ASSOCIATION ACTUARIELLE INTERNATIONALE
INTERNATIONAL ACTUARIAL ASSOCIATION

September 19, 2008

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

Dear Sir

Re: IAA comments on the Discussion Paper *Reducing Complexity in Reporting Financial Instruments*

In response to the request for comments on the Discussion Paper *Reducing Complexity in Reporting Financial Instruments* (the DP), I am pleased to transmit on behalf of the International Actuarial Association (IAA) our comments and recommendations.

These comments have been prepared by the Committee on Insurance Accounting of the IAA. 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
DISCUSSION PAPER ON REDUCING COMPLEXITY IN REPORTING FINANCIAL INSTRUMENTS ISSUED BY THE INTERNATIONAL ACCOUNTING STANDARDS BOARD: MARCH 2008

International Actuarial Association

The International Actuarial Association (the "IAA") represents the international actuarial profession. Our sixty full member actuarial associations represent more than 95% of all actuaries practicing around the world and are listed in an Appendix to these comments. 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.

IAA Commentary

The IAA appreciates the opportunity to provide comments on this IASB discussion paper. 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 around the world, with an emphasis on measurement of insurance liabilities and of reinsurance assets. Statements in this letter reflect the collective experience of the actuaries who participated in the preparation of this comment letter, experience that we believe represents an accurate and fairly comprehensive view of the actuarial profession globally. The members of the committee are listed in an Appendix to these comments. It has 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.

The following paragraphs in this letter present our general comments regarding the DP, which in turn are followed by our responses to the questions posed in the DP.

General Comments

1. We believe that the application of the concept of complexity in the Discussion Paper (DP) has been examined too narrowly. In addition to complexity as expressed in terms of the complicated nature of the standard(s) itself as is emphasized in the DP, the difficulty in understanding the results and application is also important.

   To date, complexity has not been given a prominent focus in the IASB Framework – if the Board believes that it is sufficiently important to require modification of such an important standard, it should be considered in the current Conceptual Framework project. Although it is fairly obvious that it is better to have a simple standard than one that is complex, simplicity in application, if measurement does not satisfy other considerations or attributes, such as relevance and reliability, may not be of overriding significance.

2. Measurement must also be reliable in the sense that the amount is a faithful representation of what it purports to be. Fair value measures that are based on very hypothetical transfers and that rely on observed prices of unrelated assets or liabilities to infer level 3 (as defined by SFAS 157) inputs, may not provide useful financial information. Such figures may in fact have little basis for the assertion that they are estimates of prices of the subject asset or

liability. In addition, particularly for level 3 inputs, fair values may not be the approach that is simplest to measure or easiest to understand in all instances.

3. We believe that in order for financial statements to be useful to their users, the information included therein must be understandable, at least for users who are sufficiently knowledgeable about the entity and the industries involved. Excessive complexity can lead to interpretational difficulties.

4. We believe that, where possible, assets and liabilities should be able to be measured on consistent bases. (Note that “consistent” does not mean “identical”.) Thus, elimination of accounting asymmetries should be reduced wherever possible. For example, when an insurer's assets are measured on one basis and its liabilities are measured on a different basis, the resulting financial information may produce misleading financial results. Likewise, where different contracts (e.g., certain financial instruments and insurance contracts) are measured on significantly inconsistent bases, the financial institution may have an incentive to design and sell certain of its contracts simply on the basis of accounting results, rather than on the basis of the needs of the clients or the contracts' fundamental economics. Therefore, the use of sharply drawn lines and exceptions should be avoided wherever possible and the principles from which accounting practices can be deduced should be provided.

5. We believe that, without having completed its project on the measurement of fair values and the Conceptual Framework for financial reporting, it is too early to decide whether fair values can form the optimal long term solution to reporting financial instruments. Since a consensus has not yet formed in respect of the scope of fair values and their measurement has not yet been finalized, it would be inappropriate to agree prematurely upon its use as a long-term accounting criterion. As the current IASB projects move to their conclusion, it would be appropriate and timely to begin a rigorous discussion and debate as to the desirability of this objective. Nevertheless, an expansion of the availability of the fair value option would be useful to determine whether fair values are in fact deemed to be useful by preparers and users.

6. In the meantime, it may be appropriate to consider eliminating some of the more significant sources of complexity, e.g., the excessive amount of documentation and criteria needed to apply hedge accounting or the extent of tainting rules. In any event, since the current IAS 39 is complex in respect of requirements and interpretations and not aligned with the way the business is managed, accounting for financial instruments certainly cries out for significant improvement.

7. We believe that it would be useful for the IASB to provide some guidance regarding the expected or hoped for timeframes for the adoption of any significant changes that are intended to be intermediate and long-term solutions.

