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

Re: (1) Proposed Rule 10c-1, Release No. 34-93613; File No. S7-18-21 (Proposed Rule 10c-1);[1] (2) Proposed Rule 10B-1, Release No. 34-93784; File No. S7-32-10 (Proposed Rule 10B-1);[2] and (3) Proposed Rule 13f-2, Release No. 34-94313; File No. S7-08-22 (Proposed Rule 13f-2).[3]

Dear Ms. 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 above-captioned rule proposals (the **Proposed Rules**). HSBC is a globally-active firm that operates through multiple local subsidiaries, including: (i) two entities that are registered with the Commission as security-based swap (**SBS**) dealers—HBUS and HSBC Bank plc (**HBEU**)—and (ii) one registered broker-dealer—HSBC Securities (USA) Inc. (**HSI**). Given the multijurisdictional nature of our business, and the fact that we generally operate through separately organized and managed subsidiaries throughout the world, we are significantly focused on the cross-border application of Commission rules and guidance. In this regard, we have provided comments to the Commission with respect to other rules with cross-border impacts.[4]

Each of the Proposed Rules relates to reporting and public dissemination regimes with respect to different (but sometimes related) types of securities transactions and would apply on a cross-border basis. As described in more detail below, we are concerned that the cross-border application of the Proposed Rules is unclear and overbroad. Vague rules make it difficult for us to assess the scope of any new reporting obligations, which in turn will result in challenges in implementing internal programs, policies, and procedures to ensure compliance with the new reporting regimes. Furthermore, we are concerned that overbroad rules could discourage non-

1 86 Fed Reg. 69802 (Dec. 8, 2021).

2 87 Fed. Reg. 6652 (Feb. 4, 2022).

3 87 Fed. Reg. 14950 (March 16, 2022).

4 *See, e.g.*, HSBC Comment Letter Regarding Proposed Rule Amendments and Guidance Addressing Cross-Border Application of Certain Security-Based Swap Requirements, Release No. 34-85823; File No. S7-07-19, 84 Fed. Reg. 24206 (May, 24, 2019), *available at* https://www.sec.gov/comments/s7-07-19/s70719-5851210-188587.pdf.

U.S. market participants from participation in the U.S. market by, for example, limiting interactions with Commission-registered entities (such as with HBUS, HBEU, and HSI).

We also worry that an expansive extraterritorial scope could lead to questions regarding the Commission's authority to promulgate the rules, as well as its commitment to respecting the decisions of peer regulators (such as those in the European Union (**EU**) and United Kingdom (**UK**)). Uncertainty stemming from these types of concerns, and the potential for overlapping regulations, make it even more challenging for us (and other market participants) to identify, assess, and plan for potential future compliance obligations. Given that complying with any new reporting regime is likely to be costly and operationally complex regardless of its ultimate scope—especially for large firms with global operations like us—we believe it is essential that the Commission clarify the cross-border application and certain other aspects of each of the Proposed Rules in line with the Commission's authority to promulgate rules only where necessary and appropriate in the U.S. public interest or for the protection of U.S. investors. The remainder of this letter sets out our concerns and recommendations with respect to each of the Proposed Rules.

I. Comments with respect to Proposed Rule 10c-1

Proposed Rule 10c-1 would require any person that loans securities on behalf of itself or another person (a **Lender**) to provide to a "registered national securities association" (**RSNA**) certain information regarding those loans and related information regarding the securities that the Lender has on loan and available to lend.[5] Certain elements of this information would be made public by the RSNA,[6] while other elements would remain confidential.[7] Where a bank, clearing agency, or broker-dealer acts as an intermediary to a loan (a **Lending Agent**) on behalf of a Lender that is the beneficial owner of the loaned security, the Lending Agent (or a broker-dealer with which the Lending Agent contracts) would have the reporting obligation.[8]

A. The cross-border application of Proposed Rule 10c-1 is unclear

Neither the text of Proposed Rule 10c-1 nor the proposing release discusses the cross-border application of the reporting obligation. Without clarification, market participants cannot be certain which securities lending transactions the Commission intends to make subject to Proposed Rule 10c-1. As a result, uncertainty regarding the potential extraterritorial application of Proposed Rule 10c-1 could deter non-U.S. Lenders and Lending Agents from continuing to participate in the U.S. market—including reducing or ending (i) lending to U.S. borrowers of securities; (ii) lending through U.S. banks, clearing agencies, and broker-dealers (in the case of non-U.S. Lenders); (iii) lending through use of U.S.-based personnel (in the case of non-U.S.

5 Proposed Rule § 240.10c-1(a), (e).

6 Proposed Rule § 240.10c-1(b)-(c).

7 Proposed Rule § 240.10c-1(d).

8 Proposed Rule § 240.10c-1(a)(i)(A).

Lending Agents); or (iv) lending U.S. securities. We think this would be a bad outcome for U.S. markets and U.S. market participants generally.

Section 10(c)(1) of the Securities Exchange Act of 1934, as amended (the **Exchange Act**), under which the Commission proposed to promulgate Proposed Rule 10c-1, makes it unlawful for any person to "directly or indirectly, by the use of any means or instrumentality of interstate commerce or the mails, or of any facility of any national securities exchange" (**U.S. Jurisdictional Means**) engage in securities lending activity in contravention of Commission rules that are "necessary or appropriate in the public interest or for the protection of investors."[9]

Courts have interpreted U.S. Jurisdictional Means expansively[10] and the Commission has applied the U.S. Jurisdictional Means concept to certain of its regulations, such as Regulation SHO.[11] For the reasons noted below, we believe that the Commission should clarify the scope of Proposed Rule 10c-1 to focus on those transactions that have a sufficient U.S. nexus to justify application of a U.S. reporting regime and are accordingly most likely to provide U.S. investors with relevant information.

