ISDA® Safe, Efficient Markets

Mr Philippe Maystadt
DG Internal Market & Services
Rue de Spa 2
1000 Brussels
Belgium

25 September 2013

Dear Mr Maystadt,

Draft Report by Philippe Maystadt – Should IFRS Standards be more European

We appreciate the opportunity to comment on the draft report *Should IFRS Standards be more European* ("the Report") produced as a result of your mission as Special Advisor to Commissioner Barnier to reinforce the European Union's contribution to International Financial Reporting Standards (IFRS) ("the Review").

Since 1985, ISDA has worked to make the global over-the-counter (OTC) derivatives markets safer and more efficient. Today, ISDA has over 800 member institutions from 60 countries. These members include a broad range of OTC derivatives market participants including corporations, investment managers, government and supranational entities, insurance companies, energy and commodities firms, and international and regional banks. In addition to market participants, members also include key components of the derivatives market infrastructure including exchanges, clearinghouses and repositories, as well as law firms, accounting firms and other service providers. Information about ISDA and its activities is available on the Association's web site: www.isda.org.

The Review is an important milestone in the application of International IFRS in the EU. It provides the opportunity to identify changes to the governance of institutions responsible for overseeing the use of IFRS in Europe, which are needed to ensure that the EU's interests are most effectively met. This is especially important given the new accounting standards[1] which will in the near future be presented for EU endorsement.

It is crucial that the EU voice is heard by the IASB to help ensure that global accounting standards are of the highest possible quality. The EU should encourage all stakeholders in the use of IFRS to contribute to the IASB's thinking as it formulates accounting and reporting principles. The proposed governance changes discussed in the Review should encourage and facilitate these contributions.

Please find below our comments on the Report's recommendations. We include as an Appendix our observations on some of the key additional topics discussed in the Report which were considered in formulating the Report's recommendations.

We strongly agree with the Report's Consensus point 2.1 (page 6) that the introduction of IFRS in Europe has improved the quality, comparability and reliability of financial information. Globally consistent accounting standards enhance transparency in financial reporting and provide users with comparable

[1] IFRS 4, Insurance and IFRS 9, Financial Instruments Classification and Measurement.

International Swaps and Derivatives Association, Inc.
One Bishops Square
London E1 6AD, United Kingdom
P 44 (0) 20 3088 3550 **F** 44 (0) 20 3088 3555
www.isda.org

NEW YORK WASHINGTON
LONDON BRUSSELS
HONG KONG SINGAPORE
TOKYO

financial statements. This contributes significantly to confidence, encouraging inward investment and improving the efficiency of capital markets generally. There is no viable alternative global accounting framework to IFRS available to European companies to achieve such transparency and through it the G20's goal of high quality globally consistent financial reporting. We therefore strongly support the work of the International Accounting Standard Board (IASB) as the only credible standard setting body able to achieve this.

We agree with the Report's Consensus point 2.2 (page 6) on the maintenance of a "standard by standard adoption procedure" by the EU. The Report also discusses the potential for amending the current "standard by standard" adoption process to allow for changes to a published standard or the drafting of alternative standards for use by EU companies. We strongly disagree with allowing either option. A standard by standard adoption is the only realistic way to achieve the goal of globally consistent and transparent financial reporting.

Changing the adoption criteria to allow for "carve-ins" or alternative standards in the EU would result in the fragmentation of accounting standards and relinquish the advantages that the implementation of IFRS in 2005 has brought. There should be no possibility to amend the standards piecemeal, except by the IASB itself.[2]

Setting up a separate standard setting body for the European Union is not viable. It would be costly and difficult to achieve, and would require consensus amongst its members from across the EU regarding the direction of accounting, the absence of which was one of the main reasons IFRS use was mandated in 2002. Many companies would be forced by their global listing requirements to continue to produce financial statements based on internationally accepted accounting principles, which would be costly, inefficient and cause confusion in the investor community. Setting up a European standard setter would therefore be a retrograde step which should be avoided as it would disadvantage EU companies.

Many European companies have US investors and must follow IFRS as issued by the IASB. The introduction of a "European GAAP" would result under current SEC guidance in dual reporting (IFRS as issued by the IASB and on a European GAAP basis for statutory purposes), and in future should the move to globally converged standards be reversed, might result in the additional burden of reporting under US GAAP.

