Wall Street Banks, Money Laundering and the Drug Trade

DOJ Urges Federal Court to Approve Sweetheart Deal with Drug-Tainted HSBC

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Antifascist Calling...

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You can get much farther with a kind word and a gun than you can with a kind word alone.
— Al Capone

In *Reckless Endangerment*, a lively exposé of the frauds at the heart of the subprime meltdown, journalists Gretchen Morgenson and Joshua Rosner wrote that if "mortgage originators like NovaStar or Countrywide were the equivalent of drug pushers hanging around a schoolyard and the ratings agencies were the narcotics cops looking the other way, brokerage firms providing capital to the anything-goes lenders were the overseers of the cartel."

Their observations are all the more relevant given the outrageous behavior by major banks which polluted an already terminally corrupt financial system with blood-spattered cash siphoned-off from the global drug trade.

It wouldn't be much of a stretch to insist that drug money laundered by financial giants like HSBC and Wachovia were in fact, little more than "hedges" designed to offset losses in residential mortgage backed securities (RMBS), sliced and diced into toxic collateralized debt obligations, as the 2007-2008 global economic crisis cratered the capitalist "free market."

And like Wachovia's ill-fated $25.5 billion (£16.96bn) buy-out of Golden West Financial/World Savings Bank at the top of the market in 2006, HSBC's 2002 purchase of Household International and its mortgage unit, Household Finance Corporation for the then princely sum of $15.2 billion (£10.02bn) also proved to be a proverbial deal too far.

Evidence suggests that HSBC stepped up money laundering for their cartel clients as the hyperinflated real estate bubble collapsed. Along with other self-styled masters of the universe who were bleeding cash faster than you can say credit default swaps, HSBC posted 2008 projected first quarter losses of "$17.2 billion (£8.7bn) after the decline in the US housing market hit the value of its loans," BBC News reported.

From there RMBS deficits skyrocketed. By 2010, as Senate and Justice Department investigators were taking a hard look at bank shenanigans, *Reuters* reported that HSBC Holdings was "working off $20 billion [£13.19bn] worth of loans per year in its US Household Finance Corp. unit" where "liabilities stood at about $70 billion [£46.17bn]."

However you slice today's epidemic of financial corruption, a trend already clear two decades ago when economists George Akerlof and Paul Romer published their seminal paper, *Looting: The Economic Underworld of Bankruptcy for Profit*, incentives were huge as senior bank executives inflated their balance sheets with "criminal proceeds … likely to have amounted to some 3.6 per cent of GDP (2.3-5.5 per cent) or around US$2.1 trillion in 2009," according to a 2011 estimate by the United Nations Office on Drugs and Crime (UNODC).

To make matters worse, willful criminality at the apex of the financial pyramid was aided and abetted by the US Justice Department and the federal regulatory apparatus who allowed these storied economic predators to walk.

'Change' that Banksters Can Believe In

In late January, *Bloomberg News* reported that US prosecutors have "asked a federal judge to sign off on HSBC Holdings Plc (HSBA)'s $1.9 billion [£1.2bn] settlement of charges it enabled drug cartels to launder millions of dollars in trafficking proceeds."

Prosecutors justified the settlement on grounds that "it includes the largest-ever forfeiture in the prosecution of a bank and provides for monitoring to prevent future violations," arguing that "strict conditions, and the unprecedented forfeiture and penalties imposed, serve as a significant deterrent against future similar conduct."

Let's get this sick joke straight: here's a bank that laundered billions of dollars for Colombian and Mexican drug lords, admittedly amongst the most violent gangsters on earth (120,000 dead Mexicans and counting since 2006) and we're supposed to take this deal seriously. *Seriously?* Remember, this an institution whose pretax 2012 profits will exceed $23.5 billion (£15.63bn) when earnings are reported next week and the best the US government can do is extract a promise to "do better"–next time.

That deal, a deferred prosecution agreement (DPA) was cobbled together between the outgoing head of the Justice Department's Criminal Division, Lanny A. Breuer and HSBC, Europe's largest bank. At the urging of former Treasury Secretary Timothy Geithner, no criminal charges were sought–or brought–against senior bank executives.

Why might that be the case?

During a press conference trumpeting the government's "shitty deal," Breuer breezily declared that DOJ's decision not to move forcefully against HSBC was in everyone's best interest: "Had the US authorities decided to press criminal charges, HSBC would almost certainly have lost its banking license in the US, the future of the institution would have been under threat and the entire banking system would have been destabilized."

As if allowing drug-connected money launderers license to pollute one of the world's largest financial institutions hadn't *already* "destabilized" the banking system!