B. The Commission should clarify that Proposed Rule 10c-1 only applies to loans of U.S. Exchange-Traded Securities offered by a U.S. Lender

Rather than leaving the cross-border scope of the Proposed Rule undefined, we respectfully submit that Proposed Rule 10c-1 should only apply to: (i) loans of securities listed or traded on U.S. national securities exchanges (**U.S. Exchange-Traded Securities**); and for which (ii) the Lender is organized, incorporated, or established under the laws of the U.S. or has its principal place of business in the United States (a **U.S. Lender**).[12] With respect to U.S. Exchange-Traded Securities that are dual-listed, we recommend that the Proposed Rule's reporting obligations should only apply if such securities' primary trading market is in the United States.[13]

We believe that this more focused scope is appropriate for a number of reasons. First, it would be consistent with the Commission's authority under the Exchange Act. As noted above, while the Commission may promulgate rules regulating the use of U.S. Jurisdictional Means to

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9 Exchange Act §10(c)(1).

10 *See, e.g., United States* v. *Wolfson*, 405 F.2d 779, 783–84 (2d Cir. 1968).

11 *See* 69 Fed. Reg. 48808, 48014, n. 54 ("Any broker-dealer *using the United States jurisdictional means* to effect short sales in securities traded in the United States would be subject to Regulation SHO, regardless of whether the broker-dealer is registered with the Commission or relying on an exemption from registration.") (emphasis added).

12 An example of a U.S. Exchange-Traded Security would be a National Market System security. *See* 17 C.F.R. § 242.600(b)(54) (defining NMS security as any security or class of securities for which transaction reports are collected, processed, and made available pursuant to an effective transaction reporting plan, or an effective national market system plan for reporting transactions in listed options).

13 For these purposes, "primary trading market" means that at least 55 percent of the trading in the securities on a worldwide basis took place in, on, or through the facilities of a securities market or markets in the United States during the most recently completed fiscal year of the issuer of the security. *See, e.g.*, 17 C.F.R. § 242.12g3-2(b).

effect securities lending transactions, it may only do so "as necessary or appropriate in the [U.S.] public interest or for the protection of [U.S.] investors."[14] By focusing on transactions entered into by U.S. Lenders with respect to U.S. Exchange-Traded Securities, the approach outlined above would provide U.S. investors with information that is most likely to provide them transparency with respect to the U.S. securities lending market.

This approach would also avoid overwhelming U.S. investors with voluminous information that is less likely to be relevant to their understanding of the U.S. securities lending market, but could be required to be disclosed under an expansive interpretation of Proposed Rule 10c-1. For example, it is not clear to us how the reporting and public dissemination of information regarding securities lending transactions between two non-U.S. persons that merely involved some communication with U.S.-based personnel in the structuring of such transactions would advance the public interest or protect U.S. investors.[15] Rather, we believe that our suggested cross-border application of Proposed Rule 10c-1 would provide U.S. investors with the information most likely to afford them with greater transparency into the U.S. securities lending market, which would also more effectively advance the Commission's goals of supplementing the publicly available information involving securities lending, closing the data gaps in the securities lending market, and minimizing information asymmetries among market participants.[16]

Second, a more circumscribed scope would likely reduce costs and operational complexity for market participants endeavoring to comply with Proposed Rule 10c-1. The Commission has acknowledged that it would require individual firms to devote thousands of hours and millions of dollars (and hundreds of thousands of hours and billions of dollars collectively across the industry) to ensure initial and ongoing compliance with the rule.[17] While any new securities lending reporting regime could result in significant compliance costs, we believe that, as proposed, Proposed Rule 10c-1 would impose disproportionate operational burdens and costs on the securities lending activities of non-U.S. Lenders and Lending Agents with complex, cross-border operations, given the need to comply with a potentially expansive cross-border application of the rule. Rather than shouldering these costs, such non-U.S. Lenders might instead determine to limit or end their participation in the U.S. securities lending market to the detriment of U.S. markets and market participants.

Relatedly, we worry that an overly broad or ambiguous reach of Proposed Rule 10c-1 could reduce liquidity and place U.S. intermediaries (such as U.S. banks and broker-dealers, like HBUS and HSI, respectively) at a competitive disadvantage. Market participants—particularly those outside of the United States—might determine to limit or cease trading or interacting with

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[14] Exchange Act §10(c)(1).

[15] As another example, it seems misguided to us to require a non-U.S. Lender or non-U.S. Lending Agent to make available information on securities that it has available to lend, given that the U.S. market generally would not have access to borrow such securities—even if the U.S. market did have access, the terms of any potential loan are not likely to be reflective of U.S. market terms (i.e., because such loans are likely to be entered into outside of U.S. market hours and, therefore, with a different liquidity profile). Such information is more likely to distort rather than elucidate U.S. market participants' understanding of the U.S. securities lending market.

[16] 86 Fed. Reg. 69802, 69804.

[17] 86 Fed. Reg. 69802, 69823-69843.

U.S. intermediaries (or leave the U.S. markets all together) in order to prevent public disclosure of their transactions. A narrower scope would reduce the likelihood that non-U.S. market participants in particular would leave U.S. markets, or their relationships with U.S. intermediaries, to prevent such disclosure.

