



U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5260
Facsimile: (202) 418-5527

Division of
Market Oversight

CFTC Letter No. 12-77
No-Action
December 18, 2012
Division of Market Oversight

Edward J. Rosen
Partner
Cleary Gottlieb Steen & Hamilton LLP
One Liberty Plaza
New York, NY 10006

Dear Mr. Rosen:

This letter is in response to your letter on behalf of HSBC Bank USA, N.A. (“HBUS”), HSBC Bank plc. (“HBEU”), and The Hongkong and Shanghai Banking Corporation Ltd. (“HBAP”) (collectively, “HSBC swap entities”), dated December 6, 2012 (“Letter”), to the Division of Market Oversight (“DMO” or “Division”) of the Commodity Futures Trading Commission (“CFTC” or “Commission”), in addition to subsequent communications with Staff.¹ In the Letter, you requested time-limited no-action relief for the HSBC swap entities with respect to certain reporting requirements promulgated by the Commission pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) under Parts 43,² 45,³ and 46⁴ of the Commission’s regulations. Specifically, you identified six areas in which full compliance with these reporting requirements, as they pertain to swap dealers, would not be possible as of the relevant compliance deadlines⁵ due to delays in resolving various technological issues with the HSBC swap entities’ trading and reporting systems.

¹ HBUS services swap trading hubs in the Americas. HBEU services swap trading hubs in Europe, the Middle East, and Africa. HBAP services swap trading hubs in the Asia-Pacific region.

² See generally Real-Time Public Reporting of Swap Transaction Data, 77 FR 1182 (January 9, 2012) (“Real-Time Reporting Rule”).

³ See generally Swap Data Recordkeeping and Reporting Requirements, 77 FR 2136 (January 13, 2012) (“Regulatory Reporting Rule”).

⁴ See generally Swap Data Recordkeeping and Reporting Requirements: Pre-Enactment and Transition Swaps, 77 FR 35200 (June 12, 2012) (“Historical Swap Reporting Rule”).

⁵ The earliest date upon which a swap dealer would be required to report swap transaction data for swaps in the interest rate and credit asset classes (“Compliance Date 1 Swaps”) pursuant to Parts 43 and 45 is December 31, 2012, if the swap dealer reaches the de minimis swap dealing threshold in October 2012. See generally Staff No-Action Letter No. 12-32 (November 19, 2012) (establishing the reporting compliance deadline for swap dealers under Parts 43 and 45 as the applicable registration deadline, regardless of whether the swap dealer chooses to register prior to that deadline) (“November 19 Letter”). The earliest date upon which the same swap dealer would be required to report historical Compliance Date 1 Swaps under Part 46 is January 30, 2013. See id. (establishing the reporting compliance deadline for

Generally, you represented that the HSBC swap entities are deploying a common internal technology solution for reporting swaps that requires a high degree of global coordination among multiple trading hubs. You represented that such a solution was being pursued as a more robust and sustainable way for the HSBC swap entities to optimize regulatory compliance through shared technology infrastructure, but that reliance upon third party service providers for product-specific solutions had complicated this coordinated effort.⁶ You also represented that the HSBC swap entities have already invested significant technical and business resources to meet regulatory reporting requirements, and that those trades for which relief was being requested represented only a small minority of those trades required to be reported, meaning these outliers would not adversely impact market transparency in any material way.

DMO has reviewed each specific request and determined to grant the following relief:

- A. Delay in reporting swaps that have economic features similar to both securities options and swaps under Parts 43, 45, and 46 until March 30, 2013.

In the Letter, you represented that under current Commission guidance and industry consensus, it is unclear whether certain products that include characteristics of swaps are excluded from the Commodity Exchange Act (“CEA”) definition of “swap.” In particular, you note as problematic products that include economic features similar to both securities options and swaps (e.g., a securities option with a foreign exchange (“FX”) component). You represented that the HSBC swap entities’ reporting systems therefore may not report certain of these products until industry efforts have been successful in securing clarity on the characterization of these products as swaps, but that the HSBC swap entities’ reporting systems already are being updated to report such swaps if and when they are identified (subject to a time lag for new technology to be implemented). Accordingly, the HSBC swap entities requested no-action relief with respect to reporting obligations for these products under Parts 43, 45, and 46 until March 31, 2013.

