

# Bank of England

## Prudential Regulation Authority

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### FINAL NOTICE

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To: **HSBC Bank plc (Firm Reference Number: 114216)**  
**HSBC UK Bank plc (Firm Reference Number: 765112)**

Date: 29 January 2024

## 1. Action

1.1. For the reasons set out in this Notice, the Prudential Regulation Authority (“**PRA**”) imposes a financial penalty on HSBC Bank plc (“**HBEU**”) and HSBC UK Bank plc (“**HBUK**”) (together, the “**Firms**”) of £82,025,000 for:

In respect of both Firms, breaching:

- 1.1.1. PRA Fundamental Rule 2 (a firm must conduct its business with due skill, care and diligence);
- 1.1.2. PRA Fundamental Rule 6 (a firm must organise and control its affairs responsibly and effectively); and
- 1.1.3. Rules 11, 12 and 14 of the Depositor Protection part of the PRA Rulebook (the “**DP Rules**”).

In respect of HBEU only, breaching:

- 1.1.4. PRA Fundamental Rule 7 (a firm must deal with its regulators in an open and co-operative way, and must disclose to the PRA appropriately anything relating to the firm of which the PRA would reasonably expect notice);
- 1.1.5. PRA Fundamental Rule 8 (a firm must prepare for resolution so, if the need arises, it can be resolved in an orderly manner with a minimum disruption of critical services); and

1.1.6. Rule 50 of the DP Rules.

between (i) 2015 and 2022, for HBEU; and (ii) 2018 and 2021, for HBUK; or parts thereof (the “**Relevant Period**”).

1.2. The Firms agreed to settle at an early stage of the PRA’s investigation (the “**Discount Stage**”) and qualified for a 30% discount pursuant to the PRA Settlement Policy. As a result, the financial penalty was reduced to £57,417,500.

## 2. Summary of reasons for the action

### The Firms

- 2.1. HSBC Holdings plc together with its subsidiary undertakings (“**HSBC Group**”) is one of the largest banking and financial services organisations in the world. Since 1 July 2018, HSBC Group’s UK operations have been split between ring-fenced (HBUK) and non-ring-fenced (HBEU) entities which are operationally separate and economically independent; both are wholly owned subsidiaries of HSBC Holdings plc. HBEU and HBUK are deposit-taking institutions and are regulated by both the PRA and the Financial Conduct Authority.
- 2.2. HBEU provides products and services to customers through three businesses (supported by a corporate centre): Wealth and Personal Banking (“**WPB**”), Commercial Banking (“**CMB**”), and Global Banking and Markets (“**GBM**”). In the UK, HBEU’s main business is GBM, as well as CMB activity for clients which cannot be provided by a ring-fenced bank. As a ring-fenced bank, HBUK provides products and services to eligible customers in the UK through WPB and CMB. As a result, in the UK, retail, wealth and nearly all UK commercial banking activity, is undertaken by HBUK.
- 2.3. HBUK and HBEU are both Category 1 PRA-authorized firms, meaning that they have the capacity to cause significant disruption to the UK financial system if they were to fail.
- 2.4. Further information about the Firms and their regulated activities is set out in [Annex A](#).
- 2.5. While this Notice deals, in part, with historic DP Rules and preparations for resolution, the PRA did not at any time during the Relevant Period assess that the Firms were failing or were likely to fail. The PRA understands that the Firms have fully remediated the historic DP Rule breaches.

## Breaches

- 2.6. The PRA's investigation uncovered that there were serious failings at the Firms in relation to the implementation of the DP Rules. The Firms' failure to organise their affairs responsibly and effectively and to conduct their business with due skill, care and diligence contributed to these failings.
- 2.7. HBEU failed in its preparations for resolution in respect of DP Rule compliance, and failed to deal with the PRA in an open and co-operative way by reason of it not providing information of which the PRA could reasonably have expected notice.
- 2.8. While several matters contributed to the Firms' breaches of Fundamental Rules ("FRs") 2 and 6, and HBEU's breaches of FRs 7 and 8, as set out below and detailed in [Annexes A and B](#), the PRA considers the following matters to be particularly serious. During the Relevant Period:

In respect of HBEU:

- 2.8.1. in breach of FR8 HBEU failed to (i) appropriately mark beneficiary accounts; and (ii) produce finalised versions of SCV effectiveness reports on an annual basis. Accordingly, HBEU failed to prepare for resolution in respect of DP Rule compliance;
- 2.8.2. in breach of FR7, HBEU did not deal with the PRA in an open and co-operative way by reason of it failing to disclose in a timely manner matters relating to it of which the PRA would reasonably expect notice. On 31 October 2019, the PRA asked HBEU to confirm how it was treating a particular client's accounts for the purposes of eligibility for the Financial Services Compensation Scheme ("FSCS"). HBEU stated that it regarded the accounts as ineligible for FSCS protection but would investigate the matter to confirm if this approach was correct; HBEU also noted that it would investigate the marking of other clients and accounts as required. An internal working group, established to investigate whether client deposit accounts were being correctly marked for FSCS protection, ultimately reached the incorrect conclusion that accounts were being marked appropriately. This conclusion was reached as a result of, among other things, an absence of subject matter experts on the internal working group. The PRA was not notified of this conclusion at the time. It was not until 23 April 2021 that HBEU notified the PRA regarding a potentially material issue with the marking of clients for SCV purposes. Prior to 23 April 2021, HBEU had become aware of the potential scale of the issue but did not raise this with the PRA;

- 2.8.3. in breach of the DP Rules, FR2 and FR6, HBEU failed to produce finalised versions of the SCV effectiveness reports for the period 2016 through to 2020. Furthermore, the SCV systems of HBEU did not, during the Relevant Period, meet the PRA's SCV requirements, in that HBEU incorrectly marked beneficiary accounts as ineligible for FSCS protection. This mistake was very significant where 99% of eligible deposits by value had been incorrectly marked. Notwithstanding this fact, in 2018 HBEU provided an incorrect attestation (which at the time HBEU believed to be accurate) to the PRA confirming that its SCV system "*satisfies the Depositor Protection requirements*"; and
- 2.8.4. there was a failure to ensure sufficient subject matter experts with knowledge of the SCV rules and processes remained at HBEU after the establishment of the ring-fenced bank, HBUK, from 2018.

In respect of both Firms:

- 2.8.5. in breach of FR6, the Firms failed to assign clear ownership between lines of business and functions, such as Regulatory Compliance, of risks and responsibilities for the end-to-end SCV process. The Firms failed to ensure that a senior manager, under the Senior Managers and Certification Regime ("**SMCR**"), had been allocated ownership of the SCV process and associated reporting. This constituted a very serious failing in the Firms' implementation of SMCR.
- 2.9. The PRA considers that, during the Relevant Period, HBEU breached the following PRA rules:
- 2.9.1. FRs 2, 6 and 8 for the period from at least 2015 to 28 February 2022;
- 2.9.2. FR7 for the period from 4 February 2020 to 23 April 2021;
- 2.9.3. DP 50 for the period 3 July 2015 to 30 November 2016;
- 2.9.4. DP 11 for the period from 3 July 2015 to 28 February 2022; and
- 2.9.5. DP 12 and DP 14 for the period from 1 December 2016 to 28 February 2022.
- 2.10. The PRA considers that, during the Relevant Period, HBUK breached the following PRA rules within the corresponding periods:
- 2.10.1. FRs 2 and 6 for the period from 11 July 2018 to 17 December 2021;

2.10.2. DP 11 and 12 for the period from 11 July 2018 to 17 December 2021; and

2.10.3. DP 14 for the year 2019 only.

### 3. Sanction

- 3.1. Taking into account the facts and matters in [Annex A](#) and the relevant factors set out in the PRA Penalty Policy, the PRA considers the Firms' breaches as summarised above and set out more fully in [Annex B](#) justify the imposition of a financial penalty of £82,025,000. That penalty was reduced by 30% to £57,417,500 because the Firms settled the matter with the PRA during the Discount Stage.

#### The PRA and its expectations

- 3.2. The PRA is responsible for the prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms. The PRA's general objective is to promote the safety and soundness of those firms and it promotes this objective, in part, by seeking to minimise the adverse effect that the failure of a firm could be expected to have on the stability of the UK financial system.
- 3.3. The FSCS is the statutory UK compensation scheme to protect consumers of financial services. It is operationally independent but operates within rules set out by, in part, the PRA. FSCS protection takes effect when a regulated firm is unable to meet its customers' claims. In such circumstances, the FSCS protects depositors by compensating, or paying out, depositors and aims to do so in seven days. Payment within seven days helps to reduce the systemic risk that the failure of a regulated firm might trigger a wider loss of confidence. The FSCS relies on information provided directly to it by PRA-authorised firms to be able to make quick and accurate pay outs to eligible deposits. The PRA sets out requirements for regulated firms around the production of this information in the DP Rules.
- 3.4. The preferred resolution strategy for the Firms would be via a multiple point of entry bail-in as determined by the Bank of England acting as Resolution Authority, in co-ordination with HSBC's other regulators. This strategy offers flexibility for HSBC's resolution (taking place via a bail-in at the HSBC Holdings-level, facilitating recapitalisation of operating bank subsidiaries and/or at a group level pursuant to the application of statutory resolution powers by host resolution authorities locally). The SCV information would support the evaluation of resolution options, including bail-in, to ensure eligible depositors are protected.

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- 3.5. Deposit-takers are required to prepare for resolution so, if the need arises, they can be resolved in an orderly manner with a minimum disruption of critical services. The DP Rules support resolution preparedness by requiring firms to be able to accurately identify deposits eligible for FSCS protection and to be able to provide this information within 24 hours of a request by the PRA or the FSCS. This information allows the FSCS to pay compensation to eligible depositors quickly. Among the most critical examples of such information is a firm's 'Single Customer View' ("**SCV**") and an 'exclusions view' (together, the "**SCV File**"). The SCV is a single, consistent view of a depositor's aggregate eligible deposits with a firm, while the exclusions view shows potentially eligible deposits (e.g., beneficially held, legally dormant, legally disputed or sanctioned accounts) which might qualify for FSCS compensation following investigation from the FSCS. Firms are required to produce 'SCV effectiveness reports' which confirm how they have produced their SCV and exclusions view and their effectiveness. The DP Rules underpin FSCS protection and help to minimise the adverse effect that a failure of a PRA firm could have on UK financial stability and enhance depositor confidence and therefore contribute to the safety and soundness of firms. Inaccurate information provided by PRA-authorized firms to the FSCS hampers the ability of the FSCS to make quick pay outs in the event of resolution, undermines trust in FSCS protection, and poses systemic risk. Firms therefore must fully comply with the DP Rules and expectations set out in related supervisory statements.
- 3.6. PRA-authorized firms must organise and control their affairs responsibly and effectively. Resolution preparedness and the DP Rules require firms to put in place appropriate governance and oversight arrangements to ensure implementation and accountability for the depositor protection regime requirements and the integrity of the critical information provided to FSCS.
- 3.7. PRA-authorized firms must conduct their business with due skill, care and diligence. In the context of depositor protection, this means firms must take care to comply fully with all the requirements of the DP Rules and published supervisory expectations. They must ensure they dedicate adequate resource and expertise to ensure compliance with regulatory rules. It also requires firms to ensure that attestations they provide the PRA are accurate and are provided following proper consideration.
- 3.8. The PRA approach to supervision is forward-looking, assessing firms not just against current risks, but also against those that could plausibly arise further ahead. This requires firms to be open and straightforward in their dealings with the PRA, taking the initiative to raise issues of possible concern at an early stage. The PRA is clear that it expects firms to promptly

disclose any information relating to the firm of which the PRA would reasonably expect notice. This is especially important when that information relates to specific enquiries that the PRA has put to a regulated firm. The PRA expects to be promptly notified at an early stage of any potentially material emerging issues relating to the accuracy and status of a firm's depositors given the potential significance of this to FSCS protection, the ability of the firm to be resolved and ultimately to financial stability. A firm should not wait until it has completed internal investigations or attempted to remediate issues before notifying the PRA.

