

US senators hammer HSBC's money-laundering lapses

The bank's compliance head to step down

REUTERS, Washington

HSBC Holdings Plc put itself at the mercy of the US Senate on Tuesday, acknowledging shortcomings in its anti-money laundering operations and revealing the resignation of a global executive.

David Bagley, a top compliance executive at HSBC since 2002, told a Senate investigative panel that he would step down, after the panel released a scathing report calling out a "pervasively polluted" culture at the bank.

The Senate report, which came after a year-long inquiry, said the bank had routinely acted as a financier to clients routing funds from the world's most dangerous corners, including Mexico, Iran and Syria.

While the big British bank's money-laundering problems have been flagged by regulators for nearly a decade, the report and hearing escalate pressure on the bank, as it awaits a massive fine from the Justice Department for lapses in its safeguards.

It also comes as international banks' reputations have taken a fresh blow due to allegations of a manipulation of a key global benchmark rate.



Right, Paul Thurston, chief executive for retail banking and wealth management at HSBC Hong Kong, and David Bagley, head of HSBC Group compliance, look through evidence exhibits during a hearing on Capitol Hill in Washington yesterday.

Senator Carl Levin, who chairs the Senate's Permanent Subcommittee on Investigations, kicked off the hearing on Tuesday with an extensive explanation of how HSBC's lapses

have been a threat to financial markets around the world.

A Reuters investigation has found persistent lapses in the bank's anti-money launder-

ing compliance since 2010, despite its assertions that it has cleaned up its act.

"Accountability for past conduct is essential. That's what's been missing here," Levin said, adding that the bank's charter could be at risk if it did not do better.

The hearing started with officials from the US Treasury and Department of Homeland Security, but the fireworks began when HSBC executives came to testify.

Bagley, HSBC's head of group compliance since 2002, told the hearing he had been hamstrung by the bank's structure, and that while changes had been made it was time for him to go.

"I recommended to the group that now is the appropriate time for me and for the bank, for someone new to serve as the head of group compliance. I have agreed to work with the bank's senior management towards an orderly transition," he said.

The harshest spotlight will be on Stuart Levey, who joined the bank in January as chief legal officer. He had been the Treasury Department's top official on terrorism finance from 2004 to 2011 -- during which time he was involved in cracking down on HSBC for Iran-related transgressions.

BSTI to launch special anti-adulteration drives

FROM PAGE B1

The minister urged all to carry out a social movement against the unscrupulous businessmen, who mix harmful chemicals with essential products.

"We want to turn the anti-adulteration drive into a social movement," said Barua.

The government alone cannot create the social movement, said the minister. "For this, all stakeholders, including producers, sellers and customers, will have to come forward."

Barua said he has already instructed the BSTI officials to form surveillance teams if magistrates are unavailable for conducting drives.

Last year, the BSTI conducted 1,304 drives, formed 660 surveillance teams, filed 1,764 cases and fined around Tk 3.56 crore, said the minister.

KH Masud Siddiqui, industries secretary, and AK Fazlul Ahad, director general of the BSTI, were also present.

US panel exposes governance failure at HSBC

FROM PAGE B2

HBUS immediately began providing the bank with services that included clearing US dollar monetary instruments and US wire transfers. Those services produced revenues from Social Islami Bank totaling about \$100,000 per year.

2005 review. Two years after the account was opened, as part of a broader HSBC effort to update its KYC client profiles in 2005, Social Islami Bank was the subject of a second enhanced due diligence review. The resulting 2005 FIG report again identified IIRO, the bank's largest shareholder, as linked to terrorism, noting that it was "alleged to have provided funding to terrorist groups such as Al Qaeda in the past," and is "alleged to have acted as a cover for Al-Qaeda operations in the Philippines." The FIG report stated: "Based on the frequency with which the group is connected to terrorist financing in the press, it is likely that their activities will always be under scrutiny, and future government sanctions against the group are highly probable." The report also noted that Social Islami Bank did "not appear to have correspondent relationships with many of the other major global banking corporations." The FIG report "strongly recommend[ed]" that the account not be approved "until the matter is discussed with Senior Compliance Management."

