

Security-Based Swaps Regulatory Regime

Frequently Asked Questions (FAQs) for HSBC Clients

October 2021

SEC Security-Based Swaps Regulatory Regime

Introduction

This document seeks to answer frequently asked questions from HSBC clients relating to the U.S. Securities and Exchange Commission's regulatory regime applicable to security-based swaps adopted under Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). If you have questions regarding how this regulatory regime (the **SEC SBS Regime**) applies specifically to your relationship with HSBC, in addition to seeking guidance from your external advisors and your institution's Legal and Compliance team, please contact your HSBC Sales Representative.

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Overview

What is the SEC's Security-Based Swap Regime?

The Dodd Frank Wall Street Reform and Consumer Protection Act ("Dodd Frank") came into force on 21 July 2010. It made changes to the United States financial regulatory environment and has wide cross-border impacts to the global financial services industry.

Dodd Frank was enacted to reduce systemic risk, increase transparency, and promote market integrity within the financial system, in line with G20 commitments to reform and improve the OTC derivatives market structure. Dodd Frank divided regulatory authority over OTC derivatives between the US Securities and Exchange Commission (**SEC**) and the US Commodity Futures Trading Commission (**CFTC**).

- The SEC regulates Security-Based Swaps (**SBS**) and Security-Based Swap Dealers (**SBSD**).
- The CFTC regulates Swaps and Swap Dealers (**SD**).
- The CFTC and SEC jointly regulate mixed swaps

The SEC Security-Based Swaps requirements takes effect from 06 August 2021. As a result, HSBC Bank plc and HSBC Bank USA, N.A. are registering as SBSDs, no later than 01 November 2021.

Cross-Border Application

As a U.S. Person, the obligations under the SEC SBS Regime (the **SBS Obligations**) will generally apply to all SBS transactions of HSBC Bank USA, NA, irrespective of the U.S. Person status of its counterparties.

The applicability of the SBS Obligations to a SBSD who is not a U.S. Person depends on the cross-border scope of the specific rule. In general terms, a distinction between "entity-level requirements" and "transaction-level requirements" can be made, whereby:

1. Entity-level requirements apply to HSBC Bank plc (including its branches) as a whole, irrespective of the status of its counterparty, and
2. Transaction-level requirements apply to SBS transactions with U.S. Persons, or where HSBC notifies you that we may involve US personnel to arrange, negotiate or execute SBS transactions.

The SEC's business conduct rules for SBSDs entering into SBS have a different extra-territorial scope of application compared to equivalent CFTC rules for Swaps. In particular, the SEC's business conduct rules will apply to HSBC Bank plc (a non-US SBSD) facing a non-US client where we use US-based personnel to arrange, negotiate or execute the trade ("ANE").

ANE is typically present to give clients access to a wider range of prices or greater depth of liquidity. For example, ANE might be present where a non-US client wants to trade with HSBC Bank plc outside the local trading day but during US business hours.

If, as a result of ANE, the SEC business conduct rules apply to a transaction, we will notify you and may require you to put documentation in place with HSBC Bank plc in order to avoid potential trading disruptions.

Key Dates

Ahead of the Registration Date, from 06 August 2021 (**Counting Date**), market participants will have to count certain SBS transactions connected with dealing activity, towards the registration de-minimis threshold. Exceeding this threshold will require the respective entity to register as a SBDS.

Both HSBC Bank plc and HSBC Bank USA, NA intend to register as a SBSD no later than 01 November 2021, and will comply with all applicable SBS Obligations.

FAQ

Section I: SEC SBS Regime Overview

1. What is the SEC SBS Regime?

The Dodd Frank Wall Street Reform and Consumer Protection Act (“Dodd Frank”) came into force on 21 July 2010. It made changes to the United States financial regulatory environment and has wide cross-border impacts to the global financial services industry.

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The SEC Security-Based Swaps requirements takes effect from 06 August 2021. As a result, HSBC Bank plc and HSBC Bank USA, N.A. are registering as SBSDs, no later than 01 November 2021.

2. What is the SEC SBS Regime product scope?

SBS are defined as all swaps based on (i) a single security or loan, (ii) a narrow-based (9 or less underliers) security index or (iii) the occurrence, non-occurrence, or extent of the occurrence of an event relating to a single issuer of a security or the issuers of securities in a narrow-based security index, provided that such event directly affects the financial statements, financial condition, or financial obligations of the issuer.

In scope product types include, without limitation:

- Total return swaps referencing a single underlying security or loan, or narrow-based security index
- Equity variance or dividend swaps referencing a single security or narrow-based security index
- Single name credit default swaps (CDS)
- Credit default swaps referencing a narrow-based security index (CDX)

All Swaps subject to the CFTC’s jurisdiction (e.g. Swaps based exclusively on currencies, interest rates or broad-based security indices) will not be subject to the SEC SBS Regime.

