❑ CORRESPONDENT BANKING: A GATEWAY FOR MONEY LAUNDERING

By Linda Gustitus, Elise Bean, and Robert Roach, Democratic Staff, Permanent Subcommittee on Investigations, Committee on Governmental Affairs, U.S. Senate

The Democratic staff of the U.S. Senate Permanent Subcommittee on Investigations, under the leadership of Senator Carl Levin, conducted a year-long investigation of correspondent banking and its use as a tool for laundering money. The staff's investigation led them to conclude that allowing high-risk foreign banks and their criminal clients access to U.S. correspondent bank accounts, among several negative impacts, "facilitates crime" and "undermines the U.S. financial system." In their view: "It is time for U.S. banks to shut the door to high-risk foreign banks and eliminate other abuses of the U.S. correspondent banking system."

During a series of hearings held in February and March, Senator Susan Collins, the Republican chairwoman of the subcommittee, expressed her concern about the lapses in the banking indusry revealed in the report. The hearings represented an early step in a long process where the proposals contained here, and others yet to be submitted, may be the basis for future legislative remedy and self-corrective action by the banking industry.

The staff's findings are summarized in the report "Correspondent Banking: A Gateway for Money Laundering," which was issued in February 2001 and is adapted here.

U.S. banks, through the correspondent accounts they provide to foreign banks, have become conduits for "dirty money" flowing into the American financial system and have, as a result, facilitated illicit enterprises, including drug trafficking and financial frauds. Correspondent banking involves one bank's providing services to another bank to move funds, exchange currencies, or carry out other financial transactions. Foreign banks can establish U.S. correspondent accounts with any bank that is authorized to conduct banking activity in the United States, whether or not the bank's parent company is domiciled here. These accounts give the owners and clients of poorly regulated, poorly managed, sometimes corrupt, foreign banks that have weak or no anti-money-laundering controls direct access to the U.S. financial system and the freedom to move money within the United States and around the world.

Many banks in the United States have established correspondent relationships with high-risk foreign banks. These foreign banks can be: (1) shell banks with no physical presence in any country for conducting business with their clients, (2) offshore banks with licenses limited to transacting business with persons outside the licensing jurisdiction, or (3) banks licensed and regulated by jurisdictions with weak anti-money-laundering controls that invite banking abuses and criminal misconduct. Some of these foreign banks are engaged in criminal behavior, some have clients who are engaged in criminal behavior, and some have such poor anti-money-laundering controls that they do not know whether or not their clients are engaged in criminal behavior.

These high-risk foreign banks typically have limited resources and staff, and they use their correspondent bank accounts to conduct operations, provide client services, and move funds. Many of the banks reviewed by the subcommittee deposit all of their funds in, and complete virtually all transactions through, their correspondent accounts, making correspondent banking integral to their operations. Once a correspondent account is open in a U.S. bank, not only the foreign bank but also its clients can transact business through the U.S. bank.

THE PITFALLS OF CORRESPONDENT RELATIONSHIPS

The industry norm today is for U.S. banks to have dozens, hundreds, or even thousands of correspondent relationships, including a number of relationships with high-risk foreign banks. Virtually every U.S. bank examined in the minority staff investigation had accounts with offshore banks, and some had relationships with shell banks.

In many cases, high-risk foreign banks have been able to open correspondent accounts at U.S. banks and conduct

their operations through these accounts because U.S. banks fail to adequately screen and monitor foreign banks as clients.

The prevailing principle among U.S. banks has been that any bank holding a valid license issued by a foreign jurisdiction qualifies for a correspondent account because U.S. banks should be able to rely on the foreign banking license as proof of the foreign bank's good standing. U.S. banks have too often failed to conduct careful due diligence reviews of their foreign bank clients, including obtaining information on the foreign bank's management, finances, reputation, regulatory environment, and anti-money-laundering efforts.

The frequency of U.S. correspondent relationships with high-risk banks, as well as a host of troubling case histories uncovered by the minority staff investigation, belie banking industry assertions that existing policies and practices are sufficient to prevent money laundering in the correspondent banking field. For example, several U.S. banks were unaware that they were servicing foreign banks that had no office in any location, were operating in a jurisdiction where the bank had no license to operate, had never undergone a bank examination by a regulator, or were using U.S. correspondent accounts to facilitate crime.

