ASSOCIATION ACTUARIELLE INTERNATIONALE
INTERNATIONAL ACTUARIAL ASSOCIATION

May 19, 2010

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

Dear Sir

Re: IAA comments on the IASB Exposure Draft on *Measurement of Liabilities in IAS 37*

In response to the request for comments on the Exposure Draft on *Measurement of 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 MEASUREMENT OF LIABILITIES IN IAS 37
Released by the International Accounting Standards Board: January 2010

International Actuarial Association

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.

IAA Due Process

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 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 ED/2010/1 (ED) on the important matter of improving IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. We generally support the main features of the proposed measurement requirements. The following are general comments on matters not specifically addressed by the posed questions, followed by specific observations with respect to the questions raised.

- Although paragraph B13(c) indicates that "Analysts and investors need disclosures about the uncertainties surrounding the outcome of a liability – the amount recognised in the statement of financial position is of little additional benefit", there is no further mention of guidance with respect to disclosure. We believe that there would be value in providing guidance regarding disclosure of items relevant to the liabilities within the scope of the proposed standard, such as the effect of the borrowing costs of the entity, the discount rate used and where practical the amount of the risk adjustment.

- The Exposure Draft makes no mention of insurance recoveries. We assume that entities would follow the same approach as for reinsurance recoveries. If not covered separately and that is the intent, it may be worthwhile to affirm this in the text of the standard or in the application guidance.

- Although this Exposure Draft does not deal directly with insurance contracts, we encourage as much consistency with the upcoming IFRS 4 (insurance contracts) revision as possible. We note the similarity of many of the obligations that would be subject to the resulting standard (e.g., self-insurance, warranties). This concern also applies in the case of a captive insurer between a stand-alone captive financial statement in which the captive would be reported as an insurer and a consolidated financial statement where the proposed standard may apply. Without consistency, financial reporting standards may influence insurance-purchase decisions, which we do not believe to be appropriate.

- Scope. Currently, liabilities for self-insured workers compensation exposures have mostly been measured according to IAS 19, as benefits/claims are payable to employees, although it seems that current practice across countries varies. We note that the expected patterns of cash flows and their associated risk and uncertainty are similar, in comparison both to the cash flows when those exposures are insured and to other self-insured property & casualty exposures. We suggest the IASB clarify under which standard self-insured workers compensation falls.

- It would be useful, to the extent possible, to reach a convergent position with the Financial Accounting Standards Board (FASB) on the features of this proposed standard. Although we recognize that this is not a joint project, we encourage further convergence in this area, if necessary in a subsequent project.

Comments on Specifically Raised Questions in the Exposure Draft

As requested, the following responds to the questions as posed in the Exposure Draft, indicating the specific paragraphs to which our comments relate. In some instances, we simply raise issues and/or questions for the Board to consider, while in others we provide alternative wording for the Board to consider in developing a final IFRS.

Question 1 – Overall requirements

The proposed measurement requirements are set out in paragraphs 36A-36F. Paragraphs BC2-BC11 of the Basis for Conclusions explain the Board's reasons for these proposals. Do you support the requirements proposed in paragraphs 36A-36F? If not, with which paragraphs do you disagree, and why?

IAA Comment

As indicated above, we generally support the main features of the proposed measurement requirements. We offer the following specific comments by paragraph.

> <u>36A and 36B</u>
> We support 36A and 36B and have no suggestions for change.
>
> <u>36C (and BC11)</u>
> We support 36C but suggest slightly modified wording. We are concerned that the current language could be interpreted as requiring extensive efforts to find evidence that

advantageous transfer or cancellation is possible. Thus, we suggest modifying the wording of the second sentence to prevent such misinterpretation.

> ED: "If there is no evidence that an entity could cancel or transfer an obligation for a lower amount, the entity measures the liability at the present value of the resources required to fulfill the obligation."
>
> Suggested change: "If the entity is not aware of evidence that it could cancel or transfer an obligation for a lower amount, the entity measures the liability at the present value of the resources required to fulfill the obligation in accordance with Appendix B."