#### **4. Annexes/Appendices and Procedural Matters**

- 4.1. The full particulars of the facts and matters relied on by the PRA in its decision-making process regarding the Firms can be found in [Annex A](#). The Firms' breaches and failings are detailed in [Annex B](#) and the basis for the sanction the PRA has imposed is set out in [Annex C](#). The procedural matters set out in [Annex D](#) are important. The definitions used in this Notice are set out in [Appendix 1](#) and the relevant statutory, regulatory and policy provisions applicable during the relevant period are set out in [Appendix 2](#).

**Oliver Dearie**

Head of Legal, Enforcement and Litigation Division  
for and on behalf of the PRA

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## ANNEX A: FACTS AND MATTERS RELIED UPON

### 1. Background

#### The Firms

- 1.1. HSBC is one of the largest banking and financial services organisations in the world and is headquartered in the UK.
- 1.2. Within the UK, HSBC operates through (among other entities) a non-ring-fenced bank, HBEU, and a ring-fenced bank, HBUK. Both HBEU and HBUK are wholly owned subsidiaries of HSBC Holdings plc.
- 1.3. HBUK and HBEU are Category 1 PRA-authorized firms, meaning that they have the capacity to cause significant disruption to the UK financial system if they were to fail. HBUK began trading on 1 July 2018 in advance of the introduction of 'ring-fencing' in the UK.<sup>1</sup> Prior to this point, HBEU alone was subject to the UK regulatory framework in relation to deposit protection (described below).
- 1.4. HSBC operates globally through three business lines:
  - 1.4.1. WPB;
  - 1.4.2. CMB; and
  - 1.4.3. GBM.
- 1.5. Services provided by CMB and GBM are to businesses, corporates, governments and institutions.

### 2. The relevant regulatory framework

- 2.1. The legislative framework underpinning deposit protection rules in the UK derives predominantly from the European Union ("EU"), in summary:
  - 2.1.1. a 1994 Directive on Deposit Guarantee Schemes (the "DGSD");
  - 2.1.2. in 2009 the DGSD was amended via the introduction of a new Deposit Guarantee Schemes Directive, which was transposed in the UK via rules in the Compensation

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<sup>1</sup> Ring-fencing requires the largest banking groups in the UK to separate core retail banking services from activities such as investment and international banking.

part of the-then Financial Services Authority Compensation Sourcebook, coming into force in late 2010; and

- 2.1.3. the DGSD, as amended by the 2009 Directive, was repealed and replaced in 2014 via the “**Recast DGSD**”. Most of the new rules came into force by 3 July 2015, with the rest applying after a transitional period. UK implementation was via transitional rules in parts 49-51 of the Depositor Protection part of the PRA Handbook (now the PRA Rulebook) and permanent rules in DP 11-14. The practical effect of the regulatory framework is outlined below.
- 2.2. The UK left the EU on the 31 January 2020, subject to a transition period which ended on 31 December 2020. The regime, however, continued to have effect in UK law at the end of the transition period so the same regime remained in force throughout the Relevant Period.
- 2.3. Eligible Deposits held by UK banks (both terms as defined in the PRA Rulebook) are protected by the FSCS, up to a deposit protection limit of £85,000 (and £170,000 for joint accounts). This limit applies to the total eligible deposits of each person, per PRA-authorized firm. The protection limit applies to the total amount held by a depositor across an authorised firm’s accounts not to each separate account.
- 2.4. A deposit’s eligibility for FSCS protection is defined in DP Rule 2 by exclusion of monies that are ineligible. Ineligible deposits include those sums deposited by credit institutions, investment firms, financial institutions or where the deposit holder’s identity has not been verified. Deposits held legally or beneficially by retail customers, limited companies, small businesses or charities will typically be eligible for protection.
- 2.5. The FSCS aims to effect pay out of eligible deposits within seven days of a UK bank failing. The ability of the FSCS to make timely pay outs to depositors is dependent on PRA-authorized firms accurately identifying and marking eligible, potentially eligible and ineligible deposits, and being able to provide this data to the PRA and the FSCS in a timely manner. In order to effect this, UK banks, building societies and credit unions (among others) must maintain an SCV of a client’s eligible deposits. In addition, UK deposit-takers must ensure they have appropriate systems and controls such that they are able to produce an SCV File that includes details of customer names, contact details, type of deposit and amount held.
- 2.6. UK deposit-takers must mark the following accounts in such a manner that allows for immediate identification of sums (in summary):

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- 2.6.1. Eligible deposits (for example those sums deposited by individuals in a personal account which are legally and beneficially owned by the named account holder); and
  - 2.6.2. Those deposits (i) held on behalf of beneficiaries; and (ii) which contain, or may contain, eligible deposits.
- 2.7. Deposits falling into 2.6.2 above are not recorded in the SCV but are instead listed in the 'exclusions view'. The SCV requirements and SCV systems in the DP Rules capture both SCV and exclusions view. This is because further investigation will be required by the FSCS to establish whether compensation can be paid.
  - 2.8. Both the SCV and the exclusions view must be provided to the PRA or FSCS within 24 hours of either (i) the relevant deposits becoming unavailable; or (ii) a request from either the PRA or FSCS.
  - 2.9. UK deposit-takers are also – under the Recast DGSD (which remains in effect in law following the UK's withdrawal from the EU) – required to produce an annual SCV effectiveness report, which the PRA and/or FSCS may request. Ensuring the operational effectiveness and adequacy of a firm's SCV system (as defined in the PRA Rulebook) supports – among other things – resolution options, such as a transfer of deposits or a bail-in.
  - 2.10. Other rules as applicable during the Relevant Period are summarised below and are set out in full in [Appendix 2](#).

### 3. SCV effectiveness reports

- 3.1. Since 2010, there has been a requirement for deposit-takers to produce a report on their SCV systems. This must be accompanied by a statement signed on behalf of a firm's governing body (i.e. the board of directors) confirming that the firm's SCV system satisfies the relevant regulatory requirements. The requirements during the Relevant Period are as follows:
  - 3.1.1. From 2015 under DP 51.7(2) it was a requirement that a deposit-taker's 'SCV effectiveness report must contain...a statement signed on behalf of the firm's governing body confirming that the firm satisfies the requirements...with respect to single customer views...'; and
  - 3.1.2. From 1 December 2016 onwards, DP 14.8 set out that a deposit-taker's SCV effectiveness report must contain 'a statement signed on behalf of the firm's governing body confirming that the firm's SCV system satisfies the SCV

*requirements...* DP 14.6 also required that a firm must update its SCV effectiveness report annually. As a result, from 1 December 2016 firms have been required to annually review their SCV system and ensure that the governing body confirms the system satisfies regulatory requirements.

- 3.2. From 3 July 2015 to 30 November 2016, as noted above, HBEU was required to provide the PRA or FSCS with an SCV effectiveness report if requested. However, HBEU only produced a draft SCV effectiveness report for 2016. This draft was incomplete and had not been approved by the firm's governing body.
- 3.3. From 1 December 2016, despite banks being required to annually update their SCV effectiveness reports, HBEU continued to only produce draft SCV effectiveness reports for 2017 and 2018. Similar to the 2016 draft, the draft 2017 and 2018 HBEU SCV effectiveness reports were incomplete and none had been approved by the firm's governing body. No HBEU SCV effectiveness reports have been identified for 2019 and 2020.
- 3.4. With the implementation of the ring-fencing regime, HBUK was established in 2018. The SCV effectiveness report was presented at the HBUK Risk Management Meeting ("**RMM**") on 26 September 2018, and the final 2018 SCV effectiveness report was signed on behalf of HBUK on 9 October 2018. In 2019 HBUK only prepared a draft SCV effectiveness report, which noted its board of directors would ensure they remained satisfied their SCV system continued to meet the PRA's SCV requirements via an '*annual review of the Effectiveness Report which is tabled at HSBC UK [RMM] to ensure the board remain satisfied.*' However, the draft 2019 SCV effectiveness report was never put before the governing body for review, comment and approval (an internal guidance document produced by HBUK (finalised in September 2018) regarding the annual procedure for the SCV effectiveness report incorrectly did not provide for an annual statement from the governing body confirming that the firm's systems satisfied the relevant requirements). HBUK prepared a finalised and signed SCV effectiveness report in 2020 and has continued to do so thereafter.
- 3.5. The PRA understands that there was a longstanding misunderstanding within the Firms regarding the requirements to annually update and receive signed confirmation from the governing body as to the accuracy of their SCV effectiveness reports.
- 3.6. Notwithstanding this, from at least September 2018, it appears there was knowledge of HBEU's non-compliance with the requirement for a finalised SCV effectiveness report to be produced (which would include the firm's governing body confirming its SCV system satisfied the requirements set out in DP 12). On 12 September 2018 an email exchange within the

Regulatory Compliance team noted that the signed HBEU SCV effectiveness report that was due in 2017 had not been completed.

#### 4. 2015 advice

- 4.1. In June 2015 HBEU obtained external advice on the Recast DGSD. This advice made clear that beneficial accounts must be marked in a way that allows for their immediate identification and should be treated as eligible for FSCS protection unless HSBC established that the underlying beneficiary is not entitled to such protection.
- 4.2. The PRA understands that this advice was not implemented into the SCV processes by HBEU.

#### 5. 2018 ring-fencing

- 5.1. As a result of the process to establish the ring-fenced bank (HBUK), a number of individuals with subject matter expertise regarding the application of the DP Rules were moved to HBUK. This resulted in HBEU being left without the necessary knowledge and expertise in this area, such that it was heavily reliant on staff with appropriate expertise within HBUK.
- 5.2. The establishment of the ring-fenced bank resulted in a number of changes to the firms' SCV systems, which under DP 14.3-14.4, necessitated HBEU and HBUK making statements on behalf of their boards confirming their respective SCV systems satisfied the PRA's SCV requirements. These statements on behalf of the board were to be made within three months of the ring-fencing taking place (by 11 October 2018), as this process constituted a "*material change*" to the SCV system.
- 5.3. The relevant rules required that, in the event of a "*material change*" (as defined in the PRA Rulebook), the PRA must be notified of this change and it '*must be accompanied by a statement signed on behalf of the firm's governing body confirming that the firm's SCV system satisfies the SCV requirements.*'<sup>2</sup> Attestations were made by individuals from HBEU and HBUK on behalf of their respective firms.
- 5.4. Within HBUK a number of governance steps were followed to obtain approval for an individual to attest to the compliance of HBUK's SCV system. This consisted of preparing a paper for a 26 September 2018 RMM and a supporting SCV effectiveness report. The paper that was submitted to the RMM explained the checks undertaken to ensure HBUK's SCV

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<sup>2</sup> Paragraph 14.3, Depositor Protection part of the PRA Rulebook.

system met the PRA's SCV requirements and sought the RMM's endorsement that HBUK could attest to this. HBUK also tested production of the SCV File within the required 24-hour limit and obtained approval from business lines on its SCV effectiveness report.

- 5.5. While HBUK had governance processes in place for its attestation, there was no equivalent framework in place within HBEU.
- 5.6. As the deadline approached, ownership of the HBEU attestation process remained outstanding and there were concerns within the organisation as to whether the deadline would be met. On 27 September 2018 an email, sent two weeks ahead of the deadline for providing the attestation, noted there appeared to be no Regulatory Compliance owner for the HBEU attestation.
- 5.7. The days leading up to the date of submission of the HBEU attestation and the submission day itself highlighted the numerous issues regarding the ownership, governance and resourcing for the implementation of the depositor protection rules. The practical management of the attestation process was largely left to a single individual from HBEU's Regulatory Compliance Advisory team, who noted it had fallen to them to try and complete the process, despite it not being their responsibility.
- 5.8. On 10 October 2018, the day before the HBEU attestation was due to be submitted, approvals from other business lines feeding into HBEU were still being sought. An individual responding to one such request for approval noted there remained a lack of clarity on what was being sought.
- 5.9. Another business line, HBEU CMB, noted that CMB had not up to that point been involved in any attestation relating to DP Rule compliance, as the issues had previously been dealt with by HBUK.
- 5.10. The draft attestation for signature was not provided to the office of the individual making the attestation until the morning of 11 October 2018 (the day the attestation was due). Other HBEU individuals involved with the attestation process observed that whoever provided the attestation for signature would need to explain to the relevant individual signing the attestation, on behalf of HBEU, why the process had been rushed.
- 5.11. An initial meeting scheduled for 30 minutes, then later reduced to 15 minutes, was diarised for 12:45pm on the same day for the HBEU individual to be briefed on, review and sign the attestation confirming HBEU's compliance with the PRA requirements on SCV systems. The individual confirmed via email 14 minutes later at 12:59pm that they would make the

attestation, noting certain documents (including an updated draft of the SCV effectiveness report from June 2018) were to follow. The individual providing the attestation relied on oral assurances regarding the data quality of a recent SCV File run on 5 October 2018 when signing the attestation. After making the attestation, the PRA understands that the individual asked for the HBEU SCV effectiveness report to be provided to them, but the PRA understands that this was never done. The signed attestation which was provided to the PRA and FSCS on 11 October 2018 stated HBEU's 'SCV system satisfies the Depositor Protection requirements'.

