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January 5, 2024

Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Chief Counsel's Office
Attention: Comment Processing
Office of the Comptroller of the Currency
400 7th Street, SW
Suite 3E-218
Washington, DC 20219

James P. Sheesley
Assistant Executive Secretary
Attention: Comments/Legal OES
(RIN 3064-AF29)
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Re: Proposed Regulatory Capital Rule—Large Banking Organizations and Banking Organizations with Significant Trading Activity[1] (the "Proposal")

HSBC North America Holdings, Inc., on behalf of itself and its subsidiaries (collectively, "**HSBC**"), welcomes the opportunity to provide the Agencies[2] with comments on the Proposal.

HSBC values the major U.S. trade associations' efforts on their respective comment letters, including the Bank Policy Institute, American Bankers Association, Institute of International Bankers, Securities Industry and Financial Markets Association, Futures Industry Association and International Swaps and Derivatives Association, all of which are organizations of which HSBC is a member. With this letter, HSBC wishes to emphasize concerns with certain aspects of the Proposal that may result in undue burdens for clients, including small individual borrowers, or which could put the U.S. financial system at a competitive disadvantage relative to other jurisdictions.

Specifically, many aspects of the Proposal "gold-plate" the Basel Committee requirements - that is, they are more punitive or stringent than the internationally agreed Basel standards. This gold-plating will hurt U.S. individuals and small businesses that rely on U.S. financial institutions, such

[1] 88 Fed. Reg. 64028 (Sept. 18, 2023).

[2] Specifically, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System and the Federal Deposit Insurance Corporation.

as HSBC, for loans and other critical products and services by making those products and services more expensive. This would not only impact individual customers, but also the broader U.S. economy that their commercial activity supports. Gold-plating is also likely to encourage migration of lending and other businesses outside the U.S. regulatory perimeter, either to non-U.S. banks or to non-bank institutions inside and outside of the United States. Customers could be at increased risk of loss and commercial abuse when engaging in these activities with institutions not subject to robust U.S. regulation.

HSBC is also concerned with the fundamental scope and application of the Proposal, which would eliminate many aspects of the carefully considered tailoring established under the Agencies' 2019 tailoring rules implementing the Economic Growth, Regulatory Relief, and Consumer Protection Act ("**EGRRCPA**").[3] Subjecting smaller, less risky banking organizations, such as Category III and IV intermediate holding companies ("**IHCs**") of foreign banking organizations ("**FBOs**"), to the same prudential capital requirements that are applied to U.S. GSIBs is unnecessarily complex and punitive when considering IHCs' size, risk profile, parental support, and consolidated capital requirements applied at the IHC parent's home jurisdiction.

The Proposal would also require Category III and IV banking organizations to move to a "dual stack" approach, whereby banks are required to hold capital against RWAs based on the higher of two approaches. The Proposal does not appear to be aligned with the requirements set forth in EGRRCPA and adopted by the Agencies under the 2019 tailoring rules. This seems to be contrary to the Proposal's statement that it would "*reduce complexity and operational costs through changes across multiple areas of the agencies' risk-based capital framework.*"[4] The requirement to apply a dual stack approach for Category III and IV banking organizations would impose additional costs and burdens without adequate benefit.

In addition to the suggestions in the trade association letters described above, in this letter HSBC emphasizes the following recommendations to reduce the punitive aspects of the Proposal without undermining its goals:

I. Extend the phase-in period for the removal of the Accumulated Other Comprehensive Income ("**AOCI**") opt-out from three to five years to reduce cliff effects on banks' regulatory capital and to encourage lending activity;

II. Avoid extending to Category III and IV banking organizations the capital threshold deductions and minority interest treatment for Category I and II banking organizations to better capture the different risk profiles of less complex banks; failing this, subject the lower thresholds to the same five-year phase-in period as HSBC suggests for AOCI;

III. Avoid gold-plating relative to the Basel standards and other key jurisdictions to align the U.S. capital framework with international standards;

[3] 12 CFR 3.22(b)(2); 217.22(b)(2); 324.22(b)(2).
[4] The Proposal at 64030

IV. Remove minimum haircut floors for securities financing transactions ("**SFTs**") with unregulated financial institutions to align with key non-U.S. jurisdictions and to encourage collateralized lending; failing this, consider applying certain exemptions;

V. Remove the no-stay condition from the collateral agreement requirement to align with international standards, and to reflect the risk-mitigating benefits of collateral more appropriately under the simple approach;

VI. Remove the requirement for IHCs to calculate operational risk capital twice given this is already captured in stress testing; and

VII. Apply the preferential risk weight to corporates based solely on creditworthiness and remove the requirement that corporates must be publicly traded, as this may not accurately reflect the risk of the exposure.