We assume that, in this context, reference to the entity would be interpreted to include its advisors. Otherwise, it might be necessary explicitly to include advisors' awareness.

We believe that the phrase "in accordance with Appendix B" is very important, as some people might interpret "present value of the resources to fulfill the obligation" differently from the meaning presented in Appendix B. Thus, making reference to Appendix B is important when calculating a present value under IAS 37.

Since BC11 uses the same "no evidence" criterion as 36C, we suggest a similar change to BC11.

<u>36D and 36 E</u>
We support 36D and 36E and have no suggestions for change.

<u>36F</u>
We suggest that further guidance be included in the final standard regarding how "changes in the carrying amount of a liability due to the passage of time" should be measured. For example, is the discount rate applicable to the initial recognition of the liability to be locked in or should it be a current measure, or should the initial expected payment pattern be locked in? Different ways of measuring the passage of time could produce different answers, resulting in non-comparable results.

In particular, further clarity is needed in 36F regarding what types of changes in carrying amount of a liability resulting from the passage of time should be recognized as a borrowing cost. We assume that the intention is to refer only to the unwinding of the discount, but the phrase "resulting from the passage of time" could be interpreted as referring to any change that occurs over a period of time. There are numerous categories of changes over time, including:

- unwinding in the discount, using the yield curve assumed at the start of the period;
- changes in the yield curve;
- changes in the liability;
- new information about or conditions related to the liability; and
- new interpretation of the same information.

We do not believe that the intent of 36F is to recognize changes from all these categories as a borrowing cost. We suggest that the ED specify more clearly that the intent of 36F is related to changes over time related to the discounting of liabilities. 36E could be expanded to provide further details as to recognition of changes over time that are not related to the discounting process.

<u>B3</u>
In some cases it will not be practical to specify each possible outcome and its corresponding probabilities. Therefore, we would suggest further expansion of the definition to indicate that the objective should be the expected (mean) value, an approach that would be expected to be used in many cases as described.

<u>B4</u>
We support B4 and believe that it is important to allay concerns about the effort needed to develop a probability-weighted average. Therefore, we suggest a change to the final sentence.

> ED: "Rather, a limited number of discrete outcomes and probabilities can often provide a reasonable estimate of the distribution of possible outcomes."
>
> Suggested change: "Rather, the full distribution of possible outcomes and probabilities can often be adequately represented by a standard probability distribution or by a limited number of discrete outcomes and probabilities. Similarly, a statistical mean based on observed historical experience may also be appropriate in a given situation."

<u>B6</u>
We observe that B6 suggests, by omission, that the overhead costs of managing the liability should not be recognized; yet under B8(a) any third party contractor would seek to allow for those costs in its pricing. We suggest that it may be useful to clarify this difference.

<u>B16</u>
B16 enumerates three forms of risk adjustment. We suggest that it be made clear that these are examples of forms of risk adjustment and that the list is neither complete nor exclusive.

Furthermore, we suggest that there is a fourth form that is implied, but not explicitly stated, in B16. This fourth form is an adjustment to the probabilities of the future outflow scenarios. We suggest that this fourth form should be added as B16(d). We note that this fourth method is implicitly recognized in B17.

Question 2 – Obligations fulfilled by undertaking a service
Some obligations within the scope of IAS 37 will be fulfilled by undertaking a service at a future date. Paragraph B8 of Appendix B specifies how entities should measure the future outflows required to fulfill such obligations. It proposes that the relevant outflows are the amounts that

the entity would rationally pay a contractor at a future date to undertake the service on its behalf.
Paragraphs BC19-BC22 of the Basis for Conclusions explain the Board's rationale for this proposal.
Do you support the proposal in paragraph B8? If not, why not?

IAA Comment
We generally support the approach set out in Paragraph B8, subject to the comments below.