Third, we believe that our proposed scope would minimize overlapping regulatory regimes and allow the Commission, consistent with its longstanding practice, to defer to home country regulators where appropriate. In this regard, we note that the EU and UK have implemented versions of the Securities Financing Transaction Regulation (**SFTR**), which generally only applies to certain entities established in the EU or UK (or to the EU or UK branch of a non-EU/-UK entity).[18] Limiting the application of Proposed Rule 10c-1 to U.S. Lenders would therefore decrease the potential for overlapping regulation, which would, in turn, minimize operational burdens, complexity, and cost, and reduce the possibility that such overlap could result in diminished liquidity in U.S. markets and competitive disadvantages for U.S. markets and market intermediaries.

For similar reasons, we do not think it makes sense to apply Proposed Rule 10c-1 to loans of non-U.S. securities made to U.S. borrowers. Just as home country regulators generally have a stronger interest than U.S. regulators in overseeing entities established or registered in their jurisdictions, such regulators generally have a stronger interest in regulating securities listed or traded in their jurisdictions. Furthermore, we are concerned that disparate treatment of loans to U.S. borrowers (as compared to non-U.S. borrowers) of U.S. or non-U.S. securities lending transactions could prevent U.S. borrowers from accessing non-U.S. securities lending markets altogether, given that the costs of compliance with Proposed Rule 10c-1 would be borne by the non-U.S. Lender/Lending Agent (and such costs could be avoided by transacting only with non-U.S. borrowers).

Finally, we note that limiting Proposed Rule 10c-1 to U.S. Lenders of U.S. Exchange-Traded Securities would not preclude the Commission from expanding the reporting requirement in the future. Rather, a more limited final rule would allow the Commission to analyze the effectiveness of the rule with respect to a narrower set of data and transactions, and then determine whether it is appropriate, and in the best interests of U.S. markets and investors, to expand the regulatory reporting regime.

II. Comments with respect to Proposed Rule 10B-1

Proposed Rule 10B-1 would, among other things, require any person (or group of persons under common control)[19] who is directly or indirectly the owner or seller of an SBS position that

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[18] *See*, in the EU, *Regulation (EU) 2015/2365 of the European Parliament and of the Council of 15 November 2015 on transparency of securities financing transactions and of reuse and amending Regulation (EU) No 648/2012* (**EU SFTR**) and, in the UK, the retained EU law version of the same (**UK SFTR**). Additional guidance on the scope of the EU SFTR is available here: https://www.esma.europa.eu/policy-activities/post-trading/sftr-reporting, and of the UK SFTR is available here: https://www.fca.org.uk/markets/sftr/sftr-reporting-obligation.

[19] *I.e.*, controlling, controlled by, or under common control with such person; or group of persons, who through any contract, arrangement, understanding, or relationship, after acquiring or selling directly or indirectly, any SBS, is directly or indirectly the owner or seller of an SBS position.

exceeds the applicable reporting threshold amount set forth in the rule,[20] to file (within one day) with the Commission a Schedule 10B containing certain information regarding those SBS transactions, as well as related transactions.[21] This information would become publicly available.

A. The cross-border application of Proposed Rule 10B-1 is too broad

As drafted, Proposed Rule 10B-1 would apply to all SBS positions that exceed the reporting threshold amount and where: (i) any of the transactions that comprise the SBS position would be required to be reported pursuant to Rule 908(a) of Regulation SBSR;[22] or (ii) such person holds any amount of reference securities underlying the SBS position[23] and (a) the issuer of such reference security is a partnership, corporation, trust, investment vehicle, or other legal person organized, incorporated, or established under the laws of the U.S. or having its principal place of business in the United States; or (b) such reference security is part of a class of securities

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[20] For SBS positions comprised of credit default swaps, the reporting threshold is the lesser of: (A) a long notional amount of USD 150 million (calculated by subtracting the notional amount of any long positions in a deliverable debt security underlying an SBS included in the SBS position from the long notional amount of the SBS position), (B) a short notional amount of USD 150 million, or (C) a gross notional amount (long and/or short) of USD 300 million. Proposed Rule 240.10B-1(b)(1)(i).

For non- credit default swaps SBS positions based on debt securities, the reporting threshold is a gross notional amount of USD 300 million. Proposed Rule 240.10B-1(b)(1)(ii).

For SBS positions based on equity securities, the reporting threshold is the lesser of (A) a notional threshold and (B) a percentage threshold. The notional threshold is a gross notional amount (long and/or short) of USD 300 million of an SBS position – in addition, once an SBS position exceeds a gross notional amount of USD 150 million, the calculation of the SBS position must also include the value of all the underlying equity securities beneficially owned by the holder of the SBS position (based on the most recent closing price of shares), as well as the delta-adjusted notional amount of any options, security futures or any other derivative instruments based on the same class of equity securities. The percentage threshold is an SBS position of 5% of a class of equity securities, calculated based total number of share attributable to the SBS position as a percentage of the outstanding shares of that class of equity securities.

[21] Proposed Rule § 240.10B-1(a).

[22] Rule 908(a) provides that an SBS is subject to regulatory reporting and public dissemination if: (i) there is a direct or indirect counterparty that is a U.S. person on either or both sides of the transaction; (ii) the SBS is accepted for clearing by a clearing agency having its principal place of business in the United States; (iii) the SBS is executed on a platform having its principal place of business in the United States; (iv) the SBS is effected by or through a registered broker-dealer (including a registered SBS execution facility); or (v) the transaction is connected with a non-U.S. person's SBS dealing activity and is arranged, negotiated, or executed by personnel of such non-U.S. person located in a U.S. branch or office, or by personnel of an agent of such non-U.S. person located in a U.S. branch or office. 17 C.F.R. § 242.908(a)(1). Rule 908(a) further provides that an SBS is subject to regulatory reporting (but not public dissemination) if there is a direct or indirect counterparty on either or both sides of the transaction that is a registered SBS dealer or registered major SBS participant. 17 C.F.R. § 242.908(a)(2).