DMO believes that, in light of the above-described issues with characterizing certain swap-like products for reporting and the HSBC swap entities’ representations of good faith efforts to identify which products are reportable and ready for their systems to report these products as they are identified, time-limited no-action relief is appropriate. For products that include economic features similar to both securities options and swaps (e.g., a securities option with a FX component), DMO will not recommend that the Commission commence an enforcement action against the HSBC swap entities for failure to fulfill their reporting

historical swaps under Part 46 as 30 days after the date upon which the swap dealer is required to begin reporting swap transaction data pursuant to Parts 43 and 45 for the asset class to which the historical swap belongs). For purposes of the discussion herein, DMO assumes that the HSBC swap entities anticipate having to register as swap dealers by December 31, 2012, and thus begin reporting Compliance Date 1 Swaps under Parts 43 and 45 as of December 31, 2012, and historical Compliance Date 1 Swaps under Part 46 as of January 30, 2013.

⁶ Such unrelated third-party service providers include the Depository Trust and Clearing Corporation (“DTCC”) Global Trade Repository, MarkitWire, and DSMatch.

obligations under Parts 43, 45, and 46 until **March 30, 2013**.⁷ For any product not reported to a swap data repository (“SDR”) pursuant to this no-action position that is determined to be a reportable swap during the relief period, the HSBC swap entities must report such swap pursuant to the applicable Part 43, 45, and/or 46 regulations within thirty days of such determination being made, but in no case later than April 30, 2013.

B. Delay in reporting certain data fields for interest rate, equity, and FX swaps under Parts 43, 45, and 46 until March 30, 2013.

In the Letter, you represented that, due to the mislabeling in the DTCC specifications template of the “exotic notional amount leg 2” and “exotic settlement currency leg 2” data fields as optional, the HSBC swap entities may require additional time to update their reporting systems to reflect these data fields as required under Parts 43, 45, and 46.⁸ The affected trades are limited to exotic interest rate swaps that account for approximately five percent of the HSBC swap entities’ total interest rate swap volume. Additionally, you represented that for less than one percent of the HSBC swap entities’ FX and equity trades, the HSBC swap entities’ internal systems currently capture reportable collateral data at the end of day and will require additional time to be updated such that the collateral data can be captured on an intra-day basis and the indication of collateralization data field can be reported in real-time as required under Parts 43, 45, and 46.⁹ Accordingly, the HSBC swap entities have requested no-action relief under Parts 43, 45, and 46 until April 1, 2013 in order to update their reporting systems to capture and report the foregoing data fields pursuant to the Commission’s swap date reporting rules.

DMO believes that, in light of the above-described technical difficulties and the HSBC swap entities’ representations of good-faith efforts to remedy these difficulties, time-limited no-action relief is warranted to provide additional time for the HSBC swap entities’ to bring their

⁷ In considering any no-action relief requested until March 31, 2013 or April 1, 2013, DMO is limiting the expiration date on its responsive no-action position to March 30, 2013 for purposes of achieving internal consistency among reporting deadlines. As of the date of issuance of this response, the earliest possible reporting deadline for swaps in the equity, FX, and other commodity asset classes (“Compliance Date 2 Swaps”) under Parts 43 and 45 is February 28, 2013, and under Part 46 is March 30, 2013. See CFTC Letter No. 12-41 (December 5, 2012) (“December 5 Letter”). DMO notes that the relief provided in the November 19 Letter and December 5 Letter applies to the HSBC swap entities, meaning that any relief provided in this response is supplemental and therefore should be interpreted in conjunction with the relief already issued.

⁸ Appendix A to Part 43 requires that notional currency and notional principal amount be reported as publicly disseminated data. See Real-Time Reporting Rule at 1258-59. Appendix 1 to Part 45 requires notional amount and notional currency to be reported as minimum primary economic terms data for interest rate swaps under Part 45. See Regulatory Reporting Rule at 2219. For historical swaps in existence on or after April 25, 2011, the reporting counterparty must report minimum primary economic terms data under Part 46, which includes notional amount and notional currency for interest rate swaps. See Historical Swap Reporting Rule at 35228.

