Republic of the Philippines
Department of Finance
Securities and Exchange Commission
SEC Building, EDSA, Greenhills, Mandaluyong City

Market Regulation Department

21 November 2011

SEC-MRD Opinion No. 02
Series of 2011

THE HONGKONG AND SHANGHAI BANK CORP.
HSBC Centre
3058 Fifth Avenue West
Bonifacio Global City, Taguig City
Fax: 581-8181

Attention: Atty. Michelle S. Serrano, VP, Senior Legal Counsel

SUBJECT: Amended Delivery versus Payment (DVP) Arrangements

Gentlemen:

This refers to your request for opinion on the issue whether or not the additional alternative settlement arrangements of your bank with qualified institutional buyers (QIBs) with regard to your government securities transactions achieve delivery versus payment (DVP), and hence compliant with SEC Memorandum Circular No. 14, series of 2006, otherwise known as the Rules Governing the Over-the-Counter (OTC) Market.

The said additional settlement arrangements will amend portions of your existing settlement procedures with qualified institutional buyers (QIBs) with regard to your government securities transactions which were confirmed to be compliant with Section 20 (B) of SEC Memorandum Circular No. 14 (2006), per SEC-MRD Opinion No. 2 issued on 08 October 2008.

Based on your letter, you are introducing additional alternative settlement procedures in order that your bank will be able to address dynamic market conditions. The new settlement procedures will be as follows:

SETTLEMENT DATE (T+0 and T+1)

A. ***Bank Sells Transaction***

1) BO manually prepares Confirmation of Sale (COS) using the yellow form prescribed by the Bureau of the Treasury (BTR), and secures the Confirmation of Purchase (COP) from the counterparty.

2) Cut-off time for receipt of COP from the client : 10:30 AM

3) The COS and COP are matched and should indicate the corresponding test key of HSBC and ROSS account numbers of each party.

4) COS/COP forms are transmitted to BTR via fax at tel. nos. (632) 5276257 / 5276258. Original copies (3 each) are sent on the same day via courier.

5) Cut-off time for submission of COS/COP to BTR is 3:30 PM

6) Cash settlement may occur under any of the following methods:

   a. *Debit Client's Account - BO performs earmarking of the cash settlement amount in client's account by virtue of the authorization to debit from the counterparty or as indicated in its existing standard settlement instructions.*

      i. BO staff earmarks the corresponding cash settlement amount in HUB-Front End (HFE) using function "ADD" under Hold Maintenance'.

      ii. BO officer validates earmark transaction in HFE through "REMOTE APPROVAL" function under Hold Maintenance screen.

      iii. Upon receipt of the BTR-acknowledged COS/COP forms at 3:30PM (via return-fax), BO staff phone confirms with BTR contact that transaction has been posted in their records. BO staff and officer then lifts the earmarking of the cash settlement amount in client's account through performing "DELETE" function for the Hold Maintenance in HFE.

      iv. After earmarking has been lifted, BO initiates subsequent online debit entry to client's cash account through function B462 in TREATS Online Accounting Control.

   b. *Via Manager's Check Payment*

      i. BO sends copy of deal ticket and confirms ENC availability/ approval from TC.

ii. VP/AVP Treasury Credit earmarks cash settlement amount against existing ENC credit line of counterparty or confirms ENC approval from the relevant credit authority.

iii. Once VP/AVP Treasury Credit confirms ENC availability / approval is in place via Lotus Notes (LN) Memo to BO and Network Services Center (NSC), NSC processor then performs earmarking of the check amount in HFE using "ADD" function under Hold Maintenance screen.

iv. NSC officer further validates earmark transaction in HFE through "REMOTE APPROVAL" function, which will cause progressive general ledger entries to be posted against the client's ENC line.

v. NSC then sends LN Memo to BO and TC once earmarking has taken effect.

vi. BO proceeds to send the COS/COP to the BTr.

vii. When BTR confirmation has been received that the transaction has been posted, BO to confirm to TC that the check is deemed purchased versus the ENC credit line. Thereafter, BO sends the check to Network Services Center (NSC).

c. *Thru RTGS Remittance Coursed Through the Client's Account*

i. Existing daily settlement limit (DSL) facility will be utilized for the counterparty, where payment is expected to be received via Real Time Gross Settlement (RTGS). Should there be no available credit facilities, the FO will have to seek approval from the relevant credit authority.

ii. Payment via RTGS is required to be received by 11:30am. Upon confirmation of such receipt, BO shall transmit via fax to BTR the COS/COP for the transaction. Earmarking and debit from QIB's account will follow the same procedures detailed in Part III-A-6.

d. *Thru Real Time Gross Settlement (RTGS) Remittance Directly to the Bank*

i. If funds are received via RTGS by 1:30 pm of settlement date, the Bank credits the cash settlement amount into the Cash Settlement Account and earmarks the same. If funds are not received by 1:30 pm, the Bank shall debit the Client's Daily Settlement Limit (DSL).

ii. The Bank transmits via fax to BTR the COS/COP for the transaction.

iii. Upon receipt of the BTR-acknowledged COS/COP forms at 3:30PM *(via return-fax), the Bank telephone-confirms with BTR whether* the transaction has been posted in their records.

iv. Upon obtaining such confirmation, the Bank releases the earmarking of the cash settlement amount.

e. Through ROSS-Telerate

i. Against Payment or DvP mode.

