ASSOCIATION ACTUARIELLE INTERNATIONALE
INTERNATIONAL ACTUARIAL ASSOCIATION

July 16, 2010

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sir

Re: IAA comments on the IASB Exposure Draft on *Fair Value Option for Financial Liabilities*

In response to the request for comments on the Exposure Draft on *Fair Value Option for Financial Liabilities,* I am pleased to transmit on behalf of the International Actuarial Association (IAA) our comments and recommendations.

These comments have been prepared by a task force of the Committee on Insurance Accounting. If, upon reading these comments, you identify any points that you wish to pursue, please do not hesitate to contact the chairperson of that Committee, Sam Gutterman, or any of the other members of the Committee. The IAA will be pleased to develop these ideas further with you.

Yours sincerely

Yves Guérard
Secretary General

Attachment: IAA comments

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A Commentary on the
EXPOSURE DRAFT ON FAIR VALUE OPTION FOR FINANCIAL LIABILITIES
Released by the International Accounting Standards Board: May 2010

International Actuarial Association and IAA Due Process

The International Actuarial Association (the "IAA") represents the international actuarial profession. Our sixty-three Full Member actuarial associations represent more than 95% of all actuaries practicing around the world. The Full Member associations of the IAA are listed in an Appendix to this statement. The IAA promotes high standards of actuarial professionalism across the globe and serves as the voice of the actuarial profession when dealing with other international bodies on matters falling within or likely to have an impact on the areas of expertise of actuaries. The IAA appreciates the opportunity to provide comments on this IASB exposure draft.

These comments have been prepared by the Committee on Insurance Accounting. Our comments are written from the perspective of actuaries involved in financial reporting for insurers and self-insurers around the world, with an emphasis on measurement of liabilities and reinsurance assets related to insured and self-insured exposures. Statements in this letter with respect to industry practices reflect the collective experience of the actuaries who participated in the preparation of this comment letter, which we believe represents an accurate and fairly comprehensive view of those involved in insurance and risk management globally. The members of the Committee on Insurance Accounting are listed in an Appendix to this statement. It has also been subject to the due process required for it to constitute a formal view of the IAA, and will be posted to the IAA's web site.

IAA General Comments

We thank the Board for the opportunity to comment on the proposals presented in this ED. As noted in earlier comments to other IASB papers[1], we have advocated the measurement of cash flows based on a risk-adjusted expected value approach. In concept, this is a risk-adjusted probability-weighted average of the values of all possible cash flow streams (expected value), the method of which may vary by the type of cash flow and type of risk involved. While we agree that credit risk associated with the cash flows can affect the probability of the payment of the cash flows[2], we have several significant observations regarding the discussion in the paper and, in particular, the applicability of this concept to accounting measurements. These lead us to conclude that the credit risk of the instrument should not be used as a variable in the measurement of an entity's liabilities. As a result, we believe that a change in the credit risk of the obligation is not a relevant factor that should be reflected in profit or loss of an entity, in OCI or a direct change in equity. Nevertheless, in the following, we provide some comments regarding how such calculations should/should not be made if it is decided to reflect changes in this risk in the value of these liabilities.

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[1] In particular we refer to our September 1, 2009 comments on IASB Discussion Paper *Credit Risk in Liability Measurement* and its accompanying staff paper.

[2] Although reference in these comments is to the credit risk of the entity, what is being referred to is the credit risk of the entity as it directly affects the liability, that is, the performance of the obligation for its duration, and not the general credit standing of the entity as a whole.

Comments on Specifically Raised Questions in the Exposure Draft

As requested, the following responds to the questions as posed in the Exposure Draft.

Question 1

Do you agree that for all liabilities designated under the fair value option, changes in the credit risk of the liability should not affect profit or loss? If you disagree, why?

IAA Comment: We agree that changes in "own credit risk" should not affect profit or loss for liabilities designated at fair value using the fair value option.

