BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ADDRESS OFFICIAL CORRESPONDENCE
TO THE BOARD

January 14, 2009

John G. Holinka, Esq.
Associate General Counsel
HSBC Bank USA, National Association
One HSBC Center
Buffalo, New York 14203

Dear Mr. Holinka:

This is in response to the request by HSBC Bank USA, National Association ("Bank"), McLean, Virginia, for exemptions from section 23A of the Federal Reserve Act and the Board's Regulation W[1] to permit Bank to acquire (1) automobile loans and retail installment contracts and (2) certain credit card receivables and related securitization interests from several subsidiaries of Bank's affiliate, HSBC Finance Corporation ("HSBC Finance"), Mettawa, Illinois.

HSBC North America Holdings, Inc. ("Holdings"), the top tier U.S. bank holding company, intends for the HSBC organization in the United States to cease making automobile loans, and HSBC Finance will discontinue its new automobile loan originations.[2] As part of this business plan, Bank proposes to purchase certain automobile loans (the "Auto Portfolio") from HSBC Finance's portfolio of subprime and near-prime automobile loans. As of July 31, 2008, HSBC Finance's automobile loans totaled approximately [ ] The Auto Portfolio that Bank proposes to purchase would total approximately [ ] billion in loans.[3] The Auto Portfolio would continue to be serviced by HSBC Auto Finance Inc., a subsidiary of HSBC Finance. Bank does not propose to purchase any

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1 12 U.S.C. §371c; 12 CFR part 223.

2 Bank, Holdings, and HSBC Finance are all subsidiaries of HSBC Holdings, plc, London, England ("HSBC").

3 The remaining [ ] in automobile loans will be retained by HSBC Finance until maturity.

automobile loans from its affiliates that would constitute "low-quality assets," as defined by section 23A of the Federal Reserve Act.[4]

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Bank proposes to purchase automobile loans, credit card loans, and related securitization interests from HSBC Finance to provide liquidity to HSBC Finance. Bank indicates that its purchase of the portfolios will provide a lower-cost option for the overall HSBC organization. HSBC Bank has retained [ ] to determine the fair market value of each portfolio.

Section 23A and Regulation W limit the amount of "covered transactions" between a bank and any single affiliate to 10 percent of the bank's capital stock and surplus and limit the amount of covered transactions between a bank and all its affiliates to 20 percent of the bank's capital stock and surplus. "Covered transactions" include a bank's purchase of assets from an affiliate and a bank's extension of credit to an affiliate. The statute and regulation also require a bank to secure its extensions of credit to, and certain other covered transactions with, affiliates with prescribed amounts of collateral. In addition, section 23A and Regulation W prohibit a bank from purchasing low-quality assets from an affiliate.

Section 23A and Regulation W specifically authorize the Board to exempt, in its discretion, transactions or relationships from the requirements of the statute and rule if the Board finds such exemptions to be in the public interest and

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[4] 12 CFR 223.3(v).

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consistent with the purposes of section 23A.[8] The Board has approved exemptions under section 23A for one-time asset transfers that are part of a corporate reorganization and that are structured to ensure the quality of the transferred assets. As in previous cases reviewed by the Board, the proposed transactions in this case are a byproduct of a one-time corporate reorganization. The sale of the assets to Bank is part of a restructuring HSBC's operations for automobile lending and credit cards. According to Bank, this exemption is in the public interest because the reorganization will provide liquidity to HSBC Finance and enhance its ability to offer credit to the public.

HSBC, Bank, and its mid-tier U.S. bank holding company parent, HSBC USA, Inc., New York, New York ("HSBC USA"), have made the commitments listed in Appendix A (auto loans) and Appendix B (credit cards) to ensure Bank is made whole if the quality of the assets that Bank proposes to purchase deteriorates.[9] HSBC, HSBC USA, and Bank have committed to comply with these commitments for the life of the automobile loans and for five years for the Card Portfolios. These commitments are similar to commitments relied on by the Board in previous internal corporate reorganizations. These commitments require that the funds transferred by HSBC or HSBC USA to Bank to support any of the low-quality assets will remain in the bank to provide a cushion of additional capital in excess of Bank's required regulatory capital. The commitments ensure that these funds will remain available to Bank and will not be returned to HSBC or HSBC USA through a dividend or a return of capital.[10] In addition, a majority of Bank's board of directors has reviewed and approved the transaction. The Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation have reviewed the transaction and informed the Board that they have no objection to the proposal.

In light of these considerations and all the facts presented, the reorganization transaction appears to be consistent with safe and sound banking practices and on terms that would ensure the quality of the assets transferred. Accordingly, the transaction appears to be consistent with the purposes of section 23A, and the Director of the Division of Banking Supervision and

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[8] 12 U.S.C. § 371c(f)(2); 12 CFR 223.43(a).

[9] See 12 CFR 223.41(d).

[10] See Board letter dated December 21, 2007, to Andres Navarette, Esq. (Capital One Financial Corporation).

Regulation, pursuant to authority delegated by the Board, and with the concurrence of the General Counsel, hereby grants the requested exemptions.

This determination is specifically conditioned on compliance by HSBC, HSBC USA, and Bank with all the commitments and representations made to the Board in connection with the exemption request. These commitments and representations are deemed to be conditions imposed in writing in connection with granting the exemptions and, as such, may be enforced in proceedings under applicable law. This determination also is based on the specific facts and circumstances of the proposed transaction and may be revoked if a material change in those facts or circumstances occurs or if HSBC, HSBC USA, or Bank fails to observe any of their commitments or representations. Granting this exemption request does not represent a determination concerning the permissibility of any other transactions engaged in by HSBC, HSBC USA, or Bank that are subject to section 23A or Regulation W.

