



Jersey Financial Services Commission

Public Statement

HSBC Bank Middle East Limited (“HBME” or “the Bank”)

Banking Business (Jersey) Law 1991, as amended (the “Banking Law”)

1. Action

- 1.1. The Jersey Financial Services Commission (the “Commission”) issues this public statement under Article 48(2) of the Banking Law.
- 1.2. This action supports the Commission’s objectives of protecting and enhancing the reputation and integrity of Jersey in commercial and financial matters and the need to counter financial crime both in Jersey and elsewhere.

2. Background

- 2.1. HBME is a Jersey incorporated company which provides a range of banking and related financial services in the Middle East, North Africa, and formerly, Pakistan. Its registered office is in Jersey and its operational headquarters are in the United Arab Emirates, where the majority of its customers hold their accounts. HBME is a wholly owned subsidiary within the HSBC Holdings plc group (“HSBC”).
- 2.2. HBME is authorised by the Commission to carry on deposit-taking business as defined in the Banking Law, and money services business, fund services business, general insurance mediation business and investment business, as defined in the Financial Services (Jersey) Law 1998. In addition to complying with Jersey’s regulatory regime, HBME must also comply with the regulatory requirements applicable in those other jurisdictions in which it operates.
- 2.3. On 30 November 2012, the Commission issued a Notice under Article 26(1)(b) of the Banking Law, requiring HBME to appoint a named Reporting Professional to conduct a detailed review of the Bank’s compliance with Jersey’s regulatory and anti-money laundering regime. The review was to focus primarily on the period from 1 January 2008 to 31 December 2012 (“the Reporting Period”).

- 2.4. The scope required the Reporting Professional, inter alia, to undertake a very detailed review of specific customer relationships, as directed by the Commission, in addition to reviewing an extensive random dip sample of HBME's remaining customer relationship population. Particular regard was to be had to customer take-on, risk assessment, and on-going review and monitoring procedures, in addition to an assessment of the effectiveness of HBME's systems and controls to prevent and detect money laundering and compliance with sanctions legislation in force in Jersey.
- 2.5. The Reporting Professional submitted its detailed report of findings to the Commission on 19 December 2014, together with a response from HBME's management setting out its observations on the report's content and plans to remediate the issues raised.

3. Findings

- 3.1. While the Reporting Professional considered HBME's internal control framework in place in the Reporting Period to be largely appropriate in terms of the requirements of Jersey's regulatory and anti-money laundering regime, as detailed further below, a significant number of findings were noted regarding its apparent lack of operational effectiveness.
- 3.2. The Reporting Professional also identified initiatives and improvements that the Bank had introduced to strengthen its anti-money laundering ("AML") and countering financing of terrorism ("CFT") defences during the course of the Reporting Period, but, overall, further work was needed to achieve full compliance with the regulatory standards.
- 3.3. In April 2012, HSBC Group's Chief Executive announced HSBC's commitment to implementing the highest or most effective standards to combat financial crime across its group, and since that time, HSBC has undertaken a complete overhaul of its AML and Sanctions Compliance programme globally. Further details of actions taken specifically by HBME in this respect are provided in Section 4 of this Public Statement.
- 3.4. The key findings of the Reporting Professional and the Commission are set out below. It should be noted that there was no indication that the Bank or its staff acted dishonestly, without integrity or in bad faith at any stage:

Corporate Governance

- 3.4.1. In June 2007, ahead of the effective date of the Money Laundering (Jersey) Order 2008, and the associated Handbook for the Prevention and Detection of Money Laundering and the Financing of Terrorism (the "AML Handbook"), HBME approached the Commission having noted that the draft AML Handbook contained provision for alternative approaches to compliance with its

requirements in circumstances where financial service business is conducted outside of Jersey.

HBME sought concurrence from the Commission that it could follow HSBC Group Global policies and procedures (“GPP’s”) and/or local country regulatory requirements rather than the detailed provisions of the AML Handbook, on the grounds of equivalence.

In response, the Commission requested HBME conduct and provide the Commission with:

- (i) a gap analysis of the FATF Recommendations against the Bank’s GPPs;
- (ii) gap analyses for each Bank country, cross-referencing the FATF Recommendations against the GPPs and overlaid with corresponding regulations from the relevant country; and
- (iii) a gap analysis between the provisions of the draft AML Handbook and the GPPs (together the “AML materials”).