- 5.12. There was limited governance, and unclear ownership and accountability around HBEU's SCV attestation process. Within hours of the attestation being provided, there was concern around the information being attested to, the process that had been followed, and the urgency that had been required.
- 5.13. As set out in more detail below (section 10), a subsequent review by HSBC's Internal Audit function in 2021 found there was a lack of supporting documentation for the 2018 attestation, and the draft 2018 SCV effectiveness report failed to address all of the questions requiring a full response under the DGSD rules. HBEU's SCV system did not comply with regulatory requirements as it was unable to produce an accurate SCV and exclusions view within the required 24 hours (although this was not known at the time the attestation was provided).

## 6. 2019 PRA Supervisory Information Request and FSCS Reporting

- 6.1. On 31 October 2019, the PRA made a request for information regarding one of HBEU's financial services business clients (the "Client") (the "PRA Information Request") to better understand how the Client structured its services. The PRA Information Request sought an explanation from HBEU as to, among other things, how the Client's accounts appeared for the purposes of the SCV and the exclusions view.
- 6.2. On 14 November 2019, HBEU informed the PRA that the Client's accounts were marked internally as 'ineligible' for FSCS purposes, and therefore did not appear in either the SCV or the exclusions view. HBEU noted that it would look into this marking, as well as that of other clients and accounts, to confirm if this approach was correct. HBEU informed the PRA that this review would extend to other entities if it proved necessary, and that it would keep the PRA updated.
- 6.3. On 10 December 2019, after further exchanges, HBEU informed the PRA that it was still looking into the matter, including further discussions with the Client (these being necessary to

understand how the Client used its account), and would revert to the PRA as soon as a further update was available.

- 6.4. The investigations which followed – and are outlined below – reached the erroneous conclusion that there were no issues with the marking of accounts for FSCS purposes. After this date, there were no further communications from HBEU to the PRA on the issues on which the PRA had been promised an update until, as set out at section 8.29 below, 23 April 2021 when, following the issues being considered again, HBEU flagged a potentially material emerging issue.

## **7. Investigation into FSCS issues by HBEU and HBUK following PRA requests**

- 7.1. The HBEU Regulatory Affairs team (responsible for liaising with the PRA Supervision) escalated the PRA's questions to several different teams throughout early November 2019 (including Regulatory Compliance, HBEU CMB, Client Monies and Assets Compliance (“**CMAC**”) and others). This led to the emergence of multiple strands of internal investigation within HBEU, with subject matters and personnel which frequently overlapped.
- 7.2. One strand focused on HBEU's relationship with the Client, and whether this explained why the Client's accounts were marked as ineligible for FSCS purposes. This strand of the internal investigation took place between November 2019 to 31 January 2020. It was carried out by a team from HBEU consisting of representatives from Regulatory Affairs, Regulatory Compliance, the Client's relationship manager and others. The Client had two client deposit accounts with HBEU, with one account holding funds from retail investors. At the time advice was sought from the CMAC team, who advised that the client deposit accounts were eligible for FSCS protection and should appear in the exclusions view.

## **8. 2019- 2021 HBEU internal investigations**

- 8.1. A separate strand of investigation focused on the accuracy of the SCV Files for HBEU. By 7 November 2019, the HBEU Regulatory Affairs team had obtained and reviewed a copy of HBEU's September 2019 SCV File to check how the Client appeared for FSCS purposes. This did not show the Client as appearing in the SCV or exclusions view. The HBEU Regulatory Affairs team worked to confirm the accuracy of this, given the FSCS guide stated that client money accounts (such as those held by the Client) should appear in the exclusions view. On 8 November 2019, the HBEU Regulatory Affairs team updated Compliance at one

of HBEU's business units summarising the exchanges with the PRA and the issues identified. They explained there may be a wider issue with client money deposit accounts being marked inaccurately for FSCS purposes, with the impact being they do not appear in the SCV Files.

- 8.2. This issue was escalated on the same day to HSBC Group level, specifically HSBC's Global Regulatory Compliance team, who asked on 10 November 2019 whether the FCA had been notified. In response, they were told there was no need to notify the FCA, that the PRA were not aware of the possible FSCS issue but that the dialogue with the PRA regarding the specific client was continuing, and the PRA would likely continue to be interested in the FSCS treatment of the accounts.
- 8.3. On 12 November 2019, it was noted at HSBC Group level that FSCS matters are generally of interest to both PRA and FCA. An individual from HBEU with responsibilities for regulatory compliance was copied, asking that they be briefed.
- 8.4. On 14 November 2019, HBEU Regulatory Affairs told the PRA that HBEU would be looking into the marking of the Client, *'and other clients and accounts as required, to understand the process that has been applied, and to confirm if the marking is correct for the relevant clients and products. This review will extend to other entities if the review suggests a need to do so. We will keep you updated on this.'*
- 8.5. By 15 November 2019 (two weeks after the PRA Information Request), HBEU's preliminary investigations had revealed there may be an issue with their FSCS reporting processes that required further investigation, however the potential scope of the issue was unclear. Further internal updates (shared with senior management at HBEU) noted that the PRA's recent line of questioning had highlighted that the Client's accounts may be being incorrectly excluded from HBEU's FSCS reporting. At this time, it was clear that at least one customer had been incorrectly excluded and there were concerns that other client money accounts were incorrectly excluded too. Although there was a concern the issue might be more systemic it was agreed internally that a review needed to be undertaken before this could be known. The fact the PRA may ask questions about FSCS reporting if there was thought to be a gap was noted.
- 8.6. An internal HSBC call was set up for 18 November 2019 with representatives from HBEU and HBUK to discuss the Firms' FSCS reporting process. By this date, over 15 HBEU individuals had been involved (including senior staff from Regulatory Affairs and Regulatory Compliance teams) and individuals from HBUK with regulatory responsibilities. The issue had been

escalated to at least three HBEU individuals holding Senior Management Function roles and senior staff with regulatory responsibilities at HSBC Group level.

- 8.7. The internal investigation led HBEU to establish an internal working group (the “**Working Group**”) to investigate whether client deposit accounts were being correctly reported in its SCV File. The members of the Working Group initially consisted of 15 individuals from both HBEU and (for an initial period of time) HBUK. Core members included representatives from teams responsible for regulatory change and regulatory compliance. The first meeting of the Working Group was on 20 December 2019, and the group met eight times between December 2019 and 19 May 2020 (the last meeting of the Working Group). The PRA understands the Working Group was governed informally; in that it had no terms of reference, governance structure, minutes were not formally taken, and no senior individual was assigned as accountable for owning its work and ensuring a response was provided to the PRA.
- 8.8. Members of the Working Group later noted that it was not part of a formal process nor backed by a formal structure. Members could not recall any formal reporting, and there were no closure reports or actions to be taken forward after the Working Group concluded. Members of the Working Group later gave conflicting accounts of its objectives and who was accountable for the group’s work.
- 8.9. Separately, the HBUK Regulatory Change team raised an alert on 18 November 2019 in HELIOS (HSBC’s internal system for reporting risks, controls and issues). The alert identified the need to consider whether HBUK client money accounts were being wrongly excluded from the SCV Files. No corresponding HELIOS alert was raised by HBEU until 30 October 2020, it is unclear why this was the case given the issue originated in HBEU.
- 8.10. On 20 November 2019, an HBEU internal meeting took place. The minutes of this meeting record ‘*there was an emerging issue with NBFIs [Non-bank financial intermediaries] where evidence was found that client funds were not correctly reported to the regulator as related to the Depositor Protection Scheme...*’
- 8.11. Prior to its first meeting on 20 December 2019, members of the Working Group (from HBUK Regulatory Change) located a sample of HBUK client deposit accounts which were eligible for FSCS protection. The Working Group members then checked how these were being treated for FSCS reporting purposes. An equivalent sample of HBEU accounts was also requested from the HSBC Technology team but was never provided and the issue was not followed-up. Between 20-25 November 2019, a sample of 22,000 HBUK client deposit

accounts were located and reviewed. The results of this analysis were shared on 25 November 2019 with members of the Working Group. Of the 22,000 HBUK accounts, it was found that only four accounts appeared in the HBUK SCV File, the remaining accounts were not in either the SCV or exclusions view. This was identified by the HBUK Regulatory Change team as a concerning issue that could apply '*across the board*'. The HBUK Regulatory Change team was asked to prioritise their analysis on the SCV File given the risk of reputational damage for both HBUK and HBEU if the data was inaccurate. HBEU CMB noted that HBEU only had limited experience with SCV and FSCS reporting within the business (it being based on HBUK's process) and HBEU's own reporting processes were not yet finalised.

- 8.12. On 3 December 2019 the Working Group and HBEU CMB were updated with the results of analysis by the HBUK Regulatory Change team. The analysis noted that client money accounts should be included in the exclusions view and that it seemed highly likely that HBUK was instead treating client money accounts as being ineligible for FSCS protection. The suggestion was made that there would be implications for HBEU based on the SIC codes that the analysis had identified. This was forwarded to HSBC's IT team noting '*we have a potential issue regarding the SCV file that needs to be investigated*' and requesting a description of the logic used to create the SCV File.
- 8.13. On 3 December 2019, a Working Group member from HBEU CMB's Regulatory Compliance team and a HBEU Regulatory Affairs representative discussed the issue of appropriate marking, for FSCS purposes, of client money accounts and concerns that these were being incorrectly excluded. On the same day, a Working Group member from HBEU's Regulatory Compliance team gave an update to a senior individual at HSBC Group level with responsibilities for regulatory compliance covering work since the PRA's 31 October 2019 query. The update noted that the PRA's query into the Client had triggered a broader concern around FSCS and that the Regulatory Compliance team continued to investigate FSCS reporting to identify whether or not there was an issue, and whether or not it was systemic within HBEU's commercial banking unit. Regulatory Affairs raised concerns with the limited scope of this update noting the issue may be wider than HBEU CMB only.
- 8.14. The next day, 4 December 2019, a Working Group member from HBEU's Regulatory Compliance team escalated the FSCS reporting issue via email to a colleague in the team and requested their presence on a call with colleagues involved in producing the SCV File. The email explained that through trying to answer the PRA's questions related to a specific client a broader issue had been identified with how clients were recorded for FSCS reporting.

The email explained the reasons for this were still unclear given those with responsibility for the process previously had moved to HBUK post ring-fencing.

- 8.15. In parallel – with assistance from HBUK Regulatory Compliance and Operations – HBUK members of the Working Group reviewed a further sample of HBUK accounts likely to hold client money accounts (focusing on solicitors' firms) to check how the accounts were being treated for FSCS reporting purposes. By 4 December 2019 this further review had looked at the status of 3,562 HBUK deposit accounts from solicitors' firms and found that all were (incorrectly) considered ineligible. It was noted this suggested that something was not as it should be. On 5 December 2019 this analysis was shared by the HBUK Regulatory Change team with HBEU CMB. In turn, it was forwarded to HSBC individuals involved in the production of the SCV File, along with queries on how it was produced.
- 8.16. On 9 December 2019 a call took place between two members of the Working Group from HBUK and HBEU Regulatory Compliance. In a follow-up exchange, an internal business intelligence document was discussed which set out the high-level design of the SCV extraction process. It was noted that the document correctly identified that beneficiary accounts should go into the exclusions view, but that investigations to date suggested there were accounts not following this mapping and that further investigation was required to satisfy the PRA.
- 8.17. A further strand of investigation by the Working Group was to validate or 'walkthrough' how the HBEU SCV File was created, and whether this was aligned with the requirements of FSCS reporting. This was undertaken by two Working Group members from HBEU Regulatory Compliance with HSBC's IT team on 28 January 2020. The conclusion of this exercise was reported to a senior HBEU Regulatory Compliance individual and noted that IT had a high level of confidence that the process producing the SCV File was working correctly. This was followed by an update that Working Group members' current view was that the actual SCV File production process was working correctly.
- 8.18. On 4 February 2020, a draft update to the PRA was prepared regarding the status of HBEU's investigation into the Client. This followed HBEU's previous communication to the PRA on 10 December 2019 (referred to at paragraph 6.3, above) which noted the Firm was still looking into the matter and would keep the PRA updated. However, this update was never sent.
- 8.19. The two Working Group members who attended the walkthrough reported back to the wider Working Group on 10 February 2020 that Regulatory Compliance confirmed the data pulled and extraction logic was in line with the legislation and the regulatory mapping was accurate.

