HSBC

14 June 2012

Manager, Financial Markets Unit
Corporations and Capital Markets Division
The Treasury
Langton Crescent
PARKES ACT 2600

Attn: Amy Little

Dear Madam,

We thank you for the opportunity to comment upon the Treasury's consultation paper "*Implementation of a framework for Australia's G20 over-the-counter derivatives commitments*" issued on 19 April 2012 (the **"Consultation Paper"**).

By way of introduction, HSBC is one of the world's largest banking organisations, with some 8,000 properties across 87 countries and territories, employing over 300,000 people worldwide. In Australia, HSBC operates through a locally incorporated entity, HSBC Bank Australia Limited, and also maintains a branch office of its Hong Kong domiciled parent, The Hongkong and Shanghai Banking Corporation Limited; which, in turn, is wholly owned by the UK listed HSBC Bank Holdings plc (together, the "**HSBC Group**").

As a global financial institution many of the HSBC Group's concerns echo that of other market participants, both domestic and international, and therefore we respectfully request that the Treasury should fully consider the issues raised by various industry groups, including those raised by the International Swaps and Derivatives Association, Inc. ("**ISDA**"), and the Australian Financial Markets Association ("**AFMA**"), each of which we are a member of. Thus, the focus of this submission is to draw attention to specific issues of importance relating to the HSBC Group.

"Do you have any comments on the definition of 'Party'?"

The HSBC Group is an active participant in the derivatives market in a number of jurisdictions, the majority of whom are in the process of developing or implementing measures to comply with the commitments given at the Pittsburg summit.

We believe that it is important for Treasury to recognize the potential of conflicting clearing and reporting obligations. This may occur where OTC derivative transactions are entered into on a cross-border basis. For instance, if a Australian counterparty transacts with a Singapore counterparty, both may be subject to mandatory clearing obligations in their respective jurisdictions. As the transaction can only be cleared through one clearing and settlement facility, there must be a mechanism for resolving this conflict.

In relation to reporting of a transaction, we believe that a 'party's' transactions should only be subject to reporting obligations if the transaction is booked within the jurisdiction, as opposed

to transactions which may be traded (but not booked). For example, for transactions which are traded in Australia but are booked in another offshore office, the Australian office is only responsible in originating the transaction and earning the sales credits, while the offshore office where the transaction is booked will take the risk of the transaction. Hence, the systemic risk to Australia is very minimal, and there in our view there is minimal value add by imposing mandatory reporting on such transactions for Australia.

"Do you have any comments on the definition of 'eligible facility'?"

Given the extra-territorial impact of the mandatory reporting obligations, the HSBC Group believes that a global trade repository will be the most effective solution for HSBC to provide all trades information to Australian regulators. This is because the HSBC Group, along with other international market participants, will in any event submit the majority of trades to a global trade repository. That global trade repository can then apply a predefined filter to send the data to the Australian regulators as appropriate.

"What should the minimum period of consultation imposed on ASIC in developing DTRs?"

The HSBC Group (as are most multi market participants) is already undertaking a tremendous amount of work responding to governmental consultation processes on OTC reforms in addition to being in advanced stages of planning to implement the solution to provide for the various legislative responses to the G20 commitments, with this in mind we believe that a two phase approach to consultation by ASIC in developing DTRs, being:

(a) To provide for a greater level of consultation in the initial phases of implementation, say nine to twelve months;

(b) To provide some lesser period of consultation post initial implementation of three to six months.

In addition, given the multi-jurisdictional efforts being undertaken in order to implement the Pittsburg commitments and the fact that Australia's regulatory framework will in some part be driven by developments in other jurisdictions, we also suggest ASIC should be obliged to align any future implementation of DTRs with international schedules of other regulators so as to avoid disruptions and unintended consequences of such implementation.

"What should the minimum period of notice between when a DTR is made and when any obligation under the DTR commences?"

The HSBC Group believes that the compliance or transition period for any DTR depends upon a number of circumstances, being:

(a) The scope of the DTR, including against whom and what type of transactions it shall apply, in which circumstances we believe that the broader the scope the longer the compliance or transition period should be; and

(b) Whether similar initiatives are being implemented in other jurisdictions, in which case we believe that the compliance or transition period should be aligned as closely as possible with those other jurisdictions.