Question Responses

Q1. Do current requirements for reporting financial instruments, derivative instruments and similar items require significant change to meet the concerns of preparers and their auditors and the needs of users of financial statements? If not, how should the IASB respond to assertions that the current requirements are too complex?

IAA Comments: Yes, we believe that significant improvements to IAS 39 are needed, because the current requirements result in accounting that is not always aligned with economic substance and the way business and risk is managed.

We believe that only through clearly stated principles-based accounting standards can the concerns of preparers and auditors and needs of users be satisfied. Special rules, exceptions or sharply drawn lines, in contrast with general implementation guidance where practice has or is likely to applied inconsistently, should be avoided wherever possible. The current approach promotes management actions and creation of complex instruments that might be designed more to respond to the reporting rules, rather than to meet economic needs. To the extent that contracts are measured on inconsistent bases, misleading financial information may result; to the extent that such differences can be reduced or the effects can be minimized, financial reporting will be improved.

Q2. (a) Should the IASB consider intermediate approaches to address complexity arising from measurement and hedge accounting? Why or why not? If you believe that the IASB should not make any intermediate changes, please answer questions 5 and 6, and the questions set out in Section 3.

IAA Comments: We believe that efforts toward simplification or elimination of hedge accounting, the benefits of which would significantly outweigh the associated costs, would be worth pursuing. We believe that hedge accounting should be principles-based (for designation, documentation and effectiveness). Such principles would ensure that hedge accounting is only applied in response to the entity's risk management practices and any ineffectiveness is reflected in profit and loss.

Comment letters made regarding this DP, supplemented by such methods as an advisory committee or focused Roundtables that include relevant stakeholders may be useful vehicles to identify applicable priorities for such changes. In addition, the use of soundly based techniques for the management or mitigation of the risks of the entity that would otherwise result in accounting mismatches should be permitted to be reflected appropriately.

(b) Do you agree with the criteria set out in paragraph 2.2? If not, what criteria would you use and why?

IAA Comments: In general, we agree with these criteria. Nevertheless, we have a couple of comments:

Regarding 2.2b (*a change must be consistent with the long-term measurement objective. Ideally, a change should increase the number of financial instruments measured at fair value*) **we believe that until a long-term measurement attribute is adopted and the Conceptual Framework is amended accordingly, we believe it is premature to require that any proposed change must be consistent with this attribute.**

Regarding 2.2c (*a change must not increase complexity*) **we agree conceptually, but we note that reducing complexity is not a goal in itself. Where economic reality is complex, such as is the case with complex products, simple accounting rules do not always result in more relevant and more transparent reporting.**

Q3. Approach 1 is to amend the existing measurement requirements. How would you suggest existing measurement requirements should be amended? How are your suggestions consistent with the criteria for any proposed intermediate changes as set out in paragraph 2.2?

IAA Comments: A few suggestions follow:

1. **The "held to maturity classification" in IAS 39 is subject to very detailed 'tainting' rules, and in part as a result this classification is rarely used. We believe that elimination or loosening of the 'tainting' rules, although the underlying principles should remain, will result in rules that are more aligned with the way business in managed and thus can provide an incentive to make appropriate business decisions and would facilitate a more consistent business model.**
2. **We do not agree with the consideration to remove the "held-to-maturity" or the "available for sale" categories, since such changes would result in accounting that is less aligned with the way business is managed and hence would result in less meaningful financial reporting. We believe that the measurement options should be reviewed in the context of the Conceptual Framework project and when IAS 39 is given a complete overhaul, rather than as a short-term fix.**
3. **An expansion of the availability of the fair value option. In addition, the elimination of criteria required to make use of this option may provide worthwhile information regarding whether fair values are, in fact, deemed useful by preparers and users to be more widely useful and desirable.**
4. **Implement a consistent approach for impairment of all financial instruments. A principle based approach is needed here.**

Q4. Approach 2 is to replace the existing measurement requirements with a fair value measurement principle with some optional exceptions.

(a) What restrictions would you suggest on the instruments eligible to be measured at something other than fair value? How are your suggestions consistent with the criteria set out in paragraph 2.2?

IAA Comments: The use of sharply drawn lines and exceptions should be avoided wherever possible; rather principles from which accounting can be

conducted should be provided. For example, the 80% and 120% criteria to apply hedge accounting are inconsistent with a principles-based standard; the inconsistency of results that emerge when situations close to these percentages arise, is not justifiable.

(b) How should instruments that are not measured at fair value be measured?

IAA Comments: The liability for instruments should be measured on an economically neutral (that is, does not introduce measurement bias in either direction), prospective basis. This may or may not be categorized as a fair value. This does relate to the need for possible further guidance with respect to measurement of level 3 economic values.

(c) When should impairment losses be recognized and how should the amount of impairment losses be measured?