I. HSBC Supports the Proposal to Phase In AOCI Adjustments for Category III and IV Banking Organizations, but Recommends that the Phase-In Period Be Extended to Five Years

A. Proposal

AOCI captures unrealized gains and losses on certain assets and liabilities, including available-for-sale ("**AFS**") debt securities. The Proposal would require each Category III and IV banking organization to include AOCI in its common equity tier 1 ("**CET1**") capital calculation, whether or not that banking organization exercised the one-time opt-out from AOCI permitted by the 2019 tailoring rules. In the Proposal, the Agencies estimate that Category III IHCs of FBOs will face a 13.2% increase in their CET1 requirements and a 9.7% increase in leverage capital requirements, as compared to 4.6% and 3.8%, respectively, for U.S.-headquartered Category III banking organizations.[5] The elimination of the AOCI opt-out would phase in over three years. Starting on July 1, 2025, Category III and IV banking organizations would be required to recognize 25% of AOCI in their CET1 capital. That percentage would increase to 50% on July 1, 2026; to 75% on July 1, 2027; and to a full 100% beginning on July 1, 2028.

B. Recommendations

The purpose of the phase-in period for AOCI is to provide "*banking organizations sufficient time to adjust to the proposal while minimizing the potential impact that implementation could have on their ability to lend.*"[6] The Proposal does not accomplish this goal, however, as portfolios of investment securities typically have a duration of longer than five years, meaning that a three-year phase-in period effectively requires premature replacement of much of the portfolio. As a result, it is likely that there will still be significant legacy AFS debt securities positions with disproportionate effects on CET1 capital calculations when the elimination of the AOCI opt-out

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[5] The Proposal at 64171.
[6] The Proposal at 64166.

quickly phases in over the course of three years unless banks are able to prematurely offload a significant portion of their securities positions. In order to give banking organizations sufficient time to adjust their portfolios to account for recognizing AOCI in CET1 capital, the phase-in period should be extended to five years to reduce any cliff effects to regulatory capital from sales that could create instability in the banking sector and financial markets, including the market for U.S. Treasuries. With a phase-in period shorter than five years, banks would be required to raise capital quickly, which could increase the cost for banks to raise capital as demand to raise capital outpaces the market's ability to provide that capital. Additionally, a five-year phase-in period, by supporting the stability of a bank's balance sheet, would better enable banking organizations to lend to clients and individuals, which in turn supports U.S. economic activity.

II. The Requirement for Category III and IV Banking Organizations to Apply the Same Capital Threshold Deductions and Minority Interest Treatment as Category I and II Banking Organizations is not Commensurate with the Lower Risk Profile of Less Complex Firms.

A. Proposal

The Proposal would extend to Category III and IV banking organizations the same capital threshold deduction and minority interest treatments currently applicable to Category I and II banking organizations.

Currently, Category III and IV banking organizations are only required to deduct from CET1 capital the excess above a 25% individual limit of each of three "**Threshold Deduction Items**" — mortgage servicing assets, deferred tax assets arising from temporary differences that cannot be realized through net operating loss carrybacks and investments in the capital of unconsolidated financial institutions. The threshold deduction requirements for Category I and II banking organizations are currently more stringent: the amount of each of the Threshold Deduction Items above 10% individually or 15% in aggregate must be deducted. The Proposal would impose the stricter individual and aggregate thresholds currently applicable to Category I and II banking organizations on Category III and IV banking organizations.

In addition, under the current rules, there is both a qualitative and a quantitative limit on the recognition of minority interests, which differs and is more stringent for Category I and II banking organizations compared to Category III and IV banking organizations. Minority interests are capital instruments issued by a consolidated subsidiary of a banking organization to third-party investors. The Proposal would extend the limits currently applicable to Category I and II banking organizations to Category III and IV banking organizations.

Unlike with AOCI, there is no phase-in period for the higher capital threshold deductions and minority interest treatment for Category III and IV banking organizations.

