

Instead of complaining about prosecution, banks should do a better job at managing risk

In the aftermath of the financial crisis and despite several regulatory reforms the financial sector has still not managed to regain society's trust. Today banks were fined £2 billion in penalties for rigging foreign exchange markets. Regulators said that they had found a 'free for all culture' on currency trading floors at RBS, HSBC, Citibank, JP Morgan and UBS. Chancellor George Osborne stated: "Today we take tough action to clean up corruption by a few so that we have a financial system that works for everyone". (<http://www.theguardian.com/business/2014/nov/12/foreign-exchange-fines-ubs-hsbc-citibank-jp-morgan-rbs-penalties-market-rigging>)

In the face of other recent market manipulation and money laundering scandals such as HSBC admitting that its lax controls allowed over \$800 million from drug cartels to be laundered (<http://www.reuters.com/article/2012/12/11/us-hsbc-probe-idUSBRE8BA05M20121211>) some bankers have acknowledged that the sector is in need of a change of culture. This includes a restatement of values such as integrity, accountability and transparency. However, regulatory reviews in the UK (link to FSA 2011 report <http://www.fca.org.uk/your-fca/documents/fsa-aml-final-report> and 2014 FCA report <http://www.fca.org.uk/static/documents/corporate/anti-money-laundering-annual-report-13-14.pdf>) show that banks are still failing to meet anti-money laundering regulations with 75% of the banks breaking one of the basic rules (2011 FSA review " Banks' management of high money-laundering risk situations" <http://www.fca.org.uk/your-fca/documents/fsa-aml-final-report>). Banks are obliged to undertake due diligence on their customers, which include establishing their identity and whether the source of their funds is legitimate.

The anti-money laundering system is also failing to deliver significant recovery of stolen assets to the victims of corruption. Across the OECD asset recovery of the proceeds of corruption has been assessed to be as low as 0.07 per cent of the assessed annual illicit flows¹. Some banks admitted wrongdoing and are seeking to improve their anti-money laundering system following deferred prosecution agreements. (<http://www.bloomberg.com/news/2013-07-02/hsbc-judge-approves-1-9b-drug-money-laundering-accord.html>).

More recently, however, the tone has shifted. Once again we are hearing complaints about over-regulation and unfair treatment of the financial sector with recent and ongoing enforcement actions. The argument goes as follows: enhanced prosecution of anti-money laundering cases has led to "de-risking", a term used by banks to describe their withdrawing from markets considered to be too risky, and thus to entire markets and customer groups not being served anymore increasing the number of people being excluded from financial services (Link to news article: <http://uk.reuters.com/article/2014/08/04/uk-hsbc-results-idUKKBN0G40M520140804>)

Clearly, banks should not be allowed to violate sanctions regimes and do business with corrupt regimes with horrible human rights records, such as BNP Paribas which took \$6 billion from entities linked to the regime in Sudan. (link to news article <http://www.ft.com/intl/cms/s/0/dbbd42a6-3e9a-11e4-adeb-00144feabdc0.html#axzz3lqCmYLKt>) US Department of Justice evidence revealed

¹ <http://www.transparency.org.uk/publications/15-publications/1092-ti-uk-submission-to-hm-treasury-national-risk-assessment-on-terrorist-financing-money-laundering/1092-ti-uk-submission-to-hm-treasury-national-risk-assessment-on-terrorist-financing-money-laundering>

that senior executives at the bank overruled their compliance team's warnings that this violated sanctions partly in place to stem the genocide in Darfur, on the grounds that the business was too good to turn down. (<http://www.justice.gov/sites/default/files/opa/legacy/2014/06/30/statement-of-facts.pdf>) But withdrawing entirely from markets as a measure of risk management is a very poor response by banks to enhanced prosecution. There can be no doubt that this is an inappropriate response to the threat. It results in the denial of financial services to innocent people, and opens up areas of the economy to black market and shadowy financial services. This affects countries that are considered to be high-risk as well as charities, remittance organisations and providers of humanitarian aid.

Furthermore, it is clearly a miss-application of global anti-money laundering rules. The intergovernmental body (FATF) which sets the rules made it clear that banks should only terminate or reject customers on a case-by-case basis when the risk of money laundering and terrorist financing cannot be mitigated. Crucially, banks should make sure that their application doesn't result in poor and vulnerable groups being denied access to vital banking services. (FATF statement: <http://www.fatf-gafi.org/topics/fatfrecommendations/documents/rba-and-de-risking.html>)

Financial inclusion of poor people, remittances and humanitarian aid are clearly important services financial institutions should provide. It is certainly true that there are border line cases in which it is difficult, in some cases extremely so, for banks to make the right call. FATF, national regulators, banks and civil society should work together to find ways of dealing with them. This might require a greater link between law enforcement and banks and investigators It would also be helpful if the business and charity sector would improve their reporting and anti-corruption procedures. Some banks are making positive noises and have shown willingness to collaborate with governments, regulators and charities to find constructive solutions within the parameters of the current rules (e.g. UK banks have been instrumental in helping to find a way to get humanitarian aid into Syria). This is the right approach, not seeking to undermine regulation which the countless recent scandals of bank misconduct have shown is vital.

But while there is some scope for improving regulations making sure they are fit for purpose, the general principle remains: banks should not be allowed to shy away from a proper risk assessment and risk management approach with regard to customers. Blanket denial of service is not a solution.

Given their role for the world economy financial institutions have a special responsibility to be accountable towards their stakeholders including investors, regulators, customers and citizens. Instead of continuing to outsource the costs of their actions to society, banks should be part of the solution and constructively engage with stakeholders to improve customer risk management in a way that is beneficial to society. Society is best served with a thorough and intelligent risk management approach and sanctions for wrongdoing through enhanced prosecution.