ROLE OF U.S. CORRESPONDENT BANKING IN INTERNATIONAL MONEY LAUNDERING

Exercise 1 - Material

HEARINGS

BEFORE THE

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

OF THE

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Mathewson indicated that Guardian Bank's major correspondents were Bank of New York, First Union in Miami, and Credit Suisse in Guernsey, with $1–$5 million on deposit at each bank at any given time. He said that when Guardian Bank was closed in early 1995, it had a total of about $150 million in its correspondent accounts. He estimated that, over 10 years of operation, about $300–$500 million had passed through Guardian Bank's correspondent accounts.

Mathewson said that Guardian Bank had used the services provided by its correspondent banks to provide its clients with a wide array of financial services, including checking accounts, credit cards, wire transfer services, loans and investments. He wrote, "The bank offered almost any service that a U.S. bank would offer, i.e., wire transfers, current accounts, certificates of deposit, the purchase of shares on any share market in the world, purchase of U.S. treasury bills, bonds, credit cards (Visa), and almost any investment that the client might wish." He explained that, while Guardian Bank itself lacked the resources, expertise and infrastructure needed to provide such services in-house, it easily afforded the fees charged by correspondent banks to provide these services for its clients.

Mathewson said that to ensure these correspondent services did not undermine Cayman secrecy protections, Guardian Bank had also developed a series of policies and procedures to minimize disclosure of client information.

Client Deposits. Mathewson said that one set of policies and procedures were designed to minimize documentation linking particular deposits to particular clients or accounts and to impede the tracing of individual client transactions. He said that Guardian Bank provided its clients with instructions on how to make deposits with either checks or wire transfers.

Client Deposits Through Checks. If a client wanted to use a check to make a deposit, Mathewson said, the client was advised to make the check payable to Guardian Bank; one of Guardian's subsidiaries—Fulcrum Ltd., Sentinel Ltd., or Tower Ltd.; or the client's own shelf corporation. He said the client was then instructed to wrap the check in a sheet of plain paper, and write their Guardian account number on the sheet of paper. He said that the client account number was written on the plain sheet of paper rather than on the check, so that the account number would not be directly associated with the check instrument used to make the deposit.

Mathewson said that Guardian Bank provided its clients with several options for check payees to make a pattern harder to detect at their own bank. He said that if a check was made out to the client's shelf corporation, the client was advised not to endorse it on the back and Guardian Bank would ensure payment anyway. He said that Guardian would then stamp each check on the back with: "For deposit at [name of correspondent bank] for credit to Guardian Bank" and provide Guardian's account number at the correspondent bank. He noted that this endorsement included no reference to the Cayman Islands which meant, since there were multiple Guardian Banks around the world, the transaction would be harder to trace.

Mathewson said that after Guardian Bank accumulated a number of U.S. dollar checks sent by its clients to the bank in the Cayman Islands, it batched them into groups of 50 to 100 checks and delivered them by international courier to one of its U.S. correspondent banks for deposit into a Guardian account. He said that the U.S. bank would then clear the client checks using its own U.S. bank stamp, which meant the client's U.S. bank records would show only a U.S. bank, and not a Cayman bank, as the payor. He said the correspondent bank would then credit the check funds to Guardian's account, leaving it to Guardian Bank itself to apportion the funds among its client accounts.

Mathewson explained that Guardian Bank never actually transferred client funds out of Guardian's correspondent accounts to the bank in the Cayman Islands, nor did it create subaccounts within its U.S. correspondent accounts for each client. He said that Guardian Bank purposely left all client funds in its correspondent accounts in order to earn the relatively higher interest rates paid on large deposits, thereby generating revenue for the bank. For example, Mathewson said, a Guardian correspondent account might generate 6% interest, a higher rate of return based on the large amount of funds on deposit, and Guardian Bank would then pay its clients 5%, keeping the 1% differential for itself. He said that Guardian might also transfer some funds to an investment account in its own name to generate still larger revenues for the bank. He said that Guardian Bank had opened investment accounts at 10 or more securities firms, including Prudential Bache in New York, Prudential Securities in Miami, Smith Barney Shearson, and Charles Schwab.

He explained that Guardian did not create client subaccounts or otherwise ask its correspondent banks keep track of Guardian client transactions, since to do so would have risked disclosing specific client information. Instead, he said, transactions involving individual Guardian accounts were recorded in only one place, Guardian Bank's ledgers. He said that Guardian Bank's ledgers were kept electronically, using encrypted banking software that was capable of tracking multiple clients, accounts, transactions and currencies and that ran on computers physically located in the Cayman Islands, protected by Cayman bank secrecy laws.

Client Deposits Through Wire Transfers. Mathewson also described the arrangements for client deposits made through wire transfers. He said that clients were provided the names of banks where they could direct wire transfers for depositing funds into a Guardian correspondent account. He said the wire instructions typically told clients to transfer their funds to the named bank "for further credit to Guardian Bank," and provided Guardian's correspondent account number.