B. Recommendations

HSBC recognizes the importance of supervision and regulation on banking organizations subject to Category III and IV capital standards to promote financial stability, as highlighted by the Agencies in the Proposal.[7] However, bank organizations of different sizes pose different risks, a fact that was recognized by Congress in creating the tailoring regime under EGRRCPA, which was signed into law in 2018. Indeed, just four years ago, the Agencies were in agreement that the 25% individual limit on the Threshold Deduction Items was sufficient "*to prevent, in a simple manner, unsafe and unsound concentration levels of these exposure categories*" for Category III and IV banking organizations.[8] That conclusion remains true today — even more so given the other significant changes the Proposal will make to both the numerator (e.g., AOCI, certain unsecured debt instruments) and to the denominator (e.g., new requirements for calculating operational and CVA risk-weighted assets (**"RWAs"**)).

While HSBC supports any reforms which aim to increase financial stability and capture economic risks without being overly burdensome for Category III and IV banking organizations, enhanced capital standards and the proposed treatment of minority interests will be especially impactful and result in significantly more capital deductions.

Akin to the reasoning applied to HSBC's AOCI phase-in recommendation, if the Agencies do move forward with the Proposal as it relates to capital threshold deductions and minority interest treatment, HSBC would recommend that a phase-in period of five years be included in the final rule so that Category III and IV banking organizations have time to restructure their portfolios in a manner that accounts for these significant changes. Similarly, the allowance of a five-year phase-in period would have a stabilizing effect that would better enable banking organizations to lend to clients and individuals, thereby supporting economic activity in the United States.

III. Avoid Gold-plating Relative to the Basel Standard and Other Key Jurisdictions to Improve the Risk-Sensitivity of Expanded Risk-Based Approach ("ERBA") and Align the U.S. Capital Framework with International Standards.

A. Proposal

The Proposal would gold-plate several risk weights relative to the internationally agreed Basel standard. These include credit risk weights across all loan-to-value bands for residential mortgage exposures, retail exposures, and short-dated bank exposures.[9] Under the credit valuation

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[7] 88 Fed. Reg. at 64032.

[8] Regulatory Capital Rule: Simplifications to the Capital Rule Pursuant to the Economic Growth and Regulatory Paperwork Reduction Act of 1996, 84 Fed. Reg. 35234, 35237.

[9] HSBC would encourage the Agencies to reconsider their perceived underestimation of the RWA impact of lending, as evidenced by their view that the Fundamental Review of the Trading Book would be more impactful for banks. While some banks may not experience a significant RWA impact from lending, many IHCs have a different mix of activities that are more likely to result in significant impacts from lending and which caution against the Agencies making a one-size-fits-all assessment.

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adjustments ("**CVA**") framework, the Proposal imposes higher risk weights than the Basel standard for speculative and sub-speculative grade sovereign exposures and multilateral development bank exposures. Moreover, the Proposal would treat exposures to non-bank financial institutions such as bank holding companies, savings and loans holding companies, and securities firms as corporate exposures[10], which is also inconsistent with the Basel standard. Lastly, the Proposal does not provide a separate preferential risk weight for exposures to Grade A banks which meet certain capitalization thresholds, another deviation from the Basel standard[11].

B. Recommendations

The final rule should adjust these risk weights to be consistent with the Basel standard. Doing so would improve the accuracy and sensitivity of the ERBA and align the U.S. capital framework with international standards. Higher risk weights have negative, downstream effects on customers, who are inevitably charged higher fees so that banking organizations are able to accommodate the more stringent capital requirements. In particular, first-time homebuyers and low-to-moderate income homebuyers could be negatively and disproportionately impacted by the Agencies' higher proposed risk weights to residential mortgage exposures.

As an example of a risk weight that the Agencies should adjust, the Basel standard treats non-bank financial institutions subject to prudential regulation and supervision by responsible authorities as attracting the risk weight of a regulated bank rather than a standard corporate.[12] As the Basel standard has recognized, these entities are highly regulated, which mitigates their risk profiles and makes them more similar to banks than corporations. However, the Proposal would ascribe to such non-bank financial institutions the higher risk weights of corporations. This makes it more costly for U.S. banks to lend to non-bank financial institutions relative to their non-U.S. counterparts, which is an unnecessary disadvantage for the U.S. financial system.

IV. Remove Minimum Haircut Floors for Certain SFTs with Unregulated Financial Institutions.

A. Proposal

Similar to the current standardized approach for credit risk (the "**Standardized Approach**"), under the Proposal, the ERBA would permit banking organizations to recognize the risk-mitigating impact of collateral through either a "collateral haircut approach" or a "simple approach." For the collateral haircut approach, the Proposal applies standard price volatility "haircuts" based on the residual maturity of the collateral.

