Mortgage Enhancements
HSBC North America Holdings, Inc.
HSBC Finance Corporation
Action Plan Response to FRB Consent Order
Risk Management

Final Pending Approval from the Compliance Committee

November 16, 2011

Section 11: Risk Management

Article 14

FRB Order Reference:	*Article 14*	**Corresponding OCC Article:**	*N/A*
Within 60 days of submission of the comprehensive risk assessment conducted pursuant to paragraph 12 of this Order, HNAH shall submit to the Reserve Bank an acceptable written plan to enhance its ERM program with respect to its oversight of residential mortgage loan servicing, Loss Mitigation, and foreclosure activities and operations. The plan shall be based on an evaluation of the effectiveness of HNAH's current ERM program in the areas of residential mortgage loan servicing, Loss Mitigation, and foreclosure activities and operations, and recommendations to strengthen the risk management program in these areas. The plan shall, at a minimum, be designed to:			
Action Plan As a result of the risk assessment, Ernst & Young ("EY") provided findings related to the design and operating effectiveness of controls. With respect to the design of controls, EY identified enterprise-level observations and [redacted] in the design of specific controls. [redacted]			

Management has considered and incorporated these themes as appropriate throughout its responses to the enterprise observations as well as the specific test findings.

HNAH considers EY's observations and detailed testing results to warrant specific process and control changes (documented further in Article 15(l)) at the business level as opposed to changes to the enterprise-wide risk management structure. Enhancements and modifications to the Enterprise Risk Function were already underway based on guidance provided within the Matters Requiring Attention ("MRAs") and Matters Requiring Immediate Attention ("MRIAs"), and did not change as a result of the risk assessment.

HNAH's risk management framework begins with governance at the enterprise-wide level and is supported by three lines of defense to provide specific processes, policies, and procedures to monitor Residential Mortgage Servicing operations. The Enterprise Risk Management ("ERM') structure and the three lines of defense are introduced and discussed at a summary level in this section and the ERM is discussed in more detail later within Articles 14 and 15.

The Enterprise Risk Management framework itself does not provide specific policies and procedures for Residential Mortgage Servicing, Loss Mitigation and foreclosure activities; instead it provides overall governance and works in conjunction with the specific programs that provide Residential Mortgage Servicing risk management. The programs providing the support are Residential Mortgage Servicing, Service Delivery Control Adherence, Compliance, and Group Audit North America. These four programs form three lines of defense:

- Residential Mortgage Servicing serves as the first line of defense, providing the Business Risk and Control Management ("BRCM") capability and internal control framework.
- Service Delivery Control Adherence (formerly known as NAQA) coordinates with the Residential Mortgage Servicing BRCM teams to test the controls.
- Compliance is an additional second line of defense that provides regulatory oversight to the Residential Mortgage Servicing teams to ensure that the controls put in place satisfy regulatory requirements.
- Group Audit North America serves as the third line of defense by assessing the effectiveness of Residential Mortgage Servicing controls and the functioning of the second line of defense.

Through these three lines of defense, deficiencies in mortgage servicing, Loss Mitigation and foreclosure activities are identified and promptly remediated. More specifics related to these programs are provided in the subsequent articles and the table below.

Existing Processes	Required Enhancements
• ERM providing risk management governance for HNAH supported by "three lines of defense" • Residential Mortgage Servicing serves as the first line of defense, providing the Business Risk Control Management ("BRCM") capability and internal control framework. • Service Delivery Control Adherence (formerly known as NAQA) serves as a second line of defense and coordinates with the Residential Mortgage Servicing BRCM teams to test the controls. • Compliance is an additional second line of defense that provides regulatory oversight to the Residential Mortgage Servicing teams to ensure that the controls put in place satisfy regulatory requirements. • Group Audit North America serves as the third line of defense by assessing the effectiveness of Residential Mortgage Servicing controls and the functioning of the second line of defense. • Management responses developed in response to the independent risk assessment's enterprise and control testing results	• Ongoing implementation and monitoring of remediation resulting from independent risk assessment's enterprise and control testing results and management's responses.

Documents to be submitted with the Action Plan Not applicable.
Key HSBC Contacts for the Action Plan • [redacted] SVP Strategy, Operational Risk Management and Chief Information Risk Officer, HBIO • [redacted] SVP Default Services • [redacted], SVP General Compliance • [redacted], [redacted] Risk Governance and Administration, HNAH

Article 14(a)

FRB Order Reference:	*Article 14(a)*	**Corresponding OCC Article:**	*N/A*
Ensure that the fundamental elements of the risk management program and any enhancements or revisions thereto, including a comprehensive annual risk assessment, encompass residential mortgage loan servicing, Loss Mitigation, and foreclosure activities;			

Action Plan

HNAH's risk management framework begins with governance at the enterprise-wide level and is supported by three lines of defense to provide specific processes, policies, and procedures to monitor Residential Mortgage Servicing, Loss Mitigation and foreclosure activities and includes a comprehensive annual risk assessment which encompasses Residential Mortgage Servicing, Loss Mitigation, and foreclosure activities.

The Enterprise Risk Management framework itself does not provide specific policies and procedures for Residential Mortgage Servicing, Loss Mitigation and foreclosure activities; instead it provides overall governance and works in conjunction with the specific programs that provide Residential Mortgage Servicing risk management. The programs providing the support are Residential Mortgage Servicing, Service Delivery Control Adherence, Compliance, and Group Audit North America. These four programs form three lines of defense:

- Residential Mortgage Servicing serves as the first line of defense, providing the Business Risk and Control Management ("BRCM") capability and internal control framework.
- Service Delivery Control Adherence (formerly known as NAQA) coordinates with the Residential Mortgage Servicing BRCM teams to test the controls.
- Compliance is an additional second line of defense that provides regulatory oversight to the Residential Mortgage Servicing teams to ensure that the controls put in place satisfy regulatory requirements.
- Group Audit North America serves as the third line of defense by assessing the effectiveness of Residential Mortgage Servicing controls and the functioning of the second line of defense.

Through these three lines of defense, deficiencies in mortgage servicing, Loss Mitigation and foreclosure activities are identified and promptly remediated.

<u>Three Lines of Defense</u>

Residential Mortgage Servicing (First Line of Defense)

Residential Mortgage Servicing activities are covered by the Business Risk and Control Management Team established by and under the direction of the SVP of Strategy, Operational Risk Management and Chief Information Risk Officer, HBIO.

Specific details surrounding the First Line of Defense are covered in Article 15.

Service Delivery Control Adherence (formerly known as NAQA) ("SDCA") (Second Line of Defense)

SDCA provides an independent, objective and ongoing assessment of operational adherence to policies, procedures, and Group Standards to Residential Mortgage Servicing Management. To maintain independence, SDCA is managed separately from Residential Mortgage Servicing management, reporting to a central Corporate Quality Utility. SDCA reports its findings to the appropriate business unit executive management. Consideration is given as to whether the findings reported by SDCA should also be reported as a Top Control Issue in the quarterly ORIC report.

Compliance (Second Line of Defense)

The HNAH Compliance organizational structure, as outlined below, detailed in the "HSBC – North America Compliance Risk Management Program Manual", and illustrated in the "HNAH Corporate Compliance Organizational Structure" section (see pages 26 and 65 of the Compliance Risk Management Program Manual) is designed to ensure that Compliance staff have the requisite authority and status to carry out their responsibilities:

- The Regional Compliance Officer ("RCO") reports to the HNAH Compliance Committee, the HNAH Chief Executive Officer ("CEO") and the CEO of HSBC Bank, N.A.
- The RCO also has an internal functional reporting line to the Head of Compliance within the Group Management Office ("GMO") which provides oversight of the HNAH Compliance Risk Management Program.
- The RCO is a member of the Group Compliance Executive Committee ("Group Compliance EXCO").

The Compliance governance model is designed to ensure that the functional teams and responsibility areas reporting into the RCO work effectively and efficiently together to manage the Compliance Risk Management Program. Specifically, the governance model is designed to ensure that:

- Regulatory, Group, and other stakeholder requirements applicable to Compliance are identified and addressed;
- Enterprise-wide initiatives are coordinated;
- Communications across functional areas are timely and effective;
- Issues are escalated in a timely manner;
- Information is effectively and appropriately shared; and,
- Compliance risks are effectively assessed and emerging trends are identified which may impact more than one business, legal entity or geography.

In order to monitor compliance risk and identify and remediate deficiencies, Compliance has developed Key Risk Indicators ("KRIs") that will assist Residential Mortgage Servicing in monitoring and evaluating the risks inherent in mortgage servicing business lines on a monthly basis. These KRIs include metrics to measure the mortgage servicing activities of HNAH and its subsidiaries, including Loss Mitigation, loan modification, and foreclosure activities. Examples of KRIs that have been developed are Rescinded Foreclosure Sales and SCRA reporting.

Group Audit North America (Third Line of Defense)

Group Audit North America is responsible for the internal audit activities for HNAH and its subsidiaries. These responsibilities include evaluating the effectiveness of risk management, control, and governance processes for residential mortgage loan servicing, Loss Mitigation, and foreclosure activities. Group Audit North America has assessed the identified risks for these functional areas and enhanced its audit programs to address the requirements of the Order.

<u>HNAH Risk Management Framework</u>

HNAH's enterprise-wide risk management ("ERM") program provides proper risk management with respect to the Bank's and the Mortgage Servicing Companies' residential mortgage loan servicing, Loss Mitigation, and foreclosure activities, particularly with respect to compliance with the Legal Requirements and supervisory standards and guidance of the Board of Governors as they develop. The HNAH Risk Management Framework was most recently reviewed and approved by the HNAH Board Audit Committee in December 2010. The HNAH Risk Management Program was enhanced throughout 2010 to meet the requirements of the Federal Reserve Board Memorandum of Understanding ("MOU") issued in 2009. A comprehensive risk management plan was developed per the MOU requirements, and all elements of the risk management plan have been implemented as of February 2011.

HSBC also enhanced its operational risk assessment framework globally through the rollout of the RCA process, which was designed to provide the business with a forward looking view of material operational risks and to help them proactively identify and assess the key controls to mitigate risks within acceptable levels, which has been rolled out across HNAH in order to comply with the Order. These enhancements include a new Risk and Control Assessment methodology and Internal Control Target Operating Model. HNAH takes a continuous improvement approach to risk management and, accordingly, establishes annual objectives centered on strengthening its risk management framework. (See attachment HSBC North America (HNAH) Risk Management Framework in its entirety which details HSBC's risk management approach).

The Risk Management Framework is an integral component of HNAH's operating environment. The HNAH Risk Management Framework provides for oversight of risk by the HNAH Board through the HNAH Risk Management Committee. The HNAH Risk Management Committee is a regional level risk committee that provides a forum for risk managers, functional heads, and business unit heads to establish risk appetite, assess risk, establish risk management policies and standards, discuss

emerging risk issues and agree upon appropriate actions, as necessary. The Mortgage Servicing Companies and the Bank are covered by the HNAH Risk Management Framework, which incorporates all risk categories, including operational, compliance and legal risks as well ensuring that the fundamental elements of the risk management program and any enhancements or revisions thereto, including a comprehensive annual risk assessment which encompasses residential mortgage loan servicing, Loss Mitigation, and foreclosure activities. This is facilitated by the businesses line's self assessement, Enterprise Compliance's annual risk assessment, SDCA's annual testing of controls and internal audit's ongoing testing of controls and performance. The results of the risk assessment did not identify the need for further enhancement to or modification of the HNAH Risk Management Framework beyond those enhancements already completed or underway in order to comply with the requirements of this Article..
Documents to be submitted with the Action Plan • HSBC North America (HNAH) Risk Management Framework • HSBC – North America Compliance Risk Management Program Manual
Key HSBC Contacts for the Action Plan • [redacted] SVP Strategy, Operational Risk Management and Chief Information Risk Officer, HBIO • [redacted] SVP Default Services • [redacted], SVP General Compliance • [redacted] EVP/Chief Auditor, HBIO • [redacted], [redacted] Risk Governance and Administration, HNAH

Article 14(b)

FRB Order Reference:	*Article 14(b)*	**Corresponding OCC Article:**	*N/A*
ensure that the risk management program complies with supervisory guidance of the Board of Governors, including, but not limited to, the guidance entitled, "Compliance Risk Management Programs and Oversight at Large Banking Organizations with Complex Compliance Profiles," dated October 16, 2008 (SR 08-08/CA 08-11); and			

Action Plan

HNAH has an Enterprise Compliance Program ("ECP" or "Program") which includes oversight of residential mortgage loan servicing and foreclosure activities and operations, as well as Loss Mitigation, which has been enhanced as set forth herein in compliance with the requirements of the Order. ECP is a comprehensive compliance risk management program that has been approved by the HNAH Board of Directors. The Program is structured to proactively identify as well as quickly react to emerging issues and to assess, control, measure, monitor and report compliance risks across HNAH and complies with supervisory guidance of the Board of Governors, including, but not limited to, the guidance entitled, "Compliance Risk Management Programs and Oversight at Large Banking Organizations with Complex Compliance Profiles," dated October 16, 2008 (SR 08-08/CA 08-11).

The scope of the Program includes compliance with state and federal laws and regulations, supervisory guidance, and self-regulatory standards or codes of conduct that regulate certain business activities and functions of HNAH. More specifically, HNAH maintains an inventory of the regulatory requirements that are included within the scope of this Program. The inventory is maintained in the [redacted] ("[redacted] which is linked to the [redacted] ("[redacted] As new legislation is enacted, regulatory requirements are added to [redacted] and updated to [redacted]

The compliance risk assessment process is an integral part of an effective compliance program. Two critical components are the detailed assessment that is conducted annually with business line management using [redacted] and [redacted] systems and the quarterly General Compliance Enterprise-wide Risk Assessment ("ERA"). Enhancements have been made to [redacted] which houses the risk statements applicable to the business. The enhancements to the [redacted] risk statements are discussed below in further detail.

The ERA is completed quarterly for all business units and gives a summary of compliance for each business unit [e.g. CML (Consumer and Mortgage Lending)]. It measures critical components such as: the number of MRA's that repeat, are re-opened or extended; past-due issues; and ensures policies and procedures are up to date.

HNAH's ECP is designed in accordance with the Group Legal and Compliance Functional Instructional Manual ("FIM"), Group minimum compliance standards as outlined in the Group Standards Manual ("GSM") and the principles established by the Federal Reserve in Supervision and Regulation Letter 08-8 ("SR08-8") dated October 16, 2008, and the Basel Committee on Banking Supervision's *Compliance and the compliance function in banks* ("Basel Compliance Paper") dated April 2005 as required by the Order.

HNAH's Board of Directors has overseen the development of this Program and compliance standards and processes contained in the HSBC - North America Compliance Risk Management Program Manual. HNAH Management reviewed the HNAH Compliance Risk Management Program Manual and has confirmed that, in line with the design of the ECP to include all HNAH lines of business, the scope includes residential mortgage loan servicing, foreclosure, and Loss Mitigation. More specifically, Section 1.2 of the manual states that the ECP applies to "HSBC North America Holdings, Inc. ("HNAH") and its subsidiaries, including all legal entities, business units, and support functions." Residential mortgage servicing, Loss Mitigation, and foreclosure activities are fully covered through the scope of the existing ECP program.

Additionally, to more fully denote the responsibilities of the HSBC North America Compliance Committee of the Board of Directors, the ECP was updated to include requirements of the Consent Orders as outlined in the Action Plan for Article 2, 2(d), and 2(l) of Board Oversight. Specifically, refer to the HSBC – North America Compliance Risk Management Program Manual, pages 18-20, for a listing of the responsibilities.

In addition to the ECP, the HNAH Compliance function also encompasses the Central Services Regulatory Monitoring and Assessment ("RMA") team, which manages the regulatory monitoring and change management processes to facilitate compliance with Legal Requirements and Board of Governors supervisory guidance applicable to residential mortgage servicing, Loss Mitigation and foreclosure activities, as well as the activities of other business lines. RMA holds weekly meetings with the business, Compliance Officers, Legal and Government Relations to review pending and enacted legislation as it becomes known. Year to date through September 23, 2011, 95 legislative alerts were issued by this team. (See attached New Legislation Alert ID HB 331 as an example and HSBC North America New Laws and Regulations Procedure – US.) HSBC North America New Laws and Regulations Procedure – US, pages 1 through 6 provides guidelines for monitoring and tracking regulatory changes that may impact business processes and procedures. The attached New Legislation Alert ID HB 331 is an example of a legislative alert intended to communicate a high-level summary of a law or regulatory change that may affect one or more HNAH businesses.

As law changes occur, new risk statements will be added to the Detailed Risk Assessment or will be added to the state specific information housed within the [redacted] Database. Compliance is in the process of finalizing an internal procedure to document this process. An internal procedure was completed and published on August 24, 2011, which outlines how the database will be updated (see [redacted] Database – Maintenance and Approval Procedure ALL, pages 1 through 4).

Once new laws are identified and implemented pursuant to the processes noted above, the SDCA unit monitors the bi-monthly report distributed by the Law Change Working Group ("LCWG") manager to gather information regarding which law changes are ready for review. Within 60-90 days post implementation, the SDCA unit schedules the law change for review.

In addition to the processes noted above, HNAH has in place the Service Delivery Control Adherence (formerly known as NAQA) ("SDCA") program which is managed separately from the business lines, reporting to a central Corporate Quality Utility. SDCA provides an independent, objective, and on-going assessment to senior management of operational adherence to policies, procedures, and Group standards, as well as of the effectiveness of the first line of defense internal control framework for HNAH business operations.

As of June 30, 2011, a [redacted] gap analysis was completed to ensure that risk statements for all Legal Requirements that impacted foreclosure, Loss Mitigation, and mortgage servicing were documented within [redacted] The objective of the gap analysis was two-fold: (1) to identify missing risk statements and (2) to identify control gaps for all applicable risk statements. Meetings were held with the business to walk through all identified foreclosure, Loss Mitigation, and Mortgage Servicing processes to confirm existing risk statements and controls, identify gaps, and address additional risk statements and controls needed for a given process. [redacted]

The gap analysis results were compiled into a final report as of July 22, 2011 (see attached Regulations and Risk Statement Gap Analysis Results in its entirety). A summary of the [redacted] gap analysis is also attached and was submitted to the FRB on August 12, 2011 (see MEMORANDUM [redacted]). The foregoing documents outline the Compliance Risk and Control Assessment completed within [redacted] and contain the gap analysis results from that assessment. [redacted]

[redacted]

In addition to risk statements that were added to [redacted] by Compliance during the gap analysis, the business has updated [redacted] with action plans to remediate any control gaps and a timeline for implementing revised controls.

The Foreclosure, Loss Mitigation, and Mortgage Servicing business teams have reviewed the control gaps identified in the [redacted] gap analysis report noted above and have established remediation plans with associated completion dates for each control gap as of August 12, 2011 (see the following documents in their entirety for additional detail regarding the [redacted] gap analysis remediation plans: MEMORANDUM [redacted] Detail Compliance Risks With Controls & Actions – Mtgbusadminandse, Detail Compliance Risks With Controls & Actions – CML, Detail Compliance Risks with Actions – HMC, and Detail Compliance Risks with Actions - CML).

Compliance completed a Risk Assessment of the foreclosure process from the initial breach letter through the foreclosure sale. This Risk Assessment included reviews of primary source materials; reviews of business policies, procedures, and functional manuals; and interviews of business staff involved in the foreclosure process. Risk Assessment results were compiled and the report was completed as of August 11, 2011 (see attached Compliance Foreclosure - Risk Assessment 8.26.11 Management Responses – "Compliance Risk Assessment". See page 4 for the Management Summary and pages 5 through 22 for risk assessment results). The Risk Assessment results noted policy, procedure, reporting and other related gap [redacted] Remediation of many of the noted gaps within the Risk Assessment have already been completed (e.g., [redacted] as outlined in the Compliance Risk Assessment. Additionally, as of August 26, 2011, Foreclosure management completed an action plan to remediate all other gaps (e.g., [redacted] (see Compliance Foreclosure Risk Assessment 8.26.11 management responses, pages 5 through 22). Additionally, as part of the quarterly Enterprise-wide Compliance Risk Assessment, all businesses are required to certify as to the completeness and accuracy of the Compliance Risk Assessment.