[23] Including where the reporting person would be deemed to be the beneficial owner of such reference securities, pursuant to Section 13(d) of the Exchange Act (15 U.S.C. 78m) and the rules and regulations thereunder. *See* Proposed Rule § 240.10B-1(d)(2).

registered under Section 12 or Section 15(d) of the Exchange Act.[24] We believe that the proposed approach applies too broadly and should be narrowed, as described below.

1. With respect to the first prong, Schedule 10B reporting should only be required with respect to SBS positions required to be reported pursuant to Rule 908(a)(1)(i) or (ii)

As noted, Proposed Rule 10B-1 would require reporting of SBS positions that exceed the reporting threshold amount whenever any of the transactions that comprise the SBS position would be required to be reported under Rule 908(a) of Regulation SBSR—seemingly regardless of whether the person holding such position would have themselves incurred a reporting obligation under Regulation SBSR. In particular, it would appear that even a non-U.S. entity excluded from Regulation SBSR reporting obligations pursuant to Rule 908(b) could have a Rule 10B-1 reporting obligation solely because the activities or status of its counterparty triggered a Regulation SBSR reporting obligation for that counterparty. As a result, Proposed Rule 10B-1 would inappropriately discourage participation in the U.S. market.

We are particularly concerned about Proposed Rule 10B-1 being triggered due to a non-U.S. person entering into SBS transactions subject to Rule 908(a)(1)(v), which captures transaction that are arranged, negotiated, or executed (**ANE**) by personnel of a non-U.S. person (or its agent) who are located in the United States. We are worried that this approach would inappropriately discourage non-U.S. market participants from transacting in SBSs with any non-U.S. dealer counterparty (whether Commission-registered or not) in any case where such dealer could potentially be using U.S.-based personnel to ANE a transaction (and so trigger a reporting obligation for the non-U.S. market participant transacting opposite such dealer). As a result, non-U.S. market participants would likely insist on receiving assurances that their non-U.S. dealer counterparties are not using U.S. personnel, which would unnecessarily disadvantage those dealers, reduce competition, and likely reduce liquidity. Respectfully, we do not believe it is reasonable that, for example, a single transaction between two non-U.S. entities that is ANE by U.S.-based personnel of one or both of those entities should subject entire SBS positions (and other, related positions) of both entities to public disclosure.

Furthermore, we are concerned that Proposed Rule 10B-1 would subject to reporting requirements SBS positions composed of any transactions covered by Rule 908(a)(2), such as those between a non-U.S. person and a Commission-registered non-U.S. SBS dealer (even absent any ANE activity or any other nexus to the United States). As a result, the rule would discourage non-U.S. persons from trading with Commission-registered non-U.S. SBS dealers (such as HBEU), which would unjustifiably disadvantage those firms and harm U.S. SBS market liquidity.

In order to address these issues, we urge the Commission to narrow the Regulation SBSR prong to reference only Rule 908(a)(1)(i) (for transactions for which there is a direct or indirect counterparty that is a U.S. person on either or both sides of the transaction) or Rule 908(a)(1)(ii) (for transactions accepted for clearing by a clearing agency having its principal place of business in the United States). Transactions covered by the other prongs of Rule 908(a)(1), such

[24] Proposed Rule § 240.10B-1(d).

as ANE transactions, as well as transactions covered by Rule 908(a)(2), such as transactions between a Commission-registered non-U.S. SBS dealer and a non-U.S. person, should not be covered. In addition to being consistent with how this prong is described in Proposed Rule 10B-1's preamble,[25] we also believe that it would mitigate the concern that the cross-border scope of Proposed Rule 10B-1 would inappropriately discourage parties from transacting in the United States or with Commission-registered SBS dealers.[26]

2. With respect to the second prong, Schedule 10B reporting should be narrowed to cover only reference securities issued by a company that has securities listed on a U.S. national securities exchange

Proposed Rule 10B-1 would also require reporting of SBS positions that exceed the reporting threshold amount, where a person holds any amount of reference securities underlying an SBS position and: (i) the issuer of such reference security is a partnership, corporation, trust, investment vehicle, or other legal person organized, incorporated, or established under the laws of the U.S. or having its principal place of business in the United States; or (ii) such reference security is part of a class of securities registered under Section 12 or Section 15(d) of the Exchange Act.

We believe that this prong would also apply Proposed Rule 10B-1 too broadly. For example, given the difficulties that firms may have in discerning whether an issuer has its principal place of business in the United States, such firms will face uncertainty in determining which transactions are subject to Proposed Rule 10B-1 reporting obligations, which would ultimately result in greater operational and compliance costs, and could result in inconsistent disclosure. Furthermore, we do not believe that the purported benefits of requiring disclosure of positions based on mere presence of the issuer in the United States (absent other indicia of a U.S. nexus) would outweigh the increased costs associated with complying with this aspect of the rule. Instead, we respectfully request that the Commission limit this prong to cover only reference securities that are issued by a company that has securities listed on a U.S. national securities exchange. Determining this group of securities is simple and cost-efficient, while also focusing the reporting and disclosure regime on positions with a clear and significant nexus to the United States.

