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The Morning Risk Report: HSBC Costs Illustrate New Cost of Banking

HSBC Holdings PLC's third quarter earnings call brought the striking revelation that nearly 25,000 of its 258,000 employees, almost 10%, work in compliance. Compliance was a major driver in the 5% increase in operating expenses reported, and management left no doubt that higher compliance costs would not go away soon, if ever. "I think that that's frankly a fixed cost of running this business model," said Chief Executive Stuart Gulliver.

Some applaud higher compliance spending. "While it may sound like a lot of resources dedicated to compliance, for a complex financial institution that is under a deferred prosecution agreement, having one out of 10 employees in compliance might make sense," observed Andrea Bonime-Blanc, chief executive of the consulting firm GEC Risk Advisory. Sabine Bauer, an analyst who follows HSBC for Fitch Ratings Ltd., said, "Strong corporate governance and related system upgrades come at a price…While higher costs will continue to hurt profitability, Fitch believes that tougher regulation and investments in compliance staff will ultimately strengthen banks' resilience against shocks."

Yet the cost is high enough to make banks a questionable investment proposition, according to Erin Davis, an analyst with Morningstar, who noted that compliance expense is a big part of the explanation for why major bank stocks are mostly trading at or under book value. "I think combined with the higher capital regulations it makes it really hard for a lot of global banks to have a credible plan to out-earn their cost of equity," she said. To some extent, she noted, the regulatory and compliance burdens may be helping to de-risk the banking sector, as banks reduce exposure to such high-risk, high-reward businesses as trading and investment banking for more easily understood lines, such as retail. Yet there is an unintended consequence of regualtion: it may increase risk by putting a premium on size and entrenching Too Big to Fail banks. "I think these high regulatory costs essentially increase returns to scale because they can only really be borne by large companies," she said.

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EXCLUSIVE ON RISK & COMPLIANCE JOURNAL

How to encourage bribery disclosure. Defense lawyers say their clients that uncover potential bribery issues struggle when deciding whether to report findings to the government or not. They're often torn between running to the government and hoping for a break, or trying to fix the problem in-house in hopes of avoiding a costly settlement, the Journal reported Monday. But these attorneys say there are a few changes from the U.S. Justice Department that could tilt the balance in favor of voluntary disclosure.

Bio-Rad pays to settle bribery probes. Bio-Rad Laboratories Inc. agreed to pay $55 million to settle U.S. Justice Department and Securities and Exchange Commission foreign bribery investigations, becoming the latest company to get a lighter penalty for telling the government about potential bribery issues.

Crisis experts comment on air bags. We asked crisis experts to focus on comments made by Takata Corp., the Japan-based company that manufactured the air bags being recalled by all the major automakers.

Risk management in real estate. Global real estate firm Jones Lang LaSalle Inc. has 53,000 employees but also an extensive network of third-party suppliers, many of which in turn have subcontractors of their own. The business model comes with risks as high-tech as cyberattack and as low-tech as a bribe passed to an elevator inspector. Maureen Ehrenberg, executive managing director of Jones Lang's Integrated Facilities Management business in the Americas, discusses those risks and others.

COMPLIANCE

J.P. Morgan discloses criminal probe. J.P. Morgan Chase & Co. said the Justice Department is conducting a criminal investigation of its foreign-exchange-related matters and bumped up a figure measuring the bank's potential legal costs by $1.3 billion, according to a regulatory filing that the bank released Monday, the WSJ reports. The Justice Department is working alongside other regulators focusing on civil enforcement, as talks on foreign-exchange settlements heat up with several banks and regulators across the U.S. and Europe, people familiar with the matter said.

Jury clears banker over tax evasion charges. A South Florida jury took only an hour to acquit former UBS AG wealth-management chief Raoul Weil of criminal charges he helped wealthy Americans evade taxes, delivering a blow to the Justice Department's probe aimed at stopping Americans from using Swiss banks to hide assets, the WSJ reports. Mr. Weil, whose trial began three weeks ago, was the highest-level executive to face criminal charges in the long-running Justice Department investigation. In a surprise move, Mr. Weil's defense team chose not to call any witnesses in their client's defense, instead sending the case to the jury Monday after the prosecution finished its case Friday.

SEC fines brokerages over Puerto Rico bonds. The Securities and Exchange Commission fined 13 brokerage firms for improperly selling junk-rated Puerto Rico bonds in increments below $100,000, the agency's first action under a rule designed to protect mom-and-pop municipal-bond investors from high-risk debt, the WSJ reports. Firms including Riedl First Securities Co. of Kansas and TD Ameritrade were among those that agreed to settle SEC charges that they sold portions of the U.S. commonwealth's $3.5 billion March bond offering that were smaller than the $100,000 minimum, the agency said.

U.K. ruling boosts pay. The U.K.'s Employment Appeal Tribunal ruled that overtime should be included in holiday pay, BBC News reports. It described the ruling as "groundbreaking" and said it means all people working voluntary overtime could claim for additional holiday pay. Currently, only basic pay counts when calculating holiday pay.

Indonesia to streamline permitting process. Indonesia will streamline the government's permit process by combining ministry licenses in a one-stop service, as the country seeks to attract investment to narrow a trade deficit, Bloomberg reports. Permits from ministries such as mining, forestry and transport will be moved to the investment coordinating board, said Coordinating Minister for Economic Affairs Sofyan Djalil in an interview with Bloomberg TV Indonesia in Jakarta.

