

Keynote speech of Steven Maijor, Chair of ESMA, at the IFRS Conference – 5 July 2011

Ladies and Gentlemen,

I first would like to thank Hans Hoogervorst and his team for his kind invitation to participate in this annual IFRS conference as a keynote speaker. As chairman of ESMA I take this invitation as your recognition of the important role that financial reporting plays in the good functioning of financial markets and of ESMA's role in the financial reporting community.

This year is not only a pivotal year for the international financial reporting community with the appointment of a new chairman for the IASB, the completion of the memorandum of understanding between the IASB and the FASB, and a potential US SEC decision on the use of IFRS for its domestic issuers. It is also an important year for European financial supervision with the creation of the new European System of Financial Supervision of which ESMA – the European Securities and Market Authority – forms a very important part.

In my speech today I would like to talk about ESMA's five main priorities, which I have also discussed at other recent financial markets conferences. You might be disappointed about the selection of this subject matter as you have signed up for an accounting conference. However, as you will hear, for all five main priorities there is a strong link with financial reporting issues. The five main priorities I see for ESMA concern: contributing to safeguarding financial stability, focusing on investor protection, creating a level playing field in financial supervision, the supervision of credit rating agencies and, finally, establishing a single rulebook for financial markets.

Financial stability

Let me start with what might be a surprising starting point for securities regulators: financial stability. As you will hear, stability has not only become important for accounting standard setters, but also for securities regulators.

Until the beginning of the crisis hardly anyone was arguing that financial reporting standards should be written with the objective of financial stability in mind. Now some constituents have repeatedly made the case that one of the goals of financial reporting standards should be to promote financial stability. This is not an easy one. I speak from personal experience as we at ESMA face similar challenges. As you are probably aware, the regulation founding ESMA gives us an important role in stability and requires us to monitor, assess and measure systemic risk. The objective of financial stability is now included in many individual European regulations and directives which will provide national regulators, ESMA and the European Systemic Risk Board (ESRB) with the practical toolkit to meet their mandates in this area.

How could financial reporting best contribute to financial stability? Let us not forget that there is no unambiguous definition of financial stability. Nevertheless there seems to be a broad consensus that financial stability refers to the smooth functioning of the key elements that make up the financial system. In fact I believe that accounting standards do contribute to financial stability by providing clear principles on how to account for complex transactions, such as financial instruments, and by favouring transparency: transparency being key for good market functioning and good market functioning being an essential component of financial stability. Or as Hans Hoogervorst said at a conference of the European Commission in Brussels: "Without transparency, there can be no enduring stability". This not only holds for financial reporting, but also more broadly for securities markets supervision. Hence, ESMA will continue to



focus on transparency, but understands that in the end it needs to serve the stability of European financial markets.

IFRSs have contributed tremendously to both the quality and quantity of the information provided as part of the financial statements presented by European listed companies. Transparency is extremely important for the good functioning of financial markets. Doing bad things is not good, not having any information about them is even worse.

But investors can also be overwhelmed with so much information that they get lost and do not see the bigger picture anymore or, for example, the significant risks the management of a company is taking. We are all aware of examples of financial statements more and more looking like books. Well, let me say that financial statements should not become like *James Joyce's Ulysses*: a masterpiece standing on many cupboards but only read by a few of us and even for those hard to understand. We should think collectively – standard-setters, users, preparers and regulators – what is the best way to provide information to investors. It is not about more disclosures but disclosures of the highest quality presented in a helpful fashion.

Investor protection

That brings me to a second priority for ESMA: focusing on investor protection. It goes without saying that financial statements are very relevant to the investor. After all, financial reporting was developed out of the necessity to provide investors with adequate information on the financial performance and position on the company they are investing in. High quality financial statements are important for the good functioning of financial markets. It is therefore important that their views are heard and that they are involved in the IASB's standard-setting process. I am really supportive of the many initiatives the IASB has taken to reach out to investors and I believe the IASB should continue or even strengthen its efforts. I know it is not an easy task and perhaps easier said than done. ESMA could perhaps help the Board with that. ESMA sees an important and active role for itself in the development of financial reporting standards. We already prepare comment letters focusing on investors' needs and the enforceability of proposed standards or amendments to existing standards.

But I believe it is fair to say that channelling the views of European users into the standard-setting process could be substantially improved. ESMA therefore aims to strengthen its contacts with user organisations to better understand investors' needs. It is my experience that investors do have opinions on the type of information they need but that they are not always familiar with how this fits within the technical accounting framework. It is our and the IASB's task to assist them in that.

And that brings me to the importance of the IASB's due process. It is important to differentiate between the need for the independent high quality execution of setting standards and the need for a stronger accountability framework. I am convinced that independence and accountability reinforce each other.