On 10 February 2020 an update from HBEU Regulatory Compliance confirmed Regulatory Compliance teams from HBUK, HBEU GBM and HSBC London Office GBM had reviewed the DGSD requirements and the logic applied to the extraction, and it was in line with the regulatory requirements. HBEU's testing was described as being completed and the five cases sampled were described as being in line with the SCV logic. This was shared with a senior HBEU Regulatory Compliance individual on 24 February 2020.

- 8.20. However, these conclusions were incorrect. The SCV File was in fact not being correctly produced in accordance with the DP Rules. The Working Group's investigations failed to uncover this as their *'testing was flawed in scope, design and execution'* and failed to test the extraction logic applied to the SCV. Staff from HBEU's Regulatory Compliance team who attended the walkthrough later confirmed the limitations of this exercise as they would not have known what was right or not. HBEU Regulatory Compliance did not check the logic applied to the SCV File production process. Their conclusion that the SCV data was compliant with applicable regulation was drawn from an impression that HSBC's IT team seemed to understand the issues and the regulation.
- 8.21. By 20 April 2020 the SCV reporting issue for HBEU was considered closed and the Working Group was disbanded. Its last meeting was held on 19 May 2020.
- 8.22. Although the Working Group was disbanded, work continued within HBUK to assess whether client deposit accounts were being correctly classified. By 18 August 2020 HBUK had identified that certain client deposit accounts were not being reported correctly in HBUK's SCV File. Investigations indicated that this issue was not material for HBUK.
- 8.23. On 17 September 2020, an email triggered a process to re-open HBEU's consideration of the FSCS reporting issue. HBEU's CMAC team asked the HBEU Regulatory Affairs team for an update on the FSCS reporting issue. HBEU's Regulatory Affairs team stated that the FSCS reporting issue was not flagged to the PRA and was an issue addressed internally as an isolated incident. The CMAC manager noted that the SCV File was materially inaccurate and could have a significant impact on FSCS contributions.
- 8.24. It was confirmed in an internal email on 22 January 2021 that there were errors with the Firms' reporting, which meant that HBEU and HBUK were in breach of the DP Rules. It was further noted that the Firms should determine the extent and materiality of the error for each entity and should consider any notification and reporting requirements. Despite the confirmation of regulatory breach and the suggestion of regulatory notification – which was

copied to numerous personnel with regulatory responsibilities at HBEU, HBUK and Group level – there was no notification to the PRA until 23 April 2021.

- 8.25. By 9 February 2021, early scoping of the misreporting issue indicated HBEU had been underreporting by '*£ single figure billions*'. This was reported to a senior member of HBEU's Regulatory Compliance team, including that the issue was not expected to be material for HBUK. It was noted that a notification would be required for HBEU.
- 8.26. From February 2021, a team within HBEU undertook analysis into the scope of the reporting error, the number of impacted customers and possible remediation. The team also considered whether to update the PRA. For instance, the minutes of a 22 February 2021 meeting suggested the PRA was still only at that point aware of the issue impacting the original client and had not yet been informed about the broader issue. Regulatory Affairs noted they would support any notification required if the Regulatory Compliance team or the business determined there was a need to update the PRA following completion of the internal investigation into the matter. However, this update was incorrect as the PRA was never informed of any FSCS issues impacting the Client, merely being told that the Client was marked as ineligible for FSCS purposes and that HBEU '*will be looking into the marking of...other clients...to confirm if the marking is correct...*'
- 8.27. On 1 April 2021, a short summary of the FSCS reporting issue was produced for a senior HBEU individual with responsibilities for regulatory compliance. The note stated the belief that HBEU and HBUK were in breach of the DP Rules and explained that on an initial analysis, HBEU was under-reporting its exclusions view by GBP £112 billion (representing 99% of deposits by value and 57% of clients). This figure was reached by analysing HBEU SCV data from Q4 2019 and August 2020 in the absence of more up-to-date data. The note recommended notifying the PRA of the error promptly due to the materiality of the error. By 15 April 2021 senior individuals within HBEU were apprised of the FSCS reporting issue.
- 8.28. Despite the suggestion of PRA notification, there were challenges in assessing the scope of the reporting error. The CMAC team later noted the delay was due to challenges obtaining and then analysing available data caused by business lines needing to commit significant resources to the issue at a time when they did not know it was a significant issue.
- 8.29. At a 23 April 2021 continuous assessment meeting with the PRA, HBEU informed the PRA of a potentially material emerging issue (having become aware that it was in breach of the DP Rules and that HBEU's exclusions view was potentially materially inaccurate). Representatives of HBEU told the PRA that, while they were uncertain as to how material the

matter was, HBEU was doing work to determine if there was incorrect reporting and wanted to give early awareness. The potentially material emerging issue was a reference to the FSCS reporting issues which had re-emerged from September 2020 and been in focus since January 2021.

- 8.30. On 25 June 2021, HBEU sent an email notification to the PRA on behalf of HBUK and itself. The email stated HBEU had identified issues with its FSCS Marking and exclusions view reporting as required under DP Rules 11 and 14. HBEU admitted that as a result of these errors, the majority of client accounts held by HBEU were incorrectly identified as ineligible for FSCS protection. HBEU admitted its process for producing FSCS reporting incorrectly excluded deposits made by financial services firms from the exclusions view, even if deposits in those accounts belonged to clients who were eligible for FSCS protection. HBEU also admitted that it was unable to provide any evidence that – as required under DP Rule 14 – the governing body of HBEU had annually assessed the effectiveness of its FSCS reporting or confirmed the system was meeting the relevant rules.
- 8.31. HBEU further admitted that, as a result of its errors, it estimated at the time that: (i) £4.5 billion of deposits in relation to 242 clients was incorrectly marked as ineligible for protection; and (ii) a further £2 billion of deposits in relation to 120 clients was incorrectly excluded from the exclusions view. HBEU's FSCS report at the time only included £2 million of deposits in relation to 150 clients. HBEU had therefore excluded 99% of potentially eligible deposits by value, and 70% of all potentially eligible clients. HBEU acknowledged that this would have resulted in an under-calculation of HBEU's annual fees to the FSCS. Subsequent internal investigations within HBEU revealed further significant volumes of deposits had been incorrectly marked. HBEU also acknowledged that the same issues impacted HBUK but noted that the impact was significantly smaller for HBUK at around 0.1% of covered deposits.

## 9. 2020 Internal Audit review of HBUK SCV

- 9.1. Separately, a 12 November 2020 Internal Audit at HBUK assessed whether it had complied with the PRA and FSCS requirements regarding the production of a SCV File and provision of continuity of access.
- 9.2. Overall, the Internal Audit report rated the issue as *'Needs Improvement'* due to the conclusion that *'elements of the control framework over the SCV file are not sufficient to ensure full compliance with certain regulatory requirements and to verify that all data is complete and accurate.'* The report also noted that *'[c]ontrols to confirm completeness and*

*accuracy of data in the SCV file are not fully effective and the logic of the code used to extract the data from source systems is not regularly reviewed.*’ The root cause of these issues stemmed from the 2018 ring-fencing, when *‘the actions taken to update the SCV process following the creation of HBUK in January 2018...were not fully effective.’*

- 9.3. The report identified a number of issues that were also present in the 2021 Internal Audit investigation into HBEU described below. These included unclear accountability, roles and responsibilities for the SCV process, which meant that *‘effective oversight of the SCV process was not completed in 2019...for HBUK. Under the PRA rules management should present the annual SCV effectiveness report to an appropriate governance committee for review and sign-off.’* The lack of oversight meant that *‘errors and gaps in the HBUK SCV file...are not always identified and remediated. This may lead to regulatory censure and non-payment of compensation to eligible customers.’* The report also noted a failure of management to periodically review the design logic of the code to create the SCV File, meaning *‘some customers are incorrectly assessed as ineligible and excluded from the SCV file...’* and insufficient testing of the SCV File to confirm its accuracy and completeness. This meant that *‘regulatory requirements...are not fully adhered to, leading to non-payment of compensation to eligible customers.’*
- 9.4. Management action plans were put forward to address the issues identified by the HBUK Internal Audit report. The content of the Internal Audit report was also summarised for the PRA at a Continuous Assessment Meeting in December 2020.

## 10. Investigation into FSCS issues by HBEU following PRA requests

- 10.1. In Q1 2021 HSBC’s Internal Audit function was tasked with undertaking a special review into HBEU’s compliance with the FSCS levy and associated reporting (the “**Special Review**”). This internal audit was initiated by HBEU senior management following the issues that had been notified to the PRA in April 2021. Relevant background to the Special Review was noted, in the terms of reference, to include:
- 10.1.1. the PRA engagement dated from Q4 2019;
  - 10.1.2. HBEU’s failure to identify potentially eligible clients;
  - 10.1.3. that in the *‘...event of HBEU’s insolvency, the incomplete statement of FSCS-protected deposits would have resulted in slower compensation for depositors and potentially increased costs for the FSCS due to delays in deposit identification and*

*compensation payments to affected depositors. The HBEU SCV Annual Effectiveness Report, which requires deposit takers to report on how eligible deposits are marked in their systems, has not been produced or taken through governance since 2018.'*

- 10.2. The Special Review was split into three phases, concurrent with which HBEU would produce an SCV effectiveness report in accordance with regulatory requirements.
- 10.3. Phase 1 was a timeline of events. Phase 2 of the Special Review issued on 5 November 2021 (the "**Phase 2 Report**") examined, among other things, the (i) implementation of the DP Rules since 2010; (ii) establishment of HBUK; and (iii) governance and Senior Management responsibility.
- 10.4. The Phase 2 Report found significant deficiencies in HBEU's compliance with regulatory requirements implementing the DGSD and Recast DGSD since the introduction of the rules in 2010 but it also noted that '*management did attempt to bring some rigour to the programmes of work through various phases of the implementation of the rules*'. The PRA understands that errors from prior to 2015 largely relate to an absence of evidence of compliance with the rules in force during that time period.
- 10.5. Deficiencies and failings identified in the Phase 2 Report included:
  - 10.5.1. The failure to finalise the SCV effectiveness reports identified for 2016, 2017 and 2018 (described above). These reports contained blank sections or sections with inconsistent responses and did not address all of the questions that required a full response, in line with the DGSD rules, including how HBEU's SCV system should enable the identification of eligible deposits. It is also not clear, based on Internal Audit's reviews, who was responsible for formally approving the HBEU SCV effectiveness reports or what the governance process was for them to do so;
  - 10.5.2. Internal Audit could not locate HBEU SCV effectiveness reports for 2019 and 2020, and as a result, HBEU was not compliant with the requirements of the rules over those years;
  - 10.5.3. A paper presented to the HBEU board in July 2016 on the technical challenges of producing an SCV File did not have the actions associated with the discussion recorded and as a result these were not tracked for remediation/closure;

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- 10.5.4. There was an incorrect application of the DP Rules (and antecedent rules) associated with the treatment of beneficiary accounts. It is unclear for how long this incorrect application had persisted prior to identification;
  - 10.5.5. HBEU obtained, but failed to implement, advice on the correct treatment of beneficiary accounts in 2015;
  - 10.5.6. There was a failure to capture FSCS reporting within the appropriate governance framework when establishing the ring-fenced bank (HBUK);
  - 10.5.7. There were incorrect conclusions, an absence of subject matter experts and inadequate tracking associated with the initial investigation arising out of the PRA's queries in Q4 2019;
  - 10.5.8. The Working Group was described as informal, lacking a governance structure, reporting lines or accountable senior manager; and
  - 10.5.9. While an attestation was provided in October 2018 as part of the ring-fencing process, Internal Audit found there to be a lack of supporting documentation in relation to it. HBEU's 2018 SCV effectiveness report was incomplete and Internal Audit was unable to locate evidence that the report was finalised, or that it had been provided to the governing body. Internal Audit concluded that in relation to the HBEU 2018 attestation, *'it was unclear on what basis'* the relevant individual *'obtained assurance that the attestation was accurate'* given there was no complete 2018 SCV effectiveness report.
- 10.6. Internal Audit's Phase 3 Root Cause Report dated 14 March 2022 (the "**Root Cause Report**") identified a lack of subject matter expertise and misinterpretation of the requirements around the production of the SCV, exclusions view and SCV effectiveness reports. Interviews with senior programme management confirmed that the rules had been incorrectly interpreted such that it was concluded that, although drafts were produced, the SCV effectiveness report needed only to be formally completed following a significant change or in response to material trigger events.
  - 10.7. An email exchange with Internal Audit in September 2021 noted that a review of DGSD Oversight Committee minutes revealed that concerns were raised around key DGSD individuals moving to HBUK which meant that there were not sufficient responsible individuals left at HBEU running business as usual testing and reporting. In addition, ownership of DGSD reporting and the quarterly SCV File run within HBEU were raised as

concerns. There was also no clear understanding of the requirement for board-level sign off. As a result, a formal annual effectiveness process was not put in place by the Recast DGSD programme, and draft effectiveness reports were incomplete and insufficiently reviewed.