Despite the concerns raised in the FIG report, HBUS retained Social Islami Bank as a client. At the same time, to address concerns about the account, HBUS AML Compliance required the HSBC CEO for Bangladesh to provide annual approval of the account for it to stay open. Despite this requirement, the Subcommittee uncovered only one instance in which approval was granted, and when asked, HSBC was unable to provide any additional documentation.

2006 terrorist designation. Eighteen months later, on August 3, 2006, the United States designated two branches of IIRO and a high ranking IIRO official as terrorist financiers and prohibited US persons from transacting business with them. Treasury Under Secretary for Terrorism and Financial Intelligence Stuart Levey said: "We have long been concerned about these IIRO offices; we are now taking public action to sever this link in the al Qaeda network's funding chain."

In response, on the same day, HBUS AML Compliance placed a block on the Social Islami Bank account, so that no funds could be withdrawn. The email imposing the block noted that the Social Islami Bank brought in HBUS revenues totaling \$44,000 per year.

The next day, August 4, 2006, the HSBC Financial Intelligence Group (FIG) issued an updated due diligence report on Social Islami Bank, containing significant adverse information about IIRO. Among other information, the FIG report noted that the World Check database relied on by HSBC for KYC information classified IIRO as associated with terrorism, linked it to providing assistance to al Qaeda and other terrorist organizations, and described it as "allegedly linked" to the World Trade Centre bombing, "plots to assassinate Bill Clinton and the Pope," and "the planned destruction of the Lincoln Tunnel and Brooklyn Bridge."

Two days after that, on August 6, 2006, an HSBC institutional banker from HBAP Dhaka, Muhammad Shohiduzzaman, met with Social Islami Bank to discuss IIRO. He wrote to the HSBC CEO in charge of the operations in Bangladesh, Steven Banner, that Social Islami Bank had told him that IIRO "never took part in any activities" at the bank, "did not even take possession of the shares,"

and had never been a board member. Mr Shohiduzzaman advised: "we are of the opinion that since IIRO is not involved in the operation of SIBL [Social Islami Bank Ltd.], there [are] no issues of concern locally. But since the matter has been raised by the US treasury, HBUS should take appropriate measure after careful examination of all the present and potential aspects." Mr Banner wrote to Hersel Mehani, the HSBC sales person assigned to the account: "Based on the feedback from SIBL, IIRO's role remains that of a minority shareholder that does not seek to engage in the management of the bank. We have no reason to disbelieve SIBL's statements. There are therefore no grounds for me to recommend an account closure or account freeze."

Mr Banner continued: "I appreciate, however, that HBUS may feel compelled to act firmly in the light of OFAC's (Office of Foreign Assets Control) position. This is obviously a decision that rests with HBUS and I can confirm that we will not object to such action. That said, we would much prefer it if SIBL is allowed to withdraw the balances held with HBUS before you freeze or close the account. From our perspective there appears to be no justification for depriving SIBL of their funds and to do so would open HSBC to unwanted reputational damage/regulatory scrutiny locally."

In essence, Mr Banner asked for the account to be kept open but if it were frozen, to allow Social Islami Bank to pull its money first so that none of its funds would be affected.

Later that same day, August 6, 2006, HBUS AML Compliance officer Alan Ketley forwarded the email exchange to his AML Compliance colleagues, George Tsugranes and Andrew Rizkalla, and asked for their thoughts. Both advised closing the account. Mr Tsugranes wrote: "Although the Philippine and Indonesia branch offices were cited, the Treasury action also cited Abd Al Hamid Sulaiman Al-Mujil who is a high ranking IIRO official. So although only the two branches were cited, having a top official in the organisation mentioned should be cause for concern involving the IIRO. As this organisation has a 9 percent stake and does not involve itself on the day to day operations or mgmt -- who is to say that they won't sooner or later or start moving funds through this acct."

Mr Rizkalla wrote: "I remain firm to my first opinion, the account should be closed in an orderly fashion. We still don't know if there is a nominee shareholder interest to IIRO, the US government has designated IIRO for supporting terrorism, so even the small shareholder ownership entitles them to profits and dividends from Social Investment Bank to reinvest where?? Hersel says monitor the accounts for six months, will he be doing the monitoring??"

