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July 23, 2019

Vanessa A. Countryman
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, DC 20549-1090

Re: **Proposed Rule Amendments and Guidance Addressing Cross-Border Application of Certain Security-Based Swap Requirements, Release No. 34-85823; File No. S7-07-19 (the "Proposed Rule")**[1]

Dear Secretary Countryman:

HSBC Bank USA, N.A. ("**HBUS**") on behalf of itself and its affiliates worldwide (collectively, "**HSBC**"), welcomes the opportunity to provide the Securities and Exchange Commission (the "**Commission**") with comments on the Proposed Rule.

In general, we support the efforts of the Commission and its staff to address the issues that have been raised in submissions by market participants in connection with the cross-border application of security-based swaps ("**SBS**") regulation under Title VII of the Dodd-Frank Act ("**Title VII**"). These efforts are necessary to reduce the unwarranted costs and operational burdens such application could impose and to promote consistency (where appropriate) with parallel requirements adopted by other regulators.

We generally agree with the recommendations made by the Institute of International Bankers and the Securities Industry and Financial Markets Association, whose comment letter we support. In this comment letter, we would like to focus on the Proposed Rule as it relates to the requirements applicable to SBS with non-U.S. persons arranged, negotiated, or executed ("**ANE**") by personnel located in a U.S. branch or office of a non-U.S. SBS dealer ("**SBSD**") or its agent ("**ANE transactions**"). As discussed further below, we continue to have concerns that applying Title VII rules to ANE transactions would impose costs and burdens far disproportionate to the limited U.S. interest in regulating these transactions. If, however, the Commission moves forward with regulating ANE transactions, certain refinements to the Proposed Rule would be needed to ensure that such regulation can be applied in practice, especially for globally-active firms such as HSBC that operate through multiple local subsidiaries.

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1 84 Fed. Reg. 24206 (May 24, 2019).

I. Applying Title VII Rules to ANE Transactions Would Have an Unwarranted, Disparate Impact on Firms Structured Similarly to HSBC

We reiterate the significant challenges that the Commission's regulation of ANE transactions would pose to HSBC and other firms that transact with non-U.S. counterparties through multiple locally-organized and -regulated subsidiaries, which we discussed in our 2015 comment letter to the Commission (the "**2015 Comment Letter**").[2]

As detailed in the 2015 Comment Letter, HSBC's U.S. sales and trading personnel are concentrated among employees of HBUS, which we expect to register as a SBSD, and HSBC Securities (USA) Inc. ("**HSI**"), which is registered as a broker-dealer. In addition, HSBC's SBS activities are predominantly booked to HBUS or to HSBC Bank plc ("**HBEU**"), which we also expect to register as a SBSD. As a result, the SBS activities of such personnel are or will be subject to comprehensive regulation by the Commission by virtue of its regulatory oversight over these entities.

However, from time to time, the U.S. sales and trading personnel of HBUS or HSI arrange, negotiate, or execute SBS entered into between other, non-U.S. HBSC group entities and their local, non-U.S. counterparties. U.S. personnel are often engaged due to time zone differences (*i.e.*, the trade needs to be dealt with outside the local market hours of the relevant non-U.S. HSBC group entity) or due to the particular underlier of the SBS and the related market expertise of the relevant U.S. personnel.

Although the volume of such activity is not significant in comparison to the aggregate SBS activity engaged in by HBUS and HBEU, the number of counterparties and HSBC group entities that are potentially affected by regulating ANE transactions would be substantial. HSBC provides risk management products, including swaps and SBS, to its customers in approximately 60 jurisdictions through separately capitalized banking subsidiaries of HSBC Holdings plc. Such subsidiaries are not guaranteed or owned by HSBC's U.S. entities. Should ANE transactions count toward these subsidiaries' aggregate *de minimis* calculations and consequently require them to register as SBSDs, HSBC (and the Commission in its capacity as the regulator of such subsidiaries as registrants) would incur significant costs as well as legal and logistical challenges. Moreover, needing to establish and maintain a robust trade-by-trade control framework for identifying ANE transactions and preventing U.S. personnel from inadvertently engaging in them, in order to ensure that our non-registered subsidiaries do not exceed the *de minimis* threshold, would present significant challenges to HSBC and other global firms that operate through multiple local subsidiaries, as it is virtually impossible to dynamically monitor for the transactions that would count toward the threshold across multiple subsidiaries.