Overall we believe that a compliance or transition period of six to twelve months would be reasonable.

"From the point of view of your business and/or your clients, do you have concerns around any 'back loading' requirements? For example, are there any problems with obligations applying to transactions that are outstanding at the time the rule is made?"

The HSBC Group does not support the proposal in relation to long dated derivative contracts because such back loading will incur additional clearing costs which have not been priced into the existing contracts.

We also believe that back loading if implemented in Australia would be in conflict with the position adopted by other jurisdictions (such as Europe), placing unnecessary implementation and cost burdens on Australian counter parties.

Should the proposal to back load be implemented, we suggest a grace period be provided to implement the back loading of existing derivatives contracts, and such requirement should not be effective on day 1 when trade reporting is live..

"Although the possible counterparty scope is set broadly, should minimum thresholds for some or all types of counterparty be set by regulation, so that no rule that is made will ever apply to those counterparties (unless the regulation is subsequently changed)?"

The HSBC Group supports the proposal to specify a threshold applicable against all counterparty types so as to limit the scope of the reporting obligation. We would encourage further discussion and dialogue as to whether such threshold was to apply single legal entity or consolidated group level.

"Do you agree with the option of including a broad range of entities in the mandate to report trades? If not what option do you prefer?"

Our concerns in relation to the range of entities being required to report stems around potential conflicting laws or obligations relating to privacy. We are aware that several members of the HSBC Group may be bound by, amongst other requirements, client confidentiality and bank secrecy obligations, which may prevent the provision of information to trade repositories, obtaining client consent in these circumstances may be burdensome or legally impossible. An international trade repository solution may be a potential solution as opposed to the localised model which seeks to attach extra-territorial reach.

"Are there any specific classes of transaction that should be excluded from the potential reach of trade reporting DTRs?"

We believe that trades booked offshore but originated within Australia should be excluded from mandatory reporting obligations. Our view is that where an offshore booking model is in place the Australian financial institution is exposed to the risks of the trade, but simply is responsible to originate trades and remunerates with selling credit. As such the systematic risk to Australia is minimal and it adds little value to the mandatory reporting in Australia. Further, unless the relevant institution booking the trade is incorporated in a jurisdiction which is not pursuing the G20 targets, those trades booked in such offshore entity are most

likely to report to a trade repository pursuant to the mandatory reporting obligation in its home jurisdiction.

As proposed, the mandatory reporting obligation in Australia for all trades, notwithstanding the booking office would require one trade to be submitted to multiple trade repositories and it will increase the cost of compliance for banks, and the overlapping coverage may also cause trade information to be duplicated, and therefore affecting the quality of the information especially when used in aggregate.

"Do you agree with the option of relying upon market forces and a range of other mechanisms, such as capital incentives, while monitoring the impact of such mechanisms is systemically important derivative classes and providing for possible future mandating, to ensure that central clearing becomes standard industry practice in Australia within a timeframe that is consistent with international implementation of the G20 commitments? If not, is there another option you prefer?"

The HSBC Group supports the contention that market forces will drive the support of centrally cleared OTC products.

In relation to mandated central clearing obligations, we note that the Consultation Paper has not provided a great deal of detail about the implementation the G20 commitment regarding the imposition of higher capital requirements for OTC derivatives transactions that are not centrally cleared.

Although the HSBC Group supports the implementation of Basel 3 (which should provide the incentives broadly suggested in the Consultation Paper), it believes that the imposition of capital charges will simply lead to the imposition of higher costs on OTC transactions for end users, resulting in the lack of acceptance of this type of transaction amongst those users, and the introduction of additional systemic risk to the economy flowing such lack of acceptance.

If a higher capital charge was to be imposed on uncleared trades, then such imposition should only apply to those trades that the bank can clear in any recognised exchanges but fails to do so. This carve out will ensure that counterparties are not penalised where there is no clearing house support for some specific OTC transaction.

"Are there any specific classes of transaction that should be excluded from the potential reach of trade clearing DTRs?"

