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By e-mail and courier

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Andrea Enria, Esq.
Chairperson
European Banking Authority
Floor 46
1 Canada Square
London E14 5AA

Dear Sir,

Re: HSBC Holdings plc - Redesignation of Tier 2 Discount Perpetual Capital Securities

We refer to the letter we sent to you on 8 June, 2018, in which we explained certain concerns we had relating to the redesignation by HSBC Holdings plc ("**HSBC Holdings**") of just under US$ 2 billion of certain discount perpetual Tier 2 capital securities (the "**Discos**") issued by HSBC Bank plc and The Hongkong and Shanghai Banking Corporation Limited (the "**8 June Letter**"). As at the date of this letter, our clients hold around [ ]% of the aggregate principal amount outstanding of the Discos.

The 8 June Letter was sent to you following the publication, on 30 May 2018, of the joint statement by the European Banking Authority (the "**EBA**") and the European Securities and Markets Authority ("**ESMA**") on the treatment of retail holdings of debt financial instruments subject to the E.U. Bank Recovery and Resolution Directive (the "**Joint Statement**"). Since the publication of the Joint Statement, the Bank of England Resolution Directorate has published its final policy on MREL, including internal MREL, pursuant to a Policy Statement issued on 13 June 2018.

As we explained in the 8 June Letter, on 29 May 2018, we sent a letter to HSBC Holdings requesting an explanation, preferably by an announcement to the market, for the redesignation of the Discos as eligible Tier 2 securities under the E.U. Capital Requirements Regulation (the "**CRR**"), rather than grandfathered under the CRR and, thus, ceasing to be eligible for inclusion in own funds under the CRR from 1 January 2022. We sent a second letter to HSBC Holdings on 8 June 2018 following the publication of the Joint Statement, pointing out that the Joint Statement raises points which are relevant to, and supportive of, the concerns that we raised with HSBC Holdings in a letter sent to it on 29 May, 2018.

[ ]

Although we appreciate that under the E.U. legislative framework, the responsibility for evaluating whether own funds instruments meet the applicable criteria specified in the CRR lies with the applicable competent authority – in the case of HSBC Holdings and HSBC Bank plc, the Prudential Regulation Authority - the EBA is required, by the Regulation which established it (Regulation (EU)

1093/2010), to ensure the consistent and effective application of E.U. legislation within its scope. That scope includes banking regulation, including the capital adequacy regime.

The Discos were issued in 1985 and 1986, before even the Basel 1 capital adequacy regime was published; unsurprisingly, the terms and conditions of the Discos are much shorter than those seen in modern Tier 2 securities, and they do not address, in express terms, a number of specific requirements of Article 63 of the CRR. We note that the EBA may wish to consider the questions set out below with the Prudential Regulation Authority who, we understand from statements made by HSBC Holdings, has not raised any objections to the redesignation of the capital treatment of the Discos under the CRR. We note, also, that other banks incorporated in EU member states (or their affiliates) have outstanding similar old-style, pre-Basel 1 perpetual Tier 2 securities, and that certain of these institutions treat these instruments as grandfathered Tier 2 instruments under the CRR (so they will cease to be eligible own funds from 1 January 2022), while others (including, now, HSBC Holdings) treat them as eligible Tier 2 instruments under the CRR. The different approaches to determining the eligibility of such instruments as Tier 2 capital, notwithstanding that they are all of similar vintage and have very similar contractual terms, raises concerns as to the consistency of approach in applying the criteria specified in (in this case) Article 63 of the CRR.

Against that background, we have the following specific questions relating to perpetual Tier 2 securities such as the Discos, on which we request a response from the EBA.

1. As a general matter, does the EBA consider it permissible, reasonable or appropriate for a credit institution or its holding company to change the designation of capital instruments under the CRR over four years after the CRR came into effect, without any explanation, and without any amendment to the contractual terms of the instruments in question, or any change in law affecting the instruments in question? This is exactly the situation regarding the Discos: for over four years, HSBC Holdings has informed the market that a certain capital treatment applies to the Discos; now, without any explanation, it has changed its approach. This has caused considerable confusion in the market, and raises questions around the capital adequacy designation of similar capital instruments which cannot be answered because no explanations for this change have been provided.

2. The terms and conditions of the Discos do not expressly state that the Discos may be called, redeemed or repurchased or repaid early only where the conditions specified in Article 77 are met, as referred to in paragraph (j) of Article 63 of the CRR (we are ignoring for present purposes the references in paragraph (j) to Article 78 of the CRR, because the Discos were issued more than 30 years ago). Does paragraph (j) of Article 77 require instruments eligible for inclusion in Tier 2 capital to contain contractual provisions addressing the requirement in paragraph (j) of Article 63, or is it sufficient that the issuer of the instruments is subject to a regulatory regime whereby it must obtain the prior permission of its competent authority in order to effect the call, redemption, repayment or repurchase of Tier 2 instruments?

3. If the latter (i.e. the regulatory regime suffices), how would investors or potential investors in these instruments be or become aware of the regulatory requirements relating to a redemption, repayment or purchase of Tier 2 instruments in circumstances where, as in the case of the Discos, there is no disclosure document which identifies this requirement, and the instruments are capable of being acquired by retail investors? Would a lack of disclosure relating to these issues preclude an issuer from relying on the argument that the regulatory regime suffices in order to satisfy the criterion specified in paragraph (j) of Article 63?