Further, it would be impractical for local, non-U.S. customers to move their SBS trading relationships to a registered SBSD affiliate such as HBUS or HBEU given the fact that their SBS trading activity is just a component of the much broader commercial or investment banking relationships that those customers have with their local HSBC entity. In addition, such non-U.S. customers prefer dealing with their local HSBC entity in order to have a single point of contact for all HSBC relationships, optimize collateral arrangements, and have their local law govern

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[2] The 2015 Comment Letter is available at https://www.sec.gov/comments/s7-06-15/s70615-22.pdf.

contracts. Such customers may also be constrained by regulatory requirements (*e.g.*, certain products in certain jurisdictions can only be entered into by a client with a locally-incorporated or -licensed entity). In contrast, the many firms that plan to operate through entities with international branch networks would not face similar issues, as their global SBS dealing activities could be contained in one or a more limited number of registered SBSDs.

Overall, we do not believe it was the Commission's intent to have its Title VII rules in the cross-border context disparately impact certain market participants who have organized their global operations through a subsidiary structure for *bona fide* commercial reasons and without intending to avoid regulatory oversight.

More generally, both for HSBC's non-U.S. clients and those of others, applying additional Title VII rules to ANE transactions is likely to lead these clients to avoid interacting with U.S. personnel and thus push trading offshore—bifurcating markets based on the geographic location of personnel. Such a result would lead to a loss of jobs in the United States as personnel would relocate abroad to be able to continue to service non-U.S. clients without subjecting their trades to additional and potentially burdensome U.S. regulations.

The U.S. interest in regulating ANE transactions is not sufficiently strong to outweigh these negative consequences. In particular, the key regulations that the Commission intends to apply to these transactions—SBSD registration and regulation and transaction reporting—were designed to mitigate the systemic risk of the over-the-counter ("**OTC**") derivatives markets. But given that ANE transactions take place between non-U.S. counterparties, neither of which is guaranteed by a U.S. person, such transactions do not pose systemic risk to the United States.[3]

For these reasons, we do not believe that the Commission's Title VII rules should apply to ANE transactions.

II. If Title VII Rules Apply to ANE Transactions, the Commission Should Adopt a Primary Trading Relationship Test for When These Rules Apply

If the Commission determines to apply Title VII rules to ANE transactions, then the test for determining which transactions constitute ANE transactions (the "**ANE test**") should be easily administrable. In particular, any such test should account for the fact that most systems for tracking compliance with OTC derivatives regulation are based on the statuses of the parties to the transaction, which do not change from transaction to transaction. These systems were designed and implemented separately from pre-existing systems, policies, procedures, and controls designed to comply with U.S. securities laws, recognizing the different characteristics of the OTC derivatives markets and relevant regulations as implemented after 2012 by the Commodity Futures Trading Commission ("**CFTC**") and other G20 regulators.

It would be immensely cumbersome to modify these systems to systematically monitor and track the location of any front office personnel acting for HSBC, as this changes from transaction to transaction, can frequently involve more than two jurisdictions, and can even vary over the life of a given transaction. Indeed, if the ANE test covers any front office personnel acting for

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[3] This is doubly the case for the majority of such transactions that will already be subject to corresponding G20 regulation in the non-U.S. counterparties' home jurisdictions.

HSBC, no matter how incidentally, our non-U.S. subsidiaries would effectively have to prohibit altogether the involvement of U.S. personnel, as there would be no operationally-feasible way to monitor every non-U.S. transaction that might potentially trigger the ANE test.[4]

In addition, a non-U.S. client needs to be able to determine in advance which of its transactions will be brought into scope for the application of Title VII rules, rather than finding out after the fact that, for example, its transaction has been reported or that it will have to engage in portfolio reconciliation. But it is not necessarily the case that a non-U.S. client will know, on a transaction-by-transaction basis, whether it is interacting with a dealer's U.S. personnel, especially in the electronic trading context or when the dealer is "passing the book" from a non-U.S. market to the United States.

