

US panel exposes governance failure at HSBC

The US Senate Permanent Subcommittee on Investigations, a Congressional watchdog panel, exposes governance failure in HSBC's operations in the US. Here is a portion of the report that highlights the British bank's Bangladesh operations and links to two local Islamic banks.

The US report mentioned Islami Bank Bangladesh Ltd and Social Islami Bank Ltd as the two Bangladeshi banks with suspected links to terrorist financing serviced by HSBC. Both banks cooperated with the Subcommittee's inquiries.

(1) Islami Bank Bangladesh Ltd

Islami Bank Bangladesh Ltd opened its doors in 1983, designed its operations to be in conformance with Islamic requirements, and has grown to become one of the largest private banks in Bangladesh, which is one of the most densely populated countries in the world. It provides a wide variety of individual and commercial banking services. Several of the bank's most senior officials were politically important figures within the country or in Saudi Arabia, leading to their designations as Politically Exposed Persons in the World Check database. According to Islami Bank Bangladesh, it has an extensive network of more than 600 correspondent accounts.

Islami Bank Bangladesh applied to open accounts with HSBC in 2000, and currently has accounts with HSBC in 24 locations around the world. According to the bank, it opened a US dollar account with HSBC Bank USA (HBUS) in 2000, and US dollar clearing accounts with HSBC India and HSBC Pakistan in 2006. In 2007, the HBUS branch in Singapore also sought approval to open an account for the bank to supply it with physical US dollars, cash US dollar monetary instruments such as travelers cheques and money orders, process US dollar wire transfers, and provide other services.

Opening 2007 HBUS account. Documents show that proposals to open the 2007 HBUS account for Islami Bank immediately raised anti-money laundering (AML) concerns within HBUS AML Compliance, not only because the bank was located in a country ranked by HSBC as at "high risk" of money laundering and ranked by Transparency International as one of the most corrupt countries in the world, but also because members of the Al Rajhi group held a 37 percent direct ownership interest in the bank.

In the fall of 2007, Kwok Ying Fung at the HBUS office in Singapore asked Beth Fisher at HBUS AML Compliance to approve Islami Bank's Know-Your-Customer (KYC) profile, but she declined without explaining why. On October 24, 2007, after receiving her response, he asked HBUS AML Compliance to suggest someone else to approve opening the account. Angela Cassell-Bush suggested that he "reach out to Chris Lok to see if he is willing to be the RM [Relationship Manager] Approver." Ms Fisher warned her colleagues that, given the connection between the Bangladeshi bank and Al Rajhi Bank, "[t]his is not just an RM issue. This is a KYC due diligence issue."

On November 6, 2007, Mr Fung asked Mr Lok, head of HSBC Global Banknotes and located in HBUS offices in New York, if he would consider serving as the "RM [Relationship Manager] approver" of the Islami Bank KYC profile, so that the bank could become a "shared client" of HBUS Banknotes and HBUS Payments and Cash Management (PCM). On November 8, 2007, Mr Lok responded that his interest in considering a new account depended upon whether there was enough potential revenue to make the effort of vetting Al Rajhi worth it: "First, I'm happy to be the RM [Relationship Manager] if this is an account worth chasing. How much money can you expect to make from this name? If this can be answered positively then I will ask PCM to check out the ... alrajhi connection.... The name Alrajhi has been a name heatedly debated for many years. We terminated our trading relationship following 9/11 and only a year ago after London Compliance came back telling New York the group is happy to let us resurrect the relationship that we went back. ... Not saying just because of this connection we won't do business. It's just that if the revenue is there then we're prepared for a good fight."

Mr Lok's email suggests that he expected from the outset that HBUS AML Compliance would resist opening an account for Islami Bank and it would take a "fight" to open the account.

Later the same day, Benjamin Saram of HBUS Singapore emailed Mr Lok and others with information about the likely revenues if an account were opened for Islami Bank. He wrote that, because approximately 60,000 Bangladeshis travelled to Saudi Arabia each year on religious pilgrimages and would require about \$1,000 to \$3,000 each, "we're therefore looking at about \$60 mio [million] of currency needs on an annual basis." He noted that, in 2006, HBUS Banknotes had netted about \$47,000 in profits in Bangladesh, and expected a 53 percent increase in 2007, to about \$75,000, explaining, "[w]e are a monopoly here, and margins are decent."

Mr Saram estimated that, if an account were opened for Islami Bank, the "net profit would be approximately \$75,000/year."

