

**Meeting Between Staff of the Federal Reserve Board and HSBC**  
**March 22, 2016**

**Participants:** Thomas Boemio, Felton Booker, Fang Du, Juan Climent, Sean Healey, Elizabeth Macdonald, Mark Van Der Weide, Asad Kudiya, Mark Buresh, and Greg Frischmann (Federal Reserve Board)

Gerard Mattia, Stewart James, James Chew, Thomas J. Rosenkoetter, John Cassidy, and Manuel Sebastian (HSBC)

**Summary:** Staff of the Federal Reserve Board met with representatives of HSBC to discuss the Board's outstanding proposal on long-term debt (LTD) and total loss-absorbing capacity (TLAC) requirements for the U.S. intermediate holding companies (IHCs) of foreign global systemically important banks (G-SIBs). The HSBC representatives (i) encouraged the Board to consider firm-specific characteristics in calibrating the LTD/TLAC requirements for IHCs of foreign G-SIBs, (ii) encouraged the Board to permit IHCs of foreign G-SIBs to meet the LTD/TLAC requirements with external debt issuances, and (iii) expressed concern that the LTD requirements applicable to IHCs of foreign G-SIBs may cause LTD instruments issued by such IHCs to be treated as equity rather than debt for tax purposes. A presentation provided by HSBC that describes these issues in greater detail is attached.

Attachment



# Meeting with the Federal Reserve Regarding TLAC NPR

March 22, 2016



## Overview of Three Key Issues

- **We will focus on three interrelated points in today's discussion:**
  - Issue One: The requirement to issue all internal TLAC does not allow HSBC Group to implement an efficient MPoE strategy for its US operations
  - Issue Two: The impact of the proposed requirements on HSBC Group does not reflect the non-systemic nature of HSBC Group's US operations
  - Issue Three: The LTD Requirements impose significant costs that neither US GSIBs nor local US banking groups have to bear

## Three Key Issues

1. The Proposed Rules' requirements for a Covered IHC to issue TLAC solely to its parent will create dependencies between HSBC Group in the US and the wider HSBC Group that may prejudice the implementation of an MPoE resolution strategy.
  - As such, we respectfully suggest the Board should allow Covered IHCs with a proposed MPoE resolution strategy to issue TLAC to third parties.
2. HNAH's operations non-systemic and small in scale, both in the context of the key GSIBs in the US as well as the wider HSBC Group. HNAH is a stand-alone US Covered IHC and operates through several wholly owned US domiciled and regulated entities with the same capital, liquidity and governance requirements as any other BHC and national bank.
  - As such, we believe it does not pose a systemic risk to US financial stability.
  - Essentially, HNAH is economically analogous to regional US BHCs which are not subject to any TLAC requirements, but which lack the potential for additional parent support to which HNAH has access.
  - The Board should retain flexibility to adjust both total TLAC and LTD to reflect the relative importance of the US operations of a FBO to US financial stability.
3. The requirements for a contractual conversion trigger and an explicit subordination clause are not justified and impose significant costs.
  - They are only applied to Covered IHCs and not Covered BHCs, but pose the material risk of the instruments being treated as equity for tax purposes, instead of debt.
  - We urge the Board to harmonize the LTD eligibility criteria between Covered IHCs and Covered BHCs in order to achieve the goal of consistent national treatment.



## Issue One:

The Requirement to Issue All  
Internal TLAC Does Not Allow HSBC  
Group to Implement an Efficient  
MPoE Strategy for its US Operations

