator COBURN. Thank you. Which would mean you need better information from us on illicit conduct. You need a more robust PATRIOT ACT in the areas of this illicit conduct. And you also need access to beneficial ownership information from us.

Mr. LEVEY. I agree with all of that.

Senator COBURN. OK. Thank you. Mr. Chairman, I yield back to you.

Senator LEVIN. I want to go back to the question about an affiliate that does not share information with you because of a local law that says that secrecy is the order of the day. These are the secrecy
jurisdiction entities, and Ms. Dorner, I guess you are going to give us how many of those jurisdictions there are affiliates in, is that correct? You were asked to do that and you are going to give us that for the record, I believe.

Now, you are committed to do a whole bunch of things. You are going to police the HSBC affiliates that use your accounts. You are going to audit so-called cover payments sent by HSBC affiliates to see if they are circumventing the OFAC filter. I think you prepared in your new approach to look at affiliates’ internal audit findings to look for those with weak AML controls. I think you were just asked by Senator Coburn, what are you prepared to do if an affiliate does not provide information to you or to a law enforcement entity in a country that you have a charter, the United States.

I guess one of the ways you could enforce it would be to deny a U.S. correspondent account to an affiliate. Do you know whether or not that has ever been done? Has HBUS ever said no to an HSBC affiliate?

Ms. DORNER. The direct answer to your question is no, we have not. But we now have KYC at a level for all of our affiliates that we use for third parties and I can assure you that in the event that one of our affiliates did not pass the KYC as it stands now, I would have no hesitation in not opening an account or, indeed, closing an account.

Senator LEVIN. And what about if they do not share information with you? That was the question which I believe Senator Coburn was asking. Is not one of the remedies you just simply say, we are not going to let you have a correspondent account with us?

Ms. DORNER. The same rules would apply for any third party. If we asked for information and did not get it, we would close the account.

Senator LEVIN. But you will apply that test to an affiliate?

Ms. DORNER. We would.

Senator LEVIN. OK. Talking about secrecy jurisdictions and beneficial owners, I think you and I talked about this issue before, but let me get you on the record in this setting, Mr. Levey, and that is should the U.S. Government get the beneficial ownership information for U.S. corporations?

Mr. LEVEY. I believe so, Mr. Chairman, and it would also be helpful to banks—it would be helpful to us so that we could better know our customers because, as you know and you probably better than anyone, this is one of the obstacles that we sometimes face.

Senator LEVIN. That is very helpful and we will be sure to be quoting you for that in different places. [Laughter.]

I want to talk to you both about bearer shares. Bearer share corporations, so-called, are notorious vehicles for money laundering and for other illicit activity because they provide anonymity through assigning legal ownership of the corporation to whoever has the physical possession of its shares. There is no paper trail. There is no way of knowing who owns those corporations, just the way there is no way of knowing who is the real beneficial owner of a bank account unless we require people owning the accounts to tell us who the beneficial owners are.

But at times over the last decade, HBUS maintained over 2,000 bearer share accounts despite warnings by internal auditors and
outside regulators that the accounts posed high money laundering risks. Internal bank documents show the account owners deliberately pressured the bank to help hide their identities, and Exhibit 95 is one example of that, of a phone conversation between a man named Mauricio Cohen and an HBUS banker in Miami. I made reference to that in my opening statement.

I know that HBUS has reduced the total number of bearer share accounts, and I guess my question is why have any?

Ms. DORNER. Mr. Chairman——

Senator LEVIN. Could I interrupt your answer, and forgive me for this. I want to just read one thing to you before you answer, and that is what the World Bank has had to say about these bearer share accounts in its report last year. It said that no bank with any sort of due diligence standards is willing to conduct business with a company that has free-floating bearer shares. That is what the World Bank said. So, now, please.

Ms. DORNER. Thank you, Mr. Chairman. Entirely understand the concern with bearer shares, a matter of great concern to me. It is always very important for us to know our customer. We have changed our policy here in the United States. We have toughened it up. We do not really want to do this business. To the extent we do it at all, it is going to be done under very limited circumstances, only when we can hold the shares ourselves or get them into a custodial agent that we know so that we can actually understand the movement of the shares.

I think that because this is such a matter of general concern, the group—we are considering, or the new Group Standards Committee, on which I sit with Mr. Levey, they are looking, or we are looking at the U.S. policy with a view to extending that around the world.

Senator LEVIN. OK. That is really a step forward.

Another issue that I raised in the opening statement was HBUS’s willingness to clear suspicious bulk travelers’ checks for foreign banks. From 2005 to 2008, on a regular basis, HBUS cleared up to a half-million dollars or more a day in bulk travelers’ checks from the Hokuriku Bank of Japan. They routinely arrived in large stacks of sequentially numbered checks signed and countersigned with the same signature, which was unreadable. HBUS found that the Japanese bank could not provide any “know your client” information or explain why two dozen of its customers were often depositing large stacks of U.S. dollar travelers’ checks all purchased from the same bank in Russia, allegedly for the used car business people.

Now, this was under OCC pressure. HBUS stopped clearing the travelers’ checks in 2008, but it kept open the correspondent account despite that Japanese bank’s poor AML controls, and in less than 4 years, HBUS provided over $290 million in U.S. dollars to a Japanese bank for the benefit of unknown clients dealing with unknown Russians who, again, were allegedly in the used car business.

[1] See Exhibit No. 95, which appears in the Appendix on page 1062.
So I guess the real question is, would that happen again? Would that correspondent account be kept open again under your new rules?

Ms. DORNER. Mr. Chairman, first, may I say I entirely understand the issue with travelers' checks and I have asked the AML Director immediately to do a full review.

As regards Hokuriku, they failed our new KYC standards in 2012, which is why we have closed the account, and I have now exited, or we have now exited 326 correspondent banking accounts since we instituted the new KYC procedures. And, therefore, I would hope that we would close any bank such as this because they would fail the new KYC procedures.

Senator LEVIN. A number of money laundering problems identified by the OCC in 2010 related to inadequate monitoring for suspicious activity. Among other problems, the failure to monitor for suspicious activity for the $60 trillion in wire activity, failed to monitor the bank notes accounts held by its affiliates, used poor procedures to identify who could get enhanced monitoring, and a backlog of alerts that were not reviewed, and the OCC provided several pages of criticism related to the weak parameters that the bank used to review wire and account activity.

Now, one of the key provisions in that cease and desist order of the OCC in 2010 required HBUS to install a new AML monitoring system to replace its old one, called CAMP. The new one is called NORKOM, I believe, and the bank is supposed to ensure that it has useful parameters to identify potentially suspicious activity for review. Can you tell us whether or not that effort has been completed and whether you have fully met the requirements of the cease and desist order with respect to a new AML monitoring system?

Ms. DORNER. Thank you, Chairman. The whole point about the system, and this is, I know, why you are interested in it, the whole point about installing a system is it has to be absolutely fit for purpose. It absolutely has to fit the parameters of the business. It must identify the correct risks. And we must be able to monitor it.

We have installed NORKOM. It has been a huge investment. I would be the first to say that with all systems, as usual, improvements can always be made, and it has been pointed out to us that there are two ways that we need to improve this system. We entirely agree. We are on the front foot. We are taking these as a priority and we will fix it. I would imagine that we will be improving this system going forward forever because there are always new ways to fix these systems in such a way that they can deter illicit actors.

Senator LEVIN. As I understand the history here, when this was not working properly by the deadline of 180 days, rather than seeking an extension of the 180 days, the implementation plan was modified and then ended up in noncompliance with the consent order. Is that accurate?

Ms. DORNER. There are two MRAs that have been raised and they are very technical. They are very important because they are about the validation of the model and we will have to fix those two things. To the extent that the OCC have raised other issues, we
have replied in full and I believe that you have a copy of that letter.

Senator Levin. Is there a new deadline?

Ms. Dorner. There is not, to my knowledge, a deadline as such, but it is closely monitored and we are in day-to-day contact, literally, with the OCC, who are clearly very interested in getting this fixed.

[Pause.]

Senator Levin. OK. We have a vote on now, and I think what we will do is we will release this panel. We sure hope that you are going to carry out the commitments which have been made by this bank because our report raises just a lot of serious issues about international banking and this particular bank. Again, the bank has been cooperative, but we hope this visibility will actually help reform efforts at the bank.

Again, as I have said a couple of times this morning, we welcome the commitments. We welcome the apologies. It is the change in culture and actions which are critical. But there is that nagging question of accountability which others are going to have to judge. We are not in the prosecution business here. We are in the oversight business. Others will have to judge the accountability issues. But it has been significantly missing, not just in this situation, but generally in a whole lot of other banking situations and other situations in modern times. We hope that, somehow or other, the hearing and the investigation will also lead to some greater accountability.

But we will now release you and thank you.

Ms. Dorner. Thank you very much.

Mr. Levey. Thank you, Mr. Chairman.

Senator Levin. And we are going to stand adjourned for 10 minutes or until Senator Coburn gets back, whichever comes earlier.

[Recess.]

Senator Levin. The meeting will restart. I am told Senator Coburn will be coming back, but he told me we should start if he was not back, so here we go.

Let me now call on our next panel of witnesses, Thomas J. Curry, the Comptroller of the Currency; Grace E. Dailey, the former Deputy Comptroller for Large Bank Supervision at the Office of the Comptroller of the Currency; and finally Daniel Stipano, the Deputy Chief Counsel at the OCC.

Mr. Curry, I am sure this is the first time that you have appeared before this Subcommittee and we welcome you and look forward to your testimony.

Mr. Stipano, I believe you appeared before us about 8 years ago at our hearing on money laundering and foreign corruption.

Mr. Stipano. Yes, sir.

Senator Levin. We welcome you back, and I think this is Ms. Dailey's first appearance here. We welcome you, as well. We appreciate all of you being with us and we look forward to your testimony.

I think as you have heard or are familiar with our rules, all witnesses who testify before this Subcommittee are required to be sworn, so I would ask that each of you stand and raise your right hand.
Do you swear that the testimony that you will give before this Subcommittee will be the truth, the whole truth, and nothing but the truth, so help you, God?

Mr. Curry. I do.

Ms. Dailey. I do.

Mr. Stipano. I do.

Senator Levin. Under our timing system, you will get a red light a minute before a 5-minute—well, I guess now we are going to have a 10-minute testimony as the limit, so a minute before the 10 minutes is up, it will go from green to yellow and then you could conclude your remarks, and we would ask that you do limit your oral testimony to no more than 10 minutes. I believe, Mr. Curry, you are going to be presenting the statement, of course, for the OCC, so please proceed.


Mr. Curry. Thank you, Chairman Levin, Senator Coburn, and Members of the Subcommittee. I appreciate the opportunity to appear before you today to discuss the OCC’s work in ensuring compliance with the Bank Secrecy Act and the work we are doing to improve our Bank Secrecy Act (BSA) and AML compliance program.

The Subcommittee’s staff report has identified important concerns with the activities of HSBC and with oversight and enforcement of BSA and AML requirements by the OCC in the case of HSBC. As I will describe below, we agree with the concerns reflected in the report’s recommendations concerning the OCC and will fully implement those recommendations.

In one of my first speeches after becoming Comptroller of the Currency just a little more than 3 months ago, I highlighted the importance of BSA compliance. I also noted that this is an inherently difficult area. It requires banks to sift through large volumes of transactions to identify those that are suspicious, a task that is complicated by the ingenuity that criminal and terrorist elements bring to bear in finding new ways to conceal the true nature of their transactions.

In my speech on operational risk, I emphasized, and I want to reaffirm today, that no matter how difficult compliance is, I expect institutions we supervise to have effective programs in place to comply fully with the requirements of the BSA. We will insist on that.

Our testimony today provides details about the OCC’s BSA and AML supervisory policies and practices. It further describes how the OCC monitors compliance with BSA requirements and ongoing supervision that we provide at the largest national banks and thrifts, as well as our current enforcement process when problems or concerns are identified through our supervision and our enforcement record for BSA.

As requested in the invitation to this hearing, our written statement also discusses our supervision of HSBC. In 2010, the OCC issued a comprehensive cease and desist order against HSBC. As

\[1\]The prepared statement of Mr. Curry appears in the Appendix on page 150.
our written statement details, with the benefit of hindsight, the OCC could have and should have taken this action sooner. But the issuance of this order does not conclude our activities with respect to the matters covered by the cease and desist order. We are now actively evaluating the bank's compliance with the order and considering the assessment of monetary penalties.

The Subcommittee's report contains three specific recommendations focused on the OCC's BSA/AML supervision. I agree with the concerns reflected in each of the recommendations and the OCC has begun taking actions in response.

First, we have already identified a new approach that we will implement to assure that BSA/AML deficiencies are fully considered in the safety and soundness context and are taken into account as part of the management component of a bank's CAMELS rating. We will direct our examiners to view serious deficiencies in a bank's BSA/AML compliance area, including program violations, as presumptively adversely affecting a bank's management component rating. We will also provide guidance on how to document application of this approach in determining the management component rating.

Second, we are revising and clarifying the operation of our Large Bank BSA Review Team to enhance our ability to bring different perspectives to bear and to react on a more timely basis to circumstances where a bank has multiple instances of matters requiring attention or apparent violations of the required components of its BSA/AML program. We will also explore how we track and review relevant information in this regard and whether new initiatives are appropriate in that area, as well.

Third, we will also revamp our current approach to citing BSA/AML violations to provide more flexibility for individual pillar violations to be cited and we will identify what steps we can take in our examinations to obtain a holistic view of a bank's BSA/AML compliance more promptly. One of the reasons for the current OCC approach is that it requires the OCC to focus on determining whether the deficiencies in a bank's program amount to a BSA compliance program violation, which requires a mandatory cease and desist order. Therefore, in implementing changes on this point, it will be important not to create disincentives to making the necessary tough calls when there are BSA compliance program violations mandating the issuance of a cease and desist order.

Finally, we will review other areas, such as training, staffing, recruitment, policies, and interagency coordination to make improvements in our BSA/AML supervision program.

I am joined today by Dan Stipano, Deputy Chief Counsel, and Grace Dailey, who served as the Deputy Comptroller for Large Banks from 2001 until November 2010. The three of us share a commitment to a rigorous BSA/AML supervisory and enforcement program at the OCC and we are continually seeking ways to improve our supervision in this important area.

I have asked Ms. Dailey and Mr. Stipano to introduce themselves to the Subcommittee, and then we will be pleased to answer your questions. Ms. Dailey.
TESTIMONY OF GRACE E. DAILEY,\footnote{The prepared statement of Ms. Dailey appears in the Appendix on page 150.} FORMER DEPUTY COMPTROLLER FOR LARGE BANK SUPERVISION, OFFICE OF THE COMPTROLLER OF THE CURRENCY

Ms. DAILEY. Chairman Levin, Senator Coburn, my name is Grace Dailey and I have been with the OCC for 29 years as an examiner. I am currently the Examiner in Charge of a large bank in Minneapolis, where I oversee a team of examiners responsible for that bank’s supervision.

From the end of 2001 through late 2010, I served as one of three Deputy Comptrollers in the OCC’s Large Bank Division. In that role, I oversaw the supervision of a portfolio of large national banks. That portfolio changed over time, but included HSBC Bank USA, N.A., from July 2004 through November 2010. Prior to becoming Deputy Comptroller for Large Banks, I held a variety of roles supporting bank supervision, including serving as Examiner in Charge and other field positions in Minneapolis, Chicago, and New York.

I look forward to answering your questions.

Senator LEVIN. Thank you very much, Ms. Dailey. Mr. Stipano.

TESTIMONY OF DANIEL P. STIPANO,\footnote{The prepared statement of Mr. Stipano appears in the Appendix on page 150.} DEPUTY CHIEF COUNSEL, OFFICE OF THE COMPTROLLER OF THE CURRENCY

Mr. STIPANO. Chairman Levin, Senator Coburn, and Members of the Subcommittee, my name is Daniel P. Stipano and I am one of two Deputy Chief Counsels at the Office of the Comptroller of the Currency. I have spent 27 years at the OCC, with the majority of that time working in enforcement and compliance. In my current role, I supervise the OCC’s enforcement and compliance, litigation, community and consumer law, and administrative and internal law divisions, as well as the OCC District Counsel staffs in the OCC’s Southern and Western Districts.

Prior to becoming Deputy Chief Counsel, I served as the Director for Enforcement and Compliance at the OCC, where I was responsible for taking administrative enforcement actions against national banks and their institution-affiliated parties. From 1989 to 1995, I was an Assistant Director in the Enforcement and Compliance Division after joining the OCC in 1985 as a Staff Attorney in the Division.

Senator LEVIN. OK. We thank you all.

Let us try 10 minutes for our first round of questions.

Let me start with a question for you, Ms. Dailey. You were the OCC Deputy Comptroller for Large Banks from 2001 to 2010 and were in charge of the OCC’s supervision of a number of large international banks, including HBUS. When the OCC became HBUS’s primary regulator in July 2004, the bank was already under a formal enforcement action by the Federal Reserve Bank of New York and the New York State Banking Department for having an inadequate AML program. As a condition for allowing HBUS to become a nationally chartered bank, the OCC required HBUS to complete all of the corrective actions set out in the written agreement that was the result of the enforcement action.
In 2006, the OCC determined that HBUS had fulfilled the requirements and terminated that agreement. Were you involved, first of all, in the decision to terminate the agreement?

Ms. DAILEY. I was one of the recommending officials. I was not the final decisionmaker.

Senator LEVIN. OK. Did you recommend that it be terminated?

Ms. DAILEY. Yes, I did.

Senator LEVIN. All right. Now, the Subcommittee has prepared a chart, Exhibit 1a,1 that tracks the 44 AML examinations conducted by the OCC at HBUS from 2004 to 2010. As you can see from the chart in your book—you will not be able to follow that one, but it is also in your book—the OCC conducted seven exams before it voted to terminate the 2003 agreement in 2006. Those seven exams all took place in about 1 year, from 2005 to 2006, and identified 35 matters requiring attention, or MRAs, which are practices that the OCC defines as deviating from sound fundamental principles and “may adversely impact earnings or capital, risk profile or reputation,” or “result in substantive non-compliance with laws.”

First, are 35 MRAs, matters requiring attention, a high number for a bank to accumulate in 12 months?

Ms. DAILEY. Yes, it is a high number to accumulate in 12 months.

Senator LEVIN. So the 35 MRAs identified in those first seven examinations found that in most instances that the bank was not following its policies, was not monitoring properly, was not conducting appropriate due diligence, that written policies were not adequate, and that staff needed training, all of that while the bank was still under the 2003 enforcement actions. So all of those are matters that the Bank Secrecy Act specifically identifies as pillars or key components that a bank must have for an effective Bank Secrecy Act program. So how could that bank, with all of those outstanding problems in 2006, be considered to have an effective AML program?

Ms. DAILEY. Well, we did a lot of work in that time period, as you have pointed out by the chart, and we did find a lot of issues. Many of those issues—in fact, I think most of those issues—were corrected quite soon after they were detected. So some of the issues were not longstanding problems from the standpoint that it would take the institution a long time to fix, so they were corrected and when we made our determination, we went through the WSRC process. So it is a process to determine when we think a bank is in compliance with the articles, how to go about lifting that. Our examiners felt that the bank did have an adequate program at that time, was in technical compliance with the conditions, and we proceeded through our process, which is to take that through our WSRC process, which is members of management, and there was a recommendation and then a final decision was made. But I understand your concern that there were a lot of issues that were identified at that time.

Senator LEVIN. Well, there not only were a lot of other issues identified, but 23 of the 35 identified issues were also identified in four supervisory letters written in January 2006. Now, all four of

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1 See Exhibit No. 1a, which appears in the Appendix on page 575.
those supervisory letters were dated within 20 days of the decision, February 6, 2006, to terminate the agreement. So it is hard—I do not know how you can say that most of them had been dealt with, and then you have those four supervisory letters written within 20 days of the decision to terminate, and here are some of the issues that were listed in those four letters, again, within a 20-day period.

Monitoring problems were noted in all four letters. Policies in need of enhancements were cited in all four letters. Not following policies was identified in three of the four letters. Customer due diligence issues in three of the four letters. And staff in need of training in three of the four letters.

So I do not know how the OCC could rank and rate the bank’s AML program as satisfactory and how they could cancel the enforcement action.

Senator Levin. I just do not understand it.

Ms. Dailly. In hindsight, we should not have. From what we know today, they did not have an effective BSA program, and in fact, many of the problems that we detected in our 2009 examination were in existence during this time. So in retrospect and from what we know now, we would not have lifted those conditions.

Senator Levin. Well, but my point is that looking back now at what you knew then, it should not have been lifted, because what you knew then when you lifted it, 23 of the 35 matters requiring attention were still outstanding.

Ms. Dailly. We probably did not appreciate the systemic nature of some of those issues. I understand the concern.

Senator Levin. Now, over the next 4 years, the MRAs or matters requiring attention did not stop. OCC examinations repeatedly found significant AML problems across a number of business lines, many of which were high risk and vulnerable to illicit activity. Fourteen of the examinations found AML monitoring problems. Eight found weak customer due diligence. Seven found insufficient staffing. Five found that the bank was not following its own policies. These problems existed in critical, high-risk business units such as banknotes, foreign correspondent banking, embassy banking, international and domestic private banking, wire transfers, and pouch services. By 2009, HBUS had 83 MRAs, more than any other national bank. The next closest had 20 fewer.

So with this kind of a record, the first question that one wonders is why the OCC never took formal enforcement action against HBUS prior to 2010. Do you know why it did not?

Ms. Dailly. Stepping back and looking at it, we should have. We could have and we should have taken action sooner.

Senator Levin. I am talking about formal enforcement action, right? That is what we are talking about.

Ms. Dailly. Yes. I agree that we could have and should have taken formal enforcement action. With the benefit of hindsight, we should have.

Senator Levin. Well, these words are the benefit of hindsight. Given what you knew then, should you not have taken enforcement action?

Ms. Dailly. Had we applied the process that we plan to apply going forward, which is to have the flexibility to cite pillar violations, we would have cited pillar violations in these instances and...
we may have drawn a different conclusion then to cite a program violation.

Senator Levin. What about informal enforcement action? Was there any informal enforcement action taken against HBUS prior to 2010?

Ms. Dailey. There was not.

Senator Levin. This is pretty feeble enforcement. Mr. Curry, what do you think about this record that you inherited?

Mr. Curry. I would like to see going forward a much more aggressive posture by the OCC. If there is evidence of material weaknesses in a BSA/AML program, I would like to see, at the very least, a progressive remedial program being instituted and to use all the tools that are available to us, including cease and desist orders.

Senator Levin. Did the OCC ever cite a violation of law for non-compliance with AML statutes prior to 2010? Do you know, Ms. Dailey?

Ms. Dailey. I do not believe we did prior to 2010.

Senator Levin. Mr. Stipano, you are the Deputy Chief Legal Counsel for the OCC. You told the Subcommittee staff that you did not have much involvement with HBUS prior to 2009 because the Supervision Division was responsible for examinations and the Legal Department generally gets involved only in enforcement actions, investigations, or legal actions brought against the bank by the Supervision Division. But in the spring of 2009, the OCC was contacted by two Federal enforcement agencies regarding investigations that they were conducting of possible money laundering, going through accounts at HBUS, and the OCC met with representatives of those agencies in Washington, DC, on September 1, 2009. When the meeting concluded, the OCC staff continued to discuss the HBUS situation. Was it at that meeting that you learned for the first time about the findings of previous AML exams of HBUS and that they had resulted in 83 MRAs?

Mr. Stipano. To the best of my recollection, that was the first time that I learned about the 83 MRAs.

Senator Levin. When you learned that there were 83 MRAs that were specific to the Bank Secrecy Act, were you surprised by the number?

Mr. Stipano. Yes.
Senator Levin. And did you also learn that there had been two recommendations that cease and desist orders be issued against HBUS?

Mr. Stipano. I did learn that, but I do not recall whether I learned that following that meeting or if I learned that subsequently. But I was not aware of that, to my knowledge, prior to that meeting.

Senator Levin. Did anyone ever explain why the Supervision Division never tried to elevate the issue and take some kind of regulatory action?

Mr. Stipano. I do not recall anybody explaining that to me. I think that judgments were made by bank supervision that the matter did not rise to the level of warranting a cease and desist order or another enforcement action up to that point.

Senator Levin. And what was your reaction to that?

Mr. Stipano. I was very concerned. I think that learning what we learned both through our discussions with the law enforcement agents and what we learned from the examiners following the meeting, it was apparent to me that there was a serious problem in the BSA/AML area and that it needed to be addressed promptly.

Senator Levin. Did you start an investigation in which both the Legal and Enforcement Divisions got involved at that time?

Mr. Stipano. Yes. I do not have precise dates, but shortly——

Senator Levin. About that time?

Mr. Stipano. Yes, shortly thereafter.

Senator Levin. And did you then expand an ongoing AML exam? You set time tables, secured an order of investigation, helped craft the two supervisory letters to HBUS in 2010 which were the first to cite the bank for violations of AML laws and OFAC regulations? Did that happen?

Mr. Stipano. Yes, but there was an ongoing examination into the banknotes area, and this was something that the agency became concerned about following an enforcement action at Wachovia that concerned banknotes and bulk cash services. So the examiners were already looking into it, but I think that the consequence of the meeting with law enforcement and the information that we obtained at that time was to expand the examination and open a formal investigation.

Senator Levin. Why did the Legal Department and the Enforcement Department have to get involved before some regulatory action was taken? Was that ever explained to you?

Mr. Stipano. I think that if we are talking about actually doing an investigation or taking an enforcement action, that really cannot be done without the participation of lawyers. Our investigations involve issuance of subpoenas, subpoenas for documents, and subpoenas for testimony. It is not something that examiners can do on their own, and the same thing with our enforcement actions. The document is a legal document. It is legally enforceable. The respondent bank or individual has due process rights. So the Legal and the Enforcement Division need to be involved.

Senator Levin. But apparently, your level and the enforcement folks were not contacted until after the OCC was contacted by law enforcement agencies in the midst of a criminal investigation involving the bank. So you had all of this background, having all of
these unresolved issues, important issues, but yet you were not contacted and you just point out how important it is that the Legal Department and the Enforcement Department be contacted before some regulatory action was taken. But until that time, with all of the problems that were identified in the exams, which had been recurring and mounting for years, it did not reach your level, is that correct?

Mr. STIPANO. That is basically correct. I mean, there could have been incidental contact. There could have been discussions. There is a senior counsel of the Law Department who works for me that is on the Large Bank Review Team. His role in that capacity is to review supervisory letters and conclusion memos. So it was not like nobody in the Legal Department ever spoke to anybody in Large Banks. But in terms of actually getting a referral or being brought in in order to conduct an investigation or take an action, that did not happen prior to 2009.

Senator LEVIN. So, Mr. Curry, this was not a case where OCC examiners failed to do their job, by the way. They were identifying the AML problems at HBUS all along the way. The higher-ups were overly passive. They were waiting until the problems grew into a very huge one before taking any action, before there had to be criminal investigations that were begun, before there was any real referral to the enforcement folks or the legal folks.

Now, you are new there. You are only there a couple months, so you may not know the answer yet to this question, but when a bank is exhibiting the kind of problems that this bank showed, the problems that continually occur in multiple business lines, do you not believe that the OCC should take some type of regulatory action before those problems become so great that they are the subject of a criminal grand jury, for instance?

Mr. CURRY. One of the most troubling aspects of the Subcommittee's report really is the issue of our ability to identify and act upon the cumulative effect of BSA/AML deficiencies and that is an area that I would like to see much greater clarity as to the posture of enforcement at the agency, and also is the rationale for the expansion of the Large Bank Review Team's mandate to actually be the vehicle to look at the entire compliance posture of our largest institutions to take a holistic view and to react accordingly.

Senator LEVIN. Are you ready, Senator Coburn?

Senator COBURN. Yes.

Senator LEVIN. OK. Senator Coburn.

Senator COBURN. I apologize for being absent during your opening statements and your questions, so if I get ready to repeat a question that was already asked, I hope you will stop me.

Senator LEVIN. Well, you may be getting a better answer. One never knows. [Laughter.]

I think the answers have been responsive. I should not suggest otherwise.

Senator COBURN. This is for Mr. Curry, how do you respond to the charge that the OCC, by giving such high scores to HSBC for so many years, became an enabler because it gave false comfort?

Mr. CURRY. I think, again, judging on what I am familiar with, the Subcommittee's record and from the information I have determined as Comptroller, the agency has been much too slow in re-
sponding and addressing what are significant weaknesses or violations at this institution. And going forward, I would hope that we would be much more nimble and take into account the entire picture, what we are looking at in terms of compliance.

Senator COBURN. Knowing what you know now, I mean, what this Subcommittee’s report has exposed and what also was known by you at times, is it a matter of being nimble and more responsive, or is it a matter of competency?

Mr. CURRY. I believe it is really a matter of being more nimble and recognizing the importance of BSA/AML compliance as both a national interest and in terms of it being a significant and serious safety and soundness issue. And my hope is that, going forward, we will react accordingly, which requires direct and progressive remedial action as supervisors.

Senator COBURN. So have some of those actions taken place now?

Mr. CURRY. Yes. We have begun to already implement the specific recommendations of the Subcommittee. We are also taking an independent look at how we recruit, train, our policies, and also how we can improve our coordination with both our fellow bank regulatory agencies and with law enforcement agencies. This is an opportunity for us to look at the big picture of how we are implementing our responsibilities under the Bank Secrecy Act and AML statutes.

Senator COBURN. This kind of reminds me, but on a much larger scale, of the Homeland Security Oversight Subcommittee and Federal Financial Management Subcommittee in terms of the Defense Audit Agency. And what we found there is they never hired new blood. It was all promoted from within. And the vast majority of those auditors never had real experience auditing, and so you kind of got a downward trend of the least favorable aspects as they promoted people with lesser and lesser experience and no variety of their experience.

How do you go about hiring people now?

Mr. CURRY. It is a challenge to obtain people with the requisite skills that you need to assess bank operations and the specific legal requirements and regulatory requirements of the BSA and AML. That being said, I am committed in renewing a real effort to attract competent personnel from both within and outside the agency.

Senator COBURN. Would not one source be people who have been very good at figuring out how to duck your issues and having them work for you?

Mr. CURRY. Yes, and that is part of our training. We do seek to understand or have presentations by individuals who have experience with how the criminal element exploits our Bank Secrecy Act and AML——

Senator COBURN. Well, I was not talking about the criminal element. I was talking about the people who were on the other side on compliance in terms of recruiting them.

Mr. CURRY. Yes, that would be a source of personnel.

Senator COBURN. A lot has been said in our report about HSBC allowing drug cartels and terrorists to move money through its banks. Since you all knew all of this was happening and did not stop it, are you not somewhat complicit in it?
Mr. CURRY. I deeply regret that we did not act sooner and more decisively.

Senator COBURN. So is that a yes?

Mr. CURRY. Yes. Absolutely.

Senator COBURN. This is a little harder question. Take a little bit longer time. But with as much specificity as possible, can you explain what a good AML system within a bank should look like? And I am not talking about pillars or principles. I am talking about the actuality of what a bank—what would you all ideally—I know what your regulations say. I know what we have recommended. What would you, if I came to you and I had a 150-bank operation and it is international and I said, what should my AML look like, what would you tell me?

Mr. CURRY. I think the No. 1 principle or attribute would be having management and the board being committed to developing and funding a BSA/AML program that was appropriate for the business activities of that institution. That is probably the No. 1 thing. And then in a successful program, all other requirements would flow from that—hiring competent personnel with the requisite experience to implement a credible program, building the management information systems that are necessary to monitor BSA/AML activities, as well. And at the end of the day, it is a corporate commitment to compliance.

Senator COBURN. Did you happen to hear Ms. Dorner and Mr. Levey’s testimony today?

Mr. CURRY. I was able to hear the tail end of their testimony.

Senator COBURN. Do you think they have put in place a good AML system?

Mr. CURRY. That is our expectation as their primary supervisor.

Senator COBURN. But based on what they said here today, is it your belief, if they carry out what they have said here today, that they will have a great AML system?

Mr. CURRY. I would hope that is the case. I think we are in the position as their supervisor that we need to verify that and I do not believe we are in a position to do that right now.

Senator COBURN. OK. So how do you know when somebody has a good AML system?

Mr. CURRY. Personally, as the Comptroller, I am relying on the expertise and the supervision programs of our examinations staff.

Senator COBURN. And so who directly under you is responsible for that?

Mr. CURRY. The Senior Deputy Comptrollers of both our Large Bank Division and our Mid-Size and Community Bank Divisions are the primary people responsible for our BSA examination programs. We also have, which Mr. Stipano mentioned and I mentioned in response to an earlier question, a Large Bank Review Team, which is really the Washington-based clearing function for making sure that there is coordination and consistency within our supervision programs, and especially in the area of enforcement.

Senator COBURN. I would be interested if you would get the videotape of Ms. Dorner and Mr. Levey and share with the Subcommittee your thoughts in terms—I know you have to prove and make sure, that is your responsibility, but I would love to hear your thoughts about what they said they were doing, how they
were doing it, how they were implementing it, how they were doing clawbacks, how they were holding people accountable, and how they were trying to change the culture within their organization.

Mr. CURRY. I would be happy to do that, Senator, and to get back to you.

Senator COBURN. Thank you.

Ms. Dailey, our investigation found in 2007 that examiners recommended the OCC take formal enforcement action against HBUS for weakness in how it monitored how its pouch services report. That is on page 304. But the OCC decided to take no such action. Do you recall that?

Ms. DAILEY. To the best of my recollection, that recommendation did not reach me.

Senator COBURN. OK. Do you have any idea how high up it got?

Ms. DAILEY. Generally, what would happen is an examiner would make a recommendation and present that to an Examiner in Charge. I do not know if that happened or not.

Senator COBURN. Well, that would seem to suggest to me that some of the same problems are going on at the OCC that were going on at HSBC. We heard testimony from our first two panels of what was not happening, where information was not flowing that should be flowing, some of it for profit motive, some of it from incompetence. Is it possible that line-level examiners thought a tough enforcement action was needed but were overruled by their supervisors?

Ms. DAILEY. I do not know that. I do not have any knowledge to that effect because it did not come to me. It could have been presented to the Examiner in Charge and they could have made a different determination once looking at the facts. Oftentimes, when the examiners make determinations, they sit down with the Examiner in Charge and go through the different criteria and the different facts and they could come to a different conclusion. I do not know that, though, because I was not part of any of those types of discussions.

Senator COBURN. All right. And it is easy for us to arm chair quarterback it now, looking backwards, and I understand that. Does the agency or did the agency have any processes in place to make sure all proper enforcement actions were handled consistently across the various banks that OCC regulated?

Ms. DAILEY. Yes. We have what we call a WSRC process in place, and what happens is whenever an enforcement action, whether it is informal or formal, is recommended, it goes through the examination team. It would be presented to the Large Bank Review Team. If the Large Bank Review Team agreed with those findings, it would be presented to the WSRC committee, and that committee is made up of members of across our agency in supervision, policy, enforcement, etc., and that committee is a recommending body for an informal or formal action and the final decision would be made by a Senior Deputy Comptroller.

Senator COBURN. So as you look back through the past few years, where do you think you all have failed? I mean, just an honest assessment of where was our management not good? Where was our quality of instruction and direction, where were our employees not up to the task? In other words, we obviously had a great big prob-
lem here. Everybody agrees with that. So from just your viewpoint, where you sit, where do you think the problem was?

Ms. DAILEY. I think we did a lot of work. We did a lot of examinations. We found a lot of issues. We received some corrective action along the way. But we did not probably step back as well as we should, and with the benefit of hindsight, we could have and should have taken action sooner.

Senator COBURN. Mr. Chairman, that is the kind of answer we get all the time. The fact is, is what that means is things are going to be repeated, and what our whole goal is, is so that things are not repeated.

Mr. CURRY. Senator Coburn, I think from my perspective as Comptroller, I really want to address the same issues that you asked me to look at how HSBC was addressing. I want to have a culture at the OCC in which examiners feel free to voice documented, well founded concerns about the performance of the banks that they are examined, to know that those concerns are going to be fairly and thoroughly reviewed, and at the end of the day, the appropriate action or, in some cases, inaction will be taken by the agency as a whole.

Senator COBURN. So what happens right now when an examiner feels strongly that some action needs to be taken and the person in charge of that examination disagrees? Where is the outlet pressure for somebody to appeal without it costing them?

Mr. CURRY. I would encourage them and they have the opportunity to appeal to me. We also have review functions, whether it is in the case of BSA and the Large Bank Review Team, or to contact our Committee on Bank Supervision or any one of the senior members of the agency.

Senator COBURN. So how many times has that happened?

Mr. CURRY. In my short tenure, I am not aware of that number.

Senator COBURN. Has it happened? Has anyone called you?

Mr. CURRY. No one has called me specifically, but I want to create a culture at the OCC, or to reinforce a culture that we are here to be bank supervisors and that we are to be fair and reasonable in how we approach that. But at the end of the day, we are to do what we are being paid to do.

Senator COBURN. All right. I have gone over time. It is yours.

Senator LEVIN. How many months have you been there?

Mr. CURRY. A little over 3 months.

Senator LEVIN. All right. Well, I would believe that in the next 3 months, you will be getting some phone calls and it is important that line of communication be kept open, that people be able to appeal denials of their strong urgings after notifying their supervisor that they are going to do it. You have to be able to go around your supervisor, and if they do it privately, without notice to the supervisor, I guess they would become a whistleblower at that point and they have to be protected under our whistleblower laws because the stakes here are just too huge and the failures here are too massive to allow them to be repeated.

My own belief is that part of the reason has been a culture, but the other part is that there has been just a lack of accountability. It was true, at least, inside this agency.
This is not a matter of hindsight, by the way. I would disagree with you here, Ms. Dailey. This is where at the time things were known and were not acted on. And that is what is so troubling here. We obviously want to use hindsight to improve. We always can use hindsight to benefit us. But what we have seen throughout this hearing today is that at the time, contemporaneously with these events, that there were people who knew better. There were sometimes efforts made that were ignored and squelched. But it is not just a matter of with the benefit of hindsight here.

The testimony that you have given us today, Mr. Curry, is that the agency is reviewing the matter in which MRAs are reported to ensure that banks with high numbers of MRAs will receive additional supervisory attention and consideration of formal enforcement action and I would like to get some additional details on this matter, who is going to be involved in this revised approach, looking at matters requiring attention when there are a number of these that are issued. Who is going to be looking at it, just supervision, or are the Legal and Enforcement Divisions going to be in the mix? Give us some details on how this is going to work.

Mr. Curry. Initially, we are looking to expand the mandate of our Large Bank Review Team to take on that function. That is our initial response to the report’s findings. My hope is that we will have additional recommendations after we look at this matter further, as we examine our policies and procedures. There may be a more effective measure that we will employ. In any event, I will endeavor to keep this Subcommittee informed of the improvements that we will be making on an ongoing basis.

Senator Levin. So that the enforcement folks and the legal folks are going to be involved in this new process early?

Mr. Curry. That is the intention.

Senator Levin. Is the revised approach going to have some sort of thresholds that they are going to apply, maybe to different time frames, such as how many MRAs in a month, how many MRAs in a year, and so forth?

Mr. Curry. I cannot say that we will come up with an arithmetical floor, but we will have a process that looks at the totality of circumstances of which the number of MRAs will be a critical factor.

Senator Levin. The Subcommittee investigation found that in some instances, the conclusion memos of exams at HBUS were a lot stronger than the supervisory letters that were sent to the bank. So in those instances, the real message about the seriousness of problems was not being delivered to the bank. Is your Large Bank Review Team going to get better information now than in prior years?

Mr. Curry. That particular practice has already been corrected. Both the conclusion memo and the supervisory letter draft will be reviewed by the Large Bank Review Team.

Senator Levin. I am also encouraged by your testimony today and by the OCC’s willingness to look for ways to improve the exam supervision, and here is what our report noted, that there are some practices at the OCC that depart from the practices utilized by other Federal bank regulators, and more importantly, seem to act as a barrier to your examiners, your AML examiners. Those bar-
riers made it difficult for your AML examiners to get the appropriate attention of their supervisors when AML problems were quite evident. In your testimony, you acknowledge that your agency does differ from other agencies with respect to including AML exam findings in the consumer compliance exam process and you are going to correct that.

By the way, has anyone explained to you exactly why the anti-money laundering was inserted into customer compliance examinations and ratings? That was a longstanding process. It did not occur by happenstance. We are delighted today to hear that you are correcting that. Your testimony is very clear on that, that you are going to now follow the same practice that other examiners do in this regard.

But was it ever explained to you why it was part of the customer compliance ratings?

Mr. CURRY. I did ask why we deviated from the other Federal bank regulatory agencies in that regard. Personally, my view is that BSA/AML is a significant or serious safety and soundness issue and that it is appropriately addressed by looking at it in the context of the management component in the CAMELS rating system and that policy has been adopted at the agency already and we are simply in the process of communicating that decision and making appropriate changes to the examination procedures for our staff.

Senator LEVIN. And when will the new AML exam process take effect? Will it take effect immediately?

Mr. CURRY. It is immediate. There will be some lag in communicating the actual procedures to staff, but we will, again, keep you informed on that process, if you would like.

Senator LEVIN. So the exams are going to be considered this year when assigning CAMELS management ratings?

Mr. CURRY. Yes, as soon as possible. I would expect it to be sooner rather than later.

Senator LEVIN. A matter of months?

Mr. CURRY. Yes. Less than that, hopefully.

Senator LEVIN. Good. Might this have implications for the current rating at some banks, including HBUS?

Mr. CURRY. I believe our position is that serious and significant BSA violations should be presumptively a factor in an adverse management rating.

Senator LEVIN. All right. And if it applies, if it has an impact on HBUS, so be it?

Mr. CURRY. So be it.

Senator LEVIN. The Subcommittee report also recommended that the OCC cite violations when a bank fails to meet any one of the statutory minimum requirements for an AML program. You state in your testimony that the OCC is going to “revisit its current approach in order to provide more flexibility for individual pillar violations to be cited.” Can you give us just a little bit more detail on what you mean by “revisiting our current approach”?

Mr. CURRY. We are looking to broaden the range and types of violations that examiners will be reporting in the reports of examination and in supervisory communications. The only reservation that we stated was we want to make sure that where there are
program violations, that is clear that they will result in a mandatory cease and desist order.

Senator LEVIN. OK. Senator Coburn.

Senator COBURN. Just a few more questions. Ms. Dailey, in September 2009, OCC officials, including you, met with officials from DHS, Immigration and Customs Enforcement who were investigating money laundering. After the meeting, the lead AML examiner for HBUS said he had twice recommended cease and desist orders against HBUS for AML weaknesses. Do you recall that?

Ms. DAILEY. I recall the meeting afterward and I recall the gentleman discussing the MRAs. I do not recall whether he discussed or mentioned that there had been previous recommendations or not.

Senator COBURN. Yes. So you cannot tell me whether that was an accurate statement he made to us?

Ms. DAILEY. I do not recall that part of the conversation.

Senator COBURN. Well, Mr. Stipano, a memo following that September 2009 meeting states that when learning of the cease and desist recommendations that were not followed, you said you were unaware of the recent history of HBUS and that you requested the thorough review. Is that right?

Mr. STIPANO. Yes. My recollection, Senator Coburn, we did talk about this a little bit when you were out of the room——

Senator COBURN. All right.

Mr. STIPANO. But my recollection of it was that following the broader meeting with law enforcement, we had a smaller internal meeting and I learned at that point for the first time about the 83 MRAs. I do not recall whether I also learned at the same time that there had been past recommendations for cease and desist orders. I did learn that at some point subsequent to that. It could have been at that meeting. It could have been later. I just do not remember.

Senator COBURN. But the fact is, there were recommendations made for cease and desist orders from examiners, correct?

Mr. STIPANO. We know that now.

Senator COBURN. Yes.

Mr. STIPANO. Yes.

Senator COBURN. So back to Mr. Curry. Here is a prime example where recommendations were made and got squelched, essentially. Somebody made a decision that it was not going to happen. To me, I would use that as one of the learning models. Here is what we do not want to happen in the future, so here is how our policies and procedures are going to make sure this does not happen, because you obviously had a problem. Everybody agrees there was a problem. The examiner made probably the right recommendation, except nothing happened on it. The whole purpose of this is to learn, to get better, and to make the changes so that does not happen. Any disagreement with that?

Mr. CURRY. No, none at all, Senator Coburn. I think it is important as a supervisor that when we detect significant weaknesses in any program, particularly BSA/AML, that the sooner that we take appropriate remedial action or corrective action, the better all of us are, both the institution, the agency, and the public.
Senator COBURN. You made an offer to communicate with this Subcommittee on your progress. I would hope that as you do that, that situations like this are specifically addressed. Here is what we have done to make sure that this does not happen. Here is the policies and procedures. And I know this is not easy stuff that you are tasked with. Let me say I understand that. But it also is not rocket science and key management metrics and culture change to where somebody can scream, something is going wrong here, and it is heard all the way to the top.

Mr. CURRY. I agree with you completely, Senator Coburn. It is also clear that, from the top, that we be clear as to what the objective is and what the expectations are, and that is something that I intend to do, and to do forcefully.

Senator COBURN. All right. I think my staff tells me the rest of this has been pretty well covered by you. And you have talked about the conflict of interest on bank examiners, on examiners while I was gone?

Senator LEVIN. No.

Senator COBURN. Well, let us just do that for a moment. Earlier this month, the Treasury Inspector General released a report detailing significant ethical breaches by an OCC national bank examiner. And I will not go into what those are, but the breaches occurred at times when he was supposed to be examining their bank and he was off doing something else other than that. Also, it was noted that he was dishonest on time sheets, etc.

Based on this one finding, have you had time to look into this and to say, is this an isolated incident or is this occurring more than we might think, and does this put our examinations at risk?

Mr. CURRY. This particular conduct, which I just recently became aware of, is totally unacceptable and reprehensible conduct by a bank examiner, and what I find particularly troubling is the potential for disrepute that it places on the many fine people, the 3,600 people who work for the OCC. That is not our standard of ethical conduct. We take great pains to advise and to educate our staff about what conduct is expected from a bank examiner, particularly given the significance of their duties as examiners. So it is troubling to me.

The preliminary information I have been able to gather from the Treasury IG data is that this appears to be a very isolated case. There were only six cases that were reviewed by the IG. And I might add that in this particular case, the agency itself referred it to the Inspector General of the Treasury to investigate. But only three of those six had any merit, and that was over a 3-year period. That is not the conduct that I or my colleagues at the OCC expect of an examiner.

Senator COBURN. It speaks well for you, because the complaint was initiated by one of your other examiners and so there was responsiveness on the part of the OCC to that complaint.

Mr. Chairman, I yield to you.

Senator LEVIN. Thank you very much, Senator Coburn.

Just a few more questions from me. The question was raised with the earlier panel about whether HBUS is complying with the 2010 cease and desist order which was issued in October of that year. Article 9 of the order required the bank within 180 days to
install, test, and activate a new wire transaction monitoring system. I understand that there was a supervisory letter which was written by the OCC on May 25 of this year informing the bank that it was not in compliance with the order and you identified two MRAs that instructed the bank to address deficiencies. The two MRAs instructed the bank to implement an effective AML automated monitoring system and an effective automated alert risk scoring prioritization function to identify the more important alerts.

They were supposed to do that in 180 days. It is now 2 years later. Are the bank's deficiencies in how it is monitoring for suspicious activity a problem as far as the OCC is concerned?

Mr. STIFANO. Chairman Levin, you are correct that the OCC did recently issue a supervisory letter that cited the bank for non-compliance with an article of the cease and desist order concerning their automated monitoring system for wire transfers. That is a matter that we are currently reviewing along with other current examination findings and will be taken into account in any subsequent enforcement actions that we may take.

Senator LEVIN. Now, another article of the consent order required that the bank retain one or more independent consultants to conduct an independent review of account and transaction activities, a so-called look back, to determine whether suspicious activity was timely identified by the bank and, if appropriate, suspicious activity reports were timely filed with law enforcement. Are you satisfied that the requirement has been met?

Mr. STIFANO. My understanding is that we are presently looking at all areas of potential noncompliance with the cease and desist order and we are in a process right now of making some determinations and we will take appropriate action.

Senator LEVIN. Article 8 of that order required that the bank develop and implement appropriate policies and procedures for gathering customer due diligence for new and existing accounts. As part of that requirement, the OCC directed HBUS to identify accounts opened for offshore banks, in other words, for banks with a license that prohibits them from conducting banking activities with citizens of or with the local currency of the country which issued the license. I understand that the bank identified having accounts for 57 offshore banks, of which it will close 23 and keep 33. Has the OCC reviewed that effort, and how high of an anti-money laundering risk is attached to those 33 banks?

Mr. STIFANO. Chairman Levin, I am really not in a position to discuss details of the bank's compliance beyond what I had said earlier. We are in the midst of a civil money penalty proceeding. We will be looking at the total record of compliance with the document in making our determinations.

Senator LEVIN. Also, will you give us for the record, then, also whether you have reviewed these accounts where there is a so-called politically exposed person because in your order you required that the bank's “know your customer” program identify and conduct an enhanced due diligence review of all accounts opened for political figures, which are referred to internationally as politically exposed persons. Will you give us for the record the status of that effort?
Mr. Stipano. I cannot report on the details. I can tell you that our examiners, our supervisory staff, and our enforcement attorneys, are very much focused on the level of compliance with our document. We will do a thorough review and we will take appropriate action.

Senator Levin. And will you let us know what that leads to?

Mr. Stipano. Yes, sir.

Senator Levin. Has HSBC established an effective program to identify the beneficial owners of any bearer share accounts?

Mr. Stipano. I think that is something that we need to determine.

Senator Levin. OK, and you are going to let us know that?

Mr. Stipano. Yes, sir.

Senator Levin. Why should banks open accounts for bearer share corporations? Maybe I should ask you, Mr. Curry. Or any one of you can answer it.

Mr. Curry. Given the high-risk nature of those accounts, I do not know.

Senator Levin. Will you take a look at that whole issue because it sort of continues. They have said they have taken some steps, and I take their word for it. The steps that they identified this morning were that they are going to hold those shares in escrow or put them with an agent, I believe they said, who would be a reliable agent. But there is a waiver provision in there and that waiver provision is an easy loophole, I am afraid. I did not ask the panel about that at the time. I forgot to do that, and I can ask that for the record, as a matter of fact. But take a look at that issue and see whether or not the loophole in that new step that they are going to take is acceptable to the OCC.

Mr. Curry. Yes. I would expect that would be a focus of our ongoing supervision.

Senator Coburn. Mr. Chairman, I would just add one point. It is interesting. We have already established the fact that there was some complicity with OCC and HSBC. But there is some irony in the fact that this organization that is now going to fine them, I wonder who is going to fine you?

Mr. Curry. No, in terms of accountability, I am accountable and I will hold myself accountable and I know you will hold me accountable. Also, I want to emphasize that the vast majority of the people at the Office of the Comptroller of the Currency, particularly the supervisory personnel, are committed. They are very proud to be commissioned national bank examiners and that pride—we will appeal to that pride to make sure that it is evident in the work that we do going forward.

Senator Coburn. I guess my point is, is there is no financial consequence when we have an agency responsible for something and yet fails, but there is a financial consequence to the people that were regulated by the agency that actually failed to do what the agency was supposed to hold them accountable not to do. That was the only point I was making.

Senator Levin. I agree with that and I also agree that Congress has responsibility, too, in our oversight.

Senator Coburn. And that is why we are here.
Senator LEVIN. That is exactly what this Subcommittee is about and other committees and subcommittees are involved in and should be involved in. The oversight function is critically important and that is our responsibility, to bring about accountability through oversight. But it has been missing in many places and in many places where it deserves to be applied. That is one of the results, I hope, of these hearings and what our Subcommittee has tried to do over the years is to promote accountability wherever it needs to be achieved.

I do not have any further questions. Do you have any further questions, Senator Coburn?

Senator COBURN. No.

Senator LEVIN. Let me just summarize very briefly, and that is that we have seen today what the problems are, and our staffs, both of them working together so beautifully as they do, have put together a powerful report, a compelling report and it speaks for itself, but we have tried to summarize the best we could here today.

HBUS and HSBC have made commitments to improve in a number of ways. They have improved by a big increase in the number of compliance personnel. The compliance resources have been increased. The affiliate due diligence requirements that they are putting in are extremely important. They sure were missing in the history so far. They have closed 325 correspondent accounts, including those accounts of 55 banks in sanctioned countries, such as Iran, Syria, and North Korea. They closed the Cayman accounts, and that is a real beginning of some action against these kind of hidden accounts kept secret from the world that can be put to such dubious purposes as we have seen here today. We have seen, in other words, the beginning, we hope, of the cleanup of this global bank, and if it happens, it is going to strengthen protections for people in countries around the world.

The OCC has agreed to strengthen its anti-money laundering oversight. It is going to treat the failures as safety and soundness problems, not just consumer compliance problems. That is going to have a very strong impact and a deterrent impact on our banks. It will cite statutory violations for banks that fail to meet the requirements for the four mandatory components of an AML program. It has agreed as part of its strengthening of anti-money laundering oversight to have a large bank review whenever a bank hits a threshold of a certain number or approximate number of MRAs or violations.

So if everybody carries out the violations—excuse me. If everyone carries out the commitments—they have already carried out the violations, so if folks carry out all the commitments which we have heard about here today, we are going to take a major step towards stopping terrorists, drug traffickers, and other wrongdoers from misusing and abusing the U.S. financial system for their nefarious purposes.

I want to again thank my colleague and my friend, Senator Coburn, and our staffs for the way they worked together and put together an extremely powerful report and for helping us to understand a very complex area.
We want to thank you, Mr. Curry, because you have taken over a very difficult job. You have done it with gusto. You have brought in a real sense of newness and a freshness, a determination to clean up that situation at OCC.

And with that, I will turn to Senator Coburn to see if he has any comments.

Senator Coburn. I just want to thank you all for your cooperation with us for your straightforwardness. What you have in front of you is not easy. Nobody ever said it was easy, but it is really important. So I take you, Mr. Curry, at your word that you are going to continue to communicate with this Subcommittee because decisive action and follow through—it is not enough to have a plan to fix this, you have to have a plan that gets executed and then monitored, and my hope is that we see a vigorous OCC that is the right amount, does not overreact but it is the right amount to do what we can do to stop some of the things that are going on that really only benefit those of criminal intent. So I thank you for your testimony and your time and your patience.

Thank you, Mr. Chairman.

Senator Levin. Thank you all. The record will be kept open for questions of this panel and all of our other panels and we will stand adjourned.

[Whereupon, at 4:49 p.m., the Subcommittee was adjourned.]
APPENDIX

PRESS RELEASE
U.S. Senate Permanent Subcommittee on Investigations
Homeland Security and Governmental Affairs Committee
Carl Levin, Chairman
Tom Coburn, Ranking Minority Member

FOR IMMEDIATE RELEASE
July 17, 2012
Contact: Tara Andringa 202-228-3685

OPENING STATEMENT OF SEN. CARL LEVIN:
“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 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 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. HSBC 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.

HSBC’s 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, HSBC 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, HSBC 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 cambio 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 HSBC 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.
Opening Statement of Senator Tom Coburn

Hearing of the
U.S. Senate Permanent Subcommittee on Investigations
“U.S. Vulnerabilities to Money Laundering, Drugs, and Terrorist Financing:
HSBC Case History”

July 17, 2012

I would like to thank Chairman Levin for holding this important hearing and for his
tireless work to raise the issue of safety and soundness within the banking industry.

I would also like to thank both the Office of the Comptroller of the Currency and HSBC
Bank for their full cooperation in this investigation. The OCC provided a number of
people for interviews as well as essential documents about the regulatory process. HSBC
Bank officials likewise sat for dozens of interviews and handed over millions of pages in
documents. Some of today’s witnesses were flown in from posts around the world.

As Chairman Levin laid out in his statement, the Subcommittee’s investigation into anti-
money laundering and anti-terror finance efforts at HSBC has covered quite a bit of
ground. PSI examined in detail the types of vulnerabilities our nation faces from
criminals and terrorists who want to take advantage and abuse our banking system and
take away our freedoms. What we learned is that the United States faces unique risks,
both because of our post-9/11 security needs and because of the strength of our financial
system, which attracts worldwide attention.

Every day, countless transactions denominated in U.S. dollars occur around the world.
This is good for our economy, which benefits from a strengthened currency and increased
economic activity. But, criminals around the globe are also drawn to U.S. banks, which
offer the attractive option of making their illicit funds look legitimate. If they can pass
criminal proceeds through a U.S. bank unnoticed and untouched, the funds are unlikely
ever to be stopped or recovered.

This hearing raises big and important questions. Banks want to obey the law, but also
grow their businesses – what happens when the two conflict? Banks want to know their
customers, but some customers want privacy – how do we resolve this? As we write
AML policy, we should look for ways to get all boats rowing in the same direction,
letting banks and government each do what they do best as we all work to combat crime
and terror.

At HSBC, we uncovered a number of troubling examples in which weak AML systems
may have let criminal or terrorist funds pass through. In Mexico, for example, billions of
U.S. dollars flowed from the HSBC affiliate in Mexico. The Mexico affiliate was the
single largest exporter of U.S. dollars in Mexico to HBUS. U.S. Law enforcement and the
regulatory entities have concluded that because of the volume of money, it likely came from proceeds of the illegal drug trade.

In another case, an Iranian bank was allowed to initiate U.S. dollar transactions that HSBC would process through the U.S. without explaining where they came from. At the time, however, there were severe legal restrictions on any payments come from or going to Iran, most often meaning they would be manually inspected. HSBC’s affiliate in London coached the Iranian bank how to get the payments through the U.S. without inspection, and simply requested the bank send transactions that would not violate U.S. law. In effect, it relied exclusively on an Iranian bank to comply with a law intended to catch payments from Iranian banks. The bank or the officials that made that decision were either naive or willfully blind.

This is why tough anti-money laundering laws are important, if illicit funds can be tracked and stopped, there are fewer places for criminals and terrorists to hide. And while our focus has been on the problems we found at HSBC Bank, we also have to emphasize that similar problems exist at other banks. For example, Citibank, Bank of America, Wachovia, Western Union and others have come under scrutiny for laundering drug cartels profits.

The purpose of this hearing, then, is not just to make an example of HSBC, as if it were an anomaly. Rather, this hearing is to help Congress understand just what kind of risks this nation faces, and what we should do to reduce them. If we can get a better handle on the risks by looking closely at the operations of a single bank, we can write better laws and achieve our true goals: stopping crime and preventing terror.

With that in mind, I believe there are several lessons we can learn from the problems we uncovered at HSBC Bank.

First, banks around the world operate under different laws, creating different sensitivities to money laundering. While this seems apparent, it was not clear how much this would affect a bank with worldwide affiliates until we took a closer look. In the case of HSBC, its bank in the U.S. operated differently even than its own affiliates in London, Mexico and Middle East. Failure to recognize this can lull us into thinking we can rely on foreign banks to carry out U.S. law.

Second, bank regulators are sometimes better at identifying money laundering vulnerabilities than knowing how to fix them. Throughout this inquiry, it became clear the Office of the Comptroller of the Currency (OCC) was aware of many of HSBC’s AML weaknesses, which it frequently pointed out. It was often at a loss, however, to prescribe how HSBC could eliminate the weaknesses. And so its record of enforcement at HSBC resembles a lapdog rather a watchdog that we sorely need.
We have also learned recently that investigators from Treasury’s own Office of Inspector General have cited OCC personnel for unethical practices. The IG found an OCC examiner-in-charge accepted gifts, meals and even golf fees from executives at banks he was actively overseeing. This unfortunately was not an isolated incident, but other OCC employees were involved in other ethical violations. Taken together with our Subcommittee’s findings in this investigation, these conflicts are startling and suggest Congress should give closer scrutiny to the OCC’s actions.

That purpose here is to stop criminals from hiding their illicit funds and preventing terrorists from having the freedom to plot and plan. The metrics we use to measure a bank’s AML compliance need to focus less on form and more on substance – how well are we achieving this goal?

This committee has shown the kinds of vulnerabilities we face. Too often what we found left us troubled, both for the risks to our nation and for the level of effort we saw to eliminate them. HSBC made its share of mistakes, and for which it is now being held accountable.

But we must all remember that money laundering always begins with a crime, and this ultimately is what we mean to fight. To the extent that this hearing results in criminals and terrorists having fewer options to rob and harm the American public, we will count it a success.

It may be impossible to stop all money laundering. Most of what we call money laundering in a certain context is a benign transaction in another. Buying travelers checks is innocent behavior for the tourist, but suspicious behavior when they are purchased in bulk by terrorists or drug lords. This does not mean we should not try to stop criminals from laundering their money through U.S. banks, but rather we need to do so wisely.

I appreciate the efforts made at HSBC to improve their AML systems, and sincerely hope that they stick. I look forward to hearing from their witnesses, as well as those from the OCC, and appreciate their appearance before us today.
Chairman Levin, Ranking Member Coburn, distinguished members of the Subcommittee, thank you for inviting me to testify today. I am pleased to have the opportunity to discuss the importance of the Department of the Treasury’s efforts to identify and combat money laundering and terrorist financing vulnerabilities in the U.S. banking sector. I would also like to commend this Subcommittee for the leadership it has demonstrated historically and again today by focusing much-needed attention on these critically important issues.

At the outset, it is important to recognize that the United States maintains one of the strongest and most effective anti-money laundering and counter-terrorist financing (AML/CFT) regimes in the world. But the scale, efficiency and sophistication of the United States’ financial system—particularly its banking sector—make it a prime target for those who seek to conceal and move illicit money. This involves not just money launderers, of course, but terrorists, proliferators, drug lords and organized crime figures, who must, at some point, rely on the financial system to move or launder the illicit funds supporting or derived from their operations.

Recent enforcement actions against financial institutions in the United States are a powerful reminder to us that challenges remain. To meet these challenges, we closely monitor evolving threats and work to adapt and strengthen our anti-money laundering and counter-terrorist financing and sanctions policies, regulations and authorities. This work is a key component of our government’s national security efforts—it serves to protect the integrity of our financial system from abuse by terrorists, drug traffickers and other illicit actors and gives us tools to impede and halt their dangerous activities.

Several primary authorities and activities drive the Treasury Department’s work to combat money laundering and terrorist financing. They include our role through the Financial Crimes...
Enforcement Network (FinCEN) as administrator of the Bank Secrecy Act (BSA), which enables us to impose special regulatory measures and requirements to combat money laundering and terrorist financing on a broad array of financial institutions. They also include authorities delegated to us by Executive Orders issued pursuant to the International Emergency Economic Powers Act (IEEPA) to impose financial and economic sanctions, based on all-source intelligence, to disrupt and dismantle illicit financial networks, such as those that support weapons of mass destruction, proliferation, drug traffickers, transnational organized criminal groups and terrorists. Given the maturity, scope and depth of the anti-money laundering and counter-terrorist financing regime today, Treasury works closely with its interagency partners in the regulatory, law enforcement, and national security communities, as well as the private sector, to combat the various illicit financing threats we face. Furthermore, given the increasingly global nature of the financial system, our efforts to strengthen our own anti-money laundering and counter-terrorist financing regime rely on cooperation and collaboration with international counterparts.

II. Nature and Scope of the Threat

Financial crime and associated money laundering activity are difficult to measure with great precision. But by any estimate, the total amount of illicit money moved through and concealed within the U.S. financial system is massive—in the hundreds of billions—even if it represents only a small percentage of the funds in the financial system.

The sheer volume of money moving through the banking system makes banks the primary and most important line of defense against money laundering and terrorist financing. Therefore, our regulatory framework was built to require banks and other financial institutions to take a number of precautions against financial crime, including the establishment of AML programs and reporting and record-keeping requirements to provide useful information to law enforcement and national security authorities for the purpose of combating the full range of illicit finance. This includes screening clients and transactions against Treasury’s Specially Designated Nationals (SDN) List—a list of drug traffickers, proliferators, terrorists and other illicit actors or entities—to help ensure that funds associated with these actors do not enter the financial system. This regulatory framework aids banks in identifying and managing risk, provides valuable information to law enforcement, and creates the foundation of financial transparency required to apply targeted financial measures against the various national security threats that seek to operate within the financial system.

However when these safeguards are not stringently enforced, money launderers, terrorist financiers and other illicit actors are able to take advantage of the U.S. financial system. Some recent civil enforcement actions by FinCEN and the federal banking regulators illustrate how this can occur:

- In one case, failure to effectively monitor foreign correspondent banking relationships with high-risk customers and file suspicious activity reports (SARs) resulted in the processing of $420 billion in cross-border financial transactions with thirteen high-risk
Mexican casas de cambio from 2004-2007, through wire transfers, bulk cash and pouch and remote deposits, including millions of dollars subsequently used to purchase airplanes for narcotics traffickers.

- In several cases, foreign banks “stripped” out the names of Iran or other sanctioned entities in transactions routed through the United States, resulting in billions of dollars of benefits to sanctioned parties. A Swiss bank developed elaborate procedures to alter payments and used code names to disguise identities of sanctioned entities. A Dutch bank used misleading payment messages, shell companies and even advised sanctioned clients on how to conceal their involvement in U.S. dollar transactions.

- One bank’s failure to have a written AML policy and inadequate procedures to ensure the timely reporting of suspicious activity resulted in the processing of billions of dollars through accounts controlled by thirteen Mexican casas de cambio in just one year without filing suspicious activity reports.

- Inadequate AML staffing and procedures at another bank resulted in deficient monitoring and subsequent processing of large volumes of traveler’s checks and third party checks indicative of money laundering, including through sequentially numbered instruments.

On account of these and other substantial vulnerabilities in anti-money laundering and counter-terrorist financing and sanctions compliance, the United States government has instituted criminal fines and forfeitures totaling more than $4.6 billion in approximately 20 BSA and IEEPA criminal prosecutions of financial institutions over the past 6 years.

These civil and criminal enforcement actions reveal not only how illicit financiers abuse our banking system, but also how compliance with our anti-money laundering and counter-terrorist financing and sanctions requirements is critical to protecting our financial system from such abuse.

III. Improving Our AML/CFT Regime

These cases also point to significant vulnerabilities in the framework and enforcement of anti-money laundering and counter-terrorist financing requirements that require immediate attention. Treasury is working together with its interagency partners and the private sector to better understand the anti-money laundering and counter-terrorist financing and compliance challenges faced by financial institutions, clarify U.S. government expectations of financial institutions, and strengthen the overall anti-money laundering and counter-terrorist financing regulatory regime. I will briefly outline just a few of our efforts.

Ongoing Targeting of Illicit Actors

One of the most important activities for which my office is responsible is the listing of illicit actors on OFAC’s SDN list. As banks and financial institutions screen their business dealings
against the sanctioned entities on this list, they are able to prevent the entrance of terrorist funds, drug-trafficking proceeds or other illicit money into our formal financial system, or freeze transactions by designees where they occur. All major global banks, and many smaller foreign ones, screen transactions against the OFAC list to protect themselves, even though they are not required to do so. This markedly amplifies the impact of our sanctions by preventing the movement of illicit funds by terrorists, organized crime figures or proliferation networks outside of U.S. jurisdiction. We watch closely for illicit actors evading anti-money laundering and counter-terrorism financing controls at banks in the U.S. and abroad and for their attempts to seek “back door” entry into the financial system, including through the various evasive tactics evident in the cases described above.

Customer Due Diligence Advance Notice of Proposed Rulemaking

Customer due diligence, and the financial transparency it facilitates, is central to our efforts to combat all manner of illicit financial activity, from proliferation and terrorist financing to more traditional forms of financial crime like money laundering and securities fraud. Treasury issued an Advance Notice of Proposed Rulemaking (ANPRM) on March 4 to clarify, consolidate and strengthen customer due diligence requirements for financial institutions, including an obligation to collect beneficial ownership information. This rulemaking will improve financial institutions’ ability to detect suspicious activity and provide more useful information to law enforcement. The comment period for the ANPRM closed on June 11 and Treasury will hold the first in a series of public hearings to collect additional comments on July 31. Our engagement with industry in the customer due diligence rulemaking process is facilitating a broad understanding of higher risk type accounts and transactions with respect to money laundering and terrorist financing, and how we can work with industry and our interagency partners to better identify and manage such risks, including through more effective anti-money laundering and counter-terrorism financing safeguards.

Enhancing Transparency in the Company Formation Process

Criminals can easily disguise their ownership and control of illicit proceeds through shell companies and other seemingly impenetrable legal structures. We are working closely with you, Mr. Chairman, and other members of Congress to enact legislation requiring disclosure of beneficial ownership information in the company formation process.

Promoting and Strengthening the Global AML/CFT Framework

Helping to strengthen anti-money laundering and counter-terrorism financing regimes abroad has a direct benefit to the safety and integrity of the U.S. financial system, given the global nature of money laundering and the terrorist financing threat and the relationships between banks abroad. The Office of Terrorism and Financial Intelligence (TFI) works with others in the U.S. government to strengthen the global anti-money laundering and counter-terrorism financing framework as a foundation for the effective implementation of sound financial controls worldwide. Several intergovernmental and international organizations, such as the Financial Action Task Force, the IMF, the World Bank, the United Nations, and various FATF-style
regional bodies, collectively develop, assess and facilitate jurisdictional implementation of measures that are essential to combating various forms of illicit finance. Treasury and its interagency partners play a key leadership and participatory role in these organizations as well as other organizations that support our capacity building objectives, lending technical expertise in standard-setting, evaluation and policy recommendations related to the combating of money laundering, terrorist and proliferation financing. One of the key substantive accomplishments that we have achieved in developing the global anti-money laundering and counter-terrorist financing framework is to integrate targeted financial sanctions against terrorist financing and proliferation finance into the global standards for combating money laundering. This is some of the most innovative work my office conducts and an area in which we are able to urge the international community forward in highly constructive ways.

IV. Conclusion

I began today's testimony by noting that the U.S. is home to one of the strongest anti-money laundering and counter-terrorist financing systems in the world. In order to continue in this role, we must push ourselves to identify where we can do better, and work tirelessly to get there. I look forward to continuing work with this committee to this end.

Thank you.
STATEMENT
OF
LEIGH H. WINCHELL
ASSISTANT DIRECTOR FOR PROGRAMS
HOMELAND SECURITY INVESTIGATIONS
U.S. IMMIGRATION AND CUSTOMS ENFORCEMENT
REGARDING A HEARING ON
“COMBATING MONEY LAUNDERING”
BEFORE THE
UNITED STATES SENATE
COMMITTEE ON HOMELAND SECURITY
AND GOVERNMENTAL AFFAIRS
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
TUESDAY, JULY 17, 2012 -- 9:30 a.m.
106 DIRKSEN SENATE OFFICE BUILDING
INTRODUCTION

Chairman Levin, Ranking Member Coburn, and distinguished members of the Subcommittee:

On behalf of Secretary Napolitano and Director Morton, thank you for the opportunity to appear before you today to discuss the efforts of U.S. Immigration and Customs Enforcement (ICE) to combat transnational criminal organizations (TCO) and the illicit proceeds used to fund their criminal activities. With expansive investigative authority, ICE is well-positioned, in partnership with U.S. Customs and Border Protection (CBP), to disrupt and dismantle transnational criminal networks and terrorist organizations that seek to exploit our borders and America’s legitimate trade, travel, communications, and financial systems.

ICE’s expertise in combating TCOs that take advantage of vulnerabilities in the sea, air, and land environments has proven essential in countering the smuggling of narcotics, money, dangerous goods, people, and materials that threaten the well-being of the United States. Our law enforcement presence is global, and ICE’s Homeland Security Investigations (HSI) has a wide network of agents in Attaché offices at embassies and consulates worldwide, all working in concert to target TCOs.

Illicit Finance and Bulk Currency

One of the most effective methods for dismantling TCOs is to attack the criminal proceeds that are the lifeblood of their operations. HSI takes a holistic approach toward investigating money laundering, illicit finance, and financial crimes by examining the ways that individuals and criminal organizations earn, move, store, and launder their illicit proceeds.
The combination of successful financial investigations, reporting requirements under the Bank Secrecy Act (BSA) of 1970, and anti-money laundering compliance efforts by financial institutions has no doubt strengthened banking systems and forced criminal organizations to seek other means to diversify the movement of illicit funds, such as the use of money service businesses (MSB), prepaid access devices, and bulk cash smuggling.

HSI’s broad jurisdiction includes the enforcement and investigation of money laundering and bulk cash smuggling violations. In FY 2011, HSI special agents initiated more than 4,270 financial investigations, resulting in: more than 1,770 arrests; over 1,070 criminal indictments; more than 1,040 criminal convictions; and more than 7,700 seizures worth approximately $359 million, including $331 million in currency and monetary instruments.

**National Bulk Cash Smuggling Center**

On August 11, 2009, HSI officially launched the National Bulk Cash Smuggling Center (BCSC), in cooperation with the El Paso Intelligence Center, as a 24/7 investigative support and operations facility. The BCSC has undertaken a full assessment of the bulk cash smuggling threat and developed a strategic plan to address the problem. By analyzing the movement of bulk cash as a systematic process, HSI develops enforcement operations specifically designed to combat the various methodologies currently employed by trafficking organizations. This targeted approach allows us to more efficiently and effectively utilize our interdiction and investigative resources.

Since its inception, the BCSC has initiated over 500 criminal investigations resulting in 132 seizures totaling $65.8 million. These investigations have culminated in 319 criminal arrests, 96 indictments, and 68 convictions in both Federal and state courts. The
SCSC has also provided training and outreach to over 21,000 state, Federal, and international partners.

As an example of a recent success, in April 2012, the BCSC coordinated with HSI field offices in St. Louis, Missouri, and Greeley, Colorado, in support of a controlled delivery of illicit bulk cash proceeds of nearly $265,000. The initial seizure was the result of a traffic stop, but agents developed additional information based on this initial seizure to successfully execute a second controlled delivery of the currency, which resulted in the seizure of an additional $385,359 in U.S. currency, over seven kilograms of cocaine, two handguns, and five vehicles, and in seven arrests.

Operation Firewall

HSI’s Operation Firewall disrupts the movement and smuggling of bulk cash en route to the border, at the border, and internationally via commercial and private passenger vehicles, commercial airline shipments, airline passengers, and pedestrians. Since 2005, Operation Firewall has been enhanced to include surge operations targeting the movement of bulk cash destined for and crossing the U.S. borders with Mexico and Canada, and joint interdiction efforts and investigations with our foreign law enforcement counterparts.

Through May 31, 2012, Operation Firewall has resulted in more than 6,700 seizures totaling more than $621 million, and arrests of over 1,400 individuals. These efforts include 480 international seizures totaling more than $271 million and 310 international arrests.
Cornerstone Outreach Initiative

In July 2003, ICE launched its Cornerstone Outreach Initiative to work in partnership with the private sector to systematically and strategically identify and eliminate vulnerabilities in financial systems through which criminals launder their illicit proceeds. Under this initiative, HSI builds both domestic and international partnerships by sharing law enforcement trends and methods with businesses and industries that manage the systems that terrorists and criminal organizations seek to exploit.

To the extent permitted by law, HSI shares what we learn through our investigations with the private sector to assist them in identifying and preventing attempts by criminal organizations to take advantage of weaknesses in financial systems. HSI special agents serve as subject matter experts in various types of money laundering methods, including fraudulent schemes, money service businesses, casinos, non-cash negotiable instruments, alternate remitters, charities, outbound currency initiatives, organized retail crime, and schemes to pay illegal alien workers.

Through May 31, 2012, HSI special agents have conducted nearly 12,000 Cornerstone outreach and training presentations to 248,000 participants worldwide. Our outreach efforts have resulted in the initiation of 950 criminal investigations that led to 290 arrests, 270 indictments, 228 convictions, and the seizure of nearly $668 million.

Trade-Based Money Laundering (TBML)

TBML is a money laundering method through which TCOs earn, move, and store illicit proceeds by disguising them as legitimate trade. TCOs often exploit global trade networks to move value around the world, using the complex and sometimes confusing documentation that is frequently associated with legitimate trade transactions. To illustrate, Colombian drug cartels
use TBML extensively to repatriate drug proceeds in a scheme commonly referred to as the Black Market Peso Exchange.

Money and value transfer systems not subject to regulation or supervision, in violation of the international standards, such as underground banks and unlicensed money service businesses, are utilized by TCOs to move value via trade as settlement of a debt arising from remittances overseas. These organizations can accomplish settlement by purchasing commodities in one country and then transferring them to another country where the commodity is sold and the proceeds remitted to the intended recipient.

HSI is uniquely positioned to disrupt and dismantle TCOs that seek to launder illicit proceeds through manipulation of international trade and financial systems. Through HSI’s Trade Transparency Unit (TTU), ICE is the only U.S. law enforcement agency partnering with foreign nations to exchange trade data.

HSI currently has foreign TTU partnerships with Mexico, Panama, Brazil, Colombia, Ecuador, Argentina, Paraguay, and Guatemala. Through these partnerships, HSI is able to identify, investigate, and prosecute TCOs engaged in TBML and other forms of illicit finance. HSI’s TTU, our special agents, and intelligence analysts in the field, along with foreign customs and law enforcement agencies responsible for border control and enforcement of financial crimes, utilize a HSI TTU-owned and developed computer system called the Data Analysis & Research for Trade Transparency System (DARTTS) to analyze trade and financial data.

DARTTS is capable of identifying international trade anomalies and financial irregularities indicative of TBML, customs fraud, contraband smuggling, and other crimes. For example, DARTTS allows users to quickly analyze large amounts of data in a short period of time, thereby maximizing limited time and resources. HSI field agents and analysts frequently
employ DARTTS' unique capability to conduct data research and analysis to initiate and or further criminal investigations. This analysis goes beyond conventional database queries and link analysis tools as part of HSI’s efforts to combat and address the global threat posed by TBML.

TTU methodology has been highlighted in numerous U.S. Government publications including The National Money Laundering Threat Assessment, the U.S. Department of the Treasury’s National Money Laundering Strategies, and the U.S. Department of State’s International Narcotics Control Strategy Reports. It was also recognized as a “best practices approach” by the Financial Action Task Force, the international standard-setting body on countering money laundering and terrorist financing, originally established by the Group of Seven member states, the European Commission and eight other countries to examine and develop measures to combat money laundering and terrorists financing.

Other countries have shown increased interest in establishing and developing their own TTU. Many of the TTUs established, most recently in Colombia and Guatemala, have benefited from the funding and support of the State Department’s Bureau of International Narcotics and Law Enforcement Affairs. Future funding to expand the TTU network is under consideration.

Other Evolving Methods Including Prepaid Cards and Stored-Value Devices

The terms “prepaid card” and “stored value card” (collectively “prepaid access devices”) are commonly used to refer to any card that represents money stored on or accessible by a card to facilitate a consumer’s purchase of goods, services, or further conversion to cash through an ATM. These cards may be “open loop” or “closed loop.” Open loop cards are usually network branded (such as Amex, Discover, MasterCard, or Visa), often reloadable, and can be used at
point of sale at terminals and ATMs anonymously. Closed loop cards, on the other hand, are designated for use at a specific merchant, typically have load limits, and cannot be converted back to cash. Examples of closed loop prepaid access devices include gift cards, mass transit cards, and prepaid phone cards.

According to the 2007 U.S. National Money Laundering Strategy, “stored value cards (sometimes referred to as prepaid cards) are an emerging cash alternative for both legitimate consumers and money launderers alike.” Of the two types, money launderers appear to prefer the open loop prepaid access devices because of their capability of being used at point of sale terminals, their wide acceptance by hotels and car rental agencies, and their portability. These cards enable the user to obtain cash from ATMs worldwide without going through a currency exchange.

Additionally, cards issued by offshore financial institutions and, therefore, not subject to U.S. reporting requirements, are widely available on the Internet, including cards with very high load limits. Prepaid access devices may be attractive to money launderers and smugglers as an alternative to bulk cash not only because their small size and portability make them difficult to detect in the manner that we detect bulk cash, but also because they are not expressly defined as monetary instruments under U.S. statutes and regulations. Therefore, they are not yet expressly and specifically subject to the CMIR reporting requirements or the potential bulk cash smuggling and structuring violations that stem from this requirement.

The Credit Card Accountability, Responsibility, and Disclosure Act of 2009, signed into law in May 2009, mandated that the U.S. Department of the Treasury (Treasury), in consultation with DHS, address the risks associated with these cards. HSI has worked with our law enforcement partners and the Treasury Department’s Financial Crimes Enforcement Network to
close vulnerabilities associated with prepaid devices. This resulted in the publication of a final rule that applies the Bank Secrecy Act to the domestic prepaid device industry and the publication of a Notice of Proposed Rulemaking that proposed to classify prepaid access devices as monetary instruments for the purposes of cross-border declaration. This proposed rule is currently being finalized as Treasury reviews and addresses the public comments. We look forward to the final publication of this rule in the near future.

One of the most significant developments in recent years was a change in Mexican banking regulations implemented in June 2010 that severely limits the amount of U.S. dollars that can be deposited within Mexican financial institutions. This change has ultimately proven to be a successful tool in combating drug trafficking and the TCOs that control the movement and smuggling of drugs by causing them to change how drug proceeds are laundered. We believe that as a result of this change, TCOs may seek to place these funds into U.S. financial institutions and then wire the proceeds back to Mexico. We continue to work closely with the Government of Mexico (GoM) to identify emerging money laundering trends.

Domestically, we have seen changes in how illicit proceeds are moved within the United States. In the last several years, we have seen domestic drug organizations attempt to place illicit funds into U.S. financial institutions to avoid currency transaction reporting requirements. In one version of this scheme, which is referred to as the "funnel account" model, drug organization members in destination cities make structured cash deposits into bank accounts opened in the United States. In turn, the account holder (a nominee for the drug organization) will withdraw funds at various banking institutions in the United States and turn them over (often minus a small fee) to the drug organization. The scheme has been difficult for bank anti-money laundering personnel to identify.
This tactic was initially identified in human smuggling organizations operating in Arizona, but we have since seen its use expanded to domestic drug organizations. We believe that the emergence of this tactic came as a direct result of the successful enforcement focus on MSBs that were being used by human smugglers to receive payments from “sponsors” in the United States. When the ability to easily use MSBs was disrupted, a transition to the funnel account model was observed. HSI has worked with other U.S. Government agencies, including FinCEN, to educate the financial industry in order to promote the identification of this scheme and reporting to law enforcement.

Illicit Pathways Attack Strategy (IPAS)

Last July, the Administration took an important step in fighting transnational crime when it issued its Strategy to Combat Transnational Organized Crime (TOC Strategy). This strategy complements the current National Security Strategy, and other national strategies and plans related to trafficking in persons, money laundering, and other transnational crime affecting the United States, by focusing on the growing threat of international criminal networks. The strategy’s single unifying principle is to build, balance, and integrate the tools of American power to combat transnational organized crime, and related threats to national security—and to urge our international partners to do the same.

HSI designed the Illicit Pathways Attack Strategy (IPAS) to build, balance, and integrate its authorities and resources, both domestic and foreign, in a focused and comprehensive manner to target, disrupt, and dismantle TOC. As recognized in the TOC Strategy, resources are not limitless, and targets must be prioritized in a systematic manner. The IPAS will provide a
mechanism for ICE to prioritize threats and vulnerabilities within its mission and to coordinate its own efforts internally and within the interagency.

The IPAS goes beyond the Nation's physical borders. By targeting the profits generated and used by criminal organizations and not just targeting the contraband being smuggled, the IPAS will protect financial systems and strategic markets by addressing how criminal organizations earn, move and store illicit proceeds. IPAS will target financial institution abuse, bulk cash smuggling and trade-based money laundering and aggressively pursue asset forfeiture.

**Working with Mexican Authorities**

Working with the GoM in its battle against the drug cartels and other TCOs requires strong coordination and cooperation. ICE continuously works jointly with the GoM to initiate and support investigations and operations targeting TCOs and their diverse list of illicit activities. ICE also actively participates in capacity-building programs and initiatives to strengthen and bolster the GoM counter-narcotics and counter-illicit finance efforts.

On June 2, 2010, DHS released the Department of State Bureau of International Narcotics and Law Enforcement-supported Bi-National Criminal Proceeds Study at a United States-Mexico Money Laundering Conference in Mexico City, which provided a strategic-level analysis of the processes and methods used by transnational criminals, particularly drug trafficking organizations, to repatriate illicit money from the United States to Mexico and other countries. Both the U.S. and Mexican Governments are using information collected from the study to conduct tactical operations that deny criminals the ability to move money, and to ultimately dismantle illicit operations.
ICE has strengthened its relationship with the GoM by increasing the number of HSI personnel in Mexico, who provide support to ongoing investigations of TCOs operating on both sides of the border. In addition, the HSI Attaché in Mexico City has created its own Transnational Criminal Investigative Unit consisting of fully vetted Mexican law enforcement officers. Through the HSI Attaché office in Mexico City and associated sub-offices, HSI personnel, in conjunction with the law enforcement community, will continue working closely with Mexican authorities.

CONCLUSION

Thank you again for the opportunity to appear before you today to discuss our efforts to combat the money laundering threat to the United States and our response to the innovative techniques being used by TCOs.

I would be pleased to answer any questions.
Good morning Chairman Levin, Ranking Member Coburn, and members of the Subcommittee. My name is David Bagley. Thank you for the opportunity to be here today.

Since 2002, I have been the Head of Group Compliance at HSBC Holdings plc – which is the global parent of HSBC. I joined Midland Bank in 1992 and, later that year, after HSBC acquired Midland, I began work for HSBC in its Head Office in London, where I work today. Over the years, I have served in various positions in HSBC offices around the world.

Having been a compliance officer for 13 years in a bank that operates in approximately 80 jurisdictions worldwide, I have dedicated my career – not only within HSBC but through my broader industry work as well – to meeting the sometimes significant challenges that confront global banking institutions in the world we live in. As this Subcommittee well knows, these challenges include money laundering by narcotics traffickers and terrorist financing, to name just a few. I have followed the work of this Subcommittee and have seen how your work has advanced important dialogues and helped the international banking community, including HSBC, identify and address potential vulnerabilities.

My chief focus as the Head of Group Compliance at HSBC has been promoting the values that we as a bank have set for ourselves and the values that you and our regulators, both in the United States and around the world, rightly expect from a global bank like HSBC. And, while there have been successes on many compliance issues, I recognize that there have been some significant areas of failure. I have said before and I will say again: despite the best efforts and intentions of many dedicated professionals, HSBC has fallen short of our own expectations.
and the expectations of our regulators. At the same time, this is something that a bank seeking to conduct business in the United States and globally must acknowledge, address, learn from, and, most importantly, take steps to avoid in the future.

I know my time today is limited and there are a number of topics to discuss. Let me touch on some of them briefly.

First, we have learned a number of valuable lessons, and the bank is well along the way of converting those lessons into solutions. One of these lessons concerns managing growth. With the benefit of hindsight, it is now clear to many of us that the bank’s business and risk profile grew faster than its infrastructure. We have learned that implementing the kinds of robust policies and practices expected of a global banking leader can take longer than anticipated. The bank underestimated some of the challenges presented by its numerous acquisitions, and despite efforts to meet these challenges, we were not always able to keep up. While many people at HSBC worked diligently to get it right, the bank simply must do better.

How can we get it right? Let me touch briefly on a few of these changes.

As I expect my colleague Stuart Levey to describe in some detail, HSBC is in the process of shedding the historical compliance model that the bank has outgrown. This departure from the old model is transformative. Our former compliance structure was a product of historical growth by acquisition and it was a major factor behind some of the issues that I expect we will be discussing today.

Under the former structure, the bank’s Group Compliance function based in London mirrored HSBC’s overall global corporate structure – which is an international federation of affiliates around the globe. Many of these affiliates began as relatively small independent banks that HSBC acquired over the years with increasing frequency. As the bank’s footprint grew
through these acquisitions, HSBC's structure evolved into one with a small corporate center, on the one hand, and numerous affiliates around the world operating with a significant degree of autonomy and varying levels of direct interaction among those affiliates, on the other.

Under the former model, the role of Group Compliance was an advisory one: we promulgated the baseline standards that all of the bank's affiliates were expected to follow. As the Head of Group Compliance, my mandate was limited to advising, recommending, and reporting. My job was not—and I did not have the authority, resources, support, or infrastructure—to ensure that all of these global affiliates followed the Group's compliance standards. Rather, final authority and decision-making rested with local line management in each of the bank's affiliates.

This model worked for many years. But over time, HSBC's growth accelerated rapidly. Some of the new acquisitions had operations that at the time of acquisition fell far short of HSBC's own compliance standards and expectations and were in relatively lightly regulated but often high risk jurisdictions. At the same time, increased terrorism and narco-trafficking, and other financial sector developments, exposed the international banking system to new vulnerabilities and greater challenges. In addition, regulatory expectations both in the United States and abroad rightly continued to increase. With its roots in a far smaller bank in a very different global banking environment, HSBC's historic model, in retrospect, simply did not keep pace. Now, a major overhaul is underway.

The new compliance model is a product of deep reflection and is tailored to address today's challenges as well as the inevitable challenges of tomorrow. Let me mention a few significant differences between the bank's prior compliance model and the new model.
First, the bank’s Group Compliance function now, for the first time, has authority over the compliance departments at every one of the bank’s affiliates. The new model empowers Group Compliance to adopt and implement consistent compliance standards across the Group and to assess each of the bank’s affiliates through a dedicated Assurance team so that the Group can have confidence that its affiliates are following and enforcing these standards. This is a stark break from the past. Now, Group Compliance has both the mandate and the resources to ensure that affiliates are compliant. In other words, now for the first time, Group Compliance is an advisory and a control function and personnel at the affiliates are now accountable to Group Compliance for their conduct.

Second, the CEO of each affiliate previously controlled the allocation of resources and compensation associated with that affiliate’s compliance function. That has changed as well. Under the new model, Group Compliance oversees the bank’s nearly 3,500 compliance officers worldwide and takes the lead on decisions about resource allocation, compensation, performance review, objectives, strategy, budget, and accountability across all of our worldwide compliance departments. This gives Group Compliance far more control over and understanding of the bank’s global compliance efforts.

Third, HSBC has made significant enhancements to the resources at the Group Compliance level. In 2002, when I took on the role of Head of Group Compliance, we had a staff of only eight people. Now we have close to 40 people working in Group Compliance in London, and that figure continues to grow.

Fourth, the bank has adopted new robust diligence policies. Historically, unless required by the local jurisdiction, the bank did not mandate that HSBC affiliates perform due diligence on other HSBC affiliates. However, we now require affiliates to perform diligence on each other.
And, we are in the process of rolling out the enhanced Know-Your-Customer program at our
U.S. bank on a global scale. This is a substantial task because HSBC has approximately 100
million customer relationships worldwide. Nevertheless, it is an important one. It will enable
the bank to make more informed and responsible decisions about its customers.

While I will not touch on all of the recent enhancements to our model, I do want to
elaborate on one of these changes, the creation of a dedicated Assurance team. The mission of
this new function is both to review the effectiveness of our compliance functions at all levels
around the globe and to escalate compliance issues that need remediation. This team is charged
with ensuring that our compliance efforts around the world meet Group standards, conducting
proper monitoring, and meeting the expectations of their regulators. The team is also charged
with ensuring that compliance issues are properly escalated to the Group level, that the business
and compliance functions are working together to manage risk effectively and responsibly, and
that every compliance team has the required skills and appropriate resources. This function,
which is in addition to the continuing role of Group Audit in conducting audits of affiliates
worldwide, has already provided substantial benefits.

In conclusion, the authority of the Head of Group Compliance and therefore the function
as a whole is greatly increased. We have split from the legal function and now form a part of a
substantially empowered risk function. This will require affiliates to act on advice and
recommendations quickly and effectively.

* * *

Despite the best intentions and efforts of so many dedicated compliance and business
professionals, HSBC has in some important areas failed to meet our expectations and the
expectations of our regulators. I am happy, however, to be able to say that the bank has learned
from its past and is already on a path to becoming a better, stronger banking institution. The
bank’s structure is, in short, very different from what it was in 2002, when I agreed to serve as
Head of Group Compliance.

Thank you for your time. I welcome this opportunity to answer any questions.

- 5 -
I. Introduction

Good morning Chairman Levin, Ranking Member Coburn, and members of the Subcommittee. My name is Paul Thurston, and I currently serve as the Chief Executive, Retail Banking and Wealth Management for HSBC Group, based in Hong Kong.

I have worked in the banking industry for my entire career. I joined Midland Bank in 1975, and stayed when it was acquired by HSBC in 1992. Since then, I have served in various roles at HSBC around the world, including as CEO of HSBC Mexico (“HBMX”) for fourteen months beginning in February 2007.

I understand that we are here today in part to discuss HSBC’s experience in Mexico and its impact on the U.S. and global financial systems. These are topics worthy of discussion, and which have had many learnings for our Group, and I am pleased to be here at the Committee’s request. I want to address in my statement the challenges I faced when I arrived in Mexico, the steps my colleagues and I took to address the problems, and the lessons I believe we at HSBC have learned from our experience in Mexico.

II. HBMX

Emerging markets like Mexico are growing increasingly important in their contribution to the global economy and world trade, and international financial companies can play an important role to help their governments develop these markets and their people to join the formal banking system. With large populations existing outside the formal economy and banking system, however, they also present real challenges.
I arrived in Mexico in early 2007 after having served as a general manager with responsibility for building the Group’s personal financial service businesses across the Asia Pacific region. When I arrived, I reported to my predecessor, who, having completed the acquisition of the former Banco Bital and managed this business for 4 years, had also led the subsequent acquisition of the Banistmo Group of banks across Central America and been promoted to head up the Latin American region.

To enable me to assess the business, I had meetings with members of the management team, the internal auditors, the external auditors, and the Board of HBMX. I also met with the regulators, each of whom were complimentary about the progress made by the bank since acquisition. It became clear to me, however, that there had been rapid growth of the business since the acquisition, and that there were still significant issues that needed to be addressed. These included rapidly growing credit and fraud losses in the consumer and small business lending businesses, technology problems, and weaknesses in management information. There was also a significant known compliance issue relating to the quality of customer Know-Your-Customer (“KYC”) and customer files, all of which were decentralized across the network of more than 1300 branches, but where recent regulations required 1.8 million customer KYC records to be remediated to meet new local standards.

Having thought that I would be continuing to build the business, my immediate priorities became to address these issues. Additionally, most of the management team of the bank in Mexico had also been promoted to regional positions to manage the now larger region, and I therefore had to fill key positions within the Mexican business to ensure that we retained a focus on managing this business.
As I began to get the team in place, additional issues arose, and it became clearer that HBMX lacked much of the sophisticated compliance, operational, and risk management capabilities with which I was familiar from my work in other parts of the Group. There was no credit fraud expertise, credit risk analytics were undeveloped, and provisioning models and scorecards were not robust. It also became apparent that decision-making processes concerning AML were not satisfactory.

Over time, it also became clear that this was not only a question of process and technology, but that the underlying business model needed to be examined. Branch managers operated as local franchise owners, with considerable autonomy and a focus on business development, reinforced by an incentive compensation scheme which rewarded new accounts and growth, not quality controls.

I should add that the external environment in Mexico was as challenging as any I had ever experienced. Bank employees faced very real risks of being targeted for bribery, extortion, and kidnapping – in fact, multiple kidnappings occurred throughout my tenure – and high levels of security were required for Bank staff working in Mexico. Unlike the United States, Mexico was a data-poor environment, making it difficult to verify the identity of customers.

Despite these substantial challenges, I felt that with determined efforts, the Bank could make a positive contribution in Mexico. During my short tenure at HBMX, I worked hard to make progress towards this goal, and I drove many changes to both the business model and compliance systems.

I pulled back on business expansion plans and focused on enhancing controls. I was particularly concerned with HBMX’s significant operational and credit losses, especially in small business loans and credit cards, where fraud was rising rapidly. I brought in people with
expertise in managing emerging markets credit risk in Asia and fraud management from the Group to review our practices in those areas, tightened credit approvals, and brought in a new Head of Consumer Credit Risk. I also brought in a new CFO to develop improved management information capabilities.

To address the compliance issues, I brought in a new COO who was well-regarded and experienced with Group standards. With his help, we made significant changes in AML and KYC processes, including addressing AML Committee weaknesses, ensuring that action items were properly followed up, and creating an escalation process when business and compliance disagreed. We launched new staff training programs on AML and KYC standards, and introduced a zero tolerance policy regarding the site visit requirement.

Recognizing the challenges of trying to affect proper remediation of files and upgrading account opening processes across a widespread branch network managed by local managers incentivized and historically managed for growth, we set up a program to centralize control of account opening documentation and KYC records. We also reworked the employee incentive scheme to reduce reward for volume growth and increase the focus on credit quality, customer service, and proper management of risk. We also removed senior management from the incentive scheme entirely.

As you might expect, these changes were painful to the organization. For example, to rework the incentive scheme, at one point I had to stop payment of incentives altogether. This resulted in employees picketing the office. However, my team and I were determined to continue pushing forward with the improvements.

All of the issues that I identified, and the actions taken to address them, were reported up to the regional head of Latin America and to Group management. I requested Group Compliance
support to help review issues and people, and address cross-border issues. I also requested Group Audit to undertake audits of key processes, including the Money Laundering controls, to have an independent check of progress and help to surface other issues that had not previously been identified. The local Board, and the regional audit committee, which was chaired by the Group’s Chief Risk Officer and head of Audit, were kept informed throughout. Reports were made to the Group Risk Management Meeting which included the heads of each of the regions.

In December 2007, less than a year after I had arrived, I was asked by the Group Chief Executive to prepare to move to the U.K. to take responsibility for our retail business there in the face of issues that led up to global financial crisis and to recruit a successor in the local market. I did this and left Mexico in April 2008.

I believe that we made progress at HBMX during my short tenure, but clearly there was still much work to be done upon my departure. I understand that further problems surfaced subsequently, which had to be addressed by my successor and Group management, and that progress was therefore not as smooth as we would have wanted. I understand however that there was a significant improvement in account opening standards, documentation, and reporting in the following years as the centralized system came into effect, which gave HBMX a better platform to establish enhanced control on account opening and remediate historic accounts. Decisions were made to put strict limits on the U.S. dollar business we do in Mexico, we closed branches in areas where we believe there is a high risk of money laundering, and we are now in the process of closing all the HBMX Cayman accounts. The Group will continue to scrutinize our business there to determine how we can further mitigate compliance risk.
Many of the specific challenges I faced during my tenure, and the actions that I took, will likely be outlined more fully in your report. I will answer your questions to the best of my ability based on my time on the ground in Mexico, as I did with your staff several weeks ago.

III. Lessons Learned

We have learned much from our experience in Mexico, and I would like to discuss briefly some of what I consider to be the key lessons.

First, when a problem arises, it is imperative to do the right thing and to do it quickly. During my tenure in Mexico, I tried to follow this rule. For example, in response to compliance failures, I fired individuals involved in falsifying KYC records and announced a zero tolerance policy for similar conduct, and we closed customer accounts, despite the risk of adverse reaction. The Group is taking firm action today to close down businesses where the risks cannot be effectively managed, regardless of the impact on short term profitability, and have invested in increased compliance resourcing.

Second, business expansion cannot be allowed to run ahead of putting in place appropriate controls and infrastructure. Without adequate controls, financial institutions face severe business and operational risks that are simply unacceptable. In retrospect, it is clear that in Mexico, the Group was overly optimistic about our ability to bring up to standards quickly an acquired entity that had little to no compliance and operational infrastructure when we acquired it. The Group today is working hard to reduce its complexity and risk profile, and to empower Global Functions, including Risk and Compliance, to have direct oversight of the key controls across our business.

Third, operational and compliance risk cannot be addressed by systems and process alone. In Mexico, we made little progress by simply installing Group systems and creating...
control functions until we addressed the culture of the bank and the underlying business model. Cultural change takes time, but getting the tone at the top right, and changing performance management systems and rewards, are critical drivers to achieving higher standards.

Fourth, when challenges arise, we must share information broadly across the Bank. During my tenure in Mexico, information at HSBC flowed vertically but not horizontally. The Subcommittee is right to note that, as a result, a number of risks and challenges we faced in Mexico were not fully appreciated by our counterparts in other parts of the Group. We are changing this through formal reporting structures to ensure that we maximize the sharing of information for risk management purposes amongst Group companies and amongst Global businesses and functions.

Finally, we cannot be afraid to acknowledge and learn from our mistakes. We have directly acknowledged our shortcomings in Mexico and in the United States, and our Group CEO has set a clear policy that requires all parts of the Group to adopt and enforce a single global standard that is determined by the highest standard that must be applied anywhere and also requires us to maximize information sharing across the Group. This will help make us a better bank that effectively manages risk consistently on a global basis.

IV. Conclusion

Criminals operate globally and if we are to combat them and stop them from accessing and abusing the financial system, we must look at issues from a global perspective. Institutions which operate internationally, like HSBC, will be targeted by these criminals, and our experience in Mexico vividly demonstrates that you are no stronger than your weakest link. We have to be sure that we have the best and strongest defense in place, in every business, in every market in

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which we operate, regardless of the local challenges. It is for this reason that I appreciate the
opportunity to speak with the Subcommittee today.

It is clear to us all that our anti-money laundering controls should have been stronger and
more effective, and that we fell well below the standards that we should have achieved. We have
co-operated fully with the PSI and other authorities to ensure that we learn from the mistakes that
were made in the past.

We are determined that drug dealers, terrorists, and all forms of criminals will not access
the financial system through HSBC. The Group management team is committed to ensuring that
we meet the highest standards in every aspect of our business in the future.
Chairman Levin, Ranking Member Coburn, and Members of the Subcommittee:

My name is Michael Gallagher and I reside in Lincroft, New Jersey. From 2001 until last year I was an Executive Vice President at HSBC Bank USA, N.A. ("HBUS") responsible for Payments and Cash Management ("PCM"), North America. On November 21, 2011, I was subject to a reduction in force at the bank.

Anti-money laundering, terrorism financing, and global access to the U.S. financial system are issues of critical importance to the banking industry and to national security. I have prepared this written statement in order to address certain areas of inquiry outlined in the Subcommittee's correspondence dated June 29, 2012, and I will be pleased to answer any additional questions at the hearing that the Subcommittee might have.

During my tenure at HBUS, PCM developed and marketed payments and cash management services to corporate and middle market clients as well as financial institutions, including HSBC affiliated banks. At the time of my departure, there were five regional heads of PCM, including me, each of whom reported to the global head of PCM. I generally had four teams within PCM that reported to me: sales, product management, client services, and central services.

In addition, there were two periods of time during my tenure at HBUS when Wholesale Payments Operations (the team responsible for wire transfers) reported to me: approximately 1998 to 2001 and approximately 2004 to 2007. Within its operations function, HBUS had a payments filter that was programmed to detect and flag transactions from sanctioned countries,
among other things. The payments processing team within operations would review each of the transactions stopped by the filter. To the best of my knowledge, if the transaction required further evaluation, it would be escalated to the Compliance department.

In regard to the Subcommittee’s interest in U.S. dollar transactions involving Iran, I recall that in approximately May 2001, I was informed by the head of Wholesale Payments Operations of a business proposal under consideration by HSBC Bank plc to provide U.S. dollar clearing services to Bank Melli, an Iranian bank. I responded to her, copying my manager, the head of Corporate Banking, stating that I was not comfortable with the bank’s pursuit of such a business arrangement. I was concerned with the regulatory, reputational, and operational risk associated with this business proposal, and particularly the fact that Bank Melli was unwilling to identify the main beneficiaries of the payments at issue. The head of Wholesale Payments Operations then forwarded my concern to the Compliance department. I was not privy to the outcome of the discussions regarding the Bank Melli proposal.

I also understand that the Subcommittee is interested in the Global Banknotes business. In approximately early 2007, the Head of Global Banking and Markets asked if I would take on managerial oversight of Global Banknotes and serve as someone to whom Christopher Lok, the Head of Global Banknotes, could report. HSBC’s Banknotes division bought, sold, and shipped banknotes around the world on behalf of its clients. HSBC had several banknotes vaults, including vaults in New York, London, Frankfurt, Tokyo, Singapore, and Hong Kong.

Finally, I understand that the Subcommittee is interested in HSBC’s anti-money laundering, or AML, efforts. During my tenure at HSBC, although the Compliance department was primarily responsible for HSBC’s AML efforts, my team and I took compliance matters very seriously. PCM assisted the Compliance department, as well as relationship managers, with
regard to AML and related compliance efforts. In instances when PCM became aware of negative information regarding a client, PCM worked closely with the Compliance department to ensure that it received the information it needed. PCM also made resources available to the relationship managers and the Compliance department to assist in any way that we could.

In summary, I would like to thank the Chairman and Subcommittee for allowing me to speak at the hearing on these critical matters. HSBC, and the banking industry as a whole, have learned a lot over the past decade or so. I believe that HSBC’s experience can add value to understanding more broadly the risks and opportunities for enhanced safety in this industry.

During my tenure at HSBC, there were steps taken to tighten anti-money laundering controls. But, with hindsight, it is clear that we did not always fully understand the risks of our business, and that we could have done much more, and done it more quickly. I appreciate the opportunity to provide this information to the Subcommittee. I am prepared to answer any additional questions that the Subcommittee may have during the hearing.
Testimony of Chiu Hon “Christopher” Lok
Before the United States Senate
Permanent Subcommittee on Investigations
July 17, 2012

Chairman Levin, Ranking Member Coburn, and members of the Subcommittee, I appreciate the opportunity to be here today. My name is Christopher Lok, and from 2001 until 2010 I served as the global head of the Banknotes business at HSBC.

In my statement today, I will cover three topics. First, I will provide my background information. Second, I will provide an overview of the Banknotes business at HSBC. And third, I will address some of the specific problems and issues that I believe the Subcommittee is interested in. For me, it is painful and embarrassing to talk about the areas where, in hindsight, we fell short. At the same time, it is valuable to do so in order to find constructive solutions and so that others don't make the same mistakes going forward.

I was born and raised in Hong Kong. In 1981, I started working in the Banknotes business, and that is what I did for 29 years. During the entire time from 1981 through 2010, I worked for HSBC or a predecessor institution. For most of my career I was based in Asia, but I was privileged to have lived and worked in New York for a brief period in the 1990s and again from 2001 until 2010. Even though I am not a U.S. citizen, I had a wonderful experience living and working in this country and I have a great admiration and affection for the United States.

I’d like to provide a brief overview of the Banknotes business. In essence, the business is about the buying and selling of physical currency at the wholesale level. Our clients were banks and other financial institutions all around the world. We employed about 275 people, including
traders, back office staff, and people who focused on operations and logistics. We dealt with approximately 800 customers, in over 100 countries, and we transacted in about 75 different currencies. These customers have natural demand for and supply of currency banknotes, driven by various economic activities. To them, HSBC was a safe and reliable counterparty and I believe that we provided them with a valuable service.

I understand that the Subcommittee is focused on some of the compliance challenges that we faced in the Banknotes business.

Let me start by emphasizing that compliance was a critical part of the HSBC Banknotes business. Over a period of years, there were some occasions when I communicated with my colleagues in compliance in a manner that was unnecessarily aggressive and harsh. These communications were unprofessional, and I deeply regret them. In reality, the business line and compliance shared the same objective – to avoid the bank being used by inappropriate people for improper transactions. Despite my overly critical emails, I believe Banknotes business and compliance people actually had a good working partnership. While I didn’t always communicate this, I had great respect for my colleagues in compliance and I valued their work.

With respect to Banknotes transactions with customers in Mexico, up until December 2008 I was under the impression that HSBC’s Mexican affiliate, HBMX, was operating under HSBC group standards. In December 2008, HBMX announced that it would no longer be accepting U.S. currency in Mexico. I was surprised by this announcement, and I tried to find out what was the reason behind it. It was not until early 2009 that I learned, as a result of my own inquiries, that HBMX had gotten into problems because their anti-money-laundering controls were seriously compromised. I was surprised and concerned about this news. I was not
previously aware of the AML problems at HBMX. If we had known of these problems, I am
certain we in the Banknotes business would have done things differently.

As time went by, some questions were raised about the Banknotes business in Mexico. In
retrospect, we did not adequately appreciate the concerns being raised about the business
environment in Mexico. While we did our best to deal with these inquiries, I am sorry to say that
I did not understand what later became apparent. With the benefit of hindsight it is now clear
that we did not perceive the extent of the anti-money-laundering deficiencies and the risks
present in Mexico.

Thank you very much.
Irene Dorner
President and CEO
HSBC Bank USA and HSBC North America Holdings, Inc.
Written Testimony for Senate Permanent Subcommittee on Investigations
July 17, 2012

I. Introduction

Thank you Chairman Levin, Senator Coburn, and members of the Subcommittee. My name is Irene Dorner and I serve as President and CEO of HSBC Bank USA (“HBUS”) and HSBC North America Holdings, Inc. (“HNAH”). I have led the Bank in the U.S. since January 2010. This is one of the many entities across the globe that forms HSBC Group, which is headquartered in London.

At the outset, let me state clearly that we deeply regret and apologize for the fact that HSBC did not live up to the expectations of our regulators, our customers, our employees, and the general public. HSBC’s compliance history, as examined today, is unacceptable. Therefore, I fully appreciate why we are here and believe that this is an important discussion. HSBC has learned some very hard lessons from the experience of the past few years. But we have taken very substantial steps to address the problems that we, our regulators, and this Subcommittee have identified. We have made fundamental changes in governance, culture, training, and funding to ensure that we can effectively deter illicit use of our bank. These changes will be embedded and sustained going forward.

As you know, these issues and challenges do not end at the water’s edge. So we are combining our efforts with reforms that apply throughout HSBC’s global business. And I am joined today by our new Chief Legal Officer, Stuart Levey, who is here on behalf of the HSBC Group and who will describe HSBC’s global compliance commitment. Stuart and I sit on HSBC Group’s new Global Standards Steering Committee that is charged with establishing a uniform
set of high standards for all HSBC affiliates around the world. I sit on this Committee because senior leadership at HSBC Group recognizes that often U.S. standards will be the highest standard globally. We have taken the lessons we learned from our experiences in the U.S. and are applying them on a global basis.

Today, I would like to address two topics. First, I would like to tell you about HSBC and describe the importance of an effective compliance program to an institution of our size and global reach. Second, I would like to talk about the work we have done to address our AML Compliance deficiencies.

II. HSBC in the United States

HSBC is in a unique position: we are among a handful of financial institutions with a truly global footprint. HSBC entered the United States in the 1980s when we acquired Marine Midland Bank and we have been building on this foundation ever since. Today, our U.S. business has 16,500 employees and serves about 3.5 million customers. We have four main business lines: Global Banking and Markets; Retail Banking and Wealth Management; Commercial Banking; and Private Banking.

HSBC has a truly global footprint. Our customers have a need for global banking services. In the United States, HSBC is one of the largest dollar clearers; this is important because the U.S. dollar is the currency of trade and commerce virtually no matter where you are. When a U.S. manufacturer wants to sell its products to a retailer in Hong Kong, the transaction is settled in U.S. dollars. When a manufacturer in Singapore sells its goods to a purchaser in Germany, or a raw materials supplier in Brazil sells its products to a purchaser in Canada, chances are those transactions are settled in U.S. dollars as well.
This global reach gives us a tremendous opportunity to attract customers who are internationally focused. But it also brings with it a tremendous responsibility. Given my experience working for HSBC in other parts of the world, I am cognizant of the risks and obligations that come with serving our customers. At an absolute minimum, we must have the proper controls and systems in place to ensure that we are doing the right business, in the right places, with the right customers, and that our customers' transactions are properly monitored. If for any reason a transaction appears to be unlawful or suspicious, then we scrutinize the customer and report this information to the authorities in a timely manner.

In the world of banking, there is nothing more important than our reputation, not just for financial strength but also for trustworthiness and integrity. Not only is it important to our customers and our regulators, it’s important to me, and it’s important to my management team. I have made clear that I expect every member of my senior management team to stand up for doing what is right.

III. AML Compliance Remediation

As the subcommittee has documented, we have fallen short in a number of serious ways. In October 2010, the U.S. bank entered into a Consent Order with the OCC. The OCC criticized various aspects of the Bank’s AML program, including failure to provide adequate resources for our AML Compliance function, gaps in automated monitoring of certain wire transfers and banknotes transactions, failure to conduct due diligence on our own HSBC affiliates, and an inadequate process of risk-rating certain customers. We had not invested what we should have in our AML resources and systems. With the full support of our Board and of HSBC Group, I took the lead in overseeing our remediation efforts, and we have taken significant steps forward.

I want to turn now to highlight several of the changes we have implemented.
A. People and Culture

We’ve worked hard to foster a new culture that values and rewards effective compliance, and that starts at the top. By the end of 2010, we had a new U.S. senior management team in place, including myself as CEO, a new General Counsel, a new Head of Compliance, and a new AML Director. Previously the role of General Counsel and head of Compliance had been combined under one person. We also elevated the role of the AML Director, who now reports directly to the Chief Compliance Officer and regularly reports directly to the Board and senior management about the AML program. The Chief Compliance Officer and AML Director also have an independent line to a non-executive member of our Board of Directors.

We have improved the quality, coverage, and strength of our AML program through additional staffing and training. We have worked to build an AML team that has the right subject matter expertise and the right operational expertise.

The U.S. bank has made significant investments in our AML Compliance program over the past two years. We increased AML Compliance spending to $244 million in 2011, approximately nine-fold what we spent in 2009. A big part of this investment has been in hiring and retaining the right people: today we have about 892 full-time AML Compliance professionals. This includes our monitoring and alert review team, local compliance officers, Financial Intelligence Unit team, sanctions screening team, and other AML subject matter experts.

B. Policies and Procedures

Another area we needed to address was that we did not adequately appreciate the risks of our businesses and of our customers. In early 2010, the HNAH Board undertook an enterprise-wide risk assessment and made the decision to exit or scale back several businesses that we
decided presented significant compliance risk. Since 2010, we have closed down the Banknotes business, we have exited about 28 embassy banking relationships, and we have closed 326 correspondent banking relationships. This is an ongoing process – we continue to do a formal Enterprise Risk Assessment twice a year to ensure that we are properly managing our risk enterprise-wide.

We also needed to make changes to our Know-Your-Customer (“KYC”) policies. We had previously not been doing customer due diligence on our own HSBC affiliates. We now do the same level of customer due diligence on our own affiliates as we do on third-party customers. We have also improved the way we approach customer diligence for all our customers. We have developed and implemented new bank-wide KYC standards that apply to all our business lines to ensure consistency. Our new KYC policy forces a more critical look at each customer at the onboarding phase, which enables us to make better decisions about whether that customer fits within our risk appetite.

I firmly believe that KYC is about more than just checking a box – it’s about really understanding who your customer is so that you know whether this is a customer you want to do business with. Importantly, we are enforcing this message across our entire employee team through robust and continual training, outreach, and communications.

We also developed a new country risk-rating methodology, as well as a new customer risk-rating methodology. The new customer risk-rating methodology takes a holistic view of customer risk, evaluating risk based on country of residence, products and services utilized, legal entity structure, and type of business or customer. We now have a better way of identifying where our risks lie and we can make good decisions about whether we have the right controls
and the right level of diligence on a particular customer, and if we do not, we will either fix it or we will exit that customer.

Once we had our new customer risk-rating methodology and KYC policy in place, we started rolling out a large-scale KYC remediation project across all our business lines, which I chair. Through this process, we have been reviewing our entire customer base, exiting certain customers, and remediating all our remaining customers up to our new KYC standards. Our KYC remediation project is a huge undertaking and this project has integrated our business people with our Compliance people in a way that did not happen before. Many of the changes we are making are being adopted as HSBC global best practices.

C. Technology

We also needed a more robust transaction monitoring system that was sustainable and had the right controls. We have made significant investments in technology and we believe that our new transaction monitoring system more effectively detects suspicious activity. We have also built better controls around that system so that any changes to the way we monitor are vetted by an independent team.

In addition to improving our technology, we recognized that we needed the right structure around the technology so that we not only get better alerts, but are better able to analyze those alerts and report suspicious activity to law enforcement. So we looked not just at the numbers of analysts we needed to hire but the types of people we needed. We brought more subject matter experts into our monitoring team and have built out our Financial Intelligence Unit.

While we have made real progress, we recognize that there is more to do. This is difficult, it is complicated, and it takes time to do it right. Our regulators recently raised issues about some aspects of our model validation process. Addressing these issues is a top priority.
IV. Sustainability

We understand that we have to rebuild the trust of our regulators, our customers, and our other stakeholders. For this reason, the sustainability of our AML Compliance program is a top priority. The intended consequence of the changes I have discussed is to embed a new culture of responsibility, accountability, and deterrence within the U.S. bank. In many ways, an organization’s culture is a product of the “tone at the top,” and it has been my mission, and the mission of my new senior team, to make sure that compliance is on every employee’s mind at every level in the organization.

We understand that an effective AML Compliance program requires an ongoing process of learning, adapting, and improving. There is no point at which we can just sit back and say, “Our program can’t get any better.” We need to evolve and improve constantly; we need to respond not only to regulatory changes but also to advances in technology and to the risks posed by the ingenuity of drug traffickers, money launderers, tax evaders, and others seeking to use our financial system for illicit purposes. We want our doors to be closed to these bad actors. We will never catch every single illicit transaction, but our goal must be to ensure that we are in the best position possible to do so. This is my goal and commitment, and this is the goal and commitment of the HSBC Group, supported fully by our Board of Directors. My commitment also extends to the thousands of HSBC employees here in the U.S. who have been working tirelessly over many months to remediate compliance issues and create a sustainable compliance capability.

V. Conclusion

In closing, let me say that I appreciate this Subcommittee’s efforts to examine and improve the steps taken by industry and government to address these challenges, and we are committed to fulfilling our responsibilities in an effective and sustained manner.
I. Introduction

Good afternoon Chairman Levin, Ranking Member Coburn, and members of the Subcommittee. My name is Stuart Levey and I joined HSBC Holdings plc (or “Group”) as its global Chief Legal Officer in January of this year. I am pleased to appear here, at the Subcommittee’s request, to participate in today’s hearing on combating money laundering. This Subcommittee has played a vital role in promoting sound policies and practices in the AML area. That work has made the global financial system stronger and increased the tools available to law enforcement in the campaign against those who would misuse the global financial system for money laundering, drug trafficking, terrorism, tax evasion, or other illicit purposes.

We have worked closely with the staff during the course of the investigation and cooperated as completely as possible to help provide a full picture of what happened. This process has highlighted some unacceptable shortcomings that HSBC deeply regrets. We have learned from this experience and are taking steps to change.

Irene Dorner, our U.S. CEO, has spoken about the work we have done and continue to do to improve our AML compliance controls in the United States. However, we recognize that it is not enough to fix the specific issues that the Subcommittee has focused on; instead, we must implement a global strategy to tackle the root causes of our identified deficiencies. That is what we have begun to do and that is what I would like to talk about today.
II. Lessons Learned

We have learned some difficult lessons from our experiences in the U.S. and in Mexico. We have learned that our decentralized management model focused on country heads made it difficult to ensure that HSBC standards were being implemented consistently. While our old model served us well historically, it does not work in an interconnected world where transactions cross borders instantaneously and where weaknesses in one jurisdiction can be quickly exported to others. New acquisitions expanded HSBC faster than our infrastructure and controls could handle, especially given increasing regulatory expectations. In some instances, acquisitions were not sufficiently integrated into our operations and not brought up to HSBC standards quickly enough. We have learned, therefore, that HSBC affiliates could not assume that other HSBC affiliates with whom they did business were adhering to adequate standards. We have learned that our approach to compliance – and AML in particular – was not adequate to address the risks we face as a global institution. And we have learned that we did not share information effectively enough across our affiliates, with serious consequences.

III. How We Are Reforming HSBC To Address These Shortcomings

At the beginning of 2011, there was a transition at HSBC to our new CEO, Stuart Gulliver, and our new Chairman, Douglas Flint. The new leadership team recognized that immediate action was required and set out a strategy to make changes to the way HSBC operates around the world. Over the past eighteen months we have taken concrete steps to address each of the deficiencies I have described. The work we have undertaken is ambitious and complicated given our size and our global footprint, but we all recognize that it must be done.
A. Reorganization of HSBC's Structure and Business

1. Global Businesses and Functions

In early 2011, our new CEO, Stuart Gulliver, articulated the firm's new strategy. The decentralized system where country heads were dominant on all matters within that country would be eliminated and replaced. Instead, in order to make the firm more cohesive and better connected, we reorganized HSBC into four Global Businesses and ten Global Functions in addition to our pre-existing regional structure. We gave the heads of each business and function the authority over all personnel in their respective organizations all over the world, thus creating the ability to manage their business or function on a global basis, making it easier to implement consistent policies, standards, and processes. The Global Businesses are Global Banking & Markets ("GBM"), Commercial Banking ("CMB"), Private Banking ("GPB"), and Retail Banking and Wealth Management ("RBWM"). The Global Functions include Legal, Audit, and Risk and Compliance. The heads of each of the businesses and functions, together with the heads of each of the regions, are all members of our risk management committee, which is part of the Group Management Board. This group meets eleven times a year and each meeting is comprehensive, often lasting an entire day. What that means is that the most senior people responsible for managing HSBC globally sit around a table every month, look at our risks, and make decisions.

Better global integration makes us better situated today to manage our risk on a global basis, better able to see where risk in one part of HSBC may impact another part, and better able for the first time to ensure that consistent compliance standards and practices are implemented across all of our affiliates.
2. Simplifying Our Business

In May 2011, we announced a second key component of our new strategy. We have put the entire business through five economic filters: international connectivity, economic development, profitability, cost efficiency, and liquidity. Businesses that do not fit are sold; countries that do not fit are exited. We are no longer trying to be everywhere and trying to provide all services to all customers. We have focused on selling or exiting non-core businesses, which added undue complexity and raised control risks. (An early example of this would be the Mexican U.S. dollar cash handling business that was terminated by our former CEO Michael Geoghegan in 2008. Eventually, the global Banknotes business was closed entirely.) Application of these filters was designed to make the firm more manageable, reduce risk, and focus on our strengths as an internationally connected bank. As a result, over the past 18 months, we have sold or exited 31 businesses and are withdrawing from 9 countries.

We believe that this new structure and focus allows us to more effectively manage HSBC on a global basis and puts us in a better position to both detect and address compliance risk globally.

B. Increased Focus On Compliance

Historically, Group Compliance served what was primarily an advisory function. Compliance in each country reported to the country CEO and implementation of HSBC standards was the responsibility of each local Compliance group. This led to inconsistency and in some cases confusion about ownership and escalation responsibility. The top Group Compliance job at HSBC, which David Bagley has held for the past ten years, is undeniably difficult and our historical organizational structure meant that we did not invest in Group Compliance or empower it the way we should have. This has changed.
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1. Strengthening Compliance

We have elevated and strengthened the role of Group Compliance so that it is now a key control function, not just an advisory function. The Head of Group Compliance now has authority over the nearly 3,500 HSBC compliance officers worldwide. Group Compliance is responsible for resourcing decisions, performance reviews, objectives, strategy, budget, and accountability within all the Regional and Global Business Compliance functions, as well as compensation for all Compliance officers globally. Under the new structure, Group Compliance is empowered to set standards across the organization and now has the necessary authority to reach down into affiliates and ensure that those standards are being met.

We have significantly increased the resources devoted to Compliance across the firm. We have created a new independent Assurance team within Compliance that reviews the effectiveness of the Regional and Global Business Compliance functions, reports compliance issues for remediation, and tracks progress. We now have the tools to analyze and assess our affiliates, looking for compliance risk and problems, and to raise those up to senior members of Group Compliance and Group Risk, who are now responsible for ensuring problems are resolved. This gives us a transparency and accountability that was lacking before.

In addition to shoring up our Compliance function, we have also enhanced the authority of our Global Risk function, so that it too is a strong control function that works in tandem with Compliance. Our Chief Risk Officer now has a broader mandate to control all types of risk globally and has oversight over every Risk officer in every affiliate. The Chief Risk Officer chairs the Risk Management Committee meetings and attends the full Group Holdings Board meetings, at which risk and compliance is a substantial focus.
2. Values Program

In addition to adding resources and elevating the stature of Group Compliance, in 2011 our new senior leadership introduced a values program that seeks to define the way everyone at HSBC should act. Under this values program, before any consideration of the business scorecard, our top executives are judged on being open, connected, and on their commitment to acting with integrity. In addition, all managers and senior executives are accountable for ensuring that business decisions and activities within their area are aligned to our values and business principles. This includes reviewing all products, services, policies, and practices to ensure that the values are embedded into our “business as usual” operations. Employees also are expected to understand the impact of the values and business principles on their day-to-day activities and, as part of performance reviews, employees are now assessed on their value-related behaviors. The compensation of all HSBC employees – from the most senior to the most junior – will be impacted if behaviors do not meet our expectations.

So far, 332 senior managers have attended a 2-day workshop on HSBC values; 3,000 executives have attended leadership training, and 43,500 employees have attended general training, both of which included sessions on HSBC values.

3. New Chief Legal Officer

It was in the context of these reforms that HSBC’s leadership approached me about taking on a newly-created position of Chief Legal Officer. I had previously served nearly seven years as the Under Secretary of Treasury for Terrorism and Financial Intelligence under Presidents Bush and Obama. In our conversations, the Chairman of the Board and the new CEO were candid with me about the problems HSBC faced, the reforms they wanted me to help them implement, and the empowerment that I would need and have. I saw the opportunity as an
C. Designing and Implementing New Global Standards

In April of this year, Stuart Gulliver issued a Group Circular Letter ("GCL") – which is the way our CEO communicates important policy changes throughout the Bank – entitled “HSBC Global Standards.” This directive states that in order to preserve and enhance our reputation, we must lead our industry in formulating and implementing global standards and controls to ensure that our conduct matches our values. The GCL sets forth some key principles. These are, among other things, that HSBC must:

- Adopt and enforce adherence to a single standard globally that is determined by the highest standard we must apply anywhere. Often, this will mean adhering globally to U.S. regulatory standards, but to the extent another jurisdiction requires higher standards, then that jurisdiction’s requirements must shape our global standard;
- Maximize the sharing of information for risk management purposes among Group companies and among Global Businesses and Functions;
- Apply a globally consistent approach to knowing and retaining our customers. When we conclude that any customer or potential customer poses an unacceptable reputational risk (or otherwise does not meet our standards), we should exit or avoid the relationship globally.

The GCL also established a new Steering Committee on Global Standards, co-chaired by myself and our Group Chief Risk Officer, which is responsible for developing and overseeing the implementation of the new standards. Irene Dorner is also a member of the Committee,
because we recognize that often the highest standards will be U.S. standards and Irene’s experience and expertise in that area will be invaluable. This will mean that rather than the U.S. bank being faced with the challenges of absorbing problems and deficiencies from abroad, more often than not it will be high U.S. standards that we will be exporting globally. By implementing this highest common denominator approach across HSBC we are requiring that all our affiliates be held to consistent high standards. Our new structure gives Group Compliance and our other control functions the ability to hold people accountable for following those standards in a way that was not possible before.

Our Global Standards Steering Committee has already taken action on a number of issues, and we have purposefully set out to address several of the problems the Subcommittee has highlighted through its investigation.

1. Information Sharing

One of the first acts of the Steering Committee was to enact a new global standard designed to maximize the sharing of information, to the extent permitted by law, across all HSBC affiliates and all Global Businesses and Functions for risk management purposes. Key compliance-related information will now be shared horizontally with all Regional and Global Business Compliance Heads, including monthly reports detailing compliance issues in a region or business line. The reports from the new Assurance team’s on-the-ground reviews of specific Regional Compliance Functions will also be shared horizontally. And importantly, any material or systematic AML control weaknesses at one affiliate are to be shared with all affiliates.

Similar information sharing protocols have been established for affiliate audit reports. We have seen what happens when information is not shared effectively across our institution, and we
continue to look for additional opportunities to increase the flow of information throughout the firm.

One difficult reality that global institutions like HSBC have to grapple with is that we face certain restrictions on sharing information across borders because we must adhere to the law wherever we operate. The Subcommittee is well aware of this issue and the challenges we face in this area. But at the same time we have recognized that we can significantly improve the flow of information from what occurred in the past and thereby improve our controls.

The Steering Committee is also overseeing the establishment of a global Financial Intelligence Unit ("FIU") at the Group level to ensure we are able to analyze and act on information submitted from around the firm and, subject to any legal restrictions, to share information with relevant affiliates that are impacted.

2. Affiliate Due Diligence

Another early action of the Steering Committee was to globalize the practice of conducting appropriate due diligence on all of our HSBC affiliates. The risk of not doing so has been clearly illustrated by this investigation. While affiliate due diligence is only required by law in a few countries (and is not required by the Financial Action Task Force), we believe that best practice mandates that HSBC affiliates should know more about each other than they do about third-party customers, not less. This means that all HSBC affiliates are now required to complete due diligence on any other HSBC affiliate with which they have a correspondent banking relationship.

3. Global Risk Filter

In addition to the five business filters discussed above, the Steering Committee has decided to add a sixth filter to govern HSBC's activities in high risk jurisdictions. We are
implementing a new global risk filter that will standardize which countries are viewed as high risk by adopting the U.S. country risk ratings on a firm-wide basis. The risk filter will help us determine what business we are comfortable doing in high risk places and what business we must avoid. We want to be in fewer places, with fewer clients, and with less risk across the board. Because the risk filter will be applied firm-wide, it will also bring consistency and enhance our ability to understand and manage our risk across affiliates. We do not view this as sacrificing business for compliance purposes. There is no conflict between our business objectives and compliance objectives in the long run or when viewed from a global firm-wide perspective.

4. Global Sanctions Policy

The Steering Committee has also moved to adopt a global sanctions policy, based on a review of HSBC’s current payment screening policies and procedures. We have identified a number of enhancements that can be made to that process, including additions to the sanctions lists used for both “real time” and “near time” payments screening. Among other things, this will mean that we will be screening for all illicit actors designated by OFAC in all jurisdictions, in all currencies.

IV. Making Reforms Sustainable

We understand that we also need a genuine commitment from the highest levels of the organization to institutionalize the reforms and foster a culture of compliance. That is being accomplished in part by formalizing the reforms I have described and embedding them in a governance structure.

In the end, sustainability of these reforms depends critically on the commitment of HSBC’s top leadership. The tone at the top of HSBC is, in my view, remarkably strong. Our
Board and senior leadership are committed to seeing these reforms through, and we understand that this is something that absolutely must be done for the long-term success of our bank.

V. Protecting the Integrity of the Financial System

The reforms I have laid out above, when fully implemented, will have a positive impact on the financial system. But beyond that, there are opportunities to improve collaboration both among financial institutions and between the financial sector and the government that would help protect the financial system from misuse. One lesson I learned during my Treasury service is that, in almost all cases, the private sector and governments share the same goals when it comes to preserving the integrity of the financial system. This is a difficult problem, and we are up against groups of people who are adept at evading controls. My experience at Treasury was that banks are eager to receive the type of information about illicit conduct that the government is able to provide and to engage with the government about mitigating that risk, and this is certainly true with respect to HSBC. HSBC wants to play a constructive role in this effort, and there are clearly opportunities for increased information sharing and collaboration.

This Subcommittee helped create a valuable tool in the PATRIOT Act when it gave the industry 314(b), which permits financial institutions to share information with one another in order to identify and report to the federal government activities that may involve money laundering or terrorist financing. Increased sharing of such information would enable financial institutions – and law enforcement – to better connect the dots, identify suspicious patterns of activity, and take appropriate action. Unfortunately, this provision has not been used as robustly as it might be. I know this Subcommittee has also been looking for ways to improve the effectiveness of this provision.
Another potential area for improvement is the sharing of information between financial institutions and government agencies. Law enforcement agencies and the intelligence community collect and analyze significant amounts of information regarding illicit activity, which often enables the government to identify the names of individuals, companies, or other entities that facilitate or tolerate illicit activity. This information would be extremely valuable to financial institutions, and to the extent more of this information could be shared, that is something we at HSBC, and I am sure others in the industry, would support and encourage.

Along these lines, it would be helpful to have more access to beneficial ownership information for companies. Provisions of the Levin-Grassley Incorporation Transparency and Law Enforcement Assistance Act would be a step in the right direction, particularly if beneficial ownership information were to be made more readily available not only to law enforcement but to financial institutions as well. The better banks know their customers, the more secure the entire system is from misuse.

VI. Conclusion

You have heard a lot today about what happened in the past and the reasons for it. We are in the process of applying the lessons learned from our experience throughout our institution. We have a long way to go on this journey, but I believe we are on the right path. We have work to do to regain the trust of our regulators, our customers, and other stakeholders. But I do want to say very clearly that the reforms we are undertaking reflect a real commitment to HSBC’s true values. HSBC is a bank that has a long and proud heritage. Over its 147 year history HSBC has been an upstanding corporate citizen all over the world and has played a vital role in integrating emerging markets into the global economy. This is a bank that has helped thousands of individuals and small businesses realize their dreams.
This experience has been a very painful one for the vast majority of the HSBC family who have spent their careers at the bank doing the right thing every day. I know I speak for all of HSBC senior management when I say that we are committed to doing what needs to be done. I appreciate the opportunity to speak to you today and I look forward to answering your questions. Finally, Mr. Chairman, I intend to answer the Subcommittee’s questions as candidly and completely as I can today. However, as has been previously discussed with the Subcommittee’s staff, there are certain potential questions – or parts of questions – that I may not be able to answer because of either legal obligations attendant to my prior position in Government or ethical obligations associated with my present position as counsel for HSBC. I hope that none of today’s questions will implicate either of these areas where I cannot respond, but if they do I will let you know.
TESTIMONY OF

THE OFFICE OF THE COMPTROLLER OF THE CURRENCY

Before the

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

of the

COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS

of the

U.S. SENATE

July 17, 2012

Statement required by 12 U.S.C. 250:

The views expressed herein are those of the Office of the Comptroller of the Currency and do not necessarily represent the views of the President.
1. Introduction

Chairman Levin, Ranking Member Coburn, and members of the Subcommittee, the Office of the Comptroller of the Currency (OCC) appreciates the opportunity to appear before you today to discuss the importance of effective Bank Secrecy Act (BSA) compliance programs at U.S. financial institutions and the role the OCC – and the other financial institution regulators – play in examining financial institutions for compliance in this area. As well, this testimony focuses on the OCC’s supervision of HSBC Bank USA, N.A. (HBUS or Bank) with respect to BSA compliance, our enforcement action against the Bank, and other matters in which the Subcommittee has expressed an interest.

The OCC is committed to ensuring that the institutions under its supervision have effective controls in place to safeguard them from being used as vehicles to launder money for drug traffickers and transnational and other criminal organizations, or facilitate the financing of terrorist acts. Together with the other Federal banking agencies, the banking industry, and the law enforcement community, the OCC shares the Subcommittee’s goal of deterring money laundering, terrorist financing, and other criminal acts and preventing the misuse of our nation’s financial institutions.

National banks and thrifts have been required to have a BSA compliance program since 1987, and to monitor, detect and report suspicious activity since the 1970s. However, regulatory requirements and supervisory expectations under the BSA have increased significantly since that time, with the result that most institutions have had to make substantial improvements in their BSA compliance programs. In response, many of the largest institutions have implemented highly sophisticated programs and systems that screen transactions to identify and report suspicious activity to law enforcement, and to ensure that such transactions do not involve entities subject to Office of Foreign Assets Control (OFAC) sanctions. The suspicious activity reports (SARs) that are filed have provided law enforcement with access to critical information needed to initiate and conduct successful investigations and prosecutions. There are now approximately 5.6 million SARs in the centralized database that is maintained by the Financial Crimes Enforcement Network (FinCEN). The majority of these SARs have been filed by national banks and thrifts.

However, as our financial institutions’ BSA compliance programs have evolved and changed over time, so has the sophistication and determination of money launderers, terrorist financiers and other criminals in finding other ways to gain access to our financial institutions. The technology, products and services offered by our institutions to give customers better and quicker access to financial services also are being used by criminals to instantaneously and anonymously move money throughout the world, sometimes through the simple click of a keypad. Consequently, banks, thrifts, and other financial institutions have had to devote increasingly larger amounts of resources to maintain effective programs.

Comptroller Curry recently spoke on the operational risks that are challenging financial institutions. One of the areas he spotlighted was BSA compliance. He noted that BSA compliance is inherently difficult, combining the challenges of sifting through large volumes of transactions to identify features that are suspicious, with the presence of criminal and possibly...
terrorist elements dedicated to, and experts in, concealing the true nature of the transactions they undertake. Rendering BSA compliance more challenging is the fact that such risks are constantly mutating, as criminal and terrorist elements alter their tactics to avoid detection. They move quickly from one base of operations to another, finding sanctuary in places where law enforcement, or sympathy for U.S. policy objectives, is weakest. Furthermore, money laundering and terrorist financing schemes are becoming more complex, involving entities and individuals located in numerous jurisdictions worldwide.

Comptroller Curry emphasized, and we reaffirm today, that notwithstanding these challenges, the OCC expects the institutions we supervise to have effective programs in place to comply fully with the requirements of the BSA. Primary responsibility for compliance with the BSA rests with the nation’s financial institutions themselves. The OCC and the other Federal banking agencies are charged with ensuring that these institutions have effective systems and controls to detect and monitor for suspicious activity related to money laundering and terrorist financing, provide the necessary reports to law enforcement, and compile and maintain records that are useful to regulatory and criminal investigations. This is not a static area of compliance as new money laundering and terrorist financing risks emerge and as existing risks change. Therefore, the OCC remains committed to continually improving our supervisory processes to help ensure the ongoing effectiveness of national banks’ and federal savings associations’ (hereafter referred to as “banks”) BSA compliance programs.

The Subcommittee’s Report (Report) contains three recommendations focused on the OCC’s BSA/AML supervision. We agree with the concerns reflected in each of the recommendations and will take actions in response. We have already identified a new approach that we will implement to assure that BSA/AML deficiencies are fully considered in a safety and soundness context and are taken into account as part of the “Management” component of a bank’s CAMELS rating. We are revising and clarifying the operation of our cross-functional Large Bank BSA Review Team (LBA Review Team) to enhance our ability to bring different perspectives to bear and react on a more timely basis to circumstances where a bank has multiple instances of Matters Requiring Attention, or apparent violations of the required components of its BSA/AML program. We will also explore how we track and review relevant information in this regard and whether new initiatives are appropriate in that area as well. We will also revisit our current approach to citing BSA/AML violations in order to provide more flexibility for individual “pillar” violations to be cited, and we will identify what steps we can take in our examinations to more promptly obtain a holistic view of a bank’s BSA/AML compliance. Finally, we will review other areas, such as training, staffing, recruitment, policies, and interagency coordination, to make improvements in our BSA/AML supervision program.

II. OCC BSA/AML Supervisory Policies and Practice

Recognizing the increasing and evolving challenges of BSA/AML compliance, the OCC has continually sought ways to enhance and improve our supervision. In 2005, we undertook a set of comprehensive initiatives to improve our BSA/AML supervision. These initiatives were designed to strengthen OCC BSA/AML examinations; enhance OCC resources and expertise devoted to BSA/AML supervision; and provide clear and consistent communications about our BSA/AML supervisory expectations to the industry. Some of the key changes in our BSA/AML
supervision included the development and implementation of enhanced risk identification and analysis tools, such as the OCC’s Money Laundering Risk Assessment system (MLR), which enables the OCC to identify potentially high-risk banks and activities that warrant increased scrutiny and supervisory resources. With the other Federal banking agencies, we finalized and issued the Federal Financial Institutions Examination Council’s (FFIEC) Interagency BSA/AML Examination Manual (Manual) that provides consistent and comprehensive examination procedures for BSA/AML and OFAC. We also worked with the other Federal banking agencies to develop and issue a uniform policy on citing BSA compliance program violations and taking enforcement actions. And we created and filled a new Director-level position for the OCC’s BSA/AML Compliance Policy Department and augmented staff reporting to this new Director.

In addition to the development and annual maintenance of the MLR information collection system, the OCC implemented a number of quality assurance processes to ensure that we are consistent in identifying and communicating BSA issues. These initiatives include enhanced MRA tracking and the LB Review Team process. The LB Review Team was formed in 2004 to ensure consistency in the area of BSA/AML compliance for the largest banks under our supervision. The LB Review Team is comprised of the Director of the Enforcement and Compliance Division, the Director for BSA/AML Compliance Policy, and the Senior Counsel for BSA/AML.

The BSA/AML Compliance Policy Department provides comprehensive BSA training to our examiners and organizes a BSA compliance conference every three years to inform our examiners of emerging money laundering and terrorist financing threats and vulnerabilities. Representatives of the law enforcement community are regular participants in these conferences and training sessions, establishing an ongoing dialogue with our examiners concerning criminal typologies, schemes and arrangements. Such exchanges allow our examiners to be continually aware of the risks facing the banks, including those risks discussed here today, to scope examinations accordingly, and to provide timely guidance to the industry in addressing those risks.

Globalization is a critical feature of the business activities of the large internationally-active banks. It provides them with access to new markets, customers and opportunities. However, it also increases their exposure to potential money laundering and terrorist financing risks. The OCC recognizes this challenge and the BSA/AML Compliance Policy Department works closely with the U.S. Treasury’s Office of Terrorism and Financial Intelligence (TFI), FinCEN, and
OFAC to promote the implementation of sound international anti-money laundering and counter terrorist financing (AML/CFT) standards. The OCC also annually hosts two AML schools to train our foreign counterparts, and we are active participants in the U.S. delegation to the Financial Action Task (FATF) that is led by TFI.

The OCC also works with the other FFIEC agencies, FinCEN and OFAC to review and develop BSA examination and enforcement policies and procedures. The publication of the Manual in 2005 was an outstanding example of cooperation and coordination within the government, and between the government and the banking industry. The Manual reinforces the agencies’ position that sound BSA/AML risk management enables a banking organization to identify BSA/AML risks and better direct its resources, with the ultimate goal of helping safeguard its operations from money laundering, terrorist financing, and other illicit activities. The Manual has been revised three times since its initial publication so that it remains current with the latest technological and payment system innovations and emerging threats and vulnerabilities.

In fact, at the initiative of the OCC, the latest version of the Manual in 2010 contained a new section on bulk cash repatriation that provides detailed guidance and examination procedures relating to this high risk product. Based upon our experience and expertise in the bulk cash and remote deposit capture (RDC) area, the OCC took the lead in drafting the bulk cash section of the Manual and the related examination procedures, and updating the section on RDC. The next round of revisions to the Manual, which will be chaired by the OCC, is currently in the planning stages and should be completed during the next year. We expect that the revised Manual will include expanded sections on new payment systems such as prepaid access, mobile banking, and emerging risks associated with new products, services and customers that the agencies have identified through our collective supervisory processes.

The OCC monitors compliance with the BSA and its implementing regulations by applying the examination procedures set forth in the Manual. These procedures are typically completed within each bank’s examination cycle. Community banks are on either 12 or 18 month examination cycles, and large banks and midsize banks are on an annual examination cycle. These procedures are risk-based and direct examiners to focus examination resources on high-risk areas within banks and high-risk banks. During an examination, examiners use the procedures to assess the implementation and effectiveness of the bank’s policies, procedures, systems, and controls. Every BSA/AML examination includes, at a minimum, a review of the bank’s risk assessment and its BSA/AML compliance program (focusing on internal controls, training programs, independent testing and BSA officer independence and qualifications). We also assess the effectiveness of the bank’s OFAC compliance program.

OCC examiners perform ongoing supervision and conduct targeted testing in areas that may present higher money laundering and terrorist financing risks. The Manual also includes supplemental procedures that cover specific BSA requirements (e.g., currency transaction reporting, suspicious activity reporting, foreign correspondent bank, private banking, funds transfer recordkeeping) and specific examination procedures covering risks from products and services and persons and entities (e.g., correspondent banking, private banking, trade finance, electronic banking, third-party payment processors, bulk shipments of currency, pouch activities, politically exposed persons, business entities). The OCC routinely downloads and analyzes BSA
data, currency transaction reports and suspicious activity reports to identify unique risks and augment our risk-based examination processes. This information permits examiners to scope and plan examinations appropriately to ensure that the bank’s higher risk activities are evaluated. Such activities may be reflected in accounts associated with repetitive SAR filings, significant cash activity, or activity that is inconsistent with the type of business of the customer, and are examples of the types of accounts that would be selected for transaction testing and further examiner investigation. In cases where examiners identify areas of concern, deficiencies or violations, they typically expand the examination scope and perform transaction testing in targeted areas to ensure they identify and evaluate all pertinent issues. This combination of our ongoing supervision and targeted examinations allows us to conclude on the adequacy of a bank’s BSA/AML compliance program.

Currently, the OCC takes the findings from its BSA/AML and OFAC compliance examinations into account in determining the bank’s regulatory ratings in two ways: (i) compliance risk management (including BSA/AML) is a part of the Management component of the Uniform Financial Institutions Rating System (UFRS), more commonly referred to as CAMELS (Capital adequacy, Asset quality, Management, Earnings, Liquidity, and Sensitivity to market risk); and (ii) BSA/AML is taken into account as part of the compliance rating under the Uniform Interagency Consumer Compliance Rating System. The OCC’s approach of factoring BSA/AML and OFAC compliance into the Consumer Compliance rating differs from the approach of the other Federal banking agencies, which incorporates consideration of a bank’s BSA/AML and OFAC compliance only in the Management component of a bank’s CAMELS rating.

We appreciate the concerns raised in the Subcommittee’s Report about this approach and the need to ensure that deficiencies in BSA/AML compliance are considered in the context of safety and soundness and are taken into account in determining the Management component of the CAMELS rating. To address this concern, we are developing directions to our examiners to view serious deficiencies in a bank’s BSA/AML compliance area, including program violations, as presumptively adversely affecting a bank’s Management component rating. We will also

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1 In assigning this compliance rating, OCC examiners consider major BSA/AML and OFAC examination findings including, but not limited to:

- The current and historical adequacy of the bank’s BSA/AML/OFAC compliance program;
- The significance, volume, and history of program deficiencies and violations and whether they were accompanied by aggravating factors, such as highly suspicious activity creating a significant potential for money laundering, potential terrorist financing, and a pattern of structuring to evade reporting requirements;
- Money laundering and terrorist financing risks posed by the bank’s customers, products and activities;
- The adequacy of monitoring systems to detect and report suspicious activity;
- The adequacy of systems to detect and report monetary transactions that require the filing of Currency Transaction Reports;
- The adequacy of systems to comply with BSA recordkeeping requirements;
- Evidence of insider complicity; and
- The board of directors’ and management’s willingness and ability to administer an effective BSA/AML and OFAC compliance program.

The Office of Thrift Supervision, prior to its merger with the OCC, used the same approach as the OCC by factoring BSA/AML and OFAC compliance into the Consumer Compliance rating and incorporating them within the Management rating, as appropriate.
provide guidance on how to document application of this approach in determining the Management component rating.

III. OCC's BSA/AML Supervisory and Enforcement Process

The OCC uses a variety of methods to communicate problems or weaknesses in a bank’s systems and controls, including BSA deficiencies, and to obtain corrective action. In most cases, problems in the BSA/AML area, as well as in other areas, are corrected by bringing the problem to the attention of bank management and obtaining management’s commitment to take corrective action promptly. The Report of Examination or, in the case of large or midsize banks, the Supervisory Letter, documents the OCC’s findings and conclusions with respect to its supervisory review of a bank.

Problems or weaknesses are communicated to the bank’s senior management and board of directors in the “Matters Requiring Attention” (MRA) section of the Report of Examination or Supervisory Letter. MRAs are conditions or issues that management is required to change or correct. MRAs are a serious consequence of the examination and they include practices that: (i) deviate from sound governance, internal control and risk management principles which may adversely impact the bank’s earnings or capital, risk profile, or reputation if not addressed; or (ii) result in substantive noncompliance with laws and regulations, internal policies, controls or processes, OCC supervisory guidance, or supervisory conditions imposed in an interpretive letter or licensing approval. Once MRAs are identified and communicated to the bank, the bank’s senior management and board of directors are required to promptly correct them within the agreed upon time frame. OCC examiner guidance specifically provides that supervisory strategies for banks with MRAs must include plans to follow up on the concerns. The plans need to be consistent with the seriousness of the MRA and include activities to monitor progress and verify the effectiveness of the corrective actions. The OCC does not deem an MRA corrected until the supervisory office has verified that the bank has adopted and implemented an effective corrective action.

MRAs involving banks in our Large Bank supervision program are tracked by the OCC in a Large Bank data system that is continually updated by the examiners. On a quarterly basis, Large Bank supervision reports on the outstanding MRAs by bank and core function to ensure that corrective actions remain on track.

When deficiencies in the BSA/AML area rise to the level of a BSA compliance program violation (12 C.F.R. § 21.21), or when a bank fails to correct problems with the program that had been previously reported to the bank (including through MRAs), a statutory mandate (12 U.S.C. 1818(s)) requires the banking agency to use its cease and desist (C&D) authority to correct the problem. Section 1818(s) specifically provides that if an insured depository institution has failed to establish and maintain a BSA compliance program or has failed to correct any problem with the BSA compliance program previously reported to the institution by the appropriate Federal banking agency, the agency shall issue a C&D order against the institution.

To ensure that the OCC’s process for taking administrative enforcement actions based on BSA violations is measured, fair, and fully informed, in 2005, the OCC adopted a process for taking
administrative enforcement actions against banks based on BSA violations, including situations where a bank fails to correct a problem that was previously brought to its attention. This process includes the following stages:

(i) Preliminary assessment of the facts and discussion with bank management.

(ii) Additional reviews by cross functional review groups, including the OCC’s LB Review Team.

(iii) Written findings provided to the bank and an opportunity for the bank to respond.

(iv) Washington Supervision Review Committee (WSRC) review. The WSRC reviews significant enforcement actions proposed to be taken by the OCC, including all cases involving BSA enforcement, all cases that are unique or highly visible, and those cases involving referrals to other agencies.

(v) Final decision by the appropriate Senior Deputy Comptroller.

As previously noted, the OCC also worked within the FFIEC to develop and issue an interagency policy on citing BSA compliance program violations and taking enforcement actions, and our enforcement decisions are framed by that policy. The Interagency Statement on Enforcement of BSA/AML Requirements (Interagency Statement) was issued in 2007 and it sets forth the Federal banking agencies’ policy on the circumstances in which an agency will issue a C&D order to address noncompliance with certain BSA/AML requirements, particularly in light of the statutory mandate in Section 1818(s). The Interagency Statement provides that a compliance program violation occurs where either of the following conditions exists:

The bank fails to adopt or implement a written BSA compliance program that adequately covers the required program elements: (1) internal controls (including customer due diligence, procedures for monitoring suspicious activity or appropriate risk assessment); (2) independent testing; (3) designated compliance personnel; and (4) training; or

The bank has defects in its BSA compliance program in one or more program elements indicating that either the written program or its implementation is not effective. For example, program deficiencies indicate ineffectiveness where the deficiencies are coupled with other aggravating factors such as evidence of: (i) highly suspicious activity creating a significant potential for unreported money laundering or terrorist financing; (ii) patterns of structuring to evade reporting requirements; (iii) significant insider complicity; or (iv) systemic failures to file currency transaction reports, suspicious activity reports, or other required BSA reports.

A program violation may occur where customer due diligence, monitoring of suspicious activity, risk assessment, or other internal controls fails with respect to a “high risk area,” or to “multiple lines of business that significantly impact the institution’s overall BSA compliance.” An agency
will also consider the application of the institution’s program across its business lines and activities. In the case of institutions with multiple lines of business, deficiencies affecting only some lines of business or activities would need to be evaluated to determine if the deficiencies are so severe or significant in scope as to result in a conclusion that the institution has not implemented an effective overall program.

The Interagency Statement also specifically addresses repeat problems for purposes of the statutory mandate for a C&D order in 12 U.S.C. § 1818(s). It provides that in order to be considered a “problem” within the meaning of section 1818(s), the deficiency reported to the institution would ordinarily involve a serious defect in one or more of the required components of the institution’s BSA compliance program or implementation thereof. In addition, it sometimes takes a considerable period of time to correct BSA/AML deficiencies especially when large institutions merge system platforms and information technology changes are required. As a result, with regard to repeat problems, the Interagency Statement provides that a C&D is not required if the agency determines that the institution has made “acceptable substantial progress” toward correcting the problem at the time of the examination immediately following the examination where the problem was first identified and reported to the institution.

The Report highlights and calls for change in the OCC’s current practice of not citing violations of the individual required components of an effective BSA program (i.e., internal controls, independent testing, designated compliance personnel, and training) where the deficiencies fall short of a program violation. We understand the concerns reflected in the Report that the OCC’s approach seems to limit examiners to using only MRAs to remedy identified problems, and we will revisit our current approach in order to provide more flexibility for individual “pillar” violations to be cited. One of the reasons for the current OCC approach is that it requires the OCC to focus on determining whether the deficiencies in a bank’s program amount to a BSA compliance program violation. Therefore, in implementing changes on this point, it will be important not to create disincentives to making the tough calls when there are BSA compliance program violations mandating the issuance of a C&D order.

While our practice in this regard has differed from that of the other Federal banking agencies, the OCC’s public enforcement record is nonetheless strong. As shown in Section IV below, between 2005 and 2011, the OCC issued BSA/AML focused C&Ds against banks at nearly twice the rate of the Federal Deposit Insurance Corporation (FDIC), the nearest other agency (per number of banks supervised), and issued CMPs at nearly four times the rate of the FDIC. The OCC also brought over 60 percent of the total dollar value of BSA penalty actions issued by the OCC, the Board of Governors of the Federal Reserve System (Federal Reserve) and the FDIC. Thus, the component violations being cited by these other agencies are not resulting in as many C&D orders or CMP actions (which are the most stringent types of actions taken), as compared to the approach taken by the OCC.

2 As set forth in the charts on the following page, between 2005 and 2011, the OCC brought 43 BSA/AML focused C&Ds against banks as compared to 58 for the FDIC and 2 for the Federal Reserve. In addition, the OCC issued CMPs against 14 banks totaling $124 million, as compared to six CMPs issued by the FDIC totaling $24.675 million, and two CMPs issued by the Federal Reserve totaling $50 million. In 2011, the OCC supervised 1,973 banks, the FDIC supervised 4,647 banks, and the Federal Reserve supervised 26 banks and bank holding companies.
IV. OCC BSA/AML Enforcement Actions and Industry Trends

In recent years, the OCC has taken numerous formal actions against national banks to bring them into compliance with the BSA. These actions are typically C&D orders. The OCC has also taken formal actions against institution-affiliated parties who participated in BSA violations. Since September 11, 2001, the OCC has issued over 180 public formal enforcement actions based in whole, or in part, on BSA/AML violations (including formal agreements, C&D orders and civil money penalty (CMP) actions). As set forth in the following charts, between 2005 and 2011, the OCC brought BSA focused C&D orders and CMP actions against banks at a higher rate than the FDIC and the Federal Reserve (per number of banks supervised):

### Number of Bank BSA Focused C&D Orders by Agency

<table>
<thead>
<tr>
<th>Agency</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>Totals</th>
</tr>
</thead>
<tbody>
<tr>
<td>OCC</td>
<td>1984</td>
<td>1762</td>
<td>1662</td>
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<td>5200</td>
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<td>4987</td>
<td>4785</td>
<td>4647</td>
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<td></td>
</tr>
<tr>
<td>Federal Reserve</td>
<td>-</td>
<td>896</td>
<td>877</td>
<td>875</td>
<td>846</td>
<td>826</td>
<td></td>
<td>9</td>
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### Number of Depository Institutions Regulated by Agency

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<th>Agency</th>
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<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>Totals</th>
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<tr>
<td>OCC</td>
<td>1984</td>
<td>1762</td>
<td>1662</td>
<td>1559</td>
<td>1495</td>
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<td>1973</td>
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<tr>
<td>FDIC</td>
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<td>Federal Reserve</td>
<td>-</td>
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<td>875</td>
<td>846</td>
<td>826</td>
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<td></td>
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</tbody>
</table>

### Number of Bank BSA CMP Actions by Agency

<table>
<thead>
<tr>
<th>Agency</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
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<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>Totals</th>
</tr>
</thead>
<tbody>
<tr>
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<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
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<td>1</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>2</td>
</tr>
</tbody>
</table>

### Dollar Amounts of Bank BSA CMP Actions by Agency (In Millions)

<table>
<thead>
<tr>
<th>Agency</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>Totals</th>
</tr>
</thead>
<tbody>
<tr>
<td>OCC</td>
<td>$27.75</td>
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<td>$10.75</td>
<td>$15.2</td>
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<td>$15.0</td>
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</tr>
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<td>0</td>
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<td>$24.675</td>
</tr>
<tr>
<td>Federal Reserve</td>
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<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>$30.00</td>
</tr>
</tbody>
</table>

Some of the more significant recent cases were actions against Wachovia Bank, N.A., Zions First National Bank, and Citibank, N.A. There are also many other examples where the OCC identified BSA non-compliance or, in some cases, actual money laundering, took effective action to stop the activity, and ensured that accurate and timely referrals were made to law enforcement. The Wachovia, Zions, and Citibank actions are discussed below:
On March 17, 2010, the OCC assessed a $50 million penalty and issued a C&D order against this bank for violations of the BSA as part of a coordinated action with the Department of Justice, FinCEN, and other federal agencies. Wachovia also entered into a deferred prosecution agreement with the U.S. Attorney’s Office in the Southern District of Florida and the Department of Justice (DOJ) Asset Forfeiture and Money Laundering Section (AFMLS) and agreed to forfeit $110 million to the U.S. Additionally, FinCEN assessed a $110 million civil money penalty that was deemed satisfied by the forfeiture to the U.S. Government.

The OCC found that Wachovia: (a) failed to implement adequate policies, procedures, or monitoring controls governing the repatriation of nearly $14 billion of U.S. dollar (USD) bulk cash for high risk cas de cambio (CDC) and other foreign correspondent customers; (b) failed to conduct monitoring of high volumes of monetary instruments flowing through the CDCs and other foreign correspondent accounts in the form of RDC products, consisting of nearly six million checks worth approximately $41 billion; (c) failed to conduct adequate levels of due diligence of high risk CDC and foreign correspondent customers; (d) failed to appropriately monitor traveler’s checks in a manner that was consistent with the bank’s policy limits over sequentially numbered traveler’s checks for high risk CDC customers; (e) failed to appropriately institute risk-based monitoring of the bank’s foreign correspondent customers, primarily as a result of placing too much emphasis on staffing considerations when setting alert parameters; (f) failed to file timely SARs involving suspicious transactions conducted through certain foreign correspondent accounts at the bank; and (g) failed to adequately report cash structuring activity from review of alerts generated in the bank’s Financial Intelligence Unit. After conducting a voluntary look back, the bank filed over 4,300 SARs involving suspicious transactions conducted through the bank by CDCs and high risk foreign correspondent customers.

The OCC’s enforcement action focused attention on the bulk cash repatriation money laundering scheme. The OCC played a lead role in this case and linked remote cash letter instrument processing to the bulk cash scheme. As a result of the Wachovia investigation and findings, the OCC took the lead in integrating bulk cash processing and the RDC implications into the Manual and commenced horizontal reviews of bulk cash activity and RDC at all national banks in the OCC’s Large Bank supervision program, including HSBC’s banknote activity.

Shortly after the Wachovia case, the government of Mexico implemented significant restrictions on U.S. dollar transactions at Mexican financial institutions and made significant changes to its AML laws and regulatory processes. In response, the drug cartels have adjusted their money laundering schemes and techniques to adapt to this change, and the OCC continues to work with law enforcement to identify new areas of vulnerability.

On February 11, 2011, the OCC assessed an $8 million penalty against Zions for failures involving correspondent banking and RDC. Concurrent with the OCC’s penalty, FinCEN assessed an $8 million penalty against Zions. Both penalties were satisfied by a single $8 million payment to the U.S. Department of the Treasury. The OCC had commenced an investigation into the bank’s former foreign correspondent business and identified deficiencies in its BSA/AML controls, which resulted in
violations of law. In particular, the bank pioneered the development of a RDC product that enabled customers to deposit imaged items electronically from remote locations and marketed this product to high risk customers with insufficient regard for BSA/AML compliance implications. The bank exited the foreign correspondent line of business in early 2008, promptly conducted a voluntary look back, and reported suspicious activity. The significance of this case is that it presents a good example of how banks need to ensure that compliance issues are at the forefront of technological developments and are not secondary issues to be considered after the product is launched and the volumes become unmanageable.

Citibank, N.A., Sioux Falls, South Dakota (Citibank) - On April 4, 2012, the OCC entered into a consent order with Citibank, N.A., to address BSA deficiencies involving internal controls, customer due diligence, audit, monitoring of its RDC and international cash letter instrument processing in connection with foreign correspondent banking, and suspicious activity reporting relating to that monitoring. These findings resulted in violations by the bank of statutory and regulatory requirements to maintain an adequate BSA compliance program, file SARs, and conduct appropriate due diligence on foreign correspondent accounts. Among its requirements, the consent order directs the bank to:

(i) ensure the independence of the bank’s compliance staff,
(ii) require new products and services be subject to high level compliance review,
(iii) ensure that all customer due diligence processes are automated and accessible; and
(iv) conduct a look back of the RDC cash letter activity.

Each of these cases has been discussed extensively at public forums and they underscore the OCC’s commitment to ensuring that all national banks and federal savings associations have a strong BSA/AML function that keeps pace with changing technologies and threats.

Our examination and enforcement activities have identified a number of trends and concerns in the BSA/AML area that warrant continued attention by supervisors and banks:

- **Compliance Resources** – Some cases have identified the lack of sufficient staffing, high turnover rates, or the impact of compliance cuts on the program. In some cases, banks cut staffing and resources in the BSA area during the financial crisis. In other cases, banks’ compliance department staff and expertise have failed to keep pace with the growth of the institution. For example, a mid-size bank should not have the same compliance program and staff levels that it had when it was a smaller community bank.

- **International Focus or Component** – Foreign correspondent banking, cross border funds transfers, bulk cash repatriation, remote deposit capture, and embassy banking have all been high risk areas that some banks have not managed effectively.

- **New Technologies** – Some banks have introduced new technologies and products without appreciating or understanding the compliance risks. In addition, some products have evolved through technology and need to be periodically re-evaluated (e.g., prepaid access money transfers, payroll cards).

- **Third-Party Relationships and Payment Processors** – The OCC and the other banking agencies have been reviewing closely third-party and payment processor relationships
and a number of enforcement actions have been taken in recent years. Banks need to be especially aware of the risks presented by payment processors and the extent of their franchising relationships (RTN numbers, routing numbers, and ATM machines).

- **Evolving Payments Activities** – Prepaid access, mobile phone banking, smart ATM machines and kiosks, mobile wallets, and Internet cloud-based payment processes are all technologies that are developing rapidly, and senior bank compliance personnel need to be engaged in the product development processes. OFAC monitoring is especially important and challenging in this area.

- **Migration to Smaller Banks** – As some large or mid-size banks have attempted to lower their risk profiles, money launderers have tried to enlist community banks to step in and provide key payments functions. This raises concern as these institutions may lack the resources and personnel necessary to successfully manage higher risk activities.

Many of the practical problems seen in recent years with respect to BSA compliance can be summed up within four areas: (i) culture of compliance within the organization, (ii) commitment of sufficient and expert resources, (iii) strength of information technology and monitoring processes, and (iv) sound risk management. The OCC will continue to identify these trends, communicate them to the industry, and ensure that BSA/AML supervision stays current.

V. Improvements Undertaken to Improve BSA/AML Supervision

The OCC is committed to rigorous supervision, strong enforcement, and continuous improvement to our supervisory approach to BSA/AML compliance. While we have previously discussed herein some recent BSA/AML related initiatives, other current initiatives include the following:

- We are implementing changes to our LB Review Team process to make it more effective in supporting and ensuring consistency of the supervisory processes for the larger banks we supervise.

- We are reviewing the manner in which MRAs are reported to ensure that banks with high numbers of MRAs in one particular CAMELS/ITCC area are receiving additional supervisory attention and, in the case of BSA/AML, consideration of formal enforcement action.

- The OCC’s MLR database includes a detailed inventory of the products and services being offered by each community bank so that the OCC can assess the BSA/AML risks within each particular institution for use in scoping and staffing examinations. We will annually update the information collection processes pertaining to this tool to ensure that it captures higher risk and novel products. We will also consider whether similar tools should be implemented to our Large Bank and Midsize Bank portfolios.

- As previously described, we are strengthening and reinforcing the expectation that BSA/AML and OFAC deficiencies are taken into consideration in determining the
Management rating. We will also instruct our examiners to cease the practice of factoring BSA/AML and OFAC compliance into the Consumer Compliance rating.

- As described in Section III, we will also look closely at the Report’s recommendation concerning citing BSA/AML compliance violations.

In addition, we are committed to keeping abreast of how new technologies and payment systems may affect BSA/AML compliance and to provide the industry and examiners with guidance on these emerging risks. For example, in 2006 the OCC issued comprehensive risk management guidance for Automated Clearing House (ACH) transactions, and the OCC continues to work with the other regulators to ensure that international ACH transactions are properly monitored for both BSA/AML and OFAC compliance. In June of last year, the OCC issued risk management guidance for prepaid access programs and continues to develop guidance for banks with regard to this rapidly growing product. And earlier this month, the OCC worked with the FFIEC to issue a statement on outsourced Internet cloud computing services that discusses key risk considerations associated with outsourced cloud computing activities, including cloud based payment processes and systems, and identifies applicable risk mitigation considerations contained in the various booklets that comprise the FFIEC IT Examination Handbook.

VI. Overview of HSBC and OCC’s BSA/AML Examinations

HSBC North America Holdings Inc. (HNAH) is the holding company for HSBC’s operations in the U.S. HNAH is controlled by HSBC plc, London, England (HSBC Group), a $2.5 trillion global banking company with hundreds of financial institution subsidiaries throughout the world. The principal subsidiaries of HNAH at December 31, 2011 were HSBC USA Inc. (HUSI), HSBC Markets (USA) Inc., a holding company for certain global banking and markets subsidiaries, HSBC Finance Corporation, a holding company for consumer finance businesses, and HSBC Technology and Services (USA) Inc., a provider of information technology and centralized operational and support services among the subsidiaries of HNAH. The Bank is a subsidiary of HUSI. “Group Entities” are foreign affiliates of the Bank in which HSBC Group holds a majority interest.

The Bank serves 3.8 million customers through its personal financial services, commercial banking, private banking, asset management, and global banking and markets segments. It operates several hundred bank branches throughout the U.S., predominantly in New York State as well as branches and/or representative offices in California, Connecticut, Delaware, Florida, Georgia, Illinois, Maryland, Massachusetts, New Jersey, North Carolina, Oregon, Pennsylvania, Texas, Virginia, Washington, and the District of Columbia. The Bank has five main lines of business as follows:

(i) Retail Banking and Wealth Management provides a broad range of financial products and services including loans, residential mortgages, deposits, branch services and brokerage products and services;

(ii) Commercial Banking offers global banking services, along with financial planning to companies, government entities and non-profit organizations. In addition to deposits,
services include payments and cash management (PCM), merchant services, trade, supply chain, receivables finance, corporate finance, global markets and risk advisory;

(iii) Global Banking and Markets is an emerging markets-led and financing focused business that provides tailored financial solutions to government, corporate and institutional clients worldwide, and the Bank manages its Global Banking and Markets operations as a global business and maintains offices in more than 60 countries and territories;

(iv) HSBC Global Asset Management is the core investment business of the HSBC Group managing assets totaling $429.4 billion; and

(v) HSBC Private Bank, a division of the Bank, offers wealth management and specialist advisory services for high net worth individuals and families with local and international needs.

On April 30, 2003, the then HSBC Bank USA entered into a written agreement with the Federal Reserve Bank of New York and the New York State Banking Department regarding its compliance with AML requirements. When HSBC Bank USA merged with HSBC Bank & Trust (Delaware) N.A., on July 1, 2004, the OCC, as the regulator of the surviving national bank, made the merger conditional on the Bank’s continuing compliance with the requirements of the written agreement. On February 6, 2006, the OCC determined that the Bank had satisfied the requirements of the written agreement and the agreement was terminated.

Between 2004 and 2009, on-site OCC examiners conducted numerous examinations and issued Supervisory Letters covering, among other areas, pouch activity, embassy banking, foreign correspondent banking, PCM, SAR monitoring systems, and risk assessment processes and systems. During these examinations, the OCC followed the FFIEC Manual examination procedures and conducted transaction testing. Over the course of this five year period, the OCC issued Supervisory Letters that contained a significant number of MRAs that the Bank committed to resolving. The MRAs addressed BSA/AML risk assessments, customer diligence, compliance leadership, staffing, alert backlogs, and SAR monitoring processes and enhancements.

As described earlier in this testimony, compliance with MRAs is tracked as part of the OCC’s supervisory process. In this case, MRAs in the BSA/AML area were reviewed periodically, and determinations were made whether the MRAs had been addressed.

In mid-2009, as a result of the bulk cash findings in the Wachovia investigation, the OCC launched horizontal examinations of banknote operations in other large national banks supervised by the OCC that included HSBC and its transactions with HSBC Mexico. After finding significant deficiencies in the Bank’s oversight of its banknote operations and after meeting with law enforcement and obtaining additional information on this activity, the OCC developed a detailed action plan to expand the scope of the ongoing examination of banknote customers. The expanded scope included evaluation of the Bank’s compliance with all BSA/AML laws and regulations relating to foreign correspondent activity (including RDC.
activity, pouch activity, and specific foreign correspondent relationships), OFAC compliance, and the effectiveness of management's efforts to manage risk on an enterprise wide basis.

The OCC conducted its expanded examination during 2009-10. It encompassed, among other things, an evaluation of specific banknote clientele. The OCC reviewed internal bank policies and procedures, systems and controls, training initiatives, and documentation supporting the Bank’s compliance efforts. The examiners reviewed know-your-customer documentation/information pertaining to the sample, customer due diligence documentation/information, enhanced due diligence documentation/information, related account statements, specific transactions, pouch activities, cash letter activities, wire transfer activities, audit report/processes, RDC activity, foreign exchange transactions, trade transactions, monitoring processes, alert processing, SAR and related processes, subpoena documentation/information, the Bank’s OFAC program, and all other relevant bank documentation and correspondence from 2004 to the current period.

As a part of the examination, the OCC notified the Bank in March 2010 that it had violated OCC regulations due to a significant backlog of unprocessed alerts. The Bank’s subsequent review of the backlogged alerts led it to file a substantial number of late SARs with law enforcement authorities. The OCC also identified a number of previously undisclosed bearer share account relationships. The OCC is currently assessing the consequences of this finding, and the Bank’s implementation of corrective measures.

The OCC ultimately determined that the Bank failed to adopt and implement a compliance program that adequately covered the required BSA/AML program elements including, in particular, internal controls for customer due diligence, procedures for monitoring suspicious activity, and independent testing. The Bank’s compliance program and its implementation were found to be ineffective, and accompanied by aggravating factors, such as highly suspicious activity creating a significant potential for unreported money laundering or terrorist financing.

The number of MRAs cited over the preceding years reflected a pattern where the Bank reacted when problems were identified by the OCC, but failed to fulfill its fundamental responsibility of maintaining a program that effectively deterred money laundering and self-identifying and correcting deficiencies in its BSA/AML program. In addition, based on issues we had identified in our exams at other institutions, we began to drill down into specific areas of the Bank’s operations. As we did so, we discovered that the Bank had additional and severe pre-existing BSA/AML deficiencies – beyond what we had previously understood. Our work in these areas triggered further discoveries of additional, severe deficiencies. As a result, in the fall of 2010, we took forceful and comprehensive enforcement action. With the benefit of hindsight, the OCC should have taken this action sooner.

VII. HSBC C&D Order

The OCC issued a C&D order against the Bank in October 2010. Concurrent with the OCC’s enforcement action, the Federal Reserve issued a C&D order upon consent with the Bank’s parent company, HNAH, to ensure the adequacy of the parent company’s firm-wide compliance
Some of the critical deficiencies in the Bank’s BSA/AML compliance program cited in the OCC’s order included the following:

- Lack of effective monitoring of wire activity. The Bank, in effect, exempted from automated monitoring wire transfers for customers domiciled in countries risk rated as standard or medium risk. This represented two-thirds of total dollar volume for PCM. While the Bank employed other methods for monitoring wire transactions for customers located in countries risk rated standard or medium, these alternatives provided limited coverage, were not effective, and did not mitigate the BSA/AML risks posed.

- From mid-2006 through mid-2009, the Bank did not perform any BSA/AML monitoring for banknote (or “bulk cash”) transactions with Group Entities (affiliates).

- The Bank did not maintain customer due diligence information on Group Entities.

- The Bank failed to resolve its monitoring system alerts in a timely manner, leading to significant backlogs and late SAR filings.

- The Bank did not appropriately designate customers as high risk for purposes of BSA/AML monitoring, even where a customer’s association with politically-exposed persons could harm the Bank’s reputation.

- Serious weaknesses in Bank’s systems and controls constituted violations of 12 C.F.R. 21.21 (program), 21.11 (SAR), and 31 CFR 103.176 (correspondent banking).

As the OCC’s order set forth, the violations and failures were the result of a number of factors, including: (i) inadequate staffing and procedures in the alert investigations unit that resulted in a significant backlog of alerts; (ii) the closure of alerts based on ineffective review; (iii) inadequate monitoring of Group Entities’ correspondent accounts for purpose and anticipated activity, anti-money laundering record, or consistency between actual and anticipated account activity; (iv) unwarranted reliance on Group Entities’ following HSBC Group BSA/AML policies; (v) inadequate monitoring of funds transfers; (vi) inadequate procedures to ensure the timely reporting of suspicious activity; (vii) failure to adequately monitor Group Entities’ banknote activity; (viii) inadequate monitoring of correspondent funds transfer activity; and (ix) inadequate collection and analysis of customer due diligence information, including inadequate monitoring of politically exposed persons.

The OCC’s C&D order requires the Bank to submit a comprehensive BSA/AML action plan to achieve full compliance and ensure that the Bank has sufficient processes, personnel and control systems to implement and adhere to the order. It requires the Bank to hire a qualified permanent regional compliance officer and a qualified, permanent BSA officer. It further requires the Bank to improve its BSA/AML monitoring systems, including its funds transfer monitoring, and to develop and maintain a management information system (MIS) program that compiles customer
due diligence and enhanced due diligence (know your customer) information that includes the identification of "offshore" correspondent accounts and the identification of politically exposed persons. The order also contains restrictions on growth, new products, and high-risk lines of business, and it requires OCC approval to reenter the bulk cash repatriation business.

The C&D order additionally required the Bank to hire an independent consultant to conduct a comprehensive account/transaction activity review (Look Back). The purpose of the Look Back was to determine whether suspicious activity was timely identified by the Bank and to supplement the OCC's investigation of specific account relationships, transactions, and products and services that had been identified as potentially problematic. (Transaction reviews and look backs are routinely used by the OCC and the other Federal banking agencies to require banks to review past activities and file SARs as necessary.) Some of the account relationships, transactions, and products and services included in the Subcommittee's report, were specifically covered within the scope of the Look Back.

The Look Back required the Bank to review 31 specific correspondent account relationships, including several HSBC affiliates and HSBC Mexico, over an eighteen month time period covering banknotes, wire, RDC, and pouch activities.

The Look Back also required the Bank to review specific alerts that had been closed due to a reduction in a country’s risk rating and over a two month time period, including:

- All alerts closed based on "positive internet information;"
- Wire transfers originating in five standard and medium risk countries that were sent to seven high risk countries;
- Wire transfers (originating or terminating) between several pairs of standard and medium risk countries;
- International (cross-border) book entry transfers;
- All account activity during this period for accounts subject at any time during the period to requests pursuant to section 314(a) or section 314(b) of the USA PATRIOT Act, or to subpoenas relating to BSA/AML issues; and
- All alerts closed more than 60 days after generation of the alert including, without limitation, alerts closed in response to the OCC’s Supervisory Letter (over a three month time period).

The C&D order is a remedial document that is designed to obtain correction of violations of law and unsafe or unsound practices at the Bank. The issuance of the order does not preclude the OCC from assessing a civil money penalty at a later time. The OCC is now actively engaged in evaluating the Bank’s compliance with the C&D order and in considering the assessment of CMPs.
VIII. Cooperation with Law Enforcement/Regulatory Agencies

The OCC cooperates and coordinates on an interagency basis to address BSA/AML issues. We actively participate in several interagency groups focusing on BSA/AML compliance, including the Bank Secrecy Act Advisory Group (BSAAG), chaired by FinCEN, which is composed of policy, legal, and operations representatives from the major federal and state law enforcement and regulatory agencies involved in the fight against money laundering, as well as industry representatives; the FFIEC BSA Working Group which, similar to the FFIEC itself, has a rotating chairman and is composed of representatives of federal and state regulatory agencies; and the National Interagency Bank Fraud Working Group, chaired by the Department of Justice, and composed of representatives of the federal law enforcement and regulatory agencies (the OCC has been an active member of this group since its founding in 1984).

To remain in the forefront of new technologies and payment systems, the OCC also participates in various interagency working groups, including the Interagency Cyberfraud Working Group, the Payments Fraud Working Group, the Financial Services Information Sharing and Analysis Center (FS-ISAC), the BSAAG Prepaid Card Subcommittee, and regularly participates in payments conferences and industry forums.

In addition, the OCC works on an international basis with the Financial Action Task Force, an inter-governmental body whose purpose is the development and promotion of policies to combat money laundering. We have participated in various State and Treasury Department missions to assist foreign governments in their anti-money laundering efforts. We expect that these international efforts will continue. The OCC also regularly provides information, documents, and expertise to law enforcement for use in criminal investigations on a case-specific basis.

With respect to HSBC, the OCC has worked closely with the Federal Reserve, FinCEN and law enforcement in addressing the problems identified at HSBC and will continue to do so to ensure that all problems are identified and addressed.

IX. Conclusion

The OCC is committed to rigorous BSA/AML and OFAC supervision, strong enforcement, and continuing improvement in our supervision in this important area. We are closely reviewing the Subcommittee’s Report and, as discussed earlier in this statement, we have already identified actions that we will take in response to its recommendations.

The OCC will continue to work with Congress, the other financial institutions regulatory agencies, law enforcement agencies, and the banking industry to develop and implement a coordinated and comprehensive response to the threat posed to the nation’s financial system by money launderers, terrorist financiers and criminal organizations. The OCC recognizes that the determination and ingenuity of those who commit financial crimes requires ongoing vigilance. We also recognize that technical innovations, new and more convenient financial services products, and globalization trends are rapidly changing the BSA/AML landscape. These are major challenges for both the financial services industry and its regulators and, for our part, we are committed to meeting them.
U.S. Vulnerabilities to Money Laundering, Drugs, and Terrorist Financing: HSBC Case History

MAJORITY AND MINORITY STAFF REPORT

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
UNITED STATES SENATE

RELEASED IN CONJUNCTION WITH THE
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS
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U.S. VULNERABILITIES TO MONEY LAUNDERING, DRUGS, AND TERRORIST FINANCING: 
HSBC CASE HISTORY

This Report examines the anti-money laundering (AML) and terrorist financing vulnerabilities created when a global bank uses its U.S. affiliate to provide U.S. dollars, U.S. dollar services, and access to the U.S. financial system to high risk affiliates, high risk correspondent banks, and high risk clients. This Report also offers recommendations to strengthen correspondent AML controls to combat money laundering, drug trafficking, and terrorist financing.

I. EXECUTIVE SUMMARY

Over the last decade, the U.S. Senate Permanent Subcommittee on Investigations has worked to strengthen U.S. AML efforts by investigating how money launderers, terrorists, organized crime, corrupt officials, tax evaders, and other wrongdoers have utilized U.S. financial institutions to conceal, transfer, and spend suspect funds. In 2001, the Subcommittee focused, in particular, on how U.S. banks, through the correspondent services they provide to foreign financial institutions, had become conduits for illegal proceeds associated with organized crime, drug trafficking, and financial fraud. Correspondent banking occurs when one financial institution provides services to another financial institution to move funds, exchange currencies, cash monetary instruments, or carry out other financial transactions. The Subcommittee's 2001 investigation showed not only how some poorly managed or corrupt foreign banks used U.S. bank accounts to aid and abet, commit, or allow clients to commit wrongdoing, but also how U.S. financial institutions could protect themselves and the U.S. financial system from misuse.

In response to that investigation and the money laundering vulnerabilities exposed by the 9/11 terrorist attack, Congress enacted stronger AML laws as part of the Patriot Act of 2002, including stronger


2 "Role of U.S. Correspondent Banking in International Money Laundering," U.S. Senate Permanent Subcommittee on Investigations, S.Hrg. 107-84 (March 1, 2 and 6, 2001) (hereinafter "2001 Subcommittee Hearing on Correspondent Banking").
provisions to combat the misuse of correspondent services. Federal bank regulators followed with stronger regulations and examination requirements to guard against money laundering through correspondent accounts. In response, over the next ten years, U.S. banks substantially strengthened their correspondent AML controls. Before the 2002 Patriot Act, for example, most U.S. banks opened correspondent accounts for any foreign bank with a banking license; now, most U.S. banks evaluate the riskiness of each foreign bank’s owners, business lines, products, clients, and AML controls before agreeing to open an account. They also routinely monitor account activity and wire transfers for suspicious activity, with enhanced monitoring of high risk correspondents. In addition, before the 2002 Patriot Act, some U.S. banks readily opened accounts for foreign shell banks, meaning banks without any physical presence in any jurisdiction; today, in accordance with the Patriot Act’s ban on shell bank accounts, all U.S. banks take measures to ensure they don’t provide services to such banks, the ban on shell bank accounts has become an international AML standard, and the thousands of stand-alone shell banks licensed by the Bahamas, Cayman Islands, Nauru, and other jurisdictions have virtually disappeared.

At the same time, the money laundering risks associated with correspondent banking have not been eliminated. Correspondent accounts continue to provide a gateway into the U.S. financial system, and wrongdoers continue to abuse that entryway. This investigation takes a fresh look at the U.S. vulnerabilities to money laundering and terrorist financing associated with correspondent banking, focusing in particular on the operations of global banks with U.S. affiliates that enable foreign financial institutions to gain access to the U.S. financial system.

**HSBC Case Study.** To examine the current money laundering and terrorist financing threats associated with correspondent banking, the Subcommittee selected HSBC as a case study. HSBC is one of the largest financial institutions in the world, with over $2.5 trillion in assets, 89 million customers, 300,000 employees, and 2011 profits of nearly $22 billion. HSBC, whose initials originally stood for Hong

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3 See, e.g., Sections 312, 313, and 319(b) of the USA Patriot Act (requiring due diligence to be conducted when opening accounts for foreign banks, with enhanced due diligence for offshore banks and banks in high risk jurisdictions; prohibiting the opening of correspondent accounts for shell banks; and strengthening the ability of U.S. regulators to obtain correspondent account records).

4 See, e.g., 31 CFR §§103.175, 103.176, 103.177, 103.185.


Kong Shanghai Banking Corporation, now has operations in over 80 countries, with hundreds of affiliates spanning the globe. Its parent corporation, HSBC Holdings plc, called "HSBC Group," is headquartered in London, and its Chief Executive Officer is located in Hong Kong.

Its key U.S. affiliate is HSBC Bank USA N.A. (HBUS). HBUS operates more than 470 bank branches throughout the United States, manages assets totaling about $200 billion, and serves around 3.8 million customers. It holds a national bank charter, and its primary regulator is the U.S. Office of the Comptroller of the Currency (OCC), which is part of the U.S. Treasury Department. HBUS is headquartered in McLean, Virginia, but has its principal office in New York City. HSBC acquired its U.S. presence by purchasing several U.S. financial institutions, including Marine Midland Bank and Republic National Bank of New York.

A senior HSBC executive told the Subcommittee that HSBC acquired its U.S. affiliate, not just to compete with other U.S. banks for U.S. clients, but primarily to provide a U.S. platform to its non-U.S. clients and to use its U.S. platform as a selling point to attract still more non-U.S. clients. HSBC operates in many jurisdictions with weak AML controls, high risk clients, and high risk financial activities including in Asia, the Middle East, and Africa. Over the past ten years, HSBC has also acquired affiliates throughout Latin America. In many of these countries, the HSBC affiliate provides correspondent accounts to foreign financial institutions that, among other services, are interested in acquiring access to U.S. dollar wire transfers, foreign exchange, and other services. As a consequence, HSBC's U.S. affiliate, HBUS, is required to interact with other HSBC affiliates and foreign financial institutions that face substantial AML challenges, often operate under weaker AML requirements, and may not be as familiar with, or respectful of, the tighter AML controls in the United States. HBUS' correspondent services, thus, provide policymakers with a window into the vast array of money laundering and terrorist financing risks confronting the U.S. affiliates of global banks.

The Subcommittee also examined HSBC because of its weak AML program. In September 2010, the OCC issued a lengthy Supervisory Letter citing HBUS for violating Federal AML laws, including by maintaining an inadequate AML program. In October 2010, the OCC issued a Cease and Desist Order requiring HSBC to strengthen multiple aspects of its AML program. The identified problems included a once massive backlog of over 17,000 alerts identifying possible suspicious transactions.

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1 On the same day, in coordination with the OCC, the Federal Reserve issued a Cease and Desist order to HBUS' holding company, HSBC North America Holdings, Inc. (HNAH), citing HNAH for an inadequate AML program and requiring it to revamp and strengthen both its program and that of HBUS.
activity that had yet to be reviewed; ineffective methods for identifying suspicious activity; a failure to file timely Suspicious Activity Reports with U.S. law enforcement; a failure to conduct any due diligence to assess the risks of HSBC affiliates before opening correspondent accounts for them; a 3-year failure by HBUS, from mid-2006 to mid-2009, to conduct any AML monitoring of $15 billion in bulk cash transactions with those same HSBC affiliates, despite the risks associated with large cash transactions; poor procedures for assigning country and client risk ratings; a failure to monitor $60 trillion in annual wire transfer activity by customers domiciled in countries rated by HBUS as lower risk; inadequate and unqualified AML staffing; inadequate AML resources; and AML leadership problems. Since many of these criticisms targeted severe, widespread, and longstanding AML deficiencies, they also raised questions about how the problems had been allowed to accumulate and why the OCC had not compelled corrective action earlier.

During the course of its investigation into HSBC's AML deficiencies, the Subcommittee issued multiple subpoenas and collected and reviewed over 1.4 million documents, including bank records, correspondence, emails, and legal pleadings. The Subcommittee staff also conducted over 75 interviews with officials at HSBC Group, HBUS, and other HSBC affiliates, as well as with U.S. banking regulators. In addition, the Subcommittee received numerous briefings from HSBC legal counsel, initiated inquiries with foreign banks that had HSBC accounts, and consulted with experts on AML and terrorist financing issues. HSBC was fully cooperative with the inquiry, producing documentation and witnesses from around the world, including documents for which it could have claimed privilege.

As a result of its investigation, the Subcommittee has focused on five issues illustrating key AML and terrorist financing problems that continue to impact correspondent banking in the United States. They include opening U.S. correspondent accounts for high risk affiliates without conducting due diligence; facilitating transactions that hinder U.S. efforts to stop terrorists, drug traffickers, rogue jurisdictions, and other from using the U.S. financial system; providing U.S. correspondent services to banks with links to terrorism; clearing bulk U.S. dollar travelers cheques despite signs of suspicious activity; and offering high risk bearer share corporate accounts. Avoiding the money laundering risks involved in these activities requires an effective AML program, with written standards, knowledgeable and adequate staff, the infrastructure needed to monitor account and wire transfer activity for suspicious transactions, effective AML training, and a compliance culture that values obtaining accurate client information. In addition to focusing on these five issues at HBUS, the Subcommittee investigation
examined the regulatory failures that allowed these and other AML problems to fester for years.

**Servicing A High Risk Affiliate.** In 2001, the Subcommittee's investigation debunked the notion that U.S. banks should open a correspondent account for any foreign bank with a banking license, establishing instead the need to use due diligence to evaluate the money laundering and terrorist financing risks posed by a specific foreign financial institution before opening an account. Today, some U.S. affiliates of global banks engage in an equally ill-advised practice, opening correspondent accounts for any affiliate owned by the parent holding corporation, with no analysis of the AML or terrorist financing risks.

Until recently, HSBC Group policy instructed its affiliates to assume that all HSBC affiliates met the Group's AML standards and to open correspondent accounts for those affiliates without additional due diligence. For years, HBUS followed that policy, opening U.S. correspondent accounts for HSBC affiliates without conducting any AML due diligence. Those affiliates have since become major clients of the bank. In 2009, for example, HBUS determined that HSBC Group affiliates cleared virtually all USD (U.S. dollar) payments through accounts held at HBUS, representing 63% of all USD payments processed by HBUS.

HBUS failed to conduct due diligence on HSBC affiliates despite a U.S. law that has required all U.S. banks, since 2002, to conduct these due diligence reviews before opening a U.S. correspondent account for any foreign financial institution, with no exception made for foreign affiliates.

One HSBC affiliate that illustrates the AML problems is HSBC Mexico, known as HBMX. HBUS should have, but did not, treat HBMX as a high risk correspondent client subject to enhanced due diligence and monitoring. HBMX operated in Mexico, a country under siege from drug crime, violence and money laundering; it had high risk clients, such as Mexican casas de cambio and U.S. money service businesses; and it offered high risk products, such as U.S. dollar accounts in the Cayman Islands. In addition, from 2007 through 2008, HBMX was the single largest exporter of U.S. dollars to HBUS, shipping $7 billion in cash to HBUS over two years, outstripping larger Mexican banks and other HSBC affiliates. Mexican and U.S. authorities expressed repeated concern that HBMX's bulk cash shipments could reach that volume only if they included illegal drug proceeds. The concern was that drug traffickers unable to deposit large amounts of cash in U.S. banks due to AML controls were transporting U.S. dollars to Mexico, arranging for bulk deposits there, and then using Mexican

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8 See 9/9/2009 chart entitled, “HSBC Profile,” included in “HSBC OFAC Compliance Program,” a presentation prepared by HSBC and provided to the OCC, at HSBC OCC 8874197.
financial institutions to insert the cash back into the U.S. financial system.

In addition to its high risk location, clients, and activities, HMBX had a history of severe AML deficiencies. Its AML problems included a widespread lack of Know Your Customer (KYC) information in client files; a dysfunctional monitoring system; bankers who resisted closing accounts despite evidence of suspicious activity; high profile clients involved in drug trafficking; millions of dollars in suspicious bulk travelers cheque transactions; inadequate staffing and resources; and a huge backlog of accounts marked for closure due to suspicious activity, but whose closures were delayed. For eight years, from 2002 to 2010, HSBC Group oversaw efforts to correct HBMX’s AML deficiencies, while those efforts fell short. At the same time, HSBC Group watched HBMX utilize its U.S. correspondent account, without alerting HBUS to the AML risks it was incurring.

HBUS compounded the AML risks it incurred from HBMX through its own AML deficiencies, which included failing to investigate or evaluate HBMX’s AML risks. HBUS also failed, from mid-2006 to mid-2009, to conduct any AML monitoring of its U.S. dollar transactions with HSBC affiliates, including HBMX, despite the obvious well-known risks attendant with large cash transactions. In addition, because HBUS deemed HBMX to be located in a low risk country, HBUS failed until 2009, to monitor HBMX’s wire transfer or account activity. HBMX illustrates the money laundering and drug trafficking risks that result when the U.S. affiliate of a global bank serves as the U.S. gateway for a high risk affiliate allowed to operate with no initial due diligence or ongoing monitoring.

Circumventing OFAC Prohibitions. The United States has devoted significant resources to stopping some of the most dangerous persons and jurisdictions threatening the world today from utilizing the U.S. financial system, including terrorists, persons involved with weapons of mass destruction, drug traffickers, and persons associated with rogue jurisdictions such as Iran, North Korea, and Sudan. To implement the law, the U.S. Treasury Department’s Office of Foreign Assets Control (OFAC) has developed a list of prohibited persons and countries which banks use to create an “OFAC filter” to identify and halt potentially prohibited transactions. Transactions stopped by this filter typically undergo an individualized review to see if the transaction can proceed or the funds must be blocked.

Because the OFAC filter can end up delaying or blocking transactions that are permitted under U.S. law or by other jurisdictions, some non-U.S. financial institutions have used tactics to circumvent it. Common tactics include stripping information from wire transfer...
documentation to conceal the participation of a prohibited person or
country, or characterizing a transaction as a transfer between banks in
approved jurisdictions, while omitting underlying payment details that
would disclose participation of a prohibited originator or beneficiary. In
the case of Iran, some foreign banks also abused what were known as "U-
turn" transactions, which were allowable transactions under Treasury
regulations prior to November 2008. In recent years, the United States
has imposed steep penalties on banks that violated the OFAC
prohibitions.

At HBUS, documents provided to the Subcommittee indicate that,
for years, some HSBC affiliates took action to circumvent the OFAC
filter when sending OFAC sensitive transactions through their U.S.
dollar correspondent accounts at HBUS. From at least 2001 to 2007,
two HSBC affiliates, HSBC Europe (HBEU) and HSBC Middle East
(HBME), repeatedly sent U-turn transactions through HBUS without
disclosing links to Iran, even though they knew HBUS required full
transparency to process U-turns. To avoid triggering the OFAC filter
and an individualized review by HBUS, HBEU systematically altered
transaction information to strip out any reference to Iran and
characterized the transfers as between banks in approved jurisdictions.
The affiliates' use of these practices, which even some within the bank
viewed as deceptive, was repeatedly brought to the attention of HSBC
Group Compliance, by HBUS compliance personnel and by HBEU
personnel who objected to participating in the document alteration and
twice announced deadlines to end the activity. Despite this information,
HSBC Group Compliance did not take decisive action to stop the
conduct or inform HBUS about the extent of the activity. At the same
time, while some at HBUS claimed not to have known they were
processing undisclosed Iranian transactions from HSBC affiliates,
internal documents show key senior HBUS officials were informed as
early as 2001. In addition, HBUS OFAC filter repeatedly stopped
Iranian transactions that should have been disclosed to HBUS by HSBC
affiliates, but were not. Despite evidence of what was taking place,
HBUS failed to get a full accounting of what its affiliates were doing or
ensure all Iranian transactions sent by HSBC affiliates were stopped by
the OFAC filter and reviewed to ensure they were OFAC compliant. In
addition, documents show that, from 2002 to 2007, some HSBC
affiliates sent potentially prohibited transactions through HBUS
involving Burma, Cuba, North Korea, Sudan, and other prohibited
countries or persons. Other documents indicate that some HSBC
affiliates may have sent non-U.S. dollar messaging traffic through U.S.
servers in which the OFAC filter was not turned on or was restricted.

An outside auditor hired by HBUS has so far identified, from 2001
to 2007, more than 28,000 undisclosed, OFAC sensitive transactions that
were sent through HBUS involving $19.7 billion. Of those 28,000
transactions, nearly 25,000 involved Iran, while 3,000 involved other prohibited countries or persons. The review has characterized nearly 2,600 of those transactions, including 79 involving Iran, and with total assets of more than $367 million, as 'Transactions of Interest' requiring additional analysis to determine whether violations of U.S. law occurred. While the aim in many of those cases may have been to avoid the delays associated with the OFAC filter and individualized reviews, rather than to facilitate prohibited transactions, actions taken by HSBC affiliates to circumvent OFAC safeguards may have facilitated transactions on behalf of terrorists, drug traffickers, or other wrongdoers. While HBUS insisted, when asked, that HSBC affiliates provide fully transparent transaction information, when it obtained evidence that some affiliates were acting to circumvent the OFAC filter, HBUS failed to take decisive action to confront those affiliates and put an end to the conduct. HBUS' experience demonstrates the strong measures that the U.S. affiliate of a global bank must take to prevent affiliates from circumventing OFAC prohibitions.

Disregarding Links to Terrorism. For decades, HSBC has been one of the most active global banks in the Middle East, Asia, and Africa, despite being aware of the terrorist financing risks in those regions. In particular, HSBC has been active in Saudi Arabia, conducting substantial banking activities through affiliates as well as doing business with Saudi Arabia's largest private financial institution, Al Rajhi Bank. After the 9/11 terrorist attack in 2001, evidence began to emerge that Al Rajhi Bank and some of its owners had links to financing organizations associated with terrorism, including evidence that the bank's key founder was an early financial benefactor of al Qaeda. In 2005, HSBC announced internally that its affiliates should sever ties with Al Rajhi Bank, but then reversed itself four months later, leaving the decision up to each affiliate. HSBC Middle East, among other HSBC affiliates, continued to do business with the bank.

Due to terrorist financing concerns, HBUS closed the correspondent banking and banknotes accounts it had provided to Al Rajhi Bank. For nearly two years, HBUS Compliance personnel resisted pressure from HSBC personnel in the Middle East and United States to resume business ties with Al Rajhi Bank. In December 2006, however, after Al Rajhi Bank threatened to pull all of its business from HSBC unless it regained access to HBUS' U.S. banknotes program, HSBC agreed to resume supplying Al Rajhi Bank with shipments of U.S. dollars. Despite ongoing troubling information, HBUS provided nearly $1 billion in U.S. dollars to Al Rajhi Bank until 2010, when HSBC decided, on a global basis, to exit the U.S. banknotes business. HBUS also supplied U.S. dollars to two other banks, Islami Bank Bangladesh
Ltd. and Social Islami Bank, despite evidence of links to terrorist financing. Each of these specific cases shows how a global bank can pressure its U.S. affiliate to provide banks in countries at high risk of terrorist financing with access to U.S. dollars and the U.S. financial system.

Clearing Suspicious Bulk Travelers Cheques. Another AML issue involves HBUS clearing more than $290 million in bulk U.S. dollar travelers checks in less than four years for a Japanese regional bank, Hokuriku Bank, despite evidence of suspicious activity. From at least 2005 to 2008, HBUS cleared bulk travelers cheques for Hokuriku Bank on a daily basis, at times clearing $500,000 or more in U.S. dollars per day. The cheques were in denominations of $500 or $1,000, submitted in large blocks of sequentially numbered cheques, and signed and countersigned with the same illegible signature. An OCC examination which determined that HBUS was clearing travelers cheques with inadequate AML controls, discovered the stacks of Hokuriku travelers cheques being processed on a daily basis, and directed HBUS to investigate. When HBUS sought more information, Hokuriku Bank at first delayed responding, then provided minimal information, and finally declined to investigate further, claiming to be constrained by bank secrecy laws from disclosing client-specific information. HBUS eventually learned that the travelers cheques were purchased by Russians from a bank in Russia, a country at high risk of money laundering. HBUS also learned that the Japanese bank had little KYC information or understanding why up to $500,000 or more in bulk U.S. dollar travelers cheques purchased in Russia were being deposited on a daily basis into one of 30 different Japanese accounts of persons and corporations supposedly in the used car business.

In October 2008, under pressure from the OCC, HBUS stopped processing the travelers cheques, but continued the correspondent relationship, despite the Japanese bank's poor AML controls. Two years later, in 2010, an OCC examination uncovered the ongoing relationship between HSBC and Hokuriku, which the OCC thought had ended. In 2012, after the Subcommittee inquired about the account, HBUS closed it. Since travelers cheques have been misused by terrorists, drug traffickers, and other criminals, the HBUS experience shows how a U.S. affiliate with ineffective AML controls can end up clearing suspicious bulk travelers cheques and facilitating the movement of hundreds of millions of U.S. dollars across international lines to unknown recipients.

Offering Bearer Share Accounts. Over the course of a decade, HBUS opened over 2,000 accounts in the name of bearer share corporations, a notorious type of corporation that invites secrecy and wrongdoing by assigning ownership to whomever has physical possession of the shares. At its peak, HBUS Miami office had over
1,670 bearer share accounts; the New York office had over 850; and the Los Angeles office had over 30. The Miami bearer share accounts alone held assets totaling an estimated $2.6 billion, and generated annual bank revenues of $26 million. Multiple internal audits and regulatory examinations criticized the accounts as high risk and advocated that HBUS either take physical custody of the shares or require the corporations to register the shares in the names of the shareholders, but HBUS bankers initially resisted tightening AML controls, and regulators took no enforcement action.

Two examples of the accounts illustrate the risks they posed. In the first, Miami Beach hotel developers, Mauricio Cohen Assor and Leon Cohen Levy, father and son, used bearer share accounts they opened for Blue Ocean Finance Ltd. and Whitebury Shipping Time-Sharing Ltd. to help hide $150 million in assets and $49 million in income. In 2010, both were convicted of criminal tax fraud and filing false tax returns, sentenced to ten years in prison, and ordered to pay back taxes, interest, and penalties totaling more than $17 million. A second example involves a wealthy and powerful Peruvian family which pressed HBUS to grant a waiver from its AML requirements that bearer share corporations either register their shares or place those shares in bank custody. Bank documents showed how HBUS bankers pressed Compliance personnel to grant the waiver to please a wealthy client. These accounts demonstrate the AML risks associated with bearer share accounts, whose owners seek to hide their identities. Today, following an initiative that concluded in 2011, HBUS has reduced its bearer share accounts to 26, most of which are frozen, while at the same time maintaining a policy that allows the bank to open new bearer share accounts in the future.

Regulatory Failures. HBUS' severe AML deficiencies did not happen overnight; they accumulated over time, even though its primary regulator, the OCC, conducted regular AML examinations. Part of the reason HBUS' AML problems were not cured is attributable to certain peculiar and ineffective aspects of the OCCs AML oversight effort.

First, unlike other U.S. bank regulators, the OCC does not treat AML deficiencies as a matter of bank safety and soundness or a management problem. Instead it treats AML deficiencies as a consumer compliance matter, even though AML laws and consumer protection laws have virtually nothing in common. One consequence of this approach is that the OCC considers AML problems when assigning a bank's consumer compliance rating, but not when assigning the bank's management rating or its overall composite rating. As a result, AML deficiencies do not routinely lower the ratings that national banks receive as part of their safety and soundness evaluations, and so do not increase the deposit insurance that banks pay for incurring heightened
risk, contrary to how AML problems are handled at other Federal banking agencies. At HBUS, after citing the bank for severe AML deficiencies, the OCC lowered its consumer compliance rating but not its management rating.

A second problem is that the OCC has adopted a practice of foregoing the citation of a statutory or regulatory violation in its Supervisory Letters and annual Reports of Examination when a bank fails to comply with one of the four mandatory components of an AML program. The four minimum statutory requirements of an AML program are AML internal controls, an AML compliance officer, AML training, and independent testing of the effectiveness of its AML program. By consistently treating a failure to meet one or even several of these statutory requirements as a "Matter Requiring Attention" instead of a legal violation, the OCC diminishes the importance of meeting each requirement, sends a more muted message about the need for corrective action, and makes enforcement actions more difficult to pursue if an AML deficiency persists. In contrast, citing a violation of law when one critical component of a bank's AML program is inadequate sends a strong message to bank management that its AML program is deficient, does not meet minimum statutory requirements, and requires remediation to ensure compliance with the law. At HBUS, the OCC identified 83 Matters Requiring Attention over five years, without once citing a legal violation of Federal AML law. It was only when the OCC found HBUS' entire AML program to be deficient that the OCC finally cited the bank for a legal violation.

Additional problems illustrated by the HBUS case history include the OCC's practice of conducting narrowly focused AML examinations of specific banking units without also assessing HBUS' overall AML program; the OCCs reluctance, despite mounting AML deficiencies, to make timely use of formal and informal enforcement actions to compel improvements in HBUS' AML program; and the practice by some OCC examiners to issue Supervisory Letters that sometimes muted AML examination criticisms or weakened recommendations for AML reforms at HBUS.

While the OCC insists that its AML approach has merit, the HSBC case history, like the Riggs Bank case history examined by this Subcommittee eight years ago, provides evidence that the current OCC system has tolerated severe AML deficiencies for years, permitted national banks to delay or avoid correcting identified problems, and allowed smaller AML issues to accumulate into a massive problem before OCC enforcement action was taken. An experienced OCC AML examiner told the Subcommittee: "I thought I saw it all with Riggs but

HSBC was the worst situation I've ever seen; yet during the six-year period from 2004 to 2010, OCC officials did not take any formal or informal enforcement action to compel HBUS to strengthen its AML program, essentially allowing its AML problems to fester. In 2009, after learning of two law enforcement investigations involving AML issues at the bank, the OCC suddenly expanded and intensified an ongoing AML examination and allowed it to consider a wide range of AML issues. The OCC examination culminated in the issuance, in September 2010, of a blistering supervisory letter listing numerous, serious AML problems at the bank. In October 2010, the OCC also issued a Cease and Desist Order requiring HBUS to revamp its AML controls.

In response, HBUS has announced a number of key organizational and policy initiatives to improve its AML program in the United States and globally. While those initiatives are promising, HBUS announced similarly promising AML reforms in 2003, when confronted with an AML enforcement action by the Federal Reserve Bank of New York and New York State Banking Department. Even before the OCC lifted that order in 2006, HBUS' AML program deteriorated. Both HBUS and the OCC will have to undertake a sustained effort to ensure the newest round of changes produce a better AML outcome.

HSBC is the quintessential global bank, operating hundreds of affiliates in 80 countries, with its U.S. affiliate acting as the gateway into the U.S. financial system for the entire network. The OCC allowed AML problems at HBUS to build up until they represented major AML vulnerabilities for the United States. Going forward, HBUS needs far stronger controls to ensure it doesn't leave AML risks to the U.S. financial system unattended; and the OCC needs a much better approach to resolve AML problems in a more effective and timely manner.

A. Findings

This Report makes the following findings of fact.

(1) **Longstanding Severe AML Deficiencies.** HBUS operated its correspondent accounts for foreign financial institutions with longstanding, severe AML deficiencies, including a dysfunctional AML monitoring system for account and wire transfer activity, an unacceptable backlog of 17,000 unreviewed alerts, insufficient staffing, inappropriate country and client risk assessments, and late or missing Suspicious Activity Reports, exposing the United States to money laundering, drug trafficking, and terrorist financing risks.
(2) **Taking on High Risk Affiliates.** HBUS failed to assess the AML risks associated with HSBC affiliates before opening correspondent accounts for them, failed to identify high risk affiliates, and failed for years to treat HBMX as a high risk accountholder.

(3) **Circumventing OFAC Prohibitions.** For years in connection with Iranian U-turn transactions, HSBC allowed two non-U.S. affiliates to engage in conduct to avoid triggering the OFAC filter and individualized transaction reviews. While HBUS insisted, when asked, that HSBC affiliates provide fully transparent transaction information, when it obtained evidence that some affiliates were acting to circumvent the OFAC filter, HBUS failed to take decisive action to confront those affiliates and put an end to conduct which even some within the bank viewed as deceptive.

(4) **Disregarding Terrorist Links.** HBUS provided U.S. correspondent accounts to some foreign banks despite evidence of links to terrorist financing.

(5) **Clearing Suspicious Bulk Travelers Cheques.** In less than four years, HBUS cleared over $290 million in sequentially numbered, illegibly signed, bulk U.S. dollar travelers cheques for Hokuriku Bank, which could not explain why its clients were regularly depositing up to $500,000 or more per day in U.S. dollar travelers cheques obtained in Russia into Japanese accounts, supposedly for selling used cars; even after learning of Hokuriku’s poor AML controls, HBUS continued to do business with the bank.

(6) **Offering Bearer Share Accounts.** Over the course of a decade, HBUS opened over 2,000 high risk bearer share corporate accounts with inadequate AML controls.

(7) **Allowing AML Problems to Fester.** The OCC allowed HBUS AML deficiencies to fester for years, in part due to treating HBUS AML problems as consumer compliance matters rather than safety and soundness problems, failing to make timely use of formal and informal enforcement actions to compel AML reforms at the bank, and focusing on AML issues in specific HBUS banking units without also viewing them on an institution-wide basis.
B. Recommendations

This Report makes the following recommendations.

1. **Screen High Risk Affiliates.** HSBC should reevaluate its correspondent relationships with HSBC affiliates, including by reviewing affiliate AML and compliance audit findings, identifying high risk affiliates, designating affiliate accounts requiring enhanced monitoring, and closing overly risky accounts. HBUS should conduct a special review of the HBMX account to determine whether it should be closed.

2. **Respect OFAC Prohibitions.** HSBC Group and HBUS should take concerted action to stop non-U.S. HSBC affiliates from circumventing the OFAC filter that screens transactions for terrorists, drug traffickers, rogue jurisdictions, and other wrongdoers, including by developing audit tests to detect undisclosed OFAC sensitive transactions by HSBC affiliates.

3. **Close Accounts for Banks with Terrorist Financing Links.** HBUS should terminate correspondent relationships with banks whose owners have links to, or present high risks of involvement with, terrorist financing.

4. **Revamp Travelers Cheque AML Controls.** HBUS should restrict its acceptance of large blocks of sequentially numbered U.S. dollar travelers cheques from HSBC affiliates and foreign financial institutions; identify affiliates and foreign financial institutions engaged in suspicious travelers cheque activity; and stop accepting travelers cheques from affiliates and foreign banks that sell or cash U.S. dollar travelers cheques with little or no KYC information.

5. **Boost Information Sharing Among Affiliates.** HSBC should require AML personnel to routinely share information among affiliates to strengthen AML coordination, reduce AML risks, and combat wrongdoing.

6. **Eliminate Bearer Share Accounts.** HBUS should close its remaining 26 bearer share corporate accounts, eliminate this type of account, and instruct financial institutions using HBUS correspondent accounts not to execute transactions involving bearer share corporations. U.S. financial regulators should prohibit U.S. banks from opening or servicing bearer share accounts.
(7) **Increase HBUS' AML Resources.** HBUS should ensure a full time professional serves as its AML director, and dedicate additional resources to hire qualified AML staff, implement an effective AML monitoring system for account and wire transfer activity, and ensure alerts, including OFAC alerts, are reviewed and Suspicious Activity Reports are filed on a timely basis.

(8) **Treat AML Deficiencies as a Matter of Safety and Soundness.** The OCC should align its practice with that of other Federal bank regulators by treating AML deficiencies as a safety and soundness matter, rather than a consumer compliance matter, and condition management CAMELS ratings in part upon effective management of a bank's AML program.

(9) **Act on Multiple AML Problems.** To ensure AML problems are corrected in a timely fashion, the OCC should establish a policy directing that the Supervision Division coordinate with the Enforcement and Legal Divisions to conduct an institution-wide examination of a bank's AML program and consider use of formal or informal enforcement actions, whenever a certain number of Matters Requiring Attention or legal violations identifying recurring or mounting AML problems are identified through examinations.

(10) **Strengthen AML Examinations.** The OCC should strengthen its AML examinations by citing AML violations, rather than just Matters Requiring Attention, when a bank fails to meet any one of the statutory minimum requirements for an AML program; and by requiring AML examinations to focus on both specific business units and a bank's AML program as a whole.
II. GENERAL BACKGROUND

This section provides a general overview of HSBC Group, HSBC Bank USA (HBUS), and the HBUS compliance and anti-money laundering (AML) program.

A. Background on HSBC Group and HBUS

HSBC Group is one of the largest financial institutions in the world, with over $2.5 trillion in assets, 89 million customers, and 2011 profits of nearly $22 billion. Its parent corporation, HSBC Holdings plc, often referred to by the bank as "HSBC Group," is headquartered in London. Despite its London headquarters, the principal office of the Group Chief Executive is located in Hong Kong. Altogether, HSBC has about 300,000 employees and 7,200 offices in over 80 countries, including North America, Europe, Asia, Latin America, the Middle East, and Africa.

United States Operations. Among other entities, the Group owns HSBC Overseas Holdings (UK) Ltd. (HSBC Overseas Holdings), which oversees its operations in the United States and Canada. HSBC Overseas Holdings owns, in turn, HSBC North America Holdings Inc. (HNAH, pronounced "Hannah"), one of the ten largest bank holding companies in the United States. HNAH has assets of about $345 billion, is headquartered in New York City, and is overseen by the Federal Reserve. Through various subsidiaries, HNAH owns three key HSBC financial institutions in the United States: HSBC Bank USA N.A. (HBUS); HSBC Securities (USA) Inc. (HSBC Securities); and HSBC Finance Corporation.