Transactions that are both Swaps and SBS will be “Mixed Swaps” and will be subject to the SEC SBS Regime as well as the corresponding CFTC regulatory regime for Swaps.

3. What are the Key SEC SBS Regime Dates?

The key future dates for the registration of SBSD’s are as follows:

- 06 August 2021 (**Counting Date**): From this date, market participants will have to count certain SBS transactions connected with dealing activity towards the registration de-minimis threshold. Market participants exceeding this threshold will be required to register as a SBSD
- 01 November 2021 (**Registration Date**): Registration applications are due from market participant that incur a registration obligation between the Counting Date and the end of August

- 08 November 2021 (**Reporting Date**): SBSB's are required to report transactions in SBS under the SEC SBS Regime

4. Which HSBC entities will register with the SEC under the SEC SBS Regime?

Both HSBC Bank plc and HSBC Bank USA, NA intend to register as a SBSB no later than 01 November 2021, and will comply with all applicable SBS Obligations.

5. Will clients be able to transact SBS with non-registering HSBC entities?

Non-registering HSBC entities will no longer be able to trade SBS with in-scope counterparties from 06 August 2021.

These measures are necessary to ensure that HSBC entities other than HSBC Bank plc and HSBC Bank USA, NA will not become subject to a SEC registration obligation.

6. What is substituted compliance?

Substituted compliance allows a non-U.S. SBSB's to fulfil certain requirements of the SEC SBS Regime by complying with comparable rules applicable to SBS, in its home jurisdiction.

The SEC has granted a Substituted Compliance determination for the UK market. It is HSBC's general approach in the UK to make use of substituted compliance where we meet the conditions and it is available, subject to occasional exceptions. For clients, this means we may apply UK MiFID or UK EMIR rules to our transactions, as opposed to the SEC's rules.

Section II: U.S. Self-Disclosure Letter

7. What is the U.S. Self-Disclosure Letter?

The International Swaps and Derivatives Association, Inc. (**ISDA**) U.S. Self-Disclosure Letter (**SDL**), published by ISDA on 15 January 2021, is intended to assist market participants with the exchange of the information necessary to comply with CFTC, Prudential Regulator, and SEC SBS regulations, as applicable.

Amongst other things, the SDL contains a series of questions designed to determine an entity's U.S. Person status under the different U.S. person definitions.

The SDL is available at www.isda.org/book/isda-us-self-disclosure-letter, and can be completed using the industry platform ISDA Amend. Please note that there is no charge for using this service.

8. What is a U.S. Person under the SEC SBS Regime?

The SEC SBS Regime defines U.S. person as any (except certain international organisations):

- natural person who resides in the United States (regardless of citizenship);
- partnership, corporation, trust, investment vehicle, or other legal person organized, incorporated, or established under the laws of the United States or having its principal place of business in the United States;
- discretionary or non-discretionary account of a U.S. Person; or
- estate of a decedent who was a resident of the United States at the time of death.

For purposes of this definition, an entity's principal place of business is the location of primary direction, control, and coordination of its activities, and in general, its headquarters or main office. For externally managed investment vehicles, generally, this is the location of the office from which the investment manager directs, controls, and coordinates the investment activities of the vehicle.

9. Why is it important to know if I am a U.S. Person?

Your U.S. Person status determines whether or not a non-US HSBC entity other than HSBC Bank plc may trade SBS with the counterparty (see FAQ 5).

HSBC Bank plc also needs to know your U.S. Person status in order to determine which obligations under the SEC SBS Regime it will need to comply with, when trading SBS products with you.

10. What action do I need to take if I am a U.S. Person?

A U.S. Person counterparty will need to adhere to the relevant ISDA protocol (ISDA 2021 SBS Top Up or SBS Full Protocol) in order to transact SBS with either HSBC Bank plc or HSBC Bank USA, NA, once they register as a SBSD. See Section III for further details.

11. What action do I need to take if I am not a U.S. Person?

A non-U.S. Person counterparty will need to adhere to the relevant ISDA protocol (ISDA 2021 SBS Top Up or SBS Full Protocol) in order to transact SBS with HSBC Bank USA, NA, once it registers as a SBSD.

Adherence to the relevant ISDA protocol should not be required in order to transact SBS with HSBC Bank plc or other HSBC entities that are not U.S. Persons. However, HSBC Bank plc will send non-US counterparties a one-way notification detailing whether we think you meet certain thresholds and giving you certain disclosures, in order to continue transacting SBS once registered as an SBSD. This is because there

may be ANE on our SBS transactions which bring them into scope for SEC External Business Conduct requirements. See Section III for further details.

Section III: ISDA 2021 SBS Protocols

12. What are the ISDA 2021 SBS Protocols?

The ISDA 2021 SBS Protocols are part of ISDA's Dodd Frank documentation initiative, designed to facilitate industry compliance with certain SEC SBS rules.