The Reporting Professional found that a considerable amount of work was undertaken by HBME to assure itself and the Commission that the GPPs and/or local regulatory standards were equivalent to the requirements of the AML Handbook. The conclusion of this work was that in February 2008, the Bank confirmed that it was satisfied that its GPPs and/or local regulatory standards were equivalent with the requirements of the AML Handbook, with one exception that was consequently amended.

Whilst the Commission sought to satisfy itself with the nature and completeness of the process used by the Bank in reaching that conclusion, it did not seek to validate the conclusion drawn, this being considered the responsibility of HBME and its Board. The Commission noted the Bank’s intention to follow the higher standard of either its local regulatory requirements, or HSBC group requirements, rather than specifically, the requirements of the AML Handbook.

The findings of the Reporting Professional indicate that HBME’s initial gap analysis was not conducted wholly effectively, and with one exception, subsequent to the review of the AML materials, the Board and Audit Committee of HBME did not proactively consider the applicability of Jersey’s regulatory and anti-money laundering regime to the Bank or seek to assure themselves that the Bank remained compliant with the regime;

- 3.4.2. The provisions of Article 34D were inserted into the Proceeds of Crime (Jersey) Law 1999, as amended, with effect from 4 April 2008, introducing the offence of failure to disclose knowledge or suspicion of money laundering. Prior to the introduction of these provisions, HBME had communicated to the Commission its intention to file suspicious activity reports (“SARs”) locally in its operating

jurisdictions. However, following the introduction of the provisions of Article 34D, there was no evidence of any further consideration by the Board of HBME of legal obligations imposed on the Bank to file SARs submitted in these local operating jurisdictions with the Joint Financial Crimes Unit (“JFCU”) in Jersey.

It should be noted that this matter raised complex dual reporting obligation issues, and pending further consideration of these it has been agreed that the Bank should continue to file SARs in its operating jurisdictions and not with the JFCU;

- 3.4.3. The Bank is legally obliged to report any breaches of Jersey sanctions legislation to the Chief Minister’s Office in Jersey. In considering the findings of the Reporting Professional and the content of reports made to the Chief Minister’s Office by HBME, the Commission has concluded that the Bank failed to adequately detect breaches of Jersey sanctions legislation in a timely manner. During the period in which a breach remained undetected, the Bank accordingly also failed to report breaches of Jersey sanctions legislation in a timely manner.

It should be noted that in all instances voluntary disclosure was made to the Chief Minister’s Office and to the Commission of breaches of Jersey sanctions measures when these were detected by HBME, and prompt remedial action was undertaken by the Bank. The Reporting Professional did not identify any sanctions breaches that had not already been the subject of such voluntary disclosure.

- 3.4.4. While at the time the Commission’s AML Handbook was introduced, the Bank had satisfied itself, and had assured the Commission, that it was in compliance with the requirements to establish a formal strategy to counter money laundering and to commission a business risk assessment, the Bank had nonetheless departed from these requirements; and

- 3.4.5. While there is evidence that Compliance is now able to compel the Bank to exit a relationship, even when that relationship is large or otherwise important to the Bank, an example was cited of a circumstance where the Bank may have remained vulnerable to pressure to countermand instructions of the Compliance function to exit such a relationship, as a result of external factors, including differing regulatory environments and expectations.

Suspicious Activity Reports

- 3.4.6. Partly due to differing jurisdictional requirements, HBME’s SAR process was inconsistent across its operating jurisdictions with no standardised approach to recording investigations carried out and decisions taken. Although Compliance teams appeared to be alert to large cash transactions, adverse media reports on

account holders, high risk jurisdictions, and, to some extent, politically exposed persons (“PEPs”), it did not appear that there was always an awareness of more sophisticated money laundering typologies; and

- 3.4.7. a limited number of SARs had not been externally reported in a timely manner.

Training

- 3.4.8. Despite the provision of uniform foundation training to all HBME employees by Group e-Learning, the quality, quantity and content of local training material was highly varied across the jurisdictions reviewed and, generally, appropriate measures were not considered to have been taken at a local level to make HBME staff aware of the enactments in Jersey relating to AML, CFT, and sanctions; and
- 3.4.9. Notwithstanding the frequency with which compliance monitoring reviews identified deficiencies in staff awareness, there appeared to have been little appreciation of the relationship between effective training and effective performance, and no consideration of whether the performance issues were related to ineffective training provided previously.

Review of customer files – named relationships

- 3.4.10. The reviews of each of the named relationships identified both areas of concern and examples of good practice common to most or all of the relationships. The general trend was material non-compliance with Jersey’s regulatory, anti-money laundering and sanctions regime during the beginning and middle of the Reporting Period, followed by a substantial improvement in standards of compliance towards the end.

