

# Independent Expert Enforceable Undertaking - Final Report Summary

HSBC Bank Australia Limited

20 November 2018

## LIMITATION

This Final Report Summary is prepared to provide a summary of our work carried out as the Independent Expert as defined within paragraphs 3.5.6, 3.5.7, 3.5.8 and 3.5.9 of the Enforceable Undertaking between HSBC Bank Australia Limited and the Australian Securities and Investments Commission (ASIC).

Any party other than HSBC Bank Australia Limited and ASIC who access this Final Report Summary shall only do so for their general information only and should not be relied upon by any other party.

Ernst & Young does not accept any responsibility for use of the information contained in this Final Report Summary. Ernst & Young expressly disclaims all liability for any cost, loss, damage, injury or other consequence which may arise directly or indirectly from use of, or reliance on, this Final Report Summary.

Our scope and other limitations are stated in our engagement agreement and statement of work dated 26 July 2016.



# Executive summary

## 1.1 Background

HSBC Bank Australia Limited (HSBC) entered into an Enforceable Undertaking (EU) with the Australian Securities and Investments Commission (ASIC) on 13 May 2016.

The EU requires HSBC to identify and remediate clients that were provided inappropriate financial advice from 1 January 2009 to 28 March 2013 (the 'Relevant Period') and appoint an Independent Expert.

EY was approved by ASIC and engaged by HSBC on 26 July 2016 to act as the Independent Expert.

In accordance with section 3.9.1 and 3.9.2 of the EU, HSBC developed a Remediation Plan to remediate all Affected Clients (the 'Remediation Program'), and an Assessment Plan to assess the appropriateness of the advice provided to potentially Other Affected Clients.

## 1.2 Our scope

### Design assessment and operational effectiveness programs

As required under section 3.5.6 of the EU and in consultation with HSBC and ASIC, we developed detailed design assessment and operational effectiveness work programs to address the following elements of HSBC's Assessment Plan and Remediation Plan: Governance and controls, resources, methodology, population, case assessment and remediation, communication, and learnings and closure.

### Interim report

As required under section 3.5.7 of the EU, we provided HSBC and ASIC an Interim Report on 30 January 2017, on the implementation of HSBC's Remediation Plan. The learnings identified during HSBC's initial test-and-learn phase were implemented into HSBC's Remediation Program commencing January 2017.

### Monthly reporting

In accordance with section 3.5.8 of the EU, for the period of HSBC's ongoing remediation, we have provided monthly reports with review and comment on HSBC's monthly progress reports on the progress of implementation of HSBC's Remediation Plan.

### Final report

We are required under section 3.5.8 of the EU to, within two months of HSBC completing client remediation, provide a Final Report on the effectiveness of implementation of HSBC's Remediation Plan, including the operational effectiveness of the work performed by HSBC, and

any recommendations for further action, in our opinion, that would be necessary for HSBC to rectify deficiencies in the implementation of its Remediation Plan.

### Specific Remediation Program outcomes raised by ASIC

In ASIC's email dated 13 and 27 June 2018, ASIC requested EY address specific outcomes of HSBC's Remediation Program so any residual concerns or issues can be addressed by HSBC before the finalisation of the Remediation Program:

- A. High instances of process issues, including the additional 220 cases with process issues reported in HSBC's May 2018 Monthly Report. The impact this has on EY's analysis and conclusions on process issues and advice outcomes.
- B. Advisers with high failure rates but not identified as High Risk Representatives ('HRR') and Advisers with high process issue rates but not identified as HRRs
- C. 13 of 17 Superannuation cases assessed as Inappropriate during Assessment Plan Sampling re-endorsed as Appropriate
- D. More Information Required (MIR) clients.

In ASIC's further email on 25 September 2018, ASIC requested EY assess a further four Superannuation cases re-endorsed as Appropriate or MIR and address HSBC's response to the treatment of remaining MIR and compensation due clients.

## 1.3 Our approach

Our approach centred on assessing:

- ▶ The operational effectiveness of HSBC's systems, processes and controls; and
- ▶ Whether client outcomes are consistent with the Remediation Plan and Assessment Plan objectives, principles and design.

The EU Relevant Period was from 1 January 2009 to 28 March 2013, prior to best interest duties coming into effect. Our financial advice assessment criteria is aligned with 945A requirements.