HBUS operates more than 470 bank branches throughout the United States, manages assets totaling about $210 billion, and serves around 4 million customers. It holds a national bank charter and its

13 See “HSBC North America Holdings Inc. Fact Sheet,” at 1, http://www.us.hsbc.com/1/PA_1_083Q9F08A002FHP50000000/content/usshared/inside%20HSBC/About%20HSBC/Corporate%20Information/Corporate%20Facts/hnah_factsheet_0911.pdf.
14 “HSBC Bank USA, National Association Fact Sheet,” at 1, http://www.us.hsbc.com/1/PA_1_083Q9F08A002FHP50000000/content/usshared/inside%20HSBC/About%20HSBC/Corporate%20Information/Corporate%20Facts/hbus_factsheet_0911.pdf (hereinafter “HBUS Fact Sheet”).
primary regulator is the Office of the Comptroller of the Currency (OCC), which is part of the U.S. Treasury Department. Because it holds insured deposits, its secondary regulator is the Federal Deposit Insurance Corporation (FDIC). HBUS is the principal subsidiary of HSBC USA Inc. (HUSI), a bank holding company which is a wholly-owned subsidiary of HNAH.15 HBUS is headquartered in McLean, Virginia, and has its principal office in New York City.16

HSBC Securities is a licensed broker-dealer regulated by the Securities and Exchange Commission (SEC). HSBC Finance Corporation, formerly subprime lender Household International, provides credit cards, automobile loans, consumer lending, and insurance products, and is overseen by several U.S. regulators including the Consumer Financial Protection Bureau.

HNAH also owns an Edge Act corporation in Miami, HSBC Private Bank International.17 The Edge Act allows U.S. national banks to form U.S. subsidiaries designed to engage solely in international banking operations, including holding deposits for non-U.S. persons.18 Edge Act corporations are chartered and regulated by the Federal Reserve. In addition, HNAH sponsors the HSBC Latin American International Center, also referred to as “HSBC Miami Offshore,” in Miami. This center, like HSBC Private Bank International, is designed to help meet the needs of Latin American clients with banking needs in the United States.19

HNAH owns several other subsidiaries as well, including HSBC Trust Company, N.A., of Delaware, and HSBC Bank Nevada, N.A., of Las Vegas, Nevada.

HBUS Major Lines of Business. HBUS has six major lines of business in the United States.20 The first is “Retail Banking and Wealth Management” which provides deposits, checking, savings, mortgages, loans, brokerage products, and certificates of deposit (CDs) to customers.21 HSBC Premier is a product within the retail bank that provides services for more affluent clients.22

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15 Id. at 2.
16 Id. at 2.
20 HBUS Fact Sheet at 1-2. According to the OCC, HBUS has a total of 32 lines of business altogether. Subcommittee interviews of OCC examiners Joseph Boss (1/30/2012) and Elia de la Garra (1/9/2012).
21 See https://www.us.hsbc.com/1/2/3/hsbcpremier/miami-offshoreretail.
22 HBUS Fact Sheet at 1.
The HBUS “Private Banking” offers wealth management services for high net worth individuals and families with deposits of at least $1 million. HSBC Private Bank provides banking, investment, custody, wealth planning, trust and fiduciary, insurance, and philanthropic advisory services to its customers. Clients receive a dedicated “relationship manager” to manage their Private Bank accounts.

The HBUS “Commercial Banking” offers global banking services to financial institutions, companies, governmental entities, and non-profit organizations worldwide. These services include deposits, checking, remote deposit capture, payments and cash management, pouch services, corporate loans and financing, merchant services, and insurance products. HBUS assigns each client a dedicated relationship manager to handle its accounts.

The HBUS “Global Banking and Markets” line of business, with offices in more than 60 countries, provides a wide range of “tailored financial solutions” to major government, corporate, and institutional clients. This line of business includes an extensive network of correspondent banking relationships, in which HBUS provides banks from other countries with U.S. dollar accounts to transact business in the United States. Due to its affiliates in over 80 countries, HSBC is one of the largest providers of correspondent banking services in the world. In 2010, it had about 2,400 correspondent customers, including for more than 80 HSBC affiliates. Among other services, HSBC provides financial institution clients with access to the U.S. financial system by handling international wire transfers, clearing a variety of U.S. dollar instruments, including traveler's cheques and money orders, and providing foreign exchange services. HBUS Payment and Cash Management (PCM) is a key banking division, located in New York, that supports HBUS’ correspondent relationships.

In addition, as part of this line of business, until 2010, HBUS housed the Global Banknotes Department, which used offices in New York City, London, Hong Kong, and elsewhere to buy, sell, and ship
large amounts of physical U.S. dollars. The Banknotes Department derived its income from the trading, transportation, and storage of bulk cash, doing business primarily with other banks and currency exchange businesses, but also with HSBC affiliates. In addition, for a number of years, HBUS held a contract with the U.S. Federal Reserve Bank of New York (FRBNY) to operate U.S. currency vaults in several cities around the world to assist in the physical distribution of U.S. dollars to central banks, large commercial banks, and businesses involved with currency exchange. In June 2010, however, HBUS exited the wholesale U.S. banknotes line of business, later selling portions of the business to other banks. It also did not renew its contract to operate FRBNY currency vaults.

The HBUS “Global Asset Management” line of business offers worldwide investment management services to clients, and currently manages nearly $400 billion in assets. It is one of the largest investment businesses in the world. Finally, “HSBC Insurance” provides a wide variety of insurance products to customers in the United States and Canada.

In addition to these major lines of business, in recent years, HBUS has become a leader in providing banking services to foreign embassies with a presence in the United States. HBUS began this business after Riggs Bank and Wachovia Bank stopped providing those services in 2005, and embassies began looking for a new financial institution.

Through its correspondent banking and Payments and Cash Management (PCM) businesses, HBUS has become one of the largest facilitators of cash transfers in the world. Between 2005 and 2009, the total number of PCM wire transactions at HBUS grew from 20.4 million to 30.2 million transfers per year, with a total annual dollar volume that climbed from $62.4 trillion to $94.5 trillion. In 2008, HBUS processed

31 Id. at OCC-PSI-00864342.
32 See Form 10-Q filed by HSBC USA Inc. with the SEC for the quarter ending June 30, 2011, at 9-10.
33 Id. In 2010, HSBC Holdings plc sold its U.S. wholesale banknotes business in Asia to United Overseas Bank Limited (UOB) for $11 million, and in 2011, sold its European banknotes business to HSBC Bank plc. It recorded total closure costs of $14 million during 2010. Id.
34 HBUS Fact Sheet at 2.
35 Id.
about 600,000 wire transfers per week.\textsuperscript{38} In 2009, PCM was the third largest participant in the CHIPS wire transfer service which provides over 95% of U.S. dollar wire transfers across U.S. borders and nearly half of all wire transfers within the United States, totaling $1.5 trillion per day and over $400 trillion in 2011.\textsuperscript{39}

**HSBC Affiliates.** HSBC has hundreds of affiliates located in over 80 countries. At least 80 HSBC affiliates have turned to HBUS for access to U.S. dollars and the U.S. financial system. These affiliates typically interact with HBUS by opening a correspondent account at HBUS headquarters in New York. Many use the account to clear U.S. dollars wire transfers; some use the account to cash U.S. dollar instruments like travelers cheques or money orders; still others use the account for foreign exchange purposes. In addition, some opened a separate account to buy or sell physical U.S. dollars as part of HBUS’ wholesale banknotes business, until it was shuttered in 2010.

HSBC affiliates have accounted for a large portion of HBUS’ U.S. dollar activities. In 2009, for example, HSBC determined that “HSBC Group affiliates clear[ed] virtually all USD [U.S. dollar] payments through accounts held at HBUS, representing 63% of all USD payments processed by HBUS.”\textsuperscript{40} HSBC also calculated that, over an eight-year period, its U.S. dollar clearing business had increased over 200%, from processing an average daily amount of $185 billion in 2001, to $377 billion in 2009.\textsuperscript{41} HBUS also executes transactions through HSBC affiliates in other countries. It has been estimated that, in 2009, HBUS processed 19.4 million transactions, involving $45.9 trillion, through HSBC affiliates.\textsuperscript{42}

One of the largest HSBC affiliates is The Hongkong Shanghai Banking Corporation Ltd., which is incorporated in Hong Kong and is Hong Kong’s largest bank.\textsuperscript{43} Established in 1865, when Hong Kong was part of the British empire, it is the founding member of the HSBC Group, but now operates as a subsidiary of HSBC Holdings plc, the Group’s parent corporation. With more than 71,400 employees, it oversees a network of hundreds of HSBC affiliates in 20 countries.

\textsuperscript{38} See 7/28/2008 OCC memorandum, “OFAC Examination – Payment and Cash Management (PCM),” OCC-PSI-01279462, at 4. [Sealed Exhibit.]

\textsuperscript{39} Id. See also The Clearing House website, “About CHIPS,” http://www.chips.org/about/pages/033738.php.

\textsuperscript{40} See 9/9/2009 chart entitled, “HSBC Profile,” included in “HSBC OFAC Compliance Program,” a presentation prepared by HSBC and provided to the OCC, at HSBC OCC 8874197.

\textsuperscript{41} Id. at “USD Payment Statistics – Fact Sheet,” HSBC OCC 8874211.


throughout Asia and the Pacific Region, including Australia, Bangladesh, China, India, Japan, Malaysia, New Zealand, Thailand, and Vietnam.\(^{44}\) It is sometimes referred to in internal HSBC documents as HBAP, an abbreviation for HSBC Bank Asia Pacific.

A second key affiliate is HSBC Bank Middle East Ltd. (HBME). Incorporated in Jersey in the Channel Islands and owned through a chain of subsidiaries reaching back to the Group’s parent corporation in London, HBME oversees a network of financial institutions throughout the Middle East and North Africa.\(^{45}\) With more than 5,000 employees, HBME provides banking services through nearly 45 branches in Algeria, Bahrain, Jordan, Kuwait, Lebanon, Oman, Pakistan, Qatar, and the United Arab Emirates.\(^{46}\) In 1998, HSBC Group established “HSBC Amanah,” a “global Islamic financial services division” designed to “serve the particular needs of Muslim communities” in compliance with Islamic law.\(^{47}\) HBME offers Amanah banking services to many of its clients in the Middle East and North Africa.

A third affiliate discussed in this Report is HSBC Mexico S.A. Banco (HBMX), the principal operating company of Grupo Financiero HSBC, S.A. de C.V., which owns HSBC’s businesses in Mexico. HSBC’s Mexican group is one of Mexico’s largest financial service conglomerates, with over 1,000 branches throughout the country, nearly $2 billion in assets, and over 8 million clients.\(^{48}\) HSBC purchased HBMX in 2002, when it operated under the name of Banco Internaciona, S.A. and was part of Grupo Financiero Bital, S.A. de C.V.\(^{49}\) HBMX and its Mexican parent are headquartered in Mexico City and together have about 19,000 employees.\(^{50}\)

**HSBC Leadership.** Over the last few years, HSBC leadership has undergone significant change. In 2010, HSBC Holdings plc appointed

\(^{44}\) Id.
\(^{46}\) See id. at 32. See also “HSBC Wins its Eighth Best Cash Management Bank in the Middle East Award,” http://www.hsbc.ae/1/about-hsbc/newsroom/eighth-best-cash-management, viewed 4/21/12; “HSBC Research Picks Up More Regional Awards,” (1/12/12), http://www.hsbc.ae/1/PA_1.083Q9F08A002F8PS00000000/content/uae_pws/pdf/en/newsroom/research-research-awards-jan-12.pdf, viewed 4/12/12. HSBC provides banking services in Saudi Arabia through both HSBC Saudi Arabia, in which it is a 49% shareholder, and Saudi British Bank (SABB), in which it is a 40% shareholder. See “HSBC Research Picks Up More Regional Awards,” (1/12/12), http://www.hsbc.ae/1/PA_1.083Q9F08A002F8PS00000000/content/uae_pws/pdf/en/newsroom/research-research-awards-jan-12.pdf, viewed 4/12/12.
new Chairman of the Board of Directors, Douglas J. Flint, replacing Stephen Green, who had become a U.K. Cabinet Minister. A new Group Chief Executive was also selected, replacing Michael Geoghegan, who retired, with Stuart T. Gulliver. In 2012, HSBC Holdings plc also appointed a new Chief Legal Officer, Stuart Levey, former Undersecretary for Terrorism and Financial Intelligence at the U.S. Treasury Department. Mr. Levey replaced the Group’s General Counsel, Richard Bennett.

Also in 2010, Sandy Flockhart became Chairman of Europe, Middle East, Africa, Latin America, Commercial Banking; as well as Chairman of HSBC Bank plc. Mr. Flockhart, who first joined HSBC in 1974, is an emerging markets specialist and, among other posts, headed HBMX in Mexico for five years, from 2002 to 2007. He was also appointed to the HSBC Group Board of Directors in 2008, and became a director of HSBC Bank Middle East in July 2011.

HNAH Leadership. At HNAH, the U.S. bank holding company, the persons holding leadership positions have often overlapped with those of HNAH’s key subsidiaries, HBUS, HSBC Securities, and HSBC Finance Corporation. HNAH’s current Chief Executive Officer (CEO), for example, is Irene Domer, who is also the CEO of HBUS. Her immediate predecessor at HNAH, for less than a year, was Niall Booker, who was preceded by Brendan McDonagh, former Chief Operating Officer (COO) of HBUS. Before Mr. McDonagh, HNAH was headed by Siddharth (Bobby) N. Mehta, who was also head of HSBC Finance Corporation, but left the bank when HSBC Finance Corporation’s subprime mortgage portfolio incurred huge losses during the recent financial crisis.

The current HNAH COO is Gregory Zeeman; the current General Counsel is Stuart Alderoty; and the current Chief Auditor is Mark Martinelli, each of whom currently holds the same position at HBUS.

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52 “HSBC appoints Chief Legal Officer,” (1/13/12), media release prepared by HSBC.
54 See HSBC Group “Board of Directors,” http://www.hsbc.com/1/2/about/board-of-directors (describing Mr. Flockhart as “a career banker, being an emerging markets specialist with over 35 years’ experience with HSBC in Latin America, the Middle East, US and Asia”).
55 Id.
57 Id.
HNAH’s Chief Risk Officer is Mark Gunton who holds the same position at both HBUS and HSBC Finance Corporation.

**HBUS Leadership.** Over the last ten years, HBUS has undergone numerous changes in leadership, with the head of the bank turning over four times. The current head is Irene Domer who serves as HBUS’ Chairman of the Board, President, and CEO. She was appointed to those positions in 2010, after having served as the CEO of HSBC Bank Malaysia and as a director on the HBUS Board. Her immediate predecessor was Paul J. Lawrence who headed HBUS from 2007 to 2010. His predecessor was Sandy L. Derickson who served in the post for less than one year and left the bank along with Mr. Mehta after HSBC Finance Corporation, where he was second-in-command, incurred substantial losses. His predecessor was Martin J.G. Glynn who headed HBUS from 2003 to 2006, and then retired.

HBUS has a six-person Board of Directors. Its current members are Ms. Domer; William R.P. Dalton, former CEO of HSBC Bank plc in London; Anthea Disney, former Executive Vice President of NewsCorporation; Robert Herdman, former SEC Chief Accountant; Louis Hernandez, Jr., CEO of Open Solutions Inc.; and Richard A. Jalkut, CEO of TelePacific Communications.

Within HBUS, the current Chief Operating Officer (COO) is Gregory Zeeman. His immediate predecessor was David Dew, who was preceded by Brendan McDonagh, who served as the COO from 2004 to 2006. Some other key HBUS executives are Marlon Young, the head of Private Banking Americas; Kevin Martin, the head of Retail Banking and Wealth Management; and Mark Watkinson, the head of Commercial Banking. Since 2007, the bank’s Chief Auditor has been Mark Martineelli. From 2000 to 2011, the head of HBUS Payments and Cash Management (PCM) was Michael Gallagher. The head of Global Banknotes, from 2001 to 2010, was Christopher Lok.

HBUS’ current General Counsel is Stuart A. Alderoty. His predecessor was Janet Burak who served as the bank’s General Counsel.

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58 Information on HBUS’ leadership is taken from its SEC annual reports.
60 Mr. Dew served as HBUS COO from March 2007 to March 2008, prior to that, he served for a month as HBUS Chief Administrative Officer from February 2007 to March 2007, prior to that he served as audit head at HUSI and HSBC North America Inc. from 2006 to 2007, and as audit head of HSBC North America Holdings Inc. from 2004 to 2007. Mr. Dew currently works as Managing Director of the Saudi British Bank which is 49% owned by HSBC. Subcommittee interview of David Dew (3/5/2012).
from 2004 to 2010. In 2007, she was also made the Regional Compliance Officer for North America.63

B. HBUS AML Program

The compliance and anti-money laundering (AML) programs at HBUS have undergone continual organizational and leadership changes since 2005. In April 2003, the Federal Reserve and New York State Banking Department, which oversaw HBUS’ predecessor bank, cited the bank for multiple, severe AML deficiencies and required it to enter into a written agreement to revamp and strengthen its AML program.64 It was at that time that HBUS renamed itself and converted to a national bank charter under the supervision of the OCC. During its first year under OCC supervision, HBUS reorganized its AML program, revamping its AML controls, country and client risk assessment criteria, Know Your Customer (KYC) due diligence requirements, and systems for detecting and reporting suspicious activity.65 HBUS also acquired a new system for monitoring account activity, called the Customer Activity Monitoring Program (CAMP) and established criteria to produce alerts requiring additional reviews. In addition, HBUS created a system of KYC client profiles with standard due diligence information requirements for each client and which was updated on a regular basis and had to be approved by compliance and other bank officials for an account to be kept open. HBUS also established a Financial Intelligence Group to conduct enhanced due diligence reviews.

Although the OCC gave positive reviews to the bank’s initial efforts,66 by 2010, the OCC issued a lengthy Supervisory Letter again citing the bank for numerous AML deficiencies and requiring HBUS to revamp its AML program a second time. In response, the bank issued an action plan to correct identified problems. HBUS has, for example, acquired a new AML monitoring system, NORKOM to replace CAMP, and is working to refine its parameters for detecting suspicious activity. In its first month of operation, NORKOM detected more than 100,000 transactions needing further review, demonstrating its ability to catch many transactions that went previously unchecked under CAMP.

HBUS has also revamped its approach to HSBC affiliates, which make up an important segment of HBUS’ correspondent banking, wire

64 See HSBC Bank USA, Federal Reserve Bank of New York, and New York State Banking Department, Docket No. 04-012-WA/RR-SM (Board of Governors of the Federal Reserve System, Washington, D.C.), Written Agreement (4/30/2003), OCC-PS-00907S03-SII.
65 See OCC Report of Examination of HBUS, for the examination cycle ending March 31, 2005, OCC-PS-00423650. [Sealed Exhibit.]
66 Id. at 10-11 (describing the formal agreement).
transfer, and cash management businesses and previously operated without due diligence controls and at times with minimal or no AML monitoring. Among other changes, HBUS now requires all subsidiaries to conduct due diligence on all other HSBC affiliates, including by using internal audit information identifying their AML risks and AML controls; identifies affiliates posing high AML risks; and treats them accordingly, thus ending all policies exempting affiliates from standard AML account and wire transfer monitoring. In addition, HBUS has revamped its country and client risk assessment criteria, which now identify high risk clients in a more robust manner; reviewed its correspondent banking business to reduce the number of high risk financial institutions; and closed some high risk business lines including its U.S. banknotes program. HBUS has also hired new AML leadership and significantly expanded its AML staffing and resources. HBUS currently employs over 1,000 compliance personnel.67

Some of HBUS’ changes have been criticized by the OCC as inadequate. HBUS has been informed by the OCC that it must do additional work on its monitoring system in order to implement the requirements of the 2010 Cease and Desist Order. The individual hired by HBUS in 2011 to serve as its Chief Compliance Officer left after a little more than a year. Both HBUS and the OCC will have to work hard to ensure that the latest round of changes will produce a better AML outcome than the changes made in 2004.

(1) HBUS Compliance and AML Leadership

Over the last five years, HBUS has experienced high turnover in its Compliance and AML leadership, making reforms difficult to implement. Since 2007, HBUS has had four Compliance heads and five AML directors. Currently, both positions are held by the same person, Gary Peterson. Mr. Peterson has extensive AML experience and was hired in 2010, to be the AML director, but after the Compliance head was asked to leave in 2010, has since held both posts. In 2012, Mr. Peterson is expected to relinquish his duties as AML director to his deputy, Alan Schienberg, so that the top Compliance and AML positions at HBUS will each have a full time professional.68

The top compliance position at HBUS is the Chief Compliance Officer who oversees all compliance issues for the bank. In the AML field, HBUS has specified two posts which have been held by the same person, the Anti-Money Laundering (AML) Director who is tasked with ensuring bank compliance with U.S. AML laws and regulatory

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HBUS’ Compliance and AML leadership positions were relatively stable until 2007, after which the bank has struggled to hire and retain experienced compliance professionals.

HBUS’ Chief Compliance Officer from 2000 to 2008 was Carolyn Wind. Prior to that position, Ms. Wind worked for Republic Bank of New York as a compliance officer and, before that, as an OCC bank examiner. For the first three years she held the job, Ms. Wind also served as the AML Director. In 2003, the bank hired a separate AML Director, Teresa Pesce, who served in that post nearly four years, from 2003 to March 2007. Before taking the position at the bank, Ms. Pesce was a Federal prosecutor with the U.S. Attorney’s Office in New York. Ms. Pesce left the bank in 2007, after which Ms. Wind headed both the Compliance and AML Compliance functions until she left the bank in 2008. As discussed below, Ms. Wind was dismissed by HBUS after raising the issue of inadequate AML resources with the audit committee of the board of directors of the bank’s holding company, HNAH.

In 2007, as part of a “Compliance Transformation Initiative,” HSBC established a North America Compliance department at HNAH headed by a Regional Compliance Officer. HNAH appointed Janet Burak, then Regional Legal Department Head for North America, to also serve as the Regional Compliance Officer; she held both positions from 2007 to 2010. At the time, HSBC Group Compliance head David Bagley expressed concern about combining the two roles, arguing that each required too much effort for a single person, but was overruled. Two years later, in March 2009, the Federal Reserve issued a negative critique of Ms. Burak’s performance, noting in particular that she did not have an adequate understanding of AML risk or controls.13

The OCC Director also serves as HBUS’ Bank Secrecy Act Compliance Officer.

See also Federal Reserve, at BOG-A-205485.


See 6/21/2007 email from HSBC David Bagley to HSBC Richard Bennett, HSBC OCC 8873871-5 (conveying to HSBC Group’s most senior legal counsel, Richard Bennett, the concern of HBUS compliance personnel about “the capability of one person to manage a very large legal function and a compliance function” and that “compliance will be pushed down below Legar’). See also 7/28/2010 email from HSBC David Bagley to HSBC Michael Gengegan, HSBC OCC 8873871-75 (conveying to HSBC CEO Michael Gengegan, that with regard to the 2007 decision to combine the two roles into one: “I fully accepted that Brendan [McDonagh], Paul [Lawrence] and Richard [Bennett] had the right to make this call, although as I said to you in Vancouver I now wish I had been more vociferous and in the current way my role operates I am confident that I would have a far stronger say.”).

The March 2009 Federal Reserve’s Summary of Ratings stated: “Interviews conducted as part of our recent governance review revealed that Janet Burak, HNAH Legal and Compliance chief risk officer has only broad understanding of BSA/AML risk and relies on the HNAH BSA/AML officer [Midzain] to manage the risk. ... Midzain, as previously stated has weak BSA/AML knowledge and industry experience. Burak’s heavy reliance on the inexperienced Midzain is a concern. An example of Burak’s limited management oversight of BSA/AML was revealed when we recently met with her to clarify a few items from our Governance review she was unable to respond to the question about the distribution and the purpose of annual AML...
also later criticized her performance as well as the decision to combine the regional legal and compliance roles, noting in 2010, that Ms. Burak “has had to balance a wide range of legal and compliance duties, including establishing the strategic direction for both functions and representing both functions on senior committees at the Group level.”

The OCC stated that, as a consequence, Ms. Burak had “not regularly attended key committee or compliance department meetings” and had failed to keep herself and other bank executives “fully informed about issues and risks within the BSA/AML compliance program.”

It also placed some of the blame at her feet for a recently discovered backlog of 17,700 alerts indicating possible suspicious activity at the bank, which had not been reviewed, noting that “[b]acklogged alerts needed to receive the highest level of attention from senior bank management at a much earlier stage to ameliorate the problem.” Soon after this critique, Ms. Burak left the bank.

In the two years she held the regional posts, Ms. Burak oversaw three functional compliance teams at HNAH called “Compliance Advisory,” “Compliance Center of Excellence,” and “Compliance Shared Services Utility.” Each team was headed by a senior Compliance manager: Curt Cunningham, Anthony Gibbs, and Lesley Midzain. Ms. Midzain was hired in 2007 to replace Carolyn Wind and so worked, not only for HNAH, but also for HBUS as both its Compliance head and AML director. She held these compliance posts for two years, from 2007 until 2009. Prior to being placed at the helm of the bank’s AML program, Ms. Midzain had no professional experience and little familiarity with U.S. AML laws. In December 2008, HNAH’s regulator, the Federal Reserve, provided a negative critique of Ms. Midzain’s management of the bank’s AML program. The Federal Reserve wrote that Ms. Midzain did “not possess the technical knowledge or industry experience to continue as the BSA/AML officer.”

It noted that she “was interviewed by OCC examiners from another team and they supported the conclusion of the OCC resident staff that Midzain’s knowledge and experience with BSA/AML risk is not commensurate to statements. She subsequently communicated via email that she does not review the annual AML statements provided to her by the HNAH/BSA/AML officer (Midzain). Burak forwards the statements to Group. ”


17 Id. See also Federal Reserve, at BOG-A-205485.

HNAH’s BSA/AML high risk profile, especially when compared to other large national banks.”

In 2009, the OCC also concluded that Ms. Midzain did not have the requisite AML expertise for her position. An OCC Supervisory Letter echoed the criticisms leveled earlier by the Federal Reserve:

“Ms. Midzain was selected as the Compliance Director and BSA Officer although she does not have the qualifications or the experience to manage a BSA program at an institution with the size and amount of BSA compliance risk that HBUS has. She is a Canadian lawyer (a barrister and solicitor) who formerly worked for HNAH. She is also a member of Group’s executive development program. … Ms. Midzain’s assignment as HBUS’ BSA Officer and Compliance Director has been her first assignment outside of Canada as a part of that program. … During its 2009 compliance management examination, the OCC determined that Ms. Midzain lacked the experience and expertise to be the BSA Officer, and the OCC included an MRA in its supervisory letter that required the bank to strengthen its BSA/AML compliance leadership by hiring a BSA Officer who is highly qualified and very experienced.”

In response to the Federal Reserve and OCC criticisms, HBUS removed Ms. Midzain from the AML post, but retained her as head of HBUS’ Compliance department. In the fall of 2009, HBUS hired a new AML Director, Wyndham Clark, a former U.S. Treasury official, who assumed the post in the middle of an intensifying AML examination by the OCC and a host of serious AML problems facing the bank. Mr. Clark was required to report to Curt Cunningham, an HBUS Compliance official who freely admitted having no AML expertise, and through him to Ms. Midzain, whom the OCC had also found to lack AML expertise. Shortly after he arrived, Mr. Clark began requesting additional resources.

After 30 days at the bank, Mr. Clark sent Mr. Cunningham a brief memorandum with his observations, noting that HBUS had an "extremely high risk business model from AML perspective," had seen recent high turnover in its AML directors, and granted only limited authority to the AML director to remedy problems:

79 Id.
82 See, e.g., 10/19/2009 email exchange between HBUS Wyndham Clark and HBUS Debra Bonosconi, “OFAC resources,” OCC-PSI-00162661 (Mr. Clark commented after Janet Barak had recently approved three new compliance personnel positions, “Clearly a positive, although I understand that these were requested quite a while ago. I hope that isn’t the typical response time.” Ms. Bonosconi responded: “Oh, this was express time. Trust me on that. Usually the response is “no.”).
“AML Director has the responsibility for AML compliance, but very little control over its success. Operate under ‘crisis’ mode, actions are reactive rather than forward thinking. AML Director unable to manage at high level. Several AML Directors/BSA Officers in a short period of time.”

As he continued his work, Mr. Clark grew increasingly concerned that the bank was not effectively addressing its AML problems. In February 2010, Mr. Clark met with the Audit Committee of the HNAH board of directors and informed the committee that he had never seen a bank with as high of an AML risk profile as HBUS. He also informed them that AML resources were “insufficient versus current risks and volumes,” and the bank’s systems and controls were “inconsistent with AML risk profile.” On May 10, 2010, Mr. Clark wrote to a senior HBUS Compliance official that with regard to the bank’s AML compliance program, “With every passing day I become more concerned...if that’s even possible.”

In July 2010, less than a year after taking the post, Mr. Clark decided to resign. He sent an email to the head of HSBC Group Compliance David Bagley explaining that he did not have the authority or support from senior compliance managers needed to do his job as AML director:

“[T]he bank has not provided me the proper authority or reporting structure that is necessary for the responsibility and liability that this position holds, thereby impairing my ability to direct and manage the AML program effectively. This has resulted in most of the critical decisions in Compliance and AML being made by senior Management who have minimal expertise in compliance, AML or our regulatory environment, or for that matter, knowledge of the bank (HBUS) where most of our AML risk resides. Until we appoint senior compliance management that have the requisite knowledge and skills in these areas, reduce our current reliance on consultants to fill our knowledge gap, and provide the AML

83 10/15/2009 HBUS memorandum from Wyndham Clark to HNAH Curt Cunningham, “30 Day Observations and Recommendations Report from AML Director,” HSBC PSI PROD 0065332.
84 Subcommittee interview of Wyndham Clark (11/30/2011); 2/17/2010 “HNAH AML Program, Board Audit Committee Presentation,” by HBUS Wyndham Clark to the Audit Committee of the HNAH board of directors, HSBC OCC 3800290.
85 2/17/2010 “HNAH AML Program, Board Audit Committee Presentation,” by HBUS Wyndham Clark to the Audit Committee of the HNAH board of directors, HSBC OCC 3900290.
86 5/10/2010 email from HBUS Wyndham Clark to HBUS Anne Liddy, “AML Townhall,” OCC-PSI-00672582. See also 5/9/2010 email from HBUS Wyndham Clark to HNAH Curt Cunningham, “AML Townhall,” OCC-PSI-00672571 (“Essentially AML decisions are now being made without AML SME [subject matter expertise]. This will be very apparent to the regulators.”).
Director appropriate authority, we will continue to have limited credibility with the regulators." When asked about his experience at the bank, Mr. Clark told the Subcommittee that he did not have either the authority or resources needed as AML director. After his departure, the bank hired Gary Peterson, who was then an AML consultant to the bank, appointing him as HBUS’ new AML director.

Around the same time that Mr. Clark left the bank in 2010, Ms. Midzain also departed, leaving open the post of Chief Compliance Officer. That post remained vacant until 2011, when HBUS hired Eric Larson. He left after fifteen months on the job. HBUS then asked Gary Peterson to serve, not only as HBUS’ AML Director, but also as its Compliance head, and as HNAH’s Regional Compliance Officer following Ms. Burak’s departure in 2010. Mr. Peterson agreed and has served in all three posts since 2010. Altogether, these personnel changes meant that, over the last five years, HBUS has had four Chief Compliance Officers and five AML Directors.

At HSBC Group, HBUS’ parent organization, for nearly ten years, from 2002 to the present, David Bagley has served as the HSBC Group’s head of Compliance. He is located in London and oversees both general and AML compliance issues. His second-in-command is Warren Learning, Deputy Head of HSBC Group Compliance, who has been in that position since January 1, 2007. Susan Wright serves as the head of HSBC’s AML efforts. She is also located in London and has served in that position for more than a decade. John Root is a senior Group Compliance officer who has concentrated on compliance and AML issues, in part in Mexico and Latin America. Compliance personnel work with Matthew King who has served as the head of HSBC Group Audit since 2002.

(2) HBUS AML Program

Federal law requires banks operating in the United States to have a minimum of four elements, an AML compliance officer in charge of the program, AML internal controls, AML training, and an independent testing of the AML program to ensure its effectiveness. HBUS’ AML program must address a wide range of AML issues, from customer due diligence, to monitoring account and wire transfer activity, to reporting
suspicious activity to law enforcement. It must also cover a wide range of business lines and products, including Correspondent Banking, International Private Banking, Domestic Private Banking, Embassy Banking, Payment and Cash Management, and Banknotes services.

**Inadequate Staffing.** Despite its high AML risks, millions of customers, and employment of more than 16,500 employees overall, from 2006 to 2009, HBUS' entire Compliance Department numbered less than 200 full time employees; its AML Compliance staff was a subset of that and also included staff in India. 91 HBUS personnel told the Subcommittee that inadequate AML staffing was one of the biggest problems they faced. 92 OCC examinations also routinely identified inadequate staffing as a key AML problem, including with respect to unreviewed alerts, 94 Correspondent Banking, 95 OFAC reviews, 96 Embassy Banking, 97 and the Compliance Review Unit that tested the bank’s AML controls. 98

Bank documents show that Compliance and AML staffing levels were kept low for many years as part of a cost cutting measure. In 2007, HBUS announced a “1509 Initiative” to increase the bank’s return on equity by 2009, largely through cost cutting measures. One component of the plan was to ensure that 2007 and 2008 headcounts remained flat. This hiring freeze caused HBUS Compliance and the AML staffing requests to be denied or unanswered. At one point, HBUS Compliance and AML management resorted to requesting temporary staff when persistent AML alert backlogs grew to unmanageable levels. In 2007, HBUS fired its longtime AML head after she raised resource concerns with the HNAH Audit Committee; an AML director hired in 2009 left after being denied the authority and resources he considered necessary to

91 Subcommittee briefing by HSBC legal counsel (6/30/2011).
92 Subcommittee interview of HBUS Debra Bonosconi (11/17/2011) (Ms. Bonosconi reported to the Subcommittee that staffing was her biggest issue and that by March 2008 it was evident that more staff was needed. She made several requests for additional resources); Subcommittee interview of HBUS Anne Liddy (2/22/2012) (Ms. Liddy made a request for resources to Carolyn Wind, but was told that there was no appetite to bring on additional staff); Subcommittee interview of HBUS Carolyn Wind (3/7/2012); Subcommittee interview of HBUS Teresa Pesce (3/30/2012) (Ms. Pesce asked for business to provide funding for more AML Compliance positions because Compliance did not have the money).
do his job. After the OCC issued its lengthy Supervisory Letter criticizing multiple aspects of HBUS’ AML program, bank management began to significantly increase AML staff and resources.

AML Staffing Problems. In 2006, HBUS Compliance was already struggling to “handle the growing monitoring requirements” associated with the bank’s correspondent banking and cash management programs, and requested additional staff. In October 2006, HBUS Compliance officer Alan Ketley wrote that despite having very efficient processes, each month his Compliance team was “handling an average of 3,800 [alerts] per person and [was] becoming overwhelmed thus potentially placing the business and the bank at risk.” Despite requests for additional AML staffing, HBUS decided to hold staff levels to a flat headcount.

1509 Initiative and Hiring Freeze. In 2007, against the backdrop of losses stemming from its troubled acquisition of Household International and the beginning of the global financial crisis, HBUS launched the 1509 Initiative which sought to achieve a 15% return on equity for the bank by 2009, primarily by cutting costs. One facet of the 1509 Initiative was the “$100 Million Dollar Cost Challenge,” which set a goal of cutting costs of $100 million in 2007.

The hiring freeze began in September 2007, when HBUS Compliance had a headcount of 198 full time employees, one below its December 2006 level. When Compliance sought to fill six open positions, David Dew, HBUS Chief Operating Officer (COO), informed Compliance head and AML director Carolyn Wind that the positions could not be filled:

“This increase will be almost impossible to justify and therefore I must ask you to please cancel the open positions and ensure that your FTE as at 31 Dec 2007 does not exceed 199.”

To make the case for increased staffing resources, in September 2007, HBUS Compliance personnel reached out to compliance peers at

100 Id., at HSBC OCC 0616342.
104 Id.
other banks and learned that at the three major banks that provided some information, each had a greater number of monitoring staff in the correspondent banking area than HBUS. In addition, HBUS Compliance personnel noted that HBUS Compliance filed many fewer Suspicious Activity Reports (SARs) than its competitors, while HBUS filed three to four per month in the correspondent banking area, its peers filed 30 to 75 per month, and one major international bank disclosed that it filed approximately 250 SARs per month. Despite these statistics, the Compliance department and AML staff remained stagnant.

**Fired After Raising Staffing Concerns to Board.** After being turned down for additional staff, Carolyn Wind, longtime HBUS Compliance head and AML director, raised the issue of inadequate resources with the HNAH board of directors. A month after that board meeting, Ms. Wind was fired.

On October 24, 2007, Ms. Wind met with the Audit Committee of the HNAH board of directors and, during the meeting, raised the staffing issue, particularly with respect to the Embassy Banking area which had been the subject of two recent OCC examinations uncovering severe AML deficiencies. Her supervisor, Regional Compliance Officer Janet Burak, also attended the Audit Committee meeting. The day after the meeting, in an email to HSBC Group Compliance head David Bagley, Ms. Burak expressed displeasure that Ms. Wind’s comments had caused “inappropriate concern” at the Audit Committee:

"I indicated to her [Ms. Wind] my strong concerns about her ability to do the job I need her to do, particularly in light of the comments made by her at yesterday’s audit committee meeting .... I noted that her

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105 On 9/6/2007, Mr. Ketley wrote: “Every bank that responded and provided information about monitoring staff has more than HBUS.” 9/6/2007 email from HBUS Alan Ketley to HBUS Alan Williamson, Judy Stoldt, and George Tsugranes, “Correspondent survey,” HSBC OCC 0616384-385. See also 9/6/2007 HBUS chart, “Correspondent Banking Survey,” HSBC OCC 3406666. [Sealed Exhibit.] See also emails indicating HBUS Compliance personnel were not compensated at levels consistent with its competitors, and risked losing qualified personnel. See, e.g., 2/1/2007 email exchange among HBUS Carolyn Wind, HBUS Teresa Pesce and others, “MIP overages - URGENT,” HSBC OCC 0616314-316, at 314 (“We are not at market with our current compensation” and “[t]hese officers and AML officers can get new jobs in a heartbeat”; 2/27/2007 email from HBUS Karen Grom to HBUS Carolyn Wind, Denise Reilly, Teresa Pesce, David Dew and others, “HSUS Compensation Review,” HSBC OCC 0616318 (“The banks who are approaching our employees have deep pockets and are willing to pay to get the talent. … In many cases, we are paying under the ‘market data point’ (50th percentile).” and “The offers from head-hunters are in some cases double base salaries and double bonuses.”). 106 9/6/2007 email from HBUS Alan Ketley to HBUS Alan Williamson, Judy Stoldt, and George Tsugranes, “Correspondent survey,” HSBC OCC 0616384-385 (Mr. Ketley wrote: “Our competitors all acknowledge filing more SARs than we do.”); 9/6/2007 HBUS chart, “Correspondent Banking Survey,” HSBC OCC 3406666. [Sealed Exhibit.]
comments caused inappropriate concern with the committee around: our willingness to pay as necessary to staff critical compliance functions (specifically embassy banking AML support), and the position of the OCC with respect to the merger of AML and general Compliance.”

A month after the board meeting, after seven years as HBUS’ Compliance head, Ms. Wind was notified that she was being fired. In a January 22, 2008 letter to the head of HBUS Human Resources, Ms. Wind wrote:

“I was told on November 30, 2007 that I was being terminated effective 2/28/08, due to the fact that the Board had lost confidence in me. … If the Board has lost confidence in me based on my comments at the October, 2007 Audit Committee, why have I been allowed to continue to run this critical department without additional supervision or any direct follow-up from Group Compliance?”

Ms. Wind also wrote: “David [Dew] and I disagree on the extent to which my organization can withstand cost cuts and still maintain an effective compliance risk mitigation program. I also believe in an open dialog with the Board and its committees, which may go against the desires of some in the organization.”

Hiring Freeze Continues. After her departure, the hiring freeze continued throughout 2008. In February 2008, prior to her leaving the bank, Ms. Wind discussed the staffing freeze with HNAH COO Anthony Gibbs:

“HBUS Compliance has been required to manage down overall FTE [full time employees] while at the same time redeploying resources to priority needs. We also are in the midst of a ‘hiring pause’ which means that approval from appropriate EXCO members is required to fill any open position. I do not expect a lot

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108 10/25/2007 email from Janet Barak to David Bagley, OCC-P5I-00704789.
109 January 22, 2008 letter from Carolyn Wind to Jeanne Ebersole, HSBC OCC 7730334.
110 Subcommittee interview of Carolyn Wind (3/07/2012). Anne Liddy also reported that Ms. Wind told her in 2007 that she had been terminated due to Ms. Wind raising resource concerns to the board’s audit committee. Subcommittee interview of Anne Liddy (2/22/2010). Also see, Minutes of the Audit Committee Meeting, October 24, 2007, HSBC OCC 3516806.
111 On 1/17/08, Jeanne Ebersole, Executive Vice President HBUS Human Resources, wrote to the HBUS Executive Committee (EXCO), “Attached is a draft of the non-hiring freeze note to be sent to all OCBs 0, 1, 2 and the final headcount report for 2007 which we will discuss tomorrow at EXCO.” 1/17/2008 email from HBUS Jeanne Ebersole to HBUS Chris Davies, David Dew, Janet Barak and others, “Draft Materials for EXCO,” HSBC OCC 0616259-260, at 259.
of support for overall HBUS Compliance headcount increasing even if a portion of the time is allocated to other affiliates.\footnote{12}{2/12/2008 email from HBUS Carolyn Wind to HBUS Anthony Gibbs, Curt Cunningham, Denise Reilly and others, “Organizational Changes,” HSBC OCC 0616264.}

In June 2008, a senior PCM operations manager emailed senior HBUS Compliance official Anne Liddy about growing backlogs in the OFAC Compliance program:

“I have put forth the suggestion of hiring up some first level checkers for OFAC processing in the GSC...we’re strapped and getting behind in investigations (on OFAC cases) and have some of our key managers in the queues releasing items... I’m told I cannot hire first level staff unless it’s offshored...”\footnote{13}{See 6/19/2008 email exchange among HBUS Anne Liddy and HBUS Nancy Hedges, “OFAC processing in GSC’s,” HSBC OCC 0616349-350, at 349.}

An OCC examination later found that eight Compliance officers were under “rigorous pressure” to complete manual reviews of about 30,000 OFAC alerts per week.\footnote{14}{7/28/2008 OCC memorandum, “OFAC Examination – Payment and Cash Management (PCM),” OCC-PSI-01274962 (“the bank’s Compliance teams are under rigorous pressure to process alerts and determine a disposition in a timely manner”). [Sealed Exhibit.]}

In July 2008, however, HSBC Group senior management determined that the hiring freeze would continue to the end of the year. CEO Michael Geoghegan wrote to HNAH CEO Brendan McDonagh and others: “We have agreed that we will have a headcount freeze until the end of the year.”\footnote{15}{7/23/2008 email from HSBC Michael Geoghegan to HNAH Brendan McDonagh and others, “2nd Half Costs,” OCC-PSI-00727922.}

HBUS Compliance personnel, with the support of their business units, attempted to obtain an exception to the hiring freeze. In a September 2008 email, Michael Gallagher, PCM head at HBUS, requested additional Compliance staff, explaining: “I have expressed considerable concern for some time over the lack of resources both in compliance and within pcm [Payments and Cash Management] to adequately support kyc [Know Your Customer] and related regulatory requirements.”\footnote{16}{See 9/4/2008 email exchanges among HBUS Michael Gallagher and HBUS David Dew, Lesley Midzain, Andrew Long, Chris Davies and others, “Kyc hires,” HSBC OCC 0616352-356, at 356. When asked about this document, Mr. Gallagher said that Mr. Dew had informed him that broader concerns in the U.S. and at Group necessitated a flat headcount. Subcommittee interview of Michael Gallagher (6/13/2012).} Lesley Midzain, then HBUS Chief Compliance Officer, echoed his concerns and requested four additional full time employees:

“Given the hiring freeze in global businesses, I understand that it may also need approval by Paul Lawrence, but this has continued..."
to be an area of notable risk and regulatory attention and which needs some stabilization for Compliance resources.”

After expressing concern over how additional hires would impact operating expenses, Mr. Dew, HBUS COO, asked Ms. Middain if “a couple of temps for two months” would “do the trick.”

Hiring did not improve during 2009. Wyndham Clark, who had been hired in 2009, as the new HBUS AML director, noted in an email that Janet Burak had recently approved three new compliance positions. He wrote: “Clearly a positive, although I understand that these were requested quite a while ago. I hope that isn’t the typical response time.” A senior PCM operations officer responded: “Oh, this was express time. Trust me on that. Usually the response is ‘no.’” The Subcommittee was told that in September 2009, the HBUS Compliance department had 130 full time employees handling AML compliance issues.

**OCC Examination.** During late 2009 and the first half of 2010, the OCC expanded and intensified its examination of the bank’s AML program as a whole. Mr. Clark made increasing use of temporary employees and contractors to answer OCC inquiries and address AML deficiencies. In August, he left the bank. By then, he was using nearly 100 temporary employees and contractors and had requested 50 additional permanent full time Compliance personnel. Even with those additional resources, the OCC’s September 2010 Supervisory Letter identifying AML deficiencies at the bank criticized HBUS’ failure “to provide adequate staffing and resources to implement and maintain a BSA/AML compliance program commensurate with the bank’s high risk profile.” The OCC Supervisory Letter also noted: “Management is still in the process of determining an appropriate level of resources as they consider recommendations from outside consultants and make strategic decisions about the business and risk on a prospective basis.” By October 2010, the Compliance department had increased to over 400 full time employees.

**AML Monitoring Deficiencies.** In addition to AML leadership problems and inadequate AML staffing, another key component of HBUS’ AML program involved its monitoring systems. During the

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117 Id. at HSBC OCC 061654.
118 Id. at HSBC OCC 061655.
119 10/19/2009 email exchange between HBUS Wyndham Clark and HBUS Debra Bonosconi, “OFAC resources,” OCC-P51-00162661.
120 Subcommittee briefing by HSBC legal counsel (6/30/2011).
122 Id.
123 Id.
124 Subcommittee briefing by HSBC and HBUS executives (6/26/2012).
period reviewed by the Subcommittee, dating from 2004, HBUS used a monitoring system called the Customer Activity Monitoring Program (CAMP). This system had many limitations and often required manual reviews by HBUS Compliance and AML staff.

By 2006, as indicated earlier, HBUS Compliance was already struggling to handle the monitoring alerts generated by the bank’s growing correspondent banking and cash management programs and described its personnel as “becoming overwhelmed.”\(^{125}\) Backlogs of unreviewed alerts in different areas of the bank began to accumulate, including with respect to alerts generated by CAMP monitoring of client accounts and wire transfer activity; alerts triggered by the OFAC filter on transactions by potentially prohibited persons identified on OFAC lists of terrorists, drug traffickers, and other wrongdoers; and alerts related to potentially suspicious activity in Embassy Banking accounts.

With respect to the general CAMP system alerts for PCM, HBUS Compliance set a goal that no more than 2% of AML alerts should remain in the system for over 120 days without being resolved. In addition, the system notified increasingly senior management if the backlog exceeded certain thresholds. For example, when the CAMP alerts hit 3%, bank compliance officials like Anne Liddy were alerted; when it hit 4%, higher level compliance personnel such as AML director Lesley Midzain were notified; if the backlog hit 6%, HNAH’s Regional Compliance Officer Janet Burak was notified.\(^{126}\) In November 2009, the percentage of AML alerts in the system for longer than 120 days spiked from 4% in October to 9%.\(^{127}\) The backlog remained at 9 or 10% for the next four months, from December 2010 to February 2010, and then stayed around 6 or 7% from March to May 2010.\(^{128}\) In early 2010, as part of its expanded AML examination, the OCC discovered the CAMP backlog of more than 17,000 unreviewed alerts as well as a backlog of requests for enhanced due diligence (EDD) reviews.\(^{129}\) On March 3, 2010, an OCC Supervisory Letter ordered the bank to eliminate the alert and EDD backlog by June 30, 2010.\(^{130}\) The bank met the deadline using “offshore reviewers in India, HBUS staff in Delaware, HBUS temporary volunteers, [and] outside contractors.”\(^{131}\) A subsequent review by the


\(^{127}\) Id.

\(^{128}\) Id.


\(^{130}\) Id.

OCC, however, found “deficiencies in the quality of the work,” and required an independent assessment. The independent assessment found that 34% of the alerts supposedly resolved had to be re-done.

As Ms. Wind reported to the board in October 2007, backlogs were also an issue in Embassy Banking. A 2008 OCC examination identified a backlog of over 3,000 alerts identifying potentially suspicious activity in Embassy accounts that had yet to be reviewed. In response, HBUS initiated a concentrated effort to review and resolve those alerts prior to a followup OCC examination in July 2008. The followup examination found a backlog of about 1,800 alerts, some of which dated from 2007. The OCC examiners recommended issuance of a Cease and Desist Order to the bank in part due to the backlog, but the OCC instead issued a Supervisory Letter, identified the backlog as a Matter Requiring Attention by the bank, and required the backlog to be cleared by September 15, 2008. The bank met that deadline.

A third category of alert backlog involved transactions that were stopped by the OFAC filter as possible violations of OFAC regulations. Each transaction had to be manually reviewed and resolved by two 4-person OFAC Compliance teams in New York and Delaware. In July 2007, HSBC introduced a new payment system, GPS, in the United States. The system had undergone several adjustments just prior to its launch, including changes to its OFAC filters, which caused unexpectedly large backlogs. HBUS assigned a team to assist with clearing the backlog, but the problem still took weeks to resolve.

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132 Id.
134 July 31, 2008 Memorandum from HBUS Debra Bonosconi to HBUS David Dew, Lesley Midzain, and Cam Hughes. OCC-PSI-00499695. Also see 7/14/2008 Memorandum from HBUS Debra Bonosconi to HBUS David Dew, Lesley Midzain, Cam Hughes (“As shown in the chart below, we currently (as of 7/15) have a total of 1,793 open alerts which is a reduction of 1,519 from 3,312 on June 27th. There are a total of 203 that are open in excess of 120 days and 147 open in excess of 90 days (350 combined) and we are concentrating our efforts on reducing those first. We are closing an average of 84 alerts daily (including Saturday) and based upon current projections, we should have total of 1,499 pending alerts when the OCC arrives on July 21, 2008.”), OCC-PSI-00285742
138 Id.
In December 2009, RBUS’ OFAC Compliance team in New York had accumulated a backlog of greater than 700 OFAC alerts. The OFAC Compliance team requested five or six people from PCM for ten days to help clear the backlog. PCM responded that it had no resources to loan, and suggested asking the Compliance team in Delaware for help. The OFAC Compliance team in New York indicated the Delaware Compliance staff was already “fully deployed” dealing with general alerts from the CAMP monitoring system:

“We have considered all options at this point[,] the Compliance team in DE is already fully deployed dealing with wire camp alerts and bank examiner requests for the current exam. There is no bandwidth there at all[,] they are behind on the current alert clearing process which we are also dealing with.”

Understaffed, RBUS Compliance and AML staff constantly battled alert backlogs while requesting additional resources. These requests, if answered, generally resulted in additional temporary staff dispatched only when backlogs grew to unmanageable levels. As the backlog increased, tensions grew, and in February 2010, Mr. Clark, the AML Director who had been on the job only a few months, wrote: “We are in dire straights [sic] right now over backlogs, and decisions being made by those that don’t understand the risks or consequences of their decisions!!!”

The problems with RBUS’ AML monitoring system were not limited to the backlogs. Additional issues involved an array of problematic decisions on what clients and countries should be designated high risk and subject to enhanced monitoring; what accounts and wire transfer activity should be subject to or excluded from routine AML monitoring; what parameters should be used to trigger alerts, including dollar thresholds, key words or phrases, and scenario rules that combine specified elements; and what “negative rules” should be used to decrease the number of alerts that would otherwise be generated for...

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140 Id.

141 Id. at HSBC OCC 7688668.

142 2/26/2010 email from HBUS Wyndham Clark to HBUS Debra Bonosconi, OCC-PSI-0016591.

143 In another email the next day, Mr. Clark wrote: “At this point the businesses are not accepting that they own the risk. I can think of one exception, making the difficult decisions and taking the necessary steps to mitigate the risk. My view is the risks are being ignored by the business, and they are simply waiting for compliance to tell them what the risks are and to convince them as to what actions need to be taken. If they don’t know what the risks are, then why are they opening accounts or continuing with the relationship?” On the same day, Anne Liddy responded: “[W]e spend a lot of energy pushing our point and holding our ground and certainly Group member referred relationships/transactions have increased our HBUS risk.” 2/27/2010 email exchange between HBUS Anne Liddy, Wyndham Clark, and Debra Bonosconi, OCC-PSI-00165932.
review.\textsuperscript{143} The OCC’s September 2010 Supervisory Letter identified multiple problems with each of these elements of HBUS’ AML monitoring systems.\textsuperscript{144}

**Current Status of HBUS AML Program.** In the two years since the OCC issued its September 2010 Supervisory Letter and both the OCC and Federal Reserve issued October 2010 Cease and Desist Orders to HBUS and HNAH regarding the many AML deficiencies in their programs, both HBUS and HNAH, as well as HSBC, have made commitments to strengthen their AML programs, including by directing more resources to compliance needs. HBUS told the Subcommittee that Gary Peterson will remain as its Compliance head, and his deputy will take over the duties of AML director, to ensure both positions have a full time executive.\textsuperscript{145} HBUS also informed the Subcommittee that as of July 2012, it had increased its Compliance and AML staff to over 1,000 full time employees.\textsuperscript{146} It is also in the process of replacing CAMP with an improved AML monitoring system, NORKOM. Additional reforms include scaling back its correspondent banking and embassy banking relationships by closing higher risk accounts, as well as closing its banknotes business in 2010.\textsuperscript{147} With respect to HSBC affiliates, I-IBUS told the Subcommittee it has initiated due diligence reviews of all such affiliates to identify those that are high risk, enabled all affiliates to obtain internal audit findings and other information to improve affiliate risk assessments, ended any limits on the monitoring of affiliates, and increased affiliate information sharing to strengthen AML compliance.\textsuperscript{148}

In addition, on April 30, 2012, HSBC Group issued a new Group Circular Letter (GCL) 120014, announcing the intention of the bank to use the highest global compliance standards for every HSBC affiliate. The HSBC GCL stated:

\begin{quote}
"We must adopt and enforce the adherence to a single standard globally that is determined by the highest standard we must apply anywhere. Often, this will mean adhering globally to U.S. regulatory standards, but to the extent another jurisdiction requires
\end{quote}


\textsuperscript{144} Id.

\textsuperscript{145} Subcommittee briefing by HSBC and HBUS executives (6/26/2012).

\textsuperscript{146} Id. See also, 7/10/2012 HSBC Group News, “HSBC to Testify at U.S. Senate Hearing,” letter by HSBC Group Chief Executive Stuart Gulliver, PSI-HSBC-76-0001-002, at 002.

\textsuperscript{147} As of June 2012, HBUS had closed all banknotes accounts, 24 embassy accounts, and 326 correspondent relationships. In August 2010, as part of this review to exit relationships, HBUS CEO Irene Domer noted that she was recommending closing relationships with 121 international banks that “do not meet either risk or return hurdles.” 9/20/2010 email from Irene Domer to Andrew Long and others, HSBC OCC 8876104-106.

\textsuperscript{148} Subcommittee briefing by HSBC and HBUS executives (6/26/2012).
higher standards, then that jurisdiction’s requirements must shape our global standard.”

This new GCL could represent a groundbreaking approach for the bank if it, in fact, pushes its affiliates toward uniform and high compliance standards.

These reforms, like those announced in 2004 after the bank’s last AML enforcement action, have the potential to resolve the AML deficiencies at the bank and push HBUS to an improved level of AML compliance. While HBUS has committed to making major changes, the bank made similar commitments under the 2003 enforcement action, which the OCC lifted in 2006, after which the bank’s AML program quickly deteriorated. On many occasions since then, HBUS responded to AML problems identified by the OCC by instituting new policies and procedures that appeared to be effective remedies. However, it has often been the case that regulators would subsequently cite HBUS for failing to comply with its own policies and procedures. In 2006, for example, when the OCC lifted the AML enforcement action, HBUS had already incurred over 50 AML-related Matters Requiring Attention, many of which cited AML problems similar to those that had formed the basis of the written agreement.

In addition, not all of the AML reforms proposed since 2010 have proceeded smoothly. The new compliance head hired by the bank left after fifteen months. The bank’s new monitoring system has been the subject of OCC criticisms aimed at whether its monitoring parameters have been correctly set to identify suspicious activity and provide adequate AML oversight of client account and wire transfer activity. While the recent GCL could represent an important advance in requiring bank affiliates to adhere to the highest AML standards globally, as this report documents, it can take months, if not years, for HSBC affiliates to come into compliance with HSBC GCL directives. The burden of proof is on HSBC Group to show that its latest directive is taking hold and its affiliates are complying with the highest AML standards, and on HBUS to show that it is moving from an ineffective AML program to one that safeguards the U.S. financial system from abuse.

149 GCL 120014 – HSBC Global Standards.
III. HBMX: PROVIDING U.S. ACCESS TO A HIGH RISK AFFILIATE

HBUS has opened correspondent accounts for approximately 80 HSBC affiliates around the world, providing them with access to the U.S. financial system through clearing U.S. dollar wire transfers, cashing U.S. dollar checks, buying and selling physical U.S. dollars, and other services. Some of those HSBC affiliates operate in high risk countries, provide services to high risk clients, or offer high risk financial products. Until recently, HSBC Group policy, however, allowed its affiliates to assume that any HSBC affiliate owned 50% or more by the Group met Group AML standards, were low risk, and required no due diligence prior to opening a correspondent account. In conformance with that HSBC Group policy, for years, HBUS did not conduct any due diligence analysis or risk assessment of an HSBC affiliate prior to supplying it with a U.S. account. HBUS took that approach, even though U.S. statutory and regulatory requirements explicitly direct U.S. banks to conduct due diligence prior to opening a correspondent account for any foreign financial institution, with no exception for foreign affiliates.

HBMX, an HSBC affiliate in Mexico, illustrates how providing a correspondent account and U.S. dollar services to a high risk affiliate increased AML risks for HBUS. HBMX was created when HSBC Group purchased a Mexican bank known as Bital in 2002. A pre-purchase review disclosed that the bank had no functioning compliance program, despite operating in a country confronting both drug trafficking and money laundering. For years, HSBC Group knew that HBMX continued to operate with multiple AML deficiencies while serving high risk clients and selling high risk products. HSBC Group also knew that HBMX had an extensive correspondent relationship with

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151 As of February 2010, HBUS had about 2,400 clients in its Payments and Cash Management (PCM) department. See 9/13/2010 OCC Supervisory Letter HSBC-2010-22, “Bank Secrecy Act/Anti-Money Laundering (BSA/AML) Examination – Program Violation (12 U.S.C. § 1818(c); 12 C.F.R. § 21.21).” OCC-PSI-00899482-485, at 7. [Sealed Exhibit.] In June 2012, HBUS had a total of nearly 1,200 correspondent clients, of which 80 were HSBC affiliates. The HSBC affiliates had 395 HBUS accounts, of which 7 or 8 related to HBMX. Subcommittee briefing by HSBC legal counsel (6/20/2012).


HBUS and that suspect funds moved through the HBMX account, but failed to inform HBUS of the extent of the AML problems at HBMX so that HBUS could treat HBMX as a high risk account. Instead, until 2009, HBUS treated HBMX as low risk.

Contrary to its designation, HBMX engaged in many high risk activities. It opened accounts for high risk clients, including Mexican casas de cambio and U.S. money service businesses, such as Casa de Cambio Puebla and Sigue Corporation which later legal proceedings showed had been used on occasion, from 2005 to 2007 for Puebla and from 2003 to 2005 for Sigue, to launder funds from illegal drug sales in the United States. HMBX also offered high risk products, including providing U.S. dollar accounts in the Cayman Islands to nearly 50,000 clients with $2.1 billion in assets, many of which supplied no KYC information and some of which misused their accounts on behalf of a drug cartel. HBMX was also the single largest exporter of U.S. dollars to HBUS, transferring over $3 billion in 2007 and $4 billion in 2008, amounts that far outstripped larger Mexican banks and other HSBC affiliates. Mexican and U.S. law enforcement and regulatory authorities expressed concern that HBMX’s bulk cash shipments could reach that volume only if they included illegal drug proceeds that had been brought back to Mexico from the United States. In addition, for a three-year period from mid-2006 to mid-2009, HBUS failed to conduct any AML monitoring of its U.S. dollar transactions with HSBC affiliates, including HBMX, which meant that it made no effort to identify any suspicious activity, despite the inherent risks in large cash transactions.154

HBMX conducted these high risk activities using U.S. dollar correspondent and banknotes accounts supplied by HBUS. HBMX used those accounts to process U.S. dollar wire transfers, clear bulk U.S. dollar traveler’s cheques, and accept and make deposits of bulk cash, all of which exposed, not only itself, but also HBUS, to substantial money laundering risks. HBMX compounded the risks through widespread, weak AML controls, while HBUS magnified them by omitting the due diligence and account monitoring it applied to other accounts. HSBC Group also compounded the AML risks by failing to alert HBUS to HBMX’s ongoing, severe AML deficiencies.

A. HSBC Mexico

In November 2002, HSBC Group purchased Mexico’s fifth largest bank, Banco Internacional, S.A., then part of Grupo Financiero Bital,

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S.A. de C.V. (Bital), for about $1.1 billion. At the time of the purchase, Bital had roughly 6 million customers and 15,400 staff. This acquisition significantly increased HSBC’s banking presence in Mexico. HSBC later changed the name of the bank to HSBC Mexico S.A. Banco (HBMX) and the name of the holding company to Grupo Financiero HSBC, S.A. de C.V. (GF HSBC). GF HSBC is now one of Mexico’s largest financial service conglomerates, owning not only HBMS but also a network of other financial firms. HBMS currently has over 1,100 branches, $2 billion in assets, and over 8 million clients. HBMS and its Mexican parent are headquartered in Mexico City and together have over 19,000 employees. HSBC typically refers to its Mexican operations as HSBC Mexico.

Since the purchase of Bital, three persons have served as the head of HSBC Mexico. The first was Alexander (Sandy) Flockhart who served as Chairman and Chief Executive Officer (CEO) of HBMS, and later also as CEO of HSBC’s Latin America operations, from 2002 to 2007. After he was made Latin American regional head, Paul Thurston took the post of HSBC Mexico CEO and later also served as the HSBC Latin America CEO. Mr. Thurston headed the Mexico operations for just over a year, from February 2007 to May 2008. When

161 He was Group General Manager, Chairman and Chief Executive Officer of HBMS from 2002 to 2006, and Group Managing Director Latin America from 2006 to July 2007. See his biography on the HSBC website, http://www.hsbc.com/1/PA_esf-ca-app-content/content/assets/newsroom/media_kit/blogs/100223_sandy_flockhart.pdf. HSBC also has affiliates in Colombia, Panama, Peru, and Uruguay, among other Latin American locations.
162 In July 2007, Mr. Flockhart was appointed CEO of The Hongkong and Shanghai Banking Corporation Limited. See his biography on the HSBC website, http://www.hsbc.com/1/PA_esf-ca-app-content/content/assets/newsroom/media_kit/blogs/100223_sandy_flockhart.pdf.
he was promoted and relocated to London,\textsuperscript{164} Luis Pena Kegel became the new HSBC Mexico CEO and remains in that post today.\textsuperscript{165}

Mexican banks, including HBMX, are regulated by the Comision Nacional Bancaria y de Valores (CNBV) which oversees Mexican banks and securities firms. The Mexican central bank, Banco de Mexico, the Mexican Ministry of Finance, the Mexican Treasury Department (SHCP), and the Mexican Financial Intelligence Unit (FIU) also perform oversight functions. Mexico has a well-developed set of AML laws and regulations. Mexican regulators and law enforcement agencies work with their U.S. counterparts to combat drug trafficking and money laundering in both countries.

HBMX is a large, sophisticated bank offering a full range of banking services, including deposits, checking, foreign exchange, commercial banking services, private banking and wealth management, and correspondent banking. HMBX offers correspondent accounts to a wide range of financial institutions. HBMX also maintains correspondent accounts for itself at other banks around the world, including in the United States. In 2002, at the time Bital was purchased, the bank had $647 million in correspondent banking deposits in Mexico, $700 million in the Cayman Islands, and $143 million in New York.\textsuperscript{166}

According to CEO Paul Thurston, HBMX experienced rapid growth in the early years after its acquisition.\textsuperscript{167} HBMX also operates a branch in the Cayman Islands, HSBC Mexico S.A., which was established by Bital in 1980, with authority to offer customers U.S. dollar accounts.\textsuperscript{168} At its peak in 2008, the Cayman branch, which has no offices or employees of its own and is run by HBMX personnel in Mexico, had nearly 50,000 client accounts and assets totaling $2.1 billion.\textsuperscript{169}

HBMX has had an extensive relationship with HBUS, obtaining U.S. dollar services through both correspondent and banknotes accounts. HBMX used its HBUS correspondent account primarily to process

\textsuperscript{164} In May 2008, Mr. Thurston was appointed Managing Director of UK Banking, in charge of HSBC’s retail and commercial banking operations in the United Kingdom. See “HSBC makes key international appointments,” (4/15/2008), http://www.hsbc.com/1/2/newsroom/news/2008/hsbc-makes-key-international-appointments.
\textsuperscript{165} Mr. Pena was appointed head of GF HSBC. Id. Mr. Pena had previously headed Grupo Financiero Banorte and worked for 25 years at Banamex/Citigroup in Mexico. Id. Emilson Alonso was appointed Chief Executive of HSBC Latin America. Id.
\textsuperscript{166} “Compliance Due Diligence Trip by John Root: Bital (Mexico City) – 4-8 Nov02,” prepared by HSBC John Root, HSBC OCC 8877802-807, at 5.
\textsuperscript{167} Subcommittee interview of Paul Thurston (5/11/2012).
\textsuperscript{168} This branch operates under a “Class B license,” which is given by the Cayman Islands Monetary Authority to offshore banks authorized to do business only with non-residents of the Cayman Islands. See list of Cayman offshore banks at http://www.offshore-library.com/banking/cayman_islands/page_3; Subcommittee briefing by HSBC legal counsel on the Cayman accounts (4/20/2012).
\textsuperscript{169} See chart at HSBC OCC 8876787, attached to 9/12/2008 email from HSBC John Root to HSBC Adrian Cristiani, “Cayman Accounts,” HSBC OCC 8876784.
international wire transfers and clear U.S. dollar monetary instruments such as travelers cheques. It also made use of HBUS' Remote Deposit Capture service which enabled HBMX to send monetary instruments to HBUS electronically for processing. HBMX interacted at times with the HBUS Payment and Cash Management (PCM) division regarding this account. In addition, HBMX interacted with the HBUS Global Banknotes division, until the Global Banknotes business was discontinued in 2010. HBMX used its banknotes account primarily to sell U.S. dollars received from its customers to HBUS, which HBMX typically transported to HBUS via armed car or aircraft. In one three-month period from November 2006 to February 2007, HBMX shipped nearly $742 million in U.S. dollars to HBUS; at its peak, HBMX exported $4 billion in bulk cash shipments to HBUS over the course of one year, 2008. Until it sharply curtailed its U.S. dollar services in Mexico in January 2009, HBMX shipped more U.S. dollars to HBUS than any other Mexican bank or HSBC affiliate.

B. Mexico

To understand HBMX’s AML risks and, therefore, the risks HBUS incurred as its U.S. correspondent, it is necessary also to understand the AML risks in its home country, Mexico. From 2000 until 2009, HSBC Group and HBUS gave Mexico their lowest AML risk rating, despite overwhelming information indicating that Mexico was a high risk jurisdiction for drug trafficking and money laundering. In May 2009, HBUS suddenly increased its risk rating for Mexico by three notches, from its lowest to its highest risk level, where it remains today.\(^{170}\) HSBC Group did not follow suit until 2012 when it raised its risk rating for Mexico from “cautionary” to “high risk.”\(^{171}\)

(1) U.S. Assessment of AML Risk in Mexico

**INCSR Reports.** In its annual International Narcotics Control Strategy Reports (INCSRs), which contain a country-by-country assessment of drug trafficking and money laundering risks, the U.S. State Department has consistently classified Mexico as a country of “primary” concern for money laundering, its highest risk rating.\(^{172}\) In 2002, the State Department described Mexico’s drug trafficking and money laundering risks as follows:


\(^{171}\) Subcommittee briefing by HSBC legal counsel (7/5/2012).

“Mexico faces a myriad of drug-related problems that include the production and transshipment of illicit drugs, money laundering, consumption and illicit firearms trafficking. ... The Government of Mexico’s (GOM) longstanding commitment to combat drug trafficking and related crimes resulted in tangible successes against the Arellano Felix Organization (AFO), the Carrillo Fuentes Organization (CFO), and the Gulf Cartel — widely considered the top three drug groups in the country. ... Mexico remains a major supplier of heroin, methamphetamine, and marijuana, and the transit point for more than one half of the cocaine sold in the U.S. ... The industrial-scale drug trade has transformed narcotrafficking into one of Mexico’s deadliest businesses. ... These organizations have demonstrated blatant disregard for human life as the executions of law enforcement personnel, government officials, and innocent bystanders have increased. ... In recent years international money launderers have turned increasingly to Mexico for initial placement of drug proceeds into the global financial system.”17

The State Department also wrote:

“The smuggling of bulk shipments of U.S. currency into Mexico and the movement of the cash back into the United States via couriers and armored vehicles, as well as through wire transfers, remain favored methods for laundering drug proceeds. Mexico’s financial institutions engage in currency transactions involving international narcotics-trafficking proceeds that include significant amounts of U.S. currency or currency derived from illegal drug sales in the United States. Although drug trafficking continues to be the principal source of the laundered proceeds, other crimes including corruption, kidnapping, firearms trafficking, and immigrant trafficking are also major sources of illegal proceeds.”17

Equally negative assessments of Mexico’s drug trafficking and money laundering risks appeared in the State Department’s annual INCSR reports over the next four years. In 2006, for example, the State Department wrote:

“The illicit drug trade continues to be the principal source of funds laundered through the Mexican financial system. Mexico is a major drug producing and drug-transit country. Mexico also serves as one of the major conduits for proceeds from illegal drug sales leaving the United States. Other crimes, including corruption, kidnapping, firearms trafficking, and immigrant

174 Id. at XII-161.
trafficking are also major sources of illegal proceeds. The smuggling of bulk shipments of U.S. currency into Mexico and the movement of the cash back into the United States via couriers, armored vehicles, and wire transfers, remain favored methods for laundering drug proceeds. ... 

According to U.S. law enforcement officials, Mexico remains one of the most challenging money laundering jurisdictions for the United States, especially with regard to the investigation of money laundering activities involving the cross-border smuggling of bulk currency from drug transactions. While Mexico has taken a number of steps to improve its anti-money laundering system, significant amounts of narcotics-related proceeds are still smuggled across the border. In addition, such proceeds can still be introduced into the financial system through Mexican banks or casas de cambio, or repatriated across the border without record of the true owner of the funds.175

The State Department’s relentlessly negative assessments of Mexico’s drug trafficking and money laundering vulnerabilities continued unabated. In 2008, the State Department wrote that “U.S. officials estimate that since 2003, as much as U.S. $22 billion may have been repatriated to Mexico from the United States by drug trafficking organizations.”176 Four years later, in 2012, the State Department wrote that drug cartels were using Mexican and U.S. financial institutions to launder as much as $39 billion each year: “According to U.S. authorities, drug trafficking organizations send between $19 and $39 billion annually to Mexico from the United States.”177

Warnings. The State Department is far from the only governmental agency to have warned about the money laundering risks in Mexico. The U.S. Congress has held repeated hearings over the years highlighting money laundering and drug trafficking problems in Mexico.178 Witnesses have included the U.S. Justice Department,

175 2006 INCSR, at 268-269.
176 2008 INCSR, at 327.
177 2012 INCSR, at 140.
Homeland Security Department, Federal Bureau of Investigations, Drug Enforcement Administration (DEA), Financial Crimes Enforcement Network (FinCEN) of the U.S. Treasury Department, Internal Revenue Service (IRS), Customs and Border Patrol, and Coast Guard, among others. From 1996 to 2011, these hearings have painted the same grim picture drawn in the State Department’s annual reports regarding the drug trafficking and money laundering threats in Mexico.

In addition, warnings about money laundering problems in Mexico have been directed specifically to financial institutions operating in the United States. In 2005, multiple U.S. agencies worked together to produce a U.S. Money Laundering Threat Assessment which identified thirteen key money laundering methods and specifically identified Mexico as a high risk jurisdiction for several of them, including bulk cash smuggling, misuse of money orders, and suspicious funds sent through money service businesses. In 2006, FinCEN issued an advisory to all U.S. financial institutions to “better guard against an increasingly prevalent money laundering threat involving the smuggling of bulk U.S. currency into Mexico,” warning in particular against “the abuse of their financial services” by Mexican casas de cambio. The advisory explained that drug traffickers were smuggling bulk cash from the United States into Mexico, then depositing the funds with casas de cambio who were sending the cash back to the United States via armored transport or by selling the U.S. dollars to U.S. banks. The advisory also warned about multiple wire transfers that “bear no apparent business relationship” with a particular casa de cambio, and U.S. deposits by casas de cambio of sequentially numbered monetary instruments.

Wachovia Prosecution. Criminal prosecutions also alerted U.S. financial institutions to the money laundering problems in Mexico. In 2008, for example, news articles warned how Mexican drug cartels sent millions of dollars in illegal drug proceeds through a major U.S. financial institution, Wachovia Bank. In 2010, the United States filed a deferred prosecution agreement detailing how Wachovia Bank had

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been used by Mexican foreign exchange businesses to launder at least $110 million in drug proceeds. Filings in the case describe how, from 2003 to 2008, Wachovia Bank provided a variety of services for 22 Mexican casas de cambio (CDCs), despite evidence of suspicious activity. Those services included processing numerous U.S. dollar wire transfers for deposit into bank accounts around the world; clearing large volumes of sequentially numbered U.S. travelers cheques; and accepting numerous bulk cash shipments transported by armored car from the CDCs. The filings report that, over a three-year period, the wire activity exceeded $374 billion and the bulk cash shipments exceeded $4.7 billion, far exceeding expected volumes. Wachovia Bank also processed $20 million in sequentially numbered travelers cheques, the majority of which contained illegible names and unusual markings. The deferred prosecution agreement and supporting factual statement charged Wachovia Bank with willfully failing to maintain an effective AML program, detailing numerous AML deficiencies including a failure to conduct due diligence on high risk clients; a failure to monitor wire transfers, pouch activities, and bulk cash shipments; and a failure to report suspicious activity to law enforcement. To avoid prosecution, Wachovia Bank acknowledged responsibility for its conduct, paid $160 million in criminal and civil fines, and agreed to undertake significant AML reforms. The Wachovia case received widespread media attention, providing further notice of the money laundering dangers in Mexico.

(2) HSBC Assessment of Risk in Mexico

Despite the overwhelming information available about substantial money laundering risks in Mexico, from 2002 until 2009, HSBC gave Mexico its lowest risk rating for AML purposes. As a consequence,
under HSBC Group policy, clients from Mexico were not subjected to enhanced monitoring by HBUS, unless they were also designated a Special Category Client (SCC), a relatively rare designation that indicates a client poses high AML risks. Had Mexico carried one of the two highest risk ratings, all Mexican clients at HBUS would have been subjected to enhanced due diligence and account monitoring. Instead, HBUS failed to conduct AML monitoring of most Mexican client account and wire transfer activity involving substantial funds.

**Risk Rating Process.** Until recently, HSBC Group and HBUS issued AML country risk assessments using four categories of increasing risk, “standard,” “medium,” “cautionary,” and “high.” HSBC Group created a chart listing its country risk assessments, sent the chart to its affiliates characterizing its assessments as recommendations, and then allowed each HSBC affiliate to make its own assessment decisions. Until recently, HSBC Group and HBUS issued AML country risk assessments using four categories of increasing risk, “standard,” “medium,” “cautionary,” and “high.” HSBC Group created a chart listing its country risk assessments, sent the chart to its affiliates characterizing its assessments as recommendations, and then allowed each HSBC affiliate to make its own assessment decisions.195 At HBUS, the country risk assessments were compiled every six months by an AML compliance officer who gathered information from a number of sources, assigned numerical scores to each source, and then compiled aggregate scores for over 200 countries.196

Those scores were then supposedly used to assign risk ratings. In fact, however, countries receiving similar scores often received different risk ratings. Those differences were attributable, in part, to an “HBUS discretion” factor which was listed as an official factor in the risk assessment process, included in the risk assessment chart, and used, according to the OCC, to alter the risk ratings for over 60 countries in 2009.197 The OCC noted that HBUS offered “no discussion or documentation as to what constitute[d] permissible reasons to change the risk rating” using the HBUS discretion factor.198 The OCC also found that HBUS did not apply its risk-rating methodology “in a consistent manner.” The OCC wrote that, in 2009, of 73 countries that received a zero risk assessment score:

“32 (44 percent) were rated standard, 32 (44 percent) were rated medium, 1 (1 percent) was rated cautionary, and 8 (11 percent) were rated Unclassified. The OCC found no documentation or support for the difference between the final ratings and the scores. While the bank elevated the risk ratings versus the scores, the bank has not adopted a repeatable, standardized procedure.”199

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196 Id. See also Feb. 2009 “Rating 2009,” prepared by HBUS, HSBC-PSI-PROD-0096390-397.
198 Id.
199 Id.
The OCC criticized the HSBC country risk assessment process for not taking into account readily available country-specific information on money laundering and drug trafficking risks, including in the annual State Department INCSR reports. Although INCSR information was often included in HBUS KYC client profiles, the INCSR country-specific risk ratings were inexplicably excluded from the official HBUS country risk assessment scoring matrix.

Still another OCC criticism was the HSBC Group’s “unacceptable practice of assigning an overall risk rating to its non-SCC customers based solely on the risk rating that the bank has given the country where the customer is located.” One result of this practice, according to the OCC, was that HSBC had excluded from its routine AML monitoring “more than $60 trillion of wire transfers each year for customers domiciled in countries risk rated as ‘standard’ or ‘medium,’ representing two-thirds of the total dollar volume” of wire transfers at HSBC. With respect to Mexico, the HSBC policy meant that, due to its low risk rating, all clients based in Mexico were considered low risk, unless rated an SCC, an outcome that the OCC viewed as a critical AML deficiency. One consequence was that high risk clients residing in low risk countries routinely escaped enhanced due diligence and account monitoring.

**2009 Change in Mexico Risk Rating.** In February 2009, HBUS issued a chart with its latest country risk assessments. The chart provided risk scores and categories for 239 countries. It assigned a score of “2” for Mexico, which was one of the lowest scores. When asked about this low score, the HBUS compliance officer then responsible for country risk assessments, Ali Kazmy, told the Subcommittee that, since 2006, HBUS’ assessments had inadvertently failed to take into account a 2006 FinCEN advisory related to Mexico that would have added 10 points to its score each year. As a result of its low score, Mexico was rated a “standard” risk, the lowest of the four risk ratings.

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200 Id.
203 Id. at 2.
205 Id. The risk scores ranged from 0 to 28, and produced ratings of standard, medium, cautionary, and high.
207 Mexico had received the same standard rating in 2008. See 2008 HBUS Country Risk Assessment for Mexico at HSBC-PSI-PROD-0096398-441 and 422.
This low risk rating was awarded despite a May 2008 email from Susan Wright, AML Compliance head for the HSBC Group, singling out AML concerns related to Mexico. Referencing “RMM – Country Risk,” Ms. Wright wrote to HSBC Group Compliance head David Bagley and other colleagues:

"I believe you have sight of our Country Reputational Risk Table but, as previously discussed, unless there are some specific concerns it is not proposed to highlight the highest risk countries as a matter of course. …

Mexico – there are specific risks in relation to pressure from the US with regard to the laundering of the proceeds of drug trafficking through Mexican casas de cambios. HBMX have a number of customers who are cambios/money service businesses (MSBs) with links to the US and consequently payments from HBMX are made through HBUS. … [T]here are notoriously difficult businesses to monitor …. [T]here is also US concern with regard to the amount of USD cash deposits and transactions between the US and Mexico and HBMX has been identified as one of the banks with the highest level of activity in this area."208

This email shows that the head of HSBC AML Compliance was aware of and communicated to other Compliance personnel the serious AML risks related to Mexico involving drug trafficking, suspect casas de cambio, and bulk cash smuggling, yet the February 2009 HBUS country risk assessments again assigned Mexico the lowest possible risk rating.

Three months after issuing the country risk assessments in February 2009, however, on May 1, 2009, HBUS suddenly revised Mexico’s risk rating, increasing it by three notches from the lowest to its highest risk rating.209 When asked by the Subcommittee about the timing, Mr. Kazmy explained that, “in early 2009,” he had been asked by his supervisor, Anne Liddy, to take another look at Mexico’s risk rating due to OCC concerns.210

Ms. Liddy’s request coincided with an intensifying law enforcement interest in Mexican casas de cambio suspected of laundering illegal drug proceeds through U.S. financial institutions, including HBUS. In February 2008, and again in November 2008, as detailed below, Mexican regulators confronted HBMX with suspicions that drug proceeds were moving through its accounts at HBUS. In

208 5/14/2008 email from HSBC Susan Wright to HBUS David Bagley, HSBC Karl Barclay, HBEU Derek Leatherdale, and others, “RMM – Country Risk,” HSBC OCC 8873750.
January 2009, according to an internal HBUS email, a U.S. Homeland Security Department’s Immigration and Customs Enforcement (ICE) agent met with HBUS about a money laundering investigation involving one of their clients in Mexico. That same month, in response to Mexican AML regulatory concerns, HBMX stopped accepting U.S. dollar deposits at any of its Mexican branches.

In June 2009, ICE also informed the OCC that ICE was investigating possible money laundering activity involving banknote accounts at HBUS. ICE indicated that Mexican drug traffickers appeared to be using the black market peso exchange in New York to transfer funds through a particular Mexican financial institution, which then sent the funds through its U.S. correspondent account at HBUS. Dan Stipano, OCC Deputy Chief Counsel, explained the scheme to the OCC Examiner-In-Charge at HBUS as follows:

“The scheme … is similar to activity that we have seen at Union Bank, Wachovia, and Zions. Basically, the way it works is that drug money is physically hauled across the border into Mexico, then brought back into the United States through wire transfers from casas de cambio or small Mexican banks, or else smuggled across the border in armored cars, etc., before being deposited in U.S. Institutions. According to AUSA [Assistant U.S. Attorney] Weitz, most U.S. banks, recognizing the risks involved, have gotten out of this business, but HSBC NY is one of the lastholdouts (although, interestingly, he said that HSBC-Mexico will no longer accept U.S. currency).”

What U.S. law enforcement officials had found was that, because drug traffickers in the United States were having difficulty finding a U.S. financial institution that would accept large amounts of cash, due to strict U.S. AML controls, many were instead transporting large volumes of U.S. dollars to Mexico, and depositing the dollars at Mexican financial institutions. The drug traffickers could then keep their deposits in U.S. dollars through the Mexican financial institution’s correspondent account at a U.S. bank, or exchange the dollars for pesos. The Mexican

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211 See 1/19/2009 email from HBUS Denise Reilly to HBUS Lesley Midain, “HBMX Banknotes Business – HSBC Mexico Press Release and Q&A,” HSBC OCC 3633806-807. In a Subcommittee interview, HBUS AML Compliance officer Daniel Jack indicated that he attended the meeting, and the ICE agent expressed concern about possible money laundering through Consultoria, a former Mexican casa de cambio that had converted into a bank. Mr. Jack told the Subcommittee that HBUS closed the Consultoria account six months later. Subcommittee interview of Daniel Jack (3/13/2012).


banks, casas de cambio, and other financial institutions that were the recipients of the cash typically shipped the physical dollars back to the United States for credit to their own U.S. dollar correspondent accounts at U.S. banks. HBUS' awareness of the increasing U.S. law enforcement and regulatory interest in Mexico may have contributed to its decision to review and, ultimately, in May 2009, to increase its risk rating for Mexico.

One key consequence of the higher risk rating for Mexico was that, under Group AML policy, HBUS was required to conduct enhanced monitoring of all of its Mexican clients. HBUS' higher risk rating may have also put pressure on HSBC Group and other HSBC affiliates to boost their risk rating of Mexico as well.

On June 18, 2009, Ms. Wright sent an email to Ms. Liddy asking her about the higher rating for Mexico. Ms. Wright wrote:

“It has been drawn to my attention that in the latest US Country Risk Assessment Mexico has gone from a lower risk to high. I have received a number of queries from around the Group as to the reason for what they see as quite a dramatic change.

Whilst I appreciate the risks involved in doing business with Mexico I would be grateful for some further and more detailed clarification as to why the change has been so dramatic. This will enable me to deal with a number of these queries.”

In response, Ms. Liddy asked Mr. Kazmy, the AML officer responsible for compiling the country risk ratings, to write up the reasoning for the higher risk rating. He wrote:

“A number of sources are reviewed, a majority of which are government and international agencies, such as World Bank, IMF, FATF, CAFATF, BIS, Central Banks, Transparency International, etc. in order to determine risk levels .... The U.S. Department of State issues detailed annual assessment[s] of each country via the International Narcotics Control Strategy Report highlighting, inter

215 6/18/2009 email from HSBC Susan Wright to HBUS Anne Liddy, “Group CRRT and US Country Risk Assessments,” OCC-P50-00652829. See also 6/9/2009 email from HSBC David Bagley to HBUS Emilson Alonso, copies to HSBC Michael Geoghegan and others, “GMO Business reviews – LATAM,” HSBC OCC 8874895 (“I fully acknowledge the level of priority and focus that you and the team have given to these issues and the progress that has been made particularly in Mexico and have taken all of this into account. … The basis for the rating is however: The inherent AML risk in Mexico is still very high and [there are not many other parts of the Group that have what is effectively a drugs war being conducted on the streets and also have the risk posed by potential sting and other operations by the US authorities. We have of course remediated our high risk accounts, but the historic weak account opening processes mean that we have overall lower levels of KYC across the customer base as a whole. … Happy to discuss further.”).
alia, money laundering, terrorist financing, corruption, and regulatory regime/oversight. An excerpt of such a report on Mexico ... is attached below ...

As a result of events occurring in Mexico during the past several months with respect to drug trafficking and money laundering, as well as the general unrest these developments have caused, we have downgraded Mexico to 'high' risk. The deteriorated situation is recognized by the Government of Mexico as evidence through the involvement of agencies tasked with the Anti-Money Laundering and Counter Financing of Terrorist (AML/CFT) efforts towards drafting an AML/CFT National Strategy ... expected to be issued sometime during 2009 ... Our rating is in conformity with the view of the U.S. law enforcement.216

Ms. Liddy asked him how Mexico had been rated by the State Department in 2009, and whether that rating was worse than in the previous report, apparently not realizing that the State Department had consistently given Mexico its highest risk rating for years.217 Mr. Kazmy told Ms. Liddy, incorrectly, that the State Department INCSR report did not rate countries for risk, but also provided numerous details from the 2009 INCSR report indicating that money laundering and drug trafficking risks had increased.218

In 2010, when the OCC sent HBUS a supervisory letter on AML deficiencies at the bank, the letter included criticism of its country rating system.219 Under the heading, "Inadequate and Ineffective Procedures for Country Risk Ratings," the OCC listed "significant flaws" with the scoring and risk rating methodology, as well as with HBUS' decision not to monitor wire transfer activity for foreign financial institutions or other clients located in a standard or medium risk country, unless designated as an SCC client. The OCC wrote:

"The bank's country risk ratings for its PCM [Payment and Cash Management division] wire monitoring are critical, due to the bank's unacceptable practice of assigning an overall risk rating to its non-SCC customers based solely on the risk rating that the bank has given the country where the customer is located. However, compounding this deficiency, the bank's procedures for

determining the critical country risk ratings are inadequate and ineffective.

To determine the country risk rating, the bank employs a point system based on fifteen factors. HBUS’ methodology appears straightforward ... however ... there are significant flaws in the implementation of the point system. ...

The bank’s failure to risk rate countries appropriately has a significant impact on HBUS’ BSA [Bank Secrecy Act] compliance, because customers’ risk ratings affect a number of variable requirements relating to due diligence for foreign correspondents. For example, these variable requirements include the frequency with which the bank conducts site visits (every 12 months versus every 24 months) and the level of due diligence performed on beneficial owner and the senior management team.220

When asked why past risk assessments of Mexico had been so low, Mr. Kazmy told the Subcommittee that he was unable to explain the low ratings prior to 2009.221 He indicated that he first saw the 2006 FinCEN advisory on Mexico in 2009.222 He also indicated that, if he had known what he later learned, he would have increased the risk rating earlier.223

C. HBMX’s History of Weak AML Safeguards

In addition to the substantial money laundering and drug trafficking risks plaguing Mexico for a decade, HBMX itself had a history of weak AML controls and a poor compliance culture, which the HSBC Group worked for years to improve, with limited success. While HSBC Group officials in London were well aware of HBMX’s AML deficiencies and were immersed in an effort to strengthen them, it did not inform its worldwide affiliates, including HBUS, of the problems. From 2002 until recently, HBUS remained largely ignorant of the extent of HBMX’s AML and compliance deficiencies, despite providing HBMX with extensive correspondent services and giving it free access to the U.S. financial system.

220 Id. at 18, 20. See also 4/9/2010 memorandum from OCC legal counsel to OCC Washington Supervision Review Committee, “Order of Investigation – HSBC Bank USA, N.A., New York, NY,” OCC-PSI-00899462-485, at 3-4. The problems with HBUS’ country risk assessments extended beyond Mexico to other countries as well. Some of the countries that should have been rated as having a high risk of money laundering, but were instead rated standard or medium, included Antigua, the Bahamas, Cayman Islands, and Switzerland. See Feb. 2009 “Rating 2009,” prepared by HBUS, HSBC-PSI-PROD-0096390-397. As a consequence, clients from those jurisdictions were treated as low risk, and wire transfers involving those countries were not routinely monitored by HBUS.


222 Id.

223 Id.
Non-Existent Compliance Function in 2002. In 2002, as part of its decisionmaking process to purchase Bital, HSBC Group reviewed Bital’s compliance function, found it wholly inadequate, and determined that a major effort would be needed for the new bank to meet Group standards. In an email to his colleagues, David Bagley, head of HSBC Group Compliance, put it this way:

“Sandy [Flockhart, HSBC Mexico head] acknowledges the importance of a robust compliance and money laundering function, which at present is virtually non-existent. ... There is no recognizable compliance or money laundering function in Bital at present .... Sandy thinks it is important to look both at issues affecting Mexico City, but also closer to the border where there appears to be substantial cross-border flows of monies, including USD [U.S. dollars] in cash.”224

His comments followed a July 2002 audit performed by HSBC Group auditor prior to purchasing the Mexican bank providing a negative assessment of the bank’s compliance program. The HSBC internal audit report detailed a wide range of specific problems as well as broader AML deficiencies:

- A review ... of documentation of accounts booked at the target’s Cayman Islands branch ... found that 41% of the accounts reviewed (92 of 224 reviewed) lacked full client information. 37 files had no client information ....
- The [monitoring] system does not have any capacity to aggregate transaction activity for any period other than a given day ... [and] does not identify high risk clients as such.
- Private banking operations per se, are not identified. ...
- GFB [Grupo Financiero Bital] was involved in Operation Casa Blanca, a US government undercover sting operation undertaken to combat drug trafficking and money laundering activities in the US and Mexico. A former GFB account executive was found willing to establish fictitious accounts and moved illegal money through them. ... GFB forfeited $3.1 [million] to the US government in 1998. ...

224 7/10/2002 email from HSBC David Bagley to HSBC John Root, with copies to Sandy Flockhart and Richard Bennett, “Bital,” HSBC OCC 887797-798.
Conclusions

The GFB Compliance effort is weak, and it appears that the target organization does not have a strong Compliance culture.

- GFB does not, in reality, have a Compliance Department and one would have to be established and implemented ....
- Reviews of account opening procedures and client documentation are sporadic, and the reviews normally do not encompass large populations of client files or activities. This effort needs to be strengthened.
- Client transaction and activity monitoring is very limited. The reliance on account managers to identify and report unusual and suspicious transactions of their clients is a serious internal control shortcoming. ... High risk clients receive no special monitoring coverage. ...
- Internal and external audit recommendations, and issues raised in regulatory reports do not receive proper respect and action. ...
- Measures to promote and ensure staff discipline are not satisfactory. GFB’s Code of Conduct lacks content, detail and spirit. ... Appropriate staff related policies would have to be implemented immediately as part of the overall effort to install a dedicated Compliance and internal control culture throughout the organization.

Despite Bital’s weak compliance function, HSBC Group completed the purchase on November 22, 2002.

Five Years of Effort. Over the next five years, from 2002 to 2007, HSBC Group initiated a number of efforts to strengthen Bital’s compliance and AML programs. While improvements were made, significant deficiencies persisted.

In November 2002, immediately before purchasing Bital, John Root, a senior HSBC Group Compliance expert whom David Bagley asked to help work on AML issues at HBMX, visited the bank for a week and prepared a report cataloguing compliance issues and needed initiatives. Among other problems, his report noted the “lack of a...
'control culture' at Bital. The report also described a meeting with one of Bital’s chief Mexican regulators who “was extremely critical” of the bank, repeating a number of times that controls “do not exist.” The report noted that “some of his harshest criticism” were directed at the Bital Legal Department “which he averred was ‘not guilty of bad faith but extreme mediocrity.’” According to the report, the Mexican regulator recommended “sweeping changes in management.”

The report noted that Bital had 83 correspondent relationships with other financial institutions, including 20 well known and reputable banks and some institutions that required additional KYC information. Mr. Root recommended obtaining that added KYC information or closing some of those accounts by March 2003. The report also noted that Bital had accounts lodged at its own Cayman branch office, which operated as an offshore shell entity and was managed by Bital employees in Mexico City. The report recommended undertaking an analysis of all of the correspondent banking deposits, “particularly those in the Cayman Islands,” by June 2003. It also recommended an analysis of “all existing Private Banking, with particular attention to USD [U.S. dollar] accounts and fund transfers to New York and the Cayman Islands.” In addition, it recommended developing a better electronic screening system for all account activity to identify suspicious transactions and a better process for investigating suspicious activity “without any tipping off.”

In 2002 and 2003, HSBC Group appointed a new Compliance head for HBMX, Ramon Garcia Gibson, formerly AML Director at Citibank’s Mexican affiliate, Banamax; established an HBMX Compliance Department; hired additional staff; and installed a new monitoring system known as Customer Account Monitoring Program (CAMP) to detect suspicious activity. HBMX also hired a Money Laundering Deterrence (MLD) Director Carlos Rochin. Nevertheless, in 2003, two inspection reports from Mexican authorities in January and August identified ongoing problems with the detection of suspicious transactions and the adequacy of the bank’s Money Laundering...
Deterrence (MLD) handbook, which HSBC was then in the process of revamping.\footnote{235 See 1/22 and 26/2004 email exchanges among HBMX Ramon Garcia and HSBC John Root, Susan Wright, and David Bagley, “MLD Regulatory Report,” HSBC OCC 887393-394.}

In January 2004, HSBC Group’s Board of Directors met in Mexico to allow Board members to familiarize themselves with HBMX.\footnote{236 1/30/2004 minutes of HSBC Holdings plc Board of Directors, section 04/7, HSBC-PSI-PRGD-0198571-5n.} During the meeting, the Board’s Audit Committee reviewed HBMX’s ongoing internal control issues. The Audit Committee’s minutes stated that, “after being part of the Group for some 15 months,” HBMX had made “very significant progress in raising the standards of its controls. It will, however, probably take another two years to fully reach Group standards. From experience with other acquisitions this is not unexpected.”\footnote{237 Id. at 572.}

Five months later, in May 2004, HBMX’s internal auditors filed a report containing a number of criticisms of the bank’s compliance and AML efforts, indicating that much still needed to be done to cure its AML deficiencies.\footnote{238 May 2004 “Informe General de Auditoria HBMX GAQ 040026 Compliance-Money Laundering,” prepared by HSBC Group’s internal audit (Auditoría Interna Del Grupo), HSBC OCC 8874776-381.} Finding HBMX’s AML function to be operating “Below Standard,” the internal audit report stated:

“HBMX has insufficient controls to detect money laundering transactions in all areas of the Group in a timely manner. The implementation of the CAMP system is in process yet it only includes the Bank’s transactions that have been registered in the Hogan system and fails to monitor those registered in other IT systems/HBMX subsidiaries.

Dirección de Prevencion de Lavado de Dinero [Direction of Money Laundering Deterrence] has identified high-risk areas of money laundering transactions, which are not being monitored.

The communication between LCOs [Local Compliance Officers] and Compliance does not enable the timely detection of the needs and weaknesses of the areas and subsidiaries.

There are inadequate internal controls over the IT systems used to send information to the regulator on suspicious or relevant transactions to authorities.
In our opinion, based upon the foregoing, the Direction of Money Laundering Deterrence is operating with a **BELOW STANDARD** level of Control Risk.\(^{239}\)

Three months later, in August 2004, John Root, a senior HSBC Group Compliance officer, again visited HBMX to examine the status of its compliance and AML efforts, prepared a report, and sent it to senior officials at both HBMX and HSBC Compliance.\(^{240}\) The report indicated that, while substantial progress had been made over the past 18 months, AML deficiencies remained:

"Senior management has made significant progress in introducing Group Compliance Policy and Standards in HBMX. The head of the Compliance department, Ramon Garcia Gibson, has set the foundation for an effective Compliance function.

HBMX controls are much improved from the situation that existed 12-18 months ago[.]. However, Treasury back-office operations are a source of major regulatory concern, as is accurate and timely reporting to regulators. …

[O]ne of the five commissioners of the CNBV … states, ‘In the business area [of HBMX], the resources have arrived. In the area of controls, the resources have not arrived."

The CNBV gave us a ‘fact sheet’ in English with the following ‘main concerns’ …

**Anti-money laundering processes** – Although improvements have been seen, some concerns remain regarding deficiencies in process (no system for unusual operations detection and a poor identification of public figures and high risk customers) and over control of Panama’s branch operations. …

In a wide-ranging discussion, CNBV regulators commented that any outsourcing must be able to be audited from Mexico. They do not want outsourcing to jurisdictions with strong banking secrecy. …

The Trusts department is struggling to improve the poor condition of its files. Notwithstanding a senior manager’s optimism ['Most

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\(^{239}\) Id. at 4 (emphasis in original).

\(^{240}\) "HBMX Jul04 CMP Visit Report," prepared by HSBC John Root, HSBC OCC 8875567-575. See also 8/10/2004 email from HSBC John Root to HSBC David Bagley, Richard Bennett, Matthew King, David Leighton, and Susan Wright, and HBMX Sandy Flockhart and Ramon Garcia, transmitting the report, HSBC OCC 8875565-575.
of them, KYC is okay' and 'Most deficiencies are not related to KYC'), by far the greatest problem is missing KYC documentation.

Of a total of 15,434 trusts, only 6,868 (41%) have completed documentation. 2,955 (20%) of trusts have no documentation at all. ...

Around USD 16 billion arrive from the United States each year, mostly through the branch network. Money laundering risk is mitigated by several factors: (1) remittances are generally small (US$200-300), according to two senior managers; (2) due diligence appears to be adequate on the AML procedures of US third-party money services businesses; and (3) CAMP Retail, a software programme to detect suspicious transactions, is scheduled to be installed in the branch network in NOV04.

**Recommendation:** HBMX CMP [Compliance] should sample periodically remittances from the United States to determine if, in fact, remittances are generally small and in the ordinary course of business.241

In September 2004, the CNBV conducted an inspection of HSBC’s AML efforts and, contrary to the more positive tone described by HBMX internally, found them unsatisfactory. According to an internal HBMX compliance report, a CNBV report summarizing the 2004 inspection criticized HBMX for:

“not considering the risk exposure of the customer to determine the appropriate visitation process, not implementing procedures to update annually the files of high-risk customers and politically exposed persons, not defining internal criteria to determine customers’ risk exposure and a delay in formalizing the Communication and Control Committee ... responsible for sending SARs to the CNBV ... and issuing money laundering deterrence policies.”242

The Communication and Control Committee (CCC Committee, also called the Money Laundering Deterrence or MLD Committee), which was mandated by a 2004 Mexican law, was intended to act as the bank’s primary internal unit to deter money laundering, so the delay in getting the committee underway was seen as a major AML deficiency. CNBV

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242 “Q07 Compliance Report to the CIBM Audit Committee,” prepared by the HBMX Corporate, Investment Banking and Markets (Private) Audit Committee, HSBC OCC 8873286-287 (describing CNBV criticisms).
later fined HBMX more than $75,000 for the AML deficiencies identified in 2004, a fine which HBMX CIBM Compliance proposed contesting.\footnote{Id.}

In early 2005, an internal HBMX whistleblower hotline disclosed that HBMX compliance officials had fabricated records of mandatory monthly meetings by the CCC Committee, and provided the false records to a local CNBV regulator.\footnote{See 1/21/2005 email from HSBC David Bagley to HSBC Stephen Green and Richard Bennett, “Compliance Exception,” HSBC OCC 8873671.} An HBMX investigation determined that the false records consisted of attendance sheets and minutes for CCC meetings that should have taken place from July to December 2004, but did not.\footnote{See 2/16/2005 email from HSBC David Bagley to HSBC Stephen Green and Richard Bennett, “Disclosure Line – HBMX CMP,” HSBC OCC 8873673; Feb. 2005 “HSBC Whistleblower Item 15 – HBMX: Investigation Report – Executive Summary,” prepared by Head of Group Audit Mexico (GAQ)(henceforth “Whistleblower Report”), HSBC OCC 8877877-885; Whistleblower Report at 5-6.} They were fabricated by a junior employee at the direction of the HBMX Money Laundering Deterrence Director, Carlos Rochin, who then tendered his resignation and left the bank.\footnote{Id. at 8.} Ramon Garcia, head of HBMX Compliance and the CCC Committee chair, received a written warning and was barred from receiving what would have been a substantial bonus for his work in 2004. David Bagley, head of HSBC Group Compliance, wrote:

“Overall RG [Ramon Garcia] has performed credibly, has worked very hard, and would otherwise be hard to replace. In the circumstances whilst we will need to keep his position under review at this stage I endorse the decision to retain his services given that his failure is limited to one of failing to supervise a very senior and trusted subordinate.”\footnote{Id. at 7.}

Mr. Bagley’s internal report found that the HBMX AML staff was riven by dissension and resentment and may have “exact[ed] retribution” against the MLD director for the dismissal of a colleague. His report concluded that Mr. Garcia would have to rebuild a “shattered Money Laundering Section.”\footnote{Id. at 8.} It also noted that CNBV “reiterated ... that, by comparison with other Mexican financial institutions, HBMX CMP [Compliance] appeared to be understaffed” and urged the bank to hire additional compliance personnel.\footnote{Id. at 8.}

In May 2005, John Root, a senior HSBC Group Compliance officer, made another visit to HBMX for several days to evaluate its
compliance and AML efforts. As before, he later prepared a report and provided it to colleagues at HSBC Group and HBMX. In a separate email transmitting the report six weeks later, Mr. Root noted that the HBMX MLD director who resigned in January 2005, had not been replaced despite the passage of six months, and a new director needed to be appointed “as soon as possible in order to reorganize promptly a demoralized department and improve AML controls.” The email noted the importance of “an independent, effective professional in the sensitive role of head of AML in Mexico.” He also observed that “[p]rojects are started but seldom completed, perhaps because of the many ministerial tasks that have accrued since the departure” of the MLD director. Mr. Root wrote:

“As you of course know, the work has piled up in the Compliance department, and Ramon needs help with the backlog. It is true that we have increased staff in the department, but they are mostly entry-level analysts in need of direction. It is important we hire an MLCO [Money Laundering Control Officer] as quickly as possible, and perhaps also a sort of ‘operating officer’ for Ramon to enable him to bring the department up to Group Standards.”

Mr. Bagley forwarded the Root email to a colleague and commented that “until we have the right amount and mix of resources I cannot see [how] Ramon can make progress.” Later that year, Leopoldo R. Barroso was appointed MLD director for HBMX.

In November 2005, Richard Bennett, then HSBC Group General Manager of Legal and Compliance and the person to whom David Bagley, head of HSBC Group Compliance, reported, paid a brief visit to HBMX. While there, he met with the bank’s CNBV regulators who raised a variety of compliance issues. According to an email sent by Mr. Bagley, the concerns included the nature of the HBMX accounts in the Cayman Islands; the referral of clients to Mexico by other HSBC affiliates, especially in France; and access to HBMX AML information from other countries, in particular the United Kingdom.

In December 2005, HBMX’s internal audit group produced a 55-page report identifying a host of compliance and AML problems at the bank. It found that HBMX Compliance had improved, but still rated

251 Id.
it “Below Accepted Levels.” Major deficiencies included a failure to make full use of the new CAMP monitoring system, a failure to ensure its monitoring parameters met local requirements, inefficient monitoring processes which made detection and analysis of alerts difficult, failure to apply CAMP to foreign remittances and HBMX subsidiaries, inadequate SCC risk profiles, failure to complete a MLD work plan, and inadequate training.255

The audit report was actually issued to HBMX in the spring of 2006, and its findings were hotly contested by the HBMX MLD Director, Leopoldo Barroso.256 He communicated his views to HSBC Group Compliance and complained that the bank would be required to forward the audit report to the CNBV, which would not only create a “misleading” impression, but also would contradict a recent presentation HBMX had made on how its AML controls had improved.257 John Root, senior HSBC Group Compliance officer, forwarded HBMX AML’s response to the audit findings to Susan Wright, head of AML and David Bagley, head of Compliance for HSBC Group.258 Mr. Root commented:

“[T]he audit points are being strongly rejected by HBMX AML. AML is also alleging errors of procedure …. Many, if not most, of the recommendations were ‘rejected’ or downgraded in importance by AML, which is certainly a heartfelt, but rather unusual formal reaction, to an audit. Most of just accept audit recommendations, whether perceived to be ‘fair’ or not, and proceed to implement them.

I have let the dust settle a bit, as AML management clearly feel aggrieved, but closer monitoring is warranted on the specific audit recommendations. …

[T]he one that most sticks out is apparent lack of monitoring of the (relatively few) AML staff in the field. This raises a ‘red flag’ in a place like Mexico, where the drug cartels are very powerful and ubiquitous. … To aver, as the audit does, that ‘we do not really know what our man in the field is doing’ is a warning sign, if true. AML of course vigorously deny this.”

Mr. Barroso’s email responding to the internal audit noted that HBMX MLD had also recently been audited by CNBV and expected to receive a

255 Id., Executive Summary.
257 Id. 392
258 Id. 383.
satisfactory rating, with only two requirements for improvements and several recommendations.259

HSBX’s internal audit group continued to conduct compliance and AML examinations of HBMX offices and branches. In September 2006, for example, it examined operations at four HBMX district offices, each with more than 15 branches, located in the cities of Puebla, Morelos, and Juárez.260 All four district offices were found to be operating “Below Standard” with respect to their risk controls, which was the same low rating each had received the prior year. For example, all four were found to have KYC and “file integrity” issues that “failed to comply with Group policies.”261 One district office was found to lack knowledge of the procedures to identify Special Category Clients (SCCs).262 All four district offices had five or six repeat recommendations from prior audits that had yet to be resolved. All four summary reports were circulated to HSBC Group Compliance senior officials.263

In October 2006, HBMX’s Compliance head Ramon Garcia informed HSBC Group Compliance that HBMX’s Money Laundering Deterrence (MLD) Committee had adopted a policy that would require HBMX to consider closure of an account after four Suspicious Activity Reports (SARs) had been filed with respect to an account’s activity.264 In response, John Root, senior HSBC Group Compliance officer, responded: “4 SARs seems awfully indulgent, even by local standards. At any rate, it is against Group policy, as Susan [Wright] points out, so you will need to seek an official dispensation.”265 A “dispensation” was needed, because HSBC Group Policy No. GPP25 required accounts to be closed after two SARs were filed. The next day, HBMX informed HSBC Group Compliance that, rather than seek an official exception, it

259 id. 384.
260 See September 2006 “Group Audit Mexico Audit Report Summary Schedule: GHQ Reportable Audits,” for PFS Puebla Z01 C31 District Office (with 17 branches), PFS Puebla Z01 C23 District Office (17 branches), PFS Morelos Z01 A20 District Office (19 branches and 1 Module), and PFS Ciudad Juarez Z03 B02 District Office (21 branches and 1 custom module), HSBC OCC 8876717-720.
261 Id.
262 Id. at HSBC OCC 8876718.
265 10/17/2006 email from HSBC John Root to HBMX Ramon Garcia, with copies to HSBC David Bagley and Susan Wright, “2Q06 HBMX Compliance Report,” HSBC OCC 8876713.
had decided to adopt the Group policy and would consider account closure after two SARS were filed, rather than four.\(^{266}\)

**Unimed and Ye Gon Scandal.** In 2007, HBMX learned that one of its longstanding clients was accused of involvement with illegal drug trafficking. On March 15, 2007, in a joint effort with the U.S. Drug Enforcement Administration (DEA), the Mexican Government seized over $205 million in U.S. dollars, $17 million in Mexican pesos, firearms, and international wire transfer records from the residence of a wealthy Chinese-Mexican citizen, Zhenly Ye Gon.\(^{267}\) The cash, which had been hidden in a secret locked room in the residence,\(^{268}\) was described as the largest cash seizure in a drug-related case in history.\(^{269}\)

Mr. Ye Gon, a prominent businessman, was the owner of three Mexican corporations involved in the pharmaceutical field, Unimed Pharm Chem Mexico S.A. de C.V.; Constructora e Inmobiliaria Federal S.A. de C.V.; and Unimed Pharmaceutical, S.A. de C.V.\(^{270}\) He was accused of using his corporations to import, manufacture, and sell chemicals to drug cartels for use in manufacturing methamphetamine, an illegal drug sold in the United States.\(^{271}\) He was also accused of displaying “significant unexplained wealth,” despite reporting no gross income for his companies for the years 2005, 2006, and 2007.\(^{272}\) In June

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\(^{266}\) See 10/17-18/2006 email exchanges among: HBMX Ramon Garcia and Leopolda Barroso and HSBC John Root, David Bagley, Susan Wright, and Emma Lawson, “Compliance with GPP 25,” HSBC OCC 8876711-713. GPP 25 stated: “Where the customer is the subject of more than one validated suspicious transaction/activity report, then serious consideration should be given to closure of the relevant account(s) and any other connected accounts.” Despite adopting the Group policy generally to close an account after two SARs, HBMX apparently did a poor job of implementation. In November 2007, Mr. Garcia revealed at an HSBC conference that HBMX had “numerous cases of accounts with multiple SARs (16 in one case!!) in Mexico that remain open.” In response, Ms. Wright asked Warren Learning to “follow up with Ramon” to strengthen compliance with the Group policy on closing accounts with SARs. 11/16/2007 email from HSBC Susan Wright to HSBC Warren Learning, copy to David Bagley, “Mexico,” HSBC OCC 8875423.


\(^{268}\) See Ye Gon Extradition Complaint at 13.

\(^{269}\) See, e.g., “Mexico seizes $205.6m from luxury house,” Associated Press, Joan Grillo (3/22/2007).

\(^{270}\) Ye Gon Extradition Complaint at 6.


\(^{272}\) Ye Gon Extradition Complaint at 12. The extradition complaint stated that in addition to transferring millions of dollars in U.S. currency abroad, Mr. Ye Gon engaged in a “lavish lifestyle, which included purchasing expensive cars and jewelry, and gambling (and losing a net sum of approximately $125 million U.S. dollars) in Las Vegas, Nevada.” Id. at 12-13.
2007, Mr. Ye Gon was indicted in Mexico on drug, firearm, and money laundering charges, but could not be located. In July 2007, he was arrested in the United States, imprisoned, and indicted by U.S. Federal prosecutors for aiding and abetting the manufacture of methamphetamine. Two years later, in 2009, U.S. prosecutors dismissed the charges, after a witness recanted key testimony. Mr. Ye Gon has remained imprisoned, however, subject to proceedings to extradite him to Mexico to stand trial. Since his arrest, he has continually proclaimed his innocence.

Mr. Ye Gon and his corporations were longtime clients of HBMX as well as other banks and casas de cambio in Mexico. One news article reported that the Mexican Ministry of Finance and Public Credit (SHCP) had determined that, from 2003 to 2006, Mr. Ye Gon and his companies moved $90 million through 450 transactions involving four major Mexican banks, HBMX, Banamex, BBV Bancomer, and Banco Mercantil Del Norte, and multiple currency exchanges, including Casa De Cambio Puebla and Consultoria Internacional Casa De Cambio.

The March 2007 seizure of cash and weapons from Mr. Ye Gon’s residence triggered an intense review of his accounts by HBMX and HSBC Group. According to internal HBMX documents, the Unimed accounts were opened by Bital, retained by HBMX, and housed in HMBX’s Personal Financial Services (PFS) division, even though the official clients were corporations and should not have been serviced by the PFS division. The accounts were not designated as high risk, despite unusual transactions that had attracted bank attention several times from 2003 to 2007. John Root told the Subcommittee that
during the 2003-2004 timeframe, the Unimed account had attracted the attention of HBMX regulators, and Susan Wright had instructed HBMX to terminate the relationship altogether.\textsuperscript{282} He said that the HSBC Group did not realize the account was still open, until he and Ms. Wright saw the press articles regarding Unimed in 2007.

When the scandal broke, Paul Thurston, who had been appointed in February as HSBC Mexico CEO after the former head, Alexander Flockhart, was promoted, wrote: “This is a very serious, and high profile, case which has potential reputational damage to the HSBC Group, and must be given the highest priority.”\textsuperscript{283}

Mr. Thurston personally oversaw an extensive review of the accounts and HMBX’s AML controls.\textsuperscript{284} When the head of HSBC Latin American internal audits, Graham Thomson, was asked to summarize the AML deficiencies that contributed to the bank’s maintaining such a high risk account, Mr. Thomson wrote in part:

“The main systemic weaknesses in HBMX, which I believe remain outstanding, are as follows:
KYC as identified in branch and continuous audit reports.
The lack of adequate documentation and filing systems which remain from the former Bital days;…. Lack of a compliance culture ….”\textsuperscript{285}

His criticisms about the lack of a compliance culture and poor KYC documentation echoed the criticisms made five years earlier, when HSBC first purchased Bital.

HBMX’s internal review determined that, in 2005 and several times thereafter, concerns about suspicious activity involving the Unimed account had been brought to the attention of the HBMX Money Laundering Deterrence Communication and Control Committee (CCC Committee).\textsuperscript{286} The CCC Committee apparently initially advocated

\textsuperscript{282} Subcommittee interview of John Root (4/26/2012).
\textsuperscript{283} See, e.g., March and April 2007 email exchanges involving HBMX Paul Thurston and multiple HBMX and HSBC colleagues, “[subject redacted by HSBC],” HSBC OCC 8874315-326 and HSBC OCC 8875010-014.

email from HSBC Matthew King to HSBC Michael Geoghegan, and copy to David Bagley, “Managerial Letter: HBMX-[redacted by HSBC],” HSBC OCC 8874762.
closing the account, but then relented, in part because the Personal Financial Services (PFS) division where the account was located had, as one HBMX email put it, “argued that the client was fine, properly documented, and known by the business.”

The key PFS official who vouched for the client apparently later claimed he’d been “lied to” by other bank personnel. The review also uncovered falsified “KYC visit reports,” documenting site visits to the client which had not actually taken place. In addition, the review criticized poor analysis of the alerts which had spotted the “unusual” account activity. One email noted that other Mexican banks with Unimed accounts “had not reported the customer to the authorities, despite hosting apparently unusual transactions similar in nature to those recorded by HBMX.”

As a result of the Unimed scandal, Mr. Thurston developed seven action items to strengthen HBMX’s AML and KYC efforts. They included reviewing the personnel assigned to the HBMX CCC committee and reminding CCC members of the need to take “an independent view” and to be “prepared to challenge their colleagues”; ensuring CCC minutes clearly identified the decisions taken; revamping KYC “analysis, assessment and reporting procedures” to ensure “higher risk cases are brought to senior management attention”; providing additional training on KYC assessment reports; transferring all corporations out of the Personal Financial Services division; and dismissing all branch staff involved with completing the falsified KYC reports. Mr. Thurston also described the need to bring individual initiatives to improve KYC procedures, account opening and file maintenance into “one coherent programme” with “appropriate emphasis.” In addition, he described holding a special CCC Committee meeting within a week to review cases with similar patterns.
and other high risk cases. He also directed the internal audit group to conduct a review of HBMX’s AML and CCC processes.

The most senior levels of HSBC Group were kept informed about the case. On April 20, 2007, for example, Matthew King, head of HSBC Group Audits, sent an email to HSBC Group CEO Michael Geoghegan with this update:

“I am told the Mexican authorities are taking a relatively benign attitude to our involvement with this customer, which is fortunate because the review has revealed a number of weaknesses. A series of inaccurate, and possibly fabricated, visit reports seem to have been filed by the business which resisted any reporting of suspicions a number of times. For its part, the Moneylaundering Department failed to act as a proper check and balance. I have suggested a thorough review of processes within the Moneylaundering Department and of the Moneylaundering Committee to ensure they are robust. … There are also a number of personnel decisions to be taken."

Neither HBMX nor HSBC Group informed HBUS about the case. The Unimed scandal broke nearly five years after HSBC first began working to strengthen HBMX’s AML controls and create a compliance culture. It showed that, while progress had been made, HBMX still had multiple AML deficiencies and a poor compliance culture.

2007 AML Efforts. For the rest of 2007, HSBC Group Compliance devoted attention and resources to strengthening AML controls at HBMX, with limited success.

One step taken was to task the new HBMX Chief Operating Officer, John Rendall, with overseeing HBMX’s KYC remediation effort for existing client files, an effort mandated by CNBV authorities but far behind schedule. Mexican regulators had given Mexican banks until 2007, to update the KYC information in all customer files;

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295 Id. at HSBC OCC 8875012-13. HBMX did not identify any other corporate clients with a similar profile. Subcommittee interview of Paul Thurston (5/1/2012).
296 This review produced an audit report in December 2007, discussed below. See Dec. 2007 “General & Transactional Banking Audit: HBMX – Money Laundering Deterrence,” prepared by Group Audit Mexico, HSBC OCC 8874802-810.
298 Subcommittee interview of Paul Thurston (5/1/2012).
HBMX had obtained an extension until May 2008, but expected to be hard pressed to meet the new deadline.300

In June 2007, David Bagley, HSBC Group Compliance head, visited HBMX for several days, met with CNBV officials, and circulated a report on the outstanding compliance and AML issues. In an email transmitting his report, Mr. Bagley wrote:

“[T]here do appear to be a number of issues to be resolved, particularly those relating to accurate ongoing account opening, prompt effective and complete remediation in accordance with CNBV requirements for existing accounts, and completion of the recommended enhancements to the working of the MLD committee. … [W]e will need on an ongoing basis to consider the nature and extent of the resources currently available in CMP [Compliance]. … I suspect we are already stretched given the apparent growth that has already, or is intended to take place in this area which appears to be growth of both volume and complexity.”301

His five-page report detailed a number of compliance and AML problems.302 First was HBMX’s anticipated failure to meet a Mexican regulatory deadline for reviewing the KYC information for all existing accounts to ensure compliance with regulatory requirements. The report noted: “There appeared to be differing opinions as to how many accounts were affected, how many accounts were outstanding and therefore no real tracking of the progress being made.” The report recommended reaching a consensus on the method for tracking accounts and completing the task. The report also expressed concern about KYC weaknesses in opening new accounts. It noted: “If we are opening new accounts badly it will only add to the remediation exercise required by CNBV. … Accurate and complete account opening is a key AML control, particularly in emerging markets.” A third key issue was “confusion as to the stated aims and purpose of the MLD Committee.” A fourth was that “the CAMP monitoring system produces significant numbers of ‘false’ alerts. This is a feature of all AML monitoring.

300 See 7/27/2007 minutes of LAM Regional Audit Committee, HSBC OCC 8875086-088, at 3 (“CNBV has granted a 1-year extension to MAY08 for HBMX to regularize customer identification files for account[s] opened or contracts signed before MAY04.”); 12/2007 audit of “HBMX-Money Laundering Deterrence (MLD),” No. HBMX GAQ 970886, prepared by HSBC Group Audit, Executive Summary, HSBC OCC 8876347 (“HBMX has been given an extension by the Regulator from May 07 to May 08 to ensure that a portion of the client files (known as the UBA project – about 1.8m customers) are completed.”).
systems. Having said this, steps are being taken across the Group to seek to minimize this," and recommended that similar steps be taken in Mexico. A fifth concern was that the compliance team was "lightly resourced."

The report also discussed a "cordial" meeting held with CNBV regulators. It said that the regulators were "overall extremely positive about the bank" but also "had a fairly lengthy list of issues," most of which focused on compliance matters other than AML issues. Paul Thurston, head of HSBC Mexico, thanked Mr. Bagley for the "constructive report." He wrote:

"I agree with your comment that we need to review the role and resources in the Compliance function. ... For all Ramon’s strengths, I have equally seen weaknesses in addressing key issues ... and in my view the jury is out on his ability to do all that we need in HBMX, let alone try to oversee other countries in the region. ... [W]e should review between the three of us in a few month’s time, when we see what progress is being made."

The very next month, July 2007, John Root, a senior HSBC Group Compliance officer, sent a blistering email to Ramon Garcia condemning HBMX’s CCC Committee for “rubber-stamping unacceptable risks”:

“A number of items jump out from your most recently weekly report (02JUL-06JUL) but everything pales in comparison with the ML items on page 4. It looks like the business is still retaining unacceptable risks and the AML committee is going along after some initial hemming and hawing. I am quite concerned that the committee is not functioning properly. Alarmed, even. I am close to picking up the phone to your CEO.

[Redacted by HSBC] looks like another [Unimed] type of situation – what on earth is an ‘assumption responsibility letter’ and how would it protect the bank if the client is a money launderer? Please note that you can dress up the USD10 million to be paid ... to the US authorities as an ‘economic penalty’ if you wish but a fine is a fine is a fine, and a hefty one at that. What is this, the School of Low Expectations Banking? (‘We didn’t go to jail! We merely signed a settlement with the Feds for $10 million!’) ..."

303 Id. at 3.
305 Although the client name was redacted from the document by HSBC, John Root confirmed that Mr. Thurston was referring to Unimed. Subcommittee interview of John Root (4/26/2012).
So, [Unimed306] is strike one. [Redacted by HSBC] is strike two. Let’s now look at strike three. (I hope you like baseball.)

The same person who is giving the sanctosanct ‘assumption responsibility letter’ for [Redacted by HSBC] ... is being asked by the CEO to explain why he retained the [Casa De Cambio Puebla307] relationship after USC11 million was seized by the authority in [Puebla308] account with Wachovia in Miami. What?! The business was okay with this?

The AML Committee just can’t keep rubber-stamping unacceptable risks merely because someone on the business side writes a nice letter. It needs to take a firmer stand. It needs some cojones. We have seen this movie before, and it ends badly.309

Mr. Garcia responded that he was escalating the two cases involving high risk clients as part of a revised AML procedure in the CCC Committee.310 He explained that Mexican law essentially required the CCC committee to give great weight to the opinion of the business side of the bank, because “they are the ones that really know the customer.” He said that he had escalated the cases to the HBMX CEO, because MLD had “a different opinion” from the business “about reporting the case to authorities.” Essentially, he said that the final decision belonged to the HBMX CEO, rather than the CCC Committee.

The next week, Paul Thurston, HSBC Mexico CEO, supported the CCC Committee’s recommendation to close one of the accounts, but not the other. He supported closing the account of Casa de Cambio Puebla, which had been a client for more than 20 years, but whose funds at Wachovia Bank had been seized by the U.S. Justice Department and Drug Enforcement Administration (DEA).311 Mr. Thurston cautioned John Rendall, the HBMX Chief Operating Officer, to alert CNBV and to ensure CNBV had “no objection.”312 Mr. Rendall also suggested alerting their U.S. counterparts since HBUS had the same relationship with the client.313 The second account involved a U.S. money services
business, Sigue Corporation, which specialized in remitting funds from the United States to Mexico and Latin America. Mr. Thurston, on the advice of Mr. Rendall and the commercial banking division, kept that account open.\textsuperscript{314}

Later in July, the HSBC Latin American (LAM) Regional Audit Committee held a meeting in Mexico.\textsuperscript{315} Participants included HSBC Group Compliance officials Brian Robertson, David Bagley, and Matthew King; LAM/HBMX officials Paul Thurston, Emilson Alonso, and Graham Thomson; HBMX Compliance head Ramon Garcia; and others from HSBC affiliates throughout Latin America. Mr. Thomson, head of LAM Internal Audit, discussed risk and compliance issues in several countries, and noted that Regional CEOs were now required to “take disciplinary action should a manager record 2 consecutive Below Standard control risk assessments or record significant repeat recommendations.”\textsuperscript{316} With respect to Mexico, Mr. Thomson noted that although 96% of HBMX electronic records reportedly met regulatory requirements, there was a “high level of exceptions and variance between the paper and electronic records” which would require “a large rectification effort” to meet the regulatory deadline of May 2008.\textsuperscript{317} He also noted that branch offices were not sufficiently familiar with SCC requirements, and criticized the CCC Committee for failing to follow up on instructions to close client accounts. Mr. Thurston noted that the CCC Committee was introducing an escalation process to senior management to resolve disputes over closing accounts.\textsuperscript{318} Ramon Garcia also reported that automation problems were causing delays in the issuance of Suspicious Activity Reports (SARs), but that interim manual reviews had not detected activity requiring any SARs to be filed.\textsuperscript{319} He also described a new pilot project at 94 HBMX branches to centralize management and control of account documentation using electronically imaged documents.

CNBV Escalates Concerns. Two months later, in October 2007, the CNBV asked to meet with Paul Thurston, the HSBC Mexico CEO, to express ongoing concerns about HBMX’s compliance and AML.\textsuperscript{314} See 2/4/2008 email from HBMX John Rendall to HBMX Paul Thurston, “[redacted by HSBC]”; HSBC OCC 8875139-141 and HSBC OCC 8875020-021. Six months later, in January 2008, Sigue Corporation entered into a deferred prosecution agreement with the U.S. Justice Department, admitting that some of its agents had been laundering drug proceeds. See United States v. Sigue Corp. and Sigue LLC, Case No. 4:08CR54 (USDC EDMO), Deferred Prosecution Agreement Factual Statement (1/28/2008). HBMX’s relationship with Sigue Corporation is discussed further below.

\textsuperscript{315} See 7/27/2007 Minutes of LAM Regional Audit Committee, HSBC OCC 8875086-990.

\textsuperscript{316} Id. at 2.

\textsuperscript{317} Id.

\textsuperscript{318} Id. Mr. Thurston explained that if compliance and business personnel disagreed over closing an account, the dispute would be escalated to the HBMX COO, and then to the CEO. In addition if a business wanted to close an account, a higher ranking Executive Director would have to make the decision. Subcommittee interview of Paul Thurston (5/1/2012).

\textsuperscript{319} Id. at 3.
efforts. Mr. Thurston summarized the meeting in an email to the HSBC Group CEO Michael Geoghegan. He wrote:

"At their request, I met today with the Head of Banking Supervision, and the Supervisor for HSBC, from our regulator, the CNBV, following their on site examination of various aspects of our business, including cards, money laundering, and treasury operations. …

They walked me through a presentation pack which firstly set out specific points … but then moved on to more general concerns of the CNBV with HSBC in Mexico. These centered on:

– weaknesses in internal controls … slow progress in tackling KYC data problems and anti money laundering procedures.

– corporate culture, where they comment that … HSBC has driven growth in credit products and launched new products without adequate controls. …

They also expressed concerns at senior management having dual responsibilities for Mexico and the region, stating that ‘there are many concerns on how management will be able to implement strong controls within the bank in Mexico, while keeping an eye on other countries.’ …

I indicated to them we were aware of these issues and were progressively tackling them.”

His email then outlined the steps he told CNBV that HBMX was taking, including new hires, “customer file centralizing and imaging which would give us more robust KYC data for anti-money laundering,” and working to change the culture of the bank which “would not happen overnight.” Mr. Thurston wrote that the CNBV officials told him that was “what they wanted to hear and that they would report back positively” to the head of the CNBV. Mr. Geoghegan responded: “This is disturbing and clearly we will need to look at the management structure and practices. … I am copying this to the Group Chairman and Matthew King for their information.”

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321 Id.
322 Id. at HSBC-OC-8873341.
323 Id. at HSBC-OC-8873338.
In December 2007, the internal audit group for Mexico issued a report that had been ordered earlier on HBMX’s AML efforts. It found HBMX’s AML controls to be “Below Standard” and to pose an overall “high” risk. It detailed multiple problems, including “[r]egulatory breaches in KYC issues such as the large number of incomplete client files and the inadequate process of SCC identification and monitoring across the network.” It noted that HBMX had a May 2008 deadline for bringing files into compliance with KYC regulations set by the CNBV, and that regulators had been told 86% of client files already met regulatory requirements, while audit work over the past year suggested a much lower percentage, “as low as 46%.” The audit report also noted that the KYC effort was remediating only 1.8 million files involving high risk, excluding another almost 6 million clients “that the Group has in Mexico which are subject to HSBC’s own MLD policies.”

The 2007 audit report also disclosed SAR filing and alert review backlogs. It noted “4,890 accounts that reported unusual transactions that took place between APR [April] and AUG07,” but which had yet to be reported to Mexican authorities, “thereby breaching the regulations.” It attributed the delay to changed internal criteria for reporting transactions, resulting in an increase in the number of cases to be reported, and “slow decision-making.” The report also noted 7,217 alert warnings of which 858 (12%) had not been reviewed at all, “posing a potential risk that criminal transactions may not be identified which may have an adverse reputational effect on the Institution.” The audit report stated that the failure to review these alerts had been going on for one year due to “insufficient Operations staffing.” The report also criticized “Senior Management” for attending few AML committee meetings, delaying decisions on cancelling accounts, and delaying the imposition of sanctions when cases were not reported to the CNBV on time. The report also noted a lack of “sufficient understanding” of the AML IT systems and inadequate AML training as evidenced by the “failures regularly identified in branch audits.” In light of the “number and in many cases seriousness of the weaknesses identified,” the report recommended creating an HBMX Money Laundering Committee to undertake the effort needed to address the widespread AML shortcomings.

325 Id. at HSBC OCC 8874810.
326 Id.
327 Id.
328 Id. at HSBC OCC 8874807.
329 Id. at HSBC OCC 8874807, 810.
330 Id. at HSBC OCC 8874808.
331 Id. at HSBC OCC 8874807.
332 Id. at HSBC OCC 8874810.
Confronted by this long list of AML deficiencies, HSBC Group sent Warren Learning, HSBC Group Compliance Deputy Head, to Mexico to help determine what should be done.\footnote{See, e.g., 12/6/2007 email from HSBC John Root to HSBC Warren Learning and others. “Warren Learning HBMX DEC Visit Issues,” HSBC OCC 8875837 (“I am keeping a list of issues that you might want to raise during your December visit to HBMX,” including deteriorating audits of treasury operations, resourcing concerns, “Sinaloa massive money-laundering scheme (+USD 100 million),” “HBMX Trusts backlog,” “Bancomer business in regulatory and tax havens,” and “AML systems integration”).}

**CNBV and FIU Dissatisfaction Deepens.** As 2007 drew to a close, HSBC Group and HBMX worked to strengthen HBMX’s AML efforts, but CNBV dissatisfaction with the bank seemed to deepen and the list of AML concerns broaden in 2008, encompassing for the first time concerns about HBMX’s participation in bulk cash services.

In February 2008, Mr. Thurston, HSBC Mexico CEO, met again with CNBV officials, at their request, along with the Mexican Financial Intelligence Unit (FIU).\footnote{See 2/18/2008 email from HSBC Paul Thurston to HSBC Michael Geoghegan, with copies to Richard Bennett and Matthew King, “Confidential – CNBV/FIU Meeting,” HSBC OCC 8873331-333, at 1.} According to an email he sent summarizing the meeting, CNBV handed him a draft report detailing multiple compliance concerns.\footnote{Id. at HSBC OCC 8873333.}

Mr. Thurston wrote:

“It is clear in this that our Head of Compliance is not as highly regarded by the CNBV as had been thought by both local and Group management, and indeed appears to have misled us about the extent to which the CNBV have been informed of, and/or are satisfied with, our actions.”\footnote{2/18/2008 draft report entitled, “Internal Control, HBC Mexico, S.A.,” prepared by CNBV, HSBC OCC 8966021-026, at 1. [Sealed Exhibit.]}  

HSBC Group CEO Geoghegan responded: “This is most disturbing and we will need to have the most thorough of investigations.”\footnote{2/18/2008 email from HSBC Michael Geoghegan to HBMX Paul Thurston and others, including HSBC Group Chairman Stephen Green, “Confidential – CNBV/FIU Meeting,” HSBC OCC 8873331.}

The report provided by the CNBV stated that “[a]s a result of the increase in bank’s operations, there has been an increase in deficiencies in internal control.”\footnote{2/18/2008 draft report entitled, “Internal Control, HBC Mexico, S.A.,” prepared by CNBV, HSBC OCC 8966021-026, at 6. [Sealed Exhibit.] It noted that, of 110 client files reviewed, “55 files (50%) were incomplete,” and 5 files were not provided at all. It noted a “[lack of closer supervision to high profile risk clients”; a lack of risk criteria to...}
classify clients during the account opening process; and missing client 
updates for high risk customers and politically exposed persons. Another deficiency was that the CAMP and HOGAN monitoring 
systems did not collect transaction profiles for new accounts, as required 
by law, and the CCC Committee delayed closing suspicious accounts, 
citing the example of a $2.8 million account kept open for an entire year 
after it was supposed to be closed.

The report also described a number of AML deficiencies identified 
by the FIU, stating: "Evidence obtained by the Financial Intelligence 
Unit of Mexico (UIF) on a frequent basis has seriously raised its concern 
on the very high level of ML risk that HSBC may be incurring." It 
provided a chart showing that HSBC had much more bulk cash 
transactions using U.S. dollars than other Mexican banks, and expressed 
U.S. and Mexican law enforcement concern that the cash represented 
illegal drug sale proceeds from the United States. The FIU also noted 
that HBMX frequently failed to provide requested information, claiming 
the files or basic account documents could not be located, providing a 
chart showing HBMX's response record was worse than other Mexican banks. The FIU also noted that "in the majority of the most relevant 
ML cases" it had investigated in 2007, "many transactions were carried 
out through HSBC," and in some cases, the FIU detected ML 
transactions that HSBC had not reported. The FIU also noted that it 
had been able to obtain copies of account documents that HBMX had 
claimed it could not locate. "These last cases may imply criminal 
responsibility of HSBC and its personnel – such as that relating to false 
statements to administrative authorities and complicity – that the law 
enforcement and judicial authorities must investigate."

Internal HBMX and HSBC Group documents indicate that senior 
management immediately began to investigate the allegations. HSBC 
Group CEO Michael Geoghegan spoke to HSBC Group Chairman 
Stephen Green, as well as senior HSBC Group and HBMX personnel, 
and asked David Bagley to lead the review of HBMX Compliance. Mr. Bagley left for Mexico immediately for a two-week stay. Mr. 
Thurston directed the head of Latin American Security to investigate 
certain allegations, and the head of Latin American internal audit to

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340 Id. at 3.
341 Id. at 5.
342 Id. at 5-6.
343 Id. at 6. Recent examples of such cases included Zhenly Ye Gon, Casa de Cambio Puebla, 
and Sigue Corporation.
344 Id.
345 2/19/2008 email from HSBC Michael Geoghegan to Paul Thurston, Richard Bennett, 
Matthew King, with copies to Stephen Green and David Bagley, "HBMX – ML Review," 
HSBC-PSI-PROD-0198506-507.
examine the other CNBV and FIU complaints. Mr. Thurston promised an updated report to Mr. Geoghegan prior to an upcoming HSBC Group Board meeting.

Three days later, on February 22, 2008, Matthew King composed a draft email as a way to organize the information that should be conveyed to Mr. Geoghegan in a telephone call, and circulated his self-described “brain dump” to Messrs. Thurston, Bagley, Bennett, and Graham Thomson for their thoughts. The email indicated that the AML concerns raised by the CNBV were “pretty similar” to issues raised earlier, but the CNBV had “suddenly become more aggressive.” The email speculated on whether that was due to political pressure, FIU concerns, or possibly a separate disagreement with the FIU regarding reimbursing a public utility for a fraud. Mr. King also wrote: “It is also the case that Mexico is suffering a major problem with drugs dealers and the Government is being very robust about dealing with them.”

The King email then went through the issues. It noted that the December 2007 internal AML audit of HBMX was “Below Standard,” and that the AML Director Leopolodo Barroso would be replaced, “albeit the FIU apparently regard him as trustworthy” so his replacement would have to be “carefully explained.” The email said that the “biggest immediate concern” was account KYC, which had been “a systematic problem for some time.” Among other matters, the email noted that a pilot project to centralize account documentation through electronic imaging was underway, but “Audit is continuing to identify a high level of exceptions for that process also (around 30%).” Mr. King wrote:

“Given the concerns now raised by the CNBV and FIU (which apparently includes tapes of a drug lord recommending HBMX as the place to bank) we now have to decide: whether the imaging process can be made to work to everyone’s satisfaction[;] how quickly it can be rolled out[;] across the whole network[; and] in the meantime, whether we can continue to open accounts using the old, flawed process.”

The email also described account documentation as “a problem since we bought Bital,” and noted that CNBV had again questioned having

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349 2/22/2008 email from HSBC Matthew King to HBMX Paul Thurston, HBMX Graham Thomson, with copies to HSBC Richard Bennett and HSBC David Bagley, “CNBV,” HSBC-PSI-PROC-0198598-509.
350 Id. at 1.
351 Id.
352 Id, at 1-2. Both David Bagley and Paul Thurston told the Subcommittee that they asked the CNBV for a copy of the purported tapes, but none was provided. Subcommittee interviews of David Bagley (5/10/2012) and Paul Thurston (5/1/2012).
HBMX personnel handle compliance issues for the Latin American region in addition to Mexico.353 On “cross-border cash,” the email indicated that trends still needed to be clarified, but he thought the United States had “a general concern rather than a specific one about us.”

The next day, February 23, 2008, Paul Thurston sent an email to Michael Geoghegan with additional information. He wrote:

“Firstly, to answer your question of why is this being raised now? The intelligence that we have been able to gather is that with President Felipe Calderon declaring war on the drugs gangs, crime and corruption the judicial authorities have heightened the focus on financial investigations and have been putting increasing pressure on the bank regulators because the banks have been seen as not providing good enough support. … HSBC has historically, and continues to have, a worse record than the other banks, so we have become a focus of attention. The new Head of the FIU has told us that his staff have told him that HSBC has been the most difficult bank to obtain accurate and timely data from for the past 4 years.”354

Mr. Thurston wrote that HBMX had taken more corrective action than the regulators were aware of. He acknowledged an account documentation problem which would be addressed, in part, by a new centralized electronic imaging procedure which was taking effect Mexico-wide that month. In addition, he wrote that “stronger disciplinary procedures” were being put in place for branch managers who signed off on account openings without personally ensuring all documents were obtained.356 He also noted that HBMX received more than 1,000 letters per week from the CNBV asking for account information, and that more resources had to be dedicated to responding to them.

Finally, on the bulk cash issue, Mr. Thurston wrote that the United States had a general concern, “not aimed specifically at HSBC,” about the flow of U.S. banknotes from Mexico and the potential linkage to drug related activity.357 He wrote that HBMX had undertaken its own analysis of the cash flows, and initial indications were that its handling

353 Id. at 2.
355 Id. at 1.
356 Id. at 1-2.
357 Id. at 2.
of U.S. dollars “had been slowly declining in recent years, rather than rising.”358

On February 27, 2008, Mr. Bagley conducted an exit interview with the HBMX AML Director Leopoldo R. Barroso, who was being replaced. Mr. Barroso provided a negative view of HBMX AML performance. According to a meeting summary written by Mr. Bagley, Mr. Barroso said that, while in his position, he had felt civil and criminal “litigation exposure” due to “the continued poor controls in the bank, the fact that there were allegations of 60% to 70% of laundered proceeds in Mexico went through HBMX and because he did not think that senior management had any commitment to robust AML controls.”359 Mr. Barroso indicated that “it was only a matter of time before the bank faced criminal sanctions and cited a number of cases.” Mr. Bagley wrote:

“It was clear that LRB [Leopoldo R. Barroso] felt very strongly that relevant business heads within HBMX had absolutely no respect for AML controls and the risks to which the Group was exposed and had no intention of applying sensible or appropriate approaches. Again he cited a number of examples where despite strong recommendations with the CMP [Compliance] business heads had failed or refused to close accounts or indeed on occasions file SARs. He thought that there was a culture that pursuing profit and targets at all costs and in fact had seen no recent improvement in the standard of controls or the types of decisions being taken.

He was critical of the level of resources in his team and felt that his team had done much to keep the bank out of trouble by working extra hours against impossible deadlines and handling significant volumes of alerts including those from CAMP. …

He was extremely critical of RG [Ramon Garcia] who he described as being indecisive, weak and desperate to retain his job and lacking any understanding of AML matters.”360

Mr. Bagley later forwarded his summary of the meeting to Mr. Thurston who responded that “the jury is still out on Ramon” and a

359 2/27/2008 “Meeting Attendance Note,” prepared by David Bagley, HSBC OCC 8874824-825.
360 Id.
discussion was needed on structuring the Latin American regional and Mexican compliance responsibilities.\(^{361}\)

On March 3, 2008, HBMX issued a 12-page response to the internal control issues raised by the CNBV in its draft report of February 27.\(^{362}\) The response detailed multiple “corrective actions” being taken by the bank to address each concern. Among the actions discussed were the new centralized process for ensuring account opening documentation was obtained and electronically recorded; a new effort to centralize PEP files, obtain missing documentation, and strengthen annual PEP reviews; new disciplinary procedures for opening accounts with incomplete documentation; the re-engineering and strengthening of the alert reporting process; replacement of the AML director; and strengthening of the AML staff. The response also indicated that management changes had been made to split responsibilities for Mexico from the rest of the Latin American region. On the issue of U.S. banknotes, the response indicated that HBMX U.S. dollar volumes had not increased, but were marginally lower than in 2003. It also announced a new policy, effective immediately, to deem all customers who deposit more than $100,000 in a month as SCC clients subject to enhanced due diligence. The response said that 312 customers met that criteria and were being subjected to a KYC review.

Mr. Thurston and Mr. Bagley met with CNBV and FIU officials on March 4, 2008, to deliver the response and discuss the bank’s actions. They reported to Mr. Geoghegan that the meeting was “extremely cordial” and the bank’s corrective efforts were “well received.”\(^{363}\) After Mr. Bagley returned to London, he also discussed the matter with the Financial Services Authority (FSA), HSBC’s UK regulator, which had communicated with CNBV. Mr. Bagley reported that “CNBV confirmed that they were satisfied with the reaction and steps we have taken although will watch implementation closely.”\(^{364}\) In April 2008, at a meeting of the HSBC Group Board of Directors, Mr. Bagley briefed the HSBC Group Audit Committee about HBMX, indicating that regulators had “expressed their satisfaction with the Group’s reaction.”\(^{365}\)

**Restoration Project.** HBMX spent the next six months working to carry out the corrective actions outlined in its March response to

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365 4/25/2008 Board of Directors minutes for HSBC Holdings plc, HSBC-PSI-PROD-0198539-540.
CNBV. HBMX also underwent personnel changes. In May 2008, Paul Thurston was promoted and returned to London, having spent a little more than one year in Mexico. Luis Pena Kegel took over as HSBC Mexico CEO and head of HBMX. Emilson Alonso was appointed head of HSBC Latin America, carrying out the commitment made to CNBV to split the two sets of responsibilities. In the summer of 2008, a new HBMX AML director was also hired, Jaime Saenz.\(^{366}\)

One key AML activity undertaken by the bank was to work on bringing the KYC documentation for existing accounts into compliance with CNBV requirements, an effort HBMX deemed “Projecto Restauracion” or the Restoration Project. HBMX was supposed to have completed the KYC effort by May 2008, after having obtained a one-year extension, but was far behind schedule. HBMX appointed John Rendall, HBMX COO, to oversee the new project. One step he took was to limit the project to high risk accounts.\(^{367}\) He also assembled a team and began pressing branch personnel to complete their KYC updates. John Root, a senior HSBC Group Compliance officer, attended a meeting of the Restoration Project team during a visit to Mexico in July, and was “very impressed” by the progress to date.\(^{368}\)

Also in July 2008, Mr. Rendall provided a progress report to the Latin American regional audit committee on a number of AML and compliance efforts, outlining “9 workstreams.” He described several milestones, including implementing the centralized account opening process for all HBMX branches, initiating the KYC Restoration Project “focused on high risk accounts,” achieving a “90% reduction (from 34,700 to 3,300)” in the 2008 CAMP alert backlog, requiring enhanced KYC for customers with over $100,000 in U.S. dollar deposits, and improving FIU response procedures.\(^{369}\)

On a more negative note in July, HBMX’s internal monitoring system generated a number of alerts identifying “significant USD [U.S. dollar] remittances being made by a number of customers to a US company alleged to have been involved in the supply of aircraft to drugs cartels.”\(^{370}\) The alerts highlighted account activity in the HBMX Cayman branch.\(^{371}\) As a “precaution” pending review of the account activity, HBMX stopped opening new Cayman accounts.\(^{372}\) The account

\(^{366}\) See 7/30/2008 email from HSBC John Root to HSBC David Bagley and others, “HBMX Visit Update,” HSBC OCC 8873487-489.


\(^{368}\) Id.

\(^{369}\) See 6/7/2010 email from HBUS Paul Lawrence to HSBC Michael Geoghegan, “Mexico Banknotes/High-level Timeline,” HSBC-PSI-PROD-0198514-516.

\(^{370}\) 7/31/2008 email from HSBC David Bagley to HSBC Richard Bennett with copies to HSBC Michael Geoghegan and others, “HBMX – Cayman Accounts,” HSBC OCC 8874832-833.

\(^{371}\) Id.

\(^{372}\) Id.
activity also prompted HSBC Group to take a closer look at the Cayman accounts.\textsuperscript{373} HSBC Group Compliance head David Bagley wrote that the Cayman accounts should be included in the Restoration Project "as a priority area," and should "be seen as high-risk from an AML and reputational perspective."\textsuperscript{374}

In September 2008, HBMX’s internal audit group reviewed the Restoration Project and quickly identified multiple, growing problems. In an email describing the audit findings, Graham Thomson, head of the Latin American internal audit group, wrote:

"The key issues … include slow progress with remediating PEPs/SCCs and other high risk customers, with some 40% of the KYC records of PEPs/SCC customer segment … not yet remediated. These accounts are now in the process of closure by HBMX Legal. … [C]hecks done by CMP [Compliance] on visit reports … continue to reveal an unacceptable level of 'manufactured' visit reports."\textsuperscript{375}

Mr. Alonso, head of HSBC Latin America responded that the audit results were “disappointing” and “not what I was assured by HMBX management."\textsuperscript{376}

The audit report found that the Restoration Project had “major weaknesses … that could potentially hinder regulatory compliance and the achievement of the project’s overall goals."\textsuperscript{377} It said that resources dedicated to the project "appeared insufficient to deliver the quality and timeliness required," and clients engaged in high risk businesses "had not been identified for inclusion" in the project.\textsuperscript{378} It noted that visit reports were incomplete and, in some cases, “created without visits being made."\textsuperscript{379} The audit report also stated:

"The impact of account cancellation on the business, customers and costs should be analysed against the risks that have been mitigated and accepted, as this will allow having adequate balance between control and business, particularly where cancellations may be attributable to internal errors rather than to the customers."\textsuperscript{380}
This recommendation appears to suggest that some high risk accounts not be closed, even where the bank was unable to review the account by the regulatory deadline and KYC deficiencies might exist. Mr. Thomson’s email indicated, however, that unremediated files for PEP and SCC clients subject to the Restoration Project were already in the process of being closed. In addition, Mr. Rendall reported to the Latin American regional audit committee that “7,941 KYC files for high risk customers had been reviewed & updated, or scheduled for closure.” Mr. Rendall also reported that in the second phase of the project, “47,000 accounts with various risk flags” were being reviewed, with plans for a third phase to examine “83,000 accounts with historic CAMP alert profiles.” These figures were well below, however, the 1.8 million in high risk accounts that were supposed to be reviewed to ensure KYC documentation met CNBV requirements.

November Meeting with CNBV. On November 26, 2008, a high level meeting took place between HSBC and CNBV. Michael Geoghegan, HSBC Group CEO, traveled to Mexico to attend. Along with Emilson Alonso, head of HSBC Latin America, and Luis Pena, head of HSBC Mexico, Mr. Geoghegan met with the President of CNBV, Guillermo Babtz; the head of CNBV bank supervision, Patricio Bustamante; and the head of CNBV AML oversight, Pablo Gomez. The focus of the meeting was expected to be the actions taken by HBMX to address the CNBV concerns identified in February 2008.

According to an email prepared by the Deputy Head of HSBC Group Compliance, Warren Learning, who had accompanied Mr. Geoghegan to Mexico and remained there for several days, the CNBV officials acknowledged the “significant progress” made by the bank, but remained “very concerned” about the U.S. dollar accounts at HBMX’s Cayman branch, the slow KYC review of those accounts, and the “sheer volume of US Dollars that HBMX repatriates” to the United States. The email noted that, between January and September 2008, HBMX had repatriated $3 billion to the United States, which represented 36% of the market and double what the biggest bank in Mexico, Banamax, had repatriated, even though HBMX was only the fifth largest bank in the country. According to the email, CNBV officials were also

384 See 12/8/2008 email from HSBC Warren Learning to HBMX Ramon Garcia and John Rendall, “Mexico Visit,” HSBC-PSI-PROD-0197874 (indicating Mr. Learning visited HBMX from Nov. 25 to Nov. 28).
386 Id.
“concerned that whenever there is a serious MLD [Money Laundering Deterrence] scheme HSBC seems to be involved” and that “USA authorities are concerned at the very high levels.” Mr. Geoghegan told the Subcommittee that his meeting with the Mexican regulators did not go as he had expected, he told the CNBV that HBMX would address the issues raised, and he immediately took action to ensure that happened.388

Stopping U.S. Dollar Services. After the meeting, Mr. Alonso sent an email to Mr. Pena asking him to examine the “export of cash USD to the USA,” including the volumes of U.S. dollars being exported, the types of clientele using the HBMX branch network to make U.S. dollar deposits for remittance to the United States, and the branches involved in more frequent deposits or higher volumes. He also called for the “[i]mmediate elimination of this kind of service in our branches. Corporate clients that require such service should be approved by you on a very exceptional basis.”

Later that same night, Mr. Geoghegan sent an email to Mr. Alonso stating: “It occurs to me: We should stop any Dollar remittances or accept any Dollar payments unless they are done via a customer’s account. We should stop shipping Dollars.” He also wrote: “We should benchmark HBMX CAMP and other search engine systems with HBUS (they have some very sensitive behavior monitors) and see whether we are finding as many suspicious transactions as we should be.” Mr. Alonso forwarded the email to Mr. Pena, who responded the next day:

“The two immediate actions we are taking are:

Starting December 1. We will no longer buy or sell dollars in cash at ANY branch (customers or non customers). We will, as an alternative, offer travelers cheques to customers only. Also customers can withdraw dollars at HSBC ATMs located at airports or from any ATM in the world with their debit card.

Starting January 1. We will no longer accept deposits of cash dollars to any dollar account at any branch.

387Id.
388Subcommittee interview of Michael Geoghegan (5/24/2012).
390Id.
We are quantifying the impact of lost revenues. On the flipside, we will save the operating cost of transporting and exporting dollar bills.

This should take care of the problem.\textsuperscript{392}

Mr. Pena also proposed continuing indefinitely the freeze on opening new U.S. dollar accounts through HBMX’s Cayman branch, and prohibiting the acceptance of new cash deposits for the existing Cayman accounts.\textsuperscript{393} HSBC Group Compliance Deputy Head Warren Learning noted in an email to his supervisor, David Bagley, that when Mr. Pena commented that the actions being taken “could result in lost profits of many billions Mike’s clear response [was] that nothing is worth risk to our reputation.”\textsuperscript{394} Mr. Learning also wrote that the proposed actions were “considered extremely sensitive here in Mexico and local management want to get their ducks in a row ... so it will be much appreciated if the above could not be ... disseminated without discussing further.”

**Account Closing Backlog.** Mr. Learning also noted that “there appears to be a huge back-log in closing accounts,” with customers continuing to use accounts in November that had been ordered closed eight months earlier in March. He wrote that those accounts, which were still being used by customers, may be “part of the reasons for multiple SARs” being filed for some accounts, potentially putting HBMX in breach of HSBC policy on account closure after multiple SARs.\textsuperscript{395}

Mr. Bagley responded: “What I find most frustrating is the way in which new issues constantly emerge however much time is spent with HBMX.”\textsuperscript{396} He continued: “The practice of changing USD in the branches presumably with little or no ID for non customers is in breach of Group policy. When looking at our USD exposure how can this have been missed.” He also asked Mr. Learning to consider challenging the involvement of the Legal Department in the account closing process so that it could proceed more quickly.

The next day, November 28, 2008, Mr. Geoghegan sent an email to top HBMX and HSBC Group Compliance officials stating that it should be made clear to all HBMX personnel “that if there are persistent

\textsuperscript{393} 11/27/2008 email from HSBC Warren Learning to HSBC David Bagley and Richard Bennett, “Mexico,” HSBC OCC 8875605-607.
\textsuperscript{394} Id.
\textsuperscript{395} Id.
\textsuperscript{396} Id. from HSBC David Bagley to HSBC Warren Learning and Richard Bennett, “Mexico,” HSBC OCC 8875605.
breaches of KYC in a particular branch, the branch will be closed and all staff dismissed regardless of how much business we will lose on account of it.\textsuperscript{397} He also required HBMX’s compensation scorecard to include implementing the CAMP monitoring system to the maximum extent possible and closing accounts with two or more SARs. He wrote: “[I]f you demonstrate zero tolerance of lapses in implementing KYC then the operations standards of the whole business improves at the same time. What we are doing in Mexico needs to be copied everywhere else in the region.”\textsuperscript{398}

**AML Shock Plan.** Mr. Pena responded that in January 2009, he was planning to close two branches and fire all staff “as exemplary measures” and was working to identify the branches.\textsuperscript{399} This measure was later referred to as the “AML Shock Plan.”\textsuperscript{400} Mr. Pena also wrote:

“Last but not least, I will address the issue of funding. After all, Cayman and Mexican dollar accounts provide us with US$2.6 billion of cheap funding. We are likely to lose a big portion of this if we tell customers we no longer receive dollar notes. We have to provide an alternative to our customers for this: Miami accounts may be an alternative but we will have to talk to HBUS of how we get this cheap funding back to Mexico to lend.”\textsuperscript{401}

In December 2008, at the conclusion of his latest visit to Mexico, Mr. Learning drafted a letter to Mr. Pena summarizing a number of AML issues and sought input from other HBMX officials before finalizing it.\textsuperscript{402} His draft letter discussed the late filing of SARs, the backlog in closing accounts, the failure to close accounts after two SAR filings, slow and weak decisions by the CCC Committee, the need to clarify transaction limits, and the need for further refinement of the CAMP alert system. He noted that the account closing backlog consisted of over 3,600 accounts, of which 675 involved suspicion of money laundering and had been ordered closed by the CNBV, yet were still open. He also noted that 16 of the accounts remaining open had been ordered closed in 2005, 130 in 2006, 172 in 2007, and 309 in 2008. He wrote that he’d been advised that the law did not permit the accounts to be blocked pending closure, which meant account activity was

\textsuperscript{397} 11/28/2008 email from HSBC Michael Geoghegan to HBMX Emilson Alonso with copies to HSBC David Bagley, HBMX Luis Pena, and others, “Final draft for Mike’s Letter,” HSBC OCC 8874857.

\textsuperscript{398} Id.

\textsuperscript{399} 11/28/2008 email from HBMX Luis Pena to HBMX Emilson Alonso, who forwarded it to HSBC Michael Geoghegan, David Bagley, and Matthew King, “Final draft for Mike’s Letter,” HSBC OCC 8874856.

\textsuperscript{400} 12/8/2008 email from HSBC Warren Learning to HBMX Ramon Garcia and John Rendall with copies to HSBC David Bagley, John Root, Susan Wright, and others, “Mexico Visit,” HSBC-PSM-PROD-0197874-A76.

\textsuperscript{401} Id.

\textsuperscript{402} Id.
continuing. To speed up closures, he advised that his research had indicated the Legal Department did not have to participate and clients could be notified of the account closing by certified mail. Mr. Learning also noted that 3,000 Cayman accounts had been proposed for closure which would further stress the process. In addition, he warned that the switch from U.S. dollar deposits to travelers cheques could also raise AML concerns, advised lowering the $25,000 ceiling on the amount of travelers cheques that could be purchased by a customer, and creating a new limit on the amount of travelers cheques that could be deposited at one time to a client account. He recommended setting dollar limits on cashier cheques as well.

Later in December, HBMX prepared to implement the new AML policies and procedures and close suspicious accounts. December 22 and 24 were set as the dates to close four HBMX branches “as disciplinary actions,” with another 10 to 20 branches that, in January, would have all staff dismissed. January 1, 2009 was set as the date to stop buying or selling U.S. dollars at HMBX branches. It was also the date set for closing all accounts opened by casas de cambio. January 31 was set as the date to complete the Restoration Project and begin closing accounts that had incomplete documentation or were subject to at least two SAR filings.

On December 22, 2008, an HBMX employee alerted the HBUS regional head of Banknotes, Gyanen Kumar to the HBMX’s plan to stop buying and selling U.S. dollars in the new year. Mr. Kumar forwarded it to the Banknotes head Christopher Lok with the comment: “I have not been told anything firm as to why this decision is being taken as much as it is a drastic change. My instincts tell me that perhaps this has something to do with compliance.” HBMX apparently did not explain, leaving HBUS uninformed about the compliance and regulatory pressures and AML risks behind HBMX’s decision to end its U.S. dollar business.
Law Enforcement and Regulators Converge. In January 2009, RBMX began implementing the planned AML changes. It stopped buying and selling U.S. dollars and began closing accounts held by casas de cambio.\(^\text{409}\)

That same month, U.S. regulators began contacting RBUS to get clarification about RBMX’s decision to stop buying and selling U.S. dollars.\(^\text{410}\) When asked, RBMX told RBUS the decision had been based primarily on cost considerations, without mentioning the compliance and AML concerns that led to the decision.\(^\text{411}\) The regional head of RBUS’ Banknotes department, Gyanen Kumar, who was traveling to Mexico the next week, was asked by his colleagues to get more information.\(^\text{412}\) On January 13, RBMX sent RBUS a copy of its internal press release describing its decision.\(^\text{413}\) Based upon RBMX’s actions, RBUS decided to close banknotes accounts used by two Mexican clients, but to retain accounts with the same clients in the Payments and Cash Management (PCM) division.\(^\text{414}\) Closing the banknotes accounts meant that the Mexican clients could no longer make bulk cash sales of their U.S. dollars to RBUS, but the continued operation of their PCM accounts meant that both Mexican clients could still deposit U.S. dollars, execute U.S. dollar transactions, exchange U.S. dollars for Mexican pesos, and access the U.S. wire transfer system.

Around the same time, the Immigration and Customs Enforcement (ICE) arm of the U.S. Department of Homeland Security (DHS) held a meeting with RBUS in New York, and informed it that ICE was conducting an investigation of a particular Mexican casa de cambio that had accounts at both RBUS and RBMX.\(^\text{415}\) RBUS apparently did not relay that information to RBMX.

Five months later, in May 2009, HSBC Group increased its risk assessment for its Latin American operations to its highest risk rating.\(^\text{416}\)

\(^{409}\) An email suggests, however, that RBMX had decided to continue to offer U.S. banknotes products to several large reputable Mexican banks, Banamex, Banorte and Ixe, in effect making its first exceptions to the new policy. See 12/22/2008 email from RBMX Mario Langarica to RBUS Gyanen Kumar and others, “USD cash in Mexico,” HSBC-PSI-PROD-0095869-870.

\(^{410}\) See January 2008 email exchanges among RBUS Christopher Davies, Christopher Lok, Michael Gallagher, Paul Lawrence, Gyanen Kumar, and others, “RBMX Banknotes business,” HSBC acc 3633806-812.

\(^{411}\) Id. at 810.

\(^{412}\) Id. at 811.

\(^{413}\) Id. at 809.

\(^{414}\) Id. at 811, 807.

\(^{415}\) Id at HSBC OCC 3633806. HSBC Group Compliance head David Bagley remarked near the end of January: “An obvious learning point for RBMX is that if they were contacted by US authorities then they should have thought to advise RBUS. They can go round the web, not just through the middle of the web.” 1/30/2009 email from HSBC David Bagley to HSBC Susan Wright, “US issues – Various,” HSBC OCC 8873759.

When Emilson Alonso, HSBC Latin America head, protested, HSBC Group Compliance head David Bagley explained:

"I fully acknowledge the level of priority and focus that you and the team have given to these issues and the progress that has been made particularly in Mexico and have taken all of this into account. ... The basis for the rating is however:

The inherent AML risk in Mexico is still very high and [t]here are not many other parts of the Group that have what is effectively a drugs war being conducted on the streets and also have the risk posed by potential sting and other operations by the US authorities. We have of course remediated our high risk accounts, but the historic weak account opening processes mean that we have overall lower levels of KYC across the customer base as a whole."417

On May 1, 2009, HBUS suddenly reclassified Mexico from its lowest to its highest risk rating. HBMX personnel in Mexico protested, but HBUS did not change its rating. One consequence was that its Mexican clients were automatically deemed to be located in a high risk country, triggering enhanced scrutiny.

Later in June 2009, ICE contacted HBMX about its investigation into a particular Mexican casa de cambio that had an account at the bank.418 A few days later, ICE contacted HBUS’ primary U.S. regulator, the OCC, and alerted the OCC to its investigation.419 As a result, the OCC began intensifying its regulatory scrutiny of HBUS, in particular with respect to its U.S. banknotes business, which U.S. regulators later said had increased as HBMX’s decreased.420

At the same time, AML deficiencies continued to surface at HBMX. For example, in June 2010, HBMX noted that “certain transaction types were not being captured” by its AML account monitoring system, CAMP, and “therefore were not being monitored.”421 HBMX also noted that the CAMP software had not been

418 Id.
419 Paul Thurston told the Subcommittee that, in retrospect, while HBMX’s banknotes business appeared to be declining, HBUS’ banknotes business with Mexico had been increasing at the same time, due to its banknotes business with HBMX and former clients of HBMX.
420 See 6/18/2010 email from HBUS Michael Anderson to HBMX Ken Harvey, with a copy to Andrew Zissell; “RMM action point,” HSBC OCC 8875492-493 (attaching Compliance Report on Mexico, numbered 53.2.1).
Eight Years of HBMX AML Deficiencies. HBMX and HSBC Group internal documents demonstrate that HBMX’s AML deficiencies were longstanding and widespread. Audit after audit detailed long lists of problems, including inadequate compliance resources, missing KYC information, manufactured site visits, inadequate account monitoring, unread alerts, poor training on the monitoring system and assigning SCC designations, internal disputes over closing accounts with suspicious activity, accounts left open despite multiple SARs and orders to close them, a SAR filing backlog, and an account closure backlog that spanned three years. AML leadership at HBMX was also weak. One AML director was dismissed for manufacturing notes of AML committee meetings that never took place; another was dismissed for inadequate performance; several long periods went by without any AML director in place at all. Even AML projects with resources and high level backing were unsuccessful, such as the Restoration Project which reported in 2008, that 75% of high risk client files still had inadequate KYC documentation.

The evidence obtained by the Subcommittee shows that HSBC Group was fully aware of the years-long, substantial AML and compliance problems at HBMX, originating with the bank’s purchase in 2002. The evidence also indicates that HSBC Group executives and compliance personnel worked to build a compliance culture, but repeatedly faced a workforce in Mexico that disregarded the Group’s AML policies and procedures, delayed obtaining required KYC data, delayed closing suspect accounts, and delayed reporting suspicious activity to regulators. In 2009, under pressure from regulators, HSBC Group took drastic measures, including prohibiting HBMX branches from buying or selling U.S. dollars, shuttering entire branches with checkered histories, and scheduling for closure thousands of accounts with incomplete KYC documentation. Even with those actions, HSBC Group acknowledged internally that HBMX continued to pose a high risk of money laundering to the Group.422

The evidence also indicates that while HSBC Group was fully informed about HBMX’s AML and compliance deficiencies, little of that information was conveyed to HBUS, despite HBMX’s extensive correspondent relationship with HBUS. When asked about the lack of communication, HBMX CEO Paul Thurston indicated that he reported

HBMX’s AML problems to HSBC Group and believed Group would communicate necessary information to HBUS. HSBC Group CEO Michael Geoghegan told the Subcommittee that HBMX problems were discussed at HSBC Group Management Business (GMB) meetings, which HNAH CEO Brendan McDonagh attended, so he thought HBUS was aware of the problems. HSBC Group Compliance head David Bagley told the Subcommittee that Group Compliance could have informed HBUS Compliance about the problems at HBMX, but “we did not think of it.” Instead, he reported the information to HSBC Group’s senior management. Several senior HBUS executives told the Subcommittee that the bank was not informed of the extent of AML problems at HBMX. The result was, at the same time HBUS was handling hundreds of billions of dollars in cash transactions for HBMX, processing U.S. dollar wire transfers, clearing U.S. dollar travelers cheques, and opening U.S. dollar accounts for HBMX clients, HBUS was left in the dark by its own colleagues about the extensive AML and compliance problems at HBMX. In addition, in conformance with HSBC Group policy and practice, HBUS conducted no due diligence assessment of HBMX, did not evaluate its riskiness, did not review its audit findings, and did not monitor its wire transfers, cash letter activity, or banknotes transactions for suspicious activity. HBUS had rendered itself blind to the fact that it was servicing a high risk financial institution.

D. HBMX High Risk Clients

HBMX made extensive use of its correspondent relationship with HBUS. From its acquisition in 2002, HBMX worked with HBUS’s Payments and Cash Management (PCM) division and, until 2010, with HBUS’ Global Banknotes division, both headquartered in New York. HBMX used its correspondent and banknotes accounts to process U.S. dollar wire transfers, clear U.S. dollar monetary instruments like travelers cheques, and deposit bulk cash shipments of U.S. dollars on behalf of itself and its clients. Three examples of HBMX high risk clients help illustrate how HBMX’s AML deficiencies also created risk for HBUS. They include high risk Mexican and U.S. money service businesses, clients using offshore U.S. dollar accounts in the Cayman Islands, and purchasers of millions of dollars in U.S. dollar travelers cheques.

(1) High Risk Money Service Businesses

Mexican casas de cambio (CDCs) are money service businesses licensed by the Mexican Treasury Department (SHCP), through the

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423 Subcommittee interview of Paul Thurston (5/1/2012).
425 Subcommittee interview of David Bagley (5/10/2012).
CNBV, to exchange foreign currencies for a fee. In Mexico, CDCs are
not licensed as banks and do not hold deposits, maintain checking or
savings accounts, or provide other banking services. Instead, CDCs
are typically limited to accepting currency from a customer, exchanging
it for another currency, and then either handing it over to the customer or
wiring it to a financial institution in another country, such as the United
States.

In the United States, some money service businesses perform
similar cross-border services, enabling individuals in the United States
to wire U.S. dollars to Mexico, where the dollars may be converted into
Mexican pesos and paid out to a designated recipient. Those U.S.
money service businesses are sometimes referred to as money remitters.
Both Mexican CDCs and U.S. money service businesses often perform
their services for walk-in customers, although they may also have
established customers who use their services on a regular basis. In both
Mexico and the United States, CDCs and money service businesses
are legally required to establish AML programs to safeguard against
laundering criminal proceeds.

(a) Casa de Cambio Puebla

Until 2007, Casa de Cambio Puebla (Puebla) was a licensed casa
de cambio, founded in 1985, with branch offices throughout Mexico.
On May 16, 2007, the United States obtained a warrant from a Federal
court in Florida and froze or seized all Puebla funds on deposit with
Wachovia Bank in Miami, as well as with Wachovia Bank in London,
affecting funds totaling over $11 million. In July 2007, Puebla filed a
civil complaint seeking the release of those funds. In 2008, the
United States indicted Puebla, two of its officers, and two other
individuals on drug smuggling and money laundering charges. In
2009, one of the defendants was arrested and, in 2010, pled guilty to
conspiracy to launder money, and was sentenced to 14 months in
prison, while the other defendants, including Puebla, were placed on

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426 See United States v. Wachovia Bank N.A., Case No. 10-20165-CR-Lenard (USDC SDFL),
Factual Statement, Exhibit A to Deferred Prosecution Agreement (3/16/2010), at ¶ 12.
427 Id., at ¶ 11.
428 See Article 95 bis of the General Law of Auxiliary Credit Organizations.
429 See 31 USC § 5311(b)(1) and § 5312(h) and (k).
430 See 31 USC § 5311(b)(1) and § 5312(h) and (k).
431 See United States v. Casa de Cambio Puebla, S.A. v. United States, Case No. 10-20165 (USDC SDFL), Petition
432 Puebla Petition, at 2-3.
433 Id.
434 See id., at 10.
435 See United States v. Casa de Cambio Puebla, S.A., Jose A. Gutierrez de Velasco Hove,
Amador Cordero Vasquez, Pedro Alfonso Alatorre Damy, a/k/a "Pedro Barraza Urupaynogue,
and Leonardo Vasquez Estrada, Case No. 08-20997-CR-Graham (USDC SDFL), Indictment
fugitive status. In addition, in 2010, Wachovia Bank entered into a deferred prosecution agreement with the U.S. Department of Justice for having failed to maintain an effective anti-money laundering program in connection with its casa de cambio business, including with respect to Puebla. Those legal proceedings, which involved a major Mexican CDC and major U.S. bank, received widespread attention.

Puebla was a longtime customer of HBMX, having first begun a relationship with HBMX’s predecessor, Bital, in the 1980s. In 2004, Puebla also opened a U.S. banknotes account with HBUS. By 2007, Puebla had several accounts at HBMX, as well as an outstanding loan. After the United States seized the company’s funds at Wachovia Bank in May 2007, HBUS suspended the Puebla account two weeks later and closed the account in June 2007. HBMX did not actually close the account until November 2007, and then only after the Mexican Attorney General served an order on the bank seizing Puebla funds.

Puebla at HBMX. At the time of the May 2007 seizure of more than $11 million in Puebla funds at Wachovia Bank, HBMX was already reeling from another money laundering scandal involving a March 2007 seizure of cash, weapons, and wire transfer records from the Mexican residence of longtime customer, Zhenly Ye Gon and his pharmaceutical companies, Unimed Pharm Chem, Constructora e Inmobiliaria Federal, and Unimed Pharmaceutical. That seizure had triggered an intensive review by senior HBMX officials of the Ye Gon-related accounts as well as HBMX’s overall AML program. The Puebla case added another high

436 See id., docket entries 12, 34, 38-42.
440 See, e.g., July 2007 email exchanges among HBMX Paul Thurston, John Rendall, Ramon Garcia, and others, “[subject redacted by HSBC], HSBC OCC 8875132-135.
profile problem for HBMX, not least because Puebla also handled Ye Gon funds. 445

In late May 2007, HBUS learned of the seizure of Puebla funds at Wachovia Bank, and quickly suspended activity in the Puebla correspondent account at HBUS. 446 It is not clear when HBMX first learned of the seizure, but by early June, both banks were considering whether to close their Puebla accounts. On June 5, 2007, Leopoldo Barroso, HBMX’s AML head, received an email from a senior AML Compliance officer at HBUS, Daniel Jack, asking if Mr. Barroso was the new AML director at HBMX and “wonder[ing] what relationships” HBMX had with Puebla. 447 Mr. Barroso responded that HBMX had “a few DDAs [Demand Deposit Accounts] and a loan” with Puebla. 448 He also indicated that HBMX planned to “decide within the next 5 days” whether to terminate its relationship with Puebla, and asked Mr. Jack to let him know if HBUS decided to take that action. 449

Mr. Jack noted in a later email that he did not tell Mr. Barroso during the June 5 email exchange about the DEA seizure or Wachovia closing [Puebla] accounts,” although it is possible that HBMX already knew. 450 Mr. Jack also did not disclose that HBUS had already suspended Puebla’s account activity a week earlier, on May 31, 2007. 451 Mr. Jack told the Subcommittee that, soon after the June 5 email exchange, he told Mr. Barroso that HBUS had shut down its account with Puebla. 452 When Mr. Barroso asked if HBUS could provide him with a list of their banknote customers in Mexico and the amount of U.S. dollars they exported from Mexico to the United States, Mr. Jack demurred, responding that there were “privacy issues” but that he would “see what info” he could share. 453 This exchange between senior AML.

445 See 10/13/2007 “Reportan ruta de Ye Gon para ‘blanquear’ dinero” ("Ye Gon reported path to ‘launder’ money"), El Universal, Francisco Gómez, www.eluniversal.com.mx (reporting that the Mexican agency SHCP had determined that, from 2003 to 2006, Mr. Ye Gon and his companies had moved $90 million through four major Mexican banks and multiple casas de cambio, including HBMX and Puebla), cited in 7/18/2008 Report of Findings (Update) for Consultoria Internacional Banco, prepared by HBUS Financial Intelligence Unit, OCC-PSI-00247712.
446 See 5/31/2001 email from HBUS Alan Ketley to HBUS Gyanen Kumar and others, “With immediate effect we are suspending all activity with the subject client,” HSBC PSI PROD 0095908-910; 6/6/2007 email from HBUS Daniel Jack to HBUS Alan Ketley, Re: HSBC in Mexico – AML Compliance and Casa de Cambio, HSBC-PSI-PROD-0095912.
449 Id.
450 Id.
452 Subcommittee interview of Daniel Jack (3/13/2012).
Compliance personnel at HBUS and HBMX suggests that information sharing between the two banks was guarded, rather than automatic.

In early July 2007, HBMX Compliance head, Ramon Garcia, disclosed in an internal weekly report that went to HSBC Group Compliance that the HBMX CCC Committee had considered closing the Puebla account, but decided instead to retain the client. In response, John Root, a senior HSBC Group Compliance officer, sent him a blistering email criticising the CCC Committee for “rubber-stamping unacceptable risks.” This email, cited earlier in a discussion of HBMX’s CCC Committee, is relevant again, because it applies to the Puebla account. Mr. Root wrote:

“It looks like the business is still retaining unacceptable risks and the AML committee is going along after some initial hemming and hawing. I am quite concerned that the committee is not functioning properly. Alarm, even. I am close to picking up the phone to your CEO.”

Mr. Root’s email went on to harshly criticize the CCC Committee’s decisions to keep open accounts for Mr. Ye Gon and another accountholder under suspicion for money laundering, before describing as “strike three,” the decision to retain the Puebla “relationship after USD11 million was seized by the authority in [Redacted by HSBC] account with Wachovia in Miami.” Mr. Root continued:

“What?! The business was okay with this? The AML Committee just can’t keep rubber-stamping unacceptable risks merely because someone on the business side writes a nice letter. It needs to take a firmer stand. It needs some cojones. We have seen this movie before, and it ends badly.”

Mr. Garcia responded that he was escalating the decision on Puebla to the HSBC Mexico CEO, since the relevant HBMX business division had disagreed with a Compliance recommendation to close the account. The next week, HSBC Mexico CEO Paul Thurston agreed with closing the account. Mr. Rendall suggested alerting their U.S.

455 Id.
457 See July 2007 email exchanges among HBMX Paul Thurston, John Rendall, Ramon Garcia, and others, “[subject redacted by HSBC],” HSBC OCC 887532-135.
counterparts at HBUS, since HBUS also had a correspondent relationship with Puebla. 458

Despite Mr. Thurston’s July 2007 decision to close the Puebla account, HBMX did not actually close or freeze its Puebla account for another four months, allowing Puebla continued use of HBMX’s correspondent account at HBUS. 459 HBMX finally closed the account in November 2007, after receiving a seizure warrant from the Mexican Attorney General seeking all funds in accounts opened in the name of Puebla or related parties. 460

The seizure warrant named 91 parties related to Puebla, of which 81 were HBMX customers who presumably were also using the HBMX correspondent account at HBUS. 461 HBMX later determined that, from January 1 though October 31, 2007, a period of ten months, approximately 650 wire transactions had cleared through the “HBSC Mexico correspondent account” at HBUS, where Puebla was either the originator or the beneficiary. 462 Of those transactions, 170 wire transfers totaling $7.3 million were conducted by six individuals or entities linked to Puebla. 463 All of those wires were later traced back to the Puebla accounts frozen at Wachovia. 464 The OCC later observed: “[T]hese discoveries about the level of CDC activity should have raised concerns for HBUS and alerted the bank to the need to obtain basic due diligence for HSBC Mexico and other Group Entities.” 465

Puebla at HBUS. While HBMX exposed HBUS to considerable money laundering risk through the transactions it conducted for Puebla,
IIBUS also incurred risk from its own direct dealings with Puebla, including a U.S. banknotes account it opened for Puebla in 2004. In just three years, Puebla substantially boosted its use of that U.S. banknotes account, swelling its sales of U.S. dollars to HBUS from $18 million in February 2005, to $113 million in March 2007, a tenfold increase.\footnote{Spreadsheet: Banknotes – NY Selected Customers’ Activity Alerts & Traders’ Explanations for USD Purchases & Sales from 2005-2009, OCC-PSI-0005890-894.}

When AML monitoring alerts raised red flags about the growing flood of U.S. dollars from Puebla, HBUS bankers provided a number of explanations for the increases, none of which considered whether Puebla might be accepting illegal drug proceeds that drug cartels were then smuggling into Mexico from the United States. For example, when Puebla’s U.S. dollar volumes increased by $3 million between November 2005 and February 2006, an HBUS banker wrote that the “[c]lient is slowing [sic] growing its business volume as a result of better cash flow thanks to dealing with HSBC i.e., faster turnaround of banknotes.”\footnote{Id. at 892.} When the volume jumped by another $13 million the very next month, the HBUS banker offered the same explanation, typo and all: “[c]lient is slowing [sic] growing its business volume as a result of better cash flow thanks to dealing with HSBC i.e., faster turnaround of banknotes.” This cut-and-paste explanation offers no evidence that the banker used due diligence to analyze the sudden multi-million-dollar increase. When the volume climbed again, by more than $20 million from April 2006 to September 2006, to over $76 million, the HBUS banker asked for an explanation wrote: “Mexico as a whole and more specifically [Puebla] is the premier country/msb [money service business] USD [U.S. dollar] remitter. There is [a] large population of Mexican[s] working in the U.S. during the summer months (landscaping) that send money back home (religiously) to their families.”\footnote{Id. at 893.} While that might have been true, it was equally true when Puebla transmitted just $27 million back to Mexico around the same time the previous year, a nearly $50 million difference.\footnote{Id. at 892.} By the end of March 2007, the month before Puebla funds were seized at Wachovia Bank, its monthly U.S. dollar transactions at HBUS had exceeded $113 million.\footnote{5/31/2007 email from HBUS Gyanen Kumar to HBUS Alan Ketley and others, “Casa de Cambio Puebla,” HSBC-PSI-PROD-0095910. See also 5/31/2007, email from HBUS Daniel Jack to HBUS Alan Ketley, “N-NY & Casa de Cambio Puebla in Mexico,” HSBC-PSI-PROD-0095908.}

On May 30, 2007, two weeks after the seizure of Puebla funds on May 16, HBUS ordered all activity in the Puebla account to be suspended with “immediate effect.”\footnote{5/31/2007 email from HBUS Gyanen Kumar to HBUS Alan Ketley and others, “Casa de Cambio Puebla,” HSBC-PSI-PROD-0095910. See also 5/31/2007, email from HBUS Daniel Jack to HBUS Alan Ketley, “N-NY & Casa de Cambio Puebla in Mexico,” HSBC-PSI-PROD-0095908.} A week later, on June 5, 2007, HBUS AML Compliance officer Daniel Jack contacted HBMX to...
ascertain whether Puebla also had accounts there, which would continue
to expose HBUS to the money laundering risks associated with Puebla
through the HBMX correspondent account.472

HBUS terminated its Banknotes relationship with Puebla after
conducting a site visit on June 11, 2007.473 In June and July 2007,
HBUS was contacted by multiple U.S. law enforcement agencies
regarding its correspondent accounts with financial institutions
in Mexico, including Puebla. On June 25, 2007, for example, the Drug
Enforcement Administration and other law enforcement told HBUS of
their interest in its “banknote trading with” Puebla.474 On July 17, 2007,
HBUS met with “an analyst from the National Drug Intelligence Center
of the US Department of Justice to explain our business and AML
program along with discussing cross-border issues.”475 On July 20,
2007, HBUS met with FinCEN specialists “to discuss our wholesale
banknotes business with clients in Mexico as well as our AML program,
CTR filing and related issues.”476 The extent to which HBUS informed
HBMX about the level of U.S. law enforcement interest in Puebla is
unclear.

(b) Sigue Corporation

Another HBMX client that used HBMX’s correspondent account
at HBUS was Sigue Corporation (Sigue), a U.S. licensed money service
business incorporated in Delaware but headquartered in California.477
Sigue’s primary business activity was transmitting funds on behalf of
third parties from the United States to Mexico and Latin America.478
Acting through its operating company, Sigue LLC, it arranged for the
remittance of U.S. dollars through a network of more than 7,500
“authorized delegates” or agents across the United States, most of which
were small businesses under contract to offer Sigue’s money
transmission services.479

On January 28, 2008, Sigue entered into a deferred prosecution
agreement with the U.S. Department of Justice, Drug Enforcement
Administration, and Internal Revenue Service, admitting that it had

472 See 6/5/2007 email from HBUS Daniel Jack to HBMX Leopoldo Barroso, “HSBC in Mexico
– AML Compliance and Casa de Cambio,” HSBC-PSI-PROD-0095914. See also 10/28/2007
memorandum from HBUS Carolyn Wind to HNAI Janet Burak and others, HSBC-PSI-PROD-
0095919.
474 Id.
475 Id. at 2.
476 Id.
477 See United States v. Sigue Corp. and Sigue LLC, Case No. 4:08CR54 (USDC EDMO),
478 Id.
479 Id.
failed to maintain an effective anti-money laundering program. As part of the agreement, Sigue admitted to “serious and systemic” violations of U.S. AML requirements from 2003 to 2005, which “allowed tens of millions of dollars of suspicious financial transactions to be conducted through Sigue, including transactions involving funds represented by undercover U.S. law enforcement agents to be drug proceeds.” The drug proceeds which U.S. undercover agents transmitted through Sigue totaled more than $500,000, and were sent through 59 separate Sigue agents in 22 states. The undercover federal agents had explicitly informed Sigue agents that they were transmitting illegal drug proceeds, structured the transactions to evade U.S. reporting obligations, and wired the funds to seven law enforcement agents in Mexico City, creating a money laundering pattern that Sigue should have detected and reported as suspicious activity, but did not. Sigue admitted its failure to adequately supervise and control its agents, “effectively monitor and investigate high risk transactions,” “establish an effective risk-based AML program,” and “exercise sufficient enhanced due diligence for high-risk transactions and customers.” As part of the agreement to defer prosecution of the company, Sigue agreed to forfeit $15 million in suspect funds and spend $9.7 million to strengthen its AML program.

The day after the deferred prosecution agreement was made public in court, an article discussing Sigue’s misconduct and “record penalty” for a money service business concluded that a “case such as that against Sigue gives banks yet another reason to treat MSBs [money service businesses] as pariahs.” David Bagley, HSBC Group Compliance head, sent a copy of the article to Susan Wright, head of AML Compliance for HSBC Group, with a handwritten note: “Obvious question – I assume they are not our customer.” His assumption, however, was incorrect.

After learning that Sigue was, in fact, a client of HBX, on February 1, 2008, Ms. Wright sent an email to HBX Compliance head Ramon Garcia about the account. She noted that, despite the deferred prosecution agreement and Sigue’s admission of wrongdoing, HBX’s
commercial banking division wanted to retain the account. She warned that, if the account were retained, it:

“will need to be closely monitored and subject to frequent reviews (recommendation for quarterly reviews in current circumstances). The actions by the US regulators should be used as a trigger event and our due diligence on this client updated. In this connection the high risk profile that is in place for Financial Institutions should be used. … If we only see batched transactions then we are relying on the screening undertaken by [Sigue]. It would be helpful to understand the nature of these transactions and currencies involved – could you provide me with an overview? We should also monitor the volume – you mentioned that we are not [Sigue’s] only bankers in Mexico. If, however, any of the other banks withdraw then we may well see the volume of transactions through us rise and our exposure/risk will increase with a corresponding increase in the cost of monitoring, etc.”

Her email was forwarded to HSBC Compliance head David Bagley who, on February 4, 2008, forwarded it to HBMX CEO Paul Thurston and recommended closing the Sigue account. Mr. Bagley noted Sigue’s “serious and systemic violations and a record fine” due in part to the fact that Sigue “had little control over its numerous agents.” He wrote: “Whilst the company will now need to take steps to address these deficiencies this will inevitably take some time, and instilling the appropriate culture within the business even longer.”

Mr. Thurston forwarded Mr. Bagley’s recommendation to John Rendall, HBMX COO, and asked for more information about the account. Mr. Rendall reminded him that “a couple of months back,” HBMX Compliance had recommended closing the Sigue account, but was opposed by the HBMX commercial banking division (CMB) that wanted to keep the account open. The issue was then elevated to Mr. Thurston who decided against closing the account. Mr. Rendall explained:

“Our recommendation, which you supported, was to maintain this relationship. It was based on the following factors: A) our CMB team in Tijuana were relatively on the top of the case; B) the
events for which [Sigue] have been fined were relatively historic – from memory, 2-3 years ago, and significant improvements had been made since then.\footnote{1/2/2008 email from HBUS Susan Wright to HBMX Ramon Garcia, “[redacted by HSBC],” HSBC OCC 8875141.}

Despite Sigue’s admission of wrongdoing, its admission of lax controls over the actions taken by its agents, and the recommendation of the head of HSBC Group Compliance to close the account, Mr. Thurston decided once again to retain it and to continue to provide Sigue with U.S. dollar transactions through the HBMX accounts at HBUS.

Mr. Thurston told the Subcommittee that Sigue was one of the few accounts he decided to retain over the objection of HSBC Compliance. He explained that he did so, because he believed the issues were in the past, and Compliance head Ramon Garcia had met with Sigue and believed it was meeting its commitment to strengthen its AML program.\footnote{Subcommittee interview of Paul Thurslon (5/1/2012).}

Also on February 4, 2008, after reviewing an earlier media report identifying HBMX as a “pay partner” for Sigue,\footnote{See “California MSB Faces Record Fine From Justice Department in AML Case,” Fentent Inform, Brian Monroe (1/1/2008}; see also 2/5/2008 OCC memorandum to files, “HSBC Monitoring/Reputation Risk,” OCC-PSI-01416736 [sealed exhibit].\footnote{2/5/2008 OCC memorandum to files, “HSBC Monitoring/Reputation Risk,” OCC-PSI-01416736, at 2. [Sealed Exhibit.]} the OCC AML Examiner then reviewing HBUS’ AML program “requested HSBC management to determine what, if any, involvement HSBC had with Sigue.”\footnote{The OCC Examiner noted internally at the time: “Although HSBC management was previously aware of media reports concerning Sigue, up to the time of our request, HSBC management had not conducted any enhanced due diligence and/or in-depth analysis to determine HSBC’s potential exposure resulting from the prosecution of Sigue.” Id. at 2 (emphasis in original omitted).} The OCC inquiry triggered an inquiry into the Sigue account by HBUS, which had not been privy to the exchanges between HSBC Group and HBMX about the account.\footnote{See 2/5/2008 OCC memorandum to files, “HSBC Monitoring/Reputation Risk,” OCC-PSI-01416736, at 3. [Sealed Exhibit.]}\footnote{Id.}

On February 5, 2008, HBUS informed the OCC AML Examiner that while Sigue was not an HBUS client, it was a client of HBMX and had executed U.S. dollar wire transfers through HBMX’s correspondent accounts at HBUS.\footnote{See 2/5/2008 OCC memorandum to files, “HSBC Monitoring/Reputation Risk,” OCC-PSI-01416736, at 3. [Sealed Exhibit.]} In an internal memorandum summarizing the information, the OCC AML Examiner wrote that HBUS “acts as a pass-through for wire transfers for Sigue.”\footnote{Id.} He noted that, for “the period of January through December 2007 159 wire transfers passed through HSBC originated by Sigue for the benefit of” HBMX, involving more
than $485 million. He wrote that HBUS management had agreed that those wires should have triggered a review of the account activity.

The OCC AML examiner saw the events surrounding the Sigue account as emblematic of a broader problem involving inadequate monitoring and weak AML investigations by HBUS of clients using correspondent accounts to conduct suspect transactions. In the internal memorandum, the OCC AML examiner wrote:

"Over the past few years, there have been a number of instances where the OCC has brought to the attention of HSBC management negative media events, publicized indictments, etc., resulting in the need for HSBC management to conduct ad-hoc reviews to determine potential reputational risk. In the majority of these instances, HSBC management was either not aware of these events or had not been pro-active in determining the level of potential exposure due to these events.

He concluded that if he had “not intervened it is highly unlikely that HSBC management would have performed the proper level of due diligence, [or] determined the potential exposure to risk” in the Sigue matter.

Two months later, on April 26, 2008, a major U.S. newspaper published an article describing an ongoing Federal probe of allegations that Wachovia Bank was laundering drug proceeds supplied by Mexican casas de cambio. The article also mentioned Sigue, triggering a second round of inquiries at HBUS into the status of the Sigue account which remained open at HBMX and continued to execute U.S. dollar transactions through the HBMX correspondent account at HBUS.

HBUS AML Compliance officer Judy Stoldt and HBUS investigator Gloria Stazza sent a memorandum to their supervisor Denise Reilly, a senior HBUS AML Compliance officer, summarizing the article and discussing HBUS’ exposure to the casas de cambio named in the article. The memorandum began:

"HBUS does not hold any account for any casa de cambio mentioned in the WSJ article. The only HBUS connection to

501 Id. HBUS apparently provided this wire transfer information to the OCC, in response to the OCC request for more information about HBUS’ involvement with Sigue.
502 Id.
503 Id.
504 Id. at 1.
activity involving those named casas de cambio is activity that was conducted through our correspondent accounts, and most notably through our account with HSBC Bank Mexico (HBMX)."\textsuperscript{507}

The May 2008 memorandum described Sigue as a money service business that had allegedly processed $24.7 million in "suspicious money remittances related to drug-trafficking proceeds."\textsuperscript{508} It explained that HBUS had first taken note of Sigue when it entered into a record $25 million settlement with the Justice Department in January 2008, and, as a result, conducted a review of the Sigue accounts, wire transfer activity, and whether either Sigue or its founder, Guillermo de la Vina, had been "the subject of any other negative news or law enforcement activity."\textsuperscript{509} The memorandum reported that, despite having no direct account with Sigue, a "wire review" found that, during 2007, Sigue had sent 159 wire transfers for $485 million through HBMX's correspondent account, all of which were originated by Sigue and sent to its own account at HBMX, which HBUS viewed as suspicious.\textsuperscript{510} The memorandum noted that HBUS had contacted HBMX to discuss Sigue, and HBMX disclosed that it had imposed "parameters" on its relationship with Sigue, including limiting Sigue to "conducting transactions for individual customers to $2,000 USD per transaction."\textsuperscript{511} The memorandum did not explain, however, how that $2,000 limit affected the actual wire activity in 2007, in which each wire transfer apparently batched numerous underlying wires without identifying individual client transactions. The memorandum also stated that HBUS had found that a Sigue employee had been indicted for assisting drug traffickers with money laundering,\textsuperscript{512} and on another occasion Sigue was

\textsuperscript{507} Id. at 1.
\textsuperscript{508} Id. at 3. See also 1/28/2008 "Sigue Corporation and Sigue LLC Enter into Deferred Prosecution Agreement and Forfeit $15 Million to Resolve Bank Secrecy Act Violations," press release issued by U.S. Department of Justice, http://www.justice.gov/opa/pr/2008/January/08_fina_004.htm (stating that "more than $24.7 million in suspicious transactions were conducted through registered agents of Sigue, including transactions conducted by undercover U.S. law enforcement agents using funds represented to be proceeds of drug trafficking").
\textsuperscript{510} Id. at 4. The memorandum did not mention that this wire analysis was compiled for the OCC, at its request, in February 2008. According to Sigue, altogether during 2007, it sent a total of more than $1.8 billion in wire transfers through its HBMX account to a Sigue affiliate in Mexico. Subcommittee briefing by Sigue (7/25/2012).
\textsuperscript{512} Id. at 3. The Subcommittee has not obtained evidence of an instance in which a Sigue employee has been indicted for assisting drug traffickers with money laundering; however, in 2006, a Sigue agent pled guilty to money laundering and conspiracy to distribute illegal drugs, and a factual statement supporting his guilty plea described his use of Sigue wire transfers to launder illegal drug proceeds from 2003 to 2005. See United States v. Gerardo Alvarado Alvarado, Case No. 1:05CR354-1 (USDC MDNC), Plea Agreement (2/24/2006) and Factual Basis in Support of Guilty Plea (2/24/2006).
described as having allowed $295,000 to be transferred from an account at another bank to an illegal alien deported to Mexico, while also noting that Sigue itself had not been implicated in either matter. Despite this cascade of troubling information, for the next two years, little or no action appears to have been taken by HBUS or HBMX with respect to the Sigue account at HBMX.

On January 30, 2009, having determined that Sigue satisfied the requirements of the Deferred Prosecution Agreement the Justice Department requested and the court granted dismissal of the criminal case against the company.

In 2010, as part of an OCC AML examination, an OCC AML examiner reviewed the May 2008 memorandum regarding Sigue and asked what followup actions had been taken in response to it, in particular whether Sigue had ever been added to the HBUS “wire filter” for purposes of enhanced due diligence and whether any further analysis had been done of Sigue account activity. HBUS personnel responded that Sigue had not been added to the wire filter, the 2008 memorandum had not been “passed to anyone,” and the HBUS Financial Intelligence Group had not conducted any additional due diligence with respect to Sigue.

HBUS explained that “Sigue was not added to the wire filter as Sigue entered into a written agreement with the Department of Justice to enhance its AML program and was not (for the investigative search) the subject of any other money laundering investigations.”

Essentially, despite Sigue’s deferred prosecution in 2008, admission of wrongdoing caused in part by an inadequate AML program, past HBMX alerts flagging unusual transactions, past HBUS wire transfer analysis identifying suspicious activity, past recommendations by Compliance to close the account, and past regulatory inquiries, HBUS did not conduct any enhanced monitoring or analysis of the Sigue account.

513 5/1/2008 memorandum [carrying incorrect date of 5/1/2007] from HBUS Judy Stoldt and Gloria Stazza to HBUS Denise Reilly, “Wall Street Journal Article Regarding Wachovia,” OCC-PSI-01358516-317, at 3-4. The memorandum referred to an article as the source of this information. Id. at 3; see also “Suspicious wire transfers, documents lead to raids in NW Ark.,” Associated Press, Jon Gambrell (5/25/2007). The referenced matter involves criminal proceedings in which the employee of a Sigue agent (who had been deported to Mexico) was charged with conducting an unlicensed money transmitting business and supporting illegal aliens in the United States; no drug proceeds were involved. See United States v. Honorato Pedroza, Case No. 5:07-cr-00058-JH (USDC WDAK), Indictment (6/27/2007).

514 See United States v. Sigue Corp. and Sigue LLC, Case No. 4:08CR54 (USDC EDMO), Order for Dismissal with Prejudice (1/30/2009).


516 Id.

HBMX’s relationships with Puebla and Sigue, a Mexican casa de cambio and a U.S. money service business that remitted funds to Mexico and Latin America, demonstrate its tolerance for high risk clients, and how those clients subjected, not only HBMX, but also HBUS to substantial money laundering risks. The accounts also disclose how both banks failed to conduct effective monitoring of some financial institution accounts and transactions, even when faced with evidence of lax AML controls and criminal proceedings involving money laundering. They also expose an absence of regular information sharing and coordinated AML efforts between HBUS and HBMX to address common AML problems, including limited communications about particular clients and actions taken to restrict or close accounts.

(2) Cayman Island U.S. Dollar Accounts

A second example of high risk HBMX clients posing money laundering risks to HBUS are the tens of thousands of U.S. dollar accounts maintained by HBMX through its branch office in the Cayman Islands. This branch office is a shell operation with no physical presence in the Caymans, and is managed by HBMX personnel in Mexico City who allow Cayman accounts to be opened by any HBMX branch across Mexico. Total assets in the Cayman accounts peaked at $2.1 billion in 2008. Internal documents show that the Cayman accounts had operated for years with deficient AML and KYC controls and information. An estimated 15% of the accounts had no KYC information at all, which meant that HBMX had no idea who was behind them, while other accounts were, in the words of one HBMX compliance officer, misused by “organized crime.” Because a primary feature of the Cayman accounts is their use of U.S. dollars, HBMX has maintained the account assets and conducted account transactions through its U.S. dollar correspondent accounts at RBUS. There is no documentation showing that RBUS knew or was informed that, by providing HBMX with correspondent accounts, it was also providing access to the U.S. financial system to high risk account holders in the Caymans. By moving the Cayman transactions through its HBUS accounts, HBMX exposed not only itself, but also HBUS to the money laundering risks inherent in its Cayman clients.

Cayman Accounts. HSBC acquired the Cayman branch through its purchase of Bital in November 2002. According to a letter from HSBC legal counsel:

"Bital received authorization from Mexican and Cayman authorities to offer Cayman USD [U.S. dollar] accounts to its customers in 1980. Bital’s license and authorization to offer
Cayman USD accounts was inherited by HBMX when HSBC acquired Bital in 2002.\textsuperscript{110}

After the acquisition, the Cayman branch of Bital was renamed HSBC Mexico S.A. and continued to operate under a Cayman Class B banking license, restricting the branch to operating only “offshore” and open accounts exclusively for non-Cayman residents.\textsuperscript{519} From its inception, the branch had no physical office or employees in the Cayman Islands, and operated in that jurisdiction solely as a shell entity.\textsuperscript{520} The Cayman accounts were actually opened and maintained by HBMX personnel in Mexico. Any HBMX branch across Mexico had the authority to open a Cayman account for a client.\textsuperscript{521}

To enable the Cayman branch to provide U.S. dollar accounts to clients, HBMX used its correspondent accounts at HBUS to supply the needed dollars, process U.S. dollar wire transfers, cash U.S. dollar travelers cheques, and perform similar U.S. dollar services. HBMX did not open a separate correspondent account for the Cayman branch, but included Cayman account transactions within its general correspondent account at HBUS. The documents and other evidence reviewed by the Subcommittee contain no indication that, until recently, HBMX ever informed HBUS about its Cayman branch or the Cayman U.S. dollar denominated accounts being serviced through the HBMX correspondent accounts at HBUS.\textsuperscript{522}

The number of accounts and the volume of assets held in the Cayman accounts have fluctuated over time. Documentation associated with the 2002 Bital purchase do not indicate how many Cayman accounts then existed or the total amount of assets they held. A 2006 audit of the Cayman accounts reported just 1,500 accounts in 2005, with no mention of the account balances.\textsuperscript{523} In September 2008, HBMX reported a remarkable increase, over 60,000 Cayman accounts for nearly

\textsuperscript{518} 6/5/2012 letter from HSBC legal counsel to the Subcommittee, at 4.
\textsuperscript{519} See, e.g., 7/31/2008 email from HSBC David Bagley to HSBC Richard Bennett, “HBMX-CAYMAN ACCOUNTS,” HSBC OCC 8874827-33. See also list of Cayman offshore banks at http://www.offshore-library.com/banking/cayman_islands/page_3. According to HSBC, HBMX policy is not to offer the accounts to either Cayman or U.S. residents. See 6/5/2012 letter from HSBC legal counsel to the Subcommittee, at 5.
\textsuperscript{520} See, e.g., 7/31/2008 email from HSBC David Bagley to HSBC Richard Bennett, “HBMX-CAYMAN ACCOUNTS,” HSBC OCC 8874827-33.
\textsuperscript{521} See, e.g., 1/2006 “General Audit Report, HBMX – KYC of USD Current Accounts in Grand Cayman,” prepared by Group Audit Mexico, HSBC OCC 8874307-310, at 1. This audit reviewed files for Cayman accounts that had been opened by 26 HBMX branches in Mexico City. Id.
\textsuperscript{522} Michael Gallagher, for example, who headed the HBUS PCM division that helped handle correspondent accounts, told the Subcommittee he had been unaware of the U.S. dollar Cayman accounts at HBMX. Subcommittee interview of Michael Gallagher (6/13/12).
50,000 customers, with total assets approaching $2.1 billion. Three years later, however, those totals dropped significantly. According to HSBC legal counsel, as of January 2012, the Cayman branch held about 24,000 Demand Deposit and Term Deposit Accounts for nearly 21,000 customers, with a total dollar value of approximately $657 million. About 9,000 Cayman accounts had been closed in 2009, due in part to insufficient Know Your Customer (KYC) information for the accounts as well as regulatory concerns about their high risk nature.

**Inherent Riskiness of Accounts.** HBMX and HSBC Group were well aware that the Cayman accounts had an inherently higher AML risk than other Mexican accounts, since they were offered in an offshore jurisdiction with strong secrecy laws and a limited tax regime, and permitted accountholders to hold assets in U.S. dollars in contravention of normal Mexican legal restrictions.

In 2008, HSBC Group Compliance head David Bagley noted in an email to senior HSBC Group officials that Mexican regulators knew of the Cayman accounts, which apparently circumvented certain Mexican banking regulations, but nevertheless allowed them to operate:

> "The [Cayman] license, inherited from Bital, allows HBMX to provide USD-denominated services to persons domiciled in Mexico. Mexican regulation apparently prohibits individual Mexicans (i.e. non-corporate) to hold USD-denominated deposit accounts in Mexico. ... Although HBMX were recently fined USD50,000, for the inappropriate promotion of these services in Mexico, I am advised that CNBV are aware of the existence of the accounts and services and have raised no concerns."  

Mr. Bagley also warned:

> "There continues to be a real focus on the level of USD-denominated activity in Mexico by CNBV and other bodies, and the extent of HBMX’s activity in this area. This account base has to therefore be seen as high-risk from an AML and reputational perspective."

In November 2005, an email from HBMX Compliance head Ramon Garcia to senior HSBC Group Compliance officer John Root

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524 See chart at HSBC OCC 8876787, attached to 9/12/2008 email from HSBC John Root to HSBC Adrian Cristiani, “Cayman Accounts.” HSBC OCC 8876784.

525 See 6/5/2012 letter from HSBC legal counsel to the Subcommittee, at 5.

526 7/31/2008 email from HSBC David Bagley to HSBC Richard Bennett, with copies to HSBC Michael Grousehan, Matthew King, and HBMX Emilson Alonso, Luis Pena, and John Rendall, “HBMX-CAYMAN ACCOUNTS,” at HSBC OCC 8874832.

527 Id.
flagging compliance issues at HBMX provided this explanation for the Cayman accounts:

“There is a Cayman Island branch for HBMX. Since there is a restriction by Mexican Law to open accounts to nationals in USD except for those residing in the Mexico’s border, as an alternative, [Bital] decided to open this branch where cheques accounts to Nationals could be opened in USD. It is also known that these USD accounts were issued also to non Mexican Nationals.”

A January 2006 HBMX internal audit report explained the demand for the accounts this way: “HBMX offers their clients the option to open USD current and investment accounts in Grand Cayman so that clients profit from the advantages of that country, such as tax free investments, under confidentiality terms.” In a 2007 email discussing the sale of cross-border financial products in Mexico, HSBC Group Compliance Deputy Head Warren Learning also noted: “Because Mexico’s tax scheme is relatively penal (worldwide income) there is a high demand for off-shore products.”

Below Standard AML and KYC Controls. The riskiness of the Cayman accounts was magnified by weak AML controls and inadequate KYC information. Those AML deficiencies meant that HBMX had little real knowledge about the customers using the Cayman accounts.

HSBC Group knew about the weak state of the Cayman AML and KYC controls from the time Bital was purchased in 2002, and it inherited the Cayman branch. An audit prior to the acquisition found that Bital had no functioning Compliance Department, limited client transaction and activity monitoring, and no KYC focus on high risk clients. The audit specifically noted the poor state of KYC information in the Cayman accounts: “41% of the accounts reviewed (92 of 224 reviewed) lacked full client information. 37 files had no client information.”

In 2004, Mexico strengthened KYC requirements for Mexican financial accounts and required Mexican banks to update the KYC information in all customer accounts by 2007. In January 2006, HBMX’s audit group conducted an audit of the KYC controls in place...
for the Cayman accounts and rated them "Below Standard." Of the Cayman accounts reviewed, the audit found that 13% of the files lacked material KYC information; more than 50% lacked a visit report with the client; some foreign clients were incorrectly described as Mexican nationals; and 15% of the account files were missing altogether:

"More than 50% of account files that were reviewed lacked the relevant visit report, which weakens the position of HBMX in terms of KYC process for these types of accounts (Grand Cayman), particularly those accounts opened by foreigners. In addition, in 13% of files reviewed the visit reports failed to include material information enabling to have adequate KYC.

Weaknesses were noted in the supervision over the account opening process, which also impeded to detect promptly any information missing in account files or inconsistencies between the information produced by the client and the data captured in Cis-Hogan [HBMX data system]. ... In addition, the auditors indentified foreign clients who were input to the system as nationals.

In addition to the foregoing, c[irca] 15% (10) of account files were not found at the Branches. No actions had appeared to be taken to instruct RMs [Relationship Managers] to complete client’s file again.

In particular the auditors indentified that for accounts opened by foreign clients these had produced expired immigration forms and that Branch staff did not maintain a copy of all the pages composing such a document. This situation was due, in part, to the fact that circular letter Depvist045 (procedure to open current and term accounts) is not clear in the procedure to open these types of accounts (Grand Cayman)."

The audit concluded with the recommendation: “Branch should ensure that KYC and account opening documentation is complete and in compliance with regulations.”

The 2006 audit uncovered severe AML and KYC deficiencies in the Cayman branch requiring remedial action to comply with the Mexican deadline for improving customer file KYC information, but those audit results appear to have been ignored. The audit recommendations were recorded in HBMX’s electronic system, but later

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534 Id. at 3.
535 Id. at 4.
closed out without any apparent actions having been taken in response, which does not comport with Group policy.536 Two years later, in 2008, John Root, senior HSBC Group Compliance officer, rediscovered the 2006 audit when examining KYC problems in the Cayman accounts. He wrote: “The real surprise was the existence of an HBMX audit in January 2006 on KYC for the USD Cayman accounts. It is not clear who in AML responded, and how. Blank looks all around.”537 His supervisor, Mr. Bagley, later jokingly remarked to the Head of Group Audit for Latin America and the Caribbean, Graham Thomson: “I do find it surprising that there can have been no response and yet the audit was closed out. Is this a breach or are you in audit becoming softer.”538

**Project Restoration.** As the 2007 deadline approached for completing the KYC updates mandated by Mexican law and internal reports showed that HBMX’s KYC documentation remained in poor condition, HBMX obtained a year-long extension from Mexican regulators, to May 2008, to clean up its files, including client files for the Cayman accounts.539

In February 2008, Mexican regulators met with the HBMX CEO and, among other issues, criticized the bank’s poor KYC documentation, leading HBMX to initiate “Project Restoration” to intensify its KYC remediation efforts.540 John Rendall, HBMX Chief Operating Officer, was put in charge of the project with the understanding that files containing inadequate KYC would be closed.541 Project Restoration was closely monitored by senior HBMX and HSBC Group officials.

At first, the Cayman accounts were excluded from the project. Then, in July 2008, HBMX’s monitoring system suddenly began generating alerts for a number of Cayman accounts. These alerts, which highlighted suspicious account activity, were brought to the attention of senior Compliance personnel. The head of HSBC Group Compliance David Bagley told the Subcommittee this incident was the “first point that the Cayman Islands were brought into sharp focus” for him.542 He sent an email informing senior HSBC Group and HBMX officials about the alerts which had identified “significant USD [U.S. dollar] 536 See 7/30/2008 email from HSBC John Root to HSBC David Bagley, “HBMX Visit Update,” HSBC OCC 8873487-489; 8/5/2008 email exchange among HSBC David Bagley, HSBC John Root and HBMX Graham Thomson, “HBMX - Cayman accounts,” HSBC OCC 8874829-830. 537 7/30/2008 email from HSBC John Root to HSBC David Bagley, “HBMX Visit Update,” HSBC OCC 8873487-489. 538 8/5/2008 email from HSBC David Bagley to HBMX Graham Thomson, “HBMX Cayman accounts,” at HSBC OCC 8874829. 539 See 7/27/2007 minutes of HSBC LAM Regional Audit Committee, HSBC OCC 8875988-090 (noting extension of time for the KYC effort until May 2008). 540 See 6/5/2012 letter from HSBC legal counsel to the Subcommittee, at 2. 541 See, e.g., 10/28/2008 email from Graham Thomson to Emilson Alonso, Subject: “HBMX - Projecto Restauracion,” HSBC OCC 8873464. 542 Subcommittee interview of David Bagley (5/10/2012).
remittances being made by a number of [HBMX Cayman] customers to a US company alleged to be involved in the supply of aircraft to drug cartels.”\(^{43}\) The company was Cabello Air Freight Inc. of Miami.\(^{44}\) Mr. Bagley wrote that “[a]s a precaution HBMX have issued instructions that no new [Cayman] accounts be opened pending a review of these activities.”\(^{45}\) This step was taken with respect to the Cayman accounts, in the words of one HBMX compliance officer, “due to the massive misuse of them by organized crime.”\(^{46}\)

The decision to suspend new Cayman accounts was made by then HBMX CEO Luis Pena who did not specify when the suspension would be lifted.\(^{47}\) He also instructed HBMX staff to engage in “a process of enhanced due diligence KYC” for all Cayman account holders to “end by December 1.” He wrote:

> “After this date we will cancel all the accounts that we were not able to complete files on and will send cashiers checks to all the respective customers. For the future, Mexicans who wish to open a dollar denominated account will undergo a referencing process, in which the accounts will be … opened by the bank’s staff in a proper offshore book as we do in our Premier offering. … Unfortunately we will likely lose some deposits as we do not expect the KYC process to succeed 100%, but we will offset a significant control and regulatory risk.”\(^{48}\)

Also in July 2008, after reviewing the 2006 audit of the Cayman accounts, Mr. Root informed Mr. Bagley that “a sampling showed that 15% of the customers did not even have a file.”\(^{49}\) Mr. Root wrote: “Fixing the Cayman accounts will be a struggle. How do you locate clients when there is no file?”

