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**CESR consultation on the statement of principles on the
enforcement of standards of financial information**

FEEDBACK STATEMENT

MARCH 2003



Feedback Statement on the Consultation of the SOP

On October 22nd 2002 CESR published for comments a Statement of Principles (SOP) on the enforcement of standards of financial information.

The period for comments expired on the 15th of January 2003, after a public hearing was held on the premises of CESR in Paris on the 7th of January 2003.

During the consultation period 38 letters were sent by organizations belonging to the private and public sector of Europe, including comments from countries, which do not belong to the EEA. All comment letters received have been published on the CESR website on the 27th of February 2003.

These letters were considered by the CESRfin Sub-Committee on Enforcement (SCE) in a meeting held in Rome on the 24th and 25th of February 2003.

The group examined the comments conveyed by the comment letters, most of which referred to the most critical areas dealt with by the SOP, which include:

- the level of detail of the standards on enforcement;
- scope of enforcement;
- relationships with regulators other than enforcers of financial information;
- national due process;
- exchange of information with auditors;
- definition of materiality provided by the SOP;
- mechanisms for coordination of enforcement decisions;
- pre-clearances provided by the enforcers.

This paper is aimed at providing for the rationale which led the SCE to formulate its proposals on these major areas.

Level of detail of the standards on enforcement

The majority of commentators generally appreciated that the SOP was based on general principles rather than detailed prescriptions.

The group proposed to continue with this approach which is consistent with the need to harmonize a variety of different enforcement models in Europe.

In addition, CESR will issue this standard that the CESR members will introduce in their regulatory practices according to paragraph 4.3 of the CESR Charter.

The standard will be composed of principles, which address at high level enforcement areas. The document may be followed by other principle-based standards as well as by guidelines.

The former will be aimed at providing indications on areas which are not covered by other standards while the latter may be useful to provide guidance to further harmonization by stating best practices or codes of conducts.



Scope of enforcement

Several commentators expressed the view that harmonization of enforcement of standards for financial information should aim at listed as well as non-listed companies.

Some of them based their comments on the need to improve the general credibility of financial information in Europe, including information provided to stakeholders other than the financial markets participants.

It was also stressed that differences in the enforcement regime applicable to listed and non listed issuers may eventually lead regulatory arbitrage and to limit the efficiency of the financial markets, as far as some issuers may decide to delist their securities or avoid market financing.

Although the SCE appreciated such comments, the group noted that the remit of securities regulators and the wording of recital 16 of the EU regulation on IFRS refer to financial market participants.

In addition the SCE found that enforcement models designated for financial markets, as required by the above recital of the EU Regulation, is mainly aimed at protecting the efficiency of the investors decisions, which may not necessarily overlap with protection of other stakeholders.

Therefore, the group proposed that the CESR principles on enforcement continue to be clearly addressed to protect investors and financial market integrity.

On the other hand the SCE proposed a clarification of the scope in relation to the financial reporting framework it encompasses.

Relationship with other regulators

Some commentators stressed that financial information of certain categories of issuers - such as banks or insurance companies – are subject to surveillance of prudential authorities that in some circumstances may express their view on financial information.

In order to avoid the burden of a two-tier enforcement system, these commentators urged CESR to open the appropriate channels of communication with those prudential authorities, which may be aimed at reducing the cost of regulation.

The SCE noted that the harmonized enforcement system described by the CESR standard apply at least to all listed (or would be listed) companies. Therefore, listed banks and insurances are included.

On this basis the SCE found that, however enforcement of standards for financial information is aimed at purposes which in some instances may differ from those of prudential authorities, there is a well grounded need for coordination with those regulators, cf. the section on Coordination of enforcement decisions.

National due process

Strong concern has been expressed by several commentators on the need that the due process for taking decisions at national level continues to apply also to enforcers of standards for financial information.

In particular, the right to appeal against the decision taken by the enforcers as well as the right of issuers to be heard in connection with enforcement investigations, which exist at national level, should remain untouched.



To this end the group proposed to clarify that CESR principles do not necessarily imply any impact on national due processes.

In addition, it was proposed to stress that the right to appeal against the decisions of the national enforcers is an important part of the enforcement process.

