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Michel Barnier
European
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ESMA comments on the Draft Report “Should IFRS standards be more European?”

Dear Mr Maystadt,

We would like to thank you for giving ESMA the opportunity to express its views as part of the consultation on the draft report “Should IFRS standards be more European?” (“Draft Report”) prepared by you and communicated by the European Commission (EC) for comments. We have read the draft report with great interest and discussed its recommendations with the members of ESMA’s Board of Supervisors on the 24 of September 2013 and would like to share the Board’s views on this matter with you.

ESMA welcomes the mission given to you by Commissioner Barnier, in reviewing the current system and proposing changes in order to reinforce the European contribution to the International Accounting Standards Board (IASB) and enhance the governance of the European bodies involved in this process. With the adoption of the International Financial Reporting Standards (IFRS) in more than 100 jurisdictions, the IASB has entered into a new decade in which more stakeholders will be around the table in deciding on the future of IFRS. We believe it is important that Europe ensures that it plays an important role in that process.

As a general comment, we believe that the draft report addresses the main subjects affecting the future of IFRS in Europe, but the draft report could have benefited from a more detailed analysis, including advantages and disadvantages for each of the options mentioned in the report or an analysis of the factors considered for providing recommendations and an assessment of the long-term effects of the new European structures in the global context of IFRS. ESMA believes that, in light of the importance of the likely

consequences of the recommendations providing a more detailed analysis would enable the ECOFIN to take an even better informed decision about the future of IFRS in Europe.

ESMA recognises that consensus and a common EU view will strengthen the EU's role in IFRS. As pointed out in the report, this should be accompanied by a revision of the criteria currently foreseen in the IAS Regulation in order to ensure protection of the public interest and keeping, as a last resort, the possibility of intervening in the endorsement process of each standard.

Regarding the option recommended in the second part of the report (on the body to be entrusted with responsibilities for providing endorsement advice in the EU), ESMA welcomes the objective of reinforcing the credibility and political legitimacy of the body in charge of providing advice to the EC, but believes the proposed recommendation does not fully meet this objective. Our main concern relates to the fact that it does not embody significant characteristics that would be necessary such as:

- the need for ensuring independence from private stakeholders' interests which has been identified as a significant weakness of the current system,
- the need to ensure that all EU MS are represented as part of the democratic process of establishing legislation in the EU, and
- the importance of ensuring proper interaction with existing European authorities which also play a role in the area of financial reporting.

Our comments on the first part of the draft report and our main concerns in relation to the second part of the report are included below.

ESMA comments on the commitment to IFRS and their endorsement process in Europe

The draft report (pages 6 to 9) indicates that there is consensus among the consulted parties in relation to commitment to IFRS. ESMA welcomes this fact and believes that continuous commitment to the use of IFRS is the right approach to be followed in the context of global markets and increased used of IFRS around the world.

Regarding endorsement of IFRS in the EU, the draft report suggests that the criteria for endorsement should be revised. ESMA agrees that the criteria currently foreseen in the IAS Regulation should be reviewed in order to ensure that they do not endanger financial stability and hinder the economic development of the region. We believe that such criteria should be assessed so that the long-term adherence to the single set of financial reporting standards and comparability of financial statements of issuers across the world is ensured.

The IAS Regulation played an important role in providing for a step-change in financial reporting and its role will be as important for the next period, after the finalisation of the main projects currently under review. Integrating a new IFRS or amending existing IFRS in the European legislation is an important act which requires careful political and technical assessment. In view of the crucial importance of financial reporting for capital markets, there is undoubtedly a need for a combination of a well-balanced and objective technical analysis that ensures a new set of amended IFRS will provide decision useful information to investors and of a proper and thorough assessment of the public interest and requirements to preserve financial stability.

ESMA also agrees with the last part of the conclusion on page 9 which underlines the importance of taking into consideration the public interest. Moreover, as expressed by the Ministers in the ECOFIN meeting of November 2012, we believe that this dimension should be reinforced by aligning the endorsement process in the IFRS with the general rules and procedures followed by the EU in drafting or adopting financial legislation.

ESMA comments on recommendation for the body to be entrusted with providing advice to the EC on the IFRS endorsement

In analysing the recommendations proposed in the draft report in relation to the possible options with respect to the structure that would provide advice to the EC on the IFRS endorsement (pages 12 to 19), we consider that options 2 and 3 are not sufficiently developed in the draft report to allow a real assessment of their validity and merit with respect to the objectives assigned.

Providing endorsement advice for financial legislation in the EU is a responsibility given to public authorities which have to protect the public interest. On that basis, and also considering the important role that accounting standards play as a starting point in the preparation of financial information, we believe that this area should follow similar rules and processes as other areas of financial markets regulation. Therefore, we would like to underline that the body in charge of providing advice on IFRS endorsement should be a body that operates by its constitution in the public interest.

The draft report identifies the drawbacks of the current EFRAG structure and suggests changes which are meant to reinforce the credibility, and compensate for the lack of political legitimacy by recommending a transformation of EFRAG. ESMA welcomes the suggestion that a more important role is needed for public authorities as part of that option, but we are concerned that suggested changes proposed under option 1 are not sufficient to ensure that the body which has to provide endorsement advice to the EC is really independent and fully serves public interest needs.