The Proposal introduces, for ERBA, a new requirement that would decrease the degree to which banking organizations can recognize the risk-mitigating benefits of collateral under the collateral haircut approach by requiring that they apply "minimum haircut floors" to certain SFTs with

[10] The Proposal at 64041 n. 61.

[11] Basel Committee on Banking Supervision, *Basel Framework*, footnote 15 to CRE20.21.

[12] Basel Committee on Banking Supervision, *Basel Framework*, CRE20.40.

unregulated financial institutions, including certain repo-style transactions and certain eligible margin loans. For these transactions, failure to receive enough collateral to satisfy the minimum haircut floors would prevent a banking organization from recognizing *any* of the collateral securing the transaction or netting set, thereby effectively treating it as an unsecured transaction.

B. Recommendations

The Agencies should not adopt the minimum haircut floor requirements for repo-style transactions and eligible margin loans, consistent with the implementation measures taken by a number of key non-U.S. jurisdictions, including the European Union and the United Kingdom. Adopting minimum haircut floor requirements could make certain types of lending arrangements unnecessarily complex, such as arrangements where a customer pledges collateral on a net basis across multiple types of loans that include repo-style and margin loans, or when a customer pledges collateral pursuant to multiple loans under a single agreement. For repo-style transactions and margin loans remaining in the United States, banking organizations would be forced to pass along the higher cost of capital to their clients. Finally, because of the importance of repo-style and margin loan transactions in providing banking organizations and others access to reliable liquidity, to the extent that the minimum haircut floors unnecessarily inhibit that access by complicating or raising the costs of these transactions, it also potentially increases systemic financial stability risks rather than decreasing them.

If the Agencies adopt SFT minimum haircut floors, HSBC recommends exempting repo-style transactions and eligible margin loans collateralized by U.S. Treasuries or securities issued by government-sponsored entities from the requirement. Transactions in U.S. Treasuries attract a credit risk RWA of 0%, which recognizes the lack of credit risk in these instruments regardless of the credit risk of the counterparty. Any failure of the counterparty to pay back amounts owed would result in the banking organization foreclosing on the U.S. Treasury collateral. As a result, the credit quality of the counterparty is essentially irrelevant as the collateral will be able to be readily sold given the highly liquid U.S. Treasury market. Debt securities issued by government-sponsored entities, such as Fannie Mae and Freddie Mac bonds or mortgage-backed securities, are similarly liquid and subject to a very low inherent instrument credit risk. In addition, the Agencies should consider only applying uncollateralized treatment to individual in-scope transactions and in-scope transactions of a netting set, as this more accurately reflects the risk of the transactions.

HSBC would also recommend that the Agencies amend the rules for recognition of unsettled collateral. For the purposes of determining whether the minimum haircut floor is satisfied, a banking organization should be permitted to take into account collateral that it has called from the counterparty but that has not yet settled. Collateral is frequently settled on a T+1 basis, and under the Proposal additional collateral that has been called and provided (but not yet settled) risks resulting in an unsecured exposure. For this reason, HSBC would also recommend that, if the minimum haircut floors for certain SFTs are maintained in the final rule, the collateral, that is called by either counterparty, can be treated as collateral received from the moment that it is called.

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V. Remove the No-Stay Condition from the Collateral Agreement Requirement When Using the Simple Approach.

A. *Proposal*

The Agencies have missed an opportunity in the Proposal to fix a shortcoming under the current capital rules. Under the proposed ERBA, as well as under the current Standardized Approach, a banking organization using the simple approach for collateral recognition can only recognize the credit risk mitigation benefits of collateral pledged against a loan if, among other things, the collateral is subject to a "collateral agreement" for at least the life of the exposure. The existing definition of "collateral agreement" specifically excludes any contract where the banking organization's "*exercise of rights under the agreement may be stayed or avoided.*"[13] Most collateralized lending arrangements could be stayed under the U.S. Bankruptcy Code and the lender would therefore not be able to recognize the risk-reducing effects of the pledged collateral when computing capital requirements. Consequently, any banking organization bound by the ERBA or the Standardized Approach calculation would not be able to recognize the risk-reducing effects of pledged collateral under the simple approach for most collateralized lending activity.

