

HSBC's Swiss Private Bank

Progress Update - January 2015

Overview

HSBC Global Private Banking ('GPB') and in particular its Swiss private bank have undergone a radical transformation in recent years. HSBC has implemented numerous initiatives designed to prevent its banking services being used to evade taxes or launder money.

In the past, the Swiss private banking industry operated very differently to the way it does today. Private banks, including HSBC's Swiss private bank, assumed that responsibility for payment of taxes rested with individual clients, rather than the institutions that banked them. Swiss private banks were typically used by wealthy individuals to manage their wealth in a discreet manner. Although there are numerous legitimate reasons to have a Swiss bank account, in some cases individuals took advantage of bank secrecy to hold undeclared accounts. This resulted in private banks, including HSBC's Swiss private bank, having a number of clients that may not have fully met their applicable tax obligations.

We have taken significant steps over the past several years to implement reforms and exit clients who did not meet strict new HSBC standards, including those where we had concerns in relation to tax compliance. We have also refocused our Swiss private bank on clients from strategic markets of the Group, such as owners and principals of the Group's commercial banking clients. As a result of this repositioning, HSBC's Swiss private bank has reduced its client base by almost 70% since 2007.

We are fully committed to the exchange of information with relevant authorities and are actively pursuing measures that ensure clients are tax transparent, even in advance of a regulatory or legal requirement to do so. We are also cooperating with relevant authorities investigating these matters and we acknowledge and are accountable for past control failures.

Changing Industry Expectations

Regulatory and public expectations of a bank's role in ensuring tax compliance by its clients have dramatically shifted. Banks are now expected to assist tax authorities in pursuing tax evaders in addition to not facilitating tax evasion or any form of non-compliance with tax obligations.

Major regulatory reform is underway in numerous jurisdictions to ensure the timely sharing of information with relevant authorities. Bilateral tax treaties, FATCA, OECD's Common Reporting Standard and other initiatives are designed to foster greater transparency and ensure that in the near future, an individual wishing to "hide" assets from tax authorities will be unable to do so.

HSBC fully welcomes and supports these reforms, including the move to Common Reporting in 2016-2018, and is already in the process of adopting all necessary measures to fulfil its obligations.

HSBC Reforms

History

Prior to the acquisition in 1999 of Republic National Bank of New York and Safra Republic Holdings SA, a US private bank, HSBC had a small private banking activity focused mainly on Group clients. The Swiss private bank was largely acquired through this transaction. The Republic/Safra business focused on a very different client base and had a significantly different culture to HSBC. The business acquired was not fully integrated into HSBC, allowing different cultures and standards to persist. With hindsight, it's clear that too many small and high risk accounts were maintained and the business was stretched over more than 150 geographical markets.

We acknowledge that the compliance culture and standards of due diligence in HSBC's Swiss private bank, as well as the industry in general, were significantly lower than they are today. At the same time, HSBC was run in a more federated way than it is today and decisions were frequently taken at a country level.

Beginning in 2008 HSBC began to put a more rigorous control structure in place in the Swiss private bank by, for example, introducing a new policy on US persons and reducing the number of US taxpayer accounts. In 2010, the Swiss private bank decided to exit US resident client business entirely.

Present

In January 2011, new Group management fundamentally changed the way that HSBC is structured, managed and controlled. It was reorganised along four global business lines: Global Banking & Markets, Global Private Banking, Commercial Banking and Retail Banking & Wealth Management. In addition, Global Functions, including Risk & Compliance, Legal, and Audit were created to ensure central control and improved oversight.

At the same HSBC undertook a complete overhaul of its entire private banking business, adding to initiatives it had previously taken in connection with US clients beginning in 2008. For the first time global management of GPB was moved to Switzerland to undertake this de-risking and re-shaping.

GPB has reverted to its previous business model of focusing on the owners and principals of the Group's commercial banking clients. Today, the management team in Switzerland which is carrying out these reforms is substantially different to the period before 2011.

Detailed changes

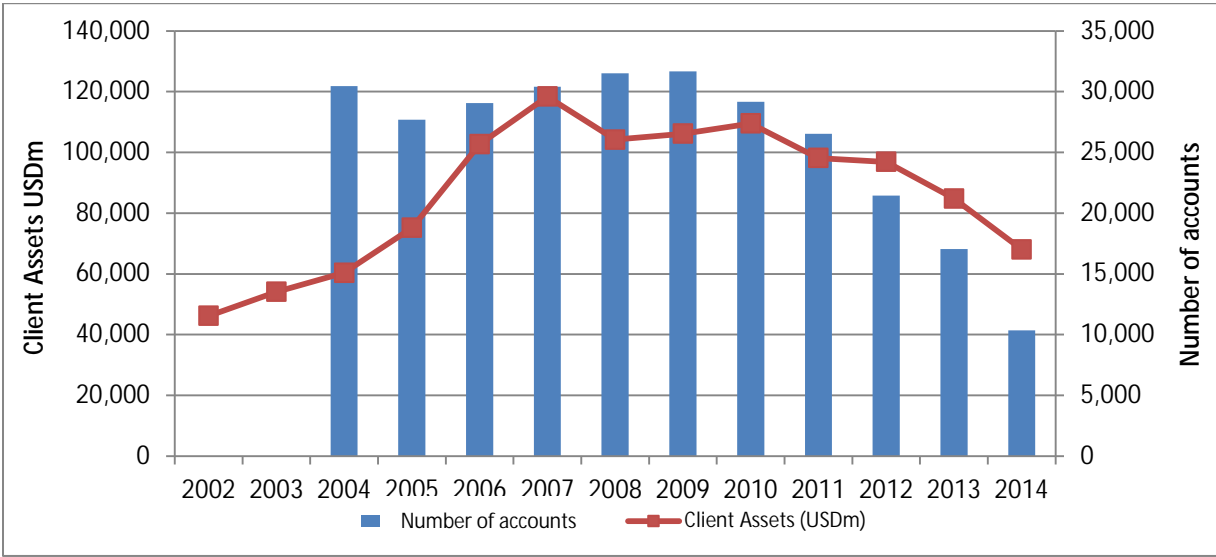
Beginning in 2012, GPB developed a tax transparency policy, stating that it will close accounts and refuse any new business where it has reason to believe the client or potential client is not in full compliance with relevant tax obligations. Under the tax transparency initiative, a review was conducted of existing accounts the bank intended to maintain. Each account was reviewed against a standard checklist to identify potential indicators of non-compliance with tax obligations. Any issues were further investigated and if not satisfactorily resolved, the account was closed or put in the process to be closed as soon as practicable.

