

8 May 2007

The Committee of European Securities Regulators
11-13 avenue de Frieland
75008 Paris
France

CESR Consultation Paper on technical advice on a mechanism for determining the equivalence of the Generally Accepted Accounting Principles of third countries (Ref. CESR/07-212)

The International Capital Market Association (ICMA) is pleased to respond to the above Consultation Paper (CP) on a mechanism for determining the equivalence of the Generally Accepted Accounting Principles (GAAP) of third countries.

ICMA is the self-regulatory organisation and trade association representing investment banks and securities firms issuing and trading in the international capital markets worldwide.

Our response is based on extensive consultations with our member firms and their professional advisors.

We attach our general comments on the CP and response to the specific questions therein as Annex to this letter and would be pleased to discuss it with you at your convenience.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Christian Krohn".

Christian Krohn
Regulatory Policy – Primary Markets
+44 (0)207 510 2704
christian.krohn@icmagroup.org

ANNEX

GENERAL COMMENTS

Definition of Equivalence

We believe that the proposed mechanism for determining equivalence is based on a definition of equivalence which may take insufficient account of the realities of investor behaviour. The CP refers to the 6 March CESR Technical Advice (ref: CESR/07-138) to the European Commission (EC) which uses an 'outcome based' approach to defining 'equivalence': a third country GAAP would be equivalent to IFRS if investors should be able to make a similar decisions irrespective of whether they are provided with financial statements based on IFRS or on such third country GAAP.

In our view, different accounting standards are likely to lead to financial statements containing different figures and/or the presentation of these figures in a different way. We believe that it may be unrealistic to expect such differences not to impact investor behaviour and that an outcome-based definition of equivalence may therefore result in 'equivalent' meaning 'the same'. This would be inconsistent with the common understanding of the term and the purpose of the equivalence provisions in the Prospective and Transparency Directives. On this basis we caution against at least a purely outcome based approach to defining equivalence and instead recommend a more purpose-based definition referenced to the quality of financial reports.

Need for Pragmatic Approach to Equivalence

The equivalence mechanism should recognise the steps taken by third country standard setters in recognising IFRS. Where a third country standard setter allows the use of IFRS in its jurisdiction, this would argue for the equivalence of that jurisdiction's GAAP with IFRS without further reconciliation, explanation or other requirements. As a case in point, the SEC has recently (25 April) announced that will propose to allow non-US issuers to use IFRS when filing reports with the SEC.

Inclusion of Service Standard

Given the importance of the determination of equivalence we suggest the inclusion of a service standard for the EC and CESR in the equivalence mechanism. The timely processing of equivalence applications will be of critical importance to both issuers and investors. For this reason and recognising the significant work for third country standard setters in initiating and substantiating applications for equivalence, we suggest the inclusion of a service standard in the equivalence mechanism. The standard would need to be sufficiently flexible to accommodate the likely very different resource demands of individual assessments but should contain a commitment to expedite applications in a timely manner.

ANSWERS TO QUESTIONS POSED IN THE CP

Question 1: Do you agree that CESR's suggested method for handling applications for equivalence is the best way?

We agree that as a general rule the process for determining equivalence should be initiated and substantiated by the standard setter seeking equivalent status of its accounting principles. We agree that this body is likely to be best placed to assess whether the disclosures and measurement principles required by the third country GAAP concerned are materially the same as IFRS and where they are not to assess the differences. However, to accommodate the (likely more exceptional) circumstances where a standard setter is not in a position to initiate and/or substantiate an

equivalence application (e.g. because it is prevented from doing so by legal or resource constraints) we suggest that the equivalence mechanism allow an issuer using the third country GAAP in question to initiate and/or substantiate an application. Such a 'direct stakeholder' approach would also be consistent with approach to equivalency taken in other closely related contexts (e.g. the determination of the equivalence of third country major share notifications and periodic financial reporting regimes envisaged by the Transparency Directive).

Question 2: Do you think that CESR should publish guidance on the information that it would consider satisfactory to ensure an informed decision?