Exchange of information with auditors

Several commentators were strongly concerned by principle 7 (former principle 5), where the power attributed to enforcers to require information from auditors is mentioned as a fundamental characteristic for harmonization of the enforcement systems in Europe.

In particular, concern has been raised that enforcement requests of auditors working papers may be inappropriate because those papers are only prepared for supporting auditors' opinions rather than informing third parties (including enforcers) on the issuers financial position and accounting practices.

In addition, the confidentiality obligation existing with the client has been mentioned.

The SCE noted that requests of information from auditors is currently envisaged by article 21 of the draft directive on prospectus among powers to be attributed to the national, independent, administrative authorities that will be charged of scrutinizing prospectuses. Therefore it is going to be officially recognised that the possibility to open a dialogue with auditors is fundamental to the above scrutiny.

In addition, experiences have been developed at national level whereby relationships with auditors are an effective tool for enforcement.

However, the group proposed to clarify that information gathered using the above mentioned powers are aimed at enforcing the reporting framework for financial information.

Consistent with the reference to national due processes such requests for information should be in line with the characteristics envisaged by the national laws, which, for instance, may require that the issuers are to be informed or that the grounds for investigation are specified.

Definition of materiality

Enforcement of the reporting framework for financial information consists of monitoring departure from such framework and taking the appropriate actions. Some commentators stresses that the SOP apparently referred to its own concept of materiality possibly inconsistent with the above framework.

In particular, it was mentioned that the concept indicated by the IASB framework might under certain circumstances be inconsistent with that described by Principle 1 (former principle 9).

Therefore, the SCE proposed to eliminate possible misunderstanding by defining materiality cross referencing the reporting framework indication: e.g. enforcement on financial statement prepared in accordance with the IFRS will be based on the definition provided by the IASB Framework, while enforcement of prospectuses will refer to the definition provided by the applicable EU directive.



Coordination of enforcement decisions

The proposed harmonized enforcement mechanism will mainly apply to a pan-European reporting framework (e.g. the endorsed IFRS). Therefore decisions of enforcers should be as consistent as possible.

This requires the setting up of a mechanism where CESR and non-CESR enforcers may meet to discuss decisions and experiences.

CESR was mentioned by the Recital 16 to the EU regulation on IFRS as the body through which the EU Commission may liaise with the Member States on enforcement issues. To this end CESR set up CESRfin and its Sub-Committee on Enforcement that is charged to act as the forum where securities regulators may discuss enforcement matters.

However, CESR recognises that various enforcement mechanisms already exist in the EU member States where the securities regulators' model is applied only in some member States.

Therefore CESRfin will establish an appropriate mechanism whereby CESR members and non CESR members may discuss enforcement issues in order to achieve a high level of coordination and convergence in the enforcement decisions. Details of this initiative will be discussed in the near future in order to effectively implement the new system.

Pre-clearances provided by the enforcers

Some enforcers presently offer issuers the possibility of obtaining pre-clearance. This practice has been seen by some respondents as conflicting with harmonization of accounting practices. The financial market participants may indeed tend to apply interpretations of standards provided by their national regulator. Regulatory arbitrage may also take place.

The SCE recognised that where enforcers issue general interpretation of the reporting standard they act as standard setters rather than real enforcers, which is inappropriate. For instance this may happen where the enforcer identifies the preferable accounting treatment where options are provided by the reporting framework to the issuers.

However, CESR recognised that the enforcers' role entail to take decision based on their judgement of the reporting policies followed. In practice, enforcers should only consider whether a specific reporting treatment is allowed or prohibited by the reporting framework.

Those decisions are normally taken when financial information has already been published. In some circumstances regulators allow the issuers to ask for their opinion on the legality of a projected reporting behaviour (i.e. before the information is published). This possibility, which is an option to companies, is considered in certain jurisdictions to be useful to the market and does not conflict with CESR standards on enforcement, as far as it is clearly characterized as limited to the specific case examined; this should be described in the pre-clearance.

On this basis, the SCE proposes to clarify within the standard all those characteristics that pre-clearance should have in order to be in line with the standard, which include amongst others the need for coordination described under principle 20 and the reporting requirement provided by principle 21.