A similar Risk Assessment was completed for Mortgage Servicing as of September 12, 2011. Risk Assessment results were compiled and a final report was completed as of September 26, 2011. Mortgage Servicing presented a response plan to remediate noted gaps on October 10, 2011 (see Compliance Loan Servicing Risk Assessment 10.10.11 Management Responses).

Also, to ensure that HNAH has fully documented policies and procedures and that all employees understand and consistently follow them, HNAH has established the Good Governance Initiative. Its objective is to ensure that there are proper procedures in place within HNAH for all applicable business and operational processes, and that these procedures are clear, concise, thorough, accurate, and reflect compliance with Legal Requirements. Currently, HNAH is completing the following:

- Reviewing procedures for accuracy
- Conducting a root cause / trend analysis of past procedural breaches

[redacted]

TRAC

HNAH has an established Testing and Risk Assessment Compliance Group ("TRAC") function as a second line of defense, a part of HNAH Compliance, which is consistent with the requirements of "Compliance Risk Management Programs and Oversight at Large Banking Organizations with Complex Compliance Profiles," dated October 16, 2008 (SR 08-08/CA 08-11) as required by the Order. TRAC is responsible for conducting on-going compliance testing and risk assessments independent of the business unit compliance.

TRAC develops and maintains a Compliance Risk Mitigation Program, which establishes HNAH-wide consistent standards and processes to enable management to proactively identify, measure, monitor, test, and report compliance risks and controls as noted on page 6 of the HSBC - North America Compliance Risk Mitigation Program. This information is used to obtain reasonable assurance that HNAH and its subsidiaries are complying with material regulatory requirements and Group Compliance policies and standards.

Additionally, below is a listing of TRAC's specific roles and responsibilities, which are provided in greater detail within the HSBC - North America Compliance Risk Management Program Manual on page 31 and include:

- developing and maintaining firm-wide compliance risk assessment processes, methodologies and tools;
- leading the execution and oversight of the General Enterprise-wide Risk Assessment and facilitating and performing quality assurance of the results of the Detail Self Assessment, in conjunction with business line management and business line Compliance Officers;
- developing and maintaining firm-wide compliance monitoring and review programs, policies, procedures, processes and standards;
- annually reviewing business line/Compliance Officer compliance programs and processes, including Compliance Officer issue remediation activities;
- annually reviewing the effectiveness of the HNAH Compliance Risk Management

Program; • administering the Matters Requiring Attention ("MRAs") tracking and validation program to include tracking of MRAs, validating remediation and reporting MRA status to Group Compliance EXCO, senior management, Risk Governance Committees, and Compliance Committee; and • maintaining processes to track, escalate, and report material compliance issues and any corrective actions identified through examinations, inspections, compliance monitoring and reviews, or other means. Based on the enhancements put in place from the [redacted] Gap Analysis and the Compliance Foreclosure and Mortgage Servicing Risk Assessments, the ECP Program did not require further modification as a result of the EY Risk Assessment.
Documents to be submitted with the Action Plan • HSBC - North America Compliance Risk Management Program Manual • New Legislation Alert - Idaho HB 331 • HSBC North America New Laws and Regulations Procedure – US • [redacted] Database – Maintenance and Approval Procedure ALL • Regulations and Risk Statement Gap Analysis Results • MEMORANDUM [redacted] • Detail Compliance Risks With Controls & Actions – Mtgbusadminandse • Detail Compliance Risks With Controls & Actions – CML • Detail Compliance Risks with Actions – HMC • Detail Compliance Risks with Actions - CML • Compliance Foreclosure - Risk Assessment 8.26.11 Management Responses • Compliance Loan Servicing Risk Assessment 10.10.11 Management Responses • HSBC - North America Compliance Risk Mitigation Program
Key HSBC Contacts for the Action Plan • [redacted] SVP Strategy, Operational Risk Management and Chief Information Risk Officer, HBIO • [redacted] SVP Default Services • [redacted], SVP General Compliance

Article 14(c)

FRB Order Reference:	*Article 14(c)*	Corresponding OCC Article:	*N/A*

establish limits for compliance, legal, and reputational risks and provide for regular review of risk limits by appropriate senior management and the board of directors or an authorized committee of the board of directors.

Action Plan

The operating principles of the HNAH Risk Framework requires processes to adequately identify risk levels, requires a method to ensure effective communication of established risk management policies, procedures, and standards to all appropriate business line and other staff, establish limits for compliance, legal, and reputational risks and provide for regular review of risk limits by appropriate senior management and the board of directors or an authorized committee of the board of directors. The operating principles are as follows (and also noted fully in section 3.3.4, pages 22 – 23, of the attached HSBC – North America Compliance Risk Management Program Manual):

- Ensure all risks are appropriately identified, measured, managed, controlled and reported;
- Develop, communicate & implement appropriate risk-related policies, procedures, & processes in collaboration with business units, functional areas and Group;
- Provide an independent review and assessment of risks by regularly reviewing risk levels and risk management practices and raising concerns to senior executive management and the Board as necessary.;
- Provide regular and ad hoc reports to senior executive management, the Board, and Group on existing and emerging risks, with recommendations to avoid, eliminate, or mitigate outsized risks;
- Ensure compliance with all relevant laws, regulations, and regulatory requirements, including Basel II;
- Assess overall capital needs and enhance capital allocation
- Set risk appetite in line with capital availability and overall business strategy;
- Establish and promote a risk management culture that appropriately balances risks and rewards;
- Assist the Board and senior executive management in establishing risk tolerances, limits, and performance measurements across HNAH;
- Share and leverage best practices across Group;
- Continually assess and monitor the risks HNAH faces, and regularly reappraise its risk appetite and align its risk profile accordingly; and,
- Formulate an internal view of capital requirements relative to risk.

The Risk Management Framework brings together risk functions across North America to ensure a consistent policy, process, and practice is applied across legal entities. An overarching HNAH Risk Limits Framework, which is maintained by the North America Risk organization in conjunction with internal business partners from

Finance, Legal and Compliance, and the business lines, provides for the identification, communication, limitation, and management of all risks across HNAH, both for discontinued and ongoing business lines.

The results of the risk assessment did not identify the need for further enhancement to or modification of the HNAH Risk Management Framework beyond those enhancements already completed or underway in order to comply with the requirements of this Article.

Documents to be submitted with the Action Plan

- HSBC – North America Compliance Risk Management Program Manual

Key HSBC Contacts for the Action Plan

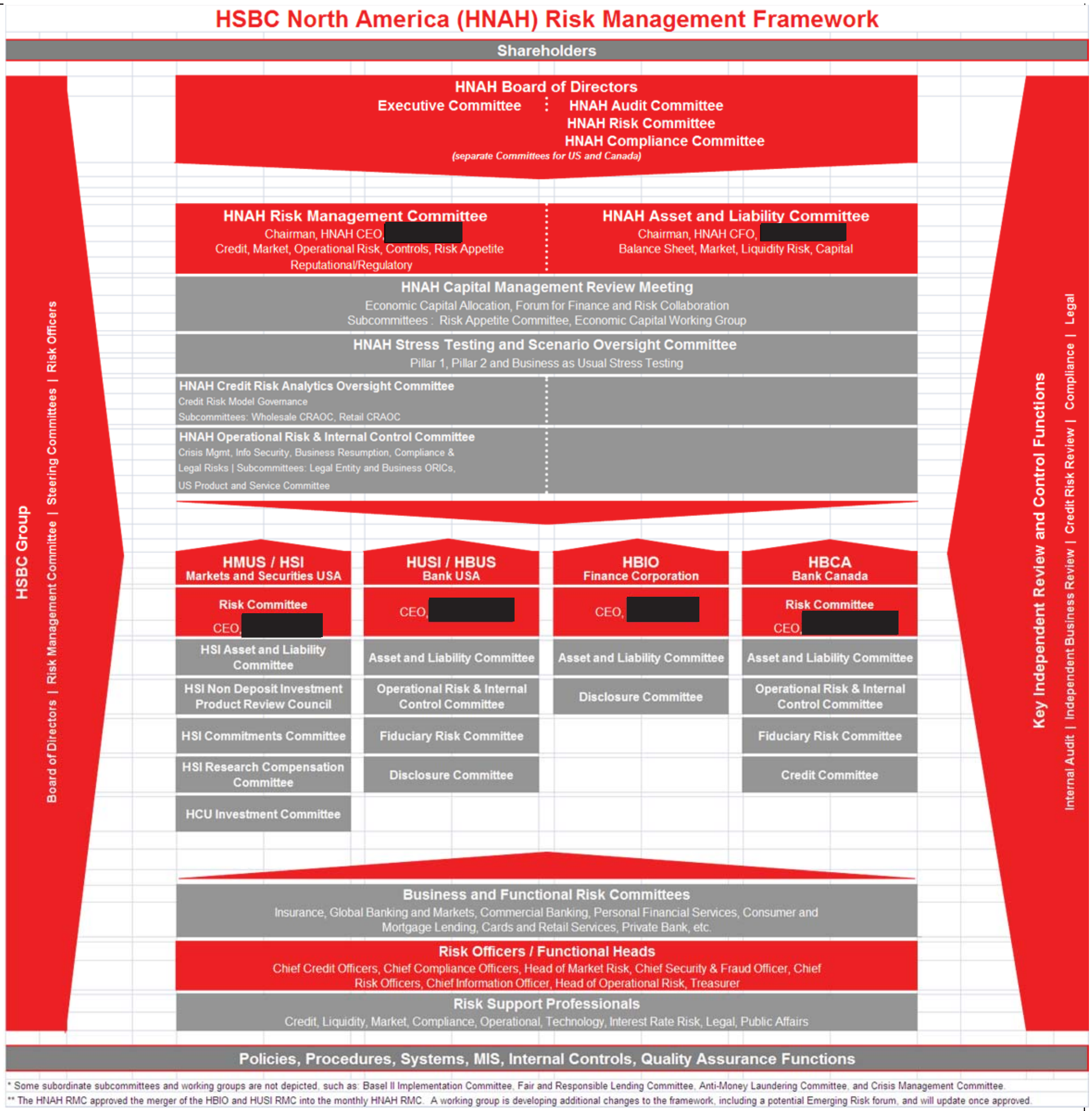
- [redacted] SVP Strategy, Operational Risk Management and Chief Information Risk Officer, HBIO
- [redacted] SVP Default Services
- [redacted], [redacted] Risk Governance and Administration, HNAH
- [redacted], SVP General Compliance

Article 15

FRB Order Reference:	*Article 15*	**Corresponding OCC Article:**	*N/A*
Within 60 days of submission of the comprehensive risk assessment conducted pursuant to paragraph 12 of this Order, HNAH and HBIO shall jointly submit to the Reserve Bank an acceptable, comprehensive risk management program for the Mortgage Servicing Companies. The program shall provide for the oversight by HNAH's senior risk managers and HBIO's board of directors and senior management of the development and implementation of formalized policies and mitigation processes for all identified risks to the Mortgage Servicing Companies. The program shall, at a minimum, address, consider, and include:			
Action Plan Please see responses included below in Articles 15(a) – 15 (l)			
Documents to be submitted with the Action Plan Not applicable.			
Key HSBC Contacts for the Action Plan • [redacted] SVP Strategy, Operational Risk Management and Chief Information Risk Officer, HBIO • [redacted] SVP Default Services			

Article 15(a)

FRB Order Reference:	*Article 15(a)*	**Corresponding OCC Article:**	*N/A*
The structure and composition of HBIO's board risk management committees and a determination of the optimum structure and composition needed to provide adequate oversight of Mortgage Servicing Companies' firm-wide risk management;			
Action Plan The Risk Management Framework is an integral component of HNAH's operating environment. The HNAH Risk Management Framework provides for oversight of risk by the HNAH Board through the HNAH Risk Management Committee. The HNAH Risk Management Committee is a regional level risk committee that provides a forum for risk managers, functional heads, and business unit heads to establish risk appetite, assess risk, establish risk management policies and standards, discuss emerging risk issues and agree upon appropriate actions, as necessary. The Mortgage Servicing Companies and the Bank are covered by the HNAH Risk Management Framework, which incorporates all risk categories, including operational, compliance and legal risks. The HNAH Risk Management Committee Framework is structured in the following manner:			



The operating principles of the HNAH Risk Framework requires processes to adequately identify risk levels and trends requires a method to ensure effective communication of established risk management policies, procedures, and standards to all appropriate business line and other staff. The operating principles are as follows:

- Ensure all risks are appropriately identified, measured, managed, controlled and reported;
- Develop, communicate & implement appropriate risk-related policies, procedures, & processes in collaboration with business units, functional areas and Group;
- Provide an independent review and assessment of risks by regularly reviewing risk levels and risk management practices and raising concerns to senior executive management and the Board as necessary.;

- Provide regular and ad hoc reports to senior executive management, the Board, and Group on existing and emerging risks, with recommendations to avoid, eliminate, or mitigate outsized risks;
- Ensure compliance with all relevant laws, regulations, and regulatory requirements, including Basel II;
- Assess overall capital needs and enhance capital allocation
- Set risk appetite in line with capital availability and overall business strategy;
- Establish and promote a risk management culture that appropriately balances risks and rewards;
- Assist the Board and senior executive management in establishing risk tolerances, limits, and performance measurements across HNAH;
- Share and leverage best practices across Group;
- Continually assess and monitor the risks HNAH faces, and regularly reappraise its risk appetite and align its risk profile accordingly; and,
- Formulate an internal view of capital requirements relative to risk.

The Risk Management Framework brings together risk functions across North America to ensure a consistent policy, process, and practice is applied across legal entities. An overarching HNAH Risk Limits Framework, which is maintained by the North America Risk organization in conjunction with internal business partners from Finance, Legal and Compliance, and the business lines, provides for the identification, communication, limitation, and management of all risks across HNAH, both for discontinued and ongoing business lines.

As depicted in the "HSBC North America (HNAH) Risk Management Framework" diagram above, the risk management framework is designed such that the business and functional risk committees (e.g., Mortgage Lending) report up through the enterprise-wide risk functions to provide consistent methodologies for the assessment of risk throughout the organization.

The results of the risk assessment did not identify the need for further enhancement to or modification of the HNAH Risk Management Framework beyond those enhancements already completed or underway in order to comply with the requirements of this Article.

Documents to be submitted with the Action Plan
Not applicable.

Key HSBC Contacts for the Action Plan

- [redacted] SVP Strategy, Operational Risk Management and Chief Information Risk Officer, HBIO
- [redacted] SVP Default Services
- [redacted], [redacted] Risk Governance and Administration, HNAH

Article 15(b)

FRB Order Reference:	*Article 15(b)*	**Corresponding OCC Article:**	*N/A*
a detailed description of the responsibilities of the line-of-business staff, legal department, and internal audit department regarding risk assessment and management, including, but not limited to, compliance and legal risks;			

Action Plan

HNAH's line of business staff, legal department and internal audit have responsibilities regarding risk assessment and management as follows:

<u>*Business Management Operational Risk (Business-line)*</u>

Operational Risk Management activities include but are not limited to:

- Serves as single point of contact coordinating with the second and third lines of defense – Tracks and monitors control weaknesses and audit findings
- Works directly with business to strengthen control gaps and assesses the adequacy and sustainability of remediation efforts
- Conducts self assessments on key controls to determine effectiveness and monitors KRI's
- Facilitates quarterly and annual workshops for RCA and [redacted]
- Facilitates annual certifications and reviews Group Policies to determine compliance with GSM and FIM
- Reports and maintains tracking and trending of operational losses

Business Management has responsibilities directly related to Residential Mortgage Servicing, while adhering to the enterprise-wide oversight. Business management has the following accountabilities:

- Identifying and assessing operational risks and controls
- Identifying and reporting incidents
- Implementing and operating internal controls and cannot rely on ORIC or other "second line of defense" control functions
- Monitoring the ongoing effectiveness of key controls to gain assurance that they are operating in line with risk appetite and any regulatory and FIM requirements.
- Establishment of Business Risk Control Management ("BRCM") capability to help undertake the appropriate level of key control monitoring.

<u>BRCM and Coordinators</u>

Operational Risk Oversight Functions have the following accountabilities within their functional area of expertise:

- Defining key operational risks and establishing minimum control standards and appropriate indicators / metrics

- Undertaking oversight to verify the appropriateness of business (and functional|) management control monitoring activity. Where oversight is conducted by these teams, ORIC may leverage this work in carrying out its oversight responsibilities to avoid duplication so long as it is satisfied that appropriately rigorous and sound standards have been followed.
- Reviewing and reporting their indicators / metrics and taking action as necessary where any business appears to be operating, or to be at risk of operating, outside the established risk appetite.
- Gaining assurance that the minimum standards in their respective FIMs are being met through oversight activity as outlined in GSM.

Additional information related to roles and responsibilities between business management and the BRCM is provided below:

Overview: Business Management and BRCM Responsibilities

Business Management Responsibilities	BRCM Responsibilities (Business Management Responsibilities if no BRCM established)
▪ Day to day operation of processes and embedded primary controls within processes. ▪ Secondary controls operated by supervisors, managers. ▪ Own and execute RCA process, which defines key risks and controls. ▪ Write and maintain local procedures to supplement FIM and BIM standards.	▪ Challenge the RCA output, including the assessment of key controls. ▪ Establish metrics/tolerance and control testing program around key controls. ▪ Execute control monitoring and testing program (independent control testing). ▪ Report control monitoring and performance data to local management and committees, when needed. ▪ Oversight of remediation of issues arising from control monitoring and testing. ▪ Oversight and challenge of procedures produced by primary operations.

Where BRCM undertakes control monitoring, a detailed monitoring plan that describes the key control monitoring activities that will be completed over the next year is established on at least annually. The monitoring plan is based on consideration of the RCA results as the basis of the annual monitoring plan, and also the following should be considered:
- New control standards issued
- Relevant local regulatory requirements
- Control issues identified in quarterly Operational Risk reporting
- Monitoring standards outlined in the FIMs
- Internal and external incident data
- Outputs of recent internal control monitoring
- Output of Group internal audit report, external auditors report and other functional reports
- Significant changes in business structure, personnel, external environment, products and systems
- Emerging risk issues / themes
- Controls where independent testing is mandated for SOX purposes
- The work plans of other areas (e.g. functions) carrying out control monitoring, to

maximize efficiency and avoid overlap.

The monitoring plan must be approved following an appropriate governance process (e.g. Business Head or appropriate business committee) on an annual basis. Significant amendments to the scope of the work plan must be agreed using the same governance process. The "appropriate governance process" will be further defined during the implementation of internal control monitoring. Review of plans and their approval and implementation may be subject to review by ORIC and Group Audit as well as Business Management.

The work plan will be submitted to the HNAH ORIC Committee for approval on an annual basis. Significant amendments to the scope of the work plan must be agreed by the ORIC Committee as required. ORIC must monitor progress against work plans on at least a quarterly basis, and consider work plan relevance, ad-hoc oversight based on emerging areas of risk, resource assessment (availability and capability), and any necessary escalation of delays. Progress will also be shared with the HNAH ORIC Committee and any delays in the execution of an activity should be adequately justified.

Where monitoring / oversight results indicate that controls are no longer effective and the risk is now outside of appetite, new issues and actions must be created to ensure appropriate rectification. A process must be in place for tracking issues and actions and ensuring their appropriate and timely resolution.

Significant issues identified through monitoring / oversight must be reported to business management and the relevant ORIC Committee.

