HSBC

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30 Cannon Street
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26 September 2008

Dear Sir David

IASB Discussion Paper – Preliminary Views on Amendments to IAS 19 Employee Benefits

We welcome the opportunity to comment on the IASB's Discussion Paper 'Preliminary Views on Amendments to IAS 19 Employee Benefits' and thank the Board for the opportunity to participate in the debate.

HSBC agrees that there is scope to make short–term improvements to the accounting for employee benefits. We welcome in particular the removal of the 'corridor' approach. Many of the proposed changes discussed in the paper, however, are more fundamental changes that should only be considered in the context of a comprehensive review of all types of post-employment benefit plans.

In particular, we do not believe that the measurement of defined contribution promises should be reviewed in isolation to defined benefit promises. We have concerns that any such decisions at this stage will pre-empt any future decision in respect of defined benefit promises.

We understand that the Board has a genuine concern about the application of IAS 19 to certain plans with benefits based on contributions and guaranteed returns, however in trying to address this relatively narrow area the Board has extended the scope of contribution-based promises too widely. The dividing line that is proposed between contribution-based and defined benefit promises is based on questionable logic, yet the classification of the promises will fundamentally change the accounting for many plans. We are concerned that such a radical change, with its potential impact on the direction of accounting for existing defined benefit plans,i s included in a short-term project.

The Board's discussion on the presentation of defined benefit promises highlights the danger of pursuing a programme of change in adherence to a theoretical ideal without regard to the practical implications. Most would agree that IAS19 permits an accounting presentation that lacks technical perfection. It relies upon an exception originally made in order to meet a pragmatic desire to show business performance in the context of funding long term retirement benefit liabilities, often from a separate store of value held specifically for that purpose. The technically correct answer is, as set out in Approach 1, Chapter 3, to remove the exception and recognise all

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changes in the defined benefit obligation and value of the plan assets through the income statement, opening up the income statement to the risk of severe short term volatility. The impact this will have will be profound, as retirement benefit plans, being the natural holders of investments for the longer term, find their behaviour constrained and altered by short term market volatility, as long term investment strategies previously considered appropriate are called into question. The impact this would have on the structure of financial markets is profound, and goes far beyond the remit of accounting standards.

HSBC believes that the outcome of the Financial Statement Presentation Project and the Conceptual Framework will have a major impact on the development of a future standard in post employment benefit plans. We consider that the existing accounting Standard for retirement benefit schemes has aided transparency of the risks within and financial status of retirement benefits schemes, and is now well understood; consequently we do not consider this to be a high priority for change. We ask the Board to reconsider the scope of the proposed changes in the Discussion Paper so that it deals with genuine short term improvements, leaving the more radical changes for a comprehensive review of the accounting for employee benefits taking into consideration the Financial Statements Presentation Project and the Conceptual Framework Our detailed responses to the questions raised within the discussion paper are set out in the Appendix to this letter.

Yours sincerely

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Appendix – Specific responses to Questions for Respondents

Question 1

Given the objective of the IASB project to address specific issues in a limited time frame, are there additional issues which you think should be addressed by the Board as part of this project? If so, why do you regard these issues as a matter of priority?

As noted in our answers to the following questions, we have concerns that the scope of this short term project is too wide and therefore do not consider that any further issues should be included.

Question 2
Chapter 2 describes the Board's deliberations on the recognition of defined benefit promises. The Board's preliminary views are summarised in paragraphs PV2–PV4.

Are there factors that the Board has not considered in arriving at its preliminary views? If so, what are those factors? Do those factors provide sufficient reason for the Board to reconsider its preliminary views? If so, why?

We are in agreement with the Board's views on eliminating the 'corridor' approach and requiring the recognition of all changes in plan assets and liabilities in the period they occur (PV2).