We believe there should be a number of categories of trades that should are excluded from the reach of trade clearing DTRs, being:

(a) Those being entered into on behalf of a commercial end user;

Commercial end users have always used derivatives to hedge against price volatility and mitigate their day-to-day commercial risk, and these derivatives is not in the nature of speculation, investing or trading. If mandatory clearing obligation is insisted on commercial end users, then it will increase cost for commercial end users as they need to post margins and pay other related costs to clearing member in order to clear trades.

(b) Intra-group transactions;

Members of the HSBC Group execute intra-Group trades to allow:

(i) local HSBC entities to provide OTC derivatives directly to clients, allowing the client to face an entity in the same jurisdiction as the client and an entity of which it is more familiar; and

(ii) improved market risk management, by "backing out" the market risk of that product to a risk management entity. Under this approach, the intra-Group trades pass market risk from the client facing entity to the entity responsible for managing the market risk on a portfolio basis. Centralisation of market risk facilitates a higher degree of efficiency in risk management.

Our view is that requiring intra-Group trades to be cleared would increase operational risk and costs, without an equivalent benefit.

The counterparty risk between intra-Group entities can be effectively managed by bilateral collateral arrangements such as the Credit Support Annex to the ISDA Master Agreement.

The imposition of intra-Group mandatory clearing obligation would lead to an increase in costs (from clearing intra-Group trades or maintaining segregated risk management centres) that would likely be passed on to corporate customers.

(c) Those transactions affected by a conflicting clearing requirement; and

As stated in our comments on the definition of a 'party' we believe that there must be a mechanism whereby cross jurisdictional trades, each of which are subject to conflicting rules on centralised clearing, can be resolved.

(d) De-clearing.

Trades that have been centrally clearing would remain there until maturity. It is worthwhile to note that hitherto major dealers have already been actually managing systematic risks through multilateral trade compressions. However it is worthwhile to note that the implementation of trade compression may be difficult in the context of central clearing, in light of the fact that operationally trades are novated to the central counterparty. As trade compression is an important tool currently used by industry players to manage counterparty exposure and reduce capital charges , the industry should be encouraged to conduct such exercises, including any de-clearing that may be necessary for the purpose of trade compression.

"What restrictions should there be on the disclosure of reported data by trade repositories? What requirements should be imposed in relation to data protection and privacy?"

Whilst The HSBC Group accepts a need for any reporting regime to transparent, it does not believe that there should be public disclosure of specific trades, in particular in relation to trade size or pricing. If it was necessary to disclose this information, it should be done on an

anonymous or aggregated basis (that is x number of transactions occurred of this size within this pricing range).

Should there be a mandated need to publically disclose individual trade data, The HSBC Group believes that provided there is sufficient clarity around the need for and circumstances in which data will be disclosed on an individual trade basis, such use can be overcome through contractual agreement or approval by underlying customers, albeit such agreement may lead to increased compliance costs and thereafter end user costs.

"Would Australian Market participants support a domestic trade repository as an alternative to an international trade repository, recognising that there are likely to be cost implications in establishing and maintaining a domestic trade repository?"

Whilst the HSBC Group sees some benefit in having a local trade repository (or at least an available repository within the local time zone), it does not believe that local market volumes are sufficient to mandate sole use of this repository. Rather, the HSBC Group believes that it would be more efficient to utilise an international trade repository, as members of the HSBC Group (as is other entities operating in multiple jurisdictions) are likely to be required to report into same in any event, thus not only will a local repository be more expensive to set up and maintain (on a value reported basis), but there will be additional costs imposed on entities who are otherwise required to report into an international repository. These duplicated or additional costs will be likely to passed on in pricing to clients.

"Should any requirements be imposed on trade repositories with respect to obligations to provide third parties with access to the information (subject to authorisation from data providers and regulators)?"

The HSBC Group would like to understand further what third parties are going to be provided with access to reported information, as it does not believe there is a need or justification for any such activity.

"Do you have any initial views on the property rights in trade information passed to trade repositories?"

The HSBC Group believes that there should be no transfer of property interests in the information passed to repositories, that is the proprietary interests belong to both the reporting party and the trade counterparty.

HSBC would be very pleased to further discuss or develop the ideas elaborated in this response with you. Please do not hesitate to contact the undersigned, should you wish to discuss any of the above.

Yours sincerely,

Peter Quirk
Senior Legal Counsel
HSBC Bank Australia Limited