HSBC

Russell C Picot
Group Chief Accounting Officer

European Financial Reporting Advisory Group
35 Square de Meeûs
B-1000 Brussels
Belgium

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Dear Sirs

European Financial Reporting Advisory Group's 'Getting a better framework' bulletins: 'the role of the business model in financial reporting' and 'the role of a conceptual framework'

We welcome the opportunity to provide comments on the European Financial Reporting Advisory Group ('EFRAG') bulletins on key aspects of the conceptual framework.

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We support EFRAG's intentions to discuss the conceptual framework and with the aim of forming a European view, before the International Accounting Standards Board publishes its proposals. We believe that consideration of the business model in determining accounting requirements can make financial reporting more useful to investors, and provides a better reflection of the economic activities of the entity. Particularly in light of the focus on the business model within IFRS 9 'Financial Instruments', we think it would be helpful to explore and define this concept within the framework. More generally, we are in favour of a revised framework where its underlying objective, assumptions and concepts provide a foundation for all standards. We think it is appropriate that the framework contains key concepts only, and that these can be expanded upon in the individual standards.

Our responses to the questions set out in the bulletins are provided in the Appendix. As always, we would be pleased to discuss our comments and concerns in more detail if this would be helpful.

Yours sincerely

Russell Picot

HSBC Holdings plc
Level 39, 8 Canada Square, London E14 5HQ
Tel: 020-7991 8888 Fax: 020-7991 4624

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Appendix: Questions for respondents

The role of the business model in financial reporting bulletin

(i) Do you think that our assumed meaning makes sense from a financial reporting perspective?

Yes. The assumed meaning of the term 'business model' refers to the value creation process, i.e. how the entity generates cash flows. This definition can be translated into financial reporting by applying recognition, measurement and presentation requirements in a manner appropriate to how the business is conducted, which could mean different criteria being applied by different businesses for the same asset. We agree that it makes sense to determine the business model at the highest level possible, looking at the overall activities of the entity. However in certain entities, a large number of business models would be unavoidable, for example, different portfolios of financial assets in a bank, as assessed under IFRS 9 'Financial Instruments'.

(ii) Do you support the tentative view that management intent and business model are distinct?

Yes. A distinction can be made between management intent for a particular item and an entity's overall business model. We believe that a business model focuses on the larger picture objectives of the entity. It can be expected to be stable and be demonstrated by the entity's systems, processes and controls in support of these objectives as well as patterns of past activity. Management intent may be thought of as more subjective and more likely to change and therefore more difficult to verify. Consequently, we agree that a documented business model can be distinguished from management intent.

(iii) Do you support the tentative view that the business model should play a role in financial reporting?

Yes. We believe that consideration of the business model makes financial reporting more useful to investors, as the resulting information can be more relevant in assessing past and potential future performance. For example, a single standard profit or loss format applied to all entities regardless of their business activities would be less useful than having different formats that are more suitable to different industries such as manufacturing or financial services. Similarly, more relevant information may be provided by recognition and measurement approaches that have regard to the business model, although such an approach needs to be balanced with other aspects of financial reporting, such as the definitions of assets and liabilities, measurement basis. Comparability is another important characteristic that needs to be considered but we would caution that making different business models seem to be alike could make it more difficult for users to assess performance and predict future cash flows.

We agree that a change in the business model is a rare and significant event, and that investors should be able to determine this from the financial statements. To present assets and liabilities in the same way after a change in business model could deprive users of information that is directly relevant to how they should assess future cash flows.

(iv) Do you support the proposed implications for the IFRS literature?

Yes. We agree that the business model is an important consideration in determining appropriate accounting requirements and it may be helpful to analyse this further in developing the conceptual framework and within individual accounting standards.

We understand that different business models could result in a different application of the definition of assets and liabilities. For example a forward contract for an entity that awaits delivery of the commodity for use in its own production may not have control of the asset, while control of the underlying asset may not be relevant to the recognition of a derivative in the trading activity of another entity. Similarly the measurement of property may be different for a property held for investment as opposed to one used in the business and these different measurements are helpful in providing the most relevant information. This is one of the strengths of considering the entity's business model.

(v) Do you have any other comments on this Bulletin?

We have no further comments.