⁹ Generally, the indication of collateralization data field must be reported as soon as technologically practicable. See, e.g., Real-Time Public Reporting Rule at 1244. Parts 43, 45, and 46 each require the indication of collateralization data field to be reported for interest rate, equity, and FX swaps. See, e.g., id. at 1251-52; Regulatory Reporting Rule at 2219; Historical Swap Reporting Rule at 35228 (requiring minimum primary economic terms specified in Appendix 1 to Part 45 to be reported for historical swaps in existence on or after April 25, 2011).

reporting systems into full compliance with capturing all data fields required under the Commission's rules. DMO will not recommend that the Commission commence an enforcement action against the HSBC swap entities for failure to fulfill their reporting obligations under Parts 43, 45, and 46 due to non-reporting of the "exotic notional amount leg 2" and "exotic settlement currency leg 2" data fields for exotic interest rate swaps,¹⁰ and untimely reporting of the indication of collateralization data field for equity and FX swaps until **March 30, 2013**. As a condition of relief, the HSBC swap entities must complete and correct their SDR reporting records with respect to the swaps and data fields subject to this no-action position as soon as technologically practicable upon resolution of the technological issue preventing timely compliance, but in no case later than April 30, 2013.

C. Delay in reporting the initial USI of an FX swap for purposes of linking that initial USI to the USI of a new swap created under Parts 43 and 45 until April 30, 2013.

In the Letter, you represented that for certain FX swaps, particularly those executed pursuant to prime brokerage arrangements or as a result of the post-trade execution allocation of a bunched order, the HSBC swap entities require additional time to develop and implement the technology infrastructure necessary to append the USI of the previously reported initial swap to the USI generated for the subsequent swap.¹¹ You represented that while the issue would not exist for the other asset classes, the extent of changes required across the HSBC swap entities and the infrastructure of key vendors for FX swaps had proven unexpectedly complex. To provide additional time to come into full compliance with the applicable provisions of Parts 43 and 45, the HSBC swap entities requested no-action relief until July 1, 2013 with respect to reporting the initial USI of an FX swap that gets reported under a new USI due to prime brokerage arrangements or post-trade execution allocations.

DMO believes that, in light of the above-described technical difficulties and the HSBC swap entities' representations of good faith efforts to remedy these difficulties, time-limited no-action relief is appropriate. Accordingly, for FX swaps that are executed pursuant to prime brokerage arrangements¹² or allocated post-trade execution, DMO will not recommend that the

¹⁰ For purposes of the no-action position taken in section B, "exotic" interest rate swaps are swaps in the interest rate asset class that meet all of the following characteristics: (i) not listed for trading on a designated contract market; (ii) not available to be traded on a swap execution facility; (iii) not eligible to be cleared by a derivatives clearing organization; (iv) not eligible to be confirmed through an electronic matching confirmation system; and (v) not represented in FpML.

¹¹ For post-execution events, including full novations and compressions where the initial swap is extinguished and replaced by a new swap, a USI for the new swap must be generated by the reporting counterparty and linked to the USI of the initial swap such that when the new swap is reported to the SDR, the SDR is able "to map the new USI back to the USIs of the swaps from which the new swap originated, in a manner sufficient to allow the Commission and other regulators to follow the entire history and audit trail of each affected swap." See Regulatory Reporting Rule at 2159.

¹² For purposes of the no-action position in section C, "prime brokerage arrangements" refer to trading arrangements under which multiple swaps result, the USIs of which must be linked such that the swaps can be traced back to an original transaction executed between a prime broker and executing dealer. DMO is not taking any interpretive position in this response as to the number of swaps that result from the prime brokerage arrangement, or as to which counterparty is responsible for linking the various swaps to the initial transaction. See Staff No Action Letter No. 12-53 (Dec. 17, 2012) (Prime Brokerage Transactions)

Commission commence an enforcement action against the HSBC swap entities for failure to fulfill their reporting obligations under Part 45 due to non-reporting of the USI associated with the initial swap for purposes of linking that initial USI with the USI of the new swap created through prime brokerage or post-trade execution allocation until **April 30, 2013**. Upon the expiration of this no-action position, the HSBC swap entities must come into full compliance with reporting the initial USI of FX swaps in order for it to be linked with the new swap's new USI created after an allocation as required under Part 45. As a condition of relief, the HSBC swap entities must complete their SDR reporting records for any initial USI data field not reported pursuant to this no-action position as soon as technologically practicable upon resolution of the technological issue preventing timely compliance, but in no case later than May 31, 2013.

D. Reporting amendments to an interest rate or FX swap that do not change the price of the swap under Part 43 until March 30, 2013.