I acknowledge that the IASB has made significant steps in developing its outreach program. However, I also believe that we have now arrived at a point in time where having a comprehensive look at the different steps of the IASB's standard-setting process would have significant merit. This would include looking at how the various steps of the due process link together in the cycle as well as looking at better defining when the Board should re-expose. A full and transparent due process giving due consideration to market participant's comments is the best guarantee for a smooth adoption of IFRSs. The IASB could consider here more systematic use of effects analyses and clearer communication on the reasons for changing accounting standards at an earlier stage of the standard-setting process in order to achieve greater transparency about its technical choices.

Post 2011 the IASB should strive for a period of calm in accounting standards. The winding-down of the IASB-FASB convergence program, combined with a more rigorous agenda-setting activity could help achieving this. This should enhance stability and comparability across time of the financial information produced on the basis of IFRS, which should benefit all users of this information – investors, preparers and regulators.



It is clear that the European Parliament has a common and important expectation of ESMA and the IASB: investor protection. We believe that investor protection is the guiding principle for the IASB, the IFRS Foundation and its Monitoring Board. The Monitoring Board has already proven to enhance the required accountability of the IASB as well as being a useful tool to protect the IASB's technical independence and due process. It is however clear that the composition of the Monitoring Board is not yet optimal. It makes sense to consider expanding the group to include representatives of more jurisdictions and in particular emerging markets.

But let me touch upon a sensitive issue closer to home: the representation of the European Union on the Monitoring Board. I fully acknowledge the important role of the European Commission in the area of financial reporting in the EU and strongly support its membership of the Monitoring Board. At the same time I strongly believe that ESMA, which brings together the securities regulators of by far the largest economic area with the highest number of entities applying IFRS, should be around the table alongside the European Commission. Considering that the US and Japanese securities regulators, ESMA's counterparts, are represented even as IFRS have yet to be adopted for domestic issuers in these countries, it is amazing that ESMA is not around the table. In effect, the securities regulators with the most extensive experience with IFRS enforcement are not represented on the Board.

I am looking forward to the proposals the Monitoring Board will release later this year and I am glad that the trustees of the IFRS Foundation are also developing a strategy for the Foundation's second decade. It should not be more than logical if both could coordinate their activities and present an integrated package of measures.

Level-playing field in financial supervision

A third priority I want to emphasize is ESMA's role in ensuring a level playing field in financial supervision. Regulatory competition is one of the root causes of this financial crisis and ESMA has an important role in avoiding favorable local treatment and breaches of EU law. Framing this more positively, creating a level-playing field and fostering one supervisory culture is one of the main objectives of ESMA.

In this context, I immediately think about the work ESMA is doing to promote consistency in enforcement of IFRS. Ensuring consistent application enables fair and efficient functioning of markets and the availability of price information within those markets: both are important for the protection of investors. CESR started already in 2003 with organizing sessions devoted to discussing decisions taken by independent national enforcers of the European Economic Area in respect of financial statements published by issuers with securities traded on a regulated market and who prepare their financial statements in accordance with IFRS. The purpose of these sessions was (and still is) to increase consistency amongst enforcers' activities across the EU by discussing enforcement cases before and after the decision is taken at the national level. These discussions gradually became formalized into the European Enforcement Co-ordination Sessions (EECS). These sessions have proven to be very valuable for national enforcers and more and more cases are discussed at the European level before a decision is taken at national level. As such, ESMA represents the widest community of enforcers of IFRS across the world.

Relevant decisions are also submitted to a database accessible for all European enforcers. CESR, and now ESMA, regularly published extracts from this database of enforcement decisions contributing to provide greater transparency for market participants. Also, decisions are shared with third country enforcers of IFRS through the International Organization of Securities Commissions Organizations (IOSCO). We understand that this is considered to be very valuable.

It is my belief that we should further improve the existing coordination between national enforcers to ensure consistent application of IFRSs and a level-playing field in the actions that are taken in the EU. The European regulation setting up ESMA has an interesting tool that we might further develop in this respect. To build a common supervisory culture and consistent approaches throughout the EU the regulation allows ESMA to provide opinions to competent authorities on the application of existing European legislations, such as the endorsed IFRSs. By issuing such an opinion ESMA expresses its view to a national competent authority on the particular application (or non-application) of an IFRS. Also, the Regulation



provides ESMA with a more powerful so-called Breach of Union law procedure. While we have no specific plans yet, it is clear that ESMA needs to think how it can use its new tools to contribute to a level-playing field, and consistency, in the application of IFRS.