Thus, instead of a location test that would require a complete systems overhaul and create confusion over which overlapping sets of rules apply, a more practical test would look at the nature of the trading relationship between the non-U.S. parties and the U.S. personnel involved in the trade (the "**Primary Trading Relationship Test**"). Under the Primary Trading Relationship Test, if U.S. personnel are directly and meaningfully involved in the trading relationship with the non-U.S. parties at the relationship level (*e.g.,* the client's primary point of contact for the SBS is located in the United States), then certain Title VII rules (*e.g.*, SBSD registration, external business conduct, reporting) should apply, subject to substituted compliance with comparable non-U.S. rules. However, if U.S. personnel are only occasionally and incidentally involved in the trading relationship with the non-U.S. parties, then those rules should not apply.

Where the primary trading relationship is between non-U.S. parties, who are subject to local law and regulation, and those parties regularly transact with each other without the involvement of U.S. personnel, there is little benefit (and a high cost) to applying Title VII rules to this trading relationship since the risk lies entirely outside of the United States and the activity is otherwise regulated by non-U.S. law. Further, traditionally, a key rationale for applying the U.S. securities laws to transactions between non-U.S. parties that involve U.S. personnel is that a non-U.S. investor will expect to be protected by the U.S. securities laws when they do business with U.S. personnel. However, that concept is particular to the way that the securities markets developed, which is with separate national securities markets with a significant retail component. By contrast, the OTC derivatives markets are more geographically dispersed and solely institutional.[5] Therefore, in the SBS context, a non-U.S. counterparty to a SBS generally would not expect that the mere involvement of U.S. personnel in an ANE transaction would trigger additional U.S. securities laws protections when such counterparty's primary trading relationship lies outside of the United States.

In addition, we understand that the Commission may have concerns regarding how to distinguish a scenario involving legitimately-incidental involvement by U.S. personnel in facilitating a SBS between a non-U.S. affiliate and that affiliate's non-U.S. client after the relevant non-U.S. market has closed, on one hand, from a scenario in which a U.S. entity waits until non-U.S.

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[4] This result would also occur if the Commission does not provide greater legal certainty regarding what ANE activity would trigger the application of Title VII rules.

[5] *See, e.g.*, Section 5(e) of the Securities Act of 1933 [15 U.S.C. 77e(e)] (prohibiting offers and sales of SBS to persons who are not "eligible contract participants").

markets close to arrange, negotiate, and execute a SBS with that U.S. entity's *own* non-U.S. client which it then books to a non-U.S. affiliate in order to circumvent the application of Title VII rules, on the other hand. The Primary Trading Relationship Test would distinguish these scenarios, appropriately excluding the former but capturing the latter.

We further understand that the goals of regulating ANE transactions include ensuring that the front office U.S. personnel involved are subject to adequate regulatory oversight, making sure there is appropriate transparency and investor protection, and preventing evasion of the Commission's rules and regulations. Each of these goals could be addressed within the context of the Primary Trading Relationship Test by conditioning the application of the test on: (i) the relevant U.S. personnel being associated with a registered broker-dealer (such as HSI) or SBSD (such as HBUS) and (ii) the relevant non-U.S. entity being subject to regulation in a non-U.S. jurisdiction that applies prudential requirements (including capital requirements) and reporting requirements consistent with Basel standards and G20 commitments. The occasional involvement of U.S. personnel in certain trading scenarios, where the primary trading relationship and risk lie outside the United States, should not cause the trading relationship to be re-characterized for purposes of determining that Title VII rules should apply because, in any event, such incidental activity would be housed within a regulated entity.

III. If the Commission Does Not Adopt the Primary Trading Relationship Test, Further Tailoring of the Title VII Rules Applicable to ANE Transactions Will Be Necessary

We believe a Primary Trading Relationship Test is more operationally feasible than the Proposed Rule's conditional exception from counting ANE transactions towards a non-US entity's *de minimis* threshold. If, however, the Commission determines not to proceed with a Primary Trading Relationship Test, it is essential that the Proposed Rule is modified in accordance with the recommendations made by the Institute of International Bankers and the Securities Industry and Financial Markets Association.

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Thank you for your attention to HSBC's comments on the Proposed Rule. We would be pleased to provide further information or assistance at the request of the Commission or its staff. If you have any questions, or require any further information, please feel free to contact the undersigned.

Very truly yours,

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