3. The Commission should exempt from Proposed Rule 10B-1's reporting requirements non-U.S. persons that are not Commission registrants and who transact in SBSs that reference securities that are not listed on a U.S. exchange

Proposed Rule 10B-1 could subject non-U.S. persons to reporting obligations in a number of other circumstances. In particular, as drafted, Proposed Rule 10B-1 would require a non-U.S. person (that is not a Commission registrant) to report SBS positions that exceed the reporting

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[25] 87 Fed. Reg. 6652, 6674.

[26] Tailoring the rule to apply to transactions involving a U.S. person as a counterparty or which are accepted for clearing by a clearing agency having its principal place of business in the United States appropriately focuses the Commission's efforts on entities with a significant U.S. nexus—non-U.S. regulators can, and do, set similar disclosure rules applicable to transactions with a significant nexus to their jurisdictions.

threshold amount, as a result of holding any amount of unlisted reference securities underlying the SBS position (*e.g.*, securities that are not registered with the Commission, but are issued by a U.S person). It also would require a non-U.S. person holding such an SBS position to report if the counterparty to such transaction engaged in activity (such as ANE activity) or had a status (such as Commission-registered SBS dealer) triggering reporting under Regulation SBSR, even if the non-U.S. person itself was neither engaged in U.S. activity nor registered with the Commission. We are worried that a reporting obligation that applied in such instances would discourage non-U.S. persons from transacting in these situations, which would result in unwarranted market distortions. In order to mitigate these concerns, we request that the Commission exempt from Proposed Rule 10B-1's reporting requirements non-U.S. persons that are *not* Commission registrants and that transact only in SBS referencing securities that are *not* listed on a U.S. exchange. We believe that this exemption is especially important to enable such non-U.S. persons to continue to transact in SBSs with Commission-registered SBS dealers or in situations where their dealer counterparties engage in ANE activities, but where such non-U.S. persons themselves have limited nexus to the United States. To the extent that the other side to the transaction (*e.g.*, the SBS dealer) itself has a position in excess of the reporting threshold, it would still be obligated to report.

4. <u>The Commission should exempt from Proposed Rule 10B-1 positions in non-U.S. sovereign credit default swaps</u>

We are concerned that Proposed Rule 10B-1 does not defer to non-U.S. regulators with respect to the sovereign credit default swaps (**CDS**) markets overseen by those regulators. Because of the relationship between CDS markets and markets for non-U.S. sovereign debt, non-U.S. regulators have, historically, applied special rules to their CDS referencing local sovereign bonds. In addition, non-U.S. sovereigns have a unique interest in the market for their sovereign debt, and since disclosure of CDS positions referencing such debt would impact that market, it would not be appropriate for U.S. authorities to interfere with that market by mandating such disclosure. In light of the special status of CDS markets and the Commission's commitment to respecting home country regulators' rules where appropriate, we believe that the Commission must exclude from Proposed Rule 10B-1 non-U.S. sovereign CDS.

B. The Commission should provide that positions need not be aggregated across independently-managed business units

Proposed Rule 10B-1 would apply to any person, including any entity controlling, controlled by, or under common control with such person , who is directly or indirectly the owner or seller of an SBS position that exceeds the reporting threshold amount.[27] Proposed Rule 10B-1 appears to require firms to aggregate the SBS positions of separate businesses units under common control for the purposes of conducting calculations in respect of the reporting thresholds, as well as with respect to Schedule 10B reporting. Absent further guidance, it seems that the Proposed Rule would disregard whether such business units are independently managed.

Requiring aggregation across independently-managed business units raises significant challenges that we believe should be addressed in any final rule. The rule, as drafted, would

[27] Proposed Rule § 240.10B-1(a)(1).

[redacted]

impose disproportionate burdens on banking groups with structures like that of HSBC, as a result of the operational challenges of aggregating, in real time, positions held by independently-managed business units operated out of separately organized and managed subsidiaries throughout the world.[28] Requiring aggregation across independently-managed business units could also result in misleading disclosure to the market.

First, Proposed Rule 10B-1, as drafted, would disregard the concerns the Commission recognized in allowing disaggregation for Section 13 beneficial reporting. For example, the Commission previously acknowledged "certain organizational groups are comprised of many different business units that operate independently of each other" and that "the need to aggregate [for reporting purposes] may have the effect of requiring diverse business units to share sensitive information, when it is otherwise not necessary for business purposes."[29] In light of this concern, the Commission issued guidance providing that "where the organization structure of the parent and related entities are such that the voting and investment powers over the subject securities are exercised independently, attribution may not be required for the purposes of determining whether a filing threshold has been exceeded and the aggregate amount owned by the controlling persons."[30] According to the Commission, whether voting and investment powers are exercised independently depends on an analysis of the particular facts and circumstances of a given situation, including the existence of informational barriers, participation in a common compensation pool, existence of written policies and procedures regarding the flow of information, and whether the entities have separate officers and directors.[31]

Second, we are concerned that aggregated reporting could result in misleading disclosure. For example, a firm could have a business unit that engages in dealing activity and a separately managed business unit that engages in asset management activities, each entering into transactions (including SBS transactions) independently of the other. If a person is required to aggregate the positions of these two independent business units as Proposed Rule 10B-1 would seem to require, then the fully hedged SBS positions held by the dealing business would be aggregated with the unhedged, directional positions held by the asset management business, even though the two businesses operate independently and enter into the positions for different purposes. Given the rule's vague, but expansive reporting and aggregation requirements and the operational complexity of certain firms that would be subject to the rule, we believe that Schedule 10B disclosures are likely to be inaccurate or misleading and could, for example, result

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[28] For example, HSBC, acting through its Global Markets business, provides risk management products, including SBSs, to customers in approximately 60 jurisdictions. Separately, HSBC, acting through its Wealth and Personal Banking business, provides asset management services, which can include SBSs, to fund clients in multiple jurisdictions. HSBC offers these services through various locally incorporated, managed, capitalized and regulated banks and securities firms, each of which is a subsidiary of an ultimate non-U.S. parent company (HSBC Holdings plc). These entities are operated independently of each other for supervisory, risk management, and regulatory purposes.