Review of customer files – dip sample of 100 customer relationships

- 3.4.11. CDD was assessed as not entirely adequate in 83 of the 100 customer relationships reviewed, with the most common issues being lack of address verification, inadequate certification of documents, and insufficient ownership and control information;
- 3.4.12. Of the 100 customer relationships reviewed, 86 were assessed by the Reporting Professional as presenting a high risk from an AML/CFT perspective, warranting the conduct of enhanced due diligence (“EDD”). HBME had not assigned a high risk rating to 39 of these relationships, however, it is noted that in 25 of these, HBME disagreed with the view of the Reporting Professional that the relationships should be classified as high risk. The Commission has not sought to reach a view on the disputed risk status of those relationships, but risk classification and the response to it will be an area of greater future regulatory

scrutiny, particularly given that in the relationships HBME did class as high risk, in only two cases were the EDD measures assessed by the Reporting Professional to be adequate;

- 3.4.13. HBME correctly identified 42 customer relationships as having PEP connections and assigned them the correct risk rating. However, in the view of the Reporting Professional, the Bank failed to properly deal with the PEP status of individuals in seven cases (and in two cases, the potential PEP status of individuals), and accordingly, did not assign the correct risk rating to those relationships. Steps were not taken to establish the source of wealth of relevant PEPs in all applicable relationships, and in few applicable relationships was source of wealth verified or verified adequately; and
- 3.4.14. In certain instances, customer relationships were not reviewed when trigger events occurred, and screening and payment alerts were closed without sufficiently documented rationale.

Systems

- 3.4.15. Issues were noted by the Reporting Professional with the operation of certain systems, whereby inaccurate population of data rendered the Bank's sanction payment screening filters less effective in four of the 415 payments that were reviewed. An in-depth review of HBME's screening systems concluded the problem was not widespread and was restricted to a very small volume of client data.

4. HBME's Remediation Plan

- 4.1. HBME dedicated considerable resources to co-operating with the Reporting Professional and has acted both proactively and in response to the recommendations to make improvements to its financial crime systems and controls.
- 4.2. Many responses to the recommendations overlap with improvement programmes which were either already in place or had been planned regardless of the review, the most significant of which being the launch of HSBC's Global Standards Programme aimed at putting in place the highest standards to combat financial crime group wide. Since 2010, a strong, clear message has been conveyed from the Board of HBME, aimed at addressing cultural barriers and establishing appropriate expectations.
- 4.3. Management of HBME has further demonstrated commitment to put into effect an appropriate remediation plan, as agreed with the Commission, and to continue to dedicate sufficient resources to the task of improving its AML/CFT defences.

- 4.4. By way of example, in terms of remediation progress to date, HBME has:
- 4.4.1. Undertaken a significant number of de-risking steps in respect of operating jurisdictions, products and customer base;
 - 4.4.2. Restructured its Compliance function and changed the focus of the Compliance role from purely advisory to a more proactive supervisory role;
 - 4.4.3. Significantly increased headcount in its Financial Crime Compliance department, including the appointment of senior and experienced personnel to oversee the development of its AML and CFT defences;
 - 4.4.4. Elevated and strengthened the role of Financial Crime Compliance globally so that it is now a key control function rather than just an advisory function;
 - 4.4.5. Improved focus on knowledge, culture and building new skills through appropriate training, employee communications, and embedding values focused on significantly raising the profile of AML/CFT with employees;
 - 4.4.6. Enhanced financial crime intelligence capabilities through the establishment of a global network of Financial Intelligence Units to assist in the identification and investigation of significant cases, trends and strategic issues related to financial crime risks;
 - 4.4.7. Responded to AML/CFT risks by strengthening the rigour with which customers are evaluated and researched; improving customer profiling, screening and risk scoring; remediating CDD issues; and putting in place a global customer selection and exit policy;
 - 4.4.8. Enhanced the Bank's monitoring and compliance with sanctions legislation in force in Jersey; and
 - 4.4.9. Appointed a Regional Head of Regulatory Affairs and Policy, tasked with monitoring regulatory changes.
- 4.5. HBME's remediation plan has been discussed at length with the Commission and significant progress has been made to date in its execution. The effectiveness of implementation of the plan will be independently verified during the course of 2015/16, and closely monitored by the Commission in liaison with regulators in the relevant jurisdictions.

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