Beyond U.S. shores: the regional impact of HSBC’s $1.9 billion fine

The repercussions of the record $1.92 billion fine imposed on HSBC are being felt well beyond the United States. In the Asia-Pacific region, where HSBC began its operations back in 1865, compliance industry figures said the enforcement action represented a wake-up call on numerous fronts. It has illustrated clearly the "long arm" of certain regulatory agencies and has also reflected the tendency to levy huge fines at a time when the U.S. government is under increasing fiscal pressure on the domestic front, industry officials said.

Martin Rogers, partner at law firm Clifford Chance in Hong Kong, said it was unlikely that regional regulators would emulate these types of multi-million and billion-dollar fines seen in the U.S. The risk for institutions outside the U.S., notably those that clear U.S.-dollar transactions, was the possibility of extra-territorial enforcement action which could carry with it significant penalties.

"Asian-based banks clearly need to be concerned about the risk that they will find themselves the subject of similar enforcement action," Rogers said. "They need to review and, where necessary, update their anti-money laundering systems and controls, including compliance resources in particular."

Professor Justin O’Brien, director of the Centre for Law, Markets and Regulation in Sydney, said the most critical element of the latest enforcement action was not the headline fine but the use of a deferred prosecution agreement (DPA). He said that this,
along with the U.S. Department of Justice's appointment of an independent monitor to oversee HSBC's compliance controls, had put the institution in an unenviable position. O'Brien said the DPA effectively meant that HSBC had pleaded guilty and that any further regulatory failures could lead to the revocation of its U.S. banking licence.

"What's really significant is that it's a deferred prosecution rather than a non-prosecution. Basically HSBC has had to accept its guilt and they're putting an external monitor in. If the external monitor finds that there is a material breach, HSBC doesn't have a leg to stand on. It has already admitted its guilt," O'Brien said.

In terms of the scale of the fine, O'Brien said it was "material", even though $1.92 billion only represented half of HSBC's quarterly profits. On an annualised basis, he said, this was clearly manageable, but the figure represented far more than a metaphorical "speeding ticket" or slap on the wrist for the institution involved.

"It's substantially more than anything before. It's three times the level of the Standard Chartered fine. So it's sending a clear message that these fines are now going to reach material levels," he said.

O'Brien predicted that the penalty would bring about a cultural change at HSBC, and possibly across banking as a whole, because of the implications if HSBC fails to rebuild its AML/CFT compliance culture.

**Political motivations**

Steve Vickers, chief executive of risk consultancy Steve Vickers & Associates in Hong Kong, said both the HSBC and the recent Standard Chartered fines were politically driven and had exposed the downfalls of the extra-territorial legal system exercised by U.S. regulators. He noted that in both cases the "much-trumpeted allegations of terrorist financing" had quickly disappeared, only to be replaced by talk of massive headline fines.
"Even banks with small exposure to the U.S. domestic market need to bow to the U.S. system or they could theoretically be barred from the U.S. clearing system. It is an invidious position to be in, especially with posturing regulators," he said.

Joy Geary, director of Australian consultancy AML Master, noted that the $1.92 billion penalty would go into U.S. government coffers and that the people negotiating the DPA were employees of the government. She said fines of this magnitude probably exceed the annual operating costs of FinCEN, the U.S. Department of Justice and the other regulators that were involved.

"When the country's deficit has ballooned to what it has, windfall inflows like this fine are welcome. HSBC was negotiating at knifepoint in a dark park far away from home as anything would be better for it than a full-blown prosecution," she said.

Geary added, however, that HSBC was the "sole architect" of its situation. "It could have stayed on the safe, well-lit path," she said.

Geary said it remained to be seen whether the U.S. government would ultimately spend the funds on a better AML/CTF system and better resources for law enforcement, or whether it would fund a general deficit reduction.

**Key messages**

Regardless of the motive behind the record HSBC penalty, the main warning for financial institutions is that AML/CFT lapses will not be treated as misdemeanours.

Christopher Clarke, a partner at law firm at DLA Piper in Hong Kong, said the enforcements were a reminder to regional financial institutions of the extensive powers wielded by regulators in the U.S. He said that firms could no longer look solely at domestic laws and needed to keep an eye on influential jurisdictions. "I would expect
more fines in the future, particularly on OFAC [Office of Foreign Assets Control] issues and also Libor rigging. It should also make [regional] financial institutions more focused on the upcoming FATCA legislation," Clarke said.

Clark said the action should prompt compliance functions to undertake a thorough review of their AML/CFT, Foreign Account Compliance Tax Act (FATCA) and anti-bribery controls across their regional businesses.