### Sample-based testing

We have performed testing of controls and client outcomes in line with our sample-based testing methodology.

We adopted a non-uniform ('front-end-loaded') approach to performing our testing. That is, when testing the operational effectiveness of HSBC's Remediation Plan and Assessment Plan we performed more testing at the beginning to identify any required amendments and provided confidence that HSBC's systems, processes and controls were delivering client outcomes consistent with the principles and design of the remediation program.

## Assessment components of a financial advice remediation program

The components of our detailed work program have been based on EY's global client remediation methodology, our knowledge of other financial advice remediation programs and recommendations within ASIC's Consultation Paper 247: *Client review and remediation programs and update to record-keeping requirements* which formed the basis of ASIC's Regulatory Guide 256: *Client review and remediation conducted*.

### 1.4 Specific Remediation Program outcomes raised by ASIC

#### A. The Program and advisers having high process issues (including the additional 220 cases)

Our data analysis indicates a direct relationship between the volume of advice and the instances of process issues. That is, more advice generally meant more process issues.

Quality of advice factors were the key differentiator between Appropriate and Inappropriate outcomes. This was consistent across Structured Products, Superannuation and HRR files.

HSBC reported an additional 220 cases with process issues in May 2018. Our conclusions on the overall data remain consistent with our original analysis.

Based on the results of our work, we found no discernible relationship between process issues count and advice outcomes.

#### B. Advisers with high fail rates

High advice failure rates is one of the risk-based flags in HSBC's High Risk Representative criteria. HSBC's Working Group actively discussed advisers with three or more case assessment failures and monitored these advisers against other criteria including complaints, historic compliance review results and adverse human resources issues.

HSBC's remediation of five HRRs derived a failure rate of 2% from a population of 436 advice files. HSBC determined this an indicator of low additional risk of further HRRs.

Based on the relatively low fail rate of 2%, and the absence of other flags being raised, we have no further recommendations for the testing of other advisers as HRR.

#### C. Superannuation cases re-endorsed as Appropriate

We independently tested 13 Superannuation cases that HSBC identified as Inappropriate during Assessment Plan Sampling and then assessed as Appropriate in the Remediation Program.

Our testing outcomes were consistent with HSBC's.

#### D. More information required clients

Throughout the Remediation Program, HSBC has sought to reduce the number of MIR clients by contacting clients through multiple mediums and assessing cases applying client first principles in the absence of information.

HSBC's EU Remediation Program Closure Report adequately describes the processes in place to cater for the remaining uncontactable clients, including appropriate decisioning and governance procedures.

## HSBC's treatment of remaining MIR and compensation due clients

As at 2 November, HSBC has 27 clients requiring further information to conclude an advice outcome (MIR clients) and 31 clients where compensation is payable but awaiting a settlement deed to be returned. HSBC provided responses ASIC's questions regarding the treatment of these clients, consistent with HSBC's remediation methodology principles and supplemental Business As Usual (BAU) Paper.

HSBC's BAU procedures are to attempt to contact MIR and compensation due clients until the end of November 2018. All clients have been notified through their domicile branch and internet banking portals. There are no time limits for clients to claim compensation or provide additional information. We consider the procedures HSBC has implemented to be consistent with our understanding of regulatory and market expectations.

### Overall comment on specific Remediation Program outcomes raised by ASIC





Based on the results of the above work, we have no further recommendations for HSBC to address before finalisation of the Remediation Program.

Section 2.8 maps the relevant sections of this report testing each of the above matters.

### 1.5 Overall summary

A summary of our assessment results for the components of HSBC's Remediation Plan is as follows:

Components of the Remediation Plan	Design	Interim	Final	Final recommendations	Report reference
1. Governance and controls	L	L	L	None	2.1
2. Resources	L	L	L	None	2.2
3. Methodology	L	L	L	None	2.3
4. Population	L	L	L	None	2.4
5. Case assessment and remediation	L	M	L	None	2.5
6. Communication	L	N/A	L	None	2.6
7. Learnings and closure	L	N/A	L	None	2.7

Legend			
Rating	Design	In-use	Progress
	Design is basic and critical opportunities for enhancements remain	More than 10% exceptions	Delays against plan that threaten key milestones
	Design is evolving and significant opportunities for enhancements remain	Between 5% to 10% exceptions	Some delays against plan, no threat to key milestones
	Design is established and limited opportunities for enhancements remain	Less than 5% exceptions	Progressing according to plan, no threat to key milestones
	Not assessed	Not assessed	Not assessed

Based on the results of our work summarised above, we have no further recommendations for HSBC to address before finalisation of the Remediation Program.