<u>Legal</u>

The North America Legal Function undertakes to manage the Legal risk of HNAH and supports the risk control functions in their management of risks The North America Legal function's duties and responsibilities relative to the support of the Compliance Function in managing compliance risk include (see pages 35 and 36 of the attached HSBC – North America Compliance Risk Management Program Manual for additional detail):

- Provide legal advice to the HNAH Compliance function and business units on regulatory compliance matters;
- Prepare and/or review standard forms and contracts which may impact regulatory compliance, including agreements that delegate or assume compliance responsibilities;
- Work with HNAH Compliance to monitor and track both new and changed laws, regulations and regulatory guidance;
- Assess legislative, judicial, and regulatory activities and developments that may impact the Financial Services industry as a whole to identify potential emerging compliance risks and developments;
- Participate in business unit-aligned working group meetings with HNAH

Compliance Central Services, Government Relations and other HNAH Compliance functions to discuss legislative and regulatory activities and developments;
- Provide legal advice on new or changed laws or other requirements;
- Review and approve impact analyses prepared by HNAH Compliance Central Services;
- Along with HNAH Compliance, advise executive management on new or changed compliance requirements and potential impacts;
- Along with HNAH Compliance, advise executive management on compliance and legal risks associated with certain business decisions; and
- Provide information to HNAH Compliance regarding litigation matters that may involve HSBC and may have a regulatory compliance impact.

<u>Internal Audit</u>

Group Audit North America ("AUN") is an integral part of the Group and HNAH control environment. It provides management and the Board with an independent and objective review of business activities, risk management and support functions. AUN's compliance-related duties and responsibilities include (see pages 34 and 35 of the attached HSBC – North America Compliance Risk Management Program Manual for additional detail):
- Maintain a dynamic auditable universe of compliance risk entities which are evaluated and updated as business or regulatory conditions change;
- Utilize compliance risk assessments as the baseline for the annual audit plan and the development of compliance audit programs;
- Validate compliance risk assessments performed by business units and HNAH Compliance;
- Maintain and execute compliance audit programs and procedures;
- Ensure that the auditors performing compliance audits possess and maintain required skill sets and knowledge of current regulatory requirements;
- Integrate compliance risk reviews and testing into business unit operational audits. This includes testing the effectiveness of business unit compliance processes and adherence with compliance requirements;
- Evaluate the design and operating effectiveness of business unit and HNAH compliance programs;
- Assess the HNAH Compliance function and RCO's effectiveness in managing compliance risk and overseeing and supporting the implementation of the Program;
- Render an annual assessment of the overall effectiveness of the HNAH compliance program to senior management and the HNAH Compliance Committee;
- Provide the HNAH Compliance Committee with status updates and results on compliance relate audits;
- Provide timely reports to line management, executive management and compliance management on the results of risk evaluations and testing activities; and
- Monitor resolution of issues raised in previous audits and report to executive management monthly and RMC and ORIC quarterly.

Role in Organization / Description

Group Audit North America is responsible for all of the internal audit activities of the U.S. mortgage business, including HBIO and HBUS. This includes audits of the effectiveness of risk management, control, and governance processes for Residential Mortgage Loan Servicing, Loss Mitigation, and foreclosure activities. Group Audit North America has performed a review, based on the Order, of its approach for these audits. Complete audit programs for Default Services have been implemented with enhancements and additions based on the Order, and Payment Services and Customer Services are in process. Additional changes will be made to audit programs as management finalizes implementation of revised procedures and controls over applicable servicing activities, Audit completes transaction walk-throughs of the revised processes and based on the independent consultant's risk assessment. The AUN RESIDENTIAL MORTGAGE SERVICING AND NON REAL ESTATE DEFAULT SERVICES document details the back-end real estate and front-end non-real estate secured default services audit, payment services, and customer services audit. In addition, the AUN RESIDENTIAL MORTGAGE SERVICING AND NON REAL ESTATE DEFAULT document includes a combination of following five audit programs:

- AUN RESIDENTIAL MORTGAGE DEFAULT SERVICES BACK- END REAL ESTATE SECURED ACCOUNTS
- AUN RESIDENTIAL MORTGAGE FRONT END COLLECTIONS AND NON REAL ESTATE SECURED DEFAULT SERVICES
- AUN STANDARD RISKS, CONTROLS & AUDIT PROGRAMS
- AUN RESIDENTIAL MORTGAGE PAYMENT SERVICES SPECIALIZED AUDIT PROGRAMS
- AUN RESIDENTIAL MORTGAGE CUSTOMER SERVICES SPECIALIZED AUDIT PROGRAMS

In addition, effectiveness of the control functions is evaluated through audits of ECP and ERM functions. Group Audit North America provides an annual assessment of the adequacy and effectiveness of the ECP to the HNAH Board of Directors, through the Audit and Risk Committee and Compliance Committee as well as senior management. Results of the ECP assessment are summarized in the GROUP AUDIT NORTH AMERICA – HNAH REGULATORY COMPLIANCE PROGRAM, pages 20 through 38). This assessment summarizes how Audit assesses compliance risk and provides details on compliance coverage as part of the audits completed during the year. A regulatory matrix is in place to assist auditors in identifying key regulations and including them in the scope of each audit as necessary. In addition, Group Audit North America completes a regulatory compliance review as part of every operational audit using a standard regulatory compliance audit program.

To address ERM, Group Audit North America completes risk assessments for every audit. Those assessments are designed to include all aspects of ERM, including, but not limited to, credit risk, compliance risk, operational risk, legal risk, and financial risk (See AUN BACK-END RE SECURED DEFAULT SERVICES AUDIT as an example of an audit risk assessment conducted). In addition, Group Audit verifies the effectiveness of operational risk management activities by assessing whether management has completed an operational risk assessment and recorded risks in the [redacted] (“[redacted] with appropriate action plans. Any missing or incomplete risks or divergence in risk assessments are reported to management.

Group Audit North America conducts periodic reviews of major Residential Mortgage Servicing business processes including Default Services, Customer Services, and Payment Services. The reviews assess the effectiveness of the compliance and risk management processes for loan servicing, Loss Mitigation, and foreclosure activities. These reviews include enhanced coverage of compliance with the Legal Requirements and supervisory guidance.

The 2011 Group Audit Plan has been designed to provide holistic risk assurance to Executive Management, Audit and Risk Committees and regulators that material risks are being managed effectively within the North American region and in line with Group’s stated risk appetite. Group Audit has evaluated risk assessment results for the audit universe and its prioritization of areas to be audited on a global basis to account for changes that have occurred in the US businesses during 2010. With these changes in mind, the Group audit plan has been designed to provide comprehensive audit coverage of internal controls in order to mitigate business risks, such as compliance and operational risk. Consistent with prior years, the audit plan has been compiled using a risk-based audit approach and have been continuously reviewed and revised during the course of the year for emerging risks (See 2011 AUDIT PLAN PRESENTATION. See pages 2 and 3 of the attached document that discuss the Audit Approach and 2011 Internal Audit Plan and Key Themes).

The audits scheduled for 2011 broadly fall into three categories: Group-Wide Risk-Based Audits designed to provide clear line-of-sight to the effectiveness of risk management around key risks; Governance Audits designed to assess the effectiveness of the oversight process at the Group-level and validate the second line of defense's work; and Project Audits designed to provide assurance around on-going flagship change programs across the Group. On an annual basis, the Audit Plan continues to be reviewed with the Federal Reserve, OCC, and KPMG prior to being submitted to the HNAH Group Audit Committee for approval (See Board Resolution for Audit Plan Approval).

The scope and frequency of audits is based on the internal audit’s assessment of risks. The scheduling of audits is an on-going dynamic process reflecting changes in internal audit’s assessment of the inherent risk of the auditable entities within the audit population. A risk calculator model is used in the Annual Operating Plan (“AOP”) process and on-going scheduling of audits. The risk calculator seeks to identify and measure entity level risks across the audit population to determine the prioritization of audits. Resourcing and staffing needs are accordingly adjusted to enable audit resources be directed to the most appropriate areas. However, the risk calculator is a guide for senior audit management and does not preclude audits being scheduled differently. It is pertinent to mention that there are established controls that require entities with a high risk score to be audited within 12 months. As such, some of the mortgage business areas are audited on an annual basis (as described below). Medium-risk entities are audited every 18 to 24 months and low-risk entities are audited every 24 to 36 months. The Group Audit Standard Manual is the primary instruction manual for Group Audit and details all key policies and procedures (See THE HSBC GROUP AUDIT STANDARDS MANUAL). The HSBC GROUP AUDIT STANDARDS MANUAL is a detailed manual that outlines the standards and practices adopted by the Audit function, which comply with the International Standards for the Professional Practice of Internal Auditing and Code of Ethics.

The Consumer Mortgage Lending Default Services audit entity is reviewed on an annual cycle. Audits covering activities pertaining to front-end, mid-range, and back-end collections are rotated every other year. However, certain activities, such as loan modifications and foreclosures, are reviewed every year based on loan volume and regulatory considerations. In addition, Group Audit North America conducts annual audits of second line of defense functions (i.e., Service Delivery Control Adherence (formerly known as NAQA), TRAC) to validate that they are operating effectively. Group Audit North America also performs ad hoc audits and reviews outside the normal audit activities on behalf of senior management. These include special reviews of changes in policy, compliance with new Group or regulatory requirements, consultancy, and investigations at the request of the Audit and Risk Committee and the Chief Executive Officers See pages 2 and 3 of the attached 2011 AUDIT PLAN PRESENTATION document which notes the Audit Approach, 2011 Internal Audit Plan, and key themes. Additionally, see the 2011 AUN AUDIT PLAN – STATUS document which outlines residential mortgage servicing and non-real estate default services audit actions, their schedule, and status.

In addition, Group Audit North America prepares and maintains a matrix of regulatory requirements to assist its auditors in identifying key regulations and including them in the scope of each audit as applicable. The Compliance Risk Assessment completed by HNAH Compliance is used to update the matrix on a semi-annual basis. Audit management ensures that staff identifies and understands the regulations that apply to the audit they are performing by using the regulatory matrix. In addition, Internal Audit monitors coverage of compliance risks during the year to ensure that there is adequate internal audit coverage of compliance risks to support the assessment at the end of the year. In addition, Group Audit North America completes a regulatory compliance review as part of every operational audit using a standard regulatory compliance audit program.

Group Audit North America employs a risk-based approach to reporting and monitoring audit findings, which is designed to ensure critical matters or exposures are escalated and addressed in a timely and comprehensive manner. For high risk findings, Group

Audit North America verifies implementation of corrective measures through detailed testing. Low risk audit findings are communicated to management, and it is the business unit's responsibility to ensure corrective measures have been taken and reported. Group Audit North America management conducts on-going monitoring of aging audit issues – which are restricted to high-and medium-risk issues – to verify whether findings have been resolved, and it regularly reports stale (greater than 180 days old) high or medium risk findings to the Audit and Risk Committee. Repeat and partial repeat findings also receive separate reporting and tracking, and management has scorecard goals to keep both stale and repeat findings at low levels.

Group Audit North America has systems in place to track and monitor the status of the audit findings and recommendations. These systems facilitate follow-up reviews and are designed to track timely completion and effectiveness of the corrective measures. For example, the Audit Issues Module includes the following:

- Detailed information about findings, including target date for resolution, next action date for review by Group Audit North America, management response and action plan, and commentary supporting actions to date;
- Tracking capabilities designed to ensure the information is accurate and up-to-date, and that timely, corrective action of audit findings have been certified by management;
- Tracking capabilities designed to ensure that all outstanding issues have been remediated; and
- Email notifications to the responsible individuals when items are due, designed to ensure timely follow-up on outstanding audit finding.

The Audit Issues Module is utilized to generate exception reports that list issues that have not been remediated. Group Audit North America submits these reports monthly to Executive Management as well as quarterly (See Audit Update – HNAH Operational Risk and Internal Control Committee (ORIC) as an example to the reporting) to the internal Operational Risk and Control Committees and the Audit and Risk Committee of the HNAH Board. Please see the following sample reports:

- HBIO High Risk Outstanding Issues (PPT)
- HBIO High Risk Outstanding Issues - 30JUN11 (XLS)
- HBIO Repeat Issues
- HBIO Repeat Issues 2Q11
- HNAH All Medium 30JUN11
- HNAH High Risk Issues 30JUN11 (XLS)
- HNAH High Risk Outstanding Issues (PPT)
- HNAH-wide including HTSU Repeat Issues
- HNAH Repeat Issues 2Q11

Group Audit North America has procedures to escalate and resolve differences of opinion between audit staff and management concerning audit exceptions and recommendations. Upon completion of audit reviews, Group Audit North America holds exit meetings with senior management to discuss audit findings and confirm that no disagreements with the facts of the audit findings exist. Minutes from these meetings are circulated to the relevant members of management and concerns, if any, are escalated to Executive Management. It is important to note that while every attempt is made to agree on the factual accuracy of the audit findings with Management, Group Audit North America is, however, ultimately responsible for the overall control risk rating and risk rating of findings in the audit report.

Process Changes

Group Audit North America conducted a gap analysis for every item in the Order, completed on April 15, 2011, to identify: 1) areas that were not previously covered in the audit scope, 2) new controls to be implemented by Residential Mortgage Servicing, and 3) areas that require more detailed review by Internal Audit. Refer to attached AUN GAP ANALYSIS – FRB CONSENT ORDERS vs. AUDIT PROGRAMS file, which has separate tabs for OCC and FRB items. The column labeled "Gap Analysis" (column E) specifically identifies enhancements to existent audit programs or new requirements. Further, there are tabs for 1) ARA – Back End RE Default Services and 2) ARA – Front End Collections & NRE Default Services. The Audit Risk Assessment (ARA) documents have new and updated controls highlighted in yellow.

As a result of the gap analysis, numerous audit programs were enhanced. (See ARA tabs in AUN GAP ANALYSIS – FRB CONSENT ORDERS vs. AUDIT PROGRAMS file, where updated controls are highlighted in yellow.) These enhancements include a more robust review of the foreclosure affidavit execution processes, notarization processes, MERS oversight, SPOC controls and attorney network oversight controls. To the extent possible, audit programs have been enhanced to include new business processes such as those pertaining to the affidavit process and MERS. However, as the independent consultants complete the risk assessment required by the Order, additional controls may be identified and audit programs will be enhanced accordingly.

For Loss Mitigation, and foreclosure activities, Group Audit North America enhanced or developed certain specialized audit programs in light of the Order described above. Further, Group Audit North America is reviewing the results of the Independent Risk Assessment to determine any audit changes required.

Additionally, the Mortgage Default Servicing Operations Audit is on an annual review cycle [redacted] This audit, scheduled to begin in October 2011, includes the following key areas:

- Collection and Default Services
    - Front-End Activities in the first 59 days overdue (e.g., ARM resets, Internal Hardship, Collection Queue Management, and Dialer Strategies)
    - Mid-Range Activities from 60 to 119 days overdue (e.g., Skip Tracing and use of

external collection agencies)
    - Back-end Operations beyond 120 days overdue (e.g., Loss Mitigation Strategies, Loan Modifications, Charge-off, Real Estate Owned and, Foreclosures)

Other audits of the mortgage business include:

- Payment Services
- Customer Services

Collection and Default Services

Audit coverage of the Collection and Default Services includes the review of collections activities on contractually delinquent accounts serviced by the Mortgage Servicing Companies and HBUS. Activities included in scope consist of front-end, mid-range and back-end collections for secured and unsecured loans. Audit coverage extends to governance and strategy and processes for restructuring (e.g., modifications and re-ages), bankruptcy, foreclosure, and Loss Mitigation activities (e.g., short-sales, deed in lieu, forbearance). Dialer management is also reviewed to ensure that telephonic customer collection dialer setting queues are systemically restricted to authorized personnel, policies and procedures are adhered to, and regulatory requirements are considered. The reviews also cover Real Estate Owned (REO) activities and monitoring of external agencies (e.g., debt management). (See ARA in AUN GAP ANALYSIS – FRB CONSENT ORDERS vs AUDIT PROGRAMS)

Payment Services

The Mortgage Servicing Payment Services audit includes the review of activities related to the receiving, tracking and posting of cash payments, cash exception processing (i.e., bankruptcy payment processing), verification that payment algorithms comply with State regulatory requirements, and validation of payment posting.

Customer Services

The Customer Services audit includes the review of activities related to the handling of customer correspondence (whether received by phone, letter, or e-mail), forecasting call volumes and routing via the Voice Response Unit (“VRU”), and management of complaints. Responsibilities for maintaining escrow accounts, monitoring accounts requiring special handling, and maintaining required property insurance are also reviewed as part of this audit.

A review of compliance with the applicable` federal and state regulatory requirements is included in each of the mortgage servicing audit programs. In addition, Group Audit North America includes the review of applicable mortgage servicing activities as part

other audits, such as Remittance Processing Center, Loan Loss Reserve, Business Unit Financial Control, State Regulatory Administration, and Sarbanes Oxley.
Documents to be submitted with the Action Plan • HSBC – North America Compliance Risk Management Program Manual • AUN RESIDENTIAL MORTGAGE SERVICING AND NON REAL ESTATE DEFAULT SERVICES • GROUP AUDIT NORTH AMERICA – HNAH REGULATORY COMPLIANCE PROGRAM • AUN BACK-END RE SECURED DEFAULT SERVICES AUDIT • Board Resolution for Audit Plan Approval • THE HSBC GROUP AUDIT STANDARDS MANUAL • Audit Update – HNAH Operational Risk and Internal Control Committee (ORIC) • HBIO High Risk Outstanding Issues (PPT) • HBIO High Risk Outstanding Issues - 30JUN11 (XLS) • HBIO Repeat Issues • HBIO Repeat Issues 2Q11 • HNAH All Medium 30JUN11 • HNAH High Risk Issues 30JUN11 (XLS) • HNAH High Risk Outstanding Issues (PPT) • HNAH-wide including HTSU Repeat Issues • HNAH Repeat Issues 2Q11 • AUN GAP ANALYSIS – FRB CONSENT ORDERS vs. AUDIT PROGRAMS • 2011 AUN AUDIT PLAN – STATUS
Key HSBC Contacts for the Action Plan • [redacted] SVP Strategy, Operational Risk Management and Chief Information Risk Officer, HBIO • [redacted] SVP Default Services • [redacted], SVP General Compliance • [redacted] EVP/Chief Auditor, HBIO

Article 15(c)

FRB Order Reference:	*Article 15(c)*	**Corresponding OCC Article:**	*N/A*
written policies, procedures, and risk management standards;			

Action Plan

The HSBC ORIC framework covers all businesses and operations of the Group. The following categories of risk are included under the definition of operational risk (the risk of loss resulting from inadequate or failed internal processes, people, and systems or from external events) and are subject to the HSBC's ORIC management framework:

- Compliance
- Fiduciary
- Legal
- Information
- Accounting
- Tax
- External Fraud
- Internal Fraud
- People
- Political
- Physical
- Business Continuity
- Systems
- Operations
- Project

Operational Risk management consists of the identification, assessment, monitoring and control of operational risk so as to maintain losses within acceptable levels and to protect the Group from foreseeable future losses. Management in all businesses and support functions operating in North America, including Global Businesses, are responsible for designing controls to mitigate operational risk and for monitoring and evidencing the effectiveness of those controls in operation. Acceptable levels of internal control should be determined by reference to the scale and nature of each business operation, but must also remain compliant with the minimum standards set out in Group Standards Manual and Group Functional Instruction Manuals; ensuring appropriate levels of economic and regulatory capital in accordance with internal and external requirements.