Question 2

Or alternatively, do you believe that changes in the credit risk of the liability should not affect profit or loss unless such treatment would create a mismatch in profit or loss (in which case, the entire fair value change would be required to be presented in profit or loss)? Why?

IAA Comment: We do not agree with the alternative suggestion. Although there is the potential for some accounting mismatches where changes in the credit risk are not recognised in profit or loss, this concern is outweighed by the resulting confusion and complexity of having two types of fair value option accounting.

In addition, we note that current IFRS do not reflect all items that are economically of importance for the entity, including many intangible assets. There are cases in which a lower credit standing affects the value of intangible assets, which are not shown on the balance sheet. To reflect credit risk in liabilities in such a situation would apply an adjustment in liabilities that is not reflected elsewhere in the balance sheet, which results in not faithfully representing the total balance sheet.

Furthermore, determining whether an accounting mismatch is created can be challenging and require the development of additional detailed guidance. Increased mismatches will be less likely to be significant where changes in the credit risk of the liability are recognised directly rather than indirectly by using the IFRS 7 default method. Calculating changes in "own credit risk" directly can avoid the often difficult measurement problems associated with separating the change in the market price of credit and liquidity risk in amounts recognised in OCI.

Question 3

Do you agree that the portion of the fair value change that is attributable to changes in the credit risk of the liability should be presented in other comprehensive income? If not, why?

IAA Comment: Yes, if "own credit risk" is reflected, we agree that changes in this risk should be presented in OCI rather than through profit and loss or directly in equity.

Question 4

Do you agree that the two-step approach provides useful information to users of financial statements? If not, what would you propose instead and why?

IAA Comment: No, we do not support the proposed two-step approach to the presentation of changes in "own credit risk". The results of the application of the two-step approach results in a less understandable, more complex presentation and does not provide sufficiently useful information to users to warrant its use. The one-step approach gives the same overall result in both profit or loss and total comprehensive income.

Question 5
Do you believe that the one-step approach is preferable to the two-step approach? If so, why?

IAA Comment: Yes, see our comment to question 4.

Question 6
Do you believe that the effects of changes in the credit risk of the liability should be presented in equity (rather than in other comprehensive income)? If so, why?

IAA Comment: No, see our comment to question 3.

Question 7
Do you agree that gains or losses resulting from changes in a liability's credit risk included in other comprehensive income (or included in equity if you responded 'yes' to Question 6) should not be reclassified to profit or loss? If not, why and in what circumstances should they be reclassified?

IAA Comment: We believe that the Board should develop a set of consistent principles to govern the use of OCI. While we accept the expansion of the use of OCI to help resolve the "own credit risk" issue, we believe that the Board should add to its post mid-2011 agenda a project to address the purpose of OCI, the types of items that should be recognised in OCI and to what extent recycling is appropriate. Pending the completion of that project we support changes in "own credit risk" being recycled to profit or loss <u>when the liability is extinguished</u>. The mechanics of the calculation results in gains and losses from "own credit risk" being reversed from OCI to profit or loss for liabilities held to maturity and settled at their contractual amount. It is inconsistent not to allow OCI balances to be recycled where the liability is extinguished early and OCI amounts are realised. Therefore, it seems appropriate to reclassify amounts from OCI to profit or loss where a gain or loss has been realised on the extinguishment of the liability.

Question 8
For the purposes of the proposals in the exposure draft, do you agree that the guidance in IFRS 7 should be used for determining the amount of the change in fair value that is attributable to changes in a liability's credit risk? If not, what would you propose instead and why?

IAA Comment: Yes, we support maintaining the flexibility that IFRS 7 provides to entities for calculating credit risk. There is no single methodology in use to calculate "own credit risk" directly. If it is required, differing methodologies should be available to reflect the different nature of the liabilities concerned and available and appropriate information for the calculation where inputs are not frequently directly observable. We prefer the overall measurement be given, with the method used disclosed and applied in a consistent manner over time, unless circumstances or improved information becomes available, in which case any such significant changes should be disclosed.