Despite their advice to close the account, Mr Ketley lifted the block on the account four days after it was imposed and approved keeping the account open:

"After reviewing the information provided by HSBC Dhaka my provisional decision is that this relationship be allowed to continue. It will need to be designated as an SCC Category 4 (reputational risk) with immediate effect and will be subject to closer monitoring as a result I am not willing to commit to the six months suggested by Hersel and we will review activity and determine what further action may be required as events warrant. ... IIRO's shareholding is a minority

holding and information received indicates that they exert neither management control nor have board representation. While this entity clearly represents a heightened reputational risk to the bank, I believe that with the knowledge we have today and the controls that are being implemented we have mitigated that risk adequately."

A few days later, FIG forwarded its report on Social Islami Bank to the head of HBUS AML Compliance, Teresa Pesce. She wrote to Mr Ketley: "This makes me very uncomfortable. Can we talk to the business about this?" Despite the discomfort she expressed and the advice of two AML compliance officers, the account was kept open. Mr Ketley reported to the Subcommittee that he understood that IIRO was a passive shareholder, that Social Islami was attempting to expel them, and that he talked about the account with Terri Pesce and Denise Reilly and believed they supported his decision to maintain the account. Ms Pesce told the Subcommittee that she did not recall much about the relationship, but the bank should have reached out to OFAC with regard to it. HBUS OFAC Compliance officer Elizabeth Protomasto told the Subcommittee that she contacted OFAC about this relationship after the SDN designation, and was told that the

Social Islami Bank's initial chairman Ahmed Akbar Sobhan was a well-known businessman who held, with his son, a 3.35 percent ownership interest in the bank. Sobhan and his son became the subjects of several criminal investigations involving bribery, corruption, fraud, and tax evasion

bank could continue to do business with Social Islami Bank, because only two branches of the IIRO had been designated by OFAC as SDNs (Specially Designated Nationals and Blocked Persons), not all branches and not the branch in Bangladesh. Social Islami Bank was also designated an SCC client.

IIRO remained a shareholder for six years.

In September 2006, Mr Ketley asked Mr Mehani to obtain additional information from the Social Islami Bank about its relationship with IIRO. In response to a question asking whether IIRO was "a customer of the bank," Mr Mehani wrote that the bank had told him: "IIRO has no relationship with the subject bank and do[es] not maintain or operate any account with the bank." In 2009, however, an internal FIG due diligence report quoted a 2008 local press article stating that the IIRO did have an account at Social Islami Bank, as well as over 50,000 bank shares which FIG estimated might net be worth \$733,000. In 2010, the HBUS KYC profile referenced a Bangladeshi central bank letter dated June 30, 2010, stating that IIRO had accounts at three Bangladeshi banks, including Social Islami Bank, that needed to be closed. Social Islami Bank told

the Subcommittee that IIRO did have a "foreign currency account" with the bank that was opened in 1995, but has a current balance of zero.

In 2006, Mr Mehani indicated that the bank planned to "oust" IIRO as a shareholder at its next board of directors meeting and sell IIRO's bank shares. Mr Mehani wrote: "IIRO never responded to their request to provide a full address rather than a PO box and they will use this to oust them by November [2006] which is allowed according to their Articles of Association which I have a copy given by them to me." Despite that communication, a 2006 Social Islami Bank board resolution authorising sale of the shares, and HBUS' repeated inquiries into their status over multiple years, IIRO has remained a shareholder of Social Islami Bank, although its ownership interest has gradually dropped from 8.62 percent in 2006, to 3.85 percent in 2009, to 1.69 percent by 2010. IIRO currently holds a 1.61 percent interest in the bank, six years after Social Islami Bank promised to ensure the shares would be sold.

In 2009, Social Islami Bank sent a letter to HBUS indicating that it was planning to seek permission from the country's High Court to sell the shares still held by IIRO. In 2010, Social Islami Bank informed HBUS that the Bangladesh government had reached an agreement with IIRO that, after certain safeguards were put in place, would allow IIRO to begin operating in the country again. One of the conditions was that the IIRO would have to "dispose" of its Social Islami Bank account, although that account remains open today with a zero balance. Social Islami Bank informed the Subcommittee that, due to the government's actions, "the bank is under definite obligation in paying dividend/issuing bonus shares/right shares to IIRO as per the instructions of the central bank and Ministry of Finance which were not paid/issued in their favor till 31/05/2010."

A second terrorist financier shareholder.