Sincerely yours,

(signed)

Robert deV. Frierson
Deputy Secretary of the Board

cc: Federal Reserve Bank of Chicago
Federal Deposit Insurance Corporation
Office of the Comptroller of the Currency

APPENDIX A
HSBC Auto Loans/Retail Installment Contracts ("Auto Loans")

1. At the first business day of the calendar year, HSBC USA Inc. ("HSBC USA") and Bank[1] will estimate the dollar value of all the transferred Auto Loans that they believes will become low-quality for that calendar year. HSBC Holdings plc ("HSBC") and HSBC USA commit to ensure that Bank receives sufficient capital to equal a dollar-for-dollar capital contribution ("capital pool") for the full book value of these assets. For any asset that becomes a low-quality asset during the year, the capital pool will be allocated against the specific asset, including any charge-offs taken since quarter end. At the end of each quarter, HSBC USA and Bank will update the estimate of potential low-quality assets in relation to the remaining unallocated capital pool. If at the time of the review, the forecast for the volume of low-quality assets exceeds the unallocated capital pool, HSBC and HSBC USA commit to ensure that additional capital is contributed to Bank in an amount adequate to provide coverage. Any additional required capital contributions should be made within 30 days from the end of each calendar quarter. This commitment will remain in effect for the remaining life of the loans, including any modifications or extensions.

2. HSBC and HSBC USA commit that Bank will hold an amount of risk-based capital equal to the book value of any low-quality assets that are transferred to Bank so long as Bank retains ownership or control of the transferred assets. For example, under this dollar-for-dollar capital requirement, the risk-based capital charge for each transferred low-quality loan asset would be 100 percent (equivalent to a 1250 percent risk weight), rather than the 8 percent requirement (equivalent to a 100 percent risk weight) that would apply to a similar defaulted loan asset that is not a part of the transferred asset pool.

3. Once the capital pool has been allocated to specific assets as described above, the capital cannot be applied to other low-quality assets if the initial low-quality asset returns to performing status. Bank can only apply the allocated capital pool to new assets if the initial assets are fully paid or sold.

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[1] In this context, Bank includes HSBC Bank USA, National Association as well as any HSBC-affiliated bank organized in the United States that may purchase or otherwise acquire Auto Loans.

APPENDIX B
HSBC Credit Card Loans ("Card Loans")

1. HSBC Holdings plc ("HSBC") and HSBC USA Inc. ("HSBC USA") commit to ensure that funds are contributed to Bank[1] in the amount of the book value of any low-quality assets[2] that are transferred to Bank at the time that the Card Loans are transferred to Bank. HSBC Holdings and HSBC USA will ensure that Bank holds an amount of risk-based capital equal to the book value of any low-quality assets that are transferred to Bank as long as Bank retains ownership or control of the transferred assets.[3] HSBC and HSBC USA commit that for a five year period following the purchase of the residual or retained interests in the trusts that hold securitized assets, cash contributions will be made as necessary to Bank to ensure that Bank holds additional capital (1) in the amount of any write down during that quarter on any such transferred residual or retained interest and (2) in any amount that Bank is required to contribute to any such securitization trust to support the performance of that trust (together, "securitized contributions").[4]

2. At the beginning of each year, HSBC USA and Bank will estimate the dollar value of (1) all the transferred Card Loans that they believe will become low-quality assets and (2) the amount of securitized contributions for that calendar year. HSBC and HSBC USA commit to ensure that Bank receives sufficient capital to equal a dollar-for-dollar capital contribution ("capital pool") for the full book value of these assets. For any asset that becomes a low-quality asset during the year, the capital pool will be allocated against

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[1] In this context, Bank includes HSBC Bank USA, National Association as well as any HSBC-affiliated bank organized in the United States that may purchase or otherwise acquire Card Loans.

[2] For the purposes of the "low-quality asset" definition, open-end credit such as credit cards are considered past due when the customer has not made the minimum payment for two or more billing cycles.

[3] For example, under this dollar-for-dollar capital requirement, the risk-based capital charge for each transferred low-quality loan asset would be 100 percent (equivalent to a 1250 percent risk weight) rather than the 8 percent requirement (equivalent to 100 percent risk weight) that would apply to a similar defaulted loan asset that is not a part of the transferred asset pool.

[4] See footnote 3.

the specific asset, including any charge-offs taken since quarter end. At the end of each quarter, HSBC USA and Bank will update the estimate of potential low-quality assets and securitized contributions in relation to the remaining unallocated capital pool. If at the time of the review, the forecast for the volume of low-quality assets and securitized contributions exceeds the unallocated capital pool, HSBC and HSBC USA commit to ensure that additional capital is contributed to Bank in an amount adequate to provide coverage. Any additional required capital contributions should be made within 30 days after the end of each calendar quarter. This commitment will remain in effect for five years after the transfer.

3. HSBC and HSBC USA commit that Bank will hold an amount of risk-based capital equal to the book value of any low-quality assets so long as Bank retains ownership or control of the assets.[5]

4. Once the capital pool has been allocated to specific assets as described above, the capital cannot be applied to other low-quality assets if the initial low-quality asset returns to performing status. Bank can only apply the allocated capital pool to new assets if the initial assets are fully paid off or sold.

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6. Before the purchase of assets is consummated, a majority of Bank's directors will review and approve the transaction.

[5] See footnote 3.