The Remediation Program was HSBC's first such remediation program under an Enforceable Undertaking. HSBC's Program commenced with a slow start, leading in with a pilot to test the effectiveness of key controls. Over the past 26 months, our monthly reports have shown despite the initial delays, remediation efforts picked up speed from March 2017 and continued meeting its progress milestones for the duration of the Program.

Case assessments and client communications were the two areas rated Amber for consecutive months. Delays in case assessments at the start of the Program in January 2017 were resolved from April 2017 by finalising case review methodology and the completion of on-boarding additional resources. We identified exceptions in the testing of outbound calls and timeliness of sending outcome letters throughout May to October 2017 and HSBC resolved these issues by implementing call QA, providing refresher call training and working through the back log of letters using approved templates.

Our assessment of HSBC's implementation of the Remediation Plan and Assessment Plan throughout the Remediation Program determined HSBC's systems, processes and controls to be operating effectively and we did not identify any material exceptions during our testing that would impact the outcomes of advice or compensation.

The Board Risk Committee (BRC) was informed of progress throughout the Remediation Program and expressed clear expectations on timely and quality delivery of the Program.

The natural tail in HSBC's Remediation Program, including client files requiring further information, has been transitioned into HSBC's business-as-usual environment. Our review of the processes in place to manage residual remediation activities and the accountability framework determined this to be reasonable.

## 1.6 Design adequacy

We independently assessed the design of the Remediation Plan and Assessment Plan and reported our results to HSBC and ASIC on 25 October 2016. HSBC updated its Remediation Plan and Assessment Plan to reflect our recommendations.

Our assessment did not identify any material exceptions in the design of the components of the program. Overall we escalated 14 matters for HSBC's consideration and ASIC raised a further seven recommendations. We undertook subsequent work to assess that HSBC had satisfactorily addressed both our matters and ASIC's recommendations and updated its Remediation Plan and Assessment Plan.

Throughout the Remediation Program, we reviewed and HSBC adopted our recommendations on HSBC's population scoping processes, case assessment business rules, compensation methodologies and outcome letter templates. Our recommendations have been reported in our Monthly Reports and HSBC's actions to address these were tracked in the published Observations Log.

## 1.7 Operational effectiveness

We assessed the operational effectiveness of the controls in HSBC's Remediation Plan during the test-and-learn phase which was a pilot involving a limited number of clients. Our recommendations were detailed in the Interim Report dated 30 January 2017. We provided real-time recommendations to improve operational efficiency and consistency of case assessment outcomes.

HSBC adopted our recommendations to refine its processes and controls for the commencement of the Remediation Plan and Assessment Plan. We tested and reported on a monthly basis the ongoing operational effectiveness of processes and controls, including those not able to be tested during the test-and-learn phase. We captured recommendations in an Observations Log in our Monthly Reports and we obtained supporting information that all 22 items were adequately addressed.

Our testing of the Remediation Plan and Assessment Plan did not identify any material exceptions that would impact the advice or compensation outcomes.

### 1. Governance

We attended oversight committees and assessed these to be operating effectively. The BRC was informed of progress throughout the Remediation Program and expressed clear expectations on timely and quality delivery of the Program. The committees discharged their responsibilities consistently and in line with Remediation Program objectives and principles.

### 2. Resources

Our testing of 20 Case Managers and 8 QA Managers on-boarded during the Program had the required knowledge, qualifications and experience for their roles. They attended induction training within a reasonable period after joining. Case assessment workshops were conducted throughout the Remediation Program, such as to discuss complex cases or the application of new business rules.

### 3. Methodology

Throughout the Remediation Program, we assessed HSBC's methodology for delivering against each component of the Remediation Program for alignment with the EU requirements, relevant

RG 256 expectations and the principles and objectives of HSBC's Remediation Plan. The results of our testing were reported in our Monthly Reports.

