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The HSBC 2012 Deferred Prosecution Case: Its Meaning for E&C Programs

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On December 11, 2012, the U.S. Department of Justice (DOJ) issued a Deferred Prosecution Agreement (DPA) against global banking giant HSBC, filing a four-count criminal felony information in the U.S. Federal Court of New York, Eastern District, charging the bank with willfully failing to: (1) maintain an effective anti-money laundering (AML) program, (2) conduct third-party due diligence, (3) observe the International Emergency Economic Powers Act and (4) comply with the Trading with the Enemy Act.

In a nutshell, because of its lax controls, ineffective global compliance program, and absence of an ethical culture at the top echelons of the organization, criminals and drug cartels were able to use HSBC for decades for massive money laundering operations and other financial crimes to fuel illicit activity. For these deeds, HSBC received the DPA including the imposition of a compliance monitor for five years and an unprecedented US\$1.9 billion total in criminal and civil fines.

The HSBC case is particularly helpful to ethics and compliance (E&C) officers (and, ultimately, their executive management and boards). It demonstrates, perhaps more clearly than ever before, the U.S. government's acceptance and indeed embrace of E&C program constructs and concepts as critical to the rehabilitation of a wayward organization. The HSBC DPA reads almost like a roadmap to rebuilding a failed E&C program. Among the salient requirements imposed by the DOJ on HSBC [listed as 5(a)-(z) in the DPA] are the following, bucketed into several relevant E&C categories:

1. Leadership and E&C Program Structure:

- Leadership change required at the very top of global management including a new CEO, Chairman, CLO, CCO, Deputy CCO, AML Chief, and others. Eighteen of the 21 top officers in the bank are new since 2011.
- Replacement of the top Group Compliance Officer (GCO) and elevation of that officer to the 50 most-senior executives in the bank.
- The GCO now has global accountability for all compliance officers worldwide who report to him/her directly.
- Separation of compliance from the legal department.
- The AML officer reports directly to the GCO, the board, and executive management.

2. E&C Program Resources:

- Nine times greater budget allocated to AML than in previous year.
- Almost ten times more staffing for AML compliance than in previous year.

3. Compliance Tied to Performance Management

- Spreading of compliance accountability to all divisional and business line heads.
- Bonus and compensation tied heavily to compliance performance up to and including voiding of year-end bonus.
- A “claw-back” of deferred compensation for several compliance officers and the CEO should compliance objectives not be met.

4. Third-Party Risk Management:

- Treatment of HSBC affiliates as third parties for due diligence purposes.
- A wholly revamped, multifaceted “know your customer” third-party due diligence program.
- A simplification of the bank’s global organizational structure.
- Implementation of a single global set of risk factors and framework.

It is very significant that just in the past week, JP Morgan has deployed several of the lessons learned from the HSBC case, the most important of which for CECOs is the fact that JP Morgan’s new chief compliance officer will not work within the bank’s legal department but will operate more independently and report directly to senior executives and the board. This is a striking and encouraging voluntary move by a leading bank in the absence of a direct governmental order.

Some of the lessons that other banks—and, frankly, any type of company—can glean from the HSBC case (and from the JP Morgan case as well) would include:

- Don't let the compliance side of your house overwhelm the ethics side (if you have one). If you don't have an ethical culture, start building one championed and led by your executive and operational leadership.
- A "massively" understaffed compliance department is a gigantic red flag both internally and externally when government investigators and prosecutors come knocking on your door. Build and maintain appropriate E&C resources.
- The U.S. government, in particular the DOJ and the Securities and Exchange Commission (SEC), seems to support the separation of E&C from the legal department in some cases and the elevation of the CECO to the higher ranks of executive management. Use the HSBC and JP Morgan cases to build your own internal business case for greater independence and visibility.
- The "silo-ization" of a "too big to fail" organization is a telltale sign of trouble. E&C programs need to be integrated with other functions and business operations—they cannot operate in silos or in isolation from the remainder of the business. Work hard to integrate your E&C program both horizontally and vertically throughout your company.
- When government investigators and prosecutors look at an organization, the more complex and opaque it is (in terms of structure, reporting relationships, and products) the greater chances the government will dig deeper. There is real value to keeping things as simple and transparent as possible.

In its press release on the HSBC case, the DOJ stated:

"The record of dysfunction that prevailed at HSBC for many years was astonishing. Today, HSBC is paying a heavy price for its conduct, and ... if the bank fails to comply with the agreement in any way, we reserve the right to fully prosecute it ..." and

"All corporate citizens, no matter how large, must be held accountable for their actions."

I would like to think that we—the E&C community and, in particular, the ECOA—through the outreach work we have done over the past few years in Washington, specifically with the DOJ and the SEC, have made a difference in underscoring the value of E&C programs in the prevention and mitigation of criminal behavior as well as the building of an ethical culture. Our work may never be over but the HSBC DPA and JP Morgan's subsequent voluntary actions are very encouraging and show real progress in our quest to create more ethical *and profitable* organizations.

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