HSBC

June 30, 2016

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Robert deV. Frierson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Total Loss-Absorbing Capacity, Long-Term Debt, and Clean Holding Company Requirements for Systemically Important U.S. Bank Holding Companies and Intermediate Holding Companies of Systemically Important Foreign Banking Organizations; Regulatory Capital Deduction for Investments in Unsecured Debt of Systemically Important U.S. Bank Holding Companies (Docket No. R-1523 and RIN 7100 AE-37)

Dear Mr. Frierson:

Following the meeting held on March 22, 2016, HSBC North America Holdings Inc. ("HNAH"), on behalf of itself and its parent company, HSBC Holdings plc, and its affiliates worldwide (collectively, the "HSBC Group" or "Group") wishes to make a supplementary submission to its original letter, dated 19 February 2016, on the recent proposal (the "Proposed Rules") by the Board of Governors of the Federal Reserve System (the "Board") to apply total loss-absorbing capacity ("TLAC") requirements to systemically important US bank holding companies ("Covered BHCs") and intermediate holding companies ("Covered IHCs") of systemically important foreign banking organizations ("FBOs").

This supplementary submission covers three areas:

(a) metrics which the Board may wish to reference if considering whether to permit a specific Covered IHC to issue External TLAC;

(b) metrics which the Board may wish to reference if considering any possible variations to the level of External TLAC to be issued by a Covered IHC; and

(c) alternatives which the Board may wish to consider when reviewing a possible variation in the proposed requirement that the issuer of TLAC must be the ultimate IHC within any FBO.

1. <u>Metrics for Considering External TLAC Issuance</u>

In our original letter, HSBC Group set out the case for allowing a Covered IHC to have the option to issue instruments eligible as TLAC to third parties, in a similar manner to Covered BHCs, where it is possible to demonstrate that the US subsidiaries of FBOs can be resolved within the US.

In the event of resolution of a Covered IHC which has issued External TLAC, these instruments would be bailed-in and their holders would become shareholders in the Covered IHC. As a result, it is possible that the Covered IHC may no longer be part of its current Parent Financial Group. In these circumstances, it will be important to ensure that the Covered IHC is capable of operating on a stand-alone basis in terms of finances, management and operations.

A number of criteria have been set out below which may be relevant. Some of these metrics are binary (i.e. a simple pass or fail) but others are criteria designed to establish the broad nature of the relevant business so as to determine whether it fits into the category of Covered IHCs which could be resolved separately from their Parent Financial Group.

Resolution Strategy *[Criteria 1]*

Under any circumstances, allowing a Covered IHC to issue External TLAC would need to be part of a resolution strategy for the Parent Financial Group which specifies a point-of-entry in the US and that this strategy would need to have been accepted by the Crisis Management Group for the Parent Financial Group. While permission to allow issuance of External TLAC by a Covered IHC (or Alternative BHC, as defined below) would lie with the Federal Reserve, the Federal Deposit Insurance Corporation and US Regulatory Authorities participating in the Crisis Management Group could be involved in such discussions and they would have the benefit of the detailed resolution plan submissions in respect of the US operations which are submitted on a regular basis.

Financial Dependencies

It may be appropriate to consider two metrics for financial dependencies, both of which would be measured over a trailing one year time-period at the time of the application to issue External TLAC.

(a) Covered IHC Concentration *[Criteria 2]*

This would measure the extent to which the operations of the FBO are concentrated in the Covered IHC and its subsidiaries and not undertaken through US branches of FBOs. More complex FBO structures may complicate any resolution in the US if subsidiary and branch operations are being resolved at the same time and, in some circumstances, it may be more desirable if more diverse operations are resolved by the Home Resolution Authority through the use of Internal TLAC.

We would suggest that any Covered IHC seeking to issue External TLAC should have:

(i) at least 75% of its operations in the US within the Covered IHC structure (as measured by total assets), with the remaining 25% to account for US branches/ agency subsidiaries that are to subject to Covered IHC requirements; and

(ii) US operations outside of the Covered IHC (i.e. in US branches of FBOs) amounting to less than $50bn in assets.

Banks not meeting this criteria but with a clear separation between their IHC and other US operations could make special representations to issue External TLAC.

As discussed later, further considerations may be applicable to entities which have all or substantially all of their US operations within a Covered IHC, effectively operating solely through entities which are directly US regulated and supervised for all purposes, alongside and are analogous to US BHCs.