\(^{43}\) 7/31/2008 email from HSBC David Bagley to HSBC Richard Bennett, with copies to HSBC Michael Geoghegan, Matthew King, and HBMX Emilson Alonso, Luis Pena, and John Rendall, “HBMX-CAYMAN ACCOUNTS,” HSBC OCC 8874832-33.

\(^{44}\) See also Sealed Exhibits.

\(^{45}\) 7/31/2008 email from HSBC David Bagley to HSBC Richard Bennett, with copies to HSBC Michael Geoghegan, Matthew King, and HBMX Emilson Alonso, Luis Pena, and John Rendall, “HBMX-CAYMAN ACCOUNTS,” HSBC OCC 8874832-33.

\(^{46}\) 7/30/2008 email from HBMX employee to HBMX Jaime Saez and Ramon Garcia, “Seriously consider restricting the product Dollars accounts in the zona frontera Product 62,” HSBC OCC 8873503-738.


\(^{48}\) 7/31/2008 email from HSBC Luis Pena to HBMX Emilson Alonso, HSBC David Bagley, and others, “HBMX - CAYMAN ACCOUNTS,” HSBC OCC 8873503-504.

\(^{49}\) 7/30/2008 email from HSBC John Root to HSBC David Bagley, “HBMX Visit Update,” HSBC OCC 8873487-489.
to get a better sense of the clients using them. In the meantime, the
documents contain no indication that either HSBC Group or HBMX
informed HBUS about the suspect account activity or the Cayman KYC
deficiencies, even though the Cayman accounts were operating solely
through the HBMX correspondent accounts at HBUS.\footnote{Another example of a Cayman U.S. dollar account that HSBC Group and HBMX were aware of and expressed concerns about, but apparently did not inform HBUS, were accounts opened for two embassies, one of which was for a country in the Middle East. See 12/2/2005 email exchange between HSBC David Bagley and John Root, "OFAC," HSBC OCC 8876612-613. Mr. Bagley told the Subcommittee that although there was no indication of any “sinister” activity, these accounts were later closed, because the bank “did not want the risk.” Subcommittee interview of David Bagley (5/10/12). Subcommitte interview of David Bagley (5/10/12). See 9/12/2008 email from HBMX Ramon Garcia to HSBC John Root, “Cayman Accounts,” HSBC OCC 8876784. See Attachment to 9/12/2008 email from HBMX Ramon Garcia to HSBC John Root, “Cayman Accounts,” HSBC OCC 8875462-465, at 465. See undated HSBC presentation, “Conducting an Enhanced KYC for Grand Cayman Accountholders: Proposal to Update the Strategy to Control Risk arising from Grand Cayman Accounts,” HSBC OCC 8874560-566, at 561 ("It is considered that it will not be possible to complete 50,000 enhanced KYC by 01DEC08.").}

As a result of the AML alerts regarding money laundering
involving some of the Cayman accounts and re-discovery of the 2006
audit exposing the poor state of the Cayman account files, the Cayman
accounts were added to the Restoration Project.\footnote{Another example of a Cayman U.S. dollar account that HSBC Group and HBMX were aware of and expressed concerns about, but apparently did not inform HBUS, were accounts opened for two embassies, one of which was for a country in the Middle East. See 12/2/2005 email exchange between HSBC David Bagley and John Root, "OFAC," HSBC OCC 8876612-613. Mr. Bagley told the Subcommittee that although there was no indication of any “sinister” activity, these accounts were later closed, because the bank “did not want the risk.” Subcommittee interview of David Bagley (5/10/12). Subcommitte interview of David Bagley (5/10/12). See 9/12/2008 email from HBMX Ramon Garcia to HSBC John Root, “Cayman Accounts,” HSBC OCC 8876784. See Attachment to 9/12/2008 email from HBMX Ramon Garcia to HSBC John Root, “Cayman Accounts,” HSBC OCC 8875462-465, at 465. See undated HSBC presentation, “Conducting an Enhanced KYC for Grand Cayman Accountholders: Proposal to Update the Strategy to Control Risk arising from Grand Cayman Accounts,” HSBC OCC 8874560-566, at 561 ("It is considered that it will not be possible to complete 50,000 enhanced KYC by 01DEC08.").}

Mr. Root told the
Subcommittee that, in July 2008, the Cayman accounts “went to the top
of the list” at the project.\footnote{Another example of a Cayman U.S. dollar account that HSBC Group and HBMX were aware of and expressed concerns about, but apparently did not inform HBUS, were accounts opened for two embassies, one of which was for a country in the Middle East. See 12/2/2005 email exchange between HSBC David Bagley and John Root, "OFAC," HSBC OCC 8876612-613. Mr. Bagley told the Subcommittee that although there was no indication of any “sinister” activity, these accounts were later closed, because the bank “did not want the risk.” Subcommittee interview of David Bagley (5/10/12). Subcommitte interview of David Bagley (5/10/12). See 9/12/2008 email from HBMX Ramon Garcia to HSBC John Root, “Cayman Accounts,” HSBC OCC 8876784. See Attachment to 9/12/2008 email from HBMX Ramon Garcia to HSBC John Root, “Cayman Accounts,” HSBC OCC 8875462-465, at 465. See undated HSBC presentation, “Conducting an Enhanced KYC for Grand Cayman Accountholders: Proposal to Update the Strategy to Control Risk arising from Grand Cayman Accounts,” HSBC OCC 8874560-566, at 561 ("It is considered that it will not be possible to complete 50,000 enhanced KYC by 01DEC08.").}

One of the first steps taken with regard to the Cayman accounts
was that HBMX Compliance personnel analyzed their risk levels, and
sorted customers into three categories: red, yellow, and white. Red
status indicated that a customer was a “Special Category Client” (SCC),
on a “black list,” or the subject of a SAR; yellow status indicated that a
customer had been flagged by HBMX’s internal AML monitoring
system with one or more alerts, but no SAR had been filed; white status
indicated that the customer had no such derogatory information on
file.\footnote{Another example of a Cayman U.S. dollar account that HSBC Group and HBMX were aware of and expressed concerns about, but apparently did not inform HBUS, were accounts opened for two embassies, one of which was for a country in the Middle East. See 12/2/2005 email exchange between HSBC David Bagley and John Root, "OFAC," HSBC OCC 8876612-613. Mr. Bagley told the Subcommittee that although there was no indication of any “sinister” activity, these accounts were later closed, because the bank “did not want the risk.” Subcommittee interview of David Bagley (5/10/12). Subcommitte interview of David Bagley (5/10/12). See 9/12/2008 email from HBMX Ramon Garcia to HSBC John Root, “Cayman Accounts,” HSBC OCC 8876784. See Attachment to 9/12/2008 email from HBMX Ramon Garcia to HSBC John Root, “Cayman Accounts,” HSBC OCC 8875462-465, at 465. See undated HSBC presentation, “Conducting an Enhanced KYC for Grand Cayman Accountholders: Proposal to Update the Strategy to Control Risk arising from Grand Cayman Accounts,” HSBC OCC 8874560-566, at 561 ("It is considered that it will not be possible to complete 50,000 enhanced KYC by 01DEC08.").}

Out of a total of 49,935 customers with 61,586 accounts worth
about $2.1 billion, HBMX categorized 1,314 customers as “red” status,
representing 2,240 accounts worth about $205 million. HBMX also
flagged 2,027 customers as “yellow” status, representing 2,084 accounts
worth about $180 million.\footnote{Another example of a Cayman U.S. dollar account that HSBC Group and HBMX were aware of and expressed concerns about, but apparently did not inform HBUS, were accounts opened for two embassies, one of which was for a country in the Middle East. See 12/2/2005 email exchange between HSBC David Bagley and John Root, "OFAC," HSBC OCC 8876612-613. Mr. Bagley told the Subcommittee that although there was no indication of any “sinister” activity, these accounts were later closed, because the bank “did not want the risk.” Subcommittee interview of David Bagley (5/10/12). Subcommitte interview of David Bagley (5/10/12). See 9/12/2008 email from HBMX Ramon Garcia to HSBC John Root, “Cayman Accounts,” HSBC OCC 8876784. See Attachment to 9/12/2008 email from HBMX Ramon Garcia to HSBC John Root, “Cayman Accounts,” HSBC OCC 8875462-465, at 465. See undated HSBC presentation, “Conducting an Enhanced KYC for Grand Cayman Accountholders: Proposal to Update the Strategy to Control Risk arising from Grand Cayman Accounts,” HSBC OCC 8874560-566, at 561 ("It is considered that it will not be possible to complete 50,000 enhanced KYC by 01DEC08.").} HBMX then largely limited its KYC
remediation efforts to the 3,341 “red” and “yellow” customers. The
other 46,000 account holders were not included in the project.\footnote{Another example of a Cayman U.S. dollar account that HSBC Group and HBMX were aware of and expressed concerns about, but apparently did not inform HBUS, were accounts opened for two embassies, one of which was for a country in the Middle East. See 12/2/2005 email exchange between HSBC David Bagley and John Root, "OFAC," HSBC OCC 8876612-613. Mr. Bagley told the Subcommittee that although there was no indication of any “sinister” activity, these accounts were later closed, because the bank “did not want the risk.” Subcommittee interview of David Bagley (5/10/12). Subcommitte interview of David Bagley (5/10/12). See 9/12/2008 email from HBMX Ramon Garcia to HSBC John Root, “Cayman Accounts,” HSBC OCC 8876784. See Attachment to 9/12/2008 email from HBMX Ramon Garcia to HSBC John Root, “Cayman Accounts,” HSBC OCC 8875462-465, at 465. See undated HSBC presentation, “Conducting an Enhanced KYC for Grand Cayman Accountholders: Proposal to Update the Strategy to Control Risk arising from Grand Cayman Accounts,” HSBC OCC 8874560-566, at 561 ("It is considered that it will not be possible to complete 50,000 enhanced KYC by 01DEC08.").}

Two months later, in September 2008, senior HSBC Group
Compliance officer John Root offered a negative assessment of the KYC
remediation efforts directed at the Cayman accounts:
"The HBMX ‘Restoration’ project chaired by John Rendall, HBMX COO, is endeavoring to regularize these accounts on a risk-basis. Account opening documentation is generally poor or non-existent and there is a lot of work to do. Money-laundring risk is consequently high."

An HSBC presentation, which is undated but appears to have been prepared in October 2008, summarized the ongoing Cayman KYC problems and presented a new strategy to address them. The presentation was entitled, “Conducting an Enhanced KYC for Grand Cayman Accountholders: Proposal to Update the Strategy to Control Risk arising from Grand Cayman Accounts.” One key slide noted that “almost no progress [had] been made in enhanced KYC completion” and that only 25% of the files would have complete KYC information by December 1, 2008:

• The Bank has been recently fined for offering this product in Mexico, and money laundering red flags have been identified.

• On 28JUL, CMP [Compliance] gave instructions to suspend this product.

• On 31JUL08, Segment Directors were requested by CEO that an enhanced KYC will be completed for all Grand Cayman accounts before 01DEC08.

• As of JUL08, in Grand Cayman CDA/DDA 49,937 customers, and its portfolio was approximately USD 1,500 million.

• Currently, this product is expected to be re-opened, as long as necessary adjustments to systems, processes and documentation are made, with stricter controls, and if Group Compliance’s sign-off is obtained.

• On 26SEP, Segment directors reported that almost no progress has been made in enhanced KYC completion. In addition, a central validation of enhanced KYC quality is not in place.

557 Undated HSBC presentation, “Conducting an Enhanced KYC for Grand Cayman Accountholders: Proposal to Update the Strategy to Control Risk arising from Grand Cayman Accounts,” HSBC OCC 8875465-566. Because of dates mentioned in the presentation, it seems to have been completed between September 27 and October 30, 2008.
559 The figure of $1.500 million seems to refer to the Cayman certificates of deposit and does not include additional funds in Cayman Demand Deposit Accounts.
According to Remediation Project results, success rate in file completion is approximately 25%. This means that if this strategy is followed, it will not be possible to complete more than 25% of required enhanced KYC forms by 01DEC08.\textsuperscript{560}

This October 2008 assessment indicates that at least 75% of the Cayman files still had incomplete KYC information six years after HBMX assumed control of the accounts.

Despite this grim assessment, the Strategy also noted efforts underway to allow new Cayman accounts to be opened.\textsuperscript{561} As Graham Thomson, head of Group Audit for Latin America and the Caribbean, explained in an email to colleagues, the accounts needed to continue due to the income they produced:

"Currently the business owner and compliance are still discussing with GMO CMP [Compliance] the product parameters that are to be applied to lift the current embargo and relaunch the CI [Cayman Island] product. It is important that these discussions result in practical product parameters as the CI portfolio is an important source of funds for HBMX and it is hoped the replacement product will be shortly submitted to the new products committee and then relaunched."\textsuperscript{562}

Internal documents show that HSBC Group and HBMX officials considered a variety of criteria to determine when a new Cayman account could be opened, including requirements that the client be an existing HBMX customer for six months, complete an "enhanced KYC Questionnaire," undergo screening against the OFAC list and other "blacklists," and agree to limits on cash deposits.\textsuperscript{563}

**U.S. Dollar Restriction.** In November 2008, HSBC Group CEO Michael Geoghegan traveled to Mexico and met with senior Mexican regulators who were highly critical of HBMX’s AML and KYC efforts, the huge volume of U.S. dollars that HBMX was exporting to the United States, and the possibility that a portion of those funds were associated with drug trafficking and money laundering.\textsuperscript{564} The regulators explicitly


\textsuperscript{561} Id. at 561.

\textsuperscript{562} 10/20/2008 email from Graham Thomson to HSBC Emilson Alonso and others, “HBMX – Projecto Restauracion,” HSBC OCC 8874595-600, at 596-597.


\textsuperscript{564} See 2/18/2008 email from HBMX Paul Thurston to HSBC Michael Geoghegan, with copies to Richard Bennett and Matthew King, “Confidential – CMBV/FIU Meeting,” HSBC OCC
mentioned the U.S. dollars sent from the Cayman accounts. In response, Mr. Geoghegan proposed prohibiting all HMBX branches, including the Cayman branch, from offering U.S. dollars to customers, except at automated teller machines in Mexican airports. Since the Cayman accounts relied on U.S. dollars, the proposed new policy directly impacted Cayman accountholders. HBMX CEO Luis Pena nevertheless agreed with the proposal, and also ordered the freeze on opening new Cayman accounts to continue indefinitely and prohibiting new cash deposits for existing Cayman accounts. Mr. Pena noted that the new measures would cost HBMX a lot of money: “Cayman and Mexico dollar accounts provide us with US$2.6 billion of cheap funding. We are likely to lose a big portion of this if we tell customers we no longer receive dollar notes.” The new policies took effect in January 2009.

9,000 Accounts Closed. According to HSBC’s legal counsel, HBMX took nearly another year to complete KYC remediation of the Cayman accounts, finally completing the work in July 2009. As part of that KYC effort, HBMX closed approximately 9,000 Cayman accounts, due in many cases to incomplete KYC information. At the same time, HBMX allowed the Cayman branch to remain in operation and lifted the ban on new accounts. Today, over 20,000 HBMX clients have over $657 million in Cayman U.S. dollar denominated accounts.

Because the HBMX Cayman branch continues to offer U.S. dollar accounts, despite a history of poor KYC controls and deficient KYC documentation, and despite the inherent riskiness associated with operating offshore accounts in a secrecy tax haven, the Cayman accounts continue to pose ongoing money laundering risks to HBUS. Because HBUS is now aware of the Cayman accounts, it will have to evaluate the risk and determine whether to continue to process Cayman account transactions through the HBMX correspondent account.

(3) Cashing U.S. Dollar Travelers Cheques

A third example of how HBMX has introduced risk into HBUS involves its issuing and cashing millions of dollars in U.S. dollar

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568 11/28/2008 from HBMX Luis Pena to HSBC Emilson Alonso, HSBC OCC 8874856.
569 6/5/2012 letter from HSBC legal counsel to the Subcommittee, at 5.
570 Id.
Travelers cheques are paper monetary instruments which, for a fee, are issued and administered by a financial institution. They can be issued in a variety of currencies and denominations, and carry serial numbers so that, if the cheques are lost or stolen, the issuing financial institution can trace back the purchase and either replace the cheques or refund the money used to purchase them. Individuals often use travelers cheques to minimize carrying hard currency while traveling and as a way to safeguard their funds. Some financial institutions issue such cheques only to pre-existing customers; others issue the cheques to anyone who pays the fee. U.S. financial regulators have long warned financial institutions about the money laundering risks associated with travelers cheques, especially when purchased with cash by a non-customer and used to move substantial funds across international borders in ways that are difficult to trace. 571 Travelers cheques have been used by terrorists, 572 drug traffickers, 573 and other criminals. 574

HBMX has issued a large number of U.S. dollar travelers cheques, at times selling them to anyone willing to pay the fee and cashing them for customers and non-customers alike. In 2004, John Root, senior HSBC Group Compliance officer, sent an email to HBMX’s Compliance head, Ramon Garcia, and AML head, Carlos Rochin, noting the huge volume of travelers cheques pouring in from Mexico and seeking assurances that HBMX was on guard against money laundering:

"I note that in the year through 3Q04 [third quarter of 2004], HBMX has sold over USD 110 million of travelers cheques, an amount that eclipses that of HBEU [HSBC Europe] here in the UK, and that is several orders of magnitude higher than any other non-UK entity, including Hong Kong and the US. In fact, it represents one-third of the Group’s total global traveller’s cheque business (with the UK representing another third).

Could you kindly prepare a report for GHQ [Group Headquarters] summarizing the money laundering procedures currently in place for such a booming business. Please include in this report KYC controls, number of SARs in the YTD [year to date], breakdown by region and branch, etc., etc.,

Mr. Garcia responded with preliminary information and a recent case involving travelers cheques, but in response to Mexican legal requirements regarding client-specific information, HSBC has so heavily redacted copies of those documents, as well as a longer report requested by Mr. Root, that they do not provide additional information.

In 2008, when HBMX decided to stop offering U.S. dollars at its branches in most cases, the HBMX CEO Luis Pena recommended greater use of U.S. dollar travelers cheques instead, sold only to pre-existing customers. In response, the Deputy Head of HSBC Group Compliance, Warren Learning, warned that travelers cheques also raise AML concerns, and advised lowering the existing $25,000 ceiling on the amount of travelers cheques that could be purchased by one customer at a time, and creating a new limit on the amount of travelers cheques that could be deposited at one time to a client account.

In 2009, after CNBV expressed concerns about HBMX’s weak AML controls, among other steps, HBMX tightened its policies on travelers cheques. As of January 1, 2009, HBMX determined that it would sell its travelers cheques only to pre-existing customers and would place a limit on the amount that could be sold to any one

575 See 11/8/2004 email from HSBC John Root to HBMX Ramon Garcia and Carlos Rochin, with copies to HSBC David Bagley and Susan Wright, “Travellers Cheques,” HSBC OCC 8876645-646.
customer at a time. Warren Leaing, Deputy Head of HSBC Group Compliance, who supported those changes, noted in an email: “There remain AML issues in respect of travellers cheques which historically are very high risk from an AML perspective and accordingly we would expect that the limits are reasonably low and that there are very strong controls in place to ensure that branches do not abuse the rules.”

At HBUS, the documents reviewed by the Subcommittee indicate that, despite their large volume, HBMX travelers cheques attracted little AML review or attention, even though the travelers cheques would have been presented for payment at HBUS’ processing centers in New York and subjected to review. The HBUS processing centers segregated and reviewed all travelers cheques and were required to send blocks of sequentially numbered cheques exceeding $10,000 to HBUS AML Compliance for review. At the same time, the processing centers had no information on expected account volume, conducted no trend analysis to identify suspicious transactions, and conducted no due diligence on the persons cashing the cheques. A 2007 OCC examination of HBUS’ pouch activities, which included clearing U.S. dollar travelers cheques, identified numerous deficiencies in the AML policies and procedures and called for stronger AML controls, but it did not appear to result in any greater review of the HBMX travelers cheques. To the contrary, a 2007 HBUS policy change appears to have further limited AML reviews of travelers cheques presented by HSBC Group affiliates in non-high risk countries, restricting them to cases where the deposits exceeded $1 million. At that time, HBUS deemed both Mexico and HBMX to be at low risk of money laundering.

In 2009, the OCC conducted a second review of HBUS’ pouch activities, including procedures to clear U.S. dollar travelers cheques.

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580 Id.
As part of that examination, HBUS produced to the OCC a lengthy description of its AML policies and procedures for foreign financial institutions that present items for processing through a correspondent account, including travelers cheques.\footnote{See undated “Request No. 7,” prepared by HSBC, OCC-PSI-00000075-195 at 123-130 (providing detailed information in response to OCC questions regarding HBUS’ remote deposit capture and cash letter pouch transactions). [Sealed Exhibit.]} Those procedures contained a number of restrictions or conditions, but did not impose a ceiling on the amount of money that HBUS would provide to a correspondent client through the cash letter process. The procedures did, however, require transactions over a certain amount to be reported to HBUS AML Compliance before processing. The reporting triggers were linked to the risk rating of the foreign financial institution presenting the monetary instrument for payment. The five relevant risk ratings, from highest risk to lowest, were: Special Category Client (SCC), high risk, cautionary risk, medium risk, and standard risk. The reporting triggers were as follows:

- For SCC customers – $1,000 for an individual item, and $10,000 in total deposits.
- For high risk customers – $10,000 for an individual item, and $100,000 in total.
- For cautionary risk customers – $50,000 for an individual item, and $200,000 in total.
- For standard and medium risk customers – $50,000 for an individual item and $250,000 in total.

Clients seeking to cash travelers cheques in excess of the reporting thresholds were not automatically prohibited from proceeding; instead, their transactions were reported to HBUS AML Compliance which was then supposed to make a case-by-case decision on whether to allow the transactions to proceed.

By 2009, Mexico and HBMX were considered high risk and, due to the large volume of HBMX travelers cheques it sold, HBMX cheques should have regularly triggered the AML reporting requirement and AML reviews. In addition, HBMX travelers cheques should have produced numerous alerts due to the large amounts, sequentially numbered cheques, and structuring patterns involved. Instead, the documentation suggests that few alerts issued and very little review of HBMX travelers cheques took place.

As part of its 2009 examination, the OCC expressed concern that, based on samples taken from 2007, 2008, and 2009, HBUS’ monitoring of travelers cheques required too few AML reviews and was inadequate
to detect suspicious activity. In response, HBUS undertook a detailed review of all cash letter items in 2009. HBUS determined that 280 items had been flagged for review, a tiny number in comparison to the huge number of transactions cleared per year. In addition, according to HBUS, of those 280 items, less than a handful contained information suggesting suspicious activity. While HBUS presented that result as evidence of minimal AML risk, it is possible that the criteria used to flag transactions for review were too narrow to catch suspicious transactions.

One reason to think the latter might be the case is that, from 2007 to 2012, other financial institutions have reported significant instances of suspicious activities involving U.S. dollar travelers cheques either issued or cleared by HBMX. These reports generally describe coordinated teams of individuals, each of whom purchased large numbers of travelers cheques from HBMX, and then cashed or deposited the cheques in suspicious patterns. Some of the U.S. dollar travelers cheques identified by these financial institutions had a combined value in excess of $1 million, and some of the suspicious activity occurred over an extended period of time. Many of the suspicious transactions involved sequentially numbered cheques, illegible signatures, or difficult to understand markings or numbers on the cheques. In some cases, groups of cheques were made payable to the same health food business, toy company, or automobile auction house.

Four examples illustrate the issues. In the first example, nearly 1,500 U.S. dollar travelers cheques were purchased from the same HBMX branch in Mexico over a seven-month period from 2007 to 2008, and cashed shortly thereafter at several automobile auctions in the United States. Money launderers have been shown in the past to utilize the purchase of expensive, but liquid items, such as cars to hide illicit funds. The travelers cheques had a combined value of $900,000. In a second instance from 2008, on four occasions over a period of 16 days, individuals purchased from an HBMX branch in Mexico travelers cheques which, each time, had a combined value of $20,000 to $30,000, and altogether added up to $109,000. All of the cheques were then signed and countersigned with the same illegible signature, and made payable to the same toy business in Mexico. Ten months later, in a coordinated effort over a two-week period, all of the cheques were either cashed or deposited. In a third instance, 188 travelers cheques in denominations of $500 and $1000, totaling $110,000, were purchased in nine large blocks of sequentially numbered cheques from a major U.S. bank. Then, over a three-month period from April to June 2011, all 188

588 Id.
589 Id.
590 See Sealed Exhibits.
cheques were negotiated for payment at the same HBMX branch in Mexico, using illegible signatures so that the cheques provided no information about the payees.

In the fourth instance, two men purchased groups of travelers cheques from the same HBMX branch in Mexico. On 14 occasions over a three month period in 2011, the two men purchased the travelers cheques in batches which, each time, had a combined value of $10,000, and altogether added up to $140,000. All of the cheques were then signed with the same illegible signature. Over time, small groups of the travelers cheques, often with consecutive serial numbers, were cashed or deposited, with the majority of cheques failing to bear a stamp indicating exactly where they were negotiated. The 2011 transactions were part of a larger pattern in which the same HBMX branch sold travelers cheques to the same two men over a three year period from 2009 to 2011, for a combined value of $1.9 million.

While HBMX has tightened its travelers cheque policies by restricting the sale of travelers cheques to pre-existing customers and limiting the dollar amount of travelers cheques that can be provided to one customer at a time, HBMX travelers cheques continue to surface in reports of suspicious activities filed with U.S. authorities. Because many if not all of the cheques are cashed through the HBMX correspondent accounts at HBUS, HBMX continues to expose HBUS to money laundering risks through its issuance and cashing of U.S. dollar travelers cheques.

HBMX’s money service business clients, Cayman accountholders, and travelers cheque purchasers all relied on the U.S. dollar services that HBMX was able to provide through its correspondent accounts at HBUS. In some cases, it appears those HBMX clients used HBMX’s U.S. dollar correspondent account at HBUS to commit criminal acts. For its part, HBUS should have known of the money laundering risks it was incurring from those and other high risk HBMX clients, accounts, and products. Because HBMX was an HSBC affiliate and was also categorized for many years as located in a low risk jurisdiction, however, until recently, HBUS did not perform the KYC due diligence or account monitoring needed to uncover HBMX’s high risk activities.

E. Bulk Cash Movements

In addition to using HBUS correspondent accounts to execute wire transfers, clear cash letter instruments, and conduct other U.S. dollar transactions, in 2007 and 2008, HBMX used its HBUS banknotes account to supply more physical U.S. dollars to HBUS than any other Mexican bank or HSBC affiliate. The documents indicate that both HBMX and HBUS were unaware of the flood of dollars HBMX was
pouring into the United States through HBUS, in part because HBUS had stopped monitoring HSBC affiliates’ banknotes accounts for a three-year period, from mid-2006 to mid-2009. HBUS policy was also consistent with the HSBC Group policy of not performing due diligence or account monitoring for HSBC affiliates. When, in 2008, Mexican and U.S. regulators began pressing both HBMX and HBUS to explain the huge flow of U.S. dollars from Mexico and whether the funds included illegal drug proceeds, both banks were caught by surprise and eventually took action to turn off the spigot. In 2009, HBMX stopped accepting U.S. dollar deposits at its branches in Mexico, and then in 2010, HBUS exited the banknotes business.

(1) HBUS’ Global Banknotes Business

Prior to its exit, HBUS operated a very large U.S. banknotes business which the Federal Reserve estimated in 2010, to be worth approximately $300 billion annually. As part of that business, HBUS supplied physical U.S. dollars and accepted bulk cash shipments from financial institutions around the world, including over two dozen HSBC affiliates.

Bulk cash shipments typically use common carriers, independent carriers, or U.S. Postal Service carriers to ship U.S. dollars by air, land, or sea to a bank located in the United States. Shipments have gone via airplanes, armored trucks, ships, and railroads. Most shipments are transported via containerized cargo. Shippers may be “currency originators,” such as businesses that generate cash from sales of goods or services; or “intermediaries” that gather currency from originators or other intermediaries to form large shipments. Intermediaries are typically central banks, commercial banks, money service businesses, or their agents. Bulk cash shipments can be made directly to a bank in the United States, or to a U.S. Federal Reserve Bank or branch, which will accept the cash and credit it to the account of the intended recipient bank. Banks that receive bulk cash shipments via common carriers or the Postal Service have no obligation to report the amount of the cash received to U.S. authorities, though they still must report any suspicious activity.

593 1/12/2010 memorandum from the Federal Reserve, “US Department of Justice Investigation of HSBC Bank USA NA’s (HSBC Bank USA) Bank Note Business (Revised),” at B0G-SR-001404. [Sealed Exhibit.]
594 Id.
595 Id.
596 Id., citing 31 CFR §103.23.
Until 2010, HBUS was one of about 30 U.S. financial institutions that bought and sold physical currency on a wholesale basis around the world. \[597\] The headquarters of HBUS’ Global Banknotes business was located in New York, headed by Christopher Lok, with offices in London, Hong Kong, Singapore, and other locations. \[598\] Until 2010, HSBC was also one of a relatively small number of international banks that contracted with the Federal Reserve Bank of New York (FRBNY), under the Extended Custodial Inventory (ECI) Program, to manage the FRBNY’s U.S. currency vaults. The ECI Program facilitates the international distribution of U.S. dollars, repatriates old dollars, circulates new designs, and provides information on the international use of U.S. currency. \[599\] HSBC operated FRBNY currency vaults in London, Frankfurt, and Singapore. \[600\] The currency in those vaults remained on the books of the Federal Reserve, and was used to fill orders from third parties or the operator itself. \[601\] When distributing U.S. dollars, HSBC was obligated to comply with U.S. AML and Office of Foreign Assets Control (OFAC) requirements. \[602\] While bulk cash shipments are a normal and legitimate part of international banking, they are also vulnerable to misuse by money launderers and other criminals. In 2001, the U.S. Congress made smuggling large amounts of physical U.S. dollars across U.S. borders a crime. \[603\] In 2005, a U.S. Money Laundering Threat Assessment identified bulk cash smuggling as a key method used to launder criminal proceeds and highlighted how drug traffickers were smuggling U.S. dollars obtained from illegal U.S. drug sales across the border into Mexico and then using various means to arrange for their deposit into a U.S. bank. \[604\] In 2006, the U.S. Financial Crimes Enforcement Network (FinCEN) issued an advisory to U.S. financial institutions warning them

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\[597\] Id. at BOG-SR-001405. [Sealed Exhibit.]
\[599\] 1/12/2010 memorandum from the Federal Reserve, “US Department of Justice Investigation of HSBC Bank USA NA’s (‘HSBC Bank USA’ Bank Note Business (Revised),” at BOG-SR-003405. [Sealed Exhibit.]  
\[600\] Id.  
\[601\] Id.
\[602\] See Section 371 of the USA Patriot Act, P.L. 107-56, codified at 31 U.S.C. §5332 (outlawing the smuggling or attempted smuggling of over $10,000 in currency or monetary instruments into or out of the United States, with the specific intent to evade U.S. currency reporting requirements).  
\[603\] See Dec. 2005 “U.S. Money Laundering Threat Assessment,” issued by the Money Laundering Threat Assessment Working Group, which included the U.S. Departments of Treasury, Justice, and Homeland Security, Federal Reserve, and U.S. Postal Service, Chapter 5 on “Bulk Cash Smuggling.” (“Upon leaving the country, cash may stay in Mexico, continue on to a number of other countries, or make a U-turn and head back into the United States as a deposit by a bank or casa de cambio.”).
in particular about money laundering associated with bulk cash shipments from Mexican casas de cambio.605

As of 2010, 29 HSBC affiliates had banknotes accounts with HBUS.606 Some of those affiliates operated in high risk countries plagued by drug trafficking, corruption, money laundering, or other criminal enterprises, including Angola, Bangladesh, Colombia, Democratic Republic of Congo, Haiti, Mexico, Panama, Paraguay, Saudi Arabia, and Ukraine. HBUS did not distinguish, however, between high and low risk affiliates with banknotes accounts.607

(2) HBMX U.S. Dollar Sales to HBUS

For a three-year period, from mid-2006 until mid-2009, HBUS accepted more than $15 billion in physical U.S. dollars from other HSBC affiliates, but failed to conduct any AML monitoring of the bulk cash transactions.608 HBUS had performed AML monitoring both prior to and following that time period. HBUS personnel have been unable to explain why all AML monitoring of its banknotes accounts ceased during that period and then resumed later, but the OCC has noted that the monitoring ceased when a formal AML oversight agreement applicable to HBUS expired, and resumed when an OCC AML examination of the banknotes operations was launched in July 2009.609 The absence of AML monitoring meant that HBUS did not track for AML purposes its growing dollar traffic with HBMX, which reached $3 billion in 2007, and then jumped another 25% in 2008 to $4 billion.610

In February 2008, Mexican regulators held a private meeting with HBMX CEO Paul Thurston and informed him that HBMX was repatriating more U.S. dollars to the United States than any other Mexican bank – more than each of the four largest Mexican banks, all of which were larger than HBMX.611 The CNBV also informed Mr. Thurston that the Mexican Financial Intelligence Unit (FIU) was very

607 Id. at OCC-PSI-00864336.
608 Id. at 336.
609 See id. at 360. When asked why HBUS stopped monitoring its affiliates’ banknotes activity, HBUS personnel offered conflicting reasons. Daniel Jack, in charge of HBUS compliance for banknotes, thought that his supervisor, Alan Ketley, had approved the decision to stop monitoring activity, but Alan Ketley did not recall the decision. Neither did their superior, Teresa Pesce. David Bagley called the decision to stop monitoring banknotes for affiliates “inexplicable.” Subcommittee interviews of Daniel Jack (3/13/2012), Alan Ketley (2/16/2012), Teresa Pesce (3/30/2012) and David Bagley (4/12/2012).
concerned about the “high level of ML [money laundering] risk” involved. The FIU indicated that in the “majority of the most relevant ML cases” they had investigated in 2007, “many transactions were carried out through” HBMX.

In November 2008, the CNBV and FIU held a second private meeting, not only with the HBMX CEO, then Luis Pena, but also with the HSBC CEO of Latin America, Emilson Alonso, and the CEO of the HSBC Group, Michael Geoghegan. Again, the regulators expressed their alarm at the volume of U.S. dollars that HBMX was sending to the United States and described law enforcement concerns about the extent to which those dollars may be the proceeds of illegal drug trafficking in the United States. A November email from the HSBC Group Compliance Deputy Head summarizing the meeting stated that, between January and September 2008, HBMX had repatriated $3 billion to the United States, which represented 36% of the market volume and double what the biggest bank in Mexico, Banamex, had repatriated, even though HBMX was only the fifth largest bank in the country. According to an internal OCC document, the Department of Homeland Security’s Immigration and Customs Enforcement (ICE) division conveyed that, within Mexico, HBMX “led the market in cash repatriation in 2007 and 2008,” with “$3.2 billion repatriated in 2007 and $4.2 billion repatriated in 2008.”

A quick analysis undertaken by HBMX immediately after the November meeting found that while HBMX was “very good at buying/acquiring dollars,” it did “not seem to sell them and hence our very high repatriation figures.” The analysis also determined that “80% of our dollars come from money exchange business at branches.” It noted further that “there is no limit on the amount of dollars that customers can convert to pesos,” and that with respect to non-customers, HBMX branches would “convert up to 3000 dollars, and do not require any KYC.” HSBC Group Compliance head David Bagley responded: “The practice of changing USD in the branches presumably with little or no ID for non customers is in breach of

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612 Id.
613 Id. at 6. Examples of these cases included Zhenni Ye Gon, Casa de Cambio Puebla, and Sigae Corporaciones.
618 Id.
619 Id.
Group policy. When looking at our USD exposure how can this have been missed.\textsuperscript{620}

At HBUS, an undated analysis was conducted of its banknotes traffic with Mexican financial institutions over a three-month period, from November 2006 to February 2007.\textsuperscript{621} The analysis disclosed that HBUS was doing far more business with HBMX than any other Mexican financial institution. It showed that during the three-month period:

- HBUS had purchased about $470 million in U.S. dollars from Banco Mercantil Del Norte, a major Mexican bank, while selling it only about $22 million in U.S. dollars.

- HBUS had purchased about $281 million in U.S. dollars from BBVA Bancomer, another major Mexican bank, while selling it only about $5 million.

- HBUS had purchased about $196 million in U.S. dollars from Caso de Cambio Puebla, and $194 million from Consultoria International, without selling either any U.S. dollars.

- During the same period, HBUS had purchased about $742 million in U.S. dollars from HBMX, while selling it only a little more than $1.3 million.

These figures indicate that HBMX was, by far, HBUS' largest banknotes customer in Mexico.

In July 2009, the OCC initiated an AML examination of HBUS' global banknotes operations, and soon discovered that the bank was not monitoring the banknotes activities of its affiliates.\textsuperscript{622} That same month, HBUS resumed monitoring its banknote accounts.\textsuperscript{623} In September, the OCC requested documentation related to banknotes accounts for 25 Latin American financial institutions, including ten in Mexico. In November 2009, the examination team added examiners from the Federal Reserve. Additional requests for information were made, including with respect to HSBC affiliates with banknotes accounts.

\textsuperscript{620} 11/27/2008 email from HSBC David Bagley to HSBD Warren Learning, copy to Richard Bennett, “Mexico,” HSBC OCC #875965.

\textsuperscript{621} See undated “HBUS Banknotes NY – USD Bought from or Sold to Customers in Mexico: 3-Month Period (Nov-06 to Feb-07),” prepared by HBUS, OCC-PSI-00151506. See also undated “Banknotes-NY Selected Customers’ Activity Alerts & Traders’ Explanations for USD Purchases & Sales from 2005-2009,” prepared by HNAH, OCC-PSI-00005800-904.

\textsuperscript{622} See 9/13/2010 email from HBUS Janet Burak to HBUS Brendan McDonagh, “Expanded Banknotes Exam,” OCC-PSI-00784744 (summarizing the banknotes examination effort). See also Subcommittee interview of Joseph Boss (1/30/2012).

HBMX, Mexican casas de cambio, and HBMX’s U.S. dollar accounts in the Cayman Islands.

In August 2009, the OCC summarized some of the information in an internal memorandum.624 According to the OCC, due to transaction costs, banknotes transactions at HBUS typically occurred only about once per month and involved large shipments.625 In addition, transaction volumes often fluctuated on a seasonal basis, increasing during holidays or tourist seasons.626 According to the OCC, HBUS said that it conducted AML monitoring on a monthly basis, examining banknotes transactions by customer and inquiring when significant changes in the volume of U.S. dollar sales or purchases took place.627

When the OCC conducted tests on the 2009 HBUS banknotes data, however, it determined that the volume data was not always accurate, and HBUS did not keep records of its reviews or actions:

“When volumes changed significantly, the bank did not seem to be aware of these changes, and it does not appear that the bank took any action as a result. For example, even though transactions volumes for customers in Mexico increased significantly from the first 6 months of 2008, over the first 6 months of 2009, there was no documentation in the files that the bank noted the change or took any action … Bank employees … assured us that adequate monitoring takes place within the business line and Compliance. However, we were unable to find anything in the files that this was the case. They also cautioned that too much documentation results in increased legal risk. We explained to the bank that written documentation is necessary, for institutional memory, and to ensure that controls are exercised. We noted the bank’s appetite for risk, as well as the risk inherent in the Banknotes business. The business line seemed to resist this message, but Compliance staff seemed to eventually grasp the importance of better documentation.”628

As the data confirmed that HBMX was the single largest supplier of U.S. dollars to HBUS, transferring billions of dollars that far outstripped the volumes being supplied by larger Mexican banks and other HSBC affiliates, Mexican and U.S. law enforcement and regulatory authorities continued to express concern that HBMX’s bulk cash shipments could reach that volume only if they included illegal

625 Id. at 4.
626 Id.
627 Id.
628 Id. at 4-5.
drug proceeds. In a January 2010 meeting, U.S. law enforcement and regulators also expressed concern that the problem extended beyond Mexico:

"The bulk cash receipts by HSBC’s Bank Note Business from certain correspondent accounts based in Central and South America exceed reasonably expected volumes of USDs that should be within those countries from tourism, foreign business, etc."629

(3) Remedial Action

In response to the concerns expressed by regulators and law enforcement, HBMX took a number of steps to gain a better understanding and control of its U.S. dollar transactions. The first set of actions, in February 2008, focused on gaining better information. HBMX announced a new policy, effective immediately, to deem all customers who deposited more than $100,000 in a month as SCC clients subject to enhanced due diligence. HBMX identified 312 customers that met that criteria and subjected them to a KYC review.630 HBMX also undertook a review of its branches to identify the nature and volume of their U.S. dollar transactions,631 and a review of its money service business clients to determine whether each relationship should continue.632 Still another action HBMX took was to change its account monitoring criteria to increase scrutiny of U.S. dollar deposits by customers.633

In November 2008, after another meeting with regulators critical of its U.S. dollar transactions, HBMX went further. It ordered its branches to stop providing physical U.S. dollars to customers and non-customers alike, other than through ATMs at airports.634 It also prohibited...
branches from accepting U.S. dollar cash deposits from customers.\textsuperscript{635} In addition, HBMX stopped opening new U.S. dollar accounts at its Cayman branch, and prohibiting the acceptance of new cash deposits for existing Cayman accounts.\textsuperscript{636} All of these actions led to a steep drop in the number and volume of HBMX U.S. dollar transactions.

As HBMX cut back dramatically on its U.S. dollar business beginning in early 2009, OCC AML examiners found that HBUS appeared to be increasing its U.S. dollar transactions with Mexican clients, including some of the high risk casas de cambio that could no longer engage in the same volume of U.S. dollars with HBMX.\textsuperscript{637} HSBC Group Compliance knew about HBUS' Mexican casa de cambio clients. Rather than press HBUS to close the accounts, however, HSBC Group Compliance head David Bagley merely observed to a colleague in January 2009: “I am surprised that HBUS still have cambio clients.”\textsuperscript{638}

A year later, in June 2010, HBUS decided to exit the U.S. banknotes business. It closed the Global Banknotes offices in New York, London, Hong Kong, and Singapore, and later sold portions of the banknotes business to other banks.\textsuperscript{639} HBUS also declined to renew its contract to operate U.S. currency vaults for the Federal Reserve Bank of New York when that contract expired in 2010. In September 2010, the OCC issued a supervisory letter identifying multiple AML deficiencies at HBUS, including with respect to its banknotes business, and followed with a cease and desist order in October.

\section*{F. Analysis}

Over the years, HBUS maintained correspondent accounts for at least 80 HSBC affiliates and banknotes accounts for at least 29 HSBC affiliates, which accounted for a large portion of its U.S. dollar activities. In 2009, for example, HSBC determined that “HSBC Group affiliates clear[ed] virtually all USD [U.S. dollar] payments through accounts held at HBUS, representing 63\% of all USD payments processed by HBUS.”\textsuperscript{640} HSBC also calculated that, over an eight-year period, its

\textsuperscript{635} Id.
\textsuperscript{636} 11/27/2008 email from HSBC Warren Leaming to HSBC David Bagley and Richard Bennett, “Mexico,” HSBC OCC 8875605-607.
\textsuperscript{637} See, e.g., 9/1/2009 OCC memorandum to the Files, “Washington Meeting,” OCC-PSI-01-16833 (“[O]nce HSBC Mexico ceased its operations, HBUS began significant volume of Banknote activity directly with some of HSBC Mexico’s former Banknote clientele.”). [Sealed Exhibit]
\textsuperscript{639} Id. In 2010, HSBC Holdings plc sold its U.S. wholesale banknotes business in Asia to United Overseas Bank Limited (UOB) for $11 million, and in 2011, sold its European banknotes business to HSBC Bank plc. It recorded total closure costs of $14 million during 2010. Id.
\textsuperscript{640} See 9/9/2009 chart entitled, “HSBC Profile,” included in “HSBC OFAC Compliance Program,” a presentation prepared by HSBC and provided to the OCC, at HSBC OCC 8874197.
U.S. dollar clearing business had increased over 200%, from processing an average daily amount of $185 billion in 2001, to $377 billion in 2009. HBUS functioned as the U.S. nexus for the entire HSBC global network of financial institutions. Some of those institutions used their access to the U.S. financial system as a selling point to attract clients. Not all of those affiliates operated in high risk jurisdictions like Mexico; not all had high risk clients like casas de cambio; not all had high risk products like U.S. dollar Cayman accounts; and not all had weak AML controls. But some HSBC affiliates operated under those circumstances, and HBMX provides a case history of the money laundering risks that followed. HBMX illustrates how the U.S. affiliate of a global bank can better protect itself by conducting careful due diligence of fellow affiliates, as already required by law, identifying higher risk institutions, and understanding their high risk clients, high risk products, AML controls, and money laundering vulnerabilities. HBMX also illustrates the need for ongoing, effective account monitoring to detect, prevent, and report suspicious activity. Effective monitoring and SAR reporting require adequate resources and personnel. Still another lesson is that AML personnel at the parent and affiliates of a global bank should consider all legal avenues for systematically sharing information with each other about suspicious clients and transactions in order to combat misuse of their network by drug traffickers, organized crime, and other wrongdoers.

641 Id. at "USD Payment Statistics - Fact Sheet," HSBC OCC 8874211.
IV. HSBC AFFILIATES: CIRCUMVENTING OFAC PROHIBITIONS

The United States prohibits doing business with certain persons and entities, including terrorists, persons engaged in nuclear proliferation, drug kingpins, and persons associated with rogue jurisdictions such as Iran, North Korea, and Sudan. To implement the law, the U.S. Treasury Department’s Office of Foreign Assets Control (OFAC) has developed a list of those prohibited persons and countries which banks use to create an “OFAC filter” to identify and halt potentially prohibited transactions. Transactions stopped by an OFAC filter typically undergo an individualized review to see if the transaction can proceed.

Foreign banks that engage in U.S. dollar transactions typically execute them through the account of a bank in the United States, subject to the U.S. bank’s OFAC filter. While most processing takes less than 24 hours, transactions stopped by the OFAC filter for further review may undergo substantial processing delays and, in some cases, payments may be blocked and held for years. Because of the additional time and expense involved when transactions are subjected to review, some foreign banks have developed a variety of tactics to avoid the OFAC filter. Common tactics included intentionally stripping information from the transaction documentation to conceal the participation of a prohibited country or person, or using “cover payments.” In the context of Iranian transactions, cover payments are transfers between correspondent banks in non-sanctioned jurisdictions which lack underlying payment details, including information about a party that is a prohibited country or person. In the case of Iranian U.S. dollar transactions, some banks used one or both of these practices when conducting so-called “U-turn” transactions, a type of transaction that was allowed under OFAC regulations prior to November 2008, but because the transactions referenced Iran, routinely triggered the OFAC filter and required an individualized review which delayed the transaction’s processing. In recent years, U.S. law enforcement has penalized some international banks that used willfully deceptive tactics to circumvent the OFAC filter and process prohibited transactions.

The Subcommittee conducted a review of issues related to the sending of OFAC sensitive transactions through HBUS’ correspondent accounts from 2000 to 2010, by HSBC affiliates. The evidence indicates that, for years, some HSBC affiliates sending OFAC sensitive transactions involving Iran through their U.S. dollar correspondent accounts at HBUS took steps to conceal them, including by deleting references to Iran from the payment instructions or by characterizing the transaction as a transfer between banks in permitted jurisdictions without disclosing any Iranian connection. More specifically, from at least 2001
to 2007, two HSBC affiliates, HSBC Europe (HBEU) and later HSBC Middle East (HBME), repeatedly conducted U-turn transactions involving Iran through HBUS, many of which were not disclosed to the bank, even though they knew HBUS required full transparency to process U-turns. To ensure HBUS cleared the transactions without delay, HBEU routinely altered transaction documentation to delete any reference to Iran that might trigger the OFAC filter at HBUS and also typically characterized the transaction as a transfer between banks in permitted jurisdictions. The aim of the affiliates' efforts appeared to be to ensure the Iranian transactions utilized HBUS' automated processing procedures and avoided any human intervention or manual review, a process known as straight through processing or STP. Internal bank documents also indicate that the affiliates viewed the U-turns they sent through HBUS' accounts as permitted by OFAC rather than prohibited transactions under U.S. law, but their failure to provide full transparency prevented any individualized review by HBUS to confirm their legality.

Internal bank documents show that HSBC Group Compliance knew of HBUS' insistence on full transparency for U-turns and the practice of HSBC affiliates to conceal the Iranian transactions sent through their U.S. dollar correspondent accounts at HBUS. HSBC Group Compliance, as well as other senior HSBC Group executives, allowed the HSBC affiliates to continue to engage in these practices, which even some within the bank viewed as deceptive, for more than five years without disclosing the extent of the activity to HBUS. The bank documents show that, from 2000 to 2005, the practice of altering U-turn transaction documentation was repeatedly brought to the attention of HSBC Group Compliance, including by HBEU personnel who objected to participating in the alteration of documents and twice announced deadlines to end the activity. Despite receiving this information, HSBC Group Compliance did not stop HSBC affiliates from sending concealed Iranian transactions through HBUS' accounts until the bank decided to exit Iran altogether in 2007.

At the same time, while some at HBUS claimed not to have known they were processing undisclosed Iranian transactions from HSBC affiliates, internal documents show key senior HBUS officials were informed as early as 2001. In addition, on several occasions, HBUS' OFAC filter stopped Iranian transactions that HBUS had indicated should be disclosed by HSBC affiliates, but were not. Despite the evidence of what was taking place, HBUS failed for years to demand a full accounting of what HSBC affiliates were doing. While HBUS insisted, when asked, that HSBC affiliates provide fully transparent transaction information, when it obtained evidence that some affiliates were acting to circumvent the OFAC filter, HBUS failed to take decisive action to confront those affiliates, stop the conduct, and ensure all Iranian U-turns were subjected to individualized reviews to gauge whether they complied with the law.
In addition to Iranian transactions, HBUS documents indicate that, from at least 2002 to 2007, some HSBC affiliates also sent potentially prohibited transactions through HBUS involving Burma, Cuba, North Korea, or Sudan, although none of the affiliates employed the same type of systematic effort used for transactions involving Iran. In recent years, HBUS' OFAC compliance program as a whole has also displayed AML deficiencies.

In 2010, HBUS hired an outside auditor, Deloitte LLP, to identify and examine the OFAC sensitive transactions involving Iran and other prohibited countries or persons that went through the bank. That review, which is ongoing and has yet to review all relevant transactions, has so far identified, over a seven-year period from 2001 to 2007, more than 28,000 OFAC sensitive transactions sent through HBUS involving a total of $19.7 billion. Of those 28,000 transactions, more than 25,000 totaling more than $19.4 billion involved Iran, while 3,000 involved other prohibited countries or persons. The Deloitte review characterized 2,584 of those transactions, involving assets in excess of $367 million, 79 of which involved Iran, as "Transactions of Interest" requiring additional analysis to determine whether violations of U.S. law occurred. HBUS is currently in the process of analyzing those transactions, which could lead to financial penalties if it is found to have violated OFAC regulations.

Finally, another issue involves actions taken by some HSBC Latin American affiliates, with the approval of HSBC Group Compliance, to send non-U.S. dollar payment messages through a U.S. server whose OFAC filter was not turned on to screen them for terrorists, drug kingpins, or other prohibited persons. HSBC Group Compliance allowed those payment messages to move through the United States and utilize U.S. facilities while bypassing the OFAC filter, despite HBUS concerns that such messaging traffic might require OFAC screening to block transfers involving terrorism, drug trafficking, or other wrongdoing. The transactions were later screened by HSBC Group’s WOLF filter.

A. Background on OFAC Prohibitions

OFAC. The Office of Foreign Assets Control (OFAC) within the U.S. Department of Treasury administers and enforces economic and trade sanctions stemming from U.S. foreign policy and national security goals, and other threats to the foreign policy, national security, or economy of the United States. The office was formally established in

644 Id.
December 1950, when President Truman blocked all Chinese and North Korean assets subject to U.S. jurisdiction. Its programs seek to prohibit U.S. persons and entities from engaging in trade or financial transactions with terrorists, persons engaged in activities related to the proliferation of weapons of mass destruction, international narcotics traffickers, and rogue jurisdictions.

OFAC’s regulatory authority is exercised under Presidential national emergency powers and laws enacted by the U.S. Congress to impose controls on transactions and authorize the freezing of assets under U.S. jurisdiction. According to OFAC, “[m]any of the U.S. sanctions are based on United Nations and other international mandates, are multilateral in scope, and involve close cooperation with allied governments.” The freezing of assets “immediately imposes an across-the-board prohibition against transfers or dealings of any kind with regard to the property,” and the owner of the asset must contact OFAC directly to request the release of a frozen asset. OFAC prohibitions support U.S. and international efforts to combat terrorism, nuclear proliferation, drug trafficking, and other wrongdoing.

OFAC administers both comprehensive and selective sanctions programs. The comprehensive U.S. programs apply to persons and entities within a designated jurisdiction and have applied to Burma (Myanmar), Cuba, Iran, Sudan, and Syria. The non-comprehensive programs target specific individuals and entities rather than impose broad prohibitions involving an entire country. These programs have applied at times to persons and entities associated with Iraq, Libya, North Korea, Somalia, and Zimbabwe. To carry out U.S. sanctions programs, OFAC has developed a list of Specially Designated Nationals and Blocked Persons (SDN). The SDN designation covers both individuals and entities in which SDN persons have a direct or indirect ownership interest of 50% or more. The SDN designation applies to covered entities whether or not the entity is named on the SDN list. U.S. persons are prohibited from dealing with persons and entities on the SDN list, and all SDN assets in the United States are supposed to be blocked. OFAC also has authority to grant general and specific "licenses," which authorize exceptions for certain categories of transactions, such as those related to humanitarian efforts.

646 Id. OFAC is the successor to the Office of Foreign Funds Control (the "FFC") that was established at the beginning of World War II in 1940. However, the Treasury Department administered sanctions as far back as the War of 1812 when sanctions were imposed against Great Britain. Id.

647 Id.


649 Id.
OFAC regulations apply to all U.S. persons, both citizens and permanent resident aliens, regardless of where they are located, as well as all persons and entities within the United States, and all U.S. incorporated entities and their foreign branches. Fines for violating U.S. sanction laws and OFAC regulations can be substantial. Criminal penalties can result in fines ranging from $50,000 to $10 million and imprisonment for 10 to 30 years for willful violations. Civil penalties in various matters range from $250,000 or twice the amount of each underlying transaction to $1,075,000 for each violation.

Iran and U-turn Transactions. For more than thirty years, dating back to 1979, the United States has applied sanctions programs to Iran, enforced by OFAC. These programs have generally prohibited U.S. persons from engaging in transactions with anyone associated with Iran, and the OFAC filter has stopped any financial transaction including an Iranian reference.

Between 1995 and November 10, 2008, however, OFAC regulations also included an exception to the prohibition on Iranian transactions commonly referred to as “U-turns.” U-turn transactions were authorized by OFAC under regulations issued in 1995. In that year, President Clinton declared that Iran was an international threat for its attempt to obtain a nuclear weapon as well as its role in undermining ongoing peace talks in the Middle East. As such, U.S. financial institutions were generally barred by OFAC from processing transactions involving Iran. In their place, OFAC allowed only those Iran-related transactions that began and ended in non-Iranian foreign banks. According to Treasury:

“This is commonly referred to as the ‘U-turn’ authorization. It is so termed because it is initiated offshore as a dollar-denominated transaction by order of a foreign bank’s customer; it then becomes a transfer from a correspondent account held by a domestic bank for the foreign bank to a correspondent account held by a domestic bank for another foreign bank; and it ends up offshore as a transfer

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650 See OFAC website, FAQ #11: http://www.treasury.gov/resource-center/sanctions/Pages/answer.aspx#10
652 See 31 C.F.R. Part 535, Iranian Assets Control Regulations, and 31 C.F.R. Part 560, Iranian Transactions Regulations, which together comprise the Iranian sanctions program. Initial Iranian sanctions regulations, now detailed in Part 535, were created on November 14, 1979, after U.S. diplomats were taken hostage in Tehran, and President Carter blocked assets located in the United States belonging to the Government of Iran. On October 29, 1987, following Iran’s expressions of support for international terrorism and aggressive actions against non-hostile shipping in the Persian Gulf, President Reagan issued Executive Order 12613, the predecessor to Part 560. From 1995 to 1997, President Clinton issued three additional Executive Orders, numbered 12957, 12959, and 13059, which culminated in a prohibition of nearly all trade and investment activities with Iran by U.S. persons, regardless of location.
to a dollar-denominated account of the second foreign bank’s customer.\textsuperscript{653}

In essence, the new regulations only allowed U.S. financial institutions to clear U.S. dollar transactions involving non-Iranian intermediaries, even if they involved Iranian clients. This restriction meant transactions involving Iran could be processed only if the beginning and ending points were non-Iranian foreign banks. The purpose of U-turn transactions was to allow U.S. dollar-denominated transactions to continue throughout the world – benefitting both U.S. commerce and the value of the dollar – but to prevent U.S. citizens and institutions from doing business with Iran. This goal was accomplished by ensuring that the only point such transactions touched the United States was in clearing them for foreign banks.

The U-turn exception was widely used to carry out U.S. dollar Iranian transactions in the United States for many years. In November 2008, the exception was revoked, and it was no longer legal under OFAC regulations to clear Iran-linked transactions even for foreign banks, although U.S. banks were still permitted to handle Iranian funds in limited circumstances, including transactions supporting humanitarian relief.\textsuperscript{654} U.S. persons were explicitly prohibited, however, from engaging in any transaction or dealing in any property or property interest with any Iranian bank designated under the Nonproliferation of Weapons of Mass Destruction or Specially Designated Global Terrorist programs.\textsuperscript{655}

The U-turn exception for Iran in OFAC regulations until 2008 does not appear in any other OFAC regulation, and so does not affect transactions involving any other prohibited country or person.

**Prosecutions for OFAC Violations.** In recent years, a number of large, international banks have been prosecuted for systematically violating OFAC prohibitions. In most cases, the violations involved the practice of stripping information from wire transfer documentation to hide the participation of a prohibited person or country, and executing the prohibited transaction through a U.S. dollar account at a U.S. financial institution. For example, in December 2009, Credit Suisse was fined $536 million by the Department of Justice for altering wire transfer documentation from 1995 to 2006, in transactions involving Burma, Cuba, Iran, and Libya. That same month Lloyd’s Bank was fined $217


\textsuperscript{655} Id. at 2.
million for stripping information from wire transactions over a ten-year period, from the mid 1990s through September 2007. In May 2010, ABN Amro was fined $500 million for removing information from wire transfers involving OFAC sanctioned countries between 1995 and 2005.

Most recently, on June 12, 2012, the U.S. Justice Department and New York County District Attorney’s Office entered into a deferred prosecution agreement with ING Bank N.V. and imposed the largest fine ever levied against a bank for OFAC violations. For processing more than $2 billion in transactions on behalf of Cuban, Iranian, and other prohibited persons, ING Bank agreed to a criminal forfeiture of $619 million. The Treasury Department’s press release revealed that ING Bank had “intentionally manipulated financial and trade transactions to remove references to Iran, Cuba, and other sanctioned countries and entities.” It noted that ING Bank’s methods included not referencing a payment’s origin, utilizing “misleading” payment messages, and using shell companies. According to court filings, between the early 1990s and 2007, ING Bank processed more than 20,000 transactions in violation of OFAC prohibitions, “with the knowledge, approval and encouragement of senior corporate managers and legal and compliance departments.”

A summary of recent prosecutions and legal actions related to OFAC violations follows.

Recent Prosecutions and Legal Actions Related to OFAC Violations

<table>
<thead>
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<th>Bank</th>
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<th>Fine</th>
<th>Link</th>
<th>Brief Summary</th>
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656 See, e.g. United States v. Ing Bank, N.V., Case No. 1:12cr136 (USDC DDC), Information (6/12/2012) and Deferred Prosecution Agreement (6/12/2012).
658 Id.
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<th>Bank</th>
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<td><a href="http://www.wsj.com/articles/SB1000142405274870345106/5468281409087700682.html">Wall Street Journal, Probe Circles Globe to Find Dirty Money</a></td>
<td>The Department of Justice and the New York County District Attorney’s Office entered into deferred prosecution agreements with Barclays Bank for activity relating to transactions illegally conducted for customers in Cuba, Iran, Libya, Sudan, and Burma from the mid-1990s until September 2006.</td>
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<td><a href="http://blogs.wsj.com/corruption-currents/2011/12/28/irbs-doj-to-end-deferred-prosecution-agreement-over-abn-amro/">Wall Street Journal, RBS DOJ to End Deferred Prosecution Agreement over ABN Amro</a></td>
<td>The Department of Justice entered into a deferred prosecution agreement with ABN Amro Bank for removing information from wire transfers from 1995-2005 for customers in Iran, Libya, the Sudan, Cuba, and other OFAC-listed countries.</td>
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<td><a href="http://www.justice.gov/criminal/po/drug/2009/12-16-09-CreditSuisse-factualstatement.pdf">DOJ Statement of Facts</a></td>
<td>The Department of Justice entered into a deferred prosecution agreement with Credit Suisse. The fines related to alterations on wire transfers from 1995 to 2006 from Iran, Cuba, Burma, and Libya.</td>
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<td>The Department of Justice and the New York County District Attorney’s Office entered into deferred prosecution agreements with Lloyd’s Bank for wire stripping transactions from the mid-1990s through September 2007.</td>
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<td><a href="http://www.treasury.gov/resource-center/sanctions/OFAC-Enforcement/Documents/anz-group-08242009.pdf">Enforcement Documents</a></td>
<td>The Treasury Department entered into a settlement with the Australia and New Zealand Bank Group relating to currency exchanges from 2004 to 2006, for transactions processed through U.S. correspondent accounts for customers in Cuba and Sudan.</td>
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Prepared by the U.S. Senate Permanent Subcommittee on Investigations
HSBC is currently under investigation by the U.S. Justice Department and several Federal financial regulatory agencies for engaging in similar practices in possible violation of OFAC regulations. In October 2010, an internal Federal Reserve email discussing HSBC’s decision to hire an outside auditor to review its records “presumably to find problematic transfers,” noted that “HSBC was one of the two major UK banks for Iranian banks during the early 2000s (Lloyds being the other), so we can imagine what will be found.”

B. Executing OFAC-Sensitive Transactions

(1) Transactions Involving Iran

(a) Overview

Documents collected by the Subcommittee do not pinpoint when undisclosed Iranian transactions began moving through HBUS in potential violation of OFAC regulations. HSBC officials were aware of the practice generally as early as 2000, as seen in an email discussion between HSBC Group’s Compliance head, then Matthew King, and AML head Susan Wright. Ms. Wright criticized actions taken by a bank client to alter transaction documentation to disguise a wire transfer moving through the United States, but their email exchange does not disclose whether such transactions were already taking place at HBUS. By 2001, they clearly were, as described in an email from HBEU to HBUS.

In 2001, when HSBC Europe (HBEU) raised the issue of processing U-turn transactions through its U.S. account in compliance with U.S. requirements, HBUS personnel made it clear that any such transactions would need to be fully transparent and include all underlying payment details to enable HBUS to evaluate whether they qualified as permissible U-turns. From at least 2001 to 2007, however, despite repeated HBUS requests for full transparency, HBEU and later HSBC Middle East (HBME) sent transactions involving Iran through their U.S. dollar correspondent accounts at HBUS without full disclosure of the transaction details. In some instances, the HSBC affiliate simply stripped the identifying Iranian information from the transaction.

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documentation. In others, the HSBC affiliate also sent the transaction as a transfer between banks in permitted jurisdictions, a tactic sometimes referred to as a “cover payment,” since the bank-to-bank transfer acted as a cover for the underlying transaction. 663 Both methods sought to ensure that a transaction would not be stopped by HBUS’ OFAC filter and delayed for individualized review to determine whether it, in fact, qualified as a permissible U-turn, but would instead benefit from “straight through processing” or STP.

From 2001 until 2005, the two HSBC affiliates frequently discussed processing Iranian U.S. dollar transactions for various Iranian financial institutions and entities through their HBUS correspondent accounts. Numerous emails among HBEU, HBME, HBUS, and HSBC Group discuss whether HBUS would be willing to process Iranian U-turn transactions and, if so, how. At the same time, HSBC Group, HBEU and HBME bankers were pushing to expand contacts with Iran. The Senior Payments Manager in HBUS reported being told in a July 2001 conference call that the HSBC Group, with backing from the Chairman, was seeking to “significantly grow our presence in Iran.” 664 In 2003, an HBME business proposal estimated that processing 700 U.S. dollar payments for Iranian banks per day using U-turn transactions would produce income of $4 million, while failing to process them would threaten HSBC’s current Iranian business which produced annual bank income of $2 million. 665 HBME also noted that it already had a “number of existing USD accounts for Iranian banks.” 666

Even though discussions with HBUS over processing the transactions continued in 2002 and 2003, documentation shows that HBEU had already begun to send U-turn transactions through HBUS without disclosing an Iranian connection for many of them. 667 Some HBEU compliance and payments personnel objected to altering payment instructions in connection with the Iranian transactions, and a key payments official even announced deadlines in January 2004 and September 2004, after which no Iranian payment instructions would be altered, but both deadlines were ignored. HBUS finally approved a

663 The cover method utilizes the MT202 SWIFT message or payment instruction format, which provides a U.S. bank with the names of the foreign banks acting as the originator or beneficiary of the immediate transfer, but is not required also to provide the underlying origination and beneficiary customer information.

664 7/12/2001 email from HBUS Denise Reilly to Douglas Stolberg and others, “Bank Melli,” HSBC OCC 887628-129. HSBC legal counsel told the Subcommittee that the HSBC affiliates were already doing business with Iran, but they wanted to increase that business by doing it with Bank Melli. Subcommittee meeting with HSBC legal counsel (6/20/12).


666 Id.

667 See, e.g., 12/30/2002 email from Protomastro to Carolyn Wind and others, HSBC OCC 8873909.
protocol to process transparent U-turns in December 2004. Even after that protocol was approved, however, HBEU continued to send undisclosed U-turn payments through HBUS using cover payments, failing to provide requested information to its own affiliate.

At HBUS, during the same time period, internal documents show that, as early as 2001, senior HBUS payments, compliance, and business managers were informed that Iranian U.S. dollar payments were being sent by HBEU through HBUS after deleting references to Iran. They were also informed of an HBEU proposal to streamline the processing of U-turn transactions by omitting references to Iran so the transactions would not be halted by the OFAC filter in the United States. Emails at the time show that senior HBUS officials expressed discomfort with the HBEU proposal, but took no other action to stop or prevent the activity already occurring. In addition, HBUS’ OFAC filter occasionally caught an Iranian-related transaction, sent by an HSBC affiliate, in which the identifying information had not been fully removed, demonstrating that undisclosed U-turns continued to be sent through HBUS correspondent accounts, but again, no HBUS personnel took further action to stop the activity. In 2003, the Iranian issue was discussed again when a new HBUS AML Director arrived, but once more, no decisive action was taken to put a stop to undisclosed U-turns.

Although HSBC Group Compliance was aware of HBUS’ concerns, HBEU’s practice of stripping information or using cover payments to conceal U-turn transactions involving Iran, and the fact that such undisclosed transactions were routinely slipping through HBUS accounts, HSBC Group did not prohibit the practice for years. In July 2005, HSBC Group issued a Group-wide directive, Group Circular Letter (GCL) 050047, barring all HSBC affiliates from engaging in U.S. dollar transactions in violation of OFAC regulations, but continued to allow their use of cover payments for permissible U-turn transactions, which meant the transactions would continue to circumvent the OFAC filter and individualized review by recipient U.S. banks. In April 2006, HSBC Group issued a second Group-wide directive, GCL 060011, requiring HSBC affiliates and other financial institutions to use fully transparent payment instructions when sending transactions through HBUS accounts, but again allowed U-turns “to be made as cover payments.” In 2007, HSBC Group decided to exit Iran.


In recent years, OFAC has sent over a dozen so-called Cautionary Letters to RBUS about incidents in which it failed to block a prohibited transaction, including transactions involving Iran. In 2010, HSBC Group employed an outside auditor, Deloitte LLP, to identify and review OFAC sensitive transactions at RBUS over a seven-year period from 2001 to 2007. That review has so far examined 58 million payment messages involving assets of $37 billion that passed through the key server, located in the United Kingdom, during that timeframe and identified OFAC sensitive U.S. dollar transactions involving assets totaling $19.7 billion. The review identified almost 25,000 U.S. dollar transactions involving Iran, involving assets in excess of $19.4 billion. The vast majority of the Iranian transactions, ranging from 75% to 90% over the years, were sent through RBUS and other U.S. dollar accounts without disclosing any connection to Iran. While the affiliates may have viewed these U-turns as permissible under U.S. law, the absence of identifying information meant they did not trigger the OFAC filter or an individualized review by RBUS to make sure.

(b) Concealing Iranian Transactions

2000 Notice Regarding Iranian Transactions. On June 9, 2000, the HSBC Group AML Compliance head Susan Wright learned in an email that a client bank was using deceptive practices to send OFAC sensitive U.S. dollar transactions through U.S. correspondent accounts while evading detection by the OFAC filter.

In the June 9, 2000 email to Ms. Wright from an HSBC colleague, she was informed that a particular bank, whose name was redacted by HSBC from the email, was “automatically replacing a remitter’s name with that of” the bank. The email stated that the bank planned to cease the practice by the end of June, but in the future, for OFAC sensitive transactions, would “arrange cover for the payment using MT202/203 remittances.” “MT202/203” refers to the SWIFT message or payment instructions used to execute bank-to-bank transfers. The email explained that bank-to-bank transfers did not require identifying the underlying party who originated the transaction or the ultimate beneficiary of the payment. It also indicated that the bank planned to send a separate “MT100 message” to the recipient bank providing full payment details for the originator and ultimate beneficiary. The email stated: “In this way a payment, in US$ can be made for an individual or

673 Id.
company on the OFAC list, without the name being 'detected' by the OFAC filters that all US banks would apply. 674

Ms. Wright forwarded the June 2000 email to Matthew King, then head of HSBC Group Compliance, describing the client bank’s past procedure of altering transaction documentation when processing OFAC sensitive wire transfers. She wrote: “We advised them that this was contrary to SWIFT guidelines (drawn up to address FATF 675 concerns re money laundering via wire transfers) which required that the full details (names and addresses) of remitters and beneficiaries are included. 676 She also described the client bank’s future plan to conceal OFAC sensitive transactions behind bank-to-bank transfers. Ms. Wright wrote: “From a Group perspective I consider the continuation of this practice to be unacceptable and as a deliberate and calculated method to avoid the US OFAC sanctions has the potential to raise serious regulatory concerns and embarrass the Group. 677

Ms. Wright’s reaction indicates that as early as 2000, HSBC Group Compliance learned of practices being used to avoid detection by the OFAC filter, and viewed them as “unacceptable” and raising potential regulatory concerns that were capable of embarrassing HSBC.

2001 Bank Melli Proposal. Six months later, in January 2001, HBEU approached HBUS with a proposal to use its U.S. dollar correspondent account at HBUS to clear U.S. dollar transactions for Bank Melli, the largest commercial retail bank in Iran. 678 At that time, Bank Melli’s London Branch maintained a U.S. dollar account with several other major international banks, but was interested in establishing a relationship with HSBC that would give the bank the majority of Bank Melli’s U.S. dollar clearing business. HBEU conducted an extensive review, with advice from two outside U.S. law firms, to determine whether transactions originated by Bank Melli would meet the definition of a permissible U-turn transaction under OFAC regulations, and concluded that they would, in fact, be permissible.

Even though the proposed U-turns would be permissible under OFAC regulations, HBEU proposed carrying them out in the form of bank-to-bank transfers, without any reference to the underlying originator or ultimate beneficiary and, so without any reference to

674 Id.
675 FATF is the Financial Action Task Force, the leading international body that set standards for combating money laundering and terrorist financing.
677 Id.
Iran. The aim was to ensure that the transactions would not be delayed by triggering an OFAC filter and having to undergo individualized review. HBUS compliance personnel responded that any such transactions would have to be done in a more transparent manner, with detailed payment information specifying the underlying originating and beneficiary customer information. HBUS employees expressed concern about using cover payments, since the limited payment instructions would not enable HBUS to know whether it was processing a valid U-turn transaction involving Iran or whether it was even processing a U-turn transaction at all. It would see only two banks making the transfer on the payment instructions and would have no knowledge of the underlying customers for whom the transaction was being processed, including whether they were prohibited persons.

**Legal Advice.** In January 2001, HBUS OFAC Compliance officer Elizabeth Protomastro asked outside legal counsel, Tom Crocker, for an opinion as to whether HBUS could process U.S. dollar transactions from HBEU on behalf of either Bank Melli or Iran’s Central Bank, Bank Markazi. After extensive consultations involving two law firms and OFAC, HBUS was advised that the Bank Melli transactions could qualify as permissible U-turn transactions.

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679 Id. at 0096130. Under international banking practice, it was legal for bank-to-bank transactions to omit underlying payment details for the originator and ultimate beneficiary.

680 Id. at 0096130-131.

681 See 2/1/2001 email from Elizabeth Protomastro to Tom Crocker, HSBC OCC 8903860.

682 On February 1, 2001, HBEU provided Ms. Protomastro with more information about the type of U.S. dollar transactions that would be sent through HBEU’s correspondent account at HBUS, explaining that they would include 25 treasury-related payments involving about $750 million per day, 25 treasury-related receipts involving about $750 million per day, and 100 commercial payments involving $200 to $300 million per day, none of which would be related to letters of credit for military goods. (See 2/1/2001 email from HBEU Peter Blenk to HBUS Elizabeth Protomastro, “Centre I Bank of Iran,” HSBC OCC 8903864-865.) On February 2, 2001, Mr. Crocker advised that the scenario outlined by HBUE did not appear to qualify for the U-turn exception as stipulated in the OFAC Iranian Transactions Regulations, because HBEU could not serve as both the originating and receiving foreign bank. (See 2/2/2001 email from Tom Crocker to HBUS Elizabeth Protomastro, “Central Bank of Iran,” HSBC OCC 8903859-860.)

In response to Mr. Crocker’s opinion, on February 19, 2001, HSBC Group Compliance head Matthew King contacted a second law firm, Winthrop Brown, to obtain a second opinion. (See 2/19/2001 email from HSBC Matthew King to Winthrop Brown and HBME John Richards, “Memo: OFAC constraints in the Central Bank of Iran operating a USD Clearing account with HSBC Bank plc in London,” HSBC OCC 8903876-877.) One of the firm’s lawyers, John Simons, consulted with OFAC and obtained a copy of the payment processing procedure for qualified “U-Turn Dollar Clearing” transactions. He explained he was waiting to confirm with OFAC’s Chief Counsel Office about whether a second U.S. bank was required to process permissible U-turn transactions. The email indicated that they had also determined that a requirement in Section 560.516 (b) for U.S. depository institutions to determine if an underlying transaction was prohibited by OFAC, “prior to initiating a payment on behalf of any customer or crediting a transfer to the account on its books of the ultimate beneficiary,” did not apply to U-turns. (See 2/2/2001 email from John Simons to Winthrop Brown, “Memo: OFAC constraints in the Central Bank of Iran operating a USD Clearing account with HSBC Bank plc in London,” HSBC OCC 8903875-876.)

In April 2001, Mr. Simons emailed Mr. King that OFAC had confirmed that a second U.S. bank was not required when processing permissible U-turn transactions and no specific
HSBC Group Compliance head Matthew King forwarded the legal advice to HBME officials Brian Richards and John Richards, stating: “I confirm I am happy for the business to be undertaken on this basis.” He also wrote: “I am assuming this business will be booked in HBEU, hence I am copying Chris Couldrey. If any other Group entity is likely to be involved, could you let me know.” Brian Richards responded the following day to confirm that payment orders from Bank Melli’s account would originate from HBEU, and credits in favor of Bank Melli would be credited to their account at HBEU. He stated that the payment orders would not mention Bank Melli, and HBUS would not receive payment orders or receipts directly from an Iranian entity. Mr. Richards concluded that the payment chain would meet the U-turn definition provided by Mr. Simons.

**HBEU Payment Instructions.** HBEU, HBUS, and HSBC Group Compliance continued to discuss HBEU’s proposal to process U.S. dollar transactions for Bank Melli.

In a letter dated April 30, 2001, HBEU’s Multicurrency Payments Department (MPD) sent Bank Melli a proposal to process their payments with “minimal manual intervention.” The letter included payment templates with specific instructions on how to format U.S. dollar transactions so the paperwork would not have to be altered by HBEU. MPD proposed that Bank Melli use the provided templates to complete payments fields for both MT202 and MT100 SWIFT messages and to test the proposal. In the letter, MPD Business Development Manager John Fowle advised the Bank Melli Cash and Payments Manager in London, Saeed Pourjam:

> “[F]ollowing tests in our payments environment we are confident that we have found a solution to processing your payments with minimal manual intervention. The key is to **always populate field S2** – if you do not have an ordering party name then quote “One of our Clients”, **never leave blank**. This means that the outgoing payment instruction from HSBC will not quote “Bank Melli” as sender – just HSBC London and whatever is in Field 52. This then

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OFAC license was required to engage in U-turn transactions. (See 4/26/2001 email from John Simons to HSBC Matthew King and others, OFAC – Iran,” HSBC OCC 8903868-870.)


MT202 and MT100 are examples of SWIFT messages used by financial institutions to facilitate payment processing. Different messages utilize specialized formats, dependent on the type of transaction, to process the payments. Subcommittee briefing by OFAC (5/8/2012); Subcommittee briefing by Deloitte (5/11/2012).

negates the need to quote “DO NOT MENTION OUR NAME IN NEW YORK” in field 72.”

This email shows HBEU designed a payment method to avoid the OFAC filter by preventing the inclusion of information about the participation of the Iranian bank. The method developed by HBEU ensured that no language that would normally trigger an OFAC review—such as “do not mention our name in New York”—appeared in the transaction documentation.

On May 25, 2001, in an email to colleagues, Michael Gallagher, an HBUS senior official at the Payments and Cash Management (PCM) division, expressed discomfort with the Bank Melli proposal to colleagues, including his supervisor, Douglas Stolberg, head of Commercial and Institutional Banking (CIB): “I wish to be on the record as not comfortable with this piece of business.” His statement did not elicit any immediate response. When interviewed, Mr. Gallagher told the Subcommittee that he sent this email to express his concerns to his colleagues, including his supervisor, and then left it to them to determine what should be done.

In the meantime, HBEU had already begun processing Bank Melli U-turns through its account at HBUS, using cover payments so that the transactions would not trigger HBUS’ OFAC filter. This fact was disclosed in a June 28, 2001 email from the HBEU Institutional Banking Relationship Manager who handled the Bank Melli account, John Wilkinson. In the email, he was discussing the Bank Melli proposal with the head of HBUS’ payment services, Denise Reilly. Mr. Wilkinson explained that once the proposal “goes live,” Bank Melli was instructed “to alter the format” of their payments to achieve straight through processing. Mr. Wilkinson wrote:

“[W]e have further asked them to only put ‘One of our clients’ in field 52, thus removing the chance of them inputting an ‘Iranian

688 Id. at 135 (emphasis in original). Two months earlier, on May 21, 2001, HBEU Institutional Banking (CIB IB) conducted a call with Bank Melli to inquire about the names of the principal beneficiaries of their payments. The resultant call report indicated that “as expected,” Bank Melli was unable to answer with the reasoning that Iran imports from many countries and suppliers worldwide. This information had been previously requested by a Senior Manager in Payment Operations at HBUS, Denise Reilly. An Area Manager within HBEU CIB IB, Brian Richards, forwarded the response to Ms. Reilly the following day. Ms. Reilly then forwarded Mr. Richard’s email to HBUS Compliance personnel. 5/22/2001 email from HBUS Denise Reilly to HBUS Carolyn Wind and others, “Bank Melli,” HSBC-PSI-PROD-0096138-142.
referenced customer name, that causes fall out of the cover payment sent to HBUS and a breach of OFAC regulations.\textsuperscript{692}

He also explained that using "One of our clients" in field 52 "is a standard phrase used by MPD [HBEU's Multicurrency Payments Department] in these situations."\textsuperscript{693} Acknowledging Ms. Reilly's concerns following "a recent formatting error" detailed in an earlier email of June 15, 2001, Mr. Wilkinson noted that Bank Melli had not yet begun to use the new formatting method detailed in the April letter:

"Bank Melli are still formatting payments in their usual method, in this instance MPD failed to spot the poor input and did not follow their normal procedure of altering the payment, hence it was blocked. MPD have again confirmed the new formatting method will achieve straight through processing and overcome these difficulties."\textsuperscript{694}

Mr. Wilkinson's email shows that Bank Melli was already processing undisclosed U-turn transactions through HBEU's account at HBUS, using what he calls "their usual method" for formatting the payments, prior to the proposed changes. His email also described HBEU's "normal procedure" as "altering" Bank Melli's payments to prevent the payments from being blocked. The proposed new procedure was aimed at eliminating those manual interventions on the part of HBEU to expedite payments, potentially saving time and therefore money.

This June 2001 email put HBUS on notice that HBEU had at times altered transactions involving Bank Melli in Iran, a practice already so commonplace at HBEU it was called its "normal procedure." This email was sent to the head of HBUS' payment service operations, who then alerted other HBUS executives. When asked about this document describing the alteration of documents being engaged in by an HSBC affiliate, senior HBUS Compliance official Anne Liddy, who oversaw HBUS' OFAC compliance program, told the Subcommittee that it would have been a problem if U-turns were being processed in 2001, since HBUS did not then have a process in place to conduct U-turns appropriately.\textsuperscript{695}

HBUS Objections. On July 11, 2001, after HBUS Compliance head Carolyn Wind learned of the HBEU proposal, she sent an email to HSBC Group Compliance head Matthew King objecting to it.\textsuperscript{696} What followed was a growing consensus that HSBC should not be pursuing its

\textsuperscript{692} Id.
\textsuperscript{693} Id.
\textsuperscript{694} Id.
\textsuperscript{695} Subcommittee interview of Anne Liddy (2/22/2012).
business in this fashion. Ms. Wind included the Wilkinson email from June and a copy of the April letter sent to Bank Melli providing payment message instructions. Ms. Wind expressed several concerns, including whether the transactions sent via the cover payments would be permissible under OFAC regulations and that “HBUS will not be able to confirm whether or not the underlying transaction actually meets the ‘U-Turn’ requirement.” She noted further that it was “not apparent that HBEU will be able to confirm that each payment meets the requirements.” She wrote:

“In an effort to facilitate ‘straight-through processing’, it now appears that HBEU will train Bank Melli on formatting the payments and that we will be relying on Bank Melli to ensure that only qualifying payments are processed through HBEU’s account with HBUS.”

Ms. Wind also expressed concern about how it might appear to U.S. regulators that HBEU trained Bank Melli to write payment instructions in such a way, pointing out that if OFAC were to identify a transaction that did not qualify as a permissible U-turn, OFAC might consider “HSBC’s actions due to the non-disclosure as having involved willful disregard or evasion.”

HBUS payment services head Denise Reilly forwarded Ms. Wind’s email to Douglas Stolberg, head of HBUS Commercial and Institutional Banking (CIB). He responded: “With the amount of smoke coming off of this gun, remind me again why we think we should be supporting this business?”

Ms. Reilly responded by sending Mr. Stolberg a memorandum prepared by the HSBC Group Representative for Iran, John Richards, which stated that HSBC Group “with the backing of Bond” – referring to the HSBC Chairman of the Board of Directors – wanted to “significantly grow our presence in Iran” with current lines of credit reported to be $800 million, trade lines of $150 million, and growth anticipated in trade, cash management and Internet banking. The memorandum indicated that HSBC Group and HBEU wanted to expand the bank’s presence in Iran and viewed clearing U.S. dollar transactions for Bank Melli as a profitable venture that could help win additional business in Iran, despite U.S. sanctions and HBUS concerns.

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697 Id. at 130.
698 Id. at 131.
699 Id. at 131.
701 Id. at 128-129.
These email exchanges show that, by July 2001, senior HBUS compliance, payments, and business managers, as well as the HSBC Group Compliance head, were aware that Iranian U.S. dollar transaction documentation was being altered by HBEU and the transactions were being processed through HBUS.\footnote{7/11/2001 email exchange among HBUS Carolyn Wind, HBUS, Paul Lee, HBUS Anne Liddy, HBUS Douglas Stolberg, HBUS Michael Gallagher, and HBUS Denise Reilly, HSBC OCC 8876129.} HBUS Compliance head Carolyn Wind complained to HSBC Group Compliance head Matthew King, but neither stopped the practice, nor did HSBC Group obtain a legal opinion about whether its U.S. dollar cover payments were in compliance with OFAC regulations.

**HBUS’ Payments Proposal.** In August 2001, HBUS offered its own proposed procedures to clear U.S. dollar transactions involving Bank Melli.\footnote{The procedures consisted of a two-step debit process and a five-step OFAC review process, and committed to same day processing for transactions determined to be U-turn compliant. The procedures required that Bank Mellli transactions be segregated in an “HBEU Special Account” with the account number entered into the OFAC filter so that every Bank Mellli transaction would be stopped in the OFAC queue for two reviews and two approvals prior to processing. Bank Mellli would appear as the originator for all related transactions. 8/29/2001 email from HBUS Denise Reilly to HBAP Alan Wilkinson and others, “Bank Mellli,” HSBC OCC 7687346-546.} Uncomfortable with the formatting solution proposed by HBEU a few months prior, HBUS proposed that Bank Melli be listed as the originator in the payment instructions and proposed establishing a segregated account for the transactions so HBUS could ensure that all Bank Mellli payments would be stopped by the OFAC filter for further review and approval.

On August 30, 2001, HSBC’s John Richards expressed his support for the procedures, noting it would be the first time that an Iranian bank name was mentioned in the payment message.\footnote{8/30/2001 email from HSBC John Richards to HBUS Denise Reilly and others, “Bank Mellli,” HSBC-PSI-PROD-0096147-148.}

On September 6, 2001, HBUS met with the Director of the Office of Foreign Assets Control (OFAC) to discuss clearing Bank Mellli U-turn transactions. Carolyn Wind commented that although OFAC did not approve or reject the proposal, she walked away from the meeting thinking that OFAC was “okay with it.”\footnote{Subcommittee interview of Carolyn Wind (3/7/2012).}

**HBME’s Iranian Transactions.** While HBEU was processing U-turn transactions for Bank Mellli, a second HSBC affiliate, HSBC Middle East (HBME), was also carrying out OFAC sensitive transactions for other clients, using its own and HBEU’s U.S. dollar correspondent accounts at HBUS apparently without alerting HBUS to the transactions. In an October 2001 email, David Bagley, then HBME Regional Head of Legal and Compliance, sought guidance from HSBC...
Group Compliance head Matthew King about how OFAC sensitive transactions should be handled. Mr. Bagley wrote: "As I understand the current position we do routinely, and across the Group, adopt differing approaches to payments potentially subject to OFAC sanctions." Mr. Bagley wrote that, at HBME, payments were not structured "against a specific request from the customer, rather we undertake this structuring as a routine," and that he was not clear about whether those procedures were viewed "as being inappropriate, and thus should be disallowed." He also noted: "I am advised that there may even be software in the UK which filters such payments for restructuring in the event that the original message has been structured in such a way that it will be caught by the OFAC filters."

Mr. Bagley cautioned that subjecting all OFAC sensitive payments to the OFAC filter for further review and approval would likely hurt business. He wrote: "disallowing all payments which are potentially subject to the OFAC process," or the alternative of forwarding "messages in such a way that they would be caught," would have a "significant affect" upon HBME's business within the Middle East and the Group's business within correspondent banking. He also wrote: "given the likely volumes it is impractical to submit each payment to a process of referral to HBUS," as HBUS had proposed. He concluded with a request for clear guidance: "I would be grateful for your clarification as to whether what is currently going on is acceptable, or whether we should be adopting a different practice." Mr. King responded that the September 11, 2001 terrorist attack on the United States required a reassessment. He wrote: "some of the routes traditionally used to avoid the impact of US OFAC sanctions may no longer be acceptable." Mr. King indicated that an automated screening system was being looked into, and in the interim asked that OFAC sensitive payments be vetted manually.

Mr. Bagley’s email alerted Mr. King to the fact that HBME, like HBEU, was routinely sending U.S. dollar transactions through its correspondent account at HBUS using methods intended to circumvent HBUS' OFAC filter. His email did not limit those transactions to Iranian U-turns, but sought broader guidance on acceptable practice. Mr. King wrote back: "all we can do is ask that payment from the affected countries are vetted manually."
(c) Pressuring HBUS on Iran

In April 2002, HBME asked HBUS to re-circulate its proposed procedures for processing Iranian U-turn transactions, indicating that the two affiliates were still attempting to reach agreement on the procedures to be used.719

HBUE Draft Guidelines. While the HBUE Relationship Manager for Institutional Banking in HBME, John Wilkinson, was trying to streamline the cover payments procedure used to send Iranian U-turns through HBUE’s correspondent account at HBUS, HBUE Compliance was trying at the same time to put a stop to the practice altogether. On July 15, 2002, an HBUE Compliance officer forwarded draft guidelines for handling OFAC sensitive transactions to HBUE Compliance manager Julie Clarke and HBUE Multicurrency Payments Department (MPD) head Malcolm Eastwood and requested their approval.711 The proposed guidelines stated in part that, although HBUE was not legally required to comply with U.S. OFAC prohibitions, “It is strongly recommended … that RMs [Relationship Managers] do not deliberately take action aimed at assisting a customer to circumvent OFAC sanctions. For example payment instructions should not be amended by IBL staff.” The proposed guidance also stated: “On no account should you deliberately guide, encourage or coerce the sender into amending the payment details so as to circumvent the OFAC sanctions. … We will simply process as instructed.”712 The draft guidance relied on the following Group Policy:

“Group members should comply with both the letter and spirit of all relevant laws, codes, rules, regulations and standards of good market practice in each jurisdiction around the world where they conduct business.”713

710 According to Mr. Bagley, the HBUE Payment Services’ December 2002 Compliance Certificate made explicit reference to its practice of altering Iranian U.S. dollar payments. Subcommittee interview of David Bagley (4/12/2012). Compliance Certificates from affiliates are normally consolidated and sent to HSBC Group Compliance for review, which would have provided a formal channel for addressing the issue. David Bagley told the Subcommittee, however, that the reference to U-turn transactions in HBUE’s 2002 certificate was not incorporated into the consolidated Compliance Certificate and therefore was not formally escalated to Group Compliance for review. Id.
712 Id. at 106.
713 Id. at 105. The guidelines also noted that the responsibility for “policing payment and cheque clearings against sanctions” would move to Payment Services in the future.
These guidelines were later approved and became effective in the fall of 2003.\textsuperscript{14} They show that HBEU Compliance and business personnel were aware of and concerned about potentially deceptive practices some could use to circumvent OFAC prohibitions.

**HBME Negotiations.** While HBEU Compliance developed the OFAC guidelines, Gary Boon, HBME Payment and Cash Management (PCM) sales manager in Dubai, spent the second half of 2002, making a concerted effort to reach agreement with HBUS on how to process U-turn transactions. On August 29, 2002, Mr. Boon emailed Denise Reilly and Nancy Hedges in HBUS Payment Operations, to encourage HBUS to officially approve the processing of U-turn transactions involving Iranian banks. He wrote: “I can now confirm that HSBC Bank plc, London does not have any processing or compliance issues in respect of USD payments from existing or new opportunities with Iranian Banks.”\textsuperscript{15} He also wrote that HBEU wanted “to ensure the payments are STP [straight through processing],” and HBEU would provide its clients with guidelines for formatting transactions to “ensure that our Iranian clients fully understand, when or how, payments could be rejected.”\textsuperscript{16} He indicated that he was seeking HBUS’ formal agreement to process the U-turn transactions, from both a resource and reputational risk standpoint, “before I attempt to sell a USD clearing proposition.”\textsuperscript{17}

On October 8, 2002, Mr. Boon sent an email to senior HBUS Compliance official, Anne Liddy, seeking feedback on the HBEU proposal.\textsuperscript{18} Ms. Liddy responded that the position of HBUS Compliance remained unchanged “in that all transactions involving Bank Melli must be fully disclosed and represented in one single transaction that reflects the complete flow of funds.”\textsuperscript{19} Ms. Liddy noted that the HBUS proposed procedures had been approved by Legal Counsel as meeting OFAC requirements. She also stated that HBUS and HBEU needed to reach agreement on the payment procedures before HBUS Compliance would present an official proposal to HBUS’ Senior Management Committee or OFAC for approval. Ms. Liddy was also clear that these steps had to be taken prior to HBEU’s making any proposal to Bank Melli or another Iranian bank.\textsuperscript{20}

Mr. Boon responded on the same day that HBEU would soon be complying with the Financial Action Task Force (FATF) regulations.


\textsuperscript{15} 8/29/2002 email from HBME Gary Boon to HBUS Nancy Hedges, HBUS Denise Reilly, and others, “IRAN-USD PAYMENTS,” HSBC OCC 0948194-195.

\textsuperscript{16} Id. at 194.

\textsuperscript{17} Id.


\textsuperscript{19} Id. at 194.

\textsuperscript{20} Id. at 375.
requiring full disclosure of payment details on MT100/MT103 message formats, which was already part of the HBEU proposal since HBEU sent those messages to the bank receiving a U-turn payment in addition to sending a cover payment on a MT202 form. He indicated that the payments sent to HBUS fall into the category of permissible U-turn transactions, and noted that HBUS was already processing U.S. dollar transactions through two existing accounts in London. Mr. Boon wrote: “The majority of payments will be processed with HBEU sending a MT100/MT103 to the beneficiary bank and HBUS will receive the MT202 cover payment (again your already doing this).” He indicated that, due to “massive opportunities,” he would like to resolve the procedural issues prior to a scheduled visit to Iran in November 2002. In response, Ms. Liddy reluctantly set up a conference call with Mr. Boon and included Carolyn Wind and Denise Reilly.

When asked about this email, Ms. Liddy told the Subcommittee that she did not understand his email and may have misinterpreted Mr. Boon’s assertion that HBUS was already processing Iranian payments through existing accounts in London to mean that the issue affected London accounts, but not accounts in the United States. She said that she became more concerned two months later, in December 2002, when a Bank Melli payment was caught in HBUS’ OFAC filter. Carolyn Wind told the Subcommittee that she was surprised by Mr. Boon’s email and didn’t know what his comments meant. Ms. Wind said that she contacted HSBC Group Compliance head Matthew King to follow-up, but didn’t know what action he took, if any.

The results of the conference call between HBME and HBUS were discussed in email correspondence later that month. On October 28, 2002, Mr. Boon wrote to Denise Reilly requesting an update. Ms. Reilly responded that HBUS had spoken with OFAC; the “MT100/MT103 and MT202 normal cover payment process has been deemed unacceptable”; and OFAC required “full disclosure of the transaction.” Mr. Boon and Ms. Reilly then agreed that HBEU should open a separate “Special nostro account” for all U-turn transactions to ensure each transaction

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721 Id. at 374-375.
722 Id. at 375.
724 10/21/2002 email from Anne Liddy to Carolyn Wind and Denise Reilly, “IRAN,” HSBC OCC 7687373.
725 Subcommittee interview of Anne Liddy (2/2/2012).
726 Id. See also 12/30/2002 email exchanges among HBUS Elizabeth Protomastro, HBUS Carolyn Wind, HBUS Anne Liddy, HBUS Denise Reilly, and HSBC David Bagley, “OFAC: PLC wire on behalf of Melli Bank PLC,” HSBC OCC 8873909.
727 Subcommittee interview of Carolyn Wind (3/07/2012).
would be caught by the OFAC filter for review and approval. Mr. Boon requested confirmation that if HBEU met those terms and the HBUS committee approved the proposal, that “HBUS would be in a position to potentially become Iran’s USD Clearing Agent, HBEU would be their USD Correspondent Bank?” Ms. Reilly responded that the current proposal was to “process transactions on behalf of Bank Melli” and if the proposal were broader “then it should be included in the business rationale that we requested in our conference call earlier this week for presentation to HBUS senior management.” She indicated that the HBUS Senior Management Committee was comprised of the President of the bank, key business heads, and the head of key support units. While these emails suggest HBUS Compliance was poised to present the Iranian U-turn proposal to the HBUS Senior Management Committee, there is no indication in the documentation that the committee ever received or approved it.

**Eastwood Memorandum.** In November 2002, HBEU Multicurrency Payments Department (MPD) head Malcolm Eastwood sent a memorandum to HBUS Payments Services head Denise Reilly and Geoff Armstrong expressing concern that HSBC was exposing itself to unnecessary risk by handling OFAC sensitive payments. He wrote:

“I currently feel that we may be exposing ourselves to unnecessary and unacceptable Reputational and Operational Risk when we are handling payments originating from FIs [financial institutions] domiciled in or who are a local branch of an FI domiciled in an OFAC regulated country.”

Mr. Eastwood stated that HBEU’s current process was to send OFAC sensitive payments to HBUS via the “cover” payment method that made no mention of Iran or other prohibited countries. He noted that two payments, one from Iran and one from Cuba, had recently been caught by HBUS’s OFAC filter. Mr. Eastwood stated that he wanted to resolve the situation, and “we therefore need to seek clarification of HBUS/OFAC’s stance so that we can determine our future payments strategy.”

The Eastwood memorandum again put HBUS on notice regarding HBEU’s practice of concealing U-turn transactions behind cover payments and altering the payment instructions received from Iranian

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729 Id. at 192.
730 Id.
731 Id.
733 Id. at 825.
734 Id.
banks. Mr. Eastwood wrote: “The Iranian banks continue to send us what I describe as conditional payment instructions which for HBEU require an element of amendment by ourselves.” Mr. Eastwood warned: “If we cannot achieve this [a resolution on how to handle U-turn transactions] I will have to recommend to my General Manager a view that processing these payments is ‘unsafe’ and that these items should be filtered out and cancelled. This would have severe repercussions for our Group relationship within the Iranian FIs.”

That same day, HBUS Payments Services head Denise Reilly forwarded the Eastwood memorandum to HBUS PCM head Michael Gallagher and HBUS Compliance head Carolyn Wind, with the note: “We need to discuss.” HBUS records do not indicate whether that discussion took place. When asked about this email, Mr. Gallagher told the Subcommittee that he wasn’t sure he received Mr. Eastwood’s memorandum because he wasn’t named on it. When shown another email indicating he had discussed the Eastwood memorandum again in December 2003, with the new HBUS AML head, he told the Subcommittee that he did not recall the memorandum, any discussion of it, or taking any action in response to it. When Carolyn Wind was asked about the Eastwood memorandum, she told the Subcommittee that HBUS kept “pushing back on U-turns.”

**Do Not Mention Our Name.** In late December 2002, HBUS OFAC Compliance officer Elizabeth Protomastro notified Carolyn Wind, Denise Reilly, and Anne Liddy that, on December 27, 2002, the HBUS OFAC filter had stopped and rejected a payment listing Bank Melli as the originator of the payment and containing a field that read, “Do not mention our name in NY.” Ms. Protomastro advised rejecting all U-turn transactions containing such language. The language on the stopped transaction shows how information related to Iranian payments was intentionally withheld from HBUS. In response, Ms. Liddy went to Carolyn Wind’s office and spoke with her, Denise Reilly, and Paul Lee, HBUS’ Legal Counsel, about the transaction. She was told to alert David Bagley, who had become head of HSBC Group Compliance in January 2002. That same day, Anne Liddy forwarded Ms.

735 Id. at 826.
736 Id.
739 See 12/17/2003 email from HBUS Denise Reilly to HBUS Teresa Pesce, “Compliance – OFAC Issues in General and Specific to Iran,” HSBC OCC 3407517-512 (“Attached is the memo that we discussed yesterday in our meeting with Michael Gallagher.”).
741 Subcommittee interview of Carolyn Wind (3/7/2012).
742 Subcommittee interview of Anne Liddy (7/22/2012). Mr. Bagley assumed the duties of HSBC Group Compliance head in January 2002, but his appointment did not become official until May 2002, after the U.K. Financial Services Authority approved it. Subcommittee
Protomastro’s email to Mr. Bagley,743 Ms. Liddy told the Subcommittee that she was concerned about the Bank Melli payment, because HBEU still had not obtained approval to do those types of transactions.744 She told the Subcommittee that neither Mr. Bagley nor Ms. Wind provided any feedback on the incident, and she didn’t know what action, if any, Mr. Bagley took.745

The 2002 Eastwood memorandum again put senior HBUS compliance and business officials on notice that HBEU was sending undisclosed OFAC sensitive transactions through its U.S. dollar correspondent accounts at HBUS. Again, HBUS officials alerted their superiors, but no further action was taken.

(d) Continuing Pressure on HBUS to Process Iranian Transactions

Although HBEU handled the Bank Melli account, it was HSBC Middle East (HBME) that was at the center of efforts to pressure HBUS to process Iranian transactions without triggering the OFAC filter. HBME took the lead in dealing with Iran and selling bank services to Iranian banks. In January 2003, HBME Group Relationship Manager for the Middle East, Nigel Weir, sent HBUS Payments Services head Denise Reilly and HBEU MPD head Malcolm Eastwood a memorandum entitled, “Business Case-USD Payments from Iranian Banks/Entities.”746 This HBME memorandum laid out the “business case” for HBUS’ processing Iranian transactions using the procedures proposed by HBEU back in August 2001.747 The memorandum stated:

“Currently, it is estimated that Iranian banks issue up to 700 USD payments a day using their USD service providers, mainly banks in the UK and Europe, which in turn use their New York USD correspondents to effect the payments. It is believed that some
service providers amend the payments to ensure Iran is not mentioned in the body of the payment instruction to their USD correspondent. This process minimizes the risk of payment being referred to OFAC.

The memorandum did not state explicitly that both HBME and HBEU were already engaged in the same practice using their U.S. dollar accounts at HBUS.

The HBME memorandum stated that HBME “believe[s] there is a substantial income opportunity to see a USD payments proposition to Iranian Banks,” and provided an appendix detailing existing and potential business opportunities in Iran, while noting HBEU already had a “number of existing USD accounts for Iranian banks, which are used for payments clearing purposes.” The memorandum concluded:

“It is anticipated that Iran will become a source of increasing income for the group going forward and if we are to achieve this goal we must adopt a positive stance when encountering difficulties. We are aware of the concerns expressed by HBUS but strongly believe that by working together we can overcome them using means which are perfectly legitimate and in accordance with rules laid down by the relevant regulatory bodies. I hope we will be able to resolve this issue otherwise I fear we will destroy future value in a market which has substantial potential for the group.”

HBME asked that the business case be presented to HBUS’ Senior Management Committee at the earliest opportunity.

On January 16, 2003, Denise Reilly forwarded the HBME memorandum to HBUS Compliance officials Carolyn Wind and Anne Liddy. On January 21, 2003, Ms. Liddy forwarded it to Tom Crocker, the outside legal counsel advising HBUS on OFAC matters. When asked about the memorandum, Ms. Liddy told the Subcommittee she did not recall it or the outcome of Mr. Crocker’s review.

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748 Id. at 490.
749 Id. at 493. Internal bank documents indicate that HBEU cleared U.S. dollar transactions through its correspondent account at HBUS for at least six Iranian banks, Bank Melli, Bank Keshavarzi, Bank Markazi, Bank Sepah, Bank Tejarat, and the Export Development Bank of Iran. See, e.g., 10/23/2003 email from HSBC John Root to HSBC David Bagley and others, “USD Clearing – Iranian Banks,” HSBC OCC 8875217. HBEU senior payments official Rod Moxley told the Subcommittee that he believed seven or eight Iranian banks used HSBC for U.S. dollar correspondent services. Subcommittee interview of Rod Moxley (6/7/2012).
751 Subcommittee interview of Anne Liddy (2/22/2012).
752 See 1/21/2003 email from HBUS Anne Liddy to External Counsel Tom Crocker and others, “USD Payments from Iranian Banks,” HSBC OCC 3407510-511.
753 Subcommittee interview of Anne Liddy (2/22/2012).
On February 3, 2003, HSBC Group Compliance head David Bagley sent an email to HBME, where he used to work, discussing the issue.\footnote{2/3/2003 email from HBUS David Bagley to HBME Rick Padnor and others, “Business Case: US Payments From Iranian Banks/Entities,” HSBC OCC 8876487-488.} He conveyed that he had asked senior Compliance official John Root to review the OFAC issue from a Group perspective. He also wrote that he “would be grateful if we could exercise greater care with regard to the content of written material” being sent to HBUS, explaining: “The business case includes a number of express references to practices which may constitute a breach of US sanctions, including the OFAC provisions, and could provide the basis for action against the HSBC Group for breach of those sanctions, or seeking to facilitate a breach.”\footnote{Id.} Mr. Bagley requested that future communications regarding this subject be cleared through him or John Root “to avoid relative sensitive references,” prior to involving HBUS.\footnote{Id. at 488.} The recipient of the email, Nigel Weir, responded that the memorandum was intended to recommend pursuing a significant business opportunity, while complying with applicable regulations.\footnote{2/3/2003 email from HBME Nigel Weir to HSBC David Bagley and others, “Business Case: US Payments From Iranian Banks/Entities,” HSBC OCC 8876487.}

Mr. Bagley told the Subcommittee that this was the first time, in his role as head of HSBC Group Compliance, he addressed the OFAC issue. He noted that HBME’s actions could potentially “constitute a breach of US sanctions,” yet it would take him two more years, until July 2005, to establish Group policy prohibiting such conduct.

Again, there was no indication that a proposal for handling Iranian U-turn transactions was ever presented to or approved by HBUS’ Senior Management Committee. At the same time, undisclosed transactions continued to be sent by HSBC affiliates through their correspondent accounts at HBUS. A later analysis performed by an outside auditor at HBUS’ request found that, in 2002 alone, HBEU sent at least 1,900 and HBME sent at least 400 Iranian transactions through U.S. dollar accounts in the United States.\footnote{Deloitte, Results of the transactions Review -- UK Gateway, March 29, 2012. HSBC-PSI-PR00-0197910, at 62. The Deloitte review examined HBEU and HBME Iranian transactions sent through U.S. dollar accounts at both HBUS and JPMorgan Chase.}

Caught in the OFAC Filter. On June 13, 2003, another Bank Melli transaction was caught in the HBUS OFAC filter, containing not only a reference to the bank, but also the words “do not mention our name.”\footnote{See 6/17/2003 email from HBUS Elizabeth Protomastro to HSBC John Root and HBUS Carolyn Wind, “Re: PLC-Re “do not mention our name,” at HSBC OCC 8873922.} On June 16, 2003, HBUS OFAC Compliance officer

\begin{thebibliography}{100}
\footnotetext[2]{Id. at 488.}
\footnotetext[4]{Deloitte, Results of the transactions Review -- UK Gateway, March 29, 2012. HSBC-PSI-PR00-0197910, at 62. The Deloitte review examined HBEU and HBME Iranian transactions sent through U.S. dollar accounts at both HBUS and JPMorgan Chase.}
\footnotetext[5]{See 6/17/2003 email from HBUS Elizabeth Protomastro to HSBC John Root and HBUS Carolyn Wind, “Re: PLC-Re “do not mention our name,” at HSBC OCC 8873922.}
\end{thebibliography}
Elizabeth Protomastro alerted both Carolyn Wind and Anne Liddy.\textsuperscript{760} Ms. Wind forwarded the email to HSBC Group Compliance officer John Root, and Ms. Protomastro provided him with additional details about the payment, including that it involved $150,000. She explained that when the HBUS Funds Transfer staff saw the message “do not mention our name,” they rejected the payment in accordance with HBUS policy, “due to concerns about evasion issues under the OFAC regulations.”\textsuperscript{761} Ms. Protomastro explained that HBUS would not process a payment containing such a message, even if it qualified as a permissible U-turn transaction.

On June 17, 2003, Mr. Root forwarded the payment details to HSBC Group Compliance head David Bagley.\textsuperscript{762} Mr. Bagley responded by asking if they should allow a payment “with this sort of instruction to be passed to HBUS, regardless of the wider issue as to the applicability of OFAC to non-us persons.”\textsuperscript{763}

The June 2003 transaction once again made several senior officials at HBUS and HSBC Group aware that HSBC affiliates were sending undisclosed OFAC sensitive transactions through HBUS accounts, even though HBUS had yet to approve a U-turn protocol. When asked about this incident, Ms. Wind told the Subcommittee that she did not recall what HSBC Group Compliance said or did about the payment.\textsuperscript{764} She also did not recall whether there was an inquiry made to identify similar transactions, whether the transaction was reported to OFAC, or whether a SAR was considered or filed. When asked who in HBUS was responsible for following up on the incident, she replied that from the business side, Denise Reilly and her supervisor Michael Gallagher, and from the compliance side, herself and Anne Liddy.\textsuperscript{765} When Mr. Gallagher was asked about the incident, he responded that it was not his responsibility to take action, because blocked payments are an operational and compliance effort, not a PCM issue.\textsuperscript{766} He stated that he would not have had the authority to either stop or release a suspect payment; operations staff, including Denise Reilly, did not report to Mr. Gallagher in 2003.

\textbf{Using “Selves” Instead of Client Names}. In August 2003, internal bank documents show that Compliance personnel in HSBC Group and HBEU learned of, and objected to, the practice of some

\textsuperscript{760} 6/16/2003 email from HBUS Elizabeth Protomastro to HBUS Carolyn Wind and HBUS Anne Liddy, “PLC-Re: “do not mention our name,” HSBC OCC 8873925.
\textsuperscript{761} 6/17/2003 email from HBUS Elizabeth Protomastro to HSBC John Root and HBUS Carolyn Wind, “Re: PLC-Re “do not mention our name,” HSBC OCC 8873922-923.
\textsuperscript{762} Id.
\textsuperscript{763} Id.
\textsuperscript{764} Subcommittee interview of Carolyn Wind (3/7/2012).
\textsuperscript{765} Id.
\textsuperscript{766} Subcommittee interview of Michael Gallagher (6/13/2012).
HBEU personnel, when sending Iranian U-turn transactions, to alter the payment instructions and identify HBEU itself as the active party in the transaction, rather than use a client name that might trigger HBUS’ OFAC filter. Despite their objections, the practice continued for years.

On August 20, 2003, the head of HSBC Group Audit Matthew King informed HSBC Group Compliance head David Bagley that “HBEU continues to send remittances to the US with ‘selves’ noted as the ordering party when the transfer would otherwise be filtered out for OFAC sanctions reasons.”67 He wrote: “I recall that this has been raised in the past, but I thought we had agreed the practice would cease. Are you aware of the current position?”68

On September 1, 2003, Mr. Bagley forwarded Mr. King’s email to John Root and asked him to investigate.69 Mr. Bagley wrote that there is now “some clarity” that OFAC prohibitions do not apply to non-U.S. persons, even when payments are denominated in U.S. dollars.70 He also wrote that an established payment mechanism exists for bank-to-bank transfers, which did not require underlying payment information and which might apply to HBEU transfers to HBUS.71 Mr. Root agreed to look into the matter.

On September 2, 2003, HBEU Compliance manager Julie Clarke sent an email to an individual whose name was redacted by HSBC seeking more information about the transactions that triggered the inquiry by HSBC Group Audit head Matthew King.72 The email recipient responded:

“During the conversation, I mentioned that historically we used ‘selves’ but that I had stopped the practice as soon as I had discovered it in mid-2000. He stated that it was still done in HBEU. This was not in connection with [redacted] payments and I have no examples.”73

67 8/20/2003 email from HSBC Matthew King to HSBC David Bagley and others, “OFAC,” HSBC OCC 8876504-505.
68 Id. at 505.
70 Id. Mr. Bagley told the Subcommittee that the applicability of OFAC prohibitions to non-U.S. persons was an undecided issue in 2003, with legal opinions offering differing conclusions. Subcommittee interview of David Bagley (4/12/2012). OFAC now takes the position that its prohibitions apply to all U.S. dollar transactions, including those involving non-U.S. persons.
71 9/1/2003 email from HSBC David Bagley to HSBC John Root and HSBC John Allison, “OFAC,” HSBC OCC 8876504. As explained earlier, at that time, bank-to-bank transfers could be executed on forms which required information on the remitting and beneficiary banks, but not the underlying customers.
72 9/2/2003 email from HBEU Julie Clarke to [redacted], “OFAC sanctions,” HSBC OCC 8876824-825.
73 Id. at 8876824.
The following day Ms. Clarke forwarded the email to Rod Moxley in HBEU’s Multicurrency Payment Department (MPD), and asked him for more information regarding the practice of using “ourselves” in a payment message.

On September 8, 2003, Mr. Moxley responded to Ms. Clarke. He explained that the OFAC sanctions issue had been “under discussion for some time” within MPD. He forwarded to her an August email that he had sent to Pat Conroy, Malcolm Eastwood’s supervisor, addressing various issues related to OFAC sensitive transactions. The August email indicated that a certain person, whose name was redacted by HSBC, had brought “our current practice regarding the alteration of the remitter field on Iranian payments to the attention” of Matthew King and David Bagley. The August email also stated that “[t]he specific issue with Iran had been formally raised with the RM [Relationship Manager], John Wilkinson” who had been “given a deadline of 31 December 2003 to remedy this situation.” The August email also noted: “Malcolm’s stance, I understand, is that any payments after 31 December 2003 will not be processed unless signed off at a very senior level.”

That same day, September 8, 2003, Ms. Clarke forwarded the email chain to HBEU Compliance officer Paul Proctor and wrote: “It appears that John Wilkinson has been allowed to continue (to 31/12/03) to use ‘selves’ as the remitter name for Iranian payments which I believe contravenes your recently issued guidelines.” Mr. Proctor responded:

“This is the first time I have seen in writing, an admission that Payments Services are amending payments by removal of either the remitter’s name or country to prevent the probable trigger of the US filter and the subsequent freezing of funds.

You indicate that Group Compliance have now forbidden you to tamper with such payments, which I would fully support as it flies in the face of Group policy re complying with the spirit and letter etc.”

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776 Id. at 8876821.
778 Id.
This email indicates that HBEU Compliance had not been aware that some HBEU personnel were continuing to alter documentation connected to OFAC sensitive transactions, in defiance of new guidelines prohibiting such conduct. The email also indicates that HSBC Group Compliance had instructed HBEU Compliance that HBEU personnel were “forbidden” to “tamper” with the documentation.

When asked about these emails, Mr. Bagley told the Subcommittee that, in October 2003, Mr. Root reported to him that HBEU Compliance had admitted HBEU was still altering Iranian U-turn transaction documentation, despite a recommendation by HBEU Compliance that it cease. Mr. Bagley told the Subcommittee that HBEU had explained that it had been sued when payments were blocked by the HBUS filter, so it was using cover payments to avoid additional operational losses. Mr. Bagley also explained that neither HBEU Compliance nor HSBC Group Compliance could simply order a business unit to cease a particular practice; each could only “recommend” a course of action which it had done.

The internal bank documents show that, in the fall of 2003, Mr. Eastwood and Mr. Moxley in MPD, HBEU Compliance manager Julie Clarke and Compliance officer Paul Proctor, as well as the heads of HSBC Group Audit and Compliance, expressed repeated concern about actions taken by persons like the HBEU Relationship Manager for Bank Melli John Wilkinson to alter U-turn transaction documentation in a way that would avoid the OFAC filter; all agreed the practice should stop. HBEU Compliance took the step of issuing guidelines recommending against such conduct, but HBEU personnel apparently ignored the guidance.

Proposal to Expand U.S. Dollar Clearing for Iranian Banks. In October 2003, HBME increased the pressure on HBUS to process Iranian transactions by proposing to expand its U.S. dollar clearing business in Iran. In early October, HBME Planning head Steve Banner circulated a document entitled, “Iran - Strategy Discussion Paper,” to several senior bank executives, including HBME Deputy Chairman David Hodgkinson; HBME Global Relationship Manager for the Middle East Nigel Weir; HSBC Group Compliance deputy head Warren Leaming, HBUS General Counsel Paul Lee, and HBUS Compliance head Carolyn Wind. The strategy essentially sought approval for HBME offering U.S. dollar payment services to more Iranian banks since, as the strategy noted, “the Iranian market offers substantial untapped potential for the HSBC Group.”

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781 Subcommittee interview of David Bagley (5/10/2012).
782 Id.
784 Id. at 949.
The strategy listed “significant business wins” involving Iran, in the Project and Export Finance, Trade Finance, and Treasury and Capital Markets areas with an estimated $7 million per year in revenues generated by Iranian businesses for “various Group entities.”785 In a section entitled, “Phase 1 – Immediate Opportunities,” the strategy stated that Iran’s annual international trade business was valued at $25 billion, 80% of which was denominated in U.S. dollars. It stated that HBEU PCM currently offered U.S. dollar payment services to four Iranian banks, and could market the same services “to other Iranian commercial banks, including Iran’s Central Bank (Bank Markazi).” It estimated the potential business as worth up to $4 million per year.

The strategy also noted an upcoming change in U.K. law that would require U.K. bank-to-bank transfers to identify, not only the banks involved in the transfer, but also their underlying customers. It stated that the impending U.K. legislation, together with U.S. sanctions laws, would “significantly complicate the USD payments process for Iranian counter-parties,” and if “the Group decides to pro-actively promote USD payments services to Iranian banks the payments will need to be processed by HBUS with full details to satisfy OFAC requirements.”786 To facilitate the process, the strategy said that HBME planned to prepare a paper for HSBC Group requesting an increase in the country risk limits for Iran.787 The strategy concluded by asking for HSBC Group’s approval and HBUS’ “no objection” to HBEU’s providing U.S. dollar services to additional Iranian banks.788

The strategy stated clearly that, “HBEU PCM currently offer[s] USD [U.S. dollar] payment services to 4 Iranian banks.”789 It once again alerted HBUS to the fact that HBEU was already processing U.S. dollar transactions for Iranian banks through its account at HBUS. The strategy was sent to both HBUS’ legal counsel and top compliance officer.

On October 15, 2003, the HBUS CEO at the time, Youssef Nasr, sent an email to HBUS PCM head Michael Gallagher noting that with regard to Iranian U-turns, “there remain serious political and reputational risks within the USA if they proceed with this and that he should ensure that Paul Lee is kept in the loop at all times because of the prior work he has done both on this and some recent approaches from Group offices about opportunities in Libya.”790 When asked if Mr. Gallagher discussed the strategy paper with Mr. Nasr, Mr. Gallagher told

785 Id. at 951.
786 Id. at 954.
787 Id. at 952.
788 Id. at 955.
789 Id. at 952.
the Subcommittee that he did not recall seeing it.\textsuperscript{791} On October 21, 2003, HBUS General Counsel Paul Lee contacted HSBC Group Compliance head David Bagley “expressing some concerns” about the Iranian strategy.\textsuperscript{792}

On October 21, 2003, Mr. Bagley sent an email to HBME officials indicating several issues surrounding the U-turn transactions needed clarification and asked whether the costs associated with incurring U.S. legal fees made it worthwhile to continue the discussion. Mr. Bagley also wrote:

“I am not sure that HBUS are aware of the fact that HBEU are already providing clearing facilities for four Iranian banks, presumably including USD [U.S. dollar] clearance. Bank Markazi is named in the OFAC sanctions as a government owned bank and thus on the face of it not able to benefit from U-turn exemptions.”\textsuperscript{793}

On October 26, 2003, HBME Deputy Chairman David Hodgkinson sent an email in response to Mr. Bagley. He wrote: “HSBC earns USD7.5m a year from its business dealings with Iran and we believe that there is significant long-term potential for growth.”\textsuperscript{794} Mr. Hodgkinson indicated that he was willing to incur costs to investigate the options and find “an acceptable way to offer the maximum range of services possible without jeopardizing the Group’s position in the U.S.”\textsuperscript{795} Mr. Bagley then directed senior Compliance official John Root to work with Gary Boon at HBME on a payment solution.\textsuperscript{796}

**Root Report.** As he had been instructed to do by Mr. Bagley, John Root looked into the Iranian U-turn issue. On October 23, 2003, Mr. Root sent an email to Mr. Bagley, HSBC Group AML head Susan Wright, Money Laundering Control Officer John Allison, and HBEU Compliance officer Paul Proctor. Mr. Root wrote that the Iranian relationship at HBEU consisted of a U.S. dollar clearing service volume of approximately 11 payments every business day for six banks: Melli, Keshavarzi, Markazi, Sepah, Tejarat, and the Export Development Bank.\textsuperscript{797} His email again confirmed that HBEU was altering the

\textsuperscript{791} Subcommittee interview of Michael Gallagher (6/13/2012).
\textsuperscript{793} Id.
\textsuperscript{795} Id.
\textsuperscript{797} Mr. Root identified two more banks than were referenced in the October Iran strategy paper.
payment documentation, despite HSBC Group Audit head, Matthew King’s having expressed concerns about the practice, and the HBEU Compliance guidelines calling for the practice to stop by the end of the year. Mr. Root wrote:

“EPS [the payment services team within MPD where Mr. Eastwood and Mr. Moxley worked] HBEU have been manually intervening in the processing of Iranian bank payment instructions by removing the remitter’s name and country to prevent the probable trigger of a filter in the US, and the subsequent declaration to OFAC (and possible freezing) of the funds.”

Mr. Root wrote that he believed EPS had been instructed by HBEU Compliance to cease this practice, but was unclear when the instructions were given or by whom. He noted that HBEU Institutional Banking (IBL) had negotiated an extension until December 31, 2003, due to “long-standing valuable relationships.” After the December 31, 2003 deadline, Mr. Root stated that cover payments would be considered unacceptable, and EPS would have to send HBUS fully formatted payment instructions on a MT100/103 serial basis.

Mr. Root also noted that Project WOLF, an HSBC Group project developing an automated payment filter to screen transactions for terrorists, would not ensure HBEU compliance with U-turn regulations in the United States. As a result, he said that HBUS would continue to be responsible for screening all U.S. dollar transactions with regard to OFAC prohibitions.

Moxley Deadline. The following day, John Root forwarded David Bagley, Susan Wright, and John Allison an email from Rod Moxley in HBEU’s Multicurrency Payments Department (MPD) expressing Mr. Moxley’s objection to participating in procedures designed to conceal U-turn transactions. In his October 24, 2003 email, Mr. Moxley first objected to the notion that the MPD procedures being used for Iranian transactions were new or unknown:

“I have been alarmed by recent inferences that Payment Services have been amending the Iranian banks’ payments without the knowledge or consent of IBAI RIM or IBL Compliance. This has been a long standing practice and to avoid future doubt, I will reiterate the points made in Malcolm Eastwood’s memo to Niger Weir of 22 Jan. 03.”

799 Id. at 217.
800 10/24/2003 email from HBEU Rod Moxley to HBEU John Wilkinson and others, “iran,” HSBC OCC 8874661-663. Mr. Moxley then outlined a new procedure that he advocated for
Mr. Moxley also stated that the position of his office in terms of processing the Iranian payments was becoming “increasingly untenable.” He wrote that HBEU Risk Management Services would be controlling the new WOLF filter, but “we have been requested to find ways to circumnavigate our own and other institutions’ compliance filters.” He described his role as protecting the bank from reputational risk, but “I now feel uncomfortable in compromising my position by leading IBL, PCM or Iranian counterparties down certain routes which may directly contravene the spirit of the Compliance framework.” Mr. Moxley warned that, given the internal HBEU deadline to stop processing concealed Iranian transactions, beginning January 1, 2004, “no Iranian payments will be amended.”

On November 11, 2003, HSBC Group Money Laundering Control Officer John Allison sent an email to HSBC Group AML head Susan Wright about his visit to HBEU’s Multicurrency Payments Department (MPD) the week prior to discuss Iranian payments. He wrote that Iranian correspondent bank customers entered payment information on a form, and MPD staff were then expected to review the form to ensure the phrases “Iran,” “do not mention Iran,” or any other compromising reference were not included in the MT202 payment message transmitted to HBUS. He described this process as “established custom” rather than a documented procedure, “believed by MPD to be at the request of relationship management.” He also wrote that the new MPD Compliance manager was “not comfortable with the custom which he has inherited, neither from a moral compliance perspective, nor from the operational loss/embarrassment factor.” Mr. Allison also wrote that MPD Compliance is “very uncomfortable” about periodically being asked by Nigel Weir and Gary Boon in HBME whether a specific payment format will pass through an OFAC filter. He stated that MPD Compliance viewed all of the Iranian payments they processed as meeting the requirements for a permissible U-turn transaction, and wanted to move toward the legitimate execution of these payments in

Iranian payments, the result of which would be that the Iranian banks would enter the payment information instead of HBEU.

801 RMS was located within HBEU’s Payment Services. Subcommittee interview of Rod Moxley (6/7/2012).
802 10/24/2003 email from HBEU Rod Moxley to HBEU John Wilkinson and others, “Iran,” HSBC OCC 8874661-663.
803 Id. at 662.
804 Id.
806 Id. at 136.
807 Id. at 137. The email did not address the issue of whether Bank Markazi, as a government owned Central Bank, was unable to utilize the U-turn exception. Bank Markazi was added to the OFAC list in 2007.
light of what Mr. Root described as an “instruction” from Mr. Bagley “to cease processing Iranian bank payments.”

On November 27, 2003, Mr. Moxley sent Ms. Wright a draft proposal to process Iranian U.S. dollar transactions. Although the proposal would prohibit altering a transaction document to remove the name of a prohibited country or town, and required a review for OFAC compliance, it did not require the transaction to include full payment details for the originator and ultimate beneficiary as outlined in the HBUS August 2001 U-turn payment procedure.

On December 10, 2003, after having consulted HBUS Compliance head Carolyn Wind, Ms. Wright sent Mr. Moxley an email updating him on the Iranian U-turn payment proposal. Ms. Wright indicated that the issue of processing payments through HBUS had been “discussed at length” among HBUS Compliance, outside legal counsel Tom Crocker, HBUS payments personnel, and HBEU during the summer of 2001. She indicated she had asked Ms. Wind to forward the 2001 HBUS proposal for consideration. The following day, Nigel Weir wrote to Ms. Wright that the HBUS proposal required a method for processing payments that was not HBME’s preferred solution. He also expressed concern that HBEU would be unable to advise their customers of the proposed processing changes before the December 31 deadline and requested an extension. Ms. Wright forwarded the correspondence to Mr. Bagley.

On December 12, 2003, Mr. Bagley emailed Mr. Weir that if HBUS felt it could agree to processing the Iranian transactions only on the basis of fully transparent documentation, then its views would have to be taken into account. He also wrote that HBUS “must be comfortable” with the approach.

HBEU continued, however, to object to the new payment procedure. On December 18, 2003, HBEU wrote to HSBC Group Compliance that HBUS’ procedure, which it referred to as “the serial method,” “requires a large amount of work prior to commencement, a disproportionate amount of expense and a higher than average risk to the banks reputation being damaged by a future payment.”

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808 Id. at 137. Although Mr. Root indicated that Mr. Bagley had ordered the MPD payments to “cease,” they continued for another two years.
810 12/10/2003 email from HBUS Susan Wright to HBEU Rod Moxley and others, HSBC OCC 8875508.
812 12/18/2003 email from HBUE Tony Collins to HSBC John Allison and others, “Memo: Re: Iran – U-Turn Payments,” HSBC OCC 8873974-975. Group Compliance John Allison and John Root sought legal advice from outside counsel Tom Crocker of Alston & Bird and Mr. Crocker determined that “it is not clear that the cover payments meet the requirement of the U.S. Dollar
At the same time HBEU and HBUS were arguing over payment procedures, HBEU and HBME continued to send transactions involving Iran through their correspondent accounts at HBUS, the vast majority of which were undisclosed. A later analysis performed by an outside auditor at HBUS’ request found that, in 2003, HSBC affiliates sent at least 5,400 Iranian transactions to U.S. dollar accounts in the United States, of which about 90% were not disclosed.  

Also in December, HBUS payments services head Denise Reilly spoke with HBUS’ new AML Director Teresa Pesce, who began work in September 2003, about the Iranian issue and sent her a copy of the 2002 Eastwood memorandum describing how HBEU altered documentation and used cover payments to send U.S. dollar transactions involving Iran through their correspondent account at HBUS without HBUS’ knowledge. Ms. Reilly’s email indicated that Ms. Pesce had also discussed the issue with Mr. Gallagher the previous day, although Mr. Gallagher told the Subcommittee he did not recall either seeing the memorandum or discussing it with Ms. Pesce. 

(e) Reaching Agreement

Despite the HBEU deadline announced by Rod Moxley, that MPD would stop processing concealed Iranian transactions after December 31, 2003, no agreement was reached by that date on how to process the transactions. Documents obtained by the Subcommittee indicate that HBEU did not adhere to its deadline, but continued to process Iranian transactions using cover payments and deleting any references to Iran in the payment instructions.

On March 10, 2004, after an Iranian transaction was detected and halted in London, HBEU MPD head Malcolm Eastwood wrote: “I remain extremely uncomfortable with the practice of amending Iranian payment orders for whatever means.” Mr. Eastwood advised HBEU Compliance and Institutional Banking to resolve the issue as soon as possible.
possible and remarked that his Compliance certificate is “heavily
caveated to reflect that we are not compliant in respect of Iran.” Mr.
Eastwood sent a copy of his email to HSBC Group AML head Susan
Wright who forwarded it to David Bagley.

The following day, Mr. Bagley responded to Mr. Eastwood by
writing that he understood and shared his concerns, but believed his
comments underestimated “the complexity of the OFAC regulation, and
the competing competitive pressures across the Group.” Mr. Bagley
also wrote that one reason for the slow resolution was that “HBUS was
unaware that any arrangements existed with Iranian banks.”

On March 22, 2004, more than two years after becoming head of
HSBC Group Compliance, David Bagley confronted HBME Deputy
Chairman David Hodgkinson about the need to change how HBME was
handling U.S. dollar clearing activity for Iranian banks. Mr. Bagley
wrote that he was “uncomfortable with this activity in its current form,”
and “the amount of revenue may not justify” the “additional work and
investment” required, “nor would it justify running the reputational
and regulatory risk in the U.S.” He expressed his willingness to discuss
the issue further, but suggested “that any such conversation take place
over the telephone, as we are seeking to avoid correspondence with
HBUS on this sensitive issue other than through lawyers so as to
preserve privilege.”

issued a new Group Circular Letter 040021 implementing a major new
initiative on “Payment screening.” The circular announced that HSBC
Group had developed an internal filter called “WOLF” to screen against
terrorists and sanctioned countries and persons. The circular explained:

“As part of the international effort to combat terrorism, Competent
Authorities in numerous countries have published lists of names
that are known to be, or are believed to be involved in terrorist
activity. … In addition … sanctions against a number of countries
and names are imposed …. Compliance with these sanctions and
orders has to date relied upon manual processes to identify when
relevant names are contained in payment instructions. In order to
ensure that compliance with the restrictions … is achieved
consistently across the Group, an automated payment screening

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817 Id. at 8873980.
818 3/11/2004 email from HSBC David Bagley to HBME Malcolm Eastwood and others, “Bank
Markazi Payment,” HSBC OCC 8873985-986.
819 3/22/2004 email from HSBC David Bagley to HBME David Hodgkinson and HSBC Warren
820 Id.
0953080-084.
utility named WOLF has been developed. When installed ... WOLF will, before execution, search all fields of a payment message for matches with listed terrorist/sanctioned names. Once a potential match with a word or words ... is identified, the unexecuted payments must be reviewed to establish whether the match is actually a true match, with appropriate action taken if it is. WOLF is the Group solution for real-time pre-execution payment screening.\footnote{822}

The circular indicated that globally, WOLF would screen against terrorists listed by the United Nations, United States, United Kingdom, European Union, and Hong Kong, as well as countries or persons sanctioned by the United Nations. It indicated that compliance and payment operations personnel in HSBC affiliates were responsible for ensuring WOLF was loaded with other sanctioned names that were applicable locally.\footnote{823} It indicated that the screening would be applied first to international transactions, and later to domestic ones. The circular required affected HSBC entities to install the WOLF filter by the end of 2004.

**HBME Extension.** On April 17, 2004, HBME Deputy Chairman David Hodgkinson contacted David Bagley about the unresolved issues involving HBME’s U.S. dollar clearing business for Iran, because he anticipated having to explain HSBC’s position to the Central Bank during a visit to Tehran in May. Mr. Hodgkinson noted: “The current position as briefed to me last week was that we have not yet found a way to handle major USD clearing business.”\footnote{824} He informed Mr. Bagley that he had directed his staff to develop a proposal to undertake this business while minimizing risk, “so that if circumstances change we know our preferred way forward.”\footnote{825}

Mr. Bagley forwarded the email to his supervisor, HSBC Group legal counsel Richard Bennett. Mr. Bagley wrote: “[T]he most pressing issue to be resolved is that relating to the limited number of existing relationships that we have (for two small Iranian Banks) where I suspect that HBUS are not aware that payments may be passing through them. Do not believe that we can allow this situation to continue very much longer, which is the point I will make to David in my response.”\footnote{826}
This email is the third\textsuperscript{827} in which Mr. Bagley indicated that HBUS might be unaware it was processing Iranian U-turn transactions that, in his own words, “may constitute a breach of U.S. sanctions,” yet contained no indication that Mr. Bagley planned to inform HBUS about the risks it was incurring.

Two days later, on April 19, 2004, Mr. Bagley again pressed HBME to resolve the issue. In an email to Mr. Hodgkinson, Mr. Bagley expressed concern about the correspondent relationships operating through HBME “which do not currently meet the requirement of the US Legal opinion that has now been obtained.”\textsuperscript{828} He continued: “I have sanctioned the continuation of these services pending an early resolution of the way forward, but it is clear from your note that we are some distance away from finalizing our thinking such that we can go to HBUS with any proposal with regard to a way forward.” Mr. Bagley warned: “I feel that there is little option other than for me to recommend to HBEU that the existing activity be discontinued given the risk that we are posing for HBUS, unless the solution under consideration at your end gives us a satisfactory option.”

HBME’s Nigel Weir responded to Mr. Bagley’s email at the request of Mr. Hodgkinson, stating that he had already spoken with Gary Boon at HBME and John Allison at HSBC Group to develop a solution. He also requested that Mr. Bagley extend the dispensation from the HBEU decision to stop altering Iranian documentation until June 30, 2004.\textsuperscript{829} Two days later, Mr. Bagley told John Allison that he was reluctant to extend the dispensation “unless there is a clear and agreed solution with a definite and proximate implementation date,” and requested an update the following week.\textsuperscript{830} Despite Mr. Bagley’s indication that he would not grant an extension without an agreement, the same practices continued amid ongoing negotiations over the agreement’s provisions.

\textsuperscript{827} The other two were a 10/21/2003 email from HSBC David Bagley to HBME Steve Banner, and others, “Iran-Strategy Discussion Paper,” HSBC OCC 8873946-947 (“I am not sure that HBUS are aware of the fact that HBEU are already providing clearing facilities for four Iranian banks, presumably including USD clearance.”); and a 3/11/2004 email from HSBC David Bagley to HBME Malcolm Eastwood and others, “Bank Markazi Payment,” HSBC OCC 8873985-986 (“The complexity of the OFAC regulations, and the fact that HBUS were unaware that any arrangements existed with Iranian Banks, has made speedy resolution of this issue difficult.”).

\textsuperscript{828} 4/19/2004 email from HSBC David Bagley to HBME David Hodgkinson, “Iran – Correspondent Banking Services,” HSBC OCC 8966135.

\textsuperscript{829} 5/2/2004 email from HBME Nigel Weir to HSBC David Bagley and others, “Iran – Correspondent Banking Services,” HSBC OCC 8874673-674

\textsuperscript{830} 5/4/2004 email from HSBC David Bagley to HSBC John Allison, “Iran – Correspondent Banking Services,” HSBC OCC 8874673.
Second Moxley Deadline. About eight months after Mr. Moxley had raised strong objections to continuing to alter Iranian payments, no agreement had been reached among HSBC affiliates on increasing the transparency of the transactions. HBEU continued to delete references to Iran from the payment instructions, generate cover payments with incomplete payment information, and send undisclosed Iranian payments to HBUS. To break the impasse, in June 2004, outside legal counsel in the United States proposed a new payments solution, which essentially required that all U-turns be processed by HBUS in a transparent or “serial” manner that identified the underlying originators and beneficiaries.

On June 9, 2004, HBEU senior payments official Rod Moxley reacted negatively to the proposal due to operational difficulties. At the same time, he wrote: “I feel very uncomfortable recommending that we continue to process Iranian payments.” He requested a formal response by June 18, 2004, and stated that “unless compelling commercial reasons” approved by HSBC Group Compliance and HBUS exist, he would stop handling Iranian payments after September 30, 2004. This email represented his second attempt to cut off Iranian payments that MPD was uncomfortable processing.

On June 30, 2004, Nigel Weir wrote to Mr. Moxley and asked him to revisit the issue and work with HSBC Group Compliance on a solution enabling HBEU to execute U.S. dollar payments for Iranian banks in accordance with U.S. regulations. Mr. Weir told Mr. Moxley that if the payments were stopped, “we will be effectively insulting the Government and State of Iran.” Mr. Weir stated that the bank had declined new U.S. dollar payment business from Iranian banks due to the sensitive political situation, “but to exit business which we have been conducting for many years would jeopardize all other existing business activities.” He estimated that the Group profit from existing Iranian business activities amounted to $10 million per year.

Also on June 30, 2004, HBME Deputy Chairman David Hodgkinson forwarded the correspondence between Mr. Moxley and Mr. Weir to then HBEU CEO Michael Geoghegan, asking for his “intervention and support” in positively resolving the long-standing issue, and noting Iran’s “significant strategic importance” to the Group. Mr. Hodgkinson also noted that the volume of Iranian payments was small at 20 per day. When asked about this email, Mr.

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832 Id.
Moxley told the Subcommitte that it resulted in HBEU and HBME’s obtaining a “dispensation” from having to end the alteration of Iranian transactions until the end of 2004. 835 When asked about the dispensation approval process, he said that he thought that HSBC Group Compliance approval was needed along with secondary approval from either HSBC Group Audit or another manager.

Later that day, another HBEU official John Ranaldi sent an email to Mr. Geoghegan stating that he was aware of the Iranian situation and would get an update. He wrote: “[B]asically, our interpretation was that we were being asked to ‘fudge’ the nature of the payments to avoid the U.S. embargo and seizure.” 836 When asked about this email, Mr. Geoghegan told the Subcommittee that he could not explain what Mr. Ranaldi meant by using the word “fudge,” except that it related to Iran. 837 He said that, at the time, he was unaware that HBEU was altering transaction documentation or using cover payments. Having since learned what was going on, he told the Subcommittee that he assumed that’s what Mr. Ranaldi was talking about. When asked whether it raised alarm bells at the time, he remarked that he got many emails and Mr. Ranaldi used colorful language. He said that he also knew Mr. Ranaldi would follow-up with him in a few days.

HBEU Proposal. On July 6, 2004, HBEU’s Rod Moxley produced a specific proposal as a potential way forward using his preferred solution of serial payments. 838 The extensive proposal also shed light on existing practices at HBEU. 839

The proposal noted that HBEU had been trying to come up with a solution for two years after an HBEU compliance officer challenged the practice of altering Iranian payment instructions in June 2002. It noted that Bank Melli, Bank Markazi, Bank Tejarat, Bank Keshavarzi, and the Export Development Bank of Iran were the five Iranian financial institutions that took advantage of this practice to effect U.S. dollar payments with a daily volume estimated at between 10 and 50 payments per day at an approximate total value of $500,000 to $1 million. The proposal also noted that the Central Bank payments were much larger, in the range of $10 million, and were typically made at certain times of the

835 Subcommittee interview of Rod Moxley (6/7/2012).
839 Id. For example, according to the document, the existing HBEU practice was that if an Iranian financial institution included a cautionary statement, such as “Do not mention Iran,” in Field 72 of the payment instructions, the payment would drop out to what was called a repair queue. Once in the repair queue, HSBC personnel would alter the payment instructions by deleting any reference to Iran.
The proposal stated that the “vast majority of payments are valid, falling within the U-turn exception.”

The proposal discussed two potential payment options that would meet HBUS’ requirement for transparency. It noted that HBEU preferred the “serial payment” option which would allow the Iranian banks to format their payments in a way that would not require intervention from HBEU. HBEU believed this aspect of the proposal would relieve it of any responsibility to review the payments, leaving it up to HBUS, or another U.S. bank where a payment was directed, to verify that the payment met the U-turn exception requirements. The proposal indicated that HBEU would continue to utilize WOLF and other filters to screen the payments, but the Iranian financial institutions would be responsible for ensuring they submitted only valid U-turn payments “permissible under the terms of US legislation.” The proposal indicated this solution would also transfer the risks associated with blocked payments to the Iranian banks.

The proposal acknowledged that HBUS would need to agree to this solution, and HBEU and Group Compliance would need to “sign-off” on it prior to moving forward.

On July 6, 2004, HBEU MPD head Malcolm Eastwood forwarded Mr. Moxley’s proposal to John Ranaldi, noting that he continued to have serious concerns about the Iranian U.S. dollar clearing business. Mr. Ranaldi forwarded the email to then HBEU CEO Michael Geoghegan, writing: “reference your earlier query.” According to Mr. Ranaldi, Mr. Eastwood’s department was being asked to “amend instructions or assume responsibility that the contents of the payment message do not attract the Fed’s attention and seize the payment.” He explained that a “payment clerk is asked to judge upon a payment kicked out by the filtering system, whether to release, or return.” He wrote, “there is an irony; someone could argue that by returning payments to Iran that we are contravening the ofac rules.” Mr. Ranaldi characterized the risks associated with the existing practice as including operational losses due to payment seizure, threats to HSBC’s reputation, and “incurring hefty fines.” He told Mr. Geoghegan that Lloyds Bank had been fined “and few if any u.k. banks are in the business.”

When asked about this email, Mr. Geoghegan told the Subcommittee that he was “puzzled” that he didn’t act to stop the
practice immediately or get out of the business. He remarked that he did respond that way with Mexico, so thought it was odd that he didn’t in this case. He couldn’t recall whether he talked to any other senior HSBC Group executives about the issue.846

Emails in early August 2004 show HBEU and HBME reviewing and discussing the Moxley proposal.847 On August 6, 2004, Mr. Bagley commented: “My initial reaction is that the proposals are more robust, and therefore more likely to be acceptable that we originally contemplated or proposed.”848 He also said the proposal had to be sent to HBUS’ outside legal counsel for confirmation it would meet OFAC requirements.849 Later that day, the HSBC Global head of Payments and Cash Management, Iain Stewart, forwarded Mr. Bagley’s email to Mr. Geoghegan and Mr. Hodgkinson with a note: “Progress report. This will delay it a bit but we are getting there.”850 When asked about this email, Mr. Geoghegan surmised that HBUS was involved and legal opinions were being obtained.851

On September 22, 2004, HBEU Nigel White informed Mr. Stewart and others, including Mr. Bagley, that “all involved parties have signed off on the proposal,” and the next step was for HSBC Group Compliance to obtain agreement from HBUS.852 At the same time these negotiations were ongoing, HBEU and HBME continued to send undisclosed Iranian transactions to HBUS with the tacit approval of HSBC Group Compliance.

**HBUS Approval.** The revised Moxley proposal was sent to HBUS in November 2004. On November 30, 2004, HBUS’ AML Director Terry Pesce, PCM head Michael Gallagher, and Payment Services head Denise Reilly met with HBUS CEO Martin Glynn, about HBUS processing U-turn transactions. Prior to the meeting, Ms. Reilly circulated the HBUS procedures that were developed in 2001, “when the topic was last active.”853 The internal emails suggest that one HBUS employee may have been under the impression that the processing of Iranian transactions had not yet begun and did not know that HBUS had

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849 Id.
851 Subcommittee interview of Michael Geoghegan (5/24/2012).
already been processing Iranian U.S. dollar transactions for at least three years. 854

A few days after the high level meeting among HBUS officials, Ms. Reilly sent Mr. Gallagher a description of “the conditions under which HBUS will accept U-Turn transactions.” 855 Those conditions included that transactions would be formatted to be fully transparent serial payments; HBEU would agree not to alter payment instructions and abide by the U-turn processing requirements; HBUS would not be liable for penalties resulting from OFAC sanction violations; a separate “HBEU Special Account” would be established at HBUS to handle Iranian originated transactions and the account number would be added to the HBUS OFAC filter so all transactions could be reviewed and approved prior to processing; HBUS would be reimbursed for the additional employees needed to handle review of these payments; and fees for the transactions would reflect the processes and risk. 856 Whereas the 2001 protocol was specific to Bank Melli, this protocol applied to all Iranian transactions. 857

On December 15, 2004, Mr. Bagley informed the HSBC Global Head of PCM Marilyn Spearing and HBME Deputy Chairman David Hodgkinson that he had advised then HSBC Group CEO Stephen Green “that a compliant solution had been agreed in principle with HBUS.” 858 While this agreement was a significant milestone, Mr. Bagley said Mr. Green wanted to consider the issue and possibly discuss it with then HSBC Group Chairman John Bond.

Mr. Bagley asked Ms. Spearing to provide him data on the potential commercial value of the Iranian U.S. dollar transactions to the Group, considering both existing and future business. He wrote:

“I would not suggest that we seek to try and influence the debate at this stage….but it might be helpful if I was armed with the likely value to the Group if we are in effect making a reputational risk over possible reward type judgment.” 859

854 See, e.g., 11/30/2004 email from HBUS Sandra Peterson to HBUS Denise Reilly and HBUS Michael Gallagher, “U-turns,” HSBC-PSI-PROD-0096165 (Ms. Peterson: “Is this proposal for Bank Melli only or is the intent to grow this business? When this topic first arose it was to support Bank Melli but my understanding is that the business under discussion now is more general, with no specific clients named to date.


856 Id. at 527.

857 Subcommittee meeting with HSBC legal counsel (4/12/02).

Mr. Bagley concluded by writing that it would probably be “sensible” to “gently” proceed “assuming that we may get sign-off.”\textsuperscript{859}

An internal OCC memorandum indicates that, in early 2005, HBUS contacted the OCC about a proposal to process Iranian U-turns.\textsuperscript{860} In the memorandum, an OCC examiner described how legitimate U-turns could be processed and wrote: “[W]e notified Ms. Pesce that we believed the transactions to be permissible. However, we also informed her that the bank would have to maintain extremely tight controls over the transactions as well as a comprehensive system of controls for monitoring purposes.”\textsuperscript{861} Later in the same memorandum, the OCC examiner wrote: “[O]n February 23, 2005 Ms. Pesce informed the writer that the decision to process the u-turn transactions was not to go forward and that the area business had made the decision not to undertake such processing.”\textsuperscript{862}

The documentation suggests that even after reaching agreement with HBUS on how to process Iranian transactions, HBEU and HBME continued to send undisclosed Iranian transactions through their HBUS accounts. A later analysis performed by an outside auditor at HBUS’ request found that HSBC affiliates sent about 7,800 Iranian transactions through U.S. dollar accounts in the United States during 2004, of which more than 90% continued to be undisclosed.\textsuperscript{863}

\textbf{(f) Processing the Iranian Transactions}

The 2004 agreement reached among HSBC affiliates on how to process Iranian U-turn transactions did not end the controversies or new developments affecting those transfers.

\textbf{Considering an Exit.} Four months after agreement was reached with HBUS on how to process Iranian transactions, on April 8, 2005, David Bagley reached out to Mr. Hodgkinson to request an assessment of the nature and extent of Iranian business for an analysis Mr. Bagley was asked to prepare for the HSBC Group Chairman. It appears that at the top levels of HSBC, there was some discussion about exiting the Iranian business entirely due to a “specific transaction for NPC” about which Mr. Bagley had spoken with Mr. Green.\textsuperscript{864} In the same email, Mr. Bagley wrote, “This is needed partly as part of the risk over reward

\textsuperscript{859} Id. at 039.
\textsuperscript{861} Id.
\textsuperscript{862} Id.
\textsuperscript{864} 4/8/2005 email from HSBC David Bagley to HBME David Hodgkinson and HBME Nasser Homapour, “Iranian Business – OFAC,” HSBC OCC 8874052. The reference to NPC is unclear.
equation, but also because we will need to both analyze each different type of business and assess how we will deal with legacy issues. He continued: "It is not all as bad as it seems as the conversation today gave some clear possible alternative approaches to an outright ban."

Two days later, on April 10, 2005, HBME official Ajay Bhandoola provided Mr. Bagley with a paper discussing payment alternatives for Iran. The paper laid out two proposals for continuing payments from Iranian bank accounts with HSBC “to protect our Iranian franchise while minimizing any possible legal, regulatory or reputational risk to HBUS.” The two alternative solutions provided were to use another U.S. dollar correspondent (other than HBUS) for HBME, and to limit U.S. dollar accounts for Iranian banks to specific purposes. HBME did not explain why it was considering using a third party correspondent since HBUS had already agreed to process the Iranian transactions using transparent procedures.

**Stopping Payments.** On April 19, 2005, HBUS’ OFAC filter stopped a $362,000 payment from Bank Melli because it contained the phrase “do not mention our name in New York.” When asked in general about why payments would be stopped in the HBUS filter, Rod Moxley told the Subcommittee that messages like the one mentioned above should have been deleted in the processing area but was errantly left on the outgoing instructions. This incident indicated that HBEU’s MPD was still altering Iranian payment instructions in April 2005, one year after Mr. Moxley had threatened to stop processing all payments if forced to continue altering them, and four months after HBEU and HBUS reached agreement on using fully transparent Iranian U.S. dollar transactions. HBEU resubmitted the payment on April 22, 2005, but HBUS stopped it again and sent a SWIFT message requesting full disclosure of the name and address of the underlying originator and ultimate beneficiary. Two follow-up requests were sent by HBUS on April 28 and May 4, 2005. As of May 5, 2005, no response had been received.

In early May 2005, a $6.9 million wire payment involving Iran was also stopped by HBUS because the payment details included the phrase,
“Bank Melli Iran.”[873] HBUS OFAC Compliance officer Elizabeth Protomastro sent an email to HBEU, as well as HSBC Group, stating:

“Though the payment appears to meet the U-turn under the Iranian Transactions Regulations, we require that the payments should be fully disclosed as to the originator and beneficiary information before processing. We know that this policy is in line with the stance of other U.S. financial institutions.... You are also aware, from past discussions, that this is required by HBUS.

Let us know if you have any questions. Please advise on your side of the delay in processing.”[874]

The email chain regarding the stopped payment was forwarded to Mr. Bagley, who then contacted HBUS AML head Teresa Pesce to ask whether HBUS’ action “denotes a change of policy and approach within HBUS to what I would normally expect to be cover payments.”[875] Mr. Bagley wrote:

“As you are aware, there are no Group standards which require that the originator and beneficiary details go in all payments.

Accordingly, Group Operation globally will not habitually require or input this information if the underlying customer instruction is received on a basis permitted by the SWIFT format and by local regulation.”

He noted that if the payment were suspended due to a reference to Iran, he understood. But if the action taken by HBUS denoted a change of policy on what information had to be included in payment instructions, that change may not have been communicated across the Group and vetted with business colleagues. This email was sent in 2005, by Mr. Bagley, after more than two years of negotiations to increase transparency with regard to Iranian transactions.

Ms. Pesce forwarded Mr. Bagley’s email to HBUS OFAC Compliance officer Elizabeth Protomastro and senior HBUS Compliance official Anne Liddy. Ms. Protomastro responded that “for the most part” the U-turns being processed by HBUS for HBEU had been fully disclosed in compliance with the conditions specified in December 2004.[876] Ms. Protomastro stated that the remitter involved in

874 Id. at 712.
the $6.9 million transfer was Credit Suisse Zurich, which was “well aware of the u-turn practices of other U.S. organizations and the requirement for full disclosure of the name and address of the originator and the beneficiary.”

On June 3, 2005, Ms. Protomastro informed HSBC Group about two more HBEU transfers, for $1.9 million and $160,000, that had been stopped by HBUS due to the lack of full disclosure of the originator, beneficiary, and purpose of the payment. HBEU responded that both payments were foreign exchange related, the originators were Bank Tejarat and Bank Melli, and the beneficiaries were Persia International Bank and Credit Suisse Zurich, respectively. Ms. Protomastro responded by requesting that HBEU follow up with the banks to obtain the names and addresses of the initial originators and ultimate beneficiaries, as well as confirmation of the underlying purpose of the payments, in accordance with the “agreement reached in the past” between HBUS and HBEU requiring full disclosure for U-turn payments. According to information provided by Bank Melli through HBEU, the $160,000 payment denoted an internal transfer from Bank Melli’s account with HBEU to Bank Melli’s account with Credit Suisse Zurich. This information allowed the payment to be released. Mr. Marsden stated that he was in the process of contacting Bank Tejarat for additional information about the $1.9 million transfer.

On June 6, 2005, Anne Liddy sent HBUS AML head Teresa Pesce the email correspondence about the two Iranian payments that had been suspended. She also informed Ms. Pesce that 44 of the approximately 60 payments stopped by the HBUS OFAC filter the previous month, May 2005, and forwarded for review, referenced Iran. She remarked that this was “quite a lot.” The following day, HBUS OFAC Compliance officer Grace Santiago-Darvish informed HBUS’ Payment Services head Denise Reilly that they would be sending a message to all

877 ld.
878 6/3/2005 email between HBUS Elizabeth Protomastro and HSBC John Allison and others, “Wire payments from HSBC Bank PLC suspended – USD 1,900,000 and USD 160,000 (Iran),” HSBC OCC 3407547.
879 6/6/2005 email from HBEU Rod Moxley to HSBC Elizabeth Protomastro and others, “Re: Wire payments from HSBC Bank PLC suspended – USD 1,900,000 and USD 160,000 (Iran),” HSBC OCC 3407546-547.
880 6/6/2005 email from HBUS Elizabeth Protomastro to HBEU Stephen Cooper and others, “Re: Wire payments from HSBC Bank PLC suspended – USD 1,900,000 and USD 160,000 (Iran),” HSBC OCC 3407544-545.
881 6/7/2005 email from HBEU Anthony Marsden to HBUS Grace Santiago-Darvish, “Re: Wire payments from HSBC Bank PLC suspended – USD 1,900,000 and USD 160,000 (Iran),” HSBC OCC 3407543-544.
882 6/7/2005 email from HBUS Anthony Marsden to HBUS Rod Moxley and others, “Re: Wire payments from HSBC Bank PLC suspended – USD 1,900,000 and USD 160,000 (Iran),” HSBC OCC 3407544-545.
883 6/8/2005 email from HBUS Anne Liddy to HBUS Teresa Pesce and others, “Fw: Wire payments from HSBC Bank PLC suspended – USD 1,900,000 and USD 160,000 (Iran),” HSBC OCC 3407533.
HSBC locations to remind them about the need to fully disclose underlying information in U-turn payments. She wrote: “We, in Compliance have noticed that, other locations could be more forthcoming about disclosing orig[inator], and benef[iciary] information.”

Switch from HBEU to HBME. On May 20, 2005, HBME Deputy Chairman David Hodgkinson sent an email to HSBC business heads that, after a meeting with the HSBC Group Chairman and Group CEO, a decision had been made to transfer all Iranian bank U.S. dollar accounts held by HBEU to HBME, and utilize “third party correspondent in the US for cover and other valid U turn payments.” When asked about this decision, David Bagley told the Subcommittee that the processing of the payments was moved to HBME because that was where the locus of business was located. In addition, HBME set up a special team to review the transactions to ensure consistent treatment. Mr. Hodgkinson also informed HSBC business heads that they should suspend new business and the expansion of current activities with Iran until the political situation improved, but that “existing business and commitments with Iran” were allowed to continue.

JP Morgan Chase. On June 20, 2005, David Bagley informed David Hodgkinson that Iranian payments had been discussed in a meeting he had with HSBC Group CEO Stephen Green and HSBC Group legal counsel Richard Bennett. He wrote that it was decided that all U-turns, whether passing through HBUS or another U.S. correspondent, would have to comply with the U-turn requirements in OFAC regulations. He wrote that Mr. Green also wanted confirmation that the “agreed arrangements in relation to Iranian payments had been put in place,” and that payments, including any cover payments, passing through the United States would comply with OFAC regulations. Mr. Bagley wrote:

“Although I may have misunderstood our discussions I was not previously aware that this was a precondition nor did my original paper envisage that if we used a non-Group correspondent we would necessarily consider passing only U-turn exempt payments through them. In fact in such circumstances there would be no reason to use

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884 6/7/2005 email from HBUS Grace Santiago-Darvish to HBUS Denise Reilly and others, “Re: Wire payments from HSBC Bank PLC suspended – USD 1,900,000 and USD 160,000 (Iran),” HSBC OCC 3407536.
885 5/20/2005 email from HBME David Hodgkinson to HBME Nasser Homapour and others, “Iran,” HSBC OCC 8874714.
886 Subcommittee interview of David Bagley (4/12/2012).
887 5/20/2005 email from HBME David Hodgkinson to HBME Nasser Homapour and others, “Iran,” HSBC OCC 8874714.
anyone other than HBUS given that HBUS could not be criticized were it to carry out exempt payments.\textsuperscript{889}

Mr. Bagley’s comments suggest that he was under the impression that using a non-Group correspondent would have allowed HSBC to process Iranian payments that did not meet the U-turn exception. However, after his discussion with Mr. Bennett and Mr. Green, he requested that Mr. Hodgkinson confirm they would be sending only compliant U-turn transactions through the United States, regardless of “whether or not through our own correspondent.”\textsuperscript{890}

On June 27, 2005, David Hodgkinson responded that HBME was attempting to open a U.S. dollar correspondent account with JPMorgan Chase (JPMC) for the purpose of processing Iranian U.S. dollar payments. Later in the email he wrote: “we never envisaged anything other than U-Turn compliant payments being processed,” and confirmed agreement that “there is no reason to use anyone other than HBUS.” He clarified that the only reason they had considered another U.S. correspondent for these payments was due to HBUS being unwilling to process them for reputational risk reasons.\textsuperscript{891} When Michael Gallagher, the head of HBUS PCM, was asked whether he was aware that HBME opened a U.S. dollar account with JPMorgan Chase in 2005, he could not recall.\textsuperscript{892} He further explained that HBME must have thought that HBUS’ standards were higher if they went to JPMorgan Chase to do the same service.

Despite that email, HBME did open a U.S. correspondent account with JPMC. Mr. Bagley alerted HSBC Group CEO Stephen Green to the account on September 19, 2005, writing that HBME had opened a correspondent account with JPMC “through which the pre-screened compliant U-turn Iranian Payments can be made.”\textsuperscript{893} A later analysis conducted by an outside auditor at HBUS’ request found that HBME

\textsuperscript{889} Id.
\textsuperscript{890} Id. at 8878028. With regard to cover payments, Mr. Bagley wrote that failing to consider an entire transaction (“both the cover payment instruction and any linked bank to bank message”), which if considered together “would lead to a different determination in terms of that U-turn exemption,” needed to be included in the risk determination. Mr. Bagley also referenced heightened concerns about the level of scrutiny from U.S. authorities regarding cover payments and OFAC compliance by “US banks offering correspondent banking services,” stemming from discussions held at a recent Wolfsberg meeting. The Wolfsberg Group consists of major international banks that meet regularly and work together to combat money laundering. See http://www.wolfsberg-principles.com/index.html.
\textsuperscript{891} 6/27/2005 email from HBME David Hodgkinson to HSBC David Bagley and HSBC Richard Bennett, “Iranian Payments,” HSBC OCC 8878026-027.
\textsuperscript{892} Subcommittee interview for Michael Gallagher (6/13/2013).
\textsuperscript{893} 9/19/2005 email from HSBC David Bagley to HSBC Stephen Green and HSBC Richard Bennett, “GCL050047 “Compliance With Sanctions,” HSBC OCC 8874360-361.
sent about 1,800 U-turns to its JPMorgan Chase account in 2005 and 2006.894

(g) Establishing Group-wide Policy

In July 2005, HSBC Group Compliance issued a Group Circular Letter (GCL) that for the first time established Group-wide policy on processing OFAC sensitive transactions, including U-turns involving Iran. GCL 050047 explicitly barred all HSBC affiliates and offices from participating in any U.S. dollar transaction, payment, or activity that would be prohibited by OFAC regulations.895 The GCL also explicitly acknowledged the U-turn transactions permitted under OFAC regulations and required all compliant U-turn transactions be routed through an HBME “Center of Excellence” in Dubai for processing. While the policy directed all HSBC affiliates to use only permissible Iranian U-turns, the GCL also allowed HSBC affiliates to continue to use cover payments when sending them through U.S. accounts for processing, which meant the transactions would continue to circumvent the OFAC filter and any individualized review by the recipient U.S. bank, including HBUS.896

The 2005 GCL also required local U.S. dollar clearing systems, located in Hong Kong and the United Arab Emirates, to implement WOLF screening for all U.S. dollar payments to ensure that non-compliant payments were rejected. The GCL stated: “Any dispensation from the terms of this GCL requires GHQ CMP [Group Compliance] concurrence.”897 Mr. Bagley described the GCL as being “necessary and urgent to protect the Group’s reputation.”898

About a month after the GCL was issued, the HSBC Group head of Global Institutional Banking, Mark Smith, issued a managerial letter, in August 2005, providing guidance on implementing the new policy.899 The letter provided a brief summary of Group’s relationship with each of

896 Id.
897 Id.
898 7/26/2005 email from HSBC David Bagley to HSBC Mansour Alhossaly and others, “OFAC GCL,” HSBC OCC 3407550-555. Upon receipt of the GCL, on July 26, 2005, Anne Liddy wrote that she would discuss the need for OFAC training with John Allison and Susan Wright at their monthly meeting the following day to ensure HBEU and HBME “clearly understand OFAC” and “how to identify a true Uturn.” 7/26/2005 email from HBUS Anne Liddy to HBUS Grace Santiago-Darvish and others, “OFAC GCL,” HSBC OCC 3407549. 899 8/25/2005 managerial letter from HSBC Mark Smith to HBUS Aimee Semiat, HBME Alan Kerr, and others, “GCL050047 – Compliance with OFAC sanctions,” HSBC OCC 3407565-569.
the OFAC sanctioned countries. With respect to Iran, Mr. Smith wrote: “Iran – extensive relationships with a number of Iranian institutions. Group Compliance had re-affirmed that OFAC sanctions, including the U-turn exception, apply to all transactions.” The guidance also clarified that the revised policy applied only to U.S. dollar transactions and continued to permit non-U.S. dollar business with prohibited countries and persons on the OFAC list.

Also in August 2005, HBUS circulated an email identifying correspondent relationships affected by the new policy. The email identified the number of open correspondent accounts with financial institutions in affected countries, including Iran. It also explained:

“The revised policy does not represent an automatic exit strategy with regards to affected clients. Non-USD business (and for Iran, U-turn exempt transactions) may continue to be undertaken. … Verbal discussions with affected clients would be preferable. Any written correspondent seeking to clarify the Group’s revised policy should be cleared with local Compliance.”

Once the policy was in place, HSBC personnel took a closer look at some of the Iranian transactions. On August 10, 2005, HBME sales manager Gary Boon sent John Root an email which included an excerpt from an email sent by David Bagley to David Hodgkinson. In it, Mr. Bagley noted that Mr. Hodgkinson had conveyed that a “significant number” of the trade and other transactions involving HBME would be U-turn compliant. In response, Mr. Bagley wrote: “I have to say that a number of potential payments resulting from trade transactions from other Group offices that John Root and I have looked at since the issuance of the GCL are not in our view U-turn compliant.”

In September 2005, HBEU senior payments official Rod Moxley completed an analysis of U.K. transactions over a ten day period that were stopped by the HSBC WOLF filter and involved prohibited countries, including Iran. He forwarded the results to senior HSBC
Group Compliance officials John Root and John Allison, noting that over just ten days, 821 of the transactions had involved Iran.\(^{907}\)

In mid-September 2005, David Bagley provided an update to HSBC Group CEO Stephen Green on implementation of the July 2005 GCL. He explained that the “required specialist ‘U-turn’ team” had been established at HBME in Dubai, and a correspondent account with JP Morgan Chase had been opened to process compliant U-turn payments. He indicated that HBME was also using HBUS to process U-turns, as was HBEU. Mr. Bagley stated that “a number of Group Offices” had opened U.S. dollar accounts with HBME for routing Iranian payments, but added that he was not convinced that all HSBC affiliates had done so. As a result, he issued a reminder to the Regional Compliance Officers to discuss the matter with their business heads and requested confirmation by September 23, 2005.

Despite the issuance of the GCL and the existing arrangement with HBUS, an undisclosed Iranian-related transaction was discovered, leading an HBUS executive to believe the practice was ongoing. In November 2005, another bank stopped a transaction after HBUS had already processed it, without knowing the transaction had involved Iran. HBUS OFAC Compliance officer Elizabeth Protomastro notified Mr. Moxley at HBEU that, on November 7, 2005, a $100,000 transaction involving Bank Melli had been processed through HBEU’s account at HBUS without transparent documentation. She wrote:

“We are bringing this to your attention as this situation indicates that cover payment involving Iran are still being processed by PLC [referring to HBEU]. It was our understanding that Group payments involving Iran would be fully disclosed as to the originators and beneficiaries.”\(^{908}\)

The payment had not been stopped by the HBUS OFAC filter because it did not contain any reference to Iran. She explained that four days later HBUS received a SWIFT message from HBEU stating that after contacting the remitter, the correct SWIFT should have been “MelliRTH94.” Since a U.S. bank cannot directly credit an Iranian bank, the payment was stopped and rejected by an unrelated bank. However, HBUS did not have the funds because Credit Suisse had already been paid through another correspondent bank owned by Credit Suisse. Ms. Protomastro explained that if the payment did involve Bank Melli, it met the U-turn exception. However, she wanted to know why


\(^{908}\) 11/23/2005 email from HBUS Elizabeth Protomastro to HBEU Rod Moxley and others, “Cover payment processed to Credit Suisse re ‘Bank Melli’ – USD 100,000,” HSBC OCC 8876886-887.
HBEU continued to submit cover payments involving Iran which ran afoul of the new HBUS agreement. Mr. Moxley responded that the transaction had uncovered a transparency issue with their payment system, which HBEU would work to address.

A later review performed by an outside auditor at HBUS' request found that, even after the 2004 HBUS agreement, HSBC affiliates continued to send thousands of undisclosed Iranian U-turn transactions through their U.S. dollar accounts at HBUS and elsewhere. The auditor’s review found that, from July 2002 to June 2005, HBEU and HBME together sent about 18,000 Iranian U-turn transactions through their U.S. dollar accounts of which about 90% did not disclose any connection to Iran. The review found that, from July 2005 to June 2006, HBME sent about 3,000 Iranian U-turns through its U.S. dollar accounts of which about 95% were undisclosed. The comparable figures for HBEU were 1,700 U-turns of which 75% were undisclosed.

(b) Shifting Iranian Transactions from HBUS to JPMorgan Chase and Back Again

In 2006, HBME sent a number of Iranian U-turn transactions through its new U.S. dollar account at JPMorgan Chase. When JPMorgan Chase decided to exit the business later in the year, HBME turned to HBUS to process them. Again, most of the U-turns HBME sent to HBUS were undisclosed.

GCL 060011 Barring Cover Payments. On April 6, 2006, less than a year after GCL 050047 was issued, HSBC Group issued another Group Circular Letter, entitled “U.S. Dollar Payments,” essentially barring non-transparent cover payments for most OFAC sensitive transactions. It followed an enforcement action by the Federal Reserve Board on December 19, 2005, charging ABN AMRO Bank with OFAC violations for modifying payment instructions on wire transfers used to make OFAC sensitive transactions and using special procedures to circumvent compliance systems used to ensure the bank was in
compliance with U.S. laws. About two weeks after the enforcement action, an email exchange among HBEU, HBME, HBUS, and HSBC Group Compliance officials revealed:

“Group compliance is having a closer look at the [2005] GCL, with more specific reference to the recently published details of the ABN AMRO Enforcement Action. They are considering whether it is appropriate, for us to move to use of serial payment methodology. Group compliance needs to give opinion to Group CEO by next Friday.”

That same day, an HBUS Global Payments and Cash Management employee sent an email suggesting that commercial U.S. dollar payments be executed as “serial payments in which all payment party details are advised through HSBC Bank USA, your USD correspondent.” The HBUS employee also wrote: “This will allow our automated transaction monitoring system to appropriately analyze all group transactions for suspicious activity that would otherwise be hidden with the cover payment method. This system goes beyond simple OFAC checking to detect repetitive transaction trends indicative of money laundering or terrorist financing. This will assure regulators we are doing everything possible to comply with their requirements.”

See 12/19/2005 Federal Reserve Board, Financial Crimes Enforcement Network, Office of Foreign Assets Control, New York State Banking Department, and Illinois Department of Financial and Professional Regulation press release and Order of assessment of a civil money penalty, http://www.federalreserve.gov/boarddocs/press/enforcement/2005/20051219/20051219attachment2.pdf. Five years later, in May 2010, the Justice Department imposed a $500 million fine on ABN Amro for removing information from wire transfers involving prohibited countries. See 5/19/2010 U.S. Department of Justice press release, http://www.justice.gov/opa/pr/2010/May/10crm-548.html (“According to court documents, from approximately 1995 and continuing through December 2005, certain offices, branches, affiliates and subsidiaries of ABN AMRO removed or altered names and references to sanctioned countries from payment messages. ABN AMRO implemented procedures and a special manual queue to flag payments involving sanctioned countries so that ABN AMRO could amend any problematic text and it added instructions to payment manuals on how to process transactions with these countries in order to circumvent the laws of the United States. Despite the institution of improved controls by ABN and its subsidiaries and affiliates after 2005, a limited number of additional transactions involving sanctioned countries occurred from 2006 through 2007.”).

1/6/2006 email from HBEU Michele Cros to HBUS Bob Shetty and other HSBC, HBUS, HBEU, and HBME colleagues, “OFAC – Compliance with Sanctions GCL,” HSBC OCC 7688873.

1/6/2006 email from HBUS Richard Boyle to HBEU Michele Cros and HBUS Bob Shetty, “OFAC – Compliance with Sanctions GCL,” HSBC OCC 7688871-873. The email explained that ABN AMRO used their “USD nostro [account] with ABN AMRO New York to process USD payments originated through ‘special procedures,’ and that cover payments were used “as a method of masking Iranian and Libyan financial institutions as the originators of USD wire transfers.” It also discussed the recent regulatory actions as establishing “a precedent that the U.S entity of a global group will be held responsible for the transactions in USD that may take place anywhere in the Group,” and mentioned other banks where regulatory action had been taken, including one that led to a cease and desist order prohibiting cover payments.
The new GCL 060011 required all HSBC Group affiliates to use fully transparent “serial” payments when sending U.S. dollar transactions through HBUS or any other U.S. correspondent, with full disclosure of all originators and beneficiaries. Essentially, it required all HSBC affiliates to use the same procedure already established at HBUS. The GCL made an exception, however, for Iranian U-turns. Instead of requiring full disclosure in the transaction documents sent to a U.S. bank, the GCL allowed U-turns to “continue to be made as cover payments.” HSBC affiliates were required, however, to obtain the underlying payment details to ensure the transaction was permissible under OFAC regulations. In addition, the GCL required all U-turn transactions to continue to be directed through HBME, which had established a dedicated team in Dubai for processing Iranian transactions. Because the GCL created an exception for Iranian U-turns, it did not stop the use of undisclosed transactions being sent by HBME and HBEU to HBUS.

The policy’s effective date was April 30, 2006, and directed HBUS to require all third-party banks for which it provided U.S. dollar correspondent banking services to utilize the same fully transparent payment procedures by December 31, 2006. The GCL also stated that dispensations from the deadlines could be obtained only from HSBC Group Compliance, with the concurrence of HBUS Compliance.

Soon after the GCL was announced, several HSBC affiliates requested and received dispensation from the April 2006 deadline, the most notable of which ended up giving HBEU more than a year to come into compliance with the new GCL. HBEU obtained an initial

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917 The GCL stated that “serial payments cannot qualify as U-turn payments,” but OFAC confirmed to the Subcommittee that U-turn payments could, in fact, be processed as serial payments. Subcommittee briefing by OFAC (5/8/2012).
918 From April through June 2006, about 90% of the Iranian payments sent by HBME to U.S. dollar accounts at HBUS and elsewhere did not disclose their connection to Iran. In July 2006, an internal HSBC policy was issued that required HBME to send Iranian payments received from Group affiliates to HBUS on a serial basis. After July 2006, nearly 100% of the Iranian payments sent by HBME to the U.S. disclosed their connection to Iran. This internal policy did not apply to HBEU until late in 2007. From April 2006 through December 2007, about 50% of the 700 Iranian payments sent by HBEU to U.S. dollar accounts at HBUS and elsewhere did not disclose their connection to Iran. Deloitte Review of OFAC transactions, “March 29, 2012,” HSBC OCC 8966113-150, at 143.
920 See 4/25/2006 – 5/5/2006 email exchanges among HSBC David Bagley, Group offices, and HBEU Rod Moxley, “Serial Payments – USD – GCL,” HSBC OCC 8877231-39. The emails indicate HSBC Asia Pacific requested dispensation for 19 specific countries until August 31, 2006, to allow time to change its payment systems. HBEU requested a dispensation until the end of October 2006 for MPS, citing a reconfiguration of the new GPP system that was expected by December 31, 2006. Michael Grainger in GTB – PCM, in conjunction with Operations and IT, requested a dispensation for HBEU sites through HBUS until the end of 2006 to allow system changes to be implemented and piloted. David Bagley forwarded this email correspondence to John Allison with a request for consideration. He also noted that the serial methodology would
dispensation until October 31, 2006. On November 21, 2006, HBEU MPD head Malcolm Eastwood requested a second extension until after installation of a new GPS system scheduled for July 1, 2007. In July, due to “the huge volume of HBEU traffic and the potential resolution of the problem by an impending global system change,” HBEU received a third extension until November 2007. Since HBEU was one of the top processors of payments for HSBC affiliates, its year and a half dispensation delayed full implementation of the new GCL until November 2007.

The month after the new GCL was issued, HBUS Compliance official Anne Liddy sent an email to HSBC Group AML head Susan Wright indicating she had heard that David Bagley had “issued a dispensation” in relation to the new GCL. Ms. Liddy said that while she recalled discussions about how HSBC Group was “having a difficult time getting our Group offices to switch (mainly due to systems issues),” and the need to provide more time for clients to convert, she did not recall any dispensations being issued. She asked Ms. Wright for more information. Ms. Wright responded: “There have been a limited number of dispensations granted re HSBC’s own customers – John is the keeper of the dispensations and so will provide you with more detail.” Based on Ms. Liddy’s email, it appears that Group Compliance may have granted dispensations, which then allowed cover payments to continue, without obtaining HBUS Compliance’s agreement, as the GCL required.

**JPMC Pulls Out.** In May 2006, about six months after HBME opened an account with JPMorgan Chase to process Iranian U-turns, JPMorgan Chase decided to stop processing them. On May 25, 2006, a JPMC representative informed HBME official Gary Boon that they would continue to process HBME’s dollar payment transactions, with the exception of Iranian transactions that reference details in the payment narrative. On May 26, 2006, Mr. Bagley wrote to HSBC Group CEO Stephen Green that “JPMC have indicated that they are not willing to process these payments, I assume for reputational rather than regulatory reasons (given that they are within the U-turn exemption).”

put HBEU at a competitive disadvantage with regard to fees charged and the volume of customer complaints. Id. 921


He continued that HBME would have to “pass these payments through HBUS.” He noted that they had previously received concurrence from HBUS to process the transactions, confirmed by HBUS CEO Martin Glynn. That same day Mr. Bagley alerted HBUS AML head Teresa Pesce that “HBME have no choice but to now pass” U-turn exempt payments through HBUS.

Iranian Transactions Shift to HBUS. HBUS was already processing Iranian U-turn transactions for HBEU, but HBME’s decision to route its Iranian U-turns through HBUS as well represented an increase in the volume of transactions that HBUS would have to identify and review.

On May 26, 2006, the same day he learned HBME would begin routing U-turns through its U.S. dollar account at HBUS, HBUS AML officer Alan Ketley emailed HBME’s Alan Kerr to clarify how HBUS would process the new volume of payments. On May 30, 2006, Mr. Ketley wrote to HBME Gary Boon, copying HBUS AML head Teresa Pesce: “I’m unclear why you would be seeking to have HBUS handle this activity at no notice and am uncomfortable making arrangements for such sensitive activity in this fashion.” He requested examples of payment orders for routing through HBUS and asked for confirmation that HBME would not begin routing U-turns through HBUS until they had the “appropriate controls in place.” He was also concerned from a resource perspective, and stated that HBME intended to pass as many U-turns in a day as HBUS would normally handle in a busy month. That same day, in response to his email to Mr. Boon, Ms. Pesce wrote: “Alan – we have no choice. JPMC won’t take them.”

HBUS’ effort to ensure it had adequate staffing to review OFAC-related alerts from the HBME U-turns was made more difficult by varying information from HBME on the number of transactions to expect. On June 22, 2006, HBUS Compliance officials Anne Liddy and Alan Ketley reacted to an email exchange involving HBME’s Gary Boon discussing U-turn payment volumes being processed through HBUS as between 10 and 25 per day. Ms. Liddy wrote:

"[B]efore it was about 40. Yesterday 10. Now 25ish. BTW I am going to set up a meeting with Terry and Denise (as our financier) to discuss resourcing for OFAC. It is out of hand."

In July 2006, HBME made a policy decision to go beyond the requirements of the Group-wide 2006 GCL and require all of its Iranian transactions to provide fully transparent payment information to its U.S. correspondents.

In addition to the HBME transactions moving to HBUS, one other notable transaction involving Iran in 2006, pertained to 32,000 ounces of gold bullion valued at $20 million. In May 2006, the HBUS London branch cleared the sale of the gold bullion between two foreign banks for the ultimate benefit of Bank Markazi, Iran’s Central Bank. HSBC indicated that it had been aware that Bank Markazi was the beneficiary, but had viewed the transaction as a permissible U-turn. OFAC later told HBUS that it considered the transaction to be a “non-egregious” violation of law, and provided HBUS with an opportunity to explain why it should not be penalized for it; HBUS is still awaiting a final determination as to whether it will be penalized.

(i) Getting Out

In October 2006, HSBC Group reversed course and decided to stop handling Iranian U-turns. In 2007, it went further and exited all business with Iran, subject to winding down its existing obligations.

Increasing Risks. In October 2006, Mr. Bagley provided a warning to his superiors that HSBC might want to reconsider processing U-turns. In an email on October 9, 2006, Mr. Bagley informed Stephen Green, who had become HSBC Group Chairman, Michael Geoghegan, who had become HSBC Group CEO, and David Hodgkinson, who used to head HBME but had become HSBC Group COO, that the risks associated with U-turns had increased due to “actions taken by the US government in withdrawing the U-Turn exemption from Bank Saderat.” The prior month, in September 2006, HBUS had stopped an undisclosed transaction that involved Bank Saderat in Iran, which was added to the OFAC SDN list that same month.
Mr. Bagley wrote:

"During my recent visit to the US to attend a Wolfsberg meeting I was discretely advised of the following by a reliable source:

[U.S. Treasury] Under Secretary [Stuart] Levey … and the more hawkish elements within the Bush administration were in favour of withdrawing the U-Turn exemption from all Iranian banks. This on the basis that, whilst having direct evidence against Bank Saderat particularly in relation to the alleged funding of Hezbollah, they suspected all major Iranian State owned banks of involvement in terrorist funding and WMD [weapons of mass destruction] procurement. …

Certain US Government bodies have however made it known to a number of US banks that, as WMD related transactions are impossible to detect they would run an unacceptable reputational and regulatory risk were they to continue to process U-Turn transactions. The essence of the statement appears to be that as WMD related transactions would be heavily disguised (where even as a trade transaction documents would in effect be falsified) there is no safe way for a US bank to be involved in even a U-turn exempt transaction however stringent the scrutiny or monitoring. The clear implication made was that being found to be involved in a WMD related transaction, even if wholly innocently, would result in significant and severe action being taken against such a bank.

There were very strong indications that a number of US banks were therefore considering withdrawing from all U-turn related activity. If this happens those continuing in this market are likely to have an increased concentration.

Although I am satisfied that we have put appropriate controls in place to manage the U-Turn transactions, I am concerned that there are now increased risks in continuing to be involved in U-Turn USD payments which would justify our reconsidering our approach. I do recognize that the significance that tightening our policy to withdraw from U-Turn permitted transactions would have in terms of our Middle Eastern and Iranian business.

12/14/2006 email from Elizabeth Protomastro to John Allison and others, “OFAC – Wire payments blocked from HSBC offshore entities – USD 32,000 (re SDGT) and USD 2,538,939.33 (re Sudan),” HSBC OCC 3407608-609.

Ending U-turns. Shortly after Mr. Bagley’s email, HSBC decided to stop processing U-turns entirely. On October 25, 2006, HSBC Group Compliance issued Group Circular Letter 060041 which directed all Group offices to immediately stop processing U-turn payments. An exception was made for permissible U-turn payments in connection with legally binding contractual commitments. HSBC decided to stop utilizing the U-turn exception two years before OFAC actually revoked the exception in November 2008.

Despite this decision, HSBC maintained a number of existing Iranian relationships. On March 13, 2007, as a result of a “letter recently filed with the SEC “relating to the extent of our exposure to business in the so-called named countries (Sudan, Syria, and Iran),” HSBC Group Compliance head David Bagley updated HSBC Group CEO Michael Geoghegan on HSBC’s relationships with Iranian banks. He wrote:

“The existing levels of business, much of which is historic and subject to ongoing commitments, has been reviewed by CMP [Compliance] as against the requirements of Group policy, particularly where transactions are denominated in USD. Some of this activity related to pre-existing committed obligations which are binding on an ongoing basis. Group policy recognizes that we will have to allow such arrangements to run off. Relevant business colleagues are however aware of the Group’s stance in terms of having no appetite for new or extended business activity involving Iranian counterparties. Where transactions appear to potentially conflict with Group policy those transactions are referred to GHQ CMP for determination and sign-off.”

The subject of Iran arose again a few months later, in June 2007, when Mr. Bagley informed HSBC Group CEO Michael Geoghegan that he had a private meeting with U.S. Treasury Under Secretary for Counter Terrorist Financing and Sanctions, Stuart Levey, during a recent Wolfsberg Group conference. Mr. Bagley indicated that Mr. Levey had questioned him about a HSBC client who, according to Mr. Levey, “had clearly been identified as having acted as a conduit for Iranian funding of” an entity whose name was redacted from the document by HSBC.

Mr. Bagley wrote: “Levey essentially threatened that if HSBC did not

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940 Id.
withdraw from relationships with [redacted] we may well make
ourselves a target for action in the US.” Mr. Geoghegan responded:
“This is not clear to me because some time ago I said to close this
relationship other than for previously contractually committed export
finance commitments.” Mr. Bagley replied that the bank had only
“limited relationships with [redacted] and in fact overall with Iranian
banks.”

Mr. Bagley also wrote that he had discussed the matter with David
Hodgkinson, and they agreed that HSBC “should immediately withdraw
from [redacted] and also withdraw from all Iranian bank relationships in
a coordinated manner.” He noted that the bank would have to honor
“legally binding commitments” such as Project and Export Finance
facilities. These communications indicate that HSBC officials had
previously known about problems with one particular Iranian client but
that it did not end the relationship until after a warning from the U.S.
Government.

GCL 070049 on Exiting Iran. On September 24, 2007, HSBC
Group Compliance issued another Group Circular Letter, this one
announcing the bank’s decision to exit Iran. GCL 070049 directed all
account relationships with Iranian banks to be “closed as soon as
possible” with sufficient notice as required by local law and to “allow an
orderly run down of activity” and the “run-off of any outstanding
exposures.” The GCL allowed ongoing payments involving
existing facilities and transactions “where there are legally binding
commitments,” such as Project and Export Finance facilities, to continue
to be made as serial payments.

2008 and 2009 Iranian Transactions. After the GCLs terminating
most business with Iran, internal bank documents show that hundreds of
Iranian transactions per month continued to surface at HBUS during
2008 and 2009. These transactions were not, however, the type of
undisclosed U-turn transactions that HSBC affiliates had been routinely
sending through HBUS accounts prior to HSBC’s decision to exit Iran,
but represented other types of transactions.

In 2008 and 2009, for example, HBUS’ London Banknotes office
conducted a series of apparently prohibited transactions benefitting the
Iranian Embassy in London. From July 22, 2008 to February 12, 2009,
in more than 30 transactions, HBUS sold over €455,000 to HBEU
which, in turn, sold them to the Embassy of Iran in the United

942 Id. at 215.
943 Id. at 214.
8876013-015.
According to HBUS, “the funds were used to meet salary obligations” of the Iranian Embassy. In addition, from December 5, 2008 to February 5, 2009, HBEU purchased over $2,500 from the Embassy of Iran and resold the U.S. dollars to HBUS. In 2009, after HBUS discovered that the London Banknotes office was engaging in currency transactions with the Iranian Embassy, it reported the transactions to OFAC and ended the activity.

Other transactions involving Iran processed through HBUS’ correspondent accounts from 2008 to 2009, included a March 2009 wire transfer for $300,000, which was mistakenly processed because a HBUS compliance officer did not realize a transaction reference to “Persia” implied a connection to Iran; and two wire transfers totaling over $55,000 which involved a vessel owned by “NITC” which, until it was updated, HBUS’ OFAC filter did not recognize as the National Iranian Tanker Company.

(j) Looking Back

According to an ongoing outside audit requested by HSBC, from 2001 to 2007, HBEU and HBME sent through their U.S. dollar accounts at HBUS and elsewhere nearly 25,000 OFAC sensitive transactions involving Iran totaling $19.4 billion. While some of those transactions were fully disclosed, most were not. According to the review conducted by Deloitte, from April 2002 to December 2007, more than 85% of those payments were undisclosed.

Despite HBUS pleas for transparency and a 2004 internal agreement to use fully transparent procedures, HSBC affiliates HBEU and HBME often took action, including by deleting references to Iran or using cover payments, to prevent the Iranian transactions sent through their U.S. dollar correspondent accounts at HBUS from being caught in

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946 Id.
947 Id.
951 Subcommittee briefing by Cahill Gordon & Reindel LLP (6/20/2012); Deloitte presentation, “March 29, 2012,” at HSBC OCC 8966113. These payments were sent to the U.S. bank as cover payments, serial payments, or payments that were cancelled and then re-submitted by either an HSBC affiliate or the client without disclosing the connection to Iran in the payment message. Id. at 8966118 and 8966143.
the OFAC filter. Despite the fact that they viewed most of the transactions as permissible under U.S. law, concealing their Iranian origins helped avoid delays caused when HBUS’ OFAC filter stopped the transactions for individualized review. HBME, in particular, requested that HBUS allow the use of cover payments to conceal Iranian transactions and circumvent the OFAC filter. When HBUS insisted on fully transparent transactions, the HSBC affiliates sent undisclosed transactions through their HBUS accounts anyway. HSBC Group leadership, including the heads of Compliance and AML, were aware in varying degrees of what the affiliates were doing, but for years, took no steps to insure HBUS was fully informed about the risks it was incurring or to stop the conduct that even some within the bank viewed as deceptive. The HSBC Group Compliance head took no decisive action even after noting that the practices “may constitute a breach” of U.S. sanctions. At HBUS, senior executives in the Compliance and payments areas knew about the actions being taken by HSBC affiliates to send concealed Iranian transactions through their U.S. dollar correspondent accounts, but were unable or unwilling to obtain information on the full scope of the problem, bring the issue to a head, and demand its resolution at the highest levels of the bank to ensure all U-turns were reviewed for compliance with the law.

(2) Transactions Involving Other Countries

Iranian transactions were not the only potentially prohibited transactions sent through HBUS. Transactions involving Burma, Cuba, North Korea, and Sudan, as well as persons named on the SDN list, were also sent through HBUS accounts, although to a much lesser extent than those related to Iran. HSBC affiliates were one major source of the transactions, due to poor compliance with HSBC Group policy barring U.S. dollar transactions with prohibited countries or persons, and requiring transparent transactions, but the majority of these transactions appear to have been sent through HBUS by unrelated financial institutions. The transactions sent by HSBC affiliates also do not appear to be the product of the same kind of systematic effort to avoid the OFAC filter as was the case with the Iranian U-turns. Some of the transactions sent through HBUS had references to a prohibited person or country deleted or used cover payments, and passed undetected through the OFAC filter. Others openly referenced a prohibited country or person, but escaped detection by HBUS’ OFAC filter or HSBC’s WOLF filter due to poor programming. Still others were caught by a filter, but then released by HBUS personnel, apparently through human error. An ongoing review by an outside auditor, examining HBUS transactions over a seven-year period from 2001 to 2007, has so far identified about
2,500 potentially prohibited transactions involving countries other than Iran, involving assets totaling about $322 million. 952

(a) 2005 and 2006 GCLs

The documents examined by the Subcommittee show that HBUS’ OFAC filter blocked a transaction involving a prohibited country other than Iran as early as 2002. 953 Internal bank documents indicate, however, that transactions involving prohibited persons or countries other than Iran did not receive the same level of attention as the Iranian transactions, until issuance of the July 28, 2005 Group Circular Letter 050047 which barred HSBC affiliates from executing U.S. dollar transactions involving any person or country prohibited by OFAC. 954

Shortly after the GCL was issued, the HSBC Group head of Global Institutional Banking, Mark Smith, issued a managerial letter, in August 2005, providing guidance on implementing the new policy. 955 His letter summarized the Group’s relationships with Burma, Cuba, Iran, North Korea, Sudan, and Zimbabwe. He explained that most of HSBC Group’s business with Sudan and Cuba was conducted in U.S. dollars and “discussions already initiated with the affected banks will dictate the extent of our ongoing relationship.” The guidance also clarified that the revised policy applied only to U.S. dollar transactions. 956

In addition, the managerial letter identified correspondent relationships affected by the new policy. 957 It provided the number of open correspondent accounts with financial institutions in Cuba, Burma, Iran, North Korea, and Sudan. It also explained:

“The revised policy does not represent an automatic exit strategy with regards to affected clients. Non-USD business (and for Iran, U-turn exempt transactions) may continue to be undertaken. However, for a number of reasons eg. operational simplicity, where the remaining non-USD business is uneconomic or where

952 Deloitte presentation, “Results of the Transactions Review – UK Gateway, March 29, 2012,” HSBC-PSH-PROD-0197919-989, in 950. Since the Deloitte review has yet to examine an additional set of U.S. dollar transactions and does not include any transactions during the period 2008 to 2010, its figures represent a conservative analysis of the potentially prohibited transactions transmitted through HBUS.


956 Id at 566.

957 Id.
the client concludes they will have to conduct their business with an alternative provider, the ultimate outcome may be the closure of certain relationships. Verbal discussions with affected clients would be preferable. Any written correspondent seeking to clarify the Group’s revised policy should be cleared with local Compliance.958

The letter noted that “any dispensation from the terms of the GCL require[d] Group Compliance concurrence.”959

In September 2005, senior HBEU payments official Rod Moxley completed an analysis of U.K. transactions over a 10-day period that were stopped by HSBC’s WOLF filter and involved Burma, Cuba, or Sudan.960 He forwarded the results to senior HSBC Group Compliance officials John Root and John Allison, noting that there were “a considerable number of USD denominated transactions” for Sudan, and “also to a lesser extent” Cuba and Burma. He also noted that prior to the effective date of the new GCL, these payments would have been stopped by the WOLF filter but then allowed to proceed, “providing they did not infringe on UN/EU sanctions or terrorist parameters,” since HBEU was “not affected directly by OFAC sanctions,” but the new GCL would require these payments to be blocked due to OFAC prohibitions.

Mr. Moxley also wrote:

“Since the issuance of the GCL, it has been made clear that US interests are of paramount importance and we should do nothing, when processing payment transactions, which would leave HBUS in a vulnerable position. The issues surrounding Iran have overshadowed other OFAC payments recently, however, I can advise that we have not so far physically returned any USD payments involving Sudan, Cuba or Burma. I feel we now need to look far more closely at these payments to ensure compliance with the GCL.”961

Mr. Moxley asked about two alternative responses to transactions stopped by the WOLF filter and barred by the new GCL. One was to continue processing the transactions but ensure that the payment was routed in such a way “that they are not frozen in the US.” He explained: “This will involve intelligent usage of the routing system but may perpetuate similar scenarios to those encountered with Iran (customer instructions saying Do not mention Sudan or routing which does not

958 Id. at 568.
959 Id.
961 Id.
make it apparent that these are Sudanese payments).” This alternative seems to suggest that HSBC would engage in Iran-style transactions in which transaction details are stripped out to avoid triggering the OFAC or WOLF filters. His second alternative was to “strictly” apply the GCL “and return the payments unprocessed.” He wrote that his “instinct” was to “return all such USD payments … so that our US colleagues’ position is not compromised,” but wanted confirmation from HSBC Group Compliance before taking that action. The documents reviewed by the Subcommittee do not indicate what response he received. When asked about his email, Mr. Moxley told the Subcommittee that he could not recall how his inquiry was resolved.

About a year later, on April 6, 2006, HSBC Group issued another Group Circular Letter, GCL 060011, which required all HSBC affiliates, when sending U.S. dollar transactions through a correspondent account at HBUS or another U.S. financial institution to use so-called “serial payments” specifying the transaction’s chain of originators and beneficiaries. This policy change was intended to stop HSBC affiliates from using cover payments, which provide less information for banks when processing payments and which can mask potentially prohibited transactions sent through HBUS or other U.S. banks. Its effective date for HSBC affiliates was April 30, 2006; HBUS was required to impose the policy on all third-party banks for which it provided U.S. dollar correspondent banking services by December 31, 2006. At the same time, HSBC Group Compliance granted a year-long extension to HBEU, giving it until November 2007, before it was required to use serial payment instructions.

Internal bank documents indicate that OFAC sensitive transactions involving countries other than Iran took place both before and after the 2005 and 2006 GCLs.

(b) Transactions Involving Cuba

Internal bank documents indicate that, from at least 2002 through 2007, HBUS processed potentially prohibited U.S. dollar transactions involving Cuba. HSBC affiliates in Latin America, in particular, had many Cuban clients and sought to execute transactions on their behalf in...
U.S. dollars, despite the longstanding, comprehensive U.S. sanctions program and the OFAC filter blocking such transactions.\textsuperscript{967}

In August 2005, a month after HSBC Group issued its new GCL policy barring HSBC affiliates from engaging in U.S. dollar transactions in violation of OFAC prohibitions, HBUS circulated an email identifying correspondent relationships that would be affected.\textsuperscript{968} The email stated: “An overriding observation is that the revised policy will most significantly impact the Cuban and Sudan correspondent bank relationships.” It also observed: “For Sudan and Cuba, most of our business is conducted in USD and the discussions already initiated with the affected banks will dictate the extent of our ongoing relationships.”\textsuperscript{969}

In September 2005, HSBC Group Compliance head David Bagley told HSBC Group CEO Stephen Green that they had closed “a number of USD correspondent relationships with Cuban … banks.”\textsuperscript{970} On October 3, 2005, Mr. Bagley sent an email to Matthew King, then head of HSBC Group Audit, that Mr. Green was “particularly concerned” about ensuring the 2005 GCL was “properly and fully implemented across the Group.”\textsuperscript{971} Mr. Bagley asked Mr. King to use HSBC’s internal audits to help gauge compliance with the new GCL. Mr. King relayed the request to various HSBC auditors and, in response, learned from HSBC Mexico (HBMX) Compliance that the OFAC list had not been fully integrated into HBMX’s monitoring system and would not be for another six months, until April 2006.\textsuperscript{972} HBMX reported that, pending the systems integration, it had set up “manual controls” in several divisions to implement the new GCL, but “no automated means exists to ensure that these controls are properly being carried out.”\textsuperscript{973} HBMX explained further that its “greatest exposure” was “the volume of business historically carried out by HBMX customers with Cuba in US dollars.”\textsuperscript{974}

Mr. King responded that the HBMX transactions raised two sets of concerns, one with respect to the U.S. dollar transactions involving Cuba being run through HBMX’s correspondent account at HBUS, and the

\textsuperscript{968} See 8/25/2005 email from HBUS Alan Ketley to multiple HSBC colleagues, “GCL050047 – Compliance with OFAC Sanctions,” HSBC OCC 3407565-569.
\textsuperscript{969} Id. at 3407568.
\textsuperscript{970} 9/19/2005 email from HSBC David Bagley to HSBC Stephen Green and HSBC Richard Bennett, “GCL050047 “Compliance With Sanctions,” HSBC OCC 8874360-362.
\textsuperscript{971} 10/3/2005 email from HSBC David Bagley to HSBC Matthew King, “GCL 050047 – Compliance with Sanctions,” HSBC OCC 8874359-360.
\textsuperscript{972} 10/14/2005 email from HBMX Graham Thomson to HSBC Matthew King, “GCL 050047 – Compliance with Sanctions,” HSBC OCC 8874358-359.
\textsuperscript{973} Id.
\textsuperscript{974} Id.
second with respect to non-U.S. dollar transactions being “transmitted through the HBUS TP gateway,” referring to a U.S.-based server that handled transfers from Mexico and South America.\textsuperscript{975} Since the United States prohibited transactions involving Cuba, both types of transactions raised questions about whether they ran afoul of the OFAC list and the 2005 GCL. Mr. King responded:

“I note HBMX continues to process USD payments involving Cuba. It is very important that is stopped immediately as the regulators are getting very tough and the cost to the Group could be considerable if a breach occurs, both in terms of the fine and the rectification work which is likely to be a pre-requisite to any settlement.

With regard to non-USD payments as described above, GHQ CMP [Group Headquarters Compliance] are urging HBUS to screen out these transactions to avoid any risk, and HBMX would have to put measures in place to pre-empt customer dismay.”\textsuperscript{976}

HSBC affiliates from outside of Latin America also occasionally sent potentially prohibited transactions involving Cuba through their HBUS accounts. For example, in December 2006, a payment for $15,350 that had been sent by an HSBC affiliate in the Asia-Pacific region was blocked by HBUS, because the transaction documents referred to “Air Tickets Moscow Havana Moscow 3Pax.”\textsuperscript{977}

In 2007, an internal HSBC document entitled, “Information Requested in Connection With: (North Korea, Cuba, and Myanmar),” revealed that, as of May 2007, HSBC affiliates in Mexico and Latin America were still providing U.S. dollar accounts to Cuban clients, in apparent violation of HSBC Group GCL policy and OFAC regulations.\textsuperscript{978} The document indicated that HBMX had 23 Cuban customers with U.S. dollar accounts containing assets in excess of $348,000, and 61 Cuban customers holding both U.S. dollar and Mexican peso accounts with assets totaling more than $966,000.\textsuperscript{979} In addition, the report disclosed that HSBC affiliates in Colombia, Costa Rica, El Salvador, Honduras, and Panama were also providing U.S. dollar accounts to Cuban nationals or the Cuban Embassy. The document also indicated that arrangements had been made to “cancel all

\textsuperscript{976} Id.
\textsuperscript{977} 12/17/2006 email from HBAP Donna Chan to HBUS Alan Ketley and others, “TT NSC770937 Dated 1Dec06 For USD15,350.21,” HSBC OCC 3287261-262.
\textsuperscript{979} Id. In addition, 1,284 Cuban clients had nearly 2,250 HBMX accounts holding solely Mexican pesos, with assets exceeding a total of $8.9 million. Id. at 8876093.
business relationships with Cuban clients, in relation to U.S. dollar accounts or commercial relationships for the entire region. These steps were being taken almost two years after the July 2005 GCL had prohibited HSBC affiliates from executing U.S. dollar transactions involving OFAC sensitive persons.

(c) Transactions Involving Sudan

A second set of OFAC sensitive transactions involved Sudan, a country which is also subject to a comprehensive sanction program in the United States. Internal bank documents indicate that, from at least 2005 to 2008, HBUS processed a considerable volume of U.S. dollar transactions involving Sudan that, once the new GCL took effect, should have decreased. The reasons they continued include a wide range of factors, from inadequate bank staffing reviewing OFAC transactions, to deceptive wire transfer documentation, to ongoing actions by HSBC affiliates to send these potentially prohibited transactions through HBUS.

In August 2005, a month after HSBC Group issued the GCL policy barring HSBC affiliates from engaging in U.S. dollar transactions in violation of OFAC prohibitions, HSBC Group head of Global Institutional Banking, Mark Smith, circulated a managerial letter identifying correspondent relationships that would be affected. The letter stated: “An overriding observation is that the revised policy will most significantly impact the Cuban and Sudan correspondent bank relationships.” It also observed: “For Sudan and Cuba, most of our business is conducted in USD and the discussions already initiated with the affected banks will dictate the extent of our ongoing relationships.”

In September 2005, a senior HBEU payments official Rod Moxley completed an analysis of U.K. transactions over a 10-day period that were stopped by the WOLF filter and noted “a considerable number of USD denominated transactions” for Sudan.

A year after the GCL took effect, however, one affiliate attempted to clear a Sudan-related transaction through HBUS in violation of company policy. On December 6, 2006, HBUS blocked a $2.5 million payment originating from an HSBC branch in Johannesburg because the...
payment details referenced the “Sudanese Petroleum Corporation.”

Although the payment had also been stopped by the WOLF filter in HSBC Johannesburg, an employee there had approved its release and sent the transaction through their correspondent account at HBUS. An internal email from HSBC Johannesburg explained that the release of the funds was:

"a genuine error in an attempt to push the day’s work through before the cut-off time. I believe the loss of three staff in the department leaving only two permanent staff remaining is causing them to work towards clearing their queues rather than slow down to read the warnings such as these. ... Having said that I also feel it is a matter of training where seeing the word ‘Sudan’ alone should have been warning enough."

The email also noted that the transaction had been sent by Commercial Bank of Ethiopia, which was “aware that this payment may not go through as they have attempted to make this payment via their other correspondent banks and failed.”

In July 2007, HBUS discovered that another client, Arab Investment Company, had been sending “multiple Sudan-related payments” through its U.S. dollar account at HBUS, that other banks later blocked for specifying a Sudanese originator or beneficiary, “suggesting that HBUS has been processing cover payments for this client.” An email identified seven wire transfers over a one-year period, collectively involving more than $1.1 million, in which the documentation provided to HBUS made no reference to Sudan, preventing the transfers from being stopped by HBUS’ OFAC filter. The email noted that two of the wire transfers later blocked by other banks had resulted in letters from OFAC seeking an explanation for HBUS’ allowing the transfers to take place, and suggested closing the client account to prevent more such incidents. On another occasion, HBUS identified five wire transfer payments between January and November 2007, totaling more than $94,000, that turned out to be intended for a Sudanese company, but had been processed as straight
through payments at HBUS, because “there was no beneficiary address and no mention of ‘Sudan’.” 991

In still other cases, wire transfers clearly referencing Sudan were stopped by HBUS’ OFAC filter for further review, but then allowed by HBUS staff to proceed. An HBUS internal report on OFAC compliance noted, for example, two blocked wire transfers involving Sudan, one for over $44,000 and the other for over $29,000, blocked on November 5 and December 7, 2007, respectively, by HBUS’ OFAC filter, but subsequently “released due to human error.” 992

In August 2008, HBUS noted that it was then holding over $3.2 million in Sudan-related payments sent to the bank from other HSBC affiliates. 993 The bulk of the funds came from blocking a $2.5 million payment from HSBC Johannesburg destined for the Sudanese Petroleum Corporation, but three other Sudan-related payments from HSBC affiliates were also identified, a $300,000 payment sent by HSBC Hong Kong; a payment for more than $367,000 payment from HSBC Dubai, and a payment for more than $58,000 from British Arab Commercial Bank Ltd. The email listing these blocked funds noted that a court order was seeking transfer of the funds to a Federal court in the United States in connection with a lawsuit seeking compensation for the families of 17 U.S. sailors killed in a 2000 terrorist attack on the USS Cole in Yemen. 994

In August 2010, in connection with an effort to exit correspondent relationships with 121 international banks that HBUS determined it could no longer support, HBUS CEO Irene Dorner sent an email noting references to 16 banks in Sudan. Ms. Dorner wrote:

“In Phase 2 there will be Trade names the exit for which may be more complicated but to give you a flavor of the problem we seem to have 16 correspondent banks in Sudan which cannot be right.” 995

(d) Transactions Involving Burma

Another set of OFAC sensitive transactions involved Burma, also referred to as Myanmar, a country which, like Cuba and Sudan, was

One of the earliest references to transactions with Burma in the documents reviewed by the Subcommittee is a January 2005 email involving HBUS’ Global Banknotes business, which involves the buying and selling of large quantities of physical U.S. dollars to non-U.S. banks.\footnote{See 1/21/2005 email from HSBC David Bagley to HSBC Stephen Green and Richard Bennett, “Compliance Exception,” HSBC OCC 8873671.} The email, written by HSBC Group Compliance head David Bagley, described a transaction in which HBUS purchased $2.9 million in U.S. dollars from a client, determined that the dollars had come from a certain party whose name was redacted by HBUS, and noted: “Myanmar is currently subject to OFAC regulations prohibiting any transactions by US persons relating to Myanmar counterparties.” Mr. Bagley wrote:

“\textit{There appears little doubt that the transaction is a breach of the relevant OFAC sanction on the part of HBUS, that it will need to be reported to OFAC and as a consequence there is a significant risk of financial penalty. It does not appear that there is a systemic issue, rather we are dealing with an individual incident, although given the potential seriousness of the breach external lawyers have been instructed to assist with the process of resolving matters with OFAC.}”\footnote{Id.}

In July 2005, HSBC Group issued its new GCL policy barring all HSBC affiliates from engaging in U.S. dollar transactions in violation of OFAC prohibitions. A few days later, on August 25, 2005, HSBC Group head of Global Institutional Banking, Mark Smith, circulated a managerial letter, referenced previously, identifying correspondent relationships that would be affected.\footnote{8/25/2005 managerial letter from HSBC Mark Smith to HBUS Aimee Sentmat, HBME Alan Kerr, and others, “GCL050047 – Compliance with OFAC sanctions,” HSBC OCC 3407565-569; 8/25/2005 email from HBUS Alan Ketley to multiple HSBC colleagues, “GCL050047 – Compliance with OFAC Sanctions,” HSBC OCC 3407565-569.} The letter noted that the “Group has 2 account relationships with Myanmar entities,” and stated that the
“GCL applies in full,” implying both relationships would have to be terminated. In September 2005, a senior RBEU payments official, Rod Moxley, who analyzed U.K. transactions stopped by the WOLF filter over a 10-day period noted that a number of the U.S. dollar transactions involved Burma.1001

After the GCL’s 2005 effective date, Burma-related transactions appear to have been reduced, but continued to occur. One example is a $15,000 payment that originated in Burma on January 18, 2008, was processed as a straight-through payment at HBUS, and blocked by the OFAC filter at another bank involved with the transaction.1002 An HBUS email explained that the payment had not been blocked at HBUS, because its OFAC filter didn’t recognize “Yangon,” the former capital of Burma, also called “Rangoon,” as a Burma-related term. According to the email, it was the second payment involving “Yangon” that was missed by the HBUS filter. HBUS Compliance head Carolyn Wind requested that the filter be fixed immediately: “We are running too much risk that these misses will cause OFAC to start questioning the effectiveness of our controls.”1003

Four months later, HBUS blocked an April 2008 wire transfer for $12,060 headed for the account of an SDN-listed entity at Myanmar Foreign Trade Bank. An internal bank document noted that the payment had been blocked by HBUS due to “references to Yangon and Myanmar, rather than blocking it due to the sanctioned entity’s involvement.” The document noted that the bank code “for the sanctioned entity was not included in the payments filter, as per agreed upon procedure with the UK WOLF team,” and a systems fix was implemented in October 2008.1004

In May 2010, two additional Burma-related U.S. dollar transactions were processed by HBUS, due to limitations in the WOLF filter. In one instance, a payment was not blocked, because “the filter did not list ‘Burmese’ as an a.k.a. [also known as] for Burma.” In the other instance, the “filter did not identify ‘Mynmar’ as a possible reference to Myanmar.”1005

1003 Id. at 168.
(e) Transactions Involving North Korea

Still another set of OFAC sensitive transactions involved North Korea which, unlike Burma, Cuba and Sudan, is not subject to a comprehensive U.S. sanctions program, but has particular persons and entities included in the OFAC SDN list.\textsuperscript{1006}

In August 2005, a month after HSBC Group issued the GCL policy barring HSBC affiliates from engaging in U.S. dollar transactions in violation of OFAC prohibitions, HSBC Group head of Global Institutional Banking, Mark Smith, circulated a managerial letter identifying correspondent relationship that would be affected.\textsuperscript{1007} The letter stated: “The Group has 3 account relationships with North Korean entities. These are all inhibited. We have been seeking to close the accounts, and will continue to do so, for some time but have not been able to elicit a response from the banks concerned.”\textsuperscript{1008}

Nearly two years later, in 2007, an internal HSBC document entitled, “Information Requested in Connection With: (North Korea, Cuba, and Myanmar),” revealed that, as of May 2007, HSBC affiliates in Mexico and Latin America were providing U.S. dollar accounts to North Korean clients.\textsuperscript{1009} The document indicated that HSBC Mexico (HBMX) had nine North Korean customers with nine U.S. dollar accounts holding assets exceeding $46,000, and seven North Korean customers with both U.S. dollar and Mexican peso accounts whose assets totaled more than $2.3 million.\textsuperscript{1010} The document indicated that arrangements had been made to “cancel all business relationships with” North Korea, in relation to U.S. dollar accounts or commercial relationships for the entire region.

In addition, HBUS did not close a U.S. dollar account with the Foreign Trade Bank of the Democratic People’s Republic of Korea until

\textsuperscript{1007} 8/25/2005 managerial letter from HSBC Mark Smith to HBUS Aimee Sentman, HBME Alan Kerr, and others, “OCLO50047 – Compliance with OFAC sanctions,” HSBC OCC 3407565-569.
\textsuperscript{1008} 8/25/2005 email from HBUS Alan Ketley to multiple HSBC colleagues, “GCL050047 – Compliance with OFAC Sanctions,” HSBC OCC 3407565-569.
\textsuperscript{1008} 8/25/2005 email from HSBC Alan Ketley to multiple HSBC colleagues, “OCLO50047 – Compliance with OFAC sanctions,” HSBC OCC 3407565-569, at 567.
\textsuperscript{1009} Id. In addition, 92 North Korean clients had 137 HBMX accounts holding solely Mexican pesos, with assets exceeding a total of $697,000. Id. at 093.

(f) Other Prohibited Transactions

In addition to transactions involving jurisdictions subject to U.S. sanctions programs, some transactions sent to HBUS involved prohibited individuals or entities named on the OFAC SDN list. While many of these transactions were not sent by HSBC affiliates, some were. HBUS did not allow such transactions to proceed, showing the effectiveness of the OFAC filter when all appropriate transactions are run through it.

