Written Statement of George T. Wendler
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Mr. Chairman, Ranking Member Levin and other Members of the Subcommittee, my name is George T. Wendler. I am Senior Executive Vice President and Chief Credit Officer for HSBC Bank USA, N.A.. Thank you for the opportunity to appear before you today.

HSBC is committed to ensuring that it operates its business in full compliance with applicable laws and regulations, and in accordance with best practices to limit the risk of Bank involvement in tax-related transactions that are abusive. HSBC is also committed to ongoing review and improvement of client intake and credit approval processes, not only to maintain compliance with changing laws and regulations, but also to protect and promote the Bank's reputation and values.

I am here today first and foremost to answer the Subcommittee's questions about the bridge loan and derivative services HSBC provided to two Quellos-advised clients between 2000 and 2002. Bank personnel have only recently learned of Quellos' use of the phrase "POINT strategy" to describe a series of transactions that included our bridge loan and derivative collar services.

I will also describe briefly the changes in law and HSBC policies that have occurred since the transactions occurred. Because of these changes, HSBC would not provide support for the Quellos-advised POINT transactions if presented with them today.

I was Chief Credit Officer of HSBC Bank USA, N.A. between 2000 and 2002, and serve in that role today. I trust the Subcommittee will understand that my business expertise is in credit matters and not in compliance or "know your customer" matters. As a result, some of the information for my testimony was provided to me by Bank personnel who have greater knowledge than me, particularly with respect to non-credit related matters. Having said that, I will do my best to answer all of your questions.

HSBC's Role in the Transactions

Let me turn first to HSBC's limited role in this matter, as I understand it from my own perspective and discussions with others.

HSBC's Domestic Private Bank was approached by the Quellos Group in the Fall of 2000 to make a competitive bid on a bridge loan and derivative "collar" for a high net worth Quellos client. The Private Bank was told that the client needed short term financing to make an investment, pursuant to a series of Quellos-advised transactions. The Private Bank was told that the bridge loan would be repaid from the proceeds of the client's sale of stock in a corporation in which the client owned a large block of stock. The Private Bank was told that the derivative "collar" was needed to implement the client's investment strategy. The size of the bridge loan was approximately $50 million and the "collar" derivative was designed for a stock portfolio initially valued at about $55.8 million.

During the course of negotiations for the loan and "collar," the Private Bank learned that some of the Quellos-advised transactions involved acquisitions of LLC interests and technology stocks from Isle of Man companies, and that a potential benefit would include tax deferral as well as an investment gain opportunity. Consistent with HSBC policies at the time, the Private Bank took steps to determine that the Bank's transactions with the client would be adequately collateralized, were highly likely to be repaid, and were being entered into with reputable individuals and entities. This included personal meetings with the client and consultations with a number of other involved entities. The Bank also insisted that the flow of funds and stocks take place in cash and custody accounts established and monitored by HSBC; that the Bank's counsel be permitted to review a tax opinion from a leading U.S. law firm before the transactions were executed; that there be clear written acknowledgment by the client that it was not relying on tax or investment advice from HSBC; and that the client had obtained such advice separately. HSBC also took steps to determine that the Bank itself had no "tax shelter registration" or other tax reporting obligations relating to the transactions. The Bank acquired documentation from the specific Isle of Man entities to open transaction execution accounts, and we understood them to be affiliated with an Austrian Bank known as EURAM, but we have been unable to find contemporaneous "Know Your Customer" ("KYC") forms for the accounts.

The Private Bank competitively bid on and entered into a similar set of transactions with a second Quellos-advised client in 2001, and provided an additional "collar" to the first Quellos client in 2002. The 2001 transactions were significantly larger than those executed in 2000, involving a loan of about $807 million and a collared stock portfolio of a similar size. The 2002 "collar" was designed for a portfolio valued at approximately $60 million. The Bank's diligence efforts in connection with the 2001 transactions were the most extensive due to the large size of the loan, and included a meeting with EURAM officials, who told a senior Bank official at the time that EURAM was the beneficial owner of the Isle of Man entities involved in the transactions. EURAM's affiliation with the Isle of Man entities is reflected in our credit files for the transactions.

HSBC Safeguards Against Involvement With Abusive Tax Shelters Today

We believe our involvement, level of review, and diligence with respect to these transactions was lawful and consistent with general industry standards at the time. While we are confident that the Bank complied fully with its legal obligations, I want to emphasize that, for any similar proposal today, the Bank would take significant additional steps.

This is in part because the law has changed. For example, large loss transactions now require additional IRS reports; and bank regulators have proposed new guidelines relating to complex structured finance activities. In addition, HSBC's prudential requirements for diligence, lending and structuring services are significantly different today.

Our current credit approval process for a large transaction is preceded by the business area's review of a variety of factors, including "know your customer" issues, business purpose of the transaction being financed, loan terms and conditions, and additional review of tax and accounting issues associated with a structured transaction, if relevant. The business area would also assess the suitability of the loan for both the borrower and the Bank. If the business area wishes to proceed, it will submit a Credit Approval Risk Management form or "CARM" to the Bank's credit approval unit. There may also be preliminary consultations to determine whether

the credit approval unit has issues or can provide an indication of interest before business area diligence is complete. There are different levels of approval based on loan size.

The credit approval process addresses risk, and reward given the level of risk. Credit approval assumes that non-credit issues have been covered or will be covered as a condition of closing. The business area is responsible both for covering these issues and for documenting their coverage.

As to "know your customer" and anti-money-laundering procedures, the Bank has benefited greatly from program enhancements and processes implemented as the result of a 2003 Written Agreement with our regulators. An affiliate merger and change to a National Charter in 2004 gave rise to an "enforceable condition" to merger approval that the Bank comply with the 2003 Written Agreement. I am pleased to report that, by letter dated February 6, 2006, after conducting extensive examinations, the Office of the Comptroller of the Currency determined that the Bank had fully satisfied the terms of the 2003 Written Agreement. The 2003 Written Agreement itself required significant enhancements in HSBC's anti-money-laundering programs, including with respect to customer due diligence, the detection and reporting of suspicious activity, and the implementation of a program for the testing of compliance with procedures.

Looking Back But Focusing Forward

In retrospect, there were a few warning signs about these transactions. We were aware that these were transactions with significant tax benefits, and that offshore corporations were involved. Our lawyers were allowed to review an outside tax opinion, but were not allowed to keep a copy for the Bank's records. Our principal focus was on the clients and their ability to meet their financial obligations to the Bank. We did not probe extensively on whether the facts would support the clients' tax positions, because the clients were obtaining their own advice and making their own judgments. Today, we would probe and review those facts more extensively before making financing decisions.

HSBC's standards today are well summarized in a letter that our Private Bank's CEO for the Americas circulated to Private Bank managers in late December 2005:

> No customer or business arrangement is worth our reputation. Knowing our customers makes good business sense and helps us preserve our reputation for integrity and fair dealing....This responsibility cannot be delegated or abdicated and should never be taken lightly.

Today's hearing confirms the wisdom of those standards, which we do our best to meet in all our business dealings.

Finally, I would like to express the appreciation of my colleagues at the Bank for the professionalism and courtesy extended by the Subcommittee's staff. Again, thank you for the opportunity to appear today. I hope my testimony has been of assistance, and I will be pleased to answer any questions.