Under the tax transparency initiative, we also enhanced both our 'know your customer' (KYC) procedures, including an independent validation by auditors, and our anti-money laundering (AML) procedures to ensure a more complete consideration of a new client's source of wealth.

We amended our standard terms and conditions to require the client to affirm that they are in compliance with their tax obligations. The amended terms and conditions allowed the private bank to refuse a cash withdrawal request, and placed strict controls on withdrawals over \$10,000. Where legally permissible, the terms and conditions provide HSBC with the right to disclose a client's information to relevant tax authorities. We discontinued the hold mail service and we implemented a new policy to remediate any bearer shares in non-individual accounts.

In addition, we have withdrawn from markets where we are unable to conduct due diligence to a satisfactory standard on our clients. We review all Politically Exposed Persons annually at the highest levels within the Group and use our Financial Intelligence Unit to support this process. In line with the rest of HSBC Group, GPB has significantly increased the number of people working in Risk and Compliance.

The result of our reforms is evident as the number of accounts and total client assets of the Swiss Private Bank have been actively managed down by this intensive de-risking exercise, where we have put compliance and tax transparency ahead of profitability:



- In 2007, the Swiss Private Bank had 30,412 accounts. At the end of 2014, we had reduced that number to 10,343.
- In 2007, the Swiss Private Bank had total client assets of USD118.4 billion. At the end of 2014, that number has been actively managed down to USD68 billion.
- In 2007, the Swiss Private Bank covered clients resident in over 150 countries. We are in the process of exiting clients residing in over 100 of those countries.

Global Standards

As a wider context, in April 2012 HSBC Chief Executive Stuart Gulliver announced HSBC's commitment to implement the highest or most effective standards across the Group to combat financial crime. HSBC is following through on that commitment to Global Standards, and is now just over two years into a five-year programme to transform the way that HSBC manages financial crime risk. The steps HSBC has taken globally to de-risk and the comprehensive reforms the Group is putting in place will ensure that HSBC has a robust, sustainable anti-money laundering and sanctions compliance programme. Among other steps, HSBC has:

- Successfully met a number of key sanctions obligations under a two-year Deferred Prosecution Agreement with the District Attorney of New York, resulting in the expiry of this DPA in December 2014.
- Strengthened Board and senior executive management over financial crime issues
- Added 1,750 compliance professionals between Q4 2013 and Q3 2014, taking the total number of compliance staff across the Group to 6,900.
- Reduced the overall financial crime risk that we are exposed to – by exiting products, customers and markets where the financial crime risks were too great to be managed.
- Published global policies for AML and Sanctions (our global standards) and we are deploying the systems, processes, training and support to implement the policies everywhere HSBC operates.
- Established a global network of Financial Intelligence Units (FIUs) to identify and investigate significant cases, trends and strategic issues related to financial crime risks and share relevant data and intelligence across the Group.

Data theft

Over a period of several months at the end of 2006 and early 2007, an IT employee of the Swiss Private Bank, Hervé Falciani (HF), systematically and deliberately downloaded details of accounts and clients. This was a blatant criminal violation of Swiss law. HF is accused of attempting to sell the data to Lebanese banks under a false name, as the Swiss Attorney General made clear in a press release on 11.12.2014 (<https://www.news.admin.ch/message/index.html?lang=en&msg-id=55629>).

HSBC has no record of HF ever escalating any concerns to his line management, or using the Whistleblowing hotline that was in place at the time of the theft.

French authorities originally seized the stolen data from HF's parents' house in France. The data was not relinquished by HF voluntarily. Since that time, the French authorities have subsequently shared the data with numerous governments around the world. HSBC has cooperated and continues to cooperate to the extent that it can with requests for information from governments regarding account holders. However, providing client data to foreign authorities would itself constitute a criminal offence under Swiss law.

It is unclear if the integrity of the data has been preserved, or even if the original data itself was complete and accurate. Recent allegations by a French law enforcement official in Nice, suggest that the data has been manipulated and could therefore contain material inaccuracies.