Mr Lok responded: "One, the money is there and we should go for this account. Two, I will jump in and wear the GRM [Global Relationship Manager] hat. ... I believe we should be able to get the K[YC] sign off." He also asked HBUS AML Compliance to look into the possible connection between Islami Bank and Al Rajhi Bank.

The next day, November 9, 2007, HBUS AML compliance officer Angela Cassell-Bush confirmed a direct link between the two banks:

"[P]lease note that there is a connection between ISLAMI BANK BANGLADESH LIMITED-Bangladesh and Al-Rajhi Bank Based on the information we have on file, the Al-Rajhi family has been associated with Islami Bank Bangladesh Limited, since its

Proposals to open the 2007 HBUS account for Islami Bank raised anti-money laundering concerns, not only because the bank was located in a "high risk" money laundering and corrupt country, but also because members of Al Rajhi group held a 37 percent direct ownership interest in the bank

inception. They have at least 37 percent direct ownership ... through their ownership within the following companies: Arabasas Travel & Tourist Agency, 9.999 percent; Janab Yousif Abdullah Abdul Aziz Al-Rajhi, 9.936 percent; Al-Rajhi Company for Industry & Trade, 9.94 percent; Abdullah Abdul Aziz Al-Rajhi, 7.58 percent. This same family has major controlling interest within Al-Rajhi bank."

Troubling information. HBUS' Singapore branch actually opened the account for Islami Bank in December 2007. Mr Lok and others approved the account, despite ongoing questions about its primary shareholder, Al Rajhi Bank, whose past links to terrorist financing had received additional attention in the media during the summer of 2007. HBUS also approved the account

HSBC's Financial Intelligence Group report said, "Abdur Rahman, chief of Jamaatul Mujahideen of Bangladesh, and his second-in-command, Bangla Bhai, were arrested for the terrorist bomb blasts of August 17, 2005." The report found that Rahman had an account at Islami Bank

despite troubling information about Islami Bank itself.

The troubling information about Islami Bank was contained in an internal report that had been prepared less than a year earlier by HSBC's Financial Intelligence Group (FIG). The May 2006 FIG report disclosed that, in March 2006, "Abdur Rahman, chief of the Jamaatul Mujahideen of Bangladesh (JMB), and his second-in-command, Bangla Bhai, were arrested for being responsible for the terrorist bomb blasts of August 17, 2005 in Bangladesh." The FIG report noted that Mr Rahman had been found to have an account at Islami Bank.

The FIG report also disclosed that an investigation by the central bank of Bangladesh found that two branches of Islami Bank had been engaged in "suspicious transactions" and urged the bank to take action against 20 bank employees, including for failing to report the suspicious transactions.

According to the FIG report, in response, Islami Bank reportedly suspended five officers and warned 15 others. The FIG report stated that Bangladeshi news articles had observed it was the third time Islami Bank had been fined by the central bank "for covering up militants' transactions."

Islami Bank's KYC profile repeated this information and indicated that the HSBC Global Relationship Manager had visited the bank to ask about the matter, and was told that the incident did not involve terrorist financing. The Global Relationship Manager advised against taking any further action, attributing the AML failures to the bank's unsophisticated technology platform. Neither the KYC profile nor the FIG report indicate whether any steps were taken to verify the bank's explanation of the incident with the central bank. The KYC profile noted that, in 2006, FIG recommended classifying Islami Bank as a "Special Category Client," or SCC, HSBC's designation for its highest risk clients, but that recommendation was rejected, which meant HSBC did not subject the bank to any enhanced monitoring.

2009 information on IIRO accounts. The account was opened near the end of 2007. About 18 months later, in May 2009, a FIG due diligence report prepared for another Bangladeshi bank with which HBUS did business, Social Islami Bank, discussed below, disclosed new information relevant to Islami Bank. This information related to the International Islamic Relief Organization (IIRO), a Saudi nonprofit organization which, in 2006, had two of its branches and a high ranking IIRO official designated by the United States as terrorist financiers and added to the list of entities with which US persons are prohibited from doing business.

The 2009 FIG report stated that the IIRO had accounts at both Social Islami Bank and Islami Bank. It quoted a 2008 local press article saying that, in response to the action taken by the United States in 2006, Islami Bank had frozen its IIRO accounts. The FIG report did not indicate when the accounts were first opened, what actions had been taken beyond freezing them, or how much money was involved. In 2010, an HBUS KYC profile for Social Islami Bank referenced a letter from the Bangladeshi central bank, dated June 30, 2010, indicating that IIRO had accounts at three Bangladeshi banks, including Islami Bank, which needed to be closed.