Although Obama's Justice Department smeared "lipstick" on this pig of a deal, their own "Statement of Facts" submitted to US District Judge John Gleeson paints a damning picture of criminal negligence that crossed the line into *outright collusion* with their Cartel clients:

> From 2006 to 2010, HSBC Bank USA violated the BSA and its implementing regulations. Specifically, HSBC Bank USA ignored the money laundering risks associated with doing business with certain Mexican customers and failed to implement a BSA/AML program that was adequate to monitor suspicious transactions from Mexico. At the same time, Grupo Financiero HSBC, S.A. de C.V. ("HSBC Mexico"), one of HSBC Bank USA's largest Mexican customers, had its own significant AML problems. As a result of these concurrent AML failures, at least $881 million in drug trafficking proceeds, including proceeds of drug trafficking by the Sinaloa Cartel in Mexico and the Norte del Valle Cartel in Colombia, were laundered through HSBC Bank USA without being detected. HSBC Group was aware of the significant AML compliance problems at HSBC Mexico, yet did not inform HSBC Bank USA of these problems and their potential impact on HSBC Bank USA's AML program.

As with Wachovia, oceans of cash generated through drug trafficking were laundered by HSBC via the Black Market Peso Exchange (BMPE), a nexus of interconnected firms controlled by Colombian and Mexican drug cartels.

According to the DPA, "peso brokers purchase bulk cash in United States dollars from drug cartels at a discounted rate, in return for Colombian pesos that belong to Colombian businessmen. The peso brokers then use the US dollars to purchase legitimate goods from businesses in the United States and other foreign countries, on behalf of the Colombian businessmen. These goods are then sent to the Colombian businessmen, who sell the goods for Colombian pesos to recoup their original investment."

"In the end," the Justice Department informed us, "the Colombian businessmen obtain US dollars at a lower exchange rate than otherwise available in Colombia, the Colombian cartel leaders receive Colombian pesos while avoiding the costs associated with depositing US dollars directly into Colombian financial institutions, and the peso brokers receive fees for their services as middlemen."

Got that? And it wasn't only plasma TVs, diamond-studded Rolexes or armored-up SUVs that cartel heavies were buying from enterprising businessmen on *this* side of the border. Add to their list of must-haves: fleets of airplanes and enough weapons to equip an army!

DOJ investigators discovered that "drug traffickers were depositing hundreds of thousands of dollars in bulk US currency each day into HSBC Mexico accounts. In order to efficiently move this volume of cash through the teller windows at HSBC Mexico branches, drug traffickers designed specially shaped boxes that fit the precise dimensions of the teller windows. The drug traffickers would send numerous boxes filled with cash through the teller windows for deposit into HSBC Mexico accounts. After the cash was deposited in the accounts, peso brokers then wire transferred the US dollars to various exporters located in New York City and other locations throughout the United States to purchase goods for

Colombian businesses. The US exporters then sent the goods directly to the businesses in Colombia."

The investigation further revealed that "because of its lax AML controls, HSBC Mexico was the preferred financial institution for drug cartels and money launderers. The drug trafficking proceeds (in physical US dollars) deposited at HSBC Mexico as part of the BMPE were sold to HSBC Bank USA through Banknotes."

What's the "get" for the bank? Former Senate investigator Jack Blum told *Rolling Stone's* Matt Taibbi: "If you have clients who are interested in 'specialty services'–that's the euphemism for the bad stuff–you can charge 'em whatever you want." Blum said "the margin on laundered money for years has been roughly 20 percent."

How's *that* for an incentive!

'Big Audits, Big Problems. No Audits, No Problems'

In cobbling together the HSBC deal, the Justice Department ignored Senate testimony by whistleblowers, some of whom were fired or eventually resigned in disgust when higher-ups thwarted their efforts to get a handle on AML "lapses" by the North American branch during a critical period when it was becoming clear that losses in the subprime market would be huge.

We were informed that senior level officials at HBUS were keep in the dark about the extent of problems plaguing HBMX by HSBC Group (London) executives, "including the CEO, Head of Compliance, Head of Audit, and Head of Legal," all of whom were aware "that the problems at HSBC Mexico involved US dollars and US dollar accounts."

We're supposed to believe that Canary Wharf "did not contact their counterparts at HSBC Bank USA to explain the significance of the problems or the potential effect on HSBC Bank USA's business." This fairy tale is further enlarged upon when we're informed that "HSBC North America's General Counsel/Regional Compliance Officer first learned of the problems at HSBC Mexico and their potential impact on HSBC Bank USA in 2010 as a result of this investigation."

According to the suspect narrative concocted by government prosecutors, HBUS's General Counsel was informed by HSBC Group Compliance Chief, David Bagley, that she wasn't told about "potential problems" at HBMX because the bank doesn't "air the dirty linen of one affiliate with another . . . we go in and fix the problems."

