Direction

COMMITTEE OF EUROPEAN SECURITIES REGULATORS
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Notre référence	Votre référence	Date	Page
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Subject: **Comments from Luxembourg Stock Exchange on CESR consultation paper ref : CESR/04/-509 on equivalence of certain third country GAAP.**

Dear Mr Demarigny,

We are pleased to provide our comments on CESR's concept paper on equivalence of certain third country GAAP and on description of certain third countries mechanism of enforcement of financial information.

Preamble:
Luxembourg Stock Exchange is a major listing centre of international bonds, equities and investment funds. On 31 December 2003, 29 102 different securities were listed on the Luxembourg Stock Exchange with more than 4,100 issuers from about 100 jurisdictions. 47 % of these are not European issuers (14% from Canada, 15% from USA, 11% from Asia and % from South America). This provides evidence that the Luxembourg Stock Exchange has one of the most relevant experiences in the listing activities related to third countries issuers on a EU regulated market, notably in the field of supervision. Like in half of EU Member states, the Luxembourg Stock Exchange is currently the competent authority for approving prospectuses and supervising compliance of issuers listing obligations.

Firstly, we would like to highlight the following general remarks and propose some suggestions to CESR.

Financial statements prepared according to US GAAP for non-EU issuers are accepted in all the EU Member States (before enlargement) without additional requirements (at the surprisingly exception of one Member state, asking additional information on a case by case basis only at the occasion of the publication of a prospectus, but not on a permanent basis). This fact is known from CESR because of the fact finding exercise asked by the European Commission in its mandate for advice on level 2 measures for the prospectus Directive. We consider it is essential to indicate the different reasons if CESR proposes a solution that departs from this unanimously accepted situation in Europe, especially at a

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moment where Member States accounting standards will considerably improve their convergence with US GAAP and also with Canadian and Japanese GAAP.

We encourage CESR to commit itself to the mandate given by the European Commission and not ask again the European Commission to find the effective solution like in its previous advice (CESR03-399 paragraph 37). There should be no further delay of the whole process. This situation has already created a lot of confusion among third country issuers and Europe has already and effectively lost business because of this uncertainty. The current situation seems to have detrimental effects for European investors that are now obliged to bear additional costs for buying securities of certain issuers outside EU. There are already several issues of securities with clauses of withdrawal from EU regulated markets if US GAAP is not declared to be equivalent to IAS for the purpose of drafting a prospectus. This is an immediate and direct consequence of the failure to find a definitive and adequate solution in CESR advice 03-399.

We would like also to draw the attention of CESR to the European Parliament amendment proposed on this issue during the negotiations for the adoption of the transparency Directive. Such amendment to the Commission proposal for a transparency Directive would have proposed a sound solution to this issue. Our understanding is that this amendment was withdrawn from the level one text in order to allow an adoption of a level 2 measures offering a similar solution for both the prospectus and the transparency Directives. We encourage CESR members to keep in mind the original wish of the European Parliament when adopting their advice.

We would like also to highlight that we have never heard from market participants and notably investors in securities issued by third countries issuers that they wish to have additional information from third country issuers producing financial statements prepared according to US GAAP. It is also important to note that among European investors, there is a large proportion of subsidiaries or funds with ties with the USA. We invite CESR members to undergo a simple on-site exercise. Representatives of their services should attend to road shows or other meetings with financial analysts organized by a third country issuer preparing their financial statements according to US GAAP and another set of accounting standards, including IAS. A simple glance of the remaining documentation left on the chairs or in the dustbin should be a striking example of what is used by market practitioners as one of their raw material for research and investment decisions. European research circulation is also not limited to EU Member states.