<u>B8</u>
As written, we believe that there are challenges with the suggested approach in B8. The problem is that it requires an estimate of the price that will be applicable in the future, not what it would be now. Hence, it ignores the charge for risk that would unwind in the intervening period. For example, a non-life insurance company can pay a third party to administer its claims for the upcoming calendar year, but such contracts typically only cover the work for that calendar year. These contracts do not usually cover the cost to settle the claims over the life of the claim, which can be many years. If an insurer had to pay a contractor to handle the claim for the life of the claim, there would be a relatively large risk load (if there were any such vendors that would even accept the risk). In contrast, the amount the insurer would pay the following year would not incorporate the charge for the uncertainty that would unwind before that date.

<u>BC15</u>
We believe that BC15 omits discussion of the important point that "the most likely outcome" can be highly dependent upon how "most likely" is interpreted. For example,

- for a continuous distribution, "most likely" as determined on a linear scale can differ markedly from "most likely" as determined on a logarithmic or exponential scale;
- discrete distributions in practice often have popular values – typically, round numbers – that can give a misleading impression;
- for a discrete distribution with a large number of possible values, the "most likely" single outcome is often zero;
- if values are grouped, the "most likely" outcome can vary markedly, depending on the width of the groups and sometimes the choice of boundaries; and
- multi-modal distributions are often found in practice.

We believe that in its current state, "most likely" is not adequately defined.

Furthermore, we note that much of IAS 37 seems to be focused on the valuation of the liability as it relates to individual transactions or occurrences. The reality is that many litigation and accident related liabilities can only be reliably measured at the portfolio or group of liabilities level. Such portfolios are also reliably measured only where the portfolio meets certain criteria (such as its volume and the independence of the obligations in the portfolio). As such, the exclusion mentioned in paragraph BC15c may not be as rare as the Exposure Draft suggests.

Question 3 – Exception for onerous sales and insurance contracts
Paragraph B9 of Appendix B proposes a limited exception for onerous contracts arising from transactions within the scope of IAS 18 Revenue or IFRS 4 Insurance Contracts. The relevant future outflows would be the costs the entity expects to incur to fulfill its contractual obligations, rather than the amounts the entity would pay a contractor to fulfill them on its behalf. Paragraphs BC23-BC27 of the Basis for Conclusions explain the reasons for this exception. Do you support the exception? If not, what would you propose instead and why?

IAA Comment
First, we agree with the intent of this change. Nevertheless, there seems to be an inconsistency in the scope of the draft standard and the ED in applying the standard to the contracts arising from transactions within the scope of IFRS 4. The draft standard and the ED in its paragraphs 2, 3(b), 4, and BC 27 exclude insurance contracts from the scope of the standard, even though the onerous contract criteria may still be applicable under the current IFRS 4. We believe that the default option in the current IFRS 4 to apply IAS 37 if the criteria in paragraph 16 of IFRS 4 are not met should not change with the adoption of a revised IAS 37 until the revised IFRS 4 is adopted. We believe that the appropriateness and application of a liability test under the new IFRS 4 should be assessed within the context of the discussions of the revised version of IFRS 4 expected to be adopted in 2011.

> <u>BC23-BC27</u>
> The currently stated definition of onerous contracts does not seem to permit a portfolio assessment of "onerous". Except for large policies sold to businesses, most non-life insurance contracts with a claim would then be considered onerous under the proposed definition. We suggest that the definition allow for units of account other than individual contracts, for those liabilities measured on a portfolio basis and not an individual contract basis.

Additional observation
Illustrative example, page 35. The current wording is not clear as to whether "pay an additional 5% to be relieved of this risk" relates to risk (a) and risk (b) or to the risk associated with the cost of dismantling the rig now. Since we presume that the charge implicitly includes the contractor's estimate of its risk for immediate dismantlement (assuming that it is a fixed price charge), the additional amount just relates to risk (a) and risk (b). It may be appropriate to clarify this reference.

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
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
Jelica Klucovska	Slovenska Spolocnost Aktuarov
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.
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)