[29] *Amendments to Beneficial Ownership Reporting Requirements*, SEC Release No. 34-39538 (January 12, 1998), 63 Fed. Reg. 2854, 2857 (January 16, 1998).

[30] *Id.* at 2857; *see also The Goldman Sachs Group, Inc.*, SEC No Action Letter (March 30, 2001), 2001 WL 314646.

[31] *Amendments to Beneficial Ownership Reporting Requirements*, SEC Release No. 34-39538 (January 12, 1998), 63 Fed. Reg. 2854, 2858 (January 16, 1998).

in double counting of certain positions or, potentially, the obfuscation of concentrated or directional exposures.

To address these concerns, the Commission should instead recalibrate Proposed Rule 10B-1 so that SBS and related securities positions held by independently-managed businesses need not be aggregated. Specifically, the rule should provide that businesses that are managed independently should not be subject to aggregation, provided that they exercise independent decision making and risk management concerning SBS and related securities positions.

Such independence could be evidenced by: (i) separate officers and directors (*e.g.*, separate reporting lines for individuals involved in making decisions regarding SBS and related securities positions); (ii) appropriate information barriers to control against improper use of information concerning SBS or related securities positions; (iii) written policies and procedures regarding information flow between businesses; and (iv) separate compensation pools for risk takers in SBS and related securities positions.

This approach would be similar to the approach the Commission took with respect to Section 13 reporting (as described above), reduce compliance costs by allowing firms to more fully rely on their existing compliance infrastructure, and lessen the likelihood of misleading disclosures.

C. The Commission should exclude inter-affiliate SBS transactions from Proposed Rule 10B-1

We believe that applying reporting obligations to inter-affiliate transactions would be unnecessarily burdensome on banking groups with structures like that of HSBC, that use these types of transactions to manage risk across an extensive network of local subsidiaries throughout the world. Separate entities within one organization may enter into SBS transactions with affiliates for a number of business purposes, including to transfer the economic interests of the security underlying the SBS to an affiliate. For a number of reasons, it may be administratively simpler or less costly to effect such transfer through an SBS rather than through the transfer of the underlying security.

However, Proposed Rule 10B-1 does not seem to include an exemption for inter-affiliate transactions even though disclosure of such transactions would not advance the Commission's goals in promulgating the rule. In fact, we believe that excluding inter-affiliate transactions from the rule would reduce costs on market participants without harming the Commission's stated policy goals of: (i) providing market participants and regulators with notice that certain market participants are building large positions, facilitating risk management, and informing pricing of SBS transactions[32] and of potential fraud and manipulation;[33] and (ii) affording SBS dealers time

[32] 87 Fed. Reg. 6652, 6667.

[33] *Id*.

to adjust their hedges or call for additional margin should an issue arise with the underlying security or the SBS counterparty's ability to pay.[34]

These benefits are not present in the context of inter-affiliate transactions, since, among other things, there is no third-party involved. Instead, disclosure of inter-affiliate transactions would likely result in misleading disclosure, for example, by double-counting both the original third-party position and also the offsetting inter-affiliate position (despite the latter adding no additional net risk to the market).

We further note that other regulatory regimes often exempt inter-affiliate transactions from certain requirements. For example, the swaps real-time public reporting rules exclude from the public dissemination requirements swaps between two entities that are both wholly owned by the same company.[35] We believe it would be reasonable for the Commission to take a similar approach with respect to the collection and dissemination of inter-affiliate transaction information under Proposed Rule 10B-1.

III. Comments with respect to Proposed Rule 13f-2

Proposed Rule 13f-2 would require institutional investment managers[36] to file, on a monthly basis, a Form SHO with regard to: (i) each equity security of an issuer that is registered pursuant to Section 12 of the Exchange Act or for which the issuer is required to file reports pursuant to Section 15(d) of the Exchange Act over which the institutional investment manager and all accounts over which the institutional investment manager (or any person under the institutional investment manager's control) has investment discretion collectively have either: (a) a gross short position in the equity security with a U.S. dollar value of $10 million or more at the close of regular trading hours on any settlement date during the calendar month; or (b) a monthly average gross short position as a percentage of shares outstanding in the equity security of 2.5% or more; and (ii) each equity security of an issuer that is *not* registered pursuant to Section 12 of the Exchange Act *or* for which the issuer is *not* required to file reports pursuant to Section 15(d) of the Exchange Act over which the institutional investment manager and all accounts over which the institutional investment manager (or any person under the institutional investment manager's control) has investment discretion collectively have a gross short position in the equity security with a U.S. dollar value of $500,000 or more at the close of regular trading hours

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34 87 Fed. Reg. 6652, 6656.

35 *See* 17 C.F.R. §§ 43.2 (definition of "publicly reportable swap transaction") and 43.3. Inter-affiliate transactions are given different treatment under (and are often exempt from) other regulatory obligations as well. *See, e.g.*, 17 C.F.R. § 50.52 (inter-affiliate exemption from the swaps clearing requirement).