We would also pray for clear-cut solutions and not complex remedies that will inevitably drive out third countries issuers from European markets. Complex remedies mainly create business for advisors and give no practical solutions for investors, or even generate confusion. Moreover, the investors will indirectly bear the overall cost. At the end, this is not only detrimental for the European markets but mainly for European investors that will anyway buy securities of such thirds countries issuers on US or Asian markets, with higher cost for transactions (they are bound to diversify their portfolio, they might also

miss investment opportunities and therefore not fulfill their fiduciary duties vis-à-vis their clients).
Aside the burden, the cost and the usefulness of asking additional information, we consider also that it is extremely difficult for an issuer to have an information policy mixing financial information prepared under different sets of accounting standards. Such practice should not be encouraged or even banned because it might lead to misleading information. Some EU issuers both listed in the EU and in the USA have already experienced this situation and deeply suffered from it.

In addition, we hope that CESR will consider at a latter stage to undergo a cost and benefit analysis and a proportionality test before the adoption of its advice by its members. This wish is in line with European Parliament and European Securities Committee reiterated demands to the European Commission when adopting level 2 measures. We consider that it is not useful, time consuming and confusing to propose an advice to the European Commission if its contents might not fulfill these two tests.

Comments on the consultation document and answers to the different questions.
First, we wonder if the second paragraph of the general background clearly reflects the provisions of the EC Regulation 809/2004. Our understanding is that a third country issuer is also entitled to present financials statements according to accounting standards equivalent to IAS as from 1st July 2005, independently of the transitional arrangements.

Question one:
We would support most of the explanations in the first five paragraphs but we do not consider them as a definition but more as CESR's understanding of the concept of equivalence. It is also up to the competent bodies to interpret what is provided in Community legislation and not for CESR to interpret Directives.
We propose to go further on the aspects related to the investors needs. Consultation will not provide a real picture of their views. A survey with simple questions to the most representatives associations of fund managers and buy side analysts would be more efficient. We consider that the other views might be interesting but should not be taken into account because outside of the purposes of the prospectus and transparency Directives and the scope of the mandate. Notably, the accounting and audit associations views should not be taken into account because they cannot qualify to represent the investor' needs and because they have a direct economic interest to create new business on this issue.
The key objectives mentioned in the mandate should be first taken into account (true and fair view for instance), the four characteristics seems to be a secondary objective as indicated in the mandate. Moreover these four characteristics are not specific to IAS/IFRS. We would propose CESR to look if US, Canadian and Japanese Gaap have similar principles.
We consider that the mandate is limited to assessment of equivalence of some non-EU accounting standards, but not for the assessment of a given issuer's financial statements. It is not a case-by-case approach.

If CESR follows the route of proposing a definition, we would support an approach that equivalence means "accounting standards that are acceptable for investors in order to make an investment decision".

Question two:
We do not agree with the imperious necessity to make a technical assessment of the significant differences between the different accounting standards. This task is not required as such in the European Commission mandate. As indicated in the executive summary, this technical assessment is an additional proposal of CESR, even if this assessment is mentioned in the mandate. We think it is not necessary for determining if US, Canadian and Japanese GAAP are or not equivalent to IAS for the purpose of the prospectus and the transparency Directives. This is time consuming and costly. CESR is not requested to perform this task which is much more relevant in the context of the IOSCO working party one or in the FASB/IASB discussion on convergence. We think this assessment will have a limited added value and only in the case where one or more of the three third country accounting standards mentioned are not considered as equivalent to IAS, in order to identify the extent of the needed remedies.

Question three:
If such assessment was at the end performed by CESR, a difference should only be considered as a significant one if it has an effective impact on the methodology used by buy side analysts and fund managers in their research on third countries issuers.

Question four:
We wish no other element should be taken into account for this assessment to avoid mixing the core elements with accounting issues related to convergence of accounting standards, which are not relevant in the context of investment decisions.