We agree that CESR should publish guidance on the degree of information on technical differences that it would expect from local standard setters. However, in that context we would caution against linking such guidance to level of detail provided in the 2005 CESR assessment of the equivalence of the GAAP of Canada, Japan and the US. As acknowledged by the CP, the degree of detail regarding the technical detail differences that standard setters should provide will vary a great deal depending on the nature of the GAAP concerned. Guidance should therefore be generic and avoid reference to previous assessments.

Question 3: Which of the two [equivalence assessment] approaches [CESR Model or Alternative Model] do you think is most appropriate?

To avoid confusing the market and to treat issuers in an equitable way, we consider that a sophisticated application of the Alternative Model to be most appropriate.

The CESR Model is based on a definition of equivalence which requires the two sets of accounts to lead to a similar investment decision at the time that assessment is made. The existence of a convergence or adoption programme by the third country standard setter which intends to eliminate at a point in the future significant differences between the local GAAP and IFRS or to replace the former entirely with latter is therefore considered irrelevant for the purposes of equivalence assessment.

We think the CESR Model (especially if applied in a mechanistic way) may lead to inappropriate results. During the transitional period issuers may continue to use GAAP in respect of which certain conditions are satisfied but if these GAAP are not converged with IFRS by the expiry of the transitional period on 1 January 2009, such issuers will no longer be permitted to use the GAAP. The consequent change in reporting principles is likely to confuse the market and may be an unwarranted burden on issuers in circumstances where there are legitimate reasons for a delay in convergence or adoption of IFRS. For example, Canadian standard setters are committed to adopting IFRS as of 1 January 2011 but issuers using Canadian GAAP and accessing EEA regulated markets or making a public offer in the EEA would be forced to do so two years early as of 1 January 2009.

We suggest the equivalence mechanism therefore be based on a sophisticated application of the Alternative Model which on an exceptions basis allows convergence or adoption programmes to be considered as an alternative to the proposed rectification process.

Question 4: Do you think that the existence of a convergence programme between the assessed third country GAAP and IFRS should play any role in the determination of equivalence?

For the reasons set out in our response to question 3 we believe that the existence of a convergence programme between the assessed third country GAAP and IFRS should play an important role in the determination of equivalence. This approach would of

course also be consistent with the EC pronouncements¹ that ‘...the progress of the convergence process should be closely examined before any decision on equivalence is taken’.

Question 5: Do you believe that filters are important and that they should be reflected in any equivalence mechanism?

We agree that the quality of financial reporting is determined by other factors than the GAAP alone and that reasonable investors will make their investment decisions based on the reduction of uncertainty through several filters. However we believe that the GAAP equivalence mechanism should be limited to the third country GAAP alone and not include the existence and quality of filters that are either addressed separately or by their nature difficult to assess objectively.

For the avoidance of doubt we recommend that CESR clarify that the equivalence of the key filter relating to the audit of financial statements is dealt with exclusively through the assessment of compliance with the 8th Directive. We note that, under the 8th Directive, there is to be a separate equivalence-determination process, which is likely to include a separate transitional period, both with different timelines. The GAAP equivalence mechanism should refer to but make no additional requirements to the 8th Directive. Moreover as the CP states in paragraph 29 ‘...even if the legislation of a third country is not considered equivalent to the 8th Directive, the GAAP of such country can still be deemed equivalent if all the other steps in the mechanism are fulfilled’. For the avoidance of doubt we also recommend that CESR explicitly exclude from any equivalence mechanism issuer or business specific filters such as the corporate governance regime applicable to a third country issuer which are difficult to assess objectively.

Question 6: Do you agree with the proposed procedure for providing impact assessments of new standards?

In the event of a local standard setter of an equivalent GAAP or the IASB issuing a new standard, the proposed equivalence mechanism envisages that the local standard setter submit to the EC an impact assessment of the new standard (unless it has been issued jointly with the IASB). We support this procedure as a reasonable step toward maintaining market confidence in the equivalence determinations. However, to avoid undue burden on standard setters, we recommend that this requirement incorporate an appropriate materiality threshold. Moreover it should be made clear that the impact assessment is only required in areas subject to material change.

¹ Recital 8 of Commission regulation 1787/2006 and recital 7 of the Commission Decision 2006/891/EC of 4 December 2006.