In the Letter, you represented that the HSBC swap entities' internal processes for determining whether an amendment to an interest rate or FX swap changes the swap's price, thus making it a publicly reportable event under Part 43,¹³ will not have been fully implemented by the applicable reporting deadline due to unforeseen complexity in testing these processes. Thus, you represented that the HSBC swap entities may report amendments to interest rate or FX swaps under Part 43 such as book changes that do not actually change the swap's price, and therefore should not have been reported. To account for this over-reporting, the HSBC swap entities have requested no-action relief until March 31, 2013 to provide additional time in which to bring their reporting systems into full compliance with Part 43 by reporting only those amendments that affect price.

DMO believes that, in light of the above-described technical difficulties and the HSBC swap entities' representations of good faith efforts to remedy these difficulties, time-limited no-action relief is appropriate to allow the HSBC swap entities additional time to test and fully implement systems capable of distinguishing between publicly reportable and non-publicly reportable swap amendments. For swaps in the interest rate and FX asset classes, DMO will not recommend that the Commission commence an enforcement action against the HSBC swap entities for failure to fulfill their reporting obligations under Part 43 by over-reporting amendments to an interest rate or FX swap, wherein such amendments are not price forming events until **March 30, 2013**.

(providing additional information with respect to reporting of swaps executed pursuant to prime brokerage arrangements).

¹³ Regulation 43.2 defines "publicly reportable swap transaction" as "[a]ny termination, assignment, novation, exchange, transfer, amendment, conveyance, or extinguishing of rights or obligations of a swap that changes the pricing of the swap." Real-Time Reporting Rule at 1244 (emphasis added). Such amendments include price-forming continuation data. See Real-Time Reporting Rule at 1226, 1255-56 ("An indication of whether such publicly reportable swap transaction is a post-execution event that affects the price of the publicly reportable swap transaction. Such price-forming continuation data may include: Terminations, assignments, novations, exchanges, transfers, amendments conveyances or extinguishing of rights that change the price of the swap."). This continuation data also may be required under Part 45, regardless of whether it changes the price of the swap. See Regulatory Reporting Rule at 2202.

E. Delay in reporting expired, non-electronically confirmed historical interest rate and credit swaps under Part 46 until March 30, 2013.

In the Letter, you represented that due to significant technological issues, the HSBC swap entities' reporting systems would not be capable of reporting historical swaps in the interest rate and credit asset classes that have expired and were not confirmed electronically by the applicable Part 46 compliance deadline. You represented, however, that ninety percent of historical credit swaps and forty percent of historical interest rate swaps would not be affected by the technological issues and thus would be reported by the applicable compliance deadline pursuant to Part 46. Accordingly, the HSBC swap entities requested no-action relief with respect to Part 46 reporting obligations for historical swaps in the interest rate and credit asset classes until March 31, 2013 in order to implement a technological fix.

DMO believes that, in light of the above-described technical difficulties and the HSBC swap entities' representations of good faith efforts to remedy these difficulties, time-limited no-action relief is warranted. For expired, non-electronically confirmed historical swaps in the interest rate and credit asset classes, DMO will not recommend that the Commission commence an enforcement action against the HSBC swap entities for failure to fulfill their reporting obligations under Part 46 until **March 30, 2013**. As a condition of relief, the HSBC swap entities must report all swaps previously not reported pursuant to this no-action position as soon as technologically practicable upon resolution of the technological issues preventing timely compliance, but in no case later than April 30, 2013. DMO is satisfied that the delay in reporting of this narrow group of historical swaps will have a minimal impact on the Commission's ability to utilize historical swap data for regulatory purposes.

F. Delay in reporting interest rate and FX swaps by certain non-hub foreign branches under Parts 43, 45, and 46 until April 30, 2013.

In the Letter, you represented that while HBEU and HBAP have focused on establishing and enhancing reporting systems in their principal global hubs, they require more time to automate their reporting systems for swaps booked in certain non-hub foreign branches.¹⁴ Until these systems are further automated, you represented that HBEU and HBAP will not be able to report by the applicable compliance deadlines a small proportional volume of global swap transactions for the interest rate asset class (approximately 1,200 new trades per month for HBAP, representing less than one percent of the total trade volume for each HBEU and HBAP, and 10,000 historical swaps for HBEU and HBAP combined) and FX asset class (less than one percent of total new trade volume¹⁵ and 43,000 historical swaps for HBEU and HBAP combined). In order to provide the affected non-hub foreign branches additional time to automate their reporting systems, HBEU and HBAP requested no-action relief from all reporting

¹⁴ You represented that the affected non-hub branches of HBEU and HBAP are located in Spain, Israel, the Czech Republic, Australia, the Maldives, Bangladesh, Mauritius, Brunei, New Zealand, India, the Philippines, Indonesia, Singapore, Japan, South Africa, Korea, Sri Lanka, Labuan, Taiwan, Macau, Malaysia, and Vietnam.

