



**ASSOCIATION ACTUARIELLE INTERNATIONALE
INTERNATIONAL ACTUARIAL ASSOCIATION**

September 14, 2004

Technical Director
Financial Accounting Standards Board of the
Financial Accounting Foundation
401 Merritt 7, P.O. Box 5116
Norwalk, CT 06856-5116
United States
(Email: director@fasb.org)

Letter of Comment No: 83
File Reference: 1201-100
Date Received: 9-14-04

Dear Sir,

Re: IAA comments on Exposure Draft of Proposed Statement of Financial Accounting Standards, *Fair Value Measurements* – File Reference No. 1201-100

In response to the request for comments to the FASB's Exposure Draft of Proposed Statement of Financial Accounting Standards, *Fair Value Measurements* (the Fair Value ED), I am pleased to transmit on behalf of the International Actuarial Association (IAA) our comments and recommendations. Our comments are intended to supplement those submitted by the American Academy of Actuaries, one of our member actuarial associations, that represents the actuarial profession in the U.S.

To summarize our principle comments, the IAA believes that:

- Although the objectives of the Fair Value ED are commendable, further work is needed in the area of the measurement of liabilities for which no active market exists. For example, in an area of considerable interest to actuaries, that is the liabilities for insurance and related contracts, the Fair Value ED provides inadequate guidance to result in relevant and reliable measurement.
- Consistent with the objective of convergence of accounting standards, we believe that the FASB should, together with the IASB (and possibly other accounting standards setters), develop a high quality consistent standard on this topic. In addition, the results of related concurrent accounting standards development projects should be considered before this ED is adopted.

These comments have been prepared by a committee of the IAA, the members of which are listed by name and association in the Appendix to this submission. The IAA member associations are also listed in the Appendix.

Yours sincerely,

Yves Guérard
Secretary General

Attachment: IAA comments

IAA Comments on the FASB's Exposure Draft of Proposed Statement of Financial Accounting Standards, *Fair Value Measurements*

THE INTERNATIONAL ACTUARIAL ASSOCIATION

The International Actuarial Association (the "IAA") represents the international actuarial profession. Our fifty Full Member actuarial associations, including the American Academy of Actuaries that represents the actuarial profession in the U.S., encompass more than 95% of all actuaries practicing around the world. The IAA promotes high standards of actuarial professionalism around 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 upon, the areas of expertise of actuaries.

We are not a trade association and do not represent the interests of either clients or employers. As actuaries, we have developed significant experience and expertise in the assessment of the value of contingent cash flows. Using this experience, actuaries will, as a profession, continue to try to provide assistance to those involved in the enhancement of financial reporting standards to make them more useful to the users of financial statements.

The IAA appreciates this opportunity to provide input to the FASB regarding its Proposed Statement of Financial Accounting Standards, *Fair Value Measurements*. We commend the IASB for addressing this important and relevant financial reporting issue.

These comments have been prepared by the Insurance Accounting Committee of the IAA, the members of whom are listed by name and association in the Appendix to this brief. The Full Member associations of the IAA are also listed in the Appendix.

IAA COMMENTS

General observations

We support the response to this ED that has been submitted by the American Academy of Actuaries ("the Academy"), one of our member associations. In these comments, the Academy notes particular disappointment that in a proposed standard regarding fair values, there is limited guidance provided for most financial liabilities, particularly those that are not traded on an active market.

Consequently, we agree that, although the objectives underlying the Fair Value ED are commendable, further work is needed in the area of the measurement of liabilities for which no active market exists. For example, in an area of considerable interest to actuaries, that is the liabilities for insurance and related contracts, the Fair Value ED is silent and provides inadequate guidance to make meaningful and comparable measurements practical. We note that none of the examples included provide any insight into measurement of liabilities. That is a clear indication that further research and discussion is needed before any such standard should be applied to long-term liabilities such as is involved in many insurance contracts. We recommend that the FASB, together with other standard setters, should either study this area and its

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application to particular situations further before a standard is adopted or exclude such liabilities from its scope.