Bank ordered to improve anti-money laundering controls. Gibraltar Private Bank & Trust Co. announced that regulators issued a new enforcement action over its anti-money laundering compliance, the South Florida Business Journal reports. The Office of the Comptroller of the Currency has issued a consent order against Gibraltar that essentially replaces a previous order, including requirements showing regulators weren't satisfied enough with the bank's progress.

CFTC official says regulators should help bitcoin. Bitcoin and other virtual currencies have great potential to reshape the financial-services industry, but policy makers should act quickly to establish a framework for their regulation, a top U.S. commodities regulator said, the WSJ reports. Mark Wetjen, a Democratic member of the Commodity Futures Trading Commission, said in an op-ed for the WSJ that bitcoin could provide "tremendous benefits" to individuals, particularly those in the developing world with limited access to banks, as well as people who rely on mobile-payment systems on their smartphones.

FATF preparing report on Australia. A delegation from the Financial Action Task Force has concluded its site visit in Australia and is now working on the country's final "mutual evaluation" report, Thomson Reuters reports. This report will be released at the FATF plenary meeting in Paris next year and will see the introduction of a new measure of the "effectiveness" of a jurisdiction's anti-money laundering regime.

U.S. says it's not targeting Myanmar. The U.S. blacklisting of a Myanmar politician and businessman ahead of a visit by President Barack Obama for a regional summit is intended to protect reforms and don't target the government, American officials said, the WSJ reports. Patrick Ventrell, a spokesman for the White House National Security Council, said Monday that blacklisting former minister Aung Thaung wasn't aimed at pressuring Myanmar's government "but rather targets an individual whose actions have undermined the democratic reform process." Neither he nor a Treasury spokesperson gave specifics.

China set to delay foreign TV shows. Recent Chinese broadcast rules look likely to delay foreign TV shows that had been available almost immediately for streaming on Chinese sites, possibly for entire seasons while censors review them, the WSJ reports. In September, the top broadcasting regulator said in a brief statement that it must approve all foreign television shows before they can be posted on Chinese video-streaming sites and that sites must pull unapproved content by early next year. Over the weekend, local Chinese media posted a draft of the rules by the regulator, the State Administration of Press, Publication, Radio, Film and Television, which said the censorship standard for streaming of foreign shows will be based on rules already applied to TV programming. The TV rules dictate that whole seasons of shows must be reviewed by censors before any episodes can air.

DATA SECURITY

Banks plan cybercrime communication platform. Wall Street soon will unveil its next line of defense against hackers, the WSJ reports. A group backed by the biggest banks plans early next month to launch a platform that would allow financial firms to communicate faster about potential cyber breaches, according to remarks to be made at an Internet-security conference Tuesday.

GOVERNANCE

Foot Locker CEO to retire. Foot Locker Inc. Chief Executive Ken Hicks plans to retire after this month, the WSJ reports. His successor, Chief Operating Officer Richard Johnson, will become CEO on Dec. 1. The handoff going into the crucial holiday selling season could rattle investors in the highflying chain. Foot Locker's shares have more than quintupled since Mr. Hicks took the reins in 2009, amid strong sales of big-ticket basketball shoes.

A+E CEO to retire, followed by another woman. Abbe Raven is announcing plans to retire Feb. 2 from A+E Networks, where she has spent her entire television career, the WSJ reports. In the process, she will complete the power transfer to her handpicked successor, Nancy Dubuc, 45, who last year had assumed the title of CEO. With her succession plan, Ms. Raven is doing something as unusual in corporate America as launching an entertainment business among underwear: handing over the reins of a major company to another woman.

IBM to replace unit head. International Business Machines Corp. plans to replace the head of its struggling technology-services unit, the latest move by Chief Executive Virginia Rometty to get Big Blue growing again, the WSJ reports. Martin Jetter, who has been leading IBM operations in Japan, has been named a senior vice president and will become head of IBM Global Technology Services, according to a notice from Ms. Rometty posted on an internal IBM website.

RISK

Baltic bank warns of Ukraine impact. The biggest bank in the Baltic region says sanctions against Russia are destroying its hopes of a recovery in credit demand in Estonia, Latvia and Lithuania, Bloomberg reports. Swedbank AB, a Swedish bank that lived through the 2009 Baltic housing collapse, was counting on a rebound in credit growth this year before the crisis in Ukraine upended its business plan.

India's ONGC hit by Russia sanctions. Plans by India's ONGC Videsh to drill for shale oil in Siberia could be delayed as sanctions against Moscow make it more difficult to work with U.S. firms to retrieve the hard-to-reach commodity in Russia, its managing director said, according to Reuters. The U.S. in September banned its firms from supporting exploration and production activities in deep water, Arctic offshore and shale projects in Russia.

REPUTATION

Emirates to end FIFA sponsorship. Emirates is dropping its sponsorship of FIFA, becoming the first backer to abandon soccer's governing body after allegations of corruption linked to voting on World Cup hosts and the group's presidency, Bloomberg reports. Emirates, the world's biggest international airline, said it won't extend the contract that began in 2006 and concludes this year.

OPERATIONS

Singapore passes first human-trafficking law. Singapore passed its first law to prevent human trafficking, Bloomberg reports. The law defines trafficking in persons, or TIP, and carries penalties including jail, fines and caning, according to Christopher De Souza, the member of parliament who proposed the legislation.

AUDIT

Companies making fewer restatements. Companies and their auditors appear to have a better handle on how to avoid major financial restatements, the WSJ's CFO Journal reports. Still, almost 1 in 4 restatements this year came with the warning that prior financial statements might not be valid, according to data and research firm Audit Analytics. While striking, that's down from more than two-thirds in 2005, the first full year that companies were required to make such disclosures under the Sarbanes-Oxley financial overhaul.