

Personal criminal liability works, like it or not

If the banking industry is to be cleaned up, rules alone will not cut it. Bankers should face personal criminal liability as well, argues David Rowe

An old personal experience came to mind while reviewing the HSBC money laundering allegations. The bottom line is, if you want compliance, nothing works as well as personal criminal liability.

Many years ago I served as chief financial officer of what was then known as a Section 20 subsidiary of a US commercial bank – an investment banking business, in simpler language. One of the first things I learned was that I had personal criminal liability for proper reporting of the firm's capital position. This was early in the period of slow erosion of the US Glass-Steagall Act and bank-owned firms such as mine were only allowed to engage in 'unsolicited transactions' with customers. Despite this restriction, I was given to understand from executives at the parent bank that we would actively solicit customer business and simply mark all trade slips 'unsolicited'.

I was not keen to be unemployed and I was not entirely sure whether my personal liability extended to this compliance issue. Nevertheless, I decided I was not going to risk hard time for anybody so I wrote an official memorandum to make it clear I would resign if this policy was pursued.

I recalled this episode while reviewing the report of the US Senate Permanent Subcommittee on Investigations concerning alleged money laundering activities at HSBC.¹ Two instances struck me as especially egregious. The first involved blatant actions by HSBC personnel to circumvent restrictions on US dollar transactions with Iranian institutions. The Office of Foreign Asset Control (OFAC)

has developed a list of prohibited persons and countries that banks use to create an 'OFAC filter' to identify and halt potentially prohibited dollar transactions.

Transactions flagged by this filter are reviewed individually to see if the transaction can proceed or if the funds must be blocked. Internal documents indicate that non-US subsidiaries of HSBC systematically altered transaction information to strip out any reference to Iran and characterise the transfers as between banks in approved jurisdictions. Despite concerns being raised repeatedly with HSBC Group's compliance function, the report says no decisive action was undertaken to halt such document alteration by non-US subsidiaries or to inform HSBC Bank USA (HBUS) about the activity.

The story gets worse. As transaction volumes grew, manual intervention became cumbersome, costly and error prone. Far from pulling back, the report describes how a multi-currency payment department at HSBC provided Iran's Bank Melli with templates on how to complete payment fields in interbank messages for US dollar transactions so they could be processed without the paperwork having to be altered manually. The effect was to make US dollar payments appear to be between HSBC's non-US branches rather than for the ultimate benefit of Iranian entities.²

Another episode described in the report involved HBUS clearing millions of dollars of suspicious traveller's cheques for Hokuriku Bank of Japan.³ These cheques, in denominations of \$500 or \$1,000, were in sequentially numbered batches and were signed and countersigned by the same person using an illegible signature – each was payable to one of 30 different companies or individuals, all claiming to be in the used car business. At one point, HBUS was clearing up to \$600,000 worth of the cheques every day.

While the beneficiaries were clients of Hokuriku Bank, the cheques were all purchased from the same Russian bank for deposit into their accounts in Japan. When HBUS finally inquired of Hokuriku Bank what business purpose lay behind Russians cashing massive numbers of US dollar traveller's cheques on a daily basis, they had little or no information to offer.

In July, HSBC chief Stuart Gulliver said the bank was putting aside \$700 million to cover the cost of this "shameful and embarrassing" scandal, but admitted the number could be "significantly larger". Obviously, settlements of this magnitude do have an effect on future behaviour – senior management must weigh the potential for massive future costs when deciding whether to engage in profitable but legally questionable activities.

As long as the penalties are purely institutional and financial, however, some organisations will always make this calculation purely on the basis of risk and reward. Sad to say, but the days appear to have passed when banks could be relied on not to break the law. So, if authorities want the law to be respected at all cost, there is one way to do so. Imposing personal criminal liability on those engaged in the process of lawbreaking would immediately change attitudes. For better or worse, personal criminal liability does work. ■

¹ www.bsgac.senate.gov/download/?id=2a76c00f-7c3a-44c8-902e-3d9b5dbd0083. The full 339 pages is rather daunting, but the 12-page executive summary is a worthwhile read for all risk managers

² See pages 119–126 of the Senate Report, especially the section entitled HBEU Payment Instructions starting on page 124

³ See pages 240–259 of the Senate Report

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