We agree with the Board's proposal that entities should not divide return on plan assets into expected return and actuarial gain or loss (PV3). As indicated within the discussion paper, expected return on plan assets provides relevant information for forecasting expected future investment returns and benchmarking investment performance. Its inclusion in IAS 19 was a pragmatic attempt to show business performance in a way which is consistent with the economic purpose of a funded retirement benefit plan, basing the measurement and presentation of returns on longer term performance measures, while recognising and presenting short term volatility separately so as not to destroy the value of the information on longer term performance. HSBC considers that the information on expected returns could be provided by way of disclosure if this was considered helpful by users of accounts. However, we would caution that the Board will need to consider carefully how actual returns on plan assets should be presented so as to preserve meaningful information on performance (see question 3).

We agree with the Board's preliminary decision to recognise unvested past service costs in full in the period of the plan amendment (PV4).

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Question 3

(a) Which approach to the presentation of changes in defined benefit costs provides the most useful information to users of financial statements? Why?
(b) In assessing the usefulness of information to users, what importance do you attach to each of the following factors, and why:
> **(i) presentation of some components of defined benefit cost in other comprehensive income; and**
> **(ii) disaggregation of information about fair value?**

(c) What would be the difficulties in applying each of the presentation approaches?

We believe that the issue of the presentation of the defined benefit costs should not be considered in isolation to the Financial Statement Presentation project to develop a long term solution to the presentation of gains and losses in the performance statement.

IAS19 permits an accounting presentation that relies upon an exception to the usual principle of recognising all income and expense that result from events in the period in the income statement. This was a pragmatic solution to the desire to show business performance in the context of funding long term retirement benefit liabilities in the income statement without having that performance completely masked by large fluctuations in balance sheet values as a result of what could be relatively small changes in assumptions. Approach 1 appears to offer the technically correct answer, recognising all changes in the defined benefit obligation and value of the plan assets through the income statement. However, this opens up the income statement to the risk of severe short term volatility. This would have a profound wider economic impact as retirement benefit plans, being the natural holders of investments for the longer term, find their behaviour constrained and altered by short term market volatility. Accordingly, Approach 1 is a fundamental change in approach, and should only be considered within the context of the Financial Statements Presentation Project and Conceptual Framework, not as part of a short term improvement project.

As short term solutions, HSBC believes that neither approach 2 nor approach 3 offer a significant improvement on the current presentation (whereby changes in actuarial assumptions and experience gains and losses on plan assets are taken to Other Comprehensive Income) because they would make it very difficult for the user of the accounts to understand business performance in the context of how the long term retirement benefit liabilities are being funded.

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Approach 2 has the following issues which would need to be addressed:-

- The presentation of interest cost in Other Comprehensive Income is inconsistent with other areas of IFRS.
- The presentation of long term inflation and discount rates in different performance statements should be reconsidered given the economic interaction of the two to give the real discount rate on the scheme obligations.
- The exclusion of any element of returns on plan assets within the income statement represent a mismatch of the costs of providing the defined benefit scheme and the benefit of funding that scheme.

Approach 3 goes some way to addressing the issues facing approach 2, however it still suffers from a failure to recognise the interaction of long term inflation and the discount rate. Furthermore we are concerned that the inclusion of actual interest and dividend income on plan assets in the income statement, while factual, would create a bias towards the selection of certain types of investment. This leaves the other options discussed of using expected return (as currently in IAS19) and using income based on a benchmark measure of interest on high quality bonds, which appear similar in approach, albeit that the latter approach would presumably be harder to manipulate.

In summary we do not see a convincing case to change the current approach within the scope of a short term project until more fundamental issues with financial statements presentation have been fully discussed and resolved

Question 4

(a) How could the Board improve the approaches discussed in this paper to provide more useful information to users of financial statements?
(b) Please explain any alternative approach to presentation that provides more useful information to users of financial statements. In what way does your approach provide more useful information to users of financial statements?

As discussed in our response to question 3, we believe that the current presentation requirements of IAS 19 are adequate in the short term and should only be reviewed by the Board in the long term in conjunction with the other long term projects such as the Financial Statement Presentation project and the Conceptual Framework.

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Question 5

Do you agree that the Board has identified the appropriate promises to be addressed in the scope of this project? If not, which promises should be included or excluded from the scope of the project, and why?

