European Securities and Markets Authority

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PUBLIC STATEMENT

ESMA Statement on disclosures related to sovereign debt to be included in IFRS financial statements

According to European Regulation no 1095/2010 establishing the European Securities and Markets Authority (ESMA), ESMA shall act in the field of financial reporting, to ensure the effective and consistent application of European Securities and Markets legislation.

As a result of recently increased market interest in sovereign debt[1], ESMA has increased its coordination of the monitoring activities of competent authorities in response to the specific market circumstances and developments in this area.

Consequently, ESMA would like to stress the need for enhanced transparency in European listed issuers' interim and annual financial statements using International Financial Reporting Standards (IFRSs)[2]. In doing this, ESMA would point out that IFRSs are issued by the International Accounting Standards Board, and the IFRS Interpretations Committee provides the authoritative guidance on the interpretation of IFRSs. Consequently this statement should not be understood as constituting guidance or recommendations on IFRS, but rather as assisting issuers in preparing disclosures on sovereign debt.

ESMA underlines that an appropriate application of relevant IFRS is essential in order to ensure adequate disclosures by listed companies of their exposures to sovereign debt and related instruments. ESMA considers that, when material, disclosures should be provided country by country.

Whilst ESMA acknowledges that reporting requirements for interim financial statements prepared under IFRS are not the same as for annual financial statements, ESMA believes that the IFRSs that most closely address those issues related to holdings of sovereign debts as financial assets, within the scope of this document, for all financial statements are: IFRS 7 – *Financial instruments: Disclosures*, IAS 1 – *Presentation of Financial Statements*, IAS 34 – *Interim financial reporting* and IAS 10 – *Events after the Reporting Period*. Without constituting an exhaustive list, particular attention should be given to the IFRS provisions mentioned in the Appendix to this Statement.

ESMA would like to encourage all issuers to provide any additional information that might be relevant to investors' understanding of the financial information. For example, an entity might consider including or making reference in its financial reporting to any disclosures made in relation to stress testing on exposures to sovereign debt performed by the issuer or a third party organisation.

[1] Sovereign debt, for the purpose of this statement, refers to bonds issued by and loans given to central and local government and governmental bodies.
[2] European Regulation 1606/2002 regarding adoption of the International Accounting Standards.

ESMA will continue to coordinate competent authorities' monitoring of the application of the relevant requirements by listed issuers with respect to sovereign debt exposures in order to ensure an adequate level of transparency.

Appendix to the Statement

- IAS 1 paragraph 122 requires disclosure of the judgements that have the most significant effect on the amounts recognised in the financial statements. IAS 1 paragraph 125 provides for disclosure of major sources of estimation uncertainty that have a significant risk of resulting in a material adjustment to the carrying amounts of assets within the next financial year to be disclosed in the notes to the financial statements.
- IAS 34 paragraph 15 and 15B require an entity to include in its interim financial report an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period. An example of such an event is where changes in the business or economic circumstances affect the fair value of the entity's financial assets and financial liabilities, whether those assets or liabilities are recognised at fair value or amortised cost.
- IFRS 7 paragraph 7 provides that an entity shall disclose sufficient information to enable users of its financial statements to evaluate the significance of financial instruments for its financial position and performance.
- IFRS 7 paragraphs 16 and 20 require specific information to be disclosed when financial assets are impaired depending on the classification of the assets. Relevant disclosures where financial assets are impaired include: explanation regarding the triggering event; amounts recognised as impairment; reconciliation of changes in the allowance account; amounts reclassified from equity to profit or loss for financial assets classified as available for sale ("AFS") and amounts of cumulative loss recognised in other comprehensive income for AFS and, if applicable, for financial instruments previously transferred from AFS to loans and receivables.
- IFRS 7 paragraph 25 provides for disclosure of the fair value for financial assets as of the end of the reporting period.
- IFRS 7 paragraph 27B requires information on the type of valuation method used according to the fair value hierarchy.
- IFRS 7 paragraphs 31 to35 set up qualitative and quantitative disclosure requirements in relation to financial risks and exposures and how they are managed. IFRS 7.34 (c) requires in particular information about material risks to which an entity is exposed. Relevant information in respect of exposures to sovereign debt held by entities might be: the level of instruments held by accounting category, the key terms of those instruments including maturity dates, the carrying amounts and fair values of those instruments.
- In addition to the elements above, as required by IFRS 7 paragraphs 36 to 42 quantitative disclosures in relation to the financial assets held by an entity and their implications for the entity might also be relevant:

- credit quality of the assets and collateral held by the entity: this information is helpful to users' assessment of the credit risk of assets and whether or not they are likely to become impaired in future periods;
  - maximum exposure to credit risk at the end of the reporting period, without taking account of any collateral held or credit enhancements. This could be particularly relevant for credit default swaps referenced to sovereign debt and similar instruments;
  - counter-party risk: where issuers engage with a limited number of counterparties, potential exposure to these counterparties should be disclosed;
  - concentration risk: information on the maturity of assets and concentration in sources of funding would allow users to understand which type of assets cause this risk;
  - liquidity risk: explanation of the entity's liquidity strategy and the implications of any risks to that strategy.

- IFRS 7 paragraph 40 requires entities to provide a sensitivity analysis for each type of market risk to which they are exposed. Such analysis is necessary in order to assist users in understanding the uncertainty in valuation arising from variations other than those due to price risk.
- IAS 10 requires entities to provide information on events after the reporting period. Issuers should consider providing an update on significant developments in the market and the management of their debt exposures since the reporting date and the consequences of those events for amounts reported.

Notes for editors

1. ESMA is an independent EU Authority established on 1 January 2011 in accordance withEU Regulation No. 1095/2010 as published on December 15, 2010, in the Official Journal of the European Union (L 331/84). The Authority contributes to safeguarding the stability of the European Union's financial system by ensuring the integrity, transparency, efficiency and orderly functioning of securities markets, as well as by enhancing investor protection. In particular, ESMA fosters supervisory convergence both amongst securities regulators, and across financial sectors by working closely with the other European Supervisory Authorities competent in the field of banking (EBA), and insurance and occupational pensions (EIOPA).

2. ESMA's work on securities legislation contributes to the development of a single rule book in Europe. This serves two purposes; firstly, it ensures the consistent treatment of investors across the Union, enabling an adequate level of protection through effective regulation and supervision. Secondly, it promotes equal conditions of competition for financial service providers, as well as ensuring the effectiveness and cost efficiency of supervision for supervised companies. As part of its role in standard setting and reducing the scope of regulatory arbitrage, ESMA strengthens international supervisory co-operation. Where requested in European law, ESMA undertakes the supervision of certain entities with pan European reach.

3. ESMA also contributes to the financial stability of the European Union, in the short, medium and long-term, through its contribution to the work of the European Systemic Risk Board, which identifies potential risks to the financial system and provides advice to diminish possible threats to the financial stability of the Union. ESMA is also responsible for coordinating the actions of securities supervisors and for adopting emergency measures in crisis situations.

4. ESMA replaced the Committee of European Securities Regulators (CESR), a body comprised of EU securities regulators that advised the European Commission from 2001 to 2010 on policy issues around securities legislation.

Further Information:

Victoria Powell
Acting Head of Communications

Tel: +33 (0) 158 36 43 23
Email: victoria.powell@esma.europa.eu

Reemt Seibel
Communication Officer

Tel: +33 (0) 158 36 42 72
Email: reemt.seibel@esma.europa.eu