4. Paragraph (d) of Article 63 provides that the claim on the principal amount of the instruments under the provisions governing the instruments or the claim of the principal amount of the subordinated loans, as applicable, is "wholly subordinated to the claims of all non-subordinated creditors". The terms and conditions of the Discos state as follows (taking as an example the issuance by Midland Bank plc, now known as HSBC Bank plc, of US$ 750,000,000 of undated floating rate primary capital notes issued on or about 17 June 1985, Condition 2)[1]:

> "....Claims in respect of principal and interest on the Notes are subordinated in the Trust Deed to the claims of Senior Creditors (as defined in the Trust Deed) and accordingly the Bank's obligation to make any payment of interest (and, where applicable, any repayment of principal) is conditional upon the Bank being able to make such payment and remain solvent (as defined in the Trust Deed) thereafter.
>
> In the event of a winding-up of the Bank in England, the Notes shall be treated as if at the close of business on the business day preceding the commencement of the winding-up of the Bank the principal amount payable in respect of the Notes together with Arrears of Interest and interest accrued in the current Interest Period had been converted into preference shares of £1 each in the capital of the Bank at the rate of exchange ruling on such preceding business day in accordance with the terms set out in Condition 9".

The Principal Trust Deed in relation to these Discos has not been made available on the website of HSBC Holdings. It is not possible, therefore, for a potential investor in these Discos to determine what is meant by "Senior Creditor", or by the term "solvent". However, it appears that it is possible for HSBC Bank plc to make payments on these Discos ahead of amounts owing under other debt obligations (including, potentially, one or both of the other issuances of Discos made by HSBC Bank plc), as long as it would remain "solvent" after making that payment; but it is impossible to tell from the publicly available information on these securities the period over which one would determine that the Bank is required to be "solvent" in order to make any payments which would otherwise be prior-ranking.

We assume that an actual investor could request a copy of the Principal Trust Deed from the Trustee or the Paying Agent, although it is by no means clear from the offering document issued in 1985 that either the Trustee or the Paying Agent would provide, or be obliged to provide, a copy of the Principal Trust Deed even to an existing investor.

It appears to us that it is at least arguable that provisions such as those contained in Condition 2 of the Discos are not compliant with paragraph (d) of Article 63; or if they are, it is impossible for any actual or potential investor to determine who the "Senior Creditors" are, or what is meant by "solvent" and, thus, how to price the risks involved accurately. In the EBA's view, are instruments which contain terms such as these, which do not expressly state that they are wholly subordinated to all non-subordinated creditors of the issuer, and which imply that in certain situations, they may not be wholly subordinated, compliant with the criterion specified in paragraph (d) of Article 63?

We would add, also, that it is not clear how the second paragraph of Condition 2, set out above, would be construed in the event of a bail-in of these securities. Bail-in should preclude a winding-up of HSBC Bank plc, so the notional conversion to preference shares

[1] A copy of the offering circular for this issuance of Discos is attached to this letter.

would not occur, yet it is unclear how the contractual provision and any valuations undertaken prior to or upon the exercise of the bail-in power in accordance with the statutory regime would value the Discos in light of the express provisions of Condition 2. The same concerns apply to the notional conversion of Discos into preference shares contemplated by Condition 9 (Enforcement). Does the EBA consider that provisions such as these cut across the criterion specified in paragraph (d) of Article 63?

5. The Discos bear interest at a margin over US dollar LIBOR for either three months or six months, depending on the issuance. LIBOR as a benchmark interest rate must be replaced by the end of 2021. As you are aware, LIBOR is not a risk-free rate, so the current discussions around a replacement risk-free rate will not necessarily apply to instruments which bear interest previously based on an interbank rate.

   Paragraph (m) of Article 63 provides that "the level of interest..... due on the instruments or subordinated loans .... will not be amended on the basis of the credit standing of the institution or its parent undertaking".

   If the replacement for LIBOR proposed by the issuers of floating rate subordinated debt instruments such as the Discos is a rate which either directly or indirectly draws on the credit standing of the applicable issuer or its holding company (or any intermediate holding company), would that replacement rate of interest result in those instruments failing to satisfy the criterion specified in paragraph (m) of Article 63?

6. Paragraph (4) of Article 78 of the CRR contains conditions which must be satisfied before the competent authority of a credit institution may permit the institution to redeem Tier 2 securities within the period of five years from the date of their issuance. Old-style perpetual subordinated securities such as the Discos do not contain contractual provisions which reflect the requirements of paragraph (4). Does the lack of contractual language to this effect disqualify such instruments for inclusion in Tier 2 capital, notwithstanding that the securities were issued over thirty years ago, or is it sufficient, in any event, if the applicable regulatory regime would require that consent be obtained from the competent authority? In the latter case, would a lack of disclosure to investors or potential investors in these instruments regarding the regulatory requirements specified in paragraph (4) of Article 78 preclude an issuer from treating such instruments as Tier 2 capital?

We look forward to your responses to the questions raised in this letter. Please do not hesitate to contact Sarah Smith of this Firm if you would like to discuss any of the issues raise.

Yours faithfully,

Akin Gump LLP.

Akin Gump LLP

Enc: Offering document for the issuance of US$750,000,000 Undated Floating Rate Primary Capital Notes, published on 24 May 1985.