We do not agree with the inclusion of 'contribution-based promises' as defined in the context of this short term project, as HSBC believes that it is not appropriate to include such a fundamental change in a short term project.

HSBC acknowledges that the current definition of defined contribution schemes in IAS19 results in the classification of cash balance schemes as defined benefit schemes, as a result of the investment risk borne by the employing company, and that this can produce a counter-intuitive result. However, the Board's proposed solution has in our view produced a definition which potentially brings in many more types of scheme than just cash balance schemes, including schemes which are in nature defined benefit schemes but which, through the precise details of the benefit calculation method, fall into the proposed definition. HSBC is concerned that schemes with significant demographic risk to the employer would be captured by the proposed definition purely because demographic risk is explicitly excluded from the consideration.

We believe that the distinction between defined contribution and defined benefit plans that exists in IAS 19 is clear and logical, and worked well for the majority of cases. In HSBC's view, a short term project should focus purely on the cash balance scheme issue without opening a wide range of new issues to resolve. We are therefore, concerned that the proposal will result in radical changes to the measurement of certain defined benefit schemes and that this will predetermine any future decision on the measurement of defined benefit promises.

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Question 6

Would many promises be reclassified from defined benefit to contribution-based under the Board's proposals? What are the practical difficulties, if any, facing entities affected by these proposals?

It would appear from the criteria set out in the discussion paper, that potentially a wide range of plans could be reclassified, for example plans that specify a return based on contributions (with guaranteed investment returns), career average promises and promises with a 'higher of' options will be reclassified.

The practical issues faced by HSBC would include the classification of schemes that have converted to cash balance schemes, and hence are contribution based promises, but have an historic element of benefit based promises. The problems posed by such schemes are the identification and measurement of obligations under the two measurement principles, and identifying and measuring the appropriate classification of benefits in payment (see Question 10).

Question 7

Contribution-based promises, as defined in this paper, include promises that IAS 19 classifies as defined contribution plans. The Board does not intend this proposal to lead to significant changes in the accounting for most promises that meet the definition of defined contribution plans in IAS 19.

Do the proposals achieve that goal? If not, why not?

We agree that the proposals will not lead to significant changes to the accounting of the majority of defined contributions schemes as the liability recognised for unpaid contributions will not be significantly different to the '*fair value assuming that the benefit promise does not change*' measurement basis proposed, provided payment is made soon after the end of the period in which the service is rendered.

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Question 8

Chapter 6 discusses recognition issues related to contribution-based promises. The Board's preliminary views are summarised in paragraphs PV9–PV11.

Do you have any comments on those preliminary views? If so, what are they?

We agree with exclusion of these issues from this short term project. In particular, the treatment of unvested benefits as a liability, as suggested in PV9, is contentious and the Board is right not to attempt to resolve it only in the context of contribution-based promises, however this is true of many of the proposed changes.
PV10 suggests that an entity should allocate benefits under a contribution-based promise in accordance with the benefits formula. This appears reasonable for a traditional defined contribution scheme. However, as previously noted the classification of 'contribution based promises' will encompass plans previously classified as defined benefit plans. Consequently, for such schemes that attribute a materially higher level of benefit in later years, the cost recognition pattern would be different under the proposals, tending to recognise costs later. Previously, under IAS 19, such benefits would have been accounted for on a straight line basis over the service period. By not addressing this issue, the proposed approach would suffer from inconsistencies in treatment between certain defined benefit promises and defined contribution promises

Question 9

(a) Are there alternative measurement approaches that better meet the measurement objectives described in this paper? Please describe the approaches and explain how they better meet the measurement objectives.
(b) To what extent should the effect of risk be included as a component of the measurement approach at this stage of the Board's post-employment benefit promises project? How should this be done?

We question the logic of proposing the fair value measurement model for one type of promise, and the discussion paper gives no real indication of its merits over existing measurement approaches. This is another major change in accounting principle, and we believe it should not be introduced as part of a short term project, in a piecemeal fashion. Indeed, we do not believe that the measurement of contribution based promises should be considered in isolation to defined benefit promises, and the long term project on fair value measurement.

