

Restoring trust

February 2021

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Restoration of trust in our industry remains a significant challenge as past misdeeds continue to remain in the spotlight. But it is a challenge we must meet successfully. We owe this not just to our customers and to society at large, but to our employees to ensure they can be rightly proud of the organisation where they work. We aim to act with courageous integrity in all we do. This guiding principle means having the courage to make decisions based on doing the right thing for customers and never compromising our ethical standards or integrity.

We have also sought to learn from past mistakes, such as the following three examples, and we are seeking to develop and implement specific measures designed to prevent recurrence of similar events in the future.

Anti-money laundering and sanctions

Between the 1990s and 2010, as acknowledged by HSBC in various agreements with US and UK authorities in 2012, HSBC failed to implement appropriate anti-money laundering ('AML') and sanctions controls. These oversight and control failures resulted in HSBC allowing at least \$881m in drug proceeds to be laundered through HSBC into the US financial system and approximately \$660m in transactions involving sanctioned countries, such as Iran, Cuba, Sudan, Libya and Burma, to be processed, in violation of applicable US laws.

In December 2012, HSBC entered into resolutions with, among others, the US Department of Justice ('DoJ') and the UK Financial Services Authority (now the Financial Conduct Authority, or 'FCA'), regarding these past AML and sanctions-related failings. Under these agreements, which included a five-year deferred prosecution agreement with the DoJ (the 'AML DPA'), HSBC made payments totalling \$1.9bn to US authorities and undertook various further obligations, including the retention of an independent compliance monitor. Over the past several years, we have radically restructured our global operations and significantly strengthened our ability to combat financial crime.

We recognise that we have a responsibility to help protect the integrity of the global financial system. In order to fulfil that responsibility, we have made, and continue to make, significant investments in our ability to detect, deter and prevent financial crime. We have exited customers, products and countries where we deemed the financial crime risk too high to manage. We are also working with governments and other banks to advance our mutual interests in this area. These steps are enabling us to much more effectively reduce the risk of financial crime.

In 2012, we launched our Global Standards initiative, which focused on putting in place the most effective standards to combat financial crime across our operations globally. As part of this effort, we designed and implemented new, globally consistent policies on AML and sanctions that often extend beyond the requirements of local laws and regulations. Among other steps, we hired experienced senior personnel to lead the effort and significantly increased our financial crime compliance capabilities; we put in place a robust investigations capability; we improved and expanded our financial crime compliance training initiatives; and we upgraded or replaced key compliance IT systems, with over \$1bn spent since 2015. In 2013, we also established a Financial System Vulnerabilities Committee ('FSVC') to oversee our financial crime risk management reforms. The FSVC reported to the Board on matters relating to financial crime and financial system abuse, and provided a forward-looking perspective on financial crime risk, anti-bribery and corruption. More recently, in order to simplify our governance framework and processes, and as a reflection of the completion of Global Standards and the growing maturity of our financial crime and fraud risk management, responsibility for the oversight of financial crime risk has now transferred from the FSVC to the Group Risk Committee, with the final meeting of the FSVC taking place on 15 January 2020.

Beyond these improvements, as part of our commitment to protect the integrity of the financial system, and to do our part to fight financial crime, we continue to enhance our systems and are working to integrate our reforms into our day-to-day risk management practices so that our programme is effective and sustainable over the long term. We continue to focus on anti-bribery and corruption as part of a dedicated three-year programme to advance the Group's anti-bribery and corruption risk management capability. As part of our commitment to the UN Global Compact, we have pledged to work against corruption in all its forms, including extortion and bribery.

The AML DPA expired in December 2017, and we are pleased that our progress in strengthening our AML and sanctions compliance capabilities has been recognised. Our work in this area will continue to be consistent with our strategic priority of safeguarding our customers and delivering industry-leading financial crime standards.

Over the coming years, we aim to evolve significantly our approach to financial crime risk management by building advanced analytical capabilities, including artificial intelligence, designed to help us target illicit conduct with greater sophistication and precision. This will help us make a step change in our effectiveness at fighting financial crime and set a new standard that aims to lead the industry. We continue to build a dynamic risk assessment process which will enable us to be faster and more accurate at detecting potential financial crime. We expect to generate actionable insight that we can use ourselves and provide to law enforcement to help keep criminals out of the financial system. This will benefit the Group, our customers and society at large.

Customer tax evasion

Prior to 2011, our Swiss private bank provided its customers with traditional Swiss banking services, which enabled customers to conceal their assets from tax authorities and avoid paying their taxes. These services included, among other things, the opening of encoded numbered accounts that kept the account holder's name confidential and the provision of 'hold mail' services whereby all mail was kept at the bank for customers to avoid receiving letters at their domestic addresses. Our Swiss private bank, through certain of its relationship managers, offered these services with the knowledge that customers would use them in order to conceal their assets from tax authorities.

HSBC has already reached agreements with multiple law enforcement authorities to resolve investigations relating to allegations of tax evasion or tax fraud, money laundering and unlawful cross-border banking solicitation arising out of these past practices. These include the deferred prosecution agreement entered into between our Swiss private bank and the DoJ in December 2019 (the 'Swiss Tax DPA'). The Group continues to cooperate in ongoing investigations by other tax administration, regulatory and law enforcement authorities around the world in connection with similar allegations. We acknowledge that the compliance culture and standards of due diligence in our Swiss private bank were significantly lower in the past than they are today. With hindsight, it is clear that we maintained too many small and high-risk customer accounts and our private banking business was stretched over too many geographical markets, all of which contributed to failings in standards, culture and controls.