(b) Liability Concentration *[Criteria 3]*

The greater the extent to which the liabilities of the Covered IHC are concentrated in the US, the easier the resolution process is likely to be, involving fewer overseas regulators and counterparties.

Any analysis of liability concentration should, however, exclude the regulatory capital and TLAC provided by the Parent Financial Group which will be extinguished or diluted in resolution. Instead, it should be focused on the other sources of funding for the Covered IHC as these are the liabilities which may be bailed-in at the point of resolution. The major liabilities for consideration would, therefore, be long and short term debt securities, inter-bank funding and deposit funding, whether or not the IHC or its subsidiaries are FDIC-insured.

We would suggest that any Covered IHC seeking to issue External TLAC should have less than 25% of its funding (excluding regulatory capital and TLAC) in the form of, *inter alia*, wholesale funding provided by the members of the Parent Financial Group, deposits from customers in non-US branches of the US bank, inter-bank liabilities from foreign banks (excluding the US branches of foreign bank organizations) or debt securities issued by the Covered IHC or subsidiaries thereof outside of the US.

Managerial Dependencies *[Criteria 4]*

A number of steps have been taken to ensure that Covered IHCs are not dependent on their foreign parent groups for management including:

(a) 12 CFR Part 252, Enhanced Prudential Standards for Bank Holding Companies and Foreign Bank Organizations, including capital, liquidity, and risk management standards;

(b) assessments undertaken as part of recovery and resolution plans, as submitted on an annual basis; and

(c) an increased focus on US capabilities within day-to-day supervisory assessments.

We would expect, therefore, that all Covered IHCs would be able to demonstrate that they have taken practical steps to eliminate critical managerial dependencies on entities outside of the Covered IHC. Accordingly, we have not set out any quantitative assessment for this criteria.

Operational Dependencies *[Criteria 5]*

We believe that prior to any Covered IHC being permitted to issue External TLAC it should be subject to a supplementary review of its operational dependencies.

Operating Expenses, as set out in financial statements, should be classified on the basis of where and by whom these are undertaken. This would be based on the expenses incurred by the Covered IHC and its subsidiaries over a one-year time period to non-IHC entities and the expenses which are paid directly by these entities, for example, expenses in the form of salary and other payments to staff. A significant portion of the US costs may be undertaken (i) within the Covered IHC itself; (ii) in bankruptcy-remote service companies within the Parent Financial Group both inside and outside of the US; and (iii) by third party providers which are not part of any financial services group.

We suggest that the assurance of operational continuity can be assessed by considering the proportion of operating expenses which are payable to banking entities outside of the IHC structure. Although some portion of these services may be provided by other parties which may be subject to financial instability, if these payments are small, there are good reasons for believing that additional payments could be made which would not be excessive in the short term and which would either deliver continuity of service or an additional form of supply (assuming that, as should be the case, there will be resilience options for critical systems).

We would propose that any Covered IHC seeking to issue External TLAC should have:

(a) over the longer term, a maximum of 5% of its total operating expenses are payable to banking entities outside of the Covered IHC, which, for the sake of clarity, shall not include payments to Service Company operating within financial services groups which are designed to be bankruptcy remote from operating banks in the group)[1]; or

(b) in the short term, as resolution plans are developed further and TLAC requirements are implemented, a maximum of 15% of its operating expenses currently within the criteria set out above and a detailed, demonstrable and agreed plan to reduce these costs to a maximum of 5% within 2 years.

We believe that any Covered IHC which has passed all of these tests should be considered by the Board as eligible to External TLAC in satisfaction of the requirements, subject to the discretion of the Board if other matters arise.

[1] Total costs are set out in reported FRY-9C and represent Total noninterest expense.

2. Metrics for considering TLAC Quantum Requirements

In addition to allowing the Covered IHCs to issue External TLAC, it may also be appropriate for the Board to consider including measures which would give it the flexibility to vary the quantum of TLAC which a Covered IHC is required to issue. This may be appropriate in circumstances for example, where:

(a) as set out in the FSB term sheet, the Crisis Management Group ("CMG") should agree adjustments to the local TLAC requirements to ensure that, for G-SIBs following a Multiple Point of Entry ("MPoE") strategy, the sum of local TLAC requirements does not exceed a consolidated view of the requirements;

(b) the requirements being placed upon FBOs which operate in substantially the same manner as domestic US banks of a similar nature (but not subject to TLAC requirements), is disproportionate simply because of their ownership and, therefore, is in conflict with the principles of national treatment for the US subsidiaries of foreign financial groups, on a par with domestic US bank treatment; or

(c) the significance of the Covered IHC in the foreign Parent Financial Group would not justify TLAC requirements under the terms of the FSB term sheet.