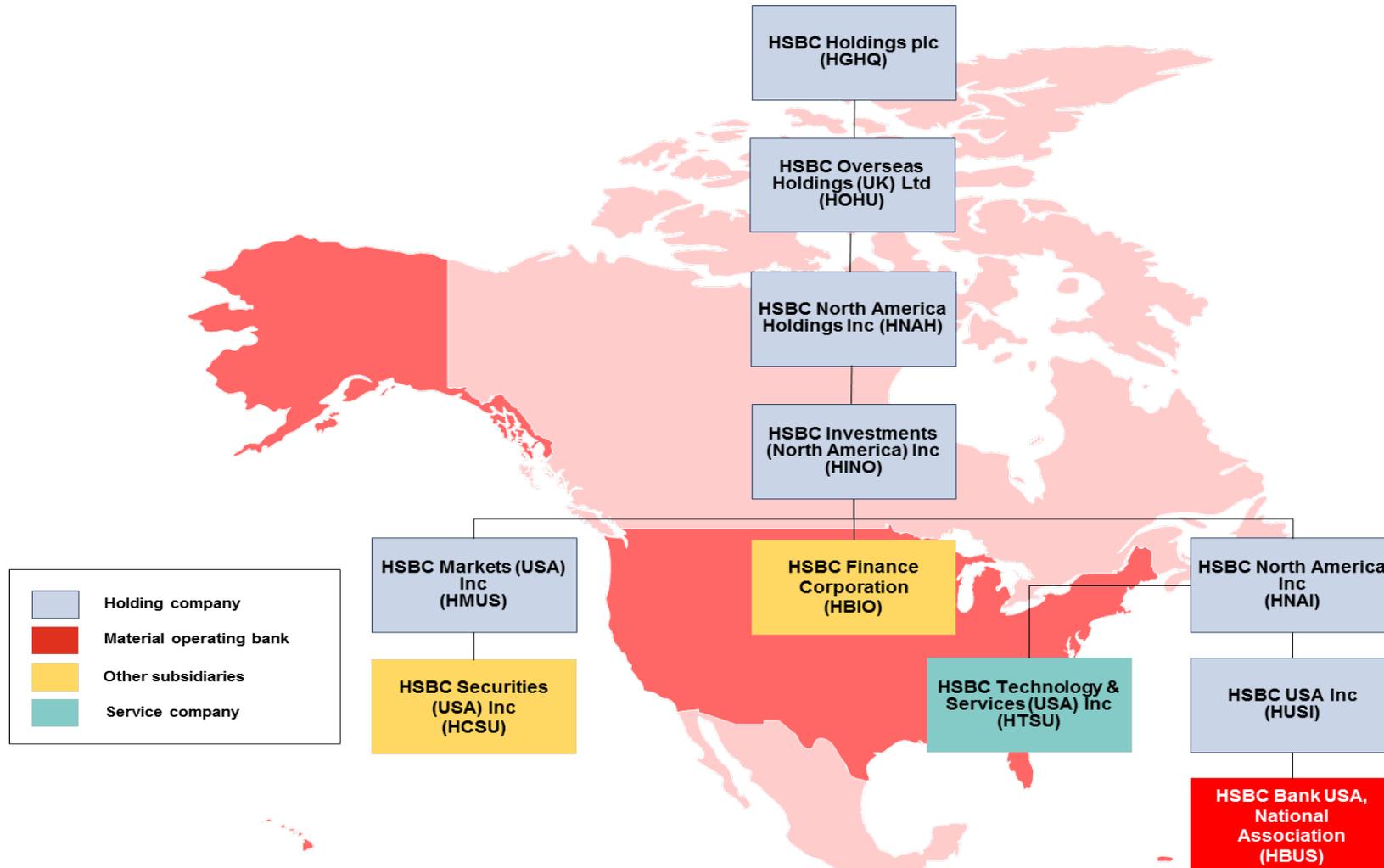
# Proposed HSBC Group Resolution Strategy

- **The requirement under the Proposed Rules for each Covered IHC to issue TLAC solely to its parent will create dependencies between HSBC Group in the US and the wider Group thereby prejudicing one of the virtues of HSBC Group's current structure.**
- The proposed HSBC Group resolution strategy is based on the resolution of regional or national groups of affiliated companies in a MPoE approach.
  - This provides for HSBC Group to be resolved by reference to its three main resolution hubs of the UK, US and Hong Kong with the applicable national regulator leading the resolution of each hub site and its domestic and overseas subsidiaries.
  - The HSBC Group's external TLAC would be issued by each of the hub sites to the market to provide the local regulator with the means of carrying out a bail-in to recapitalize the hub without involving the remainder of the HSBC Group or requiring co-operation with other regulators.
- The MPoE approach is tailored to the IHC requirements contained in the Board's Enhanced Prudential Standards for FBOs under Section 165 of the Dodd-Frank Act.
  - Those requirements treat IHCs very much like US domestic BHCs with equivalent US capital, liquidity and regulatory standards.
  - For FBOs such as HSBC Group, that are structured to conduct independent US operations and whose regulators are considering a MPoE approach, these IHC requirements generally support their resolution strategy.

