

David Bagley
Head of Group Compliance
HSBC Holdings plc
Written Testimony for Senate Permanent Subcommittee on Investigations
July 17, 2012

Good morning Chairman Levin, Ranking Member Coburn, and members of the Subcommittee. My name is David Bagley. Thank you for the opportunity to be here today.

Since 2002, I have been the Head of Group Compliance at HSBC Holdings plc – which is the global parent of HSBC. I joined Midland Bank in 1992 and, later that year, after HSBC acquired Midland, I began work for HSBC in its Head Office in London, where I work today. Over the years, I have served in various positions in HSBC offices around the world.

Having been a compliance officer for 13 years in a bank that operates in approximately 80 jurisdictions worldwide, I have dedicated my career – not only within HSBC but through my broader industry work as well – to meeting the sometimes significant challenges that confront global banking institutions in the world we live in. As this Subcommittee well knows, these challenges include money laundering by narcotics traffickers and terrorist financing, to name just a few. I have followed the work of this Subcommittee and have seen how your work has advanced important dialogues and helped the international banking community, including HSBC, identify and address potential vulnerabilities.

My chief focus as the Head of Group Compliance at HSBC has been promoting the values that we as a bank have set for ourselves and the values that you and our regulators, both in the United States and around the world, rightly expect from a global bank like HSBC. And, while there have been successes on many compliance issues, I recognize that there have been some significant areas of failure. I have said before and I will say again: despite the best efforts and intentions of many dedicated professionals, HSBC has fallen short of our own expectations

and the expectations of our regulators. At the same time, this is something that a bank seeking to conduct business in the United States and globally must acknowledge, address, learn from, and, most importantly, take steps to avoid in the future.

I know my time today is limited and there are a number of topics to discuss. Let me touch on some of them briefly.

First, we have learned a number of valuable lessons, and the bank is well along the way of converting those lessons into solutions. One of these lessons concerns managing growth. With the benefit of hindsight, it is now clear to many of us that the bank's business and risk profile grew faster than its infrastructure. We have learned that implementing the kinds of robust policies and practices expected of a global banking leader can take longer than anticipated. The bank underestimated some of the challenges presented by its numerous acquisitions, and despite efforts to meet these challenges, we were not always able to keep up. While many people at HSBC worked diligently to get it right, the bank simply must do better.

How can we get it right? Let me touch briefly on a few of these changes.

As I expect my colleague Stuart Levey to describe in some detail, HSBC is in the process of shedding the historical compliance model that the bank has outgrown. This departure from the old model is transformative. Our former compliance structure was a product of historical growth by acquisition and it was a major factor behind some of the issues that I expect we will be discussing today.

Under the former structure, the bank's Group Compliance function based in London mirrored HSBC's overall global corporate structure – which is an international federation of affiliates around the globe. Many of these affiliates began as relatively small independent banks that HSBC acquired over the years with increasing frequency. As the bank's footprint grew

through these acquisitions, HSBC's structure evolved into one with a small corporate center, on the one hand, and numerous affiliates around the world operating with a significant degree of autonomy and varying levels of direct interaction among those affiliates, on the other.

Under the former model, the role of Group Compliance was an advisory one: we promulgated the baseline standards that all of the bank's affiliates were expected to follow. As the Head of Group Compliance, my mandate was limited to advising, recommending, and reporting. My job was not – and I did not have the authority, resources, support, or infrastructure – to ensure that all of these global affiliates followed the Group's compliance standards. Rather, final authority and decision-making rested with local line management in each of the bank's affiliates.

This model worked for many years. But over time, HSBC's growth accelerated rapidly. Some of the new acquisitions had operations that at the time of acquisition fell far short of HSBC's own compliance standards and expectations and were in relatively lightly regulated but often high risk jurisdictions. At the same time, increased terrorism and narco-trafficking, and other financial sector developments, exposed the international banking system to new vulnerabilities and greater challenges. In addition, regulatory expectations both in the United States and abroad rightly continued to increase. With its roots in a far smaller bank in a very different global banking environment, HSBC's historic model, in retrospect, simply did not keep pace. Now, a major overhaul is underway.

The new compliance model is a product of deep reflection and is tailored to address today's challenges as well as the inevitable challenges of tomorrow. Let me mention a few significant differences between the bank's prior compliance model and the new model.

First, the bank's Group Compliance function now, for the first time, has authority over the compliance departments at every one of the bank's affiliates. The new model empowers Group Compliance to adopt and implement consistent compliance standards across the Group and to assess each of the bank's affiliates through a dedicated Assurance team so that the Group can have confidence that its affiliates are following and enforcing these standards. This is a stark break from the past. Now, Group Compliance has both the mandate and the resources to ensure that affiliates are compliant. In other words, now for the first time, Group Compliance is an advisory and a control function and personnel at the affiliates are now accountable to Group Compliance for their conduct.

Second, the CEO of each affiliate previously controlled the allocation of resources and compensation associated with that affiliate's compliance function. That has changed as well. Under the new model, Group Compliance oversees the bank's nearly 3,500 compliance officers worldwide and takes the lead on decisions about resource allocation, compensation, performance review, objectives, strategy, budget, and accountability across all of our worldwide compliance departments. This gives Group Compliance far more control over and understanding of the bank's global compliance efforts.

Third, HSBC has made significant enhancements to the resources at the Group Compliance level. In 2002, when I took on the role of Head of Group Compliance, we had a staff of only eight people. Now we have close to 40 people working in Group Compliance in London, and that figure continues to grow.

Fourth, the bank has adopted new robust diligence policies. Historically, unless required by the local jurisdiction, the bank did not mandate that HSBC affiliates perform due diligence on other HSBC affiliates. However, we now require affiliates to perform diligence on each other.

And, we are in the process of rolling out the enhanced Know-Your-Customer program at our U.S. bank on a global scale. This is a substantial task because HSBC has approximately 100 million customer relationships worldwide. Nevertheless, it is an important one. It will enable the bank to make more informed and responsible decisions about its customers.

While I will not touch on all of the recent enhancements to our model, I do want to elaborate on one of these changes, the creation of a dedicated Assurance team. The mission of this new function is both to review the effectiveness of our compliance functions at all levels around the globe and to escalate compliance issues that need remediation. This team is charged with ensuring that our compliance efforts around the world meet Group standards, conducting proper monitoring, and meeting the expectations of their regulators. The team is also charged with ensuring that compliance issues are properly escalated to the Group level, that the business and compliance functions are working together to manage risk effectively and responsibly, and that every compliance team has the required skills and appropriate resources. This function, which is in addition to the continuing role of Group Audit in conducting audits of affiliates worldwide, has already provided substantial benefits.

In conclusion, the authority of the Head of Group Compliance and therefore the function as a whole is greatly increased. We have split from the legal function and now form a part of a substantially empowered risk function. This will require affiliates to act on advice and recommendations quickly and effectively.

* * *

Despite the best intentions and efforts of so many dedicated compliance and business professionals, HSBC has in some important areas failed to meet our expectations and the expectations of our regulators. I am happy, however, to be able to say that the bank has learned

from its past and is already on a path to becoming a better, stronger banking institution. The bank's structure is, in short, very different from what it was in 2002, when I agreed to serve as Head of Group Compliance.

Thank you for your time. I welcome this opportunity to answer any questions.