Question five:
We do not consider it is essential to have a good knowledge of third country GAAP in order to make an informed investment decision. First, it is a matter of critical size. For instance, the use of US GAAP is far more widespread compared to IAS/IFRS, notably in Europe. It is even arguable that European financial analysts or fund managers have currently a good knowledge of IAS/IFRS. It will take years for such professionals before they assimilate the new European accounting standards compared to US GAAP for instance.
Therefore, it would be of no relevance to use IAS as a benchmark in order to decide to buy shares from General Electric Company for instance. Adopting IAS referential for preparing financial research on such company would be detrimental to European investors because they might be no more in line with the US recommendations and US market.

Question six:

Yes. We reject a theoretical approach. Fund managers and financial analysts are not accountants or auditors. They are in charge of making investment recommendations or decisions and not of comparing different accounting standards or giving an opinion on the financial statements. The assessment should only take into account if such persons are amending their research on companies like General Electric, Alcan or Sony for instance because of their respective accounting standards.

Question seven:
We do not think CESR should distinct professional and retail investors in assessing equivalence, simply because the need of professional investors should only be taken into account. The views of the retail investors on this issue should not be retained for the following reasons.
Retail investors are simply not in a position to influence the market, whatever their knowledge of accounting standards. Even if an individual makes an informed investment decision, he will not be in a position to gain from this expertise if professional investors have a different view.
In our answer to question six, we questioned the extent of the knowledge of accounting standards by fund managers and financial analysts. There is no doubt that very few retail investors have a real knowledge of accounting standards, including IAS/IFRS and any information about differences between accounting standards will be understood only by a very small percentage of retail investors.
With this answer, we would like also to comment CESR's position indicated in paragraph 8. We consider that Community legislation (Prospectus and Transparency Directives) clearly mandates a differentiation on the information given depending on the type of securities, of issuers and of markets. It is true that this differentiation is already taken into account in level one and two measures. However, it is essential that the possible proposed remedies, if one or more of the three third country accounting standards are not considered as equivalent to IAS, should take into account the different type of securities, of issuers and of markets, because they will be adopted in level 2 measures. Additional information or restatement is useless for an issuer of covered warrants because no one is producing research on the issuer of such products in order to buy covered warrants. For bonds issuers, it is, for instance, arguable that price-earning ratios are taken into account for deciding to buy or sell bonds.

Question eight:
We could broadly support the three elements mentioned for conducting a review of general principles upon the condition that the original objective is not forgotten: i.e. what European investors need. We refer to our answer to the first question where indicated that the key objectives mentioned in the mandate should be first taken into account, the four characteristics seems to be a secondary objective as indicated in the mandate. Again, we urge CESR not to focus on details that will only be useful for the accounting industry and not for buy side analysts and fund managers.

Question nine:

We consider that CESR should have a more proactive approach on this matter by doing a direct survey with European investors and not only wait for various answers to this consultation. CESR resources should be oriented on investor's needs, not on the accounting world issues on convergence of accounting standards or of recognition of IAS by other securities supervisors in the world.

Question ten:
We agree with the principles of this general review upon the condition CESR do not allocate too much time on this issue and focus on the key objectives of the mandate.

Question eleven:
We consider there is a clear hierarchy between the objective of equivalence and the review of the general principles. We do not support the articulation between the technical assessment and the general principles because we consider that this technical assessment is not required and therefore not part of the global assessment (see above our answer for questions two and three).
The main part of the task for the global assessment is to determine what is useful for investors in order to give them the possibility to make an informed investment decision. Therefore, we consider that a third country accounting standards should be declared equivalent to IAS in the context of the prospectus and the transparency Directives even if there are major accounting differences with IAS/IFRS standards on the basis that this accounting standard is suited to the investors needs. CESR should acknowledge that IAS/IFRS is most of the time not at all the benchmark or relevant for evaluating equity securities of a third country issuer.
This technical assessment should only occur if a given third country accounting standard is not deemed to be equivalent for the purpose of the prospectus and the transparency directives: i.e. not suited for financial research.

Question twelve:
We do not support this proposed approach. This identification of significant differences should be performed only if one or more of the three third country accounting standards are not considered as equivalent to IAS in order to identify the extent of the needed remedies.

