Iain J Mackay
Group Finance Director

Office of the Secretary, PCAOB
1666 K Street, N.W.
Washington, D.C. 20006-2803

Subject: PCAOB Rulemaking Docket Matter No. 37

6 December 2011

Dear Board Members of the PCAOB,

We were pleased to review the PCAOB's Concept Release on Auditor Independence and Audit Firm Rotation which was released on 16 August, 2011.

HSBC Holdings Plc ('HSBC') is one of the largest banking and financial services organisations in the world, with assets of US$2,691 billion at 30 June 2011. Headquartered in London, HSBC serves customers worldwide from more than 7,500 offices in 87 countries and territories in six geographical regions. HSBC's businesses encompass a very broad range of financial services and products, including retail banking and wealth management, commercial banking, global banking and markets, private banking and insurance. HSBC has securities listed on the London Stock Exchange, Hong Kong Stock Exchange, New York Stock Exchange, Euronext Paris and Bermuda Stock Exchange.

HSBC has been a foreign private issuer ('FPI') registered with the SEC since 1999 and has prepared and filed audited financial statements in accordance with IFRSs as issued by the IASB since 2005. HSBC has two U.S. subsidiaries, HSBC USA Inc. and HSBC Finance Corporation, which are domestic registrants and have debt registered with the SEC. HSBC's U.S. subsidiaries prepare financial statements in accordance with U.S. GAAP for SEC reporting purposes and in accordance with IFRSs for internal reporting purposes. All HSBC companies, including our U.S. subsidiaries, are managed on an IFRS basis.

In summary, we believe audit quality is driven by the existing governance in place with internal reviews of audit engagements, peer reviews of firms, audit partner rotation and the PCAOB's review of audit engagements. If the PCAOB wants to implement another form of improving audit quality, we recommend the following for consideration. In conjunction with deficiencies identified by the PCAOB, an audit firm would be required to disclose these deficiencies to the Audit Committee within a period of 90 days with an appropriate plan for remediation. This will provide the Audit Committee, which is responsible for the engagement of the audit firm, with a greater level of information regarding audit quality. If the level of audit quality and/or the audit firm's remediation plan is not acceptable, the Audit Committee at its discretion could seek to replace the audit firm. We believe expanding the use of this information and providing it to the members of the Board of Directors who are directly responsible for the engagement of the auditor, would do more to improve audit quality and effectiveness than the implementation of mandatory audit rotation. This would allow for audit effectiveness issues to be dealt with by members of the Board of Directors with the appropriate qualification on a case by case basis without imposing an overall framework of audit rotation which will require additional costs and result in lower audit effectiveness across the industry.

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We provide the following responses to the questions raised by the Board. The Chairman of our North American Audit Committee is in agreement with the Company's views on these matters.

A. Term of Engagement

1. *If the Board determined to move forward with development of a rotation proposal, what would be an appropriate term length?*

   We believe that the engagement of audit firms by companies should not be subject to an arbitrary maximum period, but should be reviewed periodically by the Audit Committee. This proposal assumes that a lengthy appointment breeds familiarity between the auditor and the company. We believe that the mandatory rotation of audit partners does indeed adequately address this concern The benefits of an auditor developing a deep understanding of its client's operations should not be underestimated and in our opinion, leads to a more rigorous and challenging audit service. Managing the change of auditors, including familiarization and training, is a significant undertaking and one should be wary of the unintended consequences of introducing such a measure.

2. *Should different term lengths for different kinds of engagements be considered? If so, what characteristics, such as client size or industry, should this differentiation be based on?*

   We do not support term lengths for any companies regardless of the size or industry. The size of a company and its geographical footprint are significant factors in both an Audit Committee and Shareholders' ability to identify an appropriately skilled audit firm to adequately address the shareholders' interests. Companies with significant complexity (for example many financial services companies) and diverse geographical footprint require a significant period of time for audit firms to gain an appropriate understanding of the business models and the control environments in which they operate. This should be considered and not underestimated by the Board.

3. *Does audit effectiveness vary over an auditor's tenure on a particular engagement? For example, are auditors either more or less effective at the beginning of a new client relationship? If there is a "learning curve" before auditors can become effective, generally how long is it, and does it vary significantly by client type?*

   Yes, the learning curve for large, complex, multinational engagements is significant and cannot be underestimated. Audit failures are more prevalent in the early years as the firms and their staffs attempt to meet the challenges of trying to understand the company and its different business models in order to be able to develop an effective audit plan. This start-up time and cost of developing an understanding typically leads to less substantative work being performed in the earlier years combined with work that is rushed and done at hours when staff are overworked and not performing at their full potential. The learning curve is typically 1 year for less complex engagements and 1 to 2 years for more complex multinational engagements.