Mathewson said that Guardian Bank had preferred its clients to send wire deposits to a non-U.S. bank, such as Credit Suisse in Guernsey, or the Bank of Butterfield in the Caymans, to minimize documentation in the United States. He said the clients were given Guardian's account number at each of the banks and were instructed to direct the funds to be deposited into Guardian's account, but not to provide any other identifying information on the wire documentation. He said clients were then instructed to telephone Guardian Bank to alert it to the incoming amount and the account to which it should be credited. He said that Guardian Bank commingled the deposit with other funds in its correspondent account, recording the individual client transaction only in its Cayman records.

Mathewson stated that, although discouraged from doing so, some clients did wire transfer funds to a Guardian correspondent account at a U.S. bank. He said that Guardian had also, on occasion, permitted clients to make cash deposits into a Guardian correspondent account at a U.S. bank. In both cases, however, he indicated that the clients were warned against providing documentation directly linking the funds to themselves or their Guardian account numbers. He said that after making a deposit at a U.S. bank, clients were supposed to telephone Guardian Bank to alert it to the deposit and to indicate which Guardian account was supposed to be credited. He indicated that, as a precaution in such cases, Guardian Bank would sometimes wire the funds to another Guardian correspondent account at a bank in a secrecy jurisdiction, such as Credit Suisse in Guernsey, before sending it to the next destination, to protect client funds from being traced.

Mathewson said that, whether a client used a check or wire transfer to deposit funds, if the client followed Guardian's instructions, the documentation at the correspondent bank ought to have contained no information directly linking the incoming funds to a named client or to a specific account at Guardian Bank in the Cayman Islands.

Exercise 1 - Questions

Exercise "Correspondent Banking"

Instructions: Read the PDF provided to answer the following questions.

1. Why would a bank like Guardian Bank want to open U.S. correspondent accounts?

2. Describe the ML risks for the U.S. Correspondent Bank when offering correspondent banking services to banks like Guardian Bank.

3. What AML measures should the U.S. Correspondent Banks take at the account opening moment?

4. Are the accounts described in the excerpts correspondent accounts or Payable Through Accounts?

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Exercise 2 - Questions

Exercise "Economic/Social Consequences of ML"

Instructions: This exercise contains excerpts from the CAMS Preparation Guide. Fill in the blanks, or choose the right answer.

1) Money laundering and terrorism financing can have potentially devastating economic, security and social consequences. While these crimes can occur in any country, they have particularly significant economic and social consequences for:

   A. Developing countries, emerging markets and countries with fragile financial systems.
   B. First world countries, including politically mature jurisdictions such as Western Europe and USA.
   C. Countries listed on the FATF PEP list.

Some of the effects of money laundering and terrorist financing are:

Increased Crime and Corruption: Successful money laundering helps enhance the profitable aspects of criminal activity. When a country is seen as a haven for money laundering, it will attract people who commit crime.

2) Typically, havens for money laundering and terrorist financing have:

   A. Limited number of predicate crimes for money laundering.
   B. Limited types of institutions and persons covered by money laundering laws and regulations.
   C. Little to no enforcement of the laws, weak penalties, or provisions that make it difficult to confiscate or freeze assets related to money laundering.
   D. All of the above

3) If money laundering is prevalent, there is likely to be more_____________. Criminals may try to bribe government officials, lawyers and employees of financial or non-financial institutions so that they can continue to run their criminal businesses.

4) One of the most serious_____________ effects of money laundering is felt in the private sector.

5) Money launderers are known to own businesses that appear legitimate and engage in legitimate business, but are in fact controlled by_______________ who commingle the proceeds of illicit activity with legitimate funds to hide the ill-gotten gains.

6) These _____________:

   A. Politically exposed persons
   B. Front companies
   C. Shell banks

Have access to substantial____________, allowing them to subsidize products and services at levels well___________ market rates. They have a competitive advantage over legitimate firms that draw capital funds from financial markets. This makes it difficult for legitimate business to_________ against them.

7) Finally, by using front companies and other investments in legitimate companies, money laundering proceeds can be used to control whole industries or sectors of the economy of certain countries. This increases the potential for monetary and economic_________ due to the misallocation of resources from artificial distortions in asset and commodity prices.

8) Money laundering and terrorist financing can harm the soundness of a country's __________ sector. They can also negatively affect the __________ of individual banks or other financial institutions.

9) Please give an example of how a bank failed due to criminal activity? Explain how it happened.

10) Among the additional challenges for financial institutions that rely on the proceeds of crime are:

    A. Loss of profitable business
    B. Liquidity problems through deposit of funds
    C. Termination of correspondent banking facilities
    D. A and C

11) Reputational risk is described as the potential that adverse_________ whether accurate or not, will cause a loss of public __________ in the integrity of the organization.

12) Operational risk is described as the potential for loss resulting from inadequate internal__________, personnel or systems or from external events. Such losses occur when institutions incur reduced or terminated inter-bank or__________ banking services or an increased cost for these services.

13) _________risk is the potential for lawsuits, adverse judgments, unenforceable contracts, fines and penalties generating losses, increased expenses for an organization, or even the closure of financial institutions that rely on the proceeds of crime.

14) What is concentration risk?