HSBC

Douglas J Flint CBE
Group Finance Director

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH

3 September 2009

Dear David,

ED/2009/9 Classification of Rights Issues

We welcome the opportunity to comment on the IASB's Exposure Draft on the Classification of Rights Issues. We would like to commend the Board for taking timely action to address this important and topical issue.

HSBC is one of the largest banking and financial services organisations in the world, with assets of US$2,422 billion at 30 June 2009. Headquartered in London, HSBC serves customers worldwide from more than 8,500 offices in 86 countries and territories in six geographical regions. HSBC's businesses encompass a very broad range of financial services and products, including personal financial services, commercial lending, global banking and markets, private banking, asset management and insurance. The ordinary shares of HSBC Holdings plc are listed on several national stock exchanges, principally the London Stock Exchange, the Hong Kong Stock Exchange and the New York Stock Exchange.

HSBC welcomes the proposed amendment to IAS 32, and believes that the amendment should be adopted as soon as possible to remove a technical anomaly, under which certain traditional rights issues that are clearly and unambiguously entered into with an entity's owners in their capacity as owners fail the technical definition of equity instruments. As the ED correctly states, this occurs where the currency (or currencies) in which the shares are offered to shareholders (which reflects the exchanges on which they trade) differs from the functional currency of the entity. This has the result that the offer of rights is classified as a derivative liability, which can result in very material profits or losses being recognised in the income statement which bear no relation to the economic consequences of the rights issue for the entity's shareholders. The results of this accounting are particularly misleading because the main factor in reporting a profit or a loss on the derivative liability over the offer period is the movement in the share price, with the effect that an increase in share price results in an increase in the derivative liability, thereby generating a reported loss which is of no relevance to shareholders. Conversely, a decrease in the share price would result in a profit being reported, a particularly curious result as the fall in share price may well reflect the disappointment of shareholders and potential investors with the raising of capital in the form of a rights issue.

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

This issue could potentially affect a large number of multinational companies whose ordinary share capital is denominated in the currencies of the national exchanges in which their shares are listed, but whose functional currencies can only be a single currency as determined under IAS21 for each entity. Furthermore, although infrequent, such transactions tend to be very significant in size, and the financial impact of this technical anomaly can be very material. As major companies increasingly list their equity instruments on more than one exchange to broaden their shareholder base, the issue in question would in our view become a larger problem than it is at present.

Our detailed responses to the questions are attached in the appendix to this letter. As always, we would be pleased to assist the Board in its deliberations and discuss our comments with you in further detail if that would be helpful.

Yours sincerely

Douglas Flint

HSBC

Appendix – Questions for respondents

Question 1: Specifying the characteristics of the rights issue.

The proposed amendment applies to instruments (rights) to be offered pro-rata to all existing owners of the same class of equity instruments and the exercise price to be a fixed amount of cash in any currency. Do you agree with the proposal to limit the amendment to instruments with these characteristics? If not, why? Are there any other instruments that should be included and why?

We agree with the proposal to limit the amendment to instruments with these characteristics. In recent months several multinational companies have made offers of rights in a fixed number of ordinary shares for fixed currency amounts denominated in the currencies of the national exchanges in which their shares are listed, but whose functional currencies can only be a single currency as determined for each entity under IAS 21. The strict interpretation of the wording in the existing paragraph 11(b)(ii) of IAS 32 that would require such offers of rights to be classified as derivative liabilities is an anomalous outcome for a transaction that is clearly and unambiguously entered into with an entity's owners in their capacity as owners, and can result in very material profits or losses being recognised in the income statement which bear no relation to the economic consequences of the rights issue for the entity's shareholders. This issue has therefore emerged as one requiring urgent remedy.

While we understand that in conceptual terms it could be preferable to seek a more general solution, this will take time due to the complexity and range of the issues that have been raised regarding the 'fixed for fixed' principle since IAS 32 was first issued. We believe that these issues are best addressed as part of the Board's major ongoing project on Financial Instruments with the Characteristics of Equity.

Accordingly we believe that the Board is to be commended for proposing to make a rapid and narrowly focused amendment to the standard to remove this anomaly.

The proposed amendment applies to rights to be offered pro-rata to all existing owners of the same class of equity instruments, correctly in our view. It is a common feature in rights issues that fractional entitlements to rights may be disregarded as a matter of practicality. Furthermore, an entity may have shareholders in jurisdictions where the local securities laws prohibit the offer of rights to shareholders in that jurisdiction. In such a situation, typically the rights attributable to those excluded shareholders are sold and the proceeds of the sale minus the rights issue subscription price are paid to the excluded shareholders, thereby ensuring that they are not disadvantaged. While these considerations are perhaps too detailed to cover in an accounting standard, we believe that they do not detract from the substance of a rights issue offered pro-rata to existing shareholders, and should not therefore preclude the classification of offers of rights with these terms as equity instruments.

HSBC

Question 2: Specifying the currency of the exercise price.

The proposed amendment specifies that the fixed amount of cash the entity will receive can be denominated in any currency. If that currency is not the entity's functional or reporting currency, the proceeds it receives from the issue of its shares will vary depending on foreign exchange rates. Do you agree with the proposal to permit an entity to classify rights with the characteristics set out above as equity instruments even when the exercise price is not fixed in its functional or reporting currency? If not, why?

We agree with the proposed amendment, which we understand requires, not permits, the classification of rights as equity instruments when those rights are to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency if they are offered pro-rata to all of the existing owners of the same class of its own non-derivative equity instruments.

As noted in our answer to question 1, a multinational company which makes an offer of rights in relation to a fixed number of ordinary shares for a fixed currency amount to its existing shareholders, where the offer is denominated in the currencies of the national exchanges in which its shares are listed, but whose functional currency is necessarily a single currency, should be able to account for the offer of rights in accordance with its substance as an equity transaction notwithstanding the fact that the currency (or currencies) in which the rights are offered differs from the functional currency. We note that the proceeds received are indeed fixed in terms of the price of the transaction in local currency, and that it is only on translation into the functional currency for reporting purposes that the proceeds can be regarded as variable. In our discussions with legal counsel it was observed that a legal interpretation would likely regard such an exchange as being for fixed terms.

Question 3: Is the requirement to apply the proposed change retrospectively appropriate? If not, what do you propose and why?

We believe that the requirement to apply the proposed change retrospectively is appropriate, in line with the general approach to changes in accounting policy set out in IAS 8 paragraph 19(b). We agree with the Board that such a change would not involve significant cost or effort.