As of January 2011, HSBC – North America began implementation of the new Group Risk and Control Assessment (RCA) methodology. This is a new methodology adopted by HSBC Group Operational Risk to replace the existing methodology, RSA or Risk Self -Assessment. The RCA is a component in the Enhanced Operational Risk

Framework implemented throughout HSBC. The RCA methodology builds on the RSA and is designed to provide businesses with a forward-looking view of operational risk and to help them proactively determine whether their key operational risks are controlled within acceptable levels. The RCA methodology enables the assessment of both the typical and extreme exposure to operational risks and considers the direct financial costs and the indirect financial impacts to the business including customer service, reputational, and regulatory impacts.

Typical exposure to operational risk events (e.g. credit card fraud) is the total loss that is expected to occur in the next 12 months given the effectiveness of the control environment.

The extreme events (e.g. rogue trading) take into account the inherent nature of risks within the business and control environment, but assume that one or more controls fail to operate as expected.

Specific aims of the RCA methodology are to:

- Identify and assess material operational risks;
- Identify and assess the effectiveness of key controls that mitigate these risks;
- Focus management attention where controls are assessed as either “Needs Improvement” or “Ineffective”, and
- Identify what monitoring of key controls is being undertaken and thereby to identify necessary management actions.

The following activities must be undertaken as part of the RCA methodology:

- Scoping – Determine where an RCA should be undertaken (i.e. which entities or what level within a country or business)
- Risk and Control Identification – Document the details of material risks and associated key controls
- Risk and Control Assessment – Record the effectiveness of the key controls and the residual risk exposure based on control assessments
- Control Monitoring – Identify the appropriate level of control monitoring required and provide input into the internal control monitoring activity
- Issues and Actions – Implementation of action plans to address control deficiencies and/ or specific people, process or technology improvements
- Governance and Reporting – Review and sign off the completed RCAs.

Roles and Responsibilities

Operational Risk and Internal Control

The HSBC – North America Operational Risk and Internal Control (HNAH ORIC) Committee provides central governance and strategic oversight of the operational risk management framework, including identification, assessment, monitoring, and appetite for operational risk. The HNAH ORIC Committee is an authorized subcommittee of the HNAH Risk Management Committee and is the senior most risk committee responsible for the oversight and management of operational risk and internal control within the North America Region.

The HNAH ORIC Committee oversees internal controls over HNAH's top operational risks and creates a regional risk and control culture by embedding operational risk and internal control management into businesses and functions and by promoting appropriate training.

The HNAH ORIC Committee is responsible for all businesses and operations in the U.S. and Canada. Country and Global Business ORIC Committees have been established as subcommittees. The Regional / Country ORIC Team coordinates the coverage of the various ORIC Committees and minimizes overlap as appropriate.

Business Management

Business Management has the following responsibilities:

- Identifying and assessing operational risks and controls in accordance with HSBC Group Operations FIM.
- Identifying and reporting incidents in accordance with HSBC Group Operations FIM B.1.5 "Operational Risk Incident Management" (See attached page 1 of the attached B.1.5 Operational Risk Incident Management document for additional detail related to the definition and management of Operational Risk Incidents
- Implementing and operating their internal controls (i.e. the business cannot rely on ORIC or other "second line of defense" control functions for this).
- Monitoring the ongoing effectiveness of key controls to gain assurance that they are operating in line with risk appetite and any regulatory and FIM requirements.
- Establishment of Business Risk Control Management ("BRCM") capability to help undertake the appropriate level of key control monitoring.

Business Risk Control Manger and Coordinators

Operational Risk Oversight Functions have the following accountabilities within their functional areas of expertise:

- Defining key operational risks and establishing minimum control standards and appropriate indicators / metrics
- Undertaking oversight to verify the appropriateness of business (and functional|) management control monitoring activity. Where oversight is conducted, ORIC may leverage this work in carrying out its oversight responsibilities to avoid duplication so long as it is satisfied that appropriately rigorous and sound standards have been followed.
- Reviewing and reporting their indicators / metrics and taking action as necessary where the business appears to be operating, or to be at risk of operating, outside the established risk appetite.

- Gaining assurance that the minimum standards in their respective FIMs are being met through oversight activity as outlined in GSM.

Within HBIO and HBUS, the BRCM has additional responsibilities with respect to the business as outlined below:

The BRCM is the central point of contact for second and third lines of defense such as Group Audit North America ("AUN"), Service Delivery Control Adherence ("SDCA") Credit Review & Risk Identification ("CRRI") and TRAC. See pages 4 and 5 of the attached Business Risk Control Management Departmental Instruction Book for additional details regarding an overview, roles and responsibilities of the BRCM. At the onset of any audit or review conducted by a second or third line of defense the BRCM is engaged and actively participates. In the event findings are issued to the business the BRCM will work with the business to develop management responses and action plans to remediate operational deficiencies. The BRCM is responsible for providing reports to management on a weekly basis which outlines the inventory of findings and the status of action plans. The BRCM and risk coordinators work closely with the business to ensure findings are appropriately remediated and that controls implemented are sustainable. The BRCM escalates issues aged over 180 days and repeat findings to the Business Unit's Senior Leadership Team and regular updates are provided at the Bi-Weekly Retail Operations Governance Meetings as detailed on pages 1 – 4 of the attached BROG Deck Prep Procedure ALL. Also please see pages 1 – 3 of the attached Executive Reporting Preparation Procedure ALL for procedures for reports prepared by the BRCM Business Analyst for usage by the BRCM Senior Vice President and the Executive Vice President

The BRCM sponsors Annual Risk Workshops within the business unit. The purpose of the workshops is to reinforce HSBC's Operational Risk framework. Following these education sessions, all existing risks are reviewed, emerging risks are discussed and updates are made to controls and action plans as necessary. Workshop attendance is required for the organizations' Senior Vice President and Vice President. See the attached Consumer & Mortgage Lending RCA Workshop One document for an example of the presentation which includes objectives of providing a brief overview of RCA methodology and defining how it differs from the RSA framework, identifying and documenting material risks (in line with the risk categorization matrix), and assessing the typical and extreme risk exposures, by business unit.

As detailed on pages 3 – 6 of the attached Business Risk Control Management Departmental Instruction Book document, it is the responsibility of every SVP within Residential Mortgage Servicing to submit loss events timely for operational risk reporting. The BRCM facilitates the process to certify losses on a monthly basis. Losses are reviewed by the BU Operational Risk, Senior Vice President on a monthly basis to review trends and ensure action plans are in place to improve controls to minimize repeat incidents.

With the implementation of RCA, the BRCM will undertake control monitoring. The BRCM is required to review the RCA output, including the assessment of key controls. The 2012 Internal Control Monitoring Work Plan must be completed and approved by the President and CEO of the Servicing Company no later than January 15, 2012. Independent Control testing will commence in 1Q12. Reporting and performance data will be provided to management and other committees such as ORIC and BROG as needed. The BRCM will provide oversight of the remediation of issues arising from control monitoring and testing. Procedures outlining detailed monitoring activities are targeted to be completed no later than February 28, 2012.

Internal Control Monitoring Plan

Where BRCM are undertaking control monitoring, business management must develop an appropriately detailed monitoring plan on at least an annual basis that sets out the key control monitoring activities that will be completed over the next year. The monitoring plan should include RCA output detail as the basis of the annual monitoring plan, and also the following should be considered:

- New control standards issued
- Relevant local regulatory requirements
- Control issues identified in quarterly Operational Risk reporting
- Monitoring standards outlined in the FIMs
- Internal and external incident data
- Outputs of recent internal control monitoring
- Output of Group internal audit report, external auditors report and other functional reports
- Significant changes in business structure, personnel, external environment, products and systems
- Emerging risk issues / themes
- Controls where independent testing is mandated for SOX purposes
- The work plans of other areas (e.g. functions) carrying out control monitoring, to maximize efficiency and avoid overlap.

The monitoring plan must be approved following an appropriate governance process (e.g. President and CEO of the Servicing Company or appropriate business committee) on an annual basis. Significant amendments to the scope of the monitoring plan must be agreed using the same governance process. The appropriate governance process will be further defined during the implementation of internal control monitoring. Review of plans and their approval and implementation may be subject to review by ORIC and Group Audit as well as Business Management.

The monitoring plan will be submitted to the HNAH ORIC Committee for approval on an annual basis. Significant amendments to the scope of the monitoring plan must be agreed by the ORIC Committee as required. ORIC must monitor progress against monitoring plans on at least a quarterly basis, and consider monitoring plan relevance, ad-hoc oversight based on emerging areas of risk, resource assessment (availability and capability), and any necessary escalation of delays. Progress will also be shared with the HNAH ORIC Committee and any delays in the execution of an activity should be adequately justified.

Where monitoring / oversight results indicate that controls are no longer effective and the risk is now outside of appetite, or new issues are identified, actions plans must be created to ensure appropriate remediation. A process must be in place for tracking issues and actions and ensuring their appropriate and timely resolution.

Significant issues identified through monitoring / oversight must be reported to business management and the relevant ORIC Committee.

BRCM Training

ORIC oversees the Operational Risk Management Framework, along with the new RCA process. Training on the new RCA was provided to BRCM in 3Q11. See page 2 of the attached HNAH Operational Risk & Internal Control document for specific topics covered in the overview which include Internal Control Monitoring Activity, Roles and Responsibilities, and Types of Monitoring Activities. In addition, the Business Unit BRCM and Risk Coordinators have access to the Operations Functional Instructions Manual, the North America Risk Policy and Mandatory Operational Risk Awareness Web-based Training ("WBT"). The purpose of the Operational Risk Awareness WBT is to reinforce the value of Operational Risk and the part that the staff plays in its management. The course emphasizes the importance of vigilance, thinking ahead and educating staff about the impact (direct and indirect) of Operational Risk losses to the business. See the page 2 of the attached Operational Risk Awareness WBT document which summarizes the operational risk categories included in the WBT (i.e., Physical, Group Security and Fraud, Information, etc.). All new joiners are required to complete this training within three months of joining HSBC. The on-line learning is followed by an assessment that requires a score of at least 80 percent to complete the training.

Good Governance Initiative

To ensure that written policies, procedures, and risk management standards are maintained, HNAH also established the Good Governance Initiative to maintain documented policies and procedures.

To ensure that HNAH has fully documented policies and procedures and that all employees understand and consistently follow them, HNAH has established the Good Governance Initiative. Its objective is to ensure that there are proper procedures in place within HNAH for all applicable business and operational processes, and that these procedures are clear, concise, thorough, and accurate. Currently, HNAH is completing the following:

- Reviewing procedures for accuracy
- Conducting a root cause / trend analysis of past procedural breaches
- Implementing improvements pertaining to areas of concern beyond the actual procedures such as accessibility of procedures, appropriate controls and oversight, training, etc.

HNAH is following a five step process for review of procedures, and identifying and addressing any gaps. There is a standard template that guides the five steps of project implementation.

- Develop Procedures and Process Inventory
- Develop Breaches Inventory
- Conduct Gap Analysis
- Define Recommendations
- Implement Recommendations

The attached “Good Governance Project US HNAH” document provides additional details regarding project background, objectives, approach, governance, and specifications. All policies and procedures are expected to be certified as part of the Good Governance Initiative by the end of the fourth quarter of 2011.

Updates Based upon Independent Risk Assessment

Residential Mortgage Services and Compliance have received the results of Ernst & Young’s Independent Risk Assessment. The Residential Mortgage Services has created action plans (see Article 15(l) for the full population of action plans) for each finding. Based on the action plans as well as review of the findings, the Residential Mortgage Services and Compliance will update its respective policies, procedures and/or risk management standards as it deems necessary.

Documents to be submitted with the Action Plan

- Good Governance Project US HNAH
- Audit Tracking and Management Reporting Procedure ALL
- BROG Deck Prep Procedure ALL
- Executive Reporting Preparation Procedure ALL
- Consumer & Mortgage Lending RCA Workshop One
- Business Risk Control Management Departmental Instruction Book (BRCM DIB)
- HNAH Operational Risk & Internal Control
- Operational Risk Awareness WBT
- B.1.5 Operational Risk Incident Management

Key HSBC Contacts for the Action Plan

- [redacted] SVP Strategy, Operational Risk Management and Chief Information Risk Officer, HBIO
- [redacted] SVP Default Services
- [redacted], SVP General Compliance
- [redacted], [redacted] Risk Governance and Administration, HNAH

Article 15(d)

FRB Order Reference:	*Article 15(d)*	**Corresponding OCC Article:**	*N/A*
processes to adequately identify risk levels and trends;			

Action Plan

The operating principles of the HNAH Risk Framework requires processes to adequately identify risk levels, requires a method to ensure effective communication of established risk management policies, procedures, and standards to all appropriate business line and other staff, establish limits for compliance, legal, and reputational risks and provide for regular review of risk limits by appropriate senior management and the board of directors or an authorized committee of the board of directors. The operating principles are as follows:

- Ensure all risks are appropriately identified, measured, managed, controlled and reported;
- Develop, communicate & implement appropriate risk-related policies, procedures, & processes in collaboration with business units, functional areas and Group;
- Provide an independent review and assessment of risks by regularly reviewing risk levels and risk management practices and raising concerns to senior executive management and the Board as necessary.;
- Provide regular and ad hoc reports to senior executive management, the Board, and Group on existing and emerging risks, with recommendations to avoid, eliminate, or mitigate outsized risks;
- Ensure compliance with all relevant laws, regulations, and regulatory requirements, including Basel II;
- Assess overall capital needs and enhance capital allocation
- Set risk appetite in line with capital availability and overall business strategy;
- Establish and promote a risk management culture that appropriately balances risks and rewards;
- Assist the Board and senior executive management in establishing risk tolerances, limits, and performance measurements across HNAH;
- Share and leverage best practices across Group;
- Continually assess and monitor the risks HNAH faces, and regularly reappraise its risk appetite and align its risk profile accordingly; and,
- Formulate an internal view of capital requirements relative to risk.

This Risk Management Framework brings together risk functions across North America to ensure a consistent policy, process, and practice is applied across legal entities. An overarching HNAH Risk Limits Framework, which is maintained by the North America Risk organization in conjunction with internal business partners from Finance, Legal and Compliance, and the business lines, provides for the identification, communication, limitation, and management of all risks across HNAH, both for discontinued and ongoing business lines.

In addition to the aforementioned Risk Management framework, the three levels of defense, as well as the Dark Corners Exercise, work in conjunction to adequately identify risk levels and trends.

The Enterprise Risk Management framework provides overall governance and works in conjunction with the specific programs that provide Residential Mortgage Servicing risk management. The programs providing the support are Residential Mortgage Servicing, Service Delivery Control Adherence, Compliance, and Group Audit North America. These four programs form three lines of defense:

- Residential Mortgage Servicing serves as the first line of defense, providing the Business Risk and Control Management ("BRCM") capability and internal control framework.
- Service Delivery Control Adherence (formerly known as NAQA) coordinates with the Residential Mortgage Servicing BRCM teams to test the controls.
- Compliance is an additional second line of defense that provides regulatory oversight to the Residential Mortgage Servicing teams to ensure that the controls put in place satisfy regulatory requirements.
- Group Audit North America serves as the third line of defense by assessing the effectiveness of Residential Mortgage Servicing controls and the functioning of the second line of defense.

Through these three lines of defense, deficiencies in mortgage servicing, Loss Mitigation and foreclosure activities are identified and promptly remediated.

Three Lines of Defense

Residential Mortgage Servicing (First Line of Defense)

Residential Mortgage Servicing activities are covered by the Business Risk and Control Management Team established by and under the direction of the SVP of Strategy, Operational Risk Management and Chief Information Risk Officer, HBIO. The BRCM Team will assist in the design of key controls identified through the implementation of the Risk and Control Assessment ("RCA") methodology. This includes controls to mitigate risk (expanded upon in the following paragraph) and monitor the effectiveness of these controls, including the key controls that mitigate material risks assessed in the areas of residential loan servicing, Loss Mitigation, and foreclosure activities. In addition, the BRCM Team will ensure that policies and procedures related to these material risks are well-designed, effective, and aligned with Group and local standards and regulations. The BRCM Team supports the business in controlling its activities and in ensuring that the business has a well-designed and effective framework of policies and procedures, as well as monitoring of controls, to mitigate operational risk impacting the business.

To expand on the existing Risk Self Assessment, Residential Mortgage Servicing adopted a new RCA in 2011 which is overseen by the HNAH Operational Risk and Internal Control ("ORIC") Team. The RCA is designed to provide the business with a forward looking view of material operational risks and to help them proactively identify and assess the key controls to mitigate risks within acceptable levels. In addition to identifying and assessing material operational risks, the RCA methodology supported by the Internal Control Target Operating Model requires the business to monitor these key internal controls. Issues and actions noted in the BRCM internal control monitoring program must be documented and progress must be monitored.

The Operational Risk and Internal Control Framework is expected to improve first line of defense management of operational risk by:

- Reducing operational events/losses;
- Reducing the occurrence of unexpected events;
- Increasing the resilience of HNAH and its subsidiaries;
- Safeguarding HSBC's reputation and regulatory standing; and,
- Setting minimum Operational Risk Management ("ORM") standards across HSBC's businesses.

Service Delivery Control Adherence (formerly known as NAQA) ("SDCA") (Second Line of Defense)

Please see responses included above in Article 14(a).

Compliance (Second Line of Defense)

Please see responses included above in Article 14(a).

Group Audit North America (Third Line of Defense)

Please see responses included above in Article 14(a).

Dark Corners Exercise

In January 2011, HNAH ORIC Committee commenced the Dark Corners exercise. The objectives of the exercise are:

- Self-identify latent or emerging operational risks and control issues that will benefit from management's attention and scrutiny
- Stay in front of emerging risks and control issues with early identification and coordinated response efforts
- ORIC, EXCO, or other appropriate committees within the businesses and support functions should drive timely remediation and revaluation of operational risk profile (as noted in the RCA) as it relates to "dark corners" risks and controls
- Escalation to HNAH ORIC Committee – assess regional impact, track progress of actions to manage risk and issues, and report as appropriate (supports the new Internal Audit management assessment grade)
- Share information and experiences across businesses and support functions to avoid like risk sand issues from resurfacing and to leverage remediation efforts

The businesses are asked to identify emerging risk, which are then categorized, tracked, and distributed to all business to determine if the risk are horizontally relevant. Themes are identified and formally presented on a quarterly to the HNAH ORIC Committee.
Documents to be submitted with the Action Plan • HSBC – North America Compliance Risk Management Program Manual
Key HSBC Contacts for the Action Plan • [redacted] SVP Strategy, Operational Risk Management and Chief Information Risk Officer, HBIO • [redacted] SVP Default Services • [redacted], SVP General Compliance • [redacted], [redacted] Risk Governance and Administration, HNAH • [redacted] EVP/Chief Auditor, HBIO

Article 15(e)

FRB Order Reference:	*Article 15(e)*	Corresponding OCC Article:	*N/A*

processes to adequately identify and control risks arising from incentive compensation programs;

Action Plan

HNAH has in place policies and processes to adequately identify and control risks arising from incentive compensation programs. Please see pages 1 and 2 of the attached Incentive Compensation Plan Approval Procedure ALL for the procedures detailed below).

Overview

HSBC periodically creates or amends its incentive plans. The request typically comes from a Global Career Band ("GCB") Level 3 (i.e., senior vice president) and above. Changes made to the business compensation plans require a written proposal outlining revisions needed to the plan.

Changes include:
- Additions
- Revisions
- Discontinuance of compensation plan

Process

A GCB Level 3 (senior vice president) or above identifies the need to create a new incentive plan, amend, or terminate an existing plan. All proposed incentive plan changes must initially be reviewed by the Strategy and Development Department, which reports directly into the President and CEO of the Servicing Company, The Strategy and Development Department which will engage any additional resources needed to assess the request, including Performance and Rewards, and the HR Relationship manager. Any department reporting to the President and CEO of the Servicing Company must submit incentive compensation requests through the Strategy and Development Department as a point of control.