To date, the Board has suggested that it does not need to provide flexibility in the US proposals to adjust the level of TLAC for Covered IHCs since adjustments could be made at the level of the External TLAC issued by the Parent Financial Group. These circumstances change, however, in the event that the Covered IHC issues External TLAC when different considerations may apply since there is no option to adjust the External TLAC at a higher level. In particular, the US Regulatory Authorities do maintain the ability to set the TLAC levels for US BHCs through:

(a) the thresholds which are used in the US to determine which BHCs are required to issue TLAC; and

(b) the metrics for determining a US G-SIB surcharge which, in turn, affects the level of TLAC required by any firm passing the threshold.

The February 2015 paper published by the Office of Financial Research (the "OFR Brief") which uses 2013 data, indicated that no Covered IHC met the US-based global systemically important BHC ("US G-SIB") threshold for issuing TLAC. Accordingly, we continue to believe that the Board should consider incorporating flexibility in its proposed rules, albeit recognizing the sensitivities about how this flexibility may be used. As a result, for any variation to be appropriate, it would be important to establish that the relevant Covered IHC was operating in a similar manner to comparable US BHCs. If this is the case, where the circumstances of the Covered IHC are most clear, we believe that it should be possible for the Covered IHC to achieve the same financial position as its domestic peers, demonstrating that the US Authorities have remained true to the principle of national treatment.

The following are metrics which the Board may wish to consider, together with potential calibrations as to how these might be applied.

Gating Criteria

We would consider that any Covered IHC would need to meet the following characteristics before any variation of the TLAC quantum requirements could be considered:

(a) External TLAC Issuance

Any Covered IHC seeking to vary its TLAC quantum requirements would need to be an issuer of External TLAC, demonstrating that it is operating as a US entity that is not dependent on its Parent Financial Group and will be subject to point-of-entry resolution in the US.

(b) Covered IHC Concentration

Any Covered IHC seeking to vary its TLAC quantum requirements should have all, or substantially all (i.e. greater than 95%) of the operations of its FBO concentrated in the Covered IHC, demonstrating that this Covered IHC represents the clear commitment of the Parent Financial Group to the US. The remaining 5% is to account for US branch/ agency subsidiaries that are to subject to Covered IHC requirements.

(c) Liability Concentration

Any relevant Covered IHC must also have over 85% its liabilities issued in the US on the basis set out in Section 1 above.

(d) US-based G-SIB and Supervisory Status

No Covered IHC activities in the US could qualify for any adjustment to its TLAC quantum requirements if those operations met the threshold to qualify as a US-Based G-SIB pursuant to 12 CFR Part 217. Similarly, a Covered IHC should not be subject to review by the Large Institution Supervision Coordinating Committee ("LISCC"), or any similar status to benefit from any adjustment to its TLAC quantum requirements.

Calibration Metrics

Subject to the Covered IHC passing these 'Gating' criteria, calibration might be adjusted using the following scorecard approach, incorporating a) global systemic importance and b) Title 1 resolution approval. The outcome of these metrics would be to provide a discount or reduction in the level of TLAC or Long Term Debt (LTD) which a Covered IHC is required to issue. The metrics set out below would be additive meaning that, in a particular set of circumstances, it would be possible for a Covered IHC which has passed the Gating Criteria, to achieve a discount in its requirements of a maximum of 7.0% of RWAs, effectively acknowledging that this represents the application of national treatment to the US subsidiary of a foreign banking group.:

(a) G-SIB Scores:

A US-based BHC is deemed to be a G-SIB if its BCBS methodology (Method 1) score, as calculated under 12 CFR Part 217, equals or exceeds 130 basis points. Subsequently a G-SIB capital surcharge is evaluated from the higher score of two methodologies: Method 1, and a US methodology that incorporates reliance on short-term wholesale funding (Method 2). A similar approach could be used as a measure of the relative risk to the US economy, and as a mechanism to establish tiers for TLAC requirements for Covered IHCs.