Islami Bank Bangladesh confirmed to the Subcommittee that IIRO had two accounts at the bank which opened in 1993 and 1994, when IIRO was a nongovernmental organization in good standing. It stated that after the IIRO was added to a United Nations sanctions list in 2006, it froze the accounts and reported them to the Bangladeshi central bank. In 2010, according to the bank, it received an "instruction from the central bank at the direction of [the] Ministry of Finance" to unfreeze the accounts and "transfer the accounts" to a government owned bank, BASIC Bank, which it did.

Despite the 2008 published article, the information in the two internal HBUS documents related to Social Islami Bank, and Islami Bank Bangladesh's willingness to discuss the accounts, no information about the IIRO accounts appeared in the HBUS KYC profile for Islami Bank. While the IIRO accounts at Social Islami Bank were the focus of extensive discussions in emails and other documents by HBUS AML Compliance personnel and HBUS bankers working in Bangladesh, no similar discussions appear in any of the HBUS documents related to Islami Bank.

In September 2009, the Islami Bank KYC profile indicates that an unnamed HSBC employee requested a new enhanced due diligence report on the bank. HBUS Compliance denied the request, indicating an update "is NOT needed at this time."

2010 SCC designation. In February 2010, HBUS AML Compliance personnel reviewed the Islami Bank account and recommended that the bank be designated a Special Category Client (SCC). One key reason given for the proposed SCC designation was Islami Bank's links to the Al Rajhi group, noting that the vice chairman of the bank and 10 percent owner was Yousif Abdullah Al Rajhi, that Al Rajhi interests held about a third of the bank's shares, and Al Rajhi itself had links to terrorist financing. 1363 Another reason given was the information provided in the 2006 FIG report, that the Bangladeshi Central Bank had issued a "notice of cause" to Islami Bank "to explain accounts opened by suspected Islamic militants," and reportedly fined the bank for the third time "for covering up militants' transactions." No mention was made of the IIRO accounts. Contrary to the outcome in 2006, in 2010, HSBC designated Islami Bank as an SCC client.

Later in 2010, an OCC (Office of the Comptroller of the Currency) AML examiner reviewing emails related to Islami Bank characterized the information provided about the bank as depicting "extreme circumstances," and recommended that the

account be reviewed as part of a larger AML "look back" effort at HSBC. In 2011, HSBC engaged in an extensive discussion with Islami Bank regarding its AML policies and procedures, also noting in its KYC profile that the bank acted as a "payout agent" for 53 money exchange businesses across the Middle East.

Today, although HSBC exited the US banknotes business in 2010, Islami Bank Bangladesh remains a customer of two dozen HSBC affiliates, including HBUS PCM, which continues to provide Islami Bank with access to US dollars, US wire transfers, and US payment systems.

(2) Social Islami Bank Ltd

A third bank serviced by HSBC despite suspected links to terrorist financing is Social Islami Bank Ltd.

Social Islami Bank Ltd was founded in 1995, changed its name from Social Invest-

Leading shareholder of Social Investment Bank (at 8.62pc), International Islamic Relief Organisation, was accused in both the Philippines and in America of funding terrorist groups. Another of the bank's shareholders, Lajnat al-Birr Al Islam (at 1.54pc) has also been connected to terrorist groups

ment Bank Ltd in 2009, and is located in Bangladesh. It operates 76 branches throughout the country and provides a variety of individual and commercial banking services, including deposits, loans, investment advice, commercial financing, foreign exchange, and wire transfers. It operates in conformance with Islamic requirements and is publicly traded on Bangladeshi stock exchanges. Its headquarters are in Dhaka, the capital of Bangladesh, one of the world's largest cities with a population of 16 million.

Until May 2012, HSBC was one of the bank's major correspondents, providing it with services in multiple countries. HSBC also has an affiliate located in Dhaka.

That affiliate, HSBC Bank Asia Pacific (HBAP) Dhaka, introduced Social Islami Bank to HBUS. In 2003, HBUS Payments and

Despite its failure to provide the additional information, the 2003 FIG report provided significant negative information about Social Islami Bank and squarely raised the question of whether HBUS should be doing business with it, given the "highly adverse" allegations

Cash Management (PCM) sought to open an account for Social Islami Bank, providing it with US dollar wire transfer and clearing services.