Really?

Keep in mind that the Office of the Comptroller of the Currency had issued not one, but *two* toothless cease-and-desist orders between 2003 and 2010 ordering HSBC to clean up their act, all of which revolved around strengthening anti-money laundering controls which were promptly ignored.

But as the US Senate Permanent Subcommittee on Investigations revealed in their 335-page report (large PDF file) and related hearings last summer, despite the fact that "Compliance and AML staffing levels were kept low for many years as part of a cost cutting measure," Senate investigators learned through HSBC internal correspondence that those charged with monitoring suspicious transactions were “struggling to ‘handle the growing monitoring requirements’ associated with the bank’s correspondent banking and cash management programs, and requested additional staff.”

“Despite requests for additional AML staffing,” the Senate reported that “HBUS decided to hold staff levels to a flat headcount.”

“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 the board meeting, after seven years as HBUS’ Compliance head Ms. Wind was fired,” Senate investigators disclosed.

Wind, who had met with HNAH’s board in October 2007 to discuss staffing, was reprimanded by her supervisor, Regional Compliance Officer and Senior Executive Vice President Janet L. Burak, for raising the issue. In an email to disgraced Group Compliance chief David Bagley, who dramatically resigned on camera during those Senate hearings, Burak “expressed displeasure” with Wind and told Bagley:

“I indicated to her 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 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.”

In marked contrast to the government’s version, it appears that HBUS had been fully apprised of “cash management” problems *three years* earlier than claimed in the DPA, yet senior level executives choose to look the other way–so long as the cash keep flowing.

Burak’s firing of Wind should have raised eyebrows at the Justice Department. As Regional Legal Department Head for North America, Burak was appointed by the HNAH board to serve as the bank’s Regional Compliance Officer, a move which was even criticized by Bagley, but he was overruled by his Canary Wharf masters.

Her appointment as Regional Compliance Officer shouldn’t come as a surprise however, considering that before joining the HSBC team, Burak “was group general counsel, Household International . . . as well as for Household’s federal regulatory coordination and compliance function,” according to a 2004 BusinessWire profile. And with the bank on the hook for some $70 billion (£46.17bn) and counting in toxic Household International mortgage liabilities, her choice by London to supervise AML operations was a slam dunk.

In her new dual-hatted role, Burak was taken to the woodshed by both the Office of the Comptroller of the Currency and the Federal Reserve “for her lack of understanding of AML risks or controls” according to the Senate report. Indeed, OCC stated that 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.”

But if the task at hand was to keep AML staff to a “flat headcount” and not make waves with pesky audits that might force compliance with trivial matters such as legal requirements under the Bank Secrecy Act, well you get the picture! Senate investigators learned however, that BSA compliance issues were legion and what they found was just a *tad* troubling:

> The identified problems included a once massive backlog of over 17,000 alerts identifying possible suspicious 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 [£9.53bn] 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 [£38.14tn] 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.

But wait, there's more!

After Wind's dismissal, the HNAH board hired Lesley Midzain to fill the posts of Compliance head and AML director. But as Senate investigators revealed, "Ms. Midzain had no professional experience and little familiarity with US AML laws." Indeed, in December 2008 "HNAH's regulator, the Federal Reserve, provided a negative critique of Ms. Midzain's management of the bank's AML program."

According to Senate staff, the Federal Reserve complained 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 HNAH's BSA/AML high risk profile, especially when compared to other large national banks."

As a result of these rather pointed criticisms, Midzain was removed from the AML post and HBUS hired a new director, Wyndham Clark, a former US Treasury official. According to the Senate report, 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."

Call it a small world.

It soon became clear to Clark that although the bank had an "extremely high risk business model from AML perspective," as director he was "granted only limited authority to the AML director to remedy problems." According to a memorandum sent by Clark to his boss Curt Cunningham, he complained that "AML Director has the responsibility for AML compliance, but very little control over its success."

If one were a "conspiracy buff" one might even argue this was *precisely as intended*.

Senate investigators revealed that as he continued his work, "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."

In May 2010, he wrote to a more senior compliance officer: "With every passing day I become more concerned…if that's even possible."

Less than a year after taking the thankless job, in July 2010 Clark quit. He wrote HSBC Group Compliance chief David Bagley that he had neither the authority nor the support from senior managers needed to do his job. He told Bagley in no uncertain terms:

> [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 Director appropriate authority, we will continue to have limited credibility with the regulators.

According to the DPA, despite the risks associated with HSBC's highly-profitable Banknotes business, used and abused by all manner of shady customers, "from 2006 to 2009, Banknotes' AML compliance consisted of one, or at times two, compliance officers."

