HSBC

Douglas J Flint CBE
Group Finance Director

Mr Carlo Comporti
Secretary General
Committee of European Securities Regulators
11-13 Avenue de Friedland
75008, Paris
FRANCE

12 September 2008

Dear Mr Comporti,

Draft CESR statement on Fair value measurement and related disclosures of financial instruments in illiquid markets

HSBC is one of the largest banking and financial services organisations in the world, with a market capitalisation of US$185 billion as at 30 June 2008. Headquartered in London, HSBC operates through long established businesses in 85 countries and territories in five geographical regions. HSBC's businesses encompass a very broad range of financial services and products, including personal financial services, commercial lending, investment banking and markets, private banking, asset management and insurance. HSBC welcomes the opportunity to comment on the consultation paper.

HSBC believes that full and transparent disclosure in financial statements is of critical importance in communicating the financial performance and position of entities to investors and other stakeholders, and regards this as a core principle of financial reporting irrespective of market conditions. The complexity of organisations and the interrelationships between them in today's financial markets makes this principle even more important. In times of market stress, timely reminders from regulators about the obligations of reporting entities, with comments on the particular issues experienced, are both appropriate and constructive.

HSBC has made significant efforts to expand its disclosure in recent reporting periods to address the conditions of market turmoil that emerged during 2007, including a significant expansion in disclosures about fair value measurement and exposures affected by market turmoil. Consistent with our belief in the importance of full and transparent disclosure, HSBC significantly expanded its disclosures in the 2007 Annual Report and Accounts for the Group, well in advance of the publication of several leading/good practice statements from various regulatory bodies made during the first half of 2008. In response to these statements, HSBC then made extensive additional disclosures in the Group's 2008 Interim Report.

In our view, Management are responsible for providing clear disclosures which convey in appropriate detail the financial position and performance of the entity, and the nature and extent of exposures and risks associated with that financial position and performance. Management are responsible for communicating this information effectively. This

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responsibility must be exercised within the framework of accounting standards and the various regulations governing financial reporting. This highlights the key issue: in the governance of financial reporting, what is the most appropriate balance to be achieved between accounting standards and regulatory requirements, and what should be the nature and purpose of regulatory pronouncements in this area?

- CESR acknowledges that the competence of setting international accounting standards, formally interpreting them and issuing general interpretation of existing standards lies with the IASB and IFRIC. HSBC welcomes this acknowledgement, and indeed believes that it is hard to understate the critical importance this has for the future development of consistent and high quality international accounting standards. HSBC is concerned, however, by the precedents set by the various pronouncements on disclosures made in the first half of 2008 by the Financial Stability Forum and, for European Banks, the Committee of European Banking Supervisors. The need for regulatory pronouncement and guidance in this area is understandable, as is the stated intention of the pronouncements to enhance the transparency, consistency and meaningfulness of disclosures in order to restore market confidence. A 'mandatory checklist' approach was not intended; however the practical effect of the approach taken has been just that. This is a result of the publication of detailed lists of disclosures, the high level of granularity proposed for the disclosures, and the need to be able to identify readily where those disclosures appear in financial reports that are already of considerable length and complexity. The effect is to establish a set of requirements that are both additional to and overlapping with the requirements of accounting standards. Furthermore, if local and regional variants of accounting practice develop in response to different legislative and regulatory models and varying appetites for different degrees of prescription and rule-setting, this would damage the transparency and comparability of financial reporting. Excessive prescription could perhaps even dilute the principle of management responsibility for full and transparent disclosure that is fundamental to effective stakeholder communication.

For this reason, HSBC strongly supports the engagement of regulators within the context of the IASB's process of accounting standards development, and believes that CESR's involvement will increase the accountability of the IASB. HSBC does not believe that the direct prescription by regulatory bodies of disclosure requirements on accounting matters or of reporting formats is in the best interests of the users of financial statements.

HSBC's detailed responses to the questions in the consultation paper are attached in the Appendix. We would be pleased to discuss our comments with you in more detail, and suggest you contact Russell Picot, Group Chief Accounting Officer, with any queries.

Yours sincerely

HSBC Holdings plc
Level 42, 8 Canada Square, London E14 5HQ
Tel: 020-7991 8888 Fax: 020-7992 4872
Web: www.hsbc.com

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Appendix – Responses to questions

Question 1: Do you agree with CESR's views above regarding the distinction between active and non active markets for fair value measurement?