In recent years, our private banking business has taken significant steps to address these historical control weaknesses, most notably in Switzerland. Beginning in 2012, our private banking business developed a tax transparency policy that included enhanced know your customer ('KYC') and AML procedures and a review of existing accounts against potential indicators of non-compliance with tax obligations. Accounts were closed where issues were identified and could not be resolved. Our private banking business has also amended its standard terms and conditions, which now require customers to affirm that they are in compliance with their tax obligations, allow the bank to refuse requests for cash withdrawals and place strict controls on withdrawals over \$10,000. Furthermore, our private banking business discontinued its 'hold mail' service and has withdrawn from markets where it has been unable to conduct due diligence to a satisfactory standard on its customers. These significant reforms have been noted by law enforcement authorities. For example, in the Swiss Tax DPA, the DoJ acknowledged that our Swiss private bank had, among other things, "substantially reduced the total number of markets and clients it serves"; "undertaken substantial remedial measures and extensively cooperated with the Department of Justice and IRS's investigation"; and "implemented new policies and procedures intended to protect against the use of its services for tax evasion, including policies limiting cash withdrawals and discontinuing the use of hold mail, as well as a tax transparency policy that required a review of accounts against possible indicia of tax evasion and the closure of any account with unresolved issues".

The number of accounts and total customer assets of our private banking business have been significantly reduced by this intensive de-risking exercise, where we have put compliance and tax transparency ahead of profitability. Where we used to offer banking services to customers in more than 140 countries, our private banking business now focuses on 35 strategic markets, with customer assets actively managed down by \$140bn between 2013 and 2018.

Foreign exchange conduct

Prior to 2013, our foreign exchange ('FX') business lacked adequate governance, oversight and risk management to ensure compliance with safe and sound banking practices and applicable internal policies. As a result, we failed to detect and address unsafe and unsound conduct by certain of our FX traders, which included the misuse of confidential inside information to conduct FX trades, possible agreements with traders of other institutions to coordinate FX trading and disclosure of confidential information to traders of other institutions.

In November 2014, HSBC agreed to regulatory settlements with the FCA and the US Commodity Futures Trading Commission in connection with their respective investigations of HSBC's trading and other conduct involving FX benchmark rates. In September 2017, HSBC entered into a consent order with the US Federal Reserve Board ('FRB') in connection with its investigation into HSBC's FX activities. Under the terms of that order, HSBC agreed to undertake certain remedial steps and to pay a civil money penalty to the FRB. In January 2018, HSBC Holdings plc entered into a three-year deferred prosecution agreement with the DoJ ('FX DPA'), regarding fraudulent conduct in connection with two particular transactions in 2010 and 2011. Having met our obligations under the FX DPA, in January 2021, the FX DPA expired. Under the terms of the FX DPA, the DoJ is expected to file a motion to dismiss the charges deferred by the FX DPA in due course.

Since the historical conduct described in these agreements, we have introduced a number of measures designed to make the control environment more robust and prevent these failings from recurring in the future. We have dedicated, and continue to dedicate, significant resources to strengthen our systems and controls. While the investigations focused specifically on our FX activity, they have also given us good reason to look again at other aspects of our conduct more broadly within the GB&M business.

Improvements to our conduct agenda started more than four years ago and continue to this day. We are enhancing and accelerating progress made in strengthening and remediating our systems and controls and broader compliance culture through a newly established GB&M Conduct Committee, led by our GB&M Chief Executive Officer. Market experts are providing input. The agenda focuses on culture and behaviours; customers, including suitability, conflicts of interest, pricing and transparency; markets, covering market conduct, trade execution and competition; governance and controls; and strategy and business planning. Progress is being tracked and reported through our own governance channels, as well as being reported to the FRB, DoJ and our regulators in line with our agreements with them all.

Conduct is core to how we operate and manage our business. We are continuing to work on implementing improvements to algorithmic trading to manage risk around benchmark orders, and embedding our updated policies and procedures for sales, order handling, managing confidential customer information and conflicts of interest, pre-hedging and market abuse. In 2019, we introduced further improvements to the management of sensitive information through technology controls, procedures and related training. We have also continued to invest in enhancing our voice, trade and electronic surveillance capabilities across the globe to improve the monitoring of telephone calls, instant messages and trades to spot potentially improper activity. Global and regional conduct governance forums have been created to provide supervision and oversight over the implementation and effectiveness of our conduct agenda. An extensive plan is in place, and we aim to deliver this as fast and efficiently as we can. Our success will determine how well we deliver the right outcomes for our customers and stakeholders, consistently and reliably, for many years to come.

This communication contains both historical and forward-looking statements. All statements other than statements of historical fact are, or may be deemed to be, forward-looking statements. Forward-looking statements may be identified by the use of terms such as 'expects,' 'targets,' 'believes,' 'seeks,' 'estimates,' 'may,' 'intends,' 'plan,' 'will,' 'should,' 'potential,' 'reasonably possible' or 'anticipates,' variation of these words, the negative thereof or similar expressions. HSBC has based the forward-looking statements on current plans, information, data, estimates, expectations and projections about future events, and therefore undue reliance should not be placed on them. These forward-looking statements are subject to risks, uncertainties and assumptions about us, as described under 'Cautionary statement regarding forward-looking statements' contained in the HSBC Holdings plc Annual Report on Form 20-F for the year ended 31 December 2020, which is expected to be filed with the SEC on 24 February 2020 (the '2020 Form 20-F') and in other reports on Form 6-K furnished to or filed with the SEC subsequent to the 2020 Form 20-F ('Subsequent Form 6-Ks'). HSBC undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. In light of these risks, uncertainties and assumptions, the forward-looking events discussed herein might not occur. Investors are cautioned not to place undue reliance on any forward-looking statements, which speak only as of their dates. Additional information, including information on factors which may affect the HSBC Group's business, is contained in the 2020 Form 20-F and Subsequent Form 6-Ks.