The role of the conceptual framework bulletin

(i) Do you think the IASB should invariably follow the Framework? (Paragraphs 6-11)?

As far as possible, we believe that the International Accounting Standards Board (the IASB) should follow the framework in developing new standards. We agree that the conceptual framework should form a robust conceptual basis for IFRS, and although exceptions may occur, these should only arise in limited cases, and a justification should be provided for the departure.

However, accounting is an evolving process and the conceptual framework and accounting standards may not be entirely aligned as new issues emerge and are resolved at the standards level or as the conceptual framework is finalised before existing standards are revised to be in line with it.

(ii) What do you think is an appropriate approach to achieve a complete Framework? (Paragraphs 15-19)

We believe that the best approach would be to constrain the framework to a few key concepts, which would provide a stable foundation for IFRS, with further requirements covered in the individual standards, as appropriate. A complete framework covering all the detailed necessary components would be unwieldy and require frequent updates, and the interaction with the standards would have to be carefully and continuously considered. As the name suggests, a framework should

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provide a sound basis for the standards, and too much detail could detract from the overall message.

(iii) Do you think the current reference in IAS 8 to the Framework as authoritative guidance is useful? (Paragraphs 23-28)

Yes. The underlying objective, assumptions and concepts in the framework should be authoritative guidance for all standards. This is particularly important in IAS 8 where an explicit reference is helpful for the development of accounting policies in the absence of a specific standard.

(iv) Do you think the Framework project should develop questions and decision trees or process flowcharts for developing IFRS requirements? (Paragraphs 31-32)

No. The decision trees and process flow charts proposed by the FASB are characteristic of the FASB's approach where all decisions must be governed by a detailed set of rules for all eventualities. We believe that it is more helpful to provide users with the tools to make decisions, based on the foundation of key concepts outlined in the framework.

(v) How should the IASB proceed with existing IFRS in the context of a revised Framework? (Paragraphs 35-37)

We support the independent development of a robust and revised framework, irrespective of the impact on existing IFRS. However, differences with current IFRS' are clearly not desirable and where these occur, we believe these should be dealt with over a reasonable time frame. We do not believe that there should not be an automatic trigger to review all current IFRS in line with the framework, as this would undermine IFRS as a stable platform, therefore a plan to tackle inconsistencies should be carefully devised.

(vi) The Framework is not an IFRS (according to the IASB's own terminology) and it is, therefore, outside the scope of endorsement. Has this caused any issues for you in practice and, if so, how do you believe they might be addressed?

We are not aware of the Framework being outside the scope of endorsement process currently causing any issues in practice.

The framework, containing the purpose and objectives of financial statements, is to some extent the marketing document for IFRS as a complete package of financial reporting requirements. If a jurisdiction assesses that financial statements described in the framework meet their requirements for financial statements required under their company law, then this should be an important part of the jurisdiction deciding to sign up to this package. Additional considerations may also be relevant, such as being comfortable with the due process and governance that balances the different aspects of the framework and different interests of the constituency, but the first step should be that the objectives are aligned with the jurisdiction's requirements.

The IAS Regulation is fairly explicit in this regard since Article 3 states that IFRS can only be adopted for use in the EU if:

- they are not contrary to the principle set out in Article 2(3) of Directive 8/660/EEC and in Article 16(3) of Directive 83/349/EEC [give a true and fair view] and are conducive to the European public good and,
- they meet the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

The second bullet point is a précis of the Framework adopted by the IASB in 2001. Wording changes in the Conceptual Framework are not intended to fundamentally change the objective of financial reporting and therefore should not change the EU's assessment that IFRS financial statements are suitable to meet company law requirements. However, there is a risk that these changes could cause some to question this. In any case, the Maystadt review may provide an opportunity to at least update the wording of the IAS Regulation or even amend and improve the Regulation and process in this area. In this regard, it may be helpful for the second bullet point to be deleted and the EU to explicitly confirm that the objectives of financial reporting in the Conceptual Framework are wholly consistent with the objectives of financial statements required by company law. Consideration could also be given to relying on such a confirmation perhaps coupled with a regular review of the IASB's due process and governance, rather than considering each individual IFRS for endorsement.

(vii) Do you have any other comments on this Bulletin?

We have no further comments.