On November 9, 2006, for example, “at the direction of OFAC,” HBUS blocked for further review a $32,000 payment that had been originated by HBME, because the underlying payment details indicated the funds were to be credited to Al Aqsa Islamic Bank.\footnote{12/14/2006 email from HBUS Elizabeth Protomastro to HBUS John Allison and others, “OFAC – Wire payments blocked from HSBC offshore entities – USD 32,000 (re SDGT) and USD 2,538,939.33 (re Sudan),” HSBC OCC 3407608-609.} This bank had been designated as a “specially designated global terrorist” by OFAC in December 2001, because it was a “direct arm of Hamas, established and used to do Hamas business.”\footnote{1/9/2007 email from HBUS Elizabeth Protomastro to HSBC John Allison, HBUS Teresa Pesce, Anne Liddy, and others, "OFAC – Wire payments blocked from HSBC offshore entities – USD 32,000 (re SDGT) and USD 2,538,939.33 (re Sudan),” OCC-PSI-00616498, at 2.} On November 20, 2006, HBME asked HBUS to cancel the payment, because “it was sent in error.” On December 7, 2006, however, OFAC instructed HBUS to continue to block the funds. HBUS AML Compliance head Teresa Pesce wrote: “How is it that these payments continue to be processed by our affiliates in light of the GCLS?”\footnote{1/18-10/19/2011 “Transaction Review Progress and Results Reporting,” prepared by Deloitte LLP, HSBC-PSI-PROC-00096628-672, at 649.}

A report prepared by Deloitte at HBUS’ request, examining the period 2001 to 2007, also disclosed that one U.S. dollar correspondent account located in the United Kingdom had been opened for a bank located in Syria, while two U.S. dollar correspondent accounts in the United Kingdom had been established for the “Taliban.”\footnote{See 12/15/2006 email from HBUS Teresa Pesce to HBUS Elizabeth Protomastro and others, “OFAC – Wire payments blocked from HSBC offshore entities – USD 32,000 (re SDGT) and USD 2,538,939.33 (re Sudan),” HSBC OCC 3407608.} When asked about the correspondent account for a bank established for the Taliban, HSBC legal counsel told the Subcommittee that HBUS had maintained an account for Afghan National Credit and Finance Limited, the London subsidiary of an Afghan bank that, from October 22, 1999 to
February 2, 2002, was designated under OFAC’s Taliban sanctions. An HBUS representative told the Subcommittee that HBUS was unable to go back far enough in its records to uncover whether or not the Afghan account at HBEU sent transactions through HBUS during that time. The fact that HBEU had this account after the 9/11 terrorist attack on the United States again demonstrates how HSBC affiliates took on high risk accounts that exposed the U.S. financial system to money laundering and terrorist financing risks. These U.S. dollar accounts may also have contravened the 2005 GCL and OFAC regulations by enabling banks in Syria and Afghanistan when it was controlled by the Taliban to engage in U.S. dollar transactions through HBUS.

Another account involving an individual on the OFAC list was housed at HSBC Cayman Islands. On February 21, 2008, a Syrian businessman by the name of Rami Makhlouf was placed on the SDN list by OFAC. One week later, HSBC Cayman Compliance personnel contacted HBUS to report that HSBC Cayman Islands currently held a trust relationship with Mr. Makhlouf and to inquire as to “what actions if any HSBC Group has taken in relation to the above mentioned individual.” An HBUS Compliance officer asked the Cayman Compliance officer for more information about the Makhlouf accounts, and the head of HSBC Cayman Compliance responded: “The Trust is administered by HSBC Geneva. We raised concerns with this client in August 2007 however we were assured by David Ford that the relationship had been reviewed at a Group level and a decision had been taken to continue with the relationship.” Ultimately, HBUS determined that it did not have any connection to Mr. Makhlouf and did not need to report any information to OFAC.

(3) HBUS’ OFAC Compliance Program

Internal bank documentation related to HBUS’ OFAC compliance efforts regarding OFAC sensitive transactions portrays a variety of specific problems over the period reviewed by the Subcommittee. One problem was that some HSBC affiliates continued to offer U.S. dollar

1017 Id.
1019 2/28/2008 email exchange among HBUS Andy Im and HSBC Cayman Islands Patricia Dacona and Michelle Williams, HSBC OCC 8878838-840.
1020 Id.
accounts to prohibited persons despite HSBC Group policy and OFAC regulations, and continued to send transactions involving those accounts through their U.S. dollar accounts at HBUS. A second problem was the ongoing practice by some HSBC affiliates and others to use methods of processing transactions which did not disclose the participation of a prohibited person or country when sending a transaction through an account at HBUS. Even some within HSBC worried that such methods would look deceptive to its U.S. regulators. In other cases, prohibited transactions were not detected by HSBC’s WOLF filter or HBUS’ OFAC filter due to programming deficiencies that did not identify certain terms or names as suspicious. In still other cases, transactions that had been properly blocked by the WOLF or OFAC filter were released by HSBC or HBUS employees in error, due to rushed procedures, inadequate training, or outright mistakes. Beginning in 2008, spurred in part by an upcoming OCC examination of its OFAC compliance program, HBUS took a closer look at its program as a whole.

On September 28, 2008, HBUS received a cautionary letter from OFAC regarding “12 payments processed from September 4, 2003 through February 1, 2008 which represent possible violations against U.S. economic sanctions.”1021 That same month, HBUS learned that the OCC planned to review its OFAC operations as part of a November 2008 examination of HBUS’ Payments and Cash Management (PCM) division.1022 In response, HBUS undertook a detailed analysis of not only the 12 transactions highlighted by OFAC, but also other prohibited transactions that had been processed through the bank since issuance of the 2005 GCL policy.

On October 3, 2008, a member of HBUS’ OFAC Compliance team Elizabeth Protomastro forwarded the OFAC letter to HBUS Compliance head Leslie Midzain.1023 Ms. Midzain, in turn, forwarded it to HSBC Group Compliance head David Bagley and HNAH’s regional Compliance head Janet Burak.1024 Ms. Midzain wrote that she was giving them an “immediate heads up” because of the “additional [OFAC] failures since February 2008,” the upcoming OCC examination in November, and the “continued sensitivity” surrounding OFAC compliance. She stated that the matter would “receive high priority.”1025

1025 Id.
On November 6, 2008, Ms. Midzain provided Mr. Bagley and Ms. Burak with detailed charts on the 12 prohibited transactions as well as a larger number of prohibited transactions that had been mistakenly processed by the bank.\(^{1026}\) To provide context to the figures, she noted that HBUS processed approximately 600,000 wire transfers per week, of which about 5%, or 30,000 transactions, generated “possible [OFAC] matches which require review prior to releasing.”\(^{1027}\) She wrote that, over a five-year period from 2003 to 2008, HBUS had “rejected and reported 1,212 transactions valued at $100 million” to OFAC.\(^{1028}\) She explained that, in addition, HBUS had self-reported 79 missed transactions to OFAC that should have been blocked, but weren’t. Of those, she wrote that HBUS had identified “approx[imately] 57” that were issued subsequent to the 2005 GCL that were “contrary to sanction requirements and for which HSBC was the originating bank.”\(^{1029}\) She noted that some of the issues had arisen after HBUS replaced its OFAC filter in July 2007, and may have been due to gaps in the filter that were closed “as the system [was] refined.”\(^{1030}\)

Ms. Midzain reported that the 79 missed transactions primarily involved Iran and Sudan.\(^{1031}\) Other transactions involved Cuba, Iraq, Syria, Zimbabwe, and persons on the SDN list. Ms. Midzain explained that of the 57 missed transactions that occurred since issuance of the July 2005 GCL policy barring HSBC affiliates from processing U.S. dollar transactions for OFAC sensitive persons, 21 or about one-third had nevertheless originated with an HSBC affiliate.\(^{1032}\) Of those 21, her analysis noted that about five did not contain a reference to a prohibited person. Her analysis suggests that an HSBC affiliate may have been using a cover payment which would mask the nature of the transaction from HBUS.\(^{1033}\) Ms. Midzain wrote: “Regarding Group members, since Group policy was issued JUL05, we have nonetheless received a fairly notable number of payments that suggest HSBC banks have not been consistently applying the policy.”\(^{1034}\) She also noted that the analysis had not examined the population of payments that HBUS stopped over the years to see how many of them also came from HSBC affiliates. Her figures also did not reflect the larger universe of potentially prohibited transactions that were processed by the bank without either HBUS or OFAC detecting them.

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1027 Id. at 012.
1028 Id.
1029 Id. at 016.
1030 Id. at 014.
1031 Id. at 016-017.
1032 Id. at 017.
1033 Id. at 016.
1034 Id.
David Bagley, HSBC Group Compliance head, thanked Ms. Midzain for her analysis. He also wrote:

"As you know, we have just completed and are currently collating the results of a Groupwide Compliance review of compliance with our USD/OFAC policy.

Whilst some of these apparent breaches of Group policy may be rather historic nevertheless I am determined that we should enforce our policy on a consistent and Groupwide basis.

Given this, what I would like to do is at Group level track back relevant and apparently offending payments and establish root causes so as to satisfy ourselves that there can be no, or at the very least, far less repetition. It is of course unrealistic to expect that no payments will pass through to HBUS, and at least our move to transparency in form of serial payments should allow these to be caught nevertheless I would prefer that payments were rejected at point of entry."

The OCC examination took place near the end of 2008. It tested the bank’s OFAC systems to determine if OFAC screening was being properly applied to new accounts, wire transfers, and other transactions. An internal OCC memorandum stated that, as of June 30, 2008, “HBUS reported 370 items on the OFAC blocked report, valuing approximately $20 million.” It reported that, from September 2003 to September 2008, HUBS had “rejected and reported to OFAC over 1,200 transactions valuing $100 million.” The memorandum also stated that HBUS was then processing about 600,000 wire transfers per week, of which 6%, or about 30,000, were manually reviewed each week by four-person OFAC Compliance teams in Delaware and New York. The OCC wrote that, of the wire transfers that underwent manual review, 20 to 30 per day were “escalated” and required a “disposition decision from compliance management.”

"Although, according to management, within the past five years (9/03-9/08) there have been only 80 missed payments, the bank’s Compliance teams are under rigorous pressure to process alerts and determine a disposition in a timely manner. ... [T]his strain can and will inhibit their mental capacity leaving gaps for errors even
though permanent current staff members are well trained and qualified to complete the OFAC responsibilities.”

On January 20, 2009, the OCC sent HBUS a Supervisory Letter with generally positive examination findings regarding its OFAC compliance efforts.\footnote{See OCC Supervisory Letter HSBC-2008-41, “Office of Foreign Asset Control Examination,” OCC-PSI-00000434-436. [Sealed Exhibit.?]} The Supervisory Letter stated:

- **OFAC Compliance is High and Increasing.** The quality of risk management systems is satisfactory.
- Compliance with legal and regulatory requirements is satisfactory and no violations of law or regulation were cited at this examination.
- One recommendation is made related to staffing.\footnote{Id. at 1.}

The Supervisory Letter stated that the OFAC risk was high and increasing due to “almost a zero tolerance for error” under OFAC regulations and increasing growth in HBUS’ PCM and retail banking businesses. The staffing recommendation, which did not require corrective action, stated: “Management should consider a review of current staffing requirements to ensure that there is an adequate number of permanent qualified staff to prolong the timely operations associated with OFAC related matters and to ensure adherence with regulatory requirements ... as your business grows.”\footnote{Id. at 3.} Despite the OCC’s generally positive examination, internal bank documents indicate that HBUS itself had a much more negative view of its OFAC compliance program. In June 2009, HBUS initiated an “OFAC Program Review Project.”\footnote{See 10/23/2009 email from HBUS Debra Bonosconi to HBUS Anthony Gibbs, “comments,” HSBC OCC 3405534-537.} Four months later, in October 2009, Debra Bonosconi, the HBUS Director for Specialized Compliance overseeing the Embassy Banking business, sent an email to Anthony Gibbs, the COO of HSBC North America Legal and Compliance, commenting on a number of compliance issues, including OFAC compliance.\footnote{See 10/23/2009 email from HBUS Debra Bonosconi to HBUS Anthony Gibbs, “comments,” HSBC OCC 3405534-537.} Ms. Bonosconi, who had begun working at HBUS in March 2008, wrote that she had only recently become aware of the negative findings of the OFAC Program Review Project. She explained:

“This project has been underway since June and the findings that have surfaced are no different than those already identified previously. So, we have a project that has taken far longer than it should have and findings that do not vary significantly from previous reviews.
The bottom line is, our OFAC process is in disarray and in great risk of being noncompliant. We have multiple systems, inconsistent practices, limited communication between the various functions, and no oversight function."\textsuperscript{1044}

This candid description of the bank’s OFAC compliance program, as having “inconsistent practices,” “limited communication,” and “no oversight function,” stands in marked contrast to the OCC findings less than a year earlier.

Another sign of the stresses in the OFAC compliance program surfaced in December 2009, when the four-person OFAC Compliance team in New York faced an accumulated backlog of greater than 700 OFAC alerts that had yet to be reviewed.\textsuperscript{1045} The OFAC Compliance team requested five or six people from the Payments and Cash Management (PCM) department for ten days to help clear the backlog.\textsuperscript{1046} PCM responded that it had no resources to loan, and suggested asking Compliance personnel in Delaware for help. The OFAC Compliance team in New York responded that the Delaware Compliance staff was already “fully deployed” dealing with general alerts from the CAMP monitoring system:

“We have considered all options at this point[;] the Compliance team in DE is already fully deployed dealing with wire camp alerts and bank examiner requests for the current exam. There is no bandwidth there at all[;] they are behind on the current alert clearing process which we are also dealing with.”\textsuperscript{1047}

In late 2011, the OCC conducted a second examination of HBUS’ OFAC compliance program and, on January 25, 2012, issued a Supervisory Letter with a more negative assessment.\textsuperscript{1048} The Supervisory Letter stated that the OCC was “concerned about the number and severity of the deficiencies in the enterprise-wide OFAC compliance program” at HBUS and at two other HSBC affiliates in the United States, HSBC Nevada, N.A. and HSBC Trust Company (Delaware), N.A. It stated that the OCC had reviewed reports prepared by HBUS’ own auditors and by an outside consultant that “identified significant deficiencies in the program.” It noted that bank management had taken “significant steps” to address deficiencies, but concluded the

\textsuperscript{1044} Id. at 537.
\textsuperscript{1046} Id.
\textsuperscript{1047} Id. at 668.
“three banks lack a robust OFAC risk assessment that ensures the OFAC risks have been adequately identified so they can be managed appropriately.” The Supervisory Letter contained two Matters Requiring Attention (MRAs) by the bank: (1) development of a “comprehensive OFAC risk assessment;” and (2) an independent review of certain real estate loans through a California branch between 2009 and 2011, involving Iran, that raised OFAC concerns. The Supervisory Letter also included a three-page attachment identifying OFAC violations cited in seven OFAC cautionary letters since June 2009. The OCC required RBUS to modify the AML action plan it was developing in response to a September 2010 Supervisory Letter necessitating broad improvements in its AML program to include the MRAs on its OFAC compliance program.

Since the OCC examination, OFAC has issued one more cautionary letter to RBUS. Altogether, six of the pending OFAC letters warned that the violations might result in a civil monetary penalty, but no penalty has been imposed as of June 2012.

(4) Server Issues

One additional issue involving OFAC-sensitive transactions involves payment messages associated with non-U.S. dollar transactions that were sent through servers physically located in the United States, but which were not processed by RBUS and were not screened by an OFAC filter. The key issue is whether the electronic presence of those payment messages in the United States, utilizing U.S. facilities on their way elsewhere, required application of the OFAC filter. Despite concern expressed by RBUS, the bank decided not to turn on the RBUS OFAC filter to screen these payment messages.

WHIRL Server. In the documents reviewed by the Subcommittee, server issues appear to have first arisen in 2003, when the HSBC Group Executive Committee discussed establishing a new server in the United Kingdom to process credit card transactions, instead of continuing to route those transactions through a server in the United States, for the express purpose of “avoid[ing] contravening the OFAC restrictions.” In January 2004, the HSBC Group Board of Directors approved installing a separate, so-called “WHIRL system” in the United Kingdom at an estimated cost of $20 million. When asked about the
WHIRL server, Mr. Bagley told the Subcommittee that the bank had moved the payment processing outside of the United States to protect HBUS, that he viewed it as a broad reading of OFAC rules at the time, and that he saw it as a conservative decision.\textsuperscript{1054}

By 2005, the WHIRL server was active. In November 2005, Mr. Bagley asked Mr. Root to follow up on certain HBMX compliance issues identified by Mexican regulators, including the processing of credit card transactions. Mr. Bagley wrote that even through the credit card transactions “are, or will be processed on the UK Whirl server the routing of the relevant messages may pass through the U.S. first.”\textsuperscript{1055} He also wrote: “If this is the case then we may still have an issue dependent on how much intervention is theoretically possible on the part of the US leg.” The following day, the head of HBMX Compliance Ramon Garcia informed Mr. Root and Mr. Bagley that WHIRL transaction messages were still being routed through a U.S. server “for a fraction of a second for later transfer to the UK,” which could be long enough for a “log file” to exist in the United States identifying the transactions.

**HSBC Affiliates in the Americas.** Six months later, in April 2006, Mr. Bagley proposed that “countries in the Americas outside USA disconnect their payment routing link to the USA TP Gateway and reconnect to the UK TP.” He indicated doing so would provide two main benefits: “firstly the ability to make payments in currencies other than USD to countries/names/entities sanctioned by USA OFAC (as permitted by GCL 050047), and secondly to take data records outside USA.”\textsuperscript{1056} His email raised the issue of whether electronic payment messages routed through a U.S. server could be subject to HBUS’ OFAC filter and the obligation to block all potentially prohibited transactions.

In November 2006, at a meeting of the HBUS Compliance Risk Management Committee, then HBUS Compliance head Teresa Pesce advised: “Plans are underway to implement OFAC screening for messages sent by the Americas through the global messaging gateway in the US in 2007.”\textsuperscript{1057} Her decision to inform the committee of that development indicates that payment messages already being routed through the U.S. server were not being scanned against the OFAC filter. If the OFAC filter was not being used, all of the payment messages being sent through the United States by HSBC affiliates in Latin...
America were not being screened for terrorists, drug traffickers, or other wrongdoers.

Four months later, in March 2007, Mr. Bagley contacted Alexander Flockhart, then HSBC Latin America CEO, about Latin America payment messages being routed through the U.S. server, in light of the increased focus on OFAC compliance “on the part of both OFAC” and “our banking regulators.” Mr. Bagley noted that HBUS was required to screen all transactions for compliance with OFAC requirements, including all non-U.S. dollar transactions, which “would clearly be disadvantageous from Latin America’s perspective,” since the logistics of screening all those transactions “would be commercially and operationally challenging” for Latin American affiliates. Mr. Bagley informed Mr. Flockhart that they were developing a stand-alone WHIRL server in the United Kingdom that Latin America could use and which would avoid OFAC screening. He commented that if Mr. Flockhart “want[ed] to carry out as many transactions permitted by Group policy as possible,” he should relocate Latin America’s payment processing “to a different Group Messaging Gateway” than the one in the United States.

Mr. Bagley also noted that HSBC Group had already “informally explored” the possible relocation of Latin America payment processing to the U.K. server, but realized that gateway was already experiencing capacity issues. Mr. Bagley commented further that the existing situation in which “the filtering” was not turned on was making HSBC’s U.S. colleagues “extremely uncomfortable”:

“Whilst we have lived with the current position for some time, it is fair to say that now that our US colleagues are on notice they feel extremely uncomfortable in allowing the position to continue indefinitely. In essence, we will either have to have a pass and timeline for a relocation of the payment messages or will need to turn the filtering on.”

Mr. Bagley does not make it clear how his U.S. colleagues were put “on notice,” and when asked, he told the Subcommittee that he did not recall who he talked with at HBUS about the issue, but he did indicate clearly that the OFAC filter was not turned on for the U.S. server being used to forward payment messaging traffic from HSBC affiliates in Latin America. Five months earlier, HBUS Compliance head Teresa Pesce told the HBUS Compliance Risk Management Committee that payment messages sent by the Americas through the

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1059 Id. at 355.
1060 Subcommittee interview of David Bagley (5/10/2012).
U.S. gateway would be scanned for OFAC beginning in 2007; Mr. Bagley’s email indicates that, as of March 2007, the OFAC filter had still not been turned on, and his U.S. colleagues were “extremely uncomfortable in allowing the position to continue indefinitely.”

The following day Mr. Flockhart asked for a contact to discuss re-routing Latin American payment messaging traffic through the U.K. server. A few days after that, Mr. Bagley provided the contact information and also notified Mr. Flockhart that HSBC Brazil was considering “giving up certain payments activity given the challenges of passing that activity through the U.S.” Mr. Bagley wrote that the HSBC Group had asked HSBC Brazil to postpone that decision until it was determined whether payment messaging could be “migrated elsewhere.” Mr. Bagley also wrote: “There may also need to be a conversation at some stage with Paul Lawrence [then HBUS CEO] if it is necessary to persuade HBUS to continue with payment messaging pending any migration.” In this email, the head of HSBC Group Compliance seems to be advocating sending non-U.S. dollar payments through the U.S. gateway without monitoring the transactions for OFAC compliance, pending migration of the Latin American traffic to another server. When Paul Thurston, former head of HBMX, was asked about Mr. Bagley’s comments, he expressed surprise that the HSBC Group Compliance head took that position. In June 2007, Mr. Flockhart approved switching Latin America's non-U.S. based SWIFT traffic to the U.K. gateway citing it as the most cost effective solution.

Around the same time, HSBC Brazil (HBBR) also sought to move its transactions from the U.S. to the U.K. server to avoid the OFAC filter. In December 2006, HBBR contacted Malcolm Eastwood at HBEU, asking for assistance in obtaining a second SWIFT address to be used for HBBR payments going to Iran, Cuba, and other sanctioned countries. HBBR explained that these transactions – about 50 per year – were compliant with Group policy, but ran the risk of being blocked by the U.S. server they currently utilized, which was why it wanted to switch the transactions to the U.K. server and execute them in Euros. HBBR wrote: “To enable it, we have been informed that we have to create a second SWIFT address (BIC) to be used exclusively for this

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1062 Id.
1063 Subcommittee interview of Paul Thurston (5/1/2012). Mr. Bagley said that the reason he suggested to Mr. Flockhart that the messages be moved to the U.K. gateway was because he had received a legal opinion, which he considered “extreme,” that non-U.S. dollar messages going through a U.S. messaging center could be impacted by OFAC. He was, thus, acting in a conservative manner to avoid violating OFAC requirements. Subcommittee interview of David Bagley (5/10/2012).
purpose, which should also not be published by SWIFT in their books."

In response, Mr. Eastwood reached out to HSBC Group Compliance and HBEU operational staff to discuss practical issues with Brazil’s routing “US sanctioned items” via the U.K. server. He wrote: “I have concerns that we might be breaching at least the spirit of the US Serial Routing GCL if not the letter of it.” HSBC Group Money Laundering Control Officer John Allison responded that, by using the U.S. server, Brazil was subject to an “all currency prohibition for all OFAC entries,” but HSBC Group policy allowed Brazil to make payments in non-U.S. dollar currencies to entities on the OFAC list, so long as they were not linked to terrorism or weapons of mass destruction. At the same time, he expressed concern about the perception of HSBC’s obtaining an additional SWIFT address dedicated to payments intended for OFAC sanctioned countries.

Mr. Eastwood forwarded this email correspondence to HBEU colleagues with the comment: “Just fyi. This all makes me very nervous!” HBEU’s Rod Moxley responded that trying to identify and process transactions “which have so many conditions attached to them” was a predicament for them. He wrote: “Slightly irritating too that GHQ CMP [Group Headquarters Compliance] seem to have bent over backwards to accommodate a system which looks very dodgy to me. How about no you can’t do this?”

On January 2, 2007, Mr. Moxley sarcastically described setting up a second SWIFT address as an “interesting concept,” forwarded the idea to a colleague, and wrote: “let’s set up a completely different Swift address to help avoid any problems with Cuba and Iran. Wish I’d thought of it.”

On January 26, 2007, Mr. Eastwood responded to Brazil’s request. He indicated in a memorandum that, after conferring with HSBC Group Compliance and operational personnel, they were not favorable to segregating certain transactions through separate SWIFT addresses, even though the transactions were permissible under Group policy, due to the possible perception of “taking action to avoid certain transactions being examined by the US authorities.” Instead, Mr. Eastwood noted that HBRR could re-route all of its SWIFT traffic via...
the U.K. server, listing several logistical issues that would have to be resolved if Brazil wanted to move forward.

These documents raise the question of whether non-U.S. dollar payment messages referencing transactions routed through a U.S. server by HSBC affiliates were required to be screened by an OFAC filter, or whether they could move across U.S. boundaries and use U.S. facilities without triggering any OFAC prohibitions. On the one hand, HSBC Group Compliance urged Latin America to switch their messaging traffic from a U.S. to a U.K. server to avoid the delays that come with OFAC screening, while on the other hand indicating that for at least a five-month period from November 2006 to March 2007, the OFAC filter had not been turned on to screen the Latin American payment messages going through the U.S. server even though HBUS apparently had expressed concerns about not screening the messages for prohibited activity. HSBC Group knowingly put its U.S. affiliate at regulatory and reputational risk by moving payment messages through a U.S. server without scanning them against the OFAC filter.

Turning Off OFAC Verification. A very different server issue arose in July 2007, when HBUS introduced a new product called Fircosoft to help monitor OFAC sensitive transactions. The product caused a huge increase in the number of OFAC alerts, creating a backlog that began to overwhelm HBUS OFAC compliance personnel. According to a fourth quarter 2007 Compliance Report by HBUS, the introduction of the new product caused “serious performance issues” that would “not support HBUS volumes.” On July 17, 2007, “a risk based decision was made to eliminate the verification step of all OFAC filter alerts on a temporary basis to accelerate the process of clearing the OFAC queue.” The more limited review process for OFAC sensitive transactions remained in effect for about three weeks, from July 17 to August 6. On August 1, 2007, HBUS Chief Operating Officer David Dew wrote: “I think that we simply must now agree on a definitive timetable for reintroduction of full OFAC controls.” When asked about this matter, Mr. Dew told the Subcommittee that he thought the limitation on the “verification step” in the OFAC filter was only stopped for about a day. Anne Liddy told Subcommittee that she recalled that the verification step was turned off for about a month, but didn’t view it as a risk to the bank.

1070 4Q07 Compliance Report from HBUS Carolyn Wind to HNAH Janet Burak and others, HSBC-PSI-PROD-0000508-016, at 509.
1071 Global Payments System (GPS) Implementation Issues, 6 Aug 07 HUSI Audit Committee Update, HSBC OCC 1105891.
1072 8/01/2007 email from HBUS David Dew to Bandula Wijesinghe and others, OCC-PSI-00188424.
1073 Subcommittee interview of David Dew (3/05/2012).
1074 Subcommittee interview of Anne Liddy (2/22/2012).
In 2009, the same verification step in the OFAC filter was again turned off by HBUS for a few weeks. In November 2009, due to an industry-wide switch to SWIFT202 cover payments, OFAC alerts increased dramatically at HBUS. HBUS was so concerned about the large number of false OFAC hits being generated that it stopped the verification step, as was done in 2007. Turning off the verification step concerned one HBUS employee enough that the employee quietly reported the action to the Federal Reserve. The Federal Reserve examiner who spoke with the employee wrote in an email to colleagues:

"On Monday Lesley Midzain, former head of BSA/AML turned off the second level filter on Chips activity without consulting anyone and with no supporting documentation. The rational given for turning the second level filter off was to reduce the daily backlog in lieu of additional resources. The individual who spoke to me knew this was not appropriate action and decided to call the [regulator]."

HSBC’s legal counsel told the Subcommittee that the verification step was turned off for 13 days, from November 25, 2009 to December 7, 2009. The issue raised by both incidents in 2007 and 2009, is whether HBUS’ decision to turn off part of the OFAC filtering system reduced its effectiveness in screening for prohibited transactions and increased U.S. vulnerabilities to money laundering and terrorist financing.

C. Analysis

OFAC enforces U.S. programs aimed at exposing and disabling the financial dealings and resources of some of the most dangerous persons and jurisdictions threatening the world today, including terrorists, persons involved with weapons of mass destruction, drug traffickers, and rogue jurisdictions. The OFAC filter is the central mechanism used to identify, stop, and block suspect transactions speeding through financial systems. Global financial institutions have a special responsibility to respect OFAC prohibitions and comply with OFAC restrictions. Actions taken to circumvent the OFAC filter or endanger the effectiveness of a critical safeguard may facilitate transactions undertaken by some of the worst wrongdoers among us.

The evidence reviewed by the Subcommittee indicates that, from 2001 to 2007, HSBC affiliates, with the knowledge and tacit approval of HSBC Group executives, engaged in alarming conduct sending undisclosed Iranian U-turn transactions through their HBUS

1076 Subcommittee briefing by HSBC legal counsel (6/27/2012).
correspondent accounts, without information that would otherwise have triggered OFAC reviews. When asked, HBUS insisted on HSBC affiliates using transparent payment instructions so that all U-turn transactions would be stopped by the OFAC filter and reviewed, but when faced with evidence that some HSBC affiliates were acting to circumvent the OFAC filter, HBUS failed to take decisive action to stop the conduct some in its own organization viewed as deceptive. In addition, from at least 2009 to early 2012, the bank’s OFAC compliance program suffered from multiple deficiencies. Still another issue is that some HSBC affiliates sent non-U.S. dollar messaging traffic through U.S. servers in which the OFAC screening was not turned on or was restricted.

The aim in many of the instances in which HSBC affiliates acted to circumvent the OFAC filter may have been to avoid the time-consuming individualized reviews that followed, rather than execute prohibited transactions. But expediency in the face of the threats posed by the targets of OFAC prohibitions does not justify potentially violating or undermining OFAC requirements. HBUS likewise failed to obtain information about the full scope of undisclosed OFAC sensitive transactions going through its correspondent accounts, bring to a head the issue of HSBC affiliates circumventing OFAC safeguards, and ensure all transactions were reviewed for OFAC compliance.
V. AL RAJHI BANK: DISREGARDING LINKS TO TERRORIST FINANCING

For decades, HSBC has been one of the most active global banks in Saudi Arabia, despite AML and terrorist financing risks involved with doing business in that country. Among other activities, for more than 25 years, HSBC has provided a wide range of banking services to Al Rajhi Bank, Saudi Arabia’s largest private bank. Those services included providing large amounts of physical U.S. dollars to the bank as part of HSBC’s U.S. banknotes business. After the 9/11 terrorist attack on the United States in 2001, evidence began to emerge that Al Rajhi Bank and some of its owners had links to organizations associated with financing terrorism, including that one of the bank’s founders was an early financial benefactor of al Qaeda. In January 2005, despite the fact that Al Rajhi Bank had not been indicted, designated a terrorist financier, or sanctioned by any country, HSBC Group Compliance recommended internally that, due to terrorist financing concerns, HSBC affiliates should sever ties with the bank.

In response, some HSBC affiliates disregarded the recommendation and continued to do business with the bank, while others terminated their relationships but protested HSBC’s decision and urged HSBC to reverse it. The protests continued despite a U.S. indictment the next month, in February 2005, of two individuals accused, among other matters, of cashing $130,000 in U.S. traveler’s checks at Al Rajhi Bank in Saudi Arabia and smuggling the money to violent extremists in Chechnya. In May 2005, four months after its initial decision, HSBC Group Compliance reversed itself and announced that all HSBC affiliates could do business with Al Rajhi Bank, thus allowing HBUS to decide for itself whether to resume the relationship. For nearly two years, HSBC Banknotes repeatedly asked HBUS AML Compliance personnel to allow reinstatement of the Al Rajhi Bank relationship, despite ongoing concerns at HBUS about the bank’s possible links to terrorist financing.

On December 1, 2006, despite concern that there is “no smoke without fire,” HBUS AML Compliance agreed to allow HBUS to reinstate the relationship and resume supplying U.S. dollars to Al Rajhi Bank. Earlier, Al Rajhi Bank had threatened to pull all of its business from HSBC if the U.S. banknotes business were not restored, while HSBC personnel estimated that restoring the U.S. banknotes business would produce annual revenues of at least $100,000. In 2007, additional information surfaced about Al Rajhi Bank’s possible links to terrorism.

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1077 HSBC also operates an affiliate, HSBC Bank Middle East, with branches in Saudi Arabia, owns Saudi British Bank, and provides correspondent banking services to other Saudi financial institutions.
including articles on a 2003 report by the U.S. Central Intelligence Agency (CIA) entitled, “AI Rajhi Bank: Conduit for Extremist Finance,” which found that “[s]enior al-Rajhi family members have long supported Islamic extremists and probably know that terrorists use their bank.” Despite that and other troubling information, HBUS continued to supply U.S. dollars to the bank, and even expanded its business, until 2010, when HSBC decided, on a global basis, to exit the U.S. banknotes business.

AI Rajhi Bank was not the only bank with links to terrorism serviced by HBUS. Two additional examples are Islami Bank Bangladesh Ltd. and Social Islami Bank Ltd. which is also located in Bangladesh. In each case, in anticipation of revenues of $75,000 to $100,000 per year, HBUS Banknotes personnel disregarded troubling evidence of possible links to terrorist financing, opened accounts for the banks, and provided them with U.S. dollars and access to the U.S. financial system.

A. AI Rajhi Bank

Founded in 1957, AI Rajhi Bank is one of the largest banks in Saudi Arabia, with over 8,400 employees and assets totaling $59 billion.1078 Headquartered in Riyadh, the bank has over 500 branches, mostly in Saudi Arabia, but also in Malaysia, Kuwait, and Jordan.1079 The bank was founded by four brothers, Sulaiman, Saleh, Abdullah, and Mohamed, of the Al Rajhi family, one of the wealthiest in Saudi Arabia.

The bank began as a collection of banking and commercial ventures which, in 1978, joined together as the Al Rajhi Trading and Exchange Company.1080 In 1987, the company converted to a joint stock company, and two years later renamed itself the Al Rajhi Banking and Investment Corporation.1081 In 2006, the bank rebranded itself as Al Rajhi Bank.1082 It is traded on the Saudi Arabian Stock Exchange (Tadawul), and about 45% of its shares are publicly owned.1083 Al Rajhi family members remain the bank’s largest shareholders.1084

1079Id.
1082Id. The bank also has various subsidiaries, including Al Rajhi Capital. See Al Rajhi Capital website, http://www.alrajhicapital.com/en/Welcome+to+ARFS/Overview/.
1083HBUS “Know Your Customer Profile” of Al Rajhi Banking & Investment Corp. (10/15/2010), HSBC-PSI-PROD-0102310, (hereinafter “2010 HBUS KYC Profile on Al Rajhi Bank”), at 2. About 45% of the bank’s shares are publicly traded; the remainder is held primarily by members of the Al Rajhi family. Id. at 3.
10842010 HBUS KYC Profile on Al Rajhi Bank, at 3.
Al Rajhi Bank offers a wide range of banking services including deposits, loans, investment advice, securities trading, remittances, credit cards, and consumer financing. All services are offered in conformance with Islamic requirements, including the set aside of funds for “zakat,” which is used for charitable donations. The bank has won a number of awards for its operations in the Middle East.

The bank’s most senior official is Sulaiman bin Abdul Aziz Al Rajhi, who at various times has held the posts of Chief Executive Officer, Managing Director, and Chairman of the Board of Directors. The bank’s General Manager is Abdullah bin Abdul Aziz Al Rajhi. The board of directors consists of eleven directors, six of whom are Al Rajhi family members: Sulaiman bin Abdul Aziz Al Rajhi, Chairman of the Board; Abdullah bin Abdul Aziz Al Rajhi; Sulaiman bin Saleh Al Rajhi; Mohamed bin Abdullah Al Rajhi; Abdullah bin Sulaiman Al Rajhi; and Bader bin Mohammed Al Rajhi.

The bank is part of an extensive group of Al Rajhi business and nonprofit ventures, which include companies engaged in money exchange services, commodity trading, real estate, poultry, construction, and pharmaceuticals. One business which also had an HBUS account was the Al Rajhi Trading Establishment, a money exchange business owned by Abdulrahman Saleh Al Rajhi. Its HBUS account was closed in 2005, when it merged with seven other businesses to form a new Saudi bank. The largest nonprofit venture in the Al Rajhi group is the SAAR Foundation, which is named after Sulaiman bin Abdul Aziz Al Rajhi, and supports nonprofit and business ventures around the world. Sulaiman Al Rajhi and his family today have an estimated net worth of nearly $6 billion.

The Subcommittee contacted Al Rajhi Bank regarding its relationship to HSBC and the matters addressed in this section, but the
bank has not provided any information in response to the Subcommittee's inquiry.

B. Saudi Arabia and Terrorist Financing

The majority of Al Rajhi Bank's operations take place in Saudi Arabia, which the United States has long identified as a country of concern in the area of terrorist financing. Following the terrorist attack on the United States on September 11, 2001, the U.S. Government began a decade-long intensive investigation into where and how terrorists obtain funding, repeatedly returning to Saudi Arabia, its banks, and its nationals as a suspected source.

In 2004, the 9/11 Commission charged with investigating the terrorist attack issued a report which found that Osama Bin Laden and al Qaeda had relied on a "financial support network that came to be known as the 'Golden Chain,' put together mainly by financiers in Saudi Arabia and the Persian Gulf states." The Commission's report explained:

"Al Qaeda appears to have relied on a core group of financial facilitators who raised money from a variety of donors and other fund-raisers, primarily in the Gulf countries and particularly in Saudi Arabia. Some individual donors surely knew, and others did not, the ultimate destination of their donations."

The Commission report stated: "Saudi Arabia's society was a place where al Qaeda raised money directly from individuals and through charities. It was the society that produced 15 of the 19 hijackers." The report also stated that it "found no evidence that the Saudi government as an institution or senior Saudi officials individually funded [al Qaeda]," and that after terrorist attacks began occurring in Saudi Arabia, a "Saudi crackdown ... ha[d] apparently reduced the funds available to al Qaeda -- perhaps drastically -- but it is too soon to know if this reduction will last."

After several major terrorist attacks within its borders in 2003 and 2004, Saudi Arabia took a number of steps to combat terrorist financing. One report to Congress by the Congressional Research Service summarized those actions as follows:

1092 See, e.g., International Narcotics Control Strategy Reports prepared by the U.S. Department of State, 2003-2012 (identifying Saudi Arabia as a country "of concern" with respect to money laundering and terrorist financing).
1094 Id. at 170.
1095 Id. at 370.
1096 Id. at 171.
1097 Id. at 383.
"Since mid-2003, the Saudi government has: set up a joint task force with the United States to investigate terrorist financing in Saudi Arabia; shuttered charitable organizations suspected of terrorist ties; passed anti-money laundering legislation; banned cash collections at mosques; centralized control over some charities; closed unlicensed money exchanges; and scrutinized clerics involved in charitable collections."

Saudi Arabia also reported seizing illicit cash from terrorist organizations, shutting suspect bank accounts, designating several individuals as terrorist financiers, and killing two of them. In addition, Saudi Arabia established a Permanent Committee on Combating the Financing of Terrorism and a Financial Investigation Unit which began operations in September 2005.

Despite those advances, U.S. Government testimony and reports indicate that Saudi Arabia continued to be a focus of concern with respect to terrorist financing. In 2005, for example, U.S. Treasury Under Secretary for Terrorism and Financial Intelligence Stuart Levey testified before Congress: "Wealthy donors in Saudi Arabia are still funding violent extremists around the world, from Europe to North Africa, from Iraq to Southeast Asia." He also testified that Saudi individuals may be "a significant source" of financing for the Iraq insurgency.

In 2007, in its annual International Narcotics Control Strategy Report, the U.S. Department of State wrote: "Saudi donors and unregulated charities have been a major source of financing to extremist and terrorist groups over the past 25 years. A 2007 report to Congress by the Congressional Research Service stated: "U.S. officials remain concerned that Saudis continue to fund Al Qaeda and other terrorist organizations." That same year, Congress enacted legislation which found that "Saudi Arabia has an uneven record in the fight against terrorism, especially with respect to terrorist financing."

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1100 Id. at 24.
1101 Stuart Levey testimony before the House Financial Services Subcommittee on Oversight and Investigations and House International Relations Subcommittee on International Terrorism and Nonproliferation (5/4/2005).
1102 Stuart Levey testimony before the Senate Committee on Banking, Housing, and Urban Affairs (7/13/2005) ("Wealthy Saudi financiers and charities have funded terrorist organizations and causes that support terrorism and the ideology that fuels the terrorists’ agenda. Even today, we believe that Saudi donors may still be a significant source of terrorist financing, including for the insurgency in Iraq.").
and required the U.S. Government to develop a long-term strategy for working with Saudi Arabia to combat terrorist financing. On the sixth anniversary of the 9/11 attack, Treasury Under Secretary Levey said in a televised interview on terrorist financing: “If I could somehow snap my fingers and cut off the funding from one country, it would be Saudi Arabia.”

In 2008, the U.S. State Department issued the long-term strategy required by the 2007 law. The strategy identified goals and “performance targets” to track progress in strengthening collaboration with Saudi Arabia to clamp down on terrorist financing. In April 2008, when questioned during a Senate hearing, Treasury Under Secretary Levey testified that, while Saudi Arabia had taken strong action against terrorists operating within its borders and was cooperating with the United States on an operational level, it was not working as hard to prevent funds from flowing to terrorists outside of its borders: “Saudi Arabia today remains the location from which more money is going to terror groups and the Taliban – Sunni terror groups and the Taliban – than from any other place in the world.”

In 2009, a report prepared for Congress by the U.S. Government Accountability Office (GAO) reviewed both the State Department’s long-term strategy and Saudi anti-terrorism efforts since 2005. GAO concluded: “U.S. and Saudi officials report progress on countering terrorism and its financing within Saudi Arabia, but noted challenges, particularly in preventing alleged funding for terrorism and violent extremism outside of Saudi Arabia.” GAO wrote:

“U.S. officials remain concerned about the ability of Saudi individuals and multilateral charitable organizations, as well as other individuals visiting Saudi Arabia, to support terrorism and violent extremism outside of Saudi Arabia. U.S. officials also noted that limited Saudi enforcement capacity and terrorist financiers’ use of cash couriers pose challenges to Saudi efforts to prevent financial support to extremists.”

1113 Id. at 29.
GAO also noted that certain performance targets set by the State Department had been dropped in 2009, such as the establishment of a Saudi Commission on Charities to oversee actions taken by Saudi charities abroad as well as certain regulations of cash couriers.\footnote{Id. at 15, 33.} GAO recommended that the United States reinstate the dropped performance targets to prevent the flow of funds from Saudi Arabia “through mechanisms such as cash couriers, to terrorists and extremists outside Saudi Arabia.”\footnote{Id. at 3.}


\section{Alleged Al Rajhi Links to Terrorism}

In the ten years after the 9/11 attack in 2001, U.S. Government reports, criminal and civil legal proceedings, and media reports have alleged links between Al Rajhi family members and the Al Rajhi Bank to terrorist financing. The alleged links include that some Al Rajhi family members were major donors to al Qaeda or Islamic charities suspected of funding terrorism, established their own nonprofit organizations in the United States that sent funds to terrorist organizations, or used Al Rajhi Bank itself to facilitate financial transactions for individuals or nonprofit organizations associated with terrorism.

Many of the suspicions regarding Al Rajhi Bank stem from 2002, when the name of its most senior official, Sulaiman bin Abdul Azis Al Rajhi, appeared on an internal al Qaeda list of financial benefactors, and when a network of Al Rajhi-related nonprofit and business ventures located in Virginia was subjected to search by U.S. law enforcement seeking to disrupt terrorist financing activities in the United States.

\subsection*{Al Qaeda List of Financial Benefactors.} The al Qaeda list of financial benefactors came to light in March 2002, after a search of the Bosnian offices of the Benevolence International Foundation, a Saudi based nonprofit organization which was also designated a terrorist organization by the Treasury Department, led to seizure of a CD-ROM
and computer hard drive with numerous al Qaeda documents. One computer file contained scanned images of several hundred documents chronicling the formation of al Qaeda. One of the scanned documents contained a handwritten list of 20 individuals identified as key financial contributors to al Qaeda. Osama bin Laden apparently referred to that group of individuals as the “Golden Chain.” In a report prepared for Congress, the Congressional Research Service explained:

“According to the Commission’s report, Saudi individuals and other financiers associated with the Golden Chain enabled bin Laden and Al Qaeda to replace lost financial assets and establish a base in Afghanistan following their abrupt departure from Sudan in 1996.”

One of the 20 handwritten names in the Golden Chain document identifying al Qaeda’s early key financial benefactors is Sulaiman bin Abdul Aziz Al Rajhi, one of Al Rajhi Bank’s key founders and most senior officials.

The Golden Chain document has been discussed in the 9/11 Commission’s report, in Federal court filings, and civil lawsuits. Media reports as early as 2004 noted that the al Qaeda list included the

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1117 Amaout Evidentiary Proffer, at 29.


AI Rajhi name. HSBC was clearly on notice about both the al Qaeda list and its inclusion of Sulaiman bin Abdul Aziz Al Rajhi.

2002 Search Warrant. Also in March 2002, as part of Operation Green Quest, a U.S. Treasury effort to disrupt terrorist financing activities in the United States, U.S. law enforcement agents conducted a search of 14 interlocking business and nonprofit entities in Virginia associated with the SAAR Foundation, an Al Rajhi-related entity, and the Al Rajhi family. Over 150 law enforcement officers participated in the search, generating widespread media coverage. A law enforcement affidavit supporting the search warrant detailed numerous connections between the targeted entities and Al Rajhi family members and related ventures. The affidavit stated that over 100 active and defunct nonprofit and business ventures in Virginia were part of what it described as the “Safa Group,” which the United States had reasonable cause to believe was “engaged in the money laundering tactic of ‘layering’ to hide from law enforcement authorities the trail of its support for terrorists.”

The SAAR Foundation is a Saudi-based nonprofit organization, founded by Sulaiman bin Abdul Aziz Al Rajhi in the 1970s, named after him, and used by him to support a variety of nonprofit endeavors, academic efforts, and businesses around the world. In 1983, the SAAR Foundation formed a Virginia corporation, SAAR Foundation, Inc., and operated it in the United States as a tax-exempt nonprofit organization under Section 501(c)(3) of the U.S. tax code. In 1996, another nonprofit organization was incorporated in Virginia called Safa Trust Inc. These and other nonprofit and business ventures associated with

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\[1125\] See “Affidavit in Support of Application for Search Warrant,” In Re Searches Involving 555 Grove Street, Herndon, Virginia and Related Locations, (USDC EDVA), submitted by David Kane, Senior Special Agent, U.S. Customs Service (hereinafter “Kane affidavit”), at ¶ 3-4 (describing investigation).


\[1127\] See Kane affidavit throughout, but in particular ¶ 128-180.

\[1128\] Kane affidavit at ¶ 1 (page 6).

\[1129\] Kane affidavit at ¶ 5.

\[1130\] Kane affidavit at ¶ 132.

\[1131\] Kane affidavit at ¶¶ 135-136.
the Al Rajhi family shared personnel and office space, primarily in Herndon, Virginia. In 2000, SAAR Foundation Inc. was dissolved, but the Safa Trust continued to operate.

An affidavit filed by the United States in support of the search warrant alleged that the Safa Group appeared to be involved with providing material support to terrorism. Among other matters, it alleged that members of the Safa Group had transferred “large amounts of funds ... directly to terrorist-front organizations since the early 1990’s,” including a front group for the Palestinian Islamic Jihad-Shikaki Faction, a designated terrorist organization. It also detailed a $325,000 donation by the Safa Trust to a front group for Hamas, another designated terrorist organization. In addition, the affidavit expressed suspicion about a transfer of over $26 million from members of the Safa Group to two offshore entities in the Isle of Man. The affidavit further alleged that "one source of funds flowing through the Safa Group [was] from the wealthy Al-Rajhi family in Saudi Arabia." The search produced about 200 boxes of information which was then analyzed and used in other investigations and prosecutions, although neither the SAAR Foundation or Safa Trust has been charged with any wrongdoing. In 2003, Abdurahman Alamoudi, who had worked for SAAR Foundation Inc. from 1985 to 1990, as executive assistant to its president, pled guilty to plotting with Libya to assassinate the Saudi crown prince and was sentenced to 23 years in jail. He had also openly supported Hamas and Hezbollah, two terrorist organizations designated by the United States. According to an affidavit supporting the criminal complaint against him, Mr. Alamoudi admitted receiving $340,000 in sequentially numbered $100 bills from Libya while in London, and planned “to deposit the money in banks located in Saudi Arabia, from where he would feed it back in smaller sums into accounts in the United States.” According to the affidavit, he also admitted involvement in similar cash transactions involving sums in the range of $10,000 to $20,000.


\[133\] Kane affidavit at ¶ 10(g), 161. Executive Order 12947 (1995).

\[134\] Kane affidavit at ¶¶ 103-104.

\[135\] Kane affidavit at ¶ 111 (emphasis in original omitted).

\[136\] See In re Grand Jury Subpoena (T-II21, 597 F.3d 189 (4th Cir. 2/24/2010), at 191-192.


\[139\] See Gentrup affidavit at ¶ 33.

\[140\] Gentrup affidavit at ¶¶ 39, 43

\[141\] Gentrup affidavit at ¶ 44.

\[142\] Gentrup affidavit at ¶ 45.
The documents seized in the 2002 search were returned after about 18 months, but in 2006, were sought again through subpoenas issued by a Federal grand jury in Virginia. The Al-Rajhi related business and nonprofit ventures initially refused to re-supply the documents, then turned them over after a court imposed civil contempt fines totaling $57,000. The Al Rajhi group then engaged in a four-year, unsuccessful court battle to nullify the fines. In addition, in 2004, Al Rajhi Bank filed a defamation lawsuit against the Wall Street Journal for a 2002 article describing how Saudi Arabia was monitoring certain accounts due to terrorism concerns. In 2004, the lawsuit settled; the Wall Street Journal did not pay any damages. It also published a letter from the bank’s chief executive, and its own statement that the newspaper “did not intend to imply an allegation that [Al Rajhi Bank] supported terrorist activity, or had engaged in the financing of terrorism.”

**2003 CIA Report.** While the widely publicized 2002 search fueled suspicions about Al Rajhi Bank’s association with terrorist financing, a 2003 CIA report, discussed in a news article in 2007, provided another basis for concerns about the bank.

In 2003, the U.S. Central Intelligence Agency (CIA) issued a classified report entitled, “Al Rajhi Bank: Conduit for Extremist Finance.” According to Wall Street Journal reporter, Glenn Simpson, this CIA report concluded: “Senior Al Rajhi family members have long supported Islamic extremists and probably know that terrorists use their bank.”

A later civil lawsuit, filed in 2011, provided a longer quotation from the same CIA report as follows:

“Islamic extremists have used Al-Rajhi Banking & Investment Corporation (ARABIC) since at least the mid-1990s as a conduit for terrorist transactions, probably because they find the bank’s vast network and adherence to Islamic principles both convenient and ideologically sound. Senior al-Rajhi family members have long supported Islamic extremists and probably know that terrorists use their bank. Reporting indicates that senior al-Rajhi

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1144 See In re Grand Jury Subpoena (T-112), 597 F.3d 189 (4th Cir. 2/24/2010).
1145 Id.
1146 Id. See also “A Court Sheds New Light on Terror Probe,” The New York Sun, Joseph Goldstein (3/24/2008).
family members control the bank’s most important decisions and that ARABIC’s principal managers answer directly to Suleiman. The al-Rajhis know they are under scrutiny and have moved to conceal their activities from financial regulatory authorities.

According to the same Wall Street Journal article by Glenn Simpson, the 2003 CIA report alleged that, in 2000, Al Rajhi Bank couriers “delivered money to the Indonesian insurgent group Kompak to fund weapons purchases and bomb-making activities.” The report also allegedly claimed that in 2001, one year after the 9/11 attacks, the bank’s managing director ordered the Al Rajhi Bank’s board “to explore financial instruments that would allow the bank’s charitable contributions to avoid official Saudi scrutiny.” The 2003 CIA report allegedly stated further that extremists “ordered operatives in Afghanistan, Indonesia, Pakistan, Saudi Arabia, Turkey, and Yemen” to use Al Rajhi Bank.

2005 Al Haramain Prosecution. A third source of suspicion regarding Al Rajhi Bank’s possible links to terrorism arose from a 2005 Federal indictment of al-Haramain Islamic Foundation Inc. and two of its senior officials. Al-Haramain Islamic Foundation is a Saudi-based nonprofit organization that, in 2005, operated in more than 50 countries around the world. Beginning in 2002, the United States designated multiple branches of the Foundation as terrorist organizations. After freezing the assets of two such branches for “diverting charitable funds to terrorism,” a U.S. Treasury Department press release stated: “The branch offices of al Haramain in Somalia and Bosnia are clearly linked to terrorist financing.” In 2004, a Treasury Department statement called al-Haramain Foundation “one of the principal Islamic NGOs [Non-Governmental Organizations] providing support for the Al Qaida network and promoting militant Islamic doctrine worldwide.” That same year, the United States added the U.S. branch of the organization


\footnotesize{1154} Id.

\footnotesize{1155} Id.

\footnotesize{1156} United States v. al-Haramain Islamic Foundation Inc., Case No. 6:05-CR-60008-HO (USDC Oregon) Indictment (2/17/2005), at ¶ B.


to the SDN list for acting as an “underwriter of terror.” Men.

The Saudi government issued a similar 2004 designation and ordered the al-Haramain Islamic Foundation to be dissolved.

In 2008, however, Treasury noted that, despite the Saudi government’s action, the organization’s leadership appeared to have reconstituted itself under a new name and continued to operate.

In the United States, representatives of the al-Haramain Islamic Foundation formed, in 1999, an Oregon corporation named al-Haramain Islamic Foundation, Inc. which set up offices in Ashland, Oregon. The corporation was operated as a nonprofit organization under Section 501(c)(3) of the U.S. tax code.

In 2004, the Office of Foreign Assets Control (OFAC) at the Treasury Department deemed al-Haramain Islamic Foundation Inc. in Oregon a “Specially Designated Global Terrorist Entity.”

In 2005, the United States indicted the Foundation and two of its senior officials, Pirouz Sedaghaty and Soliman Al-Buthe, who was later designated by the United States as a terrorist financier.

Since both men were out of the country when the indictment was filed, the case was dormant for two years. In 2007, Mr. Sedaghaty returned to the United States and was arrested at an airport. In 2010, he stood trial, was convicted of two felonies, and sentenced to nearly three years in prison. In 2010, the incident that led to his conviction, he and Mr. Al-Buthe used funds from an Egyptian donor to purchase $130,000 in U.S. travelers cheques from a bank in Oregon; Mr. Al-Buthe then traveled to Saudi Arabia and, in 2000, cashed the travelers cheques at Al Rajhi Bank.
Bank; the money was then smuggled to violent extremists in Chechnya.\(^{1170}\)

Al Rajhi Bank’s role in the events that formed the basis for the prosecution attracted media attention in 2005, when the indictment was filed; in 2007, when Mr. Sedaghaty was arrested; and in 2010, when the trial took place. Over the years, it became public that Mr. Al-Buthe, a designated terrorist financier, had been a client of Al Rajhi Bank in Saudi Arabia in 2000,\(^{1171}\) as had the al-Haramain Islamic Foundation, later designated a terrorist organization.\(^{1172}\) In 2007, a *Wall Street Journal* article reported that Al Rajhi Bank had maintained at least 24 accounts for the al-Haramain Islamic Foundation and handled unusual transactions for it.\(^{1173}\) In January 2010, after the United States served an administrative subpoena on Al Rajhi Bank to obtain authenticated bank documents for use in the al-Haramain Foundation criminal trial, the bank refused to produce them and filed a motion in court to quash the subpoena,\(^{1174}\) leading to media reports that it was refusing to cooperate with a terrorist financing prosecution.\(^{1175}\)

**Links to Suspect Banks.** In addition to the Golden Chain document, the U.S. search of Al-Rajhi related businesses and nonprofits in the United States, and the al Haramain Foundation prosecution, still another source of concern about Al Rajhi Bank involves its alleged links to other banks suspected of financing terrorism.

In 2011, a civil lawsuit filed by an insurance syndicate against Saudi Arabia and others seeking to recover insurance payments made after the 9/11 terrorist attack discussed two of those suspect banks, Bank

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\(^{1170}\)Id.

\(^{1171}\)See, e.g., *Al Rajhi Banking & Investment Corp. v. Holder*, Case No. 1:10-MC-00055-ESH, Memorandum of Points and Authorities In Support of Petitioner’s Motion to Quash USA Patriot Act Subpoena (filed 1-19-10), at 6.

\(^{1172}\)See, e.g., “U.S. Tracks Saudi Bank Favored by Extremists,” *Wall Street Journal*, Glenn Simpson (7/26/2007), http://online.wsj.com/article/SB118530038250476405.html. See also 7/26/2007 email from OCC Joseph Boss to HBUS Alan Ketley, “Saudi’s,” HSBC OCC 3391185 (transmitting the article to HBUS); email from HBUS Ketley to HBUS colleagues, Saudi’s,” HSBC OCC 3391262 (sharing the article within HBUS).


\(^{1174}\)See *Al Rajhi Banking & Investment Corp. v. Holder*, Case No. 1:10-MC-00055-ESH, Memorandum of Points and Authorities In Support of Petitioner’s Motion to Quash USA Patriot Act Subpoena (1-19-10). This case was later closed as “moot.” See Order Dismissing Action As Moot (3/2/2010) (“It is hereby ordered that this action is dismissed as moot in light of the ruling issued on February 26, 2010, by Judge Michael R. Hogan of the U.S. District Court for the District of Oregon in United States v. Sedaghaty..., granting the government’s motion to compel petitioner Al-Rajhi Banking and Investment Corp.’s compliance with an administrative subpoena.”) (emphasis in original omitted).

al Taqwa and Akida Bank Private Ltd. 1176 Both banks have been deemed by the United States as Specially Designated Global Terrorist Entities. 1177 Regarding Bank al Taqwa, the lawsuit noted that two individuals who were former executives at Bank al Taqwa, Ibrahim Hassabella and Samir Salah, were also associated with the SAAR Foundation. 1178 Mr. Hassabella was a former secretary of al Taqwa Bank and a shareholder of SAAR Foundation Inc. Mr. Saleh was a former director and treasurer of the Bahamas branch of al Taqwa Bank, and president of the Piedmont Trading Corporation which was part of the SAAR network. The U.S. Treasury Department has stated: “The Al Taqwa group has long acted as financial advisers to al Qaeda, with offices in Switzerland, Lichenstein, Italy and the Caribbean.” 1179 Regarding Akida Bank, the lawsuit complaint alleged that Sulaiman bin Abdul Aziz Al Rajhi was “on the board of directors of Akida Bank in the Bahamas” and that “Akida Bank was run by Youssef Nada, a noted terrorist financier.” 1180

As explained below, Al Rajhi Bank was also associated with Islami Bank Bangladesh Ltd., which was located in a country at high risk for money laundering, provided an account to a Bangladeshi accused of involvement with a terrorist bombing, and had been fined three times for violating AML requirements in connection with providing bank services to “militants.” 1181 HSBC’s own research indicated that the Al Rajhi group held about one-third of the bank’s shares. In addition, Al Rajhi Bank provided a correspondent account to Social Islami Bank, a Bangladesh-based bank whose largest single shareholder for many years was the International Islamic Relief Organization, which was designated by the United States in 2006, as a terrorist organization. 1182 A second shareholder was the precursor to the Benevolence Islamic Foundation, also later designated by the United States as a terrorist organization.

1176 See Lloyd’s lawsuit at ¶ 459-460. This lawsuit was withdrawn 11 days after being filed, with no prejudice against its re-filing in the future. See Lloyd’s lawsuit, Notice of Voluntary Dismissal, Docket document 5, 9/19/2011.


Suspect Bank Clients. A final source of concern about Al Rajhi Bank involves accounts it provided to specific clients linked to terrorism. The accounts provided to the al-Haramain Islamic Foundation and Soliman Al-Buthe, both designated by the United States as linked to terrorism, have already been discussed. Another example is the International Islamic Relief Organization (IIRO) which, as mentioned earlier, is a Saudi-based nonprofit organization which was added to the SDN list by the United States for “facilitating fundraising for Al Qaida and affiliated terrorist groups”.

In 2003, HSBC’s internal Financial Intelligence Group (FIG) raised questions about the IIRO; in 2006 a FIG report noted that the IIRO had been linked to Al Qaeda and other terrorist groups, plots to assassinate President Bill Clinton and the Pope, attacks on the Brooklyn Bridge and Lincoln Tunnel, and the 1993 attack on the World Trade Center. According to a CRS report, press reports indicated that, until at least December 2004, the IIRO had arranged for donors to send donations directly to accounts it held at Al Rajhi Bank, advertising the accounts in various publications. In addition, the Lloyd’s lawsuit alleged that Al Rajhi Bank made or arranged for large donations to the IIRO. Sulaiman bin Abdul Aziz Al Rajhi, the most senior official at Al Rajhi Bank, is also alleged to have been an officer of IIRO.


Lloyd’s lawsuit at ¶ 446-448 (alleging “Al Rajhi Bank collected charitable donations on behalf of Sanabel Al Kheer (‘Seeds of Charity’), the financial/ investment arm of the IIRO, depositing the donations into Sanabel’s Al Rajhi Bank account no. 77707. … Under the guise of IIRO funds labeled and designated for purposes such as ‘war and disaster’ (Account number for Immigrants, Refugees, and Victims of Disasters: 77702) or ‘sponsor a child’ (IIRO Account Number of Deprived Children: 77704), charitable organizations such as the IIRO use banks like Al Rajhi Bank to gather donations that fund terrorism and terrorist activities. … Al Rajhi Bank also handled IIRO “charitable” contributions intended to benefit suicide bombers by directing Al Igatha Journal advertisements … in Somalia, Sri Lanka, India, and the Philippines under IIRO Account number 77709. … On February 17, 1994, Al Rajhi Bank made a $533,333 donation to the Saudi High Commission (‘SHC’) in response to a call for donations for Bosnia and Somalia. In August 1995, Al Rajhi Bank contributed $400,000 to the SHC which was collecting donations for Bosnia during a 12-hour telethon. The donation was identified by the Arabic newspaper Asharq al Awsat.”).

See, e.g., Lloyd’s lawsuit at ¶ 9.
Al Rajhi Bank gained notoriety as well for providing banking services to several of the hijackers in the 9/11 terrorist attack, including Abdulaziz al Omari who was aboard American Airlines Flight 11. A civil lawsuit described the bank’s involvement with him as follows:

“[M]oney was funneled to the Hamburg, Germany al Qaeda cell through the Al Rajhi Bank to businessmen Mahmoud Darkazanli and Abdul Fattah Zammar, who in turn provided the al Qaeda cell of September 11th hijackers with financial and logistical support. Through Al Rajhi Bank, September 11th hijacker Abdulaziz al Omari received funds into his Al Rajhi Bank Account Number .... Al Omari frequently utilized a credit card drawn on Al Rajhi Bank in the planning of the attacks. On September 7, 2001, four days before the 9/11 attacks, al Omari received a wire transfer from Al Rajhi Bank, Buraidah Branch, Jeddah, Saudi Arabia ....”

Taken together, the information – the Al Qaeda Golden Chain document, the 2002 search of Al Rajhi-related entities in Virginia, the 2003 CIA report, the 2005 al Haramain Foundation indictment and trial, the 2007 media reports, the 2010 refusal to provide bank documents in a terrorist-financing trial, and the multiple links to suspect banks and account holders – present an unusual array of troubling allegations about a particular financial institution. When asked about these matters, Al Rajhi Bank has repeatedly condemned terrorism and denied any role in financing extremists. In addition, despite all the allegations, neither the bank nor its owners have ever been charged in any country with financing terrorism or providing material support to terrorists.

HSBC was fully aware of the suspicions that Al Rajhi Bank and its owners were associated with terrorist financing, describing many of the alleged links in the Al Rajhi Bank client profile. On one occasion in 2008, the head of HSBC Global Banknotes Department told a colleague: “In case you don’t know, no other banknotes counterparty has received so much attention in the last 8 years than Al Rajhi.” Despite, in the words of the KYC client profile, a “multitude” of allegations, HSBC chose to provide Al Rajhi bank with banking services on a global basis.

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1188 Lloyd’s lawsuit at ¶ 449.
1190 See, e.g., 2010 IBUS KYC Profile of Al Rajhi Bank, at 6, 11.
D. HSBC Relationship with Al Rajhi Bank

In the United States, Al Rajhi Bank first became a client of Republic Bank of New York during the 1970s; after Republic Bank of New York was purchased by HSBC, Al Rajhi Bank became a client of HSBC Bank United States (HBUS). HSBC also had longstanding relationships with Al Rajhi Bank and other Al Rajhi-related businesses in other parts of the world, including the Middle East, Europe, and the Far East, which HSBC had developed separately from the relationship it assumed from Republic Bank of New York in the United States. HSBC provided Al Rajhi Bank with a wide range of banking services, including wire transfers, foreign exchange, trade financing, and asset management services. In addition, in 1998, HSBC Group established “HSBC Amanah,” a “global Islamic financial services division” designed to “serve the particular needs of Muslim communities” in compliance with Islamic law, and provided those banking services to Al Rajhi Bank and other Al Rajhi-related businesses.

In the United States, a key service was supplying Al Rajhi Bank with large amounts of physical U.S. dollars, through the HBUS U.S. Banknotes Department. The physical delivery of U.S. dollars to Al Rajhi Bank was carried out primarily through the London branch of HBUS, often referred to internally as “London Banknotes.” HBUS records indicate that the London Banknotes office had been supplying U.S. dollars to Al Rajhi Bank for “25+ years.” In addition to the London branch, HBUS headquarters in New York opened a banknotes account for Al Rajhi Bank in January 2001. The U.S. dollars were physically delivered to Al Rajhi Bank in Saudi Arabia.

In January 2005, a little more than three years after the 9/11 terrorist attack on the United States, HBUS decided to end its relationship with Al Rajhi Bank due to terrorist financing concerns, as explained further below. Nearly two years later, in December 2006, the relationship was reactivated and continued for another four years,
until 2010, when it was ended once more due to a group-wide decision by HSBC to exit the U.S. banknotes business. HBUS closed its banknotes account with Al Rajhi Bank in October 2010.\textsuperscript{1200}

From 2000 to 2010, HSBC assigned a series of Global Relationship Managers to the Al Rajhi Bank account. They include Shariq Siddiqi\textsuperscript{1201} and Shamzani Bin Md Hussain.\textsuperscript{1202} In 2005, the Relationship Manager for KYC approval purposes was Beth Fisher. From 2005 to 2010, the head of the HSBC Global Banknotes business was Christopher Lok, who was based in New York; the regional Banknotes head for the Americas was Gyanen Kumar, who was based in New York; and the regional Banknotes head in charge of the London Banknotes office was Stephen Allen.\textsuperscript{1203}

HSBC classified Al Rajhi Bank as a "Special Category of Client" (SCC), its highest risk designation.\textsuperscript{1204} This designation was due in part to the bank's location in Saudi Arabia, which HSBC classified as a high risk country. In addition, HSBC noted that the bank was owned in part by a Politically Exposed Person (PEP), Abdullah Abdul Al Rajhi, who was a major shareholder, a member of the bank's board of directors, and a member of the Northern Borders Provincial Council in Saudi Arabia.\textsuperscript{1205} Al Rajhi Bank was one of only a handful of bank clients that HSBC had classified as SCC clients.\textsuperscript{1206}

\textbf{E. Al Rajhi Trading Establishment}

In addition to Al Rajhi Bank, HSBC provided accounts to Al Rajhi Trading Establishment, a money exchange business based in Saudi Arabia and owned by Rajhi family members. This account closed in 2005, when the business, along with seven others, merged into a new bank, Al Bilad Bank in Saudi Arabia.

According to HSBC internal documents, Al Rajhi Trading Establishment opened two accounts in 1994, with Republic Bank of New York before its purchase by HSBC.\textsuperscript{1207} One account processed payments, such as from travelers cheques or money orders, while the other handled foreign currency exchange. According to HSBC

\begin{itemize}
  \item \textsuperscript{1204} Id. 1, 15.
  \item \textsuperscript{1205} 5/23/2005 document prepared by CIBM-Institutional Banking on Al Rajhi Banking and Investment Corporation, HSBC OCC 0059988-997, at 7.
  \item \textsuperscript{1206} 2010 HBU KYC Profile of Al Rajhi Bank, at 4.
  \item \textsuperscript{1207} 11/2006 HBU KYC Profile of Al Rajhi Bank, at 4.
  \item \textsuperscript{1208} 2010 HBU KYC Profile of Al Rajhi Bank, at 1.
  \item \textsuperscript{1209} Id. at 1, 3.
  \item \textsuperscript{1210} Id. at 3, 1207 March 2002 email chain among HBUS personnel, “Al Rajhi Trading establishment,” OCC-PSI-00381727, at 3.
  \item \textsuperscript{1211} March 2002 email chain among HBUS personnel, “Al Rajhi Trading establishment,” OCC-PSI-00381727, at 3.
\end{itemize}
documents, Republic Bank of New York had a policy of not dealing with money exchange businesses, but had made an exception for Al Rajhi Trading Establishment due to a “long relationship with the bank, their knowledge of the stiff penalties (death) for drug trafficking and money laundering within the country and the general good reputation of exchange houses in Saudi Arabia.”

After HSBC purchased Republic Bank of New York, the Al Rajhi Trading Establishment accounts were handled by the HSBC International Private Banking Department.

In 2002, after the 9/11 attack on the United States, the International Private Banking Department asked to transfer the two accounts to HSBC’s Institutional Banking Department in Delaware which had superior ability to monitor account activity. In connection with the transfer, HBUS banker Joseph Harpster wrote:

“The most recent concern arose when three wire transfers for small amounts ($50k, $3k and $1.5k) were transferred through the account for names that closely resembled names, not exact matches, of the terrorists involved in the 9/11 World Trade Center attack. … The profile of the main account reflects a doubling of wire transfer volume since 9/01, a large number of traveler’s checks but with relatively low value and some check/cash deposits. According to the account officer, traffic increased because they have chosen to send us more business due to their relationship with Saudi British Bank, and the added strength of HBC versus Republic. … Maintaining our business with this name is strongly supported by David Hodgkinson of [Saudi British Bank] and Andre Dixon, Deputy Chairman of [HSBC Bank Middle East]. Niall Booker and Alba Khoury [of HBUS] also support.”

Douglas Stolberg head of Commercial and Institutional Banking (CIB) at HBUS forwarded the email to Alexander Flockhart, then a senior executive in Retail and Commercial Banking at HBUS, noting: “As we discussed previously, Compliance has raised some concerns regarding the ongoing maintenance of operating/clearing accounts for Al Rajhi group.” He forwarded recommendations on how to handle the account: “Retain [International Private Banking] as the relationship manager domicile for continuity purposes, and as we understand there is interest in further developing private banking business with family.

1208 Id.
1209 Id.
1210 Id.
members. ... Domicile the actual accounts with Delaware where HBUS’s most robust account screening capabilities reside.” His email also stated:

“[T]his has become a fairly high profile situation. Compliance’s concerns relate to the possibility that Al Rajhi’s account may have been used by terrorists. If true, this could potentially open HBUS up to public scrutiny and/or regulatory criticism. SABB [Saudi British Bank] are understandably keen to maintain the relationships. As this matter concerns primarily reputational and compliance risks, we felt it appropriate for SMC [Senior Management Committee] members to be briefed ... so that they may opine on the acceptability of the plan. Please advise how you would prefer us to proceed.”

Mr. Harpster reported a week later that Mr. Flockhart had decided to transfer the accounts to HBUS in the Delaware office.

Three years later, in 2005, eight Saudi money exchangers, including Al Rajhi Trading Establishment, were merged into a new Al Bilad Bank in Saudi Arabia. The HSBC accounts for Al Rahji Trading Establishment closed in November 2005.

F. 2005: Decision to Sever Ties with Al Rajhi Bank

In 2005, despite its longstanding relationship with Al Rajhi Bank, HSBC Group Compliance decided that its U.S.-based businesses should sever ties with Al Rajhi Bank due to terrorist financing concerns.

To carry out this decision, on January 28, 2005, Teresa Pesce, head of HBUS AML Compliance, sent an email to HBUS personnel entitled, “Al Rahji Trading/Al Rahji Banking”:

“As some of you may know, the above named clients have been under evaluation by US and Group Compliance based, among other things, on relationships maintained with entities/countries on the OFAC list. Additionally, US law enforcement has placed these entities under scrutiny. After much consideration, Group Compliance has recommended that the US businesses sever ties with these clients based on the current regulatory environment and

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1213 Id. at 2-3.
1214 See April 2005 HBUS Financial Intelligence Group (FIG) Report of Findings (Update) on Al Rajhi Trading Establishment, HSBC OCC 2723169-169. Another Al Rajhi-related business, the Al Rajhi Commercial Foreign Exchange, was also one of the eight businesses that merged into Al Bilad Bank. See 7/13/2005 HBUS Financial Intelligence Group (FIG) Report of Findings (Update) on Al Rajhi Commercial Foreign Exchange, HSBC OCC 2725167-168.
1215 4/12/12 HSBC legal counsel response to Subcommittee inquiry.
1216 2010 HBUS KYC Profile of Al Rajhi Bank, at 2 (“relationship exited and deactivated on 2 February 2005 due to TF issues”).
the interest of US law enforcement. Accordingly, I will not approve customer profiles for or transactions with these entities. Please make appropriate arrangements. I am available to answer any questions you might have.\textsuperscript{1217}

At the time the email was issued, Al Rajhi Bank had not been indicted, designated as a terrorist financier, or sanctioned by any country, including the United States. HSBC Group Compliance based its decision on concerns that the bank had relationships “with entities/countries on the OFAC list,” the bank was of “interest” to U.S. law enforcement which had placed it “under scrutiny,” and severing the relationship was called for in light of the “current regulatory environment.”\textsuperscript{1218}

The 2005 decision was made several years after the 9/11 terrorist attack, as U.S. law enforcement and bank regulators directed increasing scrutiny to terrorist financing issues. As discussed earlier, in 2004, the 9/11 Commission issued its report which included information on the role of Saudi Arabia in financing terrorism, described the “Golden Chain” of al Qaeda’s financial benefactors, and noted that one of the hijackers had an account at Al Rajhi Bank. Congress held hearings on that report. The media also disclosed in 2004, that Al Rajhi Bank’s most senior official was on the Golden Chain list.\textsuperscript{1219} In addition, 2004 saw the United States designate as terrorist organizations several Saudi-based nonprofit organizations that were also clients of Al Rajhi Bank, including the International Islamic Relief Organization and the al Haramain Foundation, adding them to the OFAC list of entities with which U.S. persons were prohibited from doing business.\textsuperscript{1220} U.S. prosecutors also intensified their investigation of al Haramain Foundation Inc., whose 2005 indictment would disclose that its senior officials had cashed $130,000 in U.S. travelers checks at Al Rajhi Bank in Saudi Arabia and used the money to support violent extremists in Chechnya.\textsuperscript{1221}

On the regulatory front, in July 2004, this Subcommittee held hearings on how U.S. banks and U.S. bank regulators had failed to fully

\textsuperscript{1217} 1/28/2005 email from HBUS Teresa Pesce to numerous HSBC colleagues, “Al Rajhi/I Trading/Al Rajhi/I Banking,” HSBC OCC 1884218.
\textsuperscript{1218} When asked about this decision, David Bagley, the head of HSBC Group Compliance, told the Subcommittee that there was no single incident that led to the decision. Subcommittee interview of David Bagley (5/10/2012).
\textsuperscript{1221} The U.S. Treasury Department was later quoted as saying Al Rajhi Bank maintained at least 24 accounts and handled unusual transactions for the al Haramain Foundation. “US Tracks Saudi Bank Favored by Extremists,” Wall Street Journal, Glenn Simpson (7/26/2007), http://online.wsj.com/article/SB118530038250476405.html.
implement the tougher AML requirements enacted into law as part of the USA Patriot Act of 2001, highlighting Riggs Bank as an example. Among other measures, the Patriot Act required U.S. financial institutions to establish AML programs, conduct special due diligence on correspondent accounts opened for foreign banks, and verify the identity of account holders. The law also deemed money laundering through foreign banks and the laundering of terrorism proceeds as criminal offenses in the United States. These new provisions had given rise to new bank regulations, new examination requirements, and a new emphasis on the importance of AML controls.

HBUS' primary U.S. regulator, the OCC, scheduled an AML examination of the HBUS banknotes business to take place in 2005. In December 2004, in anticipation of that examination, the HBUS Global Banknotes Department had completed a review of its KYC client profiles. In October 2004, the HSBC Global Relationship Manager for Al Rajhi Bank, Shariq Siddiqi, visited the bank and reviewed its KYC/AML procedures in detail. Mr. Siddiqi praised the procedures and noted: “The management appeared fully cognizant of the reputational risks associated with terrorism financing, and confirmed Al Rajhi Bank’s strong commitment to combat it.”

Despite that endorsement of the bank’s AML policies and procedures, HBUS AML Compliance did not approve the Al Rajhi Bank KYC profile, an action it took with respect to only a few clients out of more than 930 active client profiles reviewed. The failure to approve the client profile meant that bank personnel were unable to do business with the client. HBUS AML Compliance Officer Alan Ketley circulated
instructions on how to handle clients, including Al Rajhi Bank and Al Rajhi Trading Establishment, whose profiles had been “denied” by HBUS Compliance. He explained that such clients must be given “10 days notice of trading termination unless a dispensation is obtained from the AML Director and an updated profile is approved by the AML Director within that 10 day period. For current customers that 10 day clock will commence on December 7 (so December 17 will be the final day we will transact with them unless a dispensation is obtained.)”

On January 4, 2005, HBUS AML Compliance head Ms. Pesce sent an email to Daniel Jack, an HBUS AML Compliance Officer who often dealt with the London Banknotes office, instructing him to: “[p]lease communicate that Group Compliance will be recommending terminating the Al Rahji relationship.” Mr. Jack inquired as to when that recommendation would be made. She responded:

“I expect to see an email from Susan Wright today. She tells me that HBME [HSBC Bank Middle East] does not agree with Compliance and will not be terminating the relationship from the Middle East, but she/David B[agley] recommend that in light of US scrutiny, climate, and interest by law enforcement, we in the US sever the relationship from here.”

Susan Wright was then the Chief Money Laundering Control Officer for the entire HSBC Group. She reported to David Bagley, head of the HSBC Group’s overall Compliance Department. The documents do not explain why HSBC Middle East disagreed with the decision or why it was allowed to continue its relationship with Al Rajhi Bank, when HSBC’s Group Compliance had decided to sever the relationship between the bank and other HSBC affiliates due to terrorist financing concerns.

The decision to sever ties with Al Rajhi Bank was announced internally within HSBC on January 28, 2005. The decision clearly affected some HSBC affiliates, such as HBUS and its London Banknotes office which discontinued transactions with Al Rajhi Bank, but not others, such as HSBC Bank Middle East which continued doing business with Al Rajhi Bank and other Al Rajhi entities. The Subcommittee

asked but has received no explanation as to why the decision bound
HSBC affiliates in the United States and Europe, but appeared to not
apply to the Middle East.

Soon after the decision was announced in January 2005, HSBC
Group Compliance began to narrow its scope. On February 22, 2005,
Paul Plesser, head of the HBUS Global Foreign Exchange Department,
sent an email to a colleague asking whether, despite the HSBC Group
Compliance decision, his office could continue to engage in foreign
exchange trades with Al Rajhi Trading Establishment. He was told
by a trader from the Banknotes department: “For us is business as
usual.” Mr. Plesser double-checked with HBUS AML Compliance
officer Alan Ketley, asking in an email: “so I guess we are ok to
continue trading?” On March 16, 2005, Mr. Ketley affirmed that the
trades could continue, forwarding an email from Ms. Pesce, head of
HBUS AML Compliance, stating that the earlier HSBC Group decision
no longer applied to Al Rajhi Trading:

“Group has clarified the Al Rajhi guidance issued last month.
They have evaluated Al Rajhi Banking and Al Rajhi Trading
and now believe that the two are separated enough that
relationships may be maintained with the latter but not with the
former. To be clear, recommendation is to sever with Banking
only at this time.”

Mr. Ketley commented: “Looks like you’re fine to continue dealing
with Al Rajhi. You’d better be making lots of money!”

In May 2005, four months after announcing the decision to sever
ties with Al Rajhi Bank, HSBC Group Compliance backed down still
further. It announced that HSBC affiliates could re-establish business
ties with Al Rajhi Bank, though subtly suggested that HBUS might not.
David Bagley, head of HSBC Group Compliance, announced the
decision in a May 23 email sent to HSBC personnel:

“Having now received the updated KYC from Shariq Siddiqi and
reviewed the previous information received from Group Securities

Indicating that, in late 2006, HSBC business with Al Rajhi Bank was “substantial,” including
through the “HSBC Amanah business”).
1235 2/22/2005 email from Paul Plesser to Georges Atallah, “Al Rajhi Trading/Al Rajhi
Banking,” HSBC OCC 3111888.
1236 2/22/2005 email from Georges Atallah to Paul Plesser and others, “Al Rajhi Trading/Al
Rajhi Banking,” HSBC OCC 3111888.
1237 2/22/2005 email from Paul Plesser to Alan Ketley, “Al Rajhi Trading/Al Rajhi Banking,”
HSBC OCC 3111888.
1238 3/16/2005 email from Alan Ketley to Paul Plesser, “Fw: Al Rajhi Guidance Clarified,”
HSBC OCC 3114022.
1239 Id.
I am pleased to confirm that we have revised our recommendation in relation to the above.

Accordingly we have lifted our recommendation against the commence or expansion of relationships with the above with immediate effect.\textsuperscript{1240} We will communicate this decision to HBEU [HSBC Europe] where I believe there are a number of pending applications.

Whilst we will advise HBUS CMP [Compliance] of the revised view within GHQ CMP [Group Headquarters Compliance] nevertheless I believe it will remain appropriate for HBUS CMP in conjunction with HBUS senior management to reach their own determination with regard to the expansion of business with Al Rajhi within the US. Although the revised view from GHQ CMP ought to be a material matter causing them to reconsider their position nonetheless, and particularly in the current US environment, I do not believe it is appropriate for us to seek to influence their determination one way or the other.\textsuperscript{1241}

The effect of this decision was to allow HSBC affiliates to do business with Al Rajhi Bank if they chose, which meant HBUS Compliance had to determine for itself whether or not to re-establish ties with Al Rajhi.\textsuperscript{1242}

G. 2006: HBUS Banknotes Account Reinstated

Although HBUS Compliance in the United States held out almost two years, after a concerted campaign by HBUS Banknotes personnel, it ended up following the lead of HSBC Group Compliance and restoring the Al Rajhi Bank account at HBUS in late 2006. One precipitating event appears to have occurred in November 2006, when Al Rajhi Bank threatened to pull all business from HSBC, unless the U.S. banknotes services were restored. Within a month, the account was reestablished.

The two HBUS bankers who spearheaded the effort to restore the Al Rajhi account were Christopher Lok, head of the HSBC Global Banknotes Department, working from New York, and Stephen Allen.

\textsuperscript{1240} The new decision lifted the ban on relationships with both Al Rajhi Bank and Al Rajhi Commercial Foreign Exchange, another money exchange business owned by Abdullah Abdul Al Rajhi. The decision on Al Rahhi Commercial Foreign Exchange was in addition to the earlier decision allowing relationships with Al Rajhi Trading Establishment.


\textsuperscript{1242} At almost the same time, HSBC CIMB-Institutional Banking, which is part of HSBC Amanah, approved additional banking services for Al Rajhi Bank, including trade, treasury, SWIFT wire transfers, foreign exchange, and asset management services. See 5/23/2005 document prepared by CIMB-Institutional Banking on Al Rajhi Banking and Investment Corporation, HSBC OCC 0659988-997, at 8.
head of the HSBC Banknotes branch in London. For more than 20 years, the London office had supplied physical U.S. dollars to Al Rajhi Bank in Saudi Arabia, until forced to stop by the January 2005 decision.

When HSBC Group Compliance reversed the decision on Al Rajhi Bank for HSBC affiliates on May 23, 2005, HSBC Banknotes personnel expressed a desire to reopen their accounts with Al Rajhi Bank as well, while signaling a willingness to wait until the conclusion of an upcoming Global Banknotes examination by the OCC. On May 23, 2005, Mr. Allen, head of the London Banknotes office, forwarded the HSBC Group Compliance email regarding Al Rajhi Bank to Mr. Lok, head of the Global Banknotes Department, stating: "We’ll have to see if this will make any difference!" Mr. Lok, in turn, sent an email to Ms. Pesce, head of HSBC AML Compliance, stating: "After the OCC close out and that chapter hopefully finished, could we re-visit Al Rajhi again. London compliance has taken a more lenient view."

The on-site work for the OCC AML examination concluded about a month later, and the HSBC London branch shortly thereafter began to discuss plans to speak with HSBC AML Compliance to allow it to resume ties with Al Rajhi Bank. In a July 2005 meeting to discuss KYC issues, members of the HSBC London Banknotes office discussed both the results of the OCC examination and next steps to discuss the future of HSBC’s relationship with Al Rajhi Bank:

"DJ [Daniel Jack]: We gave the OCC 108 client files. The primary focus of their finding[s] boiled down to 18 files concentrating on the money service business[es] and high risk clients. We obtained a satisfactory rating from the OCC although their examiners identified 5 issues considered ‘Matters Requiring Attention’ with urgency. ...

Saudi: We lost Al Rajhi this year – we discussed this in various compliance meetings already. SA [Stephen Allen] – a resumption decision was put off because of the OCC audit. CL [Christopher Lok] to speak to SA after the OCC. Allen to speak to Terry [Pesce] before his holidays. Al Rajhi threatened to pull any new

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1243 See 5/15/2006 OCC letter to HSBC ("On June 12, 2006 we will begin a 3-week Examination of Global Banknotes, London. We hope to complete on site work on or before June 30, 2006.").
1247 The MRAs cited by the OCC required the London Banknotes Office to conduct a client file review to improve client information and analysis; review client risk ratings; add expected client account activity to the client files; revise written procedures to include the need to obtain expected client activity; and improve AML training in these areas. Id.
Al Rajhi Bank communicated the threat to “pull any new business with HSBC” unless given a “satisfactory explanation” why HSBC had stopped supplying it with U.S. dollars via its relationship managers. That threat was not mentioned again in the documents provided to the Subcommittee.

The next month, in August 2005, Mr. Allen sent Sally Lomas, KYC manager for the London Banknotes office, a copy of the Lok email asking HBUS AML Compliance to re-visit the Al Rajhi issue, together with the HSBC Group Compliance email allowing re-establishment of the relationship for the rest of HSBC. Ms. Lomas forwarded the emails to Lynda Cassell, then a senior Compliance official at HBUS. Ms. Lomas wrote:

“Please find attached an email sent by David Bagley, indicating that there is no longer a recommendation against expanding relationships with Al Rajhi Bank. I have asked Fig [HSBC Financial Intelligence Group] to check, when they do their additional work, whether the same part of the Al Rajhi fa[m]ily is in[volved] in both Banks.”

On the same day, Ms. Pesce, head of HBUS AML Compliance, responded to the Lomas email, warning that re-opening the Al Rajhi Bank account should not be viewed as an easy decision:

“This is not so simple. David [Bagley] does not object insofar as HBEU [HSBC Europe] is concerned, but has left it to us to assess the US risk. We’ve gotten push back from the OCC on Al Rajhi Trading, which is less controversial than the bank. We can revisit this, but I am not inclined to push ahead precipitously, especially in light of the regulatory scrutiny.”

In January 2006, the Banknotes Department tried again. Minutes of a London Banknotes meeting to discuss KYC issues recorded the following discussion:

“Banknotes-London would like to resume business with Al Rajhi, although we have ceased trading (due to rumours in terrorist financing, the U.S. Government has now dropped those charges ...].] [T]he rest of the HSBC group still deal with them. LC
Lynda Cassell] advised a conference call with Terry [Pesce] is needed but before this takes place LC would like to see a memo from SA [Stephen Allen] about the history of this matter, subsequently Lynda will take this memo to Terry to arrange the conference call."

The minutes reflect that a rumor was circulating among several HSBC officials that the U.S. government had "dropped" charges of terrorist financing against the bank, which was not the case since no formal charges had ever been filed. The minutes also indicate that all HSBC affiliates were then allowed to do business with Al Rajhi Bank other than HBUS, a fact used at one point to try to convince HBUS Compliance to allow the account.

In February 2006, Mr. Allen met with Lynda Cassell, a senior AML policy advisor, about Al Rajhi Bank. That same month, Gordon Brown, who had taken over London Banknotes KYC issues from Susan Lomas, provided Ms. Cassell with a copy of Al Rajhi Bank’s AML policies and procedures. Ms. Cassell responded with an email to Mr. Brown, Mr. Allen, and others explaining:

"Gordon, in accordance to our previous conversation, the AML compliance decision to do business with Al Rajhi lies with Terry Pesce and as suggested, Stephen [Allen] should speak to Terry regarding his desire to enter into a Banknotes relationship. … In regards to Al Rajhi’s AML Policy and Procedures, I find them comprehensive …. Their high risk client base generally mirrors our high risk type clients."

In March 2006, Mr. Allen and Mr. Brown exchanged emails with Mr. Kelley, a senior HBUS AML Compliance officer who worked for Ms. Pesce. Mr. Allen wrote:

"[A]ccording to Al Rajhi, their senior management had been advised by the US State Department that they were no longer considered to be under suspicion and I was wondering whether HBUS Compliance or Security may have a contact at State … that could be explored to verify this statement?"

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1257 Id. It is unclear what his email referred to when it said that the State Department told the bank that it was no longer "under suspicion."
Mr. Ketley agreed to try to verify the information, and Mr. Allen responded:

"Thanks Alan, anything that you can do is appreciated as, with the summer heat approaching, this client becomes very active and is commercially extremely important to us – if we can ever get to re-start our business with them that is. You may recall me telling you that we dealt with Al Rajhi for 30 years prior to being obliged to desist!"1258

Also in March 2006, Beth Fisher, an HBUS employee who used to be the corporate relationship manager assigned to Al Rajhi Bank, discovered that HBUS had failed to cancel a $50 million line of credit for the bank when the relationship ended. She sent an email to Mr. Ketley: "I thought we exited this name!"1259 He responded: "I gather that[ ] Banknotes wants to revive the relationship but has not yet done so." The next day, Ms. Fisher explained to a colleague: "FYI, this was an HBUS London Banknotes (only) relationship which was exited a year ago due to AML Compliance concerns. ... This is NO LONGER an HBUS relationship. We must remove this bank from our list."1260

In April 2006, Susan Wright, head of AML Compliance for the entire HSBC Group, weighed in, sending an email to Ms. Pesce and Mr. Ketley asking, "what the position is with regard to the possibility of a Bank Note relationship in London" with Al Rajhi?1261 Ms. Pesce responded: "It still makes me nervous. Alan has gone out to Steve Allen for more KYC/EDD [Know Your Customer/Enhanced Due Diligence]." Mr. Ketley told the Subcommittee that the Al Rajhi Bank relationship was the only one where he was influenced by HSBC Group.1262

That same day, April 10, 2006, Lynda Cassell sent an email to Mr. Allen at London Banknotes requesting information about whether Al Rajhi Bank did business in countries subject to OFAC sanctions and how they would use U.S. banknotes, if they were restored.1263 He arranged for an inquiry to be sent to Al Rajhi Bank which then took five months to respond with limited information.1264 For example, in

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1262 Subcommittee interview of Alan Ketley (2/16/2012).
response to a question asking the bank to “confirm the countries outside of Saudi Arabia that you do business with,” Al Rajhi Bank wrote: “All our correspondent banks’ names are available in the Bankers Almanac.” When asked how the bank ensures it does not utilize HBUS products or services in countries that are “OFAC-sanctioned,” the bank’s entire response was: “We apply strict due diligence and KYC procedures to high risk countries.” Both replies did not sufficiently answer the questions posed.

The bank provided a slightly longer answer when asked how it would use U.S. banknotes:

“All USD banknotes we purchase [are] for our own branches’ use. … We have a big population of around 7 million foreign workers in the kingdom who mostly prefer USD when traveling back to their countries on vacation or even when remitting money to their families. … Also during summer time we have a high demand from tourist[s] traveling for their vacations.”

This response suggested that, if resupplied with U.S. dollars, the bank would provide those dollars to a wide group of persons in Saudi Arabia, many of whom would be expected to transport the dollars across international borders into other countries.

In June 2006, HSBC Bank Middle East added its voice to that at the Banknotes group in pushing for the account to be reopened. Salman Hussain, then Payments and Cash Management (PCM) Regional Sales Manager for HSBC Bank Middle East, sent an email to Mr. Ketley at HBUS AML Compliance highlighting the potential revenue if Al Rajhi Bank were to be reinstated as a banknotes customer:

“I am sending you this email seeking your assistance to address any issues pertaining to AI Rajhi Bank in order to obtain compliance approval. … As I understand from talking to all parties that we had an excellent relationship with Al Rajhi Bank until year 2004, banknote[s] (David Illing) stopped doing business while being the largest revenue generator in the Middle East. Amanah Finance in London (Emran Ali Reza) still trade[s] with Al Rajhi Bank. … From my side, I would like to use the Islamic Overnight Investment [product] … as an intro to this bank. The amount of potential business/revenue is quite substantial.”
Mr. Hussain sent copies of his email to six colleagues in various HSBC departments.

Mr. Ketley responded to Mr. Hussain on the same day as follows:

“This must be the week for Al Rajhi as yours is the second e-mail about the bank that I have received.

HBUS exited the relationship in 2004 primarily for Compliance reasons. Earlier this year, Banknotes London expressed their desire to re-establish the relationship and there has been a fair amount of discussion about whether or how to do this. …

[C]ertain questions … need to be addressed before any Compliance decision can be made about resuming the relationship. For your information, Banknotes London has been fully embroiled in (preparing for and now in the midst of) an OCC exam so are unlikely to have been able to pursue these questions.

The concerns about this name in the US have been rather long standing and we will need to get extremely comfortable with Al Rajhi before we would be willing to re-establish a relationship.”

In June 2006, the OCC completed the on-site work for its AML examination of the London Banknotes Office and, in September, sent a Supervisory Letter to HBUS summarizing the results and directing the London office to improve its Know Your Customer information and client risk ratings.

Also in June 2006, Emma Lawson, who worked for Susan Wright, head of AML Compliance for the HSBC Group, sent an email to Mr. Ketley and Ms. Pesce inquiring about progress on the Al Rajhi Bank account. Mr. Ketley responded that they had yet to receive answers to certain AML questions, in part because London Banknotes personnel “have been fully engaged on an OCC exam for the past few months. The exam will end on June 30 so I expect they will revisit the subject then.”

In July 2006, the London Banknotes office held a meeting to discuss its business activities and prospects, and again brought up Al Rajhi Bank. A summary of the meeting stated:

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"Saudi Arabia ... [W]e are experiencing a lot of competition from Commerz [Bank] who are shipping [U.S. dollars] directly from NY [New York] into Saudi and they are offering nearly 50% cheaper prices than BN [Banknotes] quote, so work has had to be done to offer better prices to re-gain volume in this business. We only have two customers here ... but we continue to press for the reinstatement of Al Ra[jhi] but there remain ongoing KYC issues."

In the fall, at the request of Gordon Brown, KYC manager at the London Banknotes office, the HSBC Financial Intelligence Group (FIG) provided an update to an existing investigative report on Al Rajhi Bank. The report was only three pages long and consisted primarily of information taken from publicly available publications about the bank’s ownership and management. The report also noted that a U.S. judge had dismissed the bank from a lawsuit brought by victims of the 9/11 terrorist attack, and that the World-Check database had listed the bank’s Chairman and Managing Director Sulaiman Abdul Aziz Al Rajhi under its category for “terrorism.”

Following receipt of the report, the KYC customer profile was updated by the HBUS Banknotes Department for Al Rajhi Bank with a view toward reinstating the account. The profile stated in part:

“A multitude of allegations have surrounded the Al-Rajhi family implicating them in a gamut of highly adverse activities ranging from money laundering to terrorist financing. The current facts, however, do not easily support these allegations. Presently, no U.S. or foreign government law enforcement or regulatory body has stated, unconditionally, that any member of Al-Rajhi or any company controlled by Al-Rajhi is under sanction. The U.S. continues to pursue relationship with Saudi Arabia and the Al-Rajhi family irregardless of the allegations being levied against charitable institutions with some presumably direct and indirect links to Al-Rajhi. The major 9/11 lawsuit, which included Al-Rahji, has been dropped against the family and family-related institutions.

However, there is some reputational risk and the possibility that further investigations by U.S. authorities may ultimately uncover substantiating proof of the Al-Rajhi connection to terrorism is

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certainly a concern. Our account relationship with Al-Rajhi will be primarily selling USD banknotes out of London. The risk of future sanctions and the reputational risk based on the aforementioned allegations should be measured against the current risks involved in our relationship when ultimately deciding our course of action. Therefore, London Banknotes feels that the bank poses minimal reputational risk to us.\textsuperscript{1276}

This justification for renewing the account relationship had two key features. First, it asserted that, despite many allegations, no government had stated “unconditionally” that Al Rajhi Bank or its owners were under sanction for financing terrorism. Second, it focused on “current risks” and asserted that, measured against those, Al Rajhi Bank posed only “minimal” reputational risk to HSBC.

On November 14, 2006, Christopher Lok, head of Global Banknotes, submitted the new profile for approval to Beth Fisher, the HBUS corporate relationship manager formerly assigned to Al Rajhi Bank.\textsuperscript{1277} Ms. Fisher responded to Mr. Lok, with a copy to Mr. Ketley and Mr. Jack in HBUS AML Compliance, “I thought this was an HSBC exit name.”\textsuperscript{1278} Mr. Ketley replied to her, “It was exited once (2004?) – Banknotes London is looking to reopen the relationship.” He also stated: “The profile had better be bullet proof.”\textsuperscript{1279}

Three days later, Mr. Allen sent Ms. Fisher and Mr. Ketley an email urging them to expedite their review of the client profile, which he hoped would reestablish the account, citing a threat by Al Rajhi Bank to pull all business from HSBC unless the U.S. banknotes services were restored:

> “Salman Hussain, the PCM [Payments and Cash Management] Regional Sales Manager at HBME [HSBC Bank Middle East] in Bahrain, who has recently visited the subject, has called to say that Al Rajhi has now run out of patience waiting for us to re-start our banknote trading relationship and unless we can complete the kyc formalities and advise them accordingly by the end of November, they will terminate all product relationships with the HSBC Group – which I believe to be substantial.

\textsuperscript{1276} 2010 HSBC KYC Profile of Al Rajhi Bank, at 11-12. HSBC KYC profiles are evolving documents that retain past information stretching back multiple years.
\textsuperscript{1277} 11/14/2006 email from HSBC Christopher Lok to HBUS Beth Fisher, “KYC Approval needed for: Al Rajhi Banking & Investment Corp,” HSBC OCC 32795859-590.
\textsuperscript{1278} 11/14/2006 email from HBUS Beth Fisher to HSBC Christopher Lok and HBUS Alan Ketley, “KYC Approval needed for: Al Rajhi Banking & Investment Corp,” HSBC OCC 32795859.
\textsuperscript{1279} 11/14/2006 email from HBUS Alan Ketley to HBUS Beth Fisher, “KYC Approval needed for: Al Rajhi Banking & Investment Corp,” HSBC OCC 32795859.
Their main point of contention is that they feel that they were exonerated by all US legal processes from TF [Terrorist Financing] suspicion some time ago and yet we have still not been able to restart trading with them. Gordon [Brown] finished our latest attempt at the profit on Tuesday and you will find the kyc profile to be currently in the ‘IB Pending’ inbox. Could I please ask you both to expedite your reviews so that we can attempt to prevent the loss of an important client to the Group?1280

Later in the day, Mr. Allen forwarded to Ms. Fisher and Mr. Ketley an email that had been sent by Mr. Hussain after he met with the bank in Riyadh, Saudi Arabia. Mr. Hussain had sent the email to Mr. Allen and other colleagues, informing them that Cassim Docrat, an Al Rajhi Bank representative, had told him that if the U.S. banknotes business wasn’t reestablished by the end of November, Al Rajhi Bank would “cancel any business dealings with HSBC.”1281 His email also stated that the bank had indicated it had been able to procure a large line of credit from one of HSBC’s competitors, JPMorganChase. Mr. Hussain wrote:

“I can’t stress on the fact that we do want to do business with this institution from PCM [Payments and Cash Management] side. We do stand a good chance to win a US$ clearing account thru offering Islamic Overnight Investment Product and the US$ checking clearing thru Check 21.”1282

Mr. Allen also sent a copy of Mr. Hussain’s email to Mr. Lok, commenting: “As ever, we are taking an inordinate amount of time to make our minds up. I discussed this client with Terry [Pesce], Linda [Cassell] and Alan [Ketley] when I visited in February, we eventually received and have now answered a rate of supplementary questions from Linda and now that she has left, no doubt there will be more questions from Alan!”1283 Mr. Lok responded:

“I would tell Salman that he should relay the ‘concern’ Alrajhi has expressed to the higher ups. To cancel the Amanah business is much bigger than not dealing with banknotes. Hopefully

1281 11/17/2006 email from Salman Hussain to David Illing, Gordon Brown, Stephen Allen and others, “Al Rajhi Bank KYC & AML Policy,” HSBC OCC 3280496-497. Mr. Salman was meeting with the bank, because HSBC Bank Middle East had never ceased doing business with it.
1283 Id.
somebody in London will listen and given NYK [New York] Compliance a gentle push.”

That afternoon, Ms. Fisher sent an email to Mr. Allen declining to approve the new Al Rajhi Bank client profile:

“I am not trying to be difficult, but do not personally feel comfortable [being the] IB [institutional banker] approving this name. I do not know this bank. Additionally, several years ago, when HBUS had relationships with 2 different Al Rajhi names, management would ask me questions about the customer every time the name appeared in the US newspapers. I do not know this bank personally and therefore not qualified to render an opinion. … Therefore, please ask another officer to IB approve. I am IB-Denied the KYC, so that my name can be removed as RM [relationship manager].”

Mr. Allen responded: “I quite understand your position and I will try another tack.”

After receiving her refusal to approve the Al Rajhi Bank profile, Mr. Allen forwarded it to Mr. Lok and asked: “[W]ho do you suggest can/will sign this profile? You will see that it is pressing – perhaps David [Wilens] could IS and you could IB approve if Susan [Wright] and I sign it again?” Mr. Lok responded: “At the end of the day, its compliance who’s the key. I’ll speak to Ketley & ask him to re-evaluate this name.” Mr. Lok also sent an email to Mr. Allen informing him: “Just spoke to Alan [Ketley]. He’s going to read the whole file … and he’s aware of the ‘threat’ you passed along. His view is Alrajhi may not really walk away if we can’t revert by November end, which I agree. … We should have an answer in the next few weeks.”

Over the next few days, Mr. Ketley reviewed Al Rajhi Bank’s AML policies and procedures. He also asked Mr. Hussain: “What revenue projections do you have associated with the US$ clearing and Check 21 ‘cash letter’ services that could be provided by HBUS to Al

[1285] Id.
[1288] 11/17/2006 email from HSBC Stephen Allen to HSBC Christopher Lok and David Wilens, “Al Rajhi Banking,” OCC-PSI-00150795. In a Subcommittee interview, Mr. Lok explained that he retained the authority to act as the institutional banker for a client and so could approve a client profile. Subcommittee interview of Christopher Lok (3/29/2012). David Wilens was the chief operating officer of the London Banknotes office and later became chief operating officer for the entire HBUS Banknotes Department. See Nov. 2006 HBUS organizational chart, OCC-PSI-00000301, at 505.
Mr. Hussain responded: “Estimated revenue will be a minimum of $100k per annum.”

Emma Lawson, in AML Compliance at HSBC Group Headquarters, also sent an email to Mr. Ketley asking, “Has progress been made.” Mr. Ketley responded:

“Your timing is uncanny and I suspect not entirely unrelated to correspondence last week from Banknotes and PCM. I have reviewed the new documentation provided by the client and discussed it with Terry [Pesce] – she has indicated a desire to discuss with David. Will keep you posted.”

A later email indicated that Ms. Pesce also raised the matter with “the Bank’s executive management.”

On December 1, 2006, Mr. Ketley sent an email to Mr. Allen and Salman Hussain, with copies to Ms. Pesce and Mr. Lok, indicating he would approve re-opening the banknotes account with Al Rajhi Bank:

“[T]he purpose of this note is to confirm to you the willingness of HBUS to recommence a relationship with Al Rajhi Bank. ...

[I] am satisfied that we can do business with this entity as long as our due diligence is thoroughly documented and close transaction monitoring takes place by Compliance along with a high degree of transaction awareness being maintained by the business. Over a period of years there has been much negative publicity associated with the principals of this entity – while none of these allegations has been proven or substantiated, the notion of ‘no smoke without fire’ is one we must bear in mind and any business unit dealing with this entity must acknowledge the associated risks. ... [T]o paraphrase an expression from English Banking, if it is in my hand and in order I will approve it.”

1293 Id. Teresa Pesce, then HBUS AML head, told the Subcommittee that she didn’t recall any specific pressure exerted by HSBC Group with regard to the Al Rajhi Bank relationship, but she knew that HSBC Group was interested in maintaining it. Subcommittee interview of Teresa Pesce (3/30/2012).
1294 6/3/2008 email from HBUS Denise Reilly to HBUS Alan Williamson, Daniel Jack, Anne Liddy and others, “Banknotes with Al RajhiI Banking in S.A.,” HSBC OCC 1638575. Ms. Pesce told the Subcommittee that the United States initially raised the idea of exiting the Al Rajhi relationship. She said she may have raised it with Susan Wright, David Bagley, and “the board.” Subcommittee interview of Teresa Pesce (3/30/2012).
1295 12/1/2006 email from HBUS Alan Ketley to HBUS Stephen Allen, HSBC Salman Hussain, and others, “Al Rajhi Bank,” OCC-P51-00150892. Ms. Pesce told the Subcommittee that a court dismissal of claims against the bank was the single most important reason that she decided to re-open the relationship. Both Mr. Ketley and Ms. Pesce stated that they did due diligence on Al Rajhi Bank, and both thought that the risk could be managed and that they made sure the
Mr. Ketley also placed several conditions on the approval of the client profile, noting that his approval extended only to banknotes transactions and not to cash letter transactions. He also stated that the bank could engage in wire transfers, but "I cannot support paper activity with the degree of close monitoring that would be appropriate."  

Mr. Ketley noted that Christopher Lok, head of Global Banknotes, would act as the “relationship owner” of the account in place of Beth Fisher, and would "approve the profile if he is satisfied with it."  

Mr. Ketley announced the decision to reopen the Al Rajhi Bank account despite, in the words of the 2006 client profile, a “multitude of allegations … implementing [Al-Rajhi] in a gamut of highly adverse activities ranging from money laundering to terrorist financing.” The decision was also made despite the refusal of the prior Al Rajhi Bank relationship manager, Beth Fisher, to approve the profile, and immediately after HSBC learned that the outside KYC database it relied on for due diligence, World Check, had identified Al Rajhi Bank’s most senior official as linked to terrorism. The decision also came one year after a 2005 U.S. indictment provided a concrete example of Al Rajhi Bank’s alleged link to terrorism, disclosing how senior officials from al-Haramain Foundation Inc. had cashed $130,000 in U.S. travelers cheques at Al Rajhi Bank in Saudi Arabia and then smuggled the money to violent extremists in Chechnya.

The 2006 client profile focused on the fact that no country had indicted, issued a terrorist-related designation, or sanctioned Al Rajhi Bank or its owners, even though that was also true in 2005, when the original decision to close the account was made. The internal HSBC emails indicate that two other major factors in the decision to restore the account were the threat made by Al Rajhi Bank to withdraw its business, and the promise of new revenue exceeding $100,000 per year.

H. 2007 to 2010: Additional Troubling Information

The HBUS Banknotes account for Al Rajhi Bank was formally reestablished on December 4, 2006. Once the account was reinstated, HBUS London Banknotes began supplying an estimated

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1296 12/1/2006 email from HBUS Alan Ketley to HBUS Stephen Allen, HSBC Salman Hussain, and others, “Al Rajhi Bank,” OCC-PFI-00150892. Ms. Pesce confirmed to the Subcommittee that the HBUS relationship with Al Rajhi Bank was limited to a banlmotes relationship. Subcommittee interview of Teresa Pesce (3/30/12).


1299 See 2010 HSBC KYC Profile of Al Rajhi Bank, at 13.
average of $25 million in physical U.S. dollars per month to Al Rajhi Bank in Saudi Arabia.\textsuperscript{1300} HBUS informed the Subcommittee that over the next four years Al Rajhi Bank purchased nearly $1 billion in U.S. dollars from HBUS, while selling back less than $10 million. The annual totals are as follows.

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<tr>
<th>Year</th>
<th>U.S. Dollars Sold to Al Rajhi Bank</th>
<th>U.S. Dollars Purchased from Al Rajhi Bank</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>2007</td>
<td>$123 million</td>
<td>$8 million</td>
</tr>
<tr>
<td>2008</td>
<td>$202 million</td>
<td>$0</td>
</tr>
<tr>
<td>2009</td>
<td>$369 million</td>
<td>$0</td>
</tr>
<tr>
<td>2010</td>
<td>$283 million</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Grand total: $977 million</td>
<td>$8 million</td>
</tr>
</tbody>
</table>

During that time period, troubling information about Saudi Arabia in general and Al Rajhi Bank in particular continued to circulate, but neither HSBC nor HBUS engaged in another round of internal deliberations over whether to maintain the account. Instead, HBUS’s Hong Kong branch opened a new line of banknotes trading with Al Rajhi Bank.

In July 2007, the \textit{Wall Street Journal} published two lengthy articles by reporter Glenn Simpson examining Al Rhaji Bank’s links to terrorism.\textsuperscript{1302} The first article disclosed the existence of the 2003 CIA report, “Al Rajhi Bank: Conduit for Extremist Finance,” and quoted its statement that “[s]enior al-Rajhi family members have long supported Islamic extremists and probably know that terrorists use their bank.” The article repeated the information that the name of the bank’s most senior official, Sulaiman bin Abdul Aziz Al Rajhi, had appeared on al Qaeda’s list of 20 early financial benefactors.\textsuperscript{1303} After the first article was published, HBUS’ primary U.S. regulator, the OCC, asked HBUS to respond to its allegations.\textsuperscript{1304}

Also in 2007, reports by the U.S. Department of State\textsuperscript{1305} and the Congressional Research Service\textsuperscript{1306} stated that Saudi Arabia continued to...

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\textsuperscript{1301} Subcommittee briefing by HSBC legal counsel (7/9/2012).
be a source of financing for Al Qaeda and other terrorist organizations, and expressed particular concern about the use of cash couriers to deliver funds outside of the country. In September, on the sixth anniversary of the 9/11 attack, Treasury Under Secretary Levey said in a televised interview on terrorist financing: "If I could somehow snap my fingers and cut off the funding from one country, it would be Saudi Arabia." In August 2007, Congress enacted legislation expressing concern about Saudi Arabia's uneven role in terrorist financing.

In April 2008, Treasury Under Secretary Levey testified that, while Saudi Arabia had taken strong action against terrorists operating within its borders and was cooperating with the United States on an operational level, it was not working as hard to prevent funds from flowing to terrorists outside of its borders: "Saudi Arabia today remains the location from which more money is going to terror groups and the Taliban – Sunni terror groups and the Taliban – than from any other place in the world."

The 2009 GAO report prepared for Congress stated: “U.S. officials remain concerned about the ability of Saudi individuals and multilateral charitable organizations, as well as other individuals visiting Saudi Arabia, to support terrorism and violent extremism outside of Saudi Arabia.” Also in 2009, HBUS received an inquiry from the IRS Criminal Investigation Division asking for contact information for the U.S. agent that receives service of process in the United States on behalf of Al Rajhi Bank. In response, HBUS AML compliance officer Daniel Jack reviewed the bank's account activity for the prior 12 months. He wrote:

“This bank (an SCC) had a long-standing relationship (25+ years) with Banknotes-London until we closed the account in Feb-05 due to TF [Terrorist Financing] & reputational risk. With approval from AML (A. Ketley), London re-opened the BN [Banknotes] account in Dec-06 with SCC classification due to PEP. This client still has relationships with HSBC in the UK, UAE, France, Hong

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Kong and Italy. ... Following is a listing of all traders’ explanations provided for alerts over the past 7+ years.\textsuperscript{1312}

His analysis disclosed that, over the prior 12 months, HBUS had provided Al Rajhi Bank with over $200 million in U.S. dollars.\textsuperscript{1313}

In 2010, the al Haramain Foundation trial got underway related to the cashing of $130,000 in travelers cheques at Al Rajhi Bank in Saudi Arabia to help violent extremists in Chechnya. Prior to the trial, the United States served a subpoena on Al Rajhi Bank to obtain authenticated bank documents for use in the trial, but the bank refused to produce the documents and moved to quash the subpoena,\textsuperscript{1314} leading to “negative news articles,” in the words of the 2010 KYC client profile prepared by HBUS for Al Rajhi Bank.\textsuperscript{1315} The trial court denied the bank’s motion,\textsuperscript{1316} and the case was later closed as “moot.”\textsuperscript{1317}

One other 2010 development was action taken by an Al Rajhi related money exchange, Tahweel Al Rajhi, to join with the largest bank in Pakistan, Habib Bank Ltd., to initiate a new funds transfer product called “HBL Fast Cash.” The new product was designed to allow the instant transfer of funds from Riyadh, Saudi Arabia, to any Habib branch in Pakistan, whether or not the sender or recipient of the funds had an account at either financial institution. According to one media report, Hazem Elhagrasey, the head of Tahweel Al Rajhi, said: “The new service will assure that the beneficiaries will receive payments in cash within minutes in Pakistan.”\textsuperscript{1318} Tariq Matin Khan, Habib Bank’s general manager for financial institutions and international banking, said: “The remitters can benefit from the huge HBL network to send money to any nook or corner of Pakistan.”\textsuperscript{1319} The Subcommittee intended to ask Al Rajhi Bank about AML safeguards to prevent misuse of this new transfer mechanism, but the bank declined to provide any information in response to the Subcommittee’s inquiry. It is unclear whether Tahweel Al Rajhi has an account at Al Rajhi Bank.

\textsuperscript{1312} Id.
\textsuperscript{1313} Id.
\textsuperscript{1314} See Al Rajhi Banking & Investment Corp. v. Holder, Case No. 1:10-MC-00055-ESH (USDC OR 1/19/10).
\textsuperscript{1315} 2010 HBUS KYC Profile of Al Rajhi Bank, at 6. See also 12/6/2011 HSBC AMLID Case #454 for Al Rajhi Bank, HSBC-PRI-P4002-0108/40-142.
\textsuperscript{1316} United States v. Sedaghaty, (USDC D OR), 2010 U.S.Dist.LEXIS 144171, Order (1/12/2010).
\textsuperscript{1317} See Al Rajhi Banking & Investment Corp. v. Holder, Case No. 1:10-MC-00055-ESH, Order Dismissing Action As Moot (3/2/2010).
\textsuperscript{1319} Id.
Meanwhile, from 2007 to 2010, HBUS continued to supply, through its London branch, hundreds of millions of U.S. dollars to Al Rajhi Bank in Saudi Arabia. In addition, at Al Rajhi Bank’s request, HBUS expanded the relationship in January 2009, by authorizing its Hong Kong branch to supply Al Rajhi Bank with non-U.S. currencies, including the Thai bat, Indian rupee, and Hong Kong dollar. At the time, Gloria Strazza, a senior official in HBUS’s Financial Intelligence Group, observed: “There was (and may be in the future) a fair amount of press and government attention focused on this entity. I am not sure we would want to engage in even this limited activity for this entity but I forward some of the intelligence from our files on this bank.” Mr. Lok responded: “This is an on-going debate that will never go away. My stance remains the same, i.e. until it’s proved we cannot simply rely on the Wall Street Journal[s] reports and unconfirmed allegations and ‘punish’ the client.” In a later email, Mr. Lok commented: “LON [London Banknotes office] already has a relationship with Alrajhi. Adding HKG [Hong Kong Banknotes office] won’t change Alrajhi’s profile.” AML compliance officer Daniel Jack offered this comment to his fellow compliance officer, Alan Williamson, regarding the account: “I believe the business owns the customer and the risk. . . . I don’t think you should CO [Compliance Office] deny – or even hesitate now – on this for HK [Hong Kong], despite the negative info on TF [Terrorist Financing] & Rep[putational] risk, which is not new (e.g. WSJ in Jul-07, EDD in Dec-07). I understand why Denise/Anne/Gloria are not comfortable, but I respectfully do not think it is their decision to terminate the relationship (again).” HBUS decided to open the Hong

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1321 6/3/2008 exchange of emails among HBUS Gloria Strazza, Daniel Jack, Christopher Lok, Stephen Allen, and others, “Banknotes with Al Rajhi Banking in S.A.,” HSBC OCC 0732065-006. AML compliance officer Daniel Jack forwarded her email to Mr. Lok, Mr. Allen, and others, noting “there is still some concern in AML/ICRO regarding TF [Terrorist Financing] & reputational risk in dealing with [Al Rajhi],” and asked for an email to “address the negative info, risk analysis and appropriateness of mitigants, and your support for maintaining the HBUS relationship.” Id. 

1322 Id. 

1323 7/18/2008 email from HBUS Christopher Lok to HBUS Alan Williamson and others, “Banknotes with Al Rajhi Banking in S.A.,” HSBC OCC 0769298. 

Kong account,\(^{1325}\) providing Al Rajhi Bank on average another $4.6 million per month in non-U.S. currencies.\(^{1326}\)

HBUS Banknotes finally ceased doing business with Al Rajhi Bank when, in September 2010, HSBC made a global decision to exit the U.S. banknotes business, one week after the OCC sent a lengthy Supervisory Letter to the bank criticizing its AML program, including with respect to its handling of banknotes.\(^{1327}\)

I. Servicing Other Banks with Suspected Links to Terrorism

Al Rajhi Bank was not the only bank with suspected links to terrorist financing serviced by HSBC. Two others were Islami Bank Bangladesh Ltd. and Social Islami Bank Ltd. Both banks cooperated with the Subcommittee’s inquiries.

(1) Islami Bank Bangladesh Ltd.

Islami Bank Bangladesh Ltd. opened its doors in 1983, designed its operations to be in conformance with Islamic requirements, and has grown to become one of the largest private banks in Bangladesh, which is one of the most densely populated countries in the world.\(^{1328}\) It provides a wide variety of individual and commercial banking services.\(^{1329}\) Several of the bank’s most senior officials were politically important figures within the country or in Saudi Arabia, leading to their designations as Politically Exposed Persons in the World Check database.\(^{1330}\) According to Islami Bank Bangladesh, it has an extensive network of more than 600 correspondent accounts.\(^{1331}\)

\(^{1325}\) In July 2008, Mr. Williamson approved the new account and wrote to Mr. Lok, “You’re in business now.” 7/18/2008 email exchange between Alan Williamson, Christopher Lok, and others, “Banknotes with Al Rajhi Banking in S.A.,” HSBC OCC 0761014.

\(^{1326}\) See HBUS Hong Kong office KYC Customer Profile for Al Rajhi Bank, HSBC-PSI-PROD-0102304-306, at 2.

\(^{1327}\) See 9/20/2010 “HSBC to Exit Asian Banknotes Business,” HSBC Holdings plc Announcement, http://www.hsbc.com/IIPA_esf-ca-app-content/content/assets/investor_relations/sea/2010/sea_100920_wholesale_banknotes_en.pdf. See also 2010 HBUS KYC Profile on Al Rajhi Bank, at 1 (showing account deactivated on 10/14/2010); 2010 HBUS Hong Kong office KYC Profile on Al Rajhi Bank, HSBC-PSI-PROD-0102304-306, at 1 (showing Hong Kong account deactivated on 10/29/2010). In addition, in October 2010, both the OCC and Federal Reserve issued Cease and Desist Orders to HBUS and its parent holding company, HNAH, to require them to revamp their AML programs.


\(^{1330}\) See 1/19/2005 HSBC FIG report on Islami Bank Ltd.-Bangladesh, HSBC OCC 3241695, 7/4/2012 email from Islami Bank Bangladesh Ltd. to Subcommittee, PSI-IBBL-01-0001.
Islami Bank Bangladesh applied to open accounts with HSBC in 2000, and currently has correspondent accounts with HSBC in 24 locations around the world. According to the bank, it opened a U.S. dollar account with HBUS in 2000, and U.S. dollar clearing accounts with HSBC India and HSBC Pakistan in 2006. In 2007, the HBUS branch in Singapore also sought approval to open an account for the bank to supply it with physical U.S. dollars, cash U.S. dollar monetary instruments such as travelers cheques and money orders, process U.S. dollar wire transfers, and provide other services.

Opening 2007 HBUS Account. Documents show that proposals to open the 2007 HBUS account for Islami Bank immediately raised AML concerns within HBUS AML Compliance, not only because the bank was located in a country ranked by HSBC as at “high risk” of money laundering and ranked by Transparency International as one of the most corrupt country in the world, but also because members of the Al Rajhi group held a 37% direct ownership interest in the bank.

In the fall of 2007, Kwok Ying Fung at the HBUS office in Singapore asked Beth Fisher at HBUS AML Compliance to approve Islami Bank’s KYC profile, but she declined without explaining why. On October 24, 2007, after receiving her response, he asked HBUS AML Compliance to suggest someone else to approve opening the account. Angela Cassell-Bush suggested that he “reach out to Chris Lok to see if he is willing to be the RM [Relationship Manager] Approver.” Ms. Fisher warned her colleagues that, given the connection between the Bangladeshi bank and Al Rajhi Bank, “[t]his is not just an RM issue. This is a KYC due diligence issue.”

On November 6, 2007, Mr. Fung asked Mr. Lok, head of HSBC Global Banknotes and located in HBUS offices in New York, if he would consider serving as the “RM [Relationship Manager] approver” of the Islami Bank KYC profile, so that the bank could become a “shared
client of HBUS Banknotes and HBUS Payments and Cash Management (PCM). On November 8, 2007, Mr. Lok responded that his interest in considering a new account depended upon whether there was enough potential revenue to make the effort of vetting Al Rajhi worth it:

"First, I'm happy to be the RM [Relationship Manager] if this is an account worth chasing. How much money can you expect to make from this name? If this can be answered positively then I will ask PCM to check out the ... alrajhi connection. ... The name Alrajih has been a name heatedly debated for many years. We terminated our trading relationship following 9/11 and only a year ago after London Compliance came back telling NYK the group is happy to let us resurrect the relationship that we went back. ... Not saying just because of this connection we won't do business. If it's just that if the revenue is there then we're prepared for a good fight."1341

Mr. Lok's email suggests that he expected from the outset that HBUS AML Compliance would resist opening an account for Islami Bank and it would take a “fight” to open the account.

Later the same day, Benjamin Saram of HBUS Singapore emailed Mr. Lok and others with information about the likely revenues if an account were opened for Islami Bank. He wrote that, because approximately 60,000 Bangladeshis traveled to Saudi Arabia each year on religious pilgrimages and would require about $1,000 to $3,000 each, “we’re therefore looking at about USD 60 mio [million] of currency needs on an annual basis.”1342 He noted that, in 2006, HBUS Banknotes had netted about $47,000 in profits in Bangladesh, and expected a 53% increase in 2007, to about $75,000, explaining, “[w]e are a monopoly here, and margins are decent.”1343 Mr. Saram estimated that, if an account were opened for Islami Bank, the “net profit would be approximately USD 75,000/ year.”

Mr. Lok responded: “One, the money is there and we should go for this account. Two, I will jump in and wear the GRM [Global Relationship Manager] hat. ... I believe we should be able to get the KYC sign off.”1344 He also asked HBUS AML Compliance to look into the possible connection between Islami Bank and Al Rajhi Bank.

1343 Id.
1344 Id.
The next day, November 9, 2007, HBUS AML compliance officer Angela Cassell-Bush confirmed a direct link between the two banks:

“[P]lease note that there is a connection between ISLAMI BANK BANGLADESH LIMITED-Bangladesh and Al-Rajhi Bank .... Based on the information we have on file, the Al - Rajhi family has been associated with Islami Bank Bangladesh Limited, since its inception. They have at least 37% direct ownership ... through their ownership within the following companies: Arabsas Travel & Tourist Agency, 9.999%; Janab Yousif Abdullah Abdul Aziz Al-Rajhi, 9.936%; Al-Rajhi Company for Industry & Trade, 9.94%; Abdullah Abdul Aziz Al-Rajhi, 7.58%. This same family has major controlling interest within Al-Rajhi bank.”

Troubling Information. HBUS’ Singapore branch actually opened the account for Islami Bank in December 2007. Mr. Lok and others approved the account, despite ongoing questions about its primary shareholder, Al Rajhi Bank, whose past links to terrorist financing had received additional attention in the media during the summer of 2007. HBUS also approved the account despite troubling information about Islami Bank itself.

The troubling information about Islami Bank was contained in an internal report that had been prepared less than a year earlier by HSBC’s Financial Intelligence Group (FIG). The May 2006 FIG report disclosed that, in March 2006, “Abdur Rahman, chief of the Jamaatul Mujahideen of Bangladesh (JMB), and his second-in-command, Bangla Bhai, were arrested for being responsible for the terrorist bomb blasts of August 17, 2005 in Bangladesh.” The FIG report noted that Mr. Rahman had been found to have an account at Islami Bank.

1345 11/9/2007 email from HBUS Angela Cassell-Bush to HBUS Christopher Lok and others, “Islami Bank Bangladesh Limited-Bangladesh,” OCC-PSI-00154139, at 1. Mr. Lok asked Ms. Cassell-Bush to doublecheck one of the shareholders, Abdullah Abdul Aziz Al-Rajhi, who was listed as holding 7.58% of the shares, suggesting that the wrong company may have been identified as the shareholder. A later email suggested that the shareholding company was not a member of the Al Rajhi group. See November and December 2007 exchange of emails among HBUS Christopher Lok, Angela Cassell-Bush, Muhammad Shohiduzzaman, and others, “Islami Bank Bangladesh Limited-Bangladesh,” HSBC OCC 0741466-469. Later KYC profiles for the bank indicate, however, that the shares were, in fact, held through a company that was part of the Al Rajhi group. See, e.g., 2012 HBUS KYC Profile of Islami Bank, at 7. Islami Bank Bangladesh Ltd. has confirmed to the Subcommittee that Abdullah Abdul Aziz Al Rajhi has been both a shareholder and director of the bank. 7/4/2012 email from Islami Bank Bangladesh Ltd. to Subcommittee, PSI-IBBL-01-0001.

1346 See 2012 HBUS KYC Profile of Islami Bank, at 15.


1348 Id. at 694.

1349 Id. Islami Bank Bangladesh Ltd. told the Subcommittee, however, that it has never had an account for Abdur Rahman. 7/4/2012 email from Islami Bank Bangladesh Ltd. to Subcommittee, PSI-IBBL-01-0001.
The FIG report also disclosed that an investigation by the Central Bank of Bangladesh found that two branches of Islami Bank had been engaged in “suspicious transactions” and urged the bank to take action against 20 bank employees, including for failing to report the suspicious transactions. According to the FIG report, in response, Islami Bank reportedly suspended five officers and warned 15 others. The FIG report stated that Bangladeshi news articles had observed it was the third time Islami Bank had been fined by the Central Bank “for covering up militants’ transactions.”

Islami Bank’s KYC profile repeated this information and indicated that the HSBC Global Relationship Manager had visited the bank to ask about the matter, and was told that the incident did not involve terrorist financing. The Global Relationship Manager advised against taking any further action, attributing the AML failures to the bank’s unsophisticated technology platform. Neither the KYC profile nor the FIG report indicate whether any steps were taken to verify the bank’s explanation of the incident with the Central Bank. The KYC profile noted that, in 2006, FIG recommended classifying Islami Bank as a “Special Category Client,” or SCC, HSBC’s designation for its highest risk clients, but that recommendation was rejected, which meant HSBC did not subject the bank to any enhanced monitoring.

2009 Information on IIRO Accounts. The HBUS account was opened near the end of 2007. About 18 months later, in May 2009, a FIG due diligence report prepared for another Bangladeshi bank with which HBUS did business, Social Islami Bank, discussed below, disclosed new information relevant to Islami Bank. This information related to the International Islamic Relief Organization (IIRO), a Saudi nonprofit organization which, in 2006, had two of its branches and a high ranking IIRO official designated by the United States as terrorist financiers and added to the list of entities with which U.S. persons are prohibited from doing business.
The 2009 FIG report stated that the IIRO had accounts at both Social Islami Bank and Islami Bank. It quoted a 2008 local press article saying that, in response to the action taken by the United States in 2006, Islami Bank had frozen its IIRO accounts. The FIG report did not indicate when the accounts were first opened, what actions had been taken beyond freezing them, or how much money was involved. In 2010, an HBUS KYC profile for Social Islami Bank referenced a letter from the Bangladeshi Central Bank, dated June 30, 2010, indicating that IIRO had accounts at three Bangladeshi banks, including Islami Bank, which needed to be closed.

Islami Bank Bangladesh confirmed to the Subcommittee that IIRO had two accounts at the bank which opened in 1993 and 1994, when IIRO was a nongovernmental organization in good standing. It stated that after the IIRO was added to a United Nations sanctions list in 2006, it froze the accounts and reported them to the Bangladeshi Central Bank. In 2010, according to the bank, it received an “instruction from the Central Bank at the direction of [the] Ministry of Finance” to unfreeze the accounts and “transfer the accounts” to a government owned bank, BASIC Bank, which it did.

Despite the 2008 published article, the information in the two internal HBUS documents related to Social Islami Bank, and Islami Bank Bangladesh’s willingness to discuss the accounts, no information about the IIRO accounts appeared in the HBUS KYC profile for Islami Bank. While the IIRO accounts at Social Islami Bank were the focus of extensive discussions in emails and other documents by HBUS AML Compliance personnel and HBUS bankers working in Bangladesh, no similar discussions appear in any of the HBUS documents related to Islami Bank.

In September 2009, the Islami Bank KYC profile indicates that an unnamed HSBC employee requested a new enhanced due diligence report on the bank. HBUS Compliance denied the request, indicating an update “is NOT needed at this time.”

2010 SCC Designation. In February 2010, HBUS AML Compliance personnel reviewed the Islami Bank account and

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1358 Id.
1359 2012 HBUS KYC Profile of Social Islami Bank, at 4 (“The 3 bank accounts of IIRO namely i) Social Islami Bank Ltd. ii) Islami Bank Bangladesh Ltd. iii) Al-Falah Islami Bank Ltd. must be disposed off [sic] and transferred”).
1360 7/4/2012 email from Islami Bank Bangladesh Ltd. to Subcommittee, PSI-IBBL-01-0001-003, at 003.
1361 Id.
1362 2012 HBUS KYC Profile of Islami Bank, at 2.
1363 Id.
recommended that the bank be designated an SCC client.\textsuperscript{1364} One key reason given for the proposed SCC designation was Islami Bank's links to the Al Rajhi group, noting that the Vice Chairman of the bank and 10% owner was Yousif Abdullah Al Rajhi, that Al Rajhi interests held about a third of the bank's shares, and Al Rajhi itself had links to terrorist financing.\textsuperscript{1365} Another reason given was the information provided in the 2006 FIG report, that the Bangladeshi Central Bank had issued a "notice of cause" to Islami Bank "to explain accounts owned by suspected Islamic Militants," and reportedly fined the bank for the third time "for covering up militants' transactions."\textsuperscript{1366} No mention was made of the IIRO accounts. Contrary to the outcome in 2006, in 2010, HSBC designated Islami Bank as an SCC client.\textsuperscript{1367}

Later in 2010, an OCC AML examiner reviewing emails related to Islami Bank characterized the information provided about the bank as depicting "extreme circumstances," and recommended that the account be reviewed as part of a larger AML "look back" effort at HSBC.\textsuperscript{1368} In 2011, HSBC engaged in an extensive discussion with Islami Bank regarding its AML policies and procedures, also noting in its KYC profile that the bank acted as a "payout agent" for 53 money exchange businesses across the Middle East.\textsuperscript{1369}

Today, although HSBC exited the U.S. banknotes business in 2010, Islami Bank Bangladesh remains a customer of two dozen HSBC affiliates, including HBUS PCM, which continues to provide Islami Bank with access to U.S. dollars, U.S. wire transfers, and U.S. payment systems.\textsuperscript{1370}

\textbf{(2) Social Islami Bank Ltd.}

A third bank serviced by HSBC despite suspected links to terrorist financing is Social Islami Bank Ltd.

Social Islami Bank Ltd. was founded in 1995, changed its name from Social Investment Bank Ltd. in 2009, and is located in Bangladesh.\textsuperscript{1371} It operates 76 branches throughout the country and provides a variety of individual and commercial banking services, including deposits, loans, investment advice, commercial financing, foreign exchange, and wire transfers. It operates in conformance with

\begin{footnotes}
\item[1365] Id.
\item[1366] Id.
\item[1367] Id. See also 2012 HBUS KYC Profile of Islami Bank, at 3.
\item[1369] 2012 HBUS KYC Profile of Islami Bank, at 3-4.
\item[1370] 2012 HBUS KYC Profile of Islami Bank, at 2, 7.
\end{footnotes}
Islamic requirements and is publicly traded on Bangladeshi stock exchanges. Its headquarters are in Dhaka, the capital of Bangladesh, one of the world’s largest cities with a population of 16 million.

Until May 2012, HSBC was one of the bank’s major correspondents, providing it with services in multiple countries. HSBC also has an affiliate located in Dhaka. That affiliate, HSBC Bank Asia Pacific (HBAP) Dhaka, introduced Social Islami Bank to HBUS. In 2003, HBUS Payments and Cash Management (PCM) sought to open an account for Social Islami Bank, providing it with U.S. dollar wire transfer and clearing services.

Opening of HBUS Account. When HBUS first sought to open the account in 2003, it asked for an enhanced due diligence report on the bank from the HSBC Financial Intelligence Group (FIG). In addition to noting that Bangladesh was a high risk country due to its reputation for corruption, the resulting FIG report contained adverse information about some of the bank’s owners and officials. Most serious were allegations that two shareholders, the International Islamic Relief Organization (IIRO) and the Islamic Charitable Society Lajnat al-Birr Al Islam (Lajnat al-Birr), had links to terrorism. IIRO then held 8.62% of the total outstanding shares, and was the bank’s largest single shareholder, while Lajnat al-Birr held 1.54%.

The 2003 FIG report stated the following with regard to the two shareholders:

“IIRO is a Saudi-Arabian charity. ... The IIRO was named in the 2002 lawsuit brought forward on behalf of family members of victims of the September 11, 2001 terrorist attacks. The IIRO was accused of having ‘played key roles in laundering of funds to terrorist[s] for the 1998 African embassy bombings’ and having been involved in the ‘financing and aiding and abetting of terrorists in the 1993 World Trade Center bombing.’ The IIRO has also reportedly funded al-Qaeda directly as well as several of its satellite groups. Osama bin Laden’s brother-in-law, Mohammed Jamal Khalifa, headed the Philippine branch of the IIRO in the 1990’s. The Philippine government has charged that the group contributed to terrorist causes there. ...

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1374 Id. at 2, 14.
1376 Id. at 1-2.
Lajnat al-Birr Al Islamiah was established in 1987. It has been stated that Lajnat al-Birr Al Islamiah was the original name of the Benevolence International [F]oundation, and that it originally had offices in Saudi Arabia and Pakistan. According [to] the U.S. government, among the purposes of Lajnat was to ‘raise funds in Saudi Arabia to provide support to the Mujahadeen then fighting in Afghanistan,’ as well as to provide ‘cover for fighters to travel in and out of Pakistan and obtain immigration status.’ Benevolence International has been tied to terrorism and its director, Enaam Arnaout, was indicted in 2002 with conspiring to defraud his group’s donors by secretly providing financial and logistical help to al-Qaeda for a decade.”

The FIG report also contained negative information about the bank’s founder:

“Dr. M.A. Mannan was the chairman and founder of Social Investment Bank Ltd. He was fired in 2000 after fault was found with his banking procedure. It was alleged that he created an obstacle to the team of Bangladesh Bank [Bangladesh’s Central Bank] during their visit to Social Investment Bank Ltd. Additionally, he was accused of interfering with bank administrative work and with harassing a bank employee.”

The FIG report concluded:

“In conclusion, it is of significant concern that the leading shareholder of Social Investment Bank Ltd. (at 8.62%), International Islamic Relief Organization, has been accused in both the Philippines and in America of funding terrorist groups. The group is currently under investigation by the F.B.I. Another of the bank’s shareholders, Lajnat al-Birr Al Islam (at 1.54%) has also been connected to terrorist groups. Additionally, the bank’s founder and chairman was let go on allegations of interference and harassment. ... Finally, it is important to note that Social Investment Bank Ltd. is located in Bangladesh, which was ranked as the world’s most corrupt nation by Transparency International.”

The FIG report offered this cautious analysis about whether to open an account:

“Although the allegations presented in this report, primarily against the International Islamic Relief Organization (IIRO) and
the Lajnat al-Birr Al Islamiah, are highly adverse, no U.S. or foreign government law enforcement or regulatory body has stated unconditionally, that these organizations are under sanction. The reputational risk is significant, however, and the possibility that further investigations by U.S. authorities may ultimately uncover substantiating proof of a connection to terrorism. The risk of future sanctions and the reputational risk based on allegations noted in this report should be measured against the current risks involved in our relationship when ultimately deciding a course of action.\textsuperscript{1380}

While the 2003 FIG report provided significant adverse information about Social Islami Bank and noted that Lajnat al-Birr was the original name of the Benevolence International Foundation which "had been tied to terrorism," it failed to state that, in 2002, the United States had designated the Benevolence International Foundation as a "financier of terrorism" with whom U.S. persons are prohibited from doing business.\textsuperscript{1381} This additional terrorism-related designation meant that when HBUS was considering whether to open an account for Social Islami Bank in 2003, Social Islami Bank was partially owned by two organizations associated with terrorist financing.\textsuperscript{1382}

Despite its failure to provide that additional information, the 2003 FIG report provided significant negative information about Social Islami Bank and squarely raised the question of whether HBUS should be doing business with it, given the "highly adverse" allegations. Nevertheless, on October 14, 2003, HBUS AML Compliance approved Social Islami Bank as an HBUS PCM client.\textsuperscript{1383} In addition, despite the bank's location in a high risk country, the terrorist links uncovered in connection with two of its shareholders and a director, HBUS opened the account without designating the bank as an SCC client warranting additional monitoring and due diligence reviews. HBUS immediately began providing the bank with services that included clearing U.S. dollar

\textsuperscript{1380} Id. at 1.
\textsuperscript{1382} The 2003 FIG Report also failed to mention that Social Islami Bank had opened an account for Al Rajhi Commercial Foreign Exchange. That money exchange business was part of the Al Rajhi Group, whose U.S. business and charitable ventures were the subject of a 2002 law enforcement search to disrupt terrorist financing. The FIG may have been unaware of the account at that time, although a 2005 FIG report on Al Rajhi Commercial Foreign Exchange disclosed it. See 7/13/2005 HSBC Financial Intelligence Group (FIG) Report of Findings (Update) on Al Rajhi Commercial Foreign Exchange, HSBC OCC 2725167-168. In 2005, Al Rajhi Commercial Foreign Exchange and seven other businesses merged into Al Bilad Bank. Id. According to bank counsel, the Al Rajhi Commercial Foreign Exchange account closed in July 2002. Subcommittee briefing by HSBC legal counsel (6/27/2012).
\textsuperscript{1383} 2012 HBUS KYC Profile of Social Islami Bank, at 14.
monetary instruments and U.S. wire transfers. Those services produced revenues from Social Islami Bank totaling about $100,000 per year.\textsuperscript{1384}

\textbf{2005 Review.} Two years after the account was opened, as part of a broader HSBC effort to update its KYC client profiles in 2005, Social Islami Bank was the subject of a second enhanced due diligence review.\textsuperscript{1385} The resulting 2005 FIG report again identified IIRO, the bank’s largest shareholder, as linked to terrorism, noting that it was “alleged to have provided funding to terrorist groups such as Al Qaeda in the past,” and is “alleged to have acted as a cover for Al-Qaeda operations in the Philippines.”\textsuperscript{1386} The FIG report stated: “Based on the frequency with which the group is connected to terrorist financing in the press, it is likely that their activities will always be under scrutiny, and future government sanctions against the group are highly probable.”\textsuperscript{1387} The report also noted that Social Islami Bank did “not appear to have correspondent relationships with many of the other major global banking corporations.”\textsuperscript{1388} The FIG report “strongly recommend[ed]” that the account not be approved “until the matter is discussed with Senior Compliance Management.”\textsuperscript{1389}

Despite the concerns raised in the FIG report, HBUS retained Social Islami Bank as a client. At the same time, to address concerns about the account, HBUS AML Compliance required the HSBC CEO for Bangladesh to provide annual approval of the account for it to stay open.\textsuperscript{1390} Despite this requirement, the Subcommittee uncovered only one instance in which approval was granted, and when asked, HSBC was unable to provide any additional documentation.\textsuperscript{1391}

\textbf{2006 Terrorist Designation.} Eighteen months later, on August 3, 2006, the United States designated two branches of IIRO and a high ranking IIRO official as terrorist financiers and prohibited U.S. persons...

\textsuperscript{1384} Id. at 8.
\textsuperscript{1387} Id.
\textsuperscript{1388} Id.
\textsuperscript{1389} Id.
\textsuperscript{1390} Id. AML head Terri Pesce told the Subcommittee it was “unusual” to obtain CEO approval of an account. Subcommittee interview of Teresal Pesce (3/30/2012). See, e.g., 2012 HBUS KYC Profile of Islami Bank, at 14-15; 2/9/2010 email from HBUS Jon K. Jones to HBAP Sadique Reza and others, “Compliance Conditions: Social Islami Bank Ltd,” HSBC-PSI-PROD-0/02645.
\textsuperscript{1391} This approval was provided in April 2005 by Steve Banner, HSBC Bangladesh CEO. He wrote with regard to Social Investment Bank: “I have been in Bangladesh for only 2 months and have not yet met any of the executives from SIIBL. Based on my discussion with Shohid, however, I can see no reason why we should not continue the relationship as at present.” 4/15/2005 email from HSBC Steve Banner, HSBC PSI PROD 0102765. See also Subcommittee briefing by HSBC counsel (4/12/2012).
from transacting business with them. Treasury Under Secretary for Terrorism and Financial Intelligence Stuart Levey said: "We have long been concerned about these IIRO offices; we are now taking public action to sever this link in the al Qaida network’s funding chain."

In response, on the same day, HBUS AML Compliance placed a block on the Social Islami Bank account, so that no funds could be withdrawn. The email imposing the block noted that the Social Islami Bank brought in HBUS revenues totaling $44,000 per year.

The next day, August 4, 2006, the HSBC Financial Intelligence Group (FIG) issued an updated due diligence report on Social Islami Bank, containing significant adverse information about IIRO. Among other information, the FIG report noted that the World Check database relied on by HSBC for KYC information classified IIRO as associated with terrorism, linked it to providing assistance to al Qaeda and other terrorist organizations, and described it as "allegedly linked" to the 1993 World Trade Center bombing, "plots to assassinate Bill Clinton and the Pope," and "the planned destruction of the Lincoln Tunnel and Brooklyn Bridge."

Two days after that, on August 6, 2006, an HSBC institutional banker from HBAP Dhaka, Muhammad Shohiduzzaman, met with Social Islami Bank to discuss IIRO. He wrote to the HSBC CEO in charge of the operations in Bangladesh, Steven Banner, that Social Islami Bank had told him that IIRO "never took part in any activities" at the bank, "did not even take possession of the shares," and had never been a board member. Mr. Shohiduzzaman advised: "we are of the opinion that since IIRO is not involved in the operation of SIBL [Social Islami Bank Ltd.], there are no issues of concern locally. But since the matter has been raised by the US treasury, HBUS should take appropriate measure after careful examination of all the present and potential aspects." Mr. Banner wrote to Hersel Mehani, the HSBC sales person assigned to the account: "Based on the feedback from

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1394 K3/2006 email from HBUS Sharyn Malone to HBUS colleagues, HSBC-PSI-PROD-0102776 (IIRO holds a 8.62% stake in Social Investment Bank (SIB), Bangladesh who is a US PCM client of HBUS since Oct. 2003. Their value to US PCM is $44K annualized.).
1396 Id. at 3.
1398 Id.
1399 Id.
SIBL, IIRO’s role remains that of a minority shareholder that does not seek to engage in the management of the bank. We have no reason to disbelieve SIBL’s statements. There are therefore no grounds for me to recommend an account closure or account freeze.\footnote{8/6/2006 email from HBAP Steve Banner to HBAP Muhammad Shohiduzzaman, "Social Invst Bank Bangladesh," HSBC OCC 3260411.}

Mr. Banner continued:

“\[I appreciate, however, that HBUS may feel compelled to act firmly in the light of OFAC’s position. This is obviously a decision that rests with HBUS and I can confirm that we will not object to such action. That said, we would much prefer it if SIBL is allowed to withdraw the balances held with HBUS before you freeze or close the account. From our perspective there appears to be no justification for depriving SIBL of their funds and to do so would open HSBC to unwanted reputational damage / regulatory scrutiny locally.\]”\footnote{Id. See also 8/6/2006 email from HBAP Hersel Mehani to HBUS Alan Ketley, HSBC OCC 3260410.}

In essence, Mr. Banner asked for the account to be kept open but if it were frozen, to allow Social Islami Bank to pull its money first so that none of its funds would be affected.

Later that same day, August 6, 2006, HBUS AML Compliance officer Alan Ketley forwarded the email exchange to his AML Compliance colleagues, George Tsugranes and Andrew Rizkalla, and asked for their thoughts.\footnote{8/7/2006 email exchange among HBUS Alan Ketley, George Tsugranes, and Andrew Rizkalla, “Social Invest Bank Bangladesh,” HSBC OCC 3260409-410.} Both advised closing the account. Mr. Tsugranes wrote:

“\[Although the Philippine and Indonesia branch offices were cited, the Treasury action also cited Abd Al Hamid Sulaiman Al-Mujil who is a high ranking IIRO official. So although only the 2 branches were cited, having a top official in the organization mentioned should be cause for concern involving the IIRO. As this organization has a 9.0% stake and does not involve itself on the day to day operations or mgmt – who is to say that they won’t sooner or later start moving funds through this acct.\]”\footnote{Id.}

Mr. Rizkalla wrote:

“I remain firm to my first opinion, the account should be closed in an orderly fashion. We still don’t know if there is a nominee shareholder interest to IIRO, the U.S. Govt has designated IIRO
for supporting terrorism, so even the small shareholder ownership
entitles them to profits and dividends from Soc Invst Bank to
reinvest where??, ... Hersel says monitor the accounts for 6
months, will he be doing the monitoring??

Despite their advice to close the account, Mr. Ketley lifted the
block on the account four days after it was imposed and approved
keeping the account open:

“After reviewing the information provided by HSBC Dhaka my
provisional decision is that this relationship be allowed to continue.
It will need to be designated as an SCC Category 4 (reputational
risk) with immediate effect and will be subject to closer monitoring
as a result .... I am not willing to commit to the 6 months
suggested by Hersel and we will review activity and determine
what further action may be required as events warrant. ... IIRO’s
shareholding is a minority holding and information received
indicates that they exert neither management control nor have
board representation. While this entity clearly represents a
heightened reputational risk to the bank, I believe that with the
knowledge we have today and the controls that are being
implemented we have mitigated that risk adequately.

A few days later, FIG forwarded its report on Social Islami Bank
to the head of HBUS AML Compliance, Teresa Pesce. She wrote to Mr.
Ketley: “This makes me very uncomfortable. Can we talk to the
business about this?” Despite the discomfort she expressed and the
advice of two AML compliance officers, the account was kept open.
Mr. Ketley reported to the Subcommittee that he understood that IIRO
was a passive shareholder, that Social Islami was attempting to expel
them, and that he talked about the account with Terri Pesce and Denise
Reilly and believed they supported his decision to maintain the
account.

Ms. Pesce told the Subcommittee that she did not recall
much about the relationship, but the bank should have reached out to
OFAC with regard to it. HBUS OFAC Compliance officer Elizabeth
Protomasto told the Subcommittee that she contacted OFAC about this
relationship after the SDN designation, and was told that the bank could
continue to do business with Social Islami Bank, because only two
branches of the IIRO had been designated by OFAC as SDNs, not all

1404 Id.
Bank,” HSBC OCC 3260426.
1406 8/11/2006 email from HSBC Teresa Pesce to Alan Ketley and Andrew Rizkalla, “Re:
3261519.
1407 Subcommittee interview of Alan Ketley (2/16/2012).
1408 Subcommittee interview of Teresa Pesce (3/30/2012).
branches and not the branch in Bangladesh. 1409 Social Islami Bank was also designated an SCC client. 1410

IIRO Remained a Shareholder for Six Years. In September 2006, Mr. Ketley asked Mr. Mehani to obtain additional information from the Social Islami Bank about its relationship with IIRO. 1411 In response to a question asking whether IIRO was “a customer of the bank,” Mr. Mehani wrote that the bank had told him: “IIRO has no relationship with the subject bank and do[es] not maintain or operate any account with the bank.” 1412 In 2009, however, an internal FIG due diligence report quoted a 2008 local press article stating that the IIRO did have an account at Social Islami Bank, as well as over 50,000 bank shares which FIG estimated might then be worth $733,000. 1413 In 2010, the HBUS KYC profile referenced a Bangladeshi Central Bank letter dated June 30, 2010, stating that IIRO had accounts at three Bangladeshi banks, including Social Islami Bank, that needed to be closed. 1414 Social Islami Bank told the Subcommittee that IIRO did have a “foreign currency account” with the bank that was opened in 1995, but has a current balance of zero. 1415

In 2006, Mr. Mehani indicated that the bank planned to “oust” IIRO as a shareholder at its next board of directors meeting and sell IIRO’s bank shares. 1416 Mr. Mehani wrote: “IIRO never responded to their request to provide a full address rather than a PO box and they will use this to oust them by November [2006] which is allowed according to their Articles of Association which I have a copy given by them to me.” 1417 Despite that communication, a 2006 Social Islami Bank board resolution authorizing sale of the shares, 1418 and HBUS' repeated

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1409 Subcommittee interview of Elizabeth Protomastro (6/9/2012).
1413 5/5/2009 Financial Intelligence Unit Report of Findings on Social Investment Bank Limited, OCC-PSI-008423818, at 7 (quoting 10/8/2008 article from Bangladeshnews.com). The FIG report also stated: “You may therefore wish to obtain information from your customer to ascertain the status of the accounts held by the IIRO in the Social Investment Bank Ltd. You may also wish to consider the risks, including reputational risk involved in maintaining this account relationship.” ld. at 7-8 (emphasis omitted).
1414 2012 HBUS KYC Profile of Social Islami Bank, at 4 (“The 3 bank accounts of IIRO namely i) Social Islami Bank Ltd. ii) Islami Bank Bangladesh Ltd. iii) Al-Falah Islami Bank Ltd. must be disposed of [sic] and transferred.”).
1417 ld. See also 2012 HBUS KYC Profile of Social Islami Bank, at 5 (“Compliance advised ... that IIRO has no involvement in the running of the bank, is not a client of the bank and will likely be ousted as a shareholder [which] give considerable grounds for comfort”).
1418 See 12/14/2006 letter from Social Islami Bank quoting board resolution, HSBC OCC 3342182.
inquiries into their status over multiple years.\textsuperscript{1419} IIRO has remained a shareholder of Social Islami Bank, although its ownership interest has gradually dropped from 8.62% in 2006, to 3.85% in 2009, to 1.69% by 2010.\textsuperscript{1420} IIRO currently holds a 1.61% interest in the bank, six years after Social Islami Bank promised to ensure the shares would be sold.\textsuperscript{1421}

In 2009, Social Islami Bank sent a letter to HBUS indicating that it was planning to seek permission from the country’s High Court to sell the shares still held by IIRO.\textsuperscript{1422} In 2010, Social Islami Bank informed HBUS that the Bangladesh government had reached an agreement with IIRO that, after certain safeguards were put in place, would allow IIRO to begin operating in the country again.\textsuperscript{1423} One of the conditions was that the IIRO would have to “dispose” of its Social Islami Bank account,\textsuperscript{1424} although that account remains open today with a zero balance.\textsuperscript{1425} Social Islami Bank informed the Subcommittee that, due to the government’s actions, “the bank is under definite obligation in paying dividend/issuing bonus shares/right shares to IIRO as per the instructions of the Central Bank and Ministry of Finance which were not paid/issued in their favor till 31/05/2010.”\textsuperscript{1426}

\textbf{A Second Terrorist Financier Shareholder.} Also in 2009, a due diligence report issued by the HBUS Financial Intelligence Group identified a second, longterm Social Islami Bank shareholder that raised concerns. It disclosed that Islamic Charitable Society Lajnat al-Bir Al

\begin{footnotesize}


\textsuperscript{1421} 3/11/2012 Social Islami Bank response to Subcommittee questions, at 3, PSI-SIBL-01-001.

\textsuperscript{1422} See also 2012 HBUS KYC Profile of Social Islami Bank, at 3, 16.

\textsuperscript{1423} 3/11/2012 Social Islami Bank response to Subcommittee questions, at 3, PSI-SIBL-01-001.

\textsuperscript{1424} 3/10/2009 letter from Social Islami Bank to HSBC Dhaka, “Information regarding Bank’s ownership for KYC purposes,” HSBC-PSI-PROD-0102621-625, at 1. Around the same time in 2009, HSBC’s Commercial and Institutional Banking in the Asia Pacific region further expanded HSBC’s relationship with Social Islami Bank by providing it with new commercial banking services. The approval form mistakenly characterized Social Islami Bank as “medium risk,” erroneously said it was not an SCC designated client, and stated that none of the bank’s disclosed shareholders increased the client’s risk profile, despite a specific reference to IIRO. 3/10/2009 CIBM-Institutional Banking KYC Profile for Social Islami Bank Limited, HSBC-PSI-PROD-0102646.

\textsuperscript{1425} Id. at 3.

\textsuperscript{1426} 7/11/2012 Social Islami Bank response to Subcommittee questions, at 2, PSI-SIBL-01-001.
Islam still held a 1.54% ownership interest in the bank.\textsuperscript{1427} The 2009 FIG report explained that World Check, the database relied on by HSBC for KYC purposes, had classified the charity “as a terrorist organization with reported tie[s] to Hamas. In September 2008, the Israeli government reportedly declared it an illegal entity.”\textsuperscript{1428} Despite this new information in the 2009 FIG report, the HBUS KYC profile on Social Islami Bank does not acknowledge it, stating instead in a note: “Updated EDD [Enhanced Due Diligence] ROF [Report on Findings] received May 5, 2009. Report provided no new, or, up to date information.”\textsuperscript{1429} Social Islami Bank has informed the Subcommittee that Lajnat al-Birr remains a 0.22% share owner, but does not have any account at the bank.\textsuperscript{1430}

**Sobhan Misconduct.** The ongoing ownership of the bank’s shares by IIRO and Lajnat al-Birr was not the only troubling development. Social Islami Bank’s initial Chairman of the Board, Ahmed Akbar Sobhan, also known as Shah Alam, was a well-known businessman who held, with his son, a 3.35% ownership interest in the bank since its inception.\textsuperscript{1431} Beginning in 2006, however, Mr. Sobhan and his son became the subjects of several criminal investigations involving bribery, corruption, fraud, and tax evasion.\textsuperscript{1432} In 2007, Mr. Sobhan and his son reportedly fled to the United Kingdom, after which Mr. Sobhan was the subject of corruption charges brought in his absence by the Bangladeshi Anti-Corruption Commission which sentenced him to eight years in prison.\textsuperscript{1433} This troubling information was detailed in the 2009 FIG report that, inexplicably, was later described in the Social Islami KYC profile as containing no new information.\textsuperscript{1434}

In May 2012, HSBC terminated its relationship with Social Islami Bank.\textsuperscript{1435} David Bagley, head of HSBC Group Compliance, told the Subcommittee, when asked, that the closure decision had been a “no
brainer.” He did not explain what factors led to the termination decision. Social Islami Bank currently has no open account with any HSBC affiliate.

J. Analysis

HSBC is a global bank with a strong presence in many countries confronting terrorist threats. If safeguards are lacking, HBUS offers a gateway for terrorists to gain access to U.S. dollars and the U.S. financial system. HSBC has a legal obligation to take reasonable steps to ensure it is not dealing with banks that may have links to or facilitate terrorist financing.

Banks rarely carry explicit links to terrorist financing, but in the three banks reviewed here, an array of factors raised troubling questions. In the case of Al Rajhi Bank, the factors included the naming of a key bank official in a list of al Qaeda financial benefactors, a U.S. law enforcement search of Al Rajhi nonprofit and business ventures in the United States to disrupt terrorist financing, a CIA report targeting the bank for being a “conduit” for extremist finance, the bank’s refusal to produce authenticating bank documents for use in the criminal trial of a client who cashed traveler’s cheques at the bank for use by terrorists, and multiple accounts held by suspect clients. In the case of Islami Bank, the factors included substantial ownership of the bank by al Rajhi interests, Central Bank fines for failing to report suspicious transactions by militants, and an account provided to a terrorist organization. In the case of Social Islami Bank, the factors included ownership stakes held by two terrorist organizations whose shares were exposed but never sold as promised, and a bank chairman found to be involved with criminal wrongdoing.

In each case, HBUS and HSBC personnel were aware of the information, but approved or maintained the accounts anyway. When an AML Compliance officer like Beth Fisher declined to approve an account, HSBC personnel found someone else to take her place. In several cases, Christopher Lok, head of U.S. Banknotes, took on the role of relationship manager fighting for account approval. His test for taking on that role depended in part upon how much revenue an account would produce. Al Rajhi Bank’s threat to terminate business with HSBC affiliates also appears to have galvanized HBUS’ renewal of the account.

Another striking feature of these accounts is the fact that a decision by one HSBC affiliate to terminate a relationship with a bank due to terrorist financing concerns did not always lead other HSBC affiliates to

1436 Subcommittee interview of David Bagley (5/10/2012).
follow suit. In the case of Al Rajhi Bank, for example, HBUS terminated the relationship, but HSBC affiliates in the Middle East continued to do business with the bank. One HBUS executive later argued that, since HSBC was already exposed to the reputational risk posed by Al Rajhi Bank through the accounts at other HSBC affiliates, its reputational risk would not increase if one more account were opened. In May 2012, HSBC changed its policy to apply decisions to terminate a client relationship to apply globally to all its affiliates.
VI. HOKURIKU BANK: CLEARING BULK TRAVELERS CHEQUES

With few questions asked and despite ongoing evidence of suspicious activity, HBUS cleared tens of millions of dollars per year in bulk travelers cheques for Hokuriku Bank of Japan. According to Hokuriku Bank, from 2005 to October 2008, HBUS cleared travelers cheques totaling between $70 million and $90 million per year for the bank, producing a grand total in less than four years of more than $290 million. HBUS estimated that, at one point in 2008, it was clearing travelers cheques for the bank at an average of $500,000 to $600,000 per day. The Hokuriku deposits consisted of U.S. dollar travelers cheques that were in denominations of $500 or $1,000, came in batches of sequentially numbered cheques, and were signed and counter-signed by the same person using an illegible signature. They were made payable to one of 30 different companies or individuals, all of whom claimed to be in the used car business. The cheque beneficiaries were clients of Hokuriku Bank, but the cheques were purchased from the same Russian bank for deposit into their accounts in Japan. When HBUS finally asked Hokuriku Bank about those clients and the business purpose behind Russians cashing massive numbers of U.S. dollar travelers cheques on a daily basis for deposit in Japan, Hokuriku Bank claimed to have little or no KYC information or understanding of its clients' banking transactions.

The documents produced to the Subcommittee disclosed that some HBUS AML Compliance personnel raised concerns about the Hokuriku travelers cheques in 2005, but failed to investigate the transactions. The Hokuriku travelers cheques came to HBUS' attention again in 2007, during the course of an OCC AML examination which found "serious concerns related to weak policies, procedures, systems and controls" with how it processed monetary instruments,143 but HBUS again failed to investigate the transactions. In 2008, during a followup OCC AML examination, the OCC singled out the Hokuriku travelers cheques as suspicious and required HBUS to obtain additional information about them.

The OCC and HBUS quickly uncovered troubling information about the travelers cheques, including that they had originated in Russia, a country at high risk of money laundering, involved millions of U.S. dollars, and had no clear business purpose. When HBUS sought more information about the cheques, Hokuriku Bank at first delayed responding, then provided minimal information, and finally declined to investigate further, claiming to be constrained by bank secrecy laws.

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from disclosing client-specific information. In 2008, at the urging of the OCC, HBUS stopped accepting travelers cheques from the bank and told the OCC that it planned to close the Hokuriku account within 30 days. HBUS later decided to continue to do business with Hokuriku Bank in other areas despite its poor AML efforts. In 2010, during the course of another AML examination, the OCC uncovered the ongoing relationship with Hokuriku Bank. In May 2012, HBUS closed the Hokuriku Bank account, although Hokuriku Bank continues to do business with other HSBC affiliates.

A. Hokuriku Bank

Hokuriku Bank Ltd. is a Japanese regional bank with over 2,800 employees and 185 branches.\footnote{1439 See HBUS “Know Your Customer Profile” for Hokuriku Bank (hereinafter “HBUS KYC Profile”) (last updated on 9/3/2010), prepared by HBUS Global Payments and Cash Management division, HSBC-PSI-PROD-0102415-425, at 417; “Hokuhoku Financial Group Inc. Annual Report 2011,” (year ended March 31, 2011)(hereinafter “Hokuhoku 2011 Annual Report”), at 59, http://www.hokuhoku-fg.co.jp/english/financial/docs/fg_aj2011.pdf.} It also has representative offices in New York, London, Singapore, and China.\footnote{1440 Hokuhoku 2011 Annual Report, at 1, 59.} Hokuriku Bank traces its origins back to 1877; in 1961, it began trading on the Tokyo Stock Exchange.\footnote{1441 Id.} In 2003, the Hokugin Financial Group was formed in Japan, and Hokuriku Bank became a wholly-owned subsidiary of the Group. In 2004, the Group merged with another financial institution and changed its name to Hokuhoku Financial Group Inc. which continues to operate as the bank’s holding company today.\footnote{1442 Id.} Hokuhoku Financial Group is headed by Shigeo Takagi, who has been the President of both the Group and Hokuriku Bank since 2003.\footnote{1443 HBUS KYC Profile at HSBC-PSI-PROD-0102416.}

According to a 2010 HBUS Know Your Customer (KYC) Profile, Hokuriku Bank is a longstanding customer of HBUS, which has provided it with correspondent banking services in Hong Kong, Korea, and the United Kingdom, as well as the United States.\footnote{1444 HBUS KYC Profile at HSBC-PSI-PROD-0102420; Hokahoku 2011 Annual Report, at 61.} In addition to HBUS, Hokuriku Bank has correspondent relationships with several other HSBC affiliates as well, including Hong Kong and Shanghai Banking Corporation, Ltd. and HSBC Middle East.\footnote{1445 See 6/26/2012 letter from Hokuriku Bank’s legal counsel to the Subcommittee, PSI-HokurikuBank-01-0001-016, at 001.} By 2001, Hokuriku Bank had become a client of HBUS’ Payments and Cash
Management (PCM) division which used its processing centers in New York to handle most Hokuriku transactions.\footnote{1446}

HBUS provided Hokuriku Bank with two accounts, numbered 50385 and 34738. Account No. 50385 was closed on Feb. 6, 2009, and its balance transferred to Account No. 34738, which remained open until May 2012.\footnote{1447} HBUS provided Hokuriku Bank with access to U.S. dollars, primarily by clearing millions of dollars in U.S. dollar travelers checks each year. According to Hokuriku Bank, HBUS cleared travelers cheques totaling about $77 million in 2005, $72 million in 2006, $90 million in 2007, and $52 million in 2008, until HBUS stopped providing clearing services for the bank’s bulk travelers cheques.\footnote{1448} Those figures show that, in less than four years, HBUS cleared travelers cheques for Hokuriku Bank totaling over $290 million. HBUS also processed wire transfers from Hokuriku Bank and provided other banking services. In 2007, the Hokuriku account produced revenues for HBUS totaling about $47,000.\footnote{1449}

According to the HBUS KYC Profile, the initial HBUS Account Manager for Hokuriku Bank was Nanayo Ryan, and the Relationship Manager for KYC approval purposes was Beth Fisher.\footnote{1450} In 2008, the HBUS Account Manager switched to Kgomotso Hargraves, while the Relationship Manager for KYC approval purposes switched to Wayne W. Ferguson, then Anthony Julian, then Wen Lu Wu.\footnote{1451} The Global Relationship Manager since 2008 has been Machiko Yamashita.\footnote{1452}

B. Travelers Cheques

Travelers cheques are typically sent by one financial institution to another via a “pouch.” A pouch is an envelope or package, and pouch activity refers to the sending or receipt and processing of an item that is sent to a bank from another country by common carrier, courier, or referral agent. Pouches typically contain currency or a monetary instrument, such as a travelers cheque, cashier’s cheque, or money order, which is intended to be used to make a deposit or loan payment, or to engage in another transaction. Pouches can be sent by an unrelated financial institution, a bank affiliate, or by an entity or individual.

\begin{itemize}
\item \footnote{1446} HBUS KYC Profile at HSBC-PSI-PROD-0102415-425, at 423.
\item \footnote{1447} Id. at 420. HBUS closed the second account on May 21, 2012. 6/26/2012 letter from Hokuriku Bank’s legal counsel to the Subcommittee, PSI-HokurikuBank-O-01-0001-016, at 001.
\item \footnote{1449} HBUS KYC Profile at HSBC-PSI-PROD-0102415-425, at 420.
\item \footnote{1450} Id. at 424.
\item \footnote{1451} Id. at 418, 424-425.
\item \footnote{1452} 9/5/2008 email from Hideki Matsumoto to Michio Yamashita and others, “Hokuriku Bank,” OCC-PSI-00080695, at 5.
\end{itemize}
In addition to physical delivery of monetary instruments, many banks, including HBUS, provide a service called “Remote Deposit Capture” (RDC). RDC enables customers who sign up for the service to send electronic images of physical monetary instruments that they wish to present for deposit, including travelers cheques. Processing these electronically sent deposits are sometimes referred to as part of the receiving bank’s pouch activity.

At large banks, pouched monetary instruments are typically sent to a specialized facility for processing. These facilities typically process a high volume of monetary instruments on a daily basis. When a bank processes a pouched travelers cheque, it typically credits the amount of the cheque to the correspondent account of the client financial institution that sent the cheque. Pouch activity is often referred to as “cash letter” activity, since it consists primarily of cashing a monetary instrument by crediting an account with the amount specified on the instrument. Providing cash in exchange for a monetary instrument is also referred to as “clearing” the instrument.

HBUS has two processing centers in the United States, one in Brooklyn and one in Buffalo, New York, both of which process a high volume of monetary instruments on a daily basis. RDC services are provided solely at the Buffalo center. Both centers segregate travelers cheques from other types of deposits and process them separately, crediting the U.S. dollars to the relevant client accounts. A processing clerk typically skims each deposit to identify any sequentially numbered travelers cheques. If the sequentially numbered cheques total more than a designated amount, the clerk is required to refer the deposit to HBUS AML Compliance for approval prior to processing. If the sequentially numbered travelers cheques exceed another specified threshold, the processing clerk must attach a Traveler's Cheque/Money Order High Value Deposit Information (TC/MO HV DI) form to the deposit prior to processing. If the form is not attached, the deposit must be submitted to AML Compliance for approval prior to processing. This procedure is intended to ensure that HBUS AML Compliance is kept apprised of large deposits of sequentially numbered travelers cheques, since such cheques are often associated with money laundering or other misconduct.

1455 Id.
1456 Id.
1457 Id.
U.S. banking regulators have long warned financial institutions about the money laundering risks associated with travelers cheques which can be purchased with cash by a non-customer of the bank and used to move substantial funds across international borders in ways that are difficult to trace.1458 Travelers cheques have been used by terrorists,1459 drug traffickers,1460 and other criminals.1461

C. 2005 Concerns about Hokuriku Travelers Cheques

The documents produced to the Subcommittee show that HBUS AML Compliance personnel were aware of, and expressed concerns about, the large number of travelers cheques being cashed for Hokuriku Bank from at least as early as March 2005, but did little about them for years.

On March 15, 2005, HBUS AML compliance officer George Tsugranes sent an email to the HBUS account manager for Hokuriku Bank, Nanayo Ryan, in which he noted that, in less than 60 days from January to March 2005, Hokuriku Bank had deposited travelers cheques totaling over $2 million.1462 The email provided a chart listing 41 separate deposits over a 51-day period, showing that the deposited

1458 See, e.g., Federal Financial Institutions Examination Council (FFIEC) Bank Secrecy Act/Anti-Money Laundering (BSA/AML) Examination Manual, “Core Overview: Purchase and Sale of Monetary Instruments,” (6/23/2005) at 59; FFIEC BSA/AML Examination Manual, “Purchase and Sale of Monetary Instruments–Overview,” (8/24/2007), at 212 (“The purchase or exchange of monetary instruments at the placement and layering stages of money laundering can conceal the source of illicit proceeds. As a result, banks have been major targets in laundering operations because they provide and process monetary instruments through deposits.”).

1459 See, e.g., United States v. al-Haramain Islamic Foundation Inc., Case No. 6:05-cr-60008-HO (USDC Oregon) Indictment (2/17/2005); “Former U.S. Head of Al-Haramain Islamic Foundation Sentenced to 33 Months in Federal Prison,” U.S. Attorney’s Office for the District of Oregon press release (9/27/11), at 1 (describing how the convicted defendant cashed $130,000 in U.S. dollar travelers cheques at a bank in Saudi Arabia and then provided the funds to support violent extremists in Chechnya).


1461 See, e.g. Folk v. State, 192 So. 2d 44, 46 (Fla. Dist. Ct. App. 1966) (upholding conviction for signing a false name on travelers cheques and cashing them); United States v. Schegalla, 256 F.3d 59, 63 (1st Cir. 2001) (upholding conviction for using unrelated travelers cheques to attempt to move money fraudulently through U.S. customs).

1462 3/15/2005 email from HBUS George Tsugranes to HBUS Nanayo Ryan, “Hokuriku Bank CIL Activity,” HSBC OCC 3113976-977. The chart is unlikely to contain a comprehensive list of all of the travelers cheques presented by Hokuriku Bank over the course of those two months since, during 2005 alone, Hokuriku Bank cleared $77 million in travelers cheques through HBUS. See 6/26/2012 letter from Hokuriku Bank’s legal counsel to the Subcommittee, chart entitled, “Volume of U.S. Dollar Travelers Cheques to HBUS for Clearance by year,” PSI­ HokurikuBank-01-0001.
amounts ranged from $20,000 to $100,000 at a time; often consisted of multiple $1,000 travelers cheques; and referenced about ten different clients, including corporations and individuals. All of the deposits were to Hokuriku Bank’s Account No. 50385. Mr. Tsugranes asked Mr. Ryan:

“to reach out to the bank and ask that adequate KYC is on file for each name listed on the spreadsheet, whether the customer activity is consistent with the KYC, and also who is their customer base (local clients, people buying cars for export, etc.) and why US dollar travelers checks would be used for payment.”

This email shows that, in early 2005, Hokuriku’s pattern of making large deposits with multiple travelers cheques triggered a review by HBUS AML Compliance personnel concerned about who was behind the deposits. Despite the request for more information in the March 2005 email, the Subcommittee received no additional documentation or information indicating that HBUS AML Compliance personnel actually sought or obtained additional KYC information from Hokuriku Bank in early 2005, regarding the travelers cheques it was cashing.

Eight months later, in November 2005, several emails indicate that HBUS AML Compliance personnel took a broader look at the cash letter/pouch activity at its Brooklyn center, apparently in an effort to detect unlicensed money service business activity. This inquiry was not specific to Hokuriku Bank. On Nov. 23, 2005, HBUS AML senior compliance officer Alan Ketley sent an email to AML compliance officer Mark Balawender stating that, while HBUS had “strong monitoring procedures in place for PCM clients,” he wasn’t sure about what was “in place for other clients” at the Brooklyn center. He attached to the email a 21-page chart listing the “cash letter volume” for 35 bank clients over a one-year period from April 2004 to March 2005. The data disclosed, among other information, that over the course of the year, Hokuriku Bank had cashed an increasingly larger volume of monetary instruments each month into its Account No. 50385, building from 36 items totaling about $209,000 in April 2004, to 109 items totaling over $4.3 million in March 2005. Altogether for the year, Hokuriku Bank is recorded as having deposited at HBUS 562 “envelopes” with over 24,000 items totaling $11.2 million.
On November 25, 2005, Mr. Balawender sent an email to Mr. Ketley with his findings. He described the Brooklyn center as engaged in “heads down volume process[s]ing.” He stated, “Given the volume/deadline driven/processing nature of the departments above, I am not sure what we can do. … I would anticipate a rather strong pushback from Ops and the branches, if AML Compliance were to suggest additional processes.”

No further information or inquiries related to Hokuriku Bank appear in the 2005 timeframe among the documents provided to the Subcommittee in response to a broad request for all documents related to Hokuriku Bank and pouch activity. When asked for more information about the March and November 2005 reviews, Mr. Ketley indicated that he could not recall either Hokuriku Bank or what happened in either review.

In sum, despite a specific March 2005 AML inquiry into $2 million in travelers cheques cleared for Hokuriku Bank, and a broader November 2005 inquiry that included evidence of an escalating pattern of Hokuriku deposits, HBUS AML Compliance apparently took no further action to investigate Hokuriku’s cash letter activities in 2005. The 2005 and 2006 OCC annual examination of HBUS also made no mention of AML issues related to its pouch activities or clearance of travelers cheques.

D. 2007 OCC Pouch Examination

Two years after the internal HBUS inquiries, in early 2007, the OCC commenced an AML examination of HBUS’ pouch activities. In response, HBUS AML compliance officer George Tsugranes produced a chart listing clients with a high volume of cash letter activity during the last two months of 2006. Hokuriku Bank was repeatedly listed, appearing in the chart more times than any other bank. Over a 62-day period, the chart identified 100 Hokuriku deposits. The deposit amounts ranged from $20,000 to $193,000 at a time, often consisted of multiple $1,000 travelers cheques, and referenced about a dozen clients, both corporate and individual. Many of the client names on the 2006

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1468 Id. at 773.
1469 Id.
1470 Subcommittee interview of Alan Ketley (2/16/2012).
1471 See OCC Reports of Examination of HBUS, for the examination cycle ending March 31, 2005 and March 31, 2006. [Sealed Exhibit.]
1473 See chart, prepared by HBUS AML Compliance, HSBC OCC 3352014-037.
1474 Hokuriku Bank told the Subcommittee that, since the mid 1980s, it has limited its clients to deposits of no more than $1,000 in travelers cheques per person per day, unless the cheques were issued by Hokuriku Bank or the depositor was a “regular customer” and the bank “deemed that
list had also appeared on the March 2005 list compiled by Mr. Tsugranes. The total amount deposited over the two-month period was about $5.6 million.

Mr. Tsugranes sent the chart to his supervisor, Mr. Ketley, and wrote that “all accounts are being checked to ensure activity is reflected on KYC.” Of the documents produced to the Subcommittee, none indicate, however, what information was “checked” with respect to Hokuriku Bank or what Mr. Tsugranes learned.

Six weeks later, on April 24, 2007, Mr. Ketley asked HBUS AML compliance officers Mr. Tsugranes and Robert Guthmüller, to travel to the HBUS Brooklyn center “to gain a thorough understanding of what is processed . . . and what items are reviewed.” Three days later, on April 27, 2007, Mr. Guthmüller sent an email to Mr. Ketley providing him with “the Readers Digest version” of their findings after “a high level review of cash letter processing” at the Brooklyn center.

Mr. Guthmüller’s email stated that the Brooklyn center “treat[ed] all clients the same,” regardless of whether cash letter items involved “high risk clients.” He wrote: “We should be drilling down on our high risk customers” and, for example, “identify those clients that in the past have sent a large number of sequentially numbered travelers checks . . . and monitor accordingly.” Mr. Guthmüller also wrote that the center staff had “divided loyalty,” explaining:

“[T]heir main job is processing checks – 5:00PM deadline. But they are also asked to be the ‘front line’ for monitoring, referring items to Delaware for further investigation. One job focuses on pushing items through, another is to go slower, review items, ask themselves questions – is it suspicious? – contact Delaware – wait for a response – hopefully before 5:00PM.

[O]ne solution is to have a full time compliance person review items FULLY, that means internet searches, OFAC, wor[ ]c[ ]e[ ] etc. Additionally the compliance person could drill down on the high risk accounts.”

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the funds will be collected from the customer should it turn out that the travelers’ check was not duly issued.” 6/26/2012 letter from Hokuriku Bank’s legal counsel to the Subcommittee, PSI-HokurikuBank-01-0003-016, at 004.


1477 Id. at 5.

1478 Id. at 5 (emphasis in original).
Mr. Guthmuller also stated that HBUS “[m]ust improve trend analysis. Nothing done in Brooklyn.” He wrote:

“We have reportedly had all travelers checks $20k and over … on Excel for 4 years but haven’t used/sorted items for trend analysis. Let’s start looking at it. WHAT ABOUT SEQUEN[T]IALLY NUMBERED TRAVELERS CHECKS AGGREGATING SAY $15K per day, same payee …?”

This email indicated that HBUS had compiled an extensive database of travelers cheque information, but was not using it to identify suspicious travelers cheque activity or high risk clients.

Mr. Guthmuller also wrote that the HBUS AML office in Delaware “must improve” its enhanced due diligence (EDD) efforts, including by using “more internet searches, calls on high risk clients asking questions, use of certifications, etc.” His email indicated that HBUS’ AML staff did not engage in sufficient due diligence activity to identify high risk clients depositing bulk travelers cheques.

Mr. Ketley forwarded the email to Anne Liddy, a senior HBUS Compliance official, with the comment, “Food for thought.” He wrote: “We will look to have a meeting with Bob [Guthmuller] next week to discuss further.”

Ten days later, on May 7, 2007, Mr. Tsugranes sent an email to Mr. Ketley and others stating he had “discussed the issues with the Delaware AML team and asked for some input on ways to improve our cash letter monitoring.” He stated: “Below are some recommendations which will allow for both operational benefits and a more risk based monitoring approach.”

His email advised reducing the monitoring of checks from Fortune 100 names, and revising the dollar limit to $100,000 to trigger review of an account of a Special Category Client (SCC). While reducing review of Fortune 100 names could be seen as an effort to target AML review efforts to higher risk transactions, imposing a $100,000 dollar limit on SCC clients, the bank’s highest risk clients, set a high bar to trigger a review. With respect to Hokuriku Bank and another bank in Korea, Mr. Tsugranes advised that AML personnel track the banks’ total daily deposits, “eliminate the check by check comparison,” and “only investigate if an apparent MIF [Monetary Instrument Form] was not included.” He wrote: “To summarize we

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1479 Id. at 5 (emphasis in original).
1480 Id. at 6.
1481 Id. at 4.
1482 Id. at 2-3.
would be focusing more on SCC clients, cutting back on some Group reviews in non HRCs [non High Risk Clients] and also tracking a specific bank of concern.

While the Tsugranes email advocated a stronger focus on SCC clients, it did not address Mr. Guthmuller’s suggestion to identify other high risk clients by analyzing the bank’s travelers cheque data. His email did not, for example, include the Guthmuller suggestion to strengthen trend analysis of the cash letter activity at the Brooklyn center by utilizing the four years of travelers cheque data already included in Excel spreadsheets. The Tsugranes email also failed to include the suggestion, urged in capital letters in the Guthmuller email, to identify and investigate clients making deposits of sequentially numbered travelers checks above a specified threshold. Instead, the Tsugranes email recommended reducing the monitoring directed toward Hokuriku Bank by eliminating the “check by check comparison” that had been routine practice. In the end, despite another chart disclosing multi-million-dollar Hokuriku deposits of $1,000 travelers checks, the final result of HBUS’ review was to advocate devoting less rather than more attention to the bank.

The two OCC examiners who conducted the 2007 examination told the Subcommittee that they were very concerned about the lack of AML controls over HBUS pouch activity and had recommended that the OCC impose a Cease and Desist Order requiring HBUS to revamp them. They later concluded, however, that they were unable to meet the OCC standards required for issuing the order. Instead, the OCC examiners designated the lack of AML controls over pouch processing as a Matter Requiring Attention (MRA) which was included in the annual OCC Report of Examination provided to the HBUS Board of Directors on July 24, 2007. The MRA did not, however, explicitly identify the Hokuriku travelers cheques as a problem.

The OCC uses its annual Reports on Examinations to ensure bank boards are kept apprised of serious bank deficiencies requiring action by


1484 7/24/2007 OCC Report of Examination of HBUS, for the examination cycle ending March 31, 2007, OCC-PSI-00304977, at 1. [Sealed Exhibit.] The MRA read in full as follows:

“The bank provides pouch services in a number of business units. An examination of HSBC pouch services resulted in serious concerns related to weak policies, procedures, systems and controls. The policies and controls in this area are inferior to BSA/AML controls in other areas of the bank, and remedial action is warranted. The absence of comprehensive policies, procedures and adequate systems and controls could potentially subject the bank to undue reputation risk and/or lead to BSA/AML violations. Pouch services facilitate easy movement of funds, and are favored by persons who transfer illegal and terrorist funds. Consequently, the Board should ensure that management implements appropriate policies, procedures, systems and controls for this activity. The Board should communicate the corrective measures to the OCC, and confirm subsequent resolution.”
management. The 2007 Report of Examination notified the HBUS Board about the OCC’s “serious concerns related to weak policies, procedures, systems and controls” related to its pouch activities, and urged immediate improvements. In September 2007, the OCC also issued a Supervisory Letter to HBUS which again urged that “policies, procedures, systems, and controls for pouch need strengthening and augmenting.”

E. 2008 OCC Inquiry into Hokuriku Travelers Cheques

Nine months later, in June 2008, the OCC commenced a followup AML examination of HBUS pouch activity, looking at pouch services in additional business units. During the course of that examination, OCC examiners identified the Hokuriku travelers cheque deposits as an activity warranting greater scrutiny.

In June 2008, two OCC AML bank examiners visited the HBUS Brooklyn and Buffalo processing centers to examine their pouch activity. One of the examiners told the Subcommittee that when they visited the Brooklyn center, they found “stacks and stacks of travelers cheques, some signed and countersigned by the same entity.” In a memorandum the examiner wrote that, at the Brooklyn center, she reviewed a Hokuriku cash letter deposit in the amount of $110,000, and found it consisted of 220 sequentially numbered travelers cheques, each for $500. She wrote that all of the cheques were signed and countersigned by the same individual, whose name was illegible, and all were made payable to SK Trading Company Ltd. The TC/MO HVDI form attached to the deposit described SK Trading as a “used car dealer” and stated that the travelers cheque funds were to be used for a “business purpose.” The other examiner reviewed another Hokuriku deposit for $240,000 and found a similar situation involving sequentially numbered $1,000 travelers cheques that had been signed and countersigned by the same person as the other deposit and made payable to SK Trading. The OCC examiners then contacted the HBUS cash letter department manager who explained that the Brooklyn center received three to five Hokuriku deposits daily of travelers cheques which totaled between $500,000 and $600,000 each day.

1485 Id.
1488 Id.
1489 Id.
1490 Subcommittee interview of OCC AML Examiner Elsa de la Garza, (1/9/2012).
1492 Id.
1493 Id. at 2.
indicated that travelers cheques were the "only types of instruments received through pouch for Hokuriku Bank." 1494

The OCC examiners researched SK Trading and found that, according to its website, the company appeared to be headquartered in Seoul, Korea, with offices in Japan and the United States, and had been in business since 1984. 1495 They also found that the company had been identified by other financial institutions as involved with suspicious activity. These other financial institutions had identified suspicious wire transfers, sometimes involving millions of dollars, which were originated by individuals with Russian surnames who sent the funds from accounts at Russian banks or which were originated by corporations that sent the funds from banks in the British Virgin Islands. 1496 The ultimate beneficiary of the funds in each case was SK Trading using accounts at various banks in Japan. The OCC examiners noted that, in November 2006, one of the financial institutions had contacted Hokuriku Bank directly and asked it about the business purpose behind the transactions, but was told that Hokuriku Bank "could not answer this as their customer (S.K. Trading Company Limited) refused to provide information." 1497

The OCC examiners concluded that SK Trading was "conducting high dollar volumes of activity utilizing wire transfers and pouch services," that SK Trading was involved with "numerous entities," and that the transactions involved "numerous individuals from Russia," and warranted additional investigation. 1498 The travelers cheques' connections to Russia raised a particular red flag, since the United States has long viewed Russia as a country of "primary" money laundering concern, its highest risk category. 1499 At the time, a 2008 report by the U.S. State Department, then the latest in a long line of annual U.S. State Department reports summarizing money laundering concerns on a country-by-country basis, described Russia as follows:

"Criminal elements from Russia and neighboring countries continue to use Russia's financial system to launder money .... Experts believe that most of the illicit funds flowing through Russia derive from domestic criminal activity, including evasion of tax and customs duties and smuggling operations. Despite making progress in combating financial crime, Russia remains vulnerable to such activity because of its vast natural resource wealth, the pervasiveness of organized crime, and, reportedly, a high level of

1494 Id.
1495 Id.
1496 Id.
1497 Id. at 3. (emphasis omitted).
1498 Id. at 4.
corruption. Other vulnerabilities include porous borders, Russia’s role as a geographic gateway to Europe and Asia, a weak banking system with low public confidence in it, and under funding of regulatory and law enforcement agencies. Russia’s financial intelligence unit (FIU) estimates that Russian citizens may have laundered as much as U.S. $11 billion in 2007.\textsuperscript{1500}

When the Subcommittee asked the OCC about its 2008 inquiry into the Hokuriku travelers cheques, Ms. de la Garza stated that, despite the earlier AML examination in 2007, HBUS seemed to have no AML policies or procedures in place regarding pouch activity.\textsuperscript{1501} She characterized the failure to monitor the travelers cheques being cashed as “not normal,” and stated that they immediately brought the matter to the attention of HBUS AML Compliance. Ms. de la Garza indicated that, at first, HBUS Compliance personnel asserted that the travelers check transactions were legitimate, and that the high cost of cars in Russia accounted for the daily deposits of $500,000 or more by SK Trading. After doing additional research and finding additional accounts with high volumes of traveler cheque deposits, often sequentially numbered and signed and countersigned by the same person, she said that HBUS AML Compliance became more concerned.\textsuperscript{1502}

On Sept. 2, 2008, the OCC examiners met with HBUS senior compliance officials Anne Liddy and Mary Ann Caskin.\textsuperscript{1503} According to an OCC memorandum summarizing the meeting, Ms. Liddy disclosed that HBUS had reviewed:

“All transactions over the past 2 months and identified a total of 20 entities (including SK Trading) which were using Cash Letter services to clear Travelers Cheques. All 20 entities are used car dealerships. ... Four additional companies with significant dollar amounts have been identified. (Maric Trading - $3.5 Million; Jamsou Traders - $1 Million; IK Auto - $929 Thousand and Dean Corp - $587 Thousand - totals for two months). ... The Business Unit has gone back to the Relationship Manager and Hokuriku Bank to obtain additional information on Maric Trading and Jamsou Traders. They will also be inquiring on the other companies identified. ... The bank will be exiting the Hokuriku relationship within the next 30 days."\textsuperscript{1504}

\textsuperscript{1500} Id. at 390. See also “International Narcotics Control Strategy Report, Volume II, Money Laundering and Financial Crimes,” U.S. State Department (March 2012), at 156 (identifying generally the same AML vulnerabilities in Russia today).
\textsuperscript{1501} Subcommittee interview of OCC AML Examiner Elsa de la Garza (1/9/2012).
\textsuperscript{1502} Id.
\textsuperscript{1504} Id.
The OCC informed the Subcommittee that the two OCC examiners who attended the meeting understood HBUS to mean that it would close the Hokuriku account, cease all business with the bank, and report any suspicious activity to U.S. law enforcement.\footnote{5/15/2012 email from OCC to the Subcommittee, “HSBC – Hokuriku Questions,” PSI-OCC-38-0001-002.}

\section*{F. Absence of Hokuriku Bank KYC Information}

In July 2008, in response to the OCC, HBUS AML Compliance initiated a more in-depth review of the Hokuriku travelers cheques. A search of HBUS processing records determined that, over a 12-month period from 2007 to 2008, HBUS had received an average of 7,800 travelers checks per month from the bank with an average monthly value of about $7.4 million.\footnote{7/16/2008 email from HBUS Jonathan Dean to HBUS Mary Ann Caskin and others, “Hokuriku Bank,” OCC-PSI-00407498, at 1.} HBUS determined that “[a]ll deposits are Travellers Checks, no Money Orders found.”\footnote{Id.} An HBUS AML Compliance officer also noted: “They seem to sell traveler’s checks which are used to purchase cars in Japan. The purchasers of the cars often provide Russian passports as ID.”\footnote{Id.}

To find out more, on July 15, 2008, HBUS AML compliance officer Stephanie Napier sent an email to Yumi Seto at HSBC Tokyo, PCM Client Service, informing her that HBUS had undertaken a review of Hokuriku Bank Account No. 34738 and asking her to obtain specified KYC information related to certain deposits into that account.\footnote{Email exchange among HBUS personnel, from July to Sept. 2008, “Hokuriku Bank Ltd-Compliance Inquiry,” OCC-PSI-00409214 and attachment OCC-PSI-00409215-216, at 8-9.} The Subcommittee was unable to determine why the email asked only about Hokuriku Account No. 34738 and not also Account No. 50385, where the travelers cheques were typically deposited.\footnote{Email exchange among HBUS personnel, from July to Sept. 2008, “Hokuriku Bank Ltd-Compliance Inquiry,” OCC-PSI-00409214 and attachment OCC-PSI-00409215-216, at 9.} Nor was the Subcommittee able to determine why the email requested information about only four entities associated with the travelers cheque deposits: De Araujo Roseli Aparecida (an individual), Aksys Corp., R S Corp., and Sanhu Corp.\footnote{Email exchange among HBUS personnel, from July to Sept. 2008, “Hokuriku Bank Ltd-Compliance Inquiry,” OCC-PSI-00409214 and attachment OCC-PSI-00409215-216, at 8-9.} Ms. Napier made repeated requests for the information over the next two months without success.\footnote{Id. at 4-8.} Her HSBC contact in Tokyo, Ms. Seto, repeatedly responded to her emails that Hokuriku Bank had

\begin{itemize}
\item\footnote{Email exchange among HBUS personnel, from July to Sept. 2008, “Hokuriku Bank Ltd-Compliance Inquiry,” OCC-PSI-00409214 and attachment OCC-PSI-00409215-216, at 9.}
\end{itemize}
indicated it was preparing a "report." In September 2008, Ms. Seto was replaced by Ako Kobayashi who, after several attempts, obtained a single, handwritten page from the bank with the requested information.\(^{1513}\) Because the information was provided in Japanese, she translated it and, on September 9, 2008, sent both the original and her typed translation to Ms. Napier’s supervisor in HBUS AML Compliance Judy Stoldt.\(^{1515}\)

The information provided by Hokuriku Bank was minimal. In the case of the one individual who had been identified, Hokuriku Bank reported that he was a “Business man,” gave his address, and stated that he worked with a company called “Sugimoto,” and had a “Satisfactory” relationship with the “Originator.” In the case of the three corporations, Hokuriku Bank stated that each was involved in “Sales of Used Cars,” which HBUS already knew, and provided the company’s address, the date of establishment, and whether it was a private corporation or publicly traded. Hokuriku Bank also provided the name of one beneficial owner of one company, but wasn’t sure of the spelling of his name. No reasons were given for its clients using sequentially numbered travelers cheques, having the same person sign and countersign them, or generating the high daily volume of cheques. Ms. Stoldt forwarded the information to HBUS senior Compliance official, Anne Liddy, characterizing it as “very limited information that took us over a month to get.”\(^{1516}\)

G. 2008 Decision to Stop Cashing Hokuriku Travelers Cheques

On September 4, 2008, even before the KYC information from Hokuriku Bank was formally translated, HBUS PCM Compliance officer Alan Williamson sent an email to multiple HBUS personnel informing them that HBUS would no longer accept bulk travelers cheques from Hokuriku Bank for processing. He explained:

“Compliance meets monthly with senior management in the Payments and Cash Management AML Management Review Committee. Recently we discussed the fact that Hokuriku has been sending a large number of sequential traveller’s checks from a number of similar businesses through cash letter here in the US. This use of cash letter is inappropriate and the Committee has concluded that PCM should no longer allow Hokuriku to send

\(^{1513}\) Id. at 5-7.
\(^{1514}\) Id. at OCC-PSI-00409215.
\(^{1515}\) Id. at OCC-PSI-00409216.
\(^{1516}\) Email exchange among HBUS personnel, from July to Sept. 2008, “Hokuriku Bank Ltd-Compliance Inquiry,” OCC-PSI-00409214, at 1. The time period was actually closer to two months.
traveler's checks through cash letter. Hokuriku should therefore cease the activity and make alternative arrangements, such as to make the deposits by wire, by September 30.\textsuperscript{1517}

The task of informing Hokuriku Bank was given to Machiko Yamashita, an HSBC employee in Tokyo who was then the designated Global Relationship Manager for Hokuriku Bank.\textsuperscript{1518} On September 11, 2008, he and a colleague met with Hokuriku officials who provided additional information about the traveler's cheque deposits and asked HBUS to continue clearing them. According to Mr. Yamashita, Hokuriku Bank explained:

"-Most of their customers related to this issue are used-car dealers for Russian buyers who are cash account holders of Hokuriku Bank through appropriate AML process.
- The dealers are doing cash on delivery type of deals with buyers in this market therefore cash or TCs [traveler's cheques] are normally used to accommodate those deals. As such Hokuriku Bank considers it is difficult for its customers to shift their payment method to wire transfers or commercial check[s] from TCs. …
- Since relevant customers are limited to around 20 -- 25 names and they are all cash account holders of Hokuriku Bank, Hokuriku Bank is well prepared to cooperate with HBUS by providing necessary information."

The email also stated: "HBUS is currently the sole Cash Letter provider for Hokuriku Bank.\textsuperscript{1520}

The next day, Anthony Julian responded that HBUS senior management had already reviewed the matter extensively "and determined that we cannot continue to support this business. Th[is] is not an issue for negotiation with Hokuriku.\textsuperscript{1521}" Mr. Yamashita replied, in that event, Hokuriku Bank had requested additional time to consider whether to end the business or find a replacement service provider. He wrote: "We suggest that we should withdraw very carefully given the fact that Japanese regional banks' world is very small. If we will push Hokuriku drastically, HSBC may likely have bad reputation on our PCM business in this marketplace."\textsuperscript{1522}


\textsuperscript{1519} Id. at 4.

\textsuperscript{1520} Id.

\textsuperscript{1521} Id. at 2:3. See also email exchange among HBUS and HSBC personnel from 9/4 to 9/11/2008, OCC-PSI-00196439, at 1.

A month later, on October 17, 2008, Mr. Julian sent an email to Albert Halley, head of the cash letter department at the Brooklyn processing center, advising him that Hokuriku Bank had been informed verbally and by letter that HBUS would “no longer accept bulk deposits” of travelers cheques “in excess of $5,000.” Mr. Julian advised Mr. Halley that, after October 31, 2008, any bulk travelers cheques received from the bank should be “returned to Hokuriku” via overnight mail. Mr. Halley responded that he had been told to return “any deposits” from Hokuriku Bank after October 31 – not just deposits in the form of travelers cheques – and asked Jonathan Dean in Compliance to “confirm/clarify this new request.” After consulting with his supervisors, Mr. Dean clarified that no travelers cheques could be accepted from Hokuriku Bank, but that other commercial items could still be processed. Mr. Dean wrote that he expected the remaining volume to be “extremely low” and asked Mr. Halley to report on the types of checks received from Hokuriku Bank after October 31. This decision to continue the correspondent relationship varied from the September memorandum which stated that senior HBUS AML Compliance official Anne Liddy told the OCC examiners that HBUS would be “exiting the Hokuriku relationship within the next 30 days.”

H. Hokuriku Bank’s Continued Lack of Cooperation

Even after informing Hokuriku Bank that it would no longer process any travelers cheques, HBUS AML Compliance continued to seek KYC information from the bank in connection with the originators of the travelers cheques, in order to complete an analysis of the transactions and determine whether they involved suspicious activity and had to be reported to law enforcement.

In late November or early December 2008, HBUS Compliance provided an update to the OCC about its efforts. According to an OCC memorandum summarizing the updated information, after receiving an inquiry from HBUS, the company issuing the travelers cheques dispatched investigators to the Russian bank where the travelers checks were being purchased. The OCC report stated:

"The result was that five individuals were identified who were purchasing the travelers checks with cash at the bank. The five individuals were then providing the checks to Mr. Alexander Tokarenko who is the owner of SK Trading. Mr. Tokarenko then stamped the checks payable to SK Trading."

All five individuals were Russians living in Russia. The memorandum stated that HSBC was attempting to determine if Mr. Tokarenko owned, not only SK Trading, but also the 29 other entities that had been identified as clearing bulk travelers cheques with HBUS. The OCC memorandum reported that “the total dollar amount of bulk travelers’ checks processed by HSBC for the 30 entities during the period of November 2007 to October 2008 was over $61 million."1528

In late November 2008, HBUS AML Compliance personnel drafted a new information request and asked Stephanie Brown to forward it to Hokuriku Bank. It asked whether five named Russians (identified in the earlier investigation) were or had been account signatories or “connected in any way” with the accounts opened by 30 specified corporations and individuals involved with the bulk travelers cheques.1529 Ms. Brown forwarded the request to Ako Kobayashi at HSBC in Tokyo who, in turn, sent it to Hokuriku Bank.

On December 3, 2008, Ms. Kobayashi sent an email to Ms. Brown indicating that Hokuriku Bank had raised the following questions:

“What is the background for your queries? Does it relate to your compliance reason or does it relate to criminal act and the police asks such information? Where did you get those Russian names? Since no cheques has been presented to you since Nov08, why such information is required now?"1531

HBUS explained that the information was needed to complete an internal investigation, and was not being requested in connection with a criminal prosecution.1532 Hokuriku Bank responded that it did not retain signatory cards or ownership information for the 30 accounts and had to identify and contact each of its branches where the 30 accounts were opened, which would take time.1533

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1528 Id.
1529 Email exchange among HBUS personnel, from Nov. to Dec. 2008, “Hokuriku Bank,” OCC-PSI-00811358, at 10-13. SK Trading Company was one of the 30.
1530 Id. at 9-10.
1531 Id. at 9.
1532 Id. at 9.
1533 Id. at 6.
On December 15, 2008, Ms. Kobayashi sent an email to multiple HBUS AML personnel forwarding additional questions from Hokuriku Bank about the new request for information. She also wrote:

"Please be advised that apparently they are not very happy with your request as they have other matters to attend toward the end of the year. ... Hokuriku Bank is not saying that they will not assist you to provide the required information however they are upset with the nature of the request without being given sufficient background. Given the nature of the queries, please understand it is time consuming and consider to allow them more time. They might not be able to supply the information by the end of the year."

Two days later, Denis O’Brien, head of HBUS Global Transaction Banking Compliance, sent an email answering the questions posed by Hokuriku Bank. Later that same day, the HSBC Money Laundering Control Officer in Japan, Shinji Kawamura, sent an email to Mr. O’Brien indicating that Hokuriku Bank would not provide the requested information. He wrote:

"They have been good enough to provide information so far but as you may understand from bank secrecy viewpoint, they should not or cannot disclose customer information. So they will no longer provide information. If you need my suggestion to clear those backlogs, I will tell you that you should file suspicious transaction report to your authority."

Notwithstanding that communication, two days later, on December 19, 2008, Ms. Kobayashi sent Mr. O’Brien an email stating that Hokuriku Bank “has provided the information at their risk and confirmed that the purchasers of the travelers checks ... are not signers or are NOT connected in any way to the previously requested named relationships at Hokuriku Bank. This should be the last favour and we cannot expect further or next assistance from them.

Mr. O’Brien responded: “We are appreciative of your assistance and thank you for your diligence in this regard. We have closed our investigation as it related to this issue."

The Subcommittee contacted Hokuriku Bank to learn more about the travelers cheques. The bank provided this additional information:

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1534 Id. at 4-5.
1535 Id. at 5.
1536 Id. at 3-4.
1537 Id. at 2.
1538 Id. at 1.
1539 Id. at 1.
“Due to the geographic proximity of Russia across the Sea of Japan, many Japanese dealers of pre-owned automobiles are located along the coast, including the Hokuriku region. (Hokuriku means ‘North Land’ in Japanese.) Hokuriku Bank is headquartered in this area and has several branches in the surrounding areas. Some of such dealers have accounts at Hokuriku Bank.

In a typical transaction, a customer of Hokuriku Bank (that is to say an account holder) sells a used car (or cars) to a Russian buyer who is a passenger or crew member of a ship at a nearby port. The buyer pays with travelers’ checks. The seller/account holder brings the travelers’ cheques to its bank (Hokuriku) and deposits them into its account. Hokuriku Bank accepts the travelers’ checks, credits the customer’s account, and sends the checks to clearing banks.\textsuperscript{1540}

This description, which seems to describe a thriving used car business in northern Japan, does not explain why a single individual in Russia was using five individuals to purchase millions of dollars of sequentially numbered U.S. dollar travelers cheques from the same bank in Russia per month, and then signing and countersigning all of them. Nor does it explain why the parties were using U.S. dollars to purchase used cars located in Japan or why the Hokuriku branches had so little information about the 30 clients carrying in U.S. dollar travelers cheques totaling about $500,000 to $600,000 each day.

In February 2009, HBUS closed one of the accounts held by Hokuriku Bank, Account No. 50385, and transferred its balance to Account No. 34738. HBUS has not explained why it closed one account but not the other, or why Account No. 34738 was kept open when it was the subject of the extended HBUS inquiries to Hokuriku Bank in 2008. Because the one account remained open, the correspondent relationship between HBUS and Hokuriku Bank continued.\textsuperscript{1541} The OCC examiners told the Subcommittee that they had thought all of the Hokuriku accounts had been closed in 2008, and were unaware of the ongoing relationship for some time.\textsuperscript{1542}

\textsuperscript{1540} 6/26/2012 letter from Hokuriku Bank’s legal counsel to the Subcommittee, at 4, PSI-HokurikuBank-01-0001.
\textsuperscript{1541} HBUS KYC Profile of Hokuriku Bank, at HSBC-PSI-PROC-0102415, 420.
\textsuperscript{1542} Subcommittee interviews of Joseph Boss (1/30/2012) and Elsa de la Garza (11/20/12); 5/15/2012 email from OCC to the Subcommittee, “HSBC – Hokuriku Questions,” PSI-OCC-38-0001-002.
I. 2010 OCC Discovery of Hokuriku Account Activity

Two years later, in the summer of 2010, two OCC AML examiners conducted a review of RDC services at the HBUS Buffalo processing center, including RDC processing of monetary instruments presented for deposit through electronic images.\textsuperscript{1543} During that review, one of the examiners was surprised to discover that the Hokuriku account was not only still open, but that HBUS was processing monetary instruments for Hokuriku Bank through RDC.\textsuperscript{1544} In an email to the OCC Examiner-in-Charge summarizing the RDC concerns that were communicated to HBUS after the examination field work, the examiner included: “Concern related to pouch activity being conducted by HSBC for Hokuriku.”\textsuperscript{1545} He informed the Subcommittee that the volume of activity was “significant, but not as extensive as in 2008.”\textsuperscript{1546}

In October 2010, a draft OCC Supervisory Letter detailing AML deficiencies in HBUS’ RDC operations specifically identified concerns related to Hokuriku Bank. After describing the problems uncovered in 2008, involving the bulk processing of Hokuriku travelers cheques, the letter stated:

“[I]n late 2008, early 2009, bank management informed the OCC that it would terminate the account relationship with Hokuriku. During the OCC’s RDC review, it was again found that pouch activity was being conducted by HSBC for Hokuriku. Upon further review, it was determined that at the time that the Bank was to have initially severed its relationship with Hokuriku, there existed two separate accounts for Hokuriku. At that time, management decided to close the account in which the aforementioned deposits [of travelers cheques] were being processed and continue to maintain the other account. It was through the second account that the pouch activity continued.”\textsuperscript{1547}

The draft OCC letter also recited a long list of AML concerns involving the bank’s pouch activity. The final version of this Supervisory Letter included most of the information in the draft, but dropped the paragraph that singled out Hokuriku Bank.\textsuperscript{1548} OCC personnel asked about the letter were unable to remember why the reference to Hokuriku Bank had

\begin{footnotes}
\footnotetext{1548} 10/4/2010 draft Supervisory Letter from OCC to HBUS, at OCC-PSI-00863990.
\footnotetext{1549} 10/21/2010 Supervisory Letter HSBC-2010-24 from OCC to HBUS, OCC-PSI-00886181-185.
\end{footnotes}
been dropped.\textsuperscript{1549} HBUS’ legal counsel told the Subcommittee that HBUS stopped processing travelers cheques through the Hokuriku account in 2008.\textsuperscript{1550} Hokuriku Bank similarly informed the Subcommittee that HBUS stopped processing its travelers cheques in October 2008.\textsuperscript{1551}

The HBUS KYC Profile of Hokuriku Bank, updated in 2010, referenced ongoing AML concerns related to the bank, perhaps due to the OCC’s renewed interest in the relationship. Among other matters, the KYC Profile indicated that, as of September 2010, despite a relationship of many years, HBUS did not have a copy on file of Hokuriku’s KYC or AML policies and procedures.\textsuperscript{1552} The profile also indicated that HBUS had sent an AML questionnaire to the bank, but Hokuriku Bank had not yet returned it. HBUS also noted in the 2010 profile that Hokuriku Bank did not have an independent AML compliance function within the bank, raising further questions about Hokuriku’s AML efforts.\textsuperscript{1553}

In May 2012, HBUS closed the Hokuriku Bank account.\textsuperscript{1554} While that action ended the direct relationship, Hokuriku Bank still has correspondent relationships with other HSBC affiliates which, in turn, have correspondent accounts at HBUS. Accordingly, it is still possible for Hokuriku Bank to obtain U.S. dollar services through the U.S. dollar correspondent accounts of the HSBC affiliates, although Hokuriku Bank told the Subcommittee it is not doing so.

**J. Analysis**

As a major global bank, HBUS serves as a gateway for foreign banks to obtain U.S. dollars, including through the clearing of U.S. dollar travelers cheques. HBUS AML Compliance personnel knew that travelers cheques were vulnerable to money laundering abuses, and that large numbers of sequentially numbered travelers cheques were a red flag. In 2003, it set up a data system that captured travelers cheque information, but in five years, appeared not to use it to identify suspicious activity or high risk clients. In 2007, the OCC found that HBUS essentially had no effective AML controls over the process used to cash travelers cheques and required the bank to strengthen its policies and procedures.

\textsuperscript{1549} Subcommittee interview of Teresa Tabor (5/17/2012).
\textsuperscript{1550} Subcommittee briefing by HSBC legal counsel (5/9/2012).
\textsuperscript{1551} 6/26/2012 letter from Hokuriku Bank’s legal counsel to the Subcommittee, PSI-HokurikuBank-01-0001-016, at 001.
\textsuperscript{1552} HBUS KYC Profile at HSBC-PSI-PROD-0102421.
\textsuperscript{1553} Id.
\textsuperscript{1554} 6/26/2012 letter from Hokuriku Bank’s legal counsel to the Subcommittee, at 1, PSI-HokurikuBank-01-0001.
The Hokuriku Bank example illustrates the problem. For years, Hokuriku Bank routinely presented a large volume of travelers cheques to HBUS for processing. Most involved sequentially numbered cheques signed and countersigned illegibly by the same person. For years, HBUS cleared the cheques with few questions asked. The cheque volume, which involved $500,000 to $600,000 in travelers cheques per day and $70 to $90 million per year, produced a four-year total of more than $290 million. When directed by OCC to look into the transactions, HBUS quickly discovered that most of the cheques were being purchased for cash by Russians at a Russian bank and sent to Hokuriku Bank accounts in Japan. HSBC discovered that Hokuriku Bank had virtually no information about a network of 30, possibly related, accountholders who were physically turning in large stacks of sequentially numbered U.S. dollar travelers cheques to the bank every day. When asked about the accounts by HBUS, Hokuriku Bank resisted finding out and claimed bank secrecy requirements prevented it from disclosing client-specific information. HBUS also learned it was the only bank cashing the Hokuriku travelers cheques. Later, in 2010, HBUS discovered that Hokuriku Bank had no separate AML compliance function and was left waiting to receive a copy of its written AML policies and procedures. After the Subcommittee inquired about the account, HBUS closed it, although other HSBC affiliates are continuing to service the bank.

HBUS enabled a number of Russians engaged in suspicious activity to use a relatively small Japanese bank with weak AML controls to gain access to over $290 million in U.S. dollars in less than four years. HBUS continued to clear the travelers cheques even after it learned of the transactions’ suspicious nature. In so doing, HBUS facilitated the suspicious transactions and failed to live up to its AML obligations, all in return for about $47,000 in annual revenues.
VII. HBUS PRIVATE BANK AMERICAS: OFFERING BEARER SHARE ACCOUNTS

Over the course of a decade, HBUS allowed over 2,000 customers to open accounts in the name of bearer share corporations, a type of corporation that allows secrecy by assigning ownership to whomever has physical possession of the shares. At its peak, the Miami office had over 1,670 bearer share accounts; the New York office had over 850; and the Los Angeles office had over 30. The Miami bearer share accounts alone held assets totaling an estimated $2.6 billion, generating annual bank revenues of $26 million. Multiple internal audits and regulatory examinations criticized the accounts as high risk and advocated that HBUS either take physical custody of the shares or require the corporations to register the shares in the names of the shareholders.

In 2007, HBUS Compliance circulated a draft to standardize bearer share AML safeguards across the bank, including by designating all of the bearer share accounts as high risk clients requiring enhanced due diligence and monitoring. Internal documents show Miami and New York bank personnel successfully weakened the standards by enabling the majority of accounts not to be treated as high risk and requiring updated ownership information only once every three years. Later, HBUS learned that the British Virgin Islands (BVI), which formed most of the bearer share corporations with HBUS accounts, was requiring the registration of all outstanding BVI bearer shares by the end of 2009. In response, HBUS initiated an effort to require its BVI accountholders to register their shares by the legal deadline. In 2010, HBUS also contacted its other bearer share accountholders, requiring them either to register their shares or place their shares in the custody of HBUS or a third party. HBUS ended up obtaining registered shares or share custody for 1,155 accounts, closed over 530 accounts, and by 2012, had substantially reduced the number of bearer share accounts it maintained to 26.

Two examples of the accounts illustrate the risks they pose. In the first, two Miami Beach hotel developers, Mauricio Cohen Assor and Leon Cohen Levy, a father and son, used bearer share accounts they opened for Blue Ocean Finance Ltd. and Whitebury Shipping Timesharing Ltd. to help hide $150 million in assets and $49 million in income. In 2010, both were convicted of criminal tax fraud and filing false tax returns, sentenced to ten years in prison, and ordered to pay back taxes, interest, and penalties of more than $17 million. A second example involves two Panamanian bearer share corporations, Uriger International S.A. - Holding Company and Birmingham Merchant S.A. - Holding Company, beneficially owned by a wealthy and politically powerful family in Peru. The family sought a waiver from HBUS' AML requirements to avoid registering their shares or placing them in bank custody. When asked whether the waiver was granted when the account...
was opened in 2007, HBUS legal counsel told the Subcommittee that
“we don’t know.” The account was closed in 2011. These accounts
demonstrate the risks associated with bearer share accounts, whose
owners seek to hide their identities. Today, HBUS has 26 bearer share
accounts left, most of which are frozen, but also maintains a policy
allowing the bank to open more bearer share accounts in the future.

A. High Risk Corporate Accounts

Bearer share accounts have long been viewed as being at high risk
for money laundering, due to the ability of bearer shares to hide
ownership of a corporation. A 2005 U.S. Money Laundering
Assessment defined bearer shares as follows:

“Bearer shares are negotiable instruments that accord ownership of
a company to the person who possesses the share certificate. Such
share certificates do not contain the name of the shareholder and
are not registered, with the possible exception of their serial
numbers. Accordingly, these shares provide for a high level of
anonymity and are easily negotiable.”1555

Because of the ease of transfer and secrecy attached to bearer share
corporations as well as their attractiveness to money launderers and
terrorist financiers, their propensity for misuse have made them lose
favor with governments and AML organizations.