Question Thirteen:
No

Question fourteen:
We do not subscribe to the three potential outcomes described by CESR. As indicated above in our general comments, we favor clear-cut solutions. We do not support a regime where a third country accounting standard might considered as partially equivalent or not equivalent to IAS. This type of solution should be avoided because it will be too difficult and costly to apply it. We would like to recall that all this issue was raised in order to solve legal uncertainty for third country issuers. Therefore, we need to have a clear answer if US, Canadian and Japanese GAAPs are equivalent or not to IAS.
However, we support the approach to have different type of remedies when a third country accounting standard is considered equivalent to IAS. We urge CESR to reconsider its previous advice to the European Commission for the prospectus Directive implementing measures to request a restatement when a third country accounting standard is not considered equivalent to IAS. CESR should propose a modification of the European Commission Regulation 809/2004 on this matter. This would be in line with its new approach in this consultation document to have a tailor made approach when they are differences between the accounting models. However, we do not support complex remedies that will inevitably drive out third countries issuers from European markets. These remedies should always be defined on the basis of the needs of investors.

Question fifteen:
We do not agree that the auditor's opinion should cover the additional remedies. This new burden is costly for issuers and useless for investors. We consider this is a non-effective solution mainly proposed by securities supervisors in order to show their willingness to protect investors. However, such opinion will inevitably be accompanied with restrictions on responsibility and warnings that this opinion has no real substance. Therefore, this type of opinion is confusing for investors and might even be misleading because of the non-plain English language used for describing the extent of this opinion. If such opinion is to be requested, auditors should have a responsibility and not the right to add qualifications or comments.

Question sixteen:
First it is important to note that a remedy should be asked not because there are differences between two sets of accounting standards, rather because the given third country accounting standard is not equivalent to IAS. We do not believe that the proposed list of remedies is a complete one. Restatement is also a remedy and is already part of Community legislation. We do not support CESR interpretation of Community legislation in paragraph 60. It is also up to the competent bodies to interpret what it is provided in Community legislation and not for CESR to interpret Directives. Moreover, the mandate clearly indicates that restatement is a remedy.
At the other side of the spectrum of remedies, disclosing the list of substantial differences between two accounting standards is not mentioned as a remedy and is already part of Community legislation. CESR should also take into account the currents practices in Member states for determining remedies linked to the current application of Article 76 of Directive 2001/34/EEC that mandates third country issuers to give equivalent

information. We would also appreciate to have detailed justifications from CESR if US, Japanese, and Canadian GAAP were no more considered as giving equivalent information to European investors.

Question seventeen:
We do not support the proposed approach because of its non-compliance with the mandate. Moreover, this solution is costly and not operational. The remedies should be valid for accounting standards and not for an approach addressing the differences between two accounting standards for a given issuer. We consider that CESR three types of remedies might go beyond the mandate. They are acceptable only if it is clear that there is a standardized approach for a given accounting standard. Otherwise, CESR seems to address an issue different from the mandate, which are the differences of individual financial statements prepared according to an accounting standards different from IAS. We think this is far beyond the mandate given by the European Commission.

Question eighteen:
We do not support the proposed approach on early warning mechanisms because of the proposed creation of a specific body in charge of this task. There is no need to create a specific body because European securities supervisors will anyway have the power to monitor on a permanent basis the correct application of the Prospectus and the Transparency Directives. These supervisors are already funded and there is no reason for market participants to bear additional costs if CESR or some of their members do not wish to assume directly the responsibilities assigned to them in the mentioned directives. In any event, securities supervisors cannot delegate their final responsibilities. If they wish to have an external comfort, it seems logic that they pay for it. Part of the difficulties are also a direct consequence of CESR approach: not retaining a standardized approach with immediate legal certainty but rather a case-by-case approach where issuers should individually explain and/or give additional information on differences in their financial statements if they were prepared according to IAS and not according to their local GAAP.

Yours sincerely,

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