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4. *Some have also suggested that, in addition to being less effective at the beginning of an engagement, an auditor may be less diligent toward the end of the allowable term. On the other hand, others have suggested that auditors would be more diligent towards the end of the allowable term out of concern about what the replacement auditor might find. Would auditors become more or less diligent towards the end of their term? Does the answer depend on the length of the term?*

   We believe auditors are likely to become less diligent toward the end of a finite term of an engagement. The existing governance in place with internal reviews of audit engagements, peer reviews of firms, audit partner rotation and the PCAOB's review of audit engagements are the primary drivers of audit effectiveness. The final year of an audit engagement under a regime of mandatory audit rotation will be performed by less experienced personnel. The more senior members of the audit firm will be i) looking for new business, ii) transitioning onto new engagement or iii) working to build a relationship with the Company in which they will sell non-audit services once the audit arrangement ends. These factors also lead to more audit staff turnover during the final year of an engagement as professionals do not see career benefits in participating in the final year of an audit engagement. These factors result in a less effective final audit engagement and cannot be mitigated by a longer or shorter allowable term.

5. *How much time should be required before a rotated firm could return to an engagement?*

   If mandatory terms were implemented, we see no reason as to why an audit firm should not be able to return to an engagement at the next rotation. We do not expect the start-up costs and experience that would be needed to be significantly higher or lower for the firm that has rotated off the engagement. As firms will be required to disband teams of professionals at rotation and the underlying business models and risks within the Companies will change, we expect that audit firms that have been required to rotate off of an engagement to face the same challenges of audit effectiveness when they would return to an audit engagement.

B. Scope of Potential Requirement

6. *Should the Board consider requiring rotation for all issuer audits or just for some subset, such as audits of large issuers? Should the Board consider applying a rotation rule to some other subset of issuer audits? For example, are there reasons for applying a rotation requirement only to audits of companies in certain industries?*

   We do not see any benefits of differentiation between types of companies or industries in terms of auditor mandatory rotation. We believe auditor rotation of large, complex, multi-national companies is extremely difficult and has a higher risk of audit failure during the first 1 – 2 years of an engagement. The consequences of audit failure for larger issuers are much more severe due to both the increased number of shareholders involved and the significant market capitalization of these institutions. A proposal to only mandate rotation of audit firms for large issuers would increase the risk of audit failure in specifically the types of companies where we believe the inherent risk of changing audit

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firms is already higher due to their complexity and global footprint. **Transition and Implementation Considerations**

7. *To what extent would a rotation requirement limit a company's choice of an auditor? Are there specific industries or regions in which a rotation requirement would present particular difficulties in identifying an auditor with the necessary skills and expertise? Is it likely that some smaller audit firms might decide to leave the public company audit market due to the level of uncertainty regarding their ongoing client portfolios?*

   Large complex companies typically utilize the non-audit services and expertise of the other "Big 4" accounting firms in implementing financial accounting systems, tax compliance, staff augmentation, acquisition due-diligence, litigation services, internal audit services, Sarbanes Oxley testing etc. As a result, we expect many of the large issuers would currently be conflicted and unable to utilise any of the other "Big 4" audit firms to perform an audit of financial statements. It would take a significant amount of time for large, complex, multinational companies to be able to remediate their use of a specific firm from non-audit services in order to qualify them to be able to perform audit services. In addition, it would be extremely complex and costly for the accounting firms to continuously remediate independence issues associated with audits of large financial services clients. In essence, there will not be an appropriate Request for Proposal process that would be able to be completed as Management's divesture of a specific audit firm from non-audit services will leave both the Audit Committee and the Shareholders a single choice of audit firm for rotation. This would present specific challenges in certain countries where a single firm is known to be an expert in a single industry. Large, complex, multinational organizations will be presented with unique challenges of selecting a firm upon rotation for which they may have very little industry expertise in a specific region. We believe these unique challenges should not be underestimated as audit quality is based on the expertise of the individuals within the audit firms and this does vary significantly by geographical region.

8. *If rotation would limit the choice of auditors, are there steps that could be taken to allow a company sufficient time to transition out of non-audit service arrangements with firms that could be engaged to perform the audit? Are there other steps that could be taken to address any limitation on auditor choice?*

   We do not believe there is a universal solution to this question other than providing an appropriate transition period for companies to be able to transition out of non-audit services. We would expect that if mandatory auditor rotation were implemented, companies would have a period of time to exit non-audit services with firms that would be at least equivalent to the audit rotation period. Any shorter transition period could jeopardize existing global projects and arrangements.

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9. *If rotation were required, would audit firms have the capacity to assign appropriately qualified personnel to new engagements? If they do not currently have that capacity, could firms develop it in order to be able to compete for new clients, and would they do so?*

   If mandatory rotation were required, audit firms would not initially have the capacity to assign appropriately qualified individuals to new engagements. The volume of auditor change across the world would be too significant for firms to be able to adequately shift the balance of resources globally. This would impact audit quality for the first 1 to 2 years of implementation. We do believe firms could develop that additional capacity over time which will be an additional cost borne by the issuers as a result of mandatory audit rotation.

