



27 September 2018

General Manager Policy Development
Policy and Advice Division
Australian Prudential Regulation Authority
GPO Box 9836
SYDNEY NSW 2000

By email: ADIpolicy@apra.gov.au

Dear Sir/Madam,

Discussion Paper
Revisions to the related entities framework for ADIs

HSBC Bank Australia Limited and The Hongkong and Shanghai Banking Corporation Sydney Branch (collectively 'HSBC') welcomes the opportunity to provide comments on the Discussion Paper *Revisions to the related entities framework for ADIs*.

In Australia, the HSBC Group offers an extensive range of financial services through a network of 37 branches. These services include retail and commercial banking, trade finance, treasury and financial markets, payments and cash management and securities custody. HSBC Holdings plc, the parent company of the HSBC Group, is headquartered in London. The Group serves customers worldwide from around 4,000 offices in 70 countries and territories in Europe, Asia, North and Latin America, and the Middle East and North Africa. With assets of US\$2,522bn at 31 December 2017, HSBC is one of the world's largest banking and financial services organisations.

In relation to the Discussion Paper, HSBC has participated in the industry discussions led by the Australian Banking Association (ABA) and the Australian Financial Markets Association (AFMA) and we support the industry submissions.

We have undertaken a review of the Discussion Paper and write to provide our feedback. Please note that we have not directly addressed each of the Consultation questions under Section 9, and instead have directed our feedback towards specific areas relevant to HSBC Australia.

Definitions in the Draft Prudential Standard APS 222

- **8(a) associate:** We seek clarity as to whether the expectation is for ADIs to look beyond the customer collated and publicly available information. We note that there may be limitations on establishing an associate relationship if the public information is not readily available, particularly in the instance of non-listed customers.
- **8(b) control:** We recommend APRA issue further guidance as to what constitutes a 'significant influence' and possibly provide some examples of the type of actions that would fall under this definition.

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- *8(d) related entities:* We note that the inclusion of 'but is not limited to' within the definition suggests there may be other instances where a related party relationship can be established. We suggest APRA provides further guidance in regard to the circumstances that may constitute an 'other instance'. As an example when considering related individuals' relatives should this include immediate relatives only (eg: parents, spouse, children and siblings)?
- *8(e) related individual:* We note that the draft standard wording 'but is not limited to' implies additional individuals to the Board, senior managers and individuals with direct or indirect influence on those individuals. We recommend APRA provide further guidance by way of examples of the individuals who may exert indirect control over the ADI. We note the requirements are broad and we expect that it will pose operational and compliance costs for local subsidiaries of foreign banks which are unlikely to have exposures to offshore persons captured under these requirements. We suggest establishing limitations to contain the requirements to Australian based individuals or alternatively to set a minimum value threshold for offshore individuals within scope.

Controls of risks arising from related entities

With regard to clause 10, we note that the implementation of the proposed requirement for a locally incorporated, foreign-owned ADI which is part of a geographically diverse banking group that has a Head Office outside of Australia, would be significantly more complicated than for an Australian-based group with the majority of operations in Australia.

As an example, using the assumption that the definition of a banking group is wide-ranging in scope and a significant number of related entities outside of Australia are captured, then subclause (b) would require a locally incorporated foreign-owned ADI to assess the adequacy of systems, controls and risk management for each and every related entity, which would include those outside of Australia. We request that APRA consider clarifying whether this type of example is the operational intention of the proposed requirements.

We note with regard to clause 11(h) *third party dealings* we seek APRA's clarification that this clause is applied from the implementation date of the revised Standard and will not have any retrospective application.

Participation in group-wide operations

With regard to clause 26, we seek clarity on the scope of group-wide operations as to whether the definition refers to operational processes only, or the scope would also encompass non-operational processes such as policy development.

With regard to clause 27(e), we suggest that the requirement would apply to contracts going forward only and not to be retrospective given these contracts are already in force and it would be administratively burdensome. Where there are updates to contracts, the update would need to comply and the written clause would be incorporated.

With regard to clause 28, a Board may have previously provided delegations to managers for outsourcing which would overlap with this requirement. In such cases, we seek APRA's views if the Board would be able to rely on the delegated party to carry out this assessment? On a similar point, we would suggest that the Board be able to define a risk appetite position which delegates can operate with in making assessments for clause 28, without the need for the Board to individually consider each group operation where a delegate has been appointed.

Limits on exposures to related entities

With regard to clause 29 we seek APRA's confirmation that an exposure to a single related ADI or an overseas equivalent is to include the related ADI controlled (consolidated subsidiary ADIs) and associate ADIs. Additionally we seek APRA's confirmation that the aggregate and single exposures to related ADIs is to exclude exposures to Non ADIs that are related to the related ADI.

We recommend APRA consider the removal of clause 31 from APS 222 to avoid local subsidiaries of foreign ADIs being held to stricter limits than local ADIs. The foreign ADI parent holding of all equity and capital debt instruments are tangible incentives that mitigate potential contagion risk. Accordingly we suggest to increase the proposed limit to individual related ADIs to at least 50% of Tier 1 Capital with scope for ADIs to seek APRA's approval for higher limits considering the parent ADI specific financial soundness and its supervisory framework. We believe that proceeding with more restrictive limits on subsidiaries of foreign ADIs will present commercial and competitive challenges with unfavourable implications to the wider local banking industry and economy. As a global bank offshore corporate and trade relationships would typically require guarantee support to and from related entities to enable inbound and outbound credit and trade activities to proceed, similarly risk management activities will typically entail transfer of risk to the foreign parent entity to be more efficiently managed. We are concerned that overly restrictive limits will undermine the capacity for foreign ADIs to play a lead role in trade and inbound credit financing which risks such activities to either not proceed, incur higher premiums, or to be concentrated amongst fewer financiers.

In the instance where clause 31 is retained, we would then recommend APRA consider providing further clarification on the definition of the 'foreign parent of the ADI'. For example is this intended to be the immediate controlling foreign parent, or could it be interpreted as the ultimate foreign parent? We note that this requirement does not reference 'related' entities to foreign parents however it requires inclusion of its overseas based subsidiaries and directly owned Non-ADI entities. We seek APRA's clarification if the intent is for the exposure scope to be those entities immediately related to the foreign ADI parent (and its consolidated subsidiaries and non-ADI entities) and exclude related entities in instances where the foreign parent is controlled by another foreign parent (the ultimate foreign parent).

Further we seek to ensure that this requirement is consistent with 29(a)(i) except for the inclusion of non ADI entities owned by the foreign parent ADI and operating in Australia and exclusion of foreign parent Associates and related individuals.

We also recommend APRA considers delaying the implementation of stricter prudential limits until finalisation of the revised capital framework. As an alternative we suggest that new limits could have a phased implementation, in conjunction with the revised capital framework.

Additionally we advise that the application date requires further clarification from APRA. We note that under APS 221 the application date is January 2019, however under APS 222 the application date is January 2020.

Notification requirements

With regard to clause 42, the current wording requires immediate notification to APRA where there are any circumstances that might reasonably be seen as having a material impact or potentially adverse consequences for an ADI in the group or for the overall group. We note that

in most cases this would likely be impractical given the ADI's immediate priority would be the management of such a situation and therefore we propose a within 24 hours reporting time period as a more reasonable solution.

We thank APRA for considering our comments and should you have any questions, please do not hesitate to contact our Regulatory Affairs team via email

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Yours sincerely,


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HSBC Bank Australia Limited