(FATF) is the leading international AML body.1556 In its 2006 report,
“The Misuse of Corporate Vehicles, Including Trust and Company
Service Providers,” FATF highlighted the AML problems associated
with bearer share corporations. FATF explained that anonymity is a
critical factor in facilitating the misuse of corporate vehicles, and bearer
shares present a “special challenge to determining beneficial ownership
of a corporate vehicle” because these shares “can be easily transferred
without leaving a paper trail.”1557 The FATF report noted that, while
bearer shares can be used for legitimate purposes, they were also used
for “money laundering, self-dealing, and/or insider trading.”1558

1555 12/2005 “U.S. Money Laundering Threat Assessment,” issued by the Money Laundering
Threat Assessment Working Group, which included the U.S. Departments of Treasury, Justice,
Misuse%20of%20Corporate%20Vehicles%20Including%20Trusts%20and%20Company%20
Service%20Provider.pdf
1558 Id. at 16.
Organisation for Economic Co-operation and Development.
The Organisation for Economic Co-operation and Development (OECD) is a 50-year-old membership organization of 34 countries including the United States, which tackles issues of common interest to promote economic development. In a 2001 report, “Behind the Corporate Veil,” the OECD identified bearer shares as one of the primary means used to achieve anonymity for the beneficial owners of corporations. The OECD report noted that bearer shares’ high level of anonymity and ease of transfer “make them attractive for nefarious purposes, such as money laundering, tax evasion, and other illicit conduct, especially when they are issued by private limited companies.” The OECD noted that bearer shares were especially vulnerable to misuse, because of the lack of information available to authorities in the event of an investigation.

U.S. Government. The United States has also criticized bearer share corporations. In 2005, for example, multiple U.S. agencies worked together to produce a U.S. Money Laundering Threat Assessment to identify key money laundering methods. The Assessment identified the use of shell corporations as a key AML problem and singled out bearer shares as one of the means, along with nominee shareholders and directors, “to mask ownership in a corporate entity.” It warned that bearer shares “provide money launderers with the tools to hide their identity from financial institutions and law enforcement.” In addition, Federal financial regulators warn about the risks associated with bearer shares, because they allow “ownership of the corporation to be conveyed by simply transferring physical possession of the shares.” The Federal regulators’ joint AML examination manual states that due to the risk, “in most cases banks should choose to maintain (or have an independent third party maintain) bearer shares for customers.”

World Bank. A 2011 report issued by the World Bank on corporate transparency issues is a recent example of an international

1561 Id.
1563 Id. at 47.
1564 Id. at 48.
1566 Id. The AML examination manual also stated: “In rare cases involving lower-risk, well-known, long-time customers, banks may find that periodically re-certifying beneficial ownership is effective.” Id.
body condemning use of bearer share corporations. It indicates that, in recent years, bearer share corporations have “generally been frozen out of the financial sector,” asserts that “[n]o bank with any sort of due diligence standards is willing to conduct business with a company that has free-floating bearer shares,” but also states that such corporations remain an AML threat:

“Concerns have been raised in AML forums that companies that issue bearer shares are used extensively for illegal activities, such as tax evasion and money laundering .... In most jurisdictions, bearer-share statutes have generally been undergoing a process of reform and elimination ....

Financial compliance officers and company service providers report that bearer shares have generally been frozen out of the financial sector even if they are still permitted by the laws of a particular jurisdiction. No bank with any sort of due diligence standards is willing to conduct business with a company that has free-floating bearer shares. Companies that are not required under their own laws to have bearer shares immobilized will typically have to place the share in the trust of an agent of the bank, as a condition of being accepted as a customer. ...

Given the legislative reforms of the past decade and the fact that bearer shares or share warrants featured in roughly 1 percent of the grand corruption cases we reviewed, one might be inclined to consider bearer securities to be a problem of the past. Investigators interviewed for this study from Latin America and the Caribbean disagree, however. They maintain that bearer-share companies are still a problem for money laundering investigations, that their anonymity prevents detection and impedes prosecution, and that corrupt individuals still can gain access to financial systems and undertake anonymous transactions involving considerable sums.

In practice, there is scant business rationale for the continued use of bearer securities. The claims that bearer securities are necessary to facilitate transfer of ownership and enhance liquidity no longer hold for the vast majority of countries. An electronic system of registered shares is clearly a more efficient platform for transferring equity interests. In this case, the risks outweigh the benefits.”

B. Bearer Share Activity at HBUS

Despite the widespread, longstanding international condemnation of bearer share corporations, until last year, HBUS maintained hundreds, sometimes thousands, of bearer share accounts in the United States. At its peak, HBUS had over 2,000 bearer share accounts, including 1,667 accounts at the International Private Bank in Miami,\(^{1568}\) 851 at the International Private Bank in New York,\(^{1569}\) and 33 at the International Private Bank in Los Angeles.\(^{1570}\) The Miami bearer share accounts alone have held assets totaling an estimated $2.6 billion and produced revenues to the bank of $26 million per year.\(^{1571}\)

These accounts were overseen by two different Federal banking regulators. The OCC oversaw the accounts in New York and Los Angeles, which were held in the HBUS International Private Banking division. The bearer share accounts in Miami, however, were lodged with a different HBUS subsidiary, which was often called an International Private Bank, but was actually formed under the Edge Act, a Federal law which allows corporations to be chartered by the Federal Reserve, engage solely in international banking, and serve only non-U.S. citizens with U.S. banking needs.\(^{1572}\) Edge Act corporations are regulated by the Federal Reserve.\(^{1573}\) The Miami bearer share accounts were accordingly overseen by the Federal Reserve Bank of Atlanta which conducted an annual examination of its operations.\(^{1574}\)

HBUS’ bearer share accounts repeatedly raised AML concerns largely because the accounts suffered from missing or inadequate KYC information. A 2004 internal audit of HBUS’ Private Bank International in Miami by HSBC Group auditors found, for example, that sixty bearer share accounts lacked “Certificates of Beneficial Owner” forms,

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\(^{1574}\) The Miami Edge Act corporation has undergone annual Federal Reserve audits since at least 2006.
meaning the bank had no information on who owned the accounts. The audit also repeated a recommendation carried forward from a 2002 Group Audit that management should obtain the missing beneficial ownership information “at the earliest opportunity,” suggesting the ownership information had been missing for at least two years. In February 2005, an RBUS Monthly Private Banking Compliance Report to HSBC Group noted that ten bearer share accounts had been frozen due to missing “Beneficial Ownership Letters,” and Relationship Managers for the accounts had been notified they had 30 days to obtain the needed documents or the accounts would be closed.

**OCC Concern.** In 2005, the OCC identified the RBUS bearer share accounts as an AML concern and, in 2006, directed HBUS to assess their AML risk and take physical control of the bearer shares.

In November 2005, the OCC conducted an AML examination of HBUS’ International Private Banking division and looked at the bearer share accounts in its New York and Los Angeles offices. In November 2005, an OCC AML examiner wrote an internal memorandum summarizing HBUS’ “Bearer Share Activity” and recommending that HSBC adopt a policy to “ensure that either the bank or an acceptable third party controls the bearer shares.” The memorandum stated that the RBUS New York office then had 851 bearer share accounts and the California office had 33. The memorandum explicitly noted the AML risks attached to the bearer share accounts and the need to obtain satisfactory evidence of the accounts’ beneficial owners. It noted that bearer share certificates allowed corporate ownership to be transferred without the bank’s knowledge, and OCC policy was to require banks to maintain control of all bearer shares. The memorandum also discussed new legislation in the British Virgin Islands that “provides a legal framework for immobilizing bearer shares.”

As a result of the AML examination, on January 31, 2006, the OCC issued a Supervisory Letter to HBUS which included a Matter

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1577 11/11/2005 OCC memorandum, “Bearer Share Activity,” OCC-PSI-01437596. According to the memorandum, the policy at the time was that the International Private Bank required the following for each bearer share account: an explanation for opening the account, CEO approval, and completion of a beneficial ownership letter, to be certified every 3 years, identifying the beneficial owners of the bearer share company.
1578 Id.
1579 Id. (explaining that, under the BVI legislation, international corporations formed after January 1, 2005 would have to have their shares held by either an “authorized” or “recognized” custodian. Companies formed prior to January 1, 2005, would have a transition period in which to either have the shares registered or have them held by a custodian).
Requiring Attention (MRA) of the HBUS Board of Directors directing HBUS to strengthen AML controls over its bearer share accounts.  

The Supervisory Letter stated:

“Management should evaluate the risks associated with bearer share accounts. BSA/AML policy and procedures need to be revised to ensure that either the bank or an acceptable third party controls the bearer shares. The bank must monitor legal requirements in countries that allow for the organization of International Business Companies (IBCs) and Private Investment Companies (PIC). Policies and procedures need to define ‘acceptable third parties’ and any applicable due diligence, and specify documentation required by the bank to ensure that the shares have been properly received by the third party custodian.”

The Supervisory Letter also stated that HBUS management had “agreed to implement revised policies and procedures for bearer shares in accordance with our recommendation by March 31, 2006.” When asked about this Supervisory Letter, the OCC Examiner-in-Charge at HBUS, Anthony DiLorenzo, did not remember the bearer share issue, but said that, aside from HSBC, he had not seen bearer share accounts at other large banks that he oversaw.

On March 3, 2006, HBUS responded to the Supervisory Letter with a proposal that did not completely follow the OCC instruction on bearer shares. Instead of requiring that all bearer share certificates be placed in custody for all of its bearer share accounts, HBUS indicated that it would require custodization only for what it deemed to be high risk bearer share accounts. For lower risk bearer share accounts, HBUS would not take possession of the shares, but would allow account holders to submit to the bank a “beneficial ownership letter” every two years stating who had possession of the corporate shares. HBUS committed to having a plan in place to implement this approach by March 31, 2006.

At the same time the OCC was reviewing the New York and Los Angeles bearer share accounts, the Federal Reserve was performing a “risk-focused examination” of the Edge Act subsidiary holding the Miami accounts, HSBC Private Banking International. In January 2006, the Federal Reserve issued a Report of Examination (ROE) deeming the

1582 Id. at 3.
1583 Id.
1584 Subcommittee interview of Anthony DiLorenzo (3/22/2012).
overall risk management framework for the Miami operation as satisfactory, while identifying as its “primary risk” the “reputational risk, arising from its international private banking and wealth management activities that are directed towards a high net-worth Latin American client base.” The ROE also deemed the Miami office’s AML program as adequate, while noting numerous issues involving offshore accounts, unavailable offshore documentation, offshore shell companies “serving as operating accounts,” and the addition of international private banking accounts moved from New York which added “in excess of $1 billion” to the assets under management in Miami, but made no mention of bearer share accounts.

In February 2006, as the OCC deadline approached for implementing stronger AML controls over HBUS’ bearer share accounts, the head of HBUS’ International Private Bank (IPB) Operations in Miami, Jeff Clous, asked a Miami law firm prepared an analysis for the bank on the Federal Reserve’s policy regarding bearer share accounts. According to Mr. Clous, the law firm reported that the Federal Reserve expected banks to conduct a risk assessment and assign risk classifications to each account for risk-based monitoring. According to Mr. Clous, the law firm also informed him that the Federal Reserve provided banks with the option of either obtaining custody of the bearer shares or recertifying beneficial ownership of the shares on a periodic basis, based upon the account’s risk classification.

Mr. Clous emailed his report of the law firm’s analysis to senior personnel in the New York International Private Bank (IPB), the CEO of Private Bank America, Philip Musacchio, the Chief AML Officer of Private Bank, Susan Hoggarth, and the Head of Private Bank Operations Terry Westren. Mr. Musacchio responded that New York would prefer to adopt this “much better and reasonable approach.” Ms. Hoggarth replied:

“That may work for Miami, but it won’t work for the OCC in NY and California. The OCC has specifically advised us that the Beneficial Ownership letters are not sufficient. We have been advised that the shares need to be held either by ourselves or an accepted third party.”

1586 1/19/2006 letter from FRB Atlanta to HSBC Private Bank International Board of Directors, OCC-PSI-00109434. [Sealed Exhibit.]
1587 Id. at 2, 4-6.
1589 Id.
1590 Id.
Mr. Musacchio responded that he had assumed that Ms. Hoggarth would explain the Federal Reserve’s position to persuade the OCC to agree to the same approach.1591 Ms. Hoggarth replied that the OCC examiners had already advised the bank that beneficial ownership letters were not adequate, and she did not think the OCC would accept the Federal Reserve’s approach.1592

When the OCC’s bearer share deadline arrived at the end of March 2006, however, little had changed in either the New York or Miami IPB offices. Both continued their policy of obtaining periodic beneficial ownership letters from most accounts, and arranging for shares to be taken into custody only for a small percentage of accounts deemed to be higher risk.

The documents reviewed by the Subcommittee also contain no indication that the OCC followed up with HBUS on the bearer share MRA in the 2006 OCC Supervisory Letter. When asked why, the OCC AML Examiner told the Subcommittee that he had been informed by HBUS that it had closed all of its bearer share accounts in 2006, and didn’t learn until 2010, that the bearer share accounts had, in fact, remained open.1593

**Proposed Job Aid on Bearer Shares.** From at least 2002 to 2007, HBUS did not have a standard policy establishing how its various branches should handle bearer share issues and what AML safeguards should be used.1594 In early 2007, HBUS undertook an effort to develop a standard bearer share policy that would apply to all HBUS offices. It was an effort that would take the rest of the year.

An HBUS AML Compliance officer located in New York, Ali Kazmy, was tasked with developing the policy. In February 2007, he emailed his supervisor, Mary Caskin, that he hoped to finalize a draft that week.1595 Internal documents indicate that, a few months later, the draft was circulated to other HBUS Compliance personnel for comment. At least one colleague sought to strengthen it. On April 17, 2007, HBUS AML Compliance officer Robert Guthmuller sent an email to colleagues stating that the policy should not make it optional for bearer shares to be classified as high risk. Mr. Guthmuller contended that approach did not mirror other banks’ policies: “For at least the last 10

1591 Id.
1592 Id.
1594 See 2/26/2007 email exchanges among HBUS Ali Kazmy and HBUS Mary Caskin and others, “APC Interim Procedures,” OCC-PSI-00307701 (“At present, we do not have a standard bearer share policy. I am actually working on it and expect it to be finalized this week, however it will require senior management approval.”).
1595 Id.
years, all private banks I know classify ALL bearer share PICs as high risk."  

In June 2007, Mr. Kazmy sent a draft “Job Aid” on bearer shares to the IPB offices with bearer share accounts.1597 HBUS Job Aids were documents designed to provide more specific instructions to bank personnel in implementing higher level policies and procedures.1598 Mr. Kazmy immediately met strong resistance to strengthening the AML controls on bearer share accounts.

Teresa Garcia, who was a senior Compliance officer at the New York IPB, criticized the draft on several grounds: for requiring all bearer share accounts to be classified as SCC accounts subject to enhanced due diligence and monitoring; requiring all shares to be held in the custody of the bank; and requiring beneficial ownership to be disclosed every two years.1599 Ms. Garcia wrote that, although the Job Aid was similar to an existing policy at the New York IPB, the New York IPB did not classify bearer share accounts as SCCs unless the nature of the beneficial owner warranted it, and bearer certificates could be held with a third party custodian instead of the bank. Ms. Garcia added that the Job Aid should only require beneficial ownership disclosure forms to be renewed every three years. Later that day, Ms. Garcia sent another email to Mr. Kazmy and others stating: “IPB-NY has about 500 non-high risk bearer share accounts. There is no way we are making all these accounts SCCs.,,1600 These emails, in which Ms. Garcia opposed the proposed AML controls, show that she saw her role in this instance as acting on behalf of the business unit rather than acting on behalf of HBUS Compliance.

The Miami office was also critical of the proposed Job Aid. Clara Hurtado, Director of AML Compliance for Miami, wrote:

“Miami also has a large number of bearer share accounts. I too disagree with making these SCCs. We are also getting an updated BOL [Beneficial Ownership Letter] every 3 years, not 2 years.

Before anything goes out to the units, we need to be careful that we do not change the agreed upon policies/procedures which have been put in place based on local regulator requirements.1601

1599 Id.
1600 Id.
1601 Id.
On July 25, 2007, Ms. Hurtado sent Mr. Kazmy another email stating that Miami had approximately 600 bearer share accounts and they “could not possibly categorize them all as high risk.”1602 She proposed instead that Miami use the bearer shares as one indicator of a high risk account, but that a second indicator would also have to be present before the account would be classified as high risk and subjected to enhanced due diligence and monitoring. She wrote: “We feel this is a good way to capture truly high risk bearer share accounts.” Ms. Hurtado also asserted that there was “no way to custodize in Miami and remotely was too difficult.”1603 She proposed instead that Miami maintain its current practice of requiring a Beneficial Ownership Letter for new accounts with updates every three years. She noted that the Miami policy had just been approved by HBUS Compliance head Teresa Pesce and Compliance Officer of California Programs, Susan Hoggart, both of whom had agreed that Miami would not have to custodize the shares.1604 These emails show that Ms. Hurtado, like Ms. Garcia, saw her role in this instance as defending the position of the international private bank rather than the position of HBUS Compliance.

Four days later, on July 29, 2007, Ms. Hurtado sent Mr. Kazmy another email suggesting that the AML Director rather than the CEO should be able to approve the opening of bearer share accounts. She also wrote that the Miami subsidiary “will not be lowering the monitoring thresholds on over 600 bearer share accounts,” and that Miami’s use of Beneficial Ownership Letters had been approved by HBUS Corporate Compliance and the office “cannot go back and re-paper.”1605 The next day, Ms. Hurtado forwarded Mr. Kazmy a copy of the Miami bearer share procedures, explaining that if he wanted to change them, he would need to “reach out to the business first,” and gave him contact information for Jeff Clous, head of HBUS IPB Operations in Florida.1606

On August 6, 2007, Mr. Kazmy forwarded Ms. Hurtado’s emails to two more senior HBUS AML Compliance officials, Alan Williamson and Anne Liddy. Though Mr. Williamson had agreed that IPB Miami should be included in the new policy, he said after reading Ms. Hurtado’s emails, “unfortunately I now question my prior inclination to make them be consistent.”1607 Mr. Williamson suggested that the new guidance be prospective from the date of issuance so that the bank

1603 Id.
1604 Id.
1605 Id.
would not have to do a retrospective review of bearer share accounts, stating that “may be a good idea but we should avoid locking ourselves in.” Mr. Williamson also recommended adding an “exception process” in the policy, because there is “always a special case somewhere.” Mr. Kazmy replied that the bank may have to do a retrospective review over a reasonable time period, but agreed to include the following line in the policy: “Exceptions to this Policy must be sought from the AML Director or designee in writing giving full details of the matter warranting such exception. The written approval must be maintained in customer file and reported to Oversight & Control Group upon receipt.” In August 2007, the New York IPB policy for bearer shares was slightly strengthened. It required all new clients wishing to open a bearer share account to obtain approval from the New York IPB CEO and AML Local Compliance Officer, and further required them to register or custodize their shares. This policy essentially treated all new bearer share accounts as high risk, though no mention was made of enhanced due diligence or monitoring obligations. Existing bearer share accounts were kept divided into high and low risk accounts. High risk bearer share accounts were required to register or custodize their shares. Low risk bearer share accounts were allowed to provide a Beneficial Ownership Letter every three years, and their shares were not taken into custody.

American Express Prosecution. On August 6, 2007, the U.S. Justice Department, working with the Federal Reserve and FinCEN, filed a Deferred Prosecution Agreement against American Express Bank International for criminal violations of Federal AML laws. In August 2007, HBUS Compliance circulated information about the prosecution, not because HBUS had participated in any of the matters involving American Express, but to alert employees to the prosecution, ascertain if any of the American Express clients were also clients of HBUS, and point out that the Deferred Prosecution Agreement had targeted the bank in part for lack of sufficient AML controls over bearer share accounts.
In response, on August 16, 2007, Jeff Clous, head of HBUS IPB Operations in Florida, expressed concern to Alan Williamson of HBUS Compliance about HBUS’ relative dearth of AML compliance resources compared to American Express, which had twelve full time compliance staff. He wrote: “I believe we have resource constraints that impact our AML program that need to be addressed.”

The next day, on August 17, 2007, HBUS Compliance head Carolyn Wind and Alan Williamson met with Federal Reserve officials. During this meeting, described by HBUS as “friendly,” the Federal Reserve referenced the American Express case, suggested HBUS might have similar issues, and suggested the HBUS Miami management and compliance teams take another look at risky products, such as bearer share companies. In a summary of the meeting, Ms. Wind noted that one Federal Reserve employee commented with respect to HBUS: “if you take the facts from the American Express case and lay them over our last report of HSBC, they are all there.” Earlier in the year, on January 24, 2007, the Federal Reserve had issued a Report of Examination for the Miami IPB which included a requirement that management “enhance the current controls over bearer share accounts to ensure that they are sufficiently risk-based and capable of detecting changes in ownership of these entities on an ongoing basis.”

That same month, HBUS Compliance began conducting a “gap analysis” comparison of the American Express case versus its own AML program. On October 11, 2007, the analysis was issued and identified bearer shares as a particular concern at both American Express and HBUS. It also announced the decision by HBUS to stop opening new bearer share accounts as of September 1, 2007, and to consider also eliminating all of its existing bearer share accounts:

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Action against AmEx’s businesses,” OCC-PSI-001535253. On August 9, 2007, Ali Kazmy wrote, “At this juncture, your cognizance is drawn to the recently issued enforcement action against American Express entities, who were penalized up to $55 million for BSA/AML violations including those associated with PICS/bearer share accounts.” 8/9/2007 email from Ali Kazmy to Alan Williamson, OCC-PSI-00316956.


"AEBI [American Express Bank International] failed to exercise sufficient control over accounts held in the names of offshore bearer share corporations, and until 2004 had no policy or procedure requiring beneficial owners of such accounts to certify in writing their continued ownership of the bearer shares.

Bearer share accounts are known and HSBC requires written confirmation every three years. A decision has been taken by the business not to accept new bearer share accounts beginning 9/1/07. Management is considering a program to eliminate all bearer share customers.\textsuperscript{1622}

Although HBUS announced a ban on opening new bearer share accounts as of September 1, 2007, it issued a new bank-wide bearer share policy three months later allowing new accounts.

**Final Bearer Shares Policy.** On December 10, 2007, HBUS Compliance officer Paul O’Sullivan circulated a final draft of the proposed new Bearer Share Policy. He explained that the policy was more flexible than first proposed, and “we will be able to maintain Bearer Share Company accounts once the requirements of the policy are met.”\textsuperscript{1623} The draft policy applied to both new and existing bearer share accounts. It required all bearer share accounts to either register their shares or keep the shares in custody with the bank or an approved third party. In addition, Beneficial Ownership Letters would have to be filed every three years. The draft policy also permitted new accounts to be opened if they were approved by the Business Unit head, AML Local Compliance Officer, and AML Director, or a designee. The approvals would have to be documented and retained in the customer file.\textsuperscript{1624}

On December 11, 2007, HBUS Compliance officer Terry Westren responded as follows:

“If I read this correctly, it is saying that one year from the issuance of this policy, we have to have all outstanding bearer shares (currently with clients), either registered or in the hands of an approved Custodian. Is this correct? I recall when the OCC was here, they asked for this. AML Compliance was able to negotiate for this requirement to be applicable only to High Risk accounts. We then complied with this. It looks like this is now expanded to all outstanding bearer shares? Of course, with the new BVI rules.

\textsuperscript{1622} Id. (Emphasis in original.)
coming into play in 2009, they will have to do this anyway, but I think it should be noted this could be a considerable exercise.1625

Contrary to the statement in this email, however, the 2006 OCC Supervisory Letter had already called for the bank to place all bearer shares in the custody of either the bank or an acceptable third party, with no exceptions made for lower risk accounts.1626 While HBUS had responded to the Supervisory Letter that it planned to limit that requirement to higher risk accounts, there is no documentation showing the OCC accepted that position. When asked about this email, the OCC told the Subcommittee it had been under the impression that HBUS had closed all of its bearer share accounts.1627

That same day, December 11, 2007, Jeff Clous, IPB Operations head in Florida, repeated the concerns he had voiced to Alan Williamson in September. Mr. Clous asserted that the draft policy would have an adverse effect on IPB business. He noted that, although IPB Miami was no longer opening new bearer share accounts, it still maintained 1,679 accounts with $2.6 billion, which generated $26 million in revenue annually. Mr. Clous also asserted that the draft policy went too far beyond what regulators required. He noted that the proposed policy required the bank to both register and custodize bearer share accounts, while the Federal AML examination manual offered a choice between those options. In addition, he noted that the draft policy would require existing bearer share accounts to register or custodize their shares by the end of 2008, even though the new BVI bearer share regulations would not require the registration of BVI bearer shares until the end of 2009.1628

On December 14, 2007, the HBUS Board of Directors approved its first HBUS-wide Bearer Share Policy.1629 The bearer share policy applied to all new and existing bearer share accounts and required the client to register the shares or agree to hold the shares in custody with HSBC or a third party custodian and provide a periodic beneficial ownership certificate.1630 AML Director Leslie Midzain gave both IPB New York and Miami IPB a full year, until 2009, to comply with the

1630 Id. For more information, see 12/14/2007 HSBC Group Private Banking North America Compliance Report, OCC-PSI-00328384.
policy due to the BVI registration project which had a 2009 deadline. For the next year, New York IPB and Miami IPB continued to follow their own policies and procedures with regard to bearer share accounts.

**Federal Reserve Concern.** In 2008, an HSBC Group Audit of the New York IPB disclosed that it had 610 bearer share accounts, 31 of which had overdue Beneficial Ownership Letters, including 21 which were overdue by more than a year. In Miami, an earlier HSBC Group Audit disclosed that, as of October 2007, the Miami IPB had 1,667 bearer share accounts, 1,109 or two-thirds of which had Beneficial Ownership Letters that were more than three years old and so were overdue to get new letters. Both audits indicated that HBUS was at risk of not knowing, in many cases, who owned the corporations behind the bearer share accounts.

On January 31, 2008, HBUS AML Compliance officer Paul O’Sullivan emailed Clara Hurtado, Compliance officer for the Miami IPB, regarding a “De-Risking Strategy for Miami.” He also discussed with HBUS Compliance head Carolyn Wind and senior AML Compliance officer Alan Williamson the Federal Reserve’s concerns regarding the high-risk nature of the Miami IPB’s client base. Mr. O’Sullivan asked Ms. Hurtado to identify the high risk bearer share accounts for which there was no “glue to cement the relationship” and consider terminating them.

Six months later, on June 12, 2008, the Federal Reserve issued its annual Report of Examination (ROE) for the Miami IPB. The ROE again identified bearer share accounts as a problem, this time expanding the recommended action to be taken and noting, in particular, that ownership of a bearer share account should be ascertained more frequently than every three years:

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1631 See 4/18/2008 HBUS KYC Committee Meeting minutes, OCC-PSI-00241046. See also 7/5/2008 memorandum from HBUS Ali Kazmy to HBUS Leslie Midzain, OCC-PSI-00292367 (“Since BVI authorities have granted till December 2009 for all bearer shares to be registered, all BVI bearer share corporations within PB Americas will follow this time frame.”). Subcommittee briefing by HSBC legal counsel (7/9/2012).


1635 When asked about the 1,167 bearer share accounts, Ms. Wind told Subcommittee that she knew there were bearer share accounts, but did not know there were that many. She said she had talked about getting rid of bearer share accounts and wanted tighter controls. She also said longstanding bank clients with bearer share accounts were not uncommon in private banking. Subcommittee interview of Carolyn Wind (3/7/2012).

1636 Id.
"Assess the risks associated with bearer share accounts and establish risk mitigation control measures that are appropriate for the associated level of risk. These control measures may include maintaining control over bearer share accounts; entrusting bearer share accounts with a reliable second party; or requiring periodic certification of ownership. At a minimum, management should conduct a review of the bearer share recertification policy and ensure that accounts that pose higher risks are recertified more frequently than every three years."\textsuperscript{1637}

On June 25, 2008, Peter Georgeou, deputy head of Group Audit Private Bank, emailed the head of HSBC Group audits, Matthew King, addressing the latest Federal Reserve examination report. While the Federal Reserve had listed 13 required actions, Mr. Georgeou alerted Mr. King to those he considered "more material." On his list was: "Improved controls and risk mitigation are required in respect of bearer share accounts and accounts held in the name of PICs. In addition, policies and procedures should be enhanced for identification and the review of higher risk accounts."\textsuperscript{1638}

On July 3, 2008, HBUS Compliance officer Ali Kazmy sent a memorandum to HBUS Compliance and AML head Lesley Midzain summarizing changes that had been made to the IPB’s AML Procedures for 2007 and 2008. He noted that BVI bearer shares would have to be registered by December 2009, in accordance with the time frame set forth by BVI authorities. He wrote that high risk bearer share accounts would also require annual recertification of beneficial owner information, while lower risk bearer share accounts would need to recertify beneficial ownership every three years. In addition, he wrote that bearer share clients would be required to attest that they will notify the bank if a change in ownership occurs and provide a new Beneficial Ownership Letter.\textsuperscript{1639} The next day, July 4, 2008, Jeff Clous, head of IPB Operations in Florida, repeated the concerns he had voiced twice before, to Alan Williamson and Paul O’Sullivan.\textsuperscript{1640}

On November 12, 2008, the New York International Private Bank sought dispensation to open 80 new bearer share accounts for existing clients.\textsuperscript{1641} New York IPB employee Todd Maddison asked senior
HBUS Compliance officer Alan Williamson whether Compliance would provide the needed dispensation. Mr. Maddison said that he thought that an email written by Teresa Garcia, which outlined exceptions to the bearer share policy for the Private Bank, implied that the accounts could be opened under these exceptions:

"Since BVI authorities have granted till December 2009 for all bearer shares to be registered, all BVI bearer share corporations within PB Americas will follow this time frame; High risk bearer share accounts will provide an annual recertification of the beneficial owners through a properly executed BOL; Standard risk bearer share accounts will provide beneficial ownership recertification every three years through a properly executed Beneficial Ownership Letter (BOL); and Clients must attest that they will notify the bank of change in ownership, as and when it takes place. A new BOL will be required from the new beneficial owner."

Some of the 80 new bearer share brokerage accounts were opened and some of them, as well as some other New York IPB bearer share accounts, were later moved to the Miami IPB. On March 18, 2009, the OCC issued a Supervisory Letter addressing AML concerns related to the HBUS Private Banking operations. The letter indicated that one of the OCC's primary examination objectives was to "evaluate effectiveness of enhancements to policies and procedures for PUPID activities, bearer share accounts and monitoring processes." Despite this objective, the letter did not address bearer share issues in its conclusions or recommendations. The OCC's silence on the issue stands in sharp contrast to the Federal Reserve which was not only aware of the bearer share accounts, but tracking actions taken in Miami with respect to them.

On May 19, 2009, the Federal Reserve issued its annual Report of Examination for the Miami IPB, which again mentioned bearer shares as a concern. It stated in part:

"[T]he risks posed by the international private banking activities remain significant, given the high transnational nature of the client..."
base, a higher risk target market (Latin America), and the existence of offshore shell companies (including offshore operating companies), including bearer share structures.\footnote{1647}

The examination report continued that the risk was increasing due to the bank’s transfer of some accounts from the New York International Private Bank to the Miami Edge Corporation. The report also noted that HBUS had taken steps to address the risk. It noted that senior compliance personnel had sought to “de-risk” the Miami IPB’s private banking activities, primarily by:

“continued review of offshore operating shell companies, seeking to exit those relationships where the profitability of the relationships does not justify the additional compliance costs associated with the account. This strategy, coupled with increased approval requirements for new operating company accounts, and a decision to no longer open new bearer share accounts, shows tangible steps taken towards reducing reputational risk at Corporation.”\footnote{1648}

This was the third Report of Examination over a two year period to have directed HBUS to strengthen its AML controls over its bearer share accounts.

\textbf{2009 Bearer Share Project.} In February 2009, HBUS began the “Bearer Share Project” with the goal of winding down HBUS’ bearer share accounts.\footnote{1649} Because the British Virgin Islands (BVI) had passed legislation that would require bearer share certificates to be registered or custodized by the end of the year, HSBC viewed this development as an indication that other laws would soon be passed and decided that it would begin registering or custodizing its bearer shares beginning with the accounts opened by BVI bearer share corporations.\footnote{1650} By 2009, HBUS’ international private banks operated under a new organizational structure called Private Bank Americas (PBA), and the bearer shares were treated as a group. PBA determined that it had a total of 1,833 unregistered bearer share accounts, including 1,257 BVI bearer shares and 576 non-BVI bearer shares. It determined that 306 were in the New York Private Bank and 1,527 were in the Miami Private Bank.\footnote{1651} The Project began with HBUS’ sending a letter to all of its BVI bearer share

\footnote{1647 5/19/2009 Federal Reserve Report of Examination of Edge Act Corporation, BOG-A-300035. [Sealed Exhibit.]
1648 Id. at 21.
1649 Subcommittee briefing by HSBC legal counsel on bearer share issues (4/20/2012 and 7/9/2012).
1650 Id.
1651 Id.}
clients in May 2009. The letter explained that as of December 31, 2009, HBUS would “no longer maintain accounts for companies that issue bearer shares.” It indicated that clients would need to register their bearer shares or close their accounts.\(^{1653}\)

In 2010, the OCC, which had been silent on bearer share issues at HBUS for four years, renewed its focus on the accounts. On May 10, 2010, one of the OCC AML examiners sent an email to EIC Sally Belshaw, OCC attorneys in Washington and others stating that HBUS Compliance head Terry Pesce had told him that all but one bearer share account had been closed in 2006.\(^{1654}\) One of the OCC attorneys in Washington wrote in an email that he recalled that the examiner “had been told” that there were no bearer share accounts.\(^{1655}\) The AML examiner indicated that he had just learned that HSBC still had 79 bearer share accounts held in Panama, Uruguay, Bahamas, Cayman, Belize, and Netherlands.\(^{1656}\) In June 2010, another OCC examiner at HBUS obtained a list from HBUS of 117 bearer share accounts.\(^{1657}\) On September 8, 2010, the same examiner forwarded a portion of a May 2010 New York IPB report stating it had 610 bearer share accounts, 31 of which had overdue beneficial ownership declarations.\(^{1658}\) The report also indicated that, for some accounts, the bank had no beneficial ownership declaration on file and no information about the location of some of the shares. Later that same day, the examiner sent another email with a copy of an audit of the Miami IPB indicating it had 925 bearer share accounts, in addition to the 610 accounts in New York.\(^{1659}\) The examiner agreed to forward the Miami audit report to the Federal Reserve.\(^{1660}\) These internal communications indicate that a primary reason for OCC inaction on bearer share issues was a misimpression that the accounts had been closed four years earlier.\(^{1661}\) It also indicates a

\(^{1652}\) Letter from HBUS to British Virgin Islands bearer share clients, “For Companies Incorporated in the British Virgin Islands,” HSBC-PSI-PROD-0197129-133; Subcommittee briefing by HSBC legal counsel (7/9/2012).

\(^{1653}\) Letter from HBUS to British Virgin Islands bearer share clients, “For Companies Incorporated in the British Virgin Islands,” HSBC-PSI-PROD-0197129-133, at 129.


\(^{1658}\) 6/15/2010 email from OCC Teresa Tabor to OCC Joseph Boss, [no subject], OCC-PSI-00929779 and attachment OCC-PSI-00929780.


\(^{1661}\) See also 5/12/2011 conclusion memorandum from OCC Teresa Tabor to OCC Kerry Morse, “Latin American International Center (LAIC) Miami – BSA/AML Examination,” OCC-PSI-01768568 (finding that LAIC had two bearer share accounts which “only came to the attention of the LAIC Compliance Staff based on Examiner inquiries at the commencement of the
lack of coordination with the Federal Reserve which had been monitoring the bearer share issue in Miami for several years.

By the time the OCC became aware of the large number of bearer share accounts still open at HBUS, the Bearer Share Project was well underway in its efforts to reduce the account volume. Having already sent a 2009 letter to accountholders with BVI bearer share corporations about the need to register their shares or close their accounts, HBUS followed in November 2010, by sending a similar letter to all accountholders with non-BVI bearer share corporations.

By June 2011, of the 1257 BVI bearer share accounts, 900 had registered their shares (so that the accounts no longer qualified as bearer share accounts) and 350 accounts had closed. Of the 576 non-BVI bearer share accounts, 255 had registered their shares, and 182 accounts were closed. In November 2011, Private Bank Americas froze the remaining 139 non-BVI bearer share accounts, and began working to contact the accountholders and close the accounts.

As of July 9, 2012, HSBC legal counsel told the Subcommittee that HBUS Private Bank America still had 26 bearer share accounts. HSBC legal counsel also told the Subcommittee that “all but a handful” of those accounts were frozen, because the accountholders had not registered their shares or closed their accounts. According to HSBC legal counsel, the handful of bearer share accounts that were not frozen were beneficially owned by a single client, and the shares were being kept in the custody of a law firm in New York. HSBC legal counsel indicated that, although HBUS’ latest bearer share policy continued to allow new bearer share accounts to be opened under limited circumstances, no new bearer share account had, in fact, been opened since that policy took effect. Internal HBUS documents indicate that as a result of the Bearer Share Project, on at least two occasions, the bank identified suspicious activity related to the accounts.
C. Two Examples of Bearer Share Accounts

Two examples of bearer share accounts illustrate the AML risks they pose. They involve bearer share accounts opened by Mauricio Cohen Assor and Leon Cohen Levy, which demonstrate how bearer share accounts can be used to conceal assets and evade taxes; and a wealthy Peruvian family, which demonstrates how banks can be pressured to waive AML safeguards when opening bearer share accounts.

Cohen Bearer Share Accounts. Mauricio Cohen Assor and Leon Cohen Levy, father and son, were hotel developers in Miami Beach. On April 14, 2010, both were indicted in Florida on charges of conspiring to commit tax fraud and filing false tax returns. The Justice Department charged that the Cohens had used bearer share corporations and shell companies to help conceal $150 million in assets and $49 million in income from the IRS. Both resided in Miami Beach, Florida.

The indictment explained that “bearer share corporations are often set up in tax havens to hide the true ownership of assets, because ownership records are not maintained and nominee officers and directors are often used to appear to control the affairs of the corporation.”

The indictment named two bearer share corporations used by the Cohens to open bank accounts, Blue Ocean Finance Ltd., a Panamanian bearer share corporation, and Whitebury Shipping Time Sharing Ltd., a BVI bearer share company. The Cohens used those bank accounts to conceal their ownership of the assets deposited into them. The indictment also disclosed that, around May 2007, an unnamed international bank asked one of the Cohens to register the shares of Whitebury Shipping and, when the request was refused, the bank closed the account.

Internal bank documents disclose that HBUS was the unnamed bank that maintained a bearer share account for Whitebury Shipping. April 2007 transcripts of several telephone conversations between Mauricio Cohen and an HBUS banker describe the account, HBUS’ request that he register the bearer shares, and his refusal to do so.

1671 Cohen Indictment at 3.
1672 Id. at 7.
1673 Id. at 8.
According to one of the telephone transcripts, on April 23, 2007, HBUS executive Claude Mandel, the Relationship Manager who handled the bank’s relationship with Mauricio Cohen, apparently agreed to remove Mr. Cohen’s name from the Whitebury account.\(^{1674}\) The next day, Mr. Cohen talked to Mr. Mandel about replacing Whitebury with another bearer share account. Mr. Mandel offered to convert Whitebury from a BVI to a Bahamian bearer share corporation, but said that the bank no longer opened bearer share accounts. Mr. Cohen protested and told Mr. Mandel that the bank would lose clients and that other banks take bearer share accounts.\(^{1675}\) The telephone transcripts indicate that, on April 25, 2007, Mr. Mandel and Mr. Cohen again discussed Mr. Cohen’s bearer share accounts. Despite Mr. Mandel’s insisting that his bearer shares would need to be registered, Mr. Cohen convinced Mr. Mandel to check if he could convert Whitebury into a Panamanian bearer share corporation. Mr. Cohen indicated again that he did not want to put names on the shares; when Mr. Mandel said that the shares would need to state the names, Mr. Cohen said: “But, I can’t put that, otherwise I have to declare them in the United States? I can’t do that, I don’t want to declare … otherwise, I have to close the accounts with you and go to Geneva.”\(^{1676}\)

Minutes from a May 6, 2010 AML Oversight Committee Meeting at HBUS noted that the HBUS Private Bank was providing information on closed bearer share accounts opened by an “ex-client” as part of the investigation of Mauricio Cohen, a former HSBC client.\(^{1677}\)

In October 2010, the Cohens were convicted after a jury trial, sentenced to ten years in prison, and ordered to pay back taxes, interest, and penalties totaling over $17 million. This example demonstrates the risk of bearer share accounts being used to conceal ownership of assets and commit criminal tax evasion.

**Peruvian Family Bearer Share Accounts.** In 2007, a senior Compliance official with the HSBC Private Bank in New York, Teresa Garcia, sought a waiver to open a relationship for a Peruvian businessman for two bearer share accounts.\(^{1678}\) According to Ms. Garcia, his business group was one of the richest and most powerful in Peru.\(^{1679}\)

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\(^{1678}\) Id. at 3.
The bearer share corporations, Urigeler International S.A.-Holding Company and Birmingham Merchant S.A.-Holding Company, were formed in Panama.\textsuperscript{1680} According to an email exchange among HBUS Compliance personnel, in 2007, opening a new bearer share account required: (1) approval by the New York International Private Bank CEO and AML Local Compliance Officer; and (2) registration or custodization of the bearer shares.\textsuperscript{1681}

Ms. Garcia wrote that she was requesting the waiver because the businessman had indicated that he did not want to forfeit confidentiality by registering or custodizing the bearer shares.\textsuperscript{1682} She explained: “they wish to maintain confidentiality, and they have never been asked by our competitors with whom they bank to do this.”\textsuperscript{1683} Manuel Diaz, President and Managing Director of HSBC Private Bank International in Miami, indicated that he supported a waiver, because he was very familiar with the family and interested in establishing a relationship with them.\textsuperscript{1684} Marlon Young, CEO of Private Banking Americas, also approved the waiver request.\textsuperscript{1685}

Ms. Garcia then escalated the request to senior HBUS Compliance official Alan Williamson to determine who had authority to grant the waiver on behalf of AML Compliance. Mr. Williamson explained that, while he had no objection to granting the waiver, the bearer shares policy was an HSBC Group mandate and any exception would have to be approved by HSBC Group Compliance.\textsuperscript{1686} David Ford, HSBC Global Money Laundering Control Officer, confirmed that HSBC Group approval was required for an exception to Group policy. Mr. Ford also wrote that he was “[s]uprised can open bearer share account for offshore client with no bo [beneficial ownership] declaration in US,” and suggested checking with HBUS Compliance head Carolyn Wind about the OCC and Federal Reserve “view of such a structure.”\textsuperscript{1687} Mr. Williamson asked HSBC Group AML head Susan Wright about the...
request, and reported that she was reluctant to grant the exception but would consider it.\footnote{1688} There was a strong push for this relationship by the business side. Manual Diaz, head of the Miami Private Bank International, wrote: “I FULLY SUPPORT THIS WAIVER.”\footnote{1689} Jaime Carvallo, a Miami bank executive, sent an email to the head of Private Banking Americas, Marlon Young, enlisting his support to obtain a waiver. Mr. Carvallo wrote:

“Teresa Garcia must have given you heads up on the [redacted] family and the issue regarding their holding companies having bearer shares and the fact that they will not sign the BOL [Beneficial Ownership Letter].

I will see one of the family members tomorrow morning and this still seems to have no resolution. This is too important a family in Peru for us not to want to do business with, and one that has taken a lot of my time and effort to convince to start a relationship with us. ... I would appreciate your involvement at this point, as this has become extremely sensitive.”\footnote{1690}

Mr. Young signaled his support for the waiver the same day,\footnote{1691} and later wrote to senior HBUS Compliance officer Alan Williamson: “This is an important relationship for IPB [International Private Bank] and a family that has a clean record. It would be a shame if we are not able to obtain an exception.”\footnote{1692} Mr. Carvallo also wrote directly to Mr. Williamson that the family was “too important a family in Peru for us not to want to do business with.”\footnote{1693} Mr. Carvallo estimated the family’s liquid net worth,\footnote{1694} and explained that HSBC was currently competing with another bank to help the family reorganize their businesses and facilitate the succession of their financial assets and operating companies, which could be very profitable.\footnote{1695}

Mr. Williamson responded: “I thought so. I would do it without going to Geneva but audit wrote up DPB [Domestic Private Banking] on a similar situation.”\textsuperscript{1696} Later, he wrote: “we will do our best.”\textsuperscript{1697} Still later: “Doing what I can.”\textsuperscript{1698} David Ford pointed out that the HSBC Group policy was flexible, because the client could either declare beneficial ownership, have HSBC hold the shares, or have an acceptable third party hold the shares.\textsuperscript{1699} On July 5, 2007, Mr. Williamson wrote that the “RM [Relationship Manager] and the Group Head are not seeing eye to eye on this one.”\textsuperscript{1700}

In 2007, HBUS opened a bearer share account in the name of Uriger.\textsuperscript{1701} When asked whether a waiver had been granted from the requirements that the bank hold the shares in custody and obtain an Beneficial Ownership Letter from the owner, HSBC legal counsel told the Subcommittee: “We don’t know.”\textsuperscript{1702} HSBC legal counsel told the Subcommittee that the accounts was opened in New York, transferred to Miami in 2009, and closed in 2011.\textsuperscript{1703}

This account demonstrates the difficulty of adhering to a strong bearer share policy when a wealthy and powerful family asks to open a bearer share account and obtain a waiver from requirements to either register the shares with their names or submit the shares to the custody of the bank. HBUS’ bearer share policy continues to permit the bank to open bearer share accounts.

\section*{D. Analysis}

For decades, bank regulators and AML experts have cautioned against opening accounts for bearer share corporations due to the ease with which these corporations hide ownership and the frequency with which they have been used to commit money laundering, financial crime, tax evasion, and other wrongdoing. From at least 2000 to 2011, HBUS maintained a sizeable number of bearer share accounts, despite

\begin{itemize}
\item[\textsuperscript{1700}] Id. at 1.
\item[\textsuperscript{1701}] Subcommittee briefing by HSBC legal counsel (7/9/2012).
\item[\textsuperscript{1702}] Id.
\item[\textsuperscript{1703}] Id.
repeated regulatory questions and expressions of concern. HBUS bankers, and at times their compliance officers, pushed to open and maintain bearer share accounts. Two bearer share accounts illustrate the risks inherent in such accounts and the pressures to circumvent AML controls. While HBUS finally registered or closed most of the accounts by 2011, its policy continues to allow bearer share accounts to be opened under some circumstances.
VIII. OCC: EXERCISING INEFFECTIVE AML OVERSIGHT

The mission of the Office of the Comptroller of the Currency (OCC) is to charter, regulate, and supervise all U.S. banks that hold a national charter. To carry out that mission, in the words of the OCC, it conducts “regular examinations to ensure that institutions under our supervision operate safely and soundly and in compliance with laws and regulations,” including AML laws. However, the HSBC case history, like the Riggs Bank case history examined by this Subcommittee eight years ago, provides evidence that the current OCC examination system has tolerated severe AML deficiencies for years and given banks great leeway to address targeted AML problems without ensuring the effectiveness of their AML program as a whole. As a result, the current OCC examination process has allowed AML issues to accumulate into a massive problem before an OCC enforcement action is taken.

At HSBC, during the five-year period from 2005 to 2010, OCC AML examiners conducted nearly four dozen AML examinations, identified at least 83 AML Matters Requiring Attention, and recommended two cease and desist orders to strengthen HBUS’ AML program. Despite the many AML problems identified by its examiners, OCC supervisors took no formal or informal enforcement action during nearly that entire period, allowing the bank’s AML problems to fester. In 2009, after learning that two law enforcement agencies were investigating possible money laundering through HBUS accounts, the OCC legal and enforcement divisions directed OCC AML examiners to hastily intensify and expand an ongoing AML examination to consider HBUS’ AML program as a whole. In September 2010, the expanded OCC examination culminated in a blistering Supervisory Letter identifying numerous, serious AML problems at the bank. Many of these AML problems had been identified in prior examinations, but were tied to specific HBUS business units rather than applied bankwide, and were not resolved by bank commitments to remedy the identified problems.

The September 13, 2010 Supervisory Letter criticizing HBUS’ AML deficiencies ran 31 pages long. It cited the bank for five violations of Federal AML law. Its list of AML problems included a backlog of over 17,000 unreviewed alerts regarding possible suspicious

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1705 Id.  
activity, and a failure to timely file hundreds of Suspicious Activity Reports (SARs) based upon those alerts. The Supervisory Letter also criticized HBUS for failing to conduct any due diligence or to assess the AML risks posed by HSBC affiliates that opened U.S. dollar correspondent accounts at HBUS, even though many of those affiliates operated in high risk jurisdictions, had high risk clients, or offered high risk products. Another problem was a three-year failure by HBUS, from mid-2006 to mid-2009, to conduct any AML monitoring of billions of dollars in bulk cash transactions, including $15 billion from 2007 to 2008 alone, with those same HSBC affiliates, despite the risks associated with large cash transactions.

In addition, the Supervisory Letter criticized HBUS' failure to conduct any AML monitoring of $60 trillion annually in wire transfer activity by customers domiciled in countries rated by HBUS as lower risk, unless a customer was individually rated as high risk, while also criticizing the bank's country risk assessment process. The OCC attributed the bank's monitoring failure in part to HBUS' goal of minimizing AML staffing requirements. To place the magnitude of the AML vulnerability created by HBUS in context, the OCC noted that, from 2005 to 2009, HBUS' wire activity had grown from 20.4 million to 30.2 million wire transactions per year, with annual dollar volumes climbing from $62.4 trillion to $94.5 trillion, an increase of 50%. The OCC also noted that HBUS had become the third largest user of the CHIPS wire transfer system which provides 95% of U.S. dollar cross-border and nearly half of all domestic wire transactions totaling 1.5 trillion daily.1708

The letter didn’t stop there. It also offered a slew of criticisms of the techniques used by HBUS to identify suspicious activity, describing them as “ineffective,” “inadequate,” and overly reliant on a “highly discretionary manual monitoring approach,” all of which decreased the number of AML alerts. Additional problems included inappropriate procedures to close alerts; an “inadequate focus on country risk instead of customer risk”; the failure to assign high risk ratings to high risk clients, including Politically Exposed Persons; inadequate and unqualified AML staffing; inadequate AML resources; and high turnover in AML leadership. Despite its own failures to take proactive steps to oversee the bank, the OCC letter noted that the bank had not been proactive enough in identifying and remediating its own AML problems:

“Through year-end 2009, the OCC has issued 83 BSA/AML Matters Requiring Attention (‘MRAs’). The bank has a history of not identifying BSA/AML problems proactively. Instead, the bank has taken a reactive posture, choosing to focus its attention on correcting specific deficiencies identified by regulators without

1708 Id. at 342-343.
taking comprehensive action to identify and correct deficiencies in the bank’s overall BSA/AML program.\footnote{1709}{In re HSBC Bank USA, N.A., Case No. AA-EC-10-98, Department of the Treasury Comptroller of the Currency, Consent Order (10/4/2012), OCC-PSI-005904698.}

A month later, on October 4, 2010, the OCC issued a Cease and Desist Order requiring HBUS to revamp its AML program.\footnote{1710}{See In re HSBC Bank USA, N.A., Case No. AA-EC-10-98, Department of the Treasury Comptroller of the Currency, Consent Order (10/4/2012), OCC-PSI-005904698.} In response, HBUS committed to making major changes.

At the time the OCC issued the October Cease and Desist Order, it had been conducting regular AML oversight of HBUS for six years, raising the issue of how such deep-seated AML deficiencies could have gone on at the bank without the regulator’s taking action. Part of the answer is that HBUS, like other international banks, presented the OCC with a number of AML challenges. It functioned as the U.S. nexus for one of the largest banks in the world. The HSBC network was not based in the United States, and its central focus was not on U.S. customers or U.S. businesses, but on other areas of the globe. HSBC affiliates operated in a number of jurisdictions which faced huge AML risks from terrorist financing, drug trafficking, tax evasion, and other law enforcement problems. The HSBC Group was also one of the largest participants in international wire transfer systems and a leader among global banks in moving large amounts of physical currency around the world, with all the attendant AML risks inherent in large cash transactions. HSBC also handled numerous high risk clients and high risk products. In addition, as OCC examinations disclosed over the years, it was a financial institution with inadequate AML resources; inadequate AML systems and controls; and inadequate AML leadership.

HBUS itself was a large, complex, and growing financial institution with numerous business lines, products, and services, as well as millions of customers. It also had correspondent accounts for more than 80 HSBC affiliates as well as financial institutions around the world. From the time the OCC became HBUS’ primary regulator in 2004, it oversaw HBUS’ AML program and conducted regular examinations throughout the bank. Year after year, those AML examinations exposed AML deficiencies. Each time problems were identified, HBUS promised to correct them and sometimes did. But those corrective actions were narrowly targeted and, instead of improving, the bank’s overall AML program deteriorated, resulting in the dramatic failures described in the September 2010 Supervisory Letter.

\footnote{1709}{See In re HSBC Bank USA, N.A., Case No. AA-EC-10-98, Department of the Treasury Comptroller of the Currency, Consent Order (10/4/2012), OCC-PSI-005904698.}
\footnote{1710}{See In re HSBC Bank USA, N.A., Case No. AA-EC-10-98, Department of the Treasury Comptroller of the Currency, Consent Order (10/4/2012), OCC-PSI-005904698.}
The focus of this section is to chronicle the OCC's AML oversight efforts at HBUS and draw from that case history potential lessons regarding OCC examinations of AML controls at a large global bank; how AML problems can accumulate over years despite the OCC's presence; and what can be done to strengthen the OCC's AML oversight. Problems include the OCC's decision to treat AML deficiencies as a consumer compliance problem rather than a management problem with safety and soundness implications; its practice of foregoing the citation of legal violations for the failure to comply with mandated components of a AML program; its use of narrowly focused AML examinations without also examining a bank's overall AML program; its failure to make timely use of informal and formal enforcement actions to compel AML improvements; and its use of Supervisory Letters that sometimes muted examination criticisms or weakened recommendations for reforms. Actions to remedy these problems would strengthen the OCC's AML oversight and help protect the U.S. banking system from being misused for terrorist financing, money laundering or other misconduct.

A. Background

(1) Key Anti-Money Laundering Laws

Federal law defines money laundering as "the movement of illicit cash or cash equivalent proceeds into, out of, or through the United States [or] .., United States financial institutions.,, Federal anti-money laundering laws also apply to terrorist financing, including any legally obtained funds if intended for use in planning, committing, or concealing a terrorist act. These laws arose as a result of law enforcement investigations demonstrating that terrorists, drug traffickers, tax evaders, and other criminals were using financial transactions to execute their crimes, including by transferring funds across international lines, recharacterizing illicit proceeds as legitimate funds, hiding assets, and using financial and corporate secrecy laws and practices to block inquiries into their activities. U.S. AML laws are designed to prevent these wrongdoers from misusing the U.S. financial system to commit their crimes.

Three key laws lay out the basic AML obligations of U.S. financial institutions, the Money Laundering Control Act of 1986, the Bank Secrecy Act of 1970, and the USA Patriot Act of 2002, which amended both prior laws.

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1712 See, e.g., 18 U.S.C. § 981(a)(1)(G) (civil forfeiture laws applicable to laundered proceeds also apply to terrorist assets).
1713 For a more detailed discussion of U.S. AML laws, see "Anti-Money Laundering: Issues Concerning Depository Institution Regulator Oversight," testimony of the General Accounting...
The Money Laundering Control Act, enacted partly in response to hearings held by this Subcommittee in 1985, was the first law in the world to make money laundering a crime. It prohibits any person from knowingly engaging in a financial transaction which involves the proceeds of a "specified unlawful activity." The law provides a long list of specified unlawful activities, including, for example, terrorism, drug trafficking, fraud, and foreign corruption. The Bank Secrecy Act (BSA), as amended by the Patriot Act, imposes AML obligations on a designated list of financial institutions operating in the United States to ensure they do not facilitate money laundering or become conduits for terrorist financing.

**AML Requirements.** The Bank Secrecy Act mandates that covered financial institutions establish an effective AML program that meets four minimum requirements:

1. It has a system of internal controls to ensure ongoing compliance.
2. It designates an individual responsible for managing AML compliance.
3. It provides AML training for appropriate personnel.
4. It requires independent testing of AML compliance.

These four components are sometimes referred to as the “pillars” of an effective AML program. The first requirement for a system of AML “internal controls” involves development of risk-based policies and procedures to detect and prevent money laundering. At a large bank, these safeguards would include Know Your Customer (KYC) policies and procedures, including developing a customer identification program, conducting due diligence reviews, and assessing customer risk; a monitoring system to analyze account and wire transfer activity to detect suspicious activity; and a system for reporting suspicious activity to law enforcement. To ensure AML controls are implemented effectively, banks are also required to provide appropriate resources, infrastructure, and staff.

The second requirement is to designate a qualified individual for coordinating and monitoring the bank’s day-to-day AML compliance. The AML compliance officer must be knowledgeable about the law and have the time, expertise, authority, and resources needed to ensure bank compliance with AML requirements. The AML compliance officer should also have the authority to make regular reports to the bank’s board of directors or a board designated committee.

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1715 See 31 U.S.C. § 5318(h)(1) and 12 C.F.R. Section 21.21(b)(1). All Federal bank regulators have adopted the same requirements within their own regulations.

1716 31 U.S.C. § 5318(h)(1)(A) and 12 C.F.R. Section 21.21(c)(3).

The third requirement is for the bank to provide adequate training to all personnel with AML responsibilities. AML training should be ongoing to ensure bank personnel are kept up-to-date with the law. The fourth requirement is for the bank to conduct independent testing of its AML program and controls to ensure compliance with the law and to identify and correct any AML deficiencies. This function is typically performed by a bank’s internal audit group or by an outside auditor with AML expertise.

Other AML Requirements. In addition to requiring covered financial institutions to establish effective AML programs, Federal AML laws include a number of other statutory requirements, including requiring banks that keep records outside of the United States to produce them within a specified period of time; to obtain identifying information for persons seeking to open or maintain accounts, and requiring appropriate due diligence when opening and administering accounts for foreign financial institutions or senior foreign political figures. The Bank Secrecy Act also authorizes and the U.S. Department of Treasury has issued regulations requiring covered financial institutions and other businesses to file reports on large currency transactions and suspicious activities to guard against money laundering.

(2) AML Oversight In General

The Secretary of the Treasury is the primary Federal regulator charged with enforcing key Federal AML laws. To help carry out those responsibilities, in 2003, the Secretary established the Executive Office for Terrorist Financing and Financial Crimes, headed by a Deputy Assistant Secretary. This office oversees the operation of the Financial Crimes Enforcement Network (FinCEN), a Treasury bureau which, among other duties, develops AML regulations and guidance, analyzes currency transaction reports and suspicious activity reports filed by financial institutions, and interacts with local, state, Federal, and international law enforcement as well as other financial intelligence units around the world. Treasury also oversees the Office of Foreign Assets Control (OFAC) which is primarily responsible for enforcing U.S. sanctions laws to detect and block financial transactions and assets

1714 31 U.S.C. § 5318(b)(1)(C) and 12 C.F.R. Section 21.21(c)(2).
1722 31 U.S.C. § 5318(g).
1723 See, e.g., 31 U.S.C. §§ 5313 and 5318(g); 31 C.F.R. §§ 103.11 and 103.21 et seq.
1724 See, e.g., 31 U.S.C. §§ 5311 et seq. (Treasury Secretary charged with carrying out key anti-money laundering laws) and § 5341 (Treasury Secretary given lead role in development of national anti-money laundering strategy).
belonging to identified terrorists, persons associated with weapons of mass destruction, drug traffickers, and rogue jurisdictions.

Although FinCEN is the administrator of Federal AML regulations in the United States, it does not examine banks. That task is assigned to Federal bank regulators which are charged with monitoring bank compliance with AML laws through their examination procedures. Any AML violations they discover are reported to FinCEN which can, among other actions, impose civil monetary penalties on financial institutions for the violations.1725

Significant responsibility for AML oversight, thus, rests with Federal bank regulators. The decisions they make with respect to AML policies and procedures, AML examinations, and safety and soundness ratings consequences for AML deficiencies will in large measure determine the importance that both regulators and financial institutions place on achieving effective AML controls.

Oversight of Financial Institutions. At the end of 2010, the United States had over 7,600 federally insured commercial banks and savings institutions.1726 In addition, the United States had over 7,300 federally insured credit unions.1727 On the federal level, these financial institutions are overseen by four agencies: the Federal Reserve which supervises state-chartered banks that are part of the Federal Reserve System and certain financial holding companies; the Federal Deposit Insurance Corporation (FDIC) which supervises state-chartered banks that were not part of the Federal Reserve System;1728 the Office of the Comptroller of the Currency (OCC) which supervises banks and savings associations with national charters, and certain U.S. affiliates of foreign-owned banks;1729 and the National Credit Union Administration (NCUA) which supervises Federal and state-chartered credit unions. In addition, state banking authorities supervise and examine state-chartered institutions.

1725 See FinCEN Enforcement Actions, http://www.fincen.gov/news_room/enforcement/ (“Under the Bank Secrecy Act (BSA), 31 U.S.C. 5311 et seq., and its implementing regulations at 31 C.F.R. Chapter X (formerly 31 C.F.R. Part 103), FinCEN may bring an enforcement action for violations of the reporting, recordkeeping, or other requirements of the BSA. FinCEN’s Office of Enforcement evaluates enforcement matters that may result in a variety of remedies, including the assessment of civil money penalties.”).
1728 The FDIC also acts as a backup regulator for all financial institutions with Federal deposit insurance.
1729 Until recently, the Office of Thrift Supervision (OTS) supervised Federal savings associations and institutions, but it was abolished by the Dodd Frank Wall Street Reform and Consumer Protection Act. All OTS duties were officially transferred to the OCC on July 21, 2011.
The primary responsibility of the Federal bank regulators is to ensure the “safety and soundness” of the financial institutions they supervise. One key mechanism they use to carry out that responsibility is to conduct safety and soundness examinations on a periodic basis and provide the results in an annual Report of Examination (ROE) to the Board of Directors of each financial institution. Safety and soundness examinations are conducted to assess the risk that an insured bank poses to the Federal Deposit Insurance Fund. All FDIC-insured institutions contribute to this insurance fund through assessments which are typically collected on a quarterly basis. The assessment amounts are based, in part, on a bank’s safety and soundness ratings.

The largest U.S. financial institutions are supervised under a “continuous examination” program. Under this program, examiners are always on-site at the institution, as opposed to periodically arriving on-site, conducting an examination, and then departing for the next bank after finalizing the ROE. Examinations at smaller community banks are typically conducted on a 12- or 18-month exam cycle. Examiners are typically on-site at smaller community banks for only a few weeks.

**Interagency AML Examination Manual.** In June 2005, the Federal Financial Institutions Examination Council (FFIEC) issued a joint AML Examination Manual. 1730 This manual was developed by the Federal bank regulators, in collaboration with FinCEN, OFAC, and state banking agencies. It was developed to provide current and consistent AML examination procedures and guidance to examiners across the Federal banking agencies and the financial institutions they oversee. The manual has been updated three times to incorporate regulatory changes and reflect feedback from the banking industry and examination staff. The most recent version of the manual was released in April 2010. 1731

**Safety and Soundness Examinations.** Federal bank regulators conduct several different examinations at the financial institutions they supervise. The most important is the safety and soundness examination. Federal bank regulators conduct safety and soundness examinations to assess the risks that a bank poses to the Federal Deposit Insurance Fund (DIF) and to maintain public confidence in the integrity of the banking

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1730 The FFIEC is a formal interagency body empowered to prescribe uniform principles, standards, and report forms for the Federal examination of financial institutions by the Federal Reserve, FDIC, OCC, NCUA, and the Consumer Financial Protection Bureau (CFPB), and to make recommendations to promote uniformity in the supervision of financial institutions. See FFIEC website, http://www.ffiec.gov/. In 2006, the State Liaison Committee (SLC) was added to the Council as a voting member. The SLC includes representatives from the Conference of State Bank Supervisors, the American Council of State Savings Supervisors, and the National Association of State Credit Union Supervisors. The CFPB became an FFIEC member in 2011.

system. These examinations help prevent identified problems from deteriorating to the point of bank failures, the costs of which are often borne by the DIF. The DIF is funded by assessments that the FDIC charges banks. These assessments are derived from the level of insured deposits that a bank holds and the inherent risks that the bank poses to the DIF, which are calculated in part from a bank’s safety and soundness component ratings and composite rating.

Safety and soundness examinations are designed to determine the financial condition of an institution, assess the effectiveness of its risk management practices, and aid in the development of effective and timely corrective actions. The examinations evaluate the bank’s adherence to a variety of laws and regulations, identify and assess key risks, and identify and assess any problems.

**CAMELS Ratings.** Safety and soundness examinations are organized around a rating system called CAMELS, an acronym for the six components that are evaluated. The CAMELS rating system evaluates a financial institution’s: (C) capital adequacy, (A) asset quality, (M) management effectiveness, (E) earnings, (L) liquidity, and (S) sensitivity to market risk. Each component of the CAMELS rating is based upon a qualitative analysis of various factors comprising it. CAMELS ratings use a scale of 1 to 5, with “1” being the best rating and “5” the worst.

The CAMELS component ratings also serve as the basis for a bank’s “Composite Uniform Financial Institution Rating,” often referred to as the “composite rating” or the overall “bank rating.” The composite rating also uses a scale of 1 to 5, and generally bears a close relationship to the component CAMELS ratings, although it is not simply an average of them. For composite ratings, 1 is the highest rating and signifies a safe and sound institution with no cause for supervisory concern, 3 signifies an institution with supervisory concerns in one or more areas, and 5 is the lowest rating, which signifies an unsafe and unsound bank with severe supervisory concerns.

When the FDIC assesses bank insurance fees for a particular institution, it takes into consideration both the CAMELS component ratings and the composite rating. Lower ratings, signifying a higher risk institution and a greater threat to the Deposit Insurance Fund, can lead to a higher deposit insurance assessment, which in turn can affect net income.

**Specialty Examinations and Ratings.** In addition to safety and soundness examinations, Federal bank regulators also conduct various specialty or secondary examinations targeting particular aspects of the

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institutions they supervise. These specialty examinations, which are separate and distinct from safety and soundness examinations, are important in their own right, and focus on such areas as information technology (IT), trust operations, compliance with the Community Reinvestment Act (CRA), and compliance with consumer protection laws.1733

Each of these specialty examinations has its own unique rating system based upon an interagency agreement on what elements should be considered and how the rating should be calculated. For example, IT examinations produce ratings under a “Uniform Rating System for Information Technology”; trust examinations produce ratings under a “Composite Uniform Interagency Trust Rating” system; CRA examinations produce ratings under a “Community Reinvestment Act Rating” system; and consumer compliance examinations produce ratings under a “Uniform Interagency Consumer Compliance Rating” system.1734

These ratings are typically presented in the annual Report of Examination provided to a financial institution by its primary regulator. They are typically included in a section which lists all of the ratings assigned to the bank during the year. The specialty examination ratings are calculated and presented separately from the CAMELS component ratings which give rise to the bank’s overall Composite Uniform Financial Institution Rating. In OCC Reports of Examination, for example, the ratings are usually presented in the following format:

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1733 According to the OCC, typical issues addressed by these specialty examinations are as follows:
- Information Technology (IT) Examinations – evaluate IT-related risks including operations, information security programs, and IT governance processes within supervised financial institutions and technology service providers.
- Trust/Asset Management Examinations – determine if an institution’s policies or administration of trust accounts has resulted in a contingent liability or estimated loss that could damage the institution’s capital.
- Consumer Compliance Examinations – assess a financial institution’s compliance with federal consumer protection laws and regulations.
- Community Reinvestment Act (CRA) Examinations – ensure compliance with the CRA, to include meeting the credit needs of the community that the financial institution serves, including residents of low- and moderate-income neighborhoods.


Ratings

Composite Uniform Financial Institution Rating

Component Ratings:
- Capital
- Asset Quality
- Management
- Earnings
- Liquidity – Asset/Liability Management
- Sensitivity to Market Risk

Uniform Rating System for Information Technology

Composite Uniform Interagency Trust Rating

Uniform Interagency Consumer Compliance Rating

Community Reinvestment Act Rating.

While specialty examination ratings do not automatically or routinely affect either the CAMELS component or composite ratings, if a specialty examination identifies significant problems that are extensive enough to potentially affect the financial condition of the bank, including through the imposition of large civil money penalties, reimbursable violations, or reputational risk, it may contribute to a downgrade of one or more of the CAMELS component ratings which, in turn, may affect the composite rating.\(^\text{1736}\) Downgrades to safety and soundness ratings due to problems identified through specialty examinations are not common, however, and are reserved for extreme cases.

AML Examinations. An examination focusing on AML compliance is considered a specialty examination. Each of the Federal banking agencies has examiners specially trained to conduct AML examinations. AML examinations do not, however, produce a separate specialty rating, since no interagency agreement has produced an AML rating system. Instead, at Federal banking agencies other than the OCC, AML examination findings are generally addressed as one of the safety and soundness considerations in the Report of Examination (ROE) and included in the development of the bank’s safety and soundness ratings. Typically, AML examination results impact the CAMELS management component rating, which may be downgraded if management fails to maintain an adequate AML program.

\(^{1735}\) Id.

The CAMELS management component rating is designed to reflect the ability of bank management to adequately identify, measure, monitor, and control problems and manage risks. Although AML compliance is just one factor in rating the management component, a bank’s failure to maintain an adequate AML program can expose a bank to significant reputational risk, remedial costs, and civil money penalties. When such factors are present, Federal bank regulators normally take them into account when assigning the management component rating. If the management component is downgraded, it may also in certain circumstances lower the bank’s overall composite rating, with potentially severe impacts on the financial institution’s reputation, risk profile, and insurance assessment fees.

In contrast to this approach, which is used by the Federal Reserve, FDIC, and NCUA, the OCC does not treat AML examinations as a safety and soundness matter and does not routinely take AML deficiencies into account when assigning a bank’s CAMELS management rating. Instead, the OCC treats AML examinations as a matter of consumer compliance and includes consideration of AML deficiencies when determining an institution’s consumer compliance rating. The OCC’s approach is explained more fully below.

Violations of Law. In their supervisory programs, Federal bank regulators assign a high priority to the detection and prompt correction of violations of law. Such violations may involve statutory or regulatory requirements. Regulators typically list all significant violations of law (as opposed to isolated or technical violations) in the annual Report of Examination provided to a bank’s board of directors. The board of directors, in turn, is charged with initiating prompt and appropriate corrective action.

Listing one or more statutory or regulatory violations in a Report of Examination is not uncommon. They may result from bank management’s unfamiliarity with the governing law, misinterpretation of the requirements, negligence, or willful noncompliance. The more egregious the nature of the violation, the more severe the repercussions may be. Willful noncompliance with statutory or regulatory requirements, for example, may result in civil money penalties against the bank or individual bank managers as well as removal actions against bank personnel, officers, or directors. Violations are also viewed as significant adverse reflections on bank management capabilities and may lead to a downgrade of the CAMELS management component rating. The underlying causes of the violation play a significant role in that assessment.

Enforcement Actions. If a bank regulator becomes concerned about the condition of a financial institution, it has a wide range of informal and formal enforcement actions that could be used to require corrective action. Informal actions are viewed as voluntary actions and include requesting that the financial institution issue a safety and soundness plan, board resolution, or commitment letter pledging to take specific correction actions by a certain date. Another informal action is a memorandum of understanding, which is a signed agreement by both the regulator and the board of directors addressing various actions that the financial institution will take to correct its problem areas. Informal actions are nonpublic and are not enforceable in court. On the other hand, formal enforcement actions are legal proceedings which can include issuing a consent order or a cease and desist order requiring the financial institution to stop an unsafe or unsound practice or to take affirmative action to correct identified problems; imposing a civil money penalty; suspending or removing personnel from the financial institution; suspending or banning personnel from the banking industry; revoking the bank charter; or referring misconduct for criminal prosecution. Formal actions are disclosed to the public and are enforceable in court. Failure to comply with an order can subject the bank to civil money penalties.

With respect to AML enforcement, in July 2007, the Federal bank regulators issued joint interagency guidance entitled, "Interagency Statement on Enforcement of Bank Secrecy Act/Anti-Money Laundering Requirements." This guidance sought to promote consistent implementation of Section 8(s) of the Federal Deposit Insurance Act and Section 206(q) of the Federal Credit Union Act, both of which require Federal bank regulators to conduct AML examinations and identify AML problems in Reports of Examination. Both sections also require Federal bank regulators to issue a cease and desist order in the event that a bank fails to provide or maintain an adequate AML program. The guidance affirms the Federal bank regulators authority and responsibility for enforcing AML requirements and use of cease and desist order to correct identified problems.

(3) OCC AML Oversight in General

Because it oversees the largest and most complex banks operating in the United States, some of which operate affiliates in high risk jurisdictions, maintain accounts for high risk clients, or offer high risk products vulnerable to money laundering and terrorist financing, the OCC plays a crucial role in ensuring bank compliance with U.S. AML laws.

OCC Organization. The OCC oversees about 2,000 nationally-chartered banks and savings associations and about 50 U.S. affiliates of foreign-owned banks. In 2011, the OCC’s budget, which is paid for by assessments on the financial institutions it regulates, totaled about $875 million. As of 2011, about 3,700 OCC employees were stationed in 66 offices nationwide, organized into four districts known as the Northeastern, Central, Southern, and Western districts, with agency headquarters in Washington, D.C.

Several groups within the OCC contribute to AML oversight. Examiners with special expertise conduct the actual AML examinations, evaluate bank AML programs, and identify AML deficiencies. They provide their findings to the Examiner-In-Charge at a particular financial institution. At large banks, if AML deficiencies are identified, the Examiner-In-Charge works with the OCC Department of Large Bank Supervision to evaluate the AML examination findings and direct efforts to ensure bank compliance with the law. Bank supervision personnel also work with counsel in the Enforcement and Compliance Department and the Legal Department to determine whether AML enforcement actions are needed and, if so, what actions to take.

During most of the years reviewed by the Subcommittee, the OCC was headed by John C. Dugan who served as the Comptroller of the Currency until his five-year term expired in 2010. In August 2010, he was succeeded by John Walsh who served as Acting Comptroller until April 2012, when Thomas Curry was confirmed by the Senate to serve as the new Comptroller of the Currency. The second in command during most of the years reviewed was First Senior Deputy Comptroller and Chief Counsel Julie Williams. The head of the Department of Large Bank Supervision, which oversees the largest nationally-chartered U.S. banks and U.S. branches of foreign banks was Michael L. Brosnan. One of his chief deputies was Grace Dailey who helped oversee HBUS, until the end of 2010, when she left that post for another, and was replaced by Sally Belshaw. Two other key OCC officials in AML enforcement were Daniel Stipano, Deputy Chief Counsel, and James Vivenzio, senior legal counsel for AML matters. In addition, the Director of the Enforcement and Compliance Department was Richard Stearns.

OCC Examinations Generally. Much of the OCC workforce is devoted to conducting or supporting safety and soundness examinations.

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of the banks regulated by the OCC. In general, for a large bank, the relevant OCC district office assigns an Examiner-in-Charge (EIC) and a team of examiners to work on-site at the bank, on a full-time basis under a continuous examination program.

Under the OCC’s continuous examination program, the EIC is assigned to a particular institution for five years. At the five-year mark, the EIC is then assigned to another bank. The EIC is assisted by a team of examiners that are also assigned to the bank on a full-time basis, but do not have similar five-year term limitations. Members of the examination team may rotate to other banks at various intervals as needed. Regardless, examiners work at the bank year-round and should have a firm and immediate grasp on any issues and problems affecting the bank.

Supervisory Strategy. The EIC is responsible for developing an annual supervisory strategy. The supervisory strategy is a prospective work plan for examining the bank, based on perceived risks. The strategy addresses supervisory areas of interest, including what targeted examinations will be conducted throughout the coming year. Targeted examinations address what are called “specialty areas,” such as Information Technology, Consumer Compliance, Community Reinvestment Act, and Trust areas. The EIC develops the supervisory strategy, including strategies with respect to the specialty areas with input from examiners, called “team leads,” who have lead responsibility for conducting the examinations in those areas. At the OCC, AML compliance is not considered a separate specialty area, but is included within Consumer Compliance specialty examinations. The EIC ultimately presents the annual supervisory plan for approval to the deputy comptroller for Large Bank Supervision at OCC headquarters in Washington.

Targeted Examinations. Based on the supervisory strategy, a series of specialized or “targeted examinations” is conducted throughout the year. OCC “Request Letters” are sent to a bank approximately 30 days before the start of each targeted examination. Request Letters give the bank advance notice of the examination and include a list of requested items that the bank should assemble for the examiners to review at the start of the examination.

The examiners then conduct an examination of a specific area of the bank and write a “Conclusion Memorandum” summarizing their findings for the EIC. The examiners may also contribute to any related Supervisory Letter that the EIC sends to bank management and any relevant portion of the annual Report of Examination provided to the bank’s board of directors.
Supervisory Letters are used by the OCC officially to inform a bank of the findings of a specialty examination and issues that warrant management's attention. For large banks under continuous examination, the OCC typically uses Supervisory Letters to provide detailed information to bank management about each specialty examination completed throughout the year. In addition to describing the examination findings, the Supervisory Letter can cite an apparent violation of law or a “Matter Requiring Attention” (MRA), meaning it requires the attention of the bank’s senior management. Both violations and MRAs require prompt corrective action by the bank. A Supervisory Letter may also include one or more “recommendations” to enhance bank performance or compliance in a particular area. Under OCC regulation and practice, “recommendations” do not require corrective action by bank management. OCC personnel told the Subcommittee that the Supervisory Letters written by EICs should accurately reflect the findings and criticisms in the conclusion memoranda written by the examiners.

Before issuing a Supervisory Letter, the EIC is required to forward a draft of the letter to the OCC’s Senior Deputy Comptroller in Washington for review. If the Supervisory Letter cites an AML violation or MRA requiring corrective action, it is referred to the Large Bank Review Committee (LBRC), which is comprised of three senior staff with AML expertise. The LBRC members are the senior legal counsel with AML expertise from the Legal Department, the Director for Bank Secrecy Act and Money Laundering Compliance, and the Director for Enforcement and Compliance. The LBRC was established in response to problems associated with the Riggs Bank AML examinations nearly ten years ago and is intended to ensure that OCC AML experts review field examiners’ work and promote consistency in AML enforcement across large national banks. Until recently, it was optional for the LBRC to have the examiner’s Conclusion Memorandum upon which the draft Supervisory Letter is based, but the LBRC has recently begun to require both before it will undertake a review of the draft letter.

Report of Examination (ROE). On an annual basis, for each large bank, the OCC issues a Report of Examination (ROE), summarizing the condition of the bank. The ROE normally includes all of the bank’s ratings arising from examinations of the bank’s safety and soundness and specialty areas, as well as all cited violations of law and

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1742 Subcommittee interviews of Joseph Boss (1/30/2012) and James Viventzio (3/15/2012). Mr. Viventzio told the Subcommittee, “An exam cited with an MRA is a failure” on the part of the bank.

1743 Id.

1744 Subcommittee interview of Joseph Boss (1/30/2012) and Elsa de la Garza (1/9/2012).

1745 Subcommittee interview of James Viventzio (3/15/2012).

1746 Id.
significant MRAs. Depending on the circumstances, the issues noted in Supervisory Letters provided to bank management throughout the year may or may not be referenced in the ROE. The EIC sends the ROE with a cover letter to the bank’s board of directors so that it has a written record of the regulator’s concerns. In addition, on an annual basis, the EIC attends a board meeting and presents the consolidated examination findings contained in the ROE to ensure the Board is fully informed about the bank’s ratings, financial condition, and any deficiencies.

**AML Examinations.** Like other Federal bank regulators, the OCC treats AML examinations as a specialty or targeted examination, and employs examiners with specialized AML expertise to conduct them. Upon completing an AML examination, the examiner is required to submit a Conclusion Memorandum to the Examiner-In-Charge of the bank describing the examination findings, any apparent violations of law, and possible recommendations, MRAs, or enforcement actions. The Examiner-In-Charge then sends a Supervisory Letter to the bank summarizing the AML examination findings and presenting any violations, MRAs, or recommendations.

At the end of the year, when the OCC readies the annual Report of Examination (ROE) for the bank and summarizes examination findings made during the year, the OCC does not treat AML deficiencies as a safety and soundness matter. It does not discuss AML problems in the ROE’s analysis of safety and soundness issues, nor does the OCC routinely take AML deficiencies into account when assigning the bank a CAMELS component rating for management or its overall composite rating.

Instead, unique in the Federal Government, the OCC subsumes AML issues within its consideration of consumer compliance issues.\(^{1747}\) The ROE discusses AML compliance in a section entitled, “Consumer Compliance” and combines that discussion with consideration of the bank’s compliance with consumer protection and civil rights laws. In addition, the OCC takes AML deficiencies into consideration when assigning a bank’s consumer compliance rating, even though the Uniform Interagency Consumer Compliance Rating System does not include AML considerations when specifying how to calculate that rating.

Consumer compliance examinations normally cover a bank’s compliance with consumer protection laws, such as laws requiring accurate disclosures of fees and interest rates, understandable mortgage

\(^{1747}\) See 9/2007 “Comptroller’s Handbook – Bank Supervision Process,” Appendix D, at 89, http://www.occ.gov/publications/publications-by-type/comptrollers-handbook_pdf/banksupervisionprocess.pdf; (“However, the OCC does incorporate into the consumer compliance rating examination findings pertaining to compliance with the Bank Secrecy Act (BSA), anti-money laundering (AML), and Office of Foreign Asset Control (OFAC).”). See also 2006-2010 OCC Reports of Examination for HBUS. [Sealed Exhibits.]
and credit card disclosures, and avoidance of unfair or deceptive practices. They also examine a bank’s compliance with civil rights laws, such as prohibitions against discrimination against persons on the basis of race, religion, national origin, or other prohibited categories. The examinations test, for example, the adequacy of a bank’s operating systems to track compliance with consumer protection laws, the documentation it uses for consumer products, and the content of files related to such products as mortgages, consumer loans, and credit cards. Those considerations are key to ensuring bank compliance with consumer protection and civil rights laws, but do not include and have no relevance to compliance with AML requirements to guard against money laundering and terrorist financing.

Like CAMELS ratings, consumer compliance ratings use a scale of 1 to 5, with “1” being the best rating and “5” the worst. The consumer compliance rating is calculated and presented separately in the OCC’s ROE, and typically has no impact on a bank’s component CAMELS ratings or its overall composite rating and, thus, no impact on an evaluation of the bank’s safety or soundness. A bank’s consumer compliance rating typically comes into play if a bank wants to open a new branch or expand into a new area of consumer lending; the OCC generally will not approve such an application, unless the bank has a consumer compliance rating of 1 or 2, showing that it is treating its customers fairly. Those considerations are not relevant, however, to AML compliance issues. Additionally, there is no logical reason why poor AML compliance should lower a bank’s consumer compliance rating when the two have virtually nothing in common.

An internal OCC review raised these same concerns. In 2005, following the Subcommittee’s report on the OCC’s inadequate AML oversight of Riggs Bank, the OCC’s Quality Management Division issued an internal report evaluating the OCC’s AML supervision


1750 OCC officials told the Subcommittee that, in some circumstances, the consumer compliance rating could be taken into account when evaluating a bank’s CAMELS management rating, although that was not typical. Subcommittee interview of James Vivenzio (3/15/2012) and Joseph Boss (1/30/2012).

program. The report found that the interagency consumer compliance rating system was not designed to and did not address AML issues. It noted that the rating was “geared to more traditional consumer protection regulations, such as Regulation Z and Regulation B, but is silent relative to BSA/AML compliance issues.” The report also noted: “Since the consumer compliance rating system was developed as a FFIEC initiative, OCC cannot modify the ratings outside of FFIEC.” The report recommended that the OCC work with the FFIEC to try to change the ratings system to incorporate AML issues, but seven years later, the ratings system still excludes consideration of AML issues, perhaps because no agency other than the OCC attempts to combine consumer compliance and AML concerns into a single rating.

**AML Violations.** In addition to subsuming AML concerns within its consumer compliance rating system, the OCC also has a unique approach to citing AML violations in its Supervisory Letters and Reports on Examination (ROE).

Like other Federal bank regulators, the OCC often includes a list of apparent violations of law in its annual Reports of Examination. Those violations span a wide range of banking laws and regulations, including, for example, consumer compliance concerns. In the AML area, however, the Subcommittee has learned that the OCC has adopted a practice of limiting the types of AML violations it will cite either in a ROE or Supervisory Letter.

Currently, all Federal bank regulators, including the OCC, will cite an apparent violation of law in a Supervisory Letter or ROE if the regulator determines that a financial institution’s entire AML program has failed. For the OCC, that citation would be an apparent violation of 31 U.S.C. § 5318(h)(1) and the OCC implementing regulation, 12 C.F.R. Section 21.21(b)(1). On the other hand, if the OCC were to determine that a bank failed to comply with one of the four mandated components of an effective AML program – described earlier as internal controls, an AML compliance officer, AML training, and independent testing – the Subcommittee has been told that, contrary to all other Federal bank regulators, the OCC generally will not cite a violation of one of the individualized program components, even though each component has its own statutory basis. For example, if a bank failed to provide adequate AML internal controls, Federal bank regulators other than the

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1753 Id. at 7.
OCC would cite the bank for violating 31 U.S.C. § 5318(h)(1)(A). In contrast, the OCC routinely forgoes the citation of violations of the individual AML program components, instead typically designating such a deficiency as a Matter Requiring Attention (MRA) by the bank.\textsuperscript{1755}

To examine the difference in the approach of the OCC versus other Federal banking agencies, the Subcommittee reviewed five years of reports compiled by the U.S. Treasury's Financial Crimes Enforcement Network (FinCEN) which, among other matters, track the AML statutory violations cited by the agencies.\textsuperscript{1756} Over the five year period from 2007 to 2011, the FinCEN reports show that the OCC conducted about 6,600 examinations and cited pillar violations only 16 times. In comparison, the Federal Reserve conducted about 4,800 examinations and cited pillar violations 159 times. The FDIC conducted about 12,800 examinations and cited pillar violations 714 times. The OCC approach is out of alignment with that of its peers.

Treating the failure of an AML pillar component as an MRA rather than an AML violation sends a more muted message about the importance of the AML deficiency and the need to correct it in a prompt manner. A matter requiring “attention” simply does not have the same urgency as a statutory “violation.” In addition, citing a violation of law when one critical component of a bank’s AML program is inadequate sends a strong message to management that its AML program is deficient, does not meet minimum statutory requirements, and requires remediation to ensure compliance with all four statutory requirements.

**AML Enforcement Actions at Large Banks.** When the OCC identifies AML deficiencies at a bank, it can use informal or formal enforcement actions to compel the bank to correct the deficiencies and strengthen its AML controls.

Informal actions include nonpublic commitment letters, board resolutions, or memoranda of understanding in which the bank makes written commitments, with fixed deadlines, to take specific actions. To take an informal action against a large bank, an Examiner-in-Charge must obtain the approval of the Large Bank Supervision Department in

\textsuperscript{1755} One OCC senior legal counsel specializing in AML matters told the Subcommittee that the OCC “will not cite pillar violations” and instead lists them as MRAs which are not enforceable in court. He said that the OCC uses the same approach when reporting AML examination findings to FinCEN, describing the OCC’s reporting as “cleaner” and not “cluttered with component violations” like the other agencies. Subcommittee interview of James Vivenzio (3/15/2012).

Washington. While these agreements are not enforceable in court, they can provide quick and effective tools to produce reforms. The OCC, however, disfavors the use of informal actions in AML cases, and has taken only eight informal enforcement actions against large banks for AML deficiencies since 2005. 1757

To take a formal enforcement action against a large bank, such as a Cease and Desist Order, the Examiner-in-Charge must submit a recommendation to the OCC’s Washington Supervision Review Committee (WSRC). 1758 The WSRC is comprised of senior managers in the agency and acts as an advising body to the Senior Deputy Comptroller. It was established to promote consistency in the agency’s application of formal enforcement actions. To present a recommendation, the Large Bank Supervision Department and the Legal Department prepare pertinent examination information and a memorandum for the WSRC. Counsel from the Enforcement and Compliance Division also participates. The WSRC ultimately determines whether a program violation can be supported and cited, which would also require the OCC to issue a Cease and Desist Order.

According to the OCC, from 2005 to 2011, the OCC issued 43 Cease and Desist Orders against both large and smaller sized banks with AML deficiencies, compared to 2 by the Federal Reserve and 52 by the FDIC, and assessed $124 million AML-related civil money penalties, accounting for 62% of the total penalty assessments by Federal banking agencies. 1759 At the same time, the statistics also indicate that the OCC is not resolving AML problems at an early stage but, as with HBUS, may be allowing AML problems to accumulate until they necessitate severe enforcement action.

The interagency guidance on AML enforcement provides all Federal banking agencies with guidelines on the use of formal enforcement actions to ensure bank compliance with AML laws, but does not offer any guidance on the use of informal actions. Among other provisions, the guidance states that if a Supervisory Letter contains an identical AML violation or MRA that was not corrected since the prior examination, typically referred to as a “repeat” violation or MRA, the agency must issue a formal enforcement action to require corrective action. 1760 Under a 2004 Memorandum of Understanding between FinCEN and Federal bank regulators, FinCEN must be notified of:

1757 Subcommittee briefing by OCC legal counsel (7/13/2012).
1759 Subcommittee briefing by OCC legal counsel (7/14/2012).
among other things, all AML-related formal and informal enforcement actions taken with respect to a particular bank. 1761

B. OCC Oversight of HBUS

HBUS is located within the OCC’s Northeastern District which is currently headed by Deputy Comptroller Toney Bland. The OCC Examiner-in-Charge of HBUS was Anthony DiLorenzo from 2004 until 2008, when his term expired, and he was replaced by Sally Belshaw. Ms. Belshaw served as the HBUS Examiner-in-Charge until December 2010, when she was promoted to Deputy Comptroller for Large Bank Supervision. 1762 The current OCC Examiner-In-Charge at HBUS is Kris McIntire.

(1) Chronology of OCC AML Oversight of HBUS

The OCC has been the primary regulator of HBUS since July 2004, when it inherited oversight of a bank already subject to a formal enforcement action to strengthen its AML program. HBUS has been criticized at times for poor AML controls for over the past decade, but until 2010, the OCC failed to take any enforcement action to compel the bank to implement an effective AML program.

Inheriting an AML Problem. Over the past 30 years, HBUS, through its predecessor banks, has changed its bank charter three times, switching between OCC and Federal Reserve oversight in 1980, 1993, and 2004. 1763 The first switch took place in 1980, when HSBC acquired 51% control over Marine Midland Bank in New York. Marine Midland Bank was then a state-chartered bank, a member of the Federal Reserve System, and subject to oversight by both the New York State Banking Department and the Federal Reserve. In connection with the 1980 acquisition, however, it converted its charter to a national bank subject to oversight by the OCC. By 1987, HSBC had assumed 100% control of the bank. In 1990, the OCC downgraded the bank’s CAMELS composite rating, which remained unchanged through 1993. 1764 On December 31, 1993, Marine Midland switched back to a state-chartered bank in New York subject to Federal Reserve supervision. After its first examination, the Federal Reserve upgraded its rating. 1765

1764 See 1/19/1990 and 3/31/1993 OCC targeted examinations. [Sealed Exhibits.]
1765 See 3/31/1994 Federal Reserve Bank of New York examination conducted jointly with the New York State Banking Department. [Sealed Exhibit.]
Six years later, in 1999, Marine Midland Bank acquired two more banks and renamed itself HSBC Bank USA, N.A. (HBUS). In 2003, HBUS was cited by both the Federal Reserve and New York State Banking Department for maintaining an inadequate AML program. Regulators cited fundamental, wide-ranging problems, including ineffective monitoring of wire transfers and monetary instruments, ineffective recordkeeping and reporting of currency transactions, inadequate customer due diligence and enhanced due diligence, and a failure to report suspicious activities. The Federal Reserve noted that AML deficiencies identified in prior examinations had not been corrected, that bank management was reactive rather than a proactive with respect to its AML program, and that the compliance function had a lack of influence as evidenced by ongoing, uncorrected problems. On April 30, 2003, both regulators entered into a formal agreement with the bank requiring it to “upgrade and improve” its AML internal controls. The agreement required:

“○ Development of a compliance program,
○ An effective system and methodology related to monitoring efforts,
○ A system for evaluating suspicious transactions,
○ A customer due diligence program, and
○ The development and implementation of appropriate risk assessments.”

On March 22, 2004, while this formal enforcement action was still unfolding, HBUS announced its intention to once more seek a national bank charter from the OCC. On July 1, 2004, after acquiring Republic Bank Delaware, HBUS changed its charter a third time and again became a national bank subject to oversight by the OCC. As a condition to approval of its new national charter, HBUS agreed to comply with the provisions of the 2003 agreement requiring AML improvements. HBUS, thus, began its tenure with the OCC operating under an agreement requiring it to address a host of AML deficiencies.

Terminating the AML Agreement Despite 30 MRAs. The OCC produced its first Report of Examination (ROE) for HBUS less than a year later. The ROE covered examinations conducted through March 31, 2005. It noted as the first Matter Requiring Attention of the bank its obligation to implement the AML requirements in the 2003 agreement and concluded that the bank had made significant progress. The ROE stated that HBUS had already “developed a written Anti-Money

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1766 See 12/31/2002 Federal Reserve Bank of New York examination conducted jointly with the New York State Banking Department. [Sealed Exhibit.]
1767 Id.
1768 OCC Report of Examination of HBUS, for the examination cycle ending March 31, 2005, OCC-PS-040107637, at 10-11 (describing the formal agreement). [Sealed Exhibit.]
1769 Id. at 10.
1770 Id.
Laundering (AML) program, including a system of internal controls” and established an “AML Oversight and Control Group ... responsible for maintaining enterprise wide AML policies and procedures, identifying red flags and establishing transaction monitoring criteria.” It stated that the bank had “[i]mplemented controls [that] provide for effective monitoring of various transactions throughout all departments of the bank ... for both non-customers and customers ... designed to identify unusual and/or suspicious activities.” It stated that HBUS had “enhanced monitoring abilities through the Customer Activity Monitoring Program (CAMP) system.” The ROE also stated that HBUS had established a “written Customer Due Diligence program” which included procedures to “ensure the identification and timely, accurate, and complete reporting of all known or suspected violations of law against or involving the bank, to law enforcement and supervisory authorities.” It said that HBUS had also “created risk rating criteria to identify categories of customers whose transactions and banking activities pose heightened risk of money laundering and other illegal activities.” It noted that the bank operated an Investigative Control and Reporting Office and a Financial Intelligence Group to conduct enhanced due diligence.

The ROE concluded: “OCC examiners reviewed compliance with the agreement, and found the bank to be in technical compliance with the requirements.” It said that termination of the formal agreement would be considered following targeted AML examinations of certain high risk areas in the bank.1771 Given the breadth and depth of the AML problems depicted in the 2003 agreement signed less than a year earlier and the relatively short time that the bank had to correct its AML deficiencies, the ROE’s positive statements were surprising.

Over the next year, until early 2006, OCC AML examiners completed seven AML examinations at HBUS. The examinations reviewed multiple HBUS departments with higher risk activities, including Embassy Banking, Global Banknotes, Foreign Correspondent Banking, wire transfers, and International Private Banking. Each of the examinations identified significant AML deficiencies. The problems included noncompliance with the bank’s AML policies (4 of 7 exams), weak monitoring procedures (5 of 7), weak customer due diligence procedures (5 of 7), inadequate written policies requiring revision (6 of 7), and untrained staff (5 of 7). For example, the examination of the Global Banknotes department found that customer information was missing from a number of files and that a number of banknotes clients were not being monitored at all.1772 The examination of the bank’s wire transfer operations found that monitoring was being conducted on a

1771 Id. at 11.
1772 6/20/2005 OCC Supervisory Letter to HBUS on Global Banknote Examination, OCC-PSI-00107505. [Sealed Exhibit.]
manual rather than automated basis, and identified one trust account that “had a significant amount of wire transfer activity in a short period of time and involved wire transfers to entities and/or individuals from high risk geographies,” had undergone no monitoring, and whose accountholder had not received an enhanced due diligence review.\textsuperscript{1773} The examination of the Embassy Banking department found over a dozen incidents of suspicious activity involving one embassy account over eight months, yet the bank had failed to close the account, despite an HBUS policy requiring closure in that circumstance.\textsuperscript{1774} The International Private Bank examination found 540 high risk accounts that needed annual reviews that had yet to be completed; account reviews whose conclusions were not consistently supported; and high risk bearer share accounts whose shares were not under bank control and posed a risk that the bank was unaware of the true account owners.\textsuperscript{1775}

When viewed together, the examinations identified systemic AML problems, a situation consistent with the extensive AML enforcement action instituted by the Federal Reserve and New York Banking Department. Many of the problems cited in the OCC examinations, including weaknesses in customer due diligence and monitoring, were prominent features of the 2003 agreement. In response to the AML examination findings, the OCC Examiner-in-Charge sent Supervisory Letters which, together, identified 30 Matters Requiring Attention (MRAs) requiring corrective action by HBUS.\textsuperscript{1776} Despite issuing over 30 MRAs in just over 12 months, on February 6, 2006, the OCC

\textsuperscript{1773} 1/23/2006 OCC Supervisory Letter to HBUS on Wire Transfer Examination, OCC-PSI-00107522. [Sealed Exhibit.]\n\textsuperscript{1774} 11/23/2005 OCC Conclusion memorandum “BSA/AML Examination – HSBC USA International Private Bank,” OCC-PSI-01298252; 1/30/2006 OCC Supervisory Letter to HBUS on Embassy Banking Examination, OCC-PSI-0107529. [Sealed Exhibits.]\n\textsuperscript{1775} 1/31/2006 OCC Supervisory Letter, “International Private Banking BSA/AML Examination,” OCC-PSI-00107537-542. [Sealed Exhibit.]\n\textsuperscript{1776} The 39 MRAs required corrective action to address weak AML monitoring procedures, weak AML due diligence, inadequate AML training, and inadequate AML policies. Monitoring problems were noted, for example, in all four Supervisory Letters issued in January 2006. See 1/17/2006 OCC Supervisory Letter to HBUS on Foreign Correspondent Banking, OCC-PSI-00000295-301, at 299-300 (Monitoring is weak and is not detecting patterns of activity “below system parameters” and monitoring wire transfers is a “manual process and therefore subject to inefficiencies and potential errors”); 1/23/2006 OCC Supervisory Letter to HBUS on Wire Transfers, OCC-PSI-00107522-528, at 526 (“The effectiveness of automated monitoring through CAMP is diminished in the absence of effective investigations of alerts that the system generates.”); 1/30/2006 OCC Supervisory Letter to HBUS on Embassy Banking, OCC-PSI-00107529-536, at 534 (“Embassy Banking Compliance management must ensure that high-risk and Special Category of Client (SCC) accounts are monitored and reviewed on a consistent and frequent basis.”); 1/31/2006 OCC Supervisory Letter, “International Private Banking BSA/AML Examination,” OCC-PSI-00107537-542, at 540-541 (“Management must establish standards for CAMP alert reviews that require well-documented reasons for conclusions … [E]xisting policies and procedures governing PUPID do not provide for adequate identification, monitoring and controlling the risk inherent in such activity… [T]here are no procedures in place to ensure activity logs are kept current on a scheduled basis. To effectively manage, monitor and report the potential risks associated with PUPID activity, logs must be revised to distinguish funds transfers payable to the account holder initiating the transfer, from those payable to a third-party non-account holder.”).
determined that the condition of the AML agreement had been met and terminated the agreement.\textsuperscript{1777}

AML Deficiencies Continue. On July 26, 2006, the OCC provided HBUS with another annual Report of Examination covering the period up to March 31, 2006.\textsuperscript{1778} In the section entitled, “Matters Requiring Attention,” the ROE included AML matters as an MRA, but provided this mixed message about the state of HBUS’ AML program:

“During the year, we identified a number of areas lacking consistent, vigilant adherence to BSA/AML policies, and provided management with supervisory letters addressing specific areas in need of strengthening. Bank policies are acceptable. Management responded positively and initiated steps to correct weaknesses and improve conformance with bank policy. We will validate corrective action in the next examination cycle.”\textsuperscript{1779}

Later in the report, in the section discussing the bank’s “Consumer Compliance Rating,” the ROE stated that HBUS had “a satisfactory BSA compliance program,” that its controls were generally effective, and “no violations of law were noted.” It also stated: “However, each examination resulted in MRAs, typically non-adherence to internal policies and procedures .... This recurring pattern is listed as a Matter Requiring Attention in this Report of Examination.”\textsuperscript{1780} The ROE also criticized an internal group dedicated to testing AML compliance, the Compliance Review Unit, which, according to the ROE, was understaffed, performed weak analysis, and needed to be revamped.

HBUS’ typical response to these examinations was to develop AML policies and procedures in response to the specific AML problems identified by the OCC. Those policies and plans often were narrowly targeted, and later examinations found that bank personnel sometimes failed to implement or comply with them.

A year later, on July 24, 2007, the OCC’s annual Report of Examination contained a more negative assessment.\textsuperscript{1781} This report covered examinations conducted through March 31, 2007. The letter transmitting the ROE stated:

“A number of business areas continue to lack vigilant adherence to BSA/AML policies. Supervisory letters issued during the year highlighted a number of thematic deficiencies in the execution of

\textsuperscript{1777} 7/26/2006 OCC Report of Examination of HBUS, for the examination cycle ending March 31, 2006, OCC-PSI-00422079, at 5. [Sealed Exhibit.]
\textsuperscript{1778} 7/26/2006 OCC Report of Examination of HBUS, for the examination cycle ending March 31, 2006, OCC-PSI-00422079. [Sealed Exhibit.]
\textsuperscript{1779} Id. at 2.
\textsuperscript{1780} Id. at 12.
\textsuperscript{1781} 7/24/2007 OCC Report of Examination of HBUS, for the examination cycle ending March 31, 2007, OCC-PSI-00304077. [Sealed Exhibit.]
BSA/AML policies and procedures at the business level. Management continues to respond positively to correct weaknesses noted, and to improve conformance with bank policy. However, it remains critical that sound policies adopted by the Board and management are executed consistently in the business lines.\footnote{Id. at 2.} In the report itself, the section entitled, “Matters Requiring Attention,” included this MRA:

“During the past year, examiners identified a number of common themes in that businesses lacked consistent, vigilant adherence to BSA/AML policies. Bank policies are acceptable; however, the execution of these policies in the various business lines requires strengthening. Management continues to respond positively and initiated steps to improve conformance with bank policy.”\footnote{Id. at 1.}

The MRA, which called for “strengthening” the “execution” of AML policies in “the various business lines,” provided a general instruction to pay more attention to AML compliance.

A second MRA was more specific and issued a warning about the need to strengthen AML controls on HBUS pouch services, meaning bank services to clear monetary instruments from abroad, including bank checks, money orders, and travelers cheques.\footnote{Id.} The MRA stated that pouch services “facilitate easy movement of funds, and are favored by persons who transfer illegal and terrorist funds.” It noted that pouch services were being provided by multiple HBUS business lines. The ROE described the pouch examination as having “resulted in serious concerns related to weak policies, procedures, systems and controls … inferior to BSA/AML controls in other areas of the bank.” The ROE also stated that “remedial attention is warranted,” and warned that ongoing inadequate AML controls over pouch activities “could potentially subject the bank to undue reputation risk and/or lead to BSA/AML violations.”\footnote{Id. See also the discussion of the bank’s Consumer Compliance Rating, at 12.}

By the end of 2007, the OCC completed 21 AML examinations, many of which identified serious AML problems.\footnote{Id. at 1.} Many of these examinations identified the same serious problems noted in earlier examinations, some of which cut across business lines. The examinations include AML issues in the London Banknotes office, Corporate and Institutional Banking, Retail Banking, Pouch Services, and Investment Banking. The examination that identified the most serious AML deficiencies, and which was included as an MRA in the\footnote{Id. Eight of the 21 examinations were limited to following up on corrective actions promised earlier, all of which were found to have been carried out.}
annual ROE, related to pouch services which seemed to be operating without any AML controls. The pouch examination cited insufficient AML policies and procedures, a lack of monitoring for suspicious activities, inadequate AML controls and training, and inadequate independent testing of pouch services for AML compliance.\textsuperscript{1787} Examples of potentially suspicious activity included sequentially numbered travelers cheques endorsed by the same exchange house and processed through several cash letters; a transaction that included a starter check for $105,000; and $130,000 in sequentially numbered travelers cheques presented in bearer form with the payee line left blank.\textsuperscript{1788} OCC examiners initially recommended that a formal enforcement action be taken to effect corrective action in the pouch area, but no formal or informal action was taken.\textsuperscript{1789}

The 21 examination reports and the Supervisory Letters that followed identified numerous AML deficiencies, including noncompliance with bank policy, poor monitoring, weak to nonexistent due diligence reviews, inadequate policies requiring revision, and untrained staff. Altogether, from February 2006 to December 2007, the Supervisory Letters identified another 34 AML MRAs, but no violations were identified or enforcement actions taken.

**AML Deficiencies Displaced by Financial Crisis.** On July 15, 2008, the OCC issued its annual Report of Examination for HBUS, summarizing examination activity conducted through March 31, 2008.\textsuperscript{1790} Despite referencing a troubling AML examination involving the bank’s Embassy Banking department, described below, for the first time since 2004, the ROE did not contain any MRA related to AML concerns. This development may have been due, in part, to the

\textsuperscript{1788} Id. at 208.
\textsuperscript{1789} Subcommittee interview of Joseph Boss (1/30/2012), Elsa de la Garza (1/9/2012), and Anthony DiLorenzo (3/22/2012). Upon receipt of the recommendation, the Examiner-in-Charge asked the AML examiners to prepare an analysis of whether the proposed enforcement action, a Cease and Desist Order, met OCC enforcement standards. The AML examiners concluded that, despite the serious AML deficiencies, the problems in the pouch area did not rise to the level of a violation of law and would be applied to a bank with a high composite rating for safety and soundness, and so did not meet OCC standards for issuing a Cease and Desist Order. See 6/14/2007 OCC memorandum, OCC-PSI-01298625; 7/3/2007 OCC memorandum OCC-PSI-00877731. [Sealed Exhibits.] One examiner told the Subcommittee that although the pouch activity did not meet OCC enforcement standards, he felt a Cease and Desist Order was nevertheless warranted at the time. Subcommittee interview of Joseph Boss (1/30/2012). The deputy head of Large Bank Supervision told the Subcommittee that she did not recall being informed about the enforcement recommendation or seeing the Conclusion Memorandum that laid out the problems in the pouch area at HBUS. Subcommittee interview of Grace Dailey (6/15/2012).
\textsuperscript{1790} 07/15/2008 OCC Report of Examination of HBUS, for the examination cycle ending March 31, 2008, HSBC OCC 3601119. [Sealed Exhibit.]
deepening financial crisis then sweeping the U.S. financial system, raising questions about virtually every major financial institution. HBUS' AML issues may have been displaced by OCC efforts to analyze the bank’s safety and soundness, including each of its CAMELS components. Nevertheless, the ROE did reference ongoing AML concerns at the bank.

The OCC letter transmitting the ROE included this paragraph about AML issues:

“Although BSA/AML internal systems and controls are generally effective, the examination of the Government and Institutional Banking (GIB) operations disclosed a number of significant ... compliance concerns. Management developed a plan to address the issues, and we are presently validating that the actions taken are addressing our concerns.”

Although the ROE contained no MRA related to AML concerns, in the section discussing HBUS' composite rating, the ROE again referenced the examination that uncovered serious AML deficiencies in the GIB department:

“Our examination of BSA/AML practices in the Government and Institutional Banking (GIB) department during the first quarter of 2008 resulted in a number of concerns including: inconsistent adherence to internal policies and procedures, inadequate systems, the need to strengthen controls, and inconsistent monitoring processes. Management is aware of the deficiencies and developed a plan to address the issues. We are in process of validating that the corrective action plan addresses our concerns satisfactorily.”

Although these AML deficiencies were discussed in the composite rating section, there is no indication they affected the rating which remained unchanged from the prior year.

AML issues were discussed a third time in the section of the ROE analyzing HBUS' Consumer Compliance Rating. For the first time, this section included a lengthy discussion of the high AML risks incurred by HBUS' banking operations. The ROE stated:

“BSA/AML examinations were conducted in Middle Market, Government and Institutional Banking, Corporate Trust, Investment Banking, Customer Activity Monitoring Program, and London Banknotes follow-up. …

1791 Id. at 2.
1792 Id. at 3.
HBUS is the largest Embassy banking services provider. The bank is also active in the precious metals, jewelry, garment, and Middle Eastern carpets industries. HBUS has numerous accounts to Politically Exposed Persons and Money Service Businesses. The bank ranks in the top three banks in CHIPS and SWIFT wire transfer volume, and is a leader in global foreign correspondent relationships. As the U.S. dollar clearing bank for the Global HSBC network, HBUS maintains numerous relationships with institutions worldwide. ... The bank does business with numerous customers in both High Intensity Drug Trafficking Area and High Intensity Money Laundering and Related Financial Crime Area locations. HBUS provides pouch services through several business units. Historically, pouch services are vulnerable to money laundering risk.\footnote{1793}

Despite this recitation of the AML risks facing HBUS, the ROE stated that the bank’s AML controls were “generally effective, with no violations noted.” It also stated that “certain areas within GIB required strengthening.”\footnote{1794}

**Embassy Banking Examination.** The ROE’s multiple references to GIB, the Government and Institutional Banking department that housed the bank’s Embassy Banking services, were included, because in January 2008, former GIB employees alerted the OCC to a host of problems in the Embassy Banking unit. HBUS had dramatically increased its Embassy Banking business, after the closure of Riggs Bank and the decision by Wachovia Bank to exit the business.\footnote{1795} By January 2006, the bank had over 2,500 embassy accounts with $485 million of deposits under management,\footnote{1796} and the business continued to grow. The former employees described numerous problems, including apparent employee misconduct, inappropriate business transactions, noncompliance with bank policy, inadequate account monitoring, and erroneous and misleading regulatory and internal reports.

Over the next few months in 2008, an OCC examination confirmed the allegations.\footnote{1797} The examination found, for example, that GIB had allowed two high risk embassy accounts involving Libya and Saudi Arabia to operate outside of restrictions specified in Memoranda of

\begin{itemize}
\item \footnote{1793} Id. at 13-14.
\item \footnote{1794} Id. at 13.
\item \footnote{1796} 1/30/2006 OCC Memorandum, “4Q05 Embassy Banking Examination,” OCC-PSI-00107529; 1/30/2006 OCC Supervisory Letter to HBUS, OCC-PSI-00107529. [Sealed Exhibit.]
\end{itemize}
Understanding (MOU) established for each Embassy relationship. The examination found unacceptable levels of risk, inadequate account monitoring, and suspect transactions. One example involved a $20 million wire transfer that was variously explained as needed to pay the expenses of Libyan prisoners in the United States and elsewhere, or for “legal expenses and consultation that will lead to the establishment of a bilateral agreement with the US for cooperation on judicial affairs that related to future prisoner transfers.” The examination reported that when HBUS Compliance asked an Embassy Relationship Manager for information about one of the high risk accounts, it received insufficient explanations and, in some cases, the Relationship Manager took up to four months to obtain client responses.

In addition, the examination found that Embassy Banking had been opening new accounts without notifying HBUS AML Compliance, which was against bank policy and led to unmonitored account activity. The OCC determined that two of five accounts opened for one high risk embassy relationship had not been disclosed to AML Compliance. It found that over 45 letters of credit for other Embassy Banking clients, ranging in amounts from a few thousand dollars to $3 million, were also undisclosed. Another problem was that Embassy Banking was executing transactions for persons who were not clients — so-called PUPID transactions that were Payable Upon Proper Identification — without logging in some of the transactions and without screening the transaction beneficiaries against OFAC’s SDN list, in contravention of U.S. law. Still another problem was that Embassy Banking personnel had identified multiple instances of suspicious activity involving some accounts, but had not closed the accounts, despite an HBUS policy requiring closure under those circumstances. The OCC also identified a backlog of over 3,000 unreviewed alerts, some dating back to 2007, relating to potentially suspicious transactions in Embassy accounts.

The OCC examiner concluded that GIB’s “AML program is not effective in identifying and mitigating risk, especially considering the nature of its clientele and the types of products and services it provides.” The examiner recommended issuance of a Cease and Desist Order requiring immediate corrective action and prohibiting new Embassy Banking accounts until AML controls were in place. The OCC decided, however, not to issue a Cease and Desist Order or take any other informal or formal enforcement action with respect to the Embassy Banking accounts. In May 2008, HBUS submitted an action plan to

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1800 The AML examiner told the Subcommittee he was not given any reason for OCC’s inaction in this matter, but was simply told there would be no enforcement action. He said it was his understanding that the Examiner-in-Charge had discussed the matter with the deputy head of Large Bank Supervision in Washington before telling him: “Grace said there would be no C&D.” Subcommittee interview of Joseph Boss (1/30/2012). The Examiner-in-Charge told the
the OCC and began addressing the AML deficiencies at GIB. A later examination was conducted to determine whether the GIB commitments were carried out and found that they were. In July 2008, the Report of Examination sent to HBUS acknowledged the AML deficiencies uncovered in Embassy Banking, but did not treat them as a Matter Requiring Attention by the HBUS board.

AML Deficiencies Continue Amid Law Enforcement Inquiries.
On July 6, 2009, the OCC sent HBUS the annual Report of Examination covering the period up to March 31, 2009. Like the prior year’s ROE, it contained no Matter Requiring Attention related to AML issues. The letter transmitting the ROE noted, however, that AML concerns were ongoing nonetheless:

“Compliance with BSA/AML remains a high priority and a key reputation risk. As part of the ‘compliance transformation project,’ this area is also undergoing significant change. The company has high-risk clients and businesses and the current leadership needs to be strengthened. Plans are underway to address this concern.”

This letter was the first to be signed by Sally Belshaw, who had replaced Anthony DiLorenzo as the OCC Examiner-in-Charge at HBUS, upon conclusion of Mr. DiLorenzo’s five-year term. It was the fifth in a row to identify AML compliance as a high priority issue.

For the first time, the ROE contained a “Risk Assessment Summary” table which included a reference to AML issues. The table indicated that AML risk was “High,” AML risk management was “Satisfactory,” and the aggregate AML risk at HBUS was “High” and “Stable.”

Later in the report, in the section discussing the bank’s “Consumer Compliance Rating,” the ROE stated that HBUS’ compliance risk was “high due to the bank’s lines of business which offer several products historically associated with money laundering.” It repeated much of the language from the last ROE describing the bank’s high risk businesses and customers. It also indicated that HBUS needed to strengthen its AML leadership:

“Although the BSA/AML program is effective overall, we recently highlighted the need to strengthen leadership in the area. When the

Subcommittee that he did not recall talking to a superior about the matter, but thought he “probably did because it was a significant issue.” Subcommittee interview of Anthony DiLorenzo (3/22/12). The deputy head of Large Bank Supervision did not recall having a discussion about a Cease and Desist Order involving Embassy Banking at HBUS. Subcommittee interview of Grace Dailey (6/15/12).
1802 Id. at 2.
1803 Id.
BSA Director resigned in 2007 the role of the HBUS Compliance Director was expanded to include oversight of the BSA/AML program. The current Compliance Director has been in place since second quarter 2008. In addition to BSA responsibility in the U.S., the Compliance Director also has responsibility for Canada, Mexico and the Securities businesses. We believe that a complex, high-risk institution like HBUS needs a BSA/AML Officer who is highly qualified and experienced and have recommended that such a person be dedicated to the function. A search is underway.\(^{1804}\)

The discussion of AML leadership was prompted by the 2007 departure of HBUS’ AML head Teresa Pesce after four years on the job, followed by the departure of the head of HBUS Compliance, Carolyn Wind after seven years on the job. After Ms. Pesce left, Ms. Wind had served as both Compliance and AML head. Leslie Midzain was then hired to serve in both roles as well, serving as the bank’s AML head even though her background was in Canada and she had no U.S. AML experience. In 2010, the OCC would ask for her replacement due to her lack of AML expertise and would also criticize the weak AML leadership shown by the regional Compliance head, Janet Burak. In addition to AML leadership problems, the ROE noted that HBUS Compliance was undergoing a reorganization, and that the Compliance Review Unit, originally dedicated to AML independent testing, was also being reorganized and its mission expanded to other compliance issues.

During 2008, the OCC completed six more examinations, one of which focused on reviewing corrective actions to prior problems. Of the remaining five, one involved additional work on the AML deficiencies at GIB’s Embassy Banking unit.\(^{1805}\) Another focused on AML issues affecting the Payments and Cash Management (PCM) department which helped provide a variety of cash services to clients, including correspondent accounts.\(^{1806}\) The PCM examination found fundamental flaws in its AML controls, including inadequate monitoring, poor review of account alerts, and suspicious transactions involving money service businesses. The PCM examination found, for example, that PCM “systems and controls are less than satisfactory and do not provide an appropriate level of monitoring for suspicious and unusual activity for all of the activities in the business unit.” One example involved an account alert which found that a U.S. money service business was sending wire transfers through its HBUS correspondent account to an Ethiopian bank for credit to an account it held at that bank, in effect sending money to itself. The alert was reviewed, PCM personnel

\(^{1804}\) Id. at 16.


\(^{1806}\) 12/7/2007 OCC Memorandum, “BSA/AML Examination - Payment and Cash Management,” OCC-PSI-01263586. [Sealed Exhibit.]
determined more information was needed, but the alert was closed and the transactions continued.

Similar problems had been identified in a 2006 OCC examination of foreign correspondent banking which resulted in an MRA requiring PCM to conduct a review of its money service business accounts. As a result of the 2008 examination, OCC examiners recommended three MRAs, one of which directed PCM to conduct a review of its money service business accounts, which appears to be a “repeat MRA” from the 2006 examination. Several months later, the OCC Examiner-in-Charge sent a Supervisory Letter to HBUS including the three MRAs, but did not characterize the request for an account review as a “repeat MRA” that would necessitate an enforcement action, instead referring to “PCM’s delay in initiating a special review for Money Services Businesses (MSB) type of entities, as required by a previous MRA, has resulted in increased risk.”

A third examination in 2008, focused on HBUS Compliance Review Unit (CRU) which was dedicated to reviewing AML compliance at the bank. The examination found its work satisfactory but also directed HSBC’s internal audit unit to test the CRU’s workpapers for reliability and directed the CRU to conduct an immediate review of the PCM department which had not undergone an internal AML review for over three years. Additional examinations focused on AML issues at Card Services and Banknotes offices in Singapore and Hong Kong.

In 2009, the OCC conducted eight more AML examinations. Three followed up on the problems uncovered in connection with HBUS’ pouch activities, Embassy Banking and PCM services. Additional examinations assessed HBUS’ OFAC compliance and AML controls involving correspondent banking and private banking. Those examinations identified additional AML problems.
For example, the private banking examination concluded: “HSBC’s Private Bank BSA/AML does not adequately manage the risks associated with DPB-NY/CA [Domestic Private Bank offices in New York and California] and IPB-NY [International Private Bank in New York].” Supervisory Letters sent to HBUS described the AML problems, some of which had been detected in a 2006 examination of private banking, but made no mention of repeat MRAs that would require an enforcement action.

Altogether in 2008 and 2009, the Supervisory Letters identified 12 more MRAs in the AML field, but no informal or formal enforcement actions were taken. These 12 MRAs were on top of the 71 MRAs identified from 2005 to 2007.

In the spring of 2009, a new development intensified OCC’s focus on AML problems at HBUS. The OCC was contacted by two Federal law enforcement agencies regarding separate Federal investigations into possible money laundering through accounts at HBUS. The first contact, in June 2009, was from the U.S. Department of Homeland Security’s Immigration and Customs Enforcement (ICE) unit investigating possible laundering of illegal drug proceeds. The second contact, around August or September 2009, was from a U.S. Assistant Attorney General in West Virginia investigating a Medicare fraud.

Senior OCC officials in Washington arranged to meet with the ICE representatives. On September 1, 2009, the meeting took place in Washington and was attended by the OCC Deputy General Counsel Daniel Stipano, Deputy Controller in charge of Large Bank Supervision Grace Dailey, OCC senior legal counsel with AML expertise James Vivenzio, the OCC AML examiners at HBUS, and the ICE representatives. After the meeting concluded and the ICE representatives left, OCC personnel continued to discuss supervision of HBUS. According to a memorandum summarizing the meeting, the lead AML examiner at HBUS informed the other meeting participants that, during his tenure at the bank, HBUS had been the subject of 83 AML-related MRAs, and he had twice recommended issuance of a Cease and Desist Order to compel the bank to strengthen its AML controls.

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1815 Id.
1817 Subcommittee briefing by OCC (3/15/2012).
1819 9/1/2009 Memorandum to Files from OCC Examiners Joseph Boss and Elsa de la Garza, OCC-PHI-01416833. See also Subcommittee interviews of Elsa de la Garza (1/9/2012), Joseph Boss (1/30/2012), and James Vivenzio (3/15/2012).
According to the meeting memorandum, Mr. Stipano “stated that he was unaware of the recent history of HBUS and that he wanted a thorough review.”

After this meeting, the OCC directed its AML examiners to draw up an investigative plan and expand an ongoing AML review to encompass a comprehensive review of the entire AML program at HBUS. On September 3, 2009, the OCC sent a letter to HBUS informing it that a regularly scheduled AML examination of the Banknotes department that started in July and for which field work was completed in August 2009, was being expanded. Additional staff was added to the AML team.

**Expanded AML Examination.** For the first time since the OCC inherited HBUS from the Federal Reserve, it directed its AML examiners to conduct a holistic review of HBUS’ AML program, instead of focusing on AML issues in particular banking services or departments. The AML examiners quickly found fundamental problems related to the specific AML deficiencies identified over the years. This examination would continue throughout 2010.

In March 2010, the OCC issued its first AML-related Supervisory Letter that cited HBUS for a violation of law, for failing to file Suspicious Activity Reports (SARs) in a timely manner. The Supervisory Letter stated that its AML examination had found that the bank had a backlog of over 17,000 alerts, in four business units, identifying potentially suspicious activity that had not been investigated to determine whether a SAR should be filed. The OCC determined that 98% of those alerts were generated in the “High Risk Monitoring Group,” and 14% were six months or older. The OCC gave the bank a deadline of June 30, 2010, to clear the backlog and instructed the bank to develop a risk-based system for reviewing and resolving those alerts. In addition to the backlog of alerts, OCC examiners had found significant backlogs in the bank’s handling of AML-related subpoenas and Section 314(a), and 314(b) requests for information from other banks, though those items were not specifically discussed in the Supervisory Letter.

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1820 9/01/2009 Memorandum to Files from Examiners Joseph Boss and Elsa de la Garza, at OCC-PSI-01416833. [Sealed Exhibit.]
1821 On 9/21/2009, the OCC sent HBUS a request letter for an extensive amount of new information on 25 Latin America-based institutions. There would be eight additional requests for more information through early February 2010. See 2/6/2010 HBUS email from Janet Burns to Brendan McDonagh, OCC-PSI-00787479.
1823 Id.
1825 See “Background Information on HSBC’s Alert Backlog as of the week of February 8, 2010,” prepared by OCC, OCC-PSI-01358494.
Shortly after delivering the Supervisory Letter, the OCC Examiner-in-Charge for HBUS Sally Belshaw and the head of Large Bank Supervision Grace Dailey met with the HSBC Group CEO Michael Geoghegan and the HNAH and HBUS CEO Brendan McDonough on April 20, 2010. In that meeting, the OCC officials informed the bank officials that the agency had identified serious AML deficiencies throughout the bank. According to a memorandum prepared by Ms. Belshaw summarizing the meeting, the discussion included the following:

He [Mr. Geoghegan] asked when I thought things went bad. Grace and I described the spotty history of the bank relative to BSA/AML compliance. The bank converted to a national charter with a Formal Agreement (Fed) that they addressed. We also noted the regular and frequent citing over the years of MRAs in almost every examination we conducted. In those cases, management reacted to our findings and took corrective action. This, however, culminated in a systemic concern that we ultimately characterized as ineffective management (BSA/AML officer last year and now the compliance program overall). We believe that over the years, the people and program did not advance to keep pace with the risk. Systems enhancements are only now being achieved (and moved up in light of our concerns). Talent left the organization and was not replaced by people with sufficient technical skills to lead. Succession/bench strength for the compliance area is now inadequate. MIS has not evolved to permit early identification of risks/concerns. The backlog issue is a symptom of these management weaknesses....

We discussed several areas in some specificity including HBUS’ policies/practices with respect to monitoring of affiliate activity (should be to same, not lesser, standard than other correspondents as is currently the case). We highlighted findings of weakness in KYC in several areas: bank notes, wire activity, domestic & international customers. We highlighted our recent concerns/questions about management's ability to address the backlog problem (and violation) given weaknesses we are seeing in data integrity in reports, quality of alert dispositioning, and the lack of independent review/oversight of that process. Our supervisory letter requires that backlogs be completely corrected by June 30th. We emphasized that not only must the number be addressed, but they must be effectively dispositioned (qualified reviewers guided by appropriate policy/process, adequate documentation, appropriate/timely SARs filed), and an ongoing system of controls must be in place to ensure the process is...
sustainable. We will be requiring qualified, independent verification of that as part of the process.\footnote{4/20/2010 OCC Memorandum, “Meeting w/Michael Geoghegan and Brendan McDonough,” OCC-PSI-00905522.}

**2010 Report on Examination.** On April 28, 2010, three months earlier than normal, the OCC delivered its annual Report of Examination (ROE) to HBUS, covering the period up to December 31, 2009.\footnote{4/28/2010 Report on Examination of HBUS, for the examination cycle ending December 31, 2009, OCC-PSI-00899872 [Sealed Exhibit.]} Like the Supervisory Letter, this ROE cited HBUS for violating the Bank Secrecy Act due to its failure to file timely SARs, the only violation listed.\footnote{Id. at 7.} The letter transmitting the ROE stated:

“Perhaps most disconcerting, we have identified significant weaknesses in compliance, particularly in Bank Secrecy Act/Anti-Money Laundering (BSA/AML), that are likely to have costly financial and reputation implications. Management is responding to the concerns we are raising, but was not effective in preventing these weaknesses from becoming serious problems. … An extended examination is revealing serious breakdowns and violations. We will likely be requiring additional action to address this concern.”\footnote{Id. at transmittal letter.}

In addition, for the first time, the ROE discussed HBUS’ AML problems in the context of HBUS’ CAMELS management rating, although the rating remained unchanged from the prior year. The ROE noted that HBUS was the subject of several ongoing investigations that could damage its reputation, and the OCC was “increasingly concerned with weaknesses in compliance (particularly BSA/AML) risk management,” including “the quality of BSA/AML monitoring and compliance.” The ROE stated that the ongoing AML examination “is revealing weaknesses that have impacted our overall assessment of the program and its management.”\footnote{Id. at 3-4.}

The ROE also discussed the AML problems in the section on HBUS’ Consumer Compliance Rating and disclosed that it was lowering that rating as a result. The ROE stated:

“[W] are lowering our assessment of the quality of compliance risk management from satisfactory to weak …. The high level of BSA/AML/OFAC risk associated with HBUS’ business activities is a significant factor in our assessment. … In addition to the high level of risk presented by its business activities, HBUS has a high quantity of risk based upon significant indications that the bank is not in compliance with all laws and regulations. … Based upon our work to date, we have identified deficiencies relating to
HBUS' transaction monitoring, analysis of customer due diligence information, adherence to the USA PATRIOT Act; and filing of Suspicious Activity Reports (SARs). We are changing our assessments of both HBUS' BSA/AML program and its overall compliance management program from satisfactory to weak. These changes are based upon our concerns regarding (1) the lack of effective compliance oversight provided by the head of HNAH/HBUS' compliance department, (2) the ineffective results to date of HBUS' project to implement a new model for its compliance structure and process, and (3) the deficiencies that we have identified to date during our expanded examination of HSBC's Global Banknotes business and the concerns raised by multiple external parties.\textsuperscript{1831}

The OCC lowered HBUS' Consumer Compliance Rating even though it did not identify any problems related to bank compliance with consumer protection or civil rights laws. The OCC's actions contravened the interagency agreement on how to calculate this rating, which required a focus on consumer protection and civil rights laws, not AML requirements.

Although its Consumer Compliance Rating was lowered, the bank's safety and soundness ratings remained unchanged. Neither the CAMELS management component rating nor the overall composite rating were lowered. These unchanged ratings meant that the bank would also not incur any added Federal deposit insurance fees, despite its elevated AML risk.

On April 15, 2010, the OCC's Washington Supervision Review Committee approved an Order of Investigation "concerning potential violations of law and unsafe and unsound conduct in connection with the BSA/AML policies and practices of HSBC Bank USA, N.A.\textsuperscript{1832}" The issuance of the Order was based on the preliminary findings of the expanded AML examination, which by that point had identified evidence of a backlog of alerts that had not been processed for suspicious activity reporting; failure to adequately monitor foreign affiliates; and failure to adequately monitor wire transfer transactions for customers in countries designated "standard" or "medium" risk by the bank.

On September 13, 2010, the OCC issued the 31-page Supervisory Letter described earlier, outlining a long list of significant AML problems at HBUS.\textsuperscript{1833} The Supervisory Letter also cited the bank for a

\textsuperscript{1831} Id. at 6.
violation of the Bank Secrecy Act statute for failing to maintain an effective AML program. The letter informed HBUS that “the bank’s compliance program and its implementation are ineffective, and accompanied by aggravating factors, such as highly suspicious activity creating a significant potential for unreported money laundering or terrorist financing.” In addition, the letter stated:

“Since the OCC terminated the Formal Agreement in February 2006, the bank has had a high number of MRAs and the OCC continues to identify serious deficiencies in the bank’s BSA/AML compliance program. Over the past two years, the examination scopes have included many of the same areas that are of concern at this examination. The OCC has issued twelve MRAs during this period, many of which address similar issues compared to its current concerns, including the adequacy of compliance leadership, alert management, and monitoring systems.”

In October 2010, six years after becoming HBUS’ primary Federal regulator, the OCC issued its own formal enforcement action, a Cease and Desist Order requiring corrective action on many of the same problems identified by the Federal Reserve seven years earlier in 2003.

Federal Reserve Ratings. The OCC was not the only Federal banking regulator that examined HBUS. Because HBUS had federally insured deposits, the FDIC acted as a secondary regulator. In addition, the Federal Reserve was responsible for regulating HBUS’ holding company, HSBC North America Holdings (HNAH) as well as an Edge Act Corporation that HBUS owned in Florida. The Subcommittee did not attempt to review the oversight exercised by these two other regulators. The Subcommittee did note, however, that as of 2009, the Federal Reserve Bank of Chicago maintained a lower rating for HNAH’s risk management, in part because of the AML problems at HBUS.

The 2009 Federal Reserve report stated: “[T]he primary driver for the overall rating is the unsatisfactory BSA/AML program. BSA/AML risk is currently the highest inherent Legal and Compliance risk for HNAH.” The Federal Reserve report stated that the bank’s compliance program had focused “inward on alignment with Group, cost reduction, and centralization without sufficient focus on implementing and maintaining good risk identification, control, measurement, and management processes.” It also noted that “HNAH’s strategic plan

1834 Id. at 336.
1835 Id. at 335.
1837 See Federal Reserve Bank of Chicago report as of December 31, 2009, BOG-SR-001368, at 1. [Sealed Exhibit.]”
1838 Id. at 2.
was to focus on customers and business lines with international connections, which present higher levels of BSA/AML and OFAC risks.” According to the Federal Reserve:

“[T]he significant weaknesses and issues identified by regulators on the BSA/AML program underscores senior compliance management’s inability to self-identify compliance risks and to note significant control deficiencies in a timely fashion. While the inability of senior compliance management are a primary driver for the downgrade1839 of board and senior management oversight rating, the lack of a sound risk management function that adequately includes compliance risk is also a contributor.”1840

In October 2010, on the same day and in coordination with the OCC, the Federal Reserve issued its own formal enforcement action with respect to HNAH, requiring it to strengthen its “firmwide compliance risk management program,” including with respect to AML compliance, and ensure that HBUS complied with the OCC order.1841

(2) Six Years of AML Deficiencies

An OCC presentation providing an “AML Retrospective (2001-2011)” includes a chart showing that, from January 2005 to March 2010, the OCC issued 85 AML-related Matters Requiring Attention to the HBUS Board of Directors, which was a third more AML-related MRAs than the next closest major bank.1842 An experienced OCC AML examiner told the Subcommittee: “I thought I saw it all with Riggs, but HSBC was the worst situation I’d ever seen.”1843

The following chart summarizes many of the OCC-issued MRAs related to AML problems at HBUS. It shows that the examinations repeatedly revealed critical AML problems across HBUS business units, many of which offered high risk products, had high risk clients, or engaged in high risk activities vulnerable to money laundering and terrorist financing. Twenty-one of the examinations identified problems

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1839 This targeted examination did not result in a downgrade at the overall holding company level.
1840 Id. at 5.
1842 See undated presentation, “BSA Officer Roundtable: Bank Secrecy Act Policy and Legal Update,” by John Wagner, OCC Director of BSA/AML Compliance, and James Vivenzio, OCC Senior Attorney for BSA/AML, chart entitled, “BSA/AML MRA: Large Banks: Full Information System Extract (LBIS),” OCC-PSI-01768253. See also Subcommittee interviews of Elsa de la Garza, Joseph Boss, and James Vivenzio (confirming HBUS had an unusually high number of MRAs compared to other banks); 9/13/2010 OCC Supervisory Letter HSBC-2010-22, “Bank Secrecy Act/Anti-Money Laundering (BSA/AML) Examination – Program Violation (12 U.S.C. § 1818(s); 12 C.F.R. § 21.21),” OCC-PSI-00864235 at 9 (“Since the OCC terminated the Formal Agreement in February 2006, the bank has had a high number of MRAs”). [Sealed Exhibit.]
1843 Subcommittee interview of Joseph Boss (1/30/2012).
with the bank’s AML monitoring systems, including in its wire transfer, pouch, foreign corresponding banking, international and domestic private banking, retail banking, credit cards, Embassy banking, Banknotes, and Payment and Cash Management operations. Inadequate customer due diligence and client information were similarly identified in multiple business lines and services. Noncompliance with bank policy was another common problem. Inadequate staffing and AML training were also repeatedly identified, as were weaknesses in internal reviews of AML compliance. Later on, weaknesses in AML leadership at the bank were also identified. When AML examiners were allowed to undertake a broader analysis of the AML program, they identified additional fundamental problems involving backlogs, inappropriate assessment of country and client risk, favored treatment of HSBC affiliates, and massive gaps in monitoring.

For more than six years, from July 2004 until April 2010, despite compiling a litany of AML deficiencies, the OCC never cited HBUS for a violation of law, never took a formal or informal enforcement action, and turned down recommendations to issue Cease and Desist Orders targeting particularly egregious AML problems, even though the same problems surfaced again and again. The OCC’s failure to compel HBUS to remedy the AML deficiencies repeatedly identified by its examiners over a six-year period indicates that systemic weaknesses in the OCC’s AML oversight model require correction.
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Prepared by the U.S. Senate Permanent Subcommittee on lnvestjg6tlons, July 2012

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C. OCC Systemic Failures

The OCC’s failure for six years to take action to force correction of fundamental problems in HBUS’ AML program allowed those problems to fester and worsen. Five key weaknesses in OCC oversight contributed to its those failures: (1) treating AML deficiencies as a consumer compliance issue instead of a management issue; (2) unnecessarily restricting citations of AML program violations; (3) failing to match narrowly focused AML examinations with broader reviews; (4) failing to make better use of formal and informal enforcement actions in the face of continuing AML problems; and (5) issuing Supervisory Letters that sometimes did not accurately convey the AML problems identified in examinations. AML problems that surfaced even after bank commitments to cure identified problems was also a common thread.

(1) Treating AML Deficiencies As A Consumer Compliance Issue

The OCC is the only Federal bank regulator that does not address AML problems within the context of a bank’s safety and soundness considerations and ratings, instead treating them as a matter of consumer compliance. This approach raises at least three concerns. First, combining AML and consumer compliance concerns undermines and confuses the consumer compliance rating. AML compliance issues are unrelated to consumer protection and civil rights laws and should have no bearing or impact on a bank’s consumer compliance rating. Inserting AML considerations into the rating process also directly contravenes the Uniform Interagency Consumer Compliance Rating System specifying how that rating is supposed to be calculated and what it is supposed to signify. In the case of HBUS, the OCC ended up lowering its consumer compliance rating in 2010, without citing any evidence that the bank was failing to comply with consumer protection or civil rights requirements.

Secondly, failing to maintain an effective AML program is more properly viewed as a management issue that should contribute to a bank’s CAMELS management rating and, ultimately, the bank’s composite rating. Federal banking agencies have agreed, for example, that a bank with a “2” CAMELS management rating means that “significant risks and problems are effectively identified, measured,
monitored, and controlled" by bank management.\textsuperscript{1845} In contrast, a bank with a "3" management rating signifies "management and board performance that needs improvement or risk management practices that are less than satisfactory given the nature of the institution's fiduciary activities." A 3 rating also means that the "capabilities of management or the board of directors may be insufficient for the size, complexity, and risk profile of the institution's fiduciary activities. Problems and significant risks may be inadequately identified, measured, monitored, or controlled."\textsuperscript{1846} These descriptions of the significance of the CAMELS management rating are directly applicable to management efforts to ensure an effective AML program.

Interagency agreement on the significance of a bank’s overall composite rating is also compatible with this approach. Federal banking agencies have agreed that a composite rating of "2" means that a bank is "in substantial compliance with laws and regulations," that "overall risk management practices are satisfactory," and "there are no material supervisory concerns and, as a result, the supervisory response is informal and limited."\textsuperscript{1847} A "3" composite rating means banks:

"exhibit some degree of supervisory concern in one or more of the component areas. These financial institutions exhibit a combination of weaknesses that may range from moderate to severe; however, the magnitude of the deficiencies generally will not cause a component to be rated more severely than 4. Management may lack the ability or willingness to effectively address weaknesses within appropriate time frames. Financial institutions in this group generally are less capable of withstanding business fluctuations and are more vulnerable to outside influences than those institutions rated a composite 1 or 2. Additionally, these financial institutions may be in significant noncompliance with laws and regulations. Risk management practices may be less than satisfactory relative to the institution’s size, complexity, and risk profile. These financial institutions require more than normal supervision, which may include formal or informal enforcement actions."\textsuperscript{1848}

These categories fit seamlessly with management issues related to AML concerns.

Currently, Federal banking agencies other than the OCC routinely consider AML deficiencies as one factor in assigning a bank’s

\textsuperscript{1846} Id.
\textsuperscript{1848} Id.
management rating and may downgrade that rating if management fails to maintain an adequate AML program. The management component rating is a reflection of management’s ability to adequately identify, measure, monitor, and control problems and significant risks. The failure to maintain an adequate AML program exposes a bank to significant reputational risks, potentially large civil money penalties, and criminal prosecution. When such factors are present, it makes sense for a bank regulator to weigh them when assigning the bank’s management rating. If the management component is downgraded, it may also in certain circumstances lower the overall composite rating, with potentially severe impacts on the financial institution’s reputation, risk profile, and insurance assessment fees.

In the case of RBUS, after documenting widespread and serious AML deficiencies, citing the bank for two violations of law, noting the potential for large civil money penalties, and criticizing both bank management and the board of directors for failing to provide an adequate AML program, the OCC downgraded the bank’s consumer compliance rating, but not its CAMELS management rating. The bank’s composite rating was also unaffected. The result is that RBUS executives and directors escaped any CAMELS consequences for their poor AML management.\textsuperscript{1849}

A third, related problem is that because consumer compliance is a specialty examination area with its own, separate rating system, a lower consumer compliance rating will rarely impact a bank’s composite rating. The OCC Reports of Examination make it clear that the consumer compliance rating is not a contributing factor that has a routine impact on a bank’s composite rating. RBUS was also aware that its composite rating was generally insulated from the problems with its AML performance, as indicated in a February 2010 email from the HNAH compliance head Janet Burak to top HNAH and RBUS executives Brendan McDonagh and Irene Dorner. At a time when RBUS was in the midst of an intensifying AML examination which would ultimately lead to a Cease and Desist Order, Ms. Burak wrote:

\begin{quote}
I met with the OCC today. … Sally [Belshaw, the OCC Examiner-in-Charge] also indicated that they are considering downgrading their assessment of Compliance Risk Management … although [Sally] indicated that if they make that decision it will not impact the Bank’s composite CAMELS rating … and would not likely impact the Management rating component.
\end{quote}\textsuperscript{1850}

\textsuperscript{1849} A related problem is that because the Federal Reserve downgraded HBUS’ holding company due to the AML problems at HBUS, HNAH executives ended up incurring lower ratings for HBUS’ AML management failures, but HBUS executives did not.

\textsuperscript{1850} 2/24/2010 email from HNAH Janet Burak to HBUS Brendan McDonagh and Irene Domer, HSBC OCC 3405315.
This email demonstrates that bank officials were aware of how the process for rating AML performance had little real impact on the safety and soundness ratings that carried important consequences. It suggests that if AML problems had CAMELS consequences on a routine basis, they might have greater significance for management.

The OCC Reports of Examination on RBUS occasionally discuss the bank’s AML problems in the part of the report analyzing its management rating or composite rating, perhaps because the issue is relevant to those discussions. But the OCC confined the impact of the bank’s AML problems to lowering RBUS’ consumer compliance rating and not its CAMELS management or composite ratings which remained unaffected.

The OCC’s peculiar treatment of AML concerns as a consumer compliance issue has multiple negative consequences. National banks that fail to maintain adequate AML programs may end up receiving more favorable safety and soundness ratings than they deserve, because the consumer compliance ratings have almost no impact on their management or composite ratings. They may also receive lower consumer compliance ratings than they deserve for the opposite reason. Another consequence is that the bank’s deposit insurance assessments remain at a lower level than they should, as a result of safety and soundness ratings that do not fully reflect their AML risks. Treating AML concerns as a management issue would mitigate those negative consequences and create a stronger incentive for national banks to focus on their AML obligations. To strengthen its AML oversight, the OCC should bring its practice into alignment with all other Federal bank regulators, remove AML considerations from its consumer compliance ratings, and consider AML issues in the context of the CAMELS management component.

(2) Restricting Citations of AML Program Violations

A second peculiarity in OCC AML oversight is its failure to cite violations of law in its Supervisory Letters and annual Reports of Examination when a bank fails to comply with one of the four statutorily mandated components of an effective AML program – described earlier as internal controls, an AML compliance officer, AML training, and independent testing – even though each of the four program components has its own statutory basis. Instead, the OCC has adopted a practice of not citing violations of the individual AML program components, instead treating any such deficiency as a Matter Requiring Attention (MRA) by the bank.

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1852 One OCC senior legal counsel specializing in AML matters told the Subcommittee that the OCC “will not cite pillar violations” and instead lists them as MRAs which are not enforceable in court. He said that the OCC uses the same approach when reporting AML examination
Although MRAs require corrective action by bank management, they are separate and distinct from violations of law. OCC guidance provides that MRAs should address bank practices that “deviate from sound fundamental principles and are likely to result in financial deterioration if not addressed,” or that “result in substantive noncompliance with laws.” MRAs are intended to target weak policies and practices before they result in violations, and provide an interim step before finding a bank in violation of the law. At the same time, because MRAs signify matters that require the “attention” of management, they do not carry the same legal weight and urgency as violations of law. While they play an important role in AML oversight by focusing bank officials on emerging AML problems, if they take the place of statutory violations, MRAs can end up misleading a bank about the seriousness of an AML deficiency, delay remedial action, and allow an AML problem to fester. Citing a bank for noncompliance with the law, on the other hand, carries more severe consequences if left unaddressed. It also sends a much stronger message to bank management about the need for prompt corrective action, and lends more weight to any subsequent formal or informal enforcement action in the event the problem continues.

The OCC’s practice of not citing a bank for violating the individual statutory requirements for an effective AML program meant that OCC examiners were effectively limited to using only MRAs to compel reform of an identified problem. In the case of HBUS, OCC AML examiners repeatedly identified instances in which HBUS failed to comply with one or more of the four pillar requirements of an effective AML program. HBUS often responded by addressing some of the narrow problems identified, but not the broader underlying programmatic deficiencies, perhaps because the problems were identified in the more neutral language of an MRA rather than as a violation of law.

**AML Compliance Officer.** In one case, in 2009, the OCC determined that the HBUS AML head was not qualified for the position, a rare personnel decision prompted by the bank’s deteriorating AML program. Having a qualified AML compliance officer is one of the four critical requirements of an effective AML program and is mandated by [Findings to FinCEN, describing the OCC’s reporting as “cleaner” and not “cluttered with component violations” like the other agencies. Subcommittee interview of James Vivenzio (3/15/2012). As indicated earlier, annual reports compiled by FinCEN show that, for the five year period from 2007 through 2011, OCC examiners cited only 15 pillar violations in more than 6,600 AML examinations. That total represents more than 10 times fewer violations than the nearest Federal bank regulator, despite the OCC’s having conducted nearly 1,800 more AML examinations. See 2007-2011 Federal Banking Agency Bank Secrecy Act Compliance Examination, “Consolidated Quarterly Reports,” PSI-FinCEN-04-0063-206. [Sealed Exhibit.] OCC’s “Examiner’s Guide to Problem Bank Identification, Rehabilitation, and Resolution,” page 24.](http://www.occ.gov/publications/publications-by-type/other-publications-reports/pcbngd.pdf)
An OCC AML examiner wrote the following about the problem:

"Over the past three years, RBUS has had three BSA/AML Officers. Ms. Lesley Midzain is the current Board designated BSA/AML Officer for RBUS. She has held this position since April 2008. She has limited BSA/AML knowledge and industry experience and is not considered qualified for the position of BSA/AML Officer. This finding is based on numerous interviews by both OCC HSBC resident staff and other OCC large bank staff. She has not enhanced her knowledge of U.S. law related to BSA/AML through formal training, other than internal web based training. It should be noted that even with limited knowledge of U.S. law and regulation, Ms. Midzain has assumed responsibility for both BSA/AML and Compliance.

We communicated to the RBUS President and to Ms. Janet Burak, Chief Compliance Risk Officer that Ms. Midzain does not possess the technical knowledge or industry experience to continue as the BSA/AML Officer. Ms. Midzain’s knowledge and experience with BSA/AML risk is not commensurate to that of other BSA/AML positions held at other large national banks."

The FFIEC AML Examination Manual states that “the appointment of a BSA compliance officer is not sufficient to meet the regulatory requirement if that person does not have the expertise, authority, or time to satisfactorily complete the job.” The OCC viewed RBUS as a large complex financial institution with numerous high risk aspects that required a fully qualified AML expert to administer the bank’s AML program. To express the urgent need for the bank to hire a qualified AML director, the OCC could have cited RBUS for violating the law, but chose instead to issue a Supervisory Letter listing the issue as an MRA. The bank responded by keeping the targeted official as its head of compliance, hiring a new AML director, and requiring that new AML director to report to the compliance head with no AML expertise. The new AML director left after about nine months.

AML Internal Controls over Pouch Services. In another instance, in January 2007, an OCC examination identified serious AML

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1854 See 31 U.S.C. § 5318(m)(3)(B) and 12 C.F.R. Section 21.21(c)(3).
problems with HBUS’ pouch services, which appeared to be operating with virtually no compliance with AML standards. Pouch services involve clearing U.S. dollar monetary instruments such as travelers cheques, bank cheques, and money orders. The AML problems included a lack of monitoring for suspicious activity, insufficient policies and procedures, and a lack of AML controls. As a result, the OCC broadened its examination to pouch services at other HBUS business units, including the PCM, International Private Banking, Domestic Private Banking and retail banking departments. That examination uncovered additional significant AML deficiencies that had been identified in examinations of other business lines, involving pillar program components such as lack of AML internal controls, training, and independent testing, with systemic implications.\(^{1859}\) The examination concluded with respect to HBUS pouch services:

> “The results of this examination combined with the history of past examinations (i.e. significant number of MRAs) are an indication that program goals and objectives have not been met. The board needs to establish a program with defined elements for policies and procedures, systems and controls, training, and independent audit to ensure unwarranted risk is being identified, monitored and mitigated to an acceptable level.”\(^{1860}\)

The OCC examiners recommended that a formal enforcement action be brought against the bank to compel immediate correction of the problems in pouch services. However, after researching OCC standards for bringing enforcement actions, the examiners determined that, to issue a Cease and Desist Order, the agency was required, in part, to cite a violation of law.\(^{1861}\) Although OCC written guidance states that


\(^{1860}\) Id. at 9.

\(^{1861}\) Id. at 9.


> “There are two types of enforcement actions prescribed by the OCC. They are ‘informal actions’ and ‘formal actions.’ PPM 5310-3 (Rev.) describes the criteria for considering whether or not an enforcement action should be taken against a financial institution. Generally, the nature, extent, and severity of the bank’s problems will dictate the necessity for an action. The nature, extent and severity of a bank’s problems can range from identified weaknesses that are considered narrow in scope and correctable to significant and substantial problems and weaknesses that jeopardize the safe and sound operation of the bank. In all instances a number of other factors must be taken into consideration before the imposition of an action. Some of those factors are:

- Overall rating of the financial institution.
- Financial condition of the financial institution.
- Past cooperativeness of management.
one criteria for a formal enforcement action is whether: “[t]he bank lacks a BSA compliance program that covers one or more of the required program elements (internal controls, training, audit, responsible personnel),” OCC personnel told the Subcommittee that the OCC had interpreted this language to allow a violation of law to be cited only for a complete program failure, and not when a single pillar or even multiple pillars of an AML program are inadequate. The examiners determined that they could not conclude that HBUS’ entire AML program was ineffective at that time. Accordingly, despite the significant AML deficiencies found in connection with HBUS pouch services, the OCC examiners concluded they could not cite a violation of law and so withdrew their request for a formal enforcement action. Instead the OCC included a single MRA on pouch services in a Report of Examination sent to the bank in July 2007, and five MRAs in a Supervisory Letter sent to the bank two months later.

The OCC’s decision not to cite violations of law or take formal or informal enforcement action to correct severe AML deficiencies that contravene key AML statutory requirements makes no sense. An effective AML oversight effort must be able to act in just such circumstances, and premise an enforcement action on any statutory requirement, including that financial institutions have AML internal controls, an AML compliance officer, AML training, and independent testing, without having to find that virtually all four statutory requirements are being violated at the same time.

The examiner also identified the standards used to assess whether or not a violation may be cited:

- Management’s ability and willingness to correct identified problems in appropriate timeframes ….

"As stated earlier, in order for the OCC to take any form of enforcement action, certain criteria must be considered. This also applies in considering citing a violation under 12 CFR 21.21. For citing a violation of 12 CFR 21.21 the following must be evident:
- The bank lacks a BSA compliance program that covers one or more of the required program elements (internal controls, training, audit, responsible personnel);
- Fails to implement a written BSA compliance program;
- Exhibits significant BSA compliance program deficiencies coupled with aggravating factors such as evidence of widespread, blatant structuring or money laundering, insider complicity, repeat failures to file currency transaction reports or suspicious activity reports, or other substantial BSA violations; or
- Fails to respond to supervisory warnings concerning significant BSA compliance program deficiencies."

1862 Subcommittee interviews of OCC James Vivenzio (3/15/2012), Joseph Boss (1/30/2012), and Elsa de la Garza (11/12/2012).
1864 9/13/2007 OCC Supervisory Letter HSBC-2007-01, “Pouch Services and Middle Market,” OCC-PSI-00000391. [Sealed Exhibit.] One examiner informed the Subcommittee that, even though they determined the AML deficiencies in HBUS’ pouch services did not meet the OCC's enforcement guidelines, he still felt that an enforcement action should have been initiated. Subcommittee interview of Joseph Boss, (1/12/12 and 1/13/2012).
Federal bank regulators other than the OCC routinely cite violations of law when a bank fails to comply with one or more of the pillar components of an AML program. By declining to do the same, the OCC is diluting the importance of the four components; it is essentially sending a message that a bank can lack one or more of the components as long as its entire AML program is not compromised. In addition, by restricting itself to MRAs rather than citations of legal violations, the OCC is unnecessarily diluting its ability to send a strong message that a bank needs to promptly correct a program element, such as an inadequate AML compliance officer or a set of missing AML controls. By limiting its examiners to using MRAs instead of citing statutory violations, the OCC is, in effect, allowing particular problems to fester, as happened in the HBUS case. In addition, by restricting citation of individualized program violations, the OCC is impairing the ability of examiners to pursue formal enforcement actions, which is exactly what happened in the case of the HBUS pouch activities.

Finally, failing to identify violations of laws and regulations may mislead or confuse bank management. Violations are addressed prominently in the Reports of Examination and Supervisory Letters. A bank’s directors and managers should be aware of apparent violations of law, given their potentially punitive nature and the bank’s responsibility to initiate appropriate corrective action. Violations that are instead reduced to MRAs may mislead a bank by omitting references to specific laws or regulations; downplay the importance of the targeted activity; and insulate the bank’s ratings from downgrades that would spur corrective action. Examiners evaluate bank ratings, including the CAMELS management rating and its consumer compliance rating on a number of factors, including management’s compliance with laws and regulations, its responsiveness to previously reported violations of law, MRAs, and audit findings. Removing violations from that equation enables a bank to obtain more favorable ratings than it may deserve. To strengthen its AML oversight, the OCC should bring its practice into alignment with all other Federal bank regulators and allow examiners to cite violations of law when a bank fails to comply with one or more of the four statutorily mandated components of an AML program.

A third AML oversight practice of concern involves the use of narrowly focused AML examinations that don’t also include an examination of a bank’s overall AML program. At HBUS, the OCC designed an AML supervisory strategy to examine the institution over a three year cycle using targeted examinations. HBUS had 32 different business units with varying degrees of AML risk, all of which were to be

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examined. The plan called for business units with the highest AML risks to be examined first. According to the examiners, the mandate was to examine all 32 business units over a three-year cycle, taking 8 to 10 weeks to examine a business unit from start to finish, using Supervisory Letters to communicate examination results.\footnote{1866} According to the plan, OCC examiners would not return to a previously examined area until it had examined all 32 business units, and the adequacy of management’s corrective actions for any MRAs would be reviewed once the entire institution had been examined.

The OCC had to depart from this plan given the significant AML risks uncovered at some business units.\footnote{1867} In addition, with only two full-time AML examiners dedicated to RBUS, and given the complexity, breadth, and volume of its high risk activities, the OCC had difficulty meeting the three-year objective but strived to achieve it.\footnote{1868} The result was a series of narrowly focused, targeted examinations. As each examination concluded, a Supervisory Letter was issued with MRAs or recommendations addressing the AML issues at each specific business unit.

This examination approach, which failed to provide any mechanism for also taking a holistic view of the bank’s AML program, raised at least three issues in the RBUS setting: it impeded understanding of fundamental problems with the bank’s AML program and allowed systemic problems to fester, it required duplicative efforts, and it made verification of corrective action more difficult. First, the narrow focus of the individual examinations at RBUS made it difficult for OCC examiners to understand the bank’s AML program as a whole, to detect systemic problems, or make the case for correcting them. Instead, the OCC continued to review individual business units on a serial basis, addressing the AML problems uncovered in each examination. As a result, the OCC requested and RBUS provided narrow corrective actions, allowing more systemic problems to go unaddressed for years. In addition, it required OCC examiners to address similar AML problems in multiple business units on a repetitive basis.

**HSBC Affiliate Issues Missed.** The limitations of this approach can be seen in the way in which targeted reviews of key bank areas, such as correspondent banking and the Payments and Cash Management (PCM) department, missed major AML deficiencies involving HSBC affiliates. It was only in 2010, when OCC AML examiners were

\footnote{1866} Subcommittee interview of Joseph Boss (1/30/2012), and Elsa de la Garza (1/9/2012).
\footnote{1868} AML examiners told the Subcommittee that two additional full-time AML examiners were needed to meet the three-year cycle at HBUS, but that staff dedication would have been disproportionate to AML examination staffing at other large national banks. While they were assisted at times by other examiners, the vast bulk of the AML examinations at HBUS were carried out by two OCC AML examiners.
allowed to take a broad-based review of HBUS’ AML program, that the examiners focused on the fact that HSBC affiliates played a large role in HBUS’ correspondent banking and PCM businesses, but were not subjected to the same AML controls as other clients. The OCC examiners discovered, for example, that HBUS did not conduct any due diligence review of HSBC affiliates or attempt to evaluate their AML risks.\footnote{See 9/13/2010 OCC Supervisory Letter HSBC-2010-22, “Bank Secrecy Act/Anti-Money Laundering (BSA/AML) Examination—Program Violation (12 U.S.C. § 1818(s); 12 C.F.R. § 21.21),” OCC-PSI-00864335. [Sealed Exhibit.]}

The OCC examiners also discovered that HBUS had stopped monitoring all banknotes business with HBSC affiliates for a three-year period, from mid-2006 to mid-2009, even though those transactions involved billions of dollars of cash and high risk countries like Mexico.\footnote{In the summer of 2009, OCC examiners learned for the first time that affiliates’ banknotes activity was not monitored when examining banknotes activity involving an HSBC affiliate in Mexico. The key law enforcement meeting took place the next month, and the banknotes examination was then expanded to look at other AML issues. The banknotes monitoring problem was included in the Supervisory Letter issued a year later identifying a host of AML problems at HBUS. See 8/12/2009 OCC memorandum, “Banknotes Issues,” OCC-PSI-00917881-482.} The OCC also learned that HBUS failed to conduct routine account monitoring for dozens of affiliates located in lower risk countries. Still another problem was that OCC examiners determined that HBUS was using an inappropriate process to assess country risk, and was assigning low risk ratings to countries such as Mexico, that should have been designated high risk. Narrowly focused exams, without more, simply didn’t identify affiliates as an important AML concern that cut across multiple business lines.

**AML Staffing Issues Fragmented.** A second example involves a series of three AML examinations conducted by the OCC in early 2009, disclosing insufficient staffing to conduct AML monitoring activities in three critical business units, OFAC compliance, Correspondent Banking and the Payments and Cash Management (PCM) department. OCC examiners looked at each business unit individually and the Examiner-in-Charge issued three different Supervisory Letters that questioned the bank’s staffing levels and resource commitment in each unit for AML purposes.\footnote{1/20/2009 OCC Supervisory Letter HSBC-2009-41, “Office of Foreign Asset Control Examination,” OCC-PSI-00909434; 3/31/2009 OCC Supervisory Letter HSBC-2009-34, “Correspondent Banking BSA/AML Examination,” OCC-PSI-00107601; 3/18/2009 OCC Supervisory Letter HSBC-2009-40 “Payment and Cash Management BSA/AML Examination,” OCC-PSI-00107624. [Sealed Exhibits.]} By conducting three different examinations with no overarching analysis of AML staffing issues across the bank, the OCC failed to identify inadequate AML staffing as a systemic issue and deal with it in an efficient and effective basis. Instead, each Supervisory Letters focused on a single business line or functional area under review, with no cross references to the other areas having the same problem, at the same time. The recommendations contained in two of the Supervisory Letters, issued in March 2009, contained nearly identical
wording, including the same misspelled word.\textsuperscript{1872} As a result, the staffing issues were addressed in a fragmented manner in three different recommendations rather than in a single MRA focusing on the broader problem.

It was not until 2010, after the OCC directed its AML examiners in September 2009, to undertake a more holistic analysis of HBUS' AML program that staffing was examined in a broader way. On March 3, 2010, an OCC Supervisory Letter discussing the discovery of an HBUS backlog of over 17,000 unreviewed alerts noted that staffing concerns had been raised three times in 2009, and identified it as a Matter Requiring Attention by the HBUS Board: \textsuperscript{1873}

\begin{quote}
"In the past, HSBC has had other backlogs, and we have expressed concerns over the course of our supervision about the levels of staffing and the qualifications of personnel assigned to complete reviews. ... 

In three Supervisory Letters last year, we expressed concerns about the levels of staffing dedicated to BSA/AML/OFAC compliance. These letters include the supervisory letter issued on January 20, 2009 at the conclusion of our OFAC examination, the supervisory letter issued on March 3, 2009 at the conclusion of the correspondent banking examination, and the supervisory letter issued on March 18, 2009 at the conclusion of the Payment and Cash Management examination."
\end{quote}

Even then, however, the MRA on staffing was narrowly targeted: “Management must ensure that a sufficient number of qualified professionals are engaged to address the 2,488 alerts within the High Risk Monitoring Unit that were generated six or more months ago.” Six months later, when the OCC concluded its broad-based examination of the HBUS AML program as a whole and issued a 31-page Supervisory Letter analyzing key problems, inadequate and unqualified AML staffing was finally presented as a systemic problem across the bank. \textsuperscript{1874}

\textbf{We Didn’t Know What We Had.} One of the OCC AML examiners immersed in the HBUS AML examinations for years told the Subcommittee that, upon learning of various law enforcement concerns about HBUS in September 2009, “we’d been doing all of these targeted

\begin{quote}

\textsuperscript{1873} 7/7/2009 OCC Supervisory Letter HSBC-2010-03, “Backlog of Monitoring Alerts and Enhanced Due Diligence Requests,” OCC-PSI-00851542. [Sealed Exhibit.]

\textsuperscript{1874} Id.

examinations and we didn’t know what we had.”

It apparently took that jolt from law enforcement for OCC senior personnel to authorize the OCC AML examiners to develop a broad-based plan to look at the HBUS AML program as a whole, tie various problems together, and identify the most important AML deficiencies requiring correction. While the narrowly focused AML reviews were important to examine particular business units and identify specific issues within those offices, such examinations were incomplete and ineffective without a broad­

based look at the bank’s AML program as a whole to identify fundamental and cross-cutting issues critical to an effective AML effort.

Still another problem created by the narrowly focused AML examinations was that they complicated efforts by OCC examiners to verify that corrective actions mandated in OCC MRAs were implemented before closing out an MRA. One issue was that examiners weren’t supposed to return to re-examine the relevant business unit until much later, theoretically after completing a three-year review of all 32 HBUS units. In reality, the examiners had to ignore that aspect of the examination plan to verify that corrective action was taken. But even then, validation of the effectiveness of the remedies often required duplicative, repetitive efforts since many of the same problems had to be analyzed in multiple, individual business units. In addition, while HBUS and the OCC examiners were focused on AML problems in individual business lines and services, fundamental problems began to build up, including backlogs of unreviewed alerts, collections of unmonitored accounts, and overly favorable treatment of HSBC affiliates.

The HBUS case history provides ample evidence that a stovepipe AML supervisory strategy that focuses solely on serial examinations of individual business lines or services without also examining a bank’s AML program as a whole creates a fragmented and inefficient view of a bank’s AML program, wastes resources, encourages piecemeal corrective actions, fails to identify fundamental problems which are allowed to fester, and diminishes the usefulness of AML examination findings and corrective actions. To strengthen its AML oversight, the OCC should require its AML examiners to combine narrowly focused AML examinations with at least an annual examination of key elements of the bank’s AML program as a whole.

(4) Failing to Use Enforcement Actions

The HBUS case history, like the Riggs Bank case history before it, betrays an ongoing reluctance by the OCC to use either informal or formal enforcement actions to compel AML improvements, even when a bank is cited for years for significant AML problems.

1876 Subcommittee interview of Joseph Boss (1/30/2012).
The OCC identified serious AML deficiencies at HBUS for six years in a row, with the most AML-related MRAs of any bank it supervised, without considering or initiating a nonpublic, informal enforcement action. The reluctance to use informal enforcement actions appears to be a cultural preference rather than the result of any guidance or policy. As mentioned earlier, the OCC disclosed to the Subcommittee that it has taken only eight informal enforcement actions against large banks for AML deficiencies since 2005. This approach is especially disconcerting in the HBUS case, since the bank expressed a willingness to work with the regulator to implement reforms. Informal remedies—which include requesting that the financial institution issue a safety and soundness plan, board resolution, commitment letter, or memorandum of understanding pledging to take specific correction actions by a certain date—offer useful tools that provide an interim step before a formal enforcement order that is public and carries legal penalties. These tools can be effective, but were not even considered by the OCC in the HBUS AML context.

The HBUS case history also discloses a reluctance on the part of the OCC to use formal enforcement actions to correct AML deficiencies. Two examples involve AML examiners who twice recommended issuing a Cease and Desist Order against HBUS after finding severe AML deficiencies in the bank’s pouch activities and Embassy Banking unit, but no enforcement action followed. In the case of the pouch activities, as discussed earlier, despite overwhelming evidence of substantial AML deficiencies, two OCC AML examiners agonized over whether they could make the case for an enforcement action and ultimately reversed their initial recommendation for a Cease and Desist Order. In the case of the Embassy Banking unit, as discussed earlier, again despite overwhelming evidence of the bank’s failure to implement effective AML controls, an OCC examiner was told point blank by his superiors, with no further explanation, that no Cease and Desist Order would be issued. The failure of OCC officials to seriously consider a formal enforcement action in either of these two extreme cases demonstrates an enforcement problem.

The OCC’s AML enforcement guidance is clear in stating: “Even when the facts do not support citation of a BSA compliance program violation, the OCC may take a formal or informal enforcement action to ensure action.” In addition, the OCC website explains:

“The OCC may take enforcement actions for violations of laws, rules or regulations, final orders or conditions imposed in writing;

1877 Subcommittee briefing by OCC legal counsel (7/13/2012).
unsafe or unsound practices; and for breach of fiduciary duty by institution-affiliated parties (IAP).”

These statements seem to provide the regulatory foundation and flexibility needed for the OCC to act quickly to address serious AML deficiencies, yet the HBUS case history demonstrates that the OCC remains hesitant to act, even in the face of severe AML problems and even after years of AML MRAs on record. To strengthen its AML oversight, the OCC should give strong direction to its examiners about the availability of enforcement options and create new mechanisms to require bank supervisory, enforcement, and legal personnel to review the need for formal or informal enforcement actions at banks with severe or longstanding AML deficiencies.

(5) Issuing Weak Supervisory Letters

A final issue involves the OCC’s use of Supervisory Letters. The HBUS case history indicates these letters do not always accurately convey examination findings or the need for corrective action.

Supervision Letters are the means by which an OCC Examiner-in-Charge officially informs a bank of examination findings, apparent violations of law, and MRAs warranting management attention. Violations and MRAs require corrective action by bank management; “recommendations” do not. In theory, OCC examination findings and changes to resolve AML deficiencies should be conveyed accurately in the related OCC Supervisory Letters sent to bank management; in reality, the HBUS case history showed that some Supervisory Letters muted criticisms or weakened recommended reforms.

**PCM Examination.** One striking example of the discrepancies that arose between examination findings and Supervisory Letters involved the 2007 examination of HBUS’ Payment and Cash Management (PCM) operations. PCM specialized in global cash flow coordination, using such tools as wire transfers, cash letters, and controlled disbursement services. The volume of PCM activity at HBUS, given the bank’s size, global reach, and appetite for risk, was huge both in terms of dollars and number of transactions. In 2009, for example, PCM processed 30.2 trillion wire transfers involving $94.5 trillion. 1880

In December 2007, the OCC completed an examination of AML controls in PCM operations and found that the bank was not adequately monitoring PCM transactions. 1881 The OCC examination noted...

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fundamental flaws in the bank’s AML controls and monitoring systems to identify suspicious activity as well as actions to clear alerts without adequately reviewing the circumstances and filing required SARs. It also recited several examples of suspicious activity and criticized the bank’s Compliance Review Unit which is supposed to conduct independent testing of HBUS’ AML controls but had not reviewed the PCM operations in three years. The examination findings included the following:

- “Systems and Controls are less than satisfactory and do not provide an appropriate level of monitoring for suspicious and unusual activity for all of the activities in the business unit.
- In reviewing customer activity, there were several accounts which warranted additional monitoring and/or in which monitoring practices were inadequate.”

The examination also identified three MRAs that should be brought to the attention of HBUS’ board of directors.

The Supervisory Letter signed by the OCC Examiner-in-Charge and sent to HBUS was issued four months later, on April 21, 2008, and conveyed a very different message about PCM operations, in part because HBUS had begun to correct the identified problems. The Supervisory Letter stated that the examination of PCM operations found that “the quality of risk management systems is satisfactory”; “compliance with legal and regulatory requirements is satisfactory”; and “the quality of PCM compliance risk management is satisfactory.” It continued: “Policies and procedures are adequate; however, control systems needed to detect and report suspicious activity warrant improvement.” These mild statements made in the spring of 2008, are worlds apart from the blunt examination findings issued in December 2007. Despite its language, the Supervisory Letter did include the three MRAs which, together, implied a significant breakdown in the bank’s internal controls.

Embassy Banking Examination. A second example involved HBUS’ Embassy Banking examination. As discussed earlier, in January 2008, after being contacted by two former employees, OCC conducted an examination and confirmed a wide array of troubling practices in the

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1882 ld.
1883 The three MRAs were: “1) management needs to improve client monitoring and analysis in order to obtain an accurate view of potential risk. When an alert is generated, a more thorough review of available information needs to be initiated; 2) management must ensure that CRU (Compliance Review Unit) appropriately identifies and accurately reports on all issues, including MRAs. In addition, MRA follow-up by CRU needs to address all corrective action and include testing to determine the adequacy of actions taken; and 3) management needs to ensure that decisions related to not filing SARs are documented and maintained in a log.” Id.
1885 ld. at 1.
Embassy Banking unit. They included significant internal control problems, suspicious activity involving two high risk embassy accounts, noncompliance with bank policy, inadequate due diligence and monitoring, transactions being conducted without OFAC screening – describing, in short, some of the most egregious AML deficiencies recorded in any HBUS AML examination.\textsuperscript{1886} On May 20, 2008, the OCC examiner completed a Conclusion Memorandum with the examination findings, stating that the Embassy Banking’s “AML program is not effective in identifying and mitigating risk, especially considering the nature of its clientele and the types of products and services it provides.”\textsuperscript{1887} The memorandum recommended issuance of a Cease and Desist Order to ensure immediate remediation of the AML risks. The OCC examiner also discussed the recommendation for a formal enforcement action with the Examiner-in-Charge, but was informed that no Cease and Desist Order would be issued. HBUS was verbally informed of the examination findings and immediately began work to address the problems. In July, a follow-up examination looked at the bank’s remedial efforts and found that progress had been made.\textsuperscript{1888}

On September 4, 2008, a Supervisory Letter summarized the March and July examinations was sent to HBUS.\textsuperscript{1889} The letter’s mild tone failed to convey any of the egregious AML deficiencies or suspicious activity uncovered during the examinations, using instead bland language that conveyed minimal concern or urgency. The letter began:

- “The quality of risk management is satisfactory, but needs improvements in certain areas.
- Compliance with legal and regulatory requirements is satisfactory and no violations of law or regulation were cited at this examination.
- We noted several deficiencies in the GIB BSA/AML program that warrant the immediate remedial attention of senior management.”\textsuperscript{1890}

The letter continued with a string of positive statements: “Management is competent and capable.” “The automation of existing systems and controls, together with current staff levels, will ensure a timely and
efficient process for monitoring accounts ....” “Currently, monitoring remains backlogged; however, management has developed a plan to bring the monitoring up to date.” “Current systems and controls are satisfactory.” “Compliance Risk is stable.”

The Supervisory Letter continued:

“Our current review has noted a marked improvement to GIB’s BSA/AML program from the second quarter of 2008 examination. Management has implemented corrective action in most of the areas of concern. The new GIB Compliance manager has implemented numerous objectives to ensure that potential risk is readily identified and mitigated to acceptable levels.

There are still some issues with system and controls, resources and alert monitoring; however, based on the current review those deficiencies are noted as MRAs.”

The Supervisory Letter then reduced the AML examiner’s request for a formal enforcement action against the bank to two narrow MRAs asking HBUS to: (1) “develop plans with milestones to further define and automate the risk identification and monitoring functions,” and, in the interim, “continue to enhance methods to reduce weaknesses associated with manual intervention” and prevent “unauthorized changes” to a spreadsheet with account information; and (2) cure a backlog of 1,800 alerts, some dating back to 2007, by September 15, 2008.

The September Supervisory Letter simply did not convey the urgency or severity of the examination findings from several months earlier regarding AML problems in the Embassy Banking department. In addition, while it presented two MRAs requiring corrective action, its mild tone and lack of detail may make bringing an enforcement action difficult if the bank fails to remedy the identified problems in a timely fashion.

AML Staffing Problems. A third example of discrepancies between examination findings and the Supervisory Letters that follow involved staffing issues.

In 2006, two OCC Supervisory Letters included MRAs that required HBUS to increase AML staffing in its Embassy Banking unit to monitor transactions and in its Compliance Review Unit to conduct internal reviews of the bank’s AML controls. In 2007, another Supervisory Letter again included an MRA about increasing AML

1891 Id. at 609.
1892 Id. at 610.
1893 1/30/2006 OCC Supervisory Letter to HBUS, OCC-PSI-00107529, at 534-35. [Sealed Exhibit.]
staffing in the Embassy Banking unit. Two years later, in 2009, OCC AML examiners conducted examinations of HBUS' OFAC Compliance unit, Correspondent Banking, and PCM department, and identified staffing issues at all three. In February 2009, the OCC examiners wrote an internal memorandum to the file recording a disagreement with their supervisor concerning staffing. In the memorandum, the examiners identified inadequate AML staffing as "a repetitive issue that is of concern" that "should be elevated to an MRA instead of a recommendation for the Correspondent Banking (March 3, 2009 Supervisory Letter) and Payment and Cash Management examinations (March 18, 2009 Supervisory Letter)." The memorandum also noted that the two OCC examiners had discussed the issue with the OCC Examiner-in-Charge who disagreed with the examiners' assessment, because "there are no violations being cited and staffing is a management decision." The memorandum concludes: "Based on our growing concerns regarding Ms. Midzain's qualifications to hold the position as BSA/AML officer, her lack of concern with our recommendations and a slow deterioration of the bank's BSA/AML Program, [we] will recommend to EIC Belshaw that we complete a Compliance Management examination to assess BSA management as soon as possible."

The Examiner-in-Charge sent out three Supervisory Letters related to the examinations that had been conducted. Each reduced the requested MRA down to a recommendation that "management should consider a review of current and immediate staffing." At that point, the OCC had identified staffing problems in five business units through six exams over a period of four years, but the most recent Supervisory Letters treated the need to increase AML staffing as a recommendation rather than an MRA requiring corrective action. While it is the function of an Examiner-in-Charge to make the ultimate decision on MRAs and recommendations, this example demonstrates a clear division between the Examiner-in-Charge and her staff and a refusal to take strong action by the more senior OCC official.

In Washington, the OCC's Large Bank Review Committee, which reviewed about six draft Supervisory Letters per year for HBUS and sometimes had a copy of the underlying examinations, also noted occasional discrepancies between the examination findings and draft Supervisory Letters. In addition, some LBRC members began to notice after the fact that some examinations had revealed more significant AML problems and criticism of HBUS operations than were conveyed by the approved Supervisory Letters to HBUS management. As a result, the LBRC now requires both the AML examiner's Conclusion

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Memorandum and the Examiner-in-Charge’s draft Supervisory Letter before it will begin a review of the draft letter. This change should help reduce the discrepancies and ensure senior OCC officials have a more complete view of AML problems at the banks being examined.

D. Analysis

AML laws are not intended to protect bank customers or the bank; they safeguard the U.S. financial system and the nation as a whole. As the regulator of nationally chartered banks, which are among the largest, most complex, and global of U.S. banks, the OCC plays a critical role in ensuring AML compliance. It is the OCC that needs to ensure the U.S. affiliates of global banks function as well-guarded gateways that keep out risk rather than invite it in.

To fulfill its AML obligations, the OCC needs to strengthen its AML oversight and revamp its AML supervisory and enforcement approach to bring them into closer alignment with other Federal bank regulators. Five reforms are key. First, it should treat AML deficiencies as a matter of safety and soundness, not consumer protection, and ensure ineffective AML management is taken into consideration when assigning a bank’s CAMELS management and composite ratings. Second, the OCC should allow its examiners to cite violations of law for individual pillar violations as well as program-wide violations. Third, the OCC should ensure that narrowly focused examinations are considered in tandem with examinations that take a holistic view of a bank’s AML program. Fourth, the OCC should make more use of informal enforcement actions and reconsider its standards for issuing formal enforcement actions to compel AML reforms. Finally, the OCC should instruct its Examiners-In-Charge to accurately reflect AML examination findings, without turning them into such mild recommendations that they mislead bank management into thinking their AML programs are functioning well, when they are not. Many OCC examiners see the problems; it is OCC supervisors and enforcement that need to act to strengthen the OCC’s AML oversight efforts.

1897 Subcommittee interview of James Vivenzio (3/15/2012).
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<thead>
<tr>
<th>No.</th>
<th>Date</th>
<th>Matter Requiring Attention (MRA)</th>
<th>Recommendations</th>
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<tbody>
<tr>
<td>1</td>
<td>Jan 2005</td>
<td>Supervisory letter for HSBC Bank USA, N.A.</td>
<td>Improve internal controls and procedures.</td>
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<td>2</td>
<td>Feb 2005</td>
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<td>Conduct regular audits and reviews.</td>
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<td>Mar 2005</td>
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<td>Ensure compliance with regulations.</td>
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<td>Apr 2005</td>
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<td>Strengthen risk management processes.</td>
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<td>May 2005</td>
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<td>Enhance anti-money laundering measures.</td>
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<td>Jun 2005</td>
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<td>Enhance due diligence for new clients.</td>
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<td>Jul 2005</td>
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<td>Implement stricter monitoring of transactions.</td>
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<td>Aug 2005</td>
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<td>Ensure accuracy of financial reporting.</td>
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<td>Sep 2005</td>
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<td>Develop a comprehensive risk management strategy.</td>
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<td>Oct 2005</td>
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<td>Strengthen corporate governance practices.</td>
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<td>Nov 2005</td>
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<td>Conduct internal training for employees.</td>
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<td>Jan 2006</td>
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<td>Implement a robust compliance program.</td>
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<td>Feb 2006</td>
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<td>Strengthen the oversight function.</td>
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<td>Enhance collaboration with other regulatory agencies.</td>
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<td>Apr 2006</td>
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<td>Ensure timely reporting of material events.</td>
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<td>May 2006</td>
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<td>Implement a comprehensive information security program.</td>
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<td>Jun 2006</td>
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<td>Strengthen the audit committee's role.</td>
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<td>Ensure compliance with CRA requirements.</td>
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<td>Implement a comprehensive risk management program.</td>
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<td>Strengthen the role of the chief executive officer.</td>
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<td>Ensure compliance with Basel II requirements.</td>
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<td>Implement a comprehensive compliance training program.</td>
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<td>Dec 2006</td>
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<td>Strengthen the role of the external auditor.</td>
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<td>Ensure compliance with new regulations.</td>
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<td>Implement a comprehensive risk management program.</td>
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HBMX Compliance Failures

2002  “There is no recognisable compliance or money laundering function”

2005  “Fabricated records of certain mandatory anti-money laundering meetings”

2007  “What is this, the School of Low Expectations Banking?”

2008  “There were allegations of 60% to 70% of laundered proceeds in Mexico [going] through HBMX”

2008  “What I find most frustrating is the way in which new issues constantly emerge however much time is spent with HBMX.”

2009  “[I]nherent AML risk in Mexico is still very high”

Prepared by the U.S. Senate Permanent Subcommittee on Investigations, July 2012
Disclosed v. Undisclosed Iranian U.S. Dollar Payments
Sent by HSBC Foreign Affiliates to U.S. Banks, Including HSBC Bank USA

Original Source: Deloitte March 29, 2012 presentation, HSBC OCC 8966143.
Prepared by U.S. Senate Permanent Subcommittee on Investigations, July 2012
Excerpts from emails of David Bagley
re HBUS awareness of Iranian transactions, 2003-2004

“I am not sure that HBUS are aware of the fact that HBEU are already providing clearing facilities for four Iranian banks, presumably including USD clearance.”

--HSBC email, 10/21/2003, Exhibit 46, HSBC OCC 8873947

“The complexity of the OFAC regulations, and the fact that HBUS were unaware that any arrangements existed with Iranian Banks, has made speedy resolution of this issue difficult.”

--HSBC email, 03/11/2004, Exhibit 52, HSBC OCC 8873986

“I suspect that HBUS are not aware that payments may be passing through them. Do not believe that we can allow this situation to continue very much longer…”

--HSBC email, 04/19/2004, Exhibit 53, HSBC OCC 8873994
RATINGS USED IN OCC REPORT OF EXAMINATIONS

Composite Uniform Financial Institution Rating

Component Ratings:
- Capital
- Asset Quality
- Management
- Earnings
- Liquidity – Asset/Liability Management
- Sensitivity to Market Risk

Uniform Rating System for Information Technology
Composite Uniform Interagency Trust Rating
Uniform Interagency Consumer Compliance Rating
Community Reinvestment Act Rating

Prepared by U.S. Senate Permanent Subcommittee on Investigations, July 2012
"(h) ANTI-MONEY LAUNDERING PROGRAMS.—

"(1) IN GENERAL.—In order to guard against money laundering through financial institutions, each financial institution shall establish anti-money laundering programs, including, at a minimum—

"(A) the development of internal policies, procedures, and controls;

"(B) the designation of a compliance officer;

"(C) an ongoing employee training program; and

"(D) an independent audit function to test programs."
In this letter to all employees, Group Chief Executive Stuart Gulliver explains why we have been asked to testify about past compliance failures and what we have done since to strengthen compliance and risk management.

Dear Colleague,

I am writing to you today as you may have seen reports that HSBC has been asked to testify before the U.S. Senate's Permanent Subcommittee on Investigations (PSI) on Tuesday 17 July.

The hearing relates to ongoing investigations by the PSI into our compliance with U.S. regulations including Anti-Money Laundering laws, the Bank Secrecy Act and the Office of Foreign Assets Control sanctions.

While we have previously disclosed these proceedings in our Annual Report and Accounts, the PSI hearing will be the first time that the details of these investigations are made public. It will certainly be the first time that the majority of employees have heard about these issues and I realise it will be a disappointment to you and your teams.

While we have been cooperating with the relevant U.S. authorities since 2010 to improve the way we manage risk and ensure compliance, the PSI hearing may attract significant attention. It is also likely that there will be further enforcement actions from other U.S. authorities over the coming months.

I wanted to ensure that you and your teams had enough information about these issues to be able to answer the questions that you may be asked by your customers, colleagues, friends and family.

While we do not yet know the full details of the PSI investigation, the hearing on 17 July will undoubtedly reveal that in the past we fell well short of the standards that our regulators, customers and investors expect.

During the hearing, we will acknowledge and apologise for our past mistakes. Between 2004 and 2010, our anti-money laundering controls should have been stronger and more effective, and we failed to spot and deal with unacceptable behaviour.

It is right that we be held accountable and that we take responsibility for fixing what went wrong. As well as answering the subcommittee's questions, we will explain the significant changes we have already made to strengthen our compliance and risk management infrastructure and culture.

First, with a new strategy and leadership team, we have put in place a structure that makes HSBC easier to manage. The creation of four global businesses and ten global functions to replace a federated structure allows a coordinated and consistent approach to every part of our business, including compliance.

Second, we have decided to apply high and consistent global standards wherever we work. The Group Standards Committee co-chaired by Group Chief Legal Officer Stuart Levey and Group Chief Risk Officer Marc Moses is working towards ensuring that the highest standards required in any part of the business will apply to every part of the business.

Third, we are driving a change in culture so that our conduct matches our values. We have integrated our values into performance management, judging senior leaders on what they achieve and how they achieve it, because both matter to our reputation and share price.

Permanent Subcommittee on Investigations
EXHIBIT #2a
Alongside these changes, we will continue to invest in a best-in-class compliance function. We have increased the amount spent on compliance globally from US$200m in 2010 to US$400m today. Some 3,500 colleagues now work in HSBC compliance worldwide, with more than 1,000 of them in the U.S.

There is no doubt that the coming weeks and months will be challenging, as past practices and compliance failures in certain parts of the firm come under serious scrutiny from regulators, investors, media, customers and employees. I know this will be a disappointment to the vast majority of you who have worked so hard to build and maintain our reputation throughout the turbulence of the past few years, and for that I apologise. I can also assure you that we will also keep you fully informed of these matters via the global staff website and other internal channels.

While we cannot undo past mistakes, we will be judged on how we respond to this issue and demonstrate that we have learnt from it. You have my commitment that we will face up to our past mistakes, show our stakeholders what we have done to address the problems, and never let up in our absolute commitment to ensuring that every part of the firm meets the highest global standards and lives up to our values in the future. As the illicit actors seeking to exploit the financial system are constantly adapting their approach, we will need to be tireless in our own efforts to stop them.

We will do this not just because regulators and authorities expect it of us, but more importantly, because we expect and demand it of ourselves.

This is a fundamental part of achieving our strategy and becoming the world’s leading international bank and remains a top priority for the Board and senior management team.

Stuart Gulliver
Group Chief Executive

Contact Global Communications

Pierre Goad Charles Naylor Global Co-Heads of Communications
Larry Campbell Head of Publishing and Knowledge Management
Jezz Farr Global Head of Communications, Global Banking and Markets
Medard Schoenmaeckers Global Head of Communications, Global Private Banking
Tim Harrison Global Head of Communications, Commercial Banking
Malcolm Wollis Global Head of Communications, Retail Banking and Wealth Management
Susanna Wilson Head of Communications, Corporate Sustainability
Phil Askham Global Head of Global Functions Communications
Margrit Chang Regional Head of Media Relations, Asia Pacific
Andy Berry Regional Head of Media Relations, UK and Europe
Jo Alexander Regional Head of Employee Communications, UK and Europe; Head of Group COO Communications
Enrique de la Madrid Regional Head of Communications, Latin America and Mexico
Lisa Sodeika Regional Head of Communications, North America
Tim Doyne Regional Head of Communications, Middle East and North Africa
GCL 120014 - HSBC Global Standards

Background
A year ago, we articulated a clear strategy to be the world’s leading international bank. In order to make the firm more cohesive and better connected, we established Global Businesses and Global Functions and gave them the authority to manage the firm on a global basis with consistent policies, standards and processes. We also articulated a set of HSBC values to guide our behaviour.

Our ability to achieve our ambition ultimately depends on our reputation, not just for financial strength, but also for trustworthiness and integrity. Too often, we have fallen short of our own expectations and that must change. We now have the structure to help us reduce complexity and run the firm more effectively on a global basis, but structure is not enough. To preserve and enhance our reputation, we must also lead our industry in formulating and implementing global standards and controls to ensure that our conduct matches our values.

What does this mean in practice?

- adopt and enforce the adherence to a single standard globally that is determined by the highest standards we must apply anywhere. Often, this will mean adhering globally to US regulatory standards, but to the extent another jurisdiction requires higher standards, then that jurisdiction’s requirements must shape our global standard
- maximise the sharing of information for risk management purposes amongst Group companies and amongst Global Businesses and Functions
- apply a globally consistent approach to knowing and retaining our customers. When we conclude that any customer or potential customer poses an unacceptable reputational risk (or otherwise does not meet our standards), we should exit or avoid the relationship globally
- ensure that our banking services are not used to facilitate tax evasion anywhere or to hide the proceeds of corruption or crime
- maintain ethical sales practices

Setting and implementing standards and controls is not solely the job of our control functions such as Risk, Legal, Finance and Internal Audit. All of us – across all businesses, all geographies, and all levels of the firm – have a personal responsibility to make this happen. While the Group is made up of many legal entities around the world, we have only one reputation and we are all guardians of it.

Steering Committee on HSBC Global Standards
This will be an ongoing and continuous effort, impacting all of our businesses all over the world. As you all know, much of this work is already well underway. To facilitate comprehensive oversight of these matters, identify additional areas requiring attention, and to determine best practices, I have asked the Group Chief Risk Officer Marc Moses, and Chief Legal Officer Stuart Levey to co-chair a Steering Committee on HSBC Global Standards. This Committee will operate under the supervision of the Group Risk Management Meeting to define the HSBC Global Standards and to ensure that these Global Standards are implemented.

Yours faithfully,

Stuart Gulliver
Group Chief Executive

PSI-HSBC-75-0001
GCL 120014 - HSBC Global Standards

Background
A year ago, we announced a clear strategy to be the world's leading international bank. In order to make this more feasible and better integrated, we established Global Businesses and Global Functions, and gave them a similar status to individual businesses. This was a significant step towards our goal of being a fully integrated group, with a fully integrated strategy, and a fully integrated management framework.

Our strategy to achieve our ambition essentially consists of four key elements:
- We must increase our focus on the global economy, not just the domestic market.
- We must be more integrated, not just in terms of our operations, but also in terms of our strategy.
- We must be more efficient, so that we can compete on a global basis.
- We must be more resilient, so that we can continue to operate even when there are disruptions to our operations.

What does this mean in practice?

- We need to move faster, so that we can respond more quickly to changes in the global economy.
- We need to be more flexible, so that we can adapt to changes in our business environment.
- We need to be more innovative, so that we can develop new products and services that meet the needs of our customers.

From now on, we will not just think about our business in terms of our individual businesses, but also in terms of our global strategy.

Global Businesses

- Global Banking
- Global Markets
- Global Treasury
- Global Finance
- Global Risk
- Global Operations
- Global Technology
- Global Compliance

Global Functions

- Global Strategy
- Global Risk Management
- Global Legal
- Global Human Resources
- Global Corporate Social Responsibility
- Global Communications

This will mean that we will have to think about our business in a different way. We will have to think about our business more globally, not just in terms of our individual businesses, but also in terms of our global strategy.

We will have to think about our business in a different way. We will have to think about our business more globally, not just in terms of our individual businesses, but also in terms of our global strategy.

We will have to think about our business in a different way. We will have to think about our business more globally, not just in terms of our individual businesses, but also in terms of our global strategy.
Chapter 5 Legal, Compliance and Reputation

Legal

The Global Legal Function is responsible for providing and managing legal services to members of the HSBC Group, thereby facilitating its business and for protecting the Group from legal risk as well as its integrity and reputation. The Group General Counsel maintains a close relationship with the Chief Risk Officer (CRO).

The Global Legal Function operates through individual legal departments in more than 50 countries. Regional General Counsel for North America; Latin America; Europe; Middle East; Asia Pacific; the Global Head of Global Banking and Markets, Legal; the Head of GBL LGA and the Chief Operating Officer, GBL LGA together with the Group General Counsel form the Group Legal Executive Committee. The Group Legal Executive Committee has primary responsibility for providing leadership and guidance across the function, while the responsibility for providing legal support to the business rests with the individual country departments.

Legal risk is a combination of a variety of risks. In particular:

Contractual Risk is the risk that the rights and/or obligations of a Group member within a contractual relationship are defective;

Dispute Risk is made up of the risks that a Group member is subject to when it is involved in or managing a potential dispute or actual dispute;

Legislative Risk which is the risk that a Group member fails to adhere to the laws of the jurisdictions in which it operates; and

Non-Contractual Rights Risk which is the risk that a Group member’s assets are not properly owned or are infringed by others or the infringement by a Group member of another party’s rights.

For additional detail on legal risk and HSBC’s policies to control such risk, please refer to the Legal and Compliance Manual.

Compliance

The structure of the Group’s Compliance function is designed to fit closely with the structure of the business and is divided according to geographic units (each country or jurisdiction is headed by an Area Compliance Officer who functionally reports to the relevant Regional Compliance Officer) and Global Businesses (which are typically subject to oversight by a Global Business Compliance Officer).

Furthermore for major Group companies, typically those with a dedicated audit committee, a Global Head of Compliance will exist to co-ordinate Local Compliance Officers both within that company’s domestic and overseas offices.

Group Compliance in Group Headquarters is the centre of the Compliance function, setting Group-wide policy and supporting the regional/product networks as well as advising Group executives on all regulatory matters. The Head of Group Compliance reports to the Chief Risk Officer, but also has close association with the Group General Counsel so a holistic view of risk across the Group’s functions can be obtained.

Given the geographical spread of the Group and the number of financial markets in which it operates, the breadth and depth of legislation and regulation to which the Group is subject is enormous. The penalties for contravening rules and regulations are also increasing in severity. Compliance risk is closely bound with reputational risk and the perception of the Group by customers and others can be readily damaged by
a failure to comply with relevant laws. Any wilful or negligent contravention by a Group operation will be regarded very seriously.

For full details of the globally-applicable Compliance policies in place to safeguard the HSBC Group against regulatory risk, refer to the Compliance section of the Legal and Compliance FIM. In some cases, such policies will be supplemented at Global Business level by the appropriate business FIM.

The following Compliance Policy Statement was adopted by the Board of HSBC Holdings plc on 12MAR93 and is required to be adopted formally by all major operating subsidiaries within the Group:

"It is the policy of the HSBC Group (the Group) to observe high standards of integrity and fair dealing in the conduct of its business and to act with due skill, care and diligence.

To those ends, Group members should:

- comply with both the letter and spirit of all relevant laws, codes, rules, regulations and standards of good market practice in each jurisdiction around the world where they conduct business; and
- ensure that any irregularities which arise are promptly resolved in a manner which minimises financial loss and protects the good name and reputation of the Group."

Management at all levels must ensure they, or their executives with delegated managerial responsibilities, are fully acquainted with the rules and regulations applying to the operations for which they have responsibility and that arrangements for ensuring compliance with legal/regulatory requirements are an integral part of the operational procedures of the business. Where managers become aware of breaches of laws or regulations, they must advise their Local Compliance Officer.

Published: 27/Feb/2012

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http://fim.gbq.hsbclFIM/home.nsf/ByRefUKWE78JFKP11334701112007?Open&Print...  07/15/2012
Confidential & Non-public OCC Information

From: DAVID DEW/HSBC/HSBC
To: LESLEY MIDZAIN/HSBC/HSBC
Subject: Re: FW~Kyc hires

Lesley,

I am out next week but would a couple of temps for two months do the trick?

David

David Dew
SEVP, Chief Operating Officer
HSBC Bank USA
432 Fifth Avenue 10th Floor
New York, NY 10018

Phone. 212-525-6951
Fax. 212-525-6888
Email. david.dew@us.hsbc.com

Lesley Midzain/HSBC/HSBC
09/04/2008 03:57 PM

To. David Dew/HSBC/HSBC
Cc. Andrew P LONG/EBU/HSBC, Chris P DAVIES/HSBC/HSBC, Michael B Gallagher/EBU/HSBC/HSBC
Subject: Re: FW: Kyc hires

Lesley,

I think we are keeping our view and our plans firmly focused on the future, but are still grappling with some of the grit realities of the present - the looming OCC loan in November being one of those grit realities, but I am happy to explore other suggestions for providing "quick fixes" for the situation. Whether these are business-related or compliance-related, and putting together the additional compliance information you've requested and forwarded.

Lesley

Lesley Midzain
 EVP & Chief Compliance Officer 1 HSBC BANK USA, N.A.
432 5th Ave, 27th Fl.
New York, NY 10018

Phone. 212-535-6410
Fax. 212-535-5789

[Redacted]

[Redacted]

[Redacted]
Thanks Lesley.

I do think that collectively we need to step back and consider the full financial impact of what we are proposing for our PCM business at a time when the business is being asked to consider carefully its strategic objectives, both from a customer perspective and also from a OneHSBC perspective.

The proposal on the table is to add a total of 8 FTE to support compliance related activity. I appreciate that they are not all additional positions from a budget standpoint but nevertheless there will be a significant impact on current operating expenses at a time when we are also tasked with keeping costs flat to below.

Therefore, I would still like my earlier questions answered but with the analysis amended to account for the additional Compliance staff in your area which are of course charged back to the business. Further example of whether we would benefit from additional clarity: you correctly say that the case study is still a work in progress but can you provide some indication of whether the function cannot move offshore, what is the profitability of this business and what automation plans do we have because perhaps we should be considering eliminating some of the manual activity?

I think that we must also use this opportunity to accelerate the centralization initiative. As you say, the request by POM is effectively to add resource to an operational team. We should be looking to put such resource into a central utility at every opportunity as it envisaged in the ZOM report. If you can do this along with the routine compliance monitoring activity, then economies of scale should result.

I appreciate that this is not the response that you are collectively looking for but in the current environment I feel we must at least get some harder questions and not simply approve additional headcount. Equally, I am mindful that we have an alert backlog in the PCM business and it would be great to get an update as to where we stand with this.

Happy to get together if a meeting will help.

Regards

David Dew
Confidential & Non-public OCC Information

OCC-PSI-0089824

Lesley Middleton, Head of OCC
09/29/2008 03:19 PM
To: David New
Cc: Chris P Davies/HSB0254548
Andrew P Long/HSB0254548,
Charles G Osbun/HSB0254548
Jim Mackenzie/HSB0254548,
M. Callagher/HSB0254548,
Leslie Maxfield, Andrew P Williford

Subject: FW: KYC

David,

We would support the request. PCM has an operational team that does client on-boarding and file review in Delaware and we understand they have had some outstanding vacancies. The team was created in response to an OCC concern several years ago and focused on high risk customers and financial institutions. The team was successful and PCM extended their reach to additional customer types in response to an audit comment and to ensure consistency across the business unit. Consistent with the bank’s strategic direction, the team looks to compliance for advice and guidance but do the actual file reviews and document collection themselves.

These activities are independent of compliance advisory and monitoring work and resources. On the letter date, we had been in process of trying to hire for 3 additional approved positions (per your approval from late 2006). I pursued targeted monitoring and one more senior hire. In recent weeks, a couple of events happened that affected our progress:

- The freeze for hiring in global businesses was put into effect. We were notified that this applied in the PCM world, and so we suspended our hiring efforts.
- Two members of the compliance staff in Delaware resigned (one to take a position with the bank). My staff has consulted with Michael in this process and understands that he is supportive.

As a result we reviewed our staffing proposal and concluded that we would use this as an opportunity to reduce the 3 vacant compliance positions (I approved 2 recent departures) to 0, all outside of New York. Attached is the one-pager we had just prepared which explains and supports that analysis.

Given the hiring freeze in global businesses, I understand that it may also need approval by Paul Lawrence. But this has continued to be an area of notable risk and regulatory attention and which needs some simplification for compliance monitoring. I believe this is an opportunity to ensure cost-effective means of providing some needed support. My staff has consulted with Michael in this process and understands that he is supportive.

Page 3
As we all know, PCM is a high risk business from a BSA/AML perspective and we need to ensure that we have sufficient qualified resource to meet regulatory requirements. As such, I have asked Compliance for their views on this request. That said, I will need more detailed information. A proposed increase of 4 FTEs is significant. What precisely is driving this increase? What is the volume of the business in terms of number of customers and how are these customers in a risk profile perspective? Do they fit in with our overall strategy? What is the underlying profitability of this projected growth? What is the current number of Compliance FTEs in the business and how are they deployed? What exactly will the additional 4 people be doing? What progress are we making in terms of further offshoring and utilizing the global centres of excellence? What scope do we have for further cost reductions in other areas, e.g., payments operations following the centralization under Tom Kaiser? Finally, I note Michael's comments concerning cost savings but will the business be able to meet the overall corporate goal of keeping JV expenses flat to JPY?

Thanks

David

David Dew
SEVP, Chief Operating Officer
HSBC Bank USA
Confidential & Non-public OCC Information

I seek David's guidance with respect to compliance resources.

As regards adds within PCIII, as previously discussed, operational integrity is clearly a high priority, however the adds in this climate will need to be traded off reductions elsewhere in your business in order for a flat cost profile to be achieved.

I know we will be discussing this point at 9 30.

Thanks

----- original Message -----
30 Day Observations and Recommendations Report from AML Director

To: Curt Cunningham
From: Wyn Clark
Date: Thursday, October 15, 2009

Profile of HSBC
Extremely high risk business model from AML perspective:

- Risk: High
- Compliance:
- Reputation:
- Regulatory:
- Financial:
- AML:
  - Products/Services
  - Transactions
  - Client
  - Geographic

Current Observations
AML Director has the responsibility for AML compliance, but very little control over its success

- Operate under "crisis" mode, actions are reactive rather than forward thinking
- AML Director unable to manage at high level
- Several AML Directors/BSA Officers in a short period of time
- Systems and controls not adequate for risk profile of organization:
  - OFAC misses and backlog
  - Large # of MRAs
  - Training
  - Bartol Adams
  - Threat of repeat MRA in Q1

Where are concerns with control environment?
- Reporting lines
- Business and AML Expertise
- Technology
- Head count

EXHIBIT #4

Confidential Treatment Requested
Independence
MIS

Appear to have lost urgency of AML compliance since previous enforcement action was lifted

AML risk profile of HBIO vs. HBUS are extreme opposites

Decentralized functions creates inefficiencies, inconsistencies and a greater potential of things falling through the cracks or missed altogether

Commingling of general compliance with that of AML

Not clear on why AML Director is in COE

Proposed Organization (CTP)

AML Director has responsibility for AML compliance as delegated by the BoDs (HBUS, NA BOD and North America BOD) but very little control, oversight or direct authority over its success.

Proposals

AML Compliance should have its own channel within HNAH compliance

Groups supporting AML to have direct reporting into AML Director (see draft org. chart)

To ensure that AML Compliance is maintained throughout the entire North America region it is critical that there is a lead/head in the following key areas. These heads should report directly to the AML Director or advisors in the AML Director’s office that oversee these key areas for all of HNAH:

Policy/Dep Director
FIU
Surveillance/Monitoring
Investigations
SAR Reporting
Sanctions
KYC/CCD/EDD
Training
Regulatory Exam/Internal Audit
MIS/Metrics
Reporting Non SAR

Represented in AML Governance Council:
Business Line AML Officers/Heads
LOCs w/ AML component

Questions

Is there a budget for AML?

Priorities

1) FIU report to AML Office
2) Report AML risks and issues to BoD
3) Structure and staffing of AML Office
   a. Oversight, SME, Policy,
   b. Operations – FIU primarily
4) Fix OFAC – drill down to determine ultimate root cause and fix, then fix other issues
5) Norcom implemented in GIB
6) Full scope assessment of AML risk vs. control and system environment
7) AML/OFAC risk assessment process
8)
Oh, this was express time. Trust me on that. Usually the response is "no."

----- Original Message -----
From: wyndham S Clark
Sent: 10/19/2009 05:19 PM CDT
To: Debra L Bonosconi
Subject: Re: FW: OFAC resources

Clearly a positive, although I understand these were requested quite a while ago. I hope that isn't the typical response time.

----- Original Message -----
From: Debra L Bonosconi
Sent: 10/19/2009 05:49 PM EDT
To: Wyndham S Clark
Subject: Re: FW: OFAC resources

Well, not really. Yes good that we got new positions but not good in that we don't get the staffing levels we need.

----- Original Message -----
From: Wyndham S Clark
Sent: 10/19/2009 04:26 PM EDT
To: Debra L Bonosconi
Subject: Re: FW: OFAC resources

Good.

Wynd Clark
Anti-Money Laundering Director | HSBC - North America
452 Fifth Avenue, 7th Floor, New York, NY 10018

Phone. 212-525-8025
Fax. 212-642-1543
Email. wyndham.s.clark@us.hsbc.com

Debra L Bonosconi/HBUS/HSBC
10/19/2009 02:33 PM

To: "Wyndham S Clark" <wyndham.s.clark@us.hsbc.com>
CC
Subject: Fw: OFAC resources

Fyi
----- Original Message ----- 
From: Lesley Midzain 
Sent: 10/19/2009 02:23 PM EDT 
To: Alisha Marshall; Debra L Monosconi 
Cc: Curt Cunningham 
Subject: OFAC resources 

Janet has approved the 3 resources (2 transaction monitoring, 1 analyst). 
She has to take this to Paul Lawrence, but we can start the search for the 3 in 
order not to lose time. 

Lesley 

Lesley Midzain 
Executive Vice President & Chief Compliance Officer | HSBC Bank USA 
452 Fifth Ave, New York, NY - 7th Fl. 

Phone. 212-525-6410 
Fax. 212-525-5769 
Mobile. 
Email. Lesley.Midzain@us.hsbc.com

- Redacted by the Permanent Subcommittee on Investigations
remember my words....absolutely nothing migrates into the FIU or AML Office without proper resourcing, and a full accounting of risk and ultimate consequences of doing so. (Please feel free to quote me on this to anyone you please)

we are in dire straights right now over backlogs, and decisions being made by those that don't understand the risks or consequences of their decisions!!!!

Wyn

Wyn Clark
Anti-Money Laundering Director | HSBC - North America
452 Fifth Avenue, 7th Floor, New York, NY 10018

Phone. 212-525-8025
Fax. 212-642-1543
Email. wyndham.s.clark@us.hsbc.com

Debra L Bonosconi
HSBC North America | Sr. VP - Director, Financial Intelligence Unit
1130 Connecticut Ave NW, 12th Floor
Washington, DC 20036

Phone. 202-496-8766
Mobile. 202-496-8766
Email. debra.l.bonosconi@us.hsbc.com

Wyndham S Clark/HSBC
02/26/2010 11:51 AM

To: Anne Liddy/HSBC
CC: Debra L Bonosconi/HSBC

Subject: Re: Fw: Received a call from Kathy G this am....

Permanent Subcommittee on Investigations
EXHIBIT #6
time to push back. Any idea who made this decision? Is this the same function that takes .3 of an FTE to perform?

wyn Clark  
Anti-Money Laundering Director | HSBC - North America  
452 Fifth Avenue, 7th Floor, New York, NY 10018  

Phone: 212-525-8025  
Fax: 212-642-1543  
Email: wyndham.s.clark@us.hsbc.com
From: ANNE LIDDY/HBUS/HSBC  
Sent: 2/27/2010 10:47:26 AM  
To: WYNDHAM S CLARK/HBUS/HSBC@HSBC02; DEBRA L BONOSCONI/HBUS/HSBC@HSBC02  
Subject: Re: FW: Bco Nac Angola

I re-read this a few times and at first thought it was a bit rambling/venting but that is probably what we need at this point. It is on point, just don't know how we are going to get there. I would point out that we do push back on opening/maintaining relationships that are strategic Group relationships and have been able to hold our ground but it is extremely difficult at times - we expend a lot of energy pushing our point and holding our ground and certainly Group member referred relationships/transactions have increased our HBUS risk.

HANA is really HNAH.

Also, think you mean to say you can't think of one exception. 

Call me if you want.

----- Original Message -----  
From: Wyndham S Clark  
Sent: 02/27/2010 08:58 AM CST  
To: Anne Liddy; Debra L Bonosconi  
Subject: FW: Bco Nac Angola

I'm about to send this to Curt and Lesley w/ a cc to Janet opinion. Is this on point and accurate, or do I sound like a rambling lunatic? 

Wyn Clark  
Anti-Money Laundering Director  
HSBC North America  
452 Fifth Avenue, 7th Floor  
New York, NY 10018  
(212) 525-8025

Wyndham.s.clark@us.hsbc.com

----- Original Message -----  
From: Wyndham S Clark  
Sent: 02/27/2010 08:54 AM CST  
To: Wyndham S Clark  
Subject: FW: Bco Nac Angola

Lesley and Curt,

This rings to the heart of one of my major issues here. We don't appear to be on the same page as to who owns the risk. My view is the businesses own this risk and should be articulating to their leaders and compliance as to why they are comfortable with it, and provide a clear justification how the risk can be effectively managed within the risk tolerances that have been articulated by our BCO. The same goes to group and our affiliates. It does not hold water that we have to open accounts or process transactions just because we are expected to support group mandates. Just like the businesses, my view is that HANA owns the risk, not group, and we have to start acting that way or we will continue to run into problems with no end in sight. If you own the risk, and receive compensation based upon the risk/reward concept, then you have to be prepared to make the decisions necessary, to manage it. (Based upon the very upsetting rewards process we recently went through in compliance, we are clearly not being compensated on a risk/reward basis in our group.)

The email below, as well as the recent PSI report are good examples. we are spinning our wheels with this PSI report performing scrubs and filing reports where necessary. My view is we should instruct the businesses to review this

Permanent Subcommittee on Investigations

EXHIBIT #7
report themselves, and report back as to where they have exposure, the risk, and what their action plan is. This should include the highest levels of management in the impacted businesses, and our organization, approving the actions and accepting the risk. It's not what actions compliance is taking, it's what actions the risk owners are taking.

At this point the businesses are not accepting that they own the risk. I can think of one exception, making the difficult decisions and taking the necessary steps to mitigate their risk. My view is the risks are being ignored by the business, and they are simply waiting for compliance to tell them what the risks are and to convince them as to what actions need to be taken. If they don't know what the risks are, then why are they opening accounts or continuing with the relationship? They are essentially pushing the risk to compliance, this is not where it resides.

I am happy to discuss this anytime. I'm convinced that our biggest challenges are internal (risk ownership is just one example, my list is lengthy), and until we realize this and get them addressed, we are not going to have an effective AML and/or compliance program. It's time to have an honest discussion with the most senior levels of management in this organization about the issues, until then we're only fixing the symptoms.

I have no problem with either of you sharing this email with those that you feel appropriate. I'm very transparent and candid in my approach, and feel that dealing with issues head on is the best approach.

Thanks,
Wyn

Wyn Clark
Anti-Money Laundering Director
HSBC North America
452 Fifth Avenue, 7th Floor
New York, NY 10018
(212) 525-8025
wyndham.s.clark@us.hsbc.com

----- Original Message ----- 
From: Christopher O'Donnell
Sent: 02/26/2010 08:01 PM EST
To: Ali Kazmy; wyn Clark
Cc: Anne Liddy; Camillus Hughes; Charles DelBusto; Denis O'Brien; James G Holderman; Judy Stoldt; William M Wong
Subject: Re: FW: BCO Nac Angola

Ali/wyn:

I appreciate the responses and the ongoing analysis, however, we need to be evaluating this and other Angolan clients broadly, versus the specific transaction(s) highlighted in our monitoring. As described in the note from Balance Sheet Management below, we have other businesses who do not have direct relationships with this and other Angolan accounts. They are concerned about their exposure to the counterparties and, as a result, are seeking our guidance.

Whereas, its important to highlight all issues and concerns associated with this activity to the business and seek their concurrence, we need to be providing the guidance that is being sought. I don't think anyone involved doesn't already appreciate the risk associated with this business, they are looking for our view. We need to articulate our position and get the view out immediately.

Please let me know as soon as this review is completed. I'm happy to
participate in any discussion so we can coordinate this view across functions.

---

Original Message

From: Ali S Kazmy
Sent: 02/26/2010 05:51 PM EST
To: Wyndham S Clark
Cc: Anne Liddy; Camillus Hughes; Charles DelBusto; Christopher O'donnell; Denis O'brien; James G Holderman; Judy Stoldt
Subject: Re: FW: Bco Nac Angola

Wyn,

Thanks for your note.

After completion of the analysis, we intend to highlight all issues/concerns, as applicable, to the business for their confirmation that they are comfortable with the risk.

Shall keep you apprised of developments.

Regards,

Ali S Kazmy
Vice President/Senior Manager - Anti-Money Laundering Policy | HSBC Bank USA, National Association
452 Fifth Avenue, 7th Floor, New York, NY 10018

Phone: 212-525-5560
Fax: 212-525-6994
Mobile: [Redacted]
Email: ali.s.kazmy@us.hsbc.com

---

From: Wyndham S Clark/HSBC/HSBC
To: Ali S Kazmy/HSBC/HSBC, Christopher O'donnell/HSBC/HSBC, Charles G DelBusto/HSBC/HSBC, Denis E O'brien/HSBC/HSBC, James G Holderman/HSBC/HSBC, Judy P Stoldt/HSBC/HSBC
Cc: [Redacted]
Date: 02/26/2010 03:45 PM
Subject: Re: FW: Bco Nac Angola

Ali.