In relation to Consensus Point 2.3 on how the IASB may be influenced (page 10), we support the recommendation for Option 1 – Transforming the EFRAG. The set up of a board representing a diverse group of key stakeholders should enable the EU to coordinate its dialogue with the IASB while maintaining EFRAG's considerable technical expertise. However before the recommendation is adopted, it should be established how the various national standard setters would select their representatives. Since adoption of IFRS in Europe these bodies have been much less active in standard setting than in the past and may therefore not have the resource of staff or expertise to support the demands of the new EU structure. Moreover, it is important to ensure that independence is accorded to the EFRAG TEG to achieve a thorough debate and analysis of accounting issues.

We do not believe Option 2 (page 16) to transfer the responsibilities of EFRAG to the European Securities and Market Authorities (ESMA) should be given further consideration. Enforcement of the securities and market rules should be separated from involvement in the standard setting process. Furthermore,

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[2] Please note, one of our members would support the EU making specific amendments to IFRS in very narrow and specific circumstances.

transferring responsibilities from EFRAG to ESMA will not address concerns that the current process does not sufficiently consider stakeholder input. However it is appropriate that ESMA should have a seat on EFRAG's Board.

Option 3 (page 18) which suggests the replacement of the EFRAG by an agency of the European Union, should not be given further consideration in our view. This would not be an efficient use of resources given that the same objectives can be achieved through existing structures (albeit reformed) and through the independence and technical expertise that EFRAG's Technical Experts Group, amongst others, offers.

On Consensus points 2.4 and 2.5 (pages 19 and 20), regarding the role of the ARC and the European Parliament, the interaction with these bodies must be on a timely basis so that in particular the ARC is involved at a much earlier stage of the standards development process than is presently the case. Caution must be exercised in regard to a general extension of the timing of responses on IASB Exposure Drafts. While the appropriate time should be afforded where necessary to bodies like EFRAG to properly consider their responses, it should not be allowed to extend the due process such that it causes untoward delays.

On the Monitoring Board of the IASB (Consensus 2.6) we agree it would be beneficial to set up a group to advise the Commission on its participation in the Monitoring Board of the IASB. We believe that EFRAG should be considered for the role.

Should you have any questions or would like clarification on any of the matters raised in this letter please do not hesitate to contact the undersigned.

Yours faithfully,

David Bradbery
Barclays Bank plc
Managing Director
Chair of Accounting Policy Committee

Antonio Corbi
ISDA
Assistant Director
Risk and Capital

Appendix – Observations on key additional topics raised in the Report.

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Appendix - Observations on key additional topics raised in the Report

We highlight below a number of additional observations on key topics that are discussed in the Report that have been considered in arriving at the recommendations.

The Report refers (on page 3) to the debate on whether there was excessive use of market values for the accounting of financial instruments during the financial crisis. We do not agree with the views of some, that reporting certain items at market value contributed to the crisis. We believe transparency in reporting performance is essential to holding management accountable to stakeholders and in achieving this and that market value is often the most appropriate measure when historic cost can be unresponsive and irrelevant.

In respect of Consensus 2.1, some of the criticisms cited against IFRS (page 6), such as its instability and incompleteness including areas such as insurance accounting are unreasonable. The IASB has worked to adapt IFRS in response to problems identified during the crisis, leading to meaningful completed and in-progress changes. The length of time taken to finalise certain standards, such as insurance and financial instruments, reflects the complexity of the topics and the extensive consultation and outreach undertaken by the IASB. The development process is therefore time consuming but necessary to develop standards which meet the needs of the widest possible number of users and preparers. These and other changes have reflected efforts to converge with US GAAP, in accordance with the G20's request for high quality globally converged accounting standards. It is hoped that the revised governance process over IFRS adoption in Europe will assist the IASB as it works to further develop and finalise these standards on a timely basis.

Consensus 2.2 implies (page 9) that (i) accounting standards should not endanger financial stability and (ii) should be in compliance with the criteria regarding prudence and respect for the public interest.

We believe that if properly framed, accounting standards should reflect and portray the economic performance of companies and should have only minimal effect on the commercial decisions they take. Any risk that accounting standards could endanger financial stability must be carefully considered and addressed. However, high quality accounting standards should not hide relevant financial information as in the long run financial stability can only be achieved through transparency.

We agree that the prudence concept is important but care should be taken in this area, as the over emphasis of prudence would be damaging. For example, it could encourage an approach whereby profits are under reported in good years and released in later bad years to produce a smoothed profit and loss profile over time. Such practice results in less transparency and a loss of information, which is inconsistent with the 'true and fair view'. The IASB's Discussion Paper of 17 July 2013 requests constituents' views on whether prudence should be included in the IASB's Conceptual Framework. We consider it appropriate that the issue has been raised in the context of the IASB's consultation process and we encourage interested parties to contribute their views.