10.8. The Root Cause Report also found there was a lack of clear ownership or accountability in relation to producing the SCV effectiveness reports for HBEU. Formal accountability for the end-to-end process was not well-defined, and crucially there was a lack of clarity as to whether the HBEU board should have been informed and/or required to formally delegate the signing of the attestation to an accountable individual. First line responsibility for producing the draft SCV effectiveness reports for HBEU after ring-fencing was unclear and this contributed to the fact that supporting evidence requested at the time of the 2018 attestation was never subsequently provided. Internal Audit also identified a lack of second-line responsibility over the SCV effectiveness reports which led to these reports not being produced for HBEU following ring-fencing. The same report noted it was unclear which Senior Manager had responsibility for the SCV File and the annual SCV effectiveness report. Delegation of responsibility, if it had occurred, was not fully established or agreed; alongside this there was no manager with overall ownership of the process. Internal Audit also noted that there had been limited second-line testing prior to ring-fencing and none post-ring-fencing. In relation to the limited testing that did take place prior to ring-fencing it would appear that this was done on the basis of the incorrect reading of regulatory requirements – as they applied to beneficiary accounts – described above. HBEU produced a final form SCV effectiveness report on 28 February 2022.

10.9. The Root Cause Report noted that, although there were deficiencies in HBEU's compliance with the DP Rules, Internal Audit did not identify any evidence of intentional non-compliance by any HSBC employees.

## 11. Remediation

11.1. After the identification of the issues in 2021, the PRA understands that both Firms established revised governance processes in relation to the production of SCVs and exclusions views, as well as the production of SCV effectiveness reports. Both Firms have since taken action to fix issues once they were understood.

11.2. As the PRA would expect, the Firms have also invested significantly in their depositor protection compliance. At HBEU, this took the form of a full-scale remediation programme, which was completed in May 2023.

- 11.3. HBUK's remediation took the form of targeted corrections.
- 11.4. There has been extensive senior management engagement across both Firms in remediating the issues identified. External consultants have also been instructed to assist with the remediation.
- 11.5. The PRA understands that Depositor Protection issues are now cascaded and managed holistically across both Firms.

## ANNEX B: BREACHES AND FAILINGS

### 1. Breaches

- 1.1. During the Relevant Period, as a result of the facts and matters set out at [Annex A](#) to the Notice, the Firms breached relevant requirements of the PRA Rulebook.
- 1.2. HBEU breached:
  - 1.2.1. FRs 2, 6 and 8 from at least 2015 to 28 February 2022;
  - 1.2.2. FR7 from 4 February 2020 to 23 April 2021; and
  - 1.2.3. the DP Rules, specifically:
    - 1.2.3.1. DP 50 from 3 July 2015 to 30 November 2016, which related to transitional provisions associated with SCV requirements;
    - 1.2.3.2. DP 11 from 3 July 2015 to 28 February 2022, which relates to marking and information requirements; and
    - 1.2.3.3. DP 12 and 14 from 1 December 2016 to 28 February 2022, which relates, respectively, to SCV requirements and SCV and exclusions view reporting.
- 1.3. HBUK breached:
  - 1.3.1. FRs 2 and 6 from 11 July 2018 to 17 December 2021; and
  - 1.3.2. DP Rules 11 and 12 from 11 July 2018 to 17 December 2021, which relates, respectively, to marking and information requirements; and SCV requirements; and
  - 1.3.3. DP 14 for the year 2019 only, which relates to SCV and exclusions view reporting.
- 1.4. These rules are included at [Appendix 2](#).

### 2. The PRA's Expectations

- 2.1. The PRA requires firms to prepare for resolution so, if the need arises, they can be resolved in an orderly manner with a minimum disruption of critical services. The DP Rules support resolution preparedness by requiring firms to be able to accurately identify deposits eligible for FSCS protection and to be able to provide this information within 24 hours of a request by

the PRA or the FSCS. These rules are in place to protect depositors in the event of a firm failure and to enable the rapid pay-out of funds to depositors who are covered by the FSCS.

- 2.2. The failure by a firm to be adequately prepared for an orderly resolution leading to disruption to critical services, can have significant adverse impacts on wider financial stability and confidence in FSCS protection and other financial institutions. The FSCS aims to compensate eligible depositors within seven days of a bank failure, but this is reliant on firms being able to produce accurate SCVs and exclusions views. Therefore, the PRA expects firms to prepare for resolution by having a compliant SCV system that produces accurate SCVs and exclusions views within the time frames stipulated.
- 2.3. While a firm's preferred resolution strategy may not foresee reference to the SCV and exclusions view, it is nonetheless vital that information within those files is accurate and maintained in line with regulatory rules. This is in order to ensure that there are sufficient options available to the Resolution Authority in the event that the preferred resolution strategy is not viable.
- 2.4. The PRA relies on firms it supervises dealing with their regulators in an open and co-operative way and to proactively and promptly disclose to the PRA any information relating to the firm of which the PRA would reasonably expect notice. This is particularly important when that information relates to specific enquiries that the PRA has made. The PRA relies on firms answering its queries promptly with the information requested in order to inform its judgments about key risks.
- 2.5. The PRA expects firms to allocate clear ownership of SCV system compliance and regulatory reporting between lines of business and functions, even where this may be across several lines of business. The PRA expects firms to install and maintain appropriate governance structures, policies and procedures to support SCV system compliance and SCV File production. PRA-authorized firms should ensure that relevant expertise for critical areas such as depositor protection is not lost following internal re-organisations or restructurings.
- 2.6. The PRA expects to be promptly notified of any material issues relating to the accuracy and status of a firm's depositors. PRA-authorized firms should clearly identify and document individual and team responsibility and accountability for notifications to the PRA, particularly for matters related to resolution preparedness. The PRA recognises that a firm will want to investigate issues further once they have been identified. However, this does not mean that information which should be disclosed to the PRA can be withheld for lengthy periods until those investigations are completed. For PRA Supervision's purposes, understanding how an

error has occurred is ancillary to knowing that an error had potentially occurred. The PRA expects that firms will be open and co-operative in their dealings with the PRA, and they will disclose to the PRA anything relating to themselves of which the PRA would reasonably expect notice.

- 2.7. The PRA expects that when attestations are provided regarding a firm's compliance with regulatory requirements, they are accurate. The PRA expects verification to have taken place to ensure their accuracy. It is a very serious issue when attestations are later revealed to be inaccurate.

### 3. Failings

- 3.1. The PRA has concluded that during the Relevant Period:

3.1.1. HBEU breached (i) FRs 2, 6, 7 and 8, and (ii) DP Rules 11, 12, 14 and 50 of the PRA's Rulebook; and

3.1.2. HBUK breached (i) FRs 2 and 6; and (ii) DP Rules 11, 12 and 14 of the PRA's Rulebook.

#### Fundamental Rule 7

- 3.2. FR7 requires a firm to deal with its regulators in an open and co-operative way and to disclose to the PRA appropriately anything relating to the firm of which the PRA would reasonably expect notice.
- 3.3. HBEU breached FR7 by failing to be open and co-operative with the PRA, by reason of it not disclosing information of which it would have expected notice.
- 3.4. There was a significant delay of approximately 15 months between HBEU becoming aware it had information which reasonably suggested it may have been mismarking a significant volume of deposits from FSCS protection (something which contemporaneous correspondence made clear could have a significant adverse impact on the firm's reputation) and its 23 April 2021 notification to the PRA. (For a large part of this time, the Firm was under the mistaken impression that there was in fact no mismarking. This was because of erroneous conclusions drawn by its own investigation and the previous failure to action external legal advice.) The PRA considers HBEU's breaches of FR7 to be particularly serious because:

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- 3.4.1. there were missed opportunities to notify the PRA that a material issue relating to depositor protection had been identified and that the Firms had begun an internal investigation;
  - 3.4.2. HBEU was aware that the PRA was interested in the accuracy of SCV Files, and would therefore expect to be notified of any potentially material SCV issues, but it failed to notify the PRA in a timely manner once HBEU had information that reasonably suggested the marking of the firm's SCV Files was not compliant with certain of the requirements set out in the DP Rules; and
  - 3.4.3. HBEU's DP Rule deficiencies were only discovered due to HBEU PRA's queries. Had the PRA not made enquiries, it is unclear when HBEU would have discovered the errors.
- 3.5. There was confusion as to whether the PRA or FCA should be notified, failures to read across the results of internal investigations as between HBEU and HBUK, uncertainty about the materiality of the issue with SCV Files and whether it needed to be notified to the PRA and a mistaken view that the PRA would only need to be updated once internal investigations were further advanced.
  - 3.6. In the context of HBEU's DP Rule SCV requirements and the PRA's expectations, an investigation into a potential material SCV error was something of which the PRA would reasonably expect notice.
  - 3.7. Throughout the relevant period HBEU was aware that the accuracy of its SCV Files was relevant information that the PRA would be interested in.
  - 3.8. HBEU failed to notify the PRA at the time that it had identified the existence of a potentially material error (following the re-emergence of the issues towards the end of 2020). HBEU continued to investigate the FSCS reporting issue internally but failed to adequately notify the PRA that an investigation had begun. After it had identified a potentially material error (subsequently a confirmed material error) HBEU should have notified the PRA, but failed to do so.
  - 3.9. From early March 2020 until 23 April 2021 (and thereafter), the Firms were dealing with the demands of responding to the COVID pandemic.

