

Standard Chartered and Sanctions Violations

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The rash of controversies in the banking sector has been covered by our ESG research for several years. Rate-rigging, as in the cases of LIBOR, TIMOR, and EURIBOR, as well as sanctions violations, as in the case of the transaction ID “stripping”, exemplify the governance lapses we highlight that can have potential long-term reputational and litigation costs to the company.

On August 6, the New York Department of Financial Services (DFS) alleged that Standard Chartered violated U.S. sanctions by concealing US \$250 billion worth of Iranian transactions through its U.S. operations during the period between 2001 and 2010. The transactions, known as U-Turn transactions, involved clearing funds for Iranian clients through Standard Chartered’s New York based branch before transferring those funds back to offshore accounts. This practice was legal until 2008 for non-US banks, at which point it was banned entirely. The bank agreed on a US \$340 million settlement with DFS, though investigations with several other U.S. regulatory authorities are pending. Standard Chartered is the most recent to settle in the wake of several large-scale investigations into sanctions violations at global banks.

We believe the systematic nature of sanction-related violations can pose reputational and legal costs to the banks implicated. However, there is reason to have **less concern in the specific case of Standard Chartered**. Standard Chartered’s geographic footprint, which covers much of Asia, the Middle East, and Latin America, poses generally higher compliance costs given greater prevalence of government sanctions, particularly U.S. sanctions against Iran, Libya, and Cuba. Should the bank lose the ability to clear transactions in the U.S. dollar, its business model would be severely undermined. However, while the circumstances of Standard Chartered’s sanction violations are similar in nature to several other major banks that have been fined in the past 3 years, we believe the incidents have less impact on Standard Chartered’s outlook relative to its global banks peers:

- The **lack of systematic, willful, or patterned behavior** suggests limited scope of damage to the firm’s reputation in contrast with competitors with structural governance failures that faced similar allegations and admitted violating sanctions law. Standard Chartered confirmed that US \$300 million of transactions (approximately 0.1% of the alleged US \$250 billion of volume during the period between 2001 and 2010) were not in compliance with U.S. sanctions laws. In comparison, competitor banks have admitted to significantly larger transgressions as part of their settlements, often in the hundreds of millions or billions of dollars.
- **Global peer banks fined for similar practices have exhibited a wide range of governance and management lapses**, having paid fines or been subject to litigation for roles in the subprime mortgage crisis, rate-rigging scandals, improper foreclosures, tax evasion, fraud and improper selling to customers, and insider trading. Our MSCI ESG IVA ratings highlight a number of structural issues facing bottom performers charged with sanctions violations, including *Citigroup*, *Credit Suisse*, *Barclays*, *Wells Fargo*, and *JPMorgan*. Each faces questions surrounding internal controls, the costs of which are still unknown. In contrast, **Standard Chartered has consistently ranked highly in our ratings**, outperforming peers for its strong governance controls and business model that focuses on deposit and loan growth through

organic expansion into underbanked markets. Given this, Standard Chartered is in a better position to withstand the reputational damage of this incident.

- Following changes to U.S. sanctions law in 2008, Standard Chartered virtually ceased transactions in Iran to ensure compliance. This suggests **limited long-term material effects** as the bank has not been dependent on revenue streams derived from these types of transactions for at least four years.
- In a broader context, large foreign banks have faced larger fines by U.S. regulators. **ING, HSBC, Lloyds Banking Group, Barclays,** and **Credit Suisse** have each been fined for similar actions as Standard Chartered in the last three years for violating sanctions acts. Table 1 below details the type of sanction or violation, volume of transactions alleged to have been in violation of U.S. law, and settlement costs. Foreign banks have paid the vast majority of the settlement costs to date, and it is unclear whether or how domestic U.S. banks will be investigated. It is possible that U.S. banks face higher risk of incurring sanctions-related costs going forward, as foreign banks have internalized these costs already. Alternatively, U.S. regulators may show greater leniency toward domestic banks in penalties.

As a result of this controversy, Standard Chartered has been assessed with a ‘Severe’ status under Governance and a corresponding ‘Yellow’ flag in our MSCI ESG Impact Monitor research, and has been downgraded in our ESG ratings from ‘AAA’ to ‘AA’. Overall, Standard Chartered continues to rank among the strongest global banks on key environmental, social, and governance issues, and though we feel a downgrade from its ‘best-in-class’ rating is warranted given the nature of the controversy, we have limited concerns about the long-term implications of the investigation.

Bank	Violation	Admitted		Years	Date of		Notes
		Volume (USDm)	Timeframe		Fine (USDm)	Fine	
ING	Sanctioned Countries	\$1,600	1990 to 2007	17	\$619.0	6/12/2012	Admitted stripping identification from transactions to conceal countries of origin.
Credit Suisse	Iran Sanctions	\$1,200	1986 to 2007	21	\$538.0	12/15/2009	Admitted stripping identification from transactions to conceal countries of origin.
RBS	Sanctioned Countries	\$3,200	1995 to 2005	10	\$500.0	5/1/2010	Admitted stripping identification from transactions to conceal countries of origin.
Lloyds	Iran Sanctions	\$600	1995 to 2008	13	\$350.0	1/1/2009	Admitted stripping identification from transactions to conceal countries of origin.
StanChart	Iran Sanctions	\$300	2001 to 2010	9	\$340.0	8/14/2012	Admitted to error in USD 14m of USD 250bn transactions, denies concealing identification.
Barclays	Sanctioned Countries	\$500	1995 to 2006	11	\$298.0	8/17/2010	Admitted stripping identification from transactions to conceal countries of origin.
HSBC	Sanctioned Countries	\$1,000	2006 to 2010	4	\$700.0 est	estimated	Under investigation for money laundering with terrorist firms and violating country sanctions.
Wells Fargo	Money laundering	\$378,400	2004 to 2007	3	\$160.0	3/12/2010	Wells Fargo admitted processing transactions linked to known Mexican drug cartels.
JPMorgan	Sanctioned Countries	\$181	2005 to 2011	6	\$88.3	8/25/2011	Alleged to failed to notify regulators for transactions for clients in sanctioned countries.
Citigroup	Money laundering	n/a	n/a	n/a	\$0.0	n/a	Found to have "deficient controls" in monitoring the financing of terrorism.
Non-US Banks		\$8,400	1986 to 2010		\$3,345	93%	
US Banks		\$378,581	2004 to 2011		\$248	7%	

Table 1: Sanctions acts violations in the banking sector

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