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PRESS RELEASE

# CESR publishes for consultation a statement on fair value measurement and related disclosures of financial instruments in illiquid markets

CESR launches today a consultation on a statement entitled "Fair value measurement and related disclosures of financial instruments in illiquid markets" (Ref. CESR/08-437). This statement allows CESR, as an organisation composed of securities regulators and enforcers, to stress the importance of appropriate application of measurement and disclosure requirements.

The provisional input from CESR regarding this issue will assist preparers and auditors in the current market situation when preparing the next financial statements.

CESR acknowledges that the competence of setting standards, formally interpreting standards and issuing general interpretation of existing standards lies with the IASB/IFRIC. The work conducted by CESR remains under the domain of the application of current IFRS, as CESR Members' role regarding IFRS is the enforcement of financial information. At the same time, as securities regulators, CESR Members must ensure that issuers fulfil all information obligations under the requirements of the Transparency Directive and the Market Abuse Directive.

Recent market events imply that relevant and comprehensive financial information is needed to strengthen market confidence. Also, to ensure that investors can undertake comparisons between the financial statements of different issuers in order to evaluate their relative financial position, performance and changes in financial position, relevant disclosures about the valuation methods, assumptions used and related uncertainty as well as the judgments made by the management are highly important for investors and other users of financial statements.

The CESR statement focuses on the following accounting issues regarding financial instruments in illiquid markets:

## Measurement

The starting point for the measurement of financial instruments is the assessment of whether the financial instrument is traded on an active or a non active market. The measurement of financial instruments on active markets is conducted with the reference to quoted prices. If an active market does not exist, the measurement is determined by using valuation techniques that incorporate all factors that market participants would consider in setting a price, minimising entity-specific inputs. The distinction between active and non active markets is therefore important in the application of the measurement of financial instruments.

- On the identification of active and non active markets the statement stresses:
    - As judgment is required, a well-documented valuation policy is needed. It should be consistent across time and across financial instruments;
    - Even if the number of transactions is relatively low compared to other markets or to the past, the market could still be active;
    - The size of the holdings of instruments is not a criterion to decide whether a market should be considered active;
    - Different pricing sources can be available in an active market, such as prices for actual transactions or for binding quotes;

- Market quotes can only be disregarded if there is sufficient evidence that they do not constitute a reliable reference for valuation.

- On the use of valuation techniques CESR highlights that:

    - It entails a significant amount of judgment;
    - The issuer should document the criteria, the assumptions and the inputs to the valuation techniques to ensure consistency;
    - Transactions conducted in a market that is not considered active can often provide the most relevant input for valuation techniques;
    - Liquidity risk and correlation risk could also be relevant in addition to the inputs to valuation techniques listed in the accounting standards;
    - The use of indices (e.g. the ABX HE index) should be approached with caution.

Disclosures

Given the complexity of many business situations, the different business rationales for holding financial instruments and the uncertainty around fair values, clear disclosures are necessary for users to understand these aspects and their implications for the fair value measurements included in the financial statements. This emphasises the importance of comprehensive disclosures on how management has applied the valuation principles, the sensitivity of those valuations to changes in key assumptions and the degree of uncertainty around the values. Key messages in CESR's statement regarding disclosures are the following:

- Good disclosure practices is a natural counterpart to the use of judgment in measurement practices;
- Issuers should consider publishing the most relevant criteria and accounting policies for deciding on;
    - Active or non active markets;
    - Identification of a forced transaction, and;
    - Prioritisation among several price sources.
- and provide information (by asset subclasses) on:
    - References used in active markets;
    - Type of valuation techniques including inputs, assumptions and data;
    - Any relevant change in techniques applied to specific instruments.
- The statement also provides an example on how issuers could present a useful summary of their valuation procedures in a tabular form separating the information in the following categories:
    - Quoted prices in active markets;
    - Valuation techniques with observable and non observable inputs.

**The consultation period ends on 12 September 2008.** CESR will review the statement if necessary according to the comments received and will publish the final document in October 2008. To ensure that market participants' views are duly considered, CESR would like to encourage all interested parties to actively participate in the consultation process by sending their comments via CESR's website (www.cesr.eu) under the section "Consultations".

Notes for editors:

CESR is an independent Committee of European Securities Regulators. The role of the Committee is to:

- Improve co-ordination among securities regulators;

- Act as an advisory group to assist the EU Commission, in particular in its preparation of draft implementing measures in the field of securities;

- Work to ensure more consistent and timely day to day implementation of community legislation in the Member States.

- The Committee was established under the terms of the European Commission's decision of 6 June 2001 (2001/1501/EC). It is one of the two committees envisaged in the Final Report of the Group of Wise Men on the regulation of European securities markets. Baron Alexandre Lamfalussy chaired this group. The report itself was endorsed by the European Council and the European Parliament. The relevant documents are available on the CESR website.

Each Member State of the European Union has one member in the Committee. The members are nominated by the Member States and are the heads of the national public authorities competent in the field of securities. The European Commission has nominated the Director General of the DG Market, as its representative. Furthermore, the securities authorities of Norway and Iceland are also represented at a senior level.

Within CESR, the operational group CESR-Fin chaired by Fernando Restoy, Executive Board Member of the Spanish CNMV, has been charged with the preparation of the CESR statement on fair value measurement of illiquid financial instruments in listed companies.

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