36 5 U.S.C. § 78m(f)(6)(A) (defining the term "institutional investment manager" to include "any person, other than a natural person, investing in or buying and selling securities for its own account, and any person exercising investment discretion with respect to the account of any other person").

on any settlement date during the calendar month.[37] Under Proposed Rule 13f-2, the Commission would make certain of this information public on an aggregated basis.[38]

A. The cross-border application of Proposed Rule 13f-2 is unclear

As with Proposed Rule 10c-1, neither the text of Proposed Rule 13f-2 nor the proposing release discusses the cross-border application of the reporting obligation. Without clarification, market participants cannot be certain as to the scope of Proposed Rule 13f-2 and may assume that the Commission intends for this Proposed Rule to apply to any short-sale activity that makes use of U.S. Jurisdictional Means.[39] This uncertainty could lead market participants to leave the U.S. short-sale market, or limit trading with U.S. investors or through U.S. intermediaries altogether (including Commission-registered broker-dealers, such as HSI). Given this concern, and our belief that this approach would be overbroad—particularly as it relates to unregistered securities—we respectfully request that the Commission narrow the application of Proposed Rule 13f-2, as described below.

B. The Commission should tailor the scope of Proposed Rule 13f-2

1. <u>The securities to which Proposed Rule 13f-2 would apply should be narrowed</u>

We respectfully submit that the reporting requirements of Proposed Rule 13f-2 should be limited to: (i) equity securities registered with the Commission pursuant to Section 12 of the Exchange Act; which (ii) are traded on a Commission-registered trading platform (*e.g.*, such securities are admitted to trading on a national securities exchange); and which (iii) are included in a list published by the Commission. [40]

We believe that this approach would be consistent with the Commission's reporting requirements in similar contexts, each of which applies to a narrower set of securities than would be covered by Proposed Rule 13f-2. For example, Rule 13f-1 only requires reporting by institutional investment managers that exercise investment discretion with respect to accounts holding those securities that are included on the Commission's 13F List.[41] Similarly, we note that the Commission's expired interim final temporary Rule 10a-3T regarding the disclosure of short sales and short positions by institutional investment managers also only applied to section

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37 Proposed Rule § 240.13f-2(a).

38 Proposed Rule § 240.13f-2(a)(3).

39 This concern is heightened given (i) that Proposed Rule 13f-2 is intended to apply to equity securities in order to be consistent with Regulation SHO, 87 Fed. Reg. 14950, 14956; and (ii) the Commission's previous statement regarding the applicability of Regulation SHO to broker-dealers using any U.S. jurisdictional means to effect short sales. *See supra* note 11.

40 *See, e.g.*, 17 C.F.R. § 240.13f-1(c) (noting that, in the context of reporting by institutional investment managers of information regarding section 13(f) securities, such managers may rely upon a list of securities published by the Commission (the **13F List**)).

41 17 C.F.R. § 240.13f-1.

13(f) securities.[42] While we recognize that the Commission proposes to apply Proposed Rule 13f-2 to equity securities in order to be consistent with Regulation SHO (which generally provides for the substantive regulation of short-sale practices),[43] the Commission has not explained why that approach is more sensible than, as we proposed, aligning Proposed Rule 13f-2 with the scope of other, similar reporting and public dissemination regimes such as the one provided in Rule 13f-1 or the one previously provided in Rule 10a-3T.

Other reporting regimes are similarly focused on narrower sets of securities. For example, the Commission's Sections 13 reporting requirements principally apply to equity securities that are registered under Section 12 of the Exchange Act,[44] as does the Commission's Section 16 beneficial ownership reporting regime.[45] As another example, the Section 13(h) large trader reporting regulation focuses on transactions in National Market System securities.[46] It is not clear to us why it would be in the public interest to require much more expansive disclosure with respect to short sales than the Commission requires with respect to the long positions noted above.[47] In this regard, Proposed Rule 13f-2 could be subject to challenge that it exceeds the Commission's authority, which would introduce further uncertainty into efforts to comply with the rule.

Furthermore, we believe that the proposed scope of the rule would provide U.S. investors with information that is of limited value, particularly with respect to non-U.S. securities. As noted, Proposed Rule 13f-2(a)(2) would require disclosure with respect to certain equity securities that are not registered with the Commission.[48] The information made public pursuant to this prong of the rule would not provide an accurate picture of the full market in relevant non-U.S. securities, since, among other things, the other relevant Commission rules do not require disclosure of long positions in these securities and the rule may not capture all relevant short-sale activity. In this regard, we also believe that the Commission should take care to avoid imposing

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42 *See* 73 Fed. Reg. 61678, 61680, n.18.

43 87 Fed. Reg. 14950, 14956.

44 17 C.F.R. § 240.13d-1(i). The reporting requirement also applies to any equity security of any insurance company which would have been required to be so registered except for the exemption contained in section 12(g)(2)(G) of the Act, or any equity security issued by a closed-end investment company registered under the Investment Company Act of 1940.

45 17 C.F.R. § 240.16a-2.

46 17 C.F.R. § 240.13h-1. *See supra* note 12 for the definition of NMS security.

47 The Proposed Rule would also impose a more expansive reporting requirement that the Commission's most recent effort at short-sale disclosure in temporary rule 10a-3T, as noted above.