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### Fundamental Rule 8

- 3.10. FR8 requires a firm to prepare for resolution so, if the need arises, it can be resolved in an orderly manner with a minimum disruption to critical services.
- 3.11. HBEU's failure to generate reliable SCVs and exclusions views, as well as SCV effectiveness reports over a prolonged period undermined its readiness for resolution, such that it breached FR8.
- 3.12. Other than in 2015, HBEU failed to produce finalised SCV effectiveness reports for every year from 2015-2020. HBEU was therefore unable to confirm that its SCV systems for these years satisfied the PRA's SCV requirements. The attestation provided in 2018 that HBEU's SCV systems satisfied the PRA's SCV requirements was incorrect. In fact, HBEU's SCV systems incorrectly classified 99% of eligible deposits by value as ineligible for FSCS protection. In the event HBEU needed to be resolved, the ability of the Resolution Authority to do this in an orderly manner could have been severely disrupted, and limited the options available to the Resolution Authority.
- 3.13. HBEU's failures may also have resulted in the missed deposits incorrectly being deemed to have been bailed-in, as they would not have been deemed to be excluded from bail-in as covered deposits, and an incorrect financial contribution to the resolution from FSCS under the Act, which the FSCS would have calculated, in part, on the basis of the SCV and exclusions view.
- 3.14. The PRA's January 2014 consultation paper which discussed the introduction of FR8 noted *'compliance with FR8 would depend on how adequately prepared the firm was for resolution. For example, the failure of a firm to adequately meet the SCV requirements might signal a breach of FR8, as well as SCV rules.'* Since 2014 it has been clear that the PRA regards the compliance of a firm's SCV system as indicative of a firm demonstrating it is meeting FR8. The failure of HBEU's SCV systems to comply with the SCV requirements is a breach of FR8.
- 3.15. The PRA considers HBEU's breaches of FR8 to be particularly serious because:
- 3.15.1. The amount and proportion of incorrectly classified accounts was very significant, as 99% of eligible accounts by value had been incorrectly marked;

- 3.15.2. HBEU's SCV reporting was consistently inadequate over a long duration. The failings continued for a number of years (from at least 2015) before they were uncovered (the discovery itself only due to PRA queries);
- 3.15.3. HBEU was a Category 1 firm throughout the Relevant Period, making preparation for resolution all the more important, as its failure could have had a significant impact on the wider UK financial system; and
- 3.15.4. An attestation made on behalf of HBEU to the PRA and FSCS regarding the compliance of its SCV systems with the SCV requirements was inaccurate (albeit not knowingly).
- 3.16. HBUK also failed to produce a final form SCV effectiveness report in 2019.

#### DP Rules – HBEU and HBUK

- 3.17. DP 11: The Firms were not marking eligible deposits (specifically, those deposits held on behalf of beneficiaries) in a way that would allow for their immediate identification as eligible or potentially eligible, amounting to a breach of DPs 11.1 and 11.2. As a consequence, were the Firms asked, they would not have been able to provide the FSCS with the aggregate amount of eligible deposits of every depositor, in breach of DP 11.3. Finally, the Firms did not take reasonable steps to ensure the accuracy of the data they held to satisfy the requirements of DP 11, in breach of DP 11.7. HBEU was in breach from the advent of this rule on 3 July 2015 until 28 February 2022, on which date it produced a satisfactory final form SCV effectiveness report. HBUK was in breach from the launch of its own SCV system on 11 July 2018 until 17 December 2021, when it produced an SCV effectiveness report for 2021.
- 3.18. DP 12: Given the foregoing, the Firms would not have been able to provide the FSCS with accurate SCV and exclusions views within 24 hours of (i) the relevant deposits becoming unavailable deposits; or (ii) a request by the PRA or FSCS; had this occurred this would have been a breach of DP 12.1 and 12.2. The incorrect marking of beneficially held deposits meant the Firms breached DP 12.7 by failing to ensure that their SCV systems were automatically identifying the amount of covered deposits payable to each depositor. Finally, the Firms breached DP 12.8 by not taking reasonable steps to ensure the accuracy of data held to satisfy the requirements of DP 12. HBEU was in breach from the advent of the rule from 1 December 2016 until 28 February 2022. HBUK was in breach from 11 July 2018 to 17 December 2021.

- 3.19. DP 14: HBEU breached DP 14.6, which required firms to update their SCV effectiveness reports annually, in 2016, 2017, 2018, 2019 and 2020 because it only produced incomplete drafts in 2016, 2017 and 2018, and no drafts in 2019 and 2020. HBUK breached this rule in 2019. Among other things, DP 14.8 requires a firm's SCV effectiveness report to include a statement signed on behalf of the firm's governing body confirming that the firm's SCV system satisfies the SCV requirements. HBEU breached this by failing to make such attestations in 2016, 2017, 2019 and 2020. HBUK breached the rule in 2019 for the same reason. In 2018, both Firms made attestations, but these were inaccurate and, in relation to HBEU, fundamentally and materially incorrect.
- 3.20. DP 50: The incorrect marking of beneficially held deposits meant HBEU failed to ensure that the electronic systems producing its SCV were capable of automatically identifying the amount of covered deposits payable to each depositor. This amounts to a breach by HBEU of DP 50.6 throughout the existence of this rule, from 3 July 2015 to 30 November 2016. HBUK did not breach this rule, as it predates HBUK's existence as a UK bank.

#### Fundamental Rule 2 – HBEU and HBUK

- 3.21. FR2 requires a firm to conduct its business with due skill, care and diligence. The PRA expects firms to exercise due skill, care and diligence in complying with the PRA rules.
- 3.22. The Firms breached FR2 by failing to conduct their business with due skill, care and diligence in a number of different respects:
- 3.22.1 SCV effectiveness reports: HBEU failed to produce completed SCV effectiveness reports for 2016, 2017, 2018, 2019 and 2020 as required under the DP Rules. HBUK also failed to produce a completed SCV effectiveness report for 2019.
- 3.22.2 Inadequate SCV systems: The SCV systems of both Firms did not meet the PRA's SCV requirements. Both Firms incorrectly marked beneficiary accounts as ineligible for FSCS protection. This mistake was significant at HBEU, where 99% of eligible accounts by value had been incorrectly marked. External advice had been commissioned by HBEU in 2015 regarding the treatment of beneficiary accounts for FSCS purposes, but was never implemented.
- 3.22.3 Incorrect attestations: Attestations on behalf of both Firms that their respective SCV systems met the PRA's SCV requirements were inaccurate and (at HBEU) adequate verification procedures and governance processes were not in place to prevent this from happening.

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### Fundamental Rule 6 – HBEU and HBUK

3.23. FR6 requires firms to organise and control their affairs responsibly and effectively. The Firms breached Fundamental Rule 6 by failing to put in place appropriate governance and oversight arrangements to ensure implementation and accountability for DP Rules including SCV reporting.

#### *Governance*

3.24. The Firms failed to appreciate the significance of compliance with the DP Rules to their resolvability and FSCS protection, and therefore to the severity of the risks they might pose to the financial system as Category 1 firms.

3.25. Accountability: The Firms failed to assign clear ownership between lines of business and functions (such as Regulatory Compliance) of risks and responsibilities for the end-to-end SCV process. Failing to allocate clear ownership of risks and responsibilities for the SCV process resulted in problems that went unaddressed for significant periods of time. By way of example, some customer data was wrongly omitted from the SCV File and, in 2019, HBUK failed to present an SCV effectiveness report to an appropriate governance forum, in breach of DP Rules. The Firms failed to ensure that a senior manager, under the SMCR, had been allocated ownership of the SCV process and associated reporting. This constituted a gap in the firm's implementation of the SMCR.

3.26. Post Ring-fencing Governance: Various governance issues resulted from the split of HBEU and HBUK upon ring-fencing. The ring-fencing project did not adequately address FSCS requirements within HBEU.

#### *Data management and control*

3.27. Due to deficiencies in the SCV File's control framework, the completeness and accuracy of SCV data and the code used to extract data from source systems was not subject to regular review. Data quality issues impacting SCV were identified as a risk from at least 2010.

3.28. This is despite the PRA's Periodic Summary Meeting ("**PSM**") feedback letters making clear, on numerous occasions, the weaknesses in the Firms' IT infrastructure and data management. Although the PSM feedback letters did not comment specifically on DP Rule compliance, the PRA considers the issues cited symptomatic of the wider data and control issues:

- 3.28.1 The 2017 PSM feedback letter made clear that there were '*weaknesses in areas such as IT infrastructure, data management and controls and oversight*';
- 3.28.2 The 2018 PSM feedback letter stated that '*HSBC suffers from systemic weaknesses in its ability to capture, manage and aggregate data*';
- 3.28.3 The 2019 PSM feedback letter also noted weaknesses in end-to-end process mapping;
- 3.28.4 The 2020 PSM feedback letter also stated that '*Poor data and IT capabilities continue to limit oversight and governance*'; and
- 3.28.5 The 2021 PSM feedback letter noted that the Firms had '*underinvested in data, controls, processes, technology and risk management capabilities for years*'.

## 4. Conclusion on failings

- 4.1 The failure by HBEU – a Category 1 firm – to generate reliable SCV data, exclusions views or SCV effectiveness reports (the "**SCV Issues**") over a significant number of years undermined its readiness for resolution.
- 4.2 In the event of HBEU's insolvency, irrespective of the preferred resolution strategy, the details contained within the SCVs and exclusions views could have been vital sources of information and would provide optionality in the event that the preferred resolution strategy was not viable. The fact that this information was materially wrong could have caused significant difficulties and financial stability concerns in the event that HBEU became insolvent.
- 4.3 These failures were compounded by HBEU's inadequate approach to being open and co-operative with the PRA about the SCV Issues at an early stage. There was an almost 15-month delay between there being awareness of an issue of potential significance at HBEU, and it formally notifying the PRA that there was a potentially material emerging issue. The PRA approach to supervision is forward-looking, assessing firms not just against current risks, but also against those that could plausibly arise further ahead. This approach relies on firms alerting the PRA to emerging issues at the earliest possible opportunity, and firms understanding that this may mean making prompt notification of emerging issues outside of regularly scheduled meetings.
- 4.4 These failures are particularly serious given:
  - 4.4.1 The widespread failure at HBEU to recognise the significance of the DP Rules to both resolution preparation, and to the underpinning of FSCS protection, and

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therefore the risk that non-compliance by HBEU ultimately could pose to UK financial stability;

- 4.4.2 An attestation was made on behalf of HBEU to the PRA and FSCS which was materially incorrect in confirming HBEU's compliance with the DP Rules;
- 4.4.3 The failings were the result of long standing, serious weaknesses in governance, policies, systems, controls and procedures at the Firms; and
- 4.4.4 The failings are attributable in part to the Group and Firms' ring-fencing project, the purpose of which was to increase the stability of the UK financial system. The breach by HBEU of the DP Rules for such an extended period of time very much increased the potential risk to the UK financial system by undermining FSCS protection.

## ANNEX C: SANCTION

- 1.1. The PRA Penalty Policy for imposing a financial penalty is set out in [‘The PRA’s approach to enforcement: statutory statements of policy and procedure’ \(September 2021\)](#), in particular in the ‘Statement of the PRA’s policy on the imposition and amount of financial penalties under the Act’ (the “**PRA Penalty Policy**”). Pursuant to paragraphs 12 to 36 of the PRA Penalty Policy, the PRA applies a five-step framework to determine the appropriate level of financial penalty.
- 1.2. The PRA considered whether to calculate separate penalties in respect of breaches by both Firms of (i) FRs 2 and 6, and (ii) DP Rules 11, 12 and 14 of the PRA Rulebook, and for HBEU only, FRs 7 and 8 and DP Rule 50 of the PRA Rulebook. However, the PRA concluded that a single penalty calculation for all breaches and both Firms is appropriate.

### Step 1: Disgorgement

- 1.3. Pursuant to paragraph 17 of the PRA Penalty Policy, at Step 1 the PRA seeks to deprive a person of any economic benefits derived from, or attributable to, the breach of its requirements, where it is practicable to ascertain and quantify them.
- 1.4. HBEU’s failings meant that it miscalculated and undervalued the amount it should have paid to the FSCS under the FSCS levy. The FSCS relies on levy contributions to support depositors in the event of the failure of a deposit-taker. The PRA considers that the underpayment of FSCS levies meant HBEU derived an economic benefit from its own breaches. Sums retained by HBEU would be liable to disgorgement as a result.
- 1.5. However, HBEU has now accounted to the FSCS for the underpayment. Had HBEU not done so, the PRA would have disgorged the unpaid contributions at an appropriate interest rate.
- 1.6. The Step 1 figure is therefore **£0**.

### Step 2: The seriousness of the breach

- 1.7. Pursuant to paragraph 18 of the PRA Penalty Policy, at Step 2 the PRA determines a starting point figure for a financial penalty having regard to the seriousness of the breach by the firm, including any threat it posed, or continues to pose, to the advancement of the PRA’s statutory objectives, and the size and financial position of the firm.
- 1.8. Paragraph 19(a) of the PRA Penalty Policy sets out that a suitable indicator of the size and

financial position of the firm may include, but is not limited to, the firm's total revenue or revenue in respect of one or more areas of its business. Paragraph 19(b) provides that, in those cases where the PRA considers that revenue is an appropriate indicator of the size and financial position of the firm, ordinarily it will calculate the firm's revenue during its last business year, which is the financial year preceding the date when the breach ended.