In addition, particularly since we agree that this is quite an important financial reporting issue, it should be addressed on an international basis. We believe that, in the spirit of your objective of convergence of accounting systems, the FASB should, together with the IASB (and possibly other national accounting standards setters), develop a high quality, consistent standard on this topic. To accomplish this, far more work is needed in developing a relevant and reliable fair value standard. In addition, the results of related concurrent projects currently underway amongst various accounting standard setters should be considered before this ED is adopted.

Specific ED Questions

Our responses to the specific questions raised in the ED are the following:

Issue 1: Definition of Fair Value

Will entities be able to consistently apply the fair value measurement objective using the guidance provided by this proposed Statement together with other applicable valuation standards and generally accepted valuation practices? If not, what additional guidance is needed?

IAA response: We believe that further guidance is need for the measurement of liabilities on a fair value basis. As we have learned in the course of the IASB's project on Insurance Contracts, there exist important unresolved issues in the measurement of many types of liabilities, including those of insurance and related contracts. Among these is a lack of guidance and indeed rigorous and objective discussion of several practical and important level 3 issues including the application of a demand deposit floor, risk adjustment and the credit standing of the corporate whole versus that of a reporting segment or separate legal subsidiary of the reporting entity or whether any such credit standing should be reflected in liabilities.

With regard to insurance liabilities, we believe the application of fair value to insurance, if appropriate, should be addressed as part of the anticipated IASB/FASB limited joint project on insurance liabilities and should therefore be eliminated from the scope of this standard until the FASB and the IASB have completed that forthcoming project.

Issue 2: Valuation Techniques

Is the guidance incorporated from *FASB Concepts Statement No. 7, Using Cash Flow Information and Present Value in Accounting Measurements* sufficient? If not, what additional guidance is needed?

IAA response: The guidance provided in Concept 7 is quite limited with regard to non-traded liabilities. Paragraph 7 lists three techniques that "shall" be applied

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to level 3 valuations. However, the first technique is inoperable and the last technique does not apply (as it explicitly relates only to assets). Further, it suggests that an entity's credit standing should reflect the credit standing of back-up guarantees provided by a government-sponsored or other guarantee organization without providing any advice as to how the extent of guarantees that might be incorporated.

We suggest that to produce relevant and useful guidance, any standard on liability measurement must be based on developments from the anticipated limited joint IASB/FASB insurance project and that, in particular, insurance liabilities should be eliminated from the scope of this standard until the FASB and the IASB have completed that forthcoming project.

We point out the difficulty involved in such valuations when the asset corresponding to such a liability is not tradable. The ED approach does not always work when the corresponding asset is not traded, and may impair the relevance of liability fair value financial measures to users of financial statements when neither the liability nor the corresponding asset are tradable.

We are concerned that Paragraph 8 may restrict a change in the valuation technique applied to those circumstances where the change is intended to result in a more reliable estimate. Such a restriction is unnecessary where the change in techniques is not material to the financial statements. The restriction might also interfere with the future development of new techniques and the market for providers of such estimates. Such new techniques are frequently developed as a result of data and cost issues, future responsiveness to issues or circumstances that may develop in the future, or of a change in the available resources. Such a change may not immediately result in a more reliable estimate, but may be made with a view to the future. The proposed Paragraph 8 guidance would preclude such changes, as it implies a lock-in of methods and their accompanying requirements (as to data and expertise).

Some liabilities are appropriately evaluated on the basis of multiple valuation approaches, with no clear and consistent advantage of one technique over another. The Paragraph 8 guidance appears to require a lock-in of the technique originally used, in the absence of a clearly more reliable alternative. This would limit to only those comfortable with the technique used for the prior estimate not only enhancements of methods, but also the competitive marketplace for those who develop such estimates. We see no benefit to such a restriction. The focus should be on restricting a change in methods where such a change materially affects the financial statements without any expected improvement in reliability. Even when a change in methods materially affects a financial statement, such changes should be permitted when accompanied by adequate disclosure and when they are based on the need to adjust to changes in available data, resources or conditions.