In other cases, U.S. banks did not know that their client banks lacked basic fiscal controls and procedures and would open accounts without any account-opening documentation, would accept deposits directed to persons unknown to the bank, or would operate without written anti-money-laundering procedures. There are still other cases in which U.S. banks lacked information about the extent to which respondent banks had been named in criminal or civil proceedings involving money laundering or other wrongdoing.

U.S. banks' ongoing anti-money-laundering oversight of their correspondent accounts is often weak or ineffective. A few large banks have developed automated monitoring systems that detect and report suspicious account patterns and wire-transfer activity, but they appear to be the exception rather than the rule. Most U.S. banks appear to rely on manual reviews of account activity and to conduct limited oversight of wire transfers, even though the majority of correspondent bank transactions consist of incoming and outgoing wire transfers. And even when suspicious transactions or negative press reports about a respondent bank come to the attention of a U.S. correspondent bank, in too many cases the information does not result in a serious review of the relationship or concrete actions to prevent money laundering.

FAILURES OF DUE DILIGENCE REVIEWS

Two due diligence failures by U.S. banks are particularly noteworthy. The first is the failure of U.S. banks to determine the extent to which their foreign bank clients are allowing other foreign banks to use their U.S. accounts. On numerous occasions, high-risk foreign banks gained access to the U.S. financial system not by opening their own U.S. correspondent accounts, but by operating through U.S. correspondent accounts belonging to other foreign banks.

U.S. banks rarely ask their client banks about their correspondent practices and, in almost all cases, remain unaware of their respondent bank's own correspondent accounts. In several instances, U.S. banks were surprised to learn from minority staff investigators that they were providing wire-transfer services or handling Internet gambling deposits for foreign banks they had never heard of and with whom they had no direct relationship. In one instance, an offshore bank was allowing at least a half dozen offshore shell banks to use its U.S. accounts. In another, a U.S. bank discovered by chance that a high-risk foreign bank it would not have accepted as a client was using a correspondent account the U.S. bank had opened for another foreign bank.

The second failure is the distinction U.S. banks make in their due diligence practices between foreign banks that have few assets and no credit relationship, and foreign banks that seek or obtain credit from the U.S. bank. If a U.S. bank extends credit to a foreign bank, it usually will evaluate the foreign bank's management, finances, business activities, reputation, regulatory environment, and operating procedures. The same evaluation usually does not occur where there are only fee-based services, such as wire transfers or check clearing. Since U.S. banks usually provide cash management services on a fee-for-service basis to high-risk foreign banks and infrequently extend credit, U.S. banks have routinely opened and maintained correspondent accounts for these banks based on inadequate due diligence reviews. Yet these are the very banks that should be carefully scrutinized. Under current practice in the United States, high-risk foreign banks in non-credit relationships seem to fly under the radar screen of most U.S. banks' anti-money-laundering programs.

These due diligence failures have made the U.S. correspondent banking system a conduit for criminal proceeds and money laundering for both high-risk foreign banks and their criminal clients. Of the 10 case histories investigated by the minority staff, numerous instances of money laundering through foreign banks' U.S. bank accounts were documented, including:

• Laundering illicit proceeds and facilitating crime by accepting deposits or processing wire transfers involving funds that the high-risk foreign bank knew or should have known were associated with drug trafficking, financial fraud, or other wrongdoing.

• Conducting high-yield investment scams by convincing investors to wire-transfer funds to the correspondent account to earn high returns, and then refusing to return any monies to the defrauded investors.

• Conducting advance-fee-for-loan scams by requiring loan applicants to wire-transfer large fees to the correspondent account, retaining the fees, and then failing to issue the loans.

• Facilitating tax evasion by accepting client deposits, co-mingling them with other funds in the foreign bank's correspondent account, and encouraging clients to rely on bank and corporate secrecy laws in the foreign bank's home jurisdiction to shield the funds from U.S. tax authorities.

• Facilitating Internet gambling, illegal under U.S. law, by using the correspondent account to accept and transfer gambling proceeds.

Allowing high-risk foreign banks and their criminal clients access to U.S. correspondent bank accounts facilitates crime, undermines the U.S. financial system, burdens U.S. taxpayers and consumers, and fills U.S. court dockets with criminal prosecutions and civil litigation by wronged parties. It is time for U.S. banks to shut the door to high-risk foreign banks and eliminate other abuses of the U.S. correspondent banking system.