All U.S. Person SBS counterparties of HSBC Bank plc, as well as any SBS counterparty of HSBC Bank USA, NA, (regardless of their U.S. Person status) will be required to adhere to one of the following:

- ISDA 2021 SBS Top-Up Protocol: Any entity that has already adhered to the ISDA August 2012 Dodd-Frank Protocol and the ISDA March 2013 Dodd-Frank Protocol (the **ISDA DF Protocols**) for CFTC compliance purposes, can adhere to the ISDA 2021 SBS Top-Up Protocol to facilitate compliance with the SEC SBS Regime
- ISDA 2021 SBS Full Protocol: All entities that have not adhered to the ISDA DF Protocols, must adhere to the ISDA 2021 SBS Full Protocol

Protocol adherence can be completed using the industry platform ISDA Amend. (see FAQ 19 for information regarding associated fees).

13. How is the ISDA 2021 SBS Top-Up Protocol structured?

The Protocol consists of three parts:

- The Protocol terms, including forms of Adherence Letter and Revocation Notice;
- Appendix 1 to the Protocol (General Agreements and Notifications; Safe Harbors), which tops up the ISDA August 2012 DF Protocol for purposes of applicability to SBS; and
- Appendix 2 to the Protocol (Calculation of Risk Valuations and Dispute Resolution; Portfolio Reconciliation), which tops up the ISDA March 2013 DF Protocol for purposes of applicability to SBS

There is no requirement to exchange additional questionnaires for purposes of adhering to the ISDA 2021 SBS Top-Up Protocol. The elections made and information exchanged in the questionnaires for purposes of adhering to the ISDA DF Protocols will also apply to the ISDA 2021 SBS Top-Up Protocol.

Further information on the ISDA 2021 SBS Top-Up Protocol is available at www.isda.org/protocol/isda-2021-sbs-top-up-protocol/. The document can be completed using the industry platform ISDA Amend.

14. What agreements does the ISDA 2021 SBS Top-Up Protocol cover?

The ISDA 2021 SBS Top-Up Protocol:

- is designed to supplement existing written agreements governing the terms and conditions of one or more transactions in SBS;
- adds notices, representations and covenants responsive to Dodd-Frank Title VII requirements that must be satisfied at or prior to the time that SBS transactions are offered and executed.

The ISDA 2021 SBS Top-Up Protocol is not limited to ISDA Master Agreements, and may be used to amend all protocol covered agreements between a pair of counterparties, provided the two parties have previously adhered to the ISDA DF Protocols and the relevant agreements were bindingly amended pursuant to the terms of the ISDA DF Protocols.

15. What is the ISDA 2021 SBS Full Protocol?

The ISDA 2021 SBS Full Protocol addresses the rules covered by the ISDA 2021 SBS Top-Up Protocol in standalone format. Counterparties wishing to adhere to the ISDA 2021 SBS Full Protocol will additionally need to complete separate questionnaires.

All counterparties that have not fully adhered to the ISDA DF Protocols will need to adhere to the ISDA 2021 SBS Full Protocol.

The ISDA 2021 SBS Full Protocol is available for adherence via www.isda.org.

16. How do I submit my Adherence Letter?

Each entity executing an Adherence Letter should access the Protocol Management section of the ISDA website at www.isda.org to enter the information required online.

Either by directly downloading the populated Adherence Letter from the Protocol Management system or upon receipt via e-mail of the populated Adherence Letter, the entity must sign and upload the Adherence Letter as a PDF (portable document format) attachment into the Protocol Management system. Once the signed Adherence Letter has been approved and accepted by ISDA, the protocol adhering party will receive an e-mail confirmation of their adherence to the respective ISDA protocol.

Please note that protocol adherence needs to be completed in the same capacity as both the ISDA DF protocols (where applicable) and the master agreement that the protocol is being applied to.

17. Which entities can sign up to the ISDA 2021 SBS Protocols?

The ISDA 2021 SBS Protocols are open to both ISDA members and non-members.

18. Can I change the text of an Adherence Letter?

No. The Adherence Letter must be in the same format as the form letter published by ISDA.

19. Are there any costs to adhere to an ISDA Protocol?

Each Adhering Party must submit a one-time fee of U.S. \$500 to ISDA at or before the submission of the Adherence Letter.

Each counterparty / combination of counterparties (e.g. fund manager and fund) is considered a separate Adhering Party for the purpose of Protocol Adherence and would need to pay the adherence fee. For multi-managed funds, each of the fund managers would need to adhere on behalf of the fund.

However, an Investment/Asset Manager/Agent that adheres on behalf of one or more underlying funds or principals for whom it has entered into an ISDA Master Agreement or Other Agreement, using a single Adherence Letter, would only pay a single adherence fee for that Adherence Letter.

Disclaimer

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