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Issue 4: Valuation Premise

Is the guidance in the proposed statement, including that contained in Appendix B (Example 3) sufficient with regard to selecting the valuation premise that should be used for estimates of fair value? If not, what additional guidance is needed?

IAA response: We note that this issue focuses on physical assets and provides a conclusion regarding liabilities without sufficient discussion of principles underlying their measurement. In its application to liabilities, it appears that possible inconsistent premises have been given, e.g., in paragraph 13 between "in-use" and "in-exchange" values. As evidenced by the lack of depth of the discussion provided relating to financial liabilities and particularly a complete absence of relevance of the premises to long-term liabilities, it is clear to us that further research and discussion is warranted regarding the appropriate principles to be applied.

Issue 5: Fair Value Hierarchy

Is the guidance contained in the proposed statement, including Appendix B (Example 4) sufficient for the hierarchy to be used in selecting valuation technique inputs? If not, what additional guidance is needed?

IAA response: We find this guidance sufficient, subject to our commentary on Issue 6 regarding transaction costs.

Issue 6: Level 1 Reference Market

Is the guidance concerning the determination of the appropriate reference market sufficient? If not, what additional guidance is needed?

IAA response: Given the absence of any reference market for insurance liabilities, this guidance is not especially useful, while we suspect is also the case in other areas where there are no directly relevant markets. We are concerned that measurement techniques that focus on exchange values do not reflect the associated transaction costs of such exchange or may not fully reflect or represent relevant values associated with the circumstances of the particular financial asset or financial liability being measured.

Issue 7: Pricing in Active Dealer Markets

This proposed Statement would require that the fair value of financial instruments traded in active dealer markets where bid and asked prices are more readily and regularly available than closing prices be estimated using bid prices for long positions (assets) and asked prices for short positions (liabilities), except as otherwise specified for offsetting positions. Do you agree? If not, what alternative approaches should the Board consider?

IAA response: We believe that such short positions should be used for liability valuation only if the entity obliged to fulfill the liability is legally able to sell such

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liabilities in that market. The difference in market access for the asset versus liability "holder" is a major issue affecting the relevance and implementation ability of such guidance.

Issue 9: Level 3 Estimates

This proposed Statement would require that in the absence of quoted prices for identical or similar assets or liabilities in active markets, fair value be estimated using multiple valuation techniques consistent with the market approach, income approach, and cost approach whenever the information necessary to apply those techniques is available without undue cost and effort (Level 3 estimates). Appendix B provides general guidance for applying multiple valuation techniques (Examples 6-8). Is that guidance sufficient? If not, what additional guidance is needed?

IAA response: As mentioned in our general comments, such guidance has limited relevance to many liability valuation situations in which we are involved, such as the liability for insurance contracts. The focus on market inputs is of little assistance where significant information asymmetry exists between the general market and the particular holder of a liability. In such cases, the general market's estimates, if they exist, are likely to be unreliable and unlikely to result in a "willing" seller, and thus may not be relevant.

Although in many cases multiple valuation techniques may be appropriate, it is clear that the discussion of such techniques included in the proposed standard only relates to the measurement of certain classes of assets, presuming that they apply universally (including liabilities), which is not the case. It would be useful to develop this further so as to apply more generally.

Paragraph 24 considers such a situation, but labels the use of entity-specific assumptions in such a situation as a "practical expedient" that "may" be used. We believe the existing wording is likely to result in pressure on statement preparers to use unreliable market inputs in place of more reliable entity-specific assumptions. As such, alternative language that clarifies that entity-specific assumptions are to be used where circumstances indicate that they are appropriate should be incorporated.