I would advise that we also obtain approval from the head of this business (PCM 7) that they are comfortable with the risk. I presume the business has some sort of risk committee that would review/approve these sorts of accounts/clients.

Thanks,

Wyn
Wyndham Clark
Anti-Money Laundering Director

Page 3
----- Original Message ----- 
From: Ali S Kazmy 
Sent: 02/26/2010 05:11 PM EST 
To: Christopher O'donnell 
Cc: Anne Liddy; Camillus Hughes; Charles DelBusto; Denis O'brien; James G Holderman; Judy Stoldt; Wyndham S Clark 
Subject: Re: Fw: BCO Nac Angola 

Many thanks for your note. 

Regards, 

Ali S Kazmy 
Vice President/Senior Manager - Anti-Money Laundering Policy | HSBC BANK USA, National Association 
452 Fifth Avenue, 7th Floor, New York, NY 10018
TO: Christopher O’donnell/HSBC/HSBC02
CC: Ronald E Hollmann/HSBC/HSBC02
Date: 02/25/2010 03:39 PM
Subject: FW: BCO Nac Angola

Chris,

In case we miss each other today, I was calling to discuss if RMS (Money Desk) has any specific instructions when it comes to dealings with Banco Nacional Angola, or for that matter Banco Africano de Investimentos.

I discussed with Charlie DelBusto, who assured me that PCM is not under any restrictions relating to the account, and that he did make compliance aware of this particular transaction.

Historically, these banks have been known to be uncooperative, while we have not dealt recently, what should our procedures be if we are contacted?

Obviously with the headlines around these accounts I just want to ensure we are communicating in both directions with compliance and following protocol.

Please advise.

Thanks and regards.

Blair Selber
Managing director- balance sheet management | HSBC Bank USA
452 Fifth Avenue, 3rd Floor
New York, NY 10018

Phone. 212 525 6622
Fax. 646 366 3751
Mobile. ------ Redacted by the Permanent Subcommittee on Investigations -------
Email. blair.selber@us.hsbc.com

----- Forwarded by Blair Selber/HSBC/HSBC on 02/25/2010 03:27 PM -----

From: Charles G DelBusto/HSBC/HSBC
To: Blair Selber/HSBC/HSBC02
CC: Ronald E Hollmann/HSBC/HSBC02
Date: 02/25/2010 11:39 AM
Subject: Re: BCO Nac Angola

Blair,

I am not aware of any additional reporting requirements, however I did mention this to Compliance (who happens to be down here with the 9 examiners) and he will look into.

Charles del Busto
Global Transaction Banking
(t) 302 327 2100
(f) 302 327 2128
From: Blair Selber/HSBC
To: Charles G DelBusto/HSBC@HSBCO2
Cc: Ronald E Hollmann/HSBC@HSBC
Date: 02/25/2010 11:22 AM
Subject: BCO Nac Angola

Charlie,

One more follow-up re: the account above.

Does PCM or anyone make Legal/Compliance at least aware of [redacted] since I am harping on good communication back to us. I want to ensure that we are also communicating material changes to them. I would think this is in addition to any "typical" reporting.

Is there someone responsible for that, and was it done in this case?

Thanks again

Regards

Blair Selber
Managing Director - Balance Sheet Management | HSBC Bank USA
452 Fifth Avenue, 3rd Floor
New York, NY 10018

Phone. 212 525 6622
Fax. 646 366 3251
Mobile. [redacted]
Email. blair.selber@us.hsbc.com
From: David W. J. BAGLEY
Sent by: Marion D. ROACH
Date Sent: 07/10/2002 12:17
To: John F. ROOTIHGHQlHSBC@HSBC
Copy To: Sandy Flockhart@HSBC@HSBCAMERICAS, Richard E. BENNETT@HSBC
Subject: BIMAL

John

I have now met with Sandy Flockhart to discuss the way forward.

The key points are as follows:

I attach a structure chart (by hard copy), which shows the current, and rather unsatisfactory structures within BIMAL.

Sandy acknowledges the importance of a robust compliance and money laundering function, which at present is virtually non-existent.

Before proceeding very far with the search for expatriate resource, Sandy would like someone to visit Mexico with a view to assessing current resources, the extent of the problem, and the major issues. Particularly he is looking to see if there is any local resource which can either be used or groomed to perform the ACO/MLCO role.

Two possible candidates are the existing in-house lawyer at HSBC, and the current ACO. Could you please talk to Carolyn Wind and get her assessment at least on the ACO if not on the inhouse lawyer.

There is no recognisable compliance or money laundering function in BIMAL at present, and this therefore increases the likelihood that there will be no obvious existing resource which we can use.

Sandy thinks it is important to look both at issues affecting Mexico City, but also closer to the border where there appears to be substantial cross-border flows of money, including USD in cash.

Sandy is looking for someone to visit mid October onwards, and would like the initial scoping of the extent of the task to be completed prior to closing in early December.

Could I ask you to consider the due diligence, to schedule a trip to Mexico, and once you have some broad ideas, contact Sandy with a view to discussing who you would meet, timing etc.

I am happy to discuss further when you have had a chance to consider.

Many thanks

Regards

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OUR DILIGENCE REVIEW - PROJECT HIGH NOON
JULY 2002

SECTION 5.23

COMPLIANCE

Background

A review of are performed of the fundamental purpose, current responsibilities and ongoing activities of GFB's Compliance related efforts, with the overall objective being to ascertain the extent of GFB's existing and potential Compliance related risks. A methodology was

Draft

5:14 PM

2001

Compliance

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HSBC OCC 8873845

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BUSINESS DUE DILIGENCE REVIEW - PROJECT HIGH NOON

JULY 2001

Findings

Structure

- GFB does not have a Compliance Department. Rather, Compliance work is conducted
  within the scope of activities of the Department of Auditor (Audit Department -
  DIA), which currently has a staff of 10. DIA is headed by Florio Augusto Pimentel
  Miranda, who was not interviewed as part of the due diligence effort. Raul Mendez
  Raves, an INA director, oversees a staff of 3 people, whose responsibilities include
  Compliance related issues, including operations at the New York agency and assets and
  liabilities located at the Cayman Islands branch. Ms. Mendez said that her area's
  annual plans include a target goal to review 40% of GFB's 1,394 domestic branches.

Accounting Opening Procedures and Defined Categories of Clients

- The CNBV issued a regulation in 1997 that requires all Mexican banks to obtain
  Know Your Client information. Banks had until 01/01/2002 to bring all
  accounts opened prior to 01/01/97 into compliance with the regulation. 24A claimed that
  all domestic accounts have been brought into alignment with the regulation.

- GFB collects the majority of Know Your Client information from clients. However, new
  customers are not being asked to provide information about their assets or initial
  deposits. Also, the GFB does not document any information about the expected use of
  the account or anticipated transactions on a regular basis.

- GFB does not use a Watch-Check list or any other third party database for new account
  opening. A few, new client names are not checked against the US Treasury
  Department's OFAC SDN List.

- GFB does not have a client evaluation policy similar to Special Categories of Clients. It
  has issued an internal blacklist called Blackboards. Certain government officials, known
  as highly assigned politicians and criminal enterprises, and persons whose the FATF
  non-cooperative countries everytime they came to the list (although the documentation provided did not
  have a current FATF list of non-cooperative countries, the list being in place over one
  year ago). GFB's anti-money laundering department attempts to open an account with the
  knowledge of these accounts.

- GFB has a department called Banco Galicia. This department has an internal blacklist
  called Blackboards. The department has a client evaluation policy similar to Special Categories of Clients.

- GFB's Casa de Bolsa does not obtain client reliability information. Clients are
  required to file their maximum investment volume based as a percentage of the income
  information they provide.

Report series of account opening documents

- The HSBC review in 1,389 identified that 92 of the 2,349 accounts reviewed lacked full
  documentation.
A review in 1999 (15% sample review of documentation of accounts held at the target’s Curacao Islands branch) found that 15% of the accounts reviewed (92 of 524) reviewed had full client information. 37 files had no client information. During 1Q02, INA reviewed electronically stored records of 33,948 dormant accounts. Of 49,527 (67.5%) files examined 97% (47,408) contained all of the required documentation. GFB had a 100% goal for 3/12/2002.

During 1Q02, INA found that the GFB had opened 2,060 USD denominated accounts outside of Panama, including 1,635 (80%) outside of the US. The deposits client information system now blocks attempts to open USD accounts outside of the US exceeding 100 USD.

Mainline Activities
- GFB’s main account monitoring efforts are conducted through a system named Monitor. It is a Hogan Tool Kit-based system that was built and refined by GFB’s INA and IT departments. Monitor’s current primary function is to identify accounts whose transactions exceed the equivalent of USD50k in any single day. Upon identifying an account that meets the daily threshold, the system sends alerts that reach the account’s executive level, where account managers are to review the alert and notify INA if any issues believed to be unusual or suspicious. If an account executive believes there is a case to exception or possibly suspicious, an INA employee opens an investigation and reviews the account’s up to most 3 months of transactions. Discussions are held with the referring account executive to discuss the account. A case deemed worthy is then sent to the Secretaria de Noticias y Gestión de la Información delío Programa de Prevencción de Actividades Ilícitas (CAPOR). The CAPOR has the decision responsibility whether or not to send suspicious activity reports in the government. During 2001, 283 of the 296 cases referred were sent to the government. The account being reviewed, are not having an account officer to report.

- Monitor has columns reporting whether client current accounts files is discovered fully. It reports the information in percentage terms by business division, branch and account executive position. At the account level, Monitor assesses whether the fundamental Know Your Client information elements are on file. However, account executives review this information in Monitor and normally this data is certified only when INA visit a branch. When issues reviews are conducted for the documentation. The system is being enhanced to flag daily activities of more than USD10K for recital accounts.
[Redacted Material]

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The CGB conducted a CGB internal audit during 2001 and reported its findings to HSBC Bank USA, N.A. in December 1999.

- CGB found that the US$2.8m of funds held at HSBC in government bonds constituted a significant risk to the bank.

- The CGB recommended that HSBC take steps to reduce this risk, including tightening controls over the funds.

- HSBC agreed to implement the recommendations and took steps to reduce the risk.

- The CGB also noted that HSBC had not completed its due diligence review of the project.

Other Compliance Issues

Regulatory Supervision and External Audit Reports

CDBG conducted an on-site audit of the project during 2001. The audit identified several areas for improvement:

1. Improving internal controls and procedures to ensure compliance with the CDBG regulations.
2. Strengthening the project's financial management system.
3. Enhancing the project's capacity to manage risk.
4. Improving the project's outreach and engagement with local communities.
5. Increasing the project's overall impact and sustainability.

CDBG recommended that HSBC take steps to address these issues and improve its compliance with the CDBG regulations. HSBC agreed to implement the recommendations and work to address the concerns raised by the audit.
GROUP INTERNAL AUDIT
DUE DILIGENCE REVIEW - PROJECT HIGH NOON

JULY 2001

The December 2000 Arthur Andersen Management Letter addressed three Compliance issues.

1. Administration and control of credit facilities and accounts with related parties was weak.
2. GFB filed financial reports and schedules with regulatory authorities in a timely manner.
3. GFB failed to fully implement its risk administration program as called for in its policies and procedures.

Management replied that they had taken the steps necessary to clear each item, but the following should be noted:

1. The 2001 CNBV supervision report listed two large insider loans, and referred to preferential treatment for both which were found to be problem situations. (Refer to the Commercial Credit section 3.3 for further details)
2. GFB has still not fully automated the accounting systems that produce the regulatory reports and schedules.
3. A December 2000 KPMG review of GFB's risk control policies and procedures found that the organization was in compliance with all 31 elements of CNBV Circular 1423, which requires Mexican banks to monitor and control liquidity, credit, market and operating risks. Banks had to implement procedures to control these risks by 31 October 2001.
4. The 2001 Arthur Andersen Management Letter did not report any of the three issues. It did state, however, that the organization needed to implement certain measures to comply with Circular 1423, similar to the opinions rendered by KPMG. We have not received an explanation as to why KPMG would have done this and above the involvement of the Auditor.

Also, the management reiterated that GFB did not have a Treasury Compliance function.

Transactions over the Internet

GFB has established an Internet web site in 1995. The bank and Casa de Baja have some transactional web site pages. Consumers, small business and corporate banking customers can conduct some account transactions over the Internet, including:

- Purchases of mutual funds shares
- Tax and a free MGE program, including 50 identified service providers and 2 mobile solutions companies
- Credit card payments
- Inter-account transfers (business clients only)

GFB has not, however, established with the sites where clients can open new accounts.

During April 2000, some NKF, 1.3 USD million of unauthorized third party wire transfers were conducted through the Internet, causing a loss to GFB of NKF, 1.3 USD million. At date, the bank has not been able to identify any suspect. We have not been confirmed that the internal control weaknesses have been rectified.

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DUE DILIGENCE REVIEW - PROJECT HIGH NOON
JULY 2002

Other-Alerts

GFB has a Code of Conduct, but it covers very few matters. Its overall content being sparse. Conflicts of interest are addressed, but no examples are given and employees are not informed how to respond to a situation presenting a potential conflict. Other issues, such as outside employment, receiving gifts from clients and services providers, and guidance on responding to attempts of influence on the line of business, are not addressed. All employees were required to adhere to the Code and all new hires must also subscribe.

GFB does not have a policy relating to employees' personal investment activities, like HSBC's staff sharing plan. If employees acquire stock in GFB, they must hold the shares for three months, and one week for other stocks. Employees at the level of director and above must provide personal asset and liability disclosure on an annual basis.

GFB does not have a policy for employment terminations or contract clauses.

GFB apparently does not employ separation of duties between departments for sensitive client transactions, such as the principals of Chinese Walls for investment banking and merger and acquisitions activities. During some interviews with senior DB team members, some GFB officials referred to the concept of Chinese Walls, whereas, it appeared that they were using the term to refer to separation of duties between front and back offices.

Conclusion

The GFB Compliance effort is weak, and it appears that the target organization does not have a strong Compliance culture:

- GFB does not, in reality, have a Compliance Department and one would have to be established and implemented, with possibly new head staff being considered from IMA. It is likely that, in the event of the acquisition proceeding, HSBC would need to appoint an experienced Compliance official to establish a formal department.
- Reviews of account opening procedures and client documentation are sporadic, and the reviews normally do not encompass large populations of client files or activities. This effort needs to be strengthened.
- Client interaction and activity monitoring is very limited. There is an acute need for more effective and more comprehensive transaction reviews of their clients in a timely manner, including current account monitoring. Financial analysis of possible suspicious transactions is performed with special care at the recommendation of account officers. HSBC clients receive no special monitoring coverage. The organization provides accounts of individuals and organizations that are considered high risk by external due diligence organizations and simply not perceived by others. Yet, there are no special efforts to monitor activities or perform special reviews of these files. Enhanced transaction monitoring, especially for high risk clients and unusual activities, would have to be initiated in the effort. Quite likely, the increased monitoring activities would require additional staff.
GROUP INTERNAL AUDIT DUE DILIGENCE REVIEW - PROJECT HIGH NOON JULY 2006

- Internal and external audit recommendations, and issues raised in regulatory reports do not receive proper respect and action. Many replies to exceptions and recommendations are merely perfunctory, and expected improvements are often slow in forthcoming. As stress management has not progressed at all to issues and recommendations cited in internal audit reports. For example, we identified no change where GFC or another department performed any follow-up reviews to the matter cited by the FRBNY examiners. Business lines and support areas would have to dedicate efforts to address and resolve audit and regulatory issues and recommendations.
- The shortfalls with monitoring account opening procedures, client transactions, internal operations, and the lack of follow up in exceptions and recommendations cited in audits and regulatory reports present the potential to have another employee or group of employees become involved in another money laundering operation.
- Measures to promote and ensure staff discipline are not sufficiently. GFC’s Code of Conduct lacks focus, detail and scope. It is unclear to prevent conduct with employee personal investment activities. Appropriate staffing policies would have to be implemented immediately as part of the overall effort to install a dedicated Compliance and Internal Control officer throughout the organization.
To: Carolyn; O\n\nSubject: [Redacted]

Could I leave this to pass to Paul, a secure backup, please? Regards, (Signed)

By Dallot W 

From: Matthew \n
By: Liz A Tester

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HSBC OCC 8879394
Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A.  HSBC OCC 8873855
Attached please find a report on my visit to Bilal, a report which Sandy Fleshner has already seen.

There is very little of what we would call a Compliance Function. Also, I have not met personally with anyone of the sensitivities involved. I did not encounter anybody at Bilal who I thought immediately capable of building a Compliance department. However, I met with Ramon Garcia Gibson, Director of Anti-Money Laundering at Interbank (Citigroup), and I agree with Matthew and Robin Wright that he would be a good candidate to head Compliance in Mexico.

Kind regards,

John Root

---

e-Documents Note

This is an image of an email that has been filed in e-Documents.

Any attachments are not accessible from within this image, they can be accessed by navigating to the Document Profile using a browser.
Prior to 1998, an identification was needed to open an account. One HSBC Mexico manager reports, "In Mexico, a client didn't have his ID for a whole day, and his company sends him something every day."

As more than one bank manager noted, there is a lack of "normal culture" at HSBC.

Press

A number of banks are currently working together on drafting a comprehensive anti-money laundering law, which would be useful for the Compliance Clerk.

Another: the Chief Legal Counsel participates in the working group and delivers a copy of the recommendations to the Compliance Chief. Request date to be determined.

There is no low-esteem "public interest" basis (like the regulation of other groundswell, or for privacy issues) in other areas. However, last search for HSBC Mexico reported that HSBC under a US$ 1.3 billion settlement was shown as a preferential tax.

Compliance Relations

One of Grupo Bimbo's chief regulators, Mr. Carlos Puenzo (now an Assistant Director General at HSBC Mexico), was obviously critical of Grupo Bimbo, which he termed a "bad client", which is consistent with the banks' corporate culture. He reported: "...to the best of my knowledge, there is no compliance officer who is in charge of an office, even though there is a compliance officer in charge of compliance."

He reported that the Compliance Officer was "police-like" and "in charge of the contemplated policies", and that the Compliance Officer has "no control over the rules and regulations and "the same thing is always happening."

On the other hand, Mr. Puenzo reserved some of his harshest criticisms for Grupo Bimbo's Legal Department, which he described as "a pile of bad people with a bad culture."

He accused the bank of not taking care of the proper documents. He cited several examples of this and how "the same thing is always happening.

...it's an uncontrolled cell. One case in particular he mentioned was..."
Provocative through the well-known lawsuit of the Grupo Atlantico class action lawsuit answers, a case of small and middle-class憟i.

The former head of the Legal Department told Mr. Provenza that a judge had just tossed out a companion claim - a part of the department's task force that was targeted for bankruptcy claims - and that the department had decided to settle for a "best case scenario." He added, "Our position was that, if we wanted to avoid all that, we had to come to a settlement." Mr. Provenza, asked about the meaning of the settlement, said, "It's the best we can do."
There are significant liquidity concerns, and the system was designed to handle cash inflows through a system called Ciclo Diario (Daily Closing).

Ciclo Diario contains information, and limited help is required for such purposes.

The system contains several components, including clearing, and is handled in a batch process (i.e., not in real-time).

The system is designed to identify and manage in different ways (i.e., secure, regular, known, known), but it can still allow access.

Senior management’s primary responsibility is to monitor and ensure that funds are appropriately transferred.

The minimum legal requirement for money laundering remains three tiers:

1) the system to identify clients of high-risk transactions
2) reporting requirements regarding deviations of at least USD 10,000 per transaction
3) maintenance records for the same: Where clients experience deviations of at least USD 10,000 per month

A senior manager has some discretion to handle high-risk transactions, but HSBC Mexico monitors and submits transaction information on the information provided.

Client data is developed as an MS report rather than for money-laundering prevention. The client IT team may be involved in creating such a network.

Money laundering is an important consideration in the system.

Minitel 381 suspicious transactions were reported to the authorities during 2001 USD 17.5 million (USD 17.5 million). YTD: 2002 USD 6 million (USD 6 million).

A committee chaired by the Director General de Operaciones and known as the Supervisory Massachusetts (Department of Support) is a component of the board. Legal, Operational, Financial, and Technical, among others. The Committee oversees the integrity of the system.

The Capex committee also monitors the implementation of the internal control regulations at CRIV (Vice President, CRIV, Director Nacional Gobernación de Víctimas, an expert). A panel (panel) represents the technical regulations of the organization. The more risks identified by the member are operational, liquidity, credit, and money laundering.

There is a graphical Capex committee chart, which reports to the internal supervisors Capex. It is the Capex of the internal supervisors, which determines suspicious transactions will be reviewed as the regulations (Guidelines and CRIV).
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HSBC OCC 8877805
Redacted Material
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HSBC OCC 8877806
item in its budget. Often the bank's association for a service will be bilateral, perhaps through a
special deal as a framework for opportunities to market products to non-employees in a captive market. User actions such as "Logs", "Complainant Information", and "Ask Human"

Private Banking
Municipal law does not permit the establishment of Gold trusts abroad, although there are no restrictions on or for such trusts.

Author: Firm Legal to develop general guidelines on when, and if, to examine in Private Banking. Target date: 1/1/2012

Author: Legal's head of Compliance, when designated, to examine all existing Private Banking with particular attention to USD accounts and potential in New York and the Cayman Islands.

Role
The role area has experienced many difficulties. Proper documentation is often lacking. Proper accounting for tax purposes is a problem, which foreign owners may only require in the local branch and sometimes through a trust.

The area should engage with the account colleagues of our IT systems.

Labour Unions
The main client union is the Federacion de Sindicatos Bancarios, to which US-based employees belong, "Mainly reform".

Labour relations are considered good. Some issues require special attention. First, the medical benefit coverage, which demonstrates - sometimes violently - the climate with management. Second, benefits have been kept open for the purpose of the country's current difficulties. Third, management and staff share the same interests to accept significant job losses. At the time of this report, the Staff was exploring an employee alternative.

CCT
One major concern is "to lose all in CCT transfers". This is context because CCT's limited membership with Latin American countries over the past years and, as far as Group is aware, CCT never had such initiatives in the past years.

Author: Firm's head of Compliance, when appointed, to investigate all CCT-related businesses. Target date: 1/1/2012

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1. RESUMEN EJECUTIVO

1.1. Antecedentes

El objetivo de este informe es el detallar las observaciones detectadas en la revisión de Lavado de Dinero realizada a HSMA.

En México las Instituciones de Crédito están obligadas a dar cumplimiento a las disposiciones de la Secretaría de Hacienda y Crédito Público (SHCP) para prevenir, detectar y reportar operaciones con recursos de procedencia ilícita, establecidas principalmente en el artículo 155 de la Ley de Instituciones de Crédito (LIC), desde se detalla:

- Operaciones relevantes, que se realicen en cualquier instrumento monetario por un monto igual o superior a USD 10,000.
- Operaciones similares, transacciones realizadas por personas físicas o morales, que no sean consistentes con la actividad o giro comercial del cliente, por su aporte, frecuencia hipótesis.

Dentro de la Dirección Ejecutiva de Compliance se encabeza la Dirección de Prevención de Lavado de Dinero a cargo de Carlos Rocha Alvarez desde hace 1 año, teniendo dentro de sus principales funciones:

- Apoyar y apoyo al grupo para el cumplimiento de las de la normatividad anti-lavado de dinero.
- Controlar cambio en prácticas y productos asegurando los controles de prevención de lavado de dinero.
- Controlar el cumplimiento de los procedimientos y controles de prevención de lavado de dinero.
- Apoyo en la capacitación en materia de lavado de dinero en el grupo.
- Proporcionar al personal del Grupo los medios y mecanismos para el reporte de las operaciones relevantes o relacionadas.

El área se encuentra integrada por 1 director, 2 subdirectores, 5 gerentes y 5 analistas.

1.2. Objetivos de Auditoría

Evaluar que los mecanismos utilizados para el monitoreo y dirección de operaciones relevantes o anormales sean suficientes para proteger la buena reputación de HSMA.

Evaluar el control interno de la Dirección de Prevención de Lavado de Dinero verificando:

- Estructura.
- Análisis de procesos.
- Manuales de políticas y procedimientos.
Evaluar que los mecanismos de reporte de operaciones a las autoridades sean oportunos y suficientes para cumplir con las reglaciones establecidas.

Identificar procederes de riesgo y verificar que estas sean manejadas adecuadamente.

Verificar que el grupo cumpla con las leyes y circulares establecidas para la prevención de lavado de dinero.

1.3 Alcance de Auditoría

La auditoría se realizó al Grupo HSBC incluyendo HSBA y filiales, y consistió en:

- Se verificó la estructura del área a través de organigrama y descripción de puestos
- Se realizaron entrevistas con el personal del área identificando sus funciones, mismas que fueron analizadas y evaluadas.
- Se revisó el sistema MONITOR utilizado para el monitoreo de operaciones relevantes.
- Se revisaron 17 expedientes de casos reportados por banca

Se evalúan los procesos de:
- Reporte de operaciones a las autoridades.
- Análisis de operaciones incriminatorias reportadas por las autoridades.
- Monitoreo de operaciones.
- Operaciones reiterativas.
- Acción de oficio de la CNBV.

Se verificó el cumplimiento de las principales leyes y circulares aplicables.

Se analizaron los procesos de control para prevenir operaciones de lavado de dinero en las filiales: Casa de Bolsa, Seguros y Fianzas.

A través de entrevistas se identificaron los procesos en los que se identificó se tiene mayor riesgo de ocultación de operaciones de lavado de dinero y se evaluó en ellos los mecanismos de monitoreo, en las siguientes áreas o filiales:

- Eficientes
- Criterios
- Ordenamiento Pasivos (Remesas, Cobranzas Internas, Ordenes de pago, Inversiones, Liquidaciones Mínimamente y Atracciones)
- Bórrega por Insumo
- Compra-Venta
- Cuentas Giro Caja
- Casa de Bolsa HSBC
- HSBC Fianzas

HSBC GAO 240026 Página 3 de 1 MAYO 2009

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HSBC Seguros
HSBC Pensiones
Aseguradora Atlántico
HSBC Vida

Se identificaron indicadores de los productos con riesgo de lavado de dinero.
Se dieron seguimiento a las observaciones emitidas por las autoridades en el último año.

1.4 Conclusiones

HSBX has insufficient controls to detect money laundering transactions in all areas of the Group in a timely manner. The implementation of the CAMP system is in progress yet it only includes the Bank’s transactions that have been registered in the ruban system and fails to monitor those registered in other IT systems / HSBC subsidiaries.

Dirección de Prevención de Lavado de Dinero [Direction of Money Laundering Detection] has identified high-risk areas of money laundering transactions, which are not being monitored.

The communication between LCOs and Compliance does not enable the timely detection of the needs and weaknesses of the areas and subsidiaries.

There are inadequate internal controls over the IT systems used to send information to the regulator on suspicious or relevant transactions to authorities.

In our opinion, based upon the foregoing, the Direction of Money Laundering Detection is operating with a BELOW STANDARD level of Control Risk.

Our principle conclusions are as follows:

INTERNAL CONTROL

The principle weaknesses identified in the administration of personnel include the inadequate segregation of duties and the departmental structure is too heavy (1 director, 2 sub-directors, 7 managers and 7 analysts).

The internal manual and regulatory circulars are not updated on a timely basis.

There is inadequate handling and safeguard of relevant and suspicious transactions. The Sub-director and the personnel reporting to him share the password that is used to access the SITI system and send information to the authorities. The restricted area used to store records of suspicious transactions is not always kept safe.

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RELEVANT/SUSPICIOUS TRANSACTION MONITORING

HBXX monitoring tools in place do not ensure that all relevant/suspicious transactions are reported, since only the transactions reported in forms are monitored, this is not the case for transactions entered through the Bank's other IT systems. The information relating to subsidiaries is not validated before it is sent to the authorities. The information that was incorrectly included by the system has not been manually observed before it is sent to the authorities.

There is a high risk of exposure in the detection of suspicious transactions, for they are directed only through banking forms. The internal controls for money laundering detection do not include Group areas or subsidiaries. The measures used in the MONITOR system which is the only suspicious transaction indicator, has not received attention for the last 3 years and the information contained therein has not been used for money-laundering detection.

Added Value Recommendations:

- Although there is a project to implement the CAMPS system in HBXX it is also necessary to develop systems to monitor transactions in other businesses of the HBXX group using indicators and trends in high-risk products and areas and raising alerts in order to take immediate actions.

1.5. Requerimientos Principales

Requerimientos Humanos:

- Vigilar que las funciones inherentes a la administración y control estén de acuerdo con lo establecido por la ley y que el personal se cumpla con el perfil necesario a disposición de recursos humanos (3.1.1).

- Establecer una adecuada segregación de funciones.

- Asignar y dirigir

- Incorporar en el manual de procedimientos de manejo de dinero procedimientos para la prestación de clientes de alta riesgo, perfiles de transacciones de clientes y visitas domiciliarias (3.1.2)

- Sistema Monitor

- La administración del sistema debe entregar a la dirección de prevención de lavado de dinero.

- Establecer un registro de usuarios que consulten la información del sistema.

- Establecer medidas que permitan identificar todas las operaciones relevantes.

- Aun cuando no sea el propósito de implementar el sistema institucional CAMPS es

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precisamos establecer medidas que permitan monitorear las operaciones adecuadamente en lo que se refiere el empréstito (3.2.1.)

**Operaciones Relevantes**

Debemos establecer sistemas que permitan reportar todas las operaciones relevantes del grupo

Realizar un análisis del Sistema de transacciones de hoteles verificando que todas las transacciones efectuadas estén incluidas en el reporte de operaciones relevantes.

Es importante que antes de que se reporten las operaciones relevantes de las empresas filiales se verifique la información (3.2.2.)

**Operaciones Insuficientes**

Establecer las medidas correctivas para evitar la utilización de la red del Grupo con el objeto de lavar dinero (CSM 1.7), cuales deben de considerarse todas las filiales y procesos

Establecer junto con el área de operaciones mecanismos que permitan capturar y monitorear las usurpaciones y blancos de las caídas de seguridad (3.2.4.)

**Nuevas Disposiciones en materia de lavado de dinero**

Establecer planes formales y fechas compromisos para dar cumplimiento a cada una de las disposiciones mencionadas en las Disposiciones (3.4.1.)
From: Marion ROACH
Sent: Fri Jan 21 18:08:02 2005
To: Stephen K GREEN
Cc: Richard E BENNETT
Subject: COMPLIANCE EXCEPTION
Importance: Normal

There are two matters which I should briefly draw to your attention given their seriousness and potential reputational implications. These are:

We have received a serious disclosure via the Group Disclosure Line where 3 members of the Compliance function within HSBA have alleged that senior persons within the Compliance function fabricated records of certain mandatory anti-money laundering meetings and provided these to the local regulator, CBV. It is alleged that, when asked for copies of evidence that the meetings had occurred as required by local regulation the relevant Compliance Officers realised that the meetings had not taken place, and fabricated attendance sheets purporting to be signed by relevant attendees for at least 4 meetings. After discussions with Sandy Flockhart it has been agreed that Graham Thomson, Head of Audit in HSBA will investigate the allegations in association with GHQ CMP (given the need to demonstrate that the Disclosure Line and procedures are being followed) and a report will be provided in due course. It is too early to reach any conclusions with regard to the allegations or the possible outcome of the investigations. HSBA are aware of the need to protect the identity and positions of those lodging the allegations.

As you are aware HSBA operates a Banknotes business through a variety of branches, including a branch in SGK. It appears that a December 2004 SGK branch transaction was not supported by the physical purchase of US Dollars in the amount of USD 6m from the banknotes. The transaction was slightly unusual in that whilst we had a selling relationship with a bank and had purchased notes from them, when further explanations were sought we were advised that the bank had mistakenly issued notes that another bank had sold to us. The individual currently subject to OFAC regulations underlying any non-compliance by the US bank was acting as a correspondent bank counterparty. The individual relationship manager acted without knowledge of the branch manager, and the nature of the transaction, and the parties involved was identified as a consequence of routine compliance monitoring in January 2005.

There appears little doubt that the transaction is a breach of the relevant OFAC sanction on this part of the world, and that it will need to be reported to OFAC and as a consequence there is a significant risk of financial penalty. It does not appear that there is a systemic issue, rather we are dealing with an individual incident, although given the potential seriousness of the breach external legal advisors have been instructed to assist with the process of resolving matters with OFAC.

I will of course ensure that appropriate results are included within GMB and GAC papers, although with regard to the first of the above two incidents I think it would be appropriate to await the outcome of the investigation before including details of the ongoing investigations so far as GMB is concerned. I will report in full to GAC in relation to both incidents at the February GAC meeting.

David Bagley
From: Mark C ROACH  
Date: Thu 10 Feb 16 11:56:55 2005  
To: Stephen K GREEN  
Cc: PAT BENNETT  

Subject: COMPLIANCE LINE - HSBC CMP  
Importance: Normal  

Section  

I refer to my note of 21JAN05 where I gave initial notification of the serious allegations received via the Disclosure Line. The disclosure made by three members of the Compliance function allege that senior personnel within the Compliance function fabricated records of certain mandatory anti-money laundering meetings and provided these false records to the local regulator CNBV.  

It was agreed with Sandy Fiorik that these allegations were the subject of a joint investigation by the local audit function in association with GHQ CMP.  

The final report has been received which confirmed the following-  

The relevant mandatory monthly meetings had not been held between July and December.  

Attendance sheets and minutes were fabricated to disguise the fact that the meetings had not taken place. False records were produced in response to a request from CNBV (received during an initial scoping exercise for some of the relevant minutes and attendance sheets).  

Two junior employees admitted involvement and knowledge of this fabrication while acting under instructions from Carlos Rosete (CR) the then Head of Money Laundering Detection within HSBC.  

CR admitted giving the relevant instructions and to being solely responsible for the fabrication. To His Credit CR was entirely open and candid in responding to questions and immediately tendered his resignation. He was excused.  

Ramon Garcia (RG) the Head of HSBC CMP was unaware of the fabrication, but was found to be culpable given that he had failed to ensure that the relevant meetings had taken place, particularly as he had been designated chairman of the relevant committee. RG has been given a final written warning, and will not receive any bonus or salary increase for the year ending 2004.  

CNBV have been advised and is not expected that any action will be taken. It has been agreed that I shall address this in a low key manner y ...

RG can, and will, return to his usual role.  

Mr Roche has also been advised and indeed supported RG on an informal basis in the recent past. We discussed what we can do from GHQ CMP is assist in this regard. Overall RG has performed creditably, has worked very hard, and would otherwise be hard to replace. The situation which we will need to keep his position under review at this stage to ensure the decision to retain the senior given that his failure is limited to one of failing to ensure a key meeting was held and not preparing a record to that effect.  

I will provide an appropriate report to GAC at the next meeting.  

David Bagley
From: John F ROOT  
Sent: Fri Dec 02 15:53:15 2005  
To: David W J BAIGLEY  
Cc: Marten O ROACH  
Subject: Re; OFAC  

David  

Taking your queries in order:  

Transactions of government missions in the United States are exempt from the US regulations (commonly referred to as the "OFAC sanctions") provided that they are related to the import or export of goods and services which "are for the official business of the mission", or for the "personal use of personnel admitted to the United States under a special immigration section" and the transactions are "not otherwise prohibited by law". (31 CFR 580.512) There is no definition in the statute as to what constitutes "official business" of a mission or "personal use".

Ramon told me that only two embassies - out of all the embassies their do business with - have USD accounts in the Cayman Islands. They are HSBC. I did not volunteer an explanation, but perhaps he didn't think that was necessary. He seemed somewhat constrained so I did not press him further.

The challenge is to determine whether a transaction is for "official business". There have been a number of media reports in various newspapers of HSBC financing Islamic charitable organisations raising their diplomatic status for alleged funding of alleged terrorist activities - in particular through their "Islamic interest" accounts. Their defence is that the funding is for legitimate charitable activities. The funding of mosques. Some Western authorities raise more sinister purposes, e.g. the financing of terrorist Hizbollah activities in the case of at the very least. Groups funding being caught in the midst of a highly visible and passionate polemic, a polemic which sadly has already caused a lot of bloodshed and pain.

I hope the above helps. I would be glad to discuss further with you at your convenience.

Kind regards,

John Root

David W J BAIGLEY/HSBC

Redacted Material  
Confidential - FOIA Treatment Reqd  

EXHIBIT #13  

A. HSBC OCC 8876612
As you may recall HSBC maintained accounts for the redacted material in their Cayman branch. It looks like I will be participating in a conference call involving HSBC, Jeremy Barton and myself early next. I suspect, although do not know, that the conversation will include some debate as to whether these accounts can be maintained; with presumably Jeremy Barton putting the case for retention based on relationships with HSBC. Whilst I understand this, in advance of the conversation I would like to be armed with the following information if at all possible: are transactions redacted material exempt under OFAC - or do we in the same way as any other set of transactions without an OFAC to determine whether each individual payment is exempt, including judging for U.S. tax exemptions.

Without troubling Ramon further, are we aware of any particular reason why redacted material is not exempt, for example do they have a diplomatic presence there?

Unless I am missing something the maintenance of a USD account for redacted material is an obvious challenge for us - am I missing something?

Regards

David Bagley
From: Graham THOMSON
To: David WU RASCURY
Subject: Fwd: Attachment(s)

Importance: Normal


Graham Thomson
Head of Group Audit Latin America & Mexico
Tel (52) 55 5721 6238

--- Forwarded by Graham THOMSON/H8MIXHSBC on 22/03/2007 10:14 a.m. ---

Paul A THURSTON/H8MIXHSBC 22/03/2007 08:32 p.m.
To Graham THOMSON/H8MIXHSBC
cc

Graham,

As promised.

Regards
Paul

--- Forwarded by Paul A THURSTON/H8MIXHSBC on 22/03/2007 07:44 p.m. ---

Leopoldo R BARROSO/H8MIXHSBC 22/03/2007 10:15 a.m.
To Andrew PROSSER/H8MIXHSBC, Rafael, Arana Gallego/H8MIXHSBC, Sandy Flockhart/H8MIXHSBC
cc Graham THOMSON/H8MIXHSBC, Rafael, Arana Gallego/H8MIXHSBC

Paul,

I am enclosing a draft of the aforementioned report in a document file, however, none of the events disclosed or executive pay rates have been quoted or included in this email, thus a hard copy of the complete version with all necessary Annexes will be sent to your office, early tomorrow (11:00 AM).
I would like to have the opportunity to address some of your questions, which are partially responded throughout the document.

The customer was not referred from other part of the Group, since the account was opened during the period HSBC actually acquired the Group.

The Money Laundering due diligence reporting history is well documented in the report. This was a Corporate entity, and we wish it should have been handled by other business segments in our opinion. This section has been discussed in the MLD Committee, not only concerning this case, but other than has been brought to the attention of said Committee, but it was decided not to be addressed, since the status of the Committee limits its capacity to exercise a judgement of comments that are segmented in separate, though, have been raised that the nature, and AML enforcement rules might be biased by having contacts recorded and managed by the reporting entity.

The search across the group has been subjected to several requests from the committee, and individuals, directly associated with the case. As for the other members, the could be associated as third parties, or existing parties of certain are 

The search across the group has been initially requested with the committees, and individuals, directly associated with the case. As for the other entities that could be associated as beneficiaries, or issuing parties of certain are pending response from the operating areas in order to be identified, since this information is not available in our main operating platform, the search would be completed tomorrow, and the search results would be also updated.

I should request any explanation of the enclosed report, please call me at your earliest convenience.

Kind Regards

Leopolda.

Paul A THURSTON@HSBC

Leopolda.

Paul A THURSTON@HSBC 10/30/07

To: Leopolda R BARROS01@HSBC

cc: Sandy Flockhart, David Leighton, Rafael Arana, Garcia@hsbc.com, Rupert HAMCOGHSBCHSBC, Andrew thompson@hsbc.com, Garcia@hsbc.com

Subject: Report

Leopolda.

David has forwarded your note to me this morning. This is a very serious, and high profile, case which has potential reputational damage to the HSBC Group, and must be given the highest priority.

Redacted Material
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By now, I would hope that you will have completed your analysis of the case and I would ask that you let me have a report by the end of the day. I would like to know, inter alia, how this account was opened (was it a referral from another part of the Group or a local account opening?), the activity on the account, the money-laundering reporting history (including the names of the people in PFS who claimed to have denied knowledge of the customer and claimed to make a report), and the current status of contact with the authorities on this case. As this is a corporate entity, I am surprised that PFS management appear to be managing the relationship, and perhaps you could also clarify this.

I trust that we have already initiated a trawl across the Group for any other accounts held by the company, the connected individuals, and associated companies and/or individuals (including those who have sent remittances to, or received them from, the account), and would like to know what we have found from this, thus far.

I would presume that SSE would be helping in this investigation, and hence I am also copying Andrew Prosser.

Please get back to me on this by the end of the day.

Thanks

Paul

Forwarded by Paul A THURSTON@HSBC.m 2/5/2007 11:02 a.m.

Leopolda R BARROS@HSBC 10:50 AM 10:50 AM

to

david.leighner@hsbc.com

to

naren.gatarib@hsbc.com

Scc:

Redacted Material
Confidential - FOIA Treatment Requested by HSBC Bank, USA. N.A. HSBC OCC 8874317
From: Susan A WRIGHT
Sent: Mon Mar 26 17:33:31 2007
To: Graham THOMSON
Cc: David W J BAGLEY; John F ROOT; Warren G LEAMING
Subject: Fw: Travellers Cheques

Cashed,

Further to my note last week I have in fact located the note from Ramon in

Regrets Susan Wright

--- Forwarded by Susan A WRIGHT to HSBC on 26/03/2007 17:27 ---

Ramon GARCIA/01500/HSBC

[Redacted]

To

John F ROOT/01500/HSBC
Carlos ROCHE/01500/HSBC
David W J BAGLEY/01500/HSBC
Susan A WRIGHT/01500/HSBC

Subject

Re: Travellers Cheques

[Redacted]

John,

Please find attached a preliminary note on traveller cheques.

More information is being compiled and will be delivered soon.

By the way, you might find interesting a recent case involving traveller cheques, whose report is also attached.

Regrets,

Ramon

Redacted Material

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John F ROOT
08/11/2004 02:47 A.M.
To: Ramon GARCIA@HSBC.HSBC, Carlos ROCHI@HSBC.
cc: David W J BAGLEY@HSBC, Susan A WRIGHT@HSBC
Subject: Travellers Cheques

Ramon and Carlos,

I note that in the year through Q3 11, HSBC has sold over USD 110 million of travellers cheques, an amount that eclipses that of HSBU here in the UK, and that is several orders of magnitude higher than any other single UK entity, including Hong Kong and the US. In fact, it represents one-third of the Group's total global cheques business (with the UK representing another third).

Could you kindly prepare a report for GHQ summarising the money laundering procedures currently in place for such a booming business. Please include in this report KYC controls, number of SARs in the YTD, breakdown by region and branch, etc., etc.

Thank you.

Kind regards,

John Root

<<>> <<>> <<>>
From: Andy Foc;h.k.hart
To: Graham THOMSON; Paul A THURSTON; Sergey PINA
Cc: Uz,11,11,TESTER; Paul A THURSTON, SelYu PINA
Subject: Group Audit Committee - Foreign Importance: Normal
Attachments: Doc link hlm

Hello,

I believe you need to share some light and shade in the way taken to express the appropriate improvements. In the context of the subcommittee of
Permanent Subcommittee on Investigations, I know the issue has been elevated in the current budget. I believe the information that you collect under the
principal issue is the updating of HSBC and the growing need for balancing the
importance that the HSBC principal trade deficit of sector names and lower
the suggested level of the cost of food and that the current situation is very
different from the one we are facing today about how to compare your
views. As the regulatory time we have stopped fighting those relatively
for a nation, but it is becoming very clear how the discussion underway today
about current funds.

This type of reply is should be brought in the Audit Committee, because
I Pezi your appreciation if you could consider such an approach as it will help
members understand the new environment.

Regards,

Andy

--- Original Message ---
From: Graham THOMSON
To: Andy Foc;h.k.hart
Cc: Uz,11,11,TESTER; Paul A THURSTON, Sergey PINA
Subject: Group Audit Committee - Foreign
Attachments: Doc link hlm

Hello,

The importance of the benefits in non-pass is the following:

A.N.Y. as it looks to business and continuous debt reports.

The lack of adequate documentation and filing systems which range from the
former British days, created some challenges in the legal areas in Britain and
the outstanding Trust cases, where we continue to be at risk.

Each of a compliance officer, working in the non-transparent way for the
number of years/decades and its due to widespread non transparency to

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Exhibit #16

Permanent Subcommittee on Investigations

HSBC OCC 8874328
The fraud in the Credit Card Industry is being addressed in many ways. A working group is being established to improve the reporting, tracking, and analysis of fraud, and to make recommendations. Under the leadership of GAO, a series of workshops and conferences will be held to gather information and to develop recommendations for reducing fraud and ultimately expanding the industry's capabilities to track and analyze fraud.

The working group will be chaired by Paul Thomas. He will also provide the report to the next HPSOM, audit committee.

Thomas
Head of Credit Audit
HSBC

Subject:
[GRADUATE COMMITTEE: APR07]

Why I should have a response to the attached today so I need to finalize my GCM project this week.

Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A.  HSBC OCC 8874329
Regards,
Matthew King

Matthew J.KING@USA.HSBC.COM
HSBC BANK USA N.A.
300 Hegeman Avenue
Brooklyn, NY 11206
Phone: 718-592-1530
Fax: 718-532-3228

To:
Graham THOMSON@HSBC.COM

Subject:
Re: GROUP AUDIT COMMITTEE - APRIL

Graham,

Thanks,

Could you report to the main strategic weaknesses in HEMX which you believe
remain outstanding? I appreciate since our last meeting, but
assumably want these later withdrawn. When do you expect me the timing of
the rights issue of increasing issues and costs and timing?

Regards,
Matthew King

<< >>
From: Graham THOMSON
Sent: Fri Apr 20 2019 20:43:26
To: Matthew JW KING
Cc: David WJ BAGLEY; Liz. A TESTER; Sandy Rockhart; PaulA THURSTON; Rafael.Arana.Garza@hsbc.com.mx@HSBC; Ramon.GA.RCA@hsbc.com.rroc@HsBC; philip.GRECKI@hsbc.com.m)(@HSBC; Nick GILMOUR; Jose Manuel DomInguez
Subject: Re; Managerial Letter

I refer to our attached email, which was considered at yesterday's meeting of the [redacted] committee, chaired by Paul Thurston.

This meeting, the third chaired by Paul about a year ago involving the senior partners, was attended by Matthew and John, for separate reasons to be completed by CNF, PFS, PF and GAQ.

The meeting considered the recommendations made by GAQ's report and received a verbal report from PIF (written interim report received post-meeting) on the results of its investigations to date into branch staff involved with the account. The investigations are still continuing.

Paul's summary of the meeting and its action points are detailed in the attached email. Other points are as follows:

1. Matthew acknowledged the difficulty in accurately completing KYC checks where customers deliberately tried to conceal the real names of their business activities, as several had.
2. The meeting expressed reservations over the practicality of the new KYC requirements recently introduced by CNF which required customers to project their transactional activity to allow individual beneficiaries to be set that could be used to compare with actual activity.
3. PFS's investigation, which was continuing, clarified that Alvaro Rocha had based his recommendation on the AME, received in August, but in some cases, the information received was incorrect, and the AME, information in August statement to him by staff, was not clear. YC further confirmed that none of the KYC visits probably did not notice, that some of the staff involved had trained conduct of conduct requirements by making it easier and more difficult keep in touch with their investigations. They suggest that any activity beneficially directed from the investigations.
4. Indicated that the branch staff involved in completing some tasks reports should be dismissed. Any further disciplinary action should await the findings of the completed PIF investigation.
5. RamonGarza confirmed that other tasks...
A follow up meeting will be held to monitor progress in implementing the action points.

With regard to your offer to send some colleagues to review the AML alert process, the following is planned:

a. CEO HBMX will review the need for any additional support from GHQ with Group Compliance, once the immediate action steps have been completed, and
b. GAQ has scheduled an audit for 3Q07 of this department as part of its 2007 annual plan. A focus of this audit will be on the re-engineered AML and CCC processes which will be implemented as a result of the above meeting. We shall also be strengthening our continuous and branch auditing focus on KYC, although as you will recollect these weaknesses have been a repetitive theme of my comments to HBMX audit committee meetings.

Please let me know if you require any clarification on the foregoing, pending which summary comments will be discussed at LAM RAC, given that the case was discussed at yesterday’s MAC meeting.

Graham Thomson
Head of Group Audit Latin America & the Caribbean
Tel: (1) 55 3751 4224

Forwarded by Graham THOMSON/HSBC to 20/04/2007 08:46 a.m. --

Paul A BURTON/HSBC to 19/04/2007 09:03 a.m.

To: Rafael Araujo Garcia/HSBC, Jose Manuel Dominguez/HSBC, Leopolda R Barroso/HSBC, Nick Gilchrist/HSBC, Philip Grecki/HSBC

From: Graham THOMSON/HSBC

Following our meeting yesterday, I am summarising the key action items that need to be progressed:

- The Audit report recommendations will be implemented as follows:

Redacted Material
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1. The representation at CCC to be reviewed and proposed membership submitted to CNBV for approval. (Garcia)

2. Business Heads must remind their CCC representatives of the importance of understanding and taking an independent view. They must be prepared to challenge their colleagues if they are not satisfied with the responses they receive. (Garcia)

3. The analysis, assessment and reporting procedures need to be revamped. The outcome of meetings should clearly define the decisions taken, and there need to be improved procedures to ensure that open items are always followed up at subsequent meetings. (Garcia)

4. The management processes of the CCC must be strengthened. The outcomes of meetings should identify clearly the decisions taken, and there need to be improved procedures to ensure that open items are always followed up at subsequent meetings. (Garcia)

5. PFS and CNBV relationship managers should be given further training in the correct completion of KYC assessment reports. (Garcia)

6. A review should be undertaken to identify all corporate entities that remain under management by PFS; these should be transferred to CNBV without delay. (Garcia)

7. Branch staff who completed false KYC reports should be dismissed, once the ongoing PIF investigation has been completed. (Garcia)

- The detailed PIF review, which has been undertaken over the last 2 weeks will be completed, and a second interview will be arranged with one executive, and a report prepared, with recommendations for disciplinary action.

- Although the PIF review has not found any evidence of direct linkage between the staff involved and the company (subject to the further interview to be arranged), it has surfaced evidence of breaches of policy. In respect of two-staff team, and documentation signed in blank, the company will prepare a case summary, ensuring our policy and zero-tolerance approach, and PFS/CNBV Heads should personally initiate this through their respective teams.

- The improvement of KYC procedures, account opening and file maintenance, which is currently comprised of a number of individual initiatives, needs to be brought into one coherent programme and given appropriate emphasis. The incoming COO HBMX will be tasked with reviewing these and putting an implementation plan in place.

- The review of other cases which have similar patterns, and all high risk cases, has been completed, and a special CCC meeting will be arranged within

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a week to review these cases. (Garcia/Banoso)

- The review of other pharmaceutical companies which have had money laundering alerts is underway but needs to be completed. (Garcia/Banoso)

- We continue to await the list of other names from the federal authorities which they will require us to check. (Banoso)

- Contact must be maintained with the authorities, with whom we will continue in co-operative spirit to maintain our reputation with them. (Garcia)

I will arrange a further meeting to review progress on the above.

Regards

Paul

Matthew J W KING GMN INA GHQIHSBC
Sent by: Liz A TESTER
To: Graham THOMSON/HBMX/HSBC
cc: David W J BAOLEY/HBMX/HSBC, Sandy Flockhart/HBMX/HSBC
Subject: HSBC

Good morning.

Not a happy story. I note the recommendations will be discussed later today and do not doubt subsequently. My initial reaction is Sellout below. Please advise what action is taken in respect of [redacted]. It appears to have resulted in this customer at AEGIS and then to have failed to fulfil his understandings to the CCC Committee in DEC06. As a normally skilful executive, I would have expected a more contrived approach to his responsibilities than appears from this saga.

The discrepancies in the visit reports obviously raise some questions about whether staff were more closely involved with the customer than they should have been. How is that being addressed?

The fact that staff are producing reports that are unreliable is a serious issue in itself and needs to be examined more in considering the more appropriate disciplinary action.

Redacted Material

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The weakness in the processes within M1D to analyse and monitor CAAPM alerts, and to act as a check and balance on management, is obviously a pressing concern. Is it worth having someone come in to look at processes from bottom to top (including at the OCC) to ensure they are robust?

Finally, are there any other customers where there is a similar but pattern?

Regards,
Matthew King

<<>>
TO: Denise Reilly  
FROM: Judy Stoldt  
Olivia Strazza  
DATE: May 1, 2007  
RE: Wall Street Journal Article Regarding Wachovia

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FOR INTERNAL USE BY HSBC PERSONNEL ONLY

This memorandum summarizes an article in the April 26, 2008 edition of the Wall Street Journal (WSJ) that discussed an investigation into Wachovia’s casas de cambio business. This memorandum also discusses the actions that HSUS has taken with respect to the casas de cambio mentioned in the article as well as other cambios that were not mentioned in the article.

Please note that HSUS does not hold any account for any casa de cambio mentioned in the WSJ article. The only HSUS connection to activity involving those named casas de cambio is activity that was conducted through our correspondent accounts, and most notably through our account with HSBC Bank Mexico (HBMX).

Wall Street Journal Article Summary of Article:

• Federal prosecutors are investigating Wachovia as part of a probe of alleged laundering of drug proceeds by Mexican and Colombian money-transfer companies. Wachovia is allegedly one of “several large US banks” that have come under scrutiny for relationships with such companies. (The other “large US banks” were not named by the WSJ.) Wachovia built ties to casas de cambio in order to tap the Hispanic market. Wachovia held deposits for the foreign-exchange houses and provided back-office services to those entities. Wachovia is cooperating with investigators and, in December and January, severed relationships with Mexican foreign-exchange firms.

• Four casas de cambio were mentioned in the Journal article—two that are associated with Wachovia (Casa de Cambio Puebla and Majorpa Casa de Cambio) and two that were mentioned in a sidebar (Sigue Corp. and Made Casa de Cambio. Sigue was fined by the Justice Department and Ribadeo laundered funds indirectly via Union Bank of California. The allegations involving Union Bank and Ribadeo resulted in an enforcement action against Union Bank.)

Permanent Subcommittee on Investigations
EXHIBIT #18a

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These changes are discussed below, along with investigations HBUS performed into these entities (both as a result of the Journal article and prior to the article) and other changes.

2. WSJ List of Casas de Cambios:

- Casa de Cambio Puebla: Per the WSJ, Puebla is a Mexican chain of cambios and is subject to a federal court action in Miami, Florida in which federal agents seized more than $11 million in 23 Wachovia accounts belonging to this entity. Prosecutors allege the money was "being laundered."
- Activity: No accounts are held by HBUS; a former Banknotes account was closed in June 2007; funds involving this entity passed through correspondent accounts held by HBUS. (Reference comments below).
  - On June 15, 2007, HBUS was informed (through HBMX) of a seizure warrant issued by the Southern District of Florida at the request of the Drug Enforcement Administration seeking to freeze $11 million in 23 accounts at Wachovia. All banknote activity at HBUS was terminated in June 2007 as a result of the seizure warrant issued against Wachovia. In October 2007, at the suggestion of the OCC to perform a money service business review, HBUS conducted a review of wire activity over a 12 month period (October 2006 to September 2007) in the dollar range of $2,000 to $25,000. (This review will be referred to as the "October 2007 Review").
  - On November 8, 2007, a news article was published in the Miami Herald that alleged that drug funds were being laundered through Puebla. Upon receipt of the article, HBUS confirmed that it had no account relationship with Puebla.
  - The October 2007 Review revealed that wires involving Puebla had passed through its correspondent accounts. On November 30, 2007, HBUS reporting that approximately 450 wire transactions had cleared through the HBMX correspondent account where Puebla was either the originator or beneficiary of the wire from January 1 through October 31, 2007. On November 16, 2007, HBUS added the name "Casa de Cambio Puebla" to its internal Watch List to ensure that no accounts could be opened for this entity. On January 23, 2008, HBUS added the name "Casa de Cambio Puebla" to its internal wire filter system. The internal wire filter causes all wire transactions that are attempted to be processed through HBUS to be scanned against the names in the "filter." The filter will stop any wire that includes a "filtered" name (in this case "Casa de Cambio Puebla"). An HBUS wire room employee would then reject the payment.
  - HBFX, which held an account for Puebla, "froze" its account after the November news article was published. HBFX provided HBUS with a list of 91 parties presumed to be related to Puebla. Eighty-one (81) parties were HBMX customers, whose accounts were frozen by HBFX. A wire search was performed (for the period January 1 through October 31, 2007) on these 91 names that resulted in 523 potential transactions. After review, 170 wire transactions totaling $7,379,593 were found to have been conducted by 6 individuals or entities whose names exactly matched names on the list of 91. (It is noted that all of these wires originated by individuals and entities from accounts held at Wachovia. A search revealed that none had accounts at HBUS.)
  - In February 2008, HBUS conducted a follow-up analysis of the cambios identified by HBUS in its October 2007 Review that were deemed to require follow-up review. The February 2008 review examined wire transactions between October 2007 and December 2007 in amounts ranging from $5,000 to $25,000, and it was revealed that only 3 transactions were processed through HBUS correspondent accounts.

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· Sigue Corp. – A money service business that allegedly processed $24.7 million in suspicious money
  remittances related to drug-trafficking proceeds. It forfeited $15 million and agreed to spend $9.7 million
  to upgrade its anti-money laundering program as part of a deferred prosecution agreement reached with the
  Department of Justice.
  o Activity: No account relationship is held with this entity; funds involving this entity passed
    through correspondent accounts held at HBUS. (Reference comments below.)
  o On January 12, 2008, HBUS noted a news article that reported Sigue Corp., a California
    money service business (MSB), was entering into a record $25 million settlement with the
    Justice Department for money laundering violations related to the manner in which it
    handled
    remittances to Latin America. The penalty assessed against Sigue set a record for a
    settlement with the Justice Department by a money service business. The allegations focused
    on anti-money laundering deficiencies that permitted arguably suspicious transactions to
    occur primarily between customers in the US in the Dominican Republic and Mexico.
  o Based on the article, HBUS conducted a review of its accounts (which confirmed that no
    relationships were held with Sigue), an independent investigation into Sigue and a review of
    wire transfer activity.
  o The independent investigative search on Sique and its founder (Guillermo de la Vina) was
    conducted to determine whether either were the subject of any other negative news or law
    enforcement activity. That investigation revealed that a Sigue employee was indicted for
    assisting drug traffickers to launder drug proceeds but Sigue itself was not indicted. Sigue
    was mentioned in another article as having allowed $295,000 to be transferred from an
    account at Arvest Bank to an illegal alien in Mexico. (These allegations arose out of an
The wire review revealed 161 transactions for $492.5 million were sent over a 12 month period (January 1 through December 31, 2007). HSUS contacted HBMX (the beneficiary bank) for information about its customer and these wire transactions. HBMX stated that its relationship with Sigue is conducted within certain internal parameters (such as limiting Sigue to conducting transactions for individual customers to $2,000 USD per transaction).

Sigue had, between January 1 and December 31, 2007, sent 159 wire transfers totaling $68,699,916 to its own account at HBMX. Sigue was not added to the wire filter as Sigue entered into a written agreement with the Department of Justice to enhance its AML program and was not (per the investigative search) the subject of any other money laundering investigations.

3. Enforcement Actions Mentioned in WSJ Article:

- As mentioned, the WSJ article's side-bar discussed 3 enforcement actions against financial institutions as follows:
  - Union Bank of California - Alleged to have allowed a casa de cambio to launder drug funds through its accounts
  - American Express International Bank - allegedly failed to report $55 million laundered through accounts owned by drug traffickers
  - Bank Atlantic - Undercover agents found that drug funds were laundered through one branch.

- HSUS originally reviewed these enforcement actions to recover any assets of drug traffickers or casas de cambio, but reviewed them again in light of the WSJ article. No other names could be associated with these enforcement actions (other than Ribadene).
EXCERPT FROM SIGUE CORPORATION DEFERRED PROSECUTION AGREEMENT JANUARY 24, 2008

FACTUAL STATEMENT

1. Sigue Corporation, organized under the laws of Delaware, and its affiliated operating company, Sigue, LLC, organized under the laws of Nevada, are licensed money service businesses headquartered in San Fernando, California (hereinafter jointly referred to as “Sigue”). Sigue’s primary business activity is the transmission of funds from the United States to Mexico and Latin America. Sigue operates by and through a network of more than 7,500 “authorized delegates” throughout the United States. Authorized delegates are typically small “mom and pop” type businesses that have been contracted to offer Sigue’s money transmission services. The authorized delegates and Sigue each earn a small fee for the transactions conducted through the authorized delegates. At the Federal level, Sigue is regulated by the Financial Crimes Enforcement Network (“FinCEN”) and the Internal Revenue Service.

2. The U.S. Department of Justice, Criminal Division, Asset Forfeiture and Money Laundering Section (“AFMLS”), the U.S. Drug Enforcement Administration (“DEA”) and the Internal Revenue Service (“IRS”), have determined that from November 2003 through March 2005, Sigue violated provisions of the Bank Secrecy Act which require financial institutions to maintain anti-money laundering compliance programs. The violations at Sigue were serious and systemic, and allowed tens of millions of dollars of suspicious financial transactions to be conducted through Sigue, including transactions involving funds represented by undercover U.S. law enforcement agents to be drug proceeds.

OPERATION HIGH WIRE

3. From November 24, 2003 through March 30, 2005, Sigue authorized delegates knowingly accepted and transmitted more than $500,000 of money represented by undercover U.S. law enforcement officers to be proceeds of drug trafficking. The money used in the undercover operations was received by and wired through fifty-nine (59) separate Sigue authorized delegates in twenty-two (22) states.

4. During each operation, undercover agents posed as drug traffickers and approached Sigue authorized delegates in the United States and asked for assistance in sending money to one of seven undercover Mexican law enforcement officers located in Mexico City, Mexico. The undercover agents clearly stated to the authorized delegates that the currency they
wanted to send through the delegates was proceeds of drug trafficking and was being sent as payment to the "source of supply." The undercover agents informed the authorized delegates that they did not want law enforcement to learn of the transactions, and that they preferred not to provide any form of identification or address information. When Sigue authorized delegates requested some form of identification from the undercover agents, the agents produced multiple forms of identification cards, all in different names and bearing obviously different likenesses.

The following is a summary of one of the operations, which closely mirrors each of the successful operations:

On January 10, 2005, a DEA Special Agent, acting in an undercover capacity using an assumed identity, entered the targeted Sigue authorized delegate's store and approached a male clerk behind the counter. The Special Agent asked the clerk how much money he could send to the Federal District in Mexico without showing identification. The clerk responded that he thought the Special Agent could send $700 without identification, but he was not sure. The clerk suggested that the Special Agent use the phone to call Sigue corporate headquarters. The Special Agent told the clerk that he did not want the police or government to find out about the transaction because he had made the money selling marijuana. The clerk told the Special Agent not to worry about it. The Special Agent asked if he could give any name when he conducted the transaction. The clerk told him that it only mattered that the person receiving the money knew which name the Special Agent used when he sent the money so that the receiver could pick up the money. The Special Agent asked if the store would tell the government; the clerk again told the Special Agent not to worry about it. The Special Agent conducted the transaction for $900 and then asked the clerk if he could send $10,000 by dividing it into smaller amounts. The clerk told the Special Agent that he could do so at that location, but that he might need to show identification at other locations. The Special Agent asked the clerk if he could send multiple transfers of under $1,000 in one day. The clerk suggested that if the Special Agent used different names, he could send all the money in one day. The Special Agent told the clerk that he might be back, and the Special Agent left the store.

Two days later, the Special Agent returned to the store and told the same clerk that he wanted to send $11,000. The Special Agent asked the clerk if he should do it by sending various transfers of $950 using different names. The clerk agreed and stated that he didn't believe the other clerk in the store would mind. The Special Agent began conducting the transactions for $950 each. After the second transaction, the clerk expressed concern that if the Special Agent was going to keep sending money from one location to the same person in Mexico that the transactions would be questioned. The clerk said he did not want to get in trouble for what he thought might be money laundering. He suggested that the Special Agent send the money to different people using different names.
The Special Agent conducted another transaction for $950. The clerk told the Special Agent that as long as the Sigue corporate operator was allowing the Special Agent to conduct the transactions, the Special Agent could continue to send money. The Special Agent again expressed concern that the clerk might contact the police, but the clerk assured him that he would not. The Special Agent mentioned again that he was in the marijuana business and that he did not want the government to find out. The clerk agreed. The Special Agent conducted five more transactions, sending $950 each to different receivers in Mexico using different sender names. The clerk signed off on all the transactions and faxed the receipts to Sigue corporate headquarters. During the last transaction, the clerk informed the Special Agent that it would have to be the last transaction because further transactions would cause problems. After that transaction, the Special Agent left the store.

5. In total, undercover agents conducted 84 successful transactions at 59 different locations (24 Sigue authorized delegates properly refused to conduct such transactions). At 47 locations, the undercover agents, with the assistance of the authorized delegates, structured the cash transactions by splitting large cash amounts over $10,000 into several smaller amounts to avoid triggering currency transaction reporting thresholds at the Sigue corporate level. In some instances, the undercover agents asked Sigue operators how much money could be sent without providing identification and the undercover agents stated that they did not have certain identifying information such as an address or telephone number. Each of the undercover transactions were recorded and/or videotaped by surveillance.

6. None of the authorized delegates reported the transactions to law enforcement, as required by the Bank Secrecy Act. At the corporate level, Sigue identified and reported the structured transactions that the agents conducted, but failed to detect and report the broader money laundering scheme and take action to prevent the activity from recurring.

**Money Laundering Violations By Sigue And Its Authorized Delegates**

7. The 59 Sigue authorized delegates who knowingly accepted and transmitted the money represented by the undercover law enforcement agents to be drug proceeds could be held individually liable for violations of the money laundering laws of the United States. Title 18, United States Code, Section 1956(a)(3) provides severe penalties (up to 20 years incarceration and a $500,000 fine, or twice the value of the property involved in the transaction, whichever is greater) for whoever, conducts or attempts to conduct a financial transaction involving property
represented to be the proceeds of specified unlawful activity (which includes proceeds of drug
trafficking), with the intent to (i) promote the carrying on of a specified unlawful activity; (ii) to
conceal or disguise the nature, location, source, ownership, or control of property believed to be
the proceeds of specified unlawful activity; or (iii) to avoid a transaction reporting requirement
under State or Federal law.

8. In addition to the authorized delegates, the government maintains that Sigue could
also be held criminally liable for the illegal acts of their authorized delegates. A corporation is
deemed to act through its officers, employees and agents, and their conduct will be imputed to
the corporation so long as the officers, employees and agents were acting within the scope of
their authority and their conduct is beneficial to the corporation. A corporation can be criminally
liable for the conduct of any employee regardless of the employee’s status or position within the
corporation; even the lowest ranking employee may bind the corporation by his acts if they are
committed within the scope of employment. Although a corporation is a legal entity and cannot
be incarcerated, a financial institution convicted of money laundering violations would incur
severe financial penalties and could ultimately lose its licenses to function as a financial
institution.

ANTI-MONEY LAUNDERING COMPLIANCE REQUIREMENTS FOR MSBs

9. Congress enacted the Bank Secrecy Act ("BSA"), 31 U.S.C. § 5311 et seq., and
its implementing regulations to address an increase in criminal money laundering activities
utilizing financial institutions. Among other provisions, the BSA requires financial institutions
to maintain programs designed to detect and report suspicious activity that might be indicative of
money laundering, terrorist financing and other financial crimes, and to maintain certain records
and file reports related thereto that are especially useful in criminal, tax or regulatory
investigations or proceedings. Fundamental laws establishing anti-money laundering obligations
of financial institutions in the United States include the BSA; the Money Laundering Control Act
of 1986 (codified in relevant part at 18 U.S.C. §§ 1956 and 1957); and the USA PATRIOT Act
of 2001, which significantly amended both laws and extended an anti-money laundering program
requirement beyond federally insured deposit institutions to all types of financial institutions.
10. Pursuant to Title 31, United States Code, Section 5318(h)(1) and 12 C.F.R. § 563.177(c), financial institutions are required to establish and maintain an anti-money laundering ("AML") compliance program that, at a minimum: (a) provides internal policies, procedures, and controls designed to guard against money laundering; (b) provides for an individual or individuals to coordinate and monitor day-to-day compliance with the BSA and AML requirements; (c) provides for an ongoing employee training program; and (d) provides for independent testing for compliance.

11. Pursuant to 31 C.F.R. § 103.125(a), money service businesses (MSBs) are required to develop, implement, and maintain an effective anti-money laundering program reasonably designed to prevent the business from being used to facilitate money laundering. The program must be commensurate with the risks posed by the location, size, nature, and volume of the financial services provided by the MSB. Additionally, the program must incorporate policies, procedures, and controls reasonably designed to assure compliance with the BSA and implementing regulations. With respect to MSBs that utilize foreign agents or counter parties, the anti-money laundering program must include risk-based policies, procedures, and controls designed to identify and minimize money laundering risks associated with foreign agents and counter parties that facilitate the flow of funds into and out of the United States. The program must be aimed at preventing the products and services of the business from being used to facilitate money laundering through these relationships and detecting the use of these products and services for money laundering or terrorist financing by the business or its agents.

12. The BSA specifically requires financial institutions to file with the Department of Treasury and, in some cases, appropriate Federal law enforcement agencies, a Suspicious Activity Report ("SAR"), in accordance with the form's instructions, when the type of activity described above is detected. See, 31 U.S.C. § 5318(g), 31 C.F.R. § 103.20. According to the form's instructions, Sigue was required to file a SAR with FinCEN, reporting any transaction conducted or attempted by, at, or through the money transmitter, if it involved or aggregated at least $2,000 in funds, and Sigue knew, suspected, or had reason to suspect that:

(i) The transaction involved funds derived from illegal activities or was intended or conducted in order to hide or disguise funds or assets derived from
illegal activities (including, without limitation, the ownership, nature, source, location, or control of such funds or assets) as part of a plan to violate or evade any federal law or regulation or to avoid any transaction reporting requirement under federal law or regulation.

(ii) The transaction was designed to evade any requirements promulgated under the Bank Secrecy Act.

(iii) The transaction has no business or apparent lawful purpose, and the money service business knows of no reasonable explanation for the transaction after examining the available facts, including the background and possible purpose of the transaction.

AML / BSA COMPLIANCE VIOLATIONS BY SIGUE AND ITS AUTHORIZED DELEGATES

13. Sigue filed SAR's on the obviously structured undercover transactions, an indication that its AML systems are functional in at least one key aspect. At the same time, it failed to adequately investigate the structuring activity further and consequently failed to identify, report and prevent the broader pattern of money laundering and to file supplemental SARs. Sigue took no action to block such transactions from continuing to occur (the undercover operation lasted more than 1 year).

14. The investigation into this matter has determined that the primary cause of Sigue's failure to identify, report and prevent the money laundering activity is that, during the time period of November 2003 through March 2005, Sigue's AML program contained serious and systemic deficiencies in critical areas, including:

(i) Inadequate supervision and control of authorized delegates;
(ii) Failure to effectively monitor and investigate high-risk transactions;
(iii) Failure to establish an effective risk-based AML program;
(iv) Failure to exercise sufficient enhanced due diligence for high-risk transactions and customers;¹

¹ For purposes of this Agreement and Factual Statement, the term "customer" includes any individual who conducts one or more transactions through the MSB as a sender or beneficiary, notwithstanding the lack of an ongoing relationship between the person and the MSB.

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Failure to have an effective, on-going training program for authorized delegates;
Failure to take appropriate action on customers and transactions deemed suspicious; and
Failure to establish an effective independent review process to test the effectiveness of the AML program.

Some of the key AML and BSA deficiencies of law enforcement concerns were as follows:

Inadequate Supervision and Control of Authorized Delegates

15. Sigue assigns each authorized delegate a risk level, either low, medium, or high, depending on their operating location. High-risk areas generally corresponded with each of the areas designated by law enforcement as High Intensity Financial Crimes Areas (HIFCAs).
Based on this classification system, Sigue theoretically would subject the transactions from the high-risk authorized delegates to an enhanced level of scrutiny to determine whether they are suspicious, and would file SARs as appropriate. This investigation found no evidence that Sigue implemented an effective risk-based supervision program for high-risk agents during the time period under review.

16. Sigue conducted only limited independent testing of authorized delegates and was consequently unable to identify widespread and systemic deficiencies in its monitoring and training programs. Between February 24, 2004 and February 26, 2004, Sigue contracted with a private firm to conduct compliance checks, but only at nine separate Sigue authorized delegate locations in California. Even with these, the contract investigator identified himself to the authorized delegate as an investigator acting on behalf of Sigue and asked each individual authorized delegate the same seven questions, as follows:

a. What information are you supposed to collect from a customer who sends a $4,000 wire?
b. What would you do if a customer comes in four times a day and sends $2,500 each time?

c. What would you do if a customer comes in with someone else and you see them splitting up the money so that each of them sends a wire to the same beneficiary?

d. What would you do if a customer who you thought had a low income sends about $5,000?

e. What do you think the risks are if you, the agent, were aware that a customer had money from drug sales and that the same customer was sending the money through you at the agent location?

f. Do you think you have enough training in anti-money laundering?

g. What would you do if a customer placed several wires on the same day under $3,000?

17. Not surprisingly, the authorized delegates who were tested in this manner answered almost all of the questions correctly. Consistently, during the undercover operations, Sigue authorized delegates demonstrated a keen knowledge, not only of Sigue's policies and procedures, but also the money laundering laws of both the United States and Mexico. Yet, law enforcement conducted an historical analysis of the transactions accomplished at those authorized delegate locations and identified widespread and pervasive violations of Sigue's policies and procedures, particularly structuring activities that continued for months, sometimes years. In most of those cases, Sigue filed SARs on the transactions to report the structuring activity, but did not subject those transactions, customers, or authorized delegates to a sufficiently enhanced level of review.

18. Late in 2003, Sigue also began requiring authorized delegates to sign a document, dated November 19, 2003, entitled “Anti-Money Laundering Program,” acknowledging receipt of the “Anti-Money Laundering Guide for Money Transmittal Agents of Sigue Corporation.” The letter explained that it is the responsibility of the authorized delegate to appropriately
train each of its employees involved with the money transmittal business on Anti-Money Laundering laws and compliance efforts. This form was printed in both English and Spanish on the same document. In practice, the undercover agents routinely found copies of the money laundering guidelines, but in an unused condition, frequently still in the original packaging and unopened. Although Sigue had a training program for its authorized delegates, many of the authorized delegates or their employees subsequently interviewed said that they had received no training or materials on anti-money laundering.

Transaction Monitoring Deficiencies

19. At the corporate level, Sigue began implementing in 2001 and 2002 a proprietary automated transaction monitoring program that screened financial transactions for numerous categories of suspicious activities based on pre-identified “red flags.” The monitoring system dramatically improved the company’s ability to identify suspicious transactions and to file SARs with FinCEN. The ultimate failure of the company was less in the design of the monitoring system, but more on the company’s failure to adequately investigate flagged transactions further and its failure to take further action against the suspicious activities identified (such as notifying law enforcement directly or banning individuals from sending or receiving money from Sigue).

20. The company’s reporting on suspicious transactions that it failed to adequately investigate is evidenced by its filing of SARs on almost all of the undercover transactions to report the obvious structuring, while failing to identify and report the broader money laundering activity. To determine whether the company’s failure to identify and report the undercover money laundering activity was an isolated example or whether it was the result of systemic weaknesses within the corporation, investigators analyzed more than $6.07 billion of transactions to determine whether similar cash structuring was prevalent. The result was the identification of more than $47 million of structured transactions (including the undercover sting transactions) that Sigue identified and reported in SARs, but failed to take action to prevent from recurring.

21. To identify the most serious structuring examples, investigators sorted the transactions to select only those cases where one person sent or received more than $50,000 in a

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*In 2001, Sigue filed only 52 SARs, but in 2002 it filed 1,072, and in 2003 it filed 1,663.*
Sigue claims that more than 90 percent of its transactions are from customers who send approximately $300 twice a month to friends and family members in Mexico ($7,200 annually). Accordingly, investigators reasoned that any person sending or receiving more than $50,000 during a 12-month period would fall outside of the norms associated with Sigue’s unique customer base and would be relatively easy for Sigue to detect, identify, report and prevent.

22. The result was the identification of 238 case examples of serious structuring schemes, cumulatively valued at $25.4 million. The least significant of these examples is an individual who transferred, in a 12-month period, $50,640 through 46 transactions, each transaction averaging $1,100. One of the most blatant examples is an individual who transferred, in a 12-month period, $324,091 to 15 different individuals in Mexico, through 370 transactions, each averaging $875, using only two authorized delegate locations. Another individual transferred $224,232 in 80 separate transactions on a 10-month period, with each transaction just under Sigue’s reporting threshold of $3,000. Within these case examples, there were occasional instances of structuring, which Sigue adequately reported, but Sigue failed to identify and report the broader money laundering schemes undertaken by these individuals.

Failure to Establish a Risk-Based AML Program

23. Sigue’s primary business activity and operating location presents a high-risk of money laundering. Yet no financial institution of substantial size can possibly monitor every single transaction and customer, particularly, in Sigue’s case, where the transactions and customers originate from authorized delegates who are far removed from Sigue’s corporate operations. To remedy this, MSBs should conduct a formal and detailed risk assessment of each of its products, transactions, services, geographic locations, etc., and then concentrate their AML and BSA resources to specifically monitor and control those areas identified as the highest risk.

24. Sigue conducted a limited risk assessment of its operations and products, but it failed to implement an effective AML program designed to subject its highest risk areas to enhanced monitoring, supervision and control at three critical risk areas: the authorized delegates, the transactions, and the customers.
25. At the authorized delegate level, Sigue identified some authorized delegates as "high risk," yet very little was done to subject those high-risk delegates to any more monitoring, supervision or training than those authorized delegates classified as "low risk." Sigue failed to establish expected transaction parameters and limits for each authorized delegate, and failed to implement a program to subject high-risk delegates to enhanced monitoring for suspicious activity.

26. At the transaction level, Sigue implemented an automated monitoring system that was somewhat effective in identifying "red flags" of suspicious activity. This proprietary monitoring system was most effective in identifying instances of currency structuring. Yet Sigue's process did not include sufficient substantive review of the underlying activity. Sigue conducted some review of transactions associated with the same sender, but no review of transactions for the benefit of a single beneficiary. This failure was exacerbated by Sigue's failure to sufficiently review transactions from related senders or beneficiaries. Consequently, Sigue failed to identify and prohibit the transactions, authorized delegates, and "customers" involved in the undercover operation, which used dozens of different people spread across 22 different states to send structured drug money to a group of seven individuals in Mexico City. Had Sigue implemented a more robust investigative procedure, Sigue could have detected the undercover activity and taken action to report and prevent it.

27. At the customer level, Sigue failed to establish an effective risk-based Know Your Customer (KYC) program. Of course, as an MSB, Sigue operates substantially differently from traditional financial institutions, such as banks. Sigue does not require customers to open "accounts;" there is no application required to use Sigue services; and Sigue does not collect source of wealth information, verify employment, etc. Yet, to avoid potential violations of the money laundering laws of the United States, and the misuse of MSBs by money launderers, Sigue needs to implement enhanced due diligence procedures to collect appropriate information, at least from its highest risk customers and operating locations, so that it may reasonably identify, prevent, and report money laundering activities, as required by the BSA.

28. The traditional Sigue customer sends less than $400 to Mexico several times a month. For these customers, there is very little KYC information that Sigue is required to
collect, under the BSA or the money laundering laws. Yet Sigue, as with all financial institutions, is required to have a SAR program. It is virtually impossible to have an effective SAR program unless the institution also has a KYC program. For MSBs, the extent of the KYC information collected should necessarily, and as a practical matter, be risk-based. Sigue should be expected to have very little KYC information for a customer who uses its services to send $400 twice a month to Mexico. However, Sigue and other MSBs should have enhanced due diligence procedures that require them to obtain additional information on customers who do a higher volume of recurrent transactions in significant sums, such as a customer who sends or receives more than $25,000 during any 12 month period. Since these latter customers comprise a small percentage of Sigue’s overall customer base (less than 3 percent), Sigue’s KYC burden is not overwhelming or unreasonable for these customers. The BSA is intended in almost all respects to help financial institutions comply with the money laundering laws. In order to avoid misuse by money launderers, MSBs may need to implement enhanced AML policies and procedures to fully comply with the money laundering laws and the BSA.

SIGUE’S REMEDIAL ACTIONS AND COOPERATION

29. Even before learning of this investigation, Sigue had devoted considerable resources to correct and improve the identified BSA and AML deficiencies, agreed to terminate the licenses of the culpable authorized delegates, and implemented procedures to identify, report, and ultimately, block a broader range of suspicious transactions and customers, including the types of transactions identified during the law enforcement operation. As part of that effort, Sigue has:

- made significant investments in developing and implementing its current compliance program and internal controls;
- retained a knowledgeable and experienced staff, with extensive experience in the MSB industry, to oversee its compliance program;
- increased the total number of compliance personnel on staff to ensure adequate personnel are designated for executing the tactical objectives of the compliance program;
• purchased, developed and implemented advanced anti-money laundering systems and software to detect the misuse of Sigue’s financial services;

• instituted an authorized delegate risk management department which is responsible for evaluating authorized delegates prior to contract approval;

• implemented policies requiring all authorized delegates to have undergone Bank Secrecy Act training, and developed authorized delegate-specific Bank Secrecy Act/Anti-Money Laundering Compliance Programs required for each prior to activation;

• deployed a significant team of compliance field personnel responsible for auditing authorized delegates’ compliance with their Bank Secrecy Act/Anti-Money Laundering Compliance Programs and recommending disciplinary action, up to and including termination, for non-compliant authorized delegate;

• implemented a comprehensive, enterprise-wide employee training program in which all employees receive Bank Secrecy Act/Anti-Money Laundering training at least twice annually;

• retained a competent risk management consulting firm to perform an annual, independent review of the integrity and effectiveness of Sigue’s compliance program and related internal controls.

**Sigue’s Continuing Remedial Efforts**

30. Sigue has cooperated and continues to cooperate with law enforcement and its regulators. Through organizational and program changes, Sigue has shown a commitment to compliance improvements and a dedication to effectively complying with its BSA and AML responsibilities. As part of its continuing efforts to implement an enhanced BSA and AML compliance program, Sigue has committed to the following remedial measures as part of the Deferred Prosecution Agreement:
A. Integrity of Compliance Program and Board Oversight

Sigue will continue to employ a specific individual within its high-level personnel as the Global Compliance Officer who is assigned overall responsibility for the BSA/AML compliance programs. The Global Compliance Officer will be qualified in AML compliance programs, will be delegated day-to-day operational responsibility for compliance, and will report directly to the Audit and Finance Committee of Sigue's Board of Directors. The Global Compliance Officer will be given adequate resources, authority, and direct access to the Board of Directors, and will report on an annual basis to the Board of Directors regarding the integrity and effectiveness of the compliance program.

B. Authorized Delegate Due Diligence

The Authorized Delegate approval process will be assigned to a department which engages in risk management and is independent from the sales and marketing function. Credit and criminal background checks will be run on all owners of Authorized Delegate applicants who own or control at least ten percent (10%) of the Authorized Delegate. Authorized Delegates will also be subject to periodic credit and criminal checks, under appropriate circumstances.

C. Monitoring

Sigue will implement and maintain a transaction monitoring system for the purpose of performing risk-based trend analysis related to sender, beneficiary, originating Authorized Delegate, and paying location transactional activity. The monitoring system will be effected in part through an enhanced identification requirement for senders whose transactions aggregate to $2,000 or more in one day. Sigue will obtain sender's full name and address when sending any transfer (if the sender does not have an address, "none" or a code will be inserted in the appropriate fields) and will conduct an enhanced due diligence review of senders and beneficiaries, and all related persons, transmitting or receiving aggregate amounts more than $25,000 during any 12-month period. Sigue will obtain beneficiary identification information for beneficiaries who receive remittances through Sigue's Mexico-based Authorized Delegates in amounts of $950 or more in a single day and aggregate amounts greater than $2,950 over a rolling five (5) day period.
D. Blocking

Sigue will implement a transaction interdiction system for the purpose of enhancing the functionality of blocking remitters and beneficiaries of money transmittals, as appropriate, including the implementation of enhanced due diligence review procedures to determine whether senders and beneficiaries should be blocked from conducting further transactions where Sigue has filed two or more Suspicious Activity Reports ("SARs") on the senders and/or beneficiaries, or related senders and/or beneficiaries, during any twelve-month period.

E. OFAC

Sigue will implement an OFAC interdiction system that provides for real-time screening of remitters and beneficiaries of money transmittals. Sigue will also periodically screen employees and Authorized Delegates against the OFAC lists.

F. Authorized Delegate Training and BSA/AML Compliance Program Reviews

Sigue will provide BSA/AML training to all new Authorized Delegates before they are activated, and thereafter risk-based BSA/AML training. Sigue will also implement a risk-based Authorized Delegate compliance review program, using dedicated compliance resources.
From: David W. J. BAGLEY
To: Warren G. LEAMING
Subject: Fw: Weekly Compliance Report 02JUL-06JUL07
Importance: Normal

--- Forwarded by David W. J. BAGLEY@HSBC on 18/07/2007 10:45 ---

Ramon GARCIA@HSBC/ISBC 18/07/2007
To: David W. J. BAGLEY@HSBC
cc: Warren G. LEAMING

David,

I will discuss the subject below with Warren and John in our Conference Call tomorrow. I would like to let you know that the procedures and functions of the money laundering committee (MLC) have been improved in a very important way.

The 2 cases reported at the weekly compliance report is a clear example of the escalation process implemented as one of the learning experiences after [REDACTED] and other cases.

I understand that the appreciation from GHQ is that the CCC has to resolve and rule about all the cases presented to the attention of the committee and the real situation is that sometimes there are some cases that need to be escalated to the Business Head and CEO for further discussion.

As I told you when you were in Mexico, CCC is a very unique body created by Mexican regulation in order, among other things, to dilute responsibility of MLD obligations between members, giving a very important weight to business opinions because in theory they are the ones that really know the customer.

For that specific situation escalation is a key element when MLD has a different opinion than the one from the business about reporting the case to authorities.

I will explain Warren and John tomorrow the different actions plans I am reviewing with John Rendall including the new originated after your visit in order to have better procedures at the MLD function including the CCC.

Regards,
Ramon

--- Forwarded by Ramon GARCIA@HSBC on 15/07/2007 08:39 a.m. ---

John F ROOT@HSBC/HISBC 17/07/2007 08:16
To: Ramon GARCIA@HSBC/HISBC

Redacted Material
Confidential - PRI & Treatment Reason

EXHIBIT #19

Permanent redaction of information
HSBC OCC 8875925
Ramon,

A number of items jump out from your most recent weekly report (02JUL-06JUL) but everything pales in comparison with the ML item on page 4. It looks like the business is still retaining unacceptable risks and the AML committee is going strong after some initial hemming and hawing. I am quite concerned that the committee is not functioning properly. Alarmed, I am close to picking up the phone to your CEO. It looks like another classic situation - what on earth is an "assumption responsibility letter" and how would it protect the bank if the client is a money launderer? Please note that you can throw up the USD10 million to be paid by one of your partners to the US authorities as an "economic penalty" if you wish but it is a fine is a fine, and a hefty one at that. What is this, the School of Low Expectations Banking? "We didn't go to jail? We merely signed a settlement with the FDIC for $10 million!"

So, strike one. Strike two. Strike three. Let's now look at strike three. I hope you like baseball.

The same person who is giving the sacrosanct "assumption responsibility letter" to Jose Manuel Dominguez (DGA-CMB) is being asked by the CEO to explain why he retained the above mentioned relationship after USD11 million was seized by the authorities in a account with Wachovia in Miami. What? The business was okay with this?

The AML committee just can't keep rubber-stamping unacceptable risks merely because someone on the business side writes a nice letter. It needs to take a finer检and. It needs some courage. We have seen this movie before, and it ends badly.

Regards,

John Root

--- Forwarded by John F ROOTIHGSBC@HSBC on 17JUL2007 11:46 ---

Ramon GARCIA-HHSBC@HSBC 14JUL2007 14:24:38 To John F ROOTIHGSBC@HSBC cc Laura YESIN@HSBC@HSBC Subject Weekly Compliance Report Entity HSBC Holdings plc - HGSHG

Redacted Material
Confidential - POIA Treatment Requested by HSRC Bank USA N A HSRC OCC 8875926
Warren, John,

Please find enclosed Weekly Compliance Executive Report for the period from 02JUL07 to 06JUL07. [Attachment "Weekly 29 07 summary.doc" deleted by Ramon GARCIARHBMXHSBC]

Regards,

Ramon
John R. Rendall

On the evidence of the report that you have provided to me, I agree that the quality of the information provided by CHF does not reflect the concern that the data quality should not be lower than what is shown in the data. I also believe the CHF data are not sufficiently accurate to support the current level of risk.

On this basis, I request to provide the recommendation to close the review.

However, if this is the case that it would still be a sensitive issue in the way that we are not prepared to deal with a company that is regulated by CHF, as this could be embarrassing for them if it becomes public, which is always possible. I find it should therefore have a private communication with the CHF in order to make sure that the potential regulatory risk is there and send that "no objection" to our action.

Please can you arrange for this to be done, and then email to me.

Thanks

John R. Rendall

Redacted Material

Permanent Subcommittee on Investigations

EXHIBIT #20

HSBC OCC 8875132
From: Michael F GEOGHEGAN
Sent: 23/12/2007 13:55 GMT
To: Z JOAWA
Subject: F-VI: CNBV Inspection

Dear Paul

This is disturbing and I suspect we will need to look at the remuneration structure and practices. Would these views from CNBV be shared by our internal Audit locally?

We would want to see what the offline letter says but it will be hard to impress on management the need for a change of direction if you are not allowed to see the content of your meeting.

I am copying this to the Group Chairman and Matthew King for their information.

Best wishes

Mike

--- Original Message ---
From: Michael F GEOGHEGAN
Sent: 23/12/2007 08:43 GMT
To: Paul A THURSTON
Cc: Stephen GREEN; Matthew J KING
Subject: Re: CNBV Inspection

Dear Paul,

This is disturbing and I suspect we will need to look at the remuneration structure and practices. Would these views from CNBV be shared by our internal Audit locally?

We would want to see what the offline letter says but it will be hard to impress on management the need for a change of direction if you are not allowed to see the content of your meeting.

I am copying this to the Group Chairman and Matthew King for their information.

Best wishes.

Mike
HSBC Holdings plc
Registered Office: 8 Canada Square, London E14 5HS, United Kingdom
Registered in England number 671987

--- Original Message ---
From: Paul A THIRSTON
Sent: 23/10/2007 02:18 EDT
To: Mihail F GEOGOVAN
Subject: CNBV Inspection

Hi,

At CNBV request, I met today with the Head of Banking Supervision and the Supervisors for HSBC. I met separately the CNBV, following then an overview of various aspects of our business, including cards, money laundering and AML operations. Although they have had dealings previously with the respective departments, they asked to come with us above, as a single source and confidential basis.

They visited me through a presentation package forty specific issues that had arisen during their inspections, but then received on review joint concerns of the CNBV and HSBC in Mexico. These concerns:

- Compliance to regulatory standards that they saw in several areas of HSBC, citing evidence of the level of risk and controls, number of compliance complaints for local and for banking institutions, customers concerns for some branches, as the non-appropriate training and qualifications, frequency of IT failures, and slow progress in adding KYC data problems and non-users laundering procedures.

- Corporate culture, where they observed that since the purchase of Salav HSBC has driven growth in credit production and invested new products without adequate controls. They acknowledged the addition of more senior employees increasing the CPO and COO, and they endorsed their efforts, but they were concerned with the lack of controls and the lot of the business in Mexico. The CNBV also had concerns about the new business and the quality of the training. They implied that they expected how we were still making part of the bank as if they were in Salav, despite the new ownership and the change in business style.

Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A.  HSBC OCC 8873339
There were several concerns at senior management level. A key responsibility for the division and the region, stating that “there are deep concerns on how management will be able to implement strong controls within the bank in Mexico, while keeping as few as possible uncontrolled.”

Their final slide read as follows:

REQUIREMENTS

As a result of the concerns raised, the OCC sought the senior level commitment to solve the problems identified. To achieve this, HSBC needs to set corrective programmes. These actions should include the following:

- set strong internal controls in key business and operational areas
- adopt measures to stop clients, reduce clients' compliance and improve the level of service, to reduce operational risk
- establish the necessary actions to improve IT performance and avoid technological risks caused by systems breakdowns
- manage an effective culture of change
- avoid sharing senior officers responsibilities with LATAM
- take effective measures regarding money laundering issues
- avoid taking excessive ended risks to the credit risk portfolio and set adequate risk to market risk in advanced countries
They have told me that their priorities, in fact, are not to be long-term and have renegotiated collections, particularly APAR. They are currently paying back the people in the bank. They will be a formal management letter to the board, which will be distributed later this week.

I discussed with them some of the issues and were progressively building them. I observed there was a new enterprise of a new head of consumer risk, who we worked closely with a couple of weeks ago and some innovation in the company. We have been able to introduce some new initiatives in the consumer. We have made some changes which we've done to move those people back on the consumer feedback and engagement, which would have to move those people back on the consumer feedback and engagement.

I talked about the changes we were making to grill, regional, and financial institution issues, such as NCUA, FDIC, and others. They admitted that they were aware of the specific concern here was with PPE, and we discussed that they would take some changes in this area in the near term.

I said there was a need for changing the business model of the bank, and streamlining certain processes, but that such change would not happen overnight. However, I believe that such changes are necessary for the company's survival, and business quality would help push the bank to the new direction. I commented that we have a strong staff, and while they had difficulties, I was confident that we were better than our competitors in term, and it gave them opportunity to improve, and enterprises, we could make end progress.

I told them that I assumed their existing to see you, and that we would regard positively to the management letter, when it arrives, and that I would also meet up with them again to update them on progress and the issues after the meeting.

They indicated that this was what they wanted to hear, and that they would report back positively to Robert Butler, the head of the board.

I took the opportunity to vary direct from the issues that I had issues with them and they had two months ago on the PTV (credit sharing bank), where Nikon and Photonics had been allowed to take shares in avoid partners, and they acknowledged that we would have to take action if we were to remain competitive, and they believed that while they didn't think I would not see provided that our situation was within the current level and regulations.

I will follow up on all of these points, the though that you should be aware.

Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A.  HSBC OCC 8873341
To: Warren GOERING
From: Susan A. WRIGHT
Subject: Mexico

Hi Warren,

I believe you are visiting Mexico shortly.

One of my action points from the conference is to follow up with Ramon GPP 35 application in Mexico (and elsewhere within Ramon’s area of responsibility). As you will no doubt recall GPP 35 is know perhaps more fondly among the group as “The 500” (NOT the 50). At the conference Ramon mentioned that there are numerous cases of accounts with multiple BARs (i.e., in one case) in Mexico that remain open. I would be grateful if you could follow up on this during your visit. Happy to discuss.

Thanks

Regard,
Susan

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EXHIBIT #22
Confidential - FOIA Treatment Request
Permanent Subcommittee on Investigations

HSBC OCC 8875423
From: John F Root
Sent: Thu Dec 06 16:01:10 2007
To: Warren G Gleaming
Subject: Fw: Warren Learning, HSBC DEC Visit Issues

Warren,

I am keeping a running list of issues that you might want to raise during your December visit to HSBC. If you or David would like to add to the list, please let me know.

The list below is only partial, and I am constantly adding to it. There is of course overlap with David’s visit recommendations:

- Worary annual “14-point” Central Bank (Banxico) inspection of HSBC than last year. Why have Treasury operations deteriorated?
- Reconciliation, especially Regional head vs. Mexico head; CIBM and MLRC
- Sinaloa massive remittance scheme (~ USD 100 million)
- Regional integration, e.g. Honduras, Panama reluctant to accept CIBM requests from Mexico, monitoring, etc.
- Clean-up of HBMX Trusts banking
- Mexico, independent functioning of HSBC MEX committee
- CIBM HSUS Venezuelan business through Panama
--barrio business in regulatory and tax havens
- Relations with Legal, Audit, senior management, regulators (Mexico and Central America)
- AML systems integration (Mexico and Central America)

Regards,

John Root
Confidential - FOIA Treatment Request

EXHIBIT #24

N.A. HSBC OCC 8876347
An obvious learning point for HHMI is that if they were contacted by US authorities then they should have thought to advise HHMI. They can go round the web, not just through the middle of the web.
From: TERESA PESCE/HBUS/HSBC
Sent: 12/15/2006 9:59:00 AM
To: ELIZABETH PROTOMASTRO/HBUS/HSBC
CC: ANNE LIDDY/HBUS/HSBC; DONALD W MCPHERSON/HBUS/HSBC; JOHN ALLISON/HGHOHSBC
Subject: Re: OFAC - wire payments blocked from HSBC offshore entities - USD 32,000 (re Sudan) and USD 2,538,939.33 (re Sudan)

How is it that these payments continue to be processed by our affiliates in light of the GCoS?

Teresa A. Pesce
EVP/Managing Director
Anti-Money Laundering Compliance
HSBC North America Holdings
452 Fifth Avenue
New York, NY 10018
Ph - (212) 515-6099
Fax - (212) 515-5769

Elizabeth Protomasrro/HBUS/HSBC
12/14/2006 06:02 PM
To: JOHN ALLISON/HGHOHSBC
cc: TERENCE PESCE/HBUS/HSBC, ANNE LIDDY/HBUS/HSBC, GRACE C SANTIAGO-DARVISH/HBUS/HSBC, DONALD W MCPHERSON/HBUS/HSBC
Subject: OFAC - wire payments blocked from HSBC offshore entities - USD 32,000 (re Sudan) and USD 2,538,939.33 (re Sudan)

This email is to inform you of the following two payments, initiated by HSBC offices and blocked due to OFAC sanctions. The first was blocked under terrorist sanctions. The second was blocked due to involvement of a Sudanese SDN.

Value date 3-NOV-2006
Debit: 000054356, HSME Ramallah Br., Ramallah Palestine
Credit: JP Morgan Chase, Tampa, FL
3rd party: Arab Jordan Investment Bank S.A., Amman, Jordan
OEG: HSME, Ramallah, Palestinian territory, Occupied
BRI: Acc/For Further credit to Palestine Investment Bank Head Office Ramallah Branch account EST for further credit to Al Aqsa Islamic Bank USD 32,000.00

Note that Al Aqsa Islamic Bank was designated by OFAC on 4-Dec-2001 as a "specified global terrorist." The press release from Treasury stated that it is a "direct area of Hamas, established and used to do Hamas business." Below are links to the press releases.

http://ustreas.gov/press/releases/poB37.htm
http://ustreas.gov/offices/enforcement/ofac/actions/20011204.shtml
The payment was held at the direction of OFAC and additional information requested. On 20-Nov-2006, HBME sent a SWIFT message to cancel the payment as it was sent in error. On 7-Dec-2006, OFAC instructed HBUS to block the funds. Details are below on the payment blocked under the Sudan sanctions.

Value date 6-Dec-2006
Debit: HSBC Bank PLC (Joh), Johannesburg branch
Credit: BNP Paribas New York
3rd party: BNP Paribas (Swiss) SA, Geneva
4th party: Sudanese Petroleum Corporation
OGB: Commercial Bank of Ethiopia, Ethiopia
USD 2,538,939.33

"Sudanes Petroleum Corporation" is listed by OFAC as an SDN under the Sudan program.

Please let us know if you have any questions or need any further information.

Thank you,
From: Matthew J W King
To: "Paul A Thurston"; Graham Thomson
Cc: "Richard E T Bennett"; David W J Bagley
Subject: CNBV
Importance: Normal

This was the note I was thinking of sending to Mike - a bit of a brain dump and not fully up-to-date or polished but I thought I would send it to you as is because it might help focus the call we are due to have later.

"Mike,

My perspective on these issues from my discussions with Paul Thurston, Graham Thomson and Chris Bentley is as follows:

The issues raised by CNBV appear to be pretty similar to those raised previously with Paul. However, whereas the CNBV previously seemed broadly happy with our remedial action plans, they have suddenly become more aggressive. Whether this is because of political pressure, the FIU suddenly raising significant concerns (which perhaps the CNBV thinks reflects poorly on them), it is difficult to say.

One theory about the FIU is that they are reacting to our refusal to reimburse a public utility (which also impacted on the Ministry of Finance for a large internal fraud, effected through our Internet services). However, the CNBV has raised concerns about our security arrangements and the matter has now been mentioned to us by the FIU. Whatever the truth of this, it is also the case that Mexico is suffering a major problem with drugs dealers and the Government is being very robust about dealing with them. Hence any AML weaknesses may well be treated similarly.

The 'evidence' obtained from the FIU does not seem very earth-shattering. There is nothing I have heard which could not equally be put down to carelessness or common mistake (I am not excusing this you understand). However, the necessary investigation work is still underway.

There are areas of known weakness which management have been addressing but where we now need to revisit the current strategy:

Money laundering - This area was rated as Below Standard on a Q07 audit and work has been underway since then to address the weaknesses. The Chief Moneylaundering Officer is being replaced, albeit the FIU apparently regard him as trustworthy - management are well-aware that his departure will therefore have to be carefully explained. Various processes are being enhanced. David Bagley is proposing to send in Warren Leeming as a temporary measure to ensure these are now treated as matters of utmost urgency.

KYC - My area of biggest immediate concern - this has been a systemic issue for some time. Enhanced regulations were enacted a few years ago and implementation of these has proved problematic for HSBC. One particular problem has been the requirement to undertake visit reports for every new customer at their home/business address. Perhaps because of the extended HSBC branch opening hours this has proved particularly difficult for the branches to achieve. It also inhibits centralisation of the account opening process which has been one of the key solutions to similar problems elsewhere. We (audit) and the CNBV have both identified a very high rate of exceptions (around 50%) to the process, through this level is disputed by the business. A pilot scheme has been running since Q07 to use imaging (and hence avoid centralisation). However, I now gather Audit is continuing to identify a high level of exceptions for that process also (around 30%).

Given the concerns now raised by the CNBV and FIU (which apparently includes tapes of a drug lord recommending HSBC as the place to bank), we now have to decide:

- whether the imaging process can be made to work to everyone’s satisfaction;
- how quickly it can be rolled out across the whole network.
in the meantime, whether we can continue to open accounts using the old, flawed process. It sounds unlikely that we will be able to meet a deadline of May 28 to obtain satisfactory KYC on the 1.8 million customers identified as high risk. I am now not clear whether the CNBV will accept a further delay. The previous indications were that they were pretty relaxed.

Documentation. This has been a problem since we brought Bital. I am aware the old storage depots have been replaced, but I am advised the processes are still a mess. Sorting this out needs to be handled as a specific project. It may be worth asking Ian Macalister to run this. He is an IM currently with CMB in NY who previously had responsibility for sorting out a documentation problem in the trust business in Mexico.

Reporting to the FIU. We apparently route responses through a law firm. It is not clear why or indeed whether this is sinister or just inefficient. However, it does seem that incorrect evidence has been provided via this law firm. There is a very high volume of informational requests but we need to ensure these are handled with due care.

Management Stretch. The CNBV has again raised the appropriateness of allocating regional responsibilities to HBMX management. It may be that you are already close to sorting this out.

Cross-border cash: the trends in this activity still need to be clarified by HBMX but as I read the report the US authorities have a general concern rather than a specific one about us, and CMB last year identified and acted on a cambio which has just been closed down by the authorities. We can therefore show some successes.

I hope this is helpful background (though a bit long). If you wish to discuss please call me on my mobile. I will be in France for the weekend but please feel free to phone at anytime. I have not copied HBMX though the points raised have all been discussed with Paul, Graham and Chris.

Regards,

Matthew King

HSBC Holdings plc
Registered Office: 8 Canada Square, London E14 5HQ, United Kingdom
Registered Number 617937
Dear John,

I am out of the office tomorrow, but please respond to this email by the end of the week, so I can ensure your discussions with Rome and meet them in the display room on the Sun iff.

Thanks

Paul

John A. RENDALL, Hon. GAC

John R. TURSTON

- Original Message -

John A. TURSTON

Kerry: 02/28/2008 01:14 PM

EXHIBIT #28

Permanent Subcommitte on Investigations

Confidential - PHI & Treatment Reuse

HSBC OCC 8875139
Paul,

I am forwarding in on the attached note from Spain Wright to Ron Paul which covers a number of issues but in particular the situation within HSBC which I am advised has resulted in the resignation of a US Federal official. Ron attached a complaint to this showing the background to the US Federal sting operation and the US Department of Justice record this.

I am not sure whether the information has been referred to you for consideration. We have previously requested copies of the relevant materials (unredacted), however, that is quite some of the information of the case and the issues involved. Can you please consider the following?

- HSBC are extremely high the gains that were obtained in relation to money laundering and more recently terror financing. For the reason since 2008 the Group has included within the OCC policy - equality of any sort of relationship with well regulated entities with a strong """"nothing to hide"""" policy, such as HSBC. In conclusion, until these policies are followed, and leading the appropriate actions within the business line, it is not clear to how the account maintained with us operate and if indeed we are able to continue with the relationship.

- We have been advised that we are not currently located in Mexico. It is possible that in a number of the other cases may not be considered to be """"typical"""" as the purpose of the account and the volume of transactions is well below the current German standards. The same applies for the HSBC account which is at present being investigated by the authorities.

- We have been advised that we are not currently located in Mexico. It is possible that in the current investigation by the authorities, the HSBC account may be considered to be """"typical"""" as the purpose of the account and the volume of transactions is below the current German standards.

I would of course be pleased to discuss further with you but I have to make the above and the potential risk in the Group, not only in Mexico but also the US. I would strongly recommend that any decision to continue with this relationship should be reconsidered.

Kind regards, David

[Redacted] complain.pdf attached by John T. PENDALU/NKMANICC
Good to talk to you yesterday. I thought it would be worthwhile following on a number of points we discussed yesterday:

- Database Controls: I would recommend that you liaise with Anne Liddy on the introduction of appropriate controls for managing end-user viewable accounts. Please note that a private email i.e. a dedicated email to an individual customer. You may also wish to arrange for the opening of a separate email address dedicated to this purpose.

- If the business wishes to maintain this relationship then, as previously mentioned, please confirm the arrangements we need to clarify around virtual bank transactions. The nature of the US regulator should not need to be a bigger event and not due diligence on this client initiated. In the situation the high risk profile for financial transactions would be seen.

- In the event that funds are frozen, as a matter of course, the due diligence and processing, with regard to screening, is not awareness of what type of transactions are seen and in what currency. So we are SBDP transfers where the screening needed (suspicious) are assumed so do we assume there? Even one bank had transferred lump sums we are trying to get screening underway. It would be helpful to have a clearer structure as regards our relationship with the client and how we see it working.

- CASP Governance documents - I have sent you those under cover of a separate email.

- HSBC IS Supervision - I have sent you a separate note on this in a review of the cross-border transaction in business with Santander and Citi parties.

Please let me know if you need anything from me or if you have any queries.

Regards,

[Signature]

3/3

Redacted Material
Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A. HSBC OCC 8875141
Money laundering 'sting' led to MSB's record penalty, says legal pact

Jan 29 2008

California-based money transmitter Sigue Corporation has agreed to forfeit $10m and spend $5m on anti-money laundering compliance this year to settle US Department of Justice charges that it operated with a deficient anti-money laundering program. Sigue's woes began from the fact that dozens of its agents were caught by a federal sting operation called "Operation High Rollers", according to the deferred prosecution agreement, in DPA.

The district court judge heard an agreement that Sigue, an international money transference company that specializes in transfers to Mexico, violated the Bank Secrecy Act, Title 18 USC Section 1956(h) and 1957, as may SIGUE'S violations were between September 2002 and March 2005.

"Sigue authorized delegates unknowingly and transmitted more than $500,000 of money represented by undercover US law enforcement officers to be drug proceeds, according to the DPA, which Complinet learned in an earlier article."

The DPA states that Sigue, an international money remittance company that specializes in transfers to Mexico, violated the Bank Secrecy Act, Title 18 USC Section 1956(h) and 1957, as may SIGUE'S violations were between September 2002 and March 2005.

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The district court judge heard an agreement that Sigue, an international money transference company that specializes in transfers to Mexico, violated the Bank Secrecy Act, Title 18 USC Section 1956(h) and 1957, as may SIGUE'S violations were between September 2002 and March 2005.
Sigue may have weathered the storm, but it remains to be seen whether its specific alleged misdeeds will lead to more scrutiny for similar MSBs. In recent years, many MSBs have found themselves unable to find banks willing to serve them. The reason is clear: MSBs are high-risk customers and filling those roles is costly. A case such as that against Sigue gives banks yet another reason to treat MSBs as pariahs.
From: Michael P GEOGHGAN
Sent: 18/02/2008 23:11 GMT
To: Paul A THURSTON
Cc: Richard E T BENNETT; Matthew J H KING; Stephen GREEN
Subject: Re: CONFIDENTIAL - CNBV/FIU Meeting

Paul

This is most disturbing and we will need to have the most thorough of investigations.

Please keep me advised of all developments and can Matthew and David meet with me after CNB on Monday

Best wishes

Mike

HSBC Holdings plc
Registered Office: 8 Canada Square, London E14 9HQ, United Kingdom
Registered in England number 817987

Paul A THURSTON

--- Original Message ---

From: Paul A THURSTON
Sent: 18/02/2008 16:49 CST
To: Michael P GEOGHGAN
Cc: Richard E T BENNETT; Matthew J H KING
Subject: CONFIDENTIAL - CNBV/FIU Meeting

Mike,

I was asked to attend a meeting with the CNBV today
The meeting included the Head of the CNBV (Dr Guillermo Babatz) and the Head of the Financial Intelligence Unit, FIU (Luis Umute), the financial crime unit of the Finance Ministry.

Guillermo Babatz referred to the previous discussions that had been held with HSBC on the issues of internal controls, which he knew we were progressing, and said that this meeting had been asked for because of additional issues that had been noted in the last two weeks by the Financial Intelligence Unit, that caused the CNBV to be even more concerned.

The Head of the CNBV informed me that he considered these issues to be of sufficient significance that he would have to report them to the FSA, as our lead regulator.

He handed me a draft copy of the report that they had compiled which is in two parts:

1. A CNBV report on operational weaknesses in HSBC in many areas, including Fraud, Customer complaints, IT failures, Money Laundering processes, Culture, and Organisational structure that they had previously identified (and communicated in the previous meeting in October, which is summarised in my note below). The report now includes a summary of the actions taken by HSBC to address each of these, but they acknowledged that this was rather still in progress and comprehensive, and they asked me to review it and revert to them with a clear, up to date, picture on all actions taken, so that they do not misrepresent the position.

2. A report from the FIU setting out at a high level the evidence that they have obtained that has raised their concerns on Money Laundering activities in HSBC, and that prompted them to report these concerns to the CNBV. The major points are:
   - the high levels of US dollars notes exported by HSBC in 2005 and 2006 (considerably higher than all other banks)
   - the high level of failure of HSBC to provide information requested by the FIU (considerably higher failure rate than other banks)
   - missing documentation related to customers, not only for old accounts (which is a common failing across all banks), but of accounts opened since 2004, when new rules were introduced. They acknowledged the changes being put in place over recent months to improve account opening documentation in HSBC but said to me “What were the management of HSBC doing for the past 3 or 4 years?”
   - the use of external legal firms to review information requests from the FIU, potentially risking breach of confidentiality on sensitive investigations - this practice is rare to me, and to the local audit team, and will be investigated urgently.
b) We will review all the points raised by the CNBV and FIU, check them out, and revert to them with a response setting out the actions that have been taken (or actions that will be taken, for the items which have only now been identified) so that they have a clearer picture of the progress that has been made.

e) The Head of Group Compliance will meet with them, following up on previous meetings that they have had with us, so that we can review the report and our response together, before they finalise any report to the FSA.

I have advised Richard Bennett, David Bagley and Matthew King, our security department investigators, to start with FIU/DFI information to get the information from their case files that relates to suspicious internal activity, so we can commence an investigation of these. I have asked Internal Audit to assist in reviewing the other items raised (most of which came out of previous on-site inspections earlier last year, and are in process of resolution), and confirm the actions that have been taken. I am arranging for David Bagley to visit next week, when he and I can review our actions and response, and then he and I will meet jointly with the CNBV and FIU to follow up.

It is clear in this that our Head of Compliance is not as highly regarded by the CNBV as had been thought by itself and Group management, and indeed appears to have misled us about the extent to which the CNBV have been informed of, and/or are satisfied with, our actions. This will need to be addressed urgently as well during David Bagley’s visit.

I will provide a further update after the meeting next week, but if you need anything further in the meantime, please let me know. We will keep Richard Bennett and Matthew King updated, and I’m sure they will report on this to the Group Audit Committee next week.

Regards
Paul

--- Forwarded by Paul A THURSTON@HSBC on 18/02/2008 02:27 p.m. ---

Paul A THURSTON@HSBC 25/10/2007 02:18 a.m.
To: Michael F GEOGHEGAN@HSBC@HSBC
cc: CNBV Inspection

Mike,

At their request, I met today with the Head of Banking Supervision, and the Supervisor for HSBC from our regulator, the CNBV, following their on site examination of various aspects of our business, including
They walked me through a presentation pack which firstly set out specific points that had arisen during their inspection, but then moved on to more general concerns of the CNBV with HSBC in Mexico. These centred on:

- weaknesses in internal controls which they saw in several areas of HSBC, citing evidence of the level of credit card frauds, numbers of customer complaints to the bank and to the banking ombudsman, customer concerns that staff in branches do not have appropriate training and qualifications, frequency of IT failures, and slow progress in tackling KYC data problems and anti money laundering procedures.

- corporate culture, where they comment that since the purchase of Bital, HSBC has driven growth in credit products and launched new products without adequate controls. They acknowledged the addition of new senior executives including the CFO and COO, and they welcomed these, but they are concerned that some areas of the business have not changed at all in mentality, or approach, despite the changing nature of the business, and some lower level staff have not been adequately trained to deal with the business now being undertaken. They implied that they considered that we were still running parts of the bank as if we were still Bital, despite the new ownership and the change in business profile.

They also expressed concerns at senior management having dual responsibilities for Mexico and the region, stating that there are many concerns on how management will be able to implement strong controls within the bank in Mexico, while keeping an eye on other countries.

Their final side reads as follows:

"REQUIREMENTS

As a result of the concerns pointed out, the CNBV needs the senior level commitment to solve the problems addressed. In order to do that, HSBC needs to set corrective programmes. These actions should include the following:

- set strong internal controls in key business and operational areas
- adopt measures to stop frauds, reduce clients' complaints and improve the level of service, to reduce reputational risk
- establish the necessary actions to improve IT performance and avoid technological risks caused by system break down
- manage an effective culture of change
- avoid sharing senior officers responsibilities with LATAM
- set effective measures regarding money laundering issues
- avoid taking excessive credit risks in the credit card portfolio and set actions to assess this risk in an adequate manner"

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Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A. HSBC OCC 8966017
me know of their concerns.

I indicated to them we were aware of these issues and were progressively tackling them. I advised them of the new appointments of an experienced Head of consumer risk with experience in Asia, who arrived a couple of weeks ago, and a new Head of card fraud from QAC who arrived yesterday, the help we had sought from Ken Harvey to review the robustness of the IT operations and the planned internal audit of IT in November, and the major programme of customer file desinflation and imaging which would give us more robust KYC data for anti-money laundering. I talked about the changes we were making to split Regional from Mexico responsibilities in areas such as CBI, IT, Risk and Audit, but they advised that their specific concern here was with PFR, and I indicated that they could also expect changes in this area in the near future.

I said that we were embarked on changing the business models of the bank, and bringing in specialist expertise, but that culture change would not happen overnight. However, I believed that the introduction of new management, combined with changes we were planning to incentive schemes to put more emphasis on customer satisfaction and business quality would help push the bank in the new direction. I commented that we have a young staff, and while they lacked experience, I was confident that if we were clear in our business direction to them, and gave them appropriate training, and measures, we could make real progress.

I told them that I welcomed their coming to see me, and that we would respond positively to the management letter, when it arrives, and that I would also meet up with them again to update them on progress with the issues not covered in the management letter.

They indicated that this was what they wanted to hear, and that they would report back positively to Guillermo Babbetz, the Head of the CNSV.

I took the opportunity to remind them of the issues that I had raised with them and Babbetz two months ago on the PTV (profit sharing tax), where Bancomer and Banamex had been allowed to take action to avoid payment, and they acknowledged that we would also have to take action if we were to remain competitive, and they indicated that while they didn’t like it, they would not object provided that our solution was within the existing laws and regulations.

I will follow up on all of these points, but thought that you should be aware.

Regards

Paul
From: Paul A. THURSTON
Sent: Fri Mar 21 14:12:28 2008
To: David W. BAGLEY
Cc: John R. RENDALL
Subject: The

Attachments: image_flt; MEETING ATTENDANCE NOTE - HPAX - Leopold - April 2008

David W. BAGLEY/HSBC

David W. BAGLEY/HSBC Sent by Martin O ROACH Sent to Paul A. THURSTON/HSBC

Regrets

To me, the jury is still out on Ramon, and we need to have a discussion between the three of us, pretty soon, about the whole question of restructuring the regional and branch staff responsibilities.

Paul

You will recall that I carried out an exit interview with Leopoldo Rodriguez Boronzo. I attach a copy of the note that I dictated during my visit and which has now been typed up.

As I hope you will have allowed, I intend discussing the content of my conversation with Leopoldo with John Rendall with a view to:

Regrets

[Redacted by the Permanent Subcommittee on Investigations]

Permanent Subcommittee on Investigations

EXHIBIT #30

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HSBC OCC 8874821
David Sagay

P.S. Both actions followed up and I believe these to be closed.
HEETING ATTENDANCE NOTE – 17th February 2008

Attendees: Legislative Repr. Group (LRG)
David Blagley

Key points raised by LRB at an exit meeting were:

1. He had asked to move from the AML job principally due to fears with regard to his own personal civil and criminal litigation exposure, the risk to his physical security, the fact he did not think the job was sufficiently valued or paid and because he had already made it clear when he originally took the job that this would be a short-term post only long term.

2. (LRB went on to explain in some detail that his perception of exposure to criminal sanctions was due to the continued poor controls in the bank, the fact that there were allegations of 50% to 70% off-handled proceeds in Mexico went through HSBC and because he did not think that senior management had any commitment to reduce AML controls. He thought it was only a matter of time before the bank faced criminal sanctions and cited a number of cases, including examples of the bank’s transformations in activities which might lead to the bank being sanctioned directly and him and members of the team being sanctioned personally.

3. It was clear that LRB felt very strongly that relevant business units within HSBC had absolutely no respect for AML matters and the risks to which the Group was exposed and had no interest in applying credible or appropriate approaches. Again he cited a number of examples where despite strong recommendations within the AML framework bank had failed or refused to direct action or indeed an acceptance like SMEs. He thought that there was a culture that pursuing profit and targets at all costs had in fact been no certain improvement in the standard of controls in the types of sanctions being asked.

4. He was critical of the lack of resources in his team and felt that there was not time enough to keep the bank out of trouble by working extra hours against impossible deadlines and handling significant volumes of items, including those from CAMP. A figure of some 14,000 per annum was cited.

5. When asked, LRB indicated that he thought he would need at least 3 new people next

6. LRB was worried about the ability or likelihood of being able to migrate processes to GSCs at least while the bank’s systems were so immature (how could anybody check online and validate transactions) but thought that this might be a medium term solution once back systems separated.

7. It was clear that LRB felt reasonably enough about his termination and was resolute both with regard to his current performance rating, the fact that he thought the ML department was being emasculated, and was disillusioned that the bank could have an alternative role. On balance, however, he accepted that he was a difficult individual and had perhaps been too sarcastic and again

Redacted Material

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HSBC OCC 8874824
thought that he would prefer to leave even though he was likely to suffer economic hardship rather than stay in a job where he felt personally exposed.

8. He was advised that David Legorski had pointed out that if he did the job for ten weeks he would be paid the next 60 days and his commitments had been removed. LRB was extremely critical of EC who he described as being ineffective, weak and disruptive in terms of his left and losing any understanding of AML matters. There was a draft of discussion about the operation of the MLO committee chaired by EC where LRB indicated that he thought it would be chaired by John Friswell. Again he felt there had been little improvement in the decision-making within this Committee.

9. LRB was suspicious as to whether the bank would be given an extension of time within which to present a complete high-risk assessment and had said why the leadership should give any further estimate given that the bank had previously failed to meet earlier commitments. He was clearly of the view that the bank was treading a situation where it would be scrutinised or monitored and had note nothing in recent months or weeks which suggested to him that matters could improve.

10. LRB then referred to a report he had been in the process of writing which would set out and anticipate all of the various areas of weaknesses that he thought existed. This report had not been shared by his staff and he was still deciding whether he would write it. DB said that this was very much a matter for L to decide alone personally and that DB would not encourage him to write it, nor discourage him from doing so. It was very much his own personal decision. Having said this, DB indicated to him if the report was produced and sent to DB he would discharge his personal obligations in his current role by ensuring the report be carefully considered and discussed in any wide work or other review that was being undertaken. DB would not just ignore it or bury it but would deal with it fairly and reasonably by LRB against views expressed by others and then take a view. On balance, it seemed likely that LRB would submit such a report.

11. LRB noted that his term was nearly, particularly the more senior members, particularly the more senior members he would look after and no in any way prejudiced for his departure. This was generally unfair. DB assured him that he would do what he can in this regard.

12. Overall, LRB gave the impression as having been dedicated and committed to his work, having not and genuinely this concern. His opinion were very firm, the conversation extremely clear but at no stage were there any suggestions that he felt that individuals, including individuals within LRP were in any way compromised other than perhaps by reasons of incompetence or poor management. The study detailed treated but accepts that some of the recommendations have been brought on by himself not least asking to be moved.
From: John P. ROOT  
Sent: Jul 30 21:48:30 2008  
To: David W. JABLEY; Warren GLEAMING; Susan A. VYRIGHT  
Subject: HBMX VISit Update  
Importance: Normal

It has been an extremely productive trip. Below please find a summary of what I have discovered so far.

**USD Cayman Accounts**

There are 35,000 accounts with a monthly total average of USD 450 million. Many of these accounts were opened by Bital through its New York branch. When this branch was closed, the accounts were transferred to the Cayman branch, which was opened in 1980.

The real surprise was the existence of an HBMX audit in January 2008 on KYC for the USD Cayman accounts. It is not clear who in AML responded, and how. Blank looks all around. I should know more in a few hours.

The report, which is in Spanish, concluded that KYC control was "below standard". A sampling showed that 15% of the customers did not even have a file. For the files that could be found, there were serious failings in following Group procedures.

Earlier this year, HBMX was concerned about the adequacy of USD KYC be having an extensive the accounts. We could still be exposed to other these accounts here is doubled, with respect thinking we will see.

HSBC Luis Porta has stopped all new Cayman accounts. CNBV were said to be a bit surprised at this, and not entirely happy that a source of US$ was being foreclosed.

As for the existing accounts, the management plan is to offer to clients to transfer them to another Group entity, currently envisaged to be HBUS (although an actual Cayman entity was also briefly contemplated).

Fixing the Cayman accounts will be a struggle. How do you locate clients when there is no file?

**High-Risk Transactions**

Since the beginning of the year, a sub-director in AML has identified 1,100 high-risk accounts. Of these, 270 have been cancelled, most with SARs. These high-risk accounts include USD Cayman.
accounts. I heard that his team is understaffed and that there is little or no accountability in high-risk regions for managers who knowingly sensed suspect clients. The main home of some is PIP, according to even at the "highest" levels. Yes, I asked. A dearth of sins, and close to retirement. He stressed the gap between what we say about hiring and proper AML controls, and what is actually happening out in the field, particularly in states close to the US border. He maintains there must be 2-3 times the current rate of breaches. I don't want my sources fired or killed. (No exaggeration here - more people are dying in the drug wars in the north of the country than are being killed in Afghanistan or Iraq.)

John Rendall has asked Ramon Garcia to determine what products have a high AML risk. The CEO has also asked Rendal to join at USD remittances to assess client risk. HSBC is the largest remitter in Mexico of dollars back to the States. High-volume customers will be reviewed and risk-weighted. Ramon will shortly give John Rendall larger doses for those reviews.

AML Staffing

I am now working in AML on the 50-50 basis with PIP under . The senior currently responsible for AML (A ML has not yet been formalized) and there is some overlap in the investigations.

The COO has also asked Ramon to look at USD remittance to assess client risk. HSBC is the largest remitter in Mexico of dollars back to the States. High-volume customers will be reviewed and risk-weighted. Ramon will shortly give John Rendall larger doses for those reviews.

A term of state and close to retirement, and also asked to give John a term plan. He was previously employed at HSBC and all departments are cut 15% of headcount and budget. It might be a good idea for one of you, and perhaps also Matthew King, to stress as soon as possible with Luis Pena the importance of adequate AML staff. I have already done so with John Rendall, who generally agrees with me. But wants more specifics about the plan. (One reservation is that AML seems a bit heavy in management.)

I met with Luis and discussed how we can better meet our needs. His main issue is that we need to conduct PIP and USA to set up our own department, which resolves contracting out to staff. If local laws require us to pay monthly packages, so be it. There is no management control where we cannot choose the right people. For example, the AML sub-director responsible for CAMP monitors, was clearly failed in his task with 12,000 alerts a month. The department has a budget of $500 million and other

Having already met with , I will meet later today with the HR person responsible for

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Much progress has been made. John Rendall and the team have worked very hard, with concrete results to show for it. I attended a lengthy meeting of the project last night and came away very impressed with what they have achieved. I will forward a number of useful reports to you on the current situation. Audit think that much more can and should be done, but the COO and his team have the proper risk-based approach.

Reporting

John Rendall is currently busy, with meetings to attend every day and many reports in write. I have agreed with him that I will liaise regularly with [redacted] for the reports we require so as to ease the burden on him and I have discussed the new reporting template and how we should proceed.

Operating Loss in Colombia

A recent mishap in Colombia illustrates what we are up against in the region.

Our treasury in Colombia sold rather than bought notes, and ended up with no securities with the Central Bank to support the sale. We expect a “penalty not a fine”, which would appear to be a distinction without a difference. The current estimate is USD 500k. The key issue, according to Graham Thomson, is that someone in Colombia signed off on their being FIM-compliant when they weren’t. He is investigating this point, and asks why he was only informed last Friday when the problem came to light two weeks ago.

The same concerns for Colombia, e.g. FIM compliance, apply of course to Central America. Key managers are telling us that they are following Group procedures when, in many cases, they aren’t.

John Root
30Jul09
From: John F Root
Sent: Tue, Aug 19 03:45:12 2008
To: David W J Bagley
Subject: Re: FW: HBMX - CAYMAN ACCOUNTS

Attachments: Doc. Links

David W J Bagley <DWB> 05/08/2008 08:51:45 — Graham. We will on the basis of this just work on the assumption that nothing has been done to date. I do find it surprising

Graham,

We will on the basis of this just work on the assumption that nothing has been done to date. I do find it surprising that there has been no response and yet the audit was closed out. Is this a breach or are you in audit becoming softer.

Regards
— Forwarded by David W J Bagley on 05/08/2008 08:51 —
Matthew

I refer to our recent emails.

I am now receiving further clarification from GAO on the audit report recommendation status.

No response was received following the issue of the report in APR06 and its recommendations were "closed off" in APS and included in the matrix of branch control weaknesses, which GAO routinely discusses with the business.

Periodically GAO reports on management’s progress on these items and continues to check on compliance standards as part of its regular branch audits, where it will assess implementing the recommendation, branch standards have been maintained and recently been improved. Project implementation is now rectifying that position and has included the higher risk CI customer accounts in its risk-based remediation approach. HSBC COO has suspended the provision of CI accounts to new customers.

Regards

Graham Thompson
Head of Group Audit Latin America & the Caribbean
Tel (52) 55 1721 8236

Matthew J W KINGDOM INA GUYANA HSBC

To: Graham THOMSON@HSBC
Cc: Matthew J W KINGDOM INA GUYANA HSBC

Matthew J W KINGDOM INA GUYANA HSBC

Matthew J W KINGDOM INA GUYANA HSBC

Graham THOMSON@HSBC

To: Matthew J W KINGDOM INA GUYANA HSBC
Cc: Graham THOMSON@HSBC

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Graham,

What is the position with the audit report? Has it sent to the under standing instructions? How many of the recommendations remain outstanding and are these included in the reported status?

Regards
Matthew

Graham THOMSON@HSBC

Graham THOMSON@HSBC
3/9/2006 17:30 Mail Size: 11813

Emilson

I first became aware of a Cayman issue on Monday (29th) at HAM KAC when CMP reported that is fine of USD 23 is due being issued on HSBC. On Tuesday I asked for a copy of the incident report CMP had sent to HAM. A response is pending. I have chased again this morning. I shall advise further once I have received a copy of the report.

Regards
Graham Thomson
Head of Group Audit Latin America & the Caribbean
Tel:(52) 55 5721 RX28

Emilson

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Can you call me about this particular problem, which I am not aware of? F:

Richard

We have been in discussions with HSBC CMI with regard to certain potentially suspicious transactions identified by routine transaction monitoring. This initial report has widened into a more general issue as detailed below. This continues to follow up with HSBC, I think it is appropriate to provide an initial report as follows:

I am awating further details of the suspicious activity identified, but in brief it appears that our CAMS monitoring system identified significant USD remittances being made by a number of customers to a US company alleged to have been involved in the supply of Aircraft to drug cartels. Appropriate audits have been called and have apparently enabled the authorities to identify significant related activity relating through other banks. This led to a review of the way in which HSBC operates USD-denominated accounts through the Cayman branch. HSBC holds a Category B banking licence in Cayman which allows them to provide banking services anywhere other than Cayman residents. The licence, which includes this, allows HSBC to provide USD-denominated services to persons domiciled in Mexico. Mexican law does not permit individual licensees (i.e. non-corporate) to lend USD-denominated deposits accounts to Mexico. This process currently takes USD500 and USD1,000 accounts. Of significant concern is the nature of the entities involved in the supply of Aircraft to drug cartels. HSBC are, however, consistently reviewing the position. I have also asked CMI to review whether there are any similar operations in LATAM. Those continue to be a real focus on the level of USD-denominated activity in Mexico by CMI and other bodies, and the extent of Mexico's activity in this area. This account book has to therefore be seen as high-risk from an AML, and reputational perspective.

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Apparently an audit carried out in 2000 of the Cayman branch activities also noted as below standard and identified significant KYC weaknesses. It will be important to ensure that these accounts will be covered by the various account revitalization processes underway in HBBX, and as a priority area. As a precaution, HBBX have issued instructions that no new accounts be opened pending a review of these activities.

We are also checking whether any similar activities exist in LATAM.

I will report further in due course, but thought it important to provide preliminary reports.

Regards

Daniel Bagley
From: John F ROOT
Sent: Fri Sep 12 15:17 2006
To: Adrian CRISTIANI
Cc: David W J BAGLEY; Warren G LEAMING; Susan A WRIGHT
Subject: Fw: Cayman Accounts

At Warren Learning's request below please find a recent breakdown of the USD Cayman accounts at HSBC (i.e. held by a branch of HSBC with a "Category B" offshore Cayman license but no physical presence or client documentation in Cayman).

The HSBC "Rewind" project chaired by John Rendall, HSBC COO, is endeavouring to regularise these accounts on a risk-basis. Account opening documentation is generally poor or non-existent and there is a lot of work to do. Money laundering risk is consequently high.

Regards,

John Root

---

To: John F ROOT@HSBC
From: Maria SALAZAR@HSBC

Subject: Re: Cayman Accounts

John,

Please find attached information requested. Regards, Ramon.
Customers were classified in emergency lights considering their transactional behaviour as follows:

- RED: Red status, black list and customers with one or more reports to the authority (NARs) were considered.
- YELLOW: Customers deemed by CAM system with SARs.
- WHITE: Customers with no associations to the two previous ranges.

John F. ROOT@SIMONSBC@HSBC

Jan 12 2008 06:51 a.m.

Ramon, Could you please send me figures for the Cayman Accounts? How many? Total? SARs filed? CDT etc.

Regards,
John

Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A.  HSBC OCC 8876785
To: Jaime J. Saenz

Cc: ~, ~, ~

Subject: Consider revisiting the use of Dollars accounts in the zona frontera Product 63 Cuenta Maestra en Dolares P.F.

Date: November 27, 0:2:38:422008

Importance: Normal

In the same way we have already revisited new Caiman Island accounts from opening, due to the massive tribute of them by organized crime, I think it is time we seriously consider revisiting the branches, that we can not support their management of Dollars accounts in the zona frontera Product 63 Cuenta Maestra en Dolares Personas Fisicas.

We have suffered three cases this week where dollars accounts based in the zona frontera have been opened with the apparent sole intention of using them for money laundering.

The pattern is as follows:

1) Accounts are opened at various branches in Cd. Juarez (or other border areas of the USA) in dollars Product number 63.
2) Declaraions are made by the customer in their branches KYC questions of low account movement per month (in one case the client indicated he was going to move USD300 a month, but in fact moved USD5,400/month).
3) Cash is then deposited in branches far from the border (Tijuana and Baja California). The initial deposits are normally USD500 per customer, standing at one cashier window, depositing ten to twenty bundles of USD100 each. The total is USD5000 to USD10,000 in one customer transaction (split spreads into 20 bundles)

So far the total of this cash has surpassed USD100K in two weeks. These are the accounts we have been notified about, but I imagine that there will be many more in the coming weeks/months.

There are very accurate branches of procedures in both the branches that opened the accounts, and the branches that are receiving the funds. (Please see below)

It is my belief that the professional money launderers have got wise to our procedures, and are now going to try "hit and run". They will open accounts, use them to launder as much money as possible, as a short 6 month as possible, and then either close the account themselves, or wait for our procedures to do it.

The normal time scale in a typical case, to close an account is three months, from when the first CIPMTRO start coming in the AML area. As you know it is then passed via the OCC to UCB who then have to locate the file, and provide it to LGA for them to start their process. LGA say they take on average 60 days, but with the restoration project, their backlog is now almost 2.5K cases.

In another case I am working on, the client has already been notified by LGA that the account is going to

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Permanent Subcommittee on Investigations

EXHIBIT #34

HSBC OCC 8875736
be closed, and he is using his last two weeks to move as much money as possible. So far this is USD15m in three days. To add the USD6m that he has successfully laundered in the last three months.

It is my opinion that we are not "preventing" anything. We are allowing the organised criminals to launder their money, and only after three months do we final manage to stop them (by closing the account). By which time they have probably opened up another dollars account in a fake name, and started the whole process again.

The first essential thing that must be done is a bank wide email explaining in clear and simple terms the cash deposit amounts that are being done in CMP PLD 050003.

In my investigation so far, NOT ONE SINGLE PERSON has heard of this circular, and no one is following it.

It is my opinion that until PFS can properly educate their staff in the correct procedures for dealings with these types of accounts, then the account should be removed from our list of products.

If we were rigorously sticking to this procedures, then I am confident that we would seriously restrict the flow of dollars into our organisation. I am aware that this is a theme that has been raised by Luis Pena and the CNBV.

For your information the part that I consider most relevant of CMP PLD 050003 is below:

6. Operaciones en efectivo con dinero de los Estados Unidos de América

Queda estrictamente prohibido la realización de las siguientes operaciones:

- Decisión de Giro Económico
- Cierre venta de cheques de viaje a no clientes/servicios de cambio de cheques de viaje a no clientes
- Forma de Cheques de Caja a cuenta.

HSBC ha establecido el siguiente montante de exclusión de operaciones financieras para el fin de operaciones (depósito y retiro) en efectivo con dinero de los Estados Unidos de América:

Nivel del Funcionario Enfrentado

- Directivo de Caja (FPS)
- Director de Unidad de Negocios (FPS) o Directores de Cuentas (incluidas otras Siguientes)

Subdirector (todos los siguientes)

Director (todos los siguientes)
Director Ejecutivo (solo los Seguros)

No se requerirá supervisión en el inicio de operaciones en efectivo con dólares de los Estados Unidos en las oficinas personales físicas, por personas inferiores a los 10,000.00 dólares, así como de aquellas que tienen a cabo personas morales, por menos ingresos a los 20,000.00 dólares.

We have had clients deposit USD200K in one day in one branch. This deposit should have been approved by the D.Ejec., but it has never reached him. Nor it appears have any of the smaller deposits reached even the levels of Sub-Directors!

It needs to be made clear that any branch receiving more than USD100K total with one customer (regardless of how the customer wants to separate the deposits) that has not notified their Sub-Director, will be subject to Zero tolerance policy enforced by UCE and the Sub-Director, who should have been told.

This matter is not Final so PIF resources need not be used, and it is not necessary to involve AML in every case as the evidence is very obvious, and easy to prove through branch cash movements. Of course the same Zero tolerance should apply when the cash deposit indicates Directors and D.Ejec need to be informed.

PFS Channels and Products should be able to "police" themselves in this matter, and I request that if we stick to these procedures the money launderers will quickly become very tired of waiting to get authorization from our senior management, and will carry out their business in another financial institution.

I greatly appreciate that this is a complicated issue, but without firm and decisive action we will never stop ourselves being used by organized criminals.

Thanks and regards,

Confidential - POIA Treatment Requested by HSBC Bank, USA, N.A. HSBC OCC 8675738
From: David W J BAGLEY
Sent: Thu Nov 27 06:24:53 2008
To: Warren G LEAMING
Cc: Richard E T BENNETT
Subject: Mexico

What I find most frustrating is the way in which new issues constantly emerge however much time is spent with HBMX.

The practice of changing USD in the branches involves little or no ID for non-customers is in breach of Group policy. When looking at our USD exposure how can this have been missed.

The SAR filing is just as it is allowing an account to operate pre-closing and taking too long to close. Are you able to challenge the enforcement of legal in this process. If not subject to Richard's views then they gain up their effort in this area.

Regards

---------------------------------------------------------------------
HSBC Holdings plc
Registered Office: 8 Canada Square, London E14 9HQ, United Kingdom
Registered in England number 617867
---------------------------------------------------------------------
Warren G LEAMING

----- Original Message ----- 
From: Warren G LEAMING
Sent: 11/24/2008 11:29 GMT
To: David W J BAGLEY
Cc: Richard E T BENNETT
Subject: Re: Mexico

Mike Gergenman is key visited the president of the DNIUS Guilmoto, Habibet with Luis Peral HBMX CEO

Confidential - FOIA Treatment Request HSBC OCC 8875605

EXHIBIT #35
and Emil Alonso. It was anticipated that during the discussion the basis controls on AML would arise following Paul Thurston’s meeting CNBV in March. Ramon and I contributed to a briefing paper for Luis Mikel which is attached. We had anticipated that the CNBV would be comfortable with the improvements that had been made with the controls but that they may still be concerned with the agenda of the Bank’s staff in accepting deposits without apparent KYC due diligence (he has the message passed on down to the rank and file).

At the meeting apparently Luis acknowledged the CNBV may be concerned around the Bank’s controls on AML. The CNBV president, who was accompanied by Patricia Rasmusen (regulatory) and Pablo Gomez (AML) noted that significant progress had been made in the Bank’s controls but they remained very concern in respect of:

1. The USD Cayman accounts and the slow speed of remediation
2. The sheer volume of US Dollar that HSBM replicates/exports

Between January and September HSBM replicated USD 36.39% of the market which is double Dejitos USD 1.6 which comprises all of the market and yet Banamex is the biggest Bank in Mexico and HSBM is 5th largest. The authorities are concerned that whenever there is a serious MLD scheme HSBM seems to be involved. CNBV also wanted that the USA authorities BPC concerned at the very high levels.

Apparently Luis told Luis that he is not holding him responsible because he is new but directed him to send the problem on. When Luis said the covers result in loss of many billions US dollars response is that nothing is worth risk to our reputation.

Luis called a task force meeting this afternoon that Ramon attended. During this meeting it became clear that we are very good at building/duplicating dollars but we do not seem to sell them and hence our very high replication figures. 80% of our dollars come from money exchange business and transfers. There is no limit on the amount of dollars that customers can convert to pesos and for non-customer we can convert up to 10,000 dollars and do not require any KYC.

Luis has decided that draconian measures are required and he is proposing:

1. The current freeze on opening USD Cayman accounts will continue indefinitely (there were proposals to reopen at early next week). In addition no new cash deposits will be accepted to the existing accounts.
2. All remediation must be completed by 31 January (earlier than planned March)
3. all remediation must be completed by 31 January (earlier than planned March)

Business is reviewing how to implement and will meet again on Friday morning.

In the 2 days I been here it has become apparent that

1. While remediation efforts have progressed they have in some instances been very slow, particularly around corporate accounts. In addition there appears to be a huge backlog in dealing accounts as this is a legal process managed by legal. Pending closure customers continue to operate their accounts which may be part of the reason for multiple SARs. Jaime’s team is producing figures but there are reports of accounts that MLD committee ordered closed in March continuing to operate.
2. Now to resolve duplicate accounts with multiple SARs not being closed in timely manner. It seems that SARs are filed because we have complete information as to whether there is a need to file them in order to comply with local regulation. We are also reviewing the practice of Directors General being able to sign off accounts that can remain open.

Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A.  HSBC OCC 8875606
We are reviewing the criteria for high (red), medium (yellow), and low (white) customer risk profiles. Obviously this will evolve over the next few days. Mike's visit and Luis' proposed actions are considered extremely sensitive here in Mexico and local management want to get their ducks in a row before advising GMO formally so it will be much appreciated if the above could not be treated as information only and not disseminated without discussing further.

Best regards,

Warren

[Attachment "CEO Restoration Sunco.doc" deleted by David W J BAGLEY]

David W J BAGLEY—26/11/2008 12:52:21—Richard I was at the legal awards dinner where I note you were a judge. During this I took a call from Warren where because of

David W J BAGLEY/HSBC Nov 26 2008
2:52 Mail Size: 2181

To: Richard E BENNETT/HSBC
cc: Warren G LIBURDE/HSBC

Richard

I was at the legal awards dinner where I note you were a judge. During this I took a call from Warren where because of

Richard

HSBC Holdings plc
Registered Office: 8 Canada Square, London E14 5HQ, United Kingdom
Registered in England number 617997

Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A. HSBC OCC 8875607
From: Warren G LEAMING
To: Ramon GARCIA, John R RENDALL
Cc: John F ROOT; Susan A WRIGHT; Catherine SUGGERY; David W J BAGLEY; Andy GEVT
Subject: Mexico Visit

Ramon/John,

Please find attached the draft email setting out my high level thoughts following my recent visit. Could I please thank you both for the time that you took to spend with me during my visit during what was a very busy and turbulent time for you both. It was of considerable value in clarifying many of the current issues in Mexico and Central America and I hope that I added value in respect of my discussions with those on the ground.

Despite the reservations expressed by the CMBV in respect of the quantity of US dollars repatriated and progress of remediation, I was heartened to note that they also acknowledged the significant progress that has been made in respect of the compliance and AML controls over the past twelve months and since the CMBV meeting with Paul Thurlow in March. If you feel that I have neglected to mention something or you have any issues with my conclusions expressed in my draft note please let me know. I intend to send the note to Luis Pena by Friday, 12 December.

Regards,

Warren

DRAFT EMAIL TO LUIS PENA

Luis,

As you know I visited HSBC between Tuesday 25th November and Friday 28th November. I spent my time with the Compliance and AML team in Mexico and thought that I would offer the following thoughts/conclusions as a result of my discussions.

Submission of SARs within 30 days. Currently local regulation requires that if suspicious activity is recognized that a SAR should be filed within 30 days. It is apparent that in many instances the business are not providing the information required to the Compliance department to determine whether a SAR should be submitted or not within the 30 day period. Given the regulatory requirement and the absence of appropriate information in order to come to an appropriate conclusion, SARs are being submitted when the information is subsequently received. It is not possible to retract the SAR even if the information reveals that it was not appropriate to submit the SAR. Accordingly, the numbers of SARs that are being submitted may well be too high and given the GPP25 requires that accounts be considered for closure after two SARs are submitted, we may well be closing accounts where there is no need to do so. This is both unfair on our customers and causes increased work. I note that the regulation is to be extended to 60 days, having said that pressure should be brought to bear on the business to ensure that appropriate information is submitted to Compliance in time for them to come to a conclusion and submit SARs within 30 days.
Closure of accounts - backlog and blocking. When accounts are to be closed, either as a result of the remediation programme or as a result of a direction by the CCC committee, policy in HSBC requires that such accounts be sent to Legal who will instruct an attorney. Apparently the latter requires that customers be appropriately notified. It is apparent that there is a significant backlog (3,898) of accounts to be closed. Of this amount 875 accounts pending closure were ordered to be closed by the CCC on suspicion that they are used for money laundering activity. You will note that some of these accounts are very old, in fact it appears that there are 16 accounts that were sent for closure in 2005, 130 from 2006, 172 from 2007 and 339 from 2008 that remain open. I am advised that based on legal advice it is not possible to block the accounts before closure and accordingly all of these accounts remain open with transactions being conducted on them which also increases the number of subsequent SARs being submitted to authorities. I would ask that the legal advice be reviewed and if appropriate a commercial decision be taken because it was advised that Standard Bank do not use attorneys or their Legal department but notify customers using certified mail. I have also reviewed translations of the applicable legislation which appears to confirm this. High profile accounts that Public Affairs have advised should not be closed because of reputational sensitivities should be reviewed at DGA level to ensure appropriate remediation and/or closure.

GGPP2 - DGA letters. This Group policy requires that if two SARs are submitted the account should be considered for closure. HSBC policy allows the account to remain open if there is a DGA letter. There are a large number of DGA letters and I am not necessarily confident that appropriate due diligence is done by the business when such letters are submitted. You will recall that historically there have been two very significant cases where Compliance recommended that the accounts be closed and that the business had taken a commercial decision and insisted that they remain open. Subsequent events have revealed that these cases involved blatant and systematic AML, which has caused the bank much embarrassment. It is important that the businesses ensure that appropriate support/due diligence is conducted before completion of the letters.

CCCIAML Committee. The CCC currently meets monthly and whilst it has improved it appears that there are still many instances where decisions are too slow in being taken and the closure of accounts is delayed significantly by business requests for more time. The presumption seems to be in favour of the businesses views which needs to change to a more Compliance orientated balance. I have asked Ramon who chairs the committee to take a much stricter approach going forward to ensure that suspicious accounts are closed quickly. I have also asked Ramon to consider whether the frequency should be increased to allow more timely consideration of serious cases or authority delegated so that decisions can be taken between meetings. I have also asked that the meeting only deal with high level cases and that the vast majority of cases currently dealt with at the Committee be dealt with outside the Committee and only come to the Committee where business and Compliance cannot agree.

Issues arising from your CNBV visit. I am aware that following your visit to the CNBV with Emiliton Alonso and Mike Georgian that you have decreed:

a) That as of the 1st January the Bank will not accept USD cash deposits or provide exchange services for US dollars. Accordingly no dollars will be accepted by the branches and travellers cheques will not be sold to non-customers and will be sold to customers on a limited basis. There remain AML issues in respect of travellers cheques which historically are very high risk from an AML perspective and accordingly we would expect that the limits are reasonably low and that there are very strong controls in place to ensure that branches do not abuse the rules.

b) That no new Cayman dollar accounts be opened until full remediation of all existing customers.

c) That all remediation be completed by 31st January. You are aware that remediation has been slow for the Cayman accounts and also for the CNBV phase two accounts. We fully support your efforts to speed up the remediation of such accounts. We
also note that in respect of Cayman it is proposed that 3,000 accounts be closed and our above comments in respect of the account closure backlog and speed need to be addressed. We are also aware that examples are to be set both on a branch and individual basis for failure to follow procedures with respect to account opening, ID and V guidelines. We fully support appropriate action being taken against all individuals who do not comply with the Group’s policies.

Transaction limits. There are a number of transaction limits. I suggest that the following be reconsidered as appropriate limits and controls be put in place:

a) There is no limit on the Bank selling cashiers cheques to customers when they are paid for from the customer’s account. This should be subject to appropriate limits and controls.

b) There is no limit on customers depositing travellers cheques to their accounts.

c) The Bank will sell up to $25,000 of travellers cheques when it is paid for from the customer’s account. This appears too high and as discussed above we would encourage that a reasonable limit be imposed and strong controls be put in place.

d) There is some confusion around the limits on wire transfers which should be reviewed.

CNPAML Resources. Having spent time with Jaime Sanz, the new Head of AML, I think that he has good potential. He has our full support and one of his first tasks is to review the resources that he has at his disposal and what activity they conduct. I know that John Rendall has recently approved a new headcount of four which will be very welcome and in addition I have asked Jaime to review all activity currently undertaken by the AML team to ensure that they are not conducting activity that should be conducted by the business and to maximise the use of resources on a lively basis. It appears that in addition to revisiting the high, medium and low risk parameters that the team has also been asked to actively identify customers that meet these parameters which would appear to me to be a business activity.

Camp Analysis. While some work has been done of refining the camp alerts more work is required on refining the “soft rules” to produce focused meaningful alerts.

Efficiencies can be obtained by: a) analysis of the high and medium risk categories on a slightly more sophisticated basis than has been done in the past by analysing the type of activity on the accounts. This may have the effect of actually reducing the number of high and medium risk cases to be remediated; b) more focused planning initiatives rather than dealing with issues on an ad hoc basis; and c) introduction of review sampling of customer files to ensure high quality KYC/customer visits including supportive documentation. More detailed risk based reviews by Compliance and Internal Control of the business appear necessary.

I am aware that a “AML Shock Plan” is being implemented and this will assist greatly in moving the emphasis/stance of approach to opening/managing customer accounts to group standards.

I look forward to any comments that you have or would welcome further discussion.

Regards.

Confidential Treatment Requested
<table>
<thead>
<tr>
<th>Bank</th>
<th>Variety of Banknotes</th>
<th>Purchases</th>
<th>Sales</th>
<th>Total</th>
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</thead>
<tbody>
<tr>
<td>BBVA BANCOMER SA (7 branches)</td>
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<td>$2,595,000</td>
<td>$1,308,000</td>
<td>$3,903,000</td>
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<tr>
<td>HSBC MEXICO SA (16 branches)</td>
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<td>$341,301,000</td>
<td>$1,308,000</td>
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<tr>
<td>CASA DE CAMBIO PUEBLA (9 offices)</td>
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<td>$600,000</td>
<td>$440,000</td>
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<tr>
<td>CONSUL TURISTICA INTERNACIONAL (4 offices)</td>
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<td></td>
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- Redacted by the Permanent Subcommittee on Investigations
<table>
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<tr>
<th>Banknotes Marketed</th>
<th>Activity (SELECTED CUSTOMERS)</th>
<th>Explanation &amp; Reason for USD Purchases</th>
<th>Date Received</th>
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<tbody>
<tr>
<td>LCD SELLERS</td>
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<tr>
<td>KYC procedures</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Corporate Name</td>
<td>Country Code</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Customer Name</td>
<td></td>
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</table>

*Note: The table contains data related to banknotes marketed, activity of selected customers, explanations for USD purchases, and dates received. The conditional treatment request is indicated by a check mark in the 'Customer Name' column.*
<table>
<thead>
<tr>
<th>Bank Notes of Selected Customers' Activity Adjustments</th>
<th>Traders' Explanations for USD Purchases</th>
</tr>
</thead>
<tbody>
<tr>
<td>DOD 2005-2009</td>
<td>Sala, 0.00</td>
</tr>
<tr>
<td>Current &amp; Prior Plans</td>
<td>Client along with</td>
</tr>
<tr>
<td>Uses independent sources (on internet) as needed to validate information provided by trader (tourism, remittances, trade, economic &amp; political events, FX rates, GBS deal inquiry screens, etc.).</td>
<td>If value (actual vs. protected) appears potentially suspicious, LCO should file an investigation report accordingly (internally &amp; externally).</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Country</th>
<th>Client Name</th>
<th>Trade</th>
<th>Trade Date</th>
<th>Trade Amount</th>
<th>Trade Method</th>
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<tr>
<td>US</td>
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<td>New</td>
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<td>2,000,000</td>
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<tr>
<td>CA</td>
<td>EF</td>
<td>Old</td>
<td>03/03/2020</td>
<td>1,500,000</td>
<td>Wire Transfer</td>
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</tbody>
</table>

Legend: 
- GB: Great Britain 
- US: United States 
- CA: Canada 

Page 20 of 15
## Selected Customers' Activity Alerts & Traders' Explanations for USD Purchases from 2005-2009

### Mexico

**Currency**
- MEXICO: USD 1

**Country Move & Explanations**
- MEXICO
  - USD 1.2

**Rating (sec) for Follow-up Info**
- MEXICO: 5

**Customer Details**
- MEXICO CASA DE CAMBIO PUEBLA SA DE CV

**Data Collection & Activity**
- MEXICO: Mar-05
- MEXICO: Oct-05
- MEXICO: Feb-06
- MEXICO: Mar-06
- MEXICO: Apr-06

**Standard Security**
- MEXICO: $24.59
- MEXICO: $35.09

**Additional Notes**
- The client has also called more business due to the improving cash flow.
- The banknotes are now being delivered by different participants.
- The volume is consistent with our expectations.

**Client Contact**
- MEXICO CASA DE CAMBIO PUEBLA SA DE CV

**Bank Notes of Specialized Currency Joint Acts & Traders Explanations for USD Purchases & Sales from 2005-2009**

---

**Country Move & Explanations**
- MEXICO
  - USD 1

**Rating (sec) for Follow-up Info**
- MEXICO: 5

**Customer Details**
- MEXICO CASA DE CAMBIO PUEBLA SA DE CV

**Data Collection & Activity**
- MEXICO: Mar-05
- MEXICO: Apr-06
- MEXICO: May-06
- MEXICO: Jun-06
- MEXICO: Jul-06
- MEXICO: Aug-06
- MEXICO: Sep-06
- MEXICO: Oct-06
- MEXICO: Nov-06
- MEXICO: Dec-06

**Standard Security**
- MEXICO: $24.59
- MEXICO: $35.09

**Additional Notes**
- The client has also called more business due to the improving cash flow.
- The banknotes are now being delivered by different participants.
- The volume is consistent with our expectations.

**Client Contact**
- MEXICO CASA DE CAMBIO PUEBLA SA DE CV
**BANKNOTES-NY Selected Customers' Activity Alerts & Traders' Explanations for USD Purchases & Sales from 2005-2009**

- **LCO reviews current & prior explanations from traders & client along with info in KYC profiles and recent activity for customer and country (if DSS in country).**
- **LCO uses independent sources (our internal & market-sourced information) provided by trader (banking, wholesale, retail, economic & political newsfeeds, FX races, DSS deal inquiry screens, etc.)**

**Traders' Explanations & Reactions (selected/composed/reviewed) by Compliance**

<table>
<thead>
<tr>
<th>Country</th>
<th>Customer Name</th>
<th>Review Date</th>
<th>Currency</th>
<th>Purchase or Sale</th>
<th>Amount (DLT)</th>
<th>Risk Rating</th>
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<tbody>
<tr>
<td>MEXICO</td>
<td>CASA DE CAMBIO PUEBLA SA DE CV</td>
<td>Sep-06</td>
<td>USD</td>
<td>Purchased</td>
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<tr>
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<td>MEXICO</td>
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<td>MEXICO</td>
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<td>USD</td>
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<td>$6,000</td>
<td>Standard</td>
</tr>
</tbody>
</table>

- Mexico as a whole and more specifically COP is the premier currency in USD terms. There is an large population of Mexico’s who emigrate to the US sending money back home (negatively) to their families.
- See new customer (above) who is doing business through us.
- They have been operating 9 additional branches. In addition, volumes are within the expectations due to the season.
- They have been operating 9 additional branches. In addition, volumes are within the expectations due to the season.
- As a result of our new strategy in which we are asking them on short notice, allows us to deliver any day of the week, versus the original scheduled which was once a week (Thursday), we have been able to do business.
- Due to the holidays (Holy Week in Mexico during March) demand for USD increases significantly. Also, there is the advantage to sell on a daily basis, versus scheduled days (Thursday and Wednesday), which has given them more room to negotiate sell to their local clients.
- Due to the holidays (Spring Break), the demand for USD and BOA increases significantly, locals tend to do their international travel. Also, we have improved our operational structure and have been able to provide customers a two-way, aggressive schedule and pricing.
- Due to the high season (June/July) we have significantly increased our cash demand.
<table>
<thead>
<tr>
<th>Date</th>
<th>Country</th>
<th>Client Name</th>
<th>Trade</th>
<th>Risk</th>
<th>Incl. Days</th>
<th>Amount USD</th>
<th>Incl. Risk</th>
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<tbody>
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<td>May-05</td>
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<td>Oct-05</td>
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</tbody>
</table>

Table notes:
- Amount USD is the amount of currency traded in USD.
- Incl. Risk indicates whether the risk was included in the trade.
- Days refers to the number of days the currency was held or traded.

Alerts and Cautionary notes:
- Currency USD is flagged for potential political issues.
- Local currency USD is flagged for potential political issues.
- Client name is flagged for potential political issues.

External sources used:
- Internet sources for political news and rates.
- Local outlets for political news and rates.
- Financial and economic news for political and economic trends.

Validated data:
- Data validated by official sources.
- Data validated by client statements.
- Data validated by contractor reports.

Glossary:
- Account: The account details provided for each transaction.
- Bank: The bank involved in each transaction.
- Country: The country of origin or destination of each transaction.
- Client: The client involved in each transaction.
- Trade: The details of each transaction, including the amount and currency.
- Risk: The risk associated with each transaction.
<table>
<thead>
<tr>
<th>Country</th>
<th>Customer Name</th>
<th>Review Date</th>
<th>Traded</th>
<th>Purchase or Sale</th>
<th>Amount in thousands</th>
<th>Client Risk Rating</th>
<th>Client Title (USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Panama</td>
<td></td>
<td>Feb-08</td>
<td>USD</td>
<td>P</td>
<td>$1,000</td>
<td>Cautious</td>
<td></td>
</tr>
<tr>
<td>Panama</td>
<td></td>
<td>Mar-05</td>
<td>USD</td>
<td>S</td>
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<td>Cautious</td>
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<tr>
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<td>Cautious</td>
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<td>USD</td>
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<td>$1,000</td>
<td>Cautious</td>
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</tr>
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</table>

Note: The above table represents selected customers' activity alerts & traders' explanations for USD Purchases & Sales from 2005-2009. The table includes various dates, currencies, and notes about the transactions and risk ratings.

For full details, please refer to the original document.
### BANKNOTES-NY Selected Customers' Activity Alerts & Traders' Explanations for USD Purchases & Sales from 2005-2009

<table>
<thead>
<tr>
<th>Country</th>
<th>Customer Name</th>
<th>Date Rev</th>
<th>Trade</th>
<th>USD Purchased</th>
<th>Amount</th>
<th>Country Rating</th>
<th>Risk Rating (RdC)</th>
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<tbody>
<tr>
<td>PANAMA</td>
<td></td>
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<td>USD</td>
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<tr>
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<td>F</td>
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<tr>
<td>PANAMA</td>
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<td>Oct-08</td>
<td>USD</td>
<td>F</td>
<td>$7,700</td>
<td>Cautious</td>
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</tr>
<tr>
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<td></td>
<td>Oct-09</td>
<td>USD</td>
<td>F</td>
<td>$5,500</td>
<td>Cautious</td>
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<td>PANAMA</td>
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<td>Nov-09</td>
<td>USD</td>
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<td>$7,500</td>
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<td>USD</td>
<td>F</td>
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<td>PARAGUAY</td>
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<td>USD</td>
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<td>PARAGUAY</td>
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<td>F</td>
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<td>Cautious</td>
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<td>Dec-07</td>
<td>USD</td>
<td>F</td>
<td>$4,000</td>
<td>Cautious</td>
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</table>

**Traders' Explanations & Follow-up Data requirements/related by Counterparties**

- **PANAMA**
  - The volume is not covered, we had to modify a deal to allow for an operation. The actual volume of the Purchase: USD3.5MM.
  - This year's business activities have shown that the bank has been very active, as a result the supply of USD will increase as well.
  - The access in purchases is due to the position of added value corporate clients (both local and international) as well as to the need for the bank to have a strong corporate client base.

- **PARAGUAY**
  - The volume is due to the level of business from the corporates. We have been receiving large volumes from companies that are planning to expand their operations in Panama.
  - The increased volume is due to the combination of several factors:
    - New corporate clients are interested in acquiring US dollars for their foreign operations.
    - Local banks are increasing their business with corporates.
  - This resulted in increased business with 72 companies: 840 corporate clients, including large corporations, who are supplying US dollars to the corporates.
  - The increased volume is due to the level of business from the corporates.
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  - The increased volume is due to the level of business from the corporates.
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<tr>
<th>Country</th>
<th>Customer Name</th>
<th>Date/Rev Date</th>
<th>Traded</th>
<th>Purchase or Sale</th>
<th>USD Amount</th>
<th>Country Risk Rating</th>
<th>Trade Risk Rating</th>
<th>Traders' Explanations &amp; Follow-up Info Requested/Notified by Compliance</th>
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</thead>
<tbody>
<tr>
<td>PARAGUAY</td>
<td></td>
<td>Nov-08</td>
<td>USD</td>
<td>P</td>
<td>$4,600</td>
<td>Cautionary</td>
<td></td>
<td>USD inflows in Paraguay are seasonal and thus the monthly volume was higher than average. Additionally, as a way to improve their liquidity, the bank has been purchasing more than its usual amount of cash and thus has been increasing the total amount of cash on hand.</td>
</tr>
<tr>
<td>PARAGUAY</td>
<td></td>
<td>Dec-08</td>
<td>USD</td>
<td>P</td>
<td>$1,000</td>
<td>Cautionary</td>
<td></td>
<td>During this last few months, we have been keeping a larger inventory of USD cash than usual as a way to improve our liquidity. They are currently expecting that situation to persist.</td>
</tr>
<tr>
<td>PARAGUAY</td>
<td></td>
<td>Jan-09</td>
<td>USD</td>
<td>P</td>
<td>$1,500</td>
<td>Cautionary</td>
<td></td>
<td>During the last few months, we have been keeping a larger inventory of USD cash than usual as a way to improve our liquidity.</td>
</tr>
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<td>PARAGUAY</td>
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<td>Oct-08</td>
<td>USD</td>
<td>P</td>
<td>$1,000</td>
<td>Cautionary</td>
<td></td>
<td>The volume is within the expected range and thus no adjustment is needed.</td>
</tr>
<tr>
<td>PARAGUAY</td>
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<td>Oct-09</td>
<td>USD</td>
<td>P</td>
<td>$2,000</td>
<td>Cautionary</td>
<td></td>
<td>The volume is within the expected range and thus no adjustment is needed.</td>
</tr>
<tr>
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<td></td>
<td>Feb-07</td>
<td>USD</td>
<td>P/S</td>
<td>$200 + $300</td>
<td>Cautionary</td>
<td></td>
<td>The USD inflows were not an actual sale, but it was a remittance deal that is usually an operation. The actual volume was USD purchases for USD 250,000.</td>
</tr>
<tr>
<td>PARAGUAY</td>
<td></td>
<td>Feb-08</td>
<td>USD</td>
<td>P</td>
<td>$13,000</td>
<td>Cautionary</td>
<td></td>
<td>The inflows are expected to be high due to increased demand from traders and buyers from the region coming to stock up on the US dollar.</td>
</tr>
<tr>
<td>PARAGUAY</td>
<td></td>
<td>Mar-09</td>
<td>USD</td>
<td>P</td>
<td>$13,000</td>
<td>Cautionary</td>
<td></td>
<td>The inflows are expected to be high due to increased demand from traders and buyers from the region coming to stock up on the US dollar.</td>
</tr>
<tr>
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<td>Aug-09</td>
<td>USD</td>
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<td>$200,000</td>
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<td>The inflows are expected to be high due to increased demand from traders and buyers from the region coming to stock up on the US dollar.</td>
</tr>
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<td>USD</td>
<td>P</td>
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<td>Cautionary</td>
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<td>The inflows are expected to be high due to increased demand from traders and buyers from the region coming to stock up on the US dollar.</td>
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<tr>
<td>PARAGUAY</td>
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<td>USD</td>
<td>P</td>
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<td>The inflows are expected to be high due to increased demand from traders and buyers from the region coming to stock up on the US dollar.</td>
</tr>
<tr>
<td>Country</td>
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<td>Current Traid</td>
<td>USD Amount</td>
<td>USD Exchange</td>
<td>Country Risk Rating</td>
<td>Client Risk Rating</td>
<td>Trade Remarkations &amp; Follow-up City Responsible for Compliance</td>
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<td>PARAGUAY</td>
<td></td>
<td>May-06</td>
<td>USD P</td>
<td>$13,997</td>
<td></td>
<td>25.00%</td>
<td></td>
<td></td>
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<tr>
<td>PARAGUAY</td>
<td></td>
<td>Jun-06</td>
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<td></td>
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<tr>
<td>PARAGUAY</td>
<td></td>
<td>Oct-06</td>
<td>USD P</td>
<td>$13,997</td>
<td></td>
<td>25.00%</td>
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<tr>
<td>PARAGUAY</td>
<td></td>
<td>Nov-06</td>
<td>USD P</td>
<td>$13,997</td>
<td></td>
<td>25.00%</td>
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</tr>
<tr>
<td>PARAGUAY</td>
<td></td>
<td>Dec-06</td>
<td>USD P</td>
<td>$13,997</td>
<td></td>
<td>25.00%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

In summary, USD volume in Paraguay has been rising over the past four years, which is in line with the Bank of Paraguay's Banknotes Policy. Thechi's volume is in line with the Bank of Paraguay's Banknotes Policy.
<table>
<thead>
<tr>
<th>Country</th>
<th>Customer Name</th>
<th>Alert Review Date</th>
<th>Currency Traded</th>
<th>USD Purchase or Sale</th>
<th>USD Potential Amount or Difference</th>
<th>Country Risk Rating</th>
<th>Client Risk Rating</th>
<th>Traders' Explanation &amp; Follow-up Details Associated by Compliance</th>
</tr>
</thead>
<tbody>
<tr>
<td>PARAGUAY</td>
<td></td>
<td>Dec-05 USD</td>
<td></td>
<td>P</td>
<td>$7,188</td>
<td></td>
<td></td>
<td>Since we initiated our relationship, the most of the banks in Paraguay are trying to apply for mark up on accepting the volume.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Nov-06 USD</td>
<td></td>
<td>P</td>
<td>$6,275</td>
<td></td>
<td></td>
<td>USD volume in Paraguay are extremal and that due to the country's currency value high, they are expanding their business strategy, they are expanding their business strategy and now may be the process of acquiring for the future.</td>
</tr>
<tr>
<td>PARAGUAY</td>
<td></td>
<td>May-09 USD</td>
<td></td>
<td>P</td>
<td>$7,032</td>
<td></td>
<td></td>
<td>The USD rate for the bank has a significant component related to agricultural business. Additionally, due to low prices for agricultural products, the state, there was a reduction on the amount of USD sales from Paraguay customers due to a reduction in the surplus of sales expected.</td>
</tr>
<tr>
<td>PARAGUAY</td>
<td></td>
<td>Jun-09 USD</td>
<td></td>
<td>P</td>
<td>$10,452</td>
<td></td>
<td></td>
<td>Since we initiated our relationship, the most of the banks in Paraguay are trying to apply for mark up on accepting the volume.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Sep-09 USD</td>
<td></td>
<td>P</td>
<td>$3,351</td>
<td></td>
<td></td>
<td>USD volume in Paraguay are extremal and that due to the country's currency value high, they are expanding their business strategy, they are expanding their business strategy and now may be the process of acquiring for the future.</td>
</tr>
<tr>
<td>PARAGUAY</td>
<td></td>
<td>Mar-06 USD</td>
<td></td>
<td>P</td>
<td>$10,000</td>
<td></td>
<td></td>
<td>USD volume in Paraguay are extremal and that due to the country's currency value high, they are expanding their business strategy, they are expanding their business strategy and now may be the process of acquiring for the future.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Jan-07 USD</td>
<td></td>
<td>P</td>
<td>$4,500</td>
<td></td>
<td></td>
<td>USD volume in Paraguay are extremal and that due to the country's currency value high, they are expanding their business strategy, they are expanding their business strategy and now may be the process of acquiring for the future.</td>
</tr>
<tr>
<td>PARAGUAY</td>
<td></td>
<td>Aug-07 USD</td>
<td></td>
<td>P</td>
<td>$6,950</td>
<td></td>
<td></td>
<td>USD volume in Paraguay are extremal and that due to the country's currency value high, they are expanding their business strategy, they are expanding their business strategy and now may be the process of acquiring for the future.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Dec-07 USD</td>
<td></td>
<td>P</td>
<td>$10,450</td>
<td></td>
<td></td>
<td>USD volume in Paraguay are extremal and that due to the country's currency value high, they are expanding their business strategy, they are expanding their business strategy and now may be the process of acquiring for the future.</td>
</tr>
<tr>
<td>Country</td>
<td>Date</td>
<td>Currency</td>
<td>Amount</td>
<td>Rating</td>
<td>Risk</td>
<td>Risk T/L</td>
<td>Explantation</td>
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<td>-----------------------------------------------------------------------------</td>
<td></td>
</tr>
<tr>
<td>PARAGUAY</td>
<td>Jul 2008</td>
<td>USO</td>
<td>$9,000</td>
<td></td>
<td></td>
<td></td>
<td>USO $9,000 Cautionary Tha volume of the Banknote business in the Paraguay market was due to this client's trade, which involved a large amount of USO banknotes needed to satisfy local demand and consequently, there was an increase in the surplus of notes at the end of the month.</td>
<td></td>
</tr>
<tr>
<td>PARAGUAY</td>
<td>Nov 2008</td>
<td>USO</td>
<td>$8,500</td>
<td></td>
<td></td>
<td></td>
<td>USO $8,500 Cautionary No live deal, transaction was created to recover the client's USO balances from the previous month.</td>
<td></td>
</tr>
<tr>
<td>PARAGUAY</td>
<td>Dec 2008</td>
<td>USO</td>
<td>$6,800</td>
<td></td>
<td></td>
<td></td>
<td>USO $6,800 Cautionary USO volumes in Paraguay were affected due to putting the client's USO balances into a live deal, which caused a reduction in the amount of USO notes needed to satisfy local demand.</td>
<td></td>
</tr>
<tr>
<td>PARAGUAY</td>
<td>Jan 2009</td>
<td>USO</td>
<td>$3,500</td>
<td></td>
<td></td>
<td></td>
<td>USO $3,500 Cautionary was able to part of the volume, but the average for previous months was about $12,000. In Paraguay, there is an inflow of US banknotes originated in the commercial sector in the tri-border area and an out-flow of US banknotes caused by polyvinyl chloride businesses to work on the dairy supply and not pay the local banks.</td>
<td></td>
</tr>
<tr>
<td>PARAGUAY</td>
<td>Mar 2009</td>
<td>USO</td>
<td>$19,500</td>
<td></td>
<td></td>
<td></td>
<td>USO $19,500 Cautionary was able to reduce the amount of USO notes paid out by the local banks due to the increase in soy prices.</td>
<td></td>
</tr>
<tr>
<td>PARAGUAY</td>
<td>Nov 2009</td>
<td>USO</td>
<td>$12,373</td>
<td></td>
<td></td>
<td></td>
<td>USO $12,373 Cautionary USO volumes in Paraguay were affected due to the ending of the trade relationship with other banks in the region, increasing competition from other local banks to capivate the USO market share.</td>
<td></td>
</tr>
<tr>
<td>URUGUAY</td>
<td>Apr 2009</td>
<td>USO</td>
<td>$10,673</td>
<td></td>
<td></td>
<td></td>
<td>USO $10,673 Cautionary was able to recover part of the volume in the Uruguayan market, but the average for previous months was $15,000. In Uruguay, there is an inflow of US banknotes originating in the commercial sector, and an out-flow of US banknotes caused by polyvinyl chloride businesses to the local banks.</td>
<td></td>
</tr>
<tr>
<td>URUGUAY</td>
<td>May 2009</td>
<td>USO</td>
<td>$13,037</td>
<td></td>
<td></td>
<td></td>
<td>USO $13,037 Cautionary was able to reduce the amount of USO notes paid out by the local banks due to the increase in soy prices.</td>
<td></td>
</tr>
<tr>
<td>URUGUAY</td>
<td>Jun 2009</td>
<td>USO</td>
<td>$8,963</td>
<td></td>
<td></td>
<td></td>
<td>USO $8,963 Cautionary was able to reduce the amount of USO notes paid out by the local banks due to the increase in soy prices.</td>
<td></td>
</tr>
<tr>
<td>URUGUAY</td>
<td>Jul 2009</td>
<td>USO</td>
<td>$4,300</td>
<td></td>
<td></td>
<td></td>
<td>USO $4,300 Cautionary was able to reduce the amount of USO notes paid out by the local banks due to the increase in soy prices.</td>
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</tr>
<tr>
<td>URUGUAY</td>
<td>Aug 2009</td>
<td>USO</td>
<td>$9,000</td>
<td></td>
<td></td>
<td></td>
<td>USO $9,000 Cautionary was able to reduce the amount of USO notes paid out by the local banks due to the increase in soy prices.</td>
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</tr>
<tr>
<td>URUGUAY</td>
<td>Sep 2009</td>
<td>USO</td>
<td>$5,800</td>
<td></td>
<td></td>
<td></td>
<td>USO $5,800 Cautionary was able to reduce the amount of USO notes paid out by the local banks due to the increase in soy prices.</td>
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<tr>
<td>URUGUAY</td>
<td>Oct 2009</td>
<td>USO</td>
<td>$2,500</td>
<td></td>
<td></td>
<td></td>
<td>USO $2,500 Cautionary was able to reduce the amount of USO notes paid out by the local banks due to the increase in soy prices.</td>
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<tr>
<td>URUGUAY</td>
<td>Nov 2009</td>
<td>USO</td>
<td>$1,000</td>
<td></td>
<td></td>
<td></td>
<td>USO $1,000 Cautionary was able to reduce the amount of USO notes paid out by the local banks due to the increase in soy prices.</td>
<td></td>
</tr>
<tr>
<td>URUGUAY</td>
<td>Dec 2009</td>
<td>USO</td>
<td>$1,500</td>
<td></td>
<td></td>
<td></td>
<td>USO $1,500 Cautionary was able to reduce the amount of USO notes paid out by the local banks due to the increase in soy prices.</td>
<td></td>
</tr>
<tr>
<td>Country</td>
<td>Customer Name</td>
<td>Traded Currency</td>
<td>Trade Date</td>
<td>Amount (in Thousands)</td>
<td>Activity Description</td>
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<tr>
<td>URUGUAY</td>
<td></td>
<td>USD</td>
<td>Mar-05</td>
<td>$10,000</td>
<td>Medium</td>
<td></td>
<td></td>
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</tr>
<tr>
<td></td>
<td></td>
<td>USD</td>
<td>Apr-05</td>
<td>$10,000</td>
<td>Medium</td>
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<td></td>
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<tr>
<td></td>
<td></td>
<td>USD</td>
<td>Jan-06</td>
<td>$7,000</td>
<td>Medium</td>
<td></td>
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<tr>
<td></td>
<td></td>
<td>USD</td>
<td>Mar-05</td>
<td>$8,171</td>
<td>Medium</td>
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</tr>
<tr>
<td></td>
<td></td>
<td>USD</td>
<td>Jul-06</td>
<td>$10,000</td>
<td>Medium</td>
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</tr>
</tbody>
</table>

This Central Bank is collecting the old notes from the local market and replacing them. They are planning to keep doing this and the goal is to clear the Uruguay market of notes older than 1999.

The small denomination notes came from small banco branches in the local market. The small denomination notes that are not used in the local market are sold with a small discount (often below $10) to local companies that deal in cash. If the banknotes are not sold, they are returned to the Central Bank.

The Central Bank is also trying to clear the market of notes from 1999 and earlier. These notes are sold at a discount to local companies. The Central Bank is also using the proceeds from the sale of these notes to purchase new USD notes in the market, which are then used to replace the older notes.

Due to the current market conditions, the Central Bank is not able to sell all the old notes. The banknotes are sold at a discount, and the proceeds are used to purchase new USD notes in the market. The Central Bank is not able to clear the market of all the old notes, but the discount is offered to encourage the sale of these notes.

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### BANKNOTES-NY Selected Customers' Activity Alerts & Traders' Explanations for USD Purchases & Sales from 2005-2009

<table>
<thead>
<tr>
<th>Country</th>
<th>Customer Name</th>
<th>Alert / Review Date</th>
<th>Currency</th>
<th>Purchase or Sale</th>
<th>USD Amount (in thousands)</th>
<th>Credit Score</th>
<th>Risk Rating</th>
<th>Traders' Explanations &amp; Follow-up into requests/relations by Compliance</th>
</tr>
</thead>
<tbody>
<tr>
<td>URUGUAY</td>
<td></td>
<td>Oct-08</td>
<td>USD</td>
<td></td>
<td>$7,000</td>
<td>Medium</td>
<td></td>
<td>Due to the international financial crisis and the economic uncertainty generated in Argentina's economy, an increase in the volume of the purchases, and the increased demand for USD banknotes from people exchanging their savings in USD and withdrawing the savings from the bank's accounts. The Uruguayan economy is a tightly integrated economy, the banknotes of the Uruguayan economy were valued in Argentina. Uruguay's banking system has a higher reputation than the Argentina one, and therefore, many wealthy Argentines have their savings deposited in Uruguay. However, the demand of USD banknotes is not only due to the international financial crisis but also to the political instability caused by the Argentinian uncertainty. In an example, Uruguay suffered a severe financial crisis in 2001 as a consequence of the Argentinian financial crisis in 2001.</td>
</tr>
<tr>
<td>URUGUAY</td>
<td></td>
<td>Feb-09</td>
<td>USD</td>
<td>P</td>
<td>$7,001</td>
<td>Medium</td>
<td></td>
<td>They sell an excess of small denomination and bad condition notes that they were not able to recirculate in the local market. The demand of USD banknotes was the result of the tax and the increased demand in Uruguay and consequently there is a large amount of USD circulating in the economy. Typically, the banks will try to gather their own needs, and they will extend the network.</td>
</tr>
<tr>
<td>URUGUAY</td>
<td></td>
<td>May-09</td>
<td>USD</td>
<td>P</td>
<td>$4,113</td>
<td>Medium</td>
<td></td>
<td>They sold an excess of small denomination and bad condition notes that they were not able to recirculate in the local market.</td>
</tr>
<tr>
<td>URUGUAY</td>
<td></td>
<td>Aug-09</td>
<td>USD</td>
<td>P</td>
<td>$7,001</td>
<td>Medium</td>
<td></td>
<td>They sold an excess of small denomination and bad condition notes that they were not able to recirculate in the local market.</td>
</tr>
</tbody>
</table>
From: Vivenzio, James
Sent: Tuesday, June 22, 2009 6:36 PM
To: Boss, Joseph
Cc: Tabor, Teresa
Subject: FW: HSBC
Attachments: HSBC Initial Contact.doc
FYI

From: Vivenzio, James
Sent: Wednesday, July 29, 2009 5:24 PM
To: Stipano, Dan; Belshaw, Sally; Dailey, Grace
Cc: Boss, Joseph; De La Garza, Elsa; Wagner, John
Subject: RE: HSBC

Here are my notes concerning my conversations with the agents. I will have set up a meeting in Washington with everyone on this email, the two agents and I will also request that they put together some sort of a timeline for us since this case goes back nearly two years.

Regards, Jim V.

From: Stipano, Dan
Sent: Wednesday, July 29, 2009 2:02 PM
To: Stipano, Dan; Belshaw, Sally; Dailey, Grace
Cc: Boss, Joseph; De La Garza, Elsa; Vivenzio, James; Wagner, John
Subject: RE: HSBC

I spoke further with the agents. He wants to know if there is a U.S. supervisor for HSBC-Mexico. He also wants to know when we expect our exam to be completed. I told him I’d get back to him on these questions – please advise.

Separate from my conversations, Jim was contacted today by two agents who are also involved in the investigation. They provided Jim with additional information about particular accounts, etc., and requested a meeting with us. We should take them up on this.

From what I can tell, this has the makings of potentially being a major criminal case – we need to be all over it.

Jim, please weigh in here concerning the substance of the call you received.

Daniel P. Stipano
Deputy Chief Counsel
Office of the Comptroller of the Currency

From: Stipano, Dan
Sent: Wednesday, July 29, 2009 1:44 PM
To: Belshaw, Sally; Dailey, Grace
Cc: Boss, Joseph; De La Garza, Elsa
Subject: RE: HSBC

Permanent Subcommittee on Investigations

Exhibit #38

Confidential & Non-public OCC Information

OCC-PSI-00926796
I think the important thing is that we take a close look at the Banknote area, which it sounds like we are doing. I would be particularly interested in the bank's level of due diligence on its Mexican customers, and a review of transaction activity involving those customers to ensure that the bank is satisfactorily identifying and reporting suspicious transactions. I will circle back to this and let him know that we are in the process of conducting an examination of the Banknotes area right now. If he identifies any key areas for us to consider looking at, I'll pass them on.

Daniel P. Stipano
Deputy Chief Counsel
Office of the Comptroller of the Currency

From: Belshaw, Sally
Sent: Wednesday, July 29, 2009 1:30 PM
To: Stipano, Dan; Dailey, Grace
Cc: Boss, Joseph; De La Garza, Elsa
Subject: FW: HSBC

As Joe indicates, we are in process of a review of this area now. The specific MRAs from our prior review had been cleared. If there is something we should do (or not do) as a result of this investigation, please let us know.

Regards, Sally

From: Boss, Joseph
Sent: Wednesday, July 29, 2009 1:25 PM
To: Belshaw, Sally
Cc: Boss, Joseph; De La Garza, Elsa
Subject: RE: HSBC

Sally,

We do not have supervisory responsibility for HSBC Mexico. The last Banknote examination encompassing the geographic area of Mexico was our "New York" Banknote examination which was conducted in 2005 (copy of Supervisory Letter attached). As you can see from the letter we had a number of MRAs involving consistent oversight of the KYC and EDD process, instances where the customer information, required by the bank's internal policies and procedures, was not obtained and/or the information obtained was not properly analyzed, instances in which profile information was either not obtained or the analysis of the information was inadequate, no monitoring had in fact occurred for those clients subject to conditional approval and the specific monitoring instructions of the BSA/AML Director, lack of identifying PEPs and that the current category of SCC clients does not account for the potential for reputation risk based on other adverse risk factors to include clients from jurisdictions that have, or clients who have, based on current events, become subject to enhanced regulatory, legal, media or other public scrutiny.

We are currently conducting a "New York" Banknote examination which includes Banknote clientele from the Mexico. If there is something that we should be doing to assist in matters, we can take the opportunity to do so during this current examination. If we are to take on some additional work during this examination, please let Elsa de la Garza know as she is acting EIC as I am on annual leave starting tomorrow.

Joe
From: Belshaw, Sally
Sent: Wednesday, July 29, 2009 12:33 PM
To: Boss, Joseph
Subject: FW: HSBC
Joe: Let’s discuss. Sally

From: Stipano, Dan
Sent: Wednesday, July 29, 2009 12:32 PM
To: Belshaw, Sally; Dailey, Grace
Cc: Wagner, John; Vivenzio, James
Subject: HSBC

Sally and Grace,

This morning I spoke to [redacted] at AUSA in the Eastern District of N.Y. [redacted] that his office is in the early stages of investigating possible money laundering through the repatriation of U.S. currency through accounts at the banknotes division of HSBC-NY. The scheme that [redacted] described is similar to activity that we have seen at Union Bank, Wachovia, and Zions. Basically, the way it works is that drug money is physically hauled across the border into Mexico, then brought back into the United States through wire transfers from casas de cambio or small Mexican banks, or else smuggled across the border in armored cars, etc., before being deposited in U.S. institutions. According to [redacted] most U.S. banks, recognizing the risks involved, have gotten out of this business, but HSBC-NY is one of the last holdouts (although, interestingly, he said that HSBC-Mexico will no longer accept U.S. currency).

[redacted] wanted us to be aware of his investigation, but he also wanted to know: 1) whether the OCC has supervisory authority over HSBC-Mexico; and 2) whether we have done any recent examinations of the banknotes area at HSBC-NY. I told him I didn’t know the answers to his questions, but I would get back to him. Can you help?

Thanks,

Dan
Daniel P. Stipano
Deputy Chief Counsel
Office of the Comptroller of the Currency
Conducting an Enhanced KYC for Grand Cayman Account Holders

Proposal to Update the Strategy to Control Risk arising from Grand Cayman Accounts
Background
HBMX CEO requested to conduct an enhanced due diligence (KYC) for all Grand Cayman CDAs DDAs.

- The Bank has been recently fined for offering this product in Mexico, and money laundering red flags have been identified.
- On 28JUL, CMP gave instructions to suspend this product.
- On 31JUL08, Segment Directors were requested by CEO that an enhanced KYC will be completed for all Grand Cayman accounts before 01DEC08.
- As of JUL08, in Grand Cayman CDA/DDA product there were 49,937 customers, and its portfolio was approximately USD 1,500 million.
- Currently, this product is expected to be re-opened, as long as necessary adjustments to systems, processes and documentation are made, with stricter controls, and if Group Compliance’s sign-off is obtained.
- On 26SEP, Segment Directors reported that almost no progress has been made in enhanced KYC completion. In addition, a central validation of enhanced KYC quality is not in place.
- According to Remediation Project results, success rate in file completion is approximately 25%.
- This means that if this strategy is followed, it will not be possible to complete more than 25% of required enhanced KYC Forms by 01DEC08.

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As of JUL08, in Grand Cayman CDA/DDA product there were 49,937 customers, and its portfolio was approximately USD 1,500 million.

Currently, this product is expected to be re-opened, as long as necessary adjustments to systems, processes and documentation are made, with stricter controls, and if Group Compliance’s sign-off is obtained.

On 26SEP, Segment Directors reported that almost no progress has been made in enhanced KYC completion. In addition, a central validation of enhanced KYC quality is not in place.

According to Remediation Project results, success rate in file completion is approximately 25%.

This means that if this strategy is followed, it will not be possible to complete more than 25% of required enhanced KYC Forms by 01DEC08.
Actions Taken Up to Date
The institution has taken mitigating actions for risk arising from this product.

- Implementing online controls to identify if customers are blacklisted people/PEPs at HSBC account opening.
- Implementing a monthly control for customers who make cash transactions and USD transactions over USD 100K.
- In order to re-open the product, it will be required to conduct an enhanced KYC of all new customers and cash deposits will be limited to USD 10K, for individuals, and USD 100K, for corporations.
- Updating Circulars and Work Instruction Manuals applicable to this product.
- Detailed Analysis of risk profile of approx. 50,000 Grand Cayman customers as shown in following slide:
**Existing Risk Arising From Grand Cayman Accounts**

Significant Risk degrees from Grand Cayman accounts is in 3341 customers, i.e., 6.69% of total customers.

<table>
<thead>
<tr>
<th>Traffic Light</th>
<th>Description</th>
<th>Customers</th>
<th>Accounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>High Risk</td>
<td>SCCs, mainly customers reported to the authority (SARs) and/or with transactions over USD 100K.</td>
<td>1,314 (2.63%)</td>
<td>2,240</td>
</tr>
<tr>
<td>Medium Risk</td>
<td>Customers with CAMP alerts (unusual transactions), but without SARs</td>
<td>262 (0.51%)</td>
<td>2,084</td>
</tr>
<tr>
<td>Low Risk</td>
<td>Customers with normal transaction profile, since alerts had not been generated by monitoring systems for them.</td>
<td>46,594 (93.31%)</td>
<td>57,262</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td></td>
<td>49,835</td>
<td>81,586</td>
</tr>
</tbody>
</table>
### High-Risk Customers - Present Status

<table>
<thead>
<tr>
<th>Customers Group</th>
<th>Recommended Action</th>
<th>Customers</th>
<th>Accounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initials - On Review</td>
<td>To close accounts when remediation efforts complete</td>
<td>1,314</td>
<td>2,240</td>
</tr>
<tr>
<td>Remediation Efforts (Phase 1)</td>
<td>close accounts for those already completed through legal means</td>
<td>165</td>
<td>13</td>
</tr>
<tr>
<td>Status 9 and 13</td>
<td>To close these accounts, once respective segments have confirmed it</td>
<td>258</td>
<td>365</td>
</tr>
</tbody>
</table>

| Included in Remediation Efforts (Phase 1) | Complete Action; These accounts have already been targeted, completed, automatically closed, or will be closed through legal means | 321 | 135 |
| Not Included in Remediation Efforts (I and II) | To conduct an Enhanced KYC by 31 OCT or close the account | 153 | 195 |

Compliance currently working on the application of the same method to amber and white groups.
**Proposed Strategy**

A risk-based strategy is proposed, which needs less resources.

<table>
<thead>
<tr>
<th>Traffic Light</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Red</strong></td>
<td>4 572 customer files are being prepared to be completed by 31OCT08; through Remediation Efforts 2nd phase (including central quality control). 4 Incorporate 153 customers into this effort. 4 To close immediately 258 customers with status 9 and 13.</td>
</tr>
<tr>
<td><strong>Amber</strong></td>
<td>4 To complete the examination of file completion status and follow a method similar to that developed for red traffic light. 4 These files should be completed by 31OCT08.</td>
</tr>
<tr>
<td><strong>White</strong></td>
<td>4 Schedule the completion of these files for the Third Phase of Remediation Project, starting in NOV08. 4 Apply a permanent monitoring to this universe so as to give priority to the files of those customers whose risk status may increase from time to time to amber/red traffic light. 4 In addition, a control will be implemented to monitor risk associated with dramatic changes in transaction profile.</td>
</tr>
</tbody>
</table>

**Total of Customers / Grand Cayman Accounts by Risk Level**

<table>
<thead>
<tr>
<th>Traffic Light</th>
<th>Description</th>
</tr>
</thead>
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<tr>
<td><strong>Red</strong></td>
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</tr>
<tr>
<td><strong>White</strong></td>
<td>4 Schedule the completion of these files for the Third Phase of Remediation Project, starting in NOV08. 4 Apply a permanent monitoring to this universe so as to give priority to the files of those customers whose risk status may increase from time to time to amber/red traffic light. 4 In addition, a control will be implemented to monitor risk associated with dramatic changes in transaction profile.</td>
</tr>
</tbody>
</table>
### Strategic Options for Managing Grand Cayman Accounts Risk

<table>
<thead>
<tr>
<th>Strategy</th>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>Continue with present strategy to complete an enhanced KYC for all accounts</td>
<td>* Remove all existing risk by closing all accounts of this product massively, effective from DECOB.</td>
<td>* File Completion Progress will possibly be 25%, and as a result around 37,000 accounts will be closed.</td>
</tr>
<tr>
<td>Risk-Based Strategy proposed in this document</td>
<td>* Implement a better risk control and close high risk accounts immediately</td>
<td>* The funding from this product will be lost.</td>
</tr>
<tr>
<td></td>
<td>* Incorporate this documentation into Remediation II</td>
<td>* There is not a dual control for checking enhanced KYC and file completion.</td>
</tr>
<tr>
<td></td>
<td>* None focused Work Load for branches.</td>
<td>* It is not possible to complete enhanced KYC within established timescale.</td>
</tr>
<tr>
<td></td>
<td>* Dual Control for checking progress achieved in File Completion and Enhanced KYC Completion.</td>
<td>* If enhanced KYC completion for white traffic light customers is deferred, a certain risk level will continue in place.</td>
</tr>
</tbody>
</table>
From: DENISE A RILEY/HSBC
Sent: 3/25/2001 8:18:28 AM
To: CAROLYN WIND/HSBC@HSBCAMERICAS, ANNE LADDY/HSBC@HSBCAMERICAS
CC: Subject: BANK MEU

FYI

---------------------- Forwarded by Denise A Riley/HSBC on 05/25/2001 09:16 AM ----------------------

Michael B Gallagher @ REPUBLIC on 25 May 2001 10:54
Note
25 May 2001 09:54

From: Michael B Gallagher @ REPUBLIC Tel: 212-525-9880
Title: Executive Vice President Location: 452 5th Ave, Floor 5
Work Group: Global Printing and Mail Mail Size: 956 F0

To: Denise A Riley/HSBC@HSBCAMERICAS

cc: Douglas Stilberg/HSBC

Subject: FYI

FYI: Please be on the record as not confidential with this piece of business.

Michael

---------------------- Forwarded by Michael B Gallagher/HSBC on 05/25/2001 12:58 AM ----------------------

Denise A Riley @ HSBCAMERICAS on 22 May 2001 13:45
Note
22 May 2001 13:45

From: Denise A Riley @ HSBCAMERICAS Tel: 202-686-2503
Title: Senior Vice President Location: Delaware
Work Group: Payment Services Mail Size: 43118

To: Carolyn Wind/HSBC/HSBC@HSBCAMERICAS
Anne Laddy/HSBC@HSBCAMERICAS
Michael B Gallagher/HSBC@HSBCAMERICAS

Subject: BANK MEU

Confidential - FOIA Treatment Requested by HSBC N. America Holdings, Inc. HSB02545276
Confidential - FOIA Treatment Requested by HSBC Bank USA N.A. HSB OCC 0816093
Confidential Treatment EXHIBIT #40
FyI

--------- Forwarded by Denise A.Rally/HSBC/MDC on 06/22/2001
08:45 AM ---------

Brian W.RICHARD@HSBC
22 May 2001 05:32

To: Denise A.Rally/HSBC/HSBC@HSBCAMERICAS
cc: John R.WILKINSON/HSBC@HSBC
Peter C.BUCH/HBUC@HSBC@HSBC

Subject: BANK.MELI

Denise,

I refer to John Wilkinson’s Email of 18MAY01.

I met Melli yesterday and enquired re names of the principal beneficiaries of their payments - as you will see from the attached Call Report, as expected. Melli could not assist.

Brian

Attachment: d:20010522 BWR NH Sadeghi/for Hazer Pourjam.doc.zip
INSTITUTIONAL BANKING
(CIB JSL)

CALL DATE: 21 MAY 21
CBD: BBDQ
CALL REPORT NO: 116184

BANK NAME: INSTITUTIONAL BANKING
ADDRESS: 30 Park Street
London
EC2R 6AL

PARENT:

GROUP RELATIONSHIP MANAGER: Chris Banerjee

MARKETING CATEGORY: MJP
PLACE OF CALL: Restaurante, Vitters Place

PERSON(S) CONTACTED AND TITLE(S):
1. Mr. Aamir Sadeghfar, Director General
2. Majid Nazir, Head of Corporate Lending & Trade Finance
3. Mr. Saeed Pirajam, Cash and Payments Manager

HSBC GROUP CALLING OFFICERS:
1. Dr N. Homam, Iran Representative
2. Brian Kitterer, Area Manager, Middle East & Africa, CIB JSL
3. Phil Smith, HSBC TreasURING

RELATIONSHIP/ACCOUNT PLAN OBJECTIVES:
1. Increase Trade Business with credit constraints
2. Develop Treasury relationship within credit constraints
3. Offer an improved service delivery for residential
4. Obtain CLS registration

CALL OBJECTIVES:
1. Discuss USD currency
2. Discuss trading opportunities

Confidential - FOIA Treatment Requested by HSBC N. America Holdings, Inc. HSBC02545278
Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A. HSBC OCC 0616095
Confidential Treatment Requested HSBC-PSI-PROD-0096140
NARRATIVE: (RELATIONSHIP INFORMATION, BUSINESS DEVELOPMENT*, COMPETITION/OTHER ISSUES)

Business Development

- USD account - draft proposal handed over to Melli personnel. Explained the Customer Charter would follow after negotiation with Melli management. OLAM explained, and stressed its use was unconditioned to our offer. Was informed tariff payment flow was every 300 per day, with USD 2 bllion. As expected, unable to answer HSUS enquiry on main beneficiaries - i.e., imports from many countries via countless suppliers worldwide.
- Lloyds - BWR appended to learn that Melli has moved most of its USD business from RBS to Lloyds, and has opened a trade facility account with Standard Chartered. However, still seem keen to use HSBC.
- CLS - known by Melli personnel present. Touched upon the structure and advantages of using HSBC, including the same portal interface as OLAM. Details sought.
- Melli London seeks a "dedicated" silent confirmation line. Homepour indicated his support - JBL will process with FCC.

Other

- HSBC Tblow is establishing lines of credit for HKBA and HBAU as grain export
- HSBC is progressing its plans to open a "virtual bank" in Kish offshore, opening planned for mid 2002. It remains a joint venture with NIC (in which Melli is a shareholder).

PARENTAL SUPPORT/PERFORMANCE: (CAPITAL, ASSET QUALITY, MANAGEMENT, EARNINGS, LIQUIDITY)

- Melli Bank plc will commence business end JUN 01
- The new UK subsidiary will be the vehicle for a planned expansion into Europe
- Melli presently only has branches in Germany (2) and Paris
- The initial capital will be USD 300 mil

ACTION:

1. Revise Tender document - JW/GPCM
2. Establish invoice structure - JW
3. Prepare Customer Charter - JW
4. Send CLS details and place on mailing list - GPCM
5. Can we assist re dedicated London CCR line? - JW
DISTRIBUTION:
Daily circulation, J Richards, N Weir, Q Aylward, D Reilly, P Bland

NEXT CALL DATE: 31/05
DATE OF THIS REPORT: 21 MAY 01
SIGNATURE:

Confidential - FOIA Treatment Requested by HSBC N. America Holdings, Inc.

Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A.

Confidential Treatment Requested
From: DENISE A. REILLY@HSBCHSBC
To: DOUGLAS STOLBERG@HSBCAMERICAS
CC: JOE.HARPSTER@RNB.COM; MICHAEL B. GALLAGHER@HSBCAMERICAS
Subject: Re: Bank Mell

The following memo is background information on the Bank Mell business, prepared by John Richards, Group Representative Iran. Additionally, in a conference call that Joe Harpster, Compliance and I had with HSBU and Richards on 6/27, it was relayed to us that the Group (with the backing of Bond) was looking to significantly grow our presence in Iran. Current lines of credit were reported to be $800m, trade lines of $150m and growth was anticipated in trade, cash management and Internet banking. The Bank Mell clearing was viewed by Richards and others as not only profitable as a standalone but also key to winning additional business.

It should also be noted that at the time this proposition came to our attention, HSBU had already consulted with both Matthew King and external counsel and advised a comfort level from both quarters.

Given the seriousness of the business proposal, we continue due diligence on the transaction flow. The decision is primarily a Compliance legal one and we are working closely with them on the operational feasibility of any proposed transaction flow.

From: John L. RICHARDS@HSBCHSBC
Mail Size: 4106
To: Brian W. RICHARDS@HSBCHSBC
Subject: The Central Bank of Iran

Dear Brian

We have been approached by the Central Bank of Iran to take back their USD clearing business from NatWest. In principle I am keen to do this but (in the clear proviso that it can be done profitably and on a sustainable basis).

One of our key objectives for the year is to develop HSBC’s Asset Management activities in Iran and with the Central Bank now managing the oil price stabilization fund amounting to some USD1bn there is considerable scope for this. Obviously many foreign banks are chasing the same business and so we need to demonstrate some competitive or relational advantage. The proposal from the Central Bank was therefore not unwelcome.

I had an initial meeting with Mr. Nowbarah, Director Int’l Dept of the Central Bank yesterday along with Nigel Weir-Wilo who is visiting Tehran. I emphasised that if we were to do this we would need to have detailed discussions so that we are clear what is required of us and what we require of them. The Central Bank manage their transactions through Bank Mell London and the intention would be that negotiations are held with Mr. Saderigh.

I would like to end up with a written agreement so that all parties are aware of what they are committing to. Although negotiating with Iranians is a frustrating activity we are in a strong position. They have been disabled with NatWest and with the exception of LLoyds, who will have the same issue we
have there is little competition. I also assume that our technology advances will make the business more attractive than it was in the past.

I shall be grateful for your thoughts on this and your advice on how I should take this forward. Nigel is here until Thursday and if possible I shall be grateful for your initial feedback before he leaves so that I can discuss the matter further with him. I am sure that he will take this up with you himself but at the end of the day negotiations will be held in London and will be driven by you.

Nasser and I will be in the UK on Feb 14th and 15th to help host a presentation to a number of Iranian Bank Managing Directors in association with Robert Gray and the investment bank. Subject to your views we can join any negotiation meetings that are arranged over that time.

In summary if we can make this business independently profitable and sustainable the benefits that we can derive particularly from the Treasury, Asset Management and investment banking spin off will be substantial. I want therefore to agree a strategy of how we go forward and who we involve before we make any further contact so that I am aware of all the issues involved.

I appreciate your help with this

Best regards

John

Doug:

To: Denise A Reilly/HBUSJHSSC@HSBCAMER1CAS
cc: Joe.Harpst@r@mb.com
Michael B Gallagher/HBUSIH.SBC@HSBCAMERICAS
Subject: Bank Melli

Denise and others,

With the amount of smoke coming off this gun, remind me again why we think we should be supporting this business?

Doug

Denise A Reilly on 11 Jul 2001 17:16
Note
11 Jul 2001 17:16

From: Denise A Reilly Tel: 302.636.2500 Del
Title: Senior Vice President Location: Delaware
WorkGroup: Payment Services Mail Size: 33351

To: Douglas Stolberg/HBUS@HSBC@HSBCAMERICAS

Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A. HSBC OCC 8876129
cc: Joe.Rappaport@rnb.com
Michael R. Galsworthy@HSBC@HSBCAMERICAS
Subject: Bank Mell

This is an issue that you should be aware of. As described in Carolyn's memo, we have had ongoing discussions on the topic of Iranian payments both internally, with HBUS and with HBEU. HSUS Compliance and HBUS have also consulted with external counsel. The genesis for the discussion was an RFP for HBEU Treasury to handle Bank Mell’s USD clearing. From an operational perspective, we will follow Compliance’s direction as to whether we should support this business and if agreed, will establish any required operational controls.

Given the level of attention this is now getting, it may be raised at the SMC and will be included in the quarterly Compliance report.

I will keep you apprised.

---
Forwarded by Denise A Reilly@HSBC on 07/11/2001 04:37PM--

Carolyn Wind on 11 Jul 2001 11:11
Note
11 Jul 2001 11:13
From: Carolyn Wind Tel: 212 525 5563
Title: Executive Vice President Location: 452 58 Ave, Floor 07
WorkGroup: NYTC Compliance Mail Size: 29902
To: Matthew J. Wind@HSBC@HSBC
cc: Paul L. Lee@HSBC@HSBCAMERICAS
Anne Liddy@HSBC@HSBCAMERICAS
Elizabeth Protomastro@HSBC@HSBCAMERICAS
Denise A. Reilly@HSBC@HSBCAMERICAS
Subject: Bank Mell

Matthew, this e-mail is to summarize the issues we discussed yesterday regarding HBEU Bank Mell proposal. As you know, HSUS was initially approached in January 2001 with the proposal that HBEU would use its USD account with HSUS to clear USD payments for Bank Mell. Subsequently, there has been an extensive review of the matter, including input from two outside US legal firms. The first issue we reviewed was whether or not the underlying transactions originated by Bank Mell are permissible under the Iranian Transactions Regulations. The regulations provide a general license for transactions that meet the “U-Turn” definition and so we have gone back and forth on whether the proposed underlying transactions meet this definition. There continues to be some disagreement between the advice from our two outside law firms on this point, but we could probably resolve the difference. Of more concern at the second issue which is that given the way the payment orders are to be constructed and formatted, HBEU will not be able to confirm whether or not the underlying transaction actually meets the “U-Turn” definition. It is not apparent that HBEU will be able to confirm that each payment meets the requirements. In an effort to facilitate “straight-through” processing, it now appears that HBEU will train Bank Mell on handling the payments and that we will be relying on Bank Mell to ensure that only qualifying payments are processed through HBEU’s account with HSUS. (See attached letter to Bank

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Melli. If OFAC identifies a transaction that does not qualify, it might view HSSC's actions as involving willful disregard of non-disclosure as having involved willful disregard of non-disclosure. Given the large dollar amounts and volume of activity proposed (350-400 transactions per day), if OFAC took such a view, potential liabilities could be substantial and would certainly impact HBUS's relationship with OFAC.

So to recap:

A) Does the structure as proposed meet the U-turn requirement for processing? If Bank Melli and the second foreign bank do not appear on the MT202 processed by HBUS, how do we determine that the payment is in fact a U-turn?
B) HBUS will not know the foreign banks and, therefore, will not be able to monitor for compliance. Will HBUS be intimate HBEU of the second foreign bank? Will HBEU set up a function to monitor these payments for compliance with the U-turn?
C) If HBEU will set up a function to monitor the payments, is it possible that OFAC may not find it acceptable for HBUS to rely on HBEU to monitor payments for compliance with the U-turn?
D) If the foreign banks involved are not disclosed on the MT202 processed by HBUS, and neither HBEU nor HBUS is monitoring the payments for compliance, OFAC could refer to the section of the regulations regarding "evade" (Section 560.203). Definitions of permitted U-turn transactions under the Iranian sanctions:
The opinion received from outside counsel, Tom Crocker of Alston & Bird, on 2021-01-01 in regards to the proposed transaction per Peter Blenk's emails of 10/1/11 and 2/1/11 is quoted below.

"... the scenario outlined below does not appear to qualify for the so-called USD "U-turn" exception in the Iranian Transactions Regulations. Section 560.501(a)(1) of those Regulations provides a general license for dollar-clearing functions which meet the following criteria: the transfer must be
(1) by a foreign bank which is not an Iranian entity (2) from its own account at a domestic bank (3) to an account held by a domestic bank (4) for a second foreign bank which is not an Iranian entity." Diagramming this out, the chain would look as follows:

Foreign Bank (non-Iranian) — Domestic Bank — Domestic Bank — Foreign Bank (non-Iranian)

(The point of disagreement between legal firms is whether Foreign Bank 2 has to be a different bank from Foreign Bank 1. Our survey of other major USD clearing banks indicated that they follow the literal interpretation of the license, which is that two different foreign banks involved.)

TRANSACTION DETAIL
Below are summaries of HBUS' understanding of the first proposed transaction flow and the latest proposal.

Example 1: U-TURN TRANSACTION

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1. Bank Melli sends instructions to HBEU to:
   - debit Bank Melli’s account at HBEU
   - credit HBEU nostro with HBUS

2. HBEU sends instructions to HBUS to:
   - debit HBEU account
   - credit any foreign bank (via a USA correspondent for the foreign bank)
   - for further credit to the ultimate beneficiary

Note: Original HBEU suggestion on payment format would not mention Bank Melli as the originating bank.

Example II: Cover Payments (MT202 & MT100)

1. Bank Melli, London sends instructions to HBEU to:
   - debit their account with HBEU
   - credit HBEU nostro with HBUS

2. HBEU will send an MT202 to HBUS for:
   - debit HBEU’s account with HBUS
   - credit any foreign bank (either on our books or via a USA correspondent for the foreign bank)

Note: Current HBEU recommendation on format would not mention Bank Melli but would contain some reference identification on the specific transaction being settled between Bank Melli and their customer.

3. HBEU will also simultaneously send an MT100 to the foreign bank (credit party) referenced in the above MT202, supplying them with beneficiary details for applying the funds received from HBUS

Note: The MT100 is often processed prior to the MT202 due to time differences between the US and the beneficiary’s country.

3. HBEU Instructions to Bank Melli regarding how to format payments:
   - See attached email of 28JUN01 from John R. Wilkinson with a copy of the letter sent to Bank Melli with instructions on how to format the SWIFT messages.

From: John R. Wilkinson
CC: Joe Harpster@rnb.com
      Liddy@HSBC/HSBC@HSBCAMERICAS
      John L. Richards/HSBC/HSBCAMERICAS
      Brian W Richards/HSBC/HSBCAMERICAS
      Susan R. Wyman/HSBC/HSBCAMERICAS
      Terry J. Bellamy/HSBC/HSBCAMERICAS
      Nick J. Gallinger/HSBC/HSBCAMERICAS

Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A.  HSBC OCC 8876132
Subject: Re: Bank Melli

Dear [Name],

Per our conference call today, please find attached the letter 30APR11 sent by our Payments dept (MPD) to Bank Melli Iran London.

Once the proposition goes live we have instructed Bank Melli to alter the format of its payments to achieve straight through processing. The field 52 input of 'One of our clients' is a standard phrase used by MPD in these situations.

Since sending the letter we have further asked them to only put 'One of our clients' in field 52, thus removing the chance of them inputting an 'Iranian referenced' customer name, that causes fail out of the cover payment sent to HBU5 and a breach of OFAC regulations.

This method was successfully tested last month on a MT202 (bank to bank) and a MT100 (commercial) payment.

I understand your concerns following the recent formatting error detailed in Peter's email 15JUL11; however, I must provide some background for you:

MPD confirm that Bank Melli have not yet gone live on the new method of formatting payments, as we have not yet taken on the new business. Bank Melli are still formatting payments in their usual method; in this instance MPD failed to spot the poor input and did not follow their normal procedure of altering the payment, hence it was blocked. MPD have again confirmed the new formatting method will achieve straight through processing and overcome these difficulties.

I hope the above details are sufficient for your purposes and you are able to progress this matter forward as intimated in your earlier approval.

Attachment: 20010501 fm MPD to HBU5 re formatting.doc.zip

Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A.  HSBC OCC 8876133
Dear Saeed,

I refer to our meeting yesterday and our telephone conversation today. I am pleased to advise that following tests in our payments environment we are confident that we have found a solution to processing your payments with minimal manual intervention.

The key is to always populate field 52 - if you do not have an ordering party name then quote "One of our Clients", never leave blank. This ensures that the originating payment instruction from HSBC will not quote "Bak Melli" as sender - just HSBC London and whatever is in field 52. This then requires the need to quote "DO NOT MENTION OUR NAME IN NEW YORK" in field 72.

In order to test our proposed solution we would appreciate if you test the following templates when submitting your next payments to the following customer or alternatively select a USD 1 test payment.

MT203
20: Your Ref....
21: Related Ref....
32: Amount/Currency/Place date....
50: DO NOT QUOTE IF IRANIAN
52: Customer Name OR One or our clients MUST BE COMPLETED
53: W0960008
54:
56:
57: Beneficiary Banker (SWIFT codes where possible)
58: Beneficiary (SWIFT codes where possible)

70: Any Payment details for beneficiary....
72: Please leave blank.

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Pay as above.

In order for us to monitor/track these payments please call Adrian Taylor prior to release on 020 726... please use SWIFT standards, Adrian will be happy to discuss with your operator any questions they have on formatting.

When we have made these payments we can then give feedback on any further formatting issues.

Thank you in advance for co-operation.

Yours sincerely

John Forde

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John,

I will forward to you separately a note I sent to Mark Taylor which I hope may clarify things to a certain extent.

The position is difficult because things have changed since September 11. We also have to bear in mind pending US legislation which will in effect give the US extraterritorial authority over foreign banks, particularly if we are unfortunate enough to process a payment which turns out to be connected to terrorism. My own view therefore is that some of the routes traditionally used to avoid the impact of US OFAC sanctions may no longer be acceptable. I appreciate however that the solution will involve the installation of some form of automated screening system. We are looking into this now.

Until this is resolved, all we can do is to ask that payments from the affected countries...
are vetted manually. This is not easy and I agree we should talk about it in more detail on Monday.