Approvals

Prior to implementation, any new or revised incentive compensation plans may be reviewed and approved by the business unit governance committee. If a committee review is not required (that is, for minor plan adjustments), the impacted GCB 3 level Business Functional Head approval is required.

Final review and approval by business management, HR, HNAH Performance and Reward, Compliance, Finance, Risk and Legal (and Information Technology [IT], if applicable) is required prior to implementation of any and all changes.

As one of the approvers, Compliance reviews incentive plans to ensure the design and measurement criteria do not influence the treatment of customers by employees. As an example, the incentive plan should not drive employees to offer a customer one loss mitigation option over others. Additionally, the Compliance review confirms that incentive plans include a compliance/quality component. This component is considered a minimum qualifier to earn incentive compensation. As such, it is designed to ensure that compliance violations have some impact on an employee's incentive.

As another approver, Risk reviews incentive plans In accordance with HSBC policy and regulatory requirements to conduct an annual review and approve all formulaic incentive plans to ensure compensation arrangements appropriately balance risk and reward and do not incentivize excessive risk-taking. Risk participates in incentive compensation plan design working groups with Human Resources and the Business to ensure risk management perspectives are appropriately considered and guiding principles are established. These guiding principles form the risk evaluation which is a part of the overall Incentive Governance template that is required to be completed and addressed for each incentive compensation plan.

Note: Although many highly leveraged employees are compensated via formulaic plans, Risk is also involved in a much broader capacity with variable discretionary plans for senior level executives.

Internal Audit

In addition to the processes noted above, Group Audit North America includes compensation practices in its audit programs. As noted on pages 11 and 12 of AUN RESIDENTIAL MORTGAGE SERVICING & NON REAL ESTATE DEFAULT SERVICES - AUDIT RISK ASSESSMENT AND AUDIT PROGRAMS REVIEW, the standard audit program is designed to evaluate incentive compensation plans and processes. Key areas considered are appropriateness of plans, alignment with business objectives and principles, and potential for conflict of interests. The compensation plans should balance risk and reward; should not encourage either in spirit or practice assumption of excessive risk to the organization or encourage practices that are detrimental to customer interest.

Key controls reviewed as part of this program include, but are not limited to, the following:

- Management reporting exists to provide objective measure for performance management and incentive goals.
- Incentive plan payments are approved by the finance department and HBIO SVP of HR.
- Incentive plans are balanced to achieve the desired results in an ethical manner.
- Goals / objectives established relate specifically to the employee's functions and

responsibilities and are structured in line with senior management and Group objectives.
Documents to be submitted with the Action Plan • Incentive Compensation Plan Approval Procedure ALL • AUN RESIDENTIAL MORTGAGE SERVICING & NON REAL ESTATE DEFAULT
Key HSBC Contacts for the Action Plan • [redacted], SVP General Compliance • [redacted], SVP Risk • [redacted] EVP/Chief Auditor, HBIO

Article 15(f)

FRB Order Reference:	*Article 15(f)*	**Corresponding OCC Article:**	*N/A*
processes to document, measure, assess, and report key risk indicators;			

Action Plan

Operational risk functions includes both enterprise-wide operational risk as well as business-line (that practiced at the Residential Mortgage Servicing level) which include processes to document, measure, assess, and report key risk indicators. Each is discussed in detail below

Enhanced HSBC Group Operational Risk and Internal Control Framework (Enterprise-wide)

An enhanced HSBC Group Operational Risk and Internal Control ("Group ORIC") Framework is in the process of being rolled out across North America. The framework has been enhanced to include a new Risk and Control Assessment ("RCA") methodology. The new RCA enhances the prior risk assessment process and has been implemented within the Residential Mortgage Servicing framework. The RCA framework process assists in the identification and assessment of material operational risks as well as the effectiveness of key controls that mitigate these risks. Additional emphasis is placed on control identification and assessment, as well as the associated monitoring and testing of key controls.

The new RCA methodology and associated guidelines were published in an updated HSBC Group Operations Functional Instruction Manual ("FIM"), dated April 2010 (See FIM B.1.4 Risk and Control Assessment, FIM Appendix D.1.3 Risk and Control Assessment Guidance, and D.1.4 Risk Categorization documents). The FIM B.1.4 Risk and Control Assessment sets out the minimum requirements for the annual Risk and Control Assessment. This is designed to provide business with a forward looking view of operational risk and to help the business proactively determine whether their key operational risks are controlled within acceptable levels. The FIM Appendix D.1.3 provides guidance to support the Operations Functional Instruction Manual through a multiple step process. The D.1.4 Risk categorization identifies the different categories of operational risk. The RCA methodology implementation in North America began in January 2011, and was executed within the business units on June 30, 2011. Full implementation and quality assurance review of the new RCA methodology is expected to be completed by December 31, 2011.

Enhanced Internal Control Target Operating Model (Enterprise-wide)

In addition, the enhanced Group ORIC framework incorporates a new Internal Control Target Operating Model ("TOM"). A North America impact analysis and implementation plan was completed in 1Q2011, and approved by the HNAH ORIC

Committee on April 6, 2011. The new framework is centered around the Business Risk Control Management ("BRCM") Team that promotes and executes on business unit ownership of monitoring of key controls. The BRCM activities are subject to independent oversight by ORIC and other "2nd line of defense" teams. (See attachment HNAH Operational Risk Internal Control Target Operating Model, which in its entirety outlines the TOM, and is summarized below.)

Pursuant to the Internal Control TOM principles:

- Management of internal controls is centered around Business / Function ownership of risk and control management and activities to support effective control environment;
- Independent teams outside of the business identify risks, formulate policies, procedures, and key controls, and monitor risks and controls in respective areas; independent view of business / function risk and control management ("BRCM");
- Operational Risk Management Framework ("ORMF") provides governance, standards, and tools to ensure risks and controls are embedded, sustainable and value adding; and,
- Internal Audit provides management with an independent and objective review of business activities, risk management and support functions.

The HSBC ORIC framework covers all businesses and operations of the Group. For more information on the HSBC ORIC framework, refer to Section 2.2 "Operational Risk Application & Management" on pages 10 and 11 of the attached HSBC – North America Operational Risk and Internal Control Policy Risk Management and also see the summary below. The following categories of risk are included under the definition of Operational Risk and are subject to the HSBC's ORIC management framework:

- Compliance
- Fiduciary
- Legal
- Information
- Accounting
- Tax
- External Fraud
- Internal Fraud
- People
- Political
- Physical
- Business Continuity
- Systems
- Operations
- Project

As noted in the policy, the management of Operational Risk comprises the identification, assessment, monitoring and control of operational risk so as to maintain losses within acceptable levels and to protect the Group from foreseeable future losses. Management in all businesses and support functions operating in North

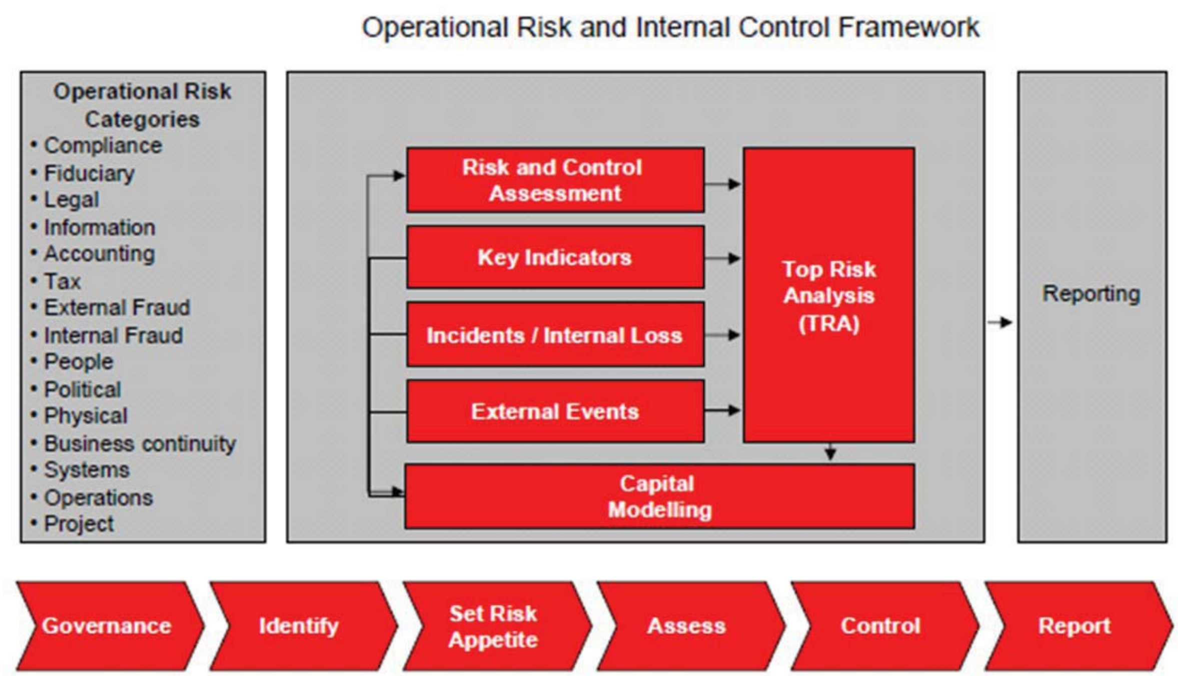
America, including Global Businesses, is responsible for designing controls to mitigate operational risk and for monitoring and evidencing the effectiveness of controls in operation. Acceptable levels of internal control should be determined by reference to the scale and nature of each business operation, but must remain compliant with the minimum standards set out in Group Standards Manual and Group Functional Instruction Manuals; ensuring appropriate levels of economic and regulatory capital in accordance with internal and external requirements.

Additionally noted in the policy, management throughout North America follows the HSBC ORIC framework, which is comprised of the following responsibilities. The application of this framework in North America is further described in various sections of the Policy (see the HSBC – North America Operational Risk and Internal Control Policy Risk Management) as referenced below.

- Assignment of responsibility for the management of operational risk and the maintenance of an appropriate internal control environment, under the oversight of a formal governance structure. Refer to Section 3 of the Policy (see the HSBC – North America Operational Risk and Internal Control Policy Risk Management, pages 14 through 24,) for details on North America's governance structure and organizational roles and responsibilities.
- Quarterly Top Risk and Control reporting at a Regional / Country level. In accordance with page 1 of the B.1.3 "Operational Risk Reporting", the Regional / Country ORIC Team reports quarterly on the North America operational risk profile, involving the relevant business and control function experts. The report is approved by the HNAH ORIC Committee; feedback from the committee's review is monitored by the Regional / Country ORIC Team. Country versions are reviewed by the HUSI and HBCA ORIC Committees. Refer to the FIM for Operational Risk profile reporting requirements.
- Identification, assessment, and reporting of operational risks by business and functional managers using the Group's standard Operational Risk and Control Assessment ("RCA") process. Refer to Section 4 of the Policy (see the HSBC – North America Operational Risk and Internal Control Policy Risk Management, pages 25 through 35) for details on North America's application of the RCA methodology
- Operational risk loss incident identification and reporting and aggregate loss reporting. Refer to Section 5 of the Policy (see the HSBC – North America Operational Risk and Internal Control Policy Risk Management, pages 36 through 42) for details of North America's loss identification and reporting processes.
- Provide assurance that key controls are designated and operating effectively through monitoring of activities. Refer to Section 4.7 of the Policy (see the HSBC – North America Operational Risk and Internal Control Policy Risk Management, pages 31 through 35) for details of the Internal Control Monitoring program that North America is implementing to support the Group framework. The roles and responsibilities of business management, risk oversight functions, and ORIC teams are described in Section 3 of the Policy (see the HSBC – North America Operational Risk and Internal Control Policy Risk Management, see pages 14 through 24).

In addition to components of the HSBC ORIC framework described above, North America considers the following components as critical to the management of operational risk and internal control and to the monitoring of North America's operational risk appetite.

- Key Indicators – The ongoing monitoring of key indicators of high-level risks to ensure risk is appropriately controlled within established limits in accordance with the Order which requires processes to document, measure, assess, and report key risk indicators. Refer to Section 4.4 of the Policy (see the HSBC – North America Operational Risk and Internal Control Policy Risk Management, pages 29 and 30) for details.
- Capital Modelling – Development of Advanced Measurement Approach (AMA) compliant quantification methodology and ongoing calculation of Regulatory and Economic Capital for Operational Risk. Regulatory Capital for HBCA is calculated under The Standardized Approach (TSA). Refer to Section 6 of the Policy (see the HSBC – North America Operational Risk and Internal Control Policy Risk Management, pages 48 and 49) for details.
- Many of the components of the Operational Risk and Internal Control Framework described above are shown in the diagram below.



Identification of Emerging Risks (Enterprise-wide and Business-level)

In January 2011, HNAH ORIC Committee commenced the Dark Corners exercise. The objectives of the exercise are:

- Self-identify latent or emerging operational risks and control issues that will benefit from management's attention and scrutiny

• Stay in front of emerging risks and control issues with early identification and coordinated response efforts • ORIC, EXCO, or other appropriate committees within the businesses and support functions should drive timely remediation and revaluation of operational risk profile (as noted in the RCA) as it relates to “dark corners” risks and controls • Escalation to HNAH ORIC Committee – assess regional impact, track progress of actions to manage risk and issues, and report as appropriate (supports the new Internal Audit management assessment grade) • Share information and experiences across businesses and support functions to avoid like risk sand issues from resurfacing and to leverage remediation efforts The businesses are asked to identify emerging risk, which are then categorized, tracked, and distributed to all business to determine if the risk are horizontally relevant. Themes are identified and formally presented on a quarterly basis to the HNAH ORIC Committee. *Business Management Operational Risk (Business-line)* Please refer to article 15(b) for additional detail related to BRCM and additional business-level processes.
Documents to be submitted with the Action Plan • FIM B.1.4 Risk and Control Assessment • FIM Appendix D.1.3 Risk and Control Assessment Guidance • D.1.4 Risk Categorization documents • HNAH Operational Risk Internal Control Target Operating Model • HSBC – North America Operational Risk and Internal Control Policy Risk Management • B.1.3 “Operational Risk Reporting”
Key HSBC Contacts for the Action Plan • [redacted] SVP Strategy, Operational Risk Management and Chief Information Risk Officer, HBIO • [redacted] SVP Default Services • [redacted], [redacted] Risk Governance and Administration, HNAH

Article 15(g)

FRB Order Reference:	*Article 15(g)*	**Corresponding OCC Article:**	*N/A*
controls to mitigate risks;			

Action Plan

Residential Mortgage Servicing activities are covered by the Business Risk and Control Management Team established by and under the direction of the SVP of Strategy, Operational Risk Management and Chief Information Risk Officer, HBIO. The BRCM Team assists in the design of key controls identified through the implementation of the Risk and Control Assessment ("RCA") methodology. This is consistent with the requirements of the Order which require that processes include controls to mitigate risk (expanded upon in the following paragraph) and monitor the effectiveness of these controls, including the key controls that mitigate material risks assessed in the areas of residential loan servicing, Loss Mitigation, and foreclosure activities. In addition, the BRCM Team will ensure that policies and procedures related to these material risks are well-designed, effective, and aligned with Group and local standards and regulations. The BRCM Team supports the business in controlling its activities and in ensuring that the business has a well-designed and effective framework of policies and procedures, as well as monitoring of controls, to mitigate operational risk impacting the business.

To expand on the existing Risk Self Assessment, Residential Mortgage Servicing adopted a new RCA in 2011 which is overseen by the HNAH Operational Risk and Internal Control ("ORIC") Team. The RCA is designed to provide the business with a forward looking view of material operational risks and to help them proactively identify and assess the key controls to mitigate risks within acceptable levels. In addition to identifying and assessing material operational risks, the RCA methodology supported by the Internal Control Target Operating Model requires the business to monitor these key internal controls. Issues and actions noted in the BRCM internal control monitoring program must be documented and progress must be monitored.

The Operational Risk and Internal Control Framework is expected to improve first line of defense management of operational risk by:
- Reducing operational events/losses;
- Reducing the occurrence of unexpected events;
- Increasing the resilience of HNAH and its subsidiaries;
- Safeguarding HSBC's reputation and regulatory standing; and,
- Setting minimum Operational Risk Management ("ORM") standards across HSBC's businesses.

Updates Based upon Independent Risk Assessment Finally, Residential Mortgage Services has received the results of Ernst & Young's Independent Risk Assessment. Residential Mortgage Services has created action plans (see Article 15(l) for the full population of action plans) for each finding. Based on the action plans as well as review of the findings, Residential Mortgage Services will update its respective policies, procedures and processes throughout 2012 to ensure that any new controls to mitigate risk are created and documented if appropriate.
Documents to be submitted with the Action Plan Not applicable.
Key HSBC Contacts for the Action Plan • [redacted] SVP Strategy, Operational Risk Management and Chief Information Risk Officer, HBIO • [redacted] SVP Default Services

Article 15(h)

FRB Order Reference:	*Article 15(h)*	**Corresponding OCC Article:**	*N/A*
procedures for the escalation of significant matters related to risks to appropriate senior officers and board committees;			

Action Plan

Operational risk functions includes both enterprise-wide operational risk as well as business-line (that practiced at the Residential Mortgage Servicing level) which include procedures for the escalation of significant matters related to risks to appropriate senior officers and board committees. Each is discussed in detail below

Enhanced HSBC Group Operational Risk and Internal Control Framework (Enterprise-wide)

An enhanced HSBC Group Operational Risk and Internal Control ("Group ORIC") Framework is in the process of being rolled out across North America. The framework has been enhanced to include a new Risk and Control Assessment ("RCA") methodology. The new RCA enhances the prior risk assessment process and has been implemented within the Residential Mortgage Servicing framework. The RCA framework process assists in the identification and assessment of material operational risks as well as the effectiveness of key controls that mitigate these risks. Additional emphasis is placed on control identification and assessment, as well as the associated monitoring and testing of key controls.

The new RCA methodology and associated guidelines were published in an updated HSBC Group Operations Functional Instruction Manual ("FIM"), dated April 2010 (See FIM B.1.4 Risk and Control Assessment, FIM Appendix D.1.3 Risk and Control Assessment Guidance, and D.1.4 Risk Categorization documents). The FIM B.1.4 Risk and Control Assessment sets out the minimum requirements for the annual Risk and Control Assessment. This is designed to provide business with a forward looking view of operational risk and to help the business proactively determine whether their key operational risks are controlled within acceptable levels. The FIM Appendix D.1.3 provides guidance to support the Operations Functional Instruction Manual through a multiple step process. The D.1.4 Risk categorization identifies the different categories of operational risk. The RCA methodology implementation in North America began in January 2011, and was executed within the business units on June 30, 2011. Full implementation and quality assurance review of the new RCA methodology is expected to be completed by December 31, 2011.

Enhanced Internal Control Target Operating Model (Enterprise-wide)

In addition, the enhanced Group ORIC framework incorporates a new Internal Control Target Operating Model ("TOM"). A North America impact analysis and implementation plan was completed in 1Q2011, and approved by the HNAH ORIC

Committee on April 6, 2011. The new framework is centered around the Business Risk Control Management ("BRCM") Team that promotes and executes on business unit ownership of monitoring of key controls. The BRCM activities are subject to independent oversight by ORIC and other "2nd line of defense" teams. (See attachment HNAH Operational Risk Internal Control Target Operating Model, which in its entirety outlines the TOM, and is summarized below.)

Pursuant to the Internal Control TOM principles:

- Management of internal controls is centered around Business / Function ownership of risk and control management and activities to support effective control environment;
- Independent teams outside of the business identify risks, formulate policies, procedures, and key controls, and monitor risks and controls in respective areas; independent view of business / function risk and control management ("BRCM");
- Operational Risk Management Framework ("ORMF") provides governance, standards, and tools to ensure risks and controls are embedded, sustainable and value adding; and,
- Internal Audit provides management with an independent and objective review of business activities, risk management and support functions.