10. *Would rotation create unique challenges for audits of multinational companies? For voluntary rotations that have taken place, what have been the implementation and cost issues and how have they been managed?*

    As previously discussed, we strongly believe that audit rotation for multinational companies presents a significant challenge. HSBC serves customers worldwide from more than 7,500 offices in 87 countries and territories in six geographical regions. There are many countries in the world where a single audit firm has the predominant technical expertise for an entire industry. This typically occurs when there are a few large companies in a specific industry and an audit firm has developed this expertise in response to the needs of those clients. The other audit firms in these counties would be at a significant disadvantage in being required to participate in global audits in which they do not possess the appropriate expertise. We do not believe we would be able to locate the expertise in each of the markets we operate without undue effort, challenges, and costs.

    Voluntary rotations present a much lower risk as the volume of change is manageable and the audit firms can relocate professionals with the appropriate expertise into the regions to meet client needs. We would expect that mandatory rotation would represent an amount of constant change that the audit firms would have difficultly absorbing and therefore could increase the risk of audit failure during the first 1 to 2 years of an engagement.

    In terms of cost, mandatory audit rotation will increase the costs of audits to issuers. The start-up costs will be significant for any firm in the first 1-2 years of an engagement and the inability of audit firms to gain efficiencies over a period of time that can be passed on to their clients will have an impact on the cost of audits if mandatory rotation were implemented. Limited competition for audits due to both independence issues as well as strategic decisions on the part of audit firms to continue providing more lucrative non-audit services will further increase the cost of audits.

11. *Would increased frequency of auditor changes disrupt audit firms' operations or interfere with their ability to focus on performing high-quality audits? How would any such disruption vary by firm size? For example, would a rotation requirement pose fewer or more implementation issues for small firms than for large ones?*

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As we have previously indicated in response to other questions, we do believe increased frequency of auditor rotation will disrupt the audit firms operations. The start-up time and cost of developing an understanding typically leads to less substantative work being performed in the earlier years combined with work that is rushed and done at hours when staff are overworked and not performing at their full potential. We believe the disruption is positively correlated by the size of the firm, complexity of its control environment and its global footprint. We believe the disruption firms would experience on smaller companies would be lower due to inherent lower complexity and the ability to audit substantively a large portion of the financial statements. This contrasts with larger companies where there is inherently a higher degree of complexity and a much more significant reliance on testing of the control environment.

12. *Would audit firms respond to a rotation requirement by devoting fewer resources to improving the quality of their audits? Would firms focus more on non-audit services than on audit services?*

Audit firms would not devote any more or less resources to improving the quality of their audits if mandatory audit rotation were implemented. Audit quality is driven by the existing governance in place with internal reviews of audit engagements, peer reviews of firms, audit partner rotation and the PCAOB's review of audit engagements. If the PCAOB wants to implement another form of improving audit quality, we recommend the following for consideration. In conjunction with deficiencies identified by the PCAOB, an audit firm would be required to disclose these deficiencies to the Audit Committee within a period of 90 days with an appropriate plan for remediation. This will provide the Audit Committee, which is responsible for the engagement of the audit firm, with a greater level of information regarding audit quality. If the level of audit quality is not acceptable and/or the audit firm's remediation plan is not acceptable, the Audit Committee at its discretion could seek to replace the audit firm. We believe expanding the use of this information and providing it to the members of the Board of Directors who are directly responsible for the engagement of the auditor, would do more to improve audit quality and effectiveness than the implementation of mandatory audit rotation.

In response to your question as to whether firms would focus more on non-audit services than audit services, we believe this may occur in specific cases, but a general conclusion across industry cannot be made.

13. *Would rotation have any effect on the market for non-audit services? Would any such effect be harmful or beneficial to investors?*

Overall, we would expect an environment of mandatory rotation to require a firm (s) to clear themselves of any independence issues in advance of being awarded an audit engagement. This would have the implication of limiting a Company's choice of non-audit firm for a period of time as audit firms work to set themselves up for proposal. Companies will be left with fewer and potentially less qualified choices for engaging non-audit services.

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14. *Some have expressed concern that rotation would lead to "opinion shopping," or that in competing for new engagements firms would offer favorable treatment. Others have suggested that rotation could be an antidote to opinion shopping because companies would know that they could not stick with a firm promising favorable treatment forever. Would opinion shopping be more or less likely if rotation were required? If rotation limits auditor choice, could it at the same time increase opinion shopping?*

    Audit firms are engaged by the Audit Committee of the Board of Directors and approved by the Shareholders of the Company. Since both of these constituents seek the same goal which is efficient and reliable financial information to understand the performance of the Company, we do not believe mandatory auditor rotation benefits "opinion shopping" as the audit firms are engaged by the Audit Committees and Shareholders that seek reliable financial information.