SUMMARY OF CONCLUSIONS

The minority staff investigation of international correspondent banking for money laundering led to several conclusions:

• U.S. correspondent banking provides a significant gateway for rogue foreign banks and their criminal clients to carry on money laundering and other criminal activity in the United States and to benefit from the protections afforded by the safety and soundness of the U.S. banking industry.

• Shell banks, offshore banks, and banks in jurisdictions with weak anti-money-laundering controls carry high money laundering risks. Because these high-risk foreign banks typically have limited resources and staff and operate outside their licensing jurisdiction, they use their correspondent banking accounts to conduct their banking operations.

• Most U.S. banks do not have adequate anti-money-laundering safeguards in place to screen and monitor foreign banks that carry high money laundering risks. This problem is longstanding, widespread, and ongoing.

• U.S. banks are often unaware of legal actions related to money laundering, fraud, and drug trafficking that involve their current or prospective respondent banks.

• U.S. banks have particularly inadequate anti-money-laundering safeguards when a correspondent relationship does not involve credit-related services.

• High-risk foreign banks that are denied their own correspondent accounts at U.S. banks can obtain the same access to the U.S. financial system by opening correspondent accounts at a foreign bank that already has a U.S. bank account. U.S. banks have largely ignored or failed to address the money laundering risks associated with "nested" correspondent banking.

• In the last two years, some U.S. banks have begun to show concern about the vulnerability of their correspondent banking to money laundering and are taking steps to reduce the money laundering risks, but the steps are slow, incomplete, and not industry-wide.

• Foreign banks with U.S. correspondent accounts have special forfeiture protections in U.S. law that are not available to other U.S. bank accounts and that present additional legal barriers to efforts by U.S. law enforcement to seize illicit funds. In some instances, money launderers appear to be deliberately using correspondent accounts to hinder seizures by law enforcement, while foreign banks may be using the

"innocent bank" doctrine to shield themselves from the consequences of lax anti-money-laundering oversight.

• If U.S. correspondent banks were to close their doors to rogue foreign banks and to adequately screen and monitor high-risk foreign banks, the United States would reap significant benefits by eliminating a major money laundering mechanism, frustrating ongoing criminal activity, reducing illicit income fueling offshore banking, and denying criminals the ability to deposit illicit proceeds in U.S. banks with impunity and profit from the safety and soundness of the U.S. financial system.

RECOMMENDATIONS

The minority staff makes the following recommendations to reduce the use of U.S. correspondent banks for money laundering:

• U.S. banks should be barred from opening correspondent accounts with foreign banks that are shell operations with no physical presence in any country.

• U.S. banks should be required to use enhanced due diligence and heightened anti-money-laundering safeguards, as specified in guidance or regulations issued by the U.S. Treasury Department, before opening correspondent accounts with foreign banks that have offshore licenses or are licensed in jurisdictions identified by the United States as non-cooperative with international anti-money-laundering efforts.

• U.S. banks should conduct a systematic review of their correspondent accounts with foreign banks to identify high-risk banks and close accounts with problem banks. They should also strengthen their anti-money-laundering oversight, including by providing regular reviews of wire-transfer activity and providing training to correspondent bankers to recognize misconduct by foreign banks.

• U.S. banks should be required to identify a respondent bank's correspondent banking clients, and refuse to open accounts for respondent banks that would allow shell foreign banks or bearer share corporations to use their U.S. accounts.

• U.S. bank regulators and law enforcement officials should offer improved assistance to U.S. banks in identifying and evaluating high-risk foreign banks.

• The forfeiture protections in U.S. law should be amended to allow U.S. law enforcement officials to seize and extinguish claims to laundered funds in a foreign bank's U.S. correspondent account on the same basis as funds seized from other U.S. accounts.

Banking and anti-money-laundering experts repeatedly advised the minority staff during the investigation that U.S. banks should terminate their correspondent relationships with certain high-risk foreign banks, in particular, shell banks. They also advised that offshore banks and banks in countries with poor bank supervision, weak anti-money-laundering controls, and strict bank secrecy laws should be carefully scrutinized.

The minority staff believes that if U.S. banks terminate relationships with the small percentage of high-risk foreign banks that cause the greatest problems and tighten their anti-money-laundering controls in the correspondent banking area, they can eliminate the bulk of the correspondent banking problem at minimal cost. ❑

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