48 "Equity security" is defined in reference to 17 C.F.R. § 240.3a11-1, which is not, by its terms, limited to securities with a U.S. nexus ("The term *equity security* is hereby defined to include any stock or similar security, certificate of interest or participation in any profit sharing agreement, preorganization certificate or subscription, transferable share, voting trust certificate or certificate of deposit for an equity security, limited partnership interest, interest in a joint venture, or certificate of interest in a business trust; any security future on any such security; or any security convertible, with or without consideration into such a security, or carrying any warrant or right to subscribe to or purchase such a security; or any such warrant or right; or any put, call, straddle, or other option or privilege of buying such a security from or selling such a security to another without being bound to do so.").

requirements that overlap with relevant EU and UK regulations—their respective Short Selling Regulations (**EU SSR** and **UK SSR**, respectively)[49] generally apply to holdings of certain equity securities admitted to trading on a venue located in, or related to the sovereign debt of, an EU nation or the UK, respectively.

Finally, we believe that a narrower rule would also limit costs to market participants.[50] We expect that our proposed alternative would help reduce compliance costs and operational burdens, particularly given that this approach would mirror the existing Section 13f-1 reporting regime with which many firms are already required to comply.

2. Proposed Rule 13f-2 should not apply to market makers

We also believe that Proposed Rule 13f-2 should not apply to market makers.[51] Tailoring the rule in this way would allow the Commission to collect information relevant to its primary concerns—monitoring for systemic risk and transparency with respect to large, unhedged, or concentrated short positions[52]—without unnecessarily burdening market participants that do not seem to be the primary or intended focus of the rule, but could nonetheless be implicated due to its expansive scope. Market makers play an important role in supporting market functioning by offering to buy and sell relevant securities, and in doing so provide liquidity to the market for such securities. They generally do not enter into directional or unhedged short positions (and instead endeavor to end each trading day flat), so the reporting and disclosure of their positions is unlikely to provide the Commission with information relevant to these concerns. In this regard, we expect that the costs to market makers to comply with Proposed Rule 13f-2, including the need to develop and maintain operations, systems, policies, and procedures to comply with the rule, would far exceed any potential benefit to the Commission.[53]

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49 *See*, in the EU, *Regulation (EU) No 236/2012 of the European Parliament and of the Council of 14 March 2012 on short selling and certain aspects of credit default swaps*, and, in the UK, the retained EU law version of the same. Additional guidance on the scope of the EU SSR is available here: https://www.esma.europa.eu/regulation/trading/short-selling, and of the UK SSR is available here: https://www.fca.org.uk/markets/short-selling.

50 As with Proposed Rule 10c-1, the Commission here estimates that Proposed Rule 13f-2 would require thousands of hours of work and hundreds of millions of dollars collectively to ensure ongoing compliance with Proposed Rule 13f-2. 87 Fed. Reg. 14950, 14972-14979.

51 For these purposes, the definition of "market maker" would be consistent with the definition provided in Section 3(a)(38) of the Exchange Act ("The term "market maker" means any specialist permitted to act as a dealer, any dealer acting in the capacity of block positioner, and any dealer who, with respect to a security, holds himself out (by entering quotations in an inter-dealer communications system or otherwise) as being willing to buy and sell such security for his own account on a regular or continuous basis.").

52 *See, e.g.*, 87 Fed. Reg. 14950, 14993 ("Having detailed information about which Managers currently hold large and unhedged short positions may also help the Commission observe potential systemic risk concerns regarding short selling. Large and concentrated short positions have the potential to increase systemic risk . . . . Manager level short position data of individuals with large short positions could allow the Commission to better observe these positions and more appropriately respond to any market events that arise.").

53 We also do not believe that the Commission's economic analysis adequately considers the costs of Proposed Rule 13f-2 to market makers. In particular, that analysis assumes there would be little cost to market makers because, outside of perhaps options market makers, market makers would not likely have positions required to be reported under the rule; even with this being the case, however, market makers would still need to bear the

Furthermore, excluding market makers from Proposed Rule 13f-2 would result in market participants receiving more helpful information regarding short sale activity. Because Proposed Rule 13f-2 requires disclosure of *gross* positions, market makers could be required to report large positions, even if a market makers' *net* position is close to zero (i.e., because such short positions are typically hedged via options or swaps). Subjecting market makers to Proposed Rule 13f-2 may, therefore, result in market participants receiving unhelpful and misleading information about the short sale market.

Finally, and consistent with our proposal in Section III.B.1 of this letter, a market maker exclusion would also be consistent with the EU SSR and the UK SSR[54] and align the Proposed Rule 13f-2 with international standards on public disclosure of short selling.[55]

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Thank you for your attention to HSBC's comments on the Proposed Rules. 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 let us know.

Sincerely,

Mark A. Steffensen
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costs of implementing the rule, seemingly only to confirm they have no reportable positions. This could have the unintended consequence of discouraging market makers from undertaking their role as such (i.e., to provide liquidity to the market) for relevant instruments.

54 *See supra* note 49 and Recital 26 and Article 17 of the EU and UK SSRs; *see also* European Securities Market Authority, Guidelines, *Exemption for market making activities and primary market operations under Regulation (EU) 236/2012 of the European Parliament and the Council on short selling and certain aspects of Credit Default Swaps* (Apr. 2, 2013), *available at* https://www.esma.europa.eu/sites/default/files/library/2015/11/2013-74.pdf].

55 *See* Fourth Principle and paragraph 3.39 of the Technical Committee of the International Organization of Securities Commissions (IOSCO), *Regulation of Short Selling*, Final Report (June 2009), *available at*: https://www.iosco.org/library/pubdocs/pdf/IOSCOPD292.pdf. ("Short selling regulation should allow appropriate exceptions for certain types of transactions for efficient market functioning and development . . . . Where public disclosure of individual positions is required, ... market authorities may need to consider whether certain types of activities should be exempted to protect the interest of the parties engaged in the 'exempted' activities. This may be particularly relevant to market making activity").