HSBC updated its remediation methodology and case assessment business rules to ensure consistent treatment as new scenarios emerged and when we provided feedback following testing. For example, HSBC limited the number of Case Managers making outbound calls and provided refresher training on the call script to reduce variability.

Case assessment was rated as Amber from February to April 2017 due to the delay in finalising case assessment tools and business rules and ramping up additional Case Manager resources.

#### 4. Population

We assessed HSBC's procedures for deriving the client population for Structured Products and determined these to be operating effectively. The results were reported in our Interim Report.

HSBC leveraged and adapted these procedures to derive the client populations for Assessment Plan Remediation (for Superannuation and HRR advice). We assessed these procedures and determined these to be operating effectively. The results are included in this Final Report.

#### 5. Case assessment and remediation

Throughout the Remediation Program, we sample tested the application of business rules and compensation methodologies for 47 Structured Product cases and two Superannuation cases. The results were reported in our Monthly Reports. We did not identify any material exceptions in our testing.

During the months between February and April 2017, we rated this component of the Program Amber due to various design and operational components taking an extended time taken to implement business rules and quality improvement activities. These delays in implementation were rectified through finalising business rules and bringing on additional resources and did not impact the outcome of advice assessments.

The table below summarises the number of files we have sampled across the Remediation Program. Where our outcomes differed from HSBC, we discussed these with HSBC and have maintained our conclusions. In some instances HSBC re-assessed the case with the same outcome independent of our feedback and in the remaining cases HSBC has further considered our feedback and erred on the side of the client.

Product type	Appr.	Inappr.	MIR	Agree	Disagree	HSBC total	% Sampled
Assessment Plan Sampling	18	3	1	21	1	283	8%
Structured Products	87	16	2	102	3	495	21%

Product type	Appr.	Inappr.	MIR	Agree	Disagree	HSBC total	% Sampled
Superannuation Remediation	31	3	1	34	1	334	10%
Superannuation - 13 reassessed cases*	11	1	1	11	2	13	100%
Superannuation - 4 reassessed cases*	3	0	1	4	0	4	100%
HRR (excluding Superannuation)	58	1	0	59	0	436	14%
<b>Total number of cases assessed</b>	<b>208</b>	<b>24</b>	<b>6</b>	<b>231</b>	<b>7</b>	<b>1,565</b>	<b>15%</b>

\*As requested by ASIC, in January 2018 we tested 13 Superannuation cases that HSBC initially assessed as Inappropriate during Assessment Plan Sampling and re-assessed as Appropriate. In October 2018 we tested a further four Superannuation cases re-assessed as Appropriate and More Information Required.

#### Communication

During the months of May to October 2017, we flagged the communication component of the Remediation Plan as Amber due to delays in sending out client outcome letters and exceptions identified in client call testing. These exceptions did not impact the outcome of advice and were rectified through improving existing controls and processes following our feedback.

### 1.8 Learnings and closure

HSBC completed an Enforceable Undertaking Closure Report and supplemental papers (collectively the 'Closure Report') which was mapped against HSBC's EU Remediation commitments, HSBC's remediation methodology and both ASIC and Independent Expert challenge and feedback. HSBC's Closure Report was tabled for endorsement by the HSBC Wealth Management Operating Committee (WMOC) and BRC on 23 May 2018.

We assessed the content of HSBC's Closure Report for accuracy against supporting evidence and did not find any material exceptions in our testing.

The rates of inappropriate advice for Superannuation and HRR Remediation (4% and 2% respectively) are differentiated to Structured Products (16%) indicating the factors causing inappropriate advice were contained to the nature of advice specific to Structured Products. Our testing results for advice Outside Relevant Period work also support the conclusion that systemic risk was contained to the Relevant Period and to Structured Products in particular.

HSBC has materially delivered on its requirements in the EU. Natural residual activities transferred to HSBC's BAU environment have been addressed in as far as possible and any further remediation activities that could arise will be dealt with under the principles of the Remediation Program.

HSBC has ceased providing personal financial advice and as such this does not bring any ongoing financial advice risks into HSBC's current business environment. Based on the results of our work, we have no further recommendations for HSBC to address before finalisation of the Remediation Program.

This executive summary should be read in junction with our limitations and disclaimers in **Section 3**.