Nevertheless, we suggest that the Board clarify the definition of such credit risk, particularly in view of the lack of observable market prices for credit risk for many entities (i.e., credit default swaps, commonly used for this purpose, are either not available or do not have reliable observable prices for these entities). With respect to unit-linked liabilities, since the amount of the obligation associated with such liabilities is generally based on the fair value of a referenced pool of assets, it may be inappropriate for the "own credit risk" adjustment for these liabilities to exclude the credit risk inherent in the referenced asset pool.

Question 9
Do you agree with the proposals related to early adoption? If not, what would you propose instead and why? How would those proposals address concerns about comparability?

IAA Comment: We believe that entities who have not previously adopted IFRS 9 should be required to simultaneously adopt IFRS 9 and the finalized standard for fair value option liabilities if they choose to adopt early. Early adoption provisions for fair value option liabilities should be consistent for IFRS 9 and revised IFRS 4, as applicable. There is no conceptual reason for adopting the new classification and measurement requirements for financial assets and liabilities separately.

In contrast, if entities previously adopted IFRS 9, they should be given the opportunity to change their prior fair value option designations or to make new elections on transition to any new standard.

Question 10
Do you agree with the proposed transition requirements? If not, what transition approach would you propose instead and why?

IAA Comment: We have no comment on the transition approach.

Appendix A

Members of the IAA Committee on Insurance Accounting

Sam Gutterman	Chairperson
David Congram	Co-Vice-Chairperson
Francis Ruygt	Co-Vice-Chairperson
Gunn Albertsen	Den Norske Aktuarforening
Victor Hugo Cesar Bagnati	Instituto Brasileiro de Atuária
Daniel N. Barron	Israel Association of Actuaries
Guy Castagnoli	Association Suisse des Actuaires
Antonella Chiricosta	Istituto Italiano degli Attuari
Alexander Dollhopf	Svenska Aktuarieföreningen
Guillermo Ezcurra Lopez De La Garma	Instituto de Actuarios Españoles
David John Finnis	Institute of Actuaries of Australia
Mark J Freedman	Society of Actuaries
Kavassery S. Gopalakrishnan	Institute of Actuaries of India
Rokas Gylys	Lietuvos aktuariju draugija
Jozef Hancár	Slovenska Spolocnost Aktuarov
William C. Hines	American Academy of Actuaries
Armand Maurice Ibo	Institut des Actuaires de Côte d'Ivoire
Dragica Jankovic	Udru enje Aktuara Srbije
Burton D Jay	Conference of Consulting Actuaries
Ad Kok	Het Actuarieel Genootschap
Christoph Krischanitz	Aktuarvereinigung Österreichs
Kurt Lambrechts	Association Royale des Actuaires Belges
Yin Lawn	Actuarial Institute of Chinese Taipei
Kristine Lomanovska	Latvijas Aktuaru Asociacija
AnaMaria Martins Pereira	Instituto dos Actuários Portugueses
Brian Joseph Morrissey	Society of Actuaries in Ireland
Yoshio Nakamura	Institute of Actuaries of Japan
Marc F Oberholtzer	Casualty Actuarial Society
Andreja Radic	Hrvatsko Aktuarsko Drustvo
Nithiarani Rajasingham	Singapore Actuarial Society
Thomas Ringsted	Den Danske Aktuarforening
Matthew Christopher Saker	Faculty of Actuaries
Jaanus Sibul	Eesti Aktuaaride Liit
Dieter Silbernagel	Deutsche Aktuarvereinigung e.V.
Mateja Slapar	Slovensko Aktuarsko Drustvo
Pentti Soininen	Suomen Aktuaariyhdistys
Bjarni Thórdarson	Félag Islenskra Tryggingastærðfræðinga
Arseny Timakov	Russian Guild of Actuaries
Charles Vincensini	Institut des Actuaires
Peter Andrew Withey	Actuarial Society of South Africa
Derek John Wright	Institute of Actuaries
Jana Zelinkova	Ceská Spolecnost Aktuárù
Jesús Alfonso Zúñiga San Martin	Colegio Nacional de Actuarios A.C.

