Getting Serious About Sanctions-Busting Banks

If a firm like BNP Paribas is convicted of a criminal offense, it may be restricted in its ability to clear dollar transactions.

By ROY C. SMITH And INGO WALTER
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BNP Paribas is expected any day to admit to criminal violations of U.S. sanctions against Iran and Sudan. This is likely to mean that the giant French bank will pay a fine of between $8 billion and $10 billion to the U.S. government, dismiss several executives, and temporarily cease its dollar-clearing business. The case has dramatically elevated the liability of global banks to the regulatory enforcement of U.S. law.

Trade and financial sanctions have long had a place in international affairs—from the high-profile sanctions applied to South Africa under apartheid to their increasing use as a substitute for military intervention in countries including Iraq, Libya, Iran, Cuba, Sudan and most recently Russia, where they are pending. They've attempted to discourage countries from building nuclear weapons, abusing human rights or invading their neighbors. Such sanctions, however, have been controversial because they have appeared to lack the cohesion and determination of allies to make them work effectively.

The U.S. prosecution of a major international bank for evading sanctions has changed the game. BNP allegedly stripped out identifying information from wire transfers to disguise sanctioned countries as origins or destinations of international payments. By raising the cost of violating the rules to significant levels, the Justice Department has ensured that U.S. sanctions will be complied with and effective.

Foreign banks and their home governments may or may not agree with the policies underlying the U.S. sanctions. But like it or not, in the dollar world U.S. law is the law. Banks around the world must comply or face consequences that have been escalating steadily since 2005. Banks including HSBC, ABN Amro, Standard Chartered, Lloyds, Barclays, Credit Suisse and now BNP have ponied up more than $20 billion to settle money-laundering and tax-evasion charges. The stocks of these banks also lost significant amounts of market value as a result of the settlements. BNP shares lost about 4% of their value after the bank was reported to be in settlement discussions.

More important than the size of the fines, however, is that the most recent lawsuits against Credit Suisse and BNP...
were brought under criminal, not civil, law. Technically the guilty plea by Credit Suisse was from a non-U.S. subsidiary that does not hold a U.S. banking license. But the two cases are warning shots. If a license-holding financial-services entity is convicted of a criminal offense, it may lose the right to do business in the U.S. The Justice Department reportedly sought the assurance of state regulators that admissions of guilt would not require the banks to surrender their licenses. But future cases might be handled differently.

Global banks today settle most of their trade and financial transactions in U.S. dollars. This is a large and profitable business for these banks, and one that it is necessary for them to service client transactions. They must have access to the U.S. clearing and settlement apparatus to conduct it.

Sanctions that restrict access to the dollar market can be very burdensome for targeted countries, particularly those with mineral resources that need to be sold abroad. Sanctions on countries like North Korea may have been ineffective, but those applied to Iran have been significant. Russia may be next, and because Russia depends on dollar-priced oil exports, it is vulnerable.

Russian President Vladimir Putin recently said he hopes to switch Russia’s enormous dollar trade in oil to the Chinese yuan, in order to reduce the impact of financial sanctions. That may be difficult, since the yuan is neither convertible nor widely used as a currency for international trade.

Mr. Putin may assume he can find banks willing to help subvert sanctions via the yuan and drive wedges between the U.S. and more sympathetic European governments. But such banks would put at risk their U.S. business and their ability to undertake clearing other currencies for U.S. dollars. Beijing may also want to think twice before putting Chinese banks’ access to the dollar market at risk to help Mr. Putin.

Many bankers and lawyers believe that the Justice Department has applied its considerable powers unfairly against BNP Paribas. The lawsuits are against the shareholders of the banks, not individuals deemed to be responsible for the alleged misconduct. Fair or not, the case demonstrates how much power the government has when it wants to enforce its rules.

Several major U.S. banks, including Bank of America and Citigroup, are trying to avoid paying massive fines related to their sales of mortgage-backed securities, and, conceivably, might go to trial rather than settle. These cases are subject to civil law and their licenses to do business are not at stake.

Sanction and tax evasion cases are a different matter. U.S. banks have not been among the offenders, but some foreign banks apparently assumed they could get around U.S. sanctions with impunity. They haven’t. The Justice Department has made it clear it will use the criminal law to enforce the rules even when the banks’ government officials have attempted to intervene.

BNP Paribas shows that the U.S. can and will impose financial sanctions unilaterally in the dollar market without the broad agreement that is typically required for other international policy issues. By pursuing this case, the U.S. government has dramatically boosted the credibility of financial sanctions that banks around the world now need to take very seriously.

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Correction
A sub-headline in an earlier version of this article mistakenly said BNP could lose the ability to do business in the U.S.