We realize the constraints and difficulties that you are facing in your mission and welcome the fact that the proposed scenario 1 envisages opening the Supervisory Board of EFRAG (SB) to the national standard setters (NSS) and that an increased role is given to other public bodies as well. We also acknowledge that this new SB is given more controlling powers as it will have to approve the technical advice proposed by the technical experts group (TEG). Nevertheless, we believe that the transformed organisation would still not fit the main characteristics required for a body which has to play such an important role in advising the European Commission on a crucial part of financial market regulation. We detail below our main concerns in that respect.

Participation of private interests

We have concerns about the increased level of influence given to market participants and the fact that they should be represented in the SB of an organisation which has to provide advice to the EC. We do believe that market participants play an important role and that their views should be carefully taken into account when analysing standards for endorsement in the EU. Nevertheless, as for other pieces of legislation, we believe that should be done through ways such as creation of consultation groups or other processes that ensure that private sector's views are properly heard and considered.

While not addressed in detail in the draft report, the same considerations might apply to the TEG members. Whereas it is important that appropriate technical expertise is used as part of forming technical advice, we believe that conflicts of interests might arise for active practitioners and that additional safeguards should be considered in order to ensure their independence.

In addition to the elements above, we would like to draw attention to the fact that the funding scheme encompassed under option 1 could lead to additional confusion by mixing private and public sources and is not in line with the objective of creating an independent structure.

Representation of all EU MS

The draft report is calling for a single European voice in order to strengthen the European position as representative of a key stakeholder of the IASB. Forming a European view implies that it is based on input from all Member States (MS), in accordance with the fundamental principle of democracy in the EU. We believe that a structural weakness of option 1 is the lack of balance in the composition of the organisation, which fails to ensure representation of all 28 MS.

Option 1 provides 6 MS with the possibility of being represented in the SB through their NSS. On the assumption that the size of the capital markets was the basis when making such proposal, another factor which might deserve attention relates to the fact that in a significant number of EU countries, the IFRS have been permitted or required also for entities outside the scope of the IAS Regulation (i.e. standalone

financial statements, consolidated financial statements of non-listed companies). We are not sure that the current recommendation considers this aspect. At the same time, we would like to draw the attention to the fact that some of the NSS in Europe are private bodies, in some cases heavily influenced by their domestic preparers and auditors, and thus they might not be able to ensure the protection of public interest. We also believe that analogy with the ECB Executive Board is not appropriate as the nature of tasks is different and the ECB members to which reference is made are independent members and are not representing national interests in that Board.

Voting mechanism

The draft report indicates that decisions in the SB should be based on consensus. Notwithstanding the fact that this concept would need to be elaborated further, we believe that achieving consensus would be very difficult when public and private stakeholders are mixed together and we have concerns on the weight to be given to each party's vote.

We also believe that, considering the enforcers' role in ensuring consistent application of the accounting standards, as defined in the European legislation, their views might be diluted and their voice might not be sufficiently heard as part of this process with potential consequences on the efficiency of the accounting enforcement activity.

Inter-relation with enforcers' role

Enforceability is one of the key characteristics of accounting standards which has to be met in order to ensure high quality standards, and in particular for IFRS which are principle-based. Providing the IASB views related to enforceability and consistent application of the new standards is particularly important, as illustrated by the IASB on several occasions (and most recently in its announcement for the protocol signed with IOSCO).

We welcome that ESMA representation is considered as part of the SB, but it is our view that it is not sufficient to ensure that enforceability views are reflected accurately and in a timely manner in any advice and we believe that enforcers should play a more prominent role in the IFRS endorsement process. We would also like to clarify that while ESMA has a general objective of ensuring investor protection, by its founding regulation, ESMA is also monitoring and assessing developments across sectors and their potential impact as part of the sectoral legislation, thus contributing to consistency of the overall financial framework.

In addition, we are surprised that EBA and EIOPA are not considered as part of the proposed structure. As part of the European System of Financial Supervision, ESMA maintains close co-operation with EBA and

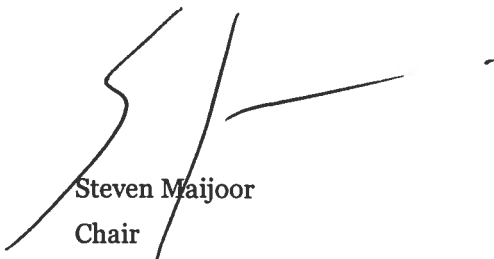


EIOPA in relation to any matter which might have cross-sectoral implications, as is the case for financial reporting. We believe their integration should also be considered as part of the envisaged solution.

In conclusion, we would like to stress that while we acknowledge that the recommended option 1 would bring some improvements to the current system, ESMA believes that it does not satisfactorily address the fundamental problems and that the overall objective of strengthening the European voice and providing the needed credibility might not be achieved through the proposed changes. A more structural revamping of the process and set-up to provide technical advice on endorsement of IFRSs should be explored with the goal that technical advice regarding financial reporting, a crucial part of financial market regulation, should be firmly based on public interest considerations.

We would be happy to further discuss the elements presented in this letter.

Yours sincerely,



Steven Maijoor
Chair
European Securities and Markets Authority

CC: Michel Barnier, European Commissioner Internal Market and Services
Jonathan Faull, Director General DG Internal Market and Services