- 1.9. HBEU's reported revenue for 2021 was £6,120,000,000 and HBUK's 2020 revenue was £6,031,000,000. Where revenue is considered an appropriate indicator, the PRA's Policy is to apply an appropriate percentage rate to the firm's relevant revenue to produce a figure at step 2 that properly reflects the nature, extent, scale and gravity of the breaches. Given the magnitude of these figures, the PRA considers that a financial penalty based on either a percentage of HBEU or HBUK's revenue figures would be disproportionate. Where the PRA determines revenue is not an appropriate indicator of size it may use an appropriate alternative indicator. In considering the size and financial position of the Firms, the PRA has had regard to the fact both HBEU and HBUK are Category 1 firms that provide critical services to the UK economy and are of systemic importance to financial stability within the UK and the PRA considers it appropriate these indicators should be taken into account and comparatively reflected in the penalty.
- 1.10. To arrive at a penalty, pursuant to paragraphs 19(a) of the PRA Penalty Policy, alongside the size and financial position and systemic importance of the Firms the PRA must also ensure it produces a figure at Step 2 that properly reflects the nature, extent, scale, gravity and overall seriousness and significance of the breaches:
  - 1.10.1. It is a statutory objective of the PRA to promote the safety and soundness of regulated firms. Safety and soundness involves avoiding harm resulting from disruption to the continuity of financial services. The failure of UK banks, particularly significant and systemically important banks, can disrupt the payment system and affect depositors' ability to undertake economic activity. The PRA therefore places considerable importance on firms' resolvability through resolution planning. Both Firms failed to correctly mark customer deposits as eligible for protection, which goes to the heart of the PRA's statutory objectives. In the case of HBEU, this represented a serious failing. While the PRA recognises that the risks did not crystallise in this case, HBEU's breaches had the potential to affect its safety and soundness. Previous PRA publications have made clear failing to adequately meet SCV requirements could be a breach of FR8;

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- 1.10.2. The volume of incorrectly marked customer deposits was very significant at HBEU. 99% of eligible deposits by value and 70% of customers at HBEU were incorrectly classified as ineligible for protection under the FSCS. The sheer magnitude of this error means it cannot represent anything other than a very serious failing;
- 1.10.3. The failure of HBEU to be open and co-operative with the PRA in not disclosing information of which the PRA would have expected notice in breach of FR7 is a serious failing. Firms are obliged to disclose to the PRA appropriately anything relating to them of which the PRA would reasonably expect notice. HBEU failed to inform the PRA of the internal investigation into potentially material depositor classification issues and then delayed in informing the PRA when the issues re-emerged.
- 1.10.4. The errors in customer marking and classification were only discovered by HBEU because of a routine supervisory inquiry from the PRA. Had the PRA not done this it is not clear whether HBEU would have discovered the errors;
- 1.10.5. The duration of the Firm's breaches was very significant:
- 1.10.5.1. From at least 2015, HBEU had failed to comply with applicable regulatory requirements set out in the DP Rules, including maintaining an SCV system that met the SCV requirements. This reflects enduring failings in governance processes and procedures at the Firm over an extended period; and
  - 1.10.5.2. There was a significant delay between HBEU commencing an investigation into an issue of potential significance and the notification given to the PRA on 23 April 2021 regarding the reporting errors that had been uncovered. This reflects serious issues with governance, identification, and escalation;
- 1.10.6. In 2018, an attestation was provided on behalf of HBEU to the PRA and FSCS which wrongly confirmed the Firm's compliance with the rules on depositor protection. The attestation was materially incorrect. The PRA expects firms and individuals to ensure attestations they make are accurate. It is a serious issue if attestations are later revealed to have been incorrect and or made without proper consideration.

- 1.10.7. The breaches revealed serious weaknesses in governance, policies, systems, controls and procedures around depositor protection, including a lack of ownership at senior management level. Serious weaknesses in escalating and sharing relevant information internally and with the PRA were also revealed; and
- 1.10.8. The PRA does not consider that the breaches were deliberate or reckless.
- 1.11. The PRA has also had regard to the matters set out at [Annexes A](#) and [B](#) to this notice.
- 1.12. Taking these factors into account, the PRA considers the failings in this case were significant and has determined that the appropriate Step 2 figure is **£96,500,000**.

### **Step 3: Adjustment for any aggravating, mitigating or other relevant factors**

- 1.13. Pursuant to paragraph 24 of the PRA Penalty Policy, the PRA may increase or decrease the Step 2 figure to take account of any factors which may aggravate or mitigate the breaches. The factors that may aggravate or mitigate the breach include those set out at paragraphs 25 and 26 of the PRA Penalty Policy. Any such adjustments will normally be made by way of a percentage adjustment to the figure determined at Step 2.
- 1.14. The PRA considers that the following factors, among others, are relevant in determining whether such adjustment should be made.
- 1.14.1. The Firms co-operated fully with the PRA's investigation. HBEU prepared a number of detailed internal audit reports into the background and root cause of the SCV Issues, including carrying out a large number of internal interviews. HBEU shared this work with the PRA, including the notes of the internal interviews and underlying documentation. This assisted the PRA's investigation;
- 1.14.2. The Firms made early admissions as to the facts and failings, including specific admissions as to breaches of individual FR and DP Rules from the PRA Rulebook. These early admissions accelerated the conclusion of the PRA's investigation;
- 1.14.3. The Firms provided a limited waiver of privilege over a number of documents which were shared for the purposes of the PRA's investigation. These assisted the PRA's investigation;
- 1.14.4. The Firms have undertaken significant efforts to remediate the identified weaknesses regarding compliance with the DP Rules. HBUK made targeted

corrections as part of an ongoing programme (due to the less material FSCS misreporting at HBUK, less extensive intervention was required). HBEU, where failings were material, has completed a remediation programme focused on its compliance with depositor protection rules. The programme included enhancements to core systems and SCV logic, as well as strengthening the control environment within front line and operations teams;

1.14.5. The PRA has made clear in the [Approach to Banking Supervision](#) and [Approach to Enforcement](#) documents, as well as in other final notices, the importance of firms being open and straightforward in their dealings with the PRA and taking the initiative to raise issues of possible concern at an early stage. The PRA has also emphasised the importance of firms being able to produce an accurate SCV File and the role this can have in minimising the adverse effect of firm failure on the stability of the financial system; and

1.14.6. PSM feedback letters in 2017, 2018, 2019, 2020 and 2021 made clear the PRA's concerns with HSBC's data management and end-to-end process mapping. Although these did not relate specifically to the issues of DP Rules, the PRA considers the issues outlined in this Notice symptomatic of the fundamental data and control issues discussed in the PSM feedback letters.

1.15. Having taken into account the above factors, the PRA considers it is appropriate to reduce the Step 2 figure by 15%.

1.16. The Step 3 figure is therefore **£82,025,000**.

#### **Step 4: Adjustment for deterrence**

1.17. Pursuant to paragraph 27 of the PRA Penalty Policy, if the PRA considers the figure arrived at after Step 3 is insufficient to effectively deter the firm that committed the breach, or others, from committing further or similar breaches, then the PRA may increase the penalty at Step 4 by making an appropriate adjustment to it.

1.18. The PRA considers that the Step 3 figure of **£82,025,000** represents a sufficient deterrent to the Firms and others, and so has not increased the penalty at Step 4.

#### **Step 5: Application of any applicable reductions for early settlement or serious financial hardship**

1.19. Pursuant to paragraph 29 of the PRA's Penalty Policy, if the PRA and the firm upon whom

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a financial penalty is to be imposed agree the amount of the financial penalty and any other appropriate settlement terms, the PRA Settlement Policy provides that the amount of the penalty which would otherwise have been payable may, subject to the stage at which a binding settlement agreement is reached, be reduced by 30% (as set out at paragraph 28 of the PRA Settlement Policy).

- 1.20. The PRA and the Firms reached an agreement to settle during the Discount Stage. Therefore, a 30% settlement discount applies to the Step 4 figure.
- 1.21. The Step 5 figure is therefore **£57,417,500**.

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## ANNEX D: PROCEDURAL MATTERS

### 1. Decision maker

- 1.1. The settlement decision makers made the decision, which gave rise to the obligation to give this Final Notice.
- 1.2. This Final Notice is given under and in accordance with section 390 of the Financial Services and Markets Act 2000 (as amended) (the “Act”).

### 2. Manner and time for payment

- 2.1. The Firms must pay the financial penalty in full to the PRA by no later than 20 February 2024. If all or any of the financial penalty is outstanding on 21 February 2024 – the day after the due date for payment – the PRA may recover the outstanding amount as a debt owed by the Firms and due to the PRA.

### 3. Publicity

- 3.1. Sections 391(4), 391(6A) and 391(7) of the Act apply to the publication of information about the matter to which this Final Notice relates. Under those provisions, the PRA must publish such information about the matter to which this Final Notice relates as the PRA considers appropriate. However, the PRA may not publish information if such publication would, in the opinion of the PRA, be unfair to the persons with respect to whom the action was taken or prejudicial to securing an appropriate degree of protection to policyholders.
- 3.2. The PRA must publish such information about the matter to which a Decision Notice or Final Notice relates as it considers appropriate. A Decision Notice or Final Notice may contain references to the facts and matters contained in this Warning Notice.

### 4. PRA contacts

- 4.1. For more information concerning this matter generally, please contact Press Office ([Press@BankofEngland.co.uk](mailto:Press@BankofEngland.co.uk)).

## APPENDIX 1: DEFINITIONS

The definitions below are used in this Notice:

1. “Act” means the Financial Services and Markets Act 2000 (as amended);
2. “Client” means one of the HBEU’s financial services business clients who was the subject of the PRA Information Request in order to better understand how the Client structured its services;
3. “CMAC” means HSBC’s Client Monies and Assets Compliance team;
4. “CMB” means the Commercial Banking business line within HSBC;
5. Deposit is defined in DP 1.4 of the PRA Rulebook as:
  - a. a credit balance which results from funds left in an account or from temporary situations deriving from normal banking transactions and which a credit institution is required to repay under the legal and contractual conditions applicable, including a fixed-term deposit and a savings deposit, but excluding a credit balance where:
    - i. its existence can only be proven by a financial instrument, unless it is a savings product which is evidenced by a certificate of deposit made out to a named person and which existed in the UK, Gibraltar or a Member State of the EU on 2 July 2014;
    - ii. its principal is not repayable at par; or
    - iii. its principal is only repayable at par under a particular guarantee or agreement provided by the credit institution or a third party;
6. “DGSD” means Directive 94/19/EC of the European Parliament and of the Council of 30 May 1994 on deposit-guarantee schemes as amended by Directive 2009/14/EC of the European Parliament and of the Council of 11 March 2009;
7. “DP Rules” means the rules contained in the Depositor Protection part of the PRA Rulebook and specific rules are indicated by the prefix ‘DP’;
8. “FCA” means the Financial Conduct Authority;

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9. “Final Notice” means this final notice, together with its Annexes and Appendices;
  10. “EU” means the European Union;
  11. “Exclusions view” means a single, consistent view of:
    - a. an account holder’s aggregate deposits with a firm limited to accounts that contain or may contain eligible deposits to which the account holder is not absolutely entitled or which are safeguarded funds; or
    - b. a depositor’s aggregate eligible deposits with a firm limited to accounts that are not active;and which contains the information required by rule 12.9 of the DP Rules;
  12. “Firms” means HBEU and HBUK;
  13. “FRs” means the Fundamental Rules contained within the Fundamental Rules part of the PRA Rulebook;
  14. “FSCS” means the Financial Services Compensation Scheme established pursuant to Part XV of the Act;
  15. “GBM” means the Global Banking and Markets business line within HSBC;
  16. “HBEU” means HSBC Bank plc;
  17. “HBUK” means HSBC UK Bank plc;
  18. “HSBC Group” means HSBC Holdings plc together with its subsidiary undertakings;
  19. “Phase 2 Report” means the Special Review issued on 5 November 2021 by HSBC’s Internal Audit function;
  20. “PRA” means the Prudential Regulation Authority;
  21. “PRA Information Request” means the request from PRA Supervision, dated 31 October 2019, for information regarding the Client;
  22. “PRA Rulebook” means the Prudential Regulation Authority Rulebook;