The HSBC ORIC framework covers all businesses and operations of the Group. For more information on the HSBC ORIC framework, refer to Section 2.2 "Operational Risk Application & Management" on pages 10 and 11 of the attached HSBC – North America Operational Risk and Internal Control Policy Risk Management and also see the summary below. The following categories of risk are included under the definition of Operational Risk and are subject to the HSBC's ORIC management framework:

- Compliance
- Fiduciary
- Legal
- Information
- Tax
- External Fraud
- Internal Fraud
- People
- Political
- Physical
- Business Continuity
- Systems
- Operations
- Project

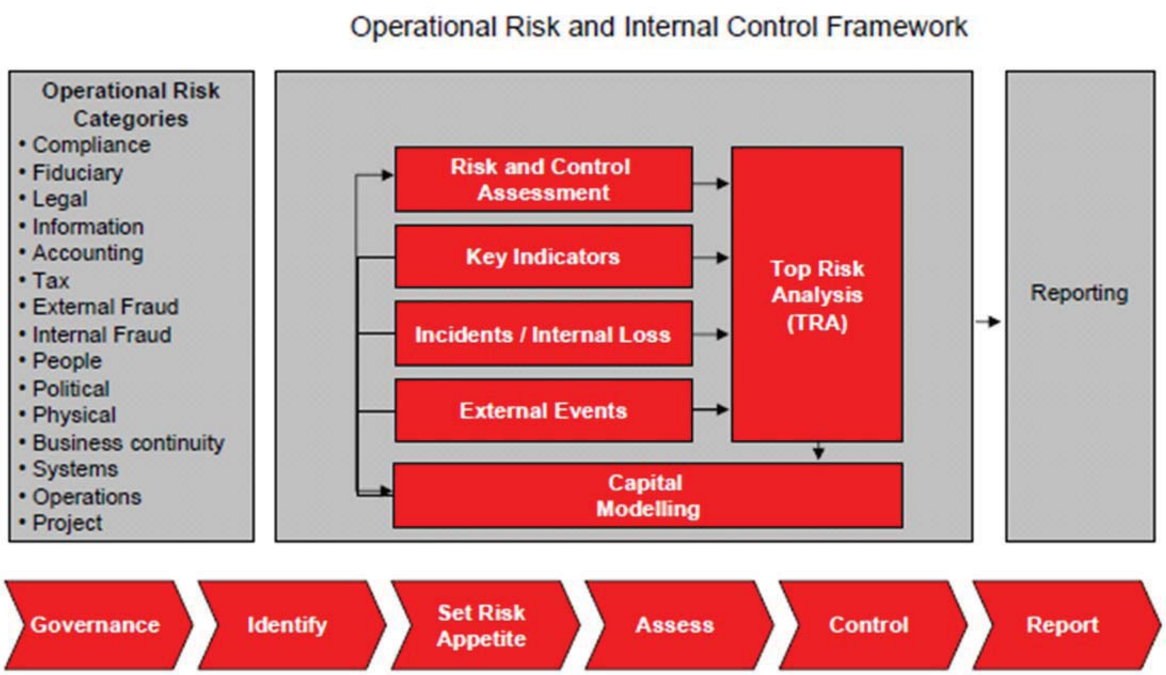
As noted in the policy, the management of Operational Risk comprises the identification, assessment, monitoring and control of operational risk so as to maintain losses within acceptable levels and to protect the Group from foreseeable future losses. Management in all businesses and support functions operating in North America, including Global Businesses, is responsible for designing controls to mitigate operational risk and for monitoring and evidencing the effectiveness of controls in operation. Acceptable levels of internal control should be determined by reference to the scale and nature of each business operation, but must remain compliant with the minimum standards set out in Group Standards Manual and Group Functional Instruction Manuals; ensuring appropriate levels of economic and regulatory capital in accordance with internal and external requirements.

Additionally noted in the policy, management throughout North America follows the HSBC ORIC framework, which is comprised of the following responsibilities. The application of this framework in North America is further described in various sections of the Policy (see the HSBC – North America Operational Risk and Internal Control Policy Risk Management) as referenced below.

- Assignment of responsibility for the management of operational risk and the maintenance of an appropriate internal control environment, under the oversight of a formal governance structure. Refer to Section 3 of the Policy (see the HSBC – North America Operational Risk and Internal Control Policy Risk Management, pages 14 through 24,) for details on North America's governance structure and organizational roles and responsibilities.
- Quarterly Top Risk and Control reporting at a Regional / Country level. In accordance with page 1 of the B.1.3 "Operational Risk Reporting", the Regional / Country ORIC Team reports quarterly on the North America operational risk profile, involving the relevant business and control function experts. The report is approved by the HNAH ORIC Committee; feedback from the committee's review is monitored by the Regional / Country ORIC Team. Country versions are reviewed by the HUSI and HBCA ORIC Committees. Refer to the FIM for Operational Risk profile reporting requirements.
- Identification, assessment, and reporting of operational risks by business and functional managers using the Group's standard Operational Risk and Control Assessment ("RCA") process. Refer to Section 4 of the Policy (see the HSBC – North America Operational Risk and Internal Control Policy Risk Management, pages 25 through 35) for details on North America's application of the RCA methodology
- Operational risk loss incident identification and reporting and aggregate loss reporting. Refer to Section 5 of the Policy (see the HSBC – North America Operational Risk and Internal Control Policy Risk Management, pages 36 through 42) for details of North America's loss identification and reporting processes.
- Provide assurance that key controls are designated and operating effectively through monitoring of activities. Refer to Section 4.7 of the Policy (see the HSBC – North America Operational Risk and Internal Control Policy Risk Management, pages 31 through 35) for details of the Internal Control Monitoring program that North America is implementing to support the Group framework. The roles and responsibilities of business management, risk oversight functions, and ORIC teams are described in Section 3 of the Policy (see the HSBC – North America Operational Risk and Internal Control Policy Risk Management, see pages 14 through 24).

In addition to components of the HSBC ORIC framework described above, North America considers the following components as critical to the management of operational risk and internal control and to the monitoring of North America's operational risk appetite.

- Key Indicators – The ongoing monitoring of key indicators of high-level risks to ensure risk is appropriately controlled within established limits. Refer to Section 4.4 of the Policy (see the HSBC – North America Operational Risk and Internal Control Policy Risk Management, pages 29 and 30) for details.
- Capital Modelling – Development of Advanced Measurement Approach (AMA) compliant quantification methodology and ongoing calculation of Regulatory and Economic Capital for Operational Risk. Regulatory Capital for HBCA is calculated under The Standardized Approach (TSA). Refer to Section 6 of the Policy (see the HSBC – North America Operational Risk and Internal Control Policy Risk Management, pages 48 and 49) for details.
- Many of the components of the Operational Risk and Internal Control Framework described above are shown in the diagram below.



Identification of Emerging Risks (Enterprise-wide and Business-wide)

In January 2011, HNAH ORIC Committee commenced the Dark Corners exercise. The objectives of the exercise are:

- Self-identify latent or emerging operational risks and control issues that will benefit from management's attention and scrutiny
- Stay in front of emerging risks and control issues with early identification and coordinated response efforts
- ORIC, EXCO, or other appropriate committees within the businesses and support

functions should drive timely remediation and revaluation of operational risk profile (as noted in the RCA) as it relates to “dark corners” risks and controls

- Escalation to HNAH ORIC Committee – assess regional impact, track progress of actions to manage risk and issues, and report as appropriate (supports the new Internal Audit management assessment grade) in accordance with the requirements of the Order to have procedures for the escalation of significant matters related to risks to appropriate senior officers and board committees
- Share information and experiences across businesses and support functions to avoid like risk sand issues from resurfacing and to leverage remediation efforts

The businesses are asked to identify emerging risk, which are then categorized, tracked, and distributed to all business to determine if the risk are horizontally relevant. Themes are identified and formally presented on a quarterly to the HNAH ORIC Committee.

Documents to be submitted with the Action Plan

- FIM B.1.4 Risk and Control Assessment
- FIM Appendix D.1.3 Risk and Control Assessment Guidance
- D.1.4 Risk Categorization documents
- HNAH Operational Risk Internal Control Target Operating Model
- HSBC – North America Operational Risk and Internal Control Policy Risk Management
- B.1.3 “Operational Risk Reporting”.

Key HSBC Contacts for the Action Plan

- [redacted] SVP Strategy, Operational Risk Management and Chief Information Risk Officer, HBIO
- [redacted] SVP Default Services
- [redacted], [redacted] Risk Governance and Administration, HNAH

Article 15(i)

FRB Order Reference:	*Article 15(i)*	**Corresponding OCC Article:**	*N/A*
the scope and frequency of comprehensive risk assessments;			

Action Plan

Operational risk includes both enterprise-wide operational risk as well as business-line (that practiced at the Residential Mortgage Servicing level) which includes the scope and frequency of comprehensive risk assessments. Each is discussed in detail below

Enhanced HSBC Group Operational Risk and Internal Control Framework (Enterprise-wide)

An enhanced HSBC Group Operational Risk and Internal Control ("Group ORIC") Framework is in the process of being rolled out across North America. The framework has been enhanced to include a new Risk and Control Assessment ("RCA") methodology. The new RCA enhances the prior risk assessment process and has been implemented within the Residential Mortgage Servicing framework. The RCA framework process assists in the identification and assessment of material operational risks as well as the effectiveness of key controls that mitigate these risks. Additional emphasis is placed on control identification and assessment, as well as the associated monitoring and testing of key controls.

The new RCA methodology and associated guidelines were published in an updated HSBC Group Operations Functional Instruction Manual ("FIM"), dated April 2010 (See FIM B.1.4 Risk and Control Assessment, FIM Appendix D.1.3 Risk and Control Assessment Guidance, and D.1.4 Risk Categorization documents). The FIM B.1.4 Risk and Control Assessment sets out the minimum requirements for the Risk and Control Assessment which is performed annually in accordance with the requirements of the Order.

This annual review is designed to provide business with a forward looking view of operational risk and to help the business proactively determine whether their key operational risks are controlled within acceptable levels. The FIM Appendix D.1.3 provides guidance to support the Operations Functional Instruction Manual through a multiple step process. The D.1.4 Risk categorization identifies the different categories of operational risk. The RCA methodology implementation in North America began in January 2011, and was executed within the business units on June 30, 2011. Full implementation and quality assurance review of the new RCA methodology is expected to be completed by December 31, 2011.

Enhanced Internal Control Target Operating Model (Enterprise-wide)

In addition, the enhanced Group ORIC framework incorporates a new Internal Control [redacted] ("[redacted] A North America impact analysis and implementation plan was completed in 1Q2011, and approved by the HNAH ORIC Committee on April 6, 2011. The new framework is centered around the Business Risk Control Management ("BRCM") Team that promotes and executes on business unit ownership of monitoring of key controls. The BRCM activities are subject to independent oversight by ORIC and other "2nd line of defense" teams. (See attachment HNAH Operational Risk Internal Control Target Operating Model, which in its entirety outlines the TOM, and is summarized below.)

Pursuant to the Internal Control TOM principles:

- Management of internal controls is centered around Business / Function ownership of risk and control management and activities to support effective control environment;
- Independent teams outside of the business identify risks, formulate policies, procedures, and key controls, and monitor risks and controls in respective areas; independent view of business / function risk and control management ("BRCM");
- Operational Risk Management Framework ("ORMF") provides governance, standards, and tools to ensure risks and controls are embedded, sustainable and value adding; and,
- Internal Audit provides management with an independent and objective review of business activities, risk management and support functions.

The HSBC ORIC framework covers all businesses and operations of the Group. For more information on the HSBC ORIC framework, refer to Section 2.2 "Operational Risk Application & Management" on pages 10 and 11 of the attached HSBC – North America Operational Risk and Internal Control Policy Risk Management and also see the summary below. The following categories of risk are included under the definition of Operational Risk and are subject to the HSBC's ORIC management framework:

- Compliance
- Fiduciary
- Legal
- Information
- Tax
- External Fraud
- Internal Fraud
- People
- Political
- Physical
- Business Continuity
- Systems
- Operations
- Project

As noted in the policy, the management of Operational Risk comprises the identification, assessment, monitoring and control of operational risk so as to maintain losses within acceptable levels and to protect the Group from foreseeable future losses. Management in all businesses and support functions operating in North America, including Global Businesses, is responsible for designing controls to mitigate operational risk and for monitoring and evidencing the effectiveness of controls in operation. Acceptable levels of internal control should be determined by reference to the scale and nature of each business operation, but must remain compliant with the minimum standards set out in Group Standards Manual and Group Functional Instruction Manuals; ensuring appropriate levels of economic and regulatory capital in accordance with internal and external requirements.

Additionally noted in the policy, management throughout North America follows the HSBC ORIC framework, which is comprised of the following responsibilities. The application of this framework in North America is further described in various sections of the Policy (see the HSBC – North America Operational Risk and Internal Control Policy Risk Management) as referenced below.

- Assignment of responsibility for the management of operational risk and the maintenance of an appropriate internal control environment, under the oversight of a formal governance structure. Refer to Section 3 of the Policy (see the HSBC – North America Operational Risk and Internal Control Policy Risk Management, pages 14 through 24,) for details on North America's governance structure and organizational roles and responsibilities.
- Quarterly Top Risk and Control reporting at a Regional / Country level. In accordance with page 1 of the B.1.3 "Operational Risk Reporting", the Regional / Country ORIC Team reports quarterly on the North America operational risk profile, involving the relevant business and control function experts. The report is approved by the HNAH ORIC Committee; feedback from the committee's review is monitored by the Regional / Country ORIC Team. Country versions are reviewed by the HUSI and HBCA ORIC Committees. Refer to the FIM for Operational Risk profile reporting requirements.
- Identification, assessment, and reporting of operational risks by business and functional managers using the Group's standard Operational Risk and Control Assessment ("RCA") process. Refer to Section 4 of the Policy (see the HSBC – North America Operational Risk and Internal Control Policy Risk Management, pages 25 through 35) for details on North America's application of the RCA methodology
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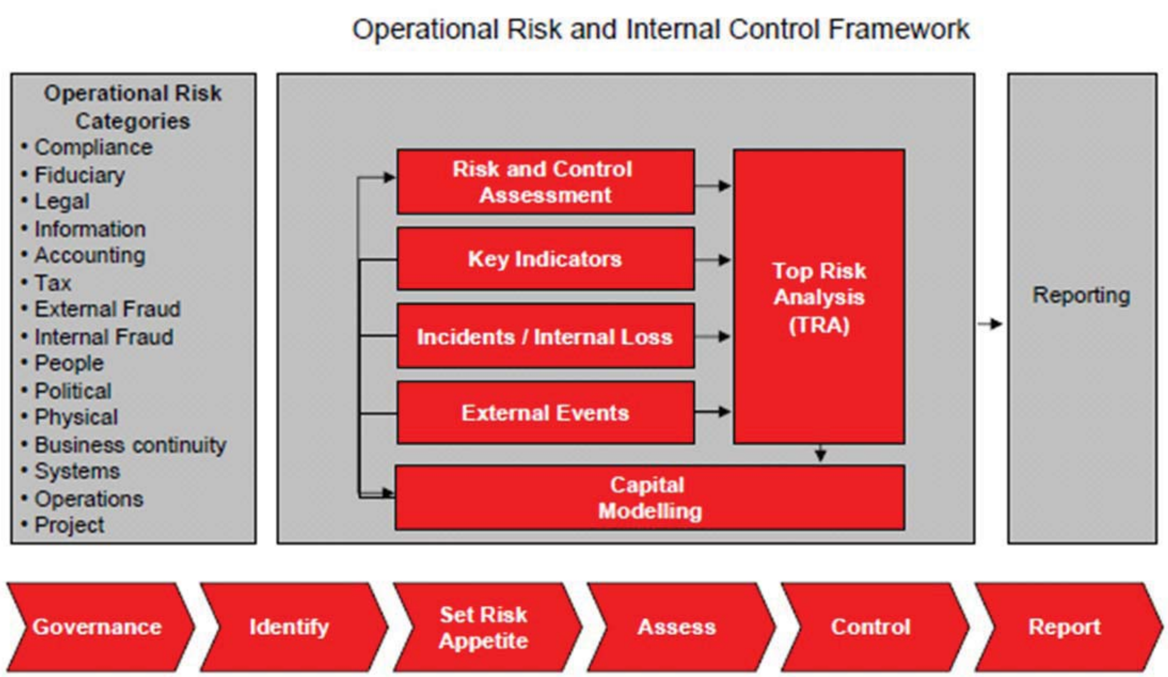
- Many of the components of the Operational Risk and Internal Control Framework described above are shown in the diagram below.



Updates Based upon Independent Risk Assessment Finally, each of the lines of defense (i.e., Residential Mortgage Services, Compliance SDCA, Internal Audit, TRAC) has received the results of Ernst & Young's Independent Risk Assessment. Each team will review the findings (see Article 15(l) for the complete list of findings and management's response) and determine whether any changes are required to each team's risk assessment scope.
Documents to be submitted with the Action Plan • FIM B.1.4 Risk and Control Assessment • FIM Appendix D.1.3 Risk and Control Assessment Guidance • D.1.4 Risk Categorization • HNAH Operational Risk Internal Control Target Operating Model • HSBC – North America Operational Risk and Internal Control Policy Risk Management • B.1.3 Operational Risk Reporting
Key HSBC Contacts for the Action Plan • [redacted] SVP Strategy, Operational Risk Management and Chief Information Risk Officer, HBIO • [redacted] SVP Default Services

Article 15(j)

FRB Order Reference:	*Article 15(j)*	**Corresponding OCC Article:**	*N/A*
a formal method to ensure effective communication of established risk management policies, procedures, and standards to all appropriate business line and other staff;			

Action Plan

The operating principles of the HNAH Risk Framework requires processes to adequately identify risk levels, requires a method to ensure effective communication of established risk management policies, procedures, and standards to all appropriate business line and other staff, establish limits for compliance, legal, and reputational risks and provide for regular review of risk limits by appropriate senior management and the board of directors or an authorized committee of the board of directors. The operating principles are as follows:

- Ensure all risks are appropriately identified, measured, managed, controlled and reported;
- Develop, communicate & implement appropriate risk-related policies, procedures, & processes in collaboration with business units, functional areas and Group;
- Provide an independent review and assessment of risks by regularly reviewing risk levels and risk management practices and raising concerns to senior executive management and the Board as necessary.;
- Provide regular and ad hoc reports to senior executive management, the Board, and Group on existing and emerging risks, with recommendations to avoid, eliminate, or mitigate outsized risks;
- Ensure compliance with all relevant laws, regulations, and regulatory requirements, including Basel II;
- Assess overall capital needs and enhance capital allocation
- Set risk appetite in line with capital availability and overall business strategy;
- Establish and promote a risk management culture that appropriately balances risks and rewards;
- Assist the Board and senior executive management in establishing risk tolerances, limits, and performance measurements across HNAH;
- Share and leverage best practices across Group;
- Continually assess and monitor the risks HNAH faces, and regularly reappraise its risk appetite and align its risk profile accordingly; and,
- Formulate an internal view of capital requirements relative to risk.

This framework brings together risk functions across North America to ensure a consistent policy, process, and practice is applied across legal entities. An overarching HNAH Risk Limits Framework, which is maintained by the North America Risk organization in conjunction with internal business partners from Finance, Legal and Compliance, and the business lines, provides for the identification, communication, limitation, and management of all risks across HNAH, both for discontinued and ongoing business lines.