A discount to the TLAC/LTD requirement (defined as a % of RWAs) could be established for entities which are of less material risk to the US measured on a scale derived from the higher of Method 1 and 2 relative to the 130bps threshold. The discount is a function of the difference between the 130bps GSIB threshold and the underlying Covered IHC G-SIB score. The mechanism to derive the revised TLAC/LTD requirement is detailed in the table below.

(b) Title 1 Resolution Approval

The FSB Guidelines indicate that BHCs could benefit from a reduction in their TLAC requirements of 2.5-3.5% (depending on 16-18% TLAC requirement) where there is an industry pre-funded deposit insurance scheme which can participate in the resolution.

We propose that where the FDIC has indicated that it would expect the insured bank within any Covered IHC could be resolved under the Federal Deposit Insurance Act without resort to a "systemic risk" exception, and with no material conditions attached to such statement, a discount of up to 3.5% could be applied to the External TLAC required to be issued by that Covered IHC.

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The table below provides the mechanics of the calibration of TLAC/LTD requirement as a function of the GSIB score and the Title 1 resolution metrics:

		TLAC/LTD Reduction	TLAC (% RWA)	LTD (%RWA)
	US TLAC NPR Proposal		18%	7%
(a)	**% of Method 2 G-SIB Threshold of 130bps**			
	> 80%	(0.7%)	17.3%	6.3%
	60% - 80%	(1.4%)	16.6%	5.6%
	40% - 60%	(2.1%)	15.9%	4.9%
	20% - 40%	(2.8%)	15.2%	4.2%
	0% - 20%	(3.5%)	14.5%	3.5%
(b)	**Title 1 Resolution Approval**			
	For 18% TLAC requirement	3.5%	11.0%	0.0%

Whilst the above calibration of TLAC/LTD requirement better recognizes the systemic risk of Covered IHCs to the US financial stability, under these suggestions it is possible that FBOs would still be disadvantaged when compared to US banks which are not G-SIBs and where no TLAC requirements are imposed. This framework would, however, create a structure where BHCs which are subsidiaries of foreign G-SIBs that concentrate on activity in the US, operating in a manner similar to US BHCs and not dependent on their Parent Financial Group, could expect a mitigation of the effects imposed as a result of proposed TLAC rules. These circumstances may be unique to the US given the existing Intermediate Holding Company ("IHC") rules for Foreign Bank Organizations which have already been put in place, establishing a strong stand-alone geographic US operations.

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3. Variation in Issuing Entity

At present, it is a requirement that all eligible TLAC is issued by the Covered IHC. We believe, however, that there may be circumstances in which the Board might consider allowing External TLAC issuance from an alternative bank holding company (an "Alternative BHC") within the US structure (i.e. a direct or indirect subsidiary of the Covered IHC) where this Alternative BHC holds substantially all the banking operations.

This may be efficient if:

(a) the Alternative BHC has traditionally been the issuer of US debt securities and can more readily take up the role of External TLAC issuer; and

(b) there are subsidiaries of the Covered IHC which would not be resolved using a bail-in approach, for example, in the case of a finance company which might be resolved by liquidation.

Issuance at the level of the Alternative BHC, which is directly and solely linked to the bank, opens the option of recapitalization through bail-in focused only on the banking entity which may be more attractive for both Internal and External TLAC holders. It may also ease any future restructuring if this is focused on the single relevant entity, for example, in a sales process where other elements within the Covered IHC may not be relevant to the buyers.

We believe that the Board should permit issuance from an Alternative BHC where:

(a) such Alternative BHC complies with the requirements for a clean holding company, as specified;

(b) there are no other subsidiaries of the Covered IHC which would be resolved using the TLAC to be issued by the Covered IHC; and

(c) the Alternative BHC and its underlying bank can be effectively separated from any other entities under the Covered IHC.

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We would be pleased to provide further information or assistance to the Board or its staff. Please contact the undersigned or John S. Cassidy, Senior Legal Counsel, if we can provide any additional information.

Sincerely,

Gerard Mattia

Chief Financial Officer, HSBC North America, Inc.

Chief Financial Officer, Global Banking & Markets

cc: Iain Mackay, Patrick Burke, Bryan Pascoe, Stuart Alderoty, James Chew, Richard Hennity

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