In 2006, the Treasury Department's Financial Crimes Enforcement Network (FinCEN) issued an Advisory warning that "US law enforcement has observed a dramatic increase in the smuggling of bulk cash proceeds from the sale of narcotics and other criminal activities from the United States into Mexico. Once the US currency is in Mexico, numerous layered transactions may be used to disguise its origins, after which it may be returned directly to the United States or further transshipped to or through other jurisdictions."

What was HSBC's response? The Justice Department informed us that despite the FinCEN notification "Banknotes stopped regular monthly monitoring of transactions for HSBC Group Affiliates, including HSBC Mexico, in July 2006."

And despite multiple notifications from government regulators, the bank accelerated their shady purchases: "Banknotes purchased approximately $7 billion [£4.51bn] in US currency from Mexico each year, with nearly half of that amount supplied by HSBC Mexico. From July 2006 to December 2008, Banknotes purchased over $9.4 [£6.06bn] billion in physical US dollars from HSBC Mexico, including over $4.1 billion [£2.64bn] in 2008 alone."

As a result of these rather willful "lapses" by senior executives, the Justice Department's "Statement of Facts" cited HSBC's,

> a. Failure to obtain or maintain due diligence or KYC information on HSBC Group Affiliates, including HSBC Mexico; b. Failure to adequately monitor over $200 trillion [£126.9tn] in wire transfers between 2006 and 2009 from customers located in countries that HSBC Bank USA classified as "standard" or "medium" risk, including over $670 billion [£425.1bn] in wire transfers from HSBC Mexico; c. Failure to adequately monitor billions of dollars in purchases of physical US dollars ("banknotes") between July 2006 and July 2009 from HSBC Group Affiliates, including over $9.4 billion [£5.96bn] from HSBC Mexico; and d. Failure to provide adequate staffing and other resources to maintain an effective AML program.

Yet in the face of evidence that laundering drug money was anything but a mistake, Judge Gleeson was told that DOJ's decision not to criminally prosecute senior HSBC executives was predicated on the fiction that the $1.9 billion settlement's "strict conditions, and the unprecedented forfeiture and penalties imposed, [will] serve as a significant deterrent against future similar conduct."

Never mind the lack of evidence that DPA's are a "deterrent" to financial crimes. Indeed, a 2009 study by the US Government Accountability Office (GAO) concluded "that the Department of Justice (DOJ) lacked performance measures to assess how Deferred Prosecution Agreements (DPA) and Non-Prosecution Agreements (NPA) contribute to its efforts to combat corporate crime."

Well, if the Justice Department lacked "metrics" as to whether or not their agreements with corporate criminals act as a deterrent to future crimes, were there other considerations behind the sweetheart deals forged between the Criminal Division, HSBC and other banks?

You bet there were and it's worth recalling statements by former UNODC director Antonio Maria Costa in this regard. In 2009, Costa told *The Observer* that "he has seen evidence that the proceeds of organised crime were 'the only liquid investment capital' available to some banks on the brink of collapse last year. He said that a majority of the $352bn (£216bn) of drugs profits was absorbed into the economic system as a result."

Costa said that "in many instances, the money from drugs was the only liquid investment capital. In the second half of 2008, liquidity was the banking system's main problem and hence liquid capital became an important factor."

"Inter-bank loans were funded by money that originated from the drugs trade and other illegal activities… There were signs that some banks were rescued that way." Although Costa declined to identify the banks involved because it would not be "appropriate," he told *The Observer* that "money is now a part of the official system and had been effectively laundered."

"That was the moment [last year] when the system was basically paralysed because of the unwillingness of banks to lend money to one another," Costa averred. "The progressive liquidisation to the system and the progressive improvement by some banks of their share values [has meant that] the problem [of illegal money] has become much less serious than it was."

In other words, as illegal cash propped up the banks while the crisis was being sorted out, at the expense of the working class mind you, the financial pirates responsible for the capitalist meltdown have become even larger, thanks to taxpayer bailouts, in effect holding the economy hostage as they became "too big" to either "fail or jail."

As Matt Taibbi observed in *Rolling Stone*, "At HSBC, the bank did more than avert its eyes to a few shady transactions. It repeatedly defied government orders as it made a conscious, years-long effort to completely stop discriminating between illegitimate and legitimate money. And when it somehow talked the U.S. government into crafting a settlement over these offenses with the lunatic aim of preserving the bank's license, it succeeded, finally, in making crime mainstream."

What we are dealing with here is nothing less than a perverse economic system thoroughly criminalized by its elites; a bizarro world as Michel Chossudovsky pointed out where "war criminals legitimately occupy positions of authority, which enable them to decide 'who are the criminals', when in fact they are the criminals."

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