Updates Based upon Independent Risk Assessment Additionally, Residential Mortgage Services has received the results of Ernst & Young's Independent Risk Assessment. Residential Mortgage Services has created action plans (see Article 15(l) for the full population of action plans) for each finding. Based on the action plans as well as review of the findings, the Residential Mortgage Services team will update its respective policies, procedures and/or risk management standards as it deems necessary and determine the best means to communicate changes. When policy and/or procedure updates are made, communication of any operational changes to employees is performed within the business by the business management, as well as via a Breaking News channel where procedural updates are electronically communicated via [redacted] ("[redacted] Finally, communication and/or training to the business may be conveyed in one of the following ways: • Informally, by on-the-job coaching or "whiteboard sessions" – Incorporated into team meetings as necessary and created/distributed by the line of business • Formally documented and communicated via information deck created and distributed by the business • Through training developed in conjunction with the North America HR Learning Team (see Article 11 for a complete description of the training program).
Documents to be submitted with the Action Plan Not applicable.
Key HSBC Contacts for the Action Plan • [redacted] SVP Strategy, Operational Risk Management and Chief Information Risk Officer, HBIO • [redacted] SVP Default Services • [redacted], SVP General Compliance • [redacted], [redacted] Risk Governance and Administration, HNAH

Article 15(k)

FRB Order Reference:	*Article 15(k)*	**Corresponding OCC Article:**	*N/A*
periodic testing of the effectiveness of the risk management program; and			

Action Plan

HNAH has an established Testing and Risk Assessment Compliance Group ("TRAC") function as a second line of defense, a part of HNAH Compliance, which is consistent with the requirements of "Compliance Risk Management Programs and Oversight at Large Banking Organizations with Complex Compliance Profiles," dated October 16, 2008 (SR 08-08/CA 08-11). TRAC is responsible for conducting on-going compliance testing and risk assessments independent of the business unit compliance as well as the HNAH Risk Management Framework.

TRAC develops and maintains a Compliance Risk Mitigation Program, which establishes HNAH-wide consistent standards and processes to enable management to proactively identify, measure, monitor, test, and report compliance risks and controls as noted on page 6 of the HSBC - North America Compliance Risk Mitigation Program. This information is used to obtain reasonable assurance that HNAH and its subsidiaries are complying with material regulatory requirements and Group Compliance policies and standards.

Additionally, below is a listing of TRAC's specific roles and responsibilities, which are provided in greater detail within the HSBC - North America Compliance Risk Management Program Manual on page 31 and include:

- developing and maintaining firm-wide compliance risk assessment processes, methodologies and tools;
- leading the execution and oversight of the General Enterprise-wide Risk Assessment and facilitating and performing quality assurance of the results of the Detail Self Assessment, in conjunction with business line management and business line Compliance Officers;
- developing and maintaining firm-wide compliance monitoring and review programs, policies, procedures, processes and standards;
- annually reviewing business line/Compliance Officer compliance programs and processes, including Compliance Officer issue remediation activities;
- annually reviewing the effectiveness of the HNAH Compliance Risk Management Program;
- administering the Matters Requiring Attention ("MRAs") tracking and validation program to include tracking of MRAs, validating remediation and reporting MRA status to Group Compliance EXCO, senior management, Risk Governance Committees, and Compliance Committee; and
- maintaining processes to track, escalate, and report material compliance issues and any corrective actions identified through examinations, inspections,

compliance monitoring and reviews, or other means.

In addition to TRAC, Group Audit North America ("AUN") is an integral part of the Group and HNAH control environment and provides periodic testing of risk functions. It provides management and the Board with an independent and objective review of business activities, risk management and support functions. AUN's compliance-related duties and responsibilities include (see pages 34 and 35 of the attached HSBC – North America Compliance Risk Management Program Manual for additional detail):

- Maintain a dynamic auditable universe of compliance risk entities which are evaluated and updated as business or regulatory conditions change;
- Utilize compliance risk assessments as the baseline for the annual audit plan and the development of compliance audit programs;
- Validate compliance risk assessments performed by business units and HNAH Compliance;
- Maintain and execute compliance audit programs and procedures;
- Ensure that the auditors performing compliance audits possess and maintain required skill sets and knowledge of current regulatory requirements;
- Integrate compliance risk reviews and testing into business unit operational audits. This includes testing the effectiveness of business unit compliance processes and adherence with compliance requirements;
- Evaluate the design and operating effectiveness of business unit and HNAH compliance programs;
- Assess the HNAH Compliance function and RCO's effectiveness in managing compliance risk and overseeing and supporting the implementation of the Program;
- Render an annual assessment of the overall effectiveness of the HNAH compliance program to senior management and the HNAH Compliance Committee;
- Provide the HNAH Compliance Committee with status updates and results on compliance relate audits;
- Provide timely reports to line management, executive management and compliance management on the results of risk evaluations and testing activities; and
- Monitor resolution of issues raised in previous audits and report to executive management monthly and RMC and ORIC quarterly.

Finally, TRAC has received the results of Ernst & Young's Independent Risk Assessment (see Article 15(I) for the full population of action plans) and will be enhancing the TRAC Testing Plan for 2012 taking into consideration management's response to each Compliance related EY Independent Risk Assessment test finding. As part of HNAH Compliance and as a second line of defense function, TRAC will ensure the business unit's compliance risk assessment is current and accurate on an annual basis. In addition, TRAC will also ensure through regular compliance reviews that the business lines have implemented appropriate testing and monitoring programs designed to ensure the effectiveness of controls in place to facilitate

adherence to applicable laws and regulation
Documents to be submitted with the Action Plan • HSBC - North America Compliance Risk Mitigation Program • HSBC – North America Compliance Risk Management Program Manual
Key HSBC Contacts for the Action Plan • [redacted], SVP General Compliance • [redacted] – SVP General Compliance (TRAC)

Article 15(l)

FRB Order Reference:	*Article 15(l)*	Corresponding OCC Article:	*N/A*

the findings and recommendations of the independent consultant described in paragraph 12 of this Order regarding risk management.

Action Plan

Section 12 of the Order required HSBC to retain an independent consultant to conduct a written, comprehensive assessment of HSBC's risk in mortgage servicing operations, particularly in the area of loss mitigation, foreclosure, and administration and disposal of other real estate owned, including but not limited to operations, compliance, and transaction, legal and reputational risk. Ernst and Young ("EY") was the independent consult selected to complete the risk assessment.

While there are no changes to the Operational Risk Management framework, the Business Unit BRCM will focus on observations from the assessment and incorporate into the Internal Control Monitoring Plan. As previously expected, RCA, which is the starting point for the internal control monitoring activities, was completed by North America in June 2011. Thus, implementation and adherence with the internal control standards was initiated in the second half of 2011 and full implementation is scheduled to commence in 2012.

Best Practices that will be incorporated into the 2012 ICM Plan are as follows:

Information Technology – The BRCM understands that as manual processes are relied upon, it increases the risk of potential human error. The Operational Risk Management framework requires that controls be assessed as either preventative or detective. In addition to these requirements, the business unit is enhancing their process to identify controls as either automated or manual. Adhoc reporting will be developed to capture this information and will be used during control monitoring testing. Where appropriate and warranted, the BRCM will recommend technology enhancements to enhance or sustain operational controls. Identification and reporting of automated and manual controls will be completed prior to the end of 1Q12.

Evidence of Controls – As part of the Internal Control Monitoring and Testing, the BRCM will review for direct or derived evidence of consistent functioning of controls. The BRCM will review the control activity trail and will retain testing results in the Operational Risk Share Point. Detailed Procedures on how testing will be conducted and tools used in the assessment of controls will be completed prior to February 28, 2012.

Quality Control – Where a quality control review is being conducted within the functional areas of Servicing, and where the quality control is being relied upon as a key control, the BRCM will report the measures and results in a dashboard to senior management. These Key Indictors will be reviewed monthly to ensure results are satisfactory and or action plans are established as appropriate. Additionally, as part of the Internal Control Monitoring Plan, the BRCM will schedule control testing to determine the controls are working as intended. Dashboards and retention of quality control results within BRCM will be completed no later than the end of 1Q12.

In addition to the best practices noted above, management responded to both EY's enterprise observations as well as specific test findings. The full set of enterprise observations and management's responses are provided below. Management responses for all testing results categorized as "Needs Improvement", "Unsatisfactory", "No Evidence of Control Activity" or "Non-Testable" are provided on pages 23 – 81 of the attached Management Response to Risk Assessment Testing Results.

Enterprise Observation – Key Employee Retention

[redacted]

Management Response as of August 11, 2011

As described below, Residential Mortgage Servicing has processes and procedures in place, which it will continue to use, to mitigate key employee retention risk. Capacity management / resource planning, along with succession and retention plans, are in place to manage the employees' workloads and address key employee retention risk.

<u>Capacity management and resource planning</u>

Residential Mortgage Servicing management has and will continue to review and manage employees' workloads. As described below, Residential Mortgage Servicing currently has several capacity management / resource planning processes in place.

The HNAH Risk Management function is responsible for conducting capacity management / resource planning for, but not limited to, loan modification, Loss Mitigation, and foreclosure areas. The tactical and strategic analyses for these areas are based on the risk forecasts and include planned attrition, hiring, staffing movements, and strategy changes. The model, which is used by the HNAH Risk Management function to conduct capacity management / resource planning, compares the expected monthly headcount against the demand as driven by the risk forecast to determine the need for hiring, staffing movements, or utilization of overtime. The planning methodology for capacity and staff workloads is continually monitored and updated based on market conditions, internal data, and forecasts. Throughout the year, the HNAH Risk Management function communicates and coordinates staffing requirements by department to HNAH Finance to ensure they receive appropriate consideration in the budgeting process. Based on this process, analysis is performed for each department's short- and long-term capacity needs.

Short-term, or tactical, rolling capacity planning process is performed one month in advance to determine strategy and capacity needs. Department managers conduct capacity planning meetings throughout the month. The final tactical capacity planning meeting for the upcoming month is held with business unit management and other support functions during the last week of the month. Long-term, or strategic, rolling capacity analyses for the aforementioned areas are performed and planned based on the estimated operations staffing requirements. These analyses are performed continually and assist management in developing the appropriate capacity initiatives, account migrations, or strategy changes. Senior management and the Bi-Weekly Retail Operations Governance ("BROG") Committee review and discuss the long-term capacity plans during the third week of the month and bi-weekly, respectively.

Capacity management / resource planning processes for areas outside of default operations differ from the process described above. Operational Risk Management ("ORM") capacity management / resource planning is performed in conjunction with HNAH Finance. As part of this process, HNAH Finance provides, long and short-term planning support based on periodic Rolling Operating Plan ("ROP") forecasts, which are typically adjusted semi-annually. Short and long-term decisions and recommendations are made based on actual data, historical trends, and feedback from the business partners.

For Mortgage Electronic Registration System ("MERS") Reconciliation, capacity management / resource planning is performed by MERS management. On an annual basis, the MERS Reconciliation function creates a ROP, to define overall resourcing needs and allocations. The MERS Reconciliation management team monitors and reviews resource needs based on the actual and historical benchmarks and productivity measures. In addition, an employee Standard Per Hour ("SPH") benchmark has been defined based on time study analysis by the MERS management team. Each employee's actual productivity is measured against the SPH through a productivity database managed by the MERS team. Historic productivity data from the database is used as a key input into the ROP. Decisions and strategies for resource planning are discussed amongst MERS management team and business partners to identify resource needs.

Succession and retention plans

In addition to capacity planning, Residential Mortgage Servicing has in place succession and retention plans for key employees. Specifically, HSBC has in place a Resourcing-Led Talent Strategy aimed substantially to improve the ability to provide a ready, high-quality, internal pipeline to fill key positions against immediate and future business needs. In accordance with the Resourcing-Led Talent Strategy, Residential Mortgage Servicing conducts Talent Management Review sessions on a semi-annual basis to discuss, debate, and confirm decisions based on merit of those employees identified by senior management, line managers, and the HNAH talent identification module in the talent pipeline. The most current talent management session for Residential Mortgage Servicing was conducted in July 2011.

The results of the Talent Management Review sessions are leveraged by Residential Mortgage Servicing management and business areas to develop succession plans. The succession plan process identifies individuals who have the potential to fill key roles and vacancies as defined by the business. It supports the business strategy by ensuring a strong and realistic pipeline of potential candidates is available for key vacancies and, more broadly, supports business continuity and risk management. Refer to Attachment 1 – “Talent Review Guidelines for HR and line managers 2011,” pages 3 through 7, and Attachment 2 – “Succession Planning Guidelines for HR and line managers 2011,” pages 3 through 8,- for further details.

Individual risk assessment and mitigation plans are also developed in an effort to retain key talent. Residential Mortgage Servicing management evaluates both quantitative and qualitative factors, such as financial compensation and rewards, career development and goals, and additional roles and responsibilities within the institution that may interest the individual. Risk mitigation plans of senior management and other identified key employees are reviewed on an as needed basis, based on industry or organization events, but not less than annually. The last retention planning for Residential Mortgage Servicing was performed in June 2011.

Management Update as of October 10, 2011

Observation closed by HSBC - No further action deemed necessary

Enterprise Observation – Information Technology

[redacted]

[redacted]

Management Response as of August 11, 2011
Currently, Residential Mortgage Servicing utilizes three key applications – [redacted] and [redacted] - for residential mortgage servicing. Both [redacted] and [redacted] are widely used within the mortgage servicing industry and include automated functionalities which, when combined with Residential Mortgage Servicing's existing processes, results in a sound control environment. HBIO management, however, acknowledges and understands that [redacted] which is a proprietary system used by HBIO, has limited automated functionalities and places more reliance on manually intensive controls. Given that HBIO residential mortgage business is a liquidating business, HBIO management is taking several steps, as described below, to determine which [redacted] technology enhancements can provide the most benefits in risk mitigation. HBIO management is reviewing and prioritizing the list of key controls provided by E&Y (as a result of the risk assessment review) to determine which [redacted] related controls would benefit the most from automation and is working with the HSBC Technology and Services ("HTS") to evaluate the feasibility of implementation. Additionally, HBIO management is reviewing the [redacted] detective controls maintained by the Operational Risk and Control ("ORIC") Committee to determine which key controls can provide the most benefit if automated. Currently, ORIC requires that controls be classified as preventative or detective but does not require identifying which controls are automated.
Management Update as of October 10, 2011
No further update at this time

Enterprise Observation– Policies and Procedures
[redacted] o Collections/Care, Disbursements, Lien Release and formalized updated procedure

[redacted]

Management Response as of August 11, 2011

Residential Mortgage Servicing is enhancing its policies and procedures related to residential mortgage loan servicing, Loss Mitigation, loan modification, and foreclosure operations. Every department is responsible for ensuring that internal controls are sufficient to protect Residential Mortgage Servicing's interests and reputation. Fundamental to this process is ensuring that the policies and procedures are readily available for employees' reference. Policies and procedures are required to be kept up to date and be sufficiently comprehensive. This ensures that Residential Mortgage Servicing consistently treats its customers and employees in a fair and ethical manner.

Residential Mortgage Servicing is subject to many legal requirements that vary by state and local municipality. As a result, it has adopted more than 100 policies and over 3, 000 procedures that address these variations. Management is committed to revising and updating procedures as necessary (e.g., to reflect changes in legal requirements or supervisory guidance). To that end, Residential Mortgage Servicing began reviewing its foreclosure procedures prior to the commencement of the interagency horizontal review of mortgage foreclosure policies and practices conducted in the fourth quarter of 2010, and it continues to make updates as processes are strengthened. Procedures are being updated on a rolling basis, and foreclosures will not resume in a particular state before the applicable procedures have been completed for that state. As noted in the Mortgage Servicing and Foreclosure Practices Consent Order Progress Reports, which were submitted to the OCC and FRB on July 29, 2011, policies and procedures specific to foreclosure related activities, Loss Mitigation and key processes within residential mortgage servicing such as Collateral Management and Servicemembers Civil Relief Act ("SCRA") are expected to be updated by September 12, 2011. Additional Residential Mortgage Servicing policies and procedures specific to Loss Mitigation related activities and key processes such as Adverse Action Suspended Letter Procedure - Consumer Mortgage Lending ("CML") and Optional Insurance Procedure –MortgageCorp ("MC") are expected to be updated in accordance with the timeline outlined in the Good Governance Initiative, which is described below (refer to Attachment 3 – "Good Governance – Project Overview," pages 2 through 5 for details).

Furthermore, to ensure that Residential Mortgage Servicing has fully documented policies and procedures and that employees understand and follow them consistently, management has established the Good Governance Initiative. This initiative aims to ensure that there are proper procedures in place for applicable residential mortgage servicing processes, and that these procedures are clear, concise, thorough, accurate and well-understood by employees. In coordination with this initiative, policies and procedures are expected to be certified by the end of the fourth quarter of 2011 by the business process owners.

Management Update as of October 10, 2011

Residential Mortgage Servicing continues to move forward with policy and procedure remediation. Foreclosure and Loss Mitigation policies and procedures identified as requiring revision as a result of the mortgage foreclosure policies and practices review are at 100% complete, with additional revisions along with new procedures being addressed as they are identified. Through the efforts of the Good Governance Initiative, all existing policies and procedures are being reviewed to ensure compliance with applicable governing documents and to ensure all documentation is thorough, clear, and effective. The business is on track to certify all policies and procedures by the end of the fourth quarter of 2011.

Enterprise Observation – Training

[redacted]

Management Response as of August 11, 2011

As described below, HBIO and HBUS have existing training in place for personnel involved in residential mortgage servicing and foreclosure processes and operations, including collections, Loss Mitigation, and loan modification. In addition, HBIO and HBUS enhanced training in April 2011 and will continue to develop new training courses, as needed.

HBIO and HBUS currently have several Loss Mitigation training modules in place for residential mortgage servicing personnel. These modules are primarily voluntary, instructor-led sessions offered to both new hires and as on-going training. Additionally, web-based training sessions are offered to qualify for certifications. To date, the primary Loss Mitigation training modules are Collections Call Model training and instruction for the HBIO loan modification tool. The Collections Call Model training prepares employees to interface with customers involved in the Loss Mitigation process. Loan modification tool training helps employees navigate the [redacted]

[redacted] (“[redacted] the primary technology used for modifications. Additional training materials are developed and conducted informally by the Skill Qualification Training (“SQT”) team, which is a support function dedicated to enhancing employee skill sets by creating and delivering process training.

In April 2011, HBUS and HBIO engaged the Learning and Development (“L&D”) Department to enhance its foreclosure training. The enhanced foreclosure training is comprised of 4 modules: Foreclosure Introduction, Foreclosure Processing, Affidavit Processing and Notary Training. Two of the four modules (Affidavit Processing and Notary Training), focus on business records training and are designed to educate employees executing affidavits on topics such as meeting legal requirements for personal knowledge and notary requirements. Training classes for these modules commenced in June 2011. It is expected that foreclosure employees will complete the required Instructor Lead Training no later than the end of the third quarter. The content for the remaining two modules, Foreclosure Introduction and Foreclosure Processing, were developed and approved internally. Training sessions for the new modules were conducted between July 11- 14, 2011, with make-up sessions to be scheduled no later than the end of the third quarter of 2011, as noted in the Mortgage Servicing and Foreclosure Practices Consent Order Progress Reports, which were submitted to the OCC and FRB on July 29, 2011. Each module is designed with an assessment to ensure comprehension of materials and reporting is in place to monitor compliance with the training requirements.

Additionally, HBUS and HBIO have developed a training framework to educate employees on the Single Point of Contact (“SPOC”) policies and procedures. The framework consists of classroom training sessions, and has been developed and approved by appropriate parties. After completing the training sessions, participants are required to pass an assessment. Existing employees to be assigned as SPOC Agents will receive this training as part of the on-boarding process.