The Bank will input the trade in ROSS-Telerate and choose 'against payment' or DvP option. This will be acknowledged by the QIB and thereafter be authorized by the Bank. After such dual authorization of both parties, a ROSS-Telerate 'completed' ticket *is generated for each settlement signifying the transfer of* securities and cash.

ii. Free of Payment/Value Received mode.

1. The Bank will input the trade in ROSS-Telerate and indicate Value Received (signifying that the transfer in ROSS-Telerate is for the securities only) upon verification of DSL or receipt of funds for earmarking.

2. The ROSS-Telerate entry will be checked and acknowledged by the QIB and thereafter be authorized by the Bank. After such dual authorization of both parties a ROSS-Telerate 'completed' ticket is generated for each settlement.

3. The Bank effects the release of earmarked funds and it's debit from either the client's account or designated Settlement Account.

Failed Trade

In the unlikely event that the securities settlement fails for any reason, BO shall, as appropriate : (a) not post the debit entry in client's cash account and shall reverse the earmarking thereof through release of Clearing Hold in HFE, (b) cause the return of the check payment to the client and request NSC to reverse the earmarking of the ENC line, or (c) issue instructions via RTGS for funds to be remitted back to the counterparty as per Standard Settlement Instructions (SSI) or upon receipt of authenticated settlement instructions.

B. ***Bank Buys Transaction***

1) BO manually prepares Confirmation of Purchase (COP) using the green form prescribed by the Bureau of the Treasury (BTR) and forwards original copies to the seller of securities.

2) The COS and COP are matched by the selling counterparty and should indicate the corresponding test key of HSBC and RoSS account numbers of each party.

3) COS/COP forms are transmitted to BTR via fax by the counterparty. Original copies (3 each) are sent on the same day.

4) Cut-off time for submission of COS/COP to BTR is 3:30 PM

5) Cash settlement may occur under any of the following methods:

   a. Credit Client's account

      i. Before 3:30PM, BO staff secures BTR-acknowledged forms and phone confirms with BTR contact that the transaction has been processed at their end.

      ii. Upon confirmation that transaction has been processed, BO officer performs subsequent online credit entry to client's account for the corresponding cash settlement amount via function B462 in TREATS Online Accounting Control or HFE.

   b. Thru RTGS Remittance Coursed Through the Client's Account

      i. Upon receipt of instructions from the counterparty, BO staff prepares remittance via TREATS/HFE.

      ii. RTGS payment will be released by BO Releasing Officer based on receipt of confirmation from BTR that transaction has been posted.

   c. Thru Real Time Gross Settlement (RTGS) Remittance Directly to Another Beneficiary Bank

      i. Upon delivery of the COP to the Client and after confirmation from the Client on the corresponding transmission of the prescribed COS/COP forms to the BTR, the Bank shall credit the cash settlement amount to the Cash Settlement Account.

ii. Before 3:30 PM, the Bank shall secure a copy of the BTR-acknowledged forms and phone confirms with BTR whether or not the transaction has been processed at their end.

iii. *Upon receiving such confirmation from the BTR, the Bank releases* earmarked funds and remits the same to the beneficiary bank as designated by the Client.

d. *Thru ROSS-Telerate Terminal*

i. Against Payment of DvP mode

The QIB will input the trade in ROSS-Telerate and choose 'against payment' or DvP option. This will be acknowledged by the Bank and thereafter be authorized by the QIB. After such dual authorization of both parties a ROSS-Telerate 'completed' ticket is generated for each settlement signifying the transfer of securities and cash.

ii. Free of Payment/Value Received mode.

a) The QIB will input the trade in ROSS-Telerate and indicate Value Received (signifying that the transfer in ROSS-Telerate is for the securities only.

b) The ROSS-Telerate entry will be checked and acknowledged by the Bank and thereafter be authorized by the QIB. After such dual authorization of both parties a ROSS-Telerate 'completed' ticket is generated for each settlement.

c) The Bank effects an earmarking of funds upon entry of QIB of the transaction in the ROSS-Telerate. These earmarked funds *in either the client's account or Settlement Account shall be* released upon the completion in ROSS-Telerate of the said transaction.

Failed Trade

In the unlikely event that securities settlement shall have failed, i.e. securities were not delivered to HSBC through RoSS, BO shall cause (a) crediting of funds to client's account to be reversed, or (b) the transaction to be earmarked against counterparty DSL line until the funds are retrieved from the counterparty. Applicable charges may be levied on the counterparty on cost of funds for the number days that funds have not been returned.

Under the above transactions, whether buy or sell, settlement will be done on a per deal basis and will not involve netting or off-setting of transactions.

The above procedures and safeguards ensure that each transfer of securities is effected only when payment occurs or assured within the settlement cycle. As extensive discussed in SEC-MRD Opinion No. 2 issued to HSBC on 08 October 2008, DVP does not require simultaneous final transfers of funds and securities. It is essential though that the securities are delivered to the buyer if and only if it is confirmed that the cash aspect of the transaction is paid. Thus, in our view, **the new settlement arrangements described above and in your manual of procedures achieve DVP.**

It is understood though that the foregoing opinion is rendered based solely on the facts you disclosed and described in the query and relevant solely to the particular issue raised therein and shall not be used in the nature of a standing rule binding upon the Commission in other cases whether of similar or dissimilar circumstances. *(SEC Memorandum Circular No. 15 (2003))*

Finally, you are directed that the detailed HSBC Manual of Procedures for GS transactions with QIBs be made part of your records and that the same shall be disclosed to your counterparties and form part of the client agreement.

For your guidance.

Very truly yours,

VICENTE GRACIANO P. FELIZMENIO JR.
Director

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