HSBC

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Mr S Enevoldsen
Chairman
European Financial Reporting Advisory Group
13-14 Avenue des Arts
B-1210 Brussels
Belgium

Dear Mr Enevoldsen

Endorsement of IFRS 9 Financial Instruments

The timely endorsement of IFRS 9 by the EU is necessary to address an urgent need to improve the accounting for financial instruments in response to the financial crisis. HSBC believes that the standard both meets the technical criteria for endorsement and represents a significant improvement in accounting for financial instruments. In addition, timely endorsement of the standard is necessary to ensure that European companies are not placed at a competitive disadvantage. Endorsement would also signal a strong affirmation of the mixed measurement model over the full fair value measurement approach at a key stage in the development of accounting for financial instruments. HSBC therefore urges the European Commission to support a decision to endorse IFRS 9 without delay.

HSBC believes that IFRS 9 meets the technical criteria for endorsement. Specifically, IFRS 9 results in information that is more relevant (the classification reflects the business model as well as instrument characteristics, and requires reclassifications when the business model changes). The Standard results in information that is no less reliable and more comparable (a result of fewer categories, a single impairment method, and the removal of different treatments for embedded derivatives). The reduction in complexity should make financial information more understandable for the users of financial statements.

In addressing the significant flaws of the existing IAS 39 in the treatment of the impairment of available-for-sale securities, as requested by many stakeholders, IFRS 9 represents an improvement in accounting standards. In addition to this improvement,

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IFRS 9 represents an effective response to user demands for reduced complexity of accounting for financial instruments, and sets a clearer principle for determining when amortised cost accounting is appropriate than did the previous standard. IFRS 9 therefore represents a significant improvement in accounting for financial instruments.

Concerns have been expressed that IFRS 9 may lead to more financial instruments being measured at fair value through the profit or loss account. Whether this is true for individual institutions will depend on the business model followed and nature of financial instruments held by those institutions. The principles on which IFRS 9 bases the use of amortised cost are, we believe, a sound basis for financial reporting. HSBC believes strongly that the proposals made by a minority of constituents, whereby the business model would be the sole criterion for amortised cost classification, would not be acceptable to users, and would not represent an improvement in accounting standards. For example, their proposals cannot be regarded as an appropriate long term solution for highly leveraged assets to be measured at amortised cost. Initial studies suggest that while there may be some transfer into fair value through profit or loss, this effect is not likely to be very significant compared to the wider benefits of the Standard.

Some have expressed concern about the staged approach to the replacement of IAS 39, and the uncertainty about the outcome of further phases. It is clear, however, that the IASB could not have met the deadlines set for it as a political imperative unless it had phased the project in this way. Classification and measurement is the foundation for the whole project, and it is possible to implement this stage in advance of hedging and impairment in order to provide better information to the users of financial statements. The recent decision to exclude financial liabilities from the scope of IFRS 9 was a sensible response to the additional complexity of the issues raised by stakeholders regarding liabilities. Importantly, the IASB have confirmed that the decisions made on the classification of financial assets in IFRS 9 will not pre-determine the outcome of the classification of liabilities, where, for example, bifurcation may be retained if it provides more relevant information.

HSBC would like to commend the IASB on the way it has conducted the process of consultation regarding IFRS 9. HSBC has participated fully in the consultation, providing feedback to the IASB on a range of matters concerning the Exposure Draft. The IASB has responded in an exemplary manner to the urgent need for action, responding to the demands of its stakeholders, engaging widely, listening to feedback and making changes to reflect stakeholder feedback. The speed at which the proposals have been developed reflects an appropriately rapid response to the crisis, and a request from European Finance Ministers to make the standard available for 2009. Even so, the IASB has ensured that there has been plenty of opportunity for respondents to proactively engage in

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the process, and we believe that their feedback has been listened to and incorporated appropriately in the standard.

We believe that IFRS 9 reflects most of the features that the majority of European stakeholders asked for, balancing the requirements of user groups with preparers, and as a result HSBC believes that IFRS 9 is as favourable an outcome as could have been expected. A delay in endorsement, or failure to endorse, would mean that non-EU companies would be able to early adopt the new standard ahead of EU companies, putting international EU companies at a competitive disadvantage. Companies are being given until 2013 to adopt, so a deferral of endorsement would make little sense to them, and would restrict their ability to take early advantage of the improvements.

If the Standard is not endorsed, major European companies with US listings will be placed in a position where they have to publish conflicting sets of financial numbers. Their statutory financial statements provided in the EU must comply with IFRS as endorsed by the EU. The financial information published in their US filings would need to be prepared using IFRS as published by the IASB, or, if prepared on any other basis, would need to be accompanied by a reconciliation to US GAAP, the production of which would be an expensive and onerous burden. Once IFRS 9 applies to their financial statements prepared under IFRS as published by the IASB, the companies would have to provide conflicting sets of financial information, which would damage confidence in the financial reporting of European companies, and would reflect badly on the quality of accounting standards in Europe generally. For the same reasons, a delay in endorsement would put US-registered EU companies in a similarly difficult position if they wished to adopt early the new standard to improve the information provided to the users of their financial statements.

Finally, a delay in endorsement would result in a loss of momentum in building international support for the mixed measurement model in favour of the full fair value approach currently being developed in the US. HSBC urges the European Commission to take a leadership position in endorsing the new standard, making this critically important affirmation of the mixed measurement model of accounting for financial instruments.

We would be pleased discuss our comments with you in further detail if that would be helpful.

Yours sincerely

Douglas Flint

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