Appendix B

Full Member Associations of the IAA
Caribbean Actuarial Association
Consejo Profesional de Ciencias Económicas de la Ciudad Autónoma de Buenos Aires (Argentina)
Institute of Actuaries of Australia (Australia)
Aktuarvereinigung Österreichs (AVÖ) (Austria)
Association Royale des Actuaires Belges (Belgique)
Instituto Brasileiro de Atuária (IBA) (Brazil)
Bulgarian Actuarial Society (Bulgaria)
Canadian Institute of Actuaries/Institut Canadien des Actuaires (Canada)
Actuarial Institute of Chinese Taipei (Chinese Taipei)
Institut des Actuaires de Côte d'Ivoire (Côte D`Ivoire)
Hrvatsko Aktuarsko Drustvo (Croatia)
Cyprus Association of Actuaries (Cyprus)
Ceská Spolecnost Aktuárù (Czech Republic)
Den Danske Aktuarforening (Denmark)
Egyptian Society of Actuaries (Egypt)
Eesti Aktuaaride Liit (Estonia)
Suomen Aktuaariyhdistys (Finland)
Institut des Actuaires (France)
Deutsche Aktuarvereinigung e.V. (DAV) (Germany)
Hellenic Actuarial Society (Greece)
Actuarial Society of Hong Kong (Hong Kong)
Magyar Aktuárius Társaság (Hungary)
Félag Islenskra Tryggingastærðfræðinga (Iceland)
Institute of Actuaries of India (India)
Persatuan Aktuaris Indonesia (Indonesia)
Society of Actuaries in Ireland (Ireland)
Israel Association of Actuaries (Israel)
Istituto Italiano degli Attuari (Italy)
Institute of Actuaries of Japan (Japan)
Japanese Society of Certified Pension Actuaries (Japan)
The Actuarial Society of Kenya (Kenya)
Latvijas Aktuaru Asociacija (Latvia)
Lebanese Association of Actuaries (Lebanon)
Lietuvos Aktuariju Draugija (Lithuania)
Persatuan Aktuari Malaysia (Malaysia)
Colegio Nacional de Actuarios A. C. (Mexico)
Association Marocaine des Actuaires (Morocco)
Het Actuarieel Genootschap (Netherlands)
New Zealand Society of Actuaries (New Zealand)
Den Norske Aktuarforening (Norway)
Pakistan Society of Actuaries (Pakistan)
Actuarial Society of the Philippines (Philippines)

Polskie Stowarzyszenie Aktuariuszy (Poland)
Instituto dos Actuários Portugueses (Portugal)
Academia de Actuarios de Puerto Rico (Puerto Rico)
Russian Guild of Actuaries (Russia)
Udruženje Aktuara Srbije (Serbia)
Singapore Actuarial Society (Singapore)
Slovenska Spolocnost Aktuarov (Slovakia)
Slovensko Aktuarsko Drustvo (Slovenia)
Actuarial Society of South Africa (South Africa)
Col.legi d'Actuaris de Catalunya (Spain)
Instituto de Actuarios Españoles (Spain)
Svenska Aktuarieföreningen (Sweden)
Association Suisse des Actuaires (Switzerland)
Society of Actuaries of Thailand (Thailand)
Faculty of Actuaries (United Kingdom)
Institute of Actuaries (United Kingdom)
American Academy of Actuaries (United States)
American Society of Pension Professionals & Actuaries (United States)
Casualty Actuarial Society (United States)
Conference of Consulting Actuaries (United States)
Society of Actuaries (United States)