B. *Recommendations*

HSBC is concerned about this issue not only as it relates to capital calculations, but also because the deviation from the internationally agreed Basel standards impacts all banks that are regulated by the Agencies using the simple approach under the ERBA and the Standardized Approach. It puts certain non-U.S. banking institutions with a U.S. bank subsidiary at a significant disadvantage relative to other non-U.S. banking institutions that engage in activities in the United States through a U.S. branch of a foreign bank. Lenders acting from the New York branch of a foreign bank may (appropriately) get credit from their home country regulator for the risk-reducing nature of collateral, while the lender using a U.S. bank subsidiary will be required to lend at a higher cost, making funding less accessible and more expensive for clients.

The Agencies should encourage all banking organizations to require collateral if appropriate to mitigate credit risk. One of the main ways in which the Agencies have encouraged U.S. banking organizations to act in particular ways is through capital requirements. But, as discussed above, neither the current U.S. capital rules nor the Proposal allow U.S. banking organizations to recognize the risk-reducing effects of eligible financial collateral pledged under loan agreements that are subject to the U.S. Bankruptcy Code. This makes the cost of lending higher than it needs to be and discourages safe lending. In effect, these banking organizations are required to treat collateralized and uncollateralized lending equally for purposes of calculating capital requirements, even though collateralized lending is inherently safer.

HSBC would encourage the Agencies to address this disparity in the final rule by removing the categorical no-stay requirement and aligning the U.S. regulations with international standards. One way to implement this in the final rule would be to simply replace the requirement with the exact

[13] 12 CFR 217.2.

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language from the Basel standards: "*The legal mechanism by which collateral is pledged or transferred must ensure that the bank has the right to liquidate or take legal possession of it, in a timely manner, in the event of the default, insolvency or bankruptcy (or one or more otherwise-defined credit events set out in the transaction documentation) of the counterparty (and, where applicable, of the custodian holding the collateral).*"[14]

VI. Remove the Requirement for IHCs Subject to Stress Testing to Calculate Operational Risk Twice.

A. Proposal

The Proposal would introduce a new approach known as the standardized approach for operational risk ("**SA-OR**") that would require all Category I-IV banking organizations to calculate RWAs for operational risk as part of their total RWAs under the ERBA. Legal risks, as well as risks stemming from external events and inadequate or failed internal processes, people and systems, are meant to be addressed by SA-OR. For Category III and IV banking organizations, this represents a new requirement because operational risks are not currently included in total RWAs under the existing standardized approach.

Operational risk is already incorporated into stress tests by the Federal Reserve and as such are already incorporated into prudential requirements for all large banking organizations with consolidated assets of more than $100 billion. It is not clear why these risks should be calculated twice: whether through SA-OR or stress testing, operational risk metrics should be counted only once.

B. Recommendations

Because the Proposal would require the calculation of operational risk metrics twice for IHCs of international banks, HSBC recommends that IHCs subject to stress testing should be exempt from the SA-OR requirements in the Proposal. Counting operational risk only once will lead to more accurate assessments of a particular banking organization's risk profile, while also reducing unnecessary operational burdens and costs on such banking organizations. This will allow banking organizations to lend to clients and individuals while holding capital in a manner that is more commensurate with risks.

VII. Apply the Preferential Risk Weight to Corporates Based Solely on the Creditworthiness of the Company, Rather Than Also Requiring that the Company be Publicly Traded.

A. Proposal

[14] Basel Committee on Banking Supervision, *Basel Framework*, CRE22.26.

The Proposal generally requires that exposures to corporates attract a 100% risk weight but permits the use of a 65% risk weight for corporate exposures where the corporate: (1) is investment grade *and* (2) has (or is controlled by a company that has) publicly traded securities outstanding.

B. Recommendations

Whether or not a company has issued publicly traded securities is not an appropriate proxy for assessing its creditworthiness and thus should not be a factor in assigning a risk weight to an exposure. In addition, it creates a bias away from companies that are not publicly traded but are otherwise investment grade in a manner that is not commensurate with the risk of the exposure. This requirement hurts the competitiveness of non-publicly traded, investment grade companies in the United States, many of which are private businesses in the U.S. entrepreneurial mold that are equally creditworthy and deserving of affordable financing as their publicly traded competitors. The final rule should be amended so that only the credit quality of the corporate is taken into account when assessing the risk weight, not whether or not the company is publicly traded.

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Thank you for your attention to HSBC's comments on the Proposal. HSBC would welcome the opportunity to provide any additional information that the Agencies may consider helpful.

Sincerely,

Kavita Mahtani

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