# HSBC US Group Resolution Strategy

- **HNAH is more analogous in structure to certain US BHCs, notwithstanding its ownership by a FBO. It would be expected to enter domestic resolution proceedings on its own and pass any losses to its creditors through that process, under a MPoE resolution. The Proposed Rules would undermine these efforts by requiring HNAH to be directly linked to its parent FBO, which is inconsistent with a MPoE resolution strategy.**
- Under the MPoE approach, the US regulators would have full control over the resolution of HSBC's US operations and there is a clear path to implementation of the resolution strategy.
- The HSBC Group's resolution strategy for its US operations is set out December 2015 submission of its US resolution plans.
  - As with previous submissions, the US resolution plans provide for the resolution of the HNAH sub-group on a national MPoE basis whereby all six of the US material entities, including HSBC Group's national bank and its dedicated US service company, are resolved or placed into bankruptcy proceedings on an entity-by-entity basis.
- There are limited financial dependencies between HSBC businesses in the US and these businesses have limited financial dependencies with the wider HSBC Group, which facilitates an MPoE strategy.
  - The primary sources of funding of HSBC Group's US operations are derived within each of the material entities under HNAH.
- Similarly, shared operational services within the US are primarily supplied by a pre-existing service company.
  - The limited operational services provided by the wider HSBC Group used by the HSBC businesses in the US have been or in the process of being moved to a service company structure.
  - This will remove inter-bank dependencies across HSBC Group.