Talking about consistency, there is a topic which is currently all over the newspapers that I would like to briefly touch upon. European political leaders and the relevant banks are currently discussing how the EU could find a solution to get out of this financial crisis. ESMA will keep a close eye on the accounting implications of such solutions. Downgrades by CRAs of the creditworthiness of some jurisdictions might trigger the recognition of impairment losses for their holders. Even mere changes to the terms and conditions of any debt may prompt similar losses. I will not go into any further detail at this stage but I can assure you that for ESMA it is very important that the accounting treatment across the EU is consistent and serves transparency for investors. While I understand the reluctance to take losses, we should realize that there are still very large amounts of troubled sovereign debt in the books of banks at pre-crisis values.

Let me conclude the consistency and level-playing field discussion by emphasizing that consistent application of IFRS goes beyond ESMA and the EU. ESMA engaged itself already in gathering third country enforcers of IFRS to improve co-ordination and the exchange of information and experience. We will do so again this year by organizing a second seminar sharing experiences between IFRS enforcers. Later in my speech, when talking about the single rule book, I will return to the so-called third country issues of IFRS.

Supervision of Credit Rating Agencies

Let me move to the fourth priority of ESMA and where we have been granted direct supervisory powers: the supervision of credit rating agencies. Since the first of July, ESMA took over the supervision of CRAs from the national authorities. While most CRAs, including the largest ones, are still in the registration phase, I expect that we will conduct the first inspection visits of the large CRAs before the end of this year.

At the beginning of the crisis, CRAs were heavily criticized for being far too optimistic: this is related to their role regarding structured products. Now they are criticized for being too pessimistic: this is related to their role in rating sovereign debt. I will not now further discuss the performance and supervision of CRAs. I have already done that in other contributions. However, I would like to briefly discuss an issue related to the quality of information available to CRAs.

ESMA is carefully planning its supervisory activities of CRAs. One of the key points that ESMA will address is to verify that CRAs base their assessments on full and high quality financial information. It goes without saying that IFRS has contributed considerably to the transparency of companies. It is important for ESMA that CRAs can and do base their ratings on high quality information. For rating sovereign debt, CRAs obviously cannot rely on IFRS reporting as governments typically base their reporting on other accounting systems.

Looking at the financial reporting systems used by governments I think it is fair to say that they are not at the same level as the ones used by listed companies, like IFRS. Investors have been taken by surprise by the level of debt, or other long-term commitments, of countries. These events raise the question whether we should expect the same level of transparency for sovereign debt holders as for corporate debt holders. I think the answer is a clear yes.

Both the IASB and ESMA always have had a strong focus on capital markets and corporate reporting, and have given limited attention to governmental accounting. However, the role of governments in securities markets has changed fundamentally and governments have becoming more and more relevant to financial markets. With the importance of sovereign debt increasing for the functioning of capital markets, and governments being more active on capital markets, I think we need to reconsider how we include the accounting and transparency of governments in our work.



Single rule book

The fifth priority is ESMA's major role in contributing to a European single rule book. ESMA will be entrusted to draft technical standards in many areas of its remit and we are committed to deliver standards of the highest quality while respecting the sometimes extremely challenging deadlines.

I already mentioned the tremendous contribution IFRSs have made to both the quality and quantity of the information provided as part of the financial statements presented by European listed companies. In fact, of all the areas related to capital markets, accounting is the one that is closest to achieving a single rule-book in Europe. Hence, I can be short on accounting and the European single rule book. However, the ambitions in accounting reach further: in Euro-speak the ambition is the achievement of a single rule book across the world.

It is difficult to underestimate the importance of achieving a single set of high quality accounting standards across the world. It is clear, however, that an environment in which standard-setters face pressure from stakeholders in their jurisdictions to tackle specific issues of purely sectoral or domestic relevance is not the most appropriate for substantive progress in this field.

Still, I think remarkable progress has been made so far. More than 100 countries have already adopted IFRS, and other countries have clear plans to adopt IFRS in the near future. It is a fact that the US and Japan are not yet there. The US authorities are undeniably committed to achieving a single set of high quality accounting standards. I am fully respectful of the ongoing reflections in the US on the implications of IFRS adoption and we appreciate the complex combination of political and economic interests that has to be taken into account. The consultation paper our American counterparts published recently is a good sign of that. Such consultation papers have the benefit of gathering views and to educate market participants on the various possibilities. I am convinced that the US SEC will look closer at other options to implement IFRS as well.

I commend the convergence achieved between the IASB and the FASB. At the same time, it is important to maintain the spirit that convergence work is only a joint reflection on possible ways to improve standards. It would be a big mistake to consider convergence work as a sort of bargaining game leading to political compromises.

Regarding the Japanese transition towards IFRS, I am not so enthusiastic about the recent announcement by the Japanese authorities to defer the timing of IFRS adoption and reinstating the option to use US GAAP. It however confirms the point ESMA made several times, and to which most European constituents would agree, that convergence cannot come at the expense of lower quality. Investors are best served with one set of accounting standards: the best possible.

Thank you for your attention.