Opening of HBUS account. When HBUS first sought to open the account in 2003, it asked for an enhanced due diligence report on the bank from the HSBC Financial Intelligence Group (FIG). In addition to noting that Bangladesh was a high risk country due to its reputation for corruption, the resulting FIG report contained adverse information about some of the bank's owners and officials. Most serious were allegations that two shareholders, the International Islamic Relief Organization (IIRO) and the Islamic Charitable Society Lajnat al-Birr Al Islam (Lajnat al-Birr), had links to terrorism. IIRO then held 8.62 percent of the total outstanding shares, and was the bank's largest single shareholder, while Lajnat al-Birr held 1.54 percent.

The 2003 FIG report stated the following

with regard to the two shareholders:

"IIRO is a Saudi-Arabian charity. ... The IIRO was named in the 2002 lawsuit brought forward on behalf of family members of victims of the September 11, 2001 terrorist attacks. The IIRO was accused of having 'played key roles in laundering of funds to terrorist[s] for the 1998 African embassy bombings' and having been involved in the 'financing and aiding and abetting of terrorists in the 1993 World Trade Center bombing. The IIRO has also reportedly funded al-Qaeda directly as well as several of its satellite groups. Osama bin Laden's brother-in-law, Mohammed Jamal Khalifa, headed the Philippine branch of the IIRO in the 1990's. The Philippine government has charged that the group contributed to terrorist causes there."

Lajnat al-Birr Al Islamiah was established in 1987. It has been stated that Lajnat al-Birr Al Islamiah was the original name of the Benevolence International (F)oundation, and that it originally had offices in Saudi Arabia and Pakistan.

According [to] the US government, among the purposes of Lajnat was to 'raise funds in Saudi Arabia to provide support to the Mujahadeen then fighting in Afghanistan,' as well as to provide 'cover for fighters to travel in and out of Pakistan and obtain immigration status.' Benevolence International has been tied to terrorism and its director, Enaam Arnaout, was indicted in 2002 with conspiring to defraud his group's donors by secretly providing financial and logistical help to al-Qaeda for a decade."

The FIG report also contained negative information about the bank's founder:

"Dr MA Mannan was the chairman and founder of Social Investment Bank Ltd. He was fired in 2000 after fault was found with his banking procedure. It was alleged that he created an obstacle to the team of Bangladesh Bank [Bangladesh's central bank] during their visit to Social Investment Bank Ltd. Additionally, he was accused of interfering with bank administrative work and with harassing a bank employee."

The FIG report concluded:

"In conclusion, it is of significant concern that the leading shareholder of Social Investment Bank Ltd (at 8.62 percent), International Islamic Relief Organisation, has been accused in both the Philippines and in America of funding terrorist groups. The group is currently under investigation by the FBI. Another of the bank's shareholders, Lajnat al-Birr Al Islam (at 1.54 percent) has also been connected to terrorist groups. Additionally, the bank's founder and chairman was let go on allegations of interference and harassment. ... Finally, it is important to note that Social Investment Bank Ltd is located in Bangladesh, which was ranked as the world's most corrupt nation by Transparency International."

The FIG report offered this cautious analysis about whether to open an account:

"Although the allegations presented in this report, primarily against the International Islamic Relief Organisation (IIRO) and the Lajnat al-Birr Al Islamiah, are highly adverse, no US or foreign government law enforcement or regulatory body has stated unconditionally, that these organisations are under sanction. The reputational risk is significant, however, and the possibility that further investigations by US authorities may ultimately uncover substantiating proof of a connection to terrorism. The risk of future sanctions and the reputational risk based on allegations noted in this report should be measured against the current risks involved in our relationship when ultimately deciding a course of action."

While the 2003 FIG report provided significant adverse information about Social Islami Bank and noted that Lajnat al-Birr was the original name of the Benevolence International Foundation which "had been tied to terrorism," it failed to state that, in 2002, the United States had designated the Benevolence International Foundation as a "financier of terrorism" with whom US persons are prohibited from doing business. This additional terrorism-related designation meant that when HBUS was considering whether to open an account for Social

Islami Bank in 2003, Social Islami Bank was partially owned by two organisations associated with terrorist financing.

Despite its failure to provide that additional information, the 2003 FIG report provided significant negative information about Social Islami Bank and squarely raised the question of whether HBUS should be doing business with it, given the "highly adverse" allegations.

Nevertheless, on October 14, 2003, HBUS AML Compliance approved Social Islami Bank as an HBUS PCM client. In addition, despite the bank's location in a high risk country, the terrorist links uncovered in connection with two of its shareholders and a director, HBUS opened the account without designating the bank as an SCC client warranting additional monitoring and due diligence reviews.