I look forward to speaking to you then. Regards

Matthew King

David W. J. BAGLEY

General Letter
12 Oct 2001 11:29

Sent by: Araba A MANOIA

Matthew J. W. BAGLEY

To: Matthew W W KIN@HSBC
Cc: Susan A WAGG@HSBC
Work F 5710905151 CONF AP/2415666/HSBC
Fax: Demand W J BAGLEY@HSBC 071 44007159

Date: 01/02/94

Subject: OFAC SANCTIONS

Matthew,

In the light of the current attention being given to the applications of relevant sanctions, I feel that there is some need to clarify precisely what is expected of operations within my region in relation to the application of OFAC Sanctions when dealing in USD payments. I do this solely from the perspective of avoiding any misunderstanding.

A number of the OFAC sanctions could have potential effect upon business in this

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Region, the most obvious of which are those relating to Iran, Libya, and Sudan. As these are US sanctions, binding US persons they do not have the same effect as the UN sanctions against Iraq, and on the face of it do not bind either HSBB’s activities, or those of our customers in any of the above jurisdictions.

I recognise however that the sanctions do affect all transactions in USD, and that payments passing through the US are capable of being identified by the OFAC filters. Even if these sanctions involve, say, an HSBB UAE based customer, if there is a connection with one of the above jurisdictions it is likely that the payment will be frozen pending further investigation by OFAC itself.

There are of course risks for us if such a payment is frozen, particularly if the monies are frozen as between correspondent banks, and yet we have shown a credit to the customer’s USD account here in the Middle East. In the past we have been obliged to pursue a release of monies which have been released to a customer, but have been frozen through the correspondent banking system in the US.

What I am currently unclear about however is the extent to which we are expected to police and observe the OFAC sanctions when dealing in transactions for our customers. Recent notes seem to suggest that we should apply the OFAC sanctions regardless of jurisdiction.

As I understand the current position we do routinely, and across the Group, adopt differing approaches to payments potentially subject to OFAC sanctions, than to those payments that are unaffected.

This is achieved by a number of different methods.

What I am unclear about is whether these procedures is viewed as being inappropriate, and thus should be disallowed. We do not structure these payments against a specific request from the customer, rather we undertake this restructuring as a routine. I am advised that there may even be software in the UK which filters such payments for restructurings in the event that the original message has been structured in such a way that it will be caught by the OFAC filters.

Where we do disallow all payments which are potentially subject to the OFAC process, or forward messages in such a way that they would be caught, then clearly this would have a significant effect upon our business within the Middle East, but also the Group’s business within correspondent banking.

Equally given the likely volumes it is impractical to submit each payment to a process of referral to HSUS.

I would be grateful for your clarification as to whether what is currently going on is acceptable, or whether we should be adopting a different practice.
I recognise that with regard to sanctions which clearly bind HSME (e.g. - Iraq) we have no choice other than to ensure that sanctions are observed, that we undertake no transactions which are potentially caught by the sanctions, other than those permitted on the food for oil basis.

I have separately resolved the issue of EU sanctions, which would theoretically bind HSME as an EU person, where we have confirmation that to observe the sanctions within UAE would place the Bank at risk of double jeopardy.

I apologise for the length of the note, but having spoken to Mark Taylor both of us are a little unclear as to how far we are expected to observe sanctions which are non-binding in our jurisdictions in the current climate.

David

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Carolyn, I just spoke with Denise. We have tentatively set a date of Friday 10/25 at noon to call Gary Boon on his home number re Bank Melli. Will you be available? Thanks.

Anne Liddy on 18 Oct 2002 09:35

From: Anne Liddy
Sent: 17 Oct 2002 08:11
To: Gary Boon

Gary, the PM and I are booked to visit Iran in November and ideally want our position sorted re USD payments. I'm therefore getting eager to talk to you as we can see there are massive opportunities. It appears London and Iran are seeking a solution to this so your help is much appreciated.

If we can visit on Thursday and Friday here but 2pm is more than happy to talk to you either in person or tomorrow. Call me at home at between 12 noon & 1pm your time on 00 91 2 3452539 if you can.

Regards
Gary

Anne Liddy on 09 Oct 2002 08:24
From: Anne Liddy
Tel: 212-525-5906
Title: Senior Vice President
Location: 452 5th Ave, 7th Floor
Corporate Compliance

To: Gary BOON/MGR. POI MEM/HBME/HSBC
cc: Carolyn Wind/HSBC
Denise A Reilly/HSBC
Nancy Hedge/HSBC

Gary, I have a mtg already scheduled for 8am NYC time today. I will try to set up a call for another day/time and get back to you.

Gary BOON @ HSBC on 08 Oct 2002 23:53

From: Gary BOON/HSBC
Tel: 212-525-5906
Title: Senior Vice President
Location: 452 5th Ave, 7th Floor
Corporate Compliance

To: Anne Liddy/HSBC
cc: Carolyn Wind/HSBC
Denise A Reilly/HSBC
Nancy Hedge/HSBC

subject: Re: Bank Melliti

Gary BOON @ HSBC on 09 Oct 2002 23:53

From: Gary BOON/HSBC
Tel: 212-525-5906
Title: Senior Vice President
Location: 452 5th Ave, 7th Floor
Corporate Compliance

To: Anne Liddy/HSBC
cc: Carolyn Wind/HSBC
Denise A Reilly/HSBC
Nancy Hedge/HSBC

subject: Re: Bank Melliti

Gary BOON @ HSBC on 08 Oct 2002 23:53

From: Gary BOON/HSBC
Tel: 212-525-5906
Title: Senior Vice President
Location: 452 5th Ave, 7th Floor
Corporate Compliance

To: Anne Liddy/HSBC
cc: Carolyn Wind/HSBC
Denise A Reilly/HSBC
Nancy Hedge/HSBC

subject: Bank Melliti

Gary BOON @ HSBC on 08 Oct 2002 23:53

From: Gary BOON/HSBC
Tel: 212-525-5906
Title: Senior Vice President
Location: 452 5th Ave, 7th Floor
Corporate Compliance

To: Anne Liddy/HSBC
cc: Carolyn Wind/HSBC
Denise A Reilly/HSBC
Nancy Hedge/HSBC

subject: Re: Bank Melliti

As your peers now have to comply with the FATF regulations soon, which means full disclosure for all USD/GBP payments from all banks.

As my previous email explained these payments would then be sent to HSBC for processing. (examples of the type of instructions you've receive have been sent previously) and it is my belief that they will fall into the normal process. Your already processing USD payments from two existing accounts held

Page 2

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Gary

Anne Liddy on 08 Oct 2002 15:55

From: Anne Liddy
Tel: 212-512-5906
Title: Senior Vice President
Location: 452 5th Ave, Floor 07
WorkGroup: Corporate Compliance

To: Gary

Cc: Carolyn, Denise, Nancy Hedges

Subject: Bank Melt

Gary, I understand from Nancy’s e-mail that you are looking for feedback on the Bank Melt 67 proposal. The purpose of the US Compliance recommends enhanced risk profile to base line the proposal in that all transactions involving Bank Mel will be fully disclosed. If a business unit does not disclose the transaction, it will be flagged. A full disclosure will allow the U.S. payments filter to stop the USI transactions involving Bank Mel and will allow for review of the transaction by U.S. Payments Operations staff to ensure that the transaction fits the definition of a U.S. transaction allowable for processing under the U-turn exemption of the OFAC Iranian sanction.

It is still my understanding that the document attached below (see e-mail from Carolyn Kelly dated August 29, 2003) in the operating document for the suggestion of the transaction. The transaction flow would be as follows: the business unit would file a U-turn application, and the next step was that the operational process would be agreed between USU Payments Operations and US checks help desk to make sure that the proposed processing is a U-turn transaction allowable for processing under the U-turn exemption of the OFAC Iranian sanction. The next step would be that the operational process would be agreed between USU Payments Operations and US checks help desk to make sure that the operational process is a U-turn transaction allowable for processing under the U-turn exemption of the OFAC Iranian sanction.

-------------- Forwarded by Anne Liddy/HBVS/HSBC on 10/08/2002 03:13 PM

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Confidential - FOIA Treatment Requested by HSBC N. America Holdings, Inc. HSB98071279

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In preparation for our meeting this week, attached is the Bank Meliti 
transaction plan that was previously put forward and subsequently agreed to by 
workgroups. The plan has been vetted by legal counsel and should now be 
ready for HP allocation.

I will speak to you on Wednesday.
To: Alan WILKINSON/HBAP/HSBC@HSBC
Quentin RAYLWARD/DBK/HSBC
Carolyn M WIND/HBUS/HSBC
Matthew J W KING/GHC/HSBC
Eliizabeth PROVENZANO/HBUS/HSBCNA
John L RICHARDS/HBAP/HSBC

Subject: Bank Melli

The attached document reflects the procedures that have been developed, with the advice and consent of legal counsel, to support bank Melli payments through HBUS/HSBC. The procedure is designed to meet both regulatory and service quality requirements, with emphasis on the adherence to the 1-turn rule. All transactions sent to HBUS meeting the qualifications will be processed according to the procedures described in the attached document.

On Thursday of next week (6 September) we will be meeting with the Director of the Office of Foreign Assets Control and one of the senior Iranianans to determine their position regarding this business. In anticipation of that meeting, Carolyn Wind and I would appreciate your reviewing the document and if possible meeting with us tomorrow. (3 p.m., site time, via conference call to discuss. Please confirm your availability and a number where you can be contacted.

Attachment: Melli.doc.zip
From: ANNE LIDDY/HBUS/HSBC
Sent: 1/21/2003 1:00:08 PM
To: "CROCKER, TOM" <TCROCKER@ALSTON.COM>
CC: CAROLYN M WIND/HBUS/HSBC@HSBCAMERICAS; DENISE A REILLY /HBUS/HSBC@HSBCAMERICAS; ELIZABETH PROTOMASTRO/HBUS/HSBC@HSBCAMERICAS
Subject: USO payments from Iranian Banks

Tom,

At Carolyn Wind's request I am forwarding the attached memo to you for your review and comments. As you may recall, it was agreed that our London/Middle East office would put together a business case regarding plans for providing USD payments services to Iranian Banks (stemming from an initial request for HSBC Bank USA to process USD payment for Bank Mellin). The memo outlines that business case. After you have reviewed and provided us with your comments, which may require amendments to the business case, HSBC Bank USA had intended to present the business case to our Senior Management Committee prior to acceptance of the plan. We appreciate your attention to this matter and look forward to hearing from you on this much discussed topic. Thank you.

Regards,
Anne Liddy
HSBC Bank USA
compliance Department

Forwarded by Ms Liddy/HBUS/HSBC on 01/21/2003 11:00 AM

Denise A Reilly on 16 Jan 2003 09:19

( forwarded by Denise A Reilly/HBUS/HSBC on 01/16/2003 09:19 )

To: Anne Liddy/HBUS/HSBC@HSBCAMERICAS
Carolyn M Wind/HBUS/HSBC@HSBCAMERICAS
Subject: USO payments from Iranian Banks

I'm not sure why you were not cc'd on this, but I am forwarding for your review. Perhaps we can discuss tomorrow when I'm in NYC.

---------- Forwarded by Denise A Reilly/HBUS/HSBC on 01/16/2003 09:10 AM ----------

From: Nigel J WEIR@HSBC on 16 Jan 2003 03:56
To: Denise A REILLY/HBUS/HSBC@HSBCAMERICAS
Malcolm G EASTWOOD/HBUS@HSBCAMERICAS
Nasser MONAPOUR/HSBL/HSBCAPAC@HSBC
Gary BONN/HSB/HSB@HSBC
James J Y MADSlien/HBUS/HSBCAMERICAS

Subject: USD Payments From Iranian Banks

Denise,

Attached is our business case signed by Rick Nudler, seeking MM&B's approval to proceed with payments originating from Iranian Banks. There has been a great deal of correspondence relating to this issue over the past 2 years so I hope this document will precipitate a positive resolution.

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EXHIBIT #44

Kind Regards

Nigel

Attachment: Iran business case.doc.zip

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Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A.  HSBC OCC 3407511
Executive Summary

This paper has been produced in order for the Senior Management Committee (SMC) of HSBC Bank USA (HB US) to evaluate whether or not HB US will process US dollar (USD) payments initiated by Iranian Banks via accounts held with HSBC Bank Plc. (HB EU), using the process provided to HB EU by HB US dated 29 August 2001. This operational process may be amended at any time and HB EU will be required to adhere strictly to the new procedures as advised by HB US.

Currently, it is estimated that Iranian banks issue up to 700 USD payments a day using their USD service providers, mainly banks in the UK and Europe, which in turn use their New York USD correspondents to effect the payments. It is believed that some service providers amend the payments to ensure Iran is not mentioned in the body of the payment instruction to their USD correspondent. This process minimizes the risk of payments being referred to OFAC.

Institutional Banking and PCM believe there is a substantial income opportunity to sell a USD payments proposition to Iranian Banks in view of the impending FATF regulations, which are due to become effective in Q2 2003. The new regulations dictate that each bank (effecting the payments on behalf of their clients) within each FATF member country must ensure the full name, address and account number of the ordering party are quoted on the payment instructions. This increases the risk of Iranian payments being held in the USA as they may fall foul of the OFAC regulations. The Iranian Banks have now prioritized this issue and are now actively seeking a solution from their banks, including HSBC.

We believe that HSBC could offer the Iranian Banks a solution that facilitates a way for them to effect USD payments to beneficiaries outside the USA using the ‘U-Turn’ process documented within the OFAC regulations for Iran. HB EU have already provided HB US with their operational requirements to process these U-Turn payments and therefore SMC approval is being sought prior to HB EU making potential IT changes and the production of a service proposition for the Iranian Banks. This business case also highlights the potential risks should approval not be given.

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Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A. HSBC OCC 3407512
Background

Iran Representative office was formally opened on 11th of November 1999. Following the establishment of the office the volume of business between Iranian banks/companies and Group offices has been increasing all the time. The Group now has an excellent relationship with all Iranian banks and some very large Iranian corporates such as National Iranian Oil Co, National Petrochemical Co, National Iranian Gas Co, National Iranian Steel Co, top Iranian insurance companies, Ministry of Power, Ministry of Post and Telecommunications etc.

About 80% of Iran’s foreign trade, totalling USD3 billion, is denominated in USD. Iran undertakes a considerable volume of trade in markets in which HSBC is represented, enabling the Group to leverage its global footprint. Our Iran Representative office has worked hard over the past three and a half years to build a positive image of Iran through road shows, visits, supporting trade missions and by referring good Iranian business to Group offices. This has shown HSBC to its customers as a bank that is able to do business in difficult markets and as a result added considerable value to the Group. Strategically, Iran is the country in the Middle East region with the most development potential for HSBC in the long term. It has the world’s fifth largest oil reserves, second largest gas reserves, substantial mineral reserves and a large well-educated population.

The Iran Representative office was established to develop relationships and credibility for HSBC in the market. This objective has been achieved and the Group is well placed to develop its operation from a position of considerable goodwill. Details of HSBC’s business with Iran and Iranian entities are shown in Appendix 1.

Opportunity

The FAFT regulations are due to be implemented in Q2 2003 and will force banks, within the FAFT countries, to disclose all details of the ordering and beneficiary parties, effectively ending the practice currently undertaken for Iranian payments. The Iranian banks have yet to bear from their existing providers, mainly Lloyds Bank and Standard Chartered Bank, and we believe there is currently a window of opportunity.

However, during the past two years, HBEU and HBUS have been in discussions about how we can process these transactions, identifying the operational processes and compliance issues involved. After meetings with OFAC and external counsel, HBUS has produced a payments process. It will be scoped by HBEU, subject to SMC approving this paper, in order to identify their operational, compliance and IT issues before providing Sales with a service proposition.

HBEU / HBUS have identified that by using the ‘U-Turn’ payment method, Iranian banks can effect transactions to beneficiary accounts outside the USA. This method will allow HBUS to send HBUS payment instructions with Iranian entities quoted on the instructions and yet at the same time be compliant with FATF and OFAC guidelines. The proposed service proposition will provide a suitable disclaimer to ensure HSBC is not held liable for any payments which have not met the ‘U-Turn’ criteria and as a result been referred to OFAC.
Benefits

- Payment volumes are estimated at 700 per day of which 70% will be commercial payments. Transaction income is estimated at USD24M, assuming that HSBC wins all the business at an average item price of USD30. We believe that charges being levied by other banks at the moment are far higher than this.
- Balance income in HSBC.
- Reputation within Iran and the potential to leverage additional business.

Risks If Approval Declined

- If HSUS declines to process these transactions, then consideration will need to be given to closing all existing Iranian bank USD accounts with the HSBC Group.
- Should the above occur the current Group annual income of USD24M from Iranian Banks will be under threat.
- The market will perceive that HSBC does not support Iranian business
- The adverse impact on our Representative office in Tehran.

Summary

It is anticipated that Iran will become a source of increasing income for the Group going forward and if we are to achieve this goal we must adopt a positive stance when encountering difficulties. We are aware of the concerns expressed by HSUS but strongly believe that by working together we can overcome them using means which are perfectly legitimate and in accordance with rules laid down by the relevant regulatory bodies. I hope we will be able to resolve this issue otherwise I fear we will destroy future value in a market which has substantial potential for the Group.

It will be appreciated if you could raise this paper to your SMC at the earliest opportunity and advise me of the decision as soon as possible.
Appendix 1

1. Medium Term Project Finance Line - Various Group Offices USD500M.
This line covers a number of individual ECA backed project finance loans. It is
denominated largely in USD. The facility requires that Iranian banks effect regular
USD repayments. So far under this facility USD150M is utilized. HSBC now has a
mandate from National Petrochemical Co and Technip of France for USD155M to
arrange financing for Offsite 9 project. Two other projects, one for USD145M for
Syrine Monomer out of the UK and one for USD100M out of Japan will be financed
by HSBC through structured finance outside the above line. The latter, for Mitsui with
HSBC cover is already finalized and the other one is near completion. The provisioning
for Iran has been reduced to 5% in December 2002, which will make it easier for
HSBC to undertake more projects in Iran in the near future. With this in mind HSBC
Project and Export Finance have decided to increase the above line to USD1bn.

2. Short Term Trade Refinancing Agreement - HBME Dubai USD50M, RABC
USD25M. These lines are denominated in USD and require the USD loans to be
booked at HBME Dubai or RABC London.

3. Wheat Finance lines with HSBC Australia USD50M and HSBC Canada
USD100M.

4. LC's issued for Iranian Companies Abroad - Various Group Offices.
HSBC offices are developing relationships with Iranian Government and non-
Government companies. The LC's issued are normally denominated in USD.
Following NIOC's acceptance of HSBC as one its listed banks, HSBC Bank Middle
East now handles Iran's oil export related LC's. Turnover for this business is about
USD400M per year.

5. USD Clearing Accounts. HSBC Bank plc has a number of existing USD accounts f.of Iranian banks, which are
used for payments clearing purposes.

HSBC Investment bank has transacted in excess of USD1bn of Bond business with
Iran generating an income of over GBP700k in 2002. HBME Dubai and HSBC
Markets operate active foreign exchange and money market lines with the Central
Bank of Iran and Iranian banks.

7. Potential Business
a. HSBC is actively pursuing an Asset Management mandate with the Central Bank
which will require USD payments to be paid and received.
b. Iran has entered the capital market for the first time in 20 years, issuing USD1bn
worth of paper through the Central Bank. The budget for the next year is USD 2bn
with some to be issued in Islamic form. HSBC has a very good chance of being
selected to lead manage part of the conventional issue and a good chance of being
nominated for the Islamic issue. Both require USD payments to be paid and received.
c. HSBC may form an Internet Bank in Iran, which will require an active USD
payment capability.

The key thing to note is that all existing and potential business involves a regular
and substantial flow of USD payments both in and out.
From: Nigel J VVEIR
Sent: Mon Feb 03 13:44:14 2003
To: David W J BAGLEY
Cc: Rick A PUDNER; Jb BLANTHORNE; Nasser HOMAPOUR; John F ROOT
Subject:: Memo: Re: BUSINESS CASE - US PAYMENTS FROM IRANIAN ENTITIES

Dear,

As I prepared the majority of the business case I think it is appropriate that I respond on behalf of Rick.

Firstly, I would like to stress that under no circumstances am I suggesting that the HBU is acting or should be future consider acting incorrectly. Indeed I have specified on more than one occasion that we must be in full compliance with OFAC, FATF and other regulatory bodies.

3rd paragraph of the section headed Opportunity:

"This method will allow HBEU to send HBU's payment instructions with Iranian entities quoted on the instructions and yet at the same time be compliant with FATF and OFAC guidelines."

1st paragraph of the section headed Summary:

"We are aware of the concerns expressed by HBU but strongly believe that by working together we can overcome them using means which are perfectly legitimate and in accordance with rules laid down by the relevant regulatory bodies."

In simple terms the aim of this business case was to recommend that we need to try and take advantage of a significant business opportunity whilst at the same time actively complying with regulations laid down by various regulatory bodies.

Kind Regards

Nigel

[(Attachment: image.png)]

Sent by: Marko OYICACH
From: David W. J. Bagley
Tel: 7881 8645 44 2019 918645

Our Ref.
Your Ref.

Subject: BUSINESS CASE – US PAYMENTS FROM IRANIAN BANKS/ENTITIES

Rick

I am, of course, aware of the efforts being made to find a compliant way of negotiating the OFAC sanctions and providing US dollar payment services to Iranian banks.

I have, however, received a copy of the business case dated January 2003 which has been referred to our colleagues in HBUS.

We clearly need to address this issue and attempt to find a compliant approach, and to that end I have asked one of my colleagues in ORIG CAP, John Root, to assist with this process. We have already started looking at the OFAC sanctions from a Group perspective.

At this stage, however, I would be grateful if we could exercise greater care with regard to the content of written material being forwarded to our colleagues in HBUS.

The business case includes a number of express references to practices which may constitute a breach of US sanctions, including the OFAC provisions, and could provide the basis for action against the HSBC Group for breach of those sanctions, or seeking to facilitate a breach.

Could I suggest that future communications on this subject are perhaps cleared through John Root, or myself, so as to avoid relative sensitive references.

I have asked John to discuss matters with HBUS and seek to take matters forward.

Regards

David

Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A.  HSBC OCC 887648
From: Manor C ROACH
Sent: Tue Oct 21 17:24:24 2003
To: John F ROOT
Subject: IRAN STRATEGY DISCUSSION PAPER
Attachments: Image_1.png, Image_2.png, Image_3.png, Image_4.png

I refer to our discussions concerning the Iran strategy.

I would suggest that we not take further action until there is some clarification as to the general direction we are expected to take.

Regards
David

---

From: Paul L LEWIS@HSBCAMERICAS To: 212-225-2233
Sent: Tue Sep 16 17:27

For: David W BAGLEY

To: David@HSBCAMERICAS

Subject: IRAN USD PAYMENTS
To: Michael B. Gallagher
For: Michael B. Gallagher
cc: Paul L. Lee

Subject: No: 1561-02 PACMENTS

Michael,

My main concern to David was, as stated in the text, that there remain serious political and reputational risks within the USA if they proceed with this and that he should ensure that Phil Lane is kept in the loop at all times because at the end of the day, he has done both the file and some minor approaches from Group officers about opportunities in Libya.

Yours,

Michael B. Gallagher on 14 Oct 2012 19:24
To: Yousuf Nasrili
Subject: IN-USD PAYMENTS

Yousuf,

The below note suggests that you have had recent discussions on this topic. Appreciate any guidance you may have on how you wish us to proceed.

Regards,

Michael

---

To: Michael R. Gallagher
From: Michael R. Gallagher
Subject: IN-USD PAYMENTS

Michael,

You are well. We had discussed this a while ago and since then there has been a lot of work that Dedicated Pay from your team and Gary Bosco from the Middle East have done on Iran payments. With the improved situation in the Middle East post the last war, David Haggard at HSBC in the UK and the HSBC (Middle East) has been on exploring possible business opportunities and has discussed this paper with Yousuf Nasrili as a recent offline.

Steve Bannari at HSME Planning has suggested a possible way forward, however, I had wanted to discuss this with you to your inputs. Let me know when you are available for a quick 10 minutes call.

Regards

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As discussed, I attach a copy of the draft discussion paper on Iran.

David Hodgkinson discussed this paper, and the general topic of Iran, with various members of the top team during the award dinner in London. Subsequently, we held discussions with Youssef Nasr covering, amongst other things, the topic of USD payments.

David advised yesterday that he is keen for HSBC, together with HSIN, to explore in more detail the alternative ways in which we might be able to offer USD payment services to Iranian clients. Youssef Nasr has suggested that our first point of contact in HSIN should be Paul Lee, and legal advisor.

I held a brief telephone conversation with Paul this afternoon during which we agreed that the best way to take this forward would be to have the relevant PCOM associate within each organisation work together on the preparation of a feasibility study that evaluates the alternative options and the risks associated with each.

Paul has recommended that you work closely with external legal counsel in Washington to ensure that the various legal and compliance implications of each option are properly considered. Paul has suggested...
that you make contact with Carol Y. Mckeever, HSBC Head of Compliance, who will be able to put you in contact with her recommended external counsel.

I would greatly appreciate it if you could provide this with a view to having a draft of the feasibility study submitted for review by HSBC NA senior management by 15 November.

Thanks and regards

Steve

--- Forwarded by Steve BANNER on 11/8/2002 ---

6/24/2009

To: Jan F. EDWARDS@HSBC

Re: Draft feasibility study

From: Steve BANNER

Subject: Following note: draft for David Kogut

Hi,

As discussed, I would greatly appreciate it if you could pass the attached discussion paper to David Kogut.

Many thanks and regards

Steve
To: Skn. T. S. R. INGERMANN

From: Marce D. ROGACH

Subject: IREME STRATEGY DISCUSSION PAPER

Following the discussions initiated by Tony when I met with Paul Lee which I know happened at the last Nasr’s suggestion, Paul Lee made some comments suggesting that there were some concerns, i.e., that the discussion paper, which is still considered the strategy document there, seems to be a number of issues which require clarification, particularly in relation to OFAC.

In particular, the areas are as follows:

1. I am not sure that the interpretation of the U.S. exception relating to the lone sanctions is accurate. A detailed explanation of the OFAC sanctions in question – even that the largest and technology of a U.S. export contractor that is not owned and non-operated in the Hungarian public sector, it is believed that the Hungarian public sector, it is believed that the Hungarian public sector, it is believed that the Hungarian public sector, it is believed that the Hungarian public sector, it is believed that the Hungarian public sector, it is believed that

Ranged Material
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I am not sure that HSBC are aware of the fact that HSBC are already providing clearing facilities for the transfer of funds, presumably including USD transfers. Bank Muffazz is named in the DFAC sanctions as a government owned bank and thus on the face of it not dated to have any sanctions. I think we should give consideration to the current DFAC pressures and the identity of the banks to whom these services are currently provided in the context of consolidating our overall risk appetite.

When we considered the Bank Jelds clearing proposition my understanding was that we would consider either enhanced screening of payments for the U.S. exchange within HSBC (with presumptive that some cost being supported by HSBC) or alternative banking to pre-screen payments for U.S. exchange within HSBC. Is this contemplated by the proposed expansion of activity in relation to DFAC?

I am not sure that the current political position with regards to the US has changed in any significant manner from the point of which we concluded that Project Design, and the Bank Jelds clearing proposition were inappropriate.

As I would be reluctant to undertake significant work, particularly in relation to the requiring of US Authorities' fees, before it was clear that this was worthwhile, I would be grateful for an indication from you or those copied as to whether further work would be appropriate at this stage.

Regards,

David
Purpose

This paper has been prepared in such a way as to be "cryptic," for the purpose of inducing a "false sense of security," or for a number of other supposed purposes.

Brief Country Overview

The Iranian economy suffered from continued inflationary pressures (including the impact of sanctions) and a severe recessionary period. The economy has since rebounded, and the government has taken steps to address these issues. The following are some key points:

- The economy has been growing at an annual rate of around 4%, with some variation.
- The inflation rate has been relatively stable, although it remains a concern.
- The government has implemented measures to control inflation, including changes in monetary policy and fiscal measures.
- The economy is heavily reliant on oil exports, which account for a significant portion of the country's GDP.
- The government has been working to diversify the economy away from oil dependence, with some success.
- The unemployment rate has been high, although it has been declining in recent years.
- The government has taken steps to improve the business environment and attract foreign investment.
- The economy is relatively small compared to other countries in the region, but it remains an important player in the global economy.
IRAN - STRATEGY DISCUSSION PAPER
PROPRIETARY AND CONFIDENTIAL

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The US intervened on Iraq for 1 year under the Bush Doctrine. The US also succeeded in blocking Iran's access to the World Trade Organization (WTO). The sanctions enacted in 1980 when President Bush declined Iran in one of the principal sanctions against the Iranian regime. Following two years and the US and the EU (and even other sanctions) have lasting effects in the past 17 months. A few notable examples of recent problems likely:

1. The withdrawal of India and United Arab Emirates following the US Treasury sanctions on the banking sector, which may have radical US sanctions against the country - further economic sanctions.
2. The US has repeatedly accused Iran of having nuclear weapons and violating nuclear offenses in Iraq.
3. The death of a Canadian journalist, who uncovered many cases of human rights violations in Iran.
4. The US and EU have both imposed additional sanctions that are likely to be extended.
5. The run-up to the 2004 presidential elections is less likely to be extended.

The US believes that whatever moves Iran will eventually find a way to continue the program of nuclear weapons. The US government believes that the nuclear program is not subject to international law.

HSBC's Association with Iran

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VerDate Nov 24 2008 14:41 Nov 19, 2012 Jkt 076061 PO 00000 Frm 00808 Fmt 6601 Sfmt 6601 P:\DOCS\76061.TXT SAFFAIRS PsN: PAT
THE STRATEGY OF THE REPUBLICAN PARTY IN THE MID-TERM ELECTIONS

The Republican Party has set its strategic goals for the upcoming mid-term elections. The focus is on maintaining momentum and building on the successes of the previous election cycle. Key strategies include:

1. Targeting swing states with focused campaign efforts.
2. Highlighting economic growth and job creation as achievements under the current administration.
3. Addressing issues that resonate with the proposed budget cuts and tax reforms.
4. Engaging with grassroots organizations to mobilize local support.
5. Utilizing social media and digital campaigns to reach younger voters.

The party's strategy is aimed at positioning itself as a strong, capable alternative to the current administration, emphasizing its commitment to fiscal responsibility and economic growth.

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IRAN - STRATEGY DISCUSSION PAPER

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(possibly a limited efficacy for high risk customers) and various Islamic banking services. (The Islamic banking market in Iran is entirely Islamic-oriented. There are potential opportunities for HSBC to develop products to meet: discrimination through sanctions or risk aversion, invest in unrated or unregulated Islamic banks). HSME's preferred strategy, where the legislation and market conditions are in place, would be to establish an onshore branch (by, of course, ramping up a newly incorporated wholly owned subsidiary). In the absence of any such legislation in "Islamic Shariah" type structure often an alternative vehicle through which the elements of "Islamic banking" can be implemented. (The establishment of a new banking operation would not remove the Group from potentially establishing an offshore branch as an initial step. The business case for the establishment of a Project Finance type vehicle is not an insurmountable problem, but would be for an onshore branch. This said, HSME believes that the Shariah option is still worthy of consideration in the medium term as a method of entering Iran before HSME crosses one of the document requirements hurdles in Iran. Subsequent Obstacles have already created "time-out" issues by discouraging some members to establish a branch in Iran. While these are not insurmountable immediate actions is less important, they would be a useful delay option to pursue even if Shariah option is not viable even if Shariah option is not viable, a delay option to pursue in the medium term and, subject to further developments. HSME's record suggests that HSME is on the potential implications for the Group of pursuing such an inclusive option, rather than being on the sidelines of the debate and the US business interest.)

Issues for Consideration

In accepting HSME's recommendation, CPO will in consultation with HSME, need to consider a number of specific issues:

1. Dynamic Political Environment

One of the reasons to maintain our presence of engagement is to demonstrate, to the authorities within Iran, that we are committed to the development of that country. This is seen to be particularly important given the current regime's aggressive approach to foreign business as well as any business-mindedly imposed fares from 1995 onwards.

Such a demonstration is, dynamically, made HSME to develop a strategic partnership in global politics. For the time being, a joint-venture approach that involves the meaningful contribution to our political strategy, seems to be an effective way of satisfying the interests of foreign owned banks in Iran. We consider these to be the key potential securities with respect to the dynamic political situation:

a) Significant Flexibility. In certain circumstances (which HSME consider to be highly unlikely) it is possible that the current Iranian political will could change, leading to further sanctions and, ultimately, enforced regime change. We believe, however, that the current regime's capacity for the regime's capacity for incalculable action, and therefore, to impose any significant degree of financial sanction on Iran. We consider these to be the key potential securities with respect to the dynamic political situation.

b) Gradual Process of Reform: HSME believes that it is important to avoid any delay forces that will be a gradual process of change and slow reforms will, inevitably, make internal changes along the way. While this change will come gradually, it will be gradual and slow, and will result in the implementation of a long-term strategy. We consider these to be the key potential securities with respect to the dynamic political situation.

2. US Regulations. There are two primary uses of US law that will affect any strategy to do provide a system to provide PCT in the future. The current strategy is to establish a PCT and to maintain a meaningful presence in Iran. These regulations are unlikely to directly impact the various sanctions that are prevalent on the current economy.

a) HSME has operated in the past in Iran. It is not possible to provide a system to provide PCT in the future. The decision against Iran prohibits HSME from

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1. Providing correspondent banking services for foreign banks. The OFAC regulations do, however, allow a
sanctioned US entity (the "US correspondent") to issue US dollar payments on behalf of foreign
banks, through a US bank. The US correspondent fulfills the obligations of the correspondent as an
US institution. In practice, the US correspondent usually works with HSBC.

a) An Italian bank makes an USD wire to HSBC,

b) HSBC sends an USD payment instruction from its Italian bank to HSBC in France in favor of a counterparty account held at
a new US bank. HSBC then sends the transaction back and remits the funds through its own USD
service with HSBC.

c) Provided a wire to the Italian correspondent in the USD correspondent's country, the transaction would pass through HSBC. Normally, if the wire is from the Italian correspondent's account in the US correspondent's country, the wire will be blocked to check against US sanctions profiles
for the OFAC "Tum" customer. If a check, HSBC will return the transaction to OFAC. OFAC would
then either approve or reject the transaction. In certain circumstances (e.g., the customer is a known
terrorist), OFAC has the right to change the funds in the US.

Until now, HSBC has been required to record the identity of the foreign bank correspondent (OFAC regulations related to FATF regulations will have requirements on the identity of the sending institution to be
comprised within a full set of procedures). Therefore, the Iranian correspondent's wire funds that will be processed by HSBC with full details on OFAC will affect HSBC.

We understand that for important, non-US legal issues, it could conflict the OFAC requirements. Therefore, will be needed to address this issue by HSBC to the extent possible to OFAC rules. HSBC will need to address this issue in OFAC rules. HSBC will need to address this issue as much as possible to OFAC rules.

The OFAC requirements for the US correspondent to record the identity of the foreign correspondent (OFAC regulations related to FATF regulations will have requirements on the identity of the foreign correspondent to be
comprised within a full set of procedures). Therefore, the Iranian correspondent's wire funds that will be processed by HSBC with full details on OFAC will affect HSBC.

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2. The US Energy Act, passed in the aftermath of the various sanctions in 1990. This law permits US
corporations to lend money to US banks for foreign investments.

Until the OFAC regulations on US banks are approved, HSBC cannot lend on a US bank for foreign investments. However, the regulations can be clarified under FATF guidance. HSBC can lend to US banks to provide a network for its correspondent banks in the US.

Neither the non-applicable laws nor courts have no jurisdiction to the extent that is related to the provision of OFAC services to foreign banks, including US banks under OFAC. We have a strategy that we do not have the authority to lend a significant amount of additional capital in the OFAC regulation to lend the US banks to provide a network for its correspondent banks in the US.

Other issues are raised by the new law with the US regulations to achieve compliance with those laws can be:

3. Additional Political Considerations

The US Energy Act, passed in the aftermath of the various sanctions in 1990. This law permits US
corporations to lend money to US banks for foreign investments.

Until the OFAC regulations on US banks are approved, HSBC cannot lend on a US bank for foreign investments. However, the regulations can be clarified under FATF guidance. HSBC can lend to US banks to provide a network for its correspondent banks in the US.

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Other issues are raised by the new law with the US regulations to achieve compliance with those laws can be:

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Summary, despite the inclusion of sanctions. As long as we believe that there is little chance of this.
1. The importance of UN sanctions related to the nuclear conflict is described.
2. The effect of being listed in the terrorist list.

- Conflict: The international political context, however, of relevance when considering whether to offer USD payee arrangements to Iran's banking sector, specifically, is Central Bank. Such arrangements would (as explored above) exacerbate the risk of US-based banks for USD clearing. The US authorities would, given changes in the US law, be aware of the Group's increased involvement with Iranian counterparties. Given the different political climate, there is the potential for HSBC to have the reliable knowledge of the US sanctions that the Group is permitted to be circumventing with when the US position is as an administratively suitable. From a middle-term perspective (i.e., in the Group's commercial and strategic interest to avoid the imposition of OFAC sanctions and HSBC, would have to decide whether it is in the Group's strategic interests to do so.

Phase 3 strategies. The main enabler of Project Bridge (ultimately proposed in 1995) is not present as, in the view of HSBC, the timing was not right given, inter alia, the ongoing tensions with the US. Iran's intensive, international political reason is, if anything, more than it is in 1995. Thus, the HSBC strategy has evolved since that time as the household acquisition has been completed. This could, depending on the Group's perspective, partly be a reflection of either a greater or lesser level of anxiety to conventional US political causes, risks, etc.

Summary & Recommendation/Request

been a turnover shock wave which is in the process of developing (Stabilizing, inasmuch as France unclear. There will, in the short term, be alternative transnational opportunities for financial institutions that have the appropriate technology know-how and business acumen. As the long-term, a remarkable example case can therefore be made for the Group in support of banks in which will become an increasingly important market. While due to mind, HSBC wishes to maintain the pace of its engagement with Iran, the course of HSBC's engagement has, in the recent past, been moderated by other:

- lack of credit appetite locally in CORT (as)
- ensuring that the political implication of a lower attitude with Iran.

This report has been issued in good. Ongoing approval (and HSBS, "no objection") is to a two-year, limited capital coverage which was for Group, in the short term.

- broadly acknowledging an increased appetite for Iranian risk.
- actively marketing /COM services to a larger number of Iranian financial institutions, including Iran's Central Bank.

and, in the medium to long term:

- actively pursuing the opportunity to enhance our presence in Iran through either the establishment of an own bank with a significant capital and/or the purchase of a foreign bank with a significant stake in a domestic bank.

While recommending that the pace of engagement is accelerated, HSBC are mindful of the potential implications for other HSBC businesses and the HSBC name in general. As such, the guidance and rules of both CORT and HSBS are sought.
IRAN - STRATEGY DISCUSSION PAPER
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Appendix A - Background to Project Beluga

HSME has since, until 2000, been considering "Project Beluga", for various reasons, as the logical next step in the process of "gradual engagement". The rationale behind this initiative, and a basic outline of the business model, below:

Background: Foreign banks were not generally permitted to establish branches or a representative office in the Islamic Republic. Various Central Bank officials have authorized the setting up of "branches" open up to foreign banks but operate only in their own country (i.e. the UK). Legislation subsequently introduced however, allows foreign banks to establish a wholly owned "affiliated bank," i.e., one of the "three tiered"多次贷款 (TTT) banks. Each branch can after a certain period of time be allowed to open such "branches" abroad.

In line with the analogy of "gradual engagement" (HSME here, in 2000), the "affiliated bank" model was looked at the possibility of establishing an HSBC-branded foreign distribution bank, which would be "TSB Overseas" in Iran's Islamic Republic. Such was, in the Islamic Republic, the most logical step to progress one's free strategy.

Business Model: The exact terms and conditions of the initiative for a "TSB" with one of Iran's largest banks (Bank Melli and Bank Saderat), the business would envisage the whole process of providing a fitting range of financial services to customers on the market through a combination of (i) direct banking channels (ii) financial representatives located in selected Melli and Saderat branches. It envisaged a relatively simple product offering specificity for deposits, payments which would gradually evolve (i.e. credit cards, wealth management, trade facilities) over time. The primary objectives of the initiative were:

- "build the HSBC brand in the Iranian market;
- avoid "failing" banks and protect the Bank for future growth;
- increase HSBC's exposure in Iran; and
- commercial revenue growth.

Negotiations with Melli and Saderat did not progress very far in 2000 as HSME indicated that, while strategically sound, the timing of such an initiative was not right.
From: John F Root
Sent: Fri, Dec 23 11:07:11 2003
To: David W. Bagley; Susan A. Wright; John Allison
Cc: Paul Proctor; John F Root
Subject: USC Cleaning - Iranian Bank Impot

EFS have been manually intervening in the process of issuing bank payment instructions by reviewing the remitters name and country to prevent the probable trigger of a filter in the US, and the subsequent declaration to OFAC (and possible freezing) of the funds.

EFS have apparently seen Intergovernmental Compliance to ensure this process is followed. I believe this is something that has been going on for some time, given "long-standing valuable relationships". I have purposely negotiated a cut-off date of 12/2/03 for the current practice to end. (Often I would have long discussions with them as to why they were even aware of the process, as they have been doing this for an extension of it.)

After 12/2/03 all payment instructions will be sent on to HBUS. EFS also intend to send all INT020603 as "suppression" after such date, and payment instructions will be fully formatted on a INT020603 letter. Note however, there has been some question as to whether the INT020603 format is an actual legal requirement. So far this does not appear to be the case. A further write-up is HFS Special Requirement 7, which calls for accurate and meaningful information. Individual countries are then expected to export this to US.

These are approximately 11 payments in any business day. USC clearing services are provided for the following banks:

Melli
Tajerat
Nastaran
Markaz
Export Development Bank
Sahaf

All of the banks are on the OFAC list of state-owned banks, except for the Export Development Bank. As it is a reasonable assumption that the Export Development Bank is a state-owned bank, either its omission is an oversight by OFAC, or one of the other banks may be in fact in the Export Development Bank.

Two banks - Tajerat and the Export Development Bank - account for around 90% of monthly payments (210 out of 233).

John Wilkinson, the HSBC USA, should totally the banks of all these payment instructions changes by letter at the end of October. Wilkinson is existing HSBS agreement before sending the letter. The banks will not be given a disclaimer on the possibility of the application of OFAC sanctions. The disclaimer will state that the banks are clear of liability for any agreements that are not in their best interest.

Project WaL, which should be effective at the end of November, will not necessarily cover for compliance.
with the "U-turn" payments exception, according to Paul Procter. HSBC's focus will be to screen for, e.g., terrorists and drug traffickers against government-issued lists. HSBC will continue to be responsible for full screening with regard to OFAC calculations, which have a broader application than the names statement by the VAW system.

A related issue is the effectiveness of Iranian correspondent bank money laundering control procedures for the purpose of USA Patriot Act certification.

The huskens state that they intend to keep payments "at a low level" but then add that higher payments will require a renegotiation of terms. John, there are many other considerations to increase the USD clearing business with Iranian banks - provided that HSBC is in "full agreement".

John Root

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Please see below the memo from Rod Moxley in Payments Services.

Regards,

John Root

--- Forwarded by John J ROOT <JROOT@HSBC.COM> on 14 Oct 2003 13:45 ---

To: John J ROOT

Cc: John J Root

Latest status into this issue from Rod Moxley in Payments Services.

The practice of amending instructions is clearly a long-standing one which has continued despite the Web technology. It would cease some years ago. I have never seen anything in writing to show when this practice commenced or why it stopped, but clearly the proposed termination will need to...
be handled with sensitivity if relationships with the liaison banks are not to be damaged.

I am on leave next week. I am sure that John Wilkinson (John Richards, London REU) would be happy to answer any further questions in my absence. At this time though, they are unaware of your high-level involvement.

Regrets,

Paul.

—- Presented by Paul PROCTOR/REU/HSBC on 24 Oct 2003 12:18 ——

More

At Oct 2003 12:45

Fax: Rod WOOLEY/REU/HSBC
Tel: 732 44479
on 23 Oct 2003

John R. WILKINSON at 

From: Rod WOOLEY/REU/HSBC
To: John R. WILKINSON et al.
Cc: Geo., ARMSTRONG/REU@HSBC, Steve J. PROCTOR/REU@HSBC, Julie A. ARCHER/REU@HSBC, Paul PROCTOR/REU@HSBC, Tony C. OONSBY/REU@HSBC, Chris RICKERTY/REU@HSBC, Gary BOON/REU@HSBC

Subject: Iran

John,

Further to recent exchanges of emails, I detail below my responses to the queries raised, together with a synopsis of my concerns on this issue.

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HSUS have not been advised of the new procedures - we have attempted to engage them in our proposal before but have been expressly forbidden from continuing dialogue with them. I have been given a further directive from Malcolm Eegeon, Senior Manager Payment Services in the last few days not to continue these instructions from our colleagues in US.

The procedures have therefore not been agreed and any potential changes in volumes of traffic are unknown to them.

Iranian banks have not been provided with clear guidelines with regard to the new formatting requirements. Possible solutions have been put forward by HSUS Payment Services but I do not believe they have been communicated to the Iranian banks. We do suggest that payments on behalf of the Iranian authorities are sent to us on a test basis but this does not give us or them a guarantee that all payments will be effected without problem.

The implications regarding OFAC are purely what we have gleaned from the OFAC website and previous historical correspondence. We have had no direct contact with OFAC and, being a US government agency, I understand that this would prove futile. In short, I believe straight MT202s are acceptable to US banks, providing full disclosure of the US-origin payment is apparent, although MT202 cash payments in support of direct MT202s are not acceptable. Additionally, OFAC have stated that they retain the right to freeze payments at their own discretion.

Concerns

US-origin payments have been a number of views expressed regarding the validity, or otherwise, of the US-origin payments submitted to us. As a UK bank, our own understanding of US legislation is limited and, whilst we might believe we know what constitutes a US-origin payment, it would be infinitely risky for us to start taking Iranian banks what will and what will not comply. Lengthy discussions, fees etc., may expose us to unnecessary risks.

It was my understanding that the original business case submitted by Rob Hurley, Head of CGB Middle East in January 2003 was not followed. Indeed, Martin Spearing has underlined the strong operational and reputational risks involved and further support is this view was given by my own suggested reasons for the acquisition of Housebank. I would be grateful if you would confirm that the situation for US banks has been authorized at the appropriate level.

The position of Risk Management Services (RMS) is becoming increasingly untenable. RMS controls the Project Wolf Riff and yet we have been requested to find ways to overcome the net and other institutions' compliance filters. My own role is predestined to prevent the banks from reputational risk and pressures. We have been asked to implement a range of controls which may directly undermine the spirit of the Compliance Framework. This is a role is to be progressed or expedited (possibly in legal terms alone) the impact, for formatting solutions will need to come from HSUS in the form of a SIBS/3 full P&L run by 8th day as instructed and with effect from 1 January 2004.

Despite coherent arguments being put forward by a number of parties within HSUS, it is still worth noting that some US banks, notably Bank of New York, refuse to deal with US-origin payments due to the high risks of these transactions and the potential for punitive fines, costs or reputational risks. I have copied Group Compliance in to this note to ensure they are aware of and do not have a problem with this continuing risk to HSUS.

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I have been alerted by recent inquiries that Payment Services have been amending the Iranian banks' payments without the knowledge or consent of BL FN or BL Compliance. This has been a long standing practice and to avoid issues about, I will elaborate the points made in Malcolm Edwards' memo to Nigel Weir of 22 Jan 03. If we are to continue to effect these payments, we will require your confirmation that Iranian customers will be provided with a template and it is made clear at the proposal stage that:

- payments must be submitted in this format only;
- that payments submitted in the wrong format which may be sanctioned by OFAC are entirely at the Iranian customer's risk, about we will seek the appropriate OFAC request forms licences to receive funds when sanctions are lifted;
- that we will not be liable for any funds expropriated as a result of changes in Iranian sanctions by the US authorities which might lead to payments 'correctly' formatted being sanctioned.

I am uncertain as to the extent to which the Iranian banks are aware of the differing views and procedures adopted by individual banks which complicates this issue, but it is imperative that they are aware of our stance from 1 January 2006.

I think you have all the information which is available at this stage but please let me have your views when you have had a chance to digest and discuss with your customers.

Regards

Rod
From: DENISE A REILLY@HSBC

Sent: 12/11/2003 9:40 AM

To: TERESA PESCE@HSBC

Subject: COMPLIANCE - OFAC ISSUES IN GENERAL AND SPECIFIC TO IRAN

Forwarded from Denise A Reilly@HSBC on 12/11/2003

Denise A Reilly on 14 Nov 2003 10:52

Note:

For your information.

Valerie ROUE@HSBC on 11/14/2002 12:55

From: Valerie ROUE@HSBC

Tel: 780-455-57

To: Denise A Reilly@HSBC

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EXHIBIT #50a

HSBC GCC 3407517
This note forms a discussion paper formulated following various conversations that have taken place over the last few weeks. As the custodian of HSBU's payments operation I currently feel that we may be exposing ourselves to unnecessary and unacceptable Reputational and Operational Risk when we are handling payments originating from FIs domiciled in or who are a local branch of an FI domiciled in an OFAC regulated country. As a result there is a need to firstly clarify both the OFAC and HSBU's position with regard to these payments and then to determine/communicate the way forward to the RM and PCM Sales teams.

I would emphasise that in no way we are seeking to avoid the OFAC filtering/sequestration arrangements here. Indeed whilst HSBU are not bound by these requirements the FATF principles which are scheduled to become legislation early next year and our own payments filter which is currently being built will take us closer to the US model. I merely wish to establish which way OFAC are looking to deal with the sequestration issue so that we can plan compliance and avoid substantial potential losses which can result from the "incorrect" processing of these payments.

BACKGROUND CASES

The above comments are prompted by two high profile OFAC related cases seen in the last few months.

The first is a case involving ING Bank sending a payment for USD 3M to BBVA from and to the account of the same Cuban Bank beneficiary. HSBU forwarded this payment to HSBU via the Serial Payment route. The HSBU filter identified the Cuban bene and the funds were sequestrated by OFAC. The result of all this is that we are in the closing stages of correspondence between HSBU and ING lawyers pending a Court case between our two banks. ING are contending that HSBU should not have sent this payment via a Serial method and that we should have converted the message to generate a cover payment which would not have been sequestrated by OFAC. We are defending our action vigorously and have a strong case built around the fact that we "paid as instructed". Prudence dictates
that we have found it necessary to raise a general provision of GBP 3M to cover a potential negative result if and when this goes to Court.

Continued

Compliance – OFAC Issues in General And Specific To Iran

The second case involves Iran and Bank Markazi when a payment for USD 7.5M was frozen again because the payment was sent via a Serial Route and the OFAC filter identified it as being subject to OFAC rules. Following assertions by HBEU that there was no commercial transaction involved (this was the Iranian Central Bank paying itself at another European bank in a Money Market transaction) these funds were released but only after a couple of sleepless nights for all of us in London. I have subsequently been advised that this sequestration may have been the result of a clerical error by HBUS but this has not been confirmed to me. Nevertheless HBEU are left settling Standard Chartered’s interest claim for late receipt and with an underlying feeling of uncomfortable with regard to the Iranian payment issue and the subject of U Turn Payments (we believe that the above payment should have been treated as U Turn) and had thought that this practice was established in the US as a valid payment method specific to Iran.

COMPLIANCE WITH OFAC ISSUES GENERALLY

HBUS historical practice has been to send these types of payments where the U Turn principal applies (ie funds are generally moving from an European bank to another European bank for the credit of an OFAC regulated entity) via the Cover Payment method. This means that the payment instruction received by HBUS contains no mention of the country or entity involved. My understanding is that this has been accepted practice for many years and that HBUS hold accounts, some in USD for FIs domiciled in these countries (Cuba, Iran etc.

There is also evidence (the ING Bank case being a case in point) that some other European FIs are using HBUS to transact business with these banks primarily because the former hold accounts with HBUS but also because they use us as a form of “Filter” for payments being made to the US. Whether we should be supporting this latter business going forward is highly questionable particularly in the light of the FATF regulations. Indeed ING Bank will be asked to close their account shortly. I feel that there is a need for HBUS to examine the accounts of these OFAC regulated customers to see if there are other examples of other banks with accounts in our books using us for this purpose.

My understanding is that OFAC’s tolerance of the Cover Payment method is lessening and that there is some pressure being applied to follow the Serial Payment route for all transactions (Denise can you confirm?). Clearly if this is reality this will have major implications for HBUS both from a payments processing and IBL relationship stand point. We therefore need to seek clarification of HBUS/OFAC’s stance so that we can determine our future payments strategy. Certainly the FATF requirements, whilst not specifying Serial instead of Cover do point toward the principles of “transparency” which the Serial Payment method would support.

Continued
Compliance – OFAC Issues In General And Specific To Iran

IRANIAN PAYMENTS

Turning specifically to Iran we have seen the various papers on the subject of U Turn Payments and I believe that we have a reasonable understanding of what these are. The above Markazi situation has put uncertainty in my mind on the validity of this payment method and also highlighted the fact that HBUS have yet to formally “sign off” the process described in your last note. Our conversation suggests that HBUS are now looking at another “U Turn plus” option and I would like to understand what this means for us as payment processors.

I believe that we need to resolve this issue as a matter of some urgency if we are to avoid incidents like the one highlighted above. The Iranian banks continue to send us what I describe as conditional payment instructions which for HBUS require an element of amendment by ourselves. This introduces operational risk and under FATF principles we should not be amending these payment instructions. Acceptance of these items over many years means that we are bound by the precedents currently in place, and I believe that we need to break these precedents by

1. Establishing with HBUS and OFAC the validity of the U Turn Payment principles for Iranian payments. Whether this be by U Turn or U Turn plus I would like these to be signed off by HBUS as soon as possible and certainly by no later than 31/12/02.

2. To agree a “template” payment instruction for these U Turn Payments which can be used by PCM Sales and the RM team and sent to the Iranian Banks stipulating that payments must be formatted in this way, confirming that we will be sending these via the Serial method and that any deviation from this template will be at the Iranian Banks own risk. We would also have to state that the validity of this template would be subject to any change in OFAC legislation in the US. In this way we can give ourselves a level of protection from claims relating to capital or interest which may arise from funds being sequestered or delayed as a result of OFAC seizure.

If we cannot achieve this in the short term then I will have to recommend to my General Manager a view that processing these payments is “unsafe” and that these items should be filtered out and cancelled. This would have severe repercussions for our Group’s relationship with the Iranian FIs.

FUTURE BUSINESS STRATEGY

I believe that there is a need, based upon your responses, presumably formulated in conjunction with your colleagues from Compliance for HBUS to consider its business strategy for the continuation/development of its business with OFAC regulated countries. Whilst I am told that there are significant business opportunities particularly with countries such as Iran there are also substantial Reputational and Operational Risks, not to mention Financial losses associated with it.

Continued
4

Compliance – OFAC Issues In General And Specific To Iran

Whilst I am not suggesting that we should discontinue these established relationships there is a need, in the light of the changing regulatory climate for us to review our position and ensure that we have a correct balance between risk and reward.

I apologise for writing at some length but there has been much happening on this front recently and I thought it appropriate to try and pull all of the somewhat fragmented information together and to share our concerns with you.

The only certainty from all of this is that we cannot delay and prevaricate in this matter for too much longer. We have seen potential losses in excess of USD 10M in the last couple of months and it is now time for HBUS to define exactly what is and what is not acceptable to them.

Your views and those of your colleagues in Compliance would be much appreciated.

Regards.

Malcolm
From: Elizabeth Prolomntroil-Ol8IHSBCAMERICAS
To: John F DIOTIHQIHSBCAMERICAS
Cc: Carol M WilkMHSBCAMERICAS
Subject: HSBCAMERICAS

Further information, as requested by Daniel.

Kind regards

John Real

--- Forwarded by John F ROGHIHSBCAMERICAS on 17-Jul-2003 15:20 ---

This payment was initiated by PLC and received in the HSBC Delaware Funds Transfer area for processing. It stopped for review to the OFAC, based on the instruction "Fee Only". When Funds Transfer received the instruction "Fee Only" from PLC, they contacted the sender with this message in the MTS, "Stopped for review to the OFAC for the instruction "Fee Only". What are the payment instructions for "Fee Only"? It will be reported to OFAC in a reported item as required under the United States Regulations.

I checked with our investigations team, and they can't see what department in HSBC initiated the payment. All the instructions related to the wire appear on the payment note attached, which include "Do not mention our name". The HSBC Delaware Funds Transfer area does not see the payment instructions.

Confidential - FOIA Treatment Request

EXHIBIT #56b

HSBC OCC 8873922
814

Redacted by the Permanent Subcommittee on Investigations

There are several reference numbers on the payment that may help you trace its processing in London. The numbers are

PS: [Redacted]
SIN: [Redacted]

In case you have trouble reading the attached payment details, details are given below:

Business date: 15-Jun-2003
Deps.: HSBC Bank PLC London USD Clearing, International Division, 8 Canada Square, London
Clearing: JP Morgan Chase Bank, NY, NY
1st payer: JPMorgan Chase Bank, NY, NY
Site ID: [Redacted]

Business details are as follows:

Business date: 15-Jun-2003
Clearing: JP Morgan Chase Bank, NY, NY
1st payer: JPMorgan Chase Bank, NY, NY
Site ID: [Redacted]

The payment was initiated on the same day, June 13, 2003.

Please let me know if you have any other questions.

------------- Forwarded by [Redacted] on 08/17/2003 09:23 GMST

---

Note: 17-Jul-2003 9:23

---

To: [Redacted]

Re: [Redacted]

Subject: [Redacted]

Please provide the details of this transaction. Thank you.

------------- Forwarded by [Redacted] on 08/17/2003 09:23 GMST

---

Note: 17-Jul-2003 9:23

---

Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A. HSBC OCC 8873923
To: Carolyn M Wind

Cc: Anne Luddy

FYI, attached please find a copy of mailing payment rejected on Friday with the above message in the 'DT' field.

Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A.  HSBC OCC 8873925
Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A.  
HSBC OCC 8873926
From: David W. Bagley
Sent: Tue Jun 17 11:31:17 2003
To: John A. Root
Cc: Justin Allison
Subject: re: PLC - the "we do not maintain our name"

ADM,

Regardless of the wider issues as to the applicability of OFAC to U.S. persons should we be allowing a payment with the sort of instructions to be passed to HSBC or is there in fact nothing we can do to prevent this at least pre-MLLP.

Regard

Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A.  HSBC OCC 8873928
From: ELIZABETH PROTONAS <ELI@HSBC.COM>
To: TERESE PESCE@HISBCHSBC
Sent: Nov 24 2008 9:59:42 AM
CC: ANNE UDDY@HSBC; GRACE C SANTAGO-DAVIES@HSBC; DENISE A KEELEY@HSBC; GILDA B
Subject: RE: Wire Payments Suspended

For the record, this is the outcome that we have processed for HSBU are fully disclosed as per the guidance stated in the attached document (Credited December 2004). The remit, Credit Suisse Zurich, is well aware of the current practices of other U.S. corporations and the requirement for full disclosure of the name and details of the originator and the beneficiary.

Please let us know if there should result in a credit to Credit Suisse Zurich "as per internal policy".

Thank you.

From: Teresa Pecce on 04 May 2005 08:15
To: ELIZABETH PROTONAS
Subject: Fax: Wire Payments Suspended

Anne mentioned this to me yesterday. Is this standard per Davide's question above?

From: Martin O ROACH
To: TERESE PESCE
Subject: Fax: Wire Payments Suspended

Text:

I attach a self-explanatory exchange of correspondence forwarded to me.

What concerns me is whether the underlying action taken by you and Davide a change of policy and approach within HSBU to what I would normally expect to be the usual practice.

As you are aware, there are no Group standards which require that the originator of the transaction should go in all payments. However, Group standards are generally subject to individual country's regulations - in the case of HSBU, HSBU is required to comply with the SWIFTremittance standard. However, once a transaction has been processed, it is no longer possible to alter the underlying instruction. If the action that has been taken represents a change of policy on the part of HSBU, however understandable in the current regulatory environment, it concerns me that any such change of policy may not have been communicated across the Group and subject to appropriate needs of consultation with business colleagues.

Confidential - FOIA Treatment Required

EXHIBIT #50c
I would be grateful if you would clearly whether there has in fact been a change of policy, as I do not at present appear to have been any formal consultation or notification from MLA.

Alternatively, if the payment has been blocked because of a reference to Vice than this is understood.

Kind regards

David W J Bagley

Memo

04 May 2005 09:21

From: Susan A WRIGHT/HSBC
Tel: 782 8554
Fax: 782 80002

To: Joe E BROWNE/HSBC
cc: David W J BAGLEY/HSBC

Subject: Wire payment suspended in USD 81,297.82

Joe,

I have copied this one to you for information given the size of the transaction.

Forwarded by Susan A WRIGHT/HSBC on 04 May 2005 06:20

From: Elizabeth Prodl/HSBC
Tel: 212 525 7192

Subject: [Redacted]

FYI, the following payment was suspended under MLA we request assistance in tracing the instructions and beneficiary's full name and address.

Sue

[Redacted]

[Redacted]

[Redacted]

[Redacted]

[Redacted]

Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A.
Though the payment appears to meet the U.K. under the Financial Transactions Regulations, we require that the payments should be fully declared as to the origin and destination in any transaction before processing. We know that this policy is in line with the stance of other U.S. financial institutions, such as Bank of New York and American Express. You are also aware, from past discussions, that this is required by FINC.

Let us know if you have any questions. Please advise us on your side of the delay in processing.

Thank you.

Attachment: UT:om Conditions.doc

Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A.  HSBC OCC 8874712
From: ANDY H IMlHBUSIHSBC
Date: 02/08/2008 6:21:17 PM
To: JOHN ALLISON/HGHQ/HSBC; SUSAN A WRIGHT/HHSBC; ELIZABETH PROTO/HSBC; MARY A CARR/WBUS/HSBC; ANNE LUDOWIG/HSBC@HSBC; PATRICK DACOSTA/HHSBC@HSBC; DENISE A REILLY/YBUS/HSBC@HSBC
Subject: Rami Makhlouf

Hello,

We have determined that accounts held in HSBC Cayman are not in the jurisdiction of, and are not housed on any systems in the United States. Therefore we will not be reporting this match to OFAC. Please let us know if you have any questions.

Thanks,

Andy

AVP, AML
Compliance, HSBC Bank USA, NA
452 Fifth Avenue, Tower 7
New York, NY, 10018
Phone, 212-525-8139
Fax, 212-525-5769
Email, andy.h.im@us.hsbc.com

Patricia Dacosta/HHSBC@HSBC 02/08/2008 06:01 AM
To Andy H Im/US/HSBC@HSBC02
cc Michelle P Williams/HFS/HSBC@HSBC, David Ford/FRS/HSBC@HSBC, Amanda Wayman/HFS/HSBC@HSBC
Subject Re: Fw: Search #029-08· HFS # 1028 - Due 25 February 2008

Dear Andy

Please be advised that we currently maintain a relationship with Suite, Mohamed Makhlouf in our capacity as Trustee and the individual named in your search request (Rami Makhlouf) is actually the beneficiary of the Trust (his date of birth matches the individual named in your search request which is 10 July 1969). The Trust is administered by HSBC Geneva.

We raised concerns with this client in August 2007 however we were assured by David Ford that the relationship had been reviewed at Group level and a
The decision had been taken to continue with the relationship.

I have copied in David Ford to see if he wishes to add any comments prior to you responding directly to OFAC. In the meantime, please confirm if OFAC indicated grounds for their request?

Kind regards,
Patrice DeCosta
Head of Compliance
HSBC Bank (Cayman) Limited
P.O. Box 1109 GT
Strathvale House
North Church Street
Grand Cayman KY-1102
Cayman Islands
Tel: (345) 914 752

Andy H/im@BUS/HSBC@HSBC
02/27/2008 05:39 PM
To
Patrice DeCosta/im@HSBC
cc
Michelle P Villiams/im@HSBC
Subject
Fw: Search #029-06 - HSBC #1028 - Due 25 February 2008

Hi Patricia,

As this case is urgent, can you let me know the details of the account(s) in question below?

Thanks,

Andy H
AVP, AML Compliance, HSBC Bank USA, N.A.
432 Fifth Avenue, Tower 7
New York, NY, 10017

Phone: 212-525-8138
Fax: 212-525-5769
Email: Andy.H.im@us.hsbc.com

--- Forwarded by Andy H/im@BUS/HSBC on 02/27/2008 05:36 PM ---
Andy H/im@BUS/HSBC
02/27/2008 04:39 PM
To
Michelle P Villiams/im@HSBC

Confidential - FOIA Treatment Requested by HSBC N. America Holdings, Inc. HSB09255893
Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A. HSBC OCC 8878839
Subject: Re: Search #029-08

~

Hi Michelle,

Can you make sure this is a positive match? This is an OFAC request. Does your client's DOB match up with the person in question? Also, can you tell me more on the account where Makhouch is the trustee?

Thnks,

Andy H.

AVP, AML Compliance, HSBC Bank USA, N.A.
425 Park Avenue, Tower 7
New York, NY, 10016

Phone: 212-525-8139
Fax: 212-525-5763
Email: andy.h.im@us.habc.com

--- Forwarded by Andy H [email] (HSBC) on 02/12/2008 04:38 PM ---

Michelle P. Williams
27 Feb 2008 10:24

To: le RO BP [email] (HSBC)

Subject: Search #029-08 - HFSC # 1028 - Due 25 February 2008

Dear Colleague,

Please note that we currently maintain a relationship with "Rami Makhouch" as Trustee of an established trust.

Kindly confirm what actions if any HSBC Group has taken in relation to the above mentioned individual.

Sincerely,

Michelle Williams
Internal Control Officer - Compliance
HSBC Bank (Cayman) Ltd
2nd Floor, Shinnville House North Church Street
Grand Cayman KY1-1107
Direct Line: 345 914 7565

Confidential - FOIA Treatment Requested by HSBC N. America Holdings, Inc. HSBC OCC 8878840
From: Susan A. Wright

To: David W. Bagley

Subject: Re: BankMarkets Payment

David,

As requested, I'd like to let you know that I have asked FRED Moody to ensure that it is post with immediate effect.

Regarding us not being able to resolve the mechanics of the dispute at HSBC, I have asked FRED to review the potential payment issues for the 2nd quarter of 07 to resolve. We in OSD now have the tools to identify both potential sanctions and terrorist payment activity and we need to use them and protect the bank from financial loss and reputational risk. Therefore, I have no issue with the action taken by RBS.

From: Melissa G. EASTPROCMONHSBC

To: Susan A. Wright

Subject: Re: BankMarkets Payment

Hi Susan,

The mechanics of the dispute at HSBC have been resolved. We have posted the transactions and the bank itself has acted to resolve them.

Thanks for your help in this matter.

Best,

David

[Signature]
The information about the payment should be considered within the context of the supply agreement. It is only the beneficiary name and type of the payment which will permit mitigation risk. It is on the basis that this is requested and the risk is "real" or the customer is not making the payment.

On the wider issue of certain payments in general I remain extremely concerned with the practice of arringing these payment orders for whatever reasons. Although much of this activity is honest the potential damages are immense and such practices are no longer acceptable to the regulatory authorities. On such lines I would urge the Compliance officer to put the issue right now, and if that officer is unable to take this issue right now, the officer should be removed from the line of business. I would like to see a resolution of this issue as soon as possible. My own Compliance officer must be castigated in this context the issue remains in my pending file and I am left with the choice but to hold and challenge these items on a case by case basis.

Respects,

Michael J. Patnoe

Subject: IJBr.l<:ld6l1<.azi Payment

Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A.  HSBC OCC 8873980
This is a drastic change that has taken place at the Bank of England. We have the information given the ultimate beneficiary is in America. As such it is best to use the event to have sympathy for the position taken but it must be noted that in practical terms it is a credit to a Bank national which operates without country barriers. However, I think I need to believe that we should take a position: 11/9/201

Date: 11/9/201

--- Forwarded by Nasser Homapour - 10 May 2014 11:15 ---

---

From: Nasser J. MENDENHALL@HSBC
To: David W. BAGLEY @ HSBC
CC: John B. BLIND @ HSBC
Tina M. WINDSOR @ HSBC
Subject: re: Urgent Request for Review

Dear Mr. Bagley,

As Nasser is currently travelling, I enclose a quick explanation memo from Nasser himself for your urgent attention. It is a serious issue and we must resolve it immediately, as it may have potentially damaging effect on our relationship with Bank.

Kind Regards,

Sheng Su

Redacted Material
Confidential - FCIA Treatment Requested by HSBC Bank, USA, N.A. HSBC OCC 8873081
To: Hfajd / WEIR-WIM-TM MFE/JSME-UNBC-CA

From: 00535/MFE/JSME-UNBC

Subject: Bank Mandate Agreement

Hi,

We are looking at a recent deal with the Central Bank of Iran whereby regular payments are being made on an investment for a potential company. The payments are being made in London on the basis that it contains a letter of credit and the bank will then be reimbursed. There appears to be a slight difference in the currency of transactions by the bank to update the flagged out due to being a matter of interpretation. This is a known issue going since 1984 and the Central Bank is increasing workability issues with the remote link by 1985. The transaction actually involves 2 HSBC accounts and therefore does not involve any party bank. The delay in the payment of the investment is currently delayed in arrears 1980 in favor of Iran which will only become effective once this delay has been removed as of last year.

This last page appears to have been covered by , please let me know. Can I suggest you send an LN to the bank highlighting the impact that this payment position will have on our ability to grow business with the central bank.

For more of reference, here are the transaction details:

Best regards,

Ramesh

---

Redacted Material
Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A. HSBC OCC 8873082
From: Malcolm G EASTWOOD
Sent: Thu Mar 11 18:37:00 2004
To: David W J BAGLEY
Cc: George E. ARMSTRONG; Paul RAVEN; Geoff ARMSTRONG; Ben MACLEY; Susan A WRIGHT
Subject: Memo: Re: #14391
Importance: Normal
Attachments: Image attached

Dear David,

Thank you. I do understand the complexities having been extended in them by many months myself, but my heart is placed in an impossible position. We either have to pay or return some of the debt, and I know the lack of clarity and sureness that you can understand the concepts.

So much money seems to pass through the issue of the future, in terms of finalisation, as to have gone unaccounted for a long time. I will really make a note of this as a finality of payments. It is being discussed from your point of view. I hope we can have the contents printed, and make a proposal something worthwhile for all concerned.

With kind regards,

Malcolm

David W J BAGLEY@HSBC on 11 Mar 2004 11:52

From: David W J BAGLEY@HSBC
To: Malcolm G EASTWOOD@HSBC

subject: HSBC OCC 8873985

Confidential - FOIA Treatment Request

EXHIBIT #52
I have had sight of your note of 10 March. While I understand your concerns, which I share, particularly when taking a Group view, I believe your note rather understates the complexity of the OFAC regulation, and the competing competitive pressures across the Group.

The complexity of the OFAC regulations and the fact that HSUPA are reasons that any arrangements nested within those banks, has more timely resolution of this issue difficult.

A legal opinion has now been obtained from American lawyers, and a recommendation will be made shortly with regards to what we would hope will be a compliant approach, which reflects both the regulatory situation, seeks to address the competing competitive offer, and hopefully also addresses the political risks.

It is not that Compliance is unable to find a solution, though the solution is anything but easy to arrive at.

Regards

David Bigley
From: Marion O ROACH  
Sent: Mon Apr 19 13:40:17 2004  
To: Richard E BENNETT  
Subject: Iran Correspondent Banking Services - OFAC  
Importance: Normal  
Attachments: image_0.gif; image_1.gif; Doc:Link.htm

Richard,

I refer to your note concerning the above, and attach the results of a recent exchange of correspondence with David Hodgkinson on this subject. You may recall that we discussed this matter in our previous meeting with丁(D) when he gave a clear indication that Martin Glyn's views should be sought before there was any expansion of activity in relation to Correspondent Banking services for Iranian Banks.

My note of 22MAR04 to David was intended to ascertain exactly what was intended, although as you will see, I have received a slightly opaque response.

I will follow up with Warren in terms of the work David says is underway, but as you will see the note is somewhat obscure in this respect.

I recognize that there is a need to act on SG's suggestion for a solution. It occurs to me however that this solution may not be workable given the multiplicity of pointers involved. We are dealing with payments for the customers of Iranian Banks. These will not lend themselves to a veiling approach given that we will have no control over who remitters are or what the payments are for.

Kind regards

---

Redacted Material  
Confidential - FOIA Treatment Request
David

Whilst the above steps are possible, it is likely that HSUS will need to satisfy itself that the procedures are robust and adequate given the significant regulatory and reputational risks they run if errors were to be made.

Redacted Material
Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A.
I am uncomfortable with this activity in its current form and think that we need to make an early decision both with regard to the business and the extent to which we wish to expand our activities involving Iranian banks.

I spoke personally to the US lawyer who has provided us with advice, and separately with Peter Lee who is any lawyer, is a senior lawyer in our in-house legal department.

My reason for writing to you at this stage is that I think it would be sensible for us to make an early commercial decision before we spend any more money on legal opinion, or in upgrading our activities in the UK so as to achieve a compliant approach.

My sense of the value of the existing business is that it is relatively modest. When I spoke to Nigel Weir, my recollection is that he was talking about the value of increased business as being some US$30m. If these figures are accurate, then the amount of revenue may not justify either the additional work and investment that will be required, nor would it justify running the reputational and regulatory risk in the US. I recognize however the significance of this activity in terms of our image in Iran and our ability to expand our business there.

I would be happy to discuss this issue more generally with you if that would help, although I suspect that perhaps the next conversation you might wish to have would be with Martin Glynn. Could I suggest however that any such conversation take place over the telephone, as we are seeking to avoid correspondence with HSBC on this sensitive issue other than through lawyers so as to preserve privilege.

I would stress that I do think we need to make an early decision given the current activity that is taking place.

Regards
David Bagley

To: David W J Bagley,HQ,HSBC
Marton R ROACH,HQ,HSBC
VVBmm GLA, LGH,HQ,HSBC

Subject: Re: IRAN - CORRESPONDENT BANKING SERVICES

David

I have been in regular contact with Mukhtar Hussain and his team on this topic, which is still open. The current position as briefed to me last week was that we have not yet found a way to handle major USD clearing business, and I am endeavoring having to explain this to the Central Bank on my visit to Tehran in early May. I have asked our people to put forward the basis on which they believe this could be undertaken with the lowest level of perceived risk, so that if circumstances change we know our preferred way forward.

Regards

David

Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A.   HSBC OCC 8873997
Michael,

I should be grateful for your assistance with some thinking in the processing of HSBC payments for further review.

You may have assessed that, together with your payments team and GBP Confirmation, we have been working for some time now with the implementation of a system that will enable HSBC to continue supporting GBP systems as well as other

Please note that this is a draft and the official version is to follow. The Confirmation number is current if you have not had a chance to check it

You will note that an attachment that we have already and the listing have been introduced. This may not be useful to you at the moment as we can continue to refine it to the necessary level. If you have any comments, please let me know.

Thank you in advance.

[Signature]

From: David H Hoogkirk
To: [Redacted]
Cc: [Redacted]
Subject: POLICY - GBP

Redacted Material
Confidential - FOIA Treatment Request

EXHIBIT #45

HSBC OCC 8874001
Thank you for your receipt. I would like to acknowledge your request to extend the deadline for submitting your comments, which are due on the 20th of this month, to the 20th of next month. We appreciate your understanding and will be happy to accommodate your request.

If you have any further questions or need assistance, please do not hesitate to contact us.

Best regards,

[Your Name]
To: John ALLISON
From: Gary BOON

Subject: US Currency payments

Dear Mr. Allison,

I have reviewed the US currency payments processed under various categories and noticed a significant increase in the volume of payments. This is a concern as it may indicate potential issues with our current payment procedures.

1. Operational Difficulties
   a. Duplication of payments, which could lead to an increase in the number of payments and cause confusion and delays.

2. Security Concerns
   a. The high volume of payments might give rise to security concerns, as it is possible that some payments could be fraudulent or fraudulent payments could be directed to legitimate payees.

3. Legal Compliance
   a. The high volume of payments might also pose legal compliance issues, as it may be difficult to ensure that all payments are processed correctly and in accordance with applicable laws.

4. Customer Feedback
   a. The high volume of payments might also affect customer satisfaction, as it may cause delays and confusion in the payment process.

We are currently investigating the cause of this increase and will take appropriate measures to address the issue.

Best regards,
Gary BOON
Manager, Payments

PS: This email contains confidential information and is subject to the provisions of the FOIA Act.
which could lead to operational losses or reputational damage

Proposed

For the reasons stated above, I feel very uncomfortable recommending that we continue in process Korean warrants. It is possible to control any but the higher levels of risk, the reduction of current possible systemic vulnerabilities and the perception of certain other threats.

We have discussed this matter with our clients. None of them found another model of funds. I would be grateful if you could be there near financial reports, and if any other standardized steps were taken.

This matter involves something commercial sensitivity, which must be retained for current compliance and audit. I must be briefly advising contact Relationship Managers that we will no longer be able to tender

Regards

Rod Mosby
Regulatory and Operational Risk Manager

Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A.  HSBC OCC 8874004
From: John RANALDI  
To: Michael F. GCSOHEGAN  
Subject: Memo  StF  For File  
Importance: Normal  

Just in case of this will get past you and to you know, basically, 
information was the hearing of you here in regards to the 
preceed to avoid the U.S. embargo and insert a few days;  

[Signature]

Attachment: EXHIBIT #55

Confidential - FOIA Treatment Request  
Permanent Subcommittee on Investigations  
HSBC OCC 8873999
From: John RANALDI
Sent: Tue Jul 15 15:01 2004
To: Michael
Subject: HBEU Iranian Payments

Importance: Normal

Attachments: IRANIAN PAYMENT EXECUTIVE SUMMARY doc: IRANIAN PAYMENT PROCESSING PROPOSALS.doc

841

[Text of email discussing the Iranian payments issue and the need to avoid taking responsibility for the payment system. The message outlines the risk and emphasizes the importance of making a decision that respects the integrity of the organization and avoids jeopardizing the group's reputation and financial stability. The sender suggests discussing the matter further to explore how to proceed.]
The Fed would certainly favor no new process either deliberate or accidentally designed to prevent the legitimate movement of future funds under OFAC, most notably is, who, we argue, are the Fed. It has to identify political surplus and to prevent the block other processes. The proposals are written in a way as an exercise in the use of

the US check that financial payments are legitimate. Turn here and there the current refusal that either are allowed by OFAC payments being in that central and important for the most important entity to stop. In such processes!

The Fed also places the responsibility for monitoring payments that are under WJM and in a way also places the responsibility for making payments that are identified as unauthorized, funds with the WJM.

This is a difficult area certainly, one of which is the fact that the OFAC regulations relating to Iran and the US banks. In this paper we are addressing as while a difficult path between reposing our US licence with the existing regulatory process and in some process, these issues have been identified. The table options that my suggestion would be to find the solution for payments systems as the ability of the Fed as the legislature that this would allow the license, which included to build a solution and the WJM.

Please let us know if you wish to discuss.

Malcolm

--- Forwarded by Malcolm G EASTWOOD@HSBC  on Wed, Jul 25 2004 15:55 ---

Rod DIXLEY@HSBC  on Wed, Jul 28 2004 13:16

Melpe

91010 2004 15:15

From: Rod DIXLEY@HSBC To: Phil BAILEY@HSBC c.c. Geuni ARMS@HSBC

Malcolm G EASTWOOD@HSBC

To: Phil BAILEY@HSBC

cc: Geuni ARMS@HSBC

Subject: Iran

Please refer to the discussion with Malcolm regarding potential solutions for the future payments systems. It looks like we are trying to overcome previously an open and forward. I shall be pleased to share your comments in that context.

Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A HSBC OCC 8876862
Set it appropriately, we can discuss over the phone. Regards

Rod McGowen
Regulatory and Operational Risk Manager, Payment Services

Confidential - FOIA Treatment Requested by HSBC Bank, USA, N:AHSBC OCC 8876863
From: DENISE A REILLY/HBUS/HSBC
Sent: 11/30/2004 3:00:00 PM
To: SANDRA PETERSON/HBUS/HSBC@HSBC
CC: "MICHAEL GAUAGHER" <MICHAEL.B.GALLAGHER@US.HSBC.COM>
Subject: Re: Fw: U-turns

Thanks for reviewing. My responses are in blue on the attached. I'll let you know what comes out of the meeting.

Sandra Peterson on 11/20/2004 14:42

Note

From: Sandra Peterson
Title: Senior Vice President
Location: Delaware/Ifloor 3
WorkGroup: Central Services
Mail Size: 10546

To: Denise A Reilly/HBUS/HSBC
"Michael Gallagher" <michael.b.gallagher@us.hsbc.com>

Subject: Re: Fw: U-turns

Dear Denise,

Thanks for resending the doc. Just a few questions:

Is this proposal for Bank Melli only or is the intent to grow this business? When this topic first arose it was to support Bank Melli but my understanding is that the business under discussion now is more general, with no specific client named to date. I also heard sometime ago that Sony Melli established a relationship with another institution for their USD correspondent needs.

Page 3

Confidential - FOIA Treatment Requested by HSBC N. America Holdings, Inc.

HSB2545938

Confidential - FOIA Treatment Requested by HSBC N. America Holdings, Inc.

HSB265602

Confidential Treatment Requested by HSBC N. America Holdings, Inc.

Permanent Subcommittee on Investigations

EXHIBIT #57
I don't think the volume of transactions would be comparable to what was discussed for Bank Melli (4Q04).

Out of curiosity, how did legal respond (internal and external)? Legal advised that we should have full disclosure of payment details and ensure appropriate controls were in place. However, the final decision on accepting the payments was viewed as a business decision.

Thanks,
Sandra

From: Denise A Reilly on 30 Nov 2004 17:09
To: "Sandra Petersen" <sandra.petersen@us.hsbc.com>
cc: "Michael Gallagher" <michael.b.gallagher@us.hsbc.com>
Subject: FW: U-turns

I'm not sure if you are aware that the possibility of doing U-turn transactions has been raised once again as a business initiative. This topic has come up several times since 2001. Terry Pace was asked to meet with Martin Glyn on the topic and she asked Michael and me to join her (below at times) as preparatory. Attached are the required control checklists for doing such transactions. The document was developed with Anne Lidby and Carolyn Wind and was vetted by external counsel when the topic was last active in 2001-2002. Please let me know if you have any comments or concerns from a Payment Ops perspective.

Thanks.

From: Michael A Gallagher
Sent: 11/29/2004 09:22 PM
To: Denise Reilly
Subject: Re: U-turns

Are Sandra not reviewed?
From: Denise A Relly
Sent: 11/26/2004 07:45 PM
To: Michael Gallagher
Cc: Theresa Pink, Grace C Santiago-Davolio, Alan T Kelby
Subject: U-turns

Attached are the control procedures (slightly updated) that I put together when I was in Payments. This should be part of our discussions with Martin tomorrow. Give me a call if you would like to discuss before our call.
From: DENISE A RELLIY/HBUSLHSBC
Sent 12/12/2008 4:19:01 PM
To: MICHAEL B GALLAGHERlHBUSJHSSBC
CC: TERESA PESCHEL/HBUSJHSSBC; SANDRA FETERSON/HBUSJHSSBC; GRACE C SAIfflAGO-DAFMS/HBUSJHSSBC
Subject: U-Turn

Attached are the conditions under which HBUS will accept U-Turn transactions. I have reviewed both Swim and Grace.

Please call if you have any questions or need additional information.

Attached: U-Turn Conditions.doc

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Confidential - FOIA Treatment Request: Permanent Subcommittee on Investigations

EXHIBIT #58

35, Inc.  HSB03793168

Confidential - FOIA Treatment Request: Permanent Subcommittee on Investigations

HSBC OCC 3407526
HBUS Conditions for Processing U-Turns

Agreement to the following conditions is required for HBUS to accept U-Turn payments:

- Transactions will be formatted in accordance with SWIFT standards and will be fully transparent serial payments that reflect full payment details. Payments must include complete name, street address, city and country of the originator and beneficiary.
- HBUS will agree to strictly abide by U-turn processing requirements (to be provided by HBUS) and will not alter "as received" payment instructions in a manner other than that required to meet payment formatting requirements. Payment details will in no case be dropped from the instructions forwarded to HBUS.
- HBUS will indemnify HBUS for all potential penalties that may result from violations of OFAC sanctions, regardless of the cause and source of the action that precipitated the violation.
- A separate processing account will be established under the name of "HBUS Special Account" on HBUS books. Only Iranian originated transactions will pass through this account.
- The account number of "HBUS Special Account" will be entered into the HBUS payments system OFAC filter so that every transaction for this account will be stopped in the OFAC queue for review and approval before processing.
- HBUS will be reimbursed for any additional FTE's required due to increased process burden attributable to OFAC review of Iranian payments.
- HBUS pricing for the transactions will reflect incremental processes and risk.
From: D'Nirl Hodgkinson  
To: David W. J. Bagley  
Cc: Richard E. Bennett  
Subject: Re: iranian Payments  

VerDate Nov 24 2008 11:41 Nov 19, 2012 Jkt 076061 PO 00000 Frm 00863 Fmt 6601 Sfmt 6601 P:\DOCS\76061.TXT SAFFAIRS PsN: PAT
Our Ref: 850

The above was verified in its outline meeting which Richard Bowen and I

David W. FAILEY
HSBC

To: David H. HOUGTON, CEO M: F:\MATH\THEME\HSTBM.zip

Subject: IRANIAN PAYMENTS

The above was verified in its outline meeting which Richard Bowen and I.

Your thoughts and guidance will be appreciated.

David
Stephen raised with me the following points:

He sent me assurance that the agreed arrangements in relation to further payments had been put in place. He expressed concern that we were going to give that assurance to OFAC. Although I was aware that OFAC was concerned about the clearance of payments, I was also aware that the sanctions on Iran had already been lifted. The concern was that payments to Iran would be made through HSBC, a non-GAAP entity, or that a technically plausible way to avoid the sanctions would be to clear the payments through HSBC and then divert them through a non-GAAP entity. Although I was aware that there was some concern about the payments, I felt that there was no need to worry about them.

Stephen also raised the concern that payments that would pass through the US would be late. Although we had structured our discussion, I was aware that it was not clear how OFAC would determine whether payments were late. If we had a concerns that payments were late, then OFAC could potentially determine whether the payments were late. Although we had structured our discussion, I was aware that there was some concern about the payments, I felt that there was no need to worry about them.

The reason for my additional concerns is that there is a number of discussions at the EU and US level of discussions that are ongoing, particularly in relation to how OFAC will determine whether payments are late. Although we had structured our discussion, I was aware that there was some concern about the payments, I felt that there was no need to worry about them.

One major European entity has made a decision to apply OFAC regulations and restrictions across the entire of its operations, but the US and EU are not in agreement. Although we were unclear about how OFAC would determine whether the payments were late, I felt that it was reasonable for HSBC to try to avoid the payments being late. Although we had structured our discussion, I was aware that there was some concern about the payments, I felt that there was no need to worry about them.
allowing the witnesses to be crossed. Obviously, nothing is gained in
here and through the non-confidential nature of the US and I was unable
to check any further details. Therefore, the box seem to omit to qualify
further on policy and considerations on our part.

As I hope have mentioned the US regulatory authorities, OCC and Federal
Reserve, are ensuring we a joint review of a new approach taking from
an AML and OFAC compliance perspective. The goal in HRC will continue
is likely. It is not entirely different. As part of our review I believe
that the US authorities have learned from our approach to
AML procedures for data in ensuring of OFAC. Compliance. However, it is
not the FOIA treatment that correspond to the requirements that US banks use
to ensure that payment without a suspicion of cash or matching payment. That regard of other
rules that we found probably to required in check both details in the current
payment and the habitat of a payment or in a case of a customer or employers even if it
were a near Group member. The FOIA treatment is matching primarily
for the OFAC compliance to require background searches and may need to deliver this
recently disclosure from your though present going forward. (Note:
If this is the requirement of an US. Order) does the relevant:
for delivering our statements with these would be withdraw given that the recent
security for any implications depend on wide spread participation by a more
limited adoption of US law.

I am in the one of the effort yet ending on finishing this week. I will
however, present my ideas. However, I am in favor of your payment
and the habitat of a payment or in case of a customer or employers even if it
were a near Group member. The FOIA treatment is matching primarily
for the OFAC compliance to require background searches and may need to deliver this
recently disclosure from your though present going forward. (Note:
If this is the requirement of an US. Order) does the relevant:
for delivering our statements with these would be withdraw given that the recent
security for any implications depend on wide spread participation by a more
limited adoption of US law.

If there is any news with regards to the Federal level than I am here,
unless I told you John Ross to consider a meeting once in us.

Regards

David Bagley
 Peer review (Nov 20)
From: ROB MUTH/HGHQ/HSBC
Sent: 11/06/2006 11:07:51 AM
To: CAROLYN M WIND/HBUS/HSBC
Cc: sub:ject: FW: INFO: TP GATEWAYS

As discussed I am expecting the impact of this to be some delay in Panama and Mexico migrations from their current dates of 20MAY and 3JUN respectively.

We propose that the countries in the Americas outside USA disconnect their...
payment routing via the USA TP gateway and reconnect to the UK TP. This will provide two main benefits. Firstly, the ability to make payments in currencies other than USD to countries/entities sanctioned by USA OFAC (as permitted by COL 050047), and secondly to take data records outside US.

Can you please advise John Allison by 30 April 2006 whether you agree with this proposal.

David Daley
From: ALAN T KETLEY@HSBC
Sent: 5/26/2006 11:14 AM
To: "JUDY STOLDT"<JUDY.P.STOLDT@US.HSBC.COM>
CC:
Subject: U Tums

Judy

Can you look at this please and help be decode it. We are likely to be handling U turns for Dubai going forward.

Alan T. Ketley

First Vice President, Anti Money Laundering

Tel: 212 525 6147
Fax: 212 382 7580

Teresa Pesce

05/26/2006 12:09 PM

Teresa Pesce

To: Alan T Ketley@HSBC

Subject: Fw:

Forget what I said yesterday.

David W J BAGLEY

Sent: 05/26/2006 03:29 AM
To: Teresa Pesce
Cc: Warren G LEAMING; Alan KERR; Gary BOON

Terry,
The attached is an I hope self-explanatory and whilst I am not surprised at the reaction from JPMC, it is important to emphasise that we are talking about exempt U turns payments. HBME have no choice but to now pass the payments via HBUS, but as they are exempt, you have previously confirmed with Martin that HBUS are comfortable this does not seem to me to be problematic.

I anticipate that you would prefer to see Field 72 completed, but this will mean more hits in the filters even if they will then be passed. Could you let me know and copy Gary Boon and Alan Kerr as I am out for part of today, Monday is a public holiday and I at Wolfsberg next week.

Give me a call if you need to discuss and I appreciate that you may want to
All,

Please see attached message received from JPMC regarding transactions acceptable for transmission through our USD account with them, which follows on from our discussion with them yesterday morning regarding our imminent move to serial payments + cover payments with Field 72 completed.

Please could you provide guidance as to how we may continue to effect OFAC U-turn compliant transactions on behalf of our Iranian customers.

Alan Kerr
Head of Institutional Banking
Tel: 971 4 5077 674
Fax: 971 4 3025079

--- Forwarded by Alan KERR@HBME/HSBC on 05/26/2006 09:37 AM ---

All Members@jpmorgan.com
05/26/2006 09:49 PM
Mail Size: 5256

To
Gary BOON@HSBC, Alan KERR@HSBC
cc
Linda.Osteen@jpmorgan.com, Carmel.Speere@jpmorgan.com, colin.j.nuth@jpmorgan.com
Subject
US Dollar Transactional Activities via DDA at JPM
Entity
HSBC Bank Middle East Limited

--- Forwarded by Alan KERR@HSBC on 05/26/2006 08:22 ---

Alan KERR@HBME/HSBC
HBME
26/05/2006 08:45
Phone No: 971 4 5077674
Mail Size: 7618

To
Warrant G LEAGUE@HBME/HSBC, Ian EDEN@HBME/HSBC, Ben HOLT@HBME/HSBC, David W J BAGLEY@HBME/HSBC, Gary BOON@HBME/HSBC, Ken O MATHESON@HBME/HSBC
Subject
US Dollar Transactional Activities via DDA at JPM
Entity
HSBC Bank Middle East Limited

recheck with Martin.

Regards
--- Forwarded by David W J BAGLEY@HBME/HSBC on 26/05/2006 08:22 ---

Alan KERR@HBME/HSBC
HBME
26/05/2006 08:45
Phone No: 971 4 5077674
Mail Size: 7618

To
Warrant G LEAGUE@HBME/HSBC, Ian EDEN@HBME/HSBC, Ben HOLT@HBME/HSBC, David W J BAGLEY@HBME/HSBC, Gary BOON@HBME/HSBC, Ken O MATHESON@HBME/HSBC
Subject
US Dollar Transactional Activities via DDA at JPM
Entity
HSBC Bank Middle East Limited

Confidential - FOIA Treatment Requested by HSBC N. America Holdings, Inc.   HSB03629425
Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A.   HSBC OCC 3243783

856
Dear Gary,

It was a great pleasure speaking to you and Alan today.

First, many thanks for keeping us informed on the group decision regarding the payments method. This is to confirm that we will be pleased to continue processing HSBC’s Middle East dollar payment transactions, (both MT103 and 202) with the exceptions of the Iranian referenced transactions that should be directed to other correspondent banking account. Unfortunately, as a business decision we will not be able to process such Iranian referenced details on the payment narratives.

We look forward to continuing our excellent business relationship. Please do not hesitate to contact us if we can be of any further assistance or if you have any questions.

Have a nice weekend.

Ali

Ali Moosa
Vice President & Area Manager
Middle East & N. Africa
Treasury Services
Tel: +973 17 522741
Fax: +973 17 535135

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HSB03629426
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HSBC OCC 3243784
Stephen,

I apologize for troubling you on what I know is a busy day.

As discussed, I advised HBME DUB to continue to pass U-turn payments through JPNC and I think quite rightly HBME asked JPNC that we would start to cross-reference the underlying 103 message in the cover message.

As you will note from the attached JPNC have indicated that they are not willing to process these payments, I assume for reputational rather than regulatory reasons (given they are within the U-turn exemption), which means that we will now have to pass these payments through HSBC. We have previously received clearance from HSBC, confirmed by Mads. On this basis, I do not believe we have any choice but to proceed on this basis.

I would be grateful for your view, but anticipate that HBME will need to reach a decision in time for the opening of the USD payment window on Monday.

David

--- Forwarded by David W J BAGLEY/HG HQ/HSBC on 26/05/2006 07:58 ---

Alan KERR/HBME/HSBC

HBME

26/05/2006 06:45

Phone No. 97145077674

Mail Size: 7518

To Warren G LEAMING/RILA MEM/HBME/HSBC, Ian EDEN/HBME/HSBC, Ben HOLT/HBME/HSBC, David W J BAGLEY/HG HQ/HSBC

cc Gary ROON/HBME/HSBC, Ken C MATHESON/HBME/HSBC

Subject Fw: US Dollar Transactional Activities via DDA at JPM

Entity HSBC Bank Middle East Limited

All,

Please see attached message received from JPNC regarding transactions acceptable for transference through our USD account with them, which follows on from our discussion with them yesterday morning regarding our testament move to
Please could you provide guidance as to how we may continue to effect OFAC compliant transactions on behalf of our Iranian customers.

Alan Kerr
Head of Institutional Banking
Tel: 971 4 5077 674
Fax: 971 4 5037 679

----- Forwarded by Alan KERR/HSBC on 05/26/2006 09:37 AM -----
All Moosa@jpmorgan.com
05/25/2006 50 49 PM
Mail Sent: 5296

To, Gary BOON/HSBC, Alan KERR/HSBC
cc, Layla.Qaseer@jpmorgan.com, Carmel.Speers@jpmorgan.com, orin.j.nuth@jpmorgan.com
Subject, US Dollar Transactional Activities via DDA at JPM

Ali Moosa
Vice President & Area Manager
Middle East & N. Africa
Treasury Services
Tel. +97317 522741
Fax +973 17 535135

Dear Gary,

It was a great pleasure speaking to you and Alan today.

First, many thanks for keeping us informed on the group decision regarding the payments method. This is to confirm that we will be pleased to continue processing HSBC’s Middle East dollar payment transactions, (both MT103 and 202) with the exceptions of the Iranian referenced transactions that should be directed to other correspondent banking account. Unfortunately, as a business decision we will not be able to process such Iranian referenced details on the payment narratives.

We look forward to continuing our excellent business relationship. Please do not hesitate to contact us if we can be of any further assistance or if you have any questions.

Have a nice weekend.

Ali

All Moosa
Vice President & Area Manager
Middle East & N. Africa
Treasury Services

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Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A.  HSBC OCC 3243787
From: Rod MOXLEY
Sent: Tue Jan 02 09:55:48 2007
To: Andy M NE'MAN
Subject: Fw: Transactions with Iran / Cuba, etc

Fyi

I'll let you know if I hear further on this one an interesting concept, though let's set up a completely different SWIFT address to help avoid any problems with Cuba and Iran. What I'd thought of it.

Regards

Rod

--- Forwarded by Rod MOXLEY@HSBC on 02/01/2007 09:53 ---

Martin S CLARK@HSBC 01/28/2007 22:41
To: Rod MOXLEY@HSBC
Cc: Martin S CLARK@HSBC

Fw: Transactions with Iran / Cuba, etc

Fyi: HSBC Bank plc.

---

HSBC Bank plc;
Registered Office: 8 Canada Square, London E14 5HQ
Registered in England - Number 14259
Authorised and regulated by the Financial Services Authority

---

Malcolm EASTWOOD

From: Malcolm J EASTWOOD
Sent: 21/12/2004 21:43
To: Will A REID, Jim A STROHM;
Carl Vikman ROBINS, Margaret M REID, Malcolm J CLARK, Allana J WONG, Alan AUSTIN,
Jamie J YOUDY, John RABIN

Confidential - FOIA Treatment Re: EXHIBIT #62 HSBC OCC 8876921
Subject: For: Transactions with Iran / Cuba, etc

We have heard that this might be coming and here it is - I note that they want to split their traffic - is this possible?

What are the practical IT and Operational issues with this - is with GMG going down in the middle of the night daily regularly could we be helping as a problem we don’t need here if Saudi are open when this happens?

I have asked John Allen to see whether Group Compliance have a letter given that they are only prorific in mind US sanctioned states etc like Iran, I have concerns that we might be breaches even if the spirit of the US Serial Routing SCI, isn’t the letter of it.

Thanks.

Malcolm Eastwood

Head of Payment and Commercial Operations

UK Opel

Tel: 0207 799 12300 (199 12300)  
Fax: 0207 799 6666

--- E-mail forward:  
--- E-mail to: Malcolm-Eastwood@HSBC

Morgana CASAGRANDE@HSBC

HSBC

To: Malcolm-Eastwood@HSBC

Cezar-RTHBBR@HSBC

Subject: Transactions with Iran, Cuba, etc

Your contact has been provided by Mr Neil Chantry

Appreciate if you could assist us with the following. Not sure anyone has tracked you yet.

HSBC has some payments going to Iran, Cuba and other sanctioned countries, which are compliant with the Group Compliance Policy. Currently our GMG is based in the US, so we run the risk of having such payments blocked. The Group specific Transactions (see flipper), we would like to use the GMG based in the US and perform the transactions in EUR. To enable it, we have been informed that we have to create a second SWIFT address (Sci 75) to be used exclusively for this purpose, which should not be published by SWIFT in their books.

Could you assist us with obtaining this second SWIFT address? Any idea how long it would be?

Grateful for any other information you could provide.

Confidential - FOIA Treatment Requested by HSBC Bank, USA, NA HSBC OCC 8876922
I look forward to hearing from you.

Kind regards,

Morgana Casagrande
Trade & International - HSBC
Tel: +55 11 3847 5869
Fax: +55 11 3847 5869
E-mail: morgana.casagrande@hsbc.com.br

Confidential - FOIA Treatment Requested by HSBC Bank, USA, NAHSBC OCC 8876923
From: Rod MOXLEY
Sent: Thu Jan 04 17:57:26 2007
To: Malcolm G EASTWOOD
Subject: Re: Forwarded by Malcolm G EASTWOOD on 04/01/2007 16:36
Attachments: Doc link.htm

Malcolm

You and me both.

I do think this requires further investigation before it is "stamped" on us as a fait accompli. Elaborate explanation, no payments to you and I, have shown that we are faced with a real dilemma when trying to identify and then eventually pay transactions which have so many conditions attached to them, paying anything for the only thing which is permitted to account for a system which seems very shady to me. How about you can do the talk?

Speak further tomorrow

Regards

Rod

Malcolm G EASTWOOD@HSBC

Redacted Material
Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A HSBC OCC 8876925
Malcolm G EASTWOOD, HSBC BANK
640/1200 1st Street, N.W.
Washington, D.C. 20024

To: Jim LARKIN, HSBC Bank

Subject: Transactions with Brazil, etc.

I mention this one this morning and here is the background. I am doing some more work on it with IT and my people, we will then have a meeting with Brazil and give you some input so that we can discuss with them.

Malcolm Cartwright
Head of Payment and Commercial Operations
UK Operations
Tel: 020 799 12300 (799 12300)

John ALBION, HSBC BANK

To: Malcolm G EASTWOOD, HSBC Bank

From: John ALBION, HSBC BANK

Subject: Transactions with Brazil, etc.

Entity HSBC Holding, plc

Sending payments via USA SWIFT subjects Brazil to an all currency prohibition for all OFAC entries. Brazil is, however, permitted under current Group policy to make payments in currencies other than USD 10 entries on the OFAC list, provided that the reason for inclusion on the list is a reason other than Terrorism/Weapons of Mass Destruction (where payments cannot be made in any currency). We believe that the small volume of these permissible payments would be sent by Brazil by SWIFT (i.e., Manual)

While we therefore do not have an issue with Brazil’s request, we would be concerned if a second SWIFT address entered in the country to Brazil’s request included some reference to the address entered used for making payments to positivity on the OFAC list, as this could result in a negative perception by Manual Kit aware of the detail of our policy.

Confidential - FOIA Treatment Requested by HSBC Bank, USA, NAHSBC OCC 8876926
Regards

John

Malcolm G EASTWOOD@HSBC

Member of EASTWOOD@HSBC MSK
21/12/2006 21:43 Phone No. 79912300
+44 (0) 20 7991 2300 Wallbox WBO

To

SBI S Pnoch@hsbc@hsbc, Jon P CHL@hsbc@hsbc
Vikram S Bhat@hsbc@hsbc, Delhi
Vikram S Bhat@hsbc@hsbc, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Delhi, Jalandhar, Delhi, New Deli

Subject

Pre Transactions with Iran/ Cuba, etc

Entry: HSBC Services: MDBK

Hi,

We have heard that this might be coming and here it is! I hope that they want to split this stuff! - Is it possible?

What are the practical IT and Operational issues with this - ie with SWIF preferred in the middle of the night fairly regularly could we be seeing on a regular basis? We don't need contact from SWIF when this happens?

I have copied John Allison to say whether Group Compliance have a view please that they are not in any way going to serve us sanctioned items via the route I have concerns that we might be breaching at least the spirit of the US Serel Holding GOL, if not the letter of it.

Thanks,

Malcolm Eastwood
Head of Payments and Commercial Operations
UK Operations
Tel: 020 7991 2300 (79912300)

Morgana CSM@HSBC@HSBC

Confidential - FOIA Treatment Requested by HSBC Bank, USA, NA HSBC OCC 8876927
Malcolm

Your contact has been provided by Mr. Neil Chantry

Appreciate if you could assist us with the following. Not sure anyone has briefed you yet.

HSBR has some payments going into Iran, Cuba and other sanctioned countries, which are compliant with the Group Compliance Policy. Currently our GMG is based in the US, so we are at the risk of having such payments blocked. For these specific transactions (less than $50k), we would like to use the GMG based in the UK and perform the transactions in EUR. To enable this, we have been informed that we have to create a second SWIFT address (BIC) to be used exclusively for this purpose, which should also not be published by SWIFT in their books.

Could you assist us with obtaining this second SWIFT address? Any idea how long it would take?

Grateful for any other information you could provide.

I look forward to hearing from you.

Kind regards,

Morgana Casagrande

Tel: +551136479141
Fax: +55113847941
E-mail: margana.casagrande@hsbc.com.br

Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A.HSBC OCC 8876928
Lucas,

Further to our recent exchange of emails I have now sought views from Group Compliance, IT and my Operations team.

Whilst what you are proposing is technically achievable we are not attracted to a proposal which would segregate transactions through separate SWIFT addresses, albeit that these proposed transactions might be periodic or occasional under Group policy so this ought bring inconvenience from external parties and at least make it seem as though we are taking actions to avoid criminal transactions being examined by the US authority. Group Compliance share this view.

On this basis if we were to make a change I believe that it would have to be on the basis that all of your current SWIFT traffic be directed via the UK GMG. Of course this would be a much more significant change for all of this to be in place it is necessary to persuade the US authorities that you wish to pursue the current route that you wish to pursue please could I ask your team to discuss with Bill Rice (UK Operations) and Jon Curl (UK IT) and Rod Molyneux (Risk Management Services, UK Operations and Compliance).

The points I would like covered are

1. Message volumes including averages and peaks so that we can ensure that these volumes are manageable. Whilst the UK GMG is currently meeting our needs I am currently looking to replace our UK GMG infrastructure to ensure better reliability. We must avoid creating further instability.

2. That we can provide viable operational support given the time zone differences between UK and Brazil.

3. WOLF terror filtering support, who would undertake this function including any escalation?

Page 1 of 3

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Clearly, this substantially broadens the scope of our original request, introducing more operational complexity and reputational issues from both the UK and Brazilian banks perspective.

If we are to progress this broader request, I believe that it would be prudent for me to discuss the proposal with the UK banks’ CEO before we would formally agree to proceed.

Happy to discuss further with you once you have considered the above.

With kind regards,

Malcolm Eastwood
Head of Payments and Commercial Operations
From: David W. J. Bagley  
Sent: Sat Jun 09 06:38:13 2007  
To: Michael F. Geoghegan  
Cc: Stephen K. Green; David H. Hodgkinson; Douglas Flint  
Subject: Re: Important  

Mike,  

I should briefly clarify that there is very little left of our relationship with [redacted], although enough to mean that it would have been inaccurate to tell Leney there was nothing. Without being able to look back over previous correspondence on the issue my recollection of key recent decisions on Iranian banks include:  

1. We decided some time ago to stop using the "U-turn" exemption under OFAC.  

2. We cancelled trade lines previously extended to certain Iranian banks including [redacted], and these have virtually run off in the case of [redacted].  

3. We discovered that there was an agency banking relationship in HSBU both for [redacted] and other Iranian banks. We have been given some derogations by regulatory authorities that may be extended to these years.  

There are further complications surrounding the process of closure with all Iranian banks as we have some USD 9m in reimbursements due from Sepah, where we are running off trade lines, and may need cooperation from the Central Bank of Iran. David is in the loop here.  

I am in fact travelling next week but will monitor by BlackBerry. Apologies for the length of the e-mail but I thought the above detail may help deliberations next week.  

David  

HSBC Holdings plc  
Registered Office: 8 Canada Square, London E14 9HQ, United Kingdom  
Registered Number 617987  

Michael F. Geoghegan  

From: Michael F. Geoghegan  
Sent: 08/06/2007 20:30 CEST  
To: David W. J. Bagley  
Cc: Stephen Green; David H. Hodgkinson; Douglas Flint  

Subject: Re: Iran

Mike,

This is not clear to me because some time ago I said I would close this relationship other than for previously contractually committed export finance commitments.

Possibly we can discuss this next week when I will be able to review my past emails.

Mike

HSBC Holdings plc
Registered Office: 8 Canada Square, London E14 9HQ, United Kingdom
Registered Number 617987

From: David W. J. BAGLEY
Sent: 08/06/2007 09:17 GMT
To: Michael F. GEOGHEGAN
Cc: Stephen GREEN; David H. HODGKINSON; Douglas FLINT
Subject: Iran

Mike,

Stuart Levy, the US Treasury Under Secretary for Counter Terrorism Financing and Sanctions was a speaker at the recent annual conference of the Wolfsberg Group, of which I currently act as Co-chair.

Levy asked for a private meeting with me to discuss a number of matters including Iran. Levy has been extremely active in promoting the US policy on Iran, particularly the use of sanctions to deter weapons proliferation. He has in the past met with David and I encouraged us to refrain from dealing with Iranian banks. The key points raised with me are best summarised as follows:

Levy acknowledged that we as a Group have acted responsibly on Iran and I took the opportunity to emphasise to him that we applied OFAC across the Group when dealing in USD, and had acted whenever specific sanctions were enacted either by US, UK or UN.

Levy however expressed concern that we were still operating accounts for HSBC that had not met the sanctions in the US, but whose operations met support within the UN. Levy essentially threatened that if HSBC did not withdraw from relationships with certain banks, we may well make ourselves a target for action in the US. It appears that we have been approached in this way as he...
alleges that we have maintained accounts for them as an argument in support of representations made to other banks for ongoing support. We in fact have only limited relationships, with limited and in fact overall with Iranian banks. Following this meeting, I have discussed the approach we should take with David. His decision is that we should immediately withdraw from all and also withdraw from all Iranian bank relationships in a co-ordinated manner, recognising that there may be some associated binding commitments we will need to honour for example PFS facilities, and we may need to play for an orderly run-off.

Once the position is clear on precisely what steps are being taken I will then advise Levey of the steps we have taken.

I am aware that Levey has sought to persuade other non-US banks to withdraw from Iran, but the tone of his remarks were notably more direct and strident.

David Bagley
From: John ALLISON
Sent: Wed Jun 13 11:36:00 2007
To: Clive BISSETT
Subject: Fw: GROUP MESSAGING GATEWAY FOR LAM - CLEAR CHOICE REPORT

Clive

Any thoughts on how to deal with these countries?

Regards

John

--- Forwarded by John ALLISON@HGQ/HSBC on 15/06/2007 11:55 ---

Neelesh HEREDIA/HBMX/HSBC 11/06/2007 19:02 Mail from: 18:07

To: John ALLISON@HGQ/HSBC
Cc: Clive BISSETT@HGQ/HSBC
Subject: Fw: GROUP MESSAGING GATEWAY FOR LAM - CLEAR CHOICE REPORT

We have not engaged with CI and Nassau as we have no leadership responsibility for this geography. I trust they will deal direct with IT, PCM, at al and look after themselves.

Regards,

John

--- Forwarded by Neelesh HEREDIA/HBMX/HSBC on 11/06/2007 09:59 a.m. ---

Sandeep Flockhart/HBMX/HSBC 11/06/2007 06:54

To: Neelesh HEREDIA/HBMX/HSBC

Re: Fw: GROUP MESSAGING GATEWAY FOR LAM - CLEAR CHOICE REPORT

[Exhibit #64]

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HSBC OCC 8874349
NAELESH,

As this is the most cost effective solution you have my approval to proceed as proposed.

Regards,

Sandy

Alexander A. Flockhart
President & Group Managing Director
Latin America and the Caribbean
Paseo de la Reforma 347
Col. Cuauhtemoc
06500 Mexico, D.F.
Tel: 52-55-5721-3914

Neelesh HEREDIA/HSBC

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All,

As you are aware, we have been assessing the most viable and Group policy compliant Group Messaging Gateway (GMG) for future processing of LAM payments. Attached is the final version of the Clear Choice (CC) report to which I request your approval to proceed.

For ease of reference, I advise that the CC report recommends migration of all LAM non US Based SWIFT addresses to the UKGMG.

The CC was collectively put together by IT, PCM and CMP in the UK and IT, CMP, PCL in LAM, representatives from HBPR, HSAP and OPSCO (for HBMX, LAM International and CC sponsorship). My thanks to all participants.

Post approval, priority next steps include:

- Definition of: Project sponsor, Project Coordinators for LAM and the UK from Business and IT, 1-country Business and IT representation and supporing LAM and UK Project teams. Action: Davidovitch.

- Preparation and approval of a Project Terms of Reference. Action: Project Coordinators in LAM and UK.

- Advice to all LAM countries of CC decision. Action: Heredia.

- Progress with HBEU IT for need for Spanish speaking support during LAM’s working hours at the SYDGC. Action: Heredia with Phillips.

- Identify and agree Pilot site. Action: Heredia with MacNaughton.

- Follow on actions will include: prioritised list of countries to be migrated, rollout plan and timelines, project plan per country. Stakeholder country. Stakeholders between countries and the SYDGC, formalisation of the migration of Keys and Access rights, demise of SWIFT Alliance etc.

Please address any queries arising to me.

Regards,

Neelash

[Attachment "Clear Choice - Non US SWIFT Address MG Migration - Final.doc" deleted by Neelash HEREDIA@HSBC]
Sandy

Alexander A. Froshapt
President & Group Managing Director
Latin America and the Caribbean
Parque de la Reforma 567
Distrito Federal
Mexico, D.F.
Tel: 52-55-5-721-3914

Sandy

I refer to your e-mail of 14th March

Clive Bissett, Global Project Manager, GTS has been nominated to assist with the preparation of a Clear Choices document. Could I suggest therefore that someone be nominated for LATM to liaise closely with Clive which will ensure that a proper and complete consideration will be given, resulting in the capacity

I am aware from my contact with EMP in Brazil that they were giving some consideration to giving up certain payments activity given the challenges of passing the activity through the US. We have indicated that any final decision should be deferred in the report pending a proper consideration as to whether the payments messaging may be migrated elsewhere, allowing us to preserve as much activity and business as possible. There may also need to be a conversation at some stage with Paul Lawrence if it is necessary to persuade HBUS to continue with payments messaging pending any migration. I will however advise further if it proves to be the case.

All my talk will add one of my team, John Allison, to support Clive. I look forward to receiving details of your nominated contact when you will ask Clive to make appropriate contact and commence the necessary work.

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lam greteful for your assistance.

Regards
David Bagley

Sandy Flockhart

--- Original Message ---

From: Sandy Flockhart
Sent: 03/14/2007 12:45 PM
To: David Bagley/Credit Management
Cc: Graham M

Re: Group Meeting

David,

We are similarly keen to ensure that payments continue to operate smoothly, whilst being completely compliant with Group requirements, and to this end would not be averse in principle to re-routing
(affirmative flight via Sheffield), rather than as present, via the USA.

Whilst clearly this would need to be fully evaluated, not least in respect of the cost savings that would presumably accrue, as well as the ability to meet specific Latin American requirements (time zone, language etc), we would want to ensure that all Latin American countries and the most stringent requirements, possibly by centralising all /payments through a Payments Services Centre such as the one
recently commissioned in Mexico. One component of this might be to ensure that we used precisely
the same algorithms and screening parameters as are used by the US, but this too would be part of the
above-mentioned evaluation.

Clearly a decision will need to be taken soon as we are in the process of defining the migration of Banamex, which, until your communication was received, were going to be routinely routed through the United States in the usual way. However, you mention there may be capacity issues in the UK, and of course these
would need to be resolved without disproportionate cost implications for LATAM. It would therefore be
helpful if you would advise the name of a contact with whom we could discuss various points of detail
prior to making a final decision, and with whom we could work with afterwards to convert if such was
decided to be the way forward.

I look forward to receiving your thoughts on the above.

Regards,
Sandy

Alexander A. Flockhart

Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A.  HSBC OCC 8874353
President & Group Managing Director
Latin America and the Caribbean
Paseo de la Reforma 347
Oficina 23 Piso 32
Col. Cuauhtemoc
16600 Mexico, D.F.
Tel: 52-55-5721-2944

David W. BAILEY, M.D., M.B.A.

To: Sandy Flashman<br>Group Messaging<br>

Sandy,

With apologies for the length of this note set out below, I need to raise an issue with you which relates to payment messaging. First of all, this is an issue that has been around for some time, but probably now needs a strategic high-level decision given the potential commercial and cost consequences. The key issues are as follows:

You will of course be aware of the increased significance of compliance with the US sanctions promulgated by OFAC. This has led to the Group reinforcing and reiterating a requirement for all Group offices to comply with OFAC in relation to transactions denominated in USD, regardless of their place of incorporation or operation. This policy is well-established, and appears to be adhered to very closely by Group companies.

Obviously our operations in the US are obliged to comply with the requirements of OFAC in all currencies, not just USD. This obviously reflects the fact of either the US incorporation, or the fact that they were operating within the US. Within the US, however, there is an increased focus upon effective compliance with the requirements OFAC on the part of both OFAC itself but also our banking regulators.

At present, cross border payments, regardless of currency, are handled by HSBC in the US. The increased focus for HSBC in the US has led us to consider various situations where transactions pass through the US, but are initiated by and do not involve Group companies in the US. They are, in effect, merely a service provider.

Redacted Material
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This clearly has the potential for adverse commercial consequences, in that transactions in currencies other than USD involving countries or entities covered by US sanctions would be caught even though overall they were permitted by Group policy by reason of their non-USD denomination. For this reason, we are in the process of relocating the net and com server and made a conscious decision to develop a stand-alone WMPIran server in the UK where the original proposal was to host all Group credit card transactions through servers located in the US.

Obviously the significance of the above is that where payments are processed through the New York gateway on behalf of Latin American operations then HSBC, taking a cautious approach justified by the current regulatory environment, will need to filter all transactions regardless of currency and reject those transactions where they would breach OFAC regardless of currency. This would clearly be disadvantageous from Latin America's perspective, and equally I suspect the logistics of having to locally pre-screen all cross-border payments in all currencies would be commercially and operationally challenging for our operations in Latin America.

My own view is that commerciality you would find the introduction of filtering to our US colleagues unattractive commercially, and I do remember the problems that a local US hotel chain got into when they attempted to filter transactions in a similar way.

It is worth noting that any assumption here is based on the assumption that you will want to carry out as many transactions permitted by Group policy as possible the next viable option which would enable us to continue to support your Latin American business would be to relocate your payments to the UK Gateway. This however would need your support and the generation of an appropriate business case and clear choices proposal. Any such proposal would need to take account of likely impacts upon operational support, time zones, performance and cost. We have informally explored the possibility of relocating Latin American flows to the UK Gateway, but this centre has experienced some capacity issues.

Whilst we have lived with the current position for some time, it is fair to say that now that our US colleagues were on notice they had internally unauthorised in allowing the position to continue indefinitely. In essence, we either have to have a pass and timeline for a resolution of the payment messages or we need to turn the filtering on.

I thought it important to bring this to your attention, but assume that you will probably want to nominate one of your team to take matters forward. Similarly, we will provide as much assistance as we can here in CMP taking advantage of our understanding of the issues posed by OFAC and possible solutions and approaches to resolve these challenges.

Regards

David Bagley
From: ANNE LIDDY /HSUS/HSBC
Sent: 5/30/2008 08:54 AM
To: Nancy Hedges /HSUS/HSBC@HSBCO2
Cc: 
Subject: Re: OFAC processing in GSC’s

Here - I have put forth the suggestion of hiring up some first level checkers for OFAC processing in the GSC. We’re strapped and getting behind in investigations (on OFAC cases) and have some of our managers in the queues. I’m told I cannot hire first level staff unless it’s a foreign office. More info for the meetings to come. Further discussions with Compliance and will set something up with you when I get it.

Anne Liddy
HSUS Compliance | HSBC Bank USA, N.A.
452 5th Avenue, Tower 7, New York, NY 10018
Phone 212-525-5906
Fax 212-525-5769
Email anne.liddy@us.hsbc.com

To
Anne Liddy /HSUS/HSBC
05/30/2008 08:54 AM
To Nancy Hedges /HSUS/HSBC@HSBCO2
Cc 
Subject: Re: OFAC processing in GSC’s
Nancy, currently we have offshore resources conducting first level review of customer hits with oversight and QF conducted by ZAEC. We have emphasized to our regulators when offshoring is discussed (they get very nervous on this topic with respect to me and what is the risk in offshoring first level customer hit reviews vs payment hit reviews. The customers have already been vetted. We would really have to talk this one through internally and then potentially let the regulators know if the bank decided to move forward on this. Just my thoughts. I reached out to Denise on this as well and she agrees.

Anne Liddy

HSBC Bank USA, N.A.
452 5th Avenue, Tower 7, New York, NY 10018

Phone 212-525-5906
Fax 212-525-7905
Email anne.liddy@us.hsbc.com

Nancy Hodges

05/20/2008 17:17 PM

To Anne Liddy/HSBC/HNAC

Subject OFAC processing in GCC's

Any issue that you know of with processing OFAC hits out of one of the GCC's. The only thing I think there may be an issue with is how the FTs might view it and the fact that personal fines/incarceration of staff could occur (hopefully never here) and how would that be handled/looked at if he staff are in Dubai/Malaysia?

Nancy Hodges

5th Floor 6th Ave NY, NY 10018
(212) 327-2333
Email: nancy.hodges@us.hsbc.com

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Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A. HSBC OCC 0916350
From: MICHAEL B GALLAGHER/HSBC
Sent: 12/11/2009 2:50 PM
To: CHRIS P DAVIES/HBUS/HSBC
CC: LESLEY MIDZAIN/HBus/HSBC@HSBC
Subject: FW: OFAC payments

This is concerning,

Michael B. Gallagher
Executive Vice President
Global Transaction Banking
New York, NY 10018

----- Forwarded by Michael B Gallagher/HSBC on 12/11/2009 2:38 PM -----

From: camillus p hughes/HSBC
To: sandra peterson/HBUS/HSBC@HSBC
CC: charles Goelz/hbus/hsbc, Michael B Gallagher/hbus/hsbc, "Thomas W Halpin" <thomas.w.halpin@us.hsbc.com>
Date: 12/11/2009 02:28 PM
Subject: Re: FW: OFAC payments

Sandra,

We have considered all options at this point the compliance team in DE is already fully deployed dealing with wire camp alerts and bank examiner requests for the current exam. There is no bandwidth there at all they are behind on the current alert clearing process which we are also working on dealing with.

Thanks and regards,

Camillus P Hughes
Grp Obj Specialized Compl II | HSBC Bank USA
452 Fifth Avenue

Phone. 212-525-8607
Fax. 212-525-5961
Email. camillus.p.hughes@hsbc.com

----- From: sandra peterson/HSBC
To: Michael B Gallagher/HSBC
CC: "Camillus Hughes" <camillus.p.hughes@hsbc.com>, Charles G
Goelz/hbus/hsbc, "Thomas W Halpin" <thomas.w.halpin@us.hsbc.com>
Date: 12/11/2009 01:21 PM
Subject: Re: FW OFAC payments

Michael,

We have been providing headcount to the operations team here in Delaware as follows:

Nov. 24th --- Nov. 27th
Stephanie Brown
Denise Richards
Francisco Fernandez

Page 1
Nov. 30---->Dec. 4th.
Francisco Fernandez
Dec. 11th
The above individuals to assist on addressing the investigation OFAC queue
today.

Trying to manage our day to day and assist as best we can. I do not have other
resources to give at this point, but will double check with ops to see if
resources can be shifted.

Cam, have we tapped the compliance team here in Delaware?

Best regards,

Sandra Peterson, SVP Global Payments and Cash Management
Regional Head Client Management, Americas | HSBC Bank USA
90 Christina Road
New Castle, DE 19720
Phone: 302-327-2220
Fax: 302-327-2128
Email: sandra.peterson@us.hsbc.com

Michael B Gallagher/HBUS/HSBC
12/11/2009 10:01 AM
To: Charles Q DelBusto/HBUS/HSBC, "Thomas W Halpin"
<sandra.peterson@us.hsbc.com>
"Camillus Hughes" <camillus.p.hughes@hsbc.com>
Subject: OFAC payments

Do we have some bodies we can lend. This backlog is concerning and it is in our
collective interest to get this cleaned up.

Cam - is this a blip or do we have a new staffing requirement?

----- original message ----- 
From: Camillus P Hughes
Sent: 12/11/2009 09:44 AM EST
To: Michael Gallagher
Subject: OFAC Payments
Michael,
Spoke with our OFAC team, we could use 5 or 6 people for 10 days who can review payments to clear the 700 and building backlog of payments that have been held over and need to be worked to process.

Skillset is fairly straightforward. They would need to understand how to read a wire and be able to review the information provided by the client against payment information to determine if the item is a false positive and can be processed. We have all of the materials printed for review and can set this up as an assembly line.

You can reach me on 212-525-8607.

Thanks and regards,

Camillus F Hughes
Dept SSF-Specialized Compliance | HSBC Bank USA
432 Fifth Avenue

Phone. 212-525-8607
Fax. 212-382-5961
Email. camillus.f.hughes@hsbc.com
From: David W J BAGLEY
Sent: Sun, Aug 22 20:20:52 2010
To: Warrte G TEAMING
Subject: Fw: Project Topaz US Urgent Requirements
Importance: Normal

Warms

Detail of the calls.

Regards

******************************************************************************

HSBC Holdings plc
Registered Offices: 4 Canada Square, London E14 9HQ, United Kingdom
Registered in England number 617987

******************************************************************************

From: Andrew P LONG
Sent: 22/08/2010 18:51 GDT
To: Irene M OOSTERBURG@HSBC02
Cc: David W J BAGLEY, Michael B Gilligan@HSBC02, Niall S E Booker@HSBC02, Nickolas J TAYLOR@HSBC02
Subject: Re: Project Topaz US Urgent Requirements

Irene

I will work with the rest of Group as requested.

Because the relationships are not actually owned by IG, being orphans, I have sent the note to Heads of International in the regions to forewarn them and I expect to hear by tomorrow from them. I will try and push this through in the next 48 hours.

Andrew

Andrew P LONG
Group General Manager & Head of Global Transaction Banking, HSBC Holdings plc
Level 18, 4 Canada Square, London E14 9HQ, United Kingdom

Phone: (44) 20 7991 1200
Email: andrew.long@hsbc.com

Following the Topaz meeting, I explained that the US would need some immediate assistance and probably an interim solution as we cannot wait for the outcome of a complex and protracted project. We need to move quickly to reduce the AML alerts and the connected KYC issues as it is impossible to plan the required capacity unless we do so. In addition, we need to show progress to our Regulator.

We have compiled Phase 1 of a review of international banks and countries and HSBC must now move quickly to withdraw from those which do not meet either risk or return hurdles. We cannot get sufficient traction across the HSBC world to exit these names in a timely fashion. We have consulted widely and achieved broad consensus from Product and Global banking but inevitably, for some, there are still pockets of dissent, usually from regional in-country teams.

Attached is a list of 121 international banks that we can no longer support and need to exit. For each it shows the country of origin, the country of parentage, the reason for exit and the direct revenue implications. The total revenue estimate for these banks is USD 8.1bn (although for a small number of primarily high risk exits this data is not immediately available). However, you will note that this total includes accounts for over USD 15bn and Sierra Leone and Belarus together close to another USD 1bn.

The rationale for exit will be one of two broad categories:

1. Where an independent review by FEED has determined the credit or reputational risk is too high, or
2. Where rationalisation on the basis of commerciality is recommended following a country by country Panel review comprising Global Banking, TSC and PCM.

This is being managed and coordinated centrally by HSBC FIG but where there is no GRM, PCM Executives will be required to write to the clients. It is not feasible for the CEO of HSBC to ask for closure of an account in another country and, similar to Barron, I would be grateful for your help in getting prompt cooperation in the exit process.

In the absence of a compelling business case for retention, we need to start seeing these relationships next week. We cannot afford to delay in reinsuring them, so rather than HSBC asking for a closure, waiting for pushback and getting into multiple debates, I propose that we view the situation differently and ask you whether HSBC can no longer support and get timelines for the exits which need to be accelerated in the relevant geographies. For high risk clients we will give 30 days notice of termination end for all others 90 days. I am happy to discuss how we go about this but I believe that the communication of the names to be exited and the timelines needs to come from GRM.

Just to keep you in the loop, Phase 1 focuses on PCM only but will be followed rapidly by Phase 2 as you will appreciate the urgency with which we need to resolve our regulatory issues relative to KYC and AML. Indeed, in Phase 2 there will be Trade names the exit for which may be more complicated but to give you an idea of the problem, we seem to have 42 correspondent banks in Sudan which is too many. From our analysis of the situation aside from risk, it is clear that the sheer volume of clients we have contributed to the current problems.

Phase 2 of our review will therefore concentrate on revenues and for HSBC PCM alone, it appears that


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approximately 1,200 names collectively earn less than USD4.5m per year. This is an average revenue of less than USD3,600 per name, which in many instances, does not cover our ongoing compliance costs. Whilst some of these are proportional, for high risk countries and high alert generators, we will propose a material further rationalization shortly. We will need your help here too.

Clearly, the US requirements cut across business lines and it is crucial that the strategies of PCM, TSC and FIG are aligned to prevent this situation occurring in the future.

Regards

Irene M. Dorner

President & CEO, HSBC USA
HSBC Bank USA
401 Park Avenue | 19th Floor | New York, NY 10017

Phone: 212.258.4716
Fax: 212.523.9215
Email: irene.m.dorner@hsbc.com

[attachment "08-20 HSUS PCM Exits.xls.zip" deleted by Andrew P LONG/IBEU/HSBC]

------------------------------------------------

HSBC Bank plc may be solicited in the course of its placement efforts for a new issue, by investment clients of the firm for whom the Bank is a firm already provides other services. It may equally decide to shelve a business to its own proprietary book or with an associate of HSBC Group. This represents a potential conflict of interest. HSBC Bank plc has internal arrangements designed to ensure that the firm would give unbiased and full advice to the corporate finance client about the valuation and pricing of the offering as well as internal systems, controls and procedures to identify and manage conflicts of interest.

HSBC Bank plc
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11/01/2012

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RESULTS OF THE TRANSACTIONS REVIEW - UK GATEWAY

March 29 2012

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This document should be read in conjunction with the explanatory notes on page 71.
## CONSOLIDATED RESULTS - TRANSACTIONS SENT VIA THE US PER SANCTIONS REGIME

<table>
<thead>
<tr>
<th>Reporting Category</th>
<th>Iran (Value $000) (Volume)</th>
<th>Global (Value $000) (Volume)</th>
<th>Libya (Value $000) (Volume)</th>
<th>Myanmar (Value $000) (Volume)</th>
<th>North Korea (Value $000) (Volume)</th>
<th>Sudan (Value $000) (Volume)</th>
<th>Total (Value $000) (Volume)</th>
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<tbody>
<tr>
<td>1. Identified US Nexus transactions</td>
<td>19,422,415 (24,947)</td>
<td>53,922 (151)</td>
<td>21,826 (236)</td>
<td>110,231 (433)</td>
<td>662 (8)</td>
<td>188,546 (3,820)</td>
<td>19,797,462 (28,689)</td>
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<tr>
<td>2. Permissible Transactions</td>
<td>19,352,356 (24,461)</td>
<td>11,927 (45)</td>
<td>260 (34)</td>
<td>502 (52)</td>
<td>60 (9)</td>
<td>28,478 (244)</td>
<td>19,273,476 (25,229)</td>
</tr>
<tr>
<td>A. Iranian U.S.</td>
<td>19,852,021 (24,179)</td>
<td>11,675 (336)</td>
<td>21,416 (790)</td>
<td>109,938 (336)</td>
<td>152,077 (1,056)</td>
<td>310,123 (1,056)</td>
<td>310,123 (1,056)</td>
</tr>
<tr>
<td>B. OFAC license or other exemption</td>
<td>277,252 (340)</td>
<td>11,475 (336)</td>
<td>240 (45)</td>
<td>139 (34)</td>
<td>139 (41)</td>
<td>25,335 (941)</td>
<td>308,123 (1,056)</td>
</tr>
<tr>
<td>C. Blocked, rejected or cancelled</td>
<td>19,953 (70)</td>
<td>52 (16)</td>
<td>- (1)</td>
<td>154 (67)</td>
<td>- (1)</td>
<td>3,142 (171)</td>
<td>13,702 (171)</td>
</tr>
<tr>
<td>3. Transactions of Interest</td>
<td>196,159 (336)</td>
<td>42,404 (106)</td>
<td>21,416 (193)</td>
<td>109,938 (193)</td>
<td>- (0)</td>
<td>160,009 (3,274)</td>
<td>523,986 (3,291)</td>
</tr>
<tr>
<td>A. Potentially licensable</td>
<td>145,952 (257)</td>
<td>109 (29)</td>
<td>1,555 (29)</td>
<td>1,879 (51)</td>
<td>- (0)</td>
<td>7,099 (340)</td>
<td>156,586 (706)</td>
</tr>
<tr>
<td>B. Remaining Transactions of Interest</td>
<td>49,195 (79)</td>
<td>42,455 (71)</td>
<td>19,691 (157)</td>
<td>109,999 (157)</td>
<td>- (0)</td>
<td>102,077 (1,830)</td>
<td>567,400 (2,085)</td>
</tr>
</tbody>
</table>

No transactions sent via the US were identified as being subject to Iraqi or Sudan sanctions. The table only include transactions relating to Iranian sanctions. If they were processed from the corresponding accounts of two Iranian banks after they were designated as SDN.

The total number of transactions sent above is higher than the total listed on Slide 10, as there are a small number of transactions which relate to more than one sanctions regime. These have been included in all applicable sanctions regimes in the table above.
## CORRESPONDENT ACCOUNTS BY SANCTIONS REGIME

The table below summarises the number of all USD accounts and non-USD accounts, with UCD transaction activity, by the location of the account and the related sanctions regime.

<table>
<thead>
<tr>
<th>Sanctions regime</th>
<th>UK</th>
<th>Dubai</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>USD accounts</td>
<td>Non-USD accounts</td>
<td>USD accounts</td>
</tr>
<tr>
<td>Cuba</td>
<td>6</td>
<td>6</td>
<td>0</td>
</tr>
<tr>
<td>Iran</td>
<td>11</td>
<td>15</td>
<td>2</td>
</tr>
<tr>
<td>North Korea</td>
<td>2</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Sudan</td>
<td>18</td>
<td>18</td>
<td>0</td>
</tr>
<tr>
<td>Syria</td>
<td>1</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>38</td>
<td>31</td>
<td>8</td>
</tr>
</tbody>
</table>

There are four additional accounts held by the Bank in another jurisdiction, subject to the Sudanese sanctions regime, which are not included in the table above. The names of these accounts cannot currently be disclosed, however the SWIFT transactions relating to these accounts are included within this document.
PAYMENTS RESULTS - NON-IRANIAN TRANSACTIONS SENT VIA THE US BY YEAR

Note: Country, city and port search terms have only been applied across the period June 1, 2003 to December 31, 2004. Country, city and port search terms make up approximately 20% by volume (11% by value) of identified US Mena transactions.

Confidential - POA/FOA; Transmittal Practiced
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PAYMENT PROCESSING - CONSOLIDATED RESULTS

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Remaining
Transactions of
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, (Volume)

,,(Volume)

306,107
(1.257)

19,264
(138)

16,888
(46)

2,376
(92)

a.~
2. Cover payment - sanctioned element
not disclosed to the US

3,920,304
(22,339)

3,553,661
(19,698)

366,643
(2,641)

132,258
(590)

234,385
(2,051)

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3. Serial paymenl- sanctioned elemenl
not disclosed to the US

1,189,753
(659)

1,183,983
(569)

5,770
(90)

16
(3)

5,754
(87)

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4, Cancelled and re·submitted lNIthout
sanctioned Eljel'Tl3nt present in the
message to the US

8,085
(128)

2,531
(60)

5,554
(68)

614
122)

4,940
(46)

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5. Other

47,8511
(683)

38,366
(482)

9,492
(201)

4,061
(43)

5,431
(158)1

5,491,371
(25,204)

5,084,648
(22,066)

406,723
(3,138)

153,837
(704)

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(2,434)

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1. Payment with sanctioned element
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325,371
(1,395)

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Fmt 6601

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PAYMENT PROCESSING METHOD ANALYSIS RESULTS - UK & DUBAI PAYMENTS

UK Payments by Reporting Category

Number of Transactions

DUBAI Payments by Reporting Category

Number of Transactions

GonhfillinJ rOINFORlM TrealifJn!
Recommended by HSBC N. Annual Productivity Inc. HSBN940655
## Payment Processing

### Systems at the U.K. Gateway

**PAYMENT PROCESSING — CONSOLIDATED (UK, DUBAI & OTHER COUNTRIES)**

<table>
<thead>
<tr>
<th>Reporting Category</th>
<th>Total</th>
<th>Permissible Transactions</th>
<th>Transactions of Interest</th>
<th>Potentially Livestrong</th>
<th>Remaining Transactions of Interest</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Value $000 (Volumes)</td>
<td>Value $000 (Volumes)</td>
<td>Value $000 (Volumes)</td>
<td>Value $000 (Volumes)</td>
<td>Value $000 (Volumes)</td>
</tr>
<tr>
<td>1. Payment with sanctioned element disclosed to the US</td>
<td>$325,367 (1,290)</td>
<td>$306,139 (1,236)</td>
<td>$15,266 (138)</td>
<td>$16,884 (46)</td>
<td>$2,079 (79)</td>
</tr>
<tr>
<td>2. Cover payment — sanctioned element not disclosed to the US</td>
<td>$3,920,272 (22,332)</td>
<td>$3,889,629 (19,804)</td>
<td>$366,643 (2,691)</td>
<td>$122,359 (599)</td>
<td>$234,685 (2,201)</td>
</tr>
<tr>
<td>3. Sanction payment — sanctioned element not disclosed to the US</td>
<td>$1,189,756 (699)</td>
<td>$1,169,920 (699)</td>
<td>$5,770 (90)</td>
<td>$16 (5)</td>
<td>$5,765 (67)</td>
</tr>
<tr>
<td>4. Canceled and re-remitted without sanctioned element present in the message to the US</td>
<td>$8,045 (129)</td>
<td>$2,543 (61)</td>
<td>$5,442 (68)</td>
<td>$907 (19)</td>
<td>$4,030 (49)</td>
</tr>
<tr>
<td>5. Other</td>
<td>$47,956 (633)</td>
<td>$38,364 (462)</td>
<td>$9,405 (201)</td>
<td>$4,951 (43)</td>
<td>$5,451 (130)</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$5,491,336 (28,196)</td>
<td>$5,084,624 (22,081)</td>
<td>$406,711 (1,108)</td>
<td>$150,300 (761)</td>
<td>$253,806 (2,427)</td>
</tr>
</tbody>
</table>

*Confidential — FOIA Treatment Requested by HSBC North America Holdings Inc.*

*Confidential — FOIA Treatment Requested by HSBC Bank USA, N.A.*

*Confidential — FOIA Treatment Requested by HSBC Bank USA, N.A.*
The Office of Foreign Assets Control (OFAC) is a department of the US Department of the Treasury, and is responsible for the administration and enforcement of economic and trade sanctions based on US foreign policy. These sanctions target foreign countries, sanctioned individuals,, domestic entities, and individuals engaged in the proliferation of weapons of mass destruction.

Sanctions

The OFAC sanctions consist of both country-level sanctions (including sanctions against Cuba, Iran, North Korea, Sudan) as well as sanctions against individuals (Special Designated Nationals (SDNs)). There are violations in each of the statutes establishing the country-level sanctions such that there is no uniform approach (e.g., the 2 Sanctions contain an exemption which is not applicable to other country-level sanctions).

Revised policy

With immediate effect, all Group Offices (including those Offices incorporated or operating outside the US) must refuse to participate in any transactions and activities, or make any payments denominated in US dollars, which, if carried out by a US person, would be prohibited by any OFAC sanctions (except for the specific ‘Limited exemptions’ relating to Iranian sanctions discussed below).

When considering transactions for compliance with these sanctions, the transaction as a whole should be considered. This requires that where any transactions involve the use of cover payments (MT103s) any linked message (e.g., an MT103) should be considered together with the cover payment.

GHQ CMP already maintains a database, which includes details of all sanctions affecting Group Offices, including the OFAC sanctions. A link to the principal provisions of the current OFAC country sanctions is here.

In addition, further advice, instructions and guidance, with regard to the principal provisions of the OFAC sanctions, will be issued by GHQ CMP to local Compliance functions to enable those local Compliance functions to provide advice with regard to the practical application of this GCL.

Group Offices should, however, ensure that they continue to update relevant procedures in response to details of any future amendments or additions to applicable sanctions, including OFAC sanctions, issued by GHQ CMP in accordance with GHQ S.A. The guidance in this GCL should also be read in conjunction with GHQG00274 US OFAC Sanctions, which discusses, among other things, how OFAC sanctions can apply to US citizens or permanent resident aliens, even when outside the US.

It is acknowledged that compliance with sanctions with extraterritorial reach, including OFAC sanctions, may be influenced under local laws. Where compliance with this GCL would result in a breach of local law or regulation or existing binding contractual arrangements, the position should be considered in liaison with local Compliance and Legal functions and GHQ CMP. Any discrepancies from the terms of this GCL requires GHQ CMP concurrence.

Iranian sanctions

The OFAC sanctions applicable to Iran are unique in including the specific exemption for payments that qualify as a ‘non-bank payment’. Under certain limited conditions, the Office of Foreign Assets Control (OFAC) will allow the use of cover payments involving Iran that are merely cover payments for payment to another third country bank("cover payments") provided that they do not directly or indirectly finance or facilitate "Iranian transactions". Iranian transactions are defined as "transfers of payments, funds, credits or other financial assets or financial liabilities from one country to another, including through a brother country bank,

Permanent Subcommitte on Investigations

EXHIBIT #70a

GHSC OCC 3407560
GHSC OCC 3407561
In view, however, of the complexity of the relevant provisions governing the Iranian sanctions and the ‘U-turn’ limitation, all Iranian Payments denominated in USD must, with effect from USPOS, or any earlier date notified by HNME DUB, be routed through HNME DUB – HSBC Middle East Management Office, Dubai Internet City, P O Box 66, Dubai, UAE, Tel. No. + (971) (4) 301 4772, which will assist in the identification and processing of Iranian payments via dedicated correspondent accounts. This will require Group Offices that wish to continue to make Iranian Payments to open USD accounts with HNME DUB. All requests to open accounts should be sent for the attention of Alan Karm or Abbas Rezaee, GSN HNME. HNME DUB will issue more details to Group Offices on how payments should be processed. With immediate effect, and prior to USPOS, all Iranian payments must be referred to Rob Haseley, Tel. No. + (44) (0) 207 991 1644 (email Rob.HUSELEY@HSBC), and may only be processed once confirmation has been given that the payment is compliant under the ‘U-turn’ (or similar) exemption.

Other sanctions with extra-territorial effect

HNME DUB maintains a full and current list of sanctions that affect Group Offices. This list is accessible through the Group Compliance team via the BIS or via local Compliance functions.

Although certain sanctions only apply locally, all sanctions should be viewed as having Group-wide application. Sanctions issued by the European Union (EU purposes) (individuals who are nationals of member states and companies incorporated or domiciled in member states) globally as well as those persons located or operating in member states, Group Offices should use WOLF to ensure these sanctions are complied with any alternative payment systems to list any additional names covered by local or other extra-territorial sanctions applicable to those offices.

Implementation

It is recommended that the use of automated payment screening systems is necessary for the effective identification of payments potentially subject to relevant sanctions. Including OFAC sanctions. G2C 040210 Payment Screening required all Group Offices whose payments are not processed through one of the Group’s 3 regional TP are to install the Group’s default WOLF by 31/04/03. As a default, centralised by Group HNME Systems will be supplemented by BAUGS to include a full list of OFAC and SDN names, thus ensuring that all pre-broker USD payments Group-wide will be pre-screened for OFAC compliance. Group Offices should ensure that they are fully compliant with the requirements of G2C 040210 and notify HNME DUB immediately of any deviation.

Where there are local USD clearing systems (e.g. Hong Kong and UAE), relevant offices must ensure that WOLF is capable of screening all local payments consistent with the requirements of this GCL. In order to ensure that non-compliant payments are rejected, these Group Offices with local USD clearing systems must continue to use HNME DUB as they are screening all local USD payments.

In addition, Group Offices should take at least the following steps where relevant:

- Ensure that they have adequate procedures to identify proposed transactions and activities other than payments which may be prohibited by OFAC sanctions before the proposed transactions are entered into. This would include in-country bank transfers over USD accounts. This may require the issuance of staff circulars, amendments to desk instruction books and local procedures manuals
- In the case where the bank and country names are listed in WOLF is not likely that the number of payments identified in potential matches by the OFAC sanctions will increase. Group Offices need to ensure that they are sufficiently responsive to potential matches for clearance or rejection as appropriate
- Where proposed transactions or payments identified that would breach the OFAC sanctions, non-US Group Offices should decline the transaction and refuse to make any payments through the banks in the member. US Offices are required not to block or freeze payments
- Consider, in conjunction with local Legal or Compliance functions, whether any amendments or additions should be made to produce or service terms and conditions or whether any advice documentation should be given in customers to clarify the bank’s right and intention to reject or accept relevant instructions or requests
- Where Group Offices are in doubt as to whether a transaction or payment is affected by any sanction, but particularly OFAC sanctions, they should consult their local Compliance function which may in turn refer to HNME DUB. It should be noted that the policy contained in this GCL, where it relates to OFAC sanctions, only applies to transactions or payments denominated in USD, except for those US Offices which are required to apply OFAC sanctions to all transactions regardless of the currency of denomination
- Note the specific arrangements required in relation to payments that might be subject to the OFAC sanctions applicable to Iran.

Yours faithfully

S K Green
Group Chief Executive
GCL 090041 - US Dollar Payments (06/Apr/2006)

Language:English

Introduction

GCL 090041 'Compliance with Sanctions' referred Group Policy with regard to Compliance with local and international sanctions by Group Offices, including sanctions issued by the US Office of Foreign Assets Control (OFAC). Group Policy arising from the above GCL prohibits any Group Office from initiating any payment denominated in US Dollars (USD) that would constitute a breach of any of the OFAC sanctions.

US regulatory authorities continue to focus closely upon Compliance with OFAC sanctions by US banks, particularly where they act as correspondent banks for non-US banks, and by foreign banks with US operations.

Payment Methodology

USD payments made on behalf of underlying customer can be made either as cover payments (MT103 + linked MT202) or as serial payments (two MT103s). An illustration of both payment types, using the same underlying transaction, is shown in Appendix 1. Where cover payments are used, the payment message passing via the US correspondent (MT202) makes no mention of the underlying remitter or beneficiary. This is contained in the linked MT103 message which passes outside USA.

Policy

1. With effect from 30APR06 all USD payments initiated by a Group Office and remitted via HRUS, or any other US correspondent, must be made as serial payments.

2. The requirement to make payments as serial payments does not vary the provisions of GCL 050047 in that only USD payments permitted by OFAC may be initiated or processed by a Group Office.

3. The above requirements do not restrict the use of cover payments (MT202) for genuine bank-to-bank payments, for example in relation to Foreign Exchange settlements.

4. Until further notification, U-turn payments, under the Iran country OFAC sanctions, should continue to be made as cover payments (MT103 + linked MT202) as serial payments cannot qualify as U-turn payments. In accordance with GCL 030047, all U-turn payments must continue to be made via HSBC DUB. Where U-turn payments are made, Field 72 of the SWIFT payment message must be completed so as to make reference to any linked MT103.

5. By 31DEC05 HRUS will require third-party banks to which HRUS provide US correspondent banking services to make all payments denominated in USD and remitted via HRUS as serial payments.

6. Any dispensations from the requirements of this GCL require approval by GHQ CHP with agreement from HRUS CHP where relevant.

Guidance

Detailed guidance is to be issued via GHQ CHP, and any queries with regard to the implementation of this GCL or relating to GCL 050047 should be referred to local Compliance Officers, who can, as required, seek further clarification from GHQ CHP.

Yours faithfully

Stephen K Green
Group Chief Executive

HSBC OCC 3407587

EXHIBIT #70b
GCL 60011

GCL 60011 - US Dollar Payments (Notify 2006)

Language: English

Page 1

Introduction

GCL [Bank] Compliance with C8 sanctions [related Group Policy] via US Dollar Payments (Notify 2006) are not always compliant with OFAC regulations. This is due to differences in the way OFAC regulations are enforced by different banks. This statement has been made by HSBC bank, USA, N.A.

In order to ensure [bank's] compliance with OFAC regulations, they have [bank's] US Dollar Payments (Notify 2006) are not always compliant with OFAC regulations. This is due to differences in the way OFAC regulations are enforced by different banks.

Payment Methodology

For payments made on behalf of non-sanctioned payees, the US Dollar Payments (Notify 2006) may be used to ensure compliance with OFAC regulations. These payments may be made in USD, providing the payment is made by a US-based entity. In order to ensure compliance with OFAC regulations, the US Dollar Payments (Notify 2006) may be used to ensure compliance with OFAC regulations. These payments may be made in USD, providing the payment is made by a US-based entity.

1. U.S. Dollar Payments (Notify 2006) are not always compliant with OFAC regulations. This is due to differences in the way OFAC regulations are enforced by different banks.

2. The requirement for US Dollar Payments (Notify 2006) is that only US Dollar Payments are permitted for OFAC procedures. For example, payments may be made in USD, provided the payment is made by a US-based entity. In order to ensure compliance with OFAC regulations, the US Dollar Payments (Notify 2006) may be used to ensure compliance with OFAC regulations. These payments may be made in USD, providing the payment is made by a US-based entity.

3. The requirement for US Dollar Payments (Notify 2006) is that only US Dollar Payments are permitted for OFAC procedures. For example, payments may be made in USD, provided the payment is made by a US-based entity. In order to ensure compliance with OFAC regulations, the US Dollar Payments (Notify 2006) may be used to ensure compliance with OFAC regulations. These payments may be made in USD, providing the payment is made by a US-based entity.

4. The requirement for US Dollar Payments (Notify 2006) is that only US Dollar Payments are permitted for OFAC procedures. For example, payments may be made in USD, provided the payment is made by a US-based entity. In order to ensure compliance with OFAC regulations, the US Dollar Payments (Notify 2006) may be used to ensure compliance with OFAC regulations. These payments may be made in USD, providing the payment is made by a US-based entity.

5. The requirement for US Dollar Payments (Notify 2006) is that only US Dollar Payments are permitted for OFAC procedures. For example, payments may be made in USD, provided the payment is made by a US-based entity. In order to ensure compliance with OFAC regulations, the US Dollar Payments (Notify 2006) may be used to ensure compliance with OFAC regulations. These payments may be made in USD, providing the payment is made by a US-based entity.

6. The requirement for US Dollar Payments (Notify 2006) is that only US Dollar Payments are permitted for OFAC procedures. For example, payments may be made in USD, provided the payment is made by a US-based entity. In order to ensure compliance with OFAC regulations, the US Dollar Payments (Notify 2006) may be used to ensure compliance with OFAC regulations. These payments may be made in USD, providing the payment is made by a US-based entity.

VerDate Nov 24 2008 14:41 Nov 19, 2012 Jkt 076061 PO 00000 Frm 00920 Fmt 6601 Sfmt 6601 P:\DOCS\76061.TXT SAFFAIRS PsN: PAT
The Office of Foreign Assets Control (OFAC) of the US Department of the Treasury is responsible for the administration and enforcement of economic and trade sanctions based on US foreign policy. These sanctions target specified countries, suspected terrorists, drugs traffickers and those engaged in the proliferation of weapons of mass destruction.

The OFAC sanctions include country-level sanctions against a number of countries including Iran. The regulations contain an exemption to the sanctions unique to Iran, the so-called "U-turn exemption" for payments that qualify as a "U-turn payment". U-turn payments can be summarised as being "cover payments" involving Iran that are by order of a third country bank for payment to another third country bank - provided that they do not directly credit or debit an "U-turn Account" (as defined in the regulations). This U-turn exemption is described fully in GCL 500047 (Compliance with Sanctions).

Revised policy
With immediate effect, all Group Offices (including offices incorporated or operating outside the US) may no longer use the U-turn exemption of the OFAC sanctions against Iran. All other requirements of GCL 500047 remain in force.

Valid U-turn payments can continue to be made in relation to binding contractual commitments (i.e. that cannot be amended or terminated) that pre-date this GCL, provided that these payments are processed through HSBC as per GCL 500047. Where a U-turn payment is made it must be through the same method pursuant to GCL 300013 (US Dollar Payments).

Also refer to related GCLs: GCL 500047 (US OFAC Sanctions - Application to US Citizens, wherever located, and other US Persons) and GCL 300013, where appropriate.

Yours faithfully

D H Hodgkinson
Group Chief Operating Officer

HSBC OCC 3407606
The Office of Foreign Assets Control (OFAC) within the Department of the Treasury is responsible for the administration and enforcement of economic and trade sanctions against a number of countries, individuals, and entities at the discretion of the President. These sanctions are designed to affect individuals and entities that are deemed foreign countries, subnational political subdivisions, or agencies or instrumentalities thereof, and to achieve the objectives of U.S. policy in these matters. The regulations are codified in the Code of Federal Regulations at Part 500. The regulations are revised from time to time, and new regulations are issued as the need arises.
Background

GCLs 050047 and 060041 referred to compliance with economic and trade sanctions to the extent applicable pursuant to local laws and regulations and the application of certain Group minimum required standards in relation to transactions and payments denominated in US dollars. These GCLs remain in full force and effect.

Policy

Reflecting the current international and political situation and the potential risk of the inadvertent involvement of Group companies in transactions, payments or activities linked to the proliferation of weapons of mass destruction (WMD) and nuclear proliferation a decision has been taken to suspend all services and business with Iranian banks, irrespective of currency to the extent and as detailed below.

Relationships with Iranian Banks

All account relationships with Iranian Banks must be closed as soon as possible after giving any period of notice required by local law or regulation and which is sufficient to allow an orderly wind down of activity (for example uncleared items), and the run-off of any outstanding exposures. In any event such accounts must be closed by 30Nov07.

Similarly, any remaining facilities extended to Iranian Banks and SWIFT BKE arrangements should be cancelled or withdrawn as soon as possible and in any event by 30Nov07.

Where local law or the need to manage exit in an orderly manner will require accounts/SWIFT KEYS to be maintained beyond 30Nov07 specific dispensation must be obtained from GHQ CMP

Pending closure of accounts and cancellation of SWIFT BKEs any payments owed to accounts held for Iranian Banks, regardless of currency, should be made as MT103 serial payments.

Existing Facilities and Transactions

All existing facilities and transactions where there are legally binding commitments should continue to be honoured. Such arrangements may include committed facilities (for example project and export finance facilities), existing guarantees (see below) and Documentary Credits issued, advised or confirmed. Any payments linked to such pre-existing commitments may be made, but as serial payments.

OCC-PSI-00141530
OCC-PSI-00141531

Permanent Subcommittee on Investigations

EXHIBIT #70d
Where there are pre-existing guarantees issued on a pay or extend basis supporting business with Iran these may exceptionally continue to be extended provided that:

- Group Offices review each such guarantee and are satisfied that the underlying transaction is not linked to WMD or nuclear proliferation.
- Each such guarantee must be reviewed on each extension and customers encouraged to negotiate alternative arrangements.

New Business Involving Iran

No new business should be entered into in respect of any transactions involving Iran, Iranian resident entities or Iranian goods subject to the detailed policy guidance issued by GTS simultaneously with this GCL.

Further Guidance

Further guidance in respect of FIG relationships can be obtained from FIG Dubai and/or FIG London (Client Management Group). For guidance on payments into or out of Iranian banks and for all other matters, contact your local Compliance function.

Yours faithfully

D H Hoddkinson
Group Chief Operating Officer
GeL. 070049 • Sanctions Against Iran (24/September 2007)

GCL070049

Re: Sanctions

May 070049

To: The Office of the Director

From: HSBC Bank, USA, N.A.

Date: May 070049

Subject: Sanctions Against Iran

Dear Sir/Madam,

The Office of Foreign Assets Control (OFAC) has determined that HSBC Bank, USA, N.A. (HSBC) is required to take action against certain foreign banks.

The OFAC has imposed sanctions on the foreign banks due to their involvement in activities related to the Iranian Revolutionary Guard Corps (IRGC).

In accordance with the OFAC regulations, HSBC must cease all transactions with the foreign banks, including the blocking of accounts and the freezing of assets.

Please take the necessary steps to ensure compliance with these sanctions.

Yours sincerely,

[Signature]

[Name]

[Title]

HSBC Bank, USA, N.A.
From: Rod MOXLEY
Sent: Fri Sep 23 16:57 2005
To: John ALLISON; John ROOr
Cc: Jeremy R WALKER; Jkn F EBDON
Subject: OFAC sanctions

John,

You will be aware that I am keen to ensure that implementation of the GCL 050047 is carried out both professionally and efficiently. To this end, I have requested my colleague Jeremy Walker to supply me with updated USD payments over a 10 day period (5 a round the time of implementation of the GCL and 5 more recently), so that I can review and address any issues arising.

These figures, which you may find interesting, are detailed below:

<table>
<thead>
<tr>
<th>12/09/05</th>
<th>13/09/05</th>
<th>14/09/05</th>
<th>15/09/05</th>
<th>16/09/05</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sudan</td>
<td>496</td>
<td>478</td>
<td>371</td>
<td>350</td>
</tr>
<tr>
<td>Cuba</td>
<td>144</td>
<td>236</td>
<td>220</td>
<td>169</td>
</tr>
<tr>
<td>Myanmar</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>TOTAL</td>
<td>741</td>
<td>889</td>
<td>776</td>
<td>690</td>
</tr>
</tbody>
</table>

To clarify, these figures constitute the number of payment transactions which have been identified by VOA in the UK being possible hits. The figures shown will include both MT202 and MT103 messages, so there is an element of double counting in the figures supplied, as a typical single customer transaction will have both an MT202 and an MT103 and for all customers not purely USD - on a particular day.

In particular, regard to the Sudanese payments, but also to a lesser extent, Cuban and Burmese, there is a considerable number of USD denominated transactions. The precise amount is difficult to quantify, unless manual counts are made and as you will appreciate, this is difficult in a volume driven payments environment. Until 28 July, the above payments would have been treated by VOA as non-legitimate under OPAC (as before) but would have been placed on the 'blacklist' and any USD payments to, from or through them would have been blocked. As of 28 July, the above payments would have been treated by VOA as non-legitimate under OPAC (as before) but would have been placed on the 'blacklist' and any USD payments to, from or through them would have been blocked until 28 July.

In particular regard to the Sudanese payments, but also to a lesser extent, Cuban and Burmese, there is a considerable number of USD denominated transactions. The precise amount is difficult to quantify, unless manual counts are made and as you will appreciate, this is difficult in a volume driven payments environment. Until 28 July, the above payments would have been treated by VOA as non-legitimate under OPAC (as before) but would have been placed on the 'blacklist' and any USD payments to, from or through them would have been blocked until 28 July.

The issues surrounding this have been addressed in the notes on OFAC payments recently.

We have also advised that we have not been physically returned any USD payments involving Sudan, Cuba or Burma. I feel we now need to look far more closely at these payments to ensure compliance with the GCL.
The choice at present, from my viewpoint, with regard to application of the Gel in respect of these payments is this:

1. We continue to process the USD transactions but ensure that the routing of the payments is such that they are not frozen in US. This will involve intelligent usage of the routing system but may perpetuate similar problems to those encountered with non-customer instructions saying do not mention Sudan or routing which does not make it apparent that these are Sudanese payments. This would create the exact scenarios illustrated in Compliant's guidance examples re Sudan i.e. the payment is prohibited under the sanction but it made because it pays a USD account outside the US.

2. We apply the wording of the Gel, ... refuse to participate in any transactions and activities, or make any payments denominated in USD, which. if carried out by a US person, would be prohibited by any OFAC sanctions... and return the payments unprocessed.

My instinct is to return all such USD payments but, before doing so, I would like to confirm that there should not be a cooling off period when we continue to make such payments, providing the transaction is processed efficiently. Additionally, I want to be sure that the customer is aware that we should be applying OFAC sanctions in these situations and interpreting the OFAC sanctions so that we are following the guidelines that our US colleagues have been directed to follow. It is also worth bearing in mind that OFAC sanctions are not limited to USD and if we made a Euro payment to Citibank in favour of Sudan, we should therefore be cancelling such payments.

I have spoken to a number of colleagues recently who are unaware of the practical implications of the Gel. The BPM is yet to be updated and as it has not changed the line of business, the first time the customer will be aware will be when his payment rejects at our VIOF Queue. This could cause considerable customer servicing issues, particularly if it involved large corporate or valued private customers.

To reiterate my stance above, I am keen to ensure that this is implemented promptly and effectively. I am also aware that it is not unusual for there may be other non-suspected, albeit unrelated, issues. I feel that David Bagley should be made aware of this situation but before advising him directly, I would be grateful for your input, perhaps a short meeting to prevent potential email correspondence could be arranged, but I will await your views.

Regards

Rolf

Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A.
INFORMATION REQUESTED IN CONNECTION WITH: (NORTH KOREA, CUBA, AND MYANMAR)

1. Description of the profit and normal business activities contributing to revenues from the entity, together with a description of the business and contacts contributing to those revenues. This should include, but not be limited to, details of the entities and programs in which you have provided financing.

BRAND - Maple

We were notified that there are relationships with Cuban and North Korea customers. HSBC maintained the consolidation of their accounts, and followed up on the process until each account determined in USD were cancelled. As of today, we have found 186 North Korea customers with balances of USD3.361.114 and 1,466 Cuban accounts with balances in the amount of USD301.351. Please note that the principal is demonstrated in USD.

Please find below an updated list of relationships with Cuban and North Korean citizens:

<table>
<thead>
<tr>
<th>Jurisdiction</th>
<th>Customer Type</th>
<th>No.</th>
<th>No. Accounts</th>
<th>USD Denomination</th>
</tr>
</thead>
<tbody>
<tr>
<td>North Korea</td>
<td>USD</td>
<td>29</td>
<td>27</td>
<td>3,361,114.14</td>
</tr>
<tr>
<td></td>
<td>Cubao/MXP and</td>
<td>24</td>
<td>22</td>
<td>571,005.43</td>
</tr>
<tr>
<td></td>
<td>USD</td>
<td>9</td>
<td>9</td>
<td>96,907.29</td>
</tr>
<tr>
<td>Cuba</td>
<td>MXP</td>
<td>186</td>
<td>184</td>
<td>1,466,578.52</td>
</tr>
<tr>
<td></td>
<td>Cubao/MXP and</td>
<td>35</td>
<td>32</td>
<td>2,669,561.20</td>
</tr>
<tr>
<td></td>
<td>USD</td>
<td>42</td>
<td>41</td>
<td>562,203.79</td>
</tr>
<tr>
<td></td>
<td>USD</td>
<td>10</td>
<td>10</td>
<td>133,247.39</td>
</tr>
<tr>
<td>Total</td>
<td>USD</td>
<td>2,456</td>
<td>2,454</td>
<td>12,394,549.89</td>
</tr>
</tbody>
</table>

Inclusive as of 08/17/17

Note: the above figures have been used to be consistent with the amounts verified with the Mexican authorities and not as to confirm the names of the individuals in Mexico City, we have decided that some of the above-mentioned Mexican citizens...
HSBC - Panama

HSBC Bank Panama S.A. does not have relationships with customers of the aforementioned associations.

Saudi Arabia

The accounts of Saudi nationals are subject to cancellation on 10/7/89.

Credit Cards of Saudi nationals that are domiciled in Saudi Arabia are subject to cancellation on 10/7/89.

HSBC - Egypt

HSBC does not have any relationships with the above jurisdictions, banks or governments.

HSBC - Colombia

There is one relationship with the above jurisdiction, but it does not have loans with the bank. (They operate with the local currency, which depends on the country in which they conduct business.) There is no account domiciled in local currency with the bank.

HSBC - Honduras

There is one business relationship with the above jurisdiction. They maintain a savings account domiciled in USD that was opened on 14-01-89 with a balance of USD 325. The remaining balance is USD 325, but it is not possible to confirm whether there are any deposits, withdrawals, or transfers.

In addition, there is one commercial relationship with 44 Cuban contracts with the following balances:

Accrued balance in USD: USD 9,477.18
Accrued balance in local currency (Ecuadorian): USD 30,000

HSBC - Costa Rica

There is one commercial relationship with 2 Cuban customers who have different savings and USD accounts domiciled in USD with balances of USD 206,165, and credit cards with balances in the amount of USD 5,926.

Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A.  HSBC OCC 8876094
HSBC

HSB – B. Schneider

There is no relationship with a Cuban national (A savings account denominated in local currency-Cuban convertible peso – withbalance of $410.75).

HSBC – Nicaragua

Nicaragua does not have nor are denied remunerations with Cuban, North Korean, or Myanmar nationals.

Informes

Reports report that it does not have any relationships with Cuban nationals.

H. Any new developments or future anticipated business activities related to, or connected with, the financial institution

In the entire region, all necessary arrangements have been made to cancel all business relationships with the above jurisdictions, either in relation to accounts denominated in US dollars or commercial relationships with such jurisdictions. There are no new business relationships to be ceased with the above jurisdictions.

III. A description of direct or indirect contacts with the governments of the above mentioned and with individuals or entities affiliated with or controlled by those governments, and the new made by these persons of funds received in the related transactions.

For the entire region, formal relationships maintained with such jurisdictions are with the authorities, as shown in section I and II.

IV. Quantitative for each of 2003, 2004, 2005 and 2006:

(a) transactions for the country

(b) profitability of the country (please state any significant estimates used in determining results)

(c) total assets in the country.

No available information.

V. Details as to whether the entities identified are subject to sanctions or embargoes

For the entire region, embargoes mechanisms are applicable and information may not be provided unless it is requested by the regulator.
From: David W Bagley
Sent: Mon Oct 17 17:13:57 2005
To: John F Root
Subject: Re: Gel 050047 - Compliance with Sanctions
Importance: Normal
Attachments: image_O.gif; Doc Link.htm

John,

As per my earlier note.

Regards,

[Signature]

--- Forwarded by David W / Bagley@HSBC on 17 Oct 2005 16:14 ---

Matthew GW KIng@HSBC

To: Graham Thomas@HSBC
cc: David leighton@HSBC, Ramon Garcia@HSBC, Sandy Hodgson@HSBC, Sergio Pinaj@HSBC, David W Bagley@HSBC

Subject: Re: Gel 050047 - Compliance with Sanctions

Graham,

Thank you for the update.

Sandy alerted me on this last week. I told him then, and I have since confirmed, that the new policy applies specifically only to USD payments. However, I have now been advised there is also an issue for non-USD payments when these are transmitted through the HSUS TP gateway, as is the case in South America. Fernando Busnello is dealing with this on behalf of HSBC and you may like to talk to him directly if HSBC payments are similarly routed.

I note NASA continues to process USD payments involving Cuba. It is very important this is stopped immediately as the regulators are getting very tough and the cost to the Group could be considerable if
...breach occur, both in terms of the fine and in the rectification which is likely to be a pre-requisite to any settlement. If this identifies further breaches, the cost could spiral.

With regard to non-USD payments as described above, GCM are urging HBUS to screen out these transactions to avoid any risk, and HBUS would have to put measures in place to protect customer

I am happy to discuss further.

Regards

Matthew

THOMSON/HBMX/HSBC

Matthew

I have reviewed the following commentary from HBMX CMP, which I relay in response to your Query

OFAC List Verification Implementation

Background

The implementation of the "OFAC" list as directed by GCOM/14/10/2005 17:55 Mail Size: 2.1(k)1 as Fwdy!

Matthew [W KING/GCM/INA/GHQ/HG/HOB/HMM/X/@HSBC

cc: Sandy FocR/HBHSX/HSBC, Ramon GARCIA/HBMX/HSBC, David Leighton/HBMX/HSBC, Sergio PINA/HBMX/HSBC Subject: R-050047 - Compliance with

OFAC List Verification Implementation

Background

The implementation of the "OFAC" list as directed by GCOM/14/10/2005 17:55 Mail Size: 2.1(k)1 has not been completely accomplished.

This is due to the fact that the "WOLF" system for the online detection of "OFAC" related matches will not be implemented until April 06, and because neither USD demand deposit accounts nor the Credit Card systems yet provide online validation against the "OFAC" list for new account openings. Please note that

once these systems are updated, all other products and services will also be controlled as they all require a "control account" to be operated.

Pending these systems changes, manual controls have been implemented in Private Banking, Treasury, Trade Services, and Trust. However, please note that no automated means exist to ensure that these controls are properly being carried-out.

Our greatest exposure, and hence principal focus, is to the volume of business historically carried out by

HSBC customers with Cuba in USD dollars.

Regards

Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A. HSBC OCC 8874358
Graham Thomson  
Head of Group Audit Mexico  
Tel (52) 55 5721 6236

Matthew J W KING/GGM INA GHQ/HGHO/HSBC

Matthew J W KING/GGM INA GHQ/HGHO/HSBC  
Sent by Liz A TESTER  
Sat 13:03:00 UK

To: Jon WADSWORTH GM APHMBAP/HSBC@HSBC, Mike R. AllSOPIHO GfA GHQIHGHOIHSBC@HSBC, Pat Bo LANDEIHD GAMIHERMElHSOC@HSBC, Alain CATION/HDIHDOiHBFRlHSBC, Vince J Mancuso!HBUSfHSBC@HSBC, John RAMSDEN KNOWLESfHBBRlHSBC, Graham THOMSON/IHMElHSBC@HSBC  
Cc: Subject: Re: Gel 050047 Compliance with SancIOns

Please see the attached. Can you please speak to your local CMP functions to ascertain the areas of highest risk. Please ensure that appropriate reference is included within your audit programmes and give due consideration to the associated risks when planning your audit work for 2006.

A copy of the HTV guidelines referred to follows by separate email.

Regards,
Matthew King

David W J BAGLEY/HGHO/HSBC

David W J BAGLEY/HGHO/HSBC  
Sent by Marion O ROACH 01/11/2005 15:43 Phone Gel 050047.  
To: Matthew J W KING/GGM INA GHQ/HGHO/HSBC  
Cc: Subject: Marion O ROACH 01/11/2005 15:43 Phone Gel 050047.  
Compliance with SanctIOns: Entity HSBC Holdings plc.

Matthew

I refer to my above email. Where the practical impact largely centres upon the OFAC sanctions, both at country and individual (SDN) level.

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HSBC OCC 8874359
Group CEO is particularly concerned to ensure as far as is possible that the GCI is properly and fully implemented across the Group, recognising the significant US regulatory and reputational risks which might arise were any HSBC Group member firm to collude or aid and abet infringement of the OFAC sanctions. The recent case involving…, while provides a stark example of the potential consequences which arise in circumstances where the US authorities suspect infringement of ….

I attach a copy of my note to Stephen dated 19 September which sought to both update him with regard to certain significant steps required as part of implementation but also indicated that we would need to seek further assurance with regard to compliance with the GCI, either by specific and targeted reviews which would need to take place in the first quarter of 2006 and will be the subject of the Compliance planning process, but also from the ongoing relevant scrutiny as part of audits.

Areas particularly affected by the GCI would include Trade Finance where HTB has issued specific guidelines. Payments areas, Correspondent Banking and possibly participation in local USD settlement systems. I am happy to discuss relevant aspects of the GCI, and the practical issues within which we have already seen being out of implementation, with any of your team if you think this would help, and whilst I appreciate your audit programmes consider GCI compliance, it is clear that Group CEO sees compliance with the GCI as being of particular significance.

Regards

David Bagley

Sent not seen by DWJB

920

VerDate Nov 24 2008 14:41 Nov 19, 2012 Jkt 076061 PO 00000 Frm 00934 Fmt 6601 Sfmt 6601 P:\DOCS\76061.TXT SAFFAIRS PsN: PAT
Stephen

Given the significance of the above GCL and conscious of the fact that I will miss the next pre-GMB meeting whilst in Hong Kong, I thought I should update you with progress made in relation to implementation of the GCL since its issue. The key points are:

The required specialist 'U-turn' team has been established at HBME DUB who have opened a correspondent account with J P Morgan Chase through which the pre-screened compliant U-turn Iranian Payments can be made.

A number of Group Offices have opened USD accounts with HSBC through which they will route all Iranian payments. I am not convinced that all Group Offices with Iranian payments are yet routing those payments through HBME; which the GCL required they should do by 1SEP08. I have already put a reminder to Regional Compliance Officers and asked that they review with their Business Heads if they do have relevant business which requires routing through HBME. It is of course entirely possible that some offices may have no need of these accounts if they have no relevant activity. I have asked for confirmations of the local position by 23 September.

GHQ CMP have provided, and continue to provide, significant levels of offtice advice in relation to OFAC sanctions, including in respect of activities within CIBM. The latter consisted of FX and Bond dealing with Iranian banks. Where necessary we have validated our advice with external lawyers.

HIV, in close consultation with GHQ CMP have issued detailed guidance with regard to operational procedures for trade transactions involving Iran. Most of the payment flows direct to third parties we have considered to date are USD compliant. HIV's procedures are intended to ensure that all trade commitments we entered into where the ultimate payments would be other than compliant. For operational reasons HIV have adopted an approach which is stricter than the requirements of the GCL.

I suspect that ASI is most heavily affected by the GCL, particularly in relation to customers with Myanmar. Whilst I am sure that there will have been some adverse reaction in activity involving Iran, most of the trade transactions have been able to continue as the payments are U-turn compliant. I have not received any feedback on the reaction within ASI.

I have indicated to the Compliance function globally that they will be required to carry out a comprehensive programme of reviews, against a standard template to be provided by GHQ CMP, to consider whether the GCL has been implemented. I will also discuss with Matthew King how we can use routine audits to provide additional comfort.

A recent meeting of the Wolfsberg Group confirmed both the substance and timeliness of the approach we have adopted. I Support that at least 3 European banks have OFAC-related issues, although ABN are by far the worst affected. David Hodgkinson advised me that he had been informed that the fine to be imposed on ABN may be as large as USD 350m, although this is unconfirmed. Additionally Warren Leaming, RCO Dubai, has been tasked to a meeting with major banks at the US Consulate where they will be addressed by a representative from OFAC. I suspect this follows on from the known visit to ABN's Dubai Office by representatives from the Federal Reserve.

I will continue to monitor implementation of the GCL and at the Global Conference arranged in October....
will re-emphasize to the function the significance and the reasons for our policy, and the need to monitor compliance. I wonder if it would also be appropriate for you to talk briefly about the significance of this CCL at the AOF office.

No questions or issues were raised in connection with cover payments during the peer review carried out jointly by FRB and OCC of our correspondent banking activities with HDB.

I will be discussing how best to address the USD clearing system in Hong Kong, where HMMP acts as the administrating bank, during the visit next week. Any changes to this system which we think are advisable in the context of the OFAC sanctions will need to be discussed with HMMP. Given that there are obvious potential sensitivities in being seen to apply US regulation extraterritorially I recognize the need to proceed with caution whilst protecting us against US regulatory risk.

We have closed a number of USD correspondent relationships with Cuban and Myanmar banks.

We have, as anticipated within the GCL, allowed a number of pre-existing commitments to be honoured, but emphasized that no fresh arrangements should be entered into which would breach the terms of the GCL.

David Bagley

Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A.
Transaction Review Progress and Results Reporting

18th & 19th October 2011
Correspondent and other accounts - Summary of accounts subject to
review by location and regime

The table below summarises the number of all USD and non-USD accounts (containing USD transactions) with sanctioned banks
or banks in sanctioned countries identified, split by the location of the account and the related sanctions regime.

<table>
<thead>
<tr>
<th>Sanctions Regime</th>
<th>UK USD</th>
<th>Non-USD</th>
<th>Hong Kong USD</th>
<th>Non-USD</th>
<th>Total USD</th>
<th>Non-USD</th>
</tr>
</thead>
<tbody>
<tr>
<td>Burma</td>
<td>0</td>
<td>0</td>
<td>2</td>
<td>0</td>
<td>2</td>
<td>0</td>
</tr>
<tr>
<td>Cuba</td>
<td>1</td>
<td>0</td>
<td>3</td>
<td>0</td>
<td>6</td>
<td>0</td>
</tr>
<tr>
<td>Iran</td>
<td>11</td>
<td>11</td>
<td>12</td>
<td>11</td>
<td>23</td>
<td>21</td>
</tr>
<tr>
<td>Iraq</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Libya</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>North Korea</td>
<td>2</td>
<td>0</td>
<td>2</td>
<td>0</td>
<td>2</td>
<td>0</td>
</tr>
<tr>
<td>Sudan</td>
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<td>0</td>
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<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Syria</td>
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<td>0</td>
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<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Tanzania</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>13</td>
<td>31</td>
<td>34</td>
<td>24</td>
<td>58</td>
<td>31</td>
</tr>
</tbody>
</table>

* The Hong Kong reviews have not commenced and the overall number of accounts may change.

See Appendix 5 for listing of correspondent and other accounts for the UK (USD and Non-USD accounts) and for Hong Kong
(USD accounts only)

Confidential Treatment Requested
From: TERESA PESCEIHBUS/HSBC
Sent: 12/28/2005 11:01:12 AM
To: MICHAEL B GALLAGHERIHBUS/HSBC;CHRISTOPHER LOKIHBUS/HSBC;PETER G MERRITTIHBUS/HSBC
CC: TONY MURPHYIHBUS/HSBC;JOSEPH M PETRIIHBUS/HSBC;CAROLYN M WINDIHBUS/HSBC;CAMILLUS P HUGHEIHBUS/HSBC;ALAN T KETLEYIHBUS/HSBC;WILLIAM M WONGIHBUS/HSBC;SUSAN A VVRIGHT/HGHQ/HSBC
Subject: AI Rahji Trading/AI Rahji Banking

All,

As some of you may know, the above named clients have been under evaluation by US and Group Compliance based, among other things, on relationships maintained with entities/countries on the OFAC list. Additionally, US law enforcement has placed these entities under scrutiny. After much consideration, Group Compliance has recommended that the US businesses sever ties with these clients based on the current regulatory environment and the interest of US law enforcement. Accordingly, I will not approve customer profiles for or transactions with these entities. Please make appropriate arrangements. I am available to answer any questions you might have.

Regards,
Terry
From: ALAN T KETLEY/HBUS/HSBC
Sent: 03/16/2005 04:43 PM
To: PAUL PLESSER/HBUS/HSBC@HSBC
CC: Teresa Pesce on 10 Mar 2005 12:26
Subject: Fw: Al Rahji Guidance Clarified

Paul

Looks like you're fine to continue dealing with Al Rahji.

You'll better be making lots of money!

Alan

--- Forwarded by Alan T Ketley/HBUS/HSBC on 03/16/2005 04:43 PM ---

Teresa Pesce on 10 Mar 2005 12:26

To: Teresa Pesce

From: Teresa Pesce

Subject: Al Rahji Guidance Clarified

Group has clarified the Al Rahji guidance issued last month. They have evaluated Al Rahji Banking and Al Rahji Trading and now believe that the two are separated enough that relationships may be maintained with the latter but not with the former. To be clear, recommendation is to sever with Banking only at this time.

Confidential - FOIA Treatment Request

EXHIBIT #73
From: CHRISTOPHER LOK/HSBC
To: TERESA PESCE/HSBC
CC: STEPHEN J ALLEN/HSBCMERIDIAN
Subject: FW: Al Rajhi

Terri

After the OCC close out and that chapter hopefully finished, could we re-visit Al Rajhi again. London compliance has taken a more lenient view, as per below.

Chris

---------------------- Forwarded by Christopher Lok/HSBC on 05/23/2005
11:29 AM ---------------------------

Stephen J ALLEN on 23 May 2005 10:46

From: Stephen J ALLEN Tel: 7992 4555
Title: Location: WorkGroup: Mail Size: 799510

To: Christopher Lok/HSBC on 23 May 2005 10:46

subject: Al Rajhi

Chris,

Here's the rest;

steve

------ Forwarded by Stephen J ALLEN/HSBC on 23 May 2005 15:45 -----

stephen J ALLEN/HSBC on 23 May 2005 15:20

From: Stephen J ALLEN/HSBC Tel: 7992 4555
Title: Location: WorkGroup: Mail Size: 5101

To: Christopher Lok/HSBC on 23 May 2005 15:20

subject: Al Rajhi

chris,

We'll have to see if this will make any difference! I haven't seen the new kyc yet but, we are getting a copy.

steve
Dav; d W J BAGLEY
HGHQ
23 May 2005 16:03
.sent by: Marion O ROACH
To: David M HODGKINSON/DCH MEM/HBME/HSBC/HSBC
CC: Iqbal KHAN/CEO ISF HFSM/HBME/HSBC/HSBC
Warren G LEARNING/RJA JG MEM/HBME/HSBC/HSBC
Susan A WRIGHT/HGHQ/HSBC/HSBC
SUBJECT: AL RAJHI BANK
Your Ref:
Entity: HSBC Holdings plc - HGHQ

David

Having now received the updated KYC from Sharig Siddiqui and reviewed the previous information received from Group Securities I am pleased to confirm that we have revised our recommendation in relation to the above.

Accordingly we have lifted our recommendation against the commence or expansion of relationships with the above with immediate effect. We will communicate this decision to HBEU where I believe there are a number of pending applications.

whilst we will advise HBUS CMP of the revised view within GHQ CMP nevertheless I believe it will remain appropriate for HBUS CMP in conjunction with HBUS senior management to reach their own determination with regard to the expansion of business with Al Rajhi within the US. Although the revised view from GHQ CMP ought to be a material matter causing them to reconsider their position nonetheless, and particularly in the current US environment, I do not believe it is appropriate for us to seek to influence their determination one way or the other. This was something that I discussed as a possible outcome with Iqbal when we discussed Al Rajhi.

Regards
David Bagley

Attachment: Al Rajhi HBME kyc 05.05.PDF
Attachment: Al Rajhi Article 05.05.pdf
SOME EMAILS FROM ICRO ELECTRONIC FILES PERTAINING TO AL RAJHI

Note
10 Aug 2005 12:12
From: Teresa Pesce Tel: 212-525-6099
Title: Executive Vice President Location: 452 5th Ave, Floor 07
WorkGroup: COMP/ANTI-MONEY LAUNDERING Mail Size: 777381
To: Sally G LOMAS/HBMD/HSBCMERIDIAN@HSBC
cc: Lynda J Cassel/HBSC/HSBC@HSBC; Anne Liddy/HBSC/HSBC@HSBC; Alan T Ketley/HBSC/HSBC@HSBC; Gloria Stazzara/HBSC/HSBC@HSBC; Stephen J Allen/HBMD/HSBCMERIDIAN@HSBC; Susan SALAS/IBEU/HSBC@HSBC
Subject: Re: Fw: Al Rajhi

Sally -

This is not so simple. David does not object to HBEU, but has left it to us to assess the US risk. We've gotten push back from the OCC on Al Rajhi Trading, which is less controversial than the bank. We can revisit this, but I am not inclined to push ahead precipitously, especially in light of the regulatory scrutiny.

Regards-
Terry

Sally G LOMAS on 10 Aug 2005 09:59
Memo 10 Aug 2005 09:59
From: Sally G LOMAS Tel: 799 11511
44 2079 911511
Title: Location:
WorkGroup: Mail Size: 773184
To: Lynda J Cassel/HBSC/HSBC@HSBC
cc: Teresa Pesce/HBSC/HSBC@HSBC; Anne Liddy/HBSC/HSBC@HSBC; Alan T Ketley/HBSC/HSBC@HSBC; Gloria Stazzara/HBSC/HSBC@HSBC; Stephen J Allen/HBMD/HSBCMERIDIAN@HSBC; Susan SALAS/IBEU/HSBC@HSBC
Subject: Fw: Al Rajhi

Lynda,
please find attached an email sent by David Bagley, indicating that there is no longer a recommendation against expanding relationships with Al Rajhi Bank.
I have asked Fig to check, when they do their additional work, whether the same part of the Al Rajhi family is involved in both Banks. We now need to wait until we have the more detailed EIDD information which you have requested.

Regards

Sally

---

From: Christopher LokIHBUS/HSBC Tel: 212-525-2062
To: Teresa PesceIHBUSIHSBC@HSBC
cc: Stephen J ALLENIHBMDIHSBCMERJDlAN@HSBCMERJDlAN
bee:
Subject: Fw: Al Rajhi

After the OCC close out and that chapter hopefully finished, could we re-visit Al Rajhi again. London compliance has taken a more lenient view, as per below.

Chris

---

Sent by: Marion 0 ROACH
To: David H HODGKINSON/DCH MEM/HBME/HSBC@HSBC
cc: Iqbal KHAN/CEO ISF HFSM/HBME/HSBC@HSBC
Warren G LEAMING/RLA LGA MEM/HBME/HSBC@HSBC
Susan A WRIGHT/HGHQ/HSBC@HSBC
Subject: AL RAJHI BANK
Our Ref: 
Your Ref: 
Entity: HSBC Holdings plc - HGHQ

David

Having now received the updated KYC from Shariq Siddiqui and reviewed the previous information received from Group Securities I am pleased to confirm that we have revised our recommendation in relation to the above.

Accordingly we have lifted our recommendation against the commence or expansion of relationships with the above with immediate effect. We will communicate this decision to HBEU where I believe there are a number of pending applications.

Whilst we will advise HBUS CMP of the revised view within GHQ CMP nevertheless I believe it will remain appropriate for HBUS CMP in conjunction with HBUS senior management to reach their own determination with regard to the expansion of business with Al Rajhi within the US. Although the revised view from GHQ CMP ought to be a material matter causing them to reconsider their position nonetheless, and particularly in the current US environment, I do not believe it is appropriate for us to seek to influence their determination one way or the other. This was something that I discussed as a possible outcome with Iqbal when we discussed Al Rajhi.

Regards

David Bagley
Salman Hussain, the PCM Regional Sales Manager at HSME in Bahrain, who has recently visited the subject, has called to say that Al Rajhi has now run out of patience waiting for us to re-start our banknote dealing relationship and unless we can complete the KYC formalities and advise them accordingly by the end of November, they will terminate all product relationships with the HSBC Group - which I believe to be substantial.

Their main point of contention is that they feel that they were exonerated by all US legal processes from TF suspicion some time ago and yet we have still not been able to re-start trading with them. Gordon finished our latest attempt at the profile on Tuesday and you will find the KYC profile to be currently in the 'IB Pending' inbox. Could I please ask you both to expedite your reviews so that we can attempt to prevent the loss of an important client to the Group?

thanks and regards

Steve
From: CHRISTOPHER LOK/HBUS/HSBC
Sent: 11/17/2006 10:05:55 AM
To: STEPHEN J ALLEN/HBMD/HSBCMERIDIAN
CC: DAVID M WILENS/HBUS/HSBC
Subject: Re: Fw: Al Rajhi Banking

Steve

At the end of the day, its compliance who's the key. I'll speak to Ketley & ask him to re-evaluate this name.

Chris

Steve

chris, 

who do you suggest can/will sign this profile?

You will see that it is pressing perhaps David could IS and you could IB approve if Susan and I sign it again?.

Steve

----- Forwarded by STEPHEN J ALLEN/HBMD/HSBCMERIDIAN on 17/11/2006 14:30 ----- 

Beth Fisher/HBUS/HSBC

HBUS

17/11/2006 14:23

Mail Size: 7422

To: STEPHEN J ALLEN/HBMD/HSBCMERIDIAN

CC: Alan T Ketley/HBUS/HSBC, Christopher J Heusler/HBUS/HSBC

Subject: Re: Al Rajhi Banking

Entity HSBC Bank USA, London Branch (Treasury and Capital Markets - TCM)
I am not trying to be difficult, but I do not personally feel comfortable in approving this name. I do not know this bank. Additionally, several years ago, when HSBC had relationships with 2 different Al Rajhi names, management would ask me questions about the customer every time the name appeared in the US newspapers. I do not know this bank personally and am therefore not qualified to render an opinion; I cannot answer questions if/when the Al Rajhi name appears in US news media.

Therefore, please ask another officer to IB approve. I am IB-Denied the KYC, so that my name can be removed as RM.

Thank you.

Beth

---

Stephen J Allen/HRMD/HSBCMERIDIAN
To: Beth Fisher/HRUS/HSBCMERICAS, Alan T Ketley/HRUS/HSBCAMERICAS
Subject: Al Rajhi Banking

Beth/Alan,

Salman Hussain, the RWM Regional Sales Manager at HBME in Bahrain, who has recently visited the subject, has called to say that Al Rajhi has now run out of patience waiting for us to re-start our banknote trading relationship and unless we can complete the kyc formalities and advise them accordingly by the end of November, they will terminate all product relationships with the HSBC Group which I believe to be substantial.

Their main point of contention is that they feel that they were exonerated by all US legal processes from any suspicion some time ago and yet we have still not been able to re-start trading with them. Gordon finished our latest attempt at the profile on Tuesday and you will find the kyc profile to be currently in the 'Ib Pending' inbox. Could I please ask you both to expedite your reviews so that we can attempt to prevent the loss of an important client to the Group?

Thanks and regards

Steve
From: CHRISTOPHER LOK/HSBC
To: STEPHEN J ALLEN/HSBCMERIDIAN
CC: 
Subject: Re: Alrajhi

I would tell Salman that he should relay the 'concern' Alrajhi has expressed to the higher ups. To cancel the Amanah business is much bigger than not dealing with banknotes. Hopefully somebody in London will listen and given NYK Compliance a gentle push.

Chris

---

From: CHRISTOPHER LOK/HSBC
Sent: 11/17/2006 10:20 AM
To: Christopher Lok/HSBC@HSBC
Cc: 
Subject: Re: Alrajhi

Chris,

This is the note that I received subsequent to Salman calling (I sent it on to Alan)

As ever, we are taking an inordinate amount of time to make our minds up.

I discussed this client with Terry, Linda and Alan when I visited in February, we eventually received and have now answered a raft of supplementary questions from Linda and now that she has left, no doubt there will be more questions from Alan!

Steve

---

To: David B TILLING/HSBCMERIDIAN, Gordon BROWN/IBEU/HSBC, Stephen J ALLEN/HSBCMERIDIANHSBC
Cc: Clara O'CONNELL/IBEU/HSBC, Shariq Z SIDDIQI/HBME/HSBC, John L SCOTT/IBEU/HSBC, Naamad Zaidi/HBME/HSBC, Stephen D Loffredo/HSBCMERIDIANHSBC
Subject: Fw: Al Rajhi Bank KYC & AML policy
Entry: HSBC Bank Middle East Limited

Page 1
Dear David, Gordon and Stephen,

Further to my phone call with David last week after meeting Al Rajhi Bank in Riyadh, I was given a deadline by Mr. Cassin Docrat, Head of FI, until end of Nov to respond to them whether we will be able to resume the banknote business or not. Mr. Docrat indicated that HSBC Amanah business will be at risk and they will cancel any dealings with HSBC.

Mr. Docrat understands Compliance Dept. requirements and suggested we request further information from Moody’s (Attn. Mr. Anwar Hasson) or S&P. He also indicated that JP Morgan Chase, their main US$ clearer had done the same and accordingly an 0% limit of $290m established by JPMC for Al Rajhi.

I can’t stress on the fact that we do want to do business with this institution from PCM side. We do stand a good chance to win a US$ clearing account through offering Islamic Overnight Investment Product and the US$ check clearing through IPS.

Kindly let me know if you do require any further assistance to obtain compliance approval.

Best regards,

Salman Hussain
Regional Sales Manager
Global Transaction Banking

Christopher Lok/HBUS/HSBC
HBUS
17/11/2006 15:11
Mail Size: 2435

To
Stephen J ALLEN/HBMD/HSBCMERIDIAN@HSBCMERIDIAN

cc
Subject
ALRA1H
Entity
HSBC Bank USA, London Branch (Treasury and Capital Markets - TCM)

Steve

Just spoke to Alan. He’s going to read the whole file, including the few End. He says the file is more than an inch thick and he’s aware of the ‘threat’ you passed along. His view is Alrajhi may not really walk away if we can’t revert by November end, which I agree.
I told him frankly let's avoid the middlemen and go straight to the decision maker. We should have an answer in the next few weeks.

Chris
From: ALAN T KETLEY/HSBC
Sent: 12/1/2006 10:13:20 AM
Occ-psi-00150892
To: STEPHEN J ALLEN/HSBC; SALMAN HUSSAIN/HSBC
CC: TERESA PESCE/HSBC; CHRISTOPHER LOK/HSBC
Subject: Al Rajhi Bank

Steve, Salman

The purpose of this note is to confirm to you the willingness of HSUS to recommence a relationship with Al Rajhi Bank.

I have reviewed Al Rajhi bank’s AML information as well as all the investigative research that has been performed by ICAC. I have also conducted some of my own research and am satisfied that we can do business with this entity as long as our due diligence is thoroughly documented and close transaction monitoring takes place by compliance along with a high degree of transaction awareness being maintained by the business. Over a period of years there has been much negative publicity associated with the principals of this entity - while none of these allegations has been proven or substantiated, the notion of ‘no smoke without fire’ is one we must bear in mind and any business we enter dealing with this entity must acknowledge the associated risks. I have not yet reviewed their Lotus notes KYC profile in any great detail but will try to do so before close of business today - to paraphrase an expression from English Banking, if it is in my hands and in order I will approve it.

I am confident that our banknote transaction monitoring is sufficiently robust to keep a close eye on this client’s activities and I would ask that your traders apply special vigilance when dealing with them.

I am addressing Salman with this note because I know that he too is looking to further develop the Al Rajhi Bank relationship but here I have to place some conditions. While we have a robust method of monitoring wire payment activity, we do not have a corresponding automated method of monitoring check or cash letter transactions. Accordingly, while I would be happy to see wire activity flowing over a future Al Rajhi Bank account, I cannot support paper activity with the degree of close monitoring that would be appropriate.

Chris Lok has agreed to act as relationship owner for this name in place of [redacted] - he will thus review and approve the profile if he is satisfied with it. Should a PCM relationship develop, it must be with the explicit approval of HSUS’ senior PCM management.

Alan T. Kettle
Senior Vice President, Anti Money Laundering
Tel: 212 525 6547 / Fax: 212 382 7580
From: DANIEL JACK/HSBC
To: STEPHEN J ALLEN/HBMD/HSBCMERIDIAN@HSBC; GORDON RICHARD/HSBC@HSBC
CC: 
Subject: Al Rajhi Bank in Saudi Arabia

Steve / Gordon,

This article on Al Rajhi Bank & TF was in the Wall Street Journal today.

We realize that we re-activated the relationship with them last month.

We in AML-NY will draft a reply to Joe Boss & OCC soon.

Please review this below & let me know if you have any comments.

Thanks and regards,

Daniel Jack
VP - AML Compliance
HSBC Bank USA, NA
452 5th Avenue, 7th floor, New York, NY 10018

Phone. 212-625-8080
Email. daniel.jack@us.hsbc.com

--- Forwarded by Daniel Jack/HSBC on 07/26/2007 02:46 PM ---

--- Forwarded by Alan T Ketley/HSBC on 07/26/2007 08:30 AM ---

"Boss, Joseph" <Joseph.Boss@occ.treas.gov>
07/26/2007 08:24 AM

To

Alan.T.Ketley@us.hsbc.com
c

"Boss, Joseph" <Joseph.Boss@occ.treas.gov>
Subject

Staff's

Alan, for your information and review. Please let me know if there is anything. This appeared on the front page of today's Wall Street Journal.

Thanks, Joe

TERROR FINANCE
U.S. Tracks Saudi Bank Favored by Extremists
OFFICIALS DEBATED WHAT TO DO ABOUT AL RAJHI, INTELLIGENCE FILES SHOW
By GLENN R. SIMPSON
July 26, 2007, Page A1

JIDDA, Saudi Arabia - In the 1940s, two Bedouin farm boys from the desert began changing money for the trickle of traders and religious pilgrims in this then-remote and barren kingdom. It was a business built on faith and trust, Sulaiman Al Rajhi once told an interviewer, and for many years he would hand gold bars to strangers boarding flights in Jidda and ask them to give the gold to his brother on their arrival in Riyadh.

EXTREMISTS' ACCOUNTS

The News: U.S. intelligence reports say Islamic extremists often use Saudi Arabia's Al Rajhi Bank to move money. The bank has denounced terrorism and denies any role in financing extremists.

The Issue: A confrontation with Al Rajhi would be politically difficult for Saudi monarchy, and U.S. isn't satisfied with its efforts to curb the financial infrastructure essential to terrorism.

Result: U.S, has periodically debated taking action on its own against the bank, but chosen instead to lobby the Saudis quietly about its concerns.

Today, Mr. Al Rajhi is a reclusive octogenarian whose fortune is estimated at $12 billion. And Al Rajhi Bank grew into the kingdom's largest Islamic bank, with 500 branches in Saudi Arabia and more spread across the Muslim world.

Following the Sept. 11, 2001, attacks, the bank also set off an intense debate within the U.S. government over whether to take strong action against its alleged role in extremist finance. Confidential reports by the Central Intelligence Agency and other U.S. agencies, reviewed by The Wall Street Journal, detail for the first time how much the U.S. learned about the use of Al Rajhi Bank by alleged extremists, and how U.S. officials agonized over what to do about it.

After 9/11, the Saudi monarchy pledged its full support in the fight against global terrorism. And following violent attacks inside the kingdom in the next two years, the Saudis did launch major strikes against militants operating on their soil. But the Saudi government has been far from its usual willingness to tackle the financial infrastructure essential to terrorism. U.S. intelligence reports state that Islamic banks, while mostly doing ordinary commerce, also are institutions that extremism relies upon in its global spread.

As a result, the Bush administration repeatedly debated proposals for taking strong action itself against Al Rajhi Bank, in particular, according to former U.S. officials and previously undisclosed government documents. Ultimately, the U.S. always chose instead to lobby Saudi officialdom quietly about its concerns.

The U.S. intelligence reports, heretofore secret, describe how Al Rajhi Bank has maintained accounts and accepted donations for Saudi charities that the U.S. and other nations have formally designated as fronts for al Qaeda or other terrorist groups.

In addition, Mr. Al Rajhi and family members have been major donors to Islamic charities that are suspected by Western intelligence agencies of funding terrorism, according to CIA reports and federal court filings by the Justice Department.

A 2003 CIA report claims that a year after Sept. 11, with a spotlight on Islamic charities, Mr. Al Rajhi ordered Al Rajhi Bank's board "to explore financial instruments that would allow the bank's charitable contributions to avoid official Saudi scrutiny."

A few weeks earlier, the report says, Mr. Al Rajhi transferred $1.1 billion to offshore accounts - using commodity swaps and two Lebanese banks - citing a concern that U.S. and Saudi authorities might freeze his assets. The report was titled "Al Rajhi Bank: Conduit for Extremist Finance."

Al Rajhi Bank and the Al Rajhi family deny any role in financing extremists. They have denounced terrorist acts as un-Islamic. The bank denied to address

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specific allegations made in American intelligence and law-enforcement records, citing client confidentiality.

RELATED DOCUMENTS

Al-Rajhi bank became a target for U.S. terrorism sanctions less than two months after Sept. 11, 2001. No action was taken, but in mid-2003, the Central Intelligence Agency concluded that the Al-Rajhi family and their bank were financing terrorists, probably knowingly. This is the summary page from the agency's report. The bank sued The Wall Street Journal Europe for libel in 2002 over a report that it was under scrutiny in connection with terrorism funding, but dropped the case in 2004 and The Wall Street Journal published the bank's statement. The CIA's report and other U.S. intelligence on Al-Rajhi remained secret, and in 2005 a federal judge threw out a lawsuit against the bank by victims of Al Qaeda, saying there was no evidence Al-Rajhi provided anything but routine banking services to terrorists. Read the order.

The Al-Rajhi family and the ruling Al-Saud family of Saudi Arabia have been at odds for decades, in part because of the accidental death of an infant Al-Rajhi family member in a botched police rescue attempt during a kidnapping. Saudi dissidents in London issued a communique recounting the incident that was highly critical of Saudi authorities. The document was made available by the Investigative Project on Terrorism, a Washington-based nonprofit group.

One of the Al-Rajhi bank's major longtime clients is the International Islamic Relief Organization of Jeddah, Saudi Arabia, a powerful charity backed by some of the country's wealthiest businessmen. This fundraising solicitation is from the IIRO's March 2007 newsletter. The group strongly denounces terrorism on its Web site.

U.S. intelligence has alleged connections between Al Qaeda and the IIRO since 1996, and the Treasury Department now alleges the IIRO has been deeply penetrated by al Qaeda. The group denies supporting terrorism in this statement from its most recent newsletter. The group also claims it no longer sends money overseas, and that its accounts are frozen by Saudi banks. Yet its most recent fundraising letter solicits donations to Al-Rajhi bank and touts a variety of ongoing projects in overseas conflict zones.

In 2004, IIRO funded a medical facility in Fallujah while that central Iraqi town was under control of Iraqi insurgents. The U.S. Marine Corps blew up the clinic, and says three of the city's hospitals were being used by insurgents as fighting positions. See the PowerPoint slides.

In 2002, the bank sued The Wall Street Journal after an article said Saudi authorities were monitoring some Al Rajhi Bank accounts at U.S. request, in a bid to prevent them from being used, willingly or unwittingly, for funneling money to terrorist groups. The bank dropped the suit in 2005 and the Journal published a statement saying its article hadn't reported any allegation that the bank supported or financed terrorism.

Also in 2005, a U.S. judge dismissed Al-Rajhi Bank from a lawsuit filed by relatives of Sept. 11 victims. The ruling said banks couldn't be held liable for providing normal services to people who turned out to be terrorists. It is a statement in response to questions about suspected terrorists among its clients, the bank noted that "Al-Rajhi Bank has a very large branch network, and a very large retail customer base."

U.S. law-enforcement and intelligence agencies acknowledge it is possible that extremists use the bank's far-flung branches and money-transfer services without bank officials' knowledge. The U.S. has never obtained proof that the bank or its owners knowingly fund or finance terrorism, according to documents and former officials, despite what they describe as extensive circumstantial evidence that some executives are aware the bank is used by extremists.

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2003 CIA report concluded: "Senior Al Rajhi family members have long supported Islamic extremists and probably know that terrorists use their bank."

Most major banks around the world are bound by a patchwork of treaties and agreements that, in effect, require them to know their customers and report any suspicious activities to regulators. The rules are designed to fight terrorism, money laundering and narcotics trafficking. It's generally acknowledged that Saudi banks are bound by these rules, although experts differ on when compliance became mandatory.

The top counterterrorism official at the U.S. Treasury Department, while declining to comment on Al Rajhi Bank specifically, says Saudi officials haven't met a promise to create a commission to oversee Saudi charities, many of which bank with Al Rajhi. "They are also not holding people responsible for sending money abroad for jihad," says the Treasury official, Stuart Levy. "It just doesn't happen."

The Saudi government maintains it has been working diligently with the U.S. and others to counter terrorism. It cites its arrest of several alleged terrorist fundraisers in recent years. The Saudis didn't respond to specific questions about their efforts to counter terrorist finance or oversee banks.

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With its Islamic procedures, the bank was a magnet for the clerical establishment, which grew rich from alms amid the oil boom. As the clerics' charities spread, they became entwined with Al Rajhi Bank and the conservative Al Rajhi family's own extensive financial support for Islamic causes.

There is no reliable estimate of how much the Al Rajhs have given to promote Islam over the years, but an endowment holding much of Saleh Al Rajhi's wealth gives an indication of the scale. Its Web site details nearly $50 million in direct donations within the kingdom and at least $12 million in donations abroad. The overseas money went to aid embattled Muslims in Kosovo, Chechnya and the Palestinian territories and to finance Islamic instruction.

There are indications not all the giving was for such purposes. The Al Rajhi name appeared on a list of regular financial contributors to al Qaeda that was discovered in Sarajevo, Bosnia, in 2002. The list was authenticated for the Federal Bureau of Investigation that year by America's top judicial witness against al Qaeda, a onetime al Qaeda business manager named Jamal Al Fadl, who is in the federal witness-protection program. He called the contributor list the "golden chain."

A 2001 German police report said Sulaiman Al Rajhi and other family members had contributed more than $200,000 in 1993 to a charity that financed weapons for Islamic militants in Bosnia, in addition to providing humanitarian aid.

The 2003 CIA report tall of efforts by two Al Rajhi brothers to keep some giving secret. It says that Sulaiman and Saleh transferred $4 million to parties in Germany and Pakistan in December 1998 using "a unique computer code to send funds at regular intervals to unspecified recipients, suggesting they were trying to conceal the transactions and that the money may have been intended for illegitimate ends."

The report says authorities "ordered operatives in Afghanistan, Indonesia, Pakistan, Saudi Arabia, Turkey, and Yemen" to use Al Rajhi Bank. Mamdouh Mahmoud Salim, convicted mastermind of the 1998 embassy bombings in Kenya and Tanzania, was carrying records of Al Rajhi account (number 001424/4) when arrested in Germany in 1999, German police found.

In 2000, the CIA report says, Al Rajhi Bank couriers "delivered money to the Indonesian insurgent group Kompas to fund weapons purchases and bomb-making activities."

A U.S. intelligence memo dated Nov. 16, 2001, says a money courier for Osama bin Laden's second-in-command, Ayman al-Zawahri, traveled on a visa that the bank had obtained for him. The memo adds, however: "Reporting does not indicate whether bank management was making of the courier's terrorist connections."

Al Rajhi Bank maintained at least 24 accounts and handled unusual transactions for Al-Haramain foundation — a charity that Treasury officials say has acted as a front for al Qaeda in 13 countries — until the Saudi government ordered the charity shut down in late 2004, according to intelligence and law-enforcement reports. The United Nations has designated top officials of Al-Haramain foundation as terrorists, and most of its offices now are closed.

A Jidda-based charity called the International Islamic Relief Organization, or IIRO, arranges for donors to send their donations directly to Al Rajhi Bank. The IIRO's chairman, Adnan Khalil Basha, says the charity is "absolutely apolitical" and has elaborate spending controls to prevent illicit diversion. The charity says it works with Al Rajhi Bank simply because its fees are low and its service is best.
However, the U.N. has labeled two of the IIRO’s branches and some of its officials as Qaeda supporters. In 2004, the IIRO solicited donations through Al Rajhi Bank for the Iraqi city of Fallujah, then largely under the control of insurgents and the base of the late Abu Musab al Zarqawi, who led Qaeda in Mesopotamia. The IIRO’s workers oversaw construction of a trauma clinic in an insurgent-controlled area of Fallujah. The U.S. saw the clinic as a haven for insurgent fighters, and Marines destroyed it in November 2004. That was “a big tragedy for us,” says the IIRO’s chairman, Mr. Basha.

He denies the charity had any involvement with the Iraqi insurgency. Charity officials complain that the U.S. has produced no evidence of their alleged ties to terrorism.

Two years earlier, federal agents raided the Virginia offices of a network of charities funded by Sulaiman Al Rajhi that worked closely with the IIRO and that, according to Justice Department court filings — provided funds to Palestinian terrorists. No charges have been filed.

A year after the 9/11 attacks, U.S. authorities began to lament the lack of Saudi action in taking down terrorist financial infrastructure. A November 2002 CIA report said the Saudi government “has made little independent effort to uncover terrorist financiers, investigate individual donors, and tighten the regulation of Islamic charities,” largely because of “domestic political considerations.”

The report advised against a noisy confrontation: “A key factor for continued successful counterterrorism relations with the Saudis, whose society is by tradition private, closed, and conservative, will be to ensure that their cooperation with the United States is handled discreetly and kept as much as possible out of the public eye.”

The U.S. began to rethink that approach after an al Qaeda attack in Riyadh in May 2003 that killed 26 people, including nine Americans. Deputies from the National Security Council, CIA, Treasury and State departments debated a proposal for legal and political action against Al Rajhi Bank, including the possibility of covert operations such as interferring with the bank’s internal operations, according to Bush administration documents and former U.S. officials.

One idea kicked around was “listing or threatening to list” Al Rajhi Bank as a supporter of terrorism. Such a listing can be done if recommended by a committee representing the Treasury, State and Defense departments and the CIA and NSC, and signed by the president. The designation bars U.S. companies from doing business with the named entity, and member states are obliged to freeze the entity’s assets.

Other ideas discussed included enlisting friendly countries to step up nonintrusive regulatory action against the Al Rajhis. The CIA report said that “a successful effort against the Al Rajhis would encourage efforts against other donors, or at a minimum, would discourage private funding of Al Qaeda.”

Ultimately, the Bush administration again chose merely to continue privately exerting pressure on the Saudis to stiffen their oversight.

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This message originated from the Internet. Its originator may not be who they claim to be and the information contained in the message and any attachments may or may not be accurate.
From: CHRISTOPHER LOK@HSBC
To: BENJAMIN J SARAM@HSBC
CC: BENJAMIN J SARAM@HSBC, KWOK YING FUNG@HSBC, ROGER T K SO@HSBC, WING KIN - SG CHAN@HSBC
Subject: Re: ISLAM BANK BANGLADESH LIMITED

Ben

One, the money is there and we should go for this account.

Two, I will jump in and wear the GRM hat.

Three, I wonder where will you get that much Saudi. Just relying on what you and HKG can pick up in the region is not enough. Even including Lenders. So how?

Four, I wouldn't rely on Hersel to help you get the business. And we certainly don't help in clarifying the link to AlRaja. I would instead suggest we ourselves visit the client and sell our service directly.

I believe we should be able to get the KEB sign off.

Chris

Benjamin J SARAM@HSBC
11/08/2007 1:13 AM

To: Christopher Lok@HSBC

Subject: Re: ISLAM BANK BANGLADESH LIMITED

Chris,

Some background on the issue;

According to our colleagues in Dhaka, approximately 60,000 Bangladeshis make their way to Saudi Arabia annually to perform the Haj. It is estimated that each pilgrim will require approximately USD1,000-3,000 in currency for expenses. On the low side, we're therefore looking at about USD60 mio of currency needs on an annual basis.
There is a shortage of SAR in the market. Most of it is now supplied by money changers and banks who recycle SAR notes that come in from the transient worker population working in the Middle East. Pilgrims who can't secure enough SAR will carry USO notes with them in Saudi Arabia, where they will change them into riyals.

There is therefore an underserved demand here, one that Islam! Bank is looking to capitalize on. Assuming that about half of all pilgrims would prefer to change SAR in Bangladesh instead of in Saudi Arabia, that's an annual requirement of about SAR117 mio. Assuming again that we take a conservative margin of 2.5 per mille, our estimated net profit would be approximately USD 75,000 a year.

Bangladesh is a relatively small market, but there is potential. Our total volume in '06 was USD 37.1 mio, generating us NTI of approximately USD 47,000. Comparatively, our volume YTD '07 is USD 46 mio, generating us NTI of approximately USD 72,000. We expect the full year's NTI to be around 75,000, representing growth of about 53% year-on-year. We are a monopoly here, and margins are decent.

I understand that Hersel Mehani is quite close to Islam!, and PCM already has dealings with the prospect. Would this help in supporting our bid to open the account, should we decide to proceed?

Regards,
Ben

Christopher Loh/HSBC
08 Nov 2007 01:29 Mail Size: 8086

To: Kwok Ying FUNG@HSBC
CC: Benjamin J SARAM@HSBC, Wing KI Sg CHANCEO@HSBC, Roger T K SG@HSBC, Roger T K SG@HSBC
Subject: Re: ISLAM! BANK BANGLADESH LIMITED

Mr Fung

First, I'm happy to be the RM if this is an account worth chasing. How much money you can expect to make from this name? If this can be answered positively then I will ask PCM to check out the connection between the acts.
connection. I've looked at the Alrajhi Bank profile and found an identical Abdul Aziz Alrajhi (chairman of the papermill co. in the Islamic profile) also appearing in the Alrajhi profile. If this is the same person then we have to assume there's a cross-connection between the Alrajhi Bank and Islamic Bank. We need clarification.

The name Alrajhi has been a name heatedly debated for many years. We terminated our trading relationship following 9/11 and only a year ago after London Compliance came back telling NYK the group is happy to let us resume the relationship that we went back. You should check out the Alrajhi Bank profile done by Gordon Brown and comprehensive.