Also in 2009, a due diligence report issued by the HBUS Financial Intelligence Group identified a second, long-term Social Islami Bank shareholder that raised concerns. It disclosed that Islamic Charitable Society Lajnat al-Birr Al Islam still held a 1.54 percent ownership interest in the bank. The 2009 FIG report explained that World Check, the database relied on by HSBC for KYC purposes, had classified the charity "as a terrorist organisation with reported tie[s] to Hamas. In September 2008, the Israeli government reportedly declared it an illegal entity." Despite this new information in the 2009 FIG report, the HBUS KYC profile on Social Islami Bank does not acknowledge it, stating instead in a note: "Updated EDD [Enhanced Due Diligence] ROF [Report on Findings] received May 5, 2009. Report provided no new, or, up to date information." Social Islami Bank has informed the Subcommittee that Lajnat al-Birr remains a 0.22 percent share owner, but does not have any account at the bank.

Sobhan misconduct. The ongoing ownership of the bank's shares by IIRO and Lajnat al-Birr was not the only troubling development. Social Islami Bank's initial Chairman of the Board, Ahmed Akbar Sobhan, also known as Shah Alam, was a well-known businessman who held, with his son, a 3.35 percent ownership interest in the bank since its inception. Beginning in 2006, however, Mr Sobhan and his son became the subjects of several criminal investigations involving bribery, corruption, fraud, and tax evasion. In 2007, Mr Sobhan and his son reportedly fled to the United Kingdom, after which Mr

Sobhan was the subject of corruption charges brought in his absence by the Bangladeshi Anti-Corruption Commission which sentenced him to eight years in prison. This troubling information was detailed in the 2009 FIG report that was later described in the Social Islami KYC profile as containing no new information.

In May 2012, HSBC terminated its relationship with Social Islami Bank. David Bagley, head of HSBC Group Compliance, told the Subcommittee, when asked, that the closure decision had been a "no brainer." He did not explain what factors led to the termination decision. Social Islami Bank currently has no open account with any HSBC affiliate.

Analysis
HSBC is a global bank with a strong presence in many countries confronting terrorist threats. If safeguards are lacking, HBUS offers a gateway for terrorists to gain access to US dollars and the US financial system. HSBC has a legal obligation to take reasonable steps to ensure it is not dealing with banks that may have links to or facilitate terrorist financing.

Banks rarely carry explicit links to terrorist financing, but in the three banks reviewed here, an array of factors raised troubling questions. In the case of Al Rajhi Bank, the factors included the naming of a key bank official in a list of al Qaeda financial benefactors, a US law enforcement search of Al Rajhi nonprofit and business ventures in the United States to disrupt terrorist financing, a CIA report targeting the bank for being a "conduit" for extremist finance, the bank's refusal to produce authenticating bank documents for use in the criminal trial of a client who cashed travelers cheques at the bank for use by terrorists, and multiple accounts held by suspect clients. In the case of Islami Bank, the factors included substantial ownership of the bank by al Rajhi interests, central bank fines for failing to report suspicious transactions by militants, and an account provided to a terrorist organisation. In the case of Social Islami Bank, the factors included ownership stakes held by two terrorist organisations whose shares were exposed but never sold as promised, and a bank chairman found to be involved with criminal wrongdoing.

In each case, HBUS and HSBC personnel were aware of the information, but approved or maintained the accounts anyway. When an AML Compliance officer like Beth Fisher declined to approve an account, HSBC personnel found someone else to take her place. In several cases, Christopher Lok, head of US Banknotes, took on the role of relationship manager fighting for account approval. His test for taking on that role depended in part upon how much revenue an account would produce. Al Rajhi Bank's threat to terminate business with HSBC affiliates also appears to have galvanised HBUS' renewal of the account.

Another striking feature of these accounts is the fact that a decision by one HSBC affiliate to terminate a relationship with a bank due to terrorist financing concerns did not always lead other HSBC affiliates to follow suit. In the case of Al Rajhi Bank, for example, HBUS terminated the relationship, but HSBC affiliates in the Middle East continued to do business with the bank. One HBUS executive later argued that, since HSBC was already exposed to the reputational risk posed by Al Rajhi Bank through the accounts at other HSBC affiliates, its reputational risk would not increase if one more account were opened. In May 2012, HSBC changed its policy to apply decisions to terminate a client relationship to apply globally to all its affiliates.