We agree that the distinction between active and non-active markets is a helpful one when considering valuation methods, although in practice there is no clear dividing line between the two characterisations of markets. The views expressed in the paper with regards to active and non-active markets are consistent with the approach to fair value measurement in IAS 39. This topic is currently under consideration by the IASB's Expert Advisory Panel, which may result in changes to IAS 39, and we recommend that CESR be involved in the process of consultation on those changes rather than publish further guidance in advance of those changes.

Question 2: Do you agree with CESR's views above regarding inputs to valuation techniques for financial instruments in illiquid markets?

The views expressed in the paper are consistent with the principles of IAS 39, and the commentary on risk factors in times of market turmoil, and on the use of indices, is helpful. We agree that IAS39.AG82 does not provide an exhaustive list of inputs in respect of valuation techniques, indeed does not intend to be exhaustive, and we would highlight that this is already a widely recognised point. In implementing IAS 39 in practice, valuation professionals consider the range of inputs which in their judgement are appropriate to the financial instruments in question, rather than confining themselves to the provisions of IAS39.AG82. Given the wide range of different types of financial instrument, we believe that this is a more appropriate approach for accounting standards to take than setting prescriptive rules.

This topic is currently under consideration by the IASB's Expert Advisory Panel. We suggest that CESR provides input and comment during the IASB's consultation process.

Question 3: Do you agree with CESR's views above regarding disclosures of financial instruments in illiquid markets?

As discussed above, HSBC believes that full and transparent disclosure in financial statements is of critical importance in communicating the financial performance and position of entities to investors and other stakeholders. In our view, Management are responsible for providing clear disclosures which convey in appropriate detail the financial position and performance of the entity, and the nature and extent of exposures and risks associated with that financial position and performance. For example, the determination of classes of financial instruments for disclosure purposes should be appropriate to the nature and size of the organisation as well as the characteristics of the financial instruments.

HSBC agrees that in times of market turmoil it may be necessary for disclosures to be expanded in order to enable the users of accounts to understand the impact of market

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conditions and risk exposures on the financial position and performance of the entity. However, with the increase in focus on the disclosures of leading financial institutions as a result of recent market turmoil, including recent regulatory pronouncements, there is a danger that too much emphasis is placed on the quantity of disclosure than on the quality of information provided. As a result we strongly believe that any additional disclosure requirements should be implemented within the context of principles-based accounting standards, and place the responsibility clearly on Management to provide relevant disclosures of appropriate detail and clarity.

We believe that in proposing the disclosure set out in Box 1 on page 19 of the paper, CESR has produced a particular interpretation of IFRS 7 paragraph 27 which treats aspects of fair value measurement guidance in IAS39.AG72 as if they were disclosure requirements, and in effect proposes disclosure requirements which go beyond the requirements of IFRS 7. As stated above, we do not believe that the direct prescription by regulatory bodies of disclosure requirements on accounting matters is in the best interests of the users of financial statements. In the case of a large and diverse financial institution such disclosure would be extremely complex and lengthy, and it would be difficult for the users of accounts to understand the information provided.

The IASB are currently examining the reporting of financial instrument exposures and undertaking a review of IFRS 7 in the light of recent market events. We encourage CESR to engage in consultation with the IASB on this project as part of the IASB's due process, rather than prescribe additional disclosures that may not be relevant to all financial institutions.

Question 4: Do you agree that the benefits of the presentation of disclosures regarding financial instruments in illiquid markets in the example in Box 2 outweigh the costs of preparing this information?

We agree with the observation made by the Senior Supervisory Group that disclosure practices can be enhanced without amending disclosure requirements. HSBC believes that the mandating of a detailed tabular format suggested in Box 2 of the CESR paper is not an appropriate approach for this disclosure. The level of detail proposed in the format may not be relevant to all institutions or provide useful information to all users. It may not provide an appropriate balance of information in the context of a large complex financial institution, and it would be difficult for the users of the accounts to understand the information provided. We believe that this tabular approach would be costly to implement without leading to the intended benefits for the users of accounts. Consistent with our response to Question 3, we would encourage CESR to work closely with the IASB to ensure that IFRS disclosures focus on disclosure principles which promote relevant and consistent reporting.

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Level 42, 8 Canada Square, London E14 5HQ
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Web: www.hsbc.com