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23. “PRA Penalty Policy” means ‘The Prudential Regulation Authority’s approach to enforcement: statutory statements of policy and procedure January 2016 – Appendix 2 – Statement of the PRA’s policy on the imposition and amount of financial penalties under the Act’;
  24. “PRA Settlement Policy” means ‘The Prudential Regulation Authority’s approach to enforcement: statutory statements of policy and procedure January 2016 – Appendix 4 - Statement of the PRA’s settlement decision-making procedure and policy for the determination of the amount of penalties and the period of suspensions or restrictions in settled cases;
  25. “PSM” means the PRA’s Periodic Summary Meeting;
  26. “Recast DGSD” means Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on deposit guarantee schemes (recast);
  27. “Relevant Period” means the period from at least 2015 to 2022, or parts thereof;
  28. “RMM” means the HBUK Risk Management Meeting;
  29. “SCV” or “Single Customer View” means a single, consistent view of a depositor’s aggregate eligible deposits with a firm which contains the information required by rule 12.9 of the DP Rules, but excludes from view those accounts included in the exclusions view;
  30. “SCV File” means, together, a firm’s SCV and exclusions view;
  31. “SCV Issues” means the failure by the Firms to generate reliable SCVs, exclusions views or SCV effectiveness reports;
  32. “SCV requirements” means the requirements on firms set out in part 12 of the DP Rules;
  33. “SCV system” means a firm’s system for satisfying the SCV requirements;
  34. “SMCR” means the Senior Managers and Certification Regime;
  35. “Special Review” means HSBC’s Internal Audit function’s programme established in Q1 2021 to review HBEU’s compliance with the FSCS levy and associated reporting;
  36. “Tribunal” means the Upper Tribunal (Tax and Chancery Chamber);
  37. “WPB” means the Wealth and Personal Banking line within HSBC; and

38. “Working Group” means the internal investigation established by HBEU to understand whether client deposit accounts were being correctly reported in its SCV File.

## APPENDIX 2: RELEVANT STATUTORY AND REGULATORY PROVISIONS

### The PRA's objectives

1. The PRA has a general objective, set out in section 2B(2) of the Act, to promote the safety and soundness of PRA-authorised persons. Section 2B(3) of the Act provides that the PRA's general objective is to be advanced primarily by:
  - (a) seeking to ensure that the business of PRA-authorised persons is carried on in a way which avoids any adverse effect on the stability of the UK financial system; and
  - (b) seeking to minimise the adverse effect that the failure of a PRA-authorised person could be expected to have on the stability of the UK financial system.

### Section 206 – Disciplinary powers

2. Section 206 of the Act provides that: *'If the appropriate regulator considers that an authorised person has contravened a relevant requirement imposed on the person, it may impose on him a penalty, in respect of the contravention, of such amount as it considers appropriate'*.
3. HBEU and HBUK are authorised persons for the purposes of section 206 of the Act. Relevant requirements imposed on authorised persons include rules made under the PRA Rulebook, including the PRA's Fundamental Rules.

## RELEVANT REGULATORY PROVISIONS

### PRA's Fundamental Rules

4. The PRA has eight Fundamental Rules which apply to all PRA-authorised firms. These are high-level rules which collectively act as an expression of the PRA's general objective of promoting the safety and soundness of regulated firms. The relevant PRA Fundamental Rules are as follows:

- a. Fundamental Rule 2: 'A firm must conduct its business with due skill, care and diligence.'
- b. Fundamental Rule 6: 'A firm must organise and control its affairs responsibly and effectively.'
- c. Fundamental Rule 7: 'A firm must deal with its regulators in an open and co-operative way and must disclose to the PRA appropriately anything relating to the firm of which the PRA would reasonably expect notice.'
- d. Fundamental Rule 8: 'A firm must prepare for resolution so, if the need arises, it can be resolved in an orderly manner with a minimum disruption of critical services.'

#### July 2015 – December 2016

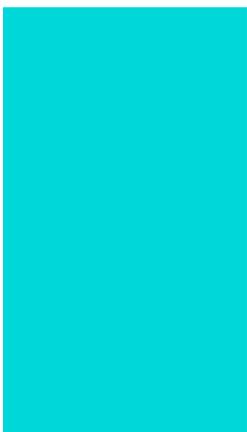
5. The Recast DGSD was implemented in a staggered manner from 3 July 2015 in the Depositor Protection part of the PRA Rulebook. The relevant rules for the purpose of this Notice from this period are shown in the table below. The rules in DP 11 came into effect immediately on 3 July 2015 and remain in force today. The rules in DP 49-51 were temporary and in force during a transitional period from 3 July 2015 – 30 November 2016:

Rule reference	Rule text
DP 11	<b>Marking and information requirements</b>
DP 11.1	A firm must mark eligible deposits in a way that allows for the immediate identification of such deposits.
DP 11.2	A firm must mark accounts (including client accounts and trust accounts) which are held on behalf of beneficiaries and which contain or may contain eligible deposits in a way that allows immediate identification of such accounts.
DP 11.5	A firm must be able to provide the FSCS with all information necessary to enable the FSCS to prepare for the payment of compensation in accordance with this Part.
DP 11.7	A firm must take reasonable steps to ensure the accuracy of the data it holds to satisfy the requirements of this Chapter.
DP 50	<b>Transitional provisions: SCV</b>
DP 50.4	A firm must be able to provide to the PRA or the FSCS its single customer view within 72 hours of a request being made by the PRA or FSCS.
DP 50.6	A firm must ensure that the electronic systems which produce the single customer view must: <ol style="list-style-type: none"> <li>(1) be capable of automatically identifying the amount of covered deposits payable to each depositor; and</li> <li>(2) include a check facility which allows the firm to identify any portion of an eligible deposit that exceeds the coverage level provided for in 4.2.</li> </ol>
DP 50.11	A firm must ensure that a single customer view contains all the information set out in the table below [...]
DP 50.15	A firm must take reasonable steps to ensure the accuracy of the data it holds to satisfy the requirements of this Chapter.

December 2016 onwards

6. From 1 December 2016 onwards, the final Recast DGSD rules came into effect and were implemented via the Depositor Protection (“**DP**”) part of the PRA Rulebook. In addition to the rules in DP 11 (above) which continued to remain in force, the following rules in DP 12 - 14 entered into force and are relevant for the purposes of this Notice:

Rule reference	Rule text
<b>DP 12</b>	<b>SCV requirements</b>
<b>DP 12.1</b>	A firm must provide to the FSCS all single customer views and exclusions views within 24 hours of the relevant deposits becoming unavailable deposits.
<b>DP 12.2</b>	A firm must provide all single customer views and exclusions views to the PRA or FSCS within 24 hours of a request by the PRA or FSCS.
<b>DP 12.7</b> <i>In force since 1 Jul 2017</i>	A firm must ensure that its SCV system: <ul style="list-style-type: none"> <li>(1) automatically identifies the amount of covered deposits payable to each depositor; and</li> <li>(2) includes a facility which identifies any portion of an eligible deposit that is over the coverage level provided for in 4.2.</li> </ul>
<b>DP 12.8</b>	A firm must take reasonable steps to ensure the accuracy of the data it holds in order to satisfy the requirements of this Chapter.
<b>DP 12.9</b>	A firm must ensure that each single customer view and exclusions view contains all the information set out in the table below...
<b>DP 14</b>	<b>SCV and exclusions view reporting</b>
<b>DP 14.2</b>	A firm must provide the PRA and FSCS with an SCV effectiveness report within three months of receiving a Part 4A permission to accept deposits.
<b>DP 14.3</b>	A firm must notify the PRA and FSCS of a material change in the firm’s SCV system within 3 months of the change.
<b>DP 14.5</b>	A firm must provide an SCV effectiveness report to the PRA or FSCS promptly upon request by the PRA or FSCS.
<b>DP 14.6</b>	A firm must update its SCV effectiveness report annually.
<b>DP 14.8</b>	A firm’s SCV effectiveness report must contain: <ul style="list-style-type: none"> <li>(1) a description of: <ul style="list-style-type: none"> <li>(a) the firm’s SCV system and how it has been implemented;</li> <li>(b) how the firm proposes to transfer to the FSCS single customer views including specifying the transfer method and format;</li> <li>(c) the testing undertaken with respect to the robustness of the firm’s SCV system (including information on preparation of the single customer view in stressed scenarios, frequency of testing and reconciliation with core systems);</li> <li>(d) the number of single customer views and exclusions views in the firm’s SCV system;</li> <li>(e) the firm’s plan for the ongoing maintenance of the firm’s SCV system;</li> <li>(f) how the firm’s governing body will ensure that they remain satisfied that the firm’s SCV system continues to satisfy the SCV requirements;</li> <li>(g) how the facility required by 12.7(2) is applied;</li> <li>(h) any other factors relevant to the design of the firm’s SCV system or to an assessment of whether the firm’s SCV system satisfies the PRA’s SCV requirements;</li> <li>(i) any dependencies in creating single customer views and exclusions views (such as reliance on group systems);</li> <li>(j) treatment of accounts which are dormant accounts;</li> <li>(k) how exclusions views are created; and</li> </ul> </li> </ul>

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- (1) a description of the procedures and controls that a firm has in place regarding the production of single customer views and exclusions views (such as secure storage and an indication of how key person dependencies are managed).
  - (2) a statement signed on behalf of the firm's governing body confirming that the firm's SCV system satisfies the SCV requirements;
  - (3) the date when the firm's SCV system last produced a single customer view and exclusions view for each depositor;
  - (4) a statement of whether the firm's SCV effectiveness report has been reviewed by external auditors, and if so a statement of the findings of that review; and
  - (5) a statement of whether there has been a material change to the firm's SCV system since the date of the firm's previous SCV effectiveness report.

7. DP 14.3 sets out what a firm must do after a material change in its SCV system. The PRA considers that a material change would include any change which would have a material impact on the firm's SCV system. For example, there is likely to be a material change in a firm's SCV system upon a merger or acquisition of a deposit book, or the introduction of a new IT system that relates to the firm's SCV system. The PRA considers minor changes to a firm's SCV system (such as to achieve the SCV changes outlined in Depositor Protection Chapter 50) would not constitute a material change to the SCV system. However, the full implementation of the SCV changes required under Depositor Protection Chapter 12, or significant steps towards this, would be considered a material change. Similarly, the full implementation of the marking requirements under Depositor Protection Chapters 11 and 13 would be considered a material change to systems to satisfy marking requirements.
8. The updated DP rules introduced a new requirement for firms to produce a single consistent view of a depositor's aggregate dormant accounts, or accounts which hold funds to which the depositor is not absolutely entitled (the exclusions view). Examples of accounts appearing in the exclusions view include those in respect of which the firm has received formal notice there is a legal dispute to the proceeds of the account, or where the account holder is holding funds on behalf of, or for the benefit for, another person. The exclusions view identifies accounts holding potentially eligible deposits, but where further investigation would be required before a pay-out could be made by the FSCS. Accounts cannot appear in both the SCV and exclusions view. Under the Recast DGSD, the SCV implementation report and SCV report were combined into a single report, the SCV effectiveness report.
9. Supervisory statement SS 18/15 sets out the PRA's expectations with regards to the DP Rules.

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## RELEVANT POLICY

### Approach to the supervision of banks

10. *The Prudential Regulation Authority's approach to banking supervision, April 2013 (as updated in October 2018) sets out the PRA's approach to banking supervision.*

### Approach to enforcement

11. *The Prudential Regulation Authority's approach to enforcement: statutory statements of policy and procedure, April 2013 (as updated in September 2021) sets out the PRA's approach to exercising its main enforcement powers under the Act.*
12. In particular, the PRA's approach to the imposition of penalties is outlined at Annex 2 - *Statement of the PRA's policy on the imposition and amount of financial penalties under the Act*, and the PRA's approach to settlement is outlined at Annex 4 - *Statement of the PRA's settlement decision-making procedure and policy for the determination of the amount of penalties and the period of suspensions or restrictions in settled cases.*