IAA Comments: We do not currently have a single preferred candidate, although a reduction in impairment models seems appropriate.

(d) Where should unrealized gains and losses be recognized on instruments measured at fair value? Why? How are your suggestions consistent with the criteria set out in paragraph 2.2?

IAA Comments: Although we do not a specific suggestion, we note than any approach taken should be principles-based.

(e) Should reclassifications be permitted? What types of reclassifications should be permitted and how should they be accounted for? How are your suggestions consistent with the criteria set out in paragraph 2.2?

IAA Comments: We believe that tainting rules should be eliminated or restricted, on a principles-based basis. As a general principle, reclassifications should be permitted, with appropriate disclosure, if and only if one of the following applies:

- **upon first time adoption or adoption of a new standard that would significantly affect the consistency of measurement of other related assets and liabilities; or**
- **management's intent regarding the instrument has changed.**

Q5. Approach 3 sets out possible simplifications of hedge accounting.

(a) Should hedge accounting be eliminated? Why or why not?

IAA Comments: We do not believe that hedge accounting should be eliminated at this time. For example, certain entities legitimately use derivatives and hedging instruments as part of their risk management business strategies. It would be appropriate, therefore, to report on these strategies in a manner consistent with their use.

(b) Should fair value hedge accounting be replaced?

IAA Comments: No. We believe that this replacement may, in certain cases, increase the complexity of accounting rather than decrease it.

Approach 3 sets out three possible approaches to replacing fair value hedge accounting.

(i) Which method(s) should the IASB consider, and why?

IAA Comments: The expanded availability (by elimination of the restrictive criteria) of the use of the fair value option may be appropriate.

(ii) Are there any other methods not discussed that should be considered by the IASB? If so, what are they and how are they consistent with the criteria set out in paragraph 2.2? If you suggest changing measurement requirements under approach 1 or approach 2, please ensure your comments are consistent with you suggested approach to changing measurement requirements.

IAA Comments: None

Q6. Section 2 also discusses how the existing hedge accounting models might be simplified. At present, there are several restrictions in the existing hedge accounting models to maintain discipline over when a hedging relationship can qualify for hedge accounting and how the application of the hedge accounting models affects earnings. This section also explains why those restrictions are required.

(a) What suggestions would you make to the IASB regarding how the existing hedge accounting models could be simplified?

IAA Comments: The existing hedge accounting models are unnecessarily complex and do not reflect the economic substance of many risk management strategies. Hedge accounting should be principles based (for designation, documentation and effectiveness). Such principles would ensure that hedge accounting is only applied to positions that are subject to the company's risk management practices and in a way to ensure that any ineffectiveness of those practices is reflected in profit and loss. Simplification of the hedge accounting documentation rules would appropriately simplify their application and would reduce burdensome accounting application, and result in incentives to follow desirable risk management strategies and tactics.

(b) Would your suggestions include restrictions that exist today? If not, why are those restrictions unnecessary?

IAA Comments: The substitution of a principle for the use of the sharply drawn lines, the 80% and 125% effective criteria, is desirable.

(c) Existing hedge accounting requirements could be simplified if partial hedges were not permitted. Should partial hedges be permitted and, if so, why? Please also explain why you believe the benefits of allowing partial hedges justify the complexity.

IAA Comments: We believe that the availability of partial hedging is appropriate. We see no reason to eliminate reporting that exists in practice and is consistent with certain legitimate and worthwhile risk management strategies.

(d) What other comments or suggestions do you have with regard to how hedge accounting might be simplified while maintaining discipline over when a hedging can qualify for hedge accounting and how the application of the hedge accounting models affects earnings?

IAA Comments: None

Q7. Do you have any other intermediate approaches for the IASB to consider other than those set out in Section 2? If so, what are they and why should the IASB consider them?

IAA Comments: Where practical, we prefer a move toward a principles-based system of measurement for all financial instruments, service contracts and insurance contracts. One approach would be to form a small sub-group of the Financial Instrument and Insurance Working Groups to develop an appropriate set of proposals for consideration by the IASB.

Q8. To reduce today's measurement related problems, Section 3 suggests that the long-term solution is to use a single method to measure all types of financial instruments within the scope of a standard for financial instruments.

Do you believe that using a single method to measure all types of financial instruments within the scope of a standard for financial instruments is appropriate? Why or why not? If you do not believe that all types of financial instruments should be measured using only one method in the long term, is there another approach to address measurement related problems in the long term? If so, what is it?