¹⁵ You noted that this statistic pertains to real-time (Part 43) and primary economic term (Part 45) data. For confirmation data as required under Part 45, you represented that approximately 23 percent of HBAP's FX trade volume, and less than one percent of HBEU's FX trade volume, will be affected by the reporting delay.

requirements under Parts 43, 45, and 46 for the affected non-hub branches with respect to swaps in the interest rate and FX asset classes until June 30, 2013.

DMO believes that, in light of the above-described technical difficulties and HBEU and HBAP's representations of good faith efforts to remedy these difficulties, time-limited no-action relief is appropriate. Additionally, given the small volume of trades affected relative to HBEU and HBAP's overall dealing in interest rate and FX swaps, DMO is satisfied that the impact on market transparency will be minimal. For swaps in the interest rate and FX asset classes executed between a U.S. person and a non-hub branch of HBEU or HBAP located in one of the affected countries,¹⁶ DMO will not recommend that the Commission commence an enforcement action against HBEU or HBAP for failure to fulfill their reporting obligations under Parts 43, 45, or 46 due to non-reporting of any data to an SDR as required under those rules until **April 30, 2013**. DMO believes that a four-month timeframe should be sufficient for HBEU and HBAP to fully connect their affected branch systems to their central reporting hub. As a condition of relief, HBEU and HBAP must promptly notify DMO if the volume of interest rate or FX swaps transacted in any one affected non-hub branches increases by 50 percent or more during any single month of the no-action relief period, as compared to the same month during the 2012 calendar year. Additionally, HBEU and HBAP must report those trades previously not reported pursuant to this no-action position under Parts 43, 45, and 46 as soon as technologically practicable upon resolution of the technological issues preventing timely compliance, but in no case later than May 31, 2013. DMO expects that HBEU and HBAP will prioritize the remediation of those affected non-hub branch locations that account for the largest volume of reportable swap transactions, and will make good faith efforts to have their counterparties to the affected trades agree to be the reporting counterparty during the no-action relief period.

The following conditions apply to each no-action position taken in sections A through F, above:

- 1) Despite each staff no-action position taken herein expiring upon a certain future date, the HSBC swap entities are required to begin reporting in full compliance with the CEA and Commission's regulations as soon as technologically practicable upon the resolution of the technological issues preventing timely compliance, even if such resolution occurs prior to the applicable no-action position expiration date.
- 2) During the pendency of remediation efforts and prior to completing or correcting all required swap transaction data records in the SDR, the HSBC swap entities must retain records with respect to all transactions covered by the relief in this response and make such records available for inspection and production immediately to the Commission upon request.
- 3) For each no-action position taken in sections A through F, above, the HSBC swap entities' chief information officers (or equivalent) must document an internal determination, no later than December 30, 2012, with respect to the technological difficulties that have resulted in an inability to comply with the applicable Commission regulations by the relevant compliance deadlines.

¹⁶ See supra note 14.

- 4) If any representations made by the HSBC swap entities in the Letter cease to be true or materially changes with respect to a no-action position, that no-action position is void.
- 5) Should the Commission promulgate additional swap data reporting rules applicable to the subject matter covered herein during the pendency of this no-action relief period, such rules would supersede the no-action relief granted herein.

This Division letter, and the no-action positions taken herein, represent the views of DMO only, and do not necessarily represent the position or views of the Commission or of any other division or office of the Commission's staff. The no-action positions taken herein do not excuse affected persons from compliance with any other applicable requirements of the CEA or Commission regulations thereunder, and applies only to the HSBC swap entities in their capacity as the requestor of this relief. Further, as with all no-action letters, DMO retains the authority to condition further, modify, suspend, terminate, or otherwise restrict the terms of the no-action relief provided herein, in its discretion.

If you have any questions regarding the content of this staff no-action letter, please contact Graham McCall, Attorney-Advisor, DMO, at 202-418-6150 or gmccall@cftc.gov.

Sincerely,

Richard A. Shilts
Acting Director
Division of Market Oversight