Were fair value measurement to be introduced, there would be a need for extensive further guidance on how this would be achieved. For example, demographic risk could be significant in some defined contribution promises, as defined, and there is a lack of guidance or discussion in the paper on this. We would also question the inclusion of credit risk as this does not reflect the characteristics of a long term funded obligation.

Clearly, the way contribution-based promises have been defined, there are similar risks for defined benefit promises and some 'contribution-based promises' that are similar in nature, such as salary risk, demographic risks, vesting uncertainties and investment risk. These are included in the actuarial computation of the defined benefit obligation under IAS 19. We believe, it is difficult to justify using a different measurement basis for these similar schemes.

Question 10

(a) Do you agree that the liability for benefits in the payout and deferment phases should be measured in the same way as they are in the accumulation phase? If not, why?
(b) What are the practical difficulties, if any, of measuring the liability for a contribution-based promise during the payout phase at fair value assuming the terms of the benefit promise do not change?

(a) In principle we agree that the liability for benefits in payment and in the deferment phase should be measured in the same way as the accumulation phase. However, we do not agree with the proposed category of a contribution-based promise as defined, nor its proposed measurement attribute.

(b) There could be practical implications of measurement during the payout phase that relate to the availability of historical data to determine which type of plan a pensioner originated. This could arise when pension obligations have been acquired or plan benefits have changed in the distant past.

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Question 11

(a) What level of disaggregation of information about changes in the liability for contribution-based promises is useful to users of financial statements? Why?
(b) Do you agree that it is difficult to disaggregate changes in the contribution-based promise liability into components similar to those required for defined benefit promises? If not, why not?

As previously stated, we do not agree with the inclusion of contribution-based promises as defined in the project.

We do, however, agree that the disaggregation of information is useful to the user of the financial statements but we would consider that the difficulties highlighted in analysing the changes in contribution-based promises would raise doubts over whether this measurement basis provides information that is useful to the user.

Question 12

Should changes in the liability for contribution-based promises:

(a) be presented in profit or loss, along with all changes in the value of any plan assets; or
(b) mirror the presentation of changes in the liability for defined benefit promises (see Chapter 3)?

Why?

Option A has the virtue of presenting the costs of the liability and the benefit of the funding of that liability together so that the effect on performance can be readily understood.

HSBC is concerned, however, about this presentation for plans which are similar in nature to defined benefit plans as defined under IAS 19, and believe that presentation of these plans should be consistent with defined benefit promises.

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Question 13

(a) What are the practical difficulties, if any, in identifying and measuring the 'higher of' option that an entity recognises separately from a host defined benefit promise?
(b) Do you have any other comments on the proposals for benefit promises with a 'higher of' option? If so, what are they?

We agree that the separation of the 'higher of' option from the host defined benefit promise, and its measurement on the same basis as contribution-based promises, is logical.

However, we would express some concerns over the complexity and practicality of calculating a fair value for such options, depending on the basis chosen for measuring the fair value.

Question 14

The Board intends to review the disclosures required about post-employment benefit promises in a later stage of this project. As part of that review, the Board intends to consider best practice disclosures in various jurisdictions. For example, explicit requirements to disclose information about the mortality rates used to measure post-employment benefit liabilities could be introduced to allow users to understand the inherent uncertainties affecting the measurement of those liabilities.
What disclosures should the Board consider as part of that review?

We are of the opinion that the current disclosure requirements under IAS 19 are useful to the user of the financial statements and careful consideration should be made before any are changed. However, since IAS 19 was published there have been significant developments in the best practice disclosure of retirement benefit schemes, and a review of the Standard's requirements would be useful and timely.

HSBC voluntarily provides additional disclosures such as information on mortality rates and sensitivity analysis of actuarial assumptions, and we support such transparent disclosures to assist the reader in understanding the assumptions and movements in these obligations.

The nature and relevance of any additional disclosure requirements will be dependent, to some extent, on the proposals made on the measurements and recognition of defined benefit promises in a later stage of this project.

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Question 15

Do you have any other comments on this paper? If so, what are they?

We do not have any further comments on this discussion paper.