15. *What effect would a rotation requirement have on competition for audit engagements? If competition would be increased, how might that affect audit quality?*

    We believe competition for audits would increase as firms would see a natural benefit to the contacts developed during the audit engagement and their ability to sell non-audit services at the end of the fixed term. As previously mentioned, we do believe the audit firm's ability to sell non-audit services at the end of the fixed audit period presents a potential conflict at the end of the fixed term as the audit firm will work to ensure their relationships are strong which could impact audit effectiveness.

16. *Are there any requirements the Board should consider to mitigate any risks posed by rotation? For example, are there enhancements to firms' quality control systems that might address such risks?*

    We refer to our response to Question 12 in which the Audit Committee would be provided information regarding the firm's audit deficiencies and their plans to remediate these deficiencies. This would allow for audit effectiveness issues to be dealt with by members of the Board of Directors with the appropriate qualification on a case by case basis without imposing an overall framework of audit rotation which will require additional costs and result in lower audit effectiveness across the industry.

17. *If the early years of an auditor-client relationship pose higher audit risks than later years, should the Board require firms to provide additional audit supervision and oversight in the first year or two of a new engagement? Should the Board impose such a requirement for auditor changes even if it does not further consider requiring audit firm rotation? If firms are accepting new clients but are unable to perform quality audits for them until several years have passed, should the Board require enhanced client acceptance procedures? What impact would additional requirements of this type have on audit costs?*

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As previously mentioned, the inherent risk of auditor rotation is directly attributable to the size, complexity and global footprint of a company. The inherent risks of audit rotation are obtaining and assigning the appropriately skilled resources in the right geographies to perform the significant amount of work required for a new engagement. When this is done correctly, additional oversight does not add an appropriate amount of value for the increased costs this would impose. However, to ensure this is done correctly, expansion of the supervision and oversight during the first two years of an engagement would lead to overall improved audit effectiveness. However, we believe identifying the additional resources with the appropriate technical expertise will be extremely challenging to accomplish this objective. In addition this would further increase the costs of audit engagements and have to be evaluated against other proposals available.

18. *If mandatory rotation were required, are existing standards relating to communications between predecessor and successor auditor sufficient? Should additional communications be required? For example, should the outgoing auditor provide the incoming auditor with a written report outlining audit risks and other important information about the company?*

In general, we believe existing standards relating to auditor communication to be sufficient. However, we see the benefits of requiring the existing firm to provide the incoming firm a written report outlining audit risks and issues. This measure would also ensure that members of the audit engagement at the highest levels remain committed to audit quality and the transition of the audit engagement to the successor firm in a controlled and transparent manner.

19. *Are there other audit procedures that should be required to mitigate any risks posed by rotation?*

We have no specific comment in this area.

20. *If the Board moved forward with development of a rotation proposal, should consideration be given to the recommendation for a cause restriction on the company's ability to remove an auditor before the end of a fixed term? Would such a provision be useful? Would there be unintended consequences of such a requirement? Should the Board work with the SEC on implementation of this recommendation? Are there other matters on which the Board should coordinate with the SEC?*

The Audit Committee of the Board of Directors has responsibility for selecting an audit firm that possesses the required expertise to perform the annual audit engagement. The shareholders of the Company have the ability to vote for or against the auditor that is recommended. We believe Audit Committees and shareholders must continue to hold these rights. If the Board chooses to implement a mandatory rotation period for audit firms, the Board should not require a fixed term as this is not in the best interest of both the Audit Committee and the Shareholders. The Audit Committee must continue to be able to independently evaluate the services being provided and make changes if necessary to fulfil their fiduciary duties. We strongly recommend that Audit Committees would

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continue to have the ability to engage the auditor to ensure adequate services and expertise are being provided to protect shareholder interests.

21. *What other transition issues might arise in the first year of a rotation requirement? How should the Board address these issues?*

The significant amount of time required for audit firms to understand the complex business models of global organizations increases the risk of audit failure in the first couple of years of an engagement. A rule requiring mandatory rotation of audit firms would create a constant element of change across the industry and we do not believe these changes would reduce overall audit risk. We would also not support a "big bang" approach to implementation if the Board so chooses to move forward with the Concept Release as we believe a long implementation period would be required to remediate independence issues with potential audit firms as well as seek out an appropriately skilled audit firm. As an alternative, we believe a systematic process of providing information to the Audit Committee regarding poor quality audits would increase audit quality performed by firms and allow the Audit Committees of companies to appropriately evaluate the audit firm's services.

We are available to discuss our comments with you in further detail if this would be helpful.

Yours sincerely,

Group Finance Director

For and on behalf of
HSBC Holdings plc

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