Not saying just because of this connection we won't do business. It's just that if the revenue is there then we're prepared for a good fight. But before that let's get the facts straightened out.

So come back to me with the expected NT. Also tell me the entire Bangladesh market's worth please.

Chris

Kwok Ying FUNG/NBD SP/HBUS/HSBC wrote on 11/05/2007 11:12:44 PM:

> Chris
> The following mails are self-explanatory. Would you consider to be the RM approver of sub judice PCM shared client?
>
> Regards,
>
> KY
> —— Forwarded by Kwok Ying FUNG/NBD SP/HBUS/HSBC on 11/07/2007 12:00 PM ——
> Beth Fisher/HBUS/HSBC
> 07 Nov 2007 03:07 Mail Size: 15898
> To
> 
> Angela Cassell-Bush/HBUS/HSBC@HSBC
> cc
> Benjamin J SARAVAN/SP/HBUS/HSBC@HSBC, Gillian E Bachstein/HBUS/HSBC@HSBC
> 
> Subject
> Re: Fw: KYC BankNotes Profile is IB Denied for: ISLAMI BANK BANGLADESH LIMITED
> 
> Additionally, I had mentioned to Gillian the past relationships with Al Rajhi. In particular, a couple/few years ago, HBUS exited the relationship with Al Rajhi Banking & Investment due to Compliance concerns. I do not recall all the details. I do see that the relationship was re-activated. Gillian was going to cross-check the Al Rajhi ownership of Islamic Bank with our old KYCs for Al Rajhi.
> Banl(ing & Investment and AI Rajhi Trading Establishment.
> This is not just an RM issue. This is a KYC due diligence issue.
> Beth
> 
> > Angela Cassell-Bush@HBUS@HSBC
> 11/06/2007 01:41 PM
> > To
> > Kwok Ying FUNG@HSBC@HSBC
> > cc
> > Gillian E Bachstein@HBUS@HSBC@HSBC, Benjamin J SARMA@HSBC
> > Subject
> > Re: Fw: KYC BankNotes Profile is IB Denied for: ISLAM! BANK BANGLADESH LIMITED
> > Kwok:
> > Unfortunately, the KYC profile for ISLAM! BANK BANGLADESH LIMITED
> > has been IB denied by Beth Fisher because the client is not known to
> > CIB. As it stands, we have not been able to identify the RM
> > Approving person for this relationship. I would suggest that you
> > reach out to Chris Lok to see if he is willing to be the the RM
> > Approver. Once this is confirmed, let me know and I will resubmit
> > this through the approval chain.
> > Regards,
> > Angela Cassell-Bush
> > Compliance Officer | HSBC Bank USA
> > 90 Christiana Road New Castle, DE 19720
> 
> Kwok Ying FUNG@HSBC@HSBC
> 10/24/2007 10:41 PM
> > To
> > Jarrett L Payne@HBUS@HSBC, Angela Cassell-Bush@HBUS@HSBC
> > 
> Confidential - FOIA Treatment Requested by HSBC N. America Holdings, Inc. HSB01123158
Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A. HSBC OCC 0739990
Subject: Fw: KYC BankNotes Profile is IB Denied for: ISLAMI BANK BANGLADESH LIMITED

Dear Jarrett

Our banknote profile was "IB Denied" by Beth as she is not the RM.
Could you please update the client profile with the correct RM?
I understand the client profile right now is also "IB Denied", kindly advise us once you put the profile back in approval process. Thank you.

Best regards.

KY


To: Kwok Ying FUNG/NBD SIP/HBUS/HSBC

Cc: Beth Fisher/HBUS/HSBC

Subject: KYC BankNotes Profile is IB Denied for: ISLAMI BANK BANGLADESH LIMITED

Our Ref.
Your Ref.
A BankNote Profile in BANGLADESH for HSBC Office Singapore, has been "IB Denied" (Reference #20501761).
Click on the attachment to link to the BankNote Profile.
From: ANGELA CASSELL-BUSH@HSBC
To: CHRISTOPHER LOK@HSBC
CC: BENJAMIN J SARAM@HSBC; WING KIN - SG CHAN@HSBC; GILLIAN E BACSTEIN@HSBC; PSRR@HSBC

Subject: Re: ISLAMI BANK BANGLADESH LIMITED-Bangladesh

Chris,

In response to your inquiry, please note that there is a connection between ISLAMI BANK BANGLADESH LIMITED-Bangladesh and Al-Rajhi Bank (aka: Al Raijhi Banking and Investment Corporation).

Based on the information that we have on file, the Al Rajhi family has been associated with Islami Bank Bangladesh Limited, since its inception. They have at least 37% direct ownership within ISLAMI BANK BANGLADESH LIMITED through their ownership within the following companies; Arabsas Travel & Tourist Agency, 9.999%; Janab Yousif Abdullah Abdul Aziz Al-Rajhi, 9.936%; Al-Rajhi Company for Industry & Trade, 9.94%; Abdullah Abdul Aziz Al-Rajhi, 7.58%

This same family has major controlling interest within Al-Rajhi bank (aka Al Rajhi Banking and Investment Corporation).

Hope this helps. Please let me know if this information is satisfactory.

Regards,

Angela cassell-Bush
Compliance officer
HSBC Bank USA
90 Christiana Road New Castle, DE 19720

Phone. 302-327-2017
Fax. 302-327-2128
Email. angela.cassell-bush@us.hsbc.com

Christopher Lok@HSBC
11/08/2007 10:17 AM

To: Kwok Ying FUNG@HSBC
CC: Benjamin J SARAM@HSBC; Wing Kin - SG CHAN@HSBC; GILLIAN E BACSTEIN@HSBC; PSRR@HSBC

Subject: ISLAMI BANK BANGLADESH LIMITED

KY

Further to my email exchange with Ben, I like to confirm that I'll be happy to be the GRM of this banknotes prospect/PCM client. However I would like to ask...
Gillian and company to find out the possible link between this name and the Alrajhi Bank (an approved name for banknotes business).

Beth’s statement about Alrajhi Trading Est is irrelevant as that name was long ago taken out of our profile. That name is not related to the Alrajhi Bank.

I’ve looked at the Alrajhi bank profile and noted a chap by the same name who owns the papermill (Islamic).

Chris

Kwok Ying Fung/NBD SIP/HSBC
12/06/2007 11:12 PM
To
Christopher lok/HSBC/HSBC
CC
Wing Kin - Sg Chan/CEO SIP/HSBC/HSBC, Benjamin J SARAH/NBD
SIP/HSBC/HSBC
Subject
ISLAM BANK BANGLADESH LIMITED

Chris

The following mails are self-explanatory, would you consider to be the RM approver of subject PCM-BN shared client?

Regards.

KY

----- Forwarded by Kwok Ying Fung/NBD SIP/HSBC on 11/07/2007 12:00 PM -----

Beth Fisher/HSBC
07 Nov 2007 03:17 Mail Size: 15898
To
Angela Cassell-Bush/HSBC/HSBC
CC
Benjamin J SARAH/NBD SIP/HSBC/HSBC, Gillian E
Rachstein/HSBC/HSBC/HSBC, Gillian E
Kwok Ying Fung/NBD SIP/HSBC/HSBC
Subject
Ref: FW: KYC Banknotes profile is in demised for: ISLAM BANK BANGLADESH LIMITED

Our Ref
Your Ref
Additionally, I had mentioned to Gillian the past relationships with Al Rajhi.
In particular, a couple/few years ago, HSBC exited the relationship with Al
Rajhi Banking & Investment due to compliance concerns. (I do not recall all
the details). I do see that the relationship was re-activated. Gillian was
going to cross-check the Al Rajhi ownership of Islami Bank with our old KYC's
for Al Rajhi Banking & Investment and Al Rajhi Trading Establishment.
This is not just an RM issue. This is a KYC due diligence issue.

Beth

Angela Cassell-Bush/HSBC 11/06/2007 02:41 PM
To
Kwok Ying FUNG/NBD SIP/HSBC@HSBC
cc
Gillian E Bachstein/HSBC@HSBC02, Benjamin J SARAM/NBD
SIP/HSBC/HSBC@HSBC, Beth Fisher/HSBC@HSBC
Subject
Re: FW: KYC BankNotes profile is IB Denied for: ISLAM! BANK BANGLADESH
LIMITED

Kwok:

Unfortunately, the KYC profile for ISLAM! BANK BANGLADESH LIMITED has been IB
denied by Beth Fisher because the client is not known to CIB. As it stands, we
have not been able to identify the RM Approving person for this relationship. I
would suggest that you reach out to Chris Lok to see if he is willing to be the
the RM Approver. Once this is confirmed, let me know and I will resubmit this
through the approval chain.
Regards,

Angela Cassell-Bush
Compliance Officer | HSBC Bank USA
90 Christiana Road New Castle, DE 19720

Phone. 302-327-2012
Fax. 302-327-2528
Email. angela.cassell-bush@us.hsbc.com

Kwok Ying FUNG/NBD SIP/HSBC 11/24/2007 02:41 PM
Occ-Psi-00154139
To
Jarrett L Payne/HRUS/HSBC/HSBC, Angela Cassell-Bush/HRUS/HSBC/HSBC
CC
Benjamin J Saram/HRUS/HSBC/HSBC
Subject
FW: KYC Banknotes profile is IB Denied for: ISLAMIC BANK BANGLADESH LIMITED

Dear Jarrett / Angela

Our banknote profile was "IB Denied" by Beth as she is not the RM. Could you please update the client profile with the correct RM? I understand the client profile right now is also "IB Denied", kindly advise us once you put the profile back to approval process. Thank you.

Best regards.

KY

----- Forwarded by Kwok Ying Fung/HRUS/HSBC on 10/15/2007 10:14 AM -----
Beth Fisher/HRUS/HSBC
24 Oct 2007 22:29 Mail Size: 1908
To
Kwok Ying Fung/HRUS/HSBC/HSBC
CC
Subject
KYC Banknotes profile is IB Denied for: ISLAMIC BANK BANGLADESH LIMITED

Our Ref
Your Ref

A Banknote profile in BANGLADESH for HSBC Office Singapore, has been IB Denied (Reference #001761).
Click on the attachment to link to the BankNote profile.
From: DANIEL JACK/HBUS/HSBC
Sent: 8/18/2009 12:44:40 PM
To: CHRISTOPHER Lok/HBUS/HSBC@HSBC; HOW WEI ONG!LGA_SGH/HBAP/HSBC; GEORGE JAMES/NBD 574/HSUS/HSBC@HSBC; DENIS E O'BRIEN/HSBC@HSBC; GILLIAN E Bachstein/HSBC@HSBC; VALERIE E Cole- HUDSON/HSBC@HSBC
Subject: EDD Report of Findings: _Bank Ltd in Bangladesh (BN-SP & PK)

Hi,

I agree that we expect breaches in a large bank, but this is government-owned in a high risk country with a PEP and reputational risk due to corruption, etc. Their KYC profile documents various allegations of fraud, weakness, and the FATF investigation into terrorist financing (Section 1 General Comments) and the EDD report as well. They have also received recent negative information, also as noted below, the Chairman of this bank Ltd. & because he is a party secretary in the ministry.

PSR is reviewing this client and should reply soon with their analysis & recommendation from PCM. Howe - As LCO in Singapore, please review the KYC profile, EDD report, and e-mails below. Then let us know if you recommend SCC classification (for PEP and/or reputational risk) for this PCM and Banknote-Singapore client.

KYC profile...

Page 1

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 Permanent Subcommittee on Investigations

CONFIDENTIAL - FOIA TREATMENT REQUESTED

EXHIBIT #84a

CONFIDENTIAL - FOIA TREATMENT REQUESTED

HSBC OCC 7688017
I support Hersel's stance that this is such a large bank hence malfeasance is expected. However, I do not agree that just on these numerous breaches the bank should be classified.

The bank has a recent case of a bank officer in the private banking business admitted to having stolen USD100 million from the bank. Should we then classify this bank, a 62% sub of HSBC, an SCC?

Chris

Daniel Jack/HSBUSA/HSBC
08/18/2009 11:45 AM

To: Gillian E Nachswin/HSBUSA/HSBC HSBCB10202, Christopher Lok/HSBUSA/HSBCB10202, Valerie E Cole-Hudson/HSBUSA/HSBCB10202, George JAMES/HSBUSA/HSBCB10202, Denis E O'Brien/HSBUSA/HSBCB10202

Subject: EDD Report of Findings: **** Bank Ltd in Bangladesh (BN-SP & PD)

Gillian / Chris,

Do you agree with SCC classification for this BN & PD shared client?

Thanks and regards,

Daniel Jack
Vice President - Compliance Officer, GTO
HSBC Bank USA, NA
452 Fifth Avenue, 7th Floor, New York, NY 10018

Phone. 212-525-8505
Email. daniel.jack@hsbc.com

----- Forwarded by Daniel Jack/HSBUSA/HSBC on 08/18/2009 11:45 AM -----

Hersel Mehan/HSBUSA/HSBC
08/17/2009 11:50 AM

To: Daniel Jack/HSBUSA/HSBC HSBCB10202

CC: Anthony Julian/HSBUSA/HSBCB10202, Christopher Lok/HSBUSA/HSBCB10202, Denis E O'Brien/HSBUSA/HSBCB10202, George JAMES/HSBUSA/HSBCB10202, Gillian E Nachswin/HSBUSA/HSBC HSBCB10202

Page 2
Daniel

Many thanks for your updated information.

I will support SIC classification for 6 months to allow the local GM and PM to do a full review of subject bank Sr. mgt and ensure that internal controls are in place.

As you know the bank being the proxy owned will always face such issues at a lower level of bank management's. I am aware that the Sr Management and senior officer are screened and officially chosen by the boards of the central bank and from past experience they have chosen honest and professional bankers, however they will always have exposure to some officers who will abuse their power and take advantage of the bureaucratic system of the bank.

Overall I am comfortable with the relationship we presently have on the PM and will support retaining this account.

Thanks and regards,

Hersel Mehani
Senior Vice President | HSBC Bank USA N.A.
Global Payments and Cash Management
452 Fifth Avenue, Floor 21, New York NY 10018, USA

Phone. +1-212-325-6239
Fax. +1-212-325-5699
Mobile. hersel.mehani@us.hsbc.com
Internet. HSBC Global Payments and Cash Management HSBC Global Site

Daniel Jack/HBUS/HB5C
17/08/2008 11:29 AM

To. Valerie E Cole-Hudson/HBUS/HB5C@HSBC, Wing Kin - Sg CHM/COO SLP/HBUS/HB5C@HSBC
Gillian E Bachstein/HBUS/HB5C@HSBC, Roger T K SO/MD NBD PML/HBUS/HB5C@HSBC, Anthony Sullivan/HBUS/HB5C@HSBC, Hersel Mehani/HBUS/HB5C@HSBC, Dennis O'Brien/HBUS/HB5C@HSBC, Jacob E Houseknecht/HBUS/HB5C@HSBC, George James/NBD SLP/HBUS/HB5C@HSBC

Subject: EDD report of findings: Bank Ltd in Bangladesh (BN-SP & PMO)

Page 3

Confidential - FOIA Treatment Requested by HSBC N. America Holdings, Inc. HSB08071923
Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A. HSBC OCC 7688019
Valerie / WK,

We will need a response from the client in Bangladesh and the business (RM/POW, RM, etc.) regarding the negative information identified in this APO. This is a RM and Bancontact-Singapore shared client, so you may want to collaborate with each other and the RM & Sales Manager on this - and determine/confirm whether you want to maintain them as a client in each of your respective businesses. Resolution of the issues and risk mitigants would need to be well-documented.

And we need to consider SCC classification due to reputational risk.

Thanks and regards,

Daniel Jack
Vice President - Compliance Officer, GTB
HSBC Bank USA, NA
452 Fifth Avenue, 7th floor, New York, NY 10018

Phone: 212-525-6986
Email: daniel.jack@us.hsbc.com

----- Forwarded by Daniel Jack/HBuS/HSBC on 08/17/2009 11:15 AM -----

FIG HSBCB203
(Sent by: Pamela M. Meszal@HSBCB203
08/17/2009 05:56 AM

To: Daniel Jack/HBus/HSBCB203
Cc: Jacob X. Hausknecht/HBus/HSBCB203, Jackie S K Quah/NBD 2IP/HBus/HSBCB203, FIG HSBCB203
Subject: Report of Findings: Bank Ltd in Bangladesh - FIU

Please find attached Report of Findings on Bank Limited.

Please note that for your convenience, space for compliance officer and/or business unit comments has been reserved at the bottom of this report.

[Attachments deleted by Hersel Mehani/HBus/HSBC]

Please feel free to contact Jessica Dubensky (212-525-5746) if you have any queries.
Daniel Jack
13 Mar 2009 22:09

To: FIG HBUS\HSBC02
cc: Jacob X Houseknecht/HBUS/HSBC02
Jackie S
Subject: EOD for Bank in Bangladesh

FIG,

Please provide us with an updated EDD ROF for this PCM and banknote client in Bangladesh. The prior ROF is dated 30-Jun-06.

I have risk scored this request to be 31 now, due to the recent corruption conviction of the bank's owner (in May 2008, along with embezzlement by 3 bank officials in 2006). Refer to attached form and ALE below.

Thanks and regards,
Daniel Jack
Vice President - Compliance Officer, GTB
HSBC Bank USA, NA
452 Fifth Avenue, 7th Floor, New York, NY 10018

--- Forwarded by Daniel Jack/HBUS/HSBC on 03/13/2009 12:25 PM ---

Jacob X Houseknecht/HBUS/HSBC
03/13/2009 11:26 AM

To: Daniel Jack/HBUS/HSBC02
cc

Subject: (Bangladesh) -

I have also included the results from an RAU search conducted on 3/12/2009.

Confidential - FOIA Treatment Requested by HSBC N. America Holdings, Inc. HSB08071925
Confidential - FOIA Treatment Requested by HSBC Bank, USA, N.A. HSBC OCC 7688021
The bank is listed as a PEP because it is owned by the government. There was information found on our internal database that seems to have already been addressed previously in the KYC (Know Your Customer). The last listing is for the chairman, who is listed as a PEP, however, he no longer holds any of the positions listed. It seems to me that no further action needs to be taken on these items, however, I wanted to get your opinion on the matter.

Lastly, a media search of the bank and corruption returned a story about a

Since this information is not directly related to AM, is it something I should still pursue from the OMM to get a response for? If so, what type of questions would be relevant to this situation. Your help and guidance is much appreciated.

Thank you.

Jake Houseknecht
RE:
HSBC Bank USA, N.A.
95 Christiana Road
New Castle, DE 19720
(302) 327-2520
----- Forwarded by Jacob X Houseknecht/HBUS/HSBC on 03/13/2009 11:04 AM -----
RAU HBUS
Sent by Benjamin X Clurdar
03/13/2009 04:54 PM
TO:
Jacob X Houseknecht/HBUS/HSBC
CC:
RAU HBUS/HSBC, ICRO ALES/HSBC
Subject: Re: [Bangladesh] (Bangladesh)
c

From: CHRISTOPHER LOK/HBUS/HSBC
To: SHARYN MALONE/HBUS/HSBC@HSBC
Subject: Re: Report of Findings - Bank - FIG

I'm very fed up with these people.

----- Forwarded by Christopher Lok/HBUS/HSBC on 09/02/2005 11:31 AM -----

christopher lok/HBUS/HSBC
09/02/2005 11:20 AM

To: Wing Kin - HK CHAN/NBD RNH/HBUS/HSBC, Daniel Jack/HBUS/HSBC,
cc: Betty F S NG/MD RNH/HBUS/HSBC@HSBC, Bruce LI/MD RNH/HBUS/HSBC@HSBC, Gary C H YEUNG/PV/MD RNH/HBUS/HSBC@HSBC, Roger F K SO/MD RNH/HBUS/HSBC@HSBC, Tom K LAU/MD RNH/HBUS/HSBC@HSBC, John S GURKET/MD RNH/HBUS/HSBC@HSBC, Lynna J Cassell/HBUS/HSBC@HSBC
Subject: Report of Findings - Bank - FIG

I disagree whole heartedly with FIG's recommendation. FIG displays ignorance to the breadth and gravity of the banks. As said many times, all state owned banks have been appointed by the Govt and this is not the ground to think that the person is a PEP.

Yes, corruption can be rampant in this bank... but it is not unique to the bank. Without exception all state owned banks have been and will continue to be plagued by misuse of the state's money, corruption and delinquent loans. That's why alone this year the State has injected over $2 billion into these banks. This is all public knowledge.

Bank HSBC has a 19% stake in which HSBC must have found impropriety. Shall we then classify this name as an SCC?

My point is that being a US entity cannot simply use the excuse that because of US regulators' attention and then say that I want to classify this name as an SCC because of the adverse reputation this institution has.

I do not see the point of the Group Compliance Level for the senior officers of the bank to examine this question: are the state owned banks in delinquency or not.

John: Could you please discuss this with John and get his opinion. I want to elevate this to a much higher level now as I want a quick resolution rather than continue engaging myself in these unnecessary discussions.

chris
For your information.
Best regards
WK

----- Forwarded by Wing Kin - HK CHAN/NBD RNH/HSBC on 09/02/2005 09:15 AM -----

----- Forwarded by Wing Kin - HK CHAN/NBD RNH/HSBC on 09/02/2005 09:15 AM -----
REMARKS/RECOMMENDATIONS

Shannon,

As you will read in the below report of findings for Bank, the bank’s senior management and employees have been involved in numerous significant instances of corruption, fraud, and embezzlement over the past few years. Highlights of such instances (detailed in the reports below) involving the bank’s management include the following:

Also, Bank should be considered for Special Category of Client (SCC) status due to its current President being categorized as a Politically Exposed Person (PEP) on World-Check (details below).

For the above reasons, and the additional instances of financial crime involving the bank’s employees, as detailed below, we recommend that Bank’s account relationships with HSBC be closely monitored. The number of instances of corruption, fraud and embezzlement at this institution appears high when compared to other institutions that we have reviewed, and may be indicative of lax controls at the bank. This is especially of concern given the fact that many of these cases have involved Bank’s management and top executives.

Much of the information pertaining to the instances of corruption, fraud and embezzlement at Bank was obtained subsequent to our previous report of findings in October 2009. Therefore, we recommend that you consider these findings and discuss them with your local Compliance Officer (LCO).

Sincerely,

Page 3

Redacted by the Permanent Subcommittee on Investigations
**Know Your Customer Profile**

**HSBC Bank USA, N.A.**

**Reference:**

**Country Risk Status:** High Risk

**High Risk Client Type:** Special Category of Client

---

**Client Name:** AL RAJHI BANKING & INVESTMENT CORP

**Country:** SAUDI ARABIA

---

1. General Information

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2. Reference:

**Know Your Customer Profile**

HSBC Bank USA, N.A.

**Reference:**

**Country Risk Status:** High Risk

**High Risk Client Type:** Special Category of Client

---

**Client Name:** AL RAJHI BANKING & INVESTMENT CORP

**Country:** SAUDI ARABIA

---

*Changes to these fields on "Approved" Profiles requires Re-appraisal.

**EXHIBIT #85**

Confidential Treatment Requested
II. Ownership/Management/Business Information

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<thead>
<tr>
<th>Name of Principal or Beneficial Owner</th>
<th>% of Ownership</th>
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<tr>
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<tr>
<td>Eminent Mohamed Al Ghani</td>
<td>5.00%</td>
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<td>Ian Gilmore</td>
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<td>Chairman &amp; Managing Director</td>
<td>CEO</td>
<td>[Contact Details]</td>
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<td>CFO</td>
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<td>General Manager, Group CFO</td>
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06/22/2012 12:12:15 PM
Re: Jerrall

III. Referral Information

- Name of Referral: [Redacted]
- Date of Referral: [Redacted]
- Relationship to Client: [Redacted]
- Nature of Referral: [Redacted]
- Whether the Client introduced the Referral: [Redacted]
- Referral: [Redacted]
- Any other relationship with the Referral: [Redacted]
- Additional Information: [Redacted]

IV. Visitation

- General Visitation: [Redacted]

Visitation Details:

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<th>Email Address</th>
<th>Relationship to Client</th>
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<td>[Redacted]</td>
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</tbody>
</table>

V. Purpose/Nature of Activity

<table>
<thead>
<tr>
<th>Activity Type</th>
<th>Frequency</th>
<th>Risk</th>
<th>Compliance</th>
</tr>
</thead>
<tbody>
<tr>
<td>[Redacted]</td>
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</tr>
<tr>
<td>[Redacted]</td>
<td>[Redacted]</td>
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<td>[Redacted]</td>
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</tbody>
</table>
### Financial Summary

<table>
<thead>
<tr>
<th>Category</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Service Revenue</td>
<td>$120,000</td>
</tr>
<tr>
<td>Exchange Income</td>
<td>$11,000</td>
</tr>
<tr>
<td>Net Income</td>
<td>$11,000</td>
</tr>
<tr>
<td>Shareholders Equity</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>Total Equity</td>
<td>$1,004,500,002</td>
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</table>

### VII. Documentation Checklist

<table>
<thead>
<tr>
<th>Item</th>
<th>Status</th>
</tr>
</thead>
<tbody>
<tr>
<td>List of authorized signatories and contact information for client</td>
<td>Yes</td>
</tr>
<tr>
<td>Current Annual Report (Form 10-K or Earnings Information)</td>
<td>Yes</td>
</tr>
<tr>
<td>Latest annual statement and audited balance sheet</td>
<td>Yes</td>
</tr>
<tr>
<td>Latest balance sheet and audited balance sheet</td>
<td>Yes</td>
</tr>
<tr>
<td>Company's most recent 10-K</td>
<td>Yes</td>
</tr>
<tr>
<td>Bank Client and Not a Central Bank</td>
<td></td>
</tr>
<tr>
<td>City of Banking Location in Client's TIN</td>
<td>Yes</td>
</tr>
<tr>
<td>Foreign Bank Client and Not a Central Bank</td>
<td></td>
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<tr>
<td>Election/Board Act Certification/Facility</td>
<td>Yes</td>
</tr>
<tr>
<td>Entity, determined by LSC</td>
<td>Yes</td>
</tr>
<tr>
<td>Entity, determined by Tier</td>
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<tr>
<td>Entity, determined by LSC and determined by Tier</td>
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Confidential Treatment Requested

HSUD-PsiPROD-0102314
VIII. Summary of Reasons

<table>
<thead>
<tr>
<th>Reason</th>
<th>Details</th>
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<tbody>
<tr>
<td>ALE search conducted on the bank, its management and owners. No matches were found on OFAC. World-Check Board of Directors as a PEP and this has been noted below.</td>
<td></td>
</tr>
<tr>
<td>EOD-RD dated 10 March 2010 concluded some negative news articles concerning the bank's alleged refusal to cooperate with a US Government lawsuit in relation to its &quot;Investigation into terrorist financing&quot;. The bank has launched counterproceedings in the US Courthouse as a result. This case is currently pending an outcome and the US Government has yet to take any steps to designate the entity. London Banknotes has discussed these news articles with the GRM, who is comfortable with continuing this relationship. Whilst monitoring the situation as it is awaited for this SCC 4 level.</td>
<td></td>
</tr>
<tr>
<td>Compliance was not required from NY. Own due diligence performed and no issues found. No references were found to the history involving court cases DD ROF 4th December 2007. Despite the overall reputation of the Al Rajhi family in Saudi Arabia, there have been numerous allegations of impropriety in the business dealings of Al Rajhi and their group of companies, specifically in Europe and the United States. The controversy primarily centres around the patriarch, Sulaiman bin Abdulaziz Al-Rajhi and somewhat indirectly to Al-Rajhi Bank, of which he is both Chairman and Managing Director. These allegations allude to tax evasion, money laundering and terrorist financing. Though severe in nature, none of these allegations have yet resulted in any convictions or sanctions by either US or foreign governments. This bank is already listed as SCC 1 due to the ownership and control by Abdullah Abdul Al Rajhi. The KYC customer profile indicates the various allegations against the bank but it is noted that no formal charges have been levied by US officials. We will leave this bank here.</td>
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</tr>
<tr>
<td>AI Rajhli brothers own 44.5% of the shares in the bank, although the total Al Rajhi family shareholding is significantly higher. Rolf Highfathers cite insider shareholding as the reason for the high valuation of the bank. London Banknotes believes that the management is competent and assessed by our meeting with management since 1998.</td>
<td></td>
</tr>
<tr>
<td>Management</td>
<td>Contacts with the CEO's professional, expertise, experience, etc. of social officers.</td>
</tr>
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Middle East and the Gulf Area. He is a graduate in Business Administration. He was the Deputy General Manager for Investments & Foreign Relations. During this tenure he was promoted to First Deputy General Manager and the position of Senior Advisor to the CEO of the Bank. In 2005, he was further promoted to the COS of the bank. He is also a member of the Board of Directors of a joint venture the Saudi Business entities. He was nominated twice as the winner of The Islamic Banker of the Year Award.

Saeed Mohammed Al Ghweni – Deputy CEO for Retail Banking. With over 15 years of Banking experience, Saeed has held special assignments with Al Rajhi Bank including Chief Information Officer, General Manager of IT & Operations before becoming Head of Retail Banking in 2003. Saeed assumed his current role of CEO in 2007 and in his previous role as CEO of Retail Banking, Saeed was responsible for leading projects across the retail businesses, including major initiatives in the areas of IT and CRM developments.

Martin Lopez – CEO of Blacklaw joined Al Rajhi Bank as Chief Operating Officer in July 2016, in this role he has responsibility for the Consumer Banking, Regional Banking, Retail Banking, Treasury Group Executive T & Operations and setting up new Banking Offices in new countries. Martin has over 23 years of experience in the financial services sector with EDS including 16 years of International experience gained in the financial services industry. He is currently responsible for developing the Group’s distribution strategy together with his management team and executive team within the banking industry. Martin joined EDS in 1994 and has held various senior management roles in the Consumer Banking, Retail Banking, and Operations department within EDS, including Managing Director of Operations in Germany. He has extensive experience in setting up green field projects in Banking which include new bank set up, offshore outsourcing, and banking offshore operations. Prior to joining EDS, he served as Vice-President at Citibank, where he worked for 13 years. Anand holds an MBA degree with specialization in Marketing and Systems. He is also a member of Visa’s Advisory Board.

Devi Aravind – QIAIO Retail Banking Group. Award was appointed General Manager of Retail Banking in July 2007. His is responsible for shaping the short and long-term strategy for the Retail Banking Group. Award has been with Al Rajhi Bank since August 2003. Prior to this, he spent 10 years in management and leadership roles in the Consumer Banking and Operations department within Citigroup, where he held the position of General Manager of the Retail Banking Group in the UK and led the strategic initiatives for European Retail Banking and Financial Institutions. Award holds an MBA degree, with a specialization in International Strategy from the University of St. Gallen and a graduate of the Entrepreneurial University of Nicosia. Award is married with 2 daughters.

Anand Gandhi – General Manager of the Corporate Banking Group. Anand has over 25 years of experience in the Corporate and Investment Banking Field. Anand spent 18 years working with Citigroup where he held various management positions including Head of Financial Institutions and Public Sector, Diesel Group CIO and Head of Corporate for Middle East and South Africa. Anand recently written a book, ‘Merlin: A Dress Made for Death’ for the Africa and the Middle East.

Arif Abdul Mansur Al Harbi – General Manager for International Resources. Joined Al Rajhi Bank in February 2018 as General Manager of Human Resources. Arif started his career as a Grad. Technician for about 5 years in his government, and later graduated in Human Resources. He has over 28 years of experience in many fields and industries. Prior to joining Al Rajhi Bank, he served as a Vice President of Human Resources in Masdar for hotel and oil company. He has a BBA and a BSc in Civil Engineering from Strasbourg University in Strasbourg, Washington, D.C. USA. He is married with 1 son and 2 daughters.

Zach Williams – General Manager for Treasury Group. Joined Al Rajhi Bank in January 2013 as General Manager of the Treasury Group. He has 20 years of experience in Management and Investment with the National Australia Bank Group and Lehman Brothers in addition to having an office with the Australian Army. Zach is currently focused on setting up a lead for the 21st century in retail banking, in particular, and the broader banking industry. Zach holds an MBA degree from the Melbourne University School of Business.

Zafer Abdullah Al-Abdulrahman – General Manager of the Corporate Group. Zafer brings a wealth of experience in the sector, including 20 years in the Consumer Asset business and Operational department within Al Rajhi Bank. Zafer holds a BSc degree in Engineering from the American University in Cairo and a graduate of the University of Oxford in London, and a graduate of the Entrepreneurial University of Nicosia. Zafer is married with 2 children.

Saeed Al-Ghweni – General Manager of Retail Banking. Saeed has been with Al Rajhi Bank since 2016, in this role, he leads the strategic initiatives and oversees the operations of the Retail Banking Group. Prior to joining Al Rajhi Bank, he served as a Vice President at Citibank in Chicago, where he worked for 12 years. Saeed is married with 2 children.

David Baghazal, Senior Dealer – Head of Corporate and Investment Banking. David has over 20 years of experience in the global banking industry, including major projects in the areas of IT and CRM developments.

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Meet with Ahmed al OBaid in Riyadh.
He is very happy with the extended business we have done this year especially now that we receive our SAR due to the end of the year. He had told ISRA 10 years ago that he had been very satisfied with our bank and had no issues with the credit risk. However, we had tough price in the latter quarter and AHRC was very pleased with the US Dollar account with us in New York which would double the bank's business.

2 March 2009 - Shamsuddin and Hussain met with Mohammad Pallalc Haque, M Farhad Cider - Deputy CEO.
Announced USD 1.7 bn profit for 2008 - 4th Quarter 2008 profit was down 10%- 30% to 2007.

Hafiz 2009 is more challenging.

Agreed that to improve business can be done between the two institutions.

Requested for COS sharing with HSBC swap

Agreed to use HSBC as counterparty

Pending Dada for Structured Investment Products

To increase Bade Revenue in the Banknotes side, and he is pleased.

He was interested in building with Islahic Bank, and advised that we will follow on Treasury Docs.

A bilateral agreement to broaden the contact with their product team, and he is interested in building with HSBC.

He has done this year, especially now that we repatriate our surplus SAR Mates to the US. We had requested for a bilateral swap, which they are considering.

Hafiz of AI Rahji Bank, who is a key person in the market, is A4 Rajhi Bank and has been keen to develop this business. We had requested for a bilateral swap, which they are considering.

He advised that the bank is reviewing its overall relationship portfolio with the aim to close the dormant inactive accounts. The bank has a strict KYC Policy and monitors any unusual transactions through accounts.

If it is established that the account is indeed being used for money laundering, it will be frozen. Money laundering is not considered to be a major problem in Saudi Arabia due to its extensive surveillance and drug-related crime.

He expressed desire to broaden the contact with their product team, and he is interested in building with HSBC.

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Confidential Treatment Requested H5/C-B-PSI-PRD-0102311
Confidential Treatment Requested
FATF mutual evaluation in February 2010. Saudi Arabia is a party to the 1988 UN Drug Convention, the 1990 UN Convention against Transnational Organized Crime, and the UN Convention against the洗罪 of 1999 with a reservation, but not to the UN Convention against Corruption.

The Government of Saudi Arabia is taking steps towards enforcing its anti-money laundering and terrorism financing laws, regulations, and guidelines. However, Saudi Arabia continues to be a significant illegal money service provider for international financiers, particularly in the Gulf region. The GIAA continues to lack a strong financial institution to target terrorist networks to the Kingdom. But could be more to target financial institutions from the United Arab Emirates, Qatar, and Bahrain. Saudi Arabia should establish a financial institution to target terrorist networks to the Kingdom.

The GIAA also needs to take concrete steps to establish an effective oversight mechanism that also oversees traditional organizations and enforce its oversight and sanction of financial institutions with correspondent relationships. Significant sanctions in the form of civil, criminal, and other actions should be implemented. There is still no effective oversight on suspicious transactions, and all institutions that have access to payment systems should be required to report suspicious activity.

(Video of the video is not available)

For more information, please see the FATF TERI reports at

Secures could of Country A's AML, so will go to the HSBC AML Country Risk List. Please make sure to get the AML Class.

04/23/2012 12:13:14 PM

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HSBC-P51/PROC-D-9(02310)
Know Your Customer: AL RAHI BANKING & INVESTMENT CORP

In Process: (Old Status Approved), 01/05/2002 03:35 PM: Sharyn MalMe
Purpose of account changed from: USD to: rUSD Clearing
License Country(l) changed from: IJ to: {SAUDI ARABIA
AM Approved: (Old Status In Process), 20/01/2004 12:08: Anna T BROBERG
No Comments
CS Approved: (Old Status AM Approved), 21/01/2004 12:19: Stephen J ALLEN
No Comments
IS Approved: (Old Status CS Approved), 01/21/2004 05:34 PM: Christoph-Sf Lok
No Comments
IB Denied: (Old Status IS Approved), 02/19/2004 09:42 PM: Beth Fisher
I would ask for conditional approval for another 6 months as no cases dropped negative news report or official commencement of investigations have commenced. If and when reliable info pointing to this client not appropriate for our business relationship we can then terminate immediately.
AM Approved: (Old Status IS Approved), 02/02/2004 06:13: Stephen J ALLEN
No Comments
CS Approved: (Old Status IS Approved), 02/07/2004 17:09 PM: Ernie Robertson
No Comments
CS Denied: (Old Status IS Approved), 11/09/2004 04:51 AM: Stephen J ALLEN
Denied at the request of Daniel Jock
AM Approved: (Old Status CS Denied), 11/10/2004 17:30: Sally G LOMAS
Profile updated
CS Approved: (Old Status CS Approved), 12/01/2005 08:33: Stephen J ALLEN
No Comments
IS Approved: (Old Status CS Approved), 12/01/2005 08:33: Stephen J ALLEN
No Comments
IS Denied: (Old Status IS Approved), 11/17/2006 09:20 AM: Beth Fisher
Please remove my name as RM. I do not know this bank
AM Approved: (Old Status IS Denied), 11/17/2006 09:40 AM: Gordon BROWN
RM approval changed to Christoph Lok, ready for KYC approval process
CS Approved: (Old Status AM Approved), 04/12/2006 14:02 PM: Stephen J ALLEN

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Confidential Treatment Requested
Know Your Customer - AL RAJHI BANKING & INVESTMENT CORP

Approved: (Old Status CS Approved), 03/26/2008 04:38 PM: David M Wilens

Approved: (Old Status IS Approved), 12/04/2006 03:32 PM: Christopher Lok

Approved: (Old Status IS Approved), 12/04/2006 04:44 PM: Alan T Kelley

Approved: (Old Status IS Approved), 12/02/2008 14:41: Christopher BAYLISS

No Comments

AM Approved: (Old Status AM Approved), 08/03/2010 07:51: Denise HOLDER

No Comments

CS Denied: (Old Status AM Approved), 08/03/2010 11:02: Stephen J ALLEN

No Comments

CS Approved: (Old Status CS Approved), 17/08/2010 13:10: Stephen J ALLEN

No Comments

CS Denied: (Old Status CS Approved), 09/09/2010 08.58: Joanna S Flanagan

CS Denied: (Old Status CS Approved), 01/11/2012 02:13:18 PM: Joanna S Flanagan

Ownership percentage changed from: (24.7, 13.7, 6.1, 10, 45.5) to: (24.9, 13.9, 5.9, 9.9, 45.4)
### Revision History

<table>
<thead>
<tr>
<th>Editor</th>
<th>Date</th>
<th>Reason for update</th>
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<tbody>
<tr>
<td>Denise HOLDER</td>
<td>01/10/2010 13:42:00</td>
<td>Annual update - Various updates</td>
</tr>
<tr>
<td>Denise HOLDER</td>
<td>01/11/2010 12:50:00</td>
<td>Updated Financials, auditors report and call report</td>
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<tr>
<td>Denise HOLDER</td>
<td>18/01/2010 09:11:03</td>
<td>Updated PIF 2010 report</td>
</tr>
<tr>
<td>Denise HOLDER</td>
<td>05/04/2010 09:12:26</td>
<td>Added Hong Kong to HSBC Banknote Office</td>
</tr>
<tr>
<td>Sally G LOMAS</td>
<td>03/01/2009 10:36:09</td>
<td>Updated EDD data</td>
</tr>
</tbody>
</table>

### Last Updated by

- **Profile Deactivated**
- **Various updates - Financials, management, EOD, PIF and A2E**
- **Updated GRM support**
- **Annual review - Various updates**
- **Updated Financials, auditors report and call report**
- **Updated PIF 2010 report**
- **Added Hong Kong to HSBC Banknote Office**
- **Updated EDD data**
Know Your Customer Profile
HSBC Bank USA, N.A.

Reference: [Redacted]  
Client Profile Approval Status: In Process  
Country Risk Status: High Risk

Client Name: Islami Bank Bangladesh Limited  
Country: BANGLADESH

* Changes to these fields on "Approved" Profiles require Re-approval.

I. General Information

<table>
<thead>
<tr>
<th>Field</th>
<th>Information</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Client Name</strong></td>
<td>Islami Bank Bangladesh Limited</td>
</tr>
<tr>
<td><strong>Industry</strong></td>
<td>Banks &amp; Securities Companies</td>
</tr>
<tr>
<td><strong>Type of Client</strong></td>
<td>Branch</td>
</tr>
<tr>
<td><strong>Legal Entity</strong></td>
<td>Parent</td>
</tr>
<tr>
<td>**Is this a &quot;Special Category of Client&quot;?</td>
<td>Yes</td>
</tr>
<tr>
<td><strong>Address (Business/Permanent)</strong></td>
<td>Dilkusha Commercial Area, Dhaka, Bangladesh 1000</td>
</tr>
<tr>
<td><strong>Telephone</strong></td>
<td>(+880) 2 556 9151</td>
</tr>
<tr>
<td><strong>SWIFT Code</strong></td>
<td>HSBCBANGL001</td>
</tr>
</tbody>
</table>

Confidential Treatment Requested

EXHIBIT #86
### Islami Bank Bangladesh Limited

**Establishment**

The establishment of Islami Bank Bangladesh Limited on March 13, 1983, is the true reflection of the inner urge of its people, which started functioning with effect from March 30, 1983. This Bank is the first of its kind in South Asia. It is committed to conduct all banking and investment activities on the basis of interest-free profit-loss sharing system. In doing so, it has unveiled a new horizon and ushered in a new era of hope towards materializing a long cherished dream of the people of Bangladesh of doing their banking transactions in line with what is prescribed by Islam.

With the active cooperation and participation of Islamic Development Bank (IDB) and some other Islamic banks, financial institutions, government bodies, and eminent personalities of the Middle East and the Gulf countries, Islami Bank Bangladesh Limited has by now established its unique position as a leading private commercial bank in Bangladesh.

*Source: [http://www.islamibankbd.com](http://www.islamibankbd.com)*

**General Comments**

The establishment of Islami Bank Bangladesh Limited on March 13, 1983, is the true reflection of the inner urge of its people, in the establishment of this Bank, which started functioning with effect from March 30, 1983. This Bank is the first of its kind in South Asia. It is committed to conduct all banking and investment activities on the basis of interest-free profit-loss sharing system. In doing so, it has unveiled a new horizon and ushered in a new era of hope towards materializing a long cherished dream of the people of Bangladesh of doing their banking transactions in line with what is prescribed by Islam. With the active cooperation and participation of Islamic Development Bank (IDB) and some other Islamic banks, financial institutions, government bodies, and eminent personalities of the Middle East and the Gulf countries, Islami Bank Bangladesh Limited has by now established its unique position as a leading private commercial bank in Bangladesh.

*Source: [http://www.islamibankbd.com](http://www.islamibankbd.com)*

---

**Know Your Customer: Islami Bank Bangladesh Limited**

<table>
<thead>
<tr>
<th>Account Number</th>
<th>Date of Account</th>
<th>Purpose of Account</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>02/01/2000</td>
<td></td>
</tr>
</tbody>
</table>

**New Client/Existing Client**

- New (prospect)
- Existing (active)
- Agency Arrangements only

**Account Number**

- 02/01/2000

**Purpose of Account**

- Foreign Exchange Services Fund Foreign Clearing Account

**Yes, Name of Exchanges**

- Dhaka & Chittagong Stock Exchanges

**CIP Verification of ID**

- Yes

**Identification**

- Yes

**CIP Verification of ID - Was the original customer identification documentation (I.D. card, passport) verified by CIP or was it later changed?**

- Yes

**Documentary Evidence by CIP**

- Yes

**Client's Address**

- Dhaka & Chittagong Stock Exchanges

**Customer Contact/Address**

- Dhaka & Chittagong Stock Exchanges, Bangladesh, Bangladesh

**Company Overview**

The establishment of Islami Bank Bangladesh Limited on March 13, 1983, is the true reflection of the inner urge of its people, which started functioning with effect from March 30, 1983. This Bank is the first of its kind in South Asia. It is committed to conduct all banking and investment activities on the basis of interest-free profit-loss sharing system. In doing so, it has unveiled a new horizon and ushered in a new era of hope towards materializing a long cherished dream of the people of Bangladesh of doing their banking transactions in line with what is prescribed by Islam. With the active cooperation and participation of Islamic Development Bank (IDB) and some other Islamic banks, financial institutions, government bodies, and eminent personalities of the Middle East and the Gulf countries, Islami Bank Bangladesh Limited has by now established its unique position as a leading private commercial bank in Bangladesh.

*Source: [http://www.islamibankbd.com](http://www.islamibankbd.com)*
Know Your Customer
Islamic Bank Bangladesh Limited

EDO POF 3/11/2005, a notice of cause was issued by the Bank of Bangladesh to the CEO of Islamic Bank in March 2005 to explore accounts owned by suspected Islamic Militants. Client was subsequently closed by Islamic Bank and take measures against 20 officers for their involvement. Proceeds targeted the formation of the Islamic Bank Ltd. was used for cloaking up Islamic transactions.

CRM was cancelled and closed account.

CLIENTS RESPONSE
The client has indicated that the above-referenced case was not of terrorist financing but rather are isolated cases of malpractices by branch officials to follow their AML guidelines and operating procedures.

CRM COMMENTS
"We performed the due diligence case yesterday afternoon. As we found the explanation on the event and response to the AML questionnaires satisfactory, we recommend NOT to take any further action on Islamic Bank. However, considering that Islamic Bank is involved in mass banking with a partly large branch network without a sophisticated or integrated IT platform, there will always be a chance that isolated incidents like this might be found. As such, we will closely monitor the future events and also pay attention to the next case of Muhammad Shahabuddin, as dated March 21, 2005 according to FAD 95/85, possibly to indicate that this is the first time that the client Islamic Bank Bangladesh has been fined for covering up Islamic transactions.

Additionally, ROF recommended that the subject client's profile should be classified as SCG due to the following reason:

"One of the shareholders, the Kuwait Finance House, along with several others (North Bank, providing shareholder, the Islamic Development Bank, Jeddah, Saudi Arabia, (7.69 %)) has memberships in 94 countries and 962 representations in 117 countries, some of which are OFAC sanctioned countries.

LCO (2) 2017/17 replied, "As for the (LC connection) I would say no to SCG.

LCO was queried to review of status 2/3/2010, replied, "The information appearing below does merit (LC classification)."

IV. AML Discussion

AML Discussion took place 3/25/2011, saw violation section for details.

V. AML Policy

AML Policy in file.

MTS Questionnaire in file. Client less 13 MSEs for which it was no political agent. Bank of Bangkok confirms the following no relationship:

Confidential Treatment Requested

Page 3
## II. Ownership/Management/Business Information

<table>
<thead>
<tr>
<th>Name of Principal or Beneficial Owners / (List all shareholders with 9% or more ownership, if Corporate Client not publicly traded, Special Category Client or High Risk Country, Sanctioned by the U.S. government or in any Sanctioned Country)</th>
<th>% of ownership</th>
</tr>
</thead>
<tbody>
<tr>
<td>Arabas South Travel &amp; Tourism Agency K.S.A</td>
<td>9.99</td>
</tr>
<tr>
<td>Al-Rahman Company for Industry &amp; Trade, Riyadh K.S.A</td>
<td>9.94</td>
</tr>
<tr>
<td>Al-Rahman Company for Industry &amp; Trade, Jeddah K.S.A</td>
<td>9.66</td>
</tr>
<tr>
<td>The Islamic Development Bank, Jeddah K.S.A</td>
<td>6.46</td>
</tr>
<tr>
<td>The Public Institution for Social Security, Kuwait City Kuwait</td>
<td>5.25</td>
</tr>
<tr>
<td>Kuwait Finance House K.S.C., Kuwait City Kuwait</td>
<td>3.84</td>
</tr>
<tr>
<td>Other, none with 9% or more ownership</td>
<td></td>
</tr>
</tbody>
</table>

### Name of Corporate Officers

<table>
<thead>
<tr>
<th>Name</th>
<th>Title</th>
</tr>
</thead>
</table>
| Abu Nasser Muhammad Mofiz Zahir | Chairman of the Board  
Shahed Muhammad | Vice-Chairman  
Abdul Mannan Shamsul Haque | Managing Director  
Mustafa Anwar | Vice Chairman |

### Total Number of Employees: 6,898

<table>
<thead>
<tr>
<th>Where is the Client Incorporated?</th>
<th>BANGLADESH</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Year Established</th>
<th>1993</th>
</tr>
</thead>
</table>

### What is the Client's Rank in country (listed here?): 3

### How many branches/offices does Client have?: 200

### Where are the branches/offices located?:

Confidential Treatment Requested
Know Your Customer: Islami Bank Bangladesh Limited

III. Referral Information

- How was the Client introduced to the bank?
  - By whom: Long-standing relationship

- Is the Client a beneficiary of the bank?
  - Yes: Yes

- Is the Client a beneficiary of the bank?
  - Yes: Yes

- If yes, the Client is currently under the same ownership for at least 10 years (in 5 years)
  - No: No

- In the Client's home country, are there any financial institutions that have similar relationships with the bank?
  - If yes: Yes

- If no, are there any other financial institutions that have similar relationships with the bank?
  - Yes: Yes

- If yes, please list:
  - HSBC

- If no, are there any other financial institutions that have similar relationships with the bank?
  - Yes: Yes

- If yes, please list:
  - HSBC

IV. Visitation

- General Visitation:
  - By whom: Shafquat Hossain, Sadique Rahman

- By whom:
  - Shafquat Hossain, Sadique Rahman

- By whom:
  - Shafquat Hossain, Sadique Rahman

- By whom:
  - Shafquat Hossain, Sadique Rahman

- By whom:
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  - Shafquat Hossain, Sadique Rahman

- By whom:
  - Shafquat Hossain, Sadique Rahman

- By whom:
  - Shafquat Hossain, Sadique Rahman

V. Purpose/Nature of Activity

<table>
<thead>
<tr>
<th>Purpose</th>
<th>Nature of Activity</th>
</tr>
</thead>
<tbody>
<tr>
<td>AML Discussion</td>
<td>On-site visit with Assistant VP Alzubair Ahmad in Chennai</td>
</tr>
</tbody>
</table>

Confidential Treatment Requested

HSBC-PSI-PROD-04117228
Know Your Customer: Amani Bank Bangladesh Limited

<table>
<thead>
<tr>
<th>ACH (Clearing House)</th>
<th>Money Market</th>
</tr>
</thead>
<tbody>
<tr>
<td>AOF (Account Reconciliation)</td>
<td>Securities Lending</td>
</tr>
<tr>
<td>Asset Management</td>
<td>Bank</td>
</tr>
<tr>
<td>Check Collection (Cash Limits)</td>
<td>Occasionally served overnight investment</td>
</tr>
<tr>
<td>Checks/Wire Transfer</td>
<td>Daily</td>
</tr>
<tr>
<td>Commercial Lines</td>
<td>Trading - Bonds</td>
</tr>
<tr>
<td>Credit Lines</td>
<td>Trading - Funds</td>
</tr>
<tr>
<td>Current Deposits</td>
<td>Trading - Emerging Markets</td>
</tr>
<tr>
<td>Current Account</td>
<td>Trading - Equities</td>
</tr>
<tr>
<td>Hedging</td>
<td>Trading - Fixed Income</td>
</tr>
<tr>
<td>Parking</td>
<td>Trading - Foreign Exchange</td>
</tr>
<tr>
<td>Forward Rate Agreements</td>
<td>Trading - Futures</td>
</tr>
<tr>
<td>Futures</td>
<td>Trading - Securities (Treasury)</td>
</tr>
<tr>
<td>Guarantees (Co-offset, Secured)</td>
<td>Trading/Lending - Precious Metal Markets</td>
</tr>
<tr>
<td>Gross Foreign Exposure Limit</td>
<td>Cash Reserve Account</td>
</tr>
<tr>
<td>Letter of Credit / Bank Guarantees</td>
<td>Occasionally</td>
</tr>
<tr>
<td>Loans</td>
<td>Other</td>
</tr>
</tbody>
</table>

* Refer to Client's file for anticipated volume of activity.

Managing for Value - Client's Profitability for HSBC

Total: 103,982

(Variation: actual or anticipated, in USD equivalent)
This is required for all POM clients

VI. Financial Summary

<table>
<thead>
<tr>
<th>Currency (Local)</th>
<th>Financial Statement date: 12/31/2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>BANGLADESH Taka</td>
<td>2010/2009</td>
</tr>
<tr>
<td>Exchange rate (per USD)</td>
<td>68.139100</td>
</tr>
<tr>
<td>Description</td>
<td>100,082</td>
</tr>
<tr>
<td>Amount</td>
<td>3,939,140,000</td>
</tr>
<tr>
<td>Balance Sheet</td>
<td>284,577,000</td>
</tr>
<tr>
<td>Net Income</td>
<td>48,174,000</td>
</tr>
</tbody>
</table>

VII. Documentation Checklist

| List of Authorized Signatories and for Corporate Resolution to | 2012/03/04 |
| Client File | Yes |
| No | |
| If no, explain: | |

Current Annual Report (Form 10-K) or Financial Statement to | Yes |
| Client File | No |

Indicate whether references to individual country and geographic areas (54.4) are below |
No | 2012/03/04 |

Indicate whether reference to individual country and geographic areas (54.4) in Client File |
Yes | Yes |
| No | No |

Confidential Treatment Requested

HSBC-P84-PROD-0117277
Know Your Customer: Islami Bank Bangladesh Limited

Bank Client and Not a Central Bank

- Copy of Banking License in Client File?
  - Yes ☐ No ☐

Foreign Bank Client and Not a Central Bank

- Is a USA Patriot Act Certification on File?
  - Yes ☐ No ☐
  - If yes, date received by HSBC:
    - 06/07/2011

VIII. Summary of Reasons

We have reviewed the information provided above in the context of the bank's "Know Your Customer" policy and "Due diligence" requirements and criteria. Based on the following summary of reasons, we feel comfortable recommending this client for banking business.

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Foreign Bank Client and Not a Central Bank

- Is a USA Patriot Act Certification on File?
  - Yes ☐ No ☐
  - If yes, date received by HSBC:
    - 06/07/2011
  - If yes, most recent Certification or File/ Certification was executed/dated by institution:
    - [if applicable]

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Confidential Treatment Requested HSBC/PS/PSD-017228
The functions of the Bank are to participate in equity capital and grant loans for productive projects and enterprises, besides providing services to member countries in the field of trade and technical co-operation.

The present membership of the Bank consists of 58 countries. The basic condition for membership is that the prospective member country should be a member of the Organisation of the Islamic Conference, pay its contribution to the capital of the Bank, and agree to accept such terms and conditions as may be detailed by the ECO Board of Governors.

Kuwait is represented in the Board by a Governor and an Alternate Governor. Each member has five hundred shares, one for every share subscribed. Generally, decisions are taken by the Board of Governors based on a majority of the voting power represented at the meeting. The Board of Governors meets once every year to review the operations of the Bank for the preceding year and to decide future policies. In its annual meeting the Board designates a Chairman, who remains in office until the election of another Chairman at the next Board meeting. The Board of Governors is the highest policy-making body. It can delegate powers to the Board of Executive Directors for the general operation of the Bank. However, only the Board of Governors can deal with issues relating to membership, increase or decrease in the Bank’s authorized capital, subsidiary cooperation agreements with international and regional organizations, elections of the President and Executive Directors and decide their remuneration.

The Board’s principal office is in Jeddah in the Kingdom of Saudi Arabia. Two regional offices were opened in 1985; one in Rabat, Morocco and the other in Kuala Lumpur, Malaysia. In July 1992, the Board of Executive Directors approved the establishment of a representative office in Jakarta, Indonesia, in addition to the Bank’s representative office in Jakarta, to serve as a link between the Bank and Islamic countries. The office became operational in July 1997 and is now a full-fledged Regional Office. The office also has field representatives in other member countries. These are: Indonesia, Iran, Uzbekistan, Libya, Pakistan, Senegal, Sudan, Tunisia, Guinea, Guinea Bissau, Mauritania and Nigeria.


The Public Institution for Social Security, Kuwait, is 44.5% owned by the Government of Kuwait and 55.5% owned by the general public. Since its inception in 1977, and in line with the tight-knit social welfare system in the public sector, the Bank is independent for its own purposes. In 2010, the government employees, and military, was followed by an independent law for pensions and insurance to the military, in accordance with law No.27 of 1981, which came into force on September 30, 1981.

The Public institution for Social Security is a public institution of independent budget, having a legal personality and subject to the supervision of the Minister of Finance. The institution is managed by a Director General and four deputies. They are liable for the implementation of the policy determined by the Board of Directors. The Director General is appointed by the Minister of Finance and can decide to appoint or dismiss each of them.

The number of the procedure was performed through five main sections, which are General Administration Sector, Insurance Sector, Investment Sector & Insurance Services Personnel, Automation Sector, Investment Sector & Insurance Service Personnel.

Source: http://www.piss.gov.kw/english/index2_eng.htm

Kuwait Finance House (KFH), the largest financial institution in Kuwait, is 44.5% owned by the Government of Kuwait, and 55.5% owned by the general public. Since its inception in 1977, the Bank is independent for its own purposes. In 2010, the government employees, and military, was followed by an independent law for pensions and insurance to the military, in accordance with law No.27 of 1981, which came into force on September 30, 1981.

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The number of the procedure was performed through five main sections, which are General Administration Sector, Insurance Sector, Investment Sector & Insurance Services Personnel.

Source: http://www.piss.gov.kw/english/index2_eng.htm
Know Your Customer: Islami Bank Bangladesh Limited

Chairman of the Board
Representative: Ibn Sina Pharmaceuticals Industry Limited

Ousmail Mohammad Akhlaq Zahirin - Chairman of the Board (Representative: Ibn Sina Pharmaceuticals Industry Limited)

Born into a devout Muslim family in Companiganj in Kolkata on July 1, 1948. He achieved his Masters Degree in English Literature from the University of Dhaka. He is the Managing Director of Ibn Sina Pharmaceuticals Industry Limited. He married his wife Shajeda in 1972 with whom he has two children, Rehana and Zafra. He is an active member of the Islamic Republican Party of Bangladesh. He has been involved in the Bangladesh Nationalist Party for a number of years. He has also been the President of the Bangladesh Nationalist Party in Dhaka and the Member of the Bangladesh National Assembly for a number of years. He is the Chairman of Islami Bank Bangladesh Limited.

Vice Chairman
Representative: At-Rajhi Co. for Industry & Trade Industrial Division

Yousuf Abdullah Al-Rajhi obtained his Masters Degree from U.S.A. He is the General Manager of At-Rajhi Company for Industry & Trade, K.S.A. Earlier, he performed duties of Branch Manager and Project Finance Manager of At-Rajhi Banking and Investment Corporation during 1977 to 1985.

Source: http://www.islamibankbd.com/management.php

Mr. Mannan took the charge of International Banking Wing in August 2005. He was promoted as Deputy Executive President in 2006.


Shamsul Haque, a career banker joined Islami Bank Bangladesh Limited in 1984 as Principal Officer and served in different capacities in IBBL. He worked as Second Officer of Narayanganj Branch & Rajshahi Branch. He also worked as Manager of Rajshahi Branch, Bogra Branch and also worked as Manager of Foreign Exchange Corporate Branch, Dhaka. He headed Dhaka North Zone 
[Continues with more details about Islami Bank Bangladesh Limited officials and their roles]
Know Your Customer: Islamic Banking Bangladesh Limited

Introduction of New Business and Branch expansion:
There has been only horizontal expansion of branch network. Total 95 branches including SME branches have been opened since 2008.

Ownership Changes:
There has not been any major change in the Bank’s ownership. A友贾 confirmed that Mr. Abdullah Nadeem Ali is holding more than 5% of the Bank’s capital shareholding as an individual.

Change in AML policy:
Both the Money Laundering Prevention Ordinance, 2009 and Anti-Terrorism Act 2009 have been approved by the Government of Bangladesh. These have had no change in the AML policy from last year’s presentations. These have not reported to the Central Bank regarding this information issue. They have an internal quarterly training on AML, ranging from the officer level to frontiers.

Client on-boarding process:
Islamic Bank Ltd. ensured that they follow very strict KYC policy prescribed by the central bank. For individual clients, photo ID of the customer, driving license etc. are obtained. In recent times, copy of National Identification Card is preferred. Two copies of customer photography duly attested by the introducer, who is an existing customer/acceptable person to the firm is obtained. Same procedures are followed while on-boarding local corporate entities to each of the Director/Managers. In case of non-resident aliens, all the related documents must be verified by the Bangladesh Embassy in the country of domicile of the client. For cross-border business other than individuals, reports are obtained through credible agencies like Dun & Bradstreet and others. In addition to the above, to meet Money Laundering Prevention Act requirement, possible transaction profile of the client is also evaluated.

Policy and status regarding Money Business & other high-risk customers:
Banking with any shell is not permissible in Bangladesh. Islam Bank Bangladesh Ltd. does not accommodate any shell bank. According to BAML, key-person relationships with some exchange houses facilitate handling of inward remittance business. These exchange houses are maintaining account with them. But the accounts are opened only after the examination of Central Bank. Bangladesh Central Bank considers transfers with money exchange license as high risk and prohibited specific guidelines to deal with this. It requires the Money Services Business permit from the Central Bank or other appropriate authority of its country of domicile. Credit report from any internationally reputed agency, audited financial report of last three years, profile of all the directors etc. Along with a certificate from the Bangladesh Consular Office in the country of domicile of the Money Service is required before commencing the relationship with them. AML confirmed that Islam Bank does not deal with any positive shell or partners.

AML: Policy & awareness process of registered clients while on-boarding and transactions:
Bangladesh is a member of AML, as FATF fully supports prevention of money laundering. All APO members commit to effectively implement FATF’s international standards for anti-money laundering and combating the financing of terrorism. Islam Bank observed that they have very strict AML policy and guidelines. The Branch and Head Office AML Compliance Officers are regularly monitoring the transactions against a list of sanctions and entities suspected for terrorism which is provided by the Central Bank. Bangladesh Bank in its AML Circular No. 03 dated 17 July 2002 specifically identified the requirements of KYC and provided formats for regular reporting of on-going/previous transactions. The Branch Managers of Islam Bank Ltd. have a ‘Know Your Money Laundering Compliance Officer (KAMLCO) who require to submit this report to Chief Anti Money Laundering Compliance Officer (CAMLCO) in the Head Office. CAMLCO decides whether to report the transaction to Central Bank or not. CAMLCO is required to submit a quarterly report to Central Bank on demarcation/appraisal transactions.

Cross border banking and possible threats experienced:
Islamic Bank Bangladesh Ltd. does not allow any of their customers to provide correspondent banking services through their account maintained with HSBC Bank USA. N.A. Payable through account is also not permissible within the Banking guideline of the country.

Site Visit: 02/10/2012
HSBC Bank Bangladesh Ltd. East Road, Dhanmondi, Dhaka 1209, Bangladesh. Tel: 880-2-8292992, 880-2-8293000 Fax: 880-2-8293001 Email: islambank@hsbc.com

We had the opportunity to visit the head office of HSBC in Bangladesh to see into the performance of Islamic banking industry in Bangladesh and to have an insight into the performance of Islamic banking in terms of market penetration, market dynamism, growth prospects and future development.

Mr. Naval Pathak, CEO gave a power point presentation on the HSBC mailing team. The presentation covered an overview of the Islamic banking market in Bangladesh and its impact on the Islamic banking in terms of market penetration, market dynamism, growth prospects and future development.

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Know Your Customer: Islami Bank Bangladesh Limited

The initiative of HSBC in Bangladesh both in terms of growth and market penetration. He advised the Islami Bank’s representatives that in future if they receive any support or identifications of any clients or product know how (Islamic banking products), they may then welcome to approach them for assistance and secondary supports on the queries of funds.

Mr. Sadiq, Head of HSBC in Bangladesh, has already presented the Automated Murabaha Service product of HSBC (overnight swing) to Islami Bank Bangladesh Limited. And the subject presented an overview and consideration for availing the said.

Upon the completion of the presentation, the Islami Bank team was elected to meet the managing director (Mr. Md Abdul Mannan) of Islami Bank. Mr. Mannan cordially received the visiting team and advised that he was aware and welcomed the HSBC's Islamic banking initiatives in Bangladesh and reviewed the positive prospects of such initiatives. Mr. Fakih thanked Mr. Mannan for his insightful advice and expressed that his (Mr. Fakih) visits to the country will increase in the coming days and years as the Astomor hopeful develops further to its growth in the peninsular of the country's Islamic banking market.

The late-st share-holding position has been requested. Islami Bank confirmed that they do not have any shareholding position. There was one change in their senior management last one year.

Mr. Sadiq advised that Islami Bank got its own AML, policies & guidelines in line with country’s Money Laundering Prevention Act, 2002. In the Act, all responsibilities have been assigned within Islami Bank to investigate and monitor AML. copies in the Banks. Islam has got a Compliance Department headed by a senior executive who is responsible for enforcing the AML policy. AML training is included in the induction training for all staff. Workshops, Seminars and training on AML are conducted by the Compliance Department in regular intervals. AML training programs with all employees in the organization are in our calendars.

Promising branch for high-value DPs. Branch is very much willing to get confirmations from HSBC with competitive pricing. They are satisfied with HSBC’s service.

Is the Client a High Value Client (HVC)?

1. Yes
2. No
3. Unknown

Is the Client a Medium Value Client (MVC)?

1. Yes
2. No
3. Unknown

Is the Client a Low Value Client (LVC)?

1. Yes
2. No
3. Unknown

What is the Client’s KYC and AML policies and procedures for new accounts? (Including submission of information on the source of funds)

1. Yes
2. No
3. Unknown

Is there a screening process regarding the procedures for the establishment of new accounts? (Indicating submission of information on the source of funds)

1. Yes
2. No
3. Unknown

Does the Institution have accurate records of the transactions and report suspicious activity?

1. Yes
2. No
3. Unknown

What are the procedures when unusual transactions are detected? The transactions are reported to the Branch Manager and they would report to the Head Office. If transactions are identified by suspicious, Head Office would report to the Central Bank.

Is the Client's KYC and AML Policies and Procedures communicated and explained in the client's network of current and former offices?

1. Yes
2. No
3. Unknown

If yes, does the Client provide AML Training to its employees?

1. Yes
2. No
3. Unknown

If yes, how often is the AML training provided to who?

1. Continuous training is provided at least annually to each staff member

2. Client has provided a copy of their comprehensive AML guidelines, which contains some such an identification procedures for new customers, record-keeping, record-keeping, and reporting of suspicious transactions, training and awareness. A copy of this document is also in the client's file.
Know Your Customer: Know Your Customer

| Country: Bangladesh
| Bank: Ace Bank Bangladesh Limited
| Question: Does the country have KYC and AML laws and regulations?
| Yes | No

Bangladesh is not a regional offshore financial center. Under the current government, the country is in a state of emergency. A law was passed on January 1, 2017, that causes funds laundered through the official banking system overseas. The new government initiated a vigorous campaign against money laundering. However, it is not clear if this campaign is being enforced. The country is not a member of the Financial Action Task Force (FATF) and does not engage in regional or international financial transactions. The principal method of laundering involves the widespread use of the underground hawala system to transfer money and value outside the formal banking network. The vast majority of financial transactions in Bangladesh are conducted in these hawala centers.

The government has passed the Money Laundering Prevention Ordinance (MLPO 2008) and the Anti-terrorist Ordinance (ATO 2008). These laws facilitate international cooperation in recovering money illegally transferred to foreign countries and mutual legal assistance in terms of criminal investigations, trial proceedings, and extradition requests. The GOB has formed a national level committee headed by the law advisor and an emergency task force headed by the governor of the CBL to retrieve illegally transferred money. For the past twenty years, corruption practices became so common that, between 2001 and 2005, Transparency International ranked Bangladesh in its Corruption Perception Index as the country with the highest level of perceived corruption. In 2007, Bangladesh was ranked 147 out of 180 countries surveyed.

Bangladeshis are not allowed to carry cash outside the country in excess of $3,000 to South Asian Association for Regional Cooperation (SAARC) countries and the equivalent of $5,000 to other countries. Proper documentation is required by authorized foreign exchange banks and dealers. The GOB does not place a limit on how much currency can be brought into the country, but amounts over $5,000 must be declared within 30 days. The Customs Bureau is primarily a revenue collection agency, accounting for 40-50 percent of Bangladesh's annual government income.

Although positive legislation has been passed and progress has been made, the government of Bangladesh should continue to strengthen its anti-money laundering/terrorist finance regime to enhance its anti-money laundering capabilities. The GOB should support technology enhancements in reporting channels from local banks to the central bank. The FIU is growing steadily, but the FIU analysts and investigators need to enhance their ability to conduct outreach, investigations, understanding money laundering techniques, and know the techniques. The GOB should enhance the enforcement and outcome should examine forms of trade-based money laundering and include money laundering and financial crimes investigations at the 'street level'. Instead of focusing only on high value transactions, the GOB should focus on larger customers to identify money laundering and financial crimes. The GOB should also focus on Anti-Terrorism and Anti-terrorist finance investigations at the 'street level' instead of waiting for a STR to be filed with the FIU. A crackdown on pervasive fraud would add new revenue streams for the GOB. Continued efforts should be made to fight corruption, which is intertwined with money laundering, smuggling, customs fraud, and tax evasion. The GOB should consider the UN Convention Against Transnational Organized Crime.

Source:
http://www.state.gov/j/iv/nr/um/rls/drl/2010/127578.htm

Confidential Treatment Requested
HSBC-PSI-PROD-0117233
Know Your Customer: Islami Bank Bangladesh Limited

Has the Client been audited?  
Yes  No

If yes, by whom (Audit Firm):
Aziz, Halim Khatr Chowdhry (Chartered Accountants)
Auditor's report was favorable

Does the Client have a credit rating?  
Yes  No

If yes, by whom (S&P, Moody’s or other):
Credit Rating Information & Services (CRISL)

Has Enhanced Due Diligence been conducted (on the Client’s AWR record)?  
Yes  No

If yes, by whom:
Credit Rating Information & Services (CRISL)

Has negative information been identified?  
Yes  No

Signature Section

Account Manager / Administrator (IS) Approval: 
Client Director / Manager (SS) Approval: 
Functional Head of Business / Executive (SS) Approval: 
Relationship Manager (SS) Approval: 
Institutional Banking / Team Leader (SS) Approval: 
Regional Mixed Lending Control Officer (SS) Approval: 

APPROVED HISTORY:

Created: 05-29-2001 10:22:26 AM Converted from Edc

Approvers:
- Needs Approval

Confidential Treatment Requested
Know Your Customer: Islami Bank Bangladesh Limited

<Exec_dept>
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<LegaLdept>
<ApprovaUegal_dept>
<Legal dep comments>

AM Approved: (Old Status In Process), 03/18/2001 12:38 PM: Ravi R Pokl
No Comments

RM Denied: (Old Status AM Approved), 05/04/2001 01:15 PM: Beth Fisher
No Comments

AM Approved: (Old Status RM Denied), 10/05/2001 12:27 PM: Ravi R Pokl

Ownership:

AR. JIH COMPANY FOR INDUSTRY AND TRADE, RIYADU 14.453%

ITALIAN DEVELOPMENT BANK, JEDDAH 7.05%

KHANAR FINANCE HOLDING KSS, JOHANNESBURG 5.05%

THE PUBLIC INSTITUTION FOR SOCIAL SECURITY, KUWAIT 8.537%

HE MOHAMMED ABDUL AZIZ 7.227%

REST OF THE SHAREHOLDERS ARE PUBLIC SPONSORS, GENERAL PUBLIC AND GOVERNMENT OF BANGLADESH

AM Approved: (Old Status AM Approved), 10/11/2001 03:09 AM: Beth Fisher
Establishing USD account with MTS.

In Process: (Old Status In Process), 07/01/2003 01:08 PM: Rhonda Lee-Thomas
Customer is sent back for re-approval.

AM Approved: (Old Status In Process), 07/03/2003 04:45 PM: Rhonda Lee-Thomas

Approved: (Old Status AM Approved), 07/13/2003 04:47 PM: Warren Proby
No Comments

In Process: (Old Status Approved), 12/15/2004 09:07 PM: Rhonda Lee-Thomas
Customer is sent back for re-approval.

AM Approved: (Old Status AM Approved), 09/29/2004 11:40 AM: Shannon M Jones
KYC profile match supporting doc's on file.

CS Approved. (Old Status AM Approved), 09/30/2004 12:20 PM: Sharyn Malone
No Comments

CS Denied: (Old Status CS Approved), 09/30/2004 03:07 PM: Beth Fisher
Rejected. Please update section VII! explaining the purpose of account and also update activity monitoring details. Under general comments, define Islamic Sharia banking.

AM Approved: (Old Status CS Denied), 09/30/2004 03:22 PM: Angela Cassell-Bush
CS concerns above have been addressed.

CS Denied: (Old Status CS Denied), 07/02/2007 03:30 PM: Gillen E Mcdaniel
Please update section VII explaining the purpose of account and also update activity monitoring details. Under general comments, define Islamic Sharia banking.

AM Approved: (Old Status CS Denied), 07/02/2007 03:45 PM: Angela Cassell-Bush
CS concerns above have been addressed.

AM Denied: (Old Status CS Denied), 09/11/2007 02:45 PM: Angela Cassell-Bush
CS concerns above have been addressed.

05/05/2012 04:17:41 PM

Confidential Treatment Requested

HSBC/PSI/PROD-011735
Know Your Customer: Islamic Sectors Bank Bangladesh Limited

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<th>CS Denied</th>
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<th>AM Approved</th>
<th>Old Status AM Approved</th>
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Profile previously CS approved, due no response from the GM regarding AM approval. CS Approved, 09/13/2007 01:45 PM Bob Shetty. Please clarify the ownership position of AlRajhi family within this bank. GRM has provided no comment, which is documented in Section 1: General Comments Section.

CS Approved, 08/30/2007 06:45 PM Bob Shetty. Based on GRM support and clarification in ownership by AlRajhi Organization.

CS Approved, 10/10/2007 09:23 AM Angela Cecil-Bush. Subject bank not known to CB.

CS Approved, 12/13/2007 02:02 AM Chisholm Kehler. No Comments.

CS Approved, 03/02/2010 01:05 PM Jan K Jones. No Comments.

AM Approved, 03/01/2010 11:14 AM Wen Lu Wu. No Comments.

CS Approved, 03/03/2010 02:14 AM Anjali MEI. No Comments.

Revision History

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Confidential Treatment Requested HSHCP#54-PROC-0117236
From: Md. Nurul Islam [mailto'mnjslam@jslamibankbd.com']
Sent: Wednesday, July 04, 2012 08:52 AM
To: Schram, Zachary (HSGAC)
Subject: Senate Inquiry

Dear Sir,

Greetings!

Please find below the responses of your queries:

1. What is Islami Bank’s relationship with HSBC, including HSBC Bank USA (HBUS)?

Islami Bank Bangladesh Limited (IBBL) is the largest private sector commercial bank in Bangladesh which has got around 600 hundred correspondent banking network including almost all globally reputed banks in different locations. HSBC is one of such correspondent banks of Islami Bank Bangladesh Limited. In this process, Relationship between Islami Bank Bangladesh Ltd. and HSBC began in early 2000 by arranging RMA (Relationship Management Application) with different HSBC Group offices. Later, an USD account in HSBC Bank USA N.A. was opened on 11 October 2000. The USD ACU (Asian Clearing Union) accounts with HSBC India and Pakistan were opened on 28 April 2006 and 23 July 2006 respectively. So far, we have got RMA arrangement with HSBC in 24 locations of the world which includes Australia, Brazil, Canada, China, Dhaka, Hong Kong, India, Indonesia, Italy, Japan, South Korea, Malaysia, Mexico, Pakistan, Peru, Singapore, Spain, Switzerland, Taiwan, Thailand, Turkey, UAE, UK and USA. The purpose of this relationship is to facilitate our foreign trade related transactions i.e. LC advising, trade confirmation, trade...
payments, trade receipts, customer receipts and treasury coverage.

2. What is Islami Bank's relationship with the Al Rajhi group and the Al Rajhi family?

At the outset, Central Bank took initiatives for establishment of Islamic Banking in Bangladesh. Islami Bank Bangladesh Limited was incorporated in 1983 with the initiatives of Government of Bangladesh including renowned local and foreign sponsors. Among the foreign sponsors, Islamic Development Bank, Kuwait Finance House, Kuwait, Dehbi Islami Bank, UAE, Bahrain Islami Bank, Bahrain, Ministry of Awqaf and Islamic Affairs, Kuwait (Present Name: Kuwait Awqaf Public Foundation, Kuwait), The Public Institution for Social Security, Kuwait, Al-Rajhi Company for Currency Exchange and Commerce KSA (Present Name: Al-Rajhi Company for Industry and Trade, KSA) and Ministry of Justice, Department of Minors Affairs Kuwait (Present Name: The Public Authority for Minors Affairs, Kuwait), Jordan Islamic Bank, Islamic Banking System International (Headings S.A., Luxembourg) were prominent. Government of Bangladesh joined with 5 percent shares and continued until government decided to offload its shares from all private commercial banks. These entities along with Al-Rajhi Company for Industry and Trade, KSA have been elected Director of our bank from time to time. At present Mr. Abdullah Abdul Aziz Al-Rajhi from Al-Rajhi family is also a shareholder and director of the Bank.

3. What are Islami Bank's KYC and AML practices?

We have adopted our AML policy in line with Central Bank regulation and relevant acts of the government and follow the same strictly and meticulously. For details, please find attached our AML Policy.

4. Did Abdur Rahman, chief of the Jamaatul Mujahidden of Bangladesh have any accounts at Islami Bank? Please describe those accounts, including relevant dates.

We have had no account in the name of either Abdur Rahman or the organization under question.

5. What were the findings of any Central Bank of Bangladesh investigation into Islami Bank since 2005?

Central Bank as a regulator of this Banking Industry conducts their regular and routine inspection & investigations from time to time since establishment of the Bank in 1983. Till today we do not have any mentionable outstanding issue with the Central Bank regarding the aforesaid investigations other than routine matters. However, an incident took place in 2006 in connection with some transactions originated from our Gazipur and Savar Branches through eight telegraphic transfers for an amount ranging from BDT 10,000 (USD 144) to BDT 79,000 (USD1,137) of
altogether sum BDT 4,17,000 equivalent to approximately USD 6,000 (United States Dollar six thousand). The transfers were destined to an account in the name of one Mr. Saidur Rahman who had opened account with our Laldighipara Branch, Sylhet in February 1999 complying all usual norms. Initially, the concerned officials did not find anything suspicious in good faith. Upon inspection from Head Office, it was revealed that the transactions were made in an inoperative account and thereby suspicious in nature and then we made STR to Central Bank. Instantly, Bank also suspended the concerned officials. As the reporting was not done in time, Central Bank fined BDT one hundred thousand (equivalent to USD 1,439) and IBBL paid the amount. Later on, IBBL carried a thorough investigation on the matter and terminated the delinquent officials from the service of the bank. Mentionable that several banks including some foreign bank were also fined by Central Bank at that time due to failure of timely STR.

6. Did the International Islamic Relief Organization have any accounts at Islami Bank?

Please describe those accounts, including relevant dates.

International Islamic Relief Organization (IIRO) had accounts bearing number ••••••• and with our bank. These accounts were opened on 17.04.1993 and 06.06.1994 respectively as a regular and approved NGO and maintained with our bank till 03.08.2010 along with other 2(two) Banks. As the entity was a UN sanction listed organization informed by Central Bank in 2006, we instantly froze the accounts and confirmed our actions to the Central Bank and there were no transactions from that date to 03.08.2010 i.e. till transfer. In 2010, we received instruction from Central Bank at the direction of Ministry of Finance, Government of Bangladesh to defreeze the accounts in the name of IIRO maintained with three banks including IBBL and transfer the accounts with IBBL to BASIC Bank, a Government owned bank and accordingly we confirmed our actions to Central Bank.

We feel our reply will satisfy your query and please feel free to contact us if you have got any query further.

Thanking You,

Md. Nurul Islam
Deputy Managing Director &
Head of International Banking Wing
Islami Bank Bangladesh Limited

[Redacted by the Permanent Subcommittee on Investigations]
Mr. Zachary Schram
Senior Counsel
Permanent Subcommittee on Investigations
United States Senate
202-224-9379

Dear Sir,

This has reference to your email dated June 30, 2012 and our subsequent reply dated July 5, 2012 on your questionnaire, pursuant to your investigations on HSBC.

In this regard, we furnish below our response to all your queries chronologically.

1. What is Social Islami Bank's relationship with HSBC, including HSBC Bank USA (HBUS)? How has the relationship changed over time?

Ans: Social Islami Bank Ltd. had account relationship with HSBC Bank USA for the purpose of reimbursement of import Payments against letters of credit opened by our different branches; receive export proceeds and also inwards remittance.

Effective from May 2012 we DO NOT have any kind of relationship with HSBC, including HSBC Bank USA.

2. What are Social Islami Bank's KYC and AML practices?

Ans: Social Islami Bank Ltd. has its own AML Policy and separate AML Compliance Cell for fighting money laundering, terrorist financing and ensuring "know your customer" KYC.

--- Original Message ---
From: AMM FARHAD/Social Islamr Bank Limited
To: Schram, Zachary (HSGAC)
Cc: Gulam Kibrja $IBL 10'; mds@sibl-bd,COffi ; 'MR MUHAMMAD ARI'; 'MR QUAZI FAYZUL
KARIM
Sent: Tuesday, July 10, 2012 7:57 PM
Subject: Re: Senate Inquiry

Dated: July 10, 2012

Mr. Zachary Schram
Senior Counsel
Permanent Subcommittee on Investigations
United States Senate
202-224-9379

Dear Sir,

This has reference to your email dated June 30, 2012 and our subsequent reply dated July 5, 2012 on your questionnaire, pursuant to your investigations on HSBC.

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--- Original Message ---
The Bank’s Management strictly ensures the compliance with all statutory and regulatory requirements, including designating AML Officer for this specific purpose and conducting training for staff at all levels.

Bank’s compliance with Anti-Money-Laundering requirements and procedures is monitored by the Central Bank of Bangladesh (Bangladesh Bank) and also by Bank’s internal and external auditors.

Each and every account of the bank and any transaction in any account are fully complied with our KYC procedures.

3. Please describe the relationship of Social Islami Bank with the Al Rajhi group?

Ans: Social Islami Bank DOES NOT have any kind of relationship with Al Rajhi group.

4. Was Abdul Majid of Singapore a director of Social Islami bank? Was the same Abdul Majid arrested by the Singapore government for terrorism-related activities? What was the result of any legal action against Mr. Majid?

Ans: SIBl Board had never a Director named Mr. Abdul Majid and as such the answer is that Mr. Abdul Majid of Singapore WAS NEVER a director of Social Islami bank.

5. Please describe the relationship of Social Islami Bank with the International Islamic Relief Organization (IIRO)? Is (or was) the IIRO a shareholder of Social Islami Bank?

Ans: International Islamic Relief Organization (IIRO) is a foreign shareholder of Social Islami Bank who currently holds 1.61% share of the bank. It is of mention that the bank doesn’t have any transactions with this organization except that this organization purchased some primary shares of the bank when it was floated in 1995, during the year of bank’s inception. In 2006 we came to know that the United Nations Security Council enlisted International Islamic Relief Organization (IIRO) under “Individuals and Entities Associated with Al Qaida” as one of the Directors of IIRO was accused of having association with Al Qaida.

The matter was viewed with due concern by the management and the Board of the bank. The management of the bank placed the issue before the Shareholders of the bank in the 11th Annual General Meeting (AGM) held on 06.11.2006 and adopted a resolution unanimously that the whole shares held by International Islamic Relief Organization will be disposed off by way of sale/transfer in accordance with the law of Securities and Exchange Commission (SEC), Bangladesh Bank and in line with the law of the land.

The matter was also taken to the notice of Bangladesh Bank and Securities Exchange Commission. The Central Bank issued instruction on 10.12.2006 not to disburse any bonus shares, issue of right shares or pay any cash dividend to IIRO until further instructions of Bangladesh Bank.
In compliance with the instructions of Bangladesh Bank, the bank immediately stopped issuing bonus shares, right shares and paying any cash dividend to IIRQ.

To overcome the situation the bank communicated with IIRQ several times and requested them to dispose of their entire share held with the bank by way of sale/transfer but they did not respond to the bank’s request to offload their shares.

A Board Memo was then placed before the Board of Directors of the bank on 30.06.2009 and the Board unanimously agreed to dispose off the whole shares held by International Islamic Relief Organization (IIRO). The Board of Directors also agreed to seek permission from the High Court praying for Court’s intervention to sell the entire shareholding of IIRO in the capital market and the proceeds may be deposited in any government account/screw account or as would be determined by the Hon’ble court of justice to save the Bank from any unwanted trouble and for smooth operation of the foreign exchange business of the Bank.

But in 2010 Ministry of Finance, Government of the Peoples Republic of Bangladesh has issued a circular dated 31/05/2010 providing IIRO permission to run their business/activities legally in Bangladesh.

The Central Bank has also endorsed the circular issued by the Ministry of Finance, Government of the Peoples Republic of Bangladesh vide their Letter No. AMID-432010-2797 dated 30.06.2010 and instructed us to comply with the Circular issued by the Ministry of Finance.

Under the above circumstance, the bank is under definite obligation in paying dividend/issuing bonus shares/right shares to IIRO as per the instructions of the Central Bank and Ministry of Finance which were not paid/issued in their favour till 31/05/2010.

06. Does (or did) IIRO have any accounts at Social Islami Bank? Please describe those accounts, including relevant dates.

Ans: IIRO has only one Foreign Currency Account with the bank which they opened in 1995 at the time of buying primary shares of the bank. Present balance of the account is zero. Other than that the bank does not have any sort of transaction in that account of IIRO.

07. Please describe the relationship of Social Islami Bank with the Islamic Charitable Society Lajnat al-Birr Al Islam (Lajnat al-Birr)? Is (or was) the Lajnat al-Birr a shareholder of Social Islami Bank?

Ans: The Islamic Charitable Society Lajnat al-Birr Al Islam (Lajnat al-Birr) is a foreign shareholder of Social Islami Bank who currently holds 0.22% share of the bank. It is of mention that the bank doesn’t have any transactions with this organization except that this organization purchased some primary shares of the bank when it was floated in 1995, during the year of bank’s inception.
08. Does (or did) Lajnat al-Birr have any accounts at Social Islami Bank? Please describe those accounts, including relevant dates.

Ans: Lajnat al-Birr DOES NOT have any account with the bank.

Should you have any query or require further clarification please feel free to contact us.

With thanks & kinds regards,

Sincerely Yours,

A.M.M. Farhad

Deputy Managing Director,
Social Islami Bank Ltd,

Head Office,
City Center, Level (16-21)
103, Motijheel C/A, Dhaka, Bangladesh.
Tel: +88 09612001122 / 10004
Fax: +88 02 9564944
Email: farhadamm@socialislami.com
Skype: farhadamm

--- Redacted by the Permanent Subcommittee on Investigations ---

PD-036-01-004
From: ANNE LIDDY /HBUS/HSBC
Sent: 9/9/2008 7:25:51 AM
To: DENISE A REILLY /HBUS/HSBC@HSBC02
CC: 
Subject: Fw: Hokuriku Bank Ltd- Compliance query

Denise, do you know when Denis was planning on providing the overall summary document on this overall topic? I am anxious to review, including together with the below info, to determine if we need to file any further reports.

Thanks.

Anne Liddy
SVP, AML compliance | HSBC Bank USA, N.A.
452 5th Avenue, Tower 7, New York, NY 10018

Phone 212-525-5906
Fax 212 525 5769
Email anne.liddy@us.hsbc.com

----- Forwarded by Anne Liddy/HBUS/HSBC on 09/09/2008 08:20 AM -----

Judy P Stoldt/HBUS/HSBC@HSBC02
09/09/2008 07:25 AM

To: Anne Liddy/HBUS/HSBC@HSBC, Denise A Reilly/HBUS/HSBC@HSBC, Mary A Caskin/HBUS/HSBC@HSBC
Cc: Jonathan Dean/HBUS/HSBC@HSBC
Subject: Fw: Hokuriku Bank Ltd- Compliance query

Information from Hokuriku Bank regarding some of the car dealerships they do business with that we questioned. Its very limited information that took us over a month to get.

Judy P Stoldt
Vice President, AML Compliance | HSBC Bank USA, National Association
One HSBC Center
Buffalo, New York 14203

Phone (716) 841-6425
Fax (716) 841-7386
Email judy.p.stoldt@us.hsbc.com

----- Forwarded by Judy P Stoldt/HBUS/HSBC on 09/09/2008 07:17 AM -----

Aka KOBAYASHI/TKY/HBAP/HSBC@HSBC
09/09/2008 03:52 AM

To: Judy P Stoldt/HBUS/HSBC@HSBC02
Cc: Anthony Julian/HBUS/HSBC@HSBC02, Garlie S K Ho/PCM ASP/HBAP/HSBC@HSBC, Jennifer E Kelleher/HBUS/HSBC@HSBC02, Jennifer Fong/TKY/HBAP/HSBC@HSBC, Stephanie L

EXHIBIT #88
Judy,

Thank you for waiting. Please find attached the original copy prepared by Hokuriku Bank and the one translated by myself.

Hope it helps.

Regarding the other batch, I shall forward the information as soon as details are received.

Best regards,

Ako Kobayashi
PCM Client Services
HSBC, Tokyo

Judy P Stoldt
08 Sep 2008 21:35 Mail Size: 49719

To
Ako Kobayashi
CC

Subject
Re: Fw: Hokuriku Bank Ltd- Compliance query

Our Ref
Your Ref

Ako,

Thank you for your assistance in getting us the information.

Regards,

Judy P Stoldt
Vice President, AML Compliance | HSBC Bank USA, National Association
One HSBC Center
Buffalo, New York 14203
Judy,

I have called Hokuriku Bank and received the required information. However as the information is provided in Japanese, I shall forward it as soon as translation is ready. It won't take long.

Appreciate your understanding.

Best regards,

Ako Kobayashi

----- Forwarded by Ako KOBAYASHI/TKY/HBAP/HSBC on 2008/09/08 18:54 -----
Stephanie,

Noted. I shall call Hokuriku Bank again first thing Monday morning and give Judy the update.

Best regards,

Ako Kobayashi

PCM Client Services
HSBC, Tokyo

Stephanie L. Napier/HRUS/HSBC@HSBC02
06 Sep 2008 00:12 Mail Size: 36347

To
Ako KOBAYASHI/TKY/HBAP/HSBC@HSBC
cc
Garie S K HO/PCM ASP/HRUS/HSBC@HSBC, Jennifer FONG/TKY/HBAP/HSBC@HSBC, Judy P
Stigler/HRUS/HSBC@HSBC02, Anthony Julian/HRUS/HSBC@HSBC02, Jennifer E
Kelleher/HRUS/HSBC@HSBC02

Subject
Re: Fw: Hokuriku Bank Ltd- Compliance query

Ako, this has been a long outstanding request. It is imperative that Compliance receive the response to our inquiry. Please urgently follow-up with client.

Best regards,

Stephanie L. Napier
AVP AML Compliance | HSBC Bank USA
90 Christiana Road, New Castle, DE 19720

Phone. 302-327-2161
Fax. 302-3272250
Email. stephanie.l.napier@us.hsbc.com

Ako KOBAYASHI/TKY/HBAP/HSBC@HSBC
Stephanie,

Regarding the information requested, I have contacted Hokuriku Bank and was advised that the report has already been prepared. I shall forward it to you as soon as the copy has been received.

Best regards,

Aka Kobayashi
PCM Client Services
HSBC, Tokyo

Stephanie L Napier/HBUS/HSBC@HSBC02
02 Sep 2008 23:28 Mail Size: 18276

To
Ako KOBAYASHI/TKY/HBAP/HSBC@HSBC

cc

Subject
Fw: Hokuriku Bank Ltd- Compliance query

Our Ref

Your Ref

Aka, I understand you have replaced Yum. Please follow-up on the promised information.

Best regards,

Stephanie L Napier
AVP AML Compliance | HSBC Bank USA
90 Christiana Road, New Castle, DE 19720

Phone. 302 327 2161
Fax. 302-3272250
Email. stephanie.l.napier@us.hsbc.com
Dear Stephanie,

They are still preparing the report and will provide us within 4th week of AUG08.

Kind regards,

Kyoko Okazaki

HSBC Tokyo

Stephanie L Napier/HSBC

06 Aug 2008 00:27 Mail size: 21975

To: Yumi Sato/TKY/HSBC

cc: Judy P Stoldt/HSBC

Subject: Re: Hokuriku Bank Ltd- compliance query

Yumi, please advise status of information required.

Thanks,

Best regards,
Yumi SETO/TKY/HSBC@HSBC
07/28/2008 04:43 AM
TO
Stephanie L Napier/HBUS/HSBC@HSBC
CC
Judy P Stoldt/HBUS/HSBC@HSBC, Kyoko OKAZAKI/TKY/HSBC@HSBC, Nanayo
Ryan/HBUS/HSBC@HSBC
Subject
Re: Hokuriku Bank Ltd- compliance query

Stephanie
They are preparing the report.
Yumi Seto
PCM Client Service
HSBC Tokyo

Stephanie L Napier/HBUS/HSBC@HSBC
26 Jul 2008 04:23 Mail size: 14298
TO
Yumi SETO/TKY/HSBC@HSBC
CC
Judy P Stoldt/HBUS/HSBC@HSBC, Kyoko OKAZAKI/TKY/HSBC@HSBC, Nanayo
Ryan/HBUS/HSBC@HSBC
Subject
Re: Hokuriku Bank Ltd- Compliance query

Our Ref
Your Ref

Yumi, just a quick follow-up. Any update?
Rest regards,
Stephanie L Napier
AVP AML Compliance | HSBC Bank USA
90 Christiana Road, New Castle, DE 19720

Phone. 302-327-2161
Fax. 302-327-2250
Email. stephanie.l.napier@us.hsbc.com

Yumi SETO/TKY/HBAP/HSBC@HSBC
07/15/2008 02:16 AM
To Stephanie L Napier/HSUS/HSBC@HSBC
CC Judy P Stoldt/HSUS/HSBC@HSBC, Kyoko OKAZAKI/TKY/HBAP/HSBC@HSBC, Nanayo Ryan/HSUS/HSBC@HSBC
Subject Re: Hokuriku Bank Ltd - Compliance query

Stephanie
We have today contacted Hokuriku Bank Ltd.
On receipt of their reply, we will advise you.
Thanks and regards,
Yumi Seto
PCM Client Service
HSBC Tokyo

Stephanie L Napier/HSUS/HSBC@HSBC
15 Jul 2008 01:13 Mail Size: 17708
To Yumi SETO/TKY/HBAP/HSBC
CC Kyoko OKAZAKI/TKY/HBAP/HSBC@HSBC, Nanayo Ryan/HSUS/HSBC@HSBC, Judy P Stoldt/HSUS/HSBC@HSBC
Subject Hokuriku Bank Ltd - Compliance query

Our Ref
Yumi, hope all is well. As you know I moved on to Compliance. I am tasked with Target Monitoring. We have undertaken a review of Hokuriku Bank acct. We've noticed a pattern of payments which we seek information for the Beneficiary & Originator (if known). Our inquiry is based on either insufficient details within the payment or lack of Internet information to adequately research BNY or OM.

We'd appreciate your reaching out to the client to obtain requested information. Thank you in advance.

Parties in question:

<table>
<thead>
<tr>
<th>Name</th>
<th>Trans Period</th>
<th>Total</th>
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<tbody>
<tr>
<td>De Araujo Roseli Aparecida</td>
<td>4/08-5/08</td>
<td>$24,480</td>
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<tr>
<td>Aksys Corporation, Japan</td>
<td>5/7/08</td>
<td>$60,000</td>
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<tr>
<td>R S Corporation</td>
<td>5/08</td>
<td>$4,000</td>
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<tr>
<td>Sanhu Corporation Ini-ishi Shitim</td>
<td>4/08-6/08</td>
<td>$810,800</td>
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I have attached a sample payment for each.

[attachment "r1495569.tif" deleted by Stephanie L Napier/HSBC]

Below Information being sought

- Individual Address & DOB or Customer Location (whichever is applicable):
- Place of Incorporation (if applicable):
- Nature of Business:
- Beneficial owners (if applicable):
- How long a client:
- Reason for the transfer(s):
- Does the bank's due diligence on this customer and transaction(s) appear satisfactory.
- Relationship between the originator / beneficiary if known.

Best regards,

Stephanie L Napier
AVP AML Compliance | HSBC Bank USA
90 Christiana Road, New Castle, DE 19720

Phone. 302 327 2161
Fax. 302-3272259
Email. stephanie.l.napier@us.hsbc.com
<table>
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<th>Place of Incorporation</th>
<th>Nature of Business</th>
<th>Beneficial Owners</th>
<th>Reason for the Transfer</th>
<th>Due the Banks Due Diligence</th>
<th>Relationship Between the Contributors</th>
<th>Other Information</th>
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<td>Company Name</td>
<td>Address</td>
<td>Postal Code</td>
<td>Date of Establishment</td>
<td>Place of Incorporation</td>
<td>Nature of Business</td>
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<tr>
<td>De Araujo Rosell</td>
<td>1-3-20, Shoseimachf, Imizu-ishi, 200 Shichimi Nakano, lmizu-ishi, Toyama Pref, Japan</td>
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<td>Aksys Corporation</td>
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<td>Sanhu Corp</td>
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<td>020c12001</td>
<td>lmizu-ishi, Toyama Pref</td>
<td>Sales of Used Cars</td>
<td>-</td>
</tr>
</tbody>
</table>

**Notes:**
- They maintain a savings account only.
- Visit made by Hokuriku staff.
- Date of birth: 01 Oct 1961.
Anthony

My apologies. I sent mistakenly to Julian Anthony.

Sorry and regards

Yamashita
----- Forwarded by Machiko M YAMASHITA/TKY /HBAP/HSBC on 2008/09/12 19:49 -----

Machiko M YAMASHITA/TKY/HBAP/HSBC
12 Sep 2008 19:01 Mail size: 35523
Phone No. 813 5203 3328

To
Julian Anthony/PFS PUN/HBAP/HSBC
cc
Ako KOBAYASHI/TKY/HBAP/HSBC, Alan P Williamson/HBUS/HSBC@HSBC, Cam ADAMS/PCM ASP/HBUS/HSBC, Hitoshi MATSUMOTO/TKY/HBAP/HSBC, Michael B Gallagher/HBUS/HSBC@HSBC, Navin GUPTA/TKY/HBAP/HSBC, Richard JAGGARD/PCM ASP/HBUS/HSBC, Takahiko KANECHIKU/TKY/HBAP/HSBC, Thomas W Halpin/HBUS/HSBC@HSBC

Subject
Fw: Hokuriku Bank

Our Ref
Your Ref

Anthony

we informed them that due to regulatory burden, HBUS decided to cease
oc-psi-00808695

processing bulk TCs used for business purpose but continue processing other ordinary TCs. Also informed that this decision is not made only for the deals with Hokuriku Bank but also for any other banks.

Their response is as follows.

They wish you to allow respite until they will fix time frame to meet with your decision given the following internal situation at their end.

- First of all, they should consider whether or not they will continue dealing this business.
- If they continue the business; 1) they have to select alternative provider. As you mentioned, it is true that there are several candidates in Japan but it may not be easy for them to select the most appropriate provider as they should consider pricing, procedure and etc through selecting process; and 2) they need to change their internal system and procedure. (As mentioned in my previous LN, their systems including accounting system are arranged to deal with HBUS. They also have to change their procedure manual etc. to meet with the alternative provider’s processing manner.)
- As you may be aware, September is the month for their interim fiscal period and due to this, it is one of the busiest months for Hokuriku Bank (not only for them but also for Japanese banks).

As to sort out TCs which HBUS can continuously deal with, they wish to know the clear definition of bulk TCs

We suggest that we should withdraw very carefully given the fact that Japanese regional banks’ world is very small. If we will push Hokuriku drastically, HSBC may likely have bad reputation on our PCM business in this marketplace. Your feedback would be appreciated.

Regards

Yamashita

----- Forwarded by Machiko M YAMASHITA/TKY/HBAP/HSBC on 2008/09/12 18:55 -----

Anthony Julian/HBUS/HSBC@HSBC
12 Sep 2008 06:48 Mail size: 30103

To: Machiko M YAMASHITA/TKY/HBAP/HSBC
CC: Ako KOBAYASHI/TKY/HBAP/HSBC, Alan P WILLIAMSON/HBUS/HSBC@HSBC, Cam ADAMS/PCM ASP/HBUS/HSBC@HSBC, Hideki MATSUMOTO/TKY/HBAP/HSBC@HSBC, Michael B CALLAGHER/HBUS/HSBC@HSBC, Kevin GUTHRA/TKY/HBAP/HSBC@HSBC, Richard JAGGERD/PCM ASP/HBUS/HSBC@HSBC, Takahiko KANECHI/KY/HBAP/HSBC@HSBC, Thomas W HAJIRI/HBUS/HSBC@HSBC

Subject: Re: Fw: Hokuriku Bank

Our Ref

Your Ref

Please note that HBUS senior management has reviewed this service extensively.
and determined that we can no longer support this business. This is not an issue for negotiation with Hokuriku. HBUS has decided to withdraw from processing bulk quantities of TCs, as the regulatory burden is costly and the operational / regulatory risk is not acceptable.

We respect Hokuriku’s perspective, and 30 days notification should be acceptable for withdrawal of services (as stated in our cash letter documentation).

As Cash letter is a manual process, there should be no significant systemic issues with them shifting this business to another provider. Hokuriku maintains accounts with all of the major USD service providers (Citibank, Chase, BNY, Wachovia, Deutsche, Amex, etc). each of whom offer competitive cash letter services. They can shift this business relatively easily, and we would appreciate their cooperation in ceasing bulk TC deposit as soon as possible. We will return bulk TC deposits received by HBUS after October 12.

Thanks and best regards

Anthony Julian
First Vice President
HBUS Bank USA, N.A.
Global Transaction Banking
office: (302) 227-2665
Mobile (BB): ••••••••••••

Machiko M YAMASHITA/TKY/HBAP/HSBC
09/11/2008 05:07 AM

To: Alan P Williamson/HSUS/HSBC/HBAP
Subject: [REDACTED]

Matsue-san and myself visited Mr. Takahashi, GM and Mr. Takarada, Deputy MGR of International Operations Center to advise of your decision.

We conveyed the message that we understand that cash process is appropriately taken by Hokuriku Bank as Anthony commented and the point we intended to discuss is how we enhance process to avoid unnecessary internal process on our side.

During the discussion, we confirmed again the background of relevant transactions.

Page 3
- Most of their customers related to this issue are used-car dealers for Russian buyers who are cash account holders of Hokuriku Bank through appropriate AML process.

- The dealers are doing cash on delivery type of deals with buyers in this market therefore cash or TCs are normally used to accommodate these deals. As such Hokuriku Bank considers it is difficult for its customers to shift their payment method to wire transfers or commercial check from TCs.

- HBUS is currently the sole cash Letter 'provider for Hokuriku Bank and if we stop providing this service to Hokuriku Bank, it needs reasonable grace period to find out alternative service provider and re-adjust its system which is currently arranged/designed to meet HBUS's requirement and also make sure the new internal process with all relevant branches/offices.

- Since relevant customers are limited around 20 - 25 names and they are all cash account holders of Hokuriku Bank, Hokuriku Bank is well prepared to cooperate with HBUS by providing necessary information / arranging operational process in order to help HBUS to streamline the process. As such if there are any measures to reduce your processing burden, they are open to discuss on that.

- For that, they wish to understand what is exactly the issue in your processing of the TCs in problem. They have already been following your requirement on high value deposit (exceeding USD20k per deposit), under which they have been providing their customers' information including name, address and business as well as amount and number of TCs. If HBUS requires further more information and/or different process, Hokuriku Bank is ready to discuss on that.

Your feedback would be appreciated.

Regards

Machiko Yamashita, FZO TKY

----- Forwarded by Machiko M YAMASHITA/TKY/HBAP/HSBC on 2008/09/11 17:34 -----­

Alan P Williamson/HBUS/HSCOB203
11 Sep 2008 01:22 Mail size: 18427

TO: Hideki MATSUMOTO/TKY/HBAP/HSBC, Navin GUPTA/TKY/HBAP/HSRCB030, Machiko M
YAMASHITA/TKY/HBAP/HSBCB030

CC: Ako KOBAYASHI/TKY/HBAP/HSBCB030, Anthony Julien/HBUS/HSCOB203, Cam
ADAMS/PCM ASP/HBAP/HSBCB030, Michael B Gallagher/HSBC/HSRCB030, Richard
JAGGARD/PCM ASP/HBAP/HSBCB030, Takahiko KANECHIKU/TKY/HBAP/HSBCB030, Thomas W
Halpin/HSBC/HSRCB030

Re: Hokuriku Bank

Our Ref

Your Ref

Gentlemen

Page 4
Can I ask for the status on this matter?

Thank you all for your help.

Alan

----- Original Message -----

From: Hideki MATSUMOTO
Sent: 09/05/2008 09:35 AM
To: Navin GUPTA; Machiko W YAMASHITA
CC: Ako KOBAYASHI; Alan P WILLIAMSON; Anthony JULLIAN/HSBC/HSBCAMERICAS; Cam ADAMS; Michael Gallagher; Richard JAGGARD; Takahiko KANECHIKU; Thomas W HALPIN
Subject: Re: Hokuriku Bank

Navin

RM is Yamashita san for Hokuriku Bank.

Yamashita san

It seems internal due date is tight for them to change structure involving their own clients. Shall we move quickly to discuss on this with Hokuriku Bank.

rgds, hideki

Navin GUPTA/TKY/HSBC
05 Sep 2008 08:29 Mail Size: 14241
Phone No. 813 5203 4252

To: Takahiko KANECHIKU/TKY/HSBC/HSBC, Hideki MATSUMOTO/TKY/HSBC/HSBC
Subject: Re: Hokuriku Bank

Our Ref
Your Ref

Kanechiku san,

Request your support in communication to Hokuriku Bank as below.

Warm Rgs, Navin
Fred SHYUR/PCM ASP/HBAP/HSBC
09/09/2008 07:40 AM
Mail Size: 3916

To
CA M ADAMS/PCM ASP/HBAP/HSBC@HSBC, Navin GUPTA/TKY/HBAP/HSBC@HSBC, Anthony
Julian/HSB@HSBCMERICAS@REPUBLIC
CC
Thomas W Halpin/HSB@HSBC02, Michael B Gallagher/HSB@HSBC02,
Richard
JAGGARD/PCM ASP/HBAP/HSBC@HSBC, Alan P Williamson/HSB@HSBC02
Subject
Re: Hokuriku Bank
Our Ref
Your Ref

Cam and Navin,

FYI. Please kindly work with Anthony and Alan on the AML issue below.

Regards,
Fred Shyur

*****************************************************************************
The Hongkong and Shanghai Banking Corporation Limited
whose registered address is 1 Queen's Road Central, Hong Kong
*****************************************************************************

----- Original Message ----- 
From: Alan P williamson
Sent: 09/04/2008 11:05 AM EDT
To: Anthony Julian/HSB@HSBC02; Fred SHYUR
Cc: Thomas W Halpin/HSB@HSBC02; Michael B Gallagher/HSB@HSBC02
Subject: Hokuriku Bank

Anthony, Fred

As you may know, Compliance meets monthly with senior management in the
Payments and Cash Management AML Management Review committee. Recently we
discussed the fact that Hokuriku has been sending a large number of sequential
traveller's checks from a number of similar businesses through cash letter here
in the US. This use of cash letter is inappropriate and the Committee has
collapsed that PCM should no longer allow Hokuriku to send traveler's checks
through cash letter. Hokuriku should therefore cease the activity and make
alternative arrangements, such as to make the deposits by wire, by September
30. Can I ask you to contact the appropriate PM's to convey this message to
Hokuriku and confirm back that they have done so?

Page 6
Thanks for your help. Please let me know if you have any questions.

Alan Williamson
POM Compliance
212 323 8043
Denis E. O'Brien
Vice President, Head of Global Transaction Banking Compliance, HSBC Securities (USA) Inc.

12/19/2008 11:16:25 AM

To: Ako KOBAYASHI/TKY/HBAP/HSBC@HSBC03
CC: ANTHONY JULIAN/HBUS/HSBC@HSBC02; DENISE A REILLY /HBUS/HSBC@HSBC02; HIDEKI MATSUMOTO/TKY/HBAP/HSBC@HSBC03; JONATHAN DEAN/HBUS/HSBC@HSBC02; JUDY P STOOL/HBUS/HSBC@HSBC02; MACHIKO M YAMASHITA/TKY/HBAP/HSBC@HSBC03; SAEKA TAKEBAYASHI/TKY/HBAP/HSBC@HSBC03; SHINJI KAWAMURA/TKY/HBAP/HSBC@HSBC03; STEPHANIE K BROWN/HBUS/HSBC@HSBC02; TAKAO TAKENAKA/TKY/HBAP/HSBC@HSBC03; WILLIAM WEHMEYER/HBUS/HSBC@HSBC02

Subject: Re: FW: Hokuriku Bank - information needed

We are appreciative of your assistance and thank you for your diligence in this regard. We have closed our investigation as it relates to this issue.

Thanks and regards,

Denis E. O'Brien

Subject: FW: Hokuriku Bank - information needed

Denis,

Hokuriku Bank has provided the information at their risk and confirmed that the purchasers of the Travelers Checks - Alexander Tokarenko, Andrey Davyдов, Yuriy Zimchuk, Leonid Efimovich Egorov, Kopychev Valery or Bulgatov Maxim; are not signers or are NOT connected in any way to the previously requested named relationships at Hokuriku Bank. This should be the last favour and we cannot expect further or next assistance from them.

Exhibit #90
Best regards,

Ako KOBAYASHI
Assistant Vice President | Global Payments and Cash Management, Asia Pacific
HSBC Building, 3-11-1 Nihonbashi, Chuo-ku, Tokyo 103-0027, Japan

Phone: 813 5203 3151
Fax: 813 5203 4235
Email: ako.kobayashi@hsbc.co.jp

----- Forwarded by Ako KOBAYASHI/TKY/HBAP/HSBC on 2008/12/19 15:58 -----

Shinji KAWAMURA/TKY/HBAP/HSBC03
17 Dec 2008 17:11 Mail Size: 50442
To:
Denise E O'Brien/HSBC/HSBC02
Jonathan Dean/HSBC/HSBC02, Judy P Stoldt/HSBC/HSBC02, Masako H YAMASHITA/TKY/HBAP/HSBC/HSBC02, Takeshi TAKAYASHI/TKY/HBAP/HSBC/HSBC03, Hideki MATSUMOTO/TKY/HBAP/HSBC/HSBC03, Stephanie K Brown/HSBC/HSBC02, William Wilmayer/HSBC/HSBC02, Ako KOBAYASHI/TKY/HBAP/HSBC/HSBC03, Anthony Jullian/HSBC/HSBC02, Takao TAKENAKA/TKY/HBAP/HSBC/HSBC03
Subject:
FW: Hokuriku Bank - information needed

Our Ref

Denise,

I am Shinji KAWAMURA, MLCO in Japan. They have been good enough to provide information so far but as you may understand from bank secrecy viewpoint, they should not or cannot disclose customer information. So they will no longer provide information. If you need my suggestion to clear those backlogs, I will tell you that you should file suspicious transaction report to your authority.

Regards,
Shinji KAWAMURA
Money Laundering Control officer
The Hongkong and Shanghai Banking Corporation, Tokyo
TEL: 813-5203-3154
FAX: 813-5203-3794
----- Forwarded by Shinji KAWAMURA/TKY/HBAP/HSBC on 2008/12/17 15:49 -----

Takao TAKENAKA/TKY/HBAP/HSBC
17 Dec 2008 08:31 Mail Size: 54754
To:
Shinji KAWAMURA/TKY/HBAP/HSBC/HSBC03

Page 2
Subject
Fw: Hokuriku Bank - information needed

Our Ref
Your Ref

----- Forwarded by Takao TAKENAKA/TKY/HBAP/HSBC on 12/17/2008 08:30 AM -----
Denis E o'brien/ABUL/HSBC@HSBC02
37 Dec 2008 03:03 Mail Size: 54194

To
Takao TAKENAKA/TKY/HBAP/HSBC03
Denise A reilly/HSBC@HSBC02, Hideki matsunoto/TKY/HBAP/HSBC@HSBC03,
Jonathan dean/ABUS/HSBC@HSBC02, Judy P Stolz/HBAP/HSBC@HSBC01, Masahiro M
Yamashita/TKY/HBAP/HSBC@HSBC03, Saeke TAKERAYASHI/TKY/HBAP/HSBC@HSBC03,
Stephanie K brown/HSBC@HSBC02, William weber/HBAP/HSBC@HSBC02, Ako
KOBAYASHI/TKY/HBAP/HSBC@HSBC02, Anthony Julien/HSBC@HSBC02.

Subject
Re: Fw: Hokuriku Bank - information needed

our Ref
Your Ref

---

Takao,

By way of introduction, I am responsible for Global Transaction Banking
Compliance in the U.S.

Ako Kobayashi has been very helpful thus far in assisting us in obtaining
additional information as it relates to Hokuriku Bank customers that were
utilizing our Cash Letter (Pouch) services. In response to the additional
questions Hokuriku Bank has requested for our specific request:

1. The reason you are reviewing transactions from first and second quarter of
2008 at this time of the year.
   Internal backlogs

2. Where did you get the name of the 30 companies?
   From Hokuriku Bank bulk deposits.

3. Are you only asking Hokuriku Bank to provide such information?
   Yes, as it relates to Hokuriku Bank transactions.

4. What would be the course of action you would take if any of the Russians are
   Page 3
related in any way with the named relationships?

(Repeat of previous response)

We are required to understand and vet transactions processed that are alerted in our systems because of patterns or trends. To the best of our knowledge, we are unaware of any pending criminal act and would appreciate any information that can be shared with us regarding any law enforcement actions. The Russian names were identified during our due diligence as purchasers of travelers checks on behalf of third parties that used the items to purchase goods from your clients. Our request for information directly relates to transactions processed and alerted in our systems.

because of the large volumes, this processing is normal as we review in arrears and currently are backlogged reviewing transactions from first and second quarter of 2008. These investigations are time consuming as in most instances, like this one, we need to rely on our customers to provide additional information.

5. What is the reason for the request when there is no more outstanding travelers checks with Hokuriku Bank.

To clear the pending HBUS system generated alerts on previous activity.

We understand from the previous e-mails that Hokuriku Bank has requested some time to gather information for us, which we greatly appreciate and understand that we cannot expect completion by year-end. Again, we cannot stress enough, that all we are asking is confirmation that the purchasers of the travelers checks - Alexander Tokarenko, Andrey Davydov, Yuriy Zimchuk, Leonid Efimovich Egorov, Kopychev Valery or Bulgarov Maxim; are not signers or are connected in any way to the previously requested named relationships at Hokuriku Bank.

Thanks and regards,

Denis E O'Brien

Vice President, Head of Global Transaction Banking Compliance, | HSBC Securities (USA) Inc.

452 Fifth Avenue, New York, NY 10018

Phone. 212 525 3147
Fax. 212 229 5217
Mobile. 212 229 5217
Email. denis.e.obrien@us.hsbc.com

Ako KOBAYASHI/TKY/HBAP/HSBC@HSBC

To: Denis E O'Brien/HBUS/HSBC@HSBC
Subject: Fw: Hokuriku Bank - information needed

Page 4
Denis,

Please be advised that other contact of Hokuriku Bank called us today and he has requested for further background for your specific request. The reason you are reviewing transaction from first and second quarter of 2008 at this time of the year.

Where did you get the name of the 30 companies?

What would be the course of action you would take if any of the Russians are related in any way with the named relationships?

What is the reason for the request when there is no more outstanding travelers checks with Hokuriku Bank?

Please be advised that apparently they are not very happy with your request as they have other matters to attend toward the end of the year. Besides they are only given a very short timeframe.

Hokuriku Bank is not saying that they will not assist you to provide the required information however they are upset with the nature of the request without being given sufficient background. Given the nature of the queries, please understand it is time consuming and consider to allow them more time.

They might not be able to supply the information by the end of the year. Appreciate your understanding on the above.

Best regards,

Aka KOBAYASHI
Assistant Vice President | Global Payments and Cash Management, Asia Pacific
HSBC Building, 3-11-1 Nihonbashii, Chuo-ku, Tokyo 103-0027, Japan

Phone. 813 5203 3161
Fax. 813 5203 4236
Email. aka.kobayashi@hsbc.co.jp

----- Forwarded by Ako KOBAYASHI/TKY/HBAP/HSBC on 2008/12/15 14:58 -----

Ako KOBAYASHI/TKY/HBAP/HSBC
11 Dec 2008 14:24 Mail size: 40837
Phone No. 813 5203 3161

To. Denis E O’Brien/HSBC/HSBC02@HSBC

cc. Denise A Reilly/HSBC/HSBC02, Jonathan Dean/HSBC/HSBC02, Judy P Stolte/HSBC/HSBC02, Saeko TAKAMATSU/TKY/HSBC/HSBC02, Stephanie K Brown/HSBC/HSBC02, William Wehrmeyer/HSBC/HSBC02

Subject. Re: Fw: Hokuriku Bank - information needed

our ref  Page 5
Denis,

I have had dialogues with the Hokuriku Bank and they do not appear to retain ownership information. According to the client, they have identified the name of the branches where these named entities maintain an account with and shall shortly make a request to each branch to supply them with the required information.

Please bear with us some time for the Hokuriku Bank to complete the whole process.

Best regards,

AKO KOBAYASHI
Assistant Vice President | Global Payments and Cash Management, Asia Pacific
HSBC Building, 3-11-3 Nihonbash, Chuo-ku, Tokyo 103-0027, Japan

Phone. 813 5203 3161
Fax. 813 5203 4236
Email. ako.kobayashi@hsbc.co.jp

Denis E O'Brien/HUS/HSBCBH6BC02
11 Dec 2008 14:32 Mail size: 35895

To. AKO KOBAYASHI/TKY/HSBC/HSBCBH6BC02, Stephanie K Brown/HUS/HSBCBH6BC02
CC. Denis E O'Brien/HUS/HSBCBH6BC02, Jonathan Dean/HUS/HSBCBH6BC02, Judy P Stoldt/HUS/HSBCBH6BC02, Takako YAMANISHI/TKY/HSBC/HSBCBH6BC02, William Weinmeyer/HUS/HSBCBH6BC02

Subject. Re: Fw: Hokuriku Bank - information needed

Your Ref

Thanks Ako,

I may be missing something here, all we are asking is if any of the named individuals are owners or account signers in the named entities. Doesn't Hokuriku Bank retain ownership information & signature cards on there customers.

Please advise as we would appreciate closing this investigation out before year end.
Thanks,
Denis O'Brien
Vice President
Head of GCB Compliance
Tel: +61 412 546 142

----- Original Message ----- 
From: Aka KOBAYASHI
Sent: 12/11/2008 01:54 PM ZST
To: Stephanie Brown
Cc: Denis O'Brien; Denise Reilly; Jonathan Dean; Judy Stoldt; Saeka TAKEBAYASHI/TKY/HSBC/HSBC03; William Wehmeyer
Subject: Re: FW: Hokuriku Bank - information needed

Stephanie,

I have called Hokuriku bank and was advised to allow some time. As they do not
know how those Russian names are pronounced, Hokuriku bank needs to visit the
companies listed below one by one and it would certainly require certain amount
of time. Please consider to wait till the end of this year.

Appreciate your understanding.

Best regards,

Aka KOBAYASHI
Assistant Vice President | Global Payments and Cash Management, Asia Pacific
HSBC Building, 3-11-1 Nihombashi, Chuo-ku, Tokyo 103-0027, Japan

Phone. 813 5203 3162
Fax. 813 5203 4236
Email. ako.kobayashi@hsbc.co.jp

Stephanie K Brown/HBUS/HSBC02
11 Dec 2008 05:41 Half Size: 31533

To: Aka KOBAYASHI/TKY/HSBC/HSBC03
Saeka TAKEBAYASHI/TKY/HSBC/HSBC03, Judy P Stoldt/HBUS/HSBC02/HSBC,
Denise A Reilly/HBUS/HSBC, Jonathan Dean/HBUS/HSBC, William
Wehmeyer/HBUS/HSBC, Denis E 'O'Brien/HBUS/HSBC
Subject
Re: FW: Hokuriku bank - information needed

Our Ref
Your Ref
Hello Ako,

Do you have any information concerning the below matter?

Please note it is imperative that we received an answer as soon as possible.

Thanks and regards,

Stephanie K Brown
HSBC Bank USA, National Association
Account Manager | GPMC Client Services
90 Christiana Road, New Castle, De. 19720

Phone 0302 327 2291
Fax 212 642 4065
Email stephanie.k.brown@us.hsbc.com

Hello Ako,

Here is additional information concerning our questions related to Hokuriku Bank:

The background of our queries stem from our requirement to understand and vet transactions processed that are alerted in our systems because of patterns or trends. To the best of our knowledge, we are unaware of any pending criminal act and would appreciate any information that can be shared with us regarding any law enforcement actions. The Russian names were identified during our due diligence as purchasers of travelers checks on behalf of third parties that used the items to purchase goods from your clients. Our request for information directly relates to transactions processed and alerted in our systems because of this large volume. This processing is normal as we review in arrears and currently are backlogged reviewing transactions from first and second quarter of 2008. These investigations are time consuming as in most instances, like this one, we need to rely on our customers to provide additional information.

Your immediate attention would be greatly appreciated in advising us if Alexander Tokarenko, Andrey Davydov, Yuriy Zimchuk, Leonid Efimovich Egorov, Kopychew Valery or Bulgarov Maxim are signers or are connected in any way to the previously requested named relationships at Hokuriku Bank.

Thanks in advance your assistance in this regard.

Thanks and regards,

Stephanie K Brown
HSBC Bank USA, National Association
Account Manager | GPMC Client Services
90 Christiana Road, New Castle, De. 19720

Phone 0302 327 2291
Fax 212 642 4065
Email stephanie.k.brown@us.hsbc.com
Stephanie,

Hokuriku Bank has raised the following questions:

What is the background for your queries? Does it relate to your compliance reason or does it relate to criminal act and the police asks such information? Where did you get those Russian names? Since no cheques has been presented to you since Nov08, why such information is required now?

Appreciate your feedback on the above.

Thanks and best regards,

Ako KOBAYASHI
Assistant Vice President | Global Payments and Cash Management, Asia Pacific
HSBC Building, 3-11-1 Nihonbashi, Chuo-ku, Tokyo 103-0027, Japan

----- Forwarded by Ako KOBAYASHI/TKY/HBAP/HSBC on 2008/12/04 10:50 -----
Ako KOBAYASHI/TKY/HBAP/HSBC
01 Dec 2008 11:21 Ma; 1. size: 20181
Phone No. 813 5203 3101

Stephanie,
I have forwarded your message to Hokuriku Bank. Upon receipt of their reply, I shall revert to you.

Best regards,

Ako KOBAYASHI
Assistant Vice President | Global Payments and Cash Management, Asia Pacific
HSBC Building, 3-11-1 Nihonbashi, Chuo-ku, Tokyo 103-0027, Japan

Phone: 813 5203 3161
Fax: 813 5203 4236
Email: ako.kobayashi@hsbc.co.jp

---

Hello Ako,

Can you please contact Hokuriku Bank and request they provide us with the following information:

Please advise within a week if Alexander Tokarenko, Andrey Davydov, Yuriy Zinchuk, Leonid Efimovich Egorenov, Kopychey Valery or Bulgarov Maxim are signers or are connected in any way to the following relationships at Hokuriku Bank:

MARIC TRADING CORPORATION
I.K. AUTO LTD
S.K. TRADING CO., LTD
GONDAL CORPORATION
SKIN KYOKA INTERNATIONAL
JAMSOU TRADERS CO., LTD.
CHOMODERSY TRADE INTL CO., LTD
AMAN INTERNATIONAL K.K.
SEKAN SANYO CO., LTD
CARLAND HOKURIKU CO.
MALIK SICHA BOEKI COMPANY
SHARI CORPORATION
H.A AMIN CORPORATION
AUTO SMH CO.
A.S.U., CORPORATION
P J ENTERPRISE
SUNRISE TRADING CO LTD
FRANISHFD MOTOR CAR K.K.
SANDO CORPORATION
GROMAKOV BORIS
AUTO STAGE LTD.
CHACHA ENTERPRISE CO., LTD.
COSMAS CORPORATION
JAPAN TREK INC.
KABIR AUTO EXPORT CO., LTD
KG COMPANY LTD., LTD
SEIZI YONEDA
SHIKIZAWAYODOSI CO LTD
ZHELOMKO RUSLAN

Feel free to contact me directly, if further information is needed.

Thanks and kind regards,
Stephanie Brown
GPCM Client Services
HSBC Bank USA, N.A.
90 Christiana Rd., New Castle, DE 19720
Telephone: 302 327 2171
Facsimile: 212 642 4008

--- Forwarded by Nanayo Ryan/HSBC on 11/26/2008 11:12 AM ---
由中国/HSBC on 11/26/2008 11:14 AM

To:
Nanayo Ryan/HSBC

Cc:
William Wehmeyer/HSBC
Denis O'Brien/HSBC

Subject:
Fw: Hokuriku Bank

Nan,
we do need the information so can you send the request to Hokuriku Bank? keep us posted.

Judy P Stoldt
Vice President, AML Compliance | HSBC Bank USA, National Association
One HSBC Center
Buffalo, New York 14203

Phone (716) 841-6425
Fax (716) 841-7586
Email judy.p.stoldt@us.hsbc.com

----- Forwarded by Judy P Stoldt/HBUS/HSBC on 11/26/2008 10:14 AM ------

To Judy P Stoldt/HBUS/HSBC
11/26/2008 10:14 AM

To Nanayo Ryan/HBUS/HSBC
cc Denis E O'Brien/HBUS/HSBC, William Wehmeyer/HBUS/HSBC
Subject Fw: Hokuriku Bank

Hello,

We talked this over and can you hold this request until tomorrow. I'll let you know if we need you to send it.

Judy P Stoldt
Vice President, AML Compliance | HSBC Bank USA, National Association
One HSBC Center
Buffalo, New York 14203

Phone (716) 841-6425
Fax (716) 841-7586
Email judy.p.stoldt@us.hsbc.com

----- Forwarded by Judy P Stoldt/HBUS/HSBC on 11/24/2008 04:29 PM ------

To Nanayo Ryan/HBUS/HSBC
cc Denis E O'Brien/HBUS/HSBC, Jonathan Dean/HBUS/HSBC
Subject Hokuriku Bank
Nah, please reach out to Hokuriku Bank and request that they advise within a week if Alexander Tokarenko, Andrey Davydov, Yuriy Zimchuk, Leonid Efimovich Egorov, Kopychne Valery or Bulgarov Maxim are signers or are connected in any way to the following relationships at Hokuriku Bank:

MARIC TRADING CORPORATION
S.K. AUTO LTD
DEAN CORPORATION CO LTD
UZNAZ CORPORATION
SHIN KYOHO INTERNATIONAL
JAMURI TRADERS CO LTD
CHOWDUNY TRADERS INTL CO LTD
AWAN INTERNATIONAL K.K.
SHIZA SAMYO CO LTD
CARLAND HOKURIKU CO
MAKIE SEIZA BKXCE COMPANY
SHAKI CORPORATION
M.A AWAN CORPORATION
AUTO SAM CO.
A.S.U CORPORATION
P 3 ENTERPRISE
SUNRISE TRADING CO LTD
FRIENDSHIP MOTOR CAR K.K.
SANDS CORPORATION
GRONAKOV BORIS
AUTO STAGE LTD
CACHA ENTERPRISE CO., LTD.
COSMOD CORPORATION
JAPAN TREK INC
KASER AUTO EXPORT CO., LTD
KE COMPANY CO., LTD
SEZIN YONEBA
SEIKIZAMASOYUZI CO LTD
ZHELOMKO RUSLAN

Please confirm to me when the message is sent and notify me on the response. Thank you for your assistance in this matter.

Regards,

William Wehmeyer
AVP - AML Compliance Officer I HSBC Bank USA NA
90 Christiana Road, New Castle, Delaware 19720

Phone: 302-327-2052
Fax: 212-642-4013
Email: william.wehmeyer@us.hsbc.com
From: Boss, Joseph
to: Dilorenzo, Anthony;
cc: Boss, Joseph;
subject: 
date: Monday, December 01, 2008 10:48;54 AM

Tony, HSBC Compliance management provided me with an update on the situation involving SK Trading.

If you recall, we uncovered huge amounts of travelers' checks (daily averages of $500M to $700M per day) being processed by HSBC for their correspondent Hokuriku Bank in Japan. The travelers' checks were being processed in bulk and all checks were payable to SK Trading, with each bundle (average size of $250M) signed by the same individual and in $1000 denominations and sequentially numbered. We were informed that the aforementioned amounts we identified during our sampling was the peak amount sent in for processing for SK Trading.

We were informed that once HSBC received a 314 request from HSBC regarding the matter, they dispatched investigators to Russia to conduct surveillance at the bank in which the travelers' checks were being purchased. The result was that HSBC identified five individuals who were purchasing the checks with cash at the Russian Savings Bank and signing the checks. In turn, the five individuals were providing the checks to Mr. Alexander Tokarenko who is the owner of SK Trading. Mr. Tokarenko then stamped the checks payable to SK Trading. HSBC identified all accounts, including SK Trading, at Hokuriku Bank that were forwarding bulk deposits of travelers' checks to HSBC for clearing. There were 30 accounts at Hokuriku Bank that were sending bulk deposits of travelers' checks. HSBC is attempting to discern if Mr. Alexander Tokarenko has ownership interest in the other 29 entities. HSBC advised that the total dollar amount of bulk travelers' checks processed by HSBC for the 30 entities during the period of November 2007 to October 2008 was over $61 million.

Recently, HSBC informed Hokuriku Bank that HSBC could no longer process travelers' checks for them. Once HSBC management ascertains if Mr. Alexander Tokarenko has ownership in any of the other entities, management will...

Please let me know if you require any further information.

Thanks, Joe

EXHIBIT #91
Confidential & Non-public OCC Inform
OCC-PSI-60986526
Re: Questions Posed to the New York Representative Office Of The Hokuriku Bank, Ltd.

Dear Mr. Schram:

Our client, the Hokuriku Bank, Ltd. ("Hokuriku Bank") has asked us to respond to the questions you posed to it in your email of May 21, 2012. The information conveyed here came from our client.

**Question 1**

What is Hokuriku’s relationship with HSBC, including HSBC Bank USA (HBUS)?

Hokuriku Bank’s relationship began with HBUS’s predecessor in interest, Marine Midland Bank, in May of 1973. In September of 1985, Hokuriku Bank and Marine Midland entered into an International Cash Letter Service Agreement, pursuant to which the two banks cleared travelers’ checks for each other. In October of 2008, the bank, by then named HBUS, stopped clearing travelers’ checks for Hokuriku Bank, and on May 21, 2012, HBUS terminated its relationship with Hokuriku Bank entirely.

Hokuriku Bank also has a correspondent relationship with Hong Kong and Shanghai Banking Corporation, Ltd. However, this relationship will be terminated by mutual consent on July 4, 2012.

Hokuriku Bank currently has a correspondent relationship with the four branches of HSBC Banking (China) Company, Ltd. pursuant to a Relationship Management Application ("RAM"). Hokuriku Bank also has a RAM arrangement with the Taiwan branch of HSBC (Taiwan) Ltd.

Hokuriku Bank also maintains correspondent relationships with HSBC Banking Middle East, Ltd. and HSBC Bank PLC (now known as HSBC PLC) pursuant to an agency agreement.
Until May 29, 2012, Hokuriku Bank had a correspondent relationship with HSBC Malaysia Berhad, pursuant to a RAM.

Questions 2 and 3

What is Hokuriku’s experience with submitting U.S. dollar travelers’ checks to HBUS for clearance from 2005 to the present, including the volume of checks submitted each year, why HBUS stopped processing the travelers’ checks in 2008, and when and why HBUS restarted processing them?

Hokuriku’s understanding of the travelers’ checks cashed by clients in Russia involved in the used car business, HBUS’s 2008 inquiry into those travelers’ checks, and whether Hokuriku is still processing those checks.

Due to the geographic proximity of Russia across the Sea of Japan, many Japanese dealers of pre-owned automobiles are located along the coast, including the Hokuriku region. (Hokuriku means “North Land” in Japanese). Hokuriku Bank is headquartered in this area and has several branches in the surrounding areas. Some of such dealers have accounts at Hokuriku Bank.

In a typical transaction, a customer of Hokuriku Bank (that is to say an account holder) sells a used car (or cars) to a Russian buyer who is a passenger or crew member of a ship at a nearby port. The buyer pays with travelers’ checks. The seller/account holder brings the travelers’ checks to its bank (Hokuriku) and deposits them into its account. Hokuriku Bank accepts the travelers’ checks, credits the customer’s account, and sends the checks to clearing banks. About 90% of the travelers’ checks which were cleared by HSBC were in denominations of $1,000 or $500. All the travelers’ checks were issued by American Express.

Until October of 2008, HBUS was the clearing bank for Hokuriku Bank in the U.S. HBUS would clear the checks and credit Hokuriku’s correspondent account at HSBC. In or about October of 2008, HBUS notified Hokuriku Bank that it would no longer clear travelers’ checks for Hokuriku Bank. The reason offered by HBUS was that the cost of processing the travelers’ checks, especially the ones submitted by used car dealers, had become too high.

Hokuriku Bank then turned to Bank of New York Mellon which has been clearing the travelers’ checks ever since. HBUS has not restarted clearing traveler’s checks for Hokuriku Bank.
Hokuriku Bank does not have “clients in Russia” who bring in travelers checks. The traveler’s checks are brought in by Hokuriku’s account holders which are companies incorporated under Japanese law. Hokuriku does not accept travelers’ checks unless deposited by customers into existing accounts (other than travelers’ checks total of which is less than $1,000 brought in by individual tourists). Please refer to the attached document which is an excerpt of the compliance manual of Hokuriku Bank. The pages attached list identification and other documentation required the Hokuriku Bank in order for them to engage in various transactions, including processing traveler’s checks.

Hokuriku Bank still accepts traveler’s checks brought in by its customers, which are now sent to Bank of New York Mellon for clearance.

Hokuriku Bank does not have any knowledge regarding “HBUS’s 2008 inquiry into those traveler’s checks.”

Please see the attachment for the volume of travelers’ checks sent to HBUS for clearance each year.

**Question 4**

**Whether Hokuriku clears its U.S. dollar travelers’ checks with any bank other than HSBC**

As stated above, The Bank of New York Mellon has been clearing Hokuriku’s U.S. dollar travelers’ checks since November 1, 2008.

**Question 5**

**What is Hokuriku’s KYC and AML practices?**

Hokuriku Bank has established comprehensive Compliance Regulations to assure compliance with all applicable laws and regulations including, without limitation, the Laws Preventing Transfer of Profits Generated by Criminal Activities and the Foreign Exchange and Foreign Trade Control Law. Hokuriku Bank reviews and updates the Compliance Regulations annually and as required by law.

The legal section which is created within the Compliance Office is responsible for overseeing the bank compliance matters.

All branches perform internal inspection on a monthly basis to ensure their compliance pursuant to certain procedures set up by the bank. In addition, the Internal Auditing Department conducts thorough investigations of all bank activities including, without limitation, compliance with AML matters.
Hokuriku Bank accepts U.S. dollar traveler's checks only on the following conditions:

- No more than $1,000 per person per day.
  Two exceptions may apply:
  
  (1) If a regular customer brings in a traveler's check in excess of 
      $1,000 and if by Hokuriku's judgment, it is deemed that the funds 
      will be collected from the customer should it turn out that the 
      traveler's check was not duly issued; or 
  
  (2) If the traveler's checks were issued by Hokuriku Bank.

- In either case, Hokuriku Bank requires an ID to clear traveler's checks in the 
  excess of ¥2,000,000. (approximately $25,000 at the exchange rate of 1$ = 
  ¥80)

- Whenever someone who does not have an account at Hokuriku (such as a 
  tourist or sailor) whose address is not verified brings in traveler's checks in 
  denominations of $500 or $1,000 or more, Hokuriku would check if a lost or 
  stolen report has been filed regarding them.

- Whenever a non-Japanese customer opens a new account, Hokuriku will 
  confirm if the customer (as well as the person in charge in case of a corporate 
  account) is subject to economic sanctions or their assets are frozen. The 
  Hokuriku Bank has a database for such confirmations and performs searches 
  based on the surname, given name, middle name and corporate name.
### Volume of U.S. Dollar Travelers Checks to HBUS for Clearance by Year

<table>
<thead>
<tr>
<th>Year</th>
<th>Volume (USD)</th>
<th>Clearing Bank</th>
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<tbody>
<tr>
<td>2005</td>
<td>78,983,897.00</td>
<td>HSBC Bank USA, N.A.</td>
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<tr>
<td>2006</td>
<td>71,802,654.00</td>
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</tr>
<tr>
<td>2007</td>
<td>90,248,281.00</td>
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<tr>
<td>2008</td>
<td>52,539,290.00</td>
<td>Bank of New York Mellon</td>
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<td>from Nov</td>
<td></td>
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<tr>
<td></td>
<td>3,992,610.00</td>
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<td>2009</td>
<td>7,031,660.00</td>
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<td>2010</td>
<td>10,598,030.00</td>
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<td>2011</td>
<td>7,991,460.00</td>
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<tr>
<td>2012</td>
<td>2,181,210.00</td>
<td></td>
</tr>
</tbody>
</table>
Zach,

Here is our client’s response to your queries:

1. When did the limits on the use of travelers checks mentioned in your answer to question 5 take effect?

   The current policy has been in effect since 1984 or around that time.

2. Why do so many purchasers of used cars use travelers checks at Hokuriku?

   The bank does not know why travelers checks were the primary method of payment in the past. Currently, most payment are being made by wire transfer.

3. How does Hokuriku receive travelers checks from its customers?

   The customers (account holders) would bring them to the branch offices and give them to the tellers.

Bill Brodsky
Fox Horan & Camerini
855 Third Avenue
New York, NY 10022
212-480-4800
From: ALAN P WILLIAMSON/HBUS/HSBC
Sent: 8/27/2007 12:09:51 PM
To: TERRY WESTREN/HBUS/HSBC
CC: CAROLYN M WIND/HBUS/HSBC; CLARA HURTADO/HBUS/HSBC; JEFF CLOUS/HBUS/HSBC; LOUIS MARINO/HBUS/HSBC; MANUEL DIAZ/HBUS/HSBC; MARTIN HOLY/HBUS/HSBC; STEFAN HARDY/HBUS/HSBC; TERESA GARCIA/HBUS/HSBC
Subject: Re: Bearer Share companies

Stefan

Note from Terry:

Alan,

As requested, below is the list of New York Bearer share accounts. It also gives the status of the documentation for these accounts and other information. The total is at the bottom of the spreadsheet.

Thanks and regards,

Terry Westren
SVP, Head of International Operations, HSBC Private Bank
452 Fifth Ave., 6th Floor, New York, N.Y. 10018

Phone. 212-525-5325
Fax. 212-525-1680
Email. terry.westren@hsbcpb.com

Terry Westren/HBUS/HSBC
08/27/2007 01:00 PM

To: Stefan HARDY/HBUS/HSBC
CC: Alan P WILLIAMSON/HBUS/HSBC; Carolyn M WIND/HBUS/HSBC; Clara HURTADO/HBUS/HSBC; Jeff CLOUS/HBUS/HSBC; Louis MARINO/HBUS/HSBC; Manuel DIAZ/HBUS/HSBC; Martin HOLY/HBUS/HSBC; Teresa GARCIA/HBUS/HSBC
Subject: Re: Bearer Share Companies

Stefan,

Ok. I have already provided the information on Bearer Shares you requested to Alan. Do you need it as well?

Thanks and regards,

Terry Westren
Thank you Alan.
Jeff - do you have a similar policy for new and existing a/c's?

Terry - I will call you to bring you up to speed with the meeting we had this morning. Can you provide a summary analysis of bearer share accounts for NY and the status for BLC's, shares in custody etc for new and existing a/c's as required by the policy listed below please?

Stefan Hardy
SVP, PB US Risk Management
New York

Phone. 212-525-0392

Alan P Williamson/HBUS/HSBC
08/27/2007 12:30 PM

To Stefan HARDY/HSBC
CC Carolyn M Wind/HSBC, Teresa Garcia/HSBC, Clara Hurtado/HSBC, Martin Holy/HSBC

Subject Bearer Share Companies
The following is our current policy for Bearer Share corporations in NY:

New Clients: For this purpose, new clients are considered to be new relationships to HSBC.

Bearer Share corporations will only be accepted if:
- CEO - NY IPB and AML CO approval is received; and,
- Client commits to registering the shares or the shares are held in custody with an approved non-US resident third party custodian, who is authorized to advise HSBC of any changes in ownership

Existing clients:
- If an existing client opens an account with a Bearer Share Corporation, then the existing clients section noted below applies:
- For Bearer Share corporations classified as "high-risk" (see below), the client either must commit to converting the corporation to a registered share corporation or the bearer shares are held in custody with HSBC or an approved non-US resident third party custodian, who is authorized to advise HSBC of any changes in ownership. For all other Bearer Share corporations, the Beneficial Ownership letter must be completed and renewed every three years.

Each of the factors noted below will be considered in determining if the Bearer Share account should be classified high-risk:
- Risk classification of ultimate beneficial owner/decision maker
- Involvement of HSBC in the creation of the Bearer share corporation (if HSBC created the corporation, the relationship manager will already have significant knowledge of the client)
- Number of accounts the Bearer Share client maintains (if the only account with HSBC is the PIC (Bearer Share corporation), then the client may be considered high risk)
- Length of time the Beneficial Owner of the Bearer Share corporation has been a client
- Level and nature of activity in the Bearer Share corporate account(s)

Exceptions:
Exceptions to this policy must be approved by any two of the following, one of whom must be the AML Officer: the CEO - NY IPB or designate, COO and Chief AML Officer, PA Americas.

Attachment: Bearer Shares Account Total.xls.zip
<table>
<thead>
<tr>
<th>Column 1</th>
<th>Column 2</th>
<th>Column 3</th>
<th>Column 4</th>
<th>Column 5</th>
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<td>Data 2</td>
<td>Data 3</td>
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<td>Data 5</td>
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</table>

Redacted by the
Permanent Subcommittee on Investigations
<table>
<thead>
<tr>
<th>Name</th>
<th>Role</th>
<th>Date</th>
<th>Location</th>
<th>Notes</th>
</tr>
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<tbody>
<tr>
<td>John Doe</td>
<td>Executive</td>
<td>2013-01-01</td>
<td>NY</td>
<td></td>
</tr>
<tr>
<td>Jane Smith</td>
<td>Manager</td>
<td>2014-02-02</td>
<td>LA</td>
<td></td>
</tr>
<tr>
<td>Mike Brown</td>
<td>Supervisor</td>
<td>2015-03-03</td>
<td>TX</td>
<td></td>
</tr>
</tbody>
</table>

Redacted by the Permanent Subcommittee on Investigations
From: JEFF CLOUS/HBUS/HSBC
Sent: 12/11/2007 4:13:08 PM
To: PAUL J O’SULLIVAN/HBUS/HSBC@HSBC02
CC: ALAN P WILLIAMSON/HBUS/HSBC; MANUEL DIAZ/HBUS/HSBC; TERRY WESTREN; LOUIS MARINO/HBUS/HSBC
Subject: Re: FW: Bearer share Corporation policy

Paul, attached are my comments on the draft Bearer share policy that I had previously sent to Alan in September. As you know, IPS Miami has ceased accepting Bearer share company accounts so draft requirements for establishing new Bearer share accounts are not relevant. IPS Miami maintains existing accounts for 1,679 Bearer Share Corporations of which 126 are considered High Risk. (See attached report.) These companies hold $2.6 billion in PUM and generate an estimated revenue of $26 million per year.

<table>
<thead>
<tr>
<th># Bearer Share PUM Bearer Share</th>
<th>Est. Margin</th>
<th>Estimated Rev</th>
</tr>
</thead>
<tbody>
<tr>
<td>1679</td>
<td>2,626,134,512</td>
<td>1.00%</td>
</tr>
</tbody>
</table>

I believe there would be a significant impact to the IPS business if we enacted the draft policy of requiring all existing Bearer shares to be held in custody by the end of next year. I would question why the draft policy would require both existing Bearer share accounts to be held in custody and re-certifying the beneficial ownership letter every three years. That seems to go beyond the expectation of the regulators. As I pointed out below, the interagency examination manual has clearly stated that periodic re-certification of the beneficial ownership of Bearer share accounts is acceptable for well known established customers. (The average age of the Miami Bearer share relationships is 13 years.) I would also question the timing of the draft policy, which requires existing Bearer share companies to convert to registered shares or be held in custody by the end of 2008, a year ahead of the BDV regulations requiring the same steps at the end of 2009. This would take a major effort on our part to accomplish and would disfavor our long standing HSBC clients many of which HSBC has assisted in establishing their company. Is there any room to revise this policy or obtain a dispensation for IPS?

Regards,

Jeff Clous, SVP
IPS Operations
1441 Brickell Avenue, 16th Floor, Miami, Florida 33131
(305) 539-4810 (Phone) (305) 374-6466 (Fax)

Alan with respect to existing Bearer share accounts the BSA/AML EXAMINATION MANUAL has changed their comment on the mitigation of risk of Bearer share accounts. In 2005 - custody was the only option. This changed in 2006/7 and re-certification is acceptable.

EXAMINERS MANUAL 2005 - Bearer Share
If ownership is held in bearer share form, the bank should maintain the physical control of the bearer shares either in house or with a trusted third party to ensure that the ownership of the corporate entity does not change without the bank’s knowledge.
EXAMINERS MANUAL 2006/7 - BEARER SHARE

If ownership is held in bearer share form, banks should assess the risks these relationships pose and determine the appropriate controls. For example, banks may choose to maintain (or have an independent third party maintain) bearer shares for new clients, or those without well established relationships with the institution.

For well-known, established customers, banks may find that periodically certifying beneficial ownership is effective.

Regards,
Jeff Cloud, SVP
IPB Operations
1441 Brickell Avenue, 16th floor, Miami, Florida 33131
(305) 539-4810 (Phone) (716) 626 6922 (Fax)

Paul J O'Sullivan/HRUS/HSBC/HSBC02
12/10/2007 06:36 PM

To
Terry Westren/HRUS/HSBC/HSBC02, Mason C Salic/HRUS/HSBC/HSBC02, Teresa Garcia/HRUS/HSBC/HSBC02, Antonio Suarez-Obregon/HRUS/HSBC/HSBC, Jeff Cloud/HRUS/HSBC/HSBC, Manuel Diaz/HRUS/HSBC/HSBC, Clarra Hurtado/HRUS/HSBC/HSBC, Patrick M Campbell/HRUS/HSBC/HSBC, Steven J Rockefeller/HRUS/HSBC/HSBC, Dennis J Duggan/HRUS/HSBC/HSBC

Cc:
Marlon Young/HRUS/HSBC/HSBC, Louis Marino/HRUS/HSBC/HSBC, Alan P Williamson/HRUS/HSBC/HSBC

Subject
FW: Bearer Share Corporation Policy

All,

Attached is the final draft of proposed policy covering bearer share company clients. There is a little more flexibility than was originally planned and we will be able to maintain bearer share company accounts once the requirements of the policy are met.

I will follow up with each group individually (IPB, IPB NY, and IPB Miami) to discuss implementation steps.

regards,
Paul

----- Forwarded by Paul J O'Sullivan/HRUS/HSBC on 12/10/2007 06:21 PM -----

All to
Paul J O'Sullivan/HRUS/HSBC/HSBC
12/10/2007 04:38 PM

To
Paul J O'Sullivan/HRUS/HSBC/HSBC02

Cc

Subject
Bearer Share Corporation Policy

Page 2
Attached is the aforementioned document for implementation purposes. Please note that we will be announcing the policy by the end of the week.

[attachment "Bearer Share Corporation Account Policy Guidance (Final Draft 082907).doc.zip" deleted by Jeff Clous/HBUS/HSBC]

In case of any questions, please let me know.

Regards,

Attachment: All Bearer Share Accounts.pdf.zip
Mr. Cohen: Hello

Claude: Yes, Mr. Cohen, you're sure that Gregoire told you that?

Mr. Cohen: Why? Yes.

Claude: He told you that he'll set up a Panamanian company for you [again]?

Mr. Cohen: A Panamanian, he gave me names and everything.

Claude: He gave you names too?

Mr. Cohen: Yes, Panamanian companies.

Claude: Because it's... sooner or later you are going to register Mr. Cohen, it's better to have registered shares.

Mr. Cohen: I don't want registered shares. If I place relatives as assignees, I don't want these assignees one day saying that the money is theirs.

Claude: [sighs]

Mr. Cohen: Eh yes, do you understand?

Claude: Yes, I see, but because sooner or later, it's going to be registered, do you understand Mr. Cohen? That's why, why you will pay money, now you will pay money all over again.

Mr. Cohen: So what do you want? That I close the account with you and that I go to Gregoire?

Claude: I didn't say that, but I didn't say that you should close the account...

Mr. Cohen: I can't do that.

Claude: ...close the account.

Mr. Cohen: Neither Safra nor Gregoire told me that. It's just you telling me that.

Claude: That what?

Mr. Cohen: Maybe in Geneva it can't exist...

Claude: ...but Mr. Cohen, I am honestly telling you that if it isn't today, its tomorrow, or the day after, it's going to be...
Mr. Cohen: Maybe in the United States, but not New York... in Geneva.

Claude: Alright, do you want to speak with Evelyne and have her better explain it to you?

Mr. Cohen: No, I do not want to speak with her [laughs]. Why?

Claude: OK, listen, I will verify with compliance and compliance will verify with Geneva if it's OK to open Panamanians and that's it.

Mr. Cohen: Check, and check if the laws in Switzerland are different than American laws.

Claude: The laws in Switzerland are different than those in the United States, we are going to verify that Mr. Cohen. Believe me, I'm doing the best for you, that's why I am going to ask.

Mr. Cohen: And older companies, no.

Claude: Older companies what.

Mr. Cohen: They don't need to register.

Claude: No, no, no, older companies no, but new new companies are asked to, all of them are going to be registered, all.

Mr. Cohen: But older companies, no.

Claude: No.

Mr. Cohen: So, I still have the old ones.

Claude: Yes, but this has nothing to do with the old ones. Now you want to open for...

Mr. Cohen: ...no I can give you an old one.

Claude: Panamanian?

Mr. Cohen: Yes, there are old Panamanians.

Claude: I'll ask...

Mr. Cohen: I have old ones that are ten and fifteen years old.
Claude: Ten and fifteen years old, but there always needs to be a new torificator, good standing, a new this, a new that, a new this, what do we... If it's ten years old, there is a new certificate of good standing.

Mr. Cohen: Yes.

Claude: There is a new... some new, the... new secretaries. (Inaudible) you know that the directors, bosses, have changed? Of the... of that company.

Mr. Cohen: Yeah, so?

Claude: And so it would need a new director, the list of new directors, the list of new ones... so it's the same thing. You need to open a new one... there needs to be a new one.

Mr. Cohen: There needs to be shareholders.

Claude: Yes.

Mr. Cohen: I'll give you the beneficial owner, but I do not want the shares to be in the name of the beneficial owner.

Claude: No, you can... you can diversify the shares.

Mr. Cohen: And so?

Claude: That means that the hundred, [inaudible] you can give all of the names, that one, that one, that one.

Mr. Cohen: And so?

Claude: It's easier than giving it to just one.

Mr. Cohen: Wait, wait a minute, but the shares, you have to, you want shares?

Claude: No, you will have the originals, but you can put for example X - M. Leon - 40; Sonia - 50... 

Mr. Cohen: But I can't put that, otherwise I have to declare them in the United States? I can't do that, I don't want to declare... otherwise, I have to close the accounts with you and go to Geneva.

Claude: Yes, I see, I see what you want...

Mr. Cohen: I can't do that because we, I'm a resident here.
Claude: Yes.
Mr. Cohen: Why do you think I put Habib...
Claude: Yes, right, right.
Mr. Cohen: ...my brother-in-law, he’s... he agrees with me. It’s not like I’m doing it without...
Claude: OK, OK, alright, I understand, I understand.
Mr. Cohen: He gives me his passport, he gives me everything.
Claude: OK so you... you absolutely want to change to Panamanian. OK, I’ll ask, I’ll ask compliance and we’ll see, alright and I will call you back.
Mr. Cohen: Keep me posted because [inaudible]... Geneva is free.
Claude: OK, I will keep you posted. He gave you names too?
Mr. Cohen: He gave me names; he’s going to make them companies.
Claude: Alright, OK, I will ask and I will call you back.
Mr. Cohen: OK.
Claude: Bye bye.
Mr. Cohen: Talk to you soon.
I, Anne Lutz, hereby certify that the document "C. Mandel 04/25/07 11:32:53 AM (43452433_C. Mandel 4_15_07 to 5_5_07 XV_21930.wav.zip)" is, to the best of my knowledge and belief, a true and accurate translation from French to English.

Anne Lutz

Sworn to before me this November 23, 2009

Signature, Notary Public

Stamp, Notary Public

Confidential Treatment Requested
From: TERESA GARCIA/HBUS/HSBC
Sent: 6/20/2007 4:05:47 PM
To: ALAN P WILLIAMSON/HBUS/HSBC@HSBC
CC: 
Subject: Re: Waiver Request

Alan,

That's where my problem comes in.

The policy reads:

For new Relationships: Bearer Share corporations will only be accepted if:
- CEO - NY TPB and AML LOO approval is received; and,
- Client commits to registering the shares or the shares are held in
  custody with an approved non-US resident third party custodian, who is
  authorized to advise HSBC of any changes in ownership. (see Procedures)

In this case, the client does not want to commit to either option. That's why
Manuel suggested if we can give them a waiver to the above. We are
talking about a potential client with an estimated net worth is in excess of

Would having a conference call with Manuel, the RM and the two of us help?
We always try to work with the business, but sometimes we just can't.

Thanks

Teresa Garcia
Senior Manager Specialized Compliance
HSBC Private Bank New York
452 Fifth Ave., 16th, NY, NY 10018
(P) 212-525-8014 (F) 212-525-8255

---

Alan P Williamson/HBUS/HSBC
06/20/2007 04:43 PM

To: Teresa Garcia/HBUS/HSBC@HSBC
CC:

Subject: Re: Waiver Request

Teresa

Thanks. Is there a procedure for waiving bearer shares - i.e. do Manuel & I
have the authority?

Alan

---

Teresa Garcia/HBUS/HSBC
06/20/2007 03:44 PM

---
Following are the RM responses:

The name of the accounts are:
- Uruguay International S.A. - Holding Company
- Birmingham Merchant S.A. - Holding Company

These two are companies that were established several years ago in Panama, which establishes companies with bearer shares.

Thanks

Teresa Garcia
Senior Manager Specialized Compliance
HSBC Private Bank New York
452 Fifth Ave., 16F, NY, NY 10018
(P) 212-525-0814  (F) 212-525-8255

Alan P williamson/HSBC/HSBC
06/20/2007 11:15 AM

To: Teresa Garcia/HSBC/HSBC
CC: 
Subject: Re: waiver Request

Teresa

Thanks for the info. What are the bs companies and why are they bs?

Alan

From: Teresa Garcia
Sent: 06/20/2007 09:58 AM EDT
To: Alan P williamson
Subject: Fw: waiver Request

Alan,

I would like to discuss with you. The RM is anxious for an answer since he is...
traveling to meet the client next week.

Thanks.

Teresa Garcia
Senior Manager Specialized Compliance
HSBC Private Bank New York
452 Fifth Ave., 16C, NYC, NY 10018
(P) 212-525-6014 (F) 212-525-8255
----- Forwarded by Teresa Garcia/HBUS/HSBC on 06/20/2007 09:57 AM -----

Teresa Garcia/HBUS/HSBC
06/14/2007 03:14 PM

To: Susan Hoggarth/HBUS/HSBC
CC: 
Subject: Waiver Request

Sue,

Jaime Carvallo is looking to open a relationship for . The two accounts are bearer shares. The client does not want the bank to register the shares, and they do not want to sign the BOL.

Jaime and I have discussed this issue with Manuel Plaza. Manuel is willing to sign a waiver in order to open the two accounts, as he is very familiar with the family and interested in establishing a relationship with them. I also know the family very well since I worked for them for 19 years. I have personally met the client.

Please let me know if you have any questions.

Best,

Teresa Garcia

----- End of Forwarded Message -----
Please let me know what your thoughts are.

Thank you.

Teresa Garcia
Senior Manager Specialized Compliance
HSBC Private Bank New York
432 Fifth Ave., 26th, NY, NY 10018
(Ph) 212-525-6014 (F) 212-525-8255

Redacted by the Permanent Subcommittee on Investigations
From: ALAN P WILLIAMSON/HBUS/HSBC
To: MANUEL DIAZ/HBUS/HSBC
CC: 
Subject: Re: FW: Waiver Request

I thought so. I would do it without going to Geneva but audit wrote up DPB on a similar situation.

Alan

MANUEL DIAZ/HBUS/HSBC
06/20/2007 06:32 PM
To: Alan P Williamson/HBUS/HSBC
CC: 
Subject: Re: FW: Waiver Request

I FULLY SUPPORT THIS WAIVER

Manuel L. Diaz
President & Managing Director
HSBC Private Bank International
1441 Brickell Ave, 17th Floor
Miami, FL 33131
(305) 559-4747 Telephone

Alan P Williamson/HBUS/HSBC
06/20/2007 06:28 PM
To: Manuel Diaz/HBUS/HSBC, Marlon Young/HBUS/HSBC
Cc: Teresa Garcia/HBUS/HSBC, Susan Hoggarth/HBUS/HSBC
Subject: FW: Waiver Request

Manuel, Marlon
I have no objection to this request, however I believe the requirement to register bearer shares is a group mandate. I understand the process to be that if you want an exception we will have to go to Geneva. I am willing to pass on

Permanent Subcommittee on Investigations
EXHIBIT #96b
the request if that is what you want.

Thanks

Alan

----- Forwarded by Alan P Williamson/HSBC on 06/20/2007 06:24 PM -----

Teresa Garcia/HSBC
06/20/2007 05:23 PM

To

Alan P Williamson/HSBC

Subject

Re: Waiver Request

Alan,

Because they wish to maintain confidentiality, and they have never been asked by our competitors with whom they bank to do this. The [REDACTED] is the most visible and influential family.

Teresa

Alan P Williamson/HSBC
06/20/2007 05:21 PM

To

Teresa Garcia/HSBC

Subject

Re: Waiver Request

Teresa

Why do they not want to register or deposit the shares?

Alan

Teresa Garcia/HSBC
06/20/2007 01:44 PM

To

Alan P Williamson/HSBC

Page 2
From: ALAN P WILLIAMSON/HBUS/HSBC
To: JAIME CARVALLO/HBUS/HSBC; MARLON YOUNG/HBUS/HSBC; "MANUEL DIAZ"
<MANUEL.DIAZ@HSBCPB.COM>; "TERESA GARCIA" <TERESA.GARCIA@HSBCPB.COM>; "SUSAN HOGGARTH" <SUSAN.HOGGARTH@U5.HSBC.COM>
Subject: Re: _ Family

I spoke to Susan Wright, Group Head of AML. She is reluctant to grant the exception but will consider it.

Jaime

Could I ask you to prepare a summary of the proposed relationship again, including details of the family and their businesses. Please specifically address whether there are any undisclosed ownership interests or political connections with these accounts. Circulate it to this group for review.

I know you already did something of this - no reason you can’t re-use most of it.

Alan

From: Jaime Carvallo
Sent: 06/26/2007 02:23 PM EDT
To: Marlon Young
Cc: Alan P Williamson
Subject: Re: _ Family

Jaime,

I forgot to mention again that this family’s liquid net worth is estimated in excess of _ and total net worth in the _ area. I hope this can be done.

Thank you again for your help.

WARM regards

Jaime

From: Marlon Young
Sent: 06/25/2007 06:33 PM EDT
To: Jaime Carvallo
Cc: Teresa Garcia; Thomas Flory; Ana Da Silva; Alan P Williamson
Subject: Re: _ Family

I have discussed with Terry and Alan Williamson and will give my support to this exception. Sorry, I was in a rush to leave Friday, I forgot to send my approval.

Regards,
Marlon

From: Jaime Carvallo
Sent: 06/25/2007 01:48 PM EDT
To: Marlon Young
Cc: Teresa Garcia; Thomas Flory; Ana Da Silva
Page 1
Subject: Family

Marlon,

Teresa Garcia must have given you heads up on the family and the issue regarding their holding companies having bearer shares and the fact that they will not sign the MOU.

I will see one of the family members tomorrow morning and this still seems to have no resolution. This is too important a family in Peru for us not to want to do business with, and one that has taken a lot of my time and effort to convince to start a relationship with us. Joao Luiz has met members of the family as well. I would appreciate your involvement at this point, as this has become extremely sensitive.

Thank you and regards,

Jaime
Teresa Garcia  
Senior Manager Specialized Compliance  
HSBC Private Bank New York  
452 Fifth Ave., 6G, NY, NY 10018  
(PH)212-525-6014  (F) 212-525-8255

Alan

Not quite resolved yet, but there is nothing else for us to do. The AM and the Group Head are not seeing eye to eye on this one. Therefore, it is now between them.

I'll keep you posted.

Teresa Garcia

Alan P Williamson/HSBC

07/03/2007 04:30 PM

To: Marlon Young/HSBC

cc: Teresa Garcia/HSBC

subject: Re: Fw: Fw: Fw: Family

Alan

Just checking to see if this is going well or if there is anything more you need us to do.

Have a good holiday

Alan

Marlon Young/HSBC

06/29/2007 06:31 AM

To: Jaime Carvallo/HSBC, Teresa Garcia/HSBC

cc: Marlon Young/HSBC, Teresa Garcia/HSBC

subject: Fw: Fw: Fw: Family

All,

Just checking to see if this is going well or if there is anything more you need us to do.

Have a good holiday

Alan

Permanent Subcommittee on Investigations

EXHIBIT #97b
Jaime and Terry,
See if you can work within the MLPP policy on bearer shares.
Regards,
Marlon

From: David Ford
Sent: 06/29/2007 10:17 AM CEDT
To: Alan P williamson
CC: Marlon Young; Manuel Diaz
Subject: Re: Fw: Fw: Family

Alan,
Attached is the relevant MLPP policy which allows either BD declaration or holding the shares by HSBC or third party banks. The MLPP provides significant flexibility since the shares can also be held by other banks acceptable to HSBC. As long as US requirements are not more stringent than our GPB KYC policy, suggest that USPB offer the client the choice of the various options under the policy.

Regards,
David

[attachment "MLPP-Bearer share.doc" deleted by Alan P williamson!HSBC]

F. David Ford
Global Money Laundering Control Officer
HSBC Private Banking Holdings (Switzerland) SA
Rue de Lausanne 18-20
Geneva, Switzerland 1211
Tel: 41-58-705-5284

Alan P williamson!HSBC
28.06.2007 19:38

To: "David Ford" <david.ford@hsbcpb.com>
CC
Subject
Fw: Fw: Family

David

Does the suggestion referred to in Jaime's email below seem viable? Sorry to keep bothering you; I didn't realise we might have so many issues.

Alan

Page 2
From: Manuel Diaz 
Sent: 06/28/2007 11:49 AM EDT 
To: Marlon Young 
Cc: Alan P Williamson; Jaime Carvallo 
Subject: Re: Fw: __ Family  

THANK YOU MARLON FOR YOUR INTEREST .....ENJOY YOUR VACATION !!!!!

Manuel L. Diaz 
President & Managing Director 
HSBC Private Bank International 
1441 Brickell Ave. 17th Floor 
Miami, FL 33131 
(305) 539-4747 Telephone  

Marlon Young/HSB/HSB 
06/28/2007 09:58 AM 
To: Jaime Carvallo/HSB/HSBC 
Cc: Manuel Diaz/HSBC/HSB; Alan P Williamson/HSBC/HSBC 
Subject: Re: Fw: __ Family  

Jaime, 
This could be a good compromise and could resolve our problem. 
Marlon  

From: Jaime Carvallo 
Sent: 06/28/2007 09:47 AM EDT 
To: Marlon Young 
Cc: Manuel Diaz 
Subject: Re: Fw: __ Family  

Marlon, 
I have asked Teresa for a draft of a letter that client could sign in lieu of 
The BOL, as have few clients in the past. While the letter states similar 
information to that in the BOL, is kept separately from account opening docs and 
may be a viable option. I am just waiting for her draft before trying anything 
else. 
Thank you for your follow up! 
Jaime  

From: Marlon Young
Jaime -

Below is a response I receive from Mike Finnamore who works for me in DPB. He used to be a senior AML specialist at Citigroup Private Bank. He is very familiar with KYC policies there and the policy on bearer shares.

Would any of the options suggested below work for the client? Would client allow us to keep bearer shares in safekeeping or execute a confidentiality agreement as suggested by Mike?

Regards,

Marlon

From: Michael G. Finnamore
Sent: 06/27/2007 10:38 PM EDT
To: Marlon Young
Subject: Re: Fw: Family

Hi Marlon,

In this day, it is not likely that any US based private bank would allow an account to be opened without knowing all the owners unless an exception/disposition was granted. Citigroup Private Bank would open an account for an entity whose shares were issued in bearer form for a client with an existing 2+ year relationship, but I never saw an exception requested because the client did not want to sign the Beneficial Ownership Letter.

Would this client feel more comfortable if we open the account for his bearer share entity without a BOL but he would allow us to hold the certificates in safekeeping? In that situation, we could make a very reasonable argument for disposition.

Or would the client provide the BOL if we provide him a confidentiality agreement? There is an 'approved version' that we have used in the US but I am certain Legal can tweak it to make the client feel more comfortable.

Hope this helps.

Thanks and regards,

Michael Finnamore, VP, CAMS
Business Risk Officer
HSBC PILS
Tower / 26th Fl.
NYC, NY, USA
tel: 212-525-8451

Marlon Young/HSBC/HSBC
06/27/2007 08:19 PM

To

Michael G Finnamore/HSBC/HSBC PILS

Subject

Fw: Family
Here are more info regarding why the family will only provide bearer shares.

Marlon

From: Jaime Carvallo
Sent: 06/26/2007 01:47 PM EDT
To: Marlon Young
Cc: Teresa Garcia; Thomas Flory; Ana Da Silva; Alan P Williamson
Subject: Re: Family

Marlon,

I met with the prospect today. While they understand our policy, he reiterated the family is extremely concerned about confidentiality and they are afraid this kind of information could put them at risk. He added that neither Citi nor JPMorgan (banks they have relationships with) have asked for them to sign a BOL. He does understand that eventually they will have to register the shares, but will only do it when absolutely necessary.

I wanted to add that another piece of business that is on the table for which we only have one other bank competing, and which we have a good chance of winning since we were the first to approach them on, is to help them reorganize the family businesses, and facilitate the succession not only of their financial assets but also their operating companies. This could be a very significant piece of business. Not opening accounts will eliminate us from this business that is very strategic for the family and a way to deepen a relationship with them over time, and needless to say, very profitable.

Thank you for your help with this!

Regards,

Jaime

From: Alan P Williamson
Sent: 06/25/2007 06:54 PM EDT
To: Marlon Young; Jaime Carvallo
Cc: Teresa Garcia; Thomas Flory; Ana Da Silva
Subject: Re: Family

Marlon,

I apologize but I thought I forwarded you David Ford's response last week. I will again, basically he wants us to get an exception from group. Since I happen to be with the head of group and I will ask her tomorrow.

Alan

From: Marlon Young
Sent: 06/25/2007 06:33 PM EDT
To: Jaime Carvallo
Cc: Teresa Garcia; Thomas Flory; Ana Da Silva; Alan P Williamson
Subject: Re: Family

I have discussed with Terry and Alan Williamson and will give my support to this.
exception. Sorry, I was in a rush to leave Friday, I forgot to send my approval.

Regards,

Marlon

From: Jaime Carvallo
Sent: 06/25/2007 01:48 PM EDT
To: Marlon Young
Cc: Teresa Garcia; Thomas Flory; Ana Da Silva
Subject: [REDACTED] Family

Marlon,

Teresa Garcia must have given you heads up on the [REDACTED] family and the issue regarding their holding companies having bearer shares and the fact that they will not sign the ROU.

I will see one of the family members tomorrow morning and this still seems to have no resolution. This is too important a family in Peru for us not to want to do business with, and one that has taken a lot of my time and effort to convince to start a relationship with us. João Luiz has met members of the family as well; I would appreciate your involvement at this point, as this has become extremely sensitive.

Thank you and regards,

Jaime
The backlog issue is an indisputable problem, and resulted from a number of factors—increases in transaction volume, increase in alerts due to system changes, law changes and protocol changes (such as WD2008V), which effectively eliminated cover payments—and a failure to increase resources early enough to deal with this. Some of these volume and alert activity should have been anticipated, some could not. The biggest issue for me is that our CEO did not result in escalation of the problem at an early enough stage so that management could address the issues—the KISs are being reviewed, and I do not expect this problem to occur again, but it is taking an enormous effort to address all the issues. I believe the hiring of significant temporary staff to work the backlog, and hiring and work began in January.

----- original Message ----- 
From: BRENDAN MCDONAGH/HBUS/HSBC
Sent: 02/24/2010 08:22 PM CST
To: Janet Burak; Irene M DORNER
Subject: OCC Meeting

Let's discuss Monday in NYC when you are back from overseas. I will be in DC on the 16/17/18 March and can see the OCC then.

One fair question is how did the alert backlog buildup?

----- original Message ----- 
From: Janet l BURAK/HBUS/HSBC
Sent: 02/24/2010 09:39 PM EST
To: Brendan MCDONAGH; Irene M DORNER
Subject: OCC Meeting

I met with the OCC today, in light of the extent of our alert backlogs, Sally indicated that they will shortly be issuing a supervisory letter finding violations of the requirements to file a SAR in certain defined circumstances, and generally within 30 days of detection of facts that may constitute a basis for filing a SAR. We make a determination of whether or not to file a SAR after an alert is reviewed, and, as you are aware, there are a significant number of aged alerts, while the OCC is unable to point to specific situations where they believe that SARs should have been filed, but would have concluded that, in light of the size of the backlogs, these situations must exist. The letter will reflect the fact that we self-identified the backlog issue, and that are taking actions to address it. Sally also indicated that they are not considering downgrading their assessment of Compliance Risk Management to "weak" from "satisfactory", although Sally indicated that if they make that decision, it will not impact the bank's composite CAMELS rating, which would remain a "2" (satisfactory), and would not likely impact the management rating component (also a "2"). For further

Compliance Risk Management, the OCC has determined to upgrade the bank's composite CAMELS rating, which would remain a "2" (satisfactory), and would not likely impact the management rating component (also a "2"). For further

Compliance Risk Management, the OCC has determined to upgrade the bank's composite CAMELS rating, which would remain a "2" (satisfactory), and would not likely impact the management rating component (also a "2"). For further
relates to the issues they have identified coming out of the "expanded
banknotes examination" as well as the fact that there is an ongoing third party
investigation of our BSA/AML compliance (I assume a reference to the OCC),
while we are finalizing our review of the examples they provided as 10 days
ago, we have told them that we are not finding anything which points to a
systemic problem rather than one-offs (if that). As such, I am inclined to
believe this may be more about an OCC concern that (if the OCC investigation
actually results in a negative finding, the OCC will be criticized for not
having identified and acted on these issues earlier. We intend to provide the
OCC with a response next week to the issues they identified, and I am hopeful
that the response will positively influence their view on compliance Risk
Management. If that appears not to be the case, I think that we will need to
take this to DC (Grace Bailey), as this is becoming an untenable situation.
Please let me know if you have any questions.

Janet L. Burak
SEVP and General Counsel
HSBC North America Holdings Inc.
HSBC USA Inc.
HSBC Bank USA, N.A.
452 Fifth Avenue, 7th Floor
New York, NY 10018
(713) 333-6593
(713) 333-8447
email: janet.l.burak@us.hsbc.com
from: O;Md W J BAGLEY
Sent: Tue Jun 09 14:07:22 2009
To: Emillion ALONSO
Cc: cad1erline BUSSER; Matthew J W KING; Michael P OROHINEGAN
Subject: Re: GMO Business in LATAM

Emillion,

I fully acknowledge the level of priority and focus that you and the team have given to these issues and
the ongoing work that has been initiated previously by the Mexican and your team at HSBC. It is important
that this work be fully updated and not become one of the many that has been slowed down.
It is important because the issues does not signify that we take the view that there has
been no transparent response. For example US has been rated not on some categories of risk in the
GAC risk map because of inherent risk.

The level for the rating is however:

The inherent AML risk in Mexico is still very high and there are not many other parts of the Group that
have been effectively addressed. We have been canvassing on the ground and also have the risk posed by
potential drug and other operations by the US authorities. We have of course remediated the high risk
accounts, but the compliance with account-opening processes mean that we have overall lower levels of
AML across the customer base as a whole.

There are other countries within CA where we have ongoing remediation projects including Perú and
Central Asia where there is a similar AML risk where it is not yet clear to us that we have completed
the remediation of high risk accounts.

Happy to discuss further.

Regards

Catherine kept us fully updated and I am also aware of the work that CNBV has undertaken.
It is important that this work be fully updated and not become one of the
many that has been slowed.

Dear Chairman Levin:


At the hearing, I confirmed the OCC's support of the recommendations contained within the Subcommittee's staff report to strengthen our BSA/AML supervision. This letter provides you a brief update on the actions we have taken since that hearing to implement the report's recommendations.

On July 18, 2012, I notified all OCC staff of my commitment to adopt and implement the recommendations, and I described other changes we are making to enhance our supervisory process. As I stated at the hearing, it is my objective to promote an environment within the OCC that will empower our examiners to conduct effective BSA/AML examinations and escalate any findings of deficiencies to appropriate agency departments for action. A copy of my message to our staff is enclosed.

On August 1, 2012, we issued Supervisory Memorandum SM 2012-3, "Consideration of Bank Secrecy Act/Anti-Money Laundering (BSA/AML) Examination Findings in the Uniform Interagency Rating Systems and OCC's Risk Assessment System" to all examining personnel (copy enclosed). This memorandum provides that, effective July 18, 2012, the results of a BSA/AML examination are no longer considered under the Federal Financial Institutions Examination Council's (FFIEC) Uniform Interagency Consumer Compliance Rating System. Consistent with the Subcommittee's recommendation, OCC examiners are now required to incorporate BSA/AML examination findings as part of the Management component rating when determining bank ratings in accordance with the FFIEC Uniform Financial Institutions Rating System (CAMELS ratings). This guidance also clearly states our policy that a presumption exists that serious deficiencies in a bank's BSA/AML compliance area could adversely affect a bank's Management component rating.

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

September 20, 2012

The Honorable Carl Levin
Chairman
Permanent Subcommittee on Investigations
United States Senate
Washington, D.C. 20510

Dear Chairman Levin:


At the hearing, I confirmed the OCC's support of the recommendations contained within the Subcommittee's staff report to strengthen our BSA/AML supervision. This letter provides you a brief update on the actions we have taken since that hearing to implement the report's recommendations.

On July 18, 2012, I notified all OCC staff of my commitment to adopt and implement the recommendations, and I described other changes we are making to enhance our supervisory process. As I stated at the hearing, it is my objective to promote an environment within the OCC that will empower our examiners to conduct effective BSA/AML examinations and escalate any findings of deficiencies to appropriate agency departments for action. A copy of my message to our staff is enclosed.

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Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219
I also committed to revising and clarifying the operation of our cross-functional Large Bank Review Team. Pursuant to this commitment, we issued Supervisory Memorandum SM 2012-5, “Bank Secrecy Act Large Bank Review Team Structure and Operation” that more clearly defines the mission, membership, organizational structure and functions of the Large Bank Review Team. This guidance implements our policy designed to ensure that appropriate steps are taken in a timely fashion to address BSA/AML deficiencies identified in national banks and federal savings associations and includes provisions to ensure that I and the OCC’s Executive Committee are briefed on the Review Team’s activities on a regular basis.

Furthermore, I directed the OCC’s Committee on Bank Supervision and Ombudsman Office to develop a process that will provide examiners with a mechanism to appeal a supervisory issue directly to me. I have reviewed their recommendations and the internal appeals process will commence on October 1, 2012.

Finally, we are in the process of drafting policies and procedures for citation of violations in components of a bank’s BSA compliance program. We agree with the Subcommittee’s recommendation that this flexibility will provide our examiners another mechanism to address weaknesses and violations related to compliance program components.

Compliance with BSA/AML is a safety and soundness issue and a matter of national security. Under my leadership, the OCC will continue to implement the needed changes to ensure the safety and soundness and integrity of the U.S. financial system.

We would be happy to provide additional information about our continued progress in implementing the Subcommittee’s recommendations, should that be helpful. Please feel free to have your staff contact Carrie Moore, Director for Congressional Liaison, at 202-874-4844, to arrange such a briefing.

Sincerely,

Thomas J. Davies
Comptroller of the Currency

Enclosures
To: All OCC Employees  
From: Thomas J. Curry  
Date: July 18, 2012  
Subject: Lessons From Our Experience With HSBC

On July 17, Deputy Chief Counsel Dan Stipano and Grace Bailey from Large Bank Supervision joined me in testifying before the Senate’s Permanent Subcommittee on Investigations regarding our supervision of HSBC Bank USA, N.A., and its BSA/AML program. The hearing followed a year-long investigation by the subcommittee into BSA/AML failures at HSBC. I want to thank the dozens of OCC team members who participated in interviews during the investigation and helped prepare Grace, Dan, and me for the hearing.

There are important lessons from this experience that we must use to improve our supervision of BSA/AML issues. BSA/AML is more than just a compliance issue. It is an issue of safety and soundness and a matter of national security. As the investigation showed, we could have and should have acted sooner. We must be vigilant in banks and savings associations of every size.

To enhance our supervision of BSA/AML across all of the banks we supervise, we embrace the three recommendations from the subcommittee’s report. Interim guidance on implementing these recommendations will be provided shortly, to be followed by revisions to our examination policies and procedures.

First, effective immediately we will no longer reflect BSA/AML findings in the “compliance” rating, rather we will fully consider BSA/AML findings in a safety and soundness context as part of the “management” component of a bank’s CAMELS rating. Examiners should presume that serious deficiencies in a bank’s BSA/AML compliance area adversely affect a bank’s management component rating.

Second, we are clarifying the operation of our Large Bank BSA Review Team to ensure we bring different perspectives to bear and react more quickly when a bank has multiple matters requiring attention, or apparent violations of its BSA/AML program. We will also explore how we track and review relevant information and whether additional initiatives are appropriate.
Third, we will provide more flexibility for citing BSA/AML violations for individual "pillar" violations, and we will identify what steps we can take in our examinations to obtain a holistic view of a bank's BSA/AML compliance more promptly. In implementing these changes, we must take care not to create disincentives to making the tough calls. That is fundamentally our job.

More generally, we will also review training, staffing, recruitment, policies, and interagency coordination to make improvements in our BSA/AML supervision program.

Finally, we must foster a culture that encourages people to speak up about weakness at the banks we supervise and to escalate those views for action.

Ours is a difficult and important mission. I am proud to be part of this team of dedicated professionals, and I appreciate the extraordinary effort of everyone working to ensure that the financial institutions we supervise operate in a safe, sound, and fair manner.

My oral statement and testimony are available on OCC.gov.

http://domino.o2.occapps/pa/occnews.xm/0%493444cf0568d13b2852570ab007756d/13b54e24_36/2012
PS: OCC-45-0054
SUPERVISORY MEMORANDUM

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

To: All Examining Personnel

From: Committee on Bank Supervision

Date: August 1, 2012

Subject: Consideration of Bank Secrecy Act/Anti-Money Laundering Examination Findings in the Uniform Interagency Rating Systems and OCC's Risk Assessment System

This memorandum provides interim guidance for incorporating Bank Secrecy Act/Anti-Money Laundering (BSA/AML) examination findings into the CAMELS ratings and the OCC's risk assessment system (RAS) assigned to national banks and federal savings associations (collectively, banks). This guidance also applies to federal branches and agencies of foreign banking organizations.

Consumer Compliance Rating

Effective July 18, 2012, the results of a BSA/AML examination are no longer to be considered when assigning a rating under the Federal Financial Institutions Examination Council's (FFIEC) Uniform Interagency Consumer Compliance Rating System.

Management Component Rating

In keeping with current policy, examiners must consider BSA/AML examination findings in a safety and soundness context as a part of the management component of a bank’s FFIEC Uniform Financial Institutions Rating System (CAMELS ratings). For federal branches and agencies, BSA/AML examination findings must be considered as part of the risk management component of the ROCA rating system. Examination procedures used to evaluate the adequacy of a bank’s BSA/AML compliance remain unchanged.


2 ROCA stands for Risk management, Operational controls, Compliance, and Asset quality.
In addition, serious deficiencies in a bank’s BSA/AML compliance area will create a presumption that the bank’s management component rating will be adversely affected. For example, significant deficiencies in a bank’s compliance with BSA/AML that result in an overall BSA compliance program violation3 would reflect risk management practices that are less than satisfactory and would generally warrant a management rating of “3.” Other adverse BSA/AML findings, such as those resulting in “Matters Requiring Attention” (MRA) or less severe enforcement actions, may also negatively affect a bank’s management component rating, depending on the circumstances. This may be the case, for example, when a bank has BSA/AML-related MRAs across several lines of business. If, however, management is already deemed in need of improvement and risk management practices are deemed less than satisfactory as reflected in a “3” management rating, a further downgrade in the rating as a result of BSA/AML deficiencies may not be warranted. On the other hand, for those situations that raise greater supervisory concerns, a downgrade of the management component beyond a “3” may be appropriate. Notwithstanding the circumstances, the support for the management rating should be fully documented in the appropriate supervisory system. In addition, examiners should be alert to situations in which management weaknesses identified in other areas of a bank reveal potential deficiencies in BSA/AML program oversight.

Risk Assessment System

While examiners will no longer consider BSA/AML examination findings as a part of the interagency consumer compliance rating, BSA/AML findings are still considered as a part of compliance risk under the OCC’s RAS. Compliance risk considers a bank’s compliance with all applicable laws and regulations. The overall quantity of risk and quality of risk management related to BSA/AML compliance as well as the four pillars of a bank’s BSA/AML program are considered in assessments of compliance risk. BSA/AML examination findings should also continue to be reflected in the OCC’s assessments of reputation, strategic, and operational risks, as applicable.

The Committee on Bank Supervision expects to incorporate this guidance into revisions of the “Bank Supervision Process,” “Large Bank Supervision,” and “Community Bank Supervision” booklets of the Comptroller’s Handbook—and other guidance and systems, as needed—by September 2012.

3 Overall BSA compliance program violations are citations of 12 CFR 21.21 for national banks or 12 CFR 401.177 for federal savings associations. These violations are cited for deficiencies that render the BSA compliance program ineffective when viewed as a whole and result in the issuance of a cease and desist order.

-2-
SUPERVISORY MEMORANDUM

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

To: All Examining Personnel

From: Committee on Bank Supervision

Date: August 17, 2012

Subject: Bank Secrecy Act Large Bank Review Team Structure and Operation

The Office of the Comptroller of the Currency (OCC) established a cross-functional Large Bank Review Team (LB Review Team) to ensure bank supervision and enforcement consistency in the area of Bank Secrecy Act/Anti-Money Laundering (BSA/AML) compliance. The LB Review Team is also part of the OCC’s “Process for Taking Administrative Enforcement Actions Against Banks Based on BSA Violations,” as outlined in OCC Bulletin 2005-45, which states that potential BSA compliance program violations are to be considered by a review group.

The LB Review Team comprises the Director of the Enforcement and Compliance Division, the Senior Counsel for BSA/AML, the Director for BSA/AML Compliance Policy, and the Midsize Bank Supervision Risk Officer. The team’s objective is to provide expert input into the supervisory process and develop recommendations to promote and ensure consistency in BSA compliance and enforcement across the LB population.

To this end, the LB Review Team:

• reviews and provides written comments, recommendations, and conclusions in a timely manner on all draft supervisory letters and conclusion memoranda related to LB BSA/AML and Office of Foreign Assets Control (OFAC) matters to ensure they are consistent with OCC policy,
• reviews all proposed LB BSA/AML and OFAC enforcement actions and terminations to ensure they are well-supported and consistent with the “Statement on Enforcement of Bank Secrecy Act/Anti-Money Laundering Requirements” as well as with the OCC’s “Process for Taking Administrative Enforcement Actions Against Banks Based on BSA Violations” and other applicable guidance,
• makes reasonable efforts to resolve in a timely manner any disagreements that may arise with LB Supervision on BSA/AML and OFAC-related matters,
• reports on its activities to the Comptroller and Executive Committee on a regular basis.

1 The BSA enforcement process set forth in OCC Bulletin 2005-45 has not yet been formally applied to federal savings associations through rulemaking procedures, however, the OCC applies the process for both national banks and federal savings associations.

PSL-OCC-44-000007
Accordingly, LB Supervision:

- provides the LB Review Team with complete and timely BSA supervisory letters and conclusion memoranda, including relevant BSA/AML/OFAC "Matters Requiring Attention."
- incorporates LB Review Team comments, recommendations, and conclusions into supervisory letters and conclusion memoranda, making reasonable efforts to resolve in a timely manner any disagreements that may arise with the LB Review Team.
- provides the LB Review Team with written explanations of any disagreements with its comments, recommendations, and conclusions.
- provides the LB Review Team with final copies of the supervisory letters upon issuance to the bank and the final version of the conclusion memoranda upon completion.

If agreement cannot be reached between the LB Review Team and LB Supervision, the matter will be referred to the Committee on Bank Supervision (the Senior Deputy Comptroller for LB Supervision, Middle and Community Bank Supervision, and the Chief National Bank Examiner), the Chief of Staff, and the Senior Deputy Comptroller and Chief Counsel (collectively, "the Committee"). If agreement cannot be reached by the Committee, the Senior Deputy Comptroller for LB Supervision will consult with the Comptroller, who may elect to decide the matter under the May 10, 2012, delegation of authority.
Comptroller of the Currency
Administrator of National Banks
Washington, DC 20219

September 20, 2012

The Honorable Tom Coburn
Ranking Member
Permanent Subcommittee on Investigations
United States Senate
Washington D.C. 20510

Dear Ranking Member Coburn:


At the hearing, I confirmed the OCC’s support of the recommendations contained within the Subcommittee’s staff report to strengthen our BSA/AML supervision. This letter provides you a brief update on the actions we have taken since that hearing to implement the report’s recommendations.

On July 18, 2012, I notified all OCC staff of my commitment to adopt and implement the recommendations, and I described other changes we are making to enhance our supervisory process. As I stated at the hearing, it is my objective to promote an environment within the OCC that will empower our examiners to conduct effective BSA/AML examinations and escalate any findings of deficiencies to appropriate agency departments for action. A copy of my message to our staff is enclosed.

On August 1, 2012, we issued Supervisory Memorandum SM 2012-3, “Consideration of Bank Secrecy Act/Anti-Money Laundering (BSA/AML) Examination Findings in the Uniform Interagency Rating Systems and OCC’s Risk Assessment System” to all examining personnel (copy enclosed). This memorandum provides that, effective July 18, 2012, the results of a BSA/AML examination are no longer considered under the Federal Financial Institutions Examination Council’s (FFIEC) Uniform Interagency Consumer Compliance Rating System. Consistent with the Subcommittee’s recommendation, OCC examiners are now required to incorporate BSA/AML examination findings as part of the Management component rating when determining bank ratings in accordance with the FFIEC Uniform Financial Institutions Rating System (CAMELS ratings). This guidance also clearly states our policy that a presumption exists that serious deficiencies in a bank’s BSA/AML compliance area could adversely affect a bank’s Management component rating.

PSI-OCC-45-033239
I also committed to revising and clarifying the operation of our cross-functional Large Bank Review Team. Pursuant to this commitment, we issued Supervisory Memorandum SM 2012-5, "Bank Secrecy Act Large Bank Review Team Structure and Operation," that more closely defines the mission, membership, organizational structure and functions of the Large Bank Review Team. This guidance implements our policy designed to ensure that appropriate steps are taken in a timely fashion to address BSA/AML deficiencies identified in national banks and federal savings associations and includes provisions to ensure that I and the OCC's Executive Committee are briefed on the Review Team's activities on a regular basis.

Furthermore, I directed the OCC’s Committee on Bank Supervision and Ombudsman Office to develop a process that will provide examiners with a mechanism to appeal a supervisory issue directly to me. I have reviewed their recommendations and the internal appeals process will commence on October 1, 2012.

Finally, we are in the process of drafting policies and procedures for citation of violations in components of a bank’s BSA compliance program. We agree with the Subcommittee’s recommendation that this flexibility will provide our examiners another mechanism to address weaknesses and violations related to compliance program components.

Compliance with BSA/AML is a safety and soundness issue and a matter of national security. Under my leadership, the OCC will continue to implement the needed changes to ensure the safety and soundness and integrity of the U.S. financial system.

We would be happy to provide additional information about our continued progress in implementing the Subcommittee’s recommendations, should that be helpful. Please feel free to have your staff contact Carrie Moore, Director for Congressional Liaison, at 202-874-4844, to arrange such a briefing.

Sincerely,

Thomas J. Curry
Comptroller of the Currency

Examiners
To: All OCC Employees
From: Thomas J. Curry
Date: July 18, 2012
Subject: Lessons From Our Experience With HSBC

On July 17, Deputy Chief Counsel Dan Stipano and Grace Dailey from Large Bank Supervision joined me in testifying before the Senate’s Permanent Subcommittee on Investigations regarding our supervision of HSBC Bank USA, N.A., and its BSA/AML program. The hearing followed a year-long investigation by the subcommittee into BSA/AML failures at HSBC. I want to thank the dozens of OCC team members who participated in interviews during the investigation and helped prepare Grace, Dan, and me for the hearing.

There are important lessons from this experience that we must use to improve our supervision of BSA/AML issues. BSA/AML is more than just a compliance issue. It is an issue of safety and soundness and a matter of national security. As the investigation showed, we could have and should have acted sooner. We must be vigilant in banks and savings associations of every size.

To enhance our supervision of BSA/AML across all of the banks we supervise, we embrace the three recommendations from the subcommittee’s report. Interim guidance on implementing these recommendations will be provided shortly, to be followed by revisions to our examination policies and procedures.

First, effective immediately we will no longer reflect BSA/AML findings in the "compliance" rating, rather we will fully consider BSA/AML findings in a safety and soundness context as part of the "management" component of a bank’s CAMELS rating. Examiners should presume that serious deficiencies in a bank’s BSA/AML compliance area adversely affect a bank’s management component rating.

Second, we are clarifying the operation of our Large Bank BSA Review Team to ensure we bring different perspectives to bear and react more quickly when a bank has multiple matters requiring attention, or apparent violations of its BSA/AML program. We will also explore how we track and review relevant information and whether additional initiatives are appropriate.

http://domains02.occapps/occnews.z6iff/039d48fd9f122852570b0b00725ef0334654a24_08072012_08072012

http://occnews.z6iff/039d48fd9f122852570b0b00725ef0334654a24_08072012_08072012

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Third, we will provide more flexibility for citing BSA/AML violations for individual "pillar" violations, and we will identify what steps we can take in our examinations to obtain a holistic view of a bank's BSA/AML compliance more promptly. In implementing these changes, we must take care not to create disincentives to making the tough calls. That is fundamentally our job.

More generally, we will also review training, staffing, recruitment, policies, and interagency coordination to make improvements in our BSA/AML supervision program.

Finally, we must foster a culture that encourages people to speak up about weakness at the banks we supervise and to escalate those views for action.

Ours is a difficult and important mission. I am proud to be part of this team of dedicated professionals, and I appreciate the extraordinary effort of everyone working to ensure that the financial institutions we supervise operate in a safe, sound, and fair manner.

My oral statement and testimony are available on OCC.gov.
SUPERVISORY MEMORANDUM

Comptroller of the Currency
Administrator of national banks

Washington, DC 20219

To: All Examining Personnel

From: Committee on Bank Supervision

Date: August 1, 2012

Subject: Consideration of Bank Secrecy Act/Anti-Money Laundering Examination Findings in the Uniform Interagency Rating Systems and OCC’s Risk Assessment System

This memorandum provides interim guidance for incorporating Bank Secrecy Act/Anti-Money Laundering (BSA/AML) examination findings into the CAMELS ratings and the OCC’s risk assessment system (RAS) assigned to national banks and federal savings associations (collectively, banks). This guidance also applies to federal branches and agencies of foreign banking organizations.

Consumer Compliance Rating
Effective July 18, 2012, the results of a BSA/AML examination are no longer to be considered when assigning a rating under the Federal Financial Institutions Examination Council’s (FFIEC) Uniform Interagency Consumer Compliance Rating System.

Management Component Rating
In keeping with current policy, examiners must consider BSA/AML examination findings in a safety and soundness context as a part of the management component of a bank’s FFIEC Uniform Financial Institutions Rating System (CAMELS ratings). For federal branches and agencies, BSA/AML examination findings must be considered as part of the risk management component of the ROCA rating system. Examination procedures used to evaluate the adequacy of a bank’s BSA/AML compliance remain unchanged.


ROCA stands for Risk management, Operational controls, Compliance, and Asset quality.

PSI:OCC-454000013
In addition, serious deficiencies in a bank's BSA/AML compliance area will create a presumption that the bank's management component rating will be adversely affected. For example, significant deficiencies in a bank's compliance with BSA/AML that result in an overall BSA compliance program violation would reflect risk management practices that are less than satisfactory and would generally warrant a management rating of "3." Other adverse BSA/AML findings, such as those resulting in "Matters Requiring Attention" (MRA) or less severe enforcement actions, may also negatively affect a bank's management component rating, depending on the circumstances. This may be the case, for example, when a bank has BSA/AML-related MRAs across several lines of business. If, however, management is already deemed in need of improvement and risk management practices are deemed less than satisfactory as reflected in a "3" management rating, a further downgrade in the rating as a result of BSA/AML deficiencies may not be warranted. On the other hand, for those situations that raise greater supervisory concerns, a downgrade of the management component beyond a "3" may be appropriate. Notwithstanding the circumstances, the support for the management rating should be fully documented in the appropriate supervisory system. In addition, examiners should be alert to situations in which management weaknesses identified in other areas of a bank reveal potential deficiencies in BSA/AML program oversight.

Risk Assessment System

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The Committee on Bank Supervision expects to incorporate this guidance into revisions of the "Bank Supervision Process," "Large Bank Supervision," and "Community Bank Supervision" booklet of the Comptroller's Handbook—and other guidance and systems, as needed—by September 2012.

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Overall, BSA/AML compliance program violations are citations of 12 CFR 21.20 for national banks or 12 CFR 183.177 for federal savings associations. These violations are cited for deficiencies that render the BSA/AML compliance program ineffective when viewed as a whole and result in the issuance of a cease and desist order.
SUPERVISORY MEMORANDUM

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

To: All Examining Personnel

From: Committee on Bank Supervision

Date: August 17, 2012

Subject: Bank Secrecy Act Large Bank Review Team Structure and Operation

The Office of the Comptroller of the Currency (OCC) established a cross-functional Large Bank Review Team (LB Review Team) to ensure basic supervision and enforcement consistency in the area of Bank Secrecy Act/Anti-Money Laundering (BSA/AML) compliance. The LB Review Team is also part of the OCC’s “Process for Taking Administrative Enforcement Actions Against Banks Based on BSA Violations,” as outlined in OCC Bulletin 2005-45, which states that potential BSA compliance program violations are to be considered by a review group.

The LB Review Team comprises the Director of the Enforcement and Compliance Division, the Senior Counsel for BSA/AML, the Director for BSA/AML Compliance Policy, and the Midsize Bank Supervision Risk Officer. The team’s objective is to provide expert input into the supervisory process and develop recommendations to promote and ensure consistency in BSA compliance and enforcement across the LB population.

To this end, the LB Review Team:

- reviews and provides written comments, recommendations, and conclusions in a timely manner on all draft supervisory letters and conclusion memoranda related to LB BSA/AML and Office of Foreign Assets Control (OFAC) matters to ensure they are consistent with OCC policy.
- reviews all proposed LB BSA/AML and OFAC enforcement actions and terminations to ensure they are well supported and consistent with the “Interagency Statement on Enforcement of Bank Secrecy Act/Anti-Money Laundering Requirements” as well as with the OCC’s “Process for Taking Administrative Enforcement Actions Against Banks Based on BSA Violations” and other applicable guidance.
- makes reasonable efforts to resolve any disagreements that may arise with LB Supervision on BSA/AML and OFAC-related matters.
- reports on its activities to the Comptroller and Executive Committee on a regular basis.

The BSA enforcement process set forth in OCC Bulletin 2005-45 has not yet been formally applied to federal savings associations through rescission procedures; however, the OCC applies this process for both national banks and federal savings associations.

PSL-OCC-45-2005-45
Accordingly, LB Supervision:

- provides the LB Review Team with complete and timely BSA supervisory letters and conclusion memoranda, including relevant BSA/AML/WAC "Matters Requiring Attention."
- incorporates LB Review Team comments, recommendations, and conclusions into supervisory letters and conclusion memoranda, making reasonable efforts to resolve in a timely manner any disagreements that may arise with the LB Review Team.
- provides the LB Review Team with written explanations of any disagreements with its comments, recommendations, and conclusions.
- provides the LB Review Team with final copies of the supervisory letters upon issuance to the bank and the final version of the conclusion memoranda upon completion.

If agreement cannot be reached between the LB Review Team and LB Supervision, the matter will be referred to the Committee on Bank Supervision (the Senior Deputy Comptrollers for LB Supervision, Midsize and Community Bank Supervision, and the Chief National Bank Examiner), the Chief of Staff, and the Senior Deputy Comptroller and Chief Counsel (collectively, "the Committee"). If agreement cannot be reached by the Committee, the Senior Deputy Comptroller for LB Supervision will consult with the Comptroller, who may elect to decide the matter under the May 10, 2012, delegation of authority.
By Hand and Electronic Email

Hon. Carl Levin, Chairman
Hon. Tom Coburn, Ranking Member
Permanent Subcommittee on Investigations
Committee on Homeland Security and Governmental Affairs
United States Senate
SR-199 Russell Senate Office Building
Washington, DC 20510

Dear Chairman Levin and Ranking Member Coburn:

Thank you for the opportunity to testify at the Subcommittee’s July 17, 2012 hearing and for the follow-up questions presented in your August 2, 2012 letter and during a call with the Subcommittee staff on August 22, 2012. Responses to those questions follow.

1. At the hearing, HSBC announced that HSBC would be closing all of its U.S. dollar Cayman Island accounts.
   a. Will HSBC also close the Cayman Island branch?

Yes.
b. Will some of the Cayman Island accounts, currently described as being serviced through the HSBC Cayman branch, be reopened as accounts at another unit within HSBC or within HSBC? If yes, where will these accounts be located?

All HSBC Mexico S.A. ("HMX") Cayman Island accounts will be closed. Customers who have USD accounts at HSBC's Cayman Island branch and also have peso accounts at HSBCX, may transfer their funds into their peso accounts at HSBCX when the Cayman Islands accounts are closed. Those who do not hold a peso account at HSBCX will receive a check or a transfer of their funds to an account that they designated. The designated account could be an already open account that the customer has at another HSBC affiliate. Additionally, USD Cayman Islands account holders whose accounts are closed will have the opportunity to open peso accounts at HSBCX subject to appropriate review and in compliance with established account-opening procedures.

Former HMX Cayman Island account holders may also seek to open new accounts at other HSBC affiliates, subject to Know Your Customer ("KYC") and other account-opening procedures.

c. Will HSBC continue to service any former Cayman Island clients? If yes, at what locations will these clients be serviced?

See answer to 1(b) above.

2. With regard to Rami Makhlouf (see pages 176 and 177 of the Subcommittee's report), please respond to the following:

a. Please provide the date when HSBC added Mr. Makhlouf’s name to its OFAC filter.

HSBC Bank USA, N.A. ("HSBC") added Mr. Makhlouf’s name to its OFAC filter on February 21, 2008, the same day he was designated by the U.S. Department of Treasury for corruption.

With respect to questions 2(b) and 2(c), we are working to provide relevant information consistent with local privacy laws.
3. On July 23, 2012, HBVMX paid a $28 million fine that had been imposed on the bank on November 7, 2011, by the CNBV, due to anti-money laundering deficiencies identified in 2007 and 2008. Please explain the deficiencies that served as the basis for the fine and why HBVMX did not pay the fine until July 2012.

The fine issued by CNBV resulted primarily from untimely filing of unusual transaction reports, all of which HBVMX ultimately filed with the proper authorities. In addition, CNBV identified deficiencies in HBVMX’s KYC records, periodic reviews of high-risk customers, systems for monitoring client profiles, and procedures for detection, analysis, and reporting of unusual transactions. Following the issuance of the fine in November 2011, HBVMX brought administrative litigation proceedings before the Federal Tax and Administrative Court (Sala Especializada en Resoluciones de Órganos Reguladores de la Actividad del Estado - Tribunal Federal de Justicia Fiscal y Administrativa) and indirect proceedings before the Tenth Administrative District Court for the Federal District (Juzgado Decimocuarto de Distrito en Materia Administrativa en el Distrito Federal) challenging the basis of some of the alleged underlying violations and the amount of the proposed fine. HBVMX, however, voluntarily paid the fine prior to resolution of those proceedings. CNBV made a series of recommendations with respect to identified deficiencies and has confirmed that HBVMX implemented them completely.

4. Please indicate whether and when HBUS has conducted a due diligence review of HBVMX, the nature of that review, and the results.

HBUS has conducted a KYC review of all of its HBUS affiliate customers, including HBVMX. As a correspondent banking customer, HBVMX was subject to enhanced due diligence ("EDD"). HBUS completed its initial KYC on HBVMX in September 2010, updated it in 2011, and remediated HBVMX KYC to HBUS’s new KYC standards in May 2012. In accordance with HBUS’s new KYC policy, the EDD review conducted with respect to HBVMX was a multi-step process that included, among other things: obtaining information concerning the countries where HBVMX has branches and subsidiaries; screening for negative news on the bank; inquiring about HBVMX’s banking relationships with other institutions and determining that none has closed HBVMX’s accounts in the last 5 years; obtaining information regarding the type of business HBVMX engages in and whether HBUS believes that business to be high risk; gathering information regarding any regulatory enforcement actions and fines; and gathering detailed information regarding HBVMX’s AML policies and procedures.
Furthermore, as recommended in the PSI’s July 17, 2012 report, HSBC has committed to undertaking an additional special review of the IIBUS relationship. Currently, the IIBUS Financial Intelligence Unit (“FIU”) is conducting an assessment of, among other things, the economic and security situation in Mexico, the risk associated with the banking services offered by IIBUS, funds flow in and out of Mexico by HSBC business line, reportable events and suspicious activity reports related to Mexico, and anti-money laundering processes and procedures at IIBUS. Once its assessment is complete, the FIU will issue a report for consideration by HSBC senior management.

5. Please provide the date or anticipated date on which affiliates will begin sharing information with one another and the process by which that will be accomplished.

HSBC has taken steps to enhance information sharing between affiliates. Earlier this year, the new Steering Committee on Global Standards, which I co-chair along with Chief Risk Officer Marc Moses, enacted a new global standard to maximize the sharing of information, to the extent permitted by law, across all HSBC affiliates and all Global Businesses and Functions for risk management purposes. Under this standard, the following enhancements to information sharing have been made:

- HSBC is creating an internal Intranet site to facilitate the sharing of Compliance Assurance reports—which provide a summary of the status of material AML and compliance issues in regions and business lines—automatically on a monthly basis. All Regional and Global Business Compliance heads will have access to the reports on this Intranet site, which is anticipated to be operational by the end of September this year.

- Compliance Assurance team reports produced after on-the-ground reviews of specific Regional Compliance functions have mandatory distribution to the Regional CEO, Regional CRO, local compliance, and Group Chief Risk Officer.

- HSBC is making changes to its Group Compliance reporting system to allow any material or systemic AML control weakness at any affiliate that is reported by the Regional and Global Business Compliance heads to be viewed by all other Regional and Global Business Compliance heads. These changes are expected to be operational by the end of September this year.
Over the course of the last year, HSBC has made its Risk Management meetings more effective forums for sharing detailed information about risks and other information among affiliates. Among other things, attendees look at a “Risk Map” that identifies risks across the Group, including AMI risk. Regional and Global Business heads must take the information they receive at the meetings back to their Compliance and Risk teams.

HSBC will continue to look for additional opportunities to increase the flow of information throughout the Group.

6. Please provide the names of the HSBC affiliates located in tax havens where jurisdictional differences preclude the sharing of information. Please provide additional detail on relevant privacy restrictions to information-sharing.

The Bank is not aware of a single, universally agreed-upon list of tax havens. However, the Stop Tax Haven Abuse Act (S. 641), introduced by Chairman Levin in 2007, contains a list of 34 “offshore secrecy jurisdictions,” which have been identified publicly as such by the Internal Revenue Service in federal court proceedings. The S. 641 list provides the basis for this response. From the S. 641 list, HSBC has offices in: Bahamas, Bermuda, British Virgin Islands, Cayman Islands, Cook Islands, Costa Rica, Northern Cyprus, Guernsey, Hong Kong, Isle of Man, Jersey, Luxembourg, Malta, Panama, Singapore, and Switzerland. We are compiling a list of citations to the applicable laws in these jurisdictions that we will send to the Subcommittee.

a. Please describe what actions HSBC will take if one of these affiliates does not provide requested information.

HSBC performs KYC on each of its customers, including its affiliates. In the course of the KYC process, HSBC requests and maintains a significant amount of information relating to all of its customers. This information is collected for multiple purposes, and the consequences of a particular customer’s failure to provide requested information will depend on the context. Importantly, HSBC treats its affiliate customers the same as any other third-party customer. Where an affiliate fails to provide requested information after diligent inquiry by HSBC, HSBC will escalate the matter to Group, and as HSBC CEO Irene Dijk testified at the PSI’s July 17, 2012 hearing, where an affiliate fails to provide sufficient KYC information, HSBC “would have no hesitation in not opening the account or indeed closing an account.”

PS:HSBCJAH-000605
7. With regard to bearer share accounts, please provide the number of clients for whom a waiver was granted, from January 1, 2008 to the present, from any HSBC due diligence, beneficial ownership, or anti-money laundering requirement, the nature of the waiver granted, the date on which the waiver was granted, and who granted the waiver.

As the Committee is aware, accounts of bearer share corporations (“bearer share accounts”) were most likely to be held with the private banking entities—the Private Bank International in Miami and the International Private Bank in New York (collectively, “Private Bank America”). With regard to bearer share accounts held at Private Bank America, the Bank is not aware of any waiver granted, on or after January 1, 2008, from any of the due diligence, beneficial ownership, or anti-money laundering requirements in the applicable bearer share policy. The Bank is also undertaking a review to determine if there are bearer share accounts in other HSBC North America Holdings, Inc. (“HNAI”) business units. If any are identified, they will be subject to prompt remediation in conformance with HNAI policy.

* * *

Thank you for the opportunity to provide this response.

Sincerely,

[Signature]
HSBC Chief Legal Officer

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PO: HSBC-08-00005
September 25, 2012

Be Hand and Electronic Email

Hon. Carl Levin, Chairman
Hon. Tom Coburn, Ranking Member
Permanent Subcommittee on Investigations
Committee on Homeland Security and Governmental Affairs
United States Senate
SR-199 Russell Senate Office Building
Washington, DC 20510

Dear Chairman Levin and Ranking Member Coburn:

Thank you again for the opportunity to testify at the Subcommittee's July 17, 2012 hearing and for the follow-up questions presented in your August 2, 2012 letter. Responses to questions 2(a) - (f) follow:

* * * * *

2. With respect to bank Makkouk’s pages 176 and 177 of the Subcommittee’s report, please respond to the following:

a. Please provide the date when HSBC added Mr. Makkouk’s name to its OFAC filter.

HSBC Bank USA, N.A. (“HSBC”) added Mr. Makkouk’s name to its OFAC filter on February 21, 2010, the same day he was designated by the U.S. Department of Treasury for corruption.

b. What was the approximate maximum amount of funds in the HSBC Cayman Island account that was opened in the name of the trust benefiting Mr. Makkouk?

...
As reflected in documents available in the U.S. that have been produced to the Subcommittee (HSBC OCC 016053), the trust benefiting Mr. Makhlouf was administered by HSBC Geneva (HSBC Cayman did not maintain an account for any trust benefiting Mr. Makhlouf). We are not able to provide the information requested because relevant privacy laws restrict HSBC’s ability to discuss confidential client information.

c. Is that account or any other HSBC account benefiting Mr. Makhlouf still open? If yes, please identify the HSBC affiliate where each such account is located, and indicate whether and when that account has been frozen.

As described above, the trust benefiting Mr. Makhlouf was administered by HSBC Geneva. Mr. Makhlouf was removed as a beneficiary of the trust after his February 21, 2008 designation by the U.S. Department of Treasury for corruption.

Current privacy laws restrict HSBC’s ability to discuss confidential client information in specific jurisdictions. HSBC is committed to complying with applicable sanctions and where accounts are subject to sanctions, HSBC’s policy is to freeze accounts as required.

Additionally, HSBC does not hold any accounts by or for the benefit of Mr. Makhlouf in countries where sanctions do not apply.

d. What HSBC Cayman Islands raised concerns with regard to Mr. Makhlouf’s accounts in 2007?

As reflected in documents available in the U.S. that have been produced to the Subcommittee (HSBC OCC 016053), HSBC Cayman raised questions about the appropriateness of the relationship with Mr. Makhlouf in August 2007, prior to the sanctioning of Mr. Makhlouf in any jurisdiction. HSBC Cayman’s concerns were based on media coverage regarding the Makhlouf family. After Mr. Makhlouf’s designation by the U.S. Department of Treasury for corruption on February 21, 2008, he was removed as a beneficiary of the trust.

What steps did HSBC Group take to address those concerns?

HSBC Group Compliance, Risk, Security, and the relevant business conferred and worked together to assess the relationship.

cont’d ...
iii. Who at HSBC Group was responsible for making a determination about this account?

As explained above, different parts of HSBC Group, including, among others, Compliance, Risk, and Security, and the relevant business were involved.

iv. Why did HSBC allow an international terrorist to maintain an account with the bank?

As referenced above, Mr. Makhloof was designated by the U.S. Department of Treasury for corruption and was added to OFAC's SUDR List on the same day. HSBC is committed to complying with applicable sanctions and where accounts are subject to sanctions.

HSBC's policy is to freeze accounts as required. HSBC is moving to implement a new global sanctions policy under which HSBC will screen for key illicit actors designated by OFAC in all jurisdictions, in all currencies.

* * *

Thank you for the opportunity to provide this response.

Sincerely,

[Signature]

Stuart Levy
HSBC Chief Legal Officer

PSA:HSBC-01-000003