Furthermore, HBUS and HBIO are developing further training courses for other areas of residential mortgage servicing and default, including the following:

- Default
  - Bankruptcy
  - Charge-off
  - Collections
  - Foreclosure
  - Loss Mitigation Retention
  - Loss Mitigation Exit Strategies
  - Loan Modification
  - Real Estate Owned
  - Invoice Processing
- Mortgage Servicing
  - Customer Service Phones
  - Escrow Administration

- Lien Release
- MERS
- Payment Services
- Records Administration
- General Servicing (Research, Payoffs, Special Loans, SCRA)

These modules have been prioritized and are targeted for completion from December 2011 through June 2012. By December 31, 2011, a more detailed deployment timeline will be developed. New modules will be developed concurrently with the L&D Department to produce a more formalized structure, including attendance tracking, exam history, and certification requirements. Refer to Attachment 4 – "Learning and Development Functional Training Gap Analysis" for additional detail.

Management Update as of October 10, 2011
The Foreclosure team has created the training platform and conducted the training sessions in August 2011. In addition, there are 18 training courses on the schedule to be designed through a total of seven phases with a completion of the design and rollout scheduled for June 2012.

Management Response to Control Design Findings

As part of the risk assessment, prior to performing the control testing, EY performed a control design assessment. The observations from the control design assessment and HSBC management's responses thereto are stated below.

Escrow, Taxes and Insurance
The escrow process captures the servicing of escrow / non-escrow accounts and management of the relationship with the third-party escrow servicing vendor (Corelogic). The escrow process covers activities from receipt of customer payment through remittance to the appropriate tax or insurance agency.
Risk
[redacted]
Observation
[redacted]

[redacted]

Management Response as of August 11, 2011

Management is already aware of the issue noted in this observation and, as described below, based on the strategic evaluation and cost / benefit analysis conducted, management has determined that it is willing to accept the risk of not implementing systemic controls in [redacted] to mitigate this risk.

Currently, a third party provider, Corelogic, is used to provide tax information and perform proactive searches on delinquent taxes for non-escrowed borrower's real estate tax accounts maintained on [redacted] and [redacted] Corelogic performs searches of tax status with the applicable counties in an effort to identify any delinquent tax balances prior to a loss of lien at tax sale or an expired redemption date, and advances payment based upon established disbursement guidelines. While Corelogic is not used to perform proactive search on non-escrowed borrower accounts maintained on [redacted] the Escrow Department personnel monitor and review for payment the tax bills and/or notifications from taxing authorities, and process disbursements according to the documented Business Unit policies and procedures.

Residential Mortgage Servicing continually evaluates and reviews its policies, procedures, and processes, and in connection with a review conducted in the fourth quarter of 2010, HBIO evaluated its practices of monitoring and paying taxes on non-escrowed borrower accounts maintained in the [redacted] system. The Credit Risk function, HNAH Finance, and the Servicing Organizations (i.e., mortgage servicing and default) performed a cost benefit analysis of non-escrowed borrower accounts within [redacted] This analysis was documented and reported to HBIO's senior management in the fourth quarter of 2010 and it was decided that the costs of completing proactive searches outweigh the benefits due to the number of complex system changes which would be required to be made to [redacted] Additionally, it was determined by senior management that the timeline required to enhance the system used by the HBIO residential mortgage business, which is a liquidating business, was not feasible. HBIO's management acknowledges and understands the potential risk of financial loss with this decision. Refer to Attachment 5 – "Tax Search for [redacted] for additional information on the analysis performed.

Management Update as of October 10, 2011

Observation closed by HSBC - No further action deemed necessary

Disbursements

The disbursements process includes payments made on behalf of loans in default status for expenses including Broker Price Opinions ("BPO"), attorney fees, property preservation, and property inspection. Invoices received directly from vendors are either handled internally or routed to HBIO's offshore team for processing.

Risk

[redacted]

Observation

[redacted]

Management Response as of August 11, 2011

HBIO is committed to evaluating its policies and procedures regarding the assessment of fees and charges, recoverable and non-recoverable and/or claimable by the investor. HBIO is currently reviewing these processes and will strengthen preventive and detection controls (and enhance quality controls) as applicable.

To date, HBIO has engaged internal and external legal counsel to review its existing practices specific to fees and charges assessed by the foreclosure firms. In addition, to ensure compliance with state requirements, Compliance has completed a 50 state review of default related fees such as Property Preservation and BPO. A comprehensive review is underway and includes the frequency of fee assessments, documentation supporting relevant services performed, and systemic controls designed to ensure duplicate charges are not assessed. This detailed review will be completed by September 12, 2011. After the detailed review is complete, the control enhancements may require changes to the current technology environment and as such, a plan for implementation will be developed based on the quantity of controls requiring enhancement. Implementation efforts will commence in the fourth quarter of 2011 and may continue into 2012 depending on the quantity of controls requiring enhancements.

Management Update as of October 10, 2011

The comprehensive review has been amended and enhanced with an updated completion date of September 30, 2011. Control enhancements for reporting and QC will be completed early in the fourth quarter 2011 with a target of IT implementation towards the end of first quarter 2012.

Special Loans

Special loans include, but are not limited to Usury loans, Adjustable Rate Mortgage ("ARM") loans, balloon loans, and SCRA loans. A dedicated team of analysts are assigned to service special loans.

Risk

[redacted]

Observation

[redacted]

Management Response as of August 11, 2011

Residential Mortgage Servicing has a number of preventative and detective controls to ensure ARM loans on [redacted] and [redacted] are adjusted appropriately. These controls include restricted system access, a report to identify accounts on which rates need to be adjusted, and management review of a sample of adjusted loans.

Residential Mortgage Servicing has a dedicated Special Loans team, which is comprised of 27 individuals, to monitor and manage rate adjustments on ARM loans. System access to adjust rates and indices is restricted to members of the Special Loans team. Access entitlements are given only to members of the Special Loans team. System access is administered and monitored by the Business Information Risk Officer ("BIRO").

Currently, a daily ARM loan exception report is generated from the system that identifies only accounts whose rates need to be updated. The Special Loans analysts utilize this report to make adjustments to the applicable loans. Once loans are adjusted, management performs a quality assurance check by sampling and reviewing 10% of ARM adjustments.

[redacted] However, as explained above, the access to adjust ARM loans is restricted to the individuals within the Special Loans team and is administered by BIRO. [redacted] However, management will implement a detective control which will include creating a report (generated from the applicable systems) to identify adjustments outside the current adjustment period. This report will be generated no less than monthly and the management of the Special Loans team will review and follow up on the loans noted in the report. Based on prioritization, it is estimated that this report will be in place on or before the end of November 2011.

Management Update as of October 10, 2011

The Special Loans management team is currently working with MIS to create reporting that identifies adjustments to ARM loans that happen outside of contract time periods.

Foreclosure

Various third party attorneys are engaged in the execution of foreclosure actions to assist in compliance with specific state and local laws and regulations.

Risk

[redacted]

Observation

[redacted]

Management Response as of August 11, 2011

Residential Mortgage Servicing is enhancing its vendor management processes within residential mortgage loan servicing and is investing in significant resources to ensure appropriate oversight and monitoring of Third-Party Providers, which includes law firms. The existing Operational Risk Management team is expanding and a centralized dedicated team, the Third Party Operational Risk Management Group ("TPORMG"), has been formed. The TPORMG will engage with VRM to provide oversight, management and subject matter expertise for residential mortgage loan servicing vendor relationships, including law firms and trustees that provide foreclosure and bankruptcy related services to Residential Mortgage Servicing in accordance with applicable foreclosure or bankruptcy laws, rules, and regulations (collectively the "Firms" or "Law Firms"). This centralized dedicated team, while working closely with VRM, Legal, and Information Security Risk, will serve as the primary point of contact and relationship manager for material vendors and will review, evaluate and take appropriate actions on any relevant risk assessment requirements for these vendors. The TPORMG will develop and implement the necessary tools, including a database and related user manuals to monitor Third-Party Providers by September 12, 2011.

The TPORMG will ensure that Residential Mortgage Servicing departments comply with the VRM Policy and Procedures and adhere to the Group Operations Functional Instruction Manual ("FIM"). Specifically, TPORMG is focusing on the following:

- Controls to initiate, renew, or terminate Third-Party Providers and coordination of the ongoing periodic reviews, monitoring and assessment of Third-Party Providers;
- Development and monitoring of vendor performance against defined service levels, performance levels, and contract terms and coordinate the distribution of a Master Services Agreement ("MSA") to be executed by approved existing and future Law Firms;
- Comprehensive schedule of periodic audits and reviews to include prescribed timeframes;
- Dashboard reporting used to monitor, manage and age Third-Party Provider remediation efforts to include Information Security Risk, Legal and Operations' audit findings;
- Improved reporting and oversight of relevant vendor related documentation and the accurate capture and reporting of inventory;
- Reporting and trending of customer complaints specific to third parties; and
- An in-depth review of legacy relationships to ensure compliance with the VRM Policy and Procedures.

A Governance Oversight Committee ("Committee") comprised of individuals from Operations, TPORMG, Compliance and Legal has been established and a charter for the Committee has been developed. One of the key objectives of the Committee is to evaluate and make decisions regarding Third-Party Providers based on the results of the periodic Third-Party Provider reviews.

In addition to the establishment and centralization of the TPORMG, HNAH Legal has developed specific procedures for the review and management of Law Firms (the "Law Firm Procedures") to assess the legal risk. Management is finalizing a user manual to supplement the Law Firm Procedures and expects to complete it by September 12, 2011. The Legal department has been and will continue to oversee and manage reviews of Law Firm compliance with applicable laws, rules and regulations, and TPORMG will also oversee and ensure that reviews of Third-Party Providers are completed to monitor compliance with quality, reputational, operational and other risks consistent with Residential Mortgage Servicing policies, procedures and practices and the VRM Program.

Additionally, Residential Mortgage Servicing management, together with HNAH Legal, is developing the standard Master Services Agreement for Law Firms that includes performance metrics and work standards. This agreement will be completed by August 11, 2011, and distributed to Law Firms by September 12, 2011. Also, the HSBC Best Practices for Its Outside Foreclosure Firms ("Best Practices"), which contains guidelines to ensure compliance with the letter and spirit of foreclosure, procedural and other laws, rules and regulations, and applicable HSBC policies and procedures have been developed and were distributed to active foreclosure Law Firms along with the HSBC Standard Non-Disclosure Agreement ("NDA"). To date, all Law Firms have executed the Non-Disclosure Agreement and all but one Law Firm have formally acknowledged the Best Practices requirements. Adherence to the Best Practices will be validated during the periodic review of the Firms.

For additional information on the progress related to third party management, refer to the Mortgage Servicing and Foreclosure Practices Consent Order Progress Reports, which were submitted to the OCC and FRB on July 29, 2011.

Management Update as of October 10, 2011

TPORMG accomplishments:

1. Implementation of the TPORMG database by 9/12/11. Database will allow for dashboard reporting to monitor, manage and age Third party Provider remediation efforts, track review schedules, communication to attorney firms as well as escalated complaints. Currently in the process of mapping vendor data into database as well as transferring contracts, reviews and any available scorecards into TPORMG Sharepoint database.
2. Completed Third Part Risk Management Procedures as well as Law Firm Termination Procedures.
3. Distributed MSA and revised Best Practices to 81 law firms which contain defined service levels. Following up for return from each firm. Assessing current measurements in place on [redacted] for monitoring vendor performance and prioritizing future enhancements to improve monitoring of attorney firms.
4. Completing gap analysis on MSA work standards and current scorecards for all non-attorney Third Party Vendors.
5. Completed in depth review of legacy relationships to ensure compliance with VRM Policy and Procedures.

Research

The account research process includes the receipt and resolution of customer research requests including: credit bureau, demographic changes, payment histories, loan documents, cease and desist, and fee waivers. Upon resolution, the appropriate response is sent back to the customer and logged in a tracking tool.

Risk

[redacted]

[redacted]

Observation

[redacted]

Management Response as of August 11, 2011

Residential Mortgage Servicing management is aware of the issue noted in this observation and is in the process of remediation. For [redacted] and [redacted] the turnaround time for customer inquiries can be tracked and monitoring within those systems or in the [redacted] (“[redacted] solution, which is a system in which incoming and outgoing correspondence is imaged and retained. [redacted]

Previously the Research Department generated a Turnaround Time Report from the [redacted] to track and monitor the turnaround times for customer inquiries related to the accounts maintained on [redacted] As set forth below, a system enhancement was implemented to address this matter. However, in the interim, as a mitigating control, the Research Department team tracked customer inquiries, including volumes and managed turnaround times, through a manual reporting process. In addition, managers performed quality assurance checks by reviewing a minimum of 10 responses per Research Department representative each month.

Management engaged the HTS to re-engineer the process and enhance the functionality. Refer to Attachment 6 – 4013 – “CML RESPA QWR – Functional Design,” pages 7 through 16 for additional details regarding the system enhancement. The system enhancement will be able to handle the increased reporting needs and allow users to track that responses or acknowledgement letters are sent to customers timely to comply with the Real Estate Settlement Procedures Act (“RESPA”) and Dodd

Frank Act requirements. This technology enhancement was implemented on August 7, 2011.

Management Update as of October 10, 2011

The Research team has validated that the reporting to ensure proper monitoring of non-standard customer responses has been remediated and is currently being utilized by the business.

Technology

The Technology section comprised an evaluation of the general IT general control environment (security, change management, logical access, operations, etc.,) as it relates to the key operational areas.

Risk

[redacted]

Observation

[redacted]

Management Response as of August 11, 2011

Residential Mortgage Servicing management is aware of the issue noted in this observation and remediation is in process. In the 2010 CML Line of Business Risk Assessment dated February 17, 2011, which also includes MC residential mortgage servicing functions, Residential Mortgage Servicing management acknowledged and self-identified that Residential Mortgage Servicing has a partial inventory of their key information assets. The report recommended that Residential Mortgage Servicing should complete the inventory of key information assets (i.e., applications, vendors, data transmissions, projects, and Local Area Network directories). This will assist the prioritization of activities and initiatives necessary to evaluate exposure or compromise to the confidentiality, integrity and availability of those information assets.

Currently, HSBC has a two pronged approach to managing the risk of its inventory of applications and systems. At the organizational level, HSBC North America maintains an inventory of key applications and systems which are critical to its business functions. The single inventory of North American applications is stored in a single, global repository, also containing the inventories for other regions within HSBC. This inventory is monitored and updated according to the business application and system requirements. The applications and systems included in the list are prioritized and ranked using a risk-based approach, resulting in ratings from two areas: the business owner via Information Security Risk ("ISR") and technology via Disaster Recovery ("DR"). Assigning and identifying priority of the applications and systems is dependent upon but not limited to the business unit, application and/or system importance to the business, application and system dependency, business continuity plans, and run time objectives. In addition, during this process, the application to business services and business services to application relationships are identified to understand the multiple technology dependencies across North America. This continuous effort is enforced by the HSBC DR team with assistance from Information Security and Business Information Risk Officers of the North American business units. Each application and system in the inventory is also aligned to an owner(s) within information technology and business unit(s).

When managing the risk of its inventory of applications and systems, HSBC utilizes two scoring methods to define risk. First, ISR performs a process called Group Application Security Risk Assessment ("GASRA") against the applications in the HSBC North America inventory, which results in a rating from 1 to 5 (5 representing the greatest risk). This rating is referred to as the Business Impact Assessment ("BIA") score.

Second, the GASRA information, combined with the Service Level Agreements ("SLAs") for the services provided by the underlying applications, and a resulting Recovery Time Objective ("RTO") results in a DR plan in which the applications are given a letter grade of A thru D. A letter grade of A indicates the application must return to service followed by the remaining subsequent letter grades. The combination of Business Criticality and System interdependency determines the order in which the systems are returned to service in the event of a disaster. Each selected application is tested once or more per year to validate the RTO.

The process by which North America Software Delivery keeps the application inventory in synch with the GASRA process and with the DR process is an ongoing effort with ISR and BIRO on the business side, and DR and Quality Delivery on the technology side.

At the business unit level, management also maintains an inventory of applications and systems which it risk ranks based on established criteria including but not limited to business importance, system dependency, and risk. As noted above, Residential Mortgage Servicing management has self identified that it has only a partial inventory of key information assets. Residential Mortgage Servicing management is currently in the process of documenting, reviewing, and risk ranking the key business applications and systems. This process is expected to be completed by February 2012.

Management Update as of October 10, 2011

The HSBC BIRO team is on target to complete the process of documenting, reviewing, and risk ranking the key business applications and systems by the February 2012 delivery date.

Risk

[redacted]

Observation

[redacted]

Management Response as of August 11, 2011

Residential Mortgage Servicing management acknowledges and understands the need to enhance the monitoring of DBA activities to mitigate the risk of unauthorized access. This observation was previously identified by Group Audit North America and is noted by management as an area of improvement across HSBC globally.

HSBC has undertaken an exercise to select, implement and utilize a database monitoring tool. HSBC began implementing a database activity monitoring software, [redacted] in the third quarter of 2009. [redacted] supports database activity monitoring along with the ability to monitor privileged users.

Implementation of [redacted] was initiated following a risk based approach with a focus on Sarbanes-Oxley ("SOX") related databases. Implementation proceeded until the second quarter of 2010 when IBM acquired [redacted] and imposed a significant cost increase to HSBC. The implementation was placed on hold while HSBC and IBM negotiated new terms. Negotiations concluded in the second quarter of 2011, and the contract is expected to be finalized by mid-September 2011. Once the contract is executed, licensing and hardware requirements will be finalized and a risk based deployment plan will be developed to implement [redacted] across HSBC.
Management Update as of October 10, 2011
No update at this time
Risk
[redacted]
Observation
[redacted]
Management Response as of August 11, 2011
Residential Mortgage Servicing management is aware of the issue noted in this observation and remediation is in process. In the 2010 CML Line of Business Risk Assessment dated February 17, 2011, which also includes MC residential mortgage servicing functions, Residential Mortgage Servicing management acknowledged and self-identified that Residential Mortgage Servicing needs to strengthen the access controls over its applications and supporting infrastructure to mitigate the risk of unauthorized access to information. Currently, Residential Mortgage Servicing participates in the [redacted] Program, supported by HSBC North America Information Security Risk, which provides an automated solution to certifying high risk

applications. Five high risk applications (i.e., [redacted] and [redacted][1] which support Residential Mortgage Servicing are included in the [redacted] Program. The automated certification is performed on an annual basis by the line managers with direct reports that have high risk access to in-scope systems. Additionally, individuals that own IT system accounts are also asked to recertify the need for those accounts and associated entitlements during the recertification process. In addition to the automated annual certification process explained above, each business is required to conduct a periodic entitlement review on a risk-based approach for applications and supporting infrastructure which are key to its business. As noted above, Residential Mortgage Servicing management has self identified that Residential Mortgage Servicing should continue to strengthen access controls. Residential Mortgage Servicing management acknowledges that to strengthen access controls, including conducting periodic entitlement review, it first needs to create an inventory of key applications and systems (including supporting infrastructure) and risk rank them to determine the frequency of the entitlement review. As noted above, the Residential Mortgage Servicing management is currently in the process of documenting, reviewing, and risk ranking the key business applications and systems. Residential Mortgage Servicing management will utilize this risk ranked application and system inventory list to determine the frequency of the entitlement review. This process is expected to be completed by February 2012.
Management Update as of October 10, 2011
The HSBC BIRO team is on target to complete the process of documenting, reviewing, and risk ranking the key business applications and systems by the February 2012 delivery date.

Documents to be submitted with the Action Plan

- Management Response to Risk Assessment Testing Results
- Talent Review Guidelines for HR and line managers 2011
- Succession Planning Guidelines for HR and line managers 2011
- Good Governance - Project Overview
- Learning and Development Functional Training Gap Analysis
- Tax Search for [redacted]
- 4013 - CML RESPA QWR - Functional Design

Key HSBC Contacts for the Action Plan

- [redacted] SVP Strategy, Operational Risk Management and Chief Information Risk Officer, HBIO
- [redacted] SVP Default Services

[1] Only [redacted] and [redacted] were in scope for the purpose of E&Y risk assessment review.