Since a common Level 3 approach is a discounted cash flow analysis, it would be useful to include an example of such an approach. We find that the examples included provide little if any insight regarding the application of the proposed standard regarding the long-term liabilities that actuaries are involved with.

We also are concerned with the interpretation of "without undue cost and effort." Such a test can only lead to inconsistent measurement.

Along with other responders to this Invitation to Comment, the IAA appreciates the opportunity to express our views on this Exposure Draft and hope our comments add value to the deliberations.

Members of the IAA's Insurance Accounting Committee

Sam Gutterman	(Chair)
W. Paul McCrossan	(Vice-chair)
Francis Ruygt	(Vice-chair)
Clive Aaron	Institute of Actuaries of Australia
William Abbott	Institute of Actuaries
Yutaka Amino	Institute of Actuaries of Japan
Angie Felipe Checa	Col.legi d'Actuaris de Catalunya
Daniel Barron	Israel Association of Actuaries
Ralph Blanchard	Casualty Actuarial Society
Guy Castagnoli	Association Suisse des Actuaire
Paolo De Angelis	Istituto Italiano degli Attuari
Mark J. Freedman	Society of Actuaries
Mariano Gongora Roman	Instituto de Actuarios Españoles
Stephen Handler	Actuarial Society of South Africa
William C. Hines	American Academy of Actuaries
Antony John Jeffery	Society of Actuaries in Ireland
Ad A.M. Kok	Het Actuarieel Genootschap
Kurt Lambrechts	Association Royale des Actuaire Belges
Jean-Pierre Lassus	Institut des Actuaire
Kristine Lomanosvka	Latvijas Aktuaru Asociacija
W. Paul McCrossan	Canadian Institute of Actuaries/Institut Canadien des Actuaire
Richard O'Sullivan	Society of Actuaries in Ireland
Markku Paakkanen	Suomen Aktuaariyhdistys
Venkatarama Rajagopalan	Actuarial Society of India
Nithiarani Rajasingham	Singapore Actuarial Society
Jaanus Sibul	Eesti Aktuaaride Liit
Dieter Silbernagel	Deutsche Aktuarvereinigung e. V. (DAV)
David Stevenson	Faculty of Actuaries
Bjarni Thordarson	Félag Islenskra Tryggingastærðfræðinga
Wilma Torres	Instituto Brasileiro de Atuária (IBA)
Tuomo Virolainen	Svenska Aktuarieföreningen
Robert E. Wilcox	Conference of Consulting Actuaries
Kevin Yah	Actuarial Society of the Republic of China
Jesús Zúñiga	Colegio Nacional de Actuarios A. C.

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 Actuaire Belges (Belgique)

Instituto Brasileiro de Atuária (IBA) (Brazil)

Canadian Institute of Actuaries/Institut Canadien des Actuaire (Canada)

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 Actuaire (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)

Actuarial Society of India (India)

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)

Persatuan Aktuari Malaysia (Malaysia)

Colegio Nacional de Actuarios A. C. (Mexico)

Het Actuarieel Genootschap (Netherlands)

New Zealand Society of Actuaries (New Zealand)

Den Norske Aktuarforening (Norway)

Actuarial Society of the Philippines (Philippines)

Polskie Stowarzyszenie Aktuaruszy (Poland)

Instituto dos Actuários Portugueses (Portugal)

Academia de Actuarios de Puerto Rico (Puerto Rico)

Singapore Actuarial Society (Singapore)

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 Actuaire (Switzerland)

Actuarial Institute of the Republic of China (Taiwan)

Faculty of Actuaries (United Kingdom)

Institute of Actuaries (United Kingdom)

American Academy of Actuaries (United States)

American Society of Pension Actuaries (United States)

Casualty Actuarial Society (United States)

Conference of Consulting Actuaries (United States)

Society of Actuaries (United States)