# HSBC's Stand-alone US Group Corporate Structure



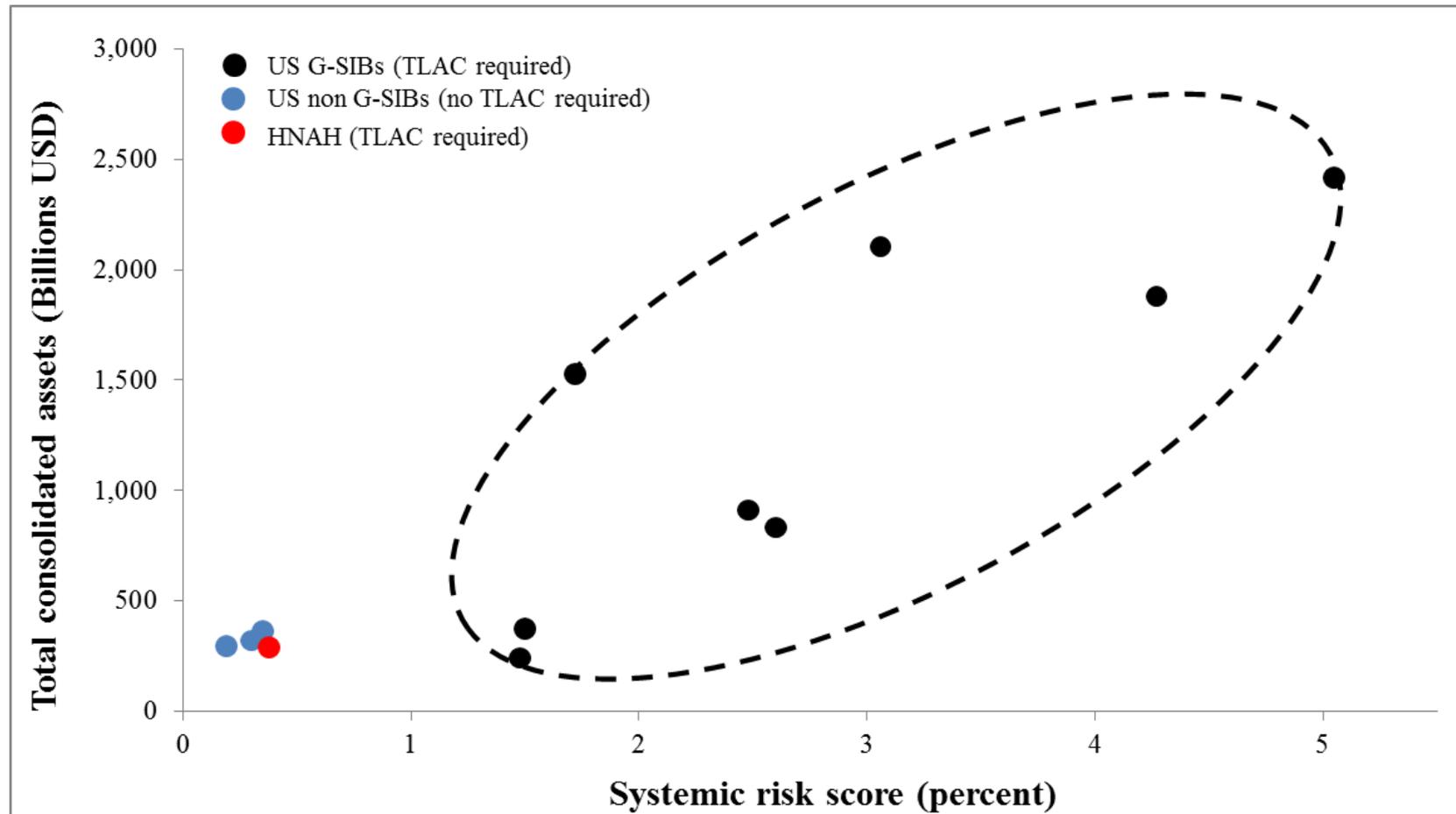
As of September 30, 2015



## Issue Two:

The Impact of the Proposed  
Requirements on HSBC Group Does  
Not Reflect the Non-systemic Nature  
of HSBC Group's US Operations

## Systemic Risk: HNAH's Closest Peers Are US Non-GSIBs



The figure compares HNAH to the eight US G-SIBs and to some of its US peer institutions (US Bancorp, PNC and Capital One) on the basis of total consolidated assets as of December 2013 and the institutions' 2013 systemic risk scores, according to data from the Board's National Information Center and Treasury's Office of Financial Research. Consolidated assets are as reported on the Board's National Information Center, as of December 31, 2013. Systemic risk score data is as reported in the February 2015 paper published by the Office of Financial Research, "Systemic Importance Indicators for 33 U.S. Bank Holding Companies: An Overview of Recent Data See Office of Financial Research", at 2 (Feb. 2015).

<https://financialresearch.gov/briefs/files/2015-02-12-systemic-importance-indicators-for-us-bank-holding-companies.pdf>.



## Issue Three:

The LTD Requirements Impose  
Significant Costs That Neither US  
GSIBs Nor Local US Banking  
Groups Have to Bear

# Cost Impact on the HSBC Group of the Internal LTD Requirement

- Holding LTD to comply with TLAC requirements will impose additional costs on the HSBC Group:
  - Senior unsecured debt is currently predominantly held by HUSI. This TLAC Proposal requires that **LTD needs to be held at the HNAH level**:
    - Costs associated with **credit rating** – HNAH vs HUSI
  - Internal LTD must contain a **contractual conversion trigger** (not required for Covered BHCs). This is anticipated to be costly based on Canadian/Australian Tier 2 instruments currently in existence.
  - Internal LTD must be **contractually subordinated** (only structural subordination is required for Covered BHCs).
  - The requirement for a contractual conversion trigger and explicit subordination clause pose the risk of the instruments being treated as **equity for tax purposes for IHCs, instead of debt**. Interest payments on such instruments would not be deductible for tax purposes.

# Proposed Solutions

- We respectfully request that the Federal Reserve:
  - Issue final rules that adjust the internal issuance requirement and permit MPoE banks to issue TLAC externally
  - Retain the flexibility to adjust both total TLAC and LTD to reflect the relative importance of an FBO's US operations by treating HSBC Group's US operations as a non-GSIB US BHC or, at most, like a GSIB US BHC without the need for a GSIB buffer and with a reduction in calibration of TLAC and LTD requirements
  - Harmonize the LTD eligibility criteria between Covered IHCs and Covered BHCs in order to achieve the goal of consistent national treatment by:
    - Issuing final rules that remove the requirement for the internal LTD contractual terms that would, under current tax standards, cause internal LTD to be treated as equity for tax purposes; or
    - Working with the Treasury and IRS to issue regulations or guidance that unequivocally confirm that internal LTD will be treated as debt for tax purposes notwithstanding the required contractual terms