IAA Comments: It is appealing to have a single principles-based measurement basis and, to the extent practical, this should be pursued further. Nevertheless, we believe that, without having completed its project on the measurement of fair values and the Conceptual Framework for financial reporting, it is too early to decide whether fair values can form the optimal long term solution to reporting financial instruments. Since a consensus has not yet formed in favour of the scope and measurement of fair values has not yet been finalized, it would be inappropriate to agree prematurely upon their use as a long-term accounting criterion. As the current IASB projects move to their conclusion, it would be appropriate to begin a rigorous discussion and debate as to the desirability of this objective. Nevertheless, an expansion of the availability of the fair value option would be worthwhile to determine whether fair values are in fact deemed useful by preparers and users.

We suggest being somewhat more specific as to what "long-term" is being used to represent, e.g., about 10 or 20 years. Providing this guidance might provide an appropriate lead time prior to adoption.

Q9. Part A of Section 3 suggests that fair value seems to be the only measurement attribute that is appropriate for all types of financial instruments within the scope of a standard for financial instruments.

(a) Do you believe that fair value is the only measurement attribute that is appropriate for all types of financial instruments within the scope of a standard for financial instruments?

IAA Comments: Although we have concerns about the implementation of certain expanded fair value applications, we do not believe that fair value is conceptually unsound. Nevertheless, we believe that additional guidance in the case of level 3 inputs may be worthwhile, as long as they remain principles-based. We believe that economically neutral values, measured on a prospective basis would be appropriate.

We believe that proper and transparent treatment of fair values in the income statement (performance report) is just as important to appropriate measurement of assets and liabilities as is consideration of the balance sheet effect. Therefore, significant effort is needed to provide transparent information in relation to changes in the fair value of financial assets and liabilities prior to expanding the application of fair values. Something similar to a source of changes analysis of insurance contracts should be developed in order to make this meaningful, whether on the face of the performance measurement statement or as part of disclosure.

(b) If not, what measurement attribute other than fair value is appropriate for all types of financial instruments within the scope of a standard for financial instruments? Why do you think that measurement attribute is appropriate for all types of financial instruments within the scope of a standard for financial instruments? Does that measurement attribute reduce today's measurement related complexity and provide users with information that is necessary to assess the cash flow prospects for all types of financial instruments?

IAA Comments: None

Q10. Part B of Section 3 sets out concerns about fair value measurement of financial instruments. Are there any significant concerns about fair value measurement of financial instruments other than those identified in Section 37? If so, what are they and why are they matters for concern?

IAA Comments: The SFAS 157 fair value hierarchy assumes that market prices are always the best source of measurement inputs. We do not believe that any single trade appropriately defines the market price; if a market is very thin, then this single price should not be considered to determine a reliable price. It may be appropriate to

develop a reliability test, based on principles, to help determine the reliability of a market price.

Q11. Part C of Section 3 identifies four issues that the IASB needs to resolve before proposing fair value measurement as a general requirement for all types of financial instruments within the scope of a standard for financial instruments.

(a) Are there other issues that you believe the IASB should address before proposing a general fair value measurement requirement for financial instruments? If so, what are they? How should the IASB address them?

IAA Comments: First, the IASB should complete several significant related current projects, e.g., Conceptual Framework, Fair Value Measurement and Revenue Recognition. This should include a rigorous discussion on appropriate objectives of financial reporting.

(b) Are there any issues identified in part C of Section 3 that do not have to be resolved before proposing a general fair value measurement requirement? If so, what are they and why do they not need to be resolved before proposing fair value as a general measurement requirement?

IAA Comments: None

Q12. Do you have any comments for the IASB on how it could improve and simplify the accounting for financial instruments?

IAA Comments: The IASB should make certain that the accounting for financial instruments is consistent with the conclusions reached in the IASB's Insurance Contracts project.

Members of the IAA Insurance Accounting Committee

Sam Gutterman	Chairperson
David James Congram	Co-Vice-Chairperson
Francis Ruygt	Co-Vice-Chairperson
Gunn Albertsen	Den Norske Aktuarforening
Yutaka Amino	Institute of Actuaries of Japan
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Daniel N. Barron	Israel Association of Actuaries
Ralph Sumner Blanchard III	Casualty Actuarial Society
Guy Castagnoli	Association Suisse des Actuaires
Antonella Chiricosta	Istituto Italiano degli Attuari
David James Congram	Canadian Institute of Actuaries
Alexander Dollhopf	Svenska Aktuarieföreningen
Guillermo Ezcurra Lopez De La Garma	Instituto de Actuarios Españoles
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
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Yin Lawn	Actuarial Institute of Chinese Taipei
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Matthew Christopher Saker	Faculty of Actuaries
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Charles Vincensini	Institut des Actuaires
Peter Andrew Withey	Actuarial Society of South Africa
Derek John Wright	Institute of Actuaries
Jana Zelinkov	Ceská Spolecnost Aktuárù
Jesús Zúñiga San Martin	Colegio Nacional de Actuarios A.C.

Appendix B

Full Member Associations of the IAA

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)
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)
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)