Vickers said the HSBC and Standard Chartered cases had raised deeper questions about the effectiveness of the compliance systems and controls that existed in most financial institutions. He said it was clear from breaches such as these that responsibility needed to be escalated all the way to the board and senior management.

"The hard reality is that compliance departments that often myopically review ever-changing rules will never protect banks. Only real, substantive, hands-on, top-down management unfettered by matrix management and empowered to make tough decisions will avert such problems," Vickers said.

**Displacing the risk**

Julian Russell, a director of Pacific Risk, a risk management in Hong Kong, said there was always a risk that the improvement of HSBC's compliance controls might simply lead organised crime groups to use other banks to launder their funds. He said that unless standards improved across the board, this phenomenon, known as "displacement", would continue to undermine law enforcement efforts. He argued that this posed a significant risk to financial institutions across the globe.

"Criminals will continue to find banks that have weaker controls or senior executives who are indifferent to crime and [who will] use these banks instead. Life will become more risky for criminals trying to hide money since they will be channelled into using a smaller number of banks which will also become obvious to law enforcement," Russell
Russell added that smaller financial institutions should review their AML controls to ensure that they did not fall victim to "displacement" and become a magnet for tainted funds. "Compliance officers in smaller banks should now ensure front line bank staff pay extra attention to new clients suddenly transferring their accounts for no apparent reason from the banks that have received prominent fines," he said.

**Changing behaviour**

Geary said that while the recent AML and sanctions fines had captured headlines around the world, it was debatable whether they would lead to a change in behaviour in the long term, and especially outside the U.S. So far, the missing ingredient in this enforcement action had been individual penalties for the main players at HSBC. She argued that at this stage the main victims of the penalties would be the shareholders.

"Those that are bearing the brunt of this fine, the shareholders, might be able to leverage some change through shareholder action but that also will not be long-lasting," she said.

Geary said that ML/TF risk should be owned by the business and individual business owners should face criminal consequences, including jail time, for breaches of AML/CFT and sanction laws.

She also questioned the influence that an independent monitor appointed for a limited period would have. Geary said what was needed was a fundamental change in the "hearts and minds" of those controlling and working within HSBC. She said the only way to achieve this was to hold them accountable, through the threat of criminal prosecutions if the conduct amounted to criminality.

"HSBC claims to have sacked all the senior staff involved in the circumstances behind
this fine. If they can be identified and sacked then one hopes that the Department of Justice can follow that trail of sackings and prosecute them under criminal law. This entire story could not happen except through the actions of employees and through the support and control of senior staff," Geary said.

Geary said the board at a financial institution is ultimately responsible for setting the culture of the organisation and for oversight. "Given the period of time involved, questions must be asked by shareholders and regulators about the board's intervention on non-compliance or what might be their blindness to what was occurring in the business," she said.

**Shareholder pressure**

Jay Jhaveri, the Singapore-based former head of World-Check (a Thomson Reuters company) in Asia, said the size of the fine meant there was a greater chance that shareholders would put pressure on the board and senior management at banks. He said that with fines of this scale there was a greater chance that shareholders would avoid companies that were known to have lax AML/CTF compliance controls.

Jhaveri said that following these fines it would be impossible for banks to assume a "business-as-usual" stance and regard these penalties as simply a cost of doing business. "Shareholders must exercise their vote and demonstrate their confidence, or lack of it, in the board and the management of these institutions," Jhaveri said.

He agreed that the penalties should lead to a re-think of the compliance reporting lines at financial institutions, with the function ideally being given a reporting line direct to the board. "I strongly believe the time has come to revisit the reporting structure of compliance officers. One must consider the option of compliance officers having a reporting line directly to the board, not dissimilar to the audit committees, and not just to management."
Monitoring compliance

Other industry figures have said that the financial sector should not underestimate the impact that the threat of an external monitor would have at HSBC in the future. Lanny Breuer, head of criminal prosecutions at the Department of Justice, has described the monitor as a "sword of Damocles" hanging over the institution.

O'Brien argued that the blade of the sword of Damocles was not just hanging over HSBC, but over the entire banking sector, in the sense that the potential revocation of HSBC's licence would have implications for the industry as a whole. "The entire system is now held hostage to the extent to which HSBC itself changes its practices. That is a serious risk, although it's a calculated risk on the part of the regulators. If they get this wrong then they are going to have to do the very thing that they don't want to do, and that's to create a global panic through HSBC's immediate licence revocation," O'Brien said.

"So everybody, not just HSBC — it's HSBC, the global banking regulators and global banking as a whole — is drinking at the last chance saloon with this enforcement action."