

Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities

The ABI Investment Committee's response to the FASB Exposure Draft

Introduction

1. The Investment Committee of the Association of British Insurers (ABI)* welcomes the opportunity to respond to FASB's proposals on accounting for financial instruments. This response from our Association particularly reflects the views of our members as institutional investors and therefore users of accounts.

General Comments

2. The ABI generally responds to consultations issued by the International Accounting Standards Board (IASB), thereby contributing to the efforts to achieve global convergence in financial reporting. On this occasion FASB's proposals in what is a critical area differ markedly from those that are being put forward by the IASB and we are responding to this consultation to register our disappointment and concern. Failure to achieve alignment on accounting for financial instruments will seriously undermine the credibility of the overall convergence project.
3. Broadly speaking the FASB proposals involve a greater use of fair values than the mixed measurement approach being employed by the IASB. Although there is a range of opinion amongst investors and other users of accounts on the optimum balance between fair values and cost-based numbers there appears to us to be a clear consensus that a mixed measurement approach is right and that the IASB's proposals represent a more appropriate starting point for devising properly converged accounting. We believe that the views of investors in the UK and other countries are not significantly different from those in the USA as to the appropriate bases for valuing asset and liabilities and reporting performance. Indeed it would be surprising if the views of participants in the investment markets, which do not exist in national isolation, were to be substantially different.
4. We wish to highlight some of the areas of concern we have with FASB's proposals as compared to the approach being adopted by the IASB. The application of fair values to most financial liabilities is likely to be particularly problematic and potentially misleading to shareholders and other investors who are interested in what remains after the entity has discharged its liabilities according to their contractual terms. Similarly, we do not agree that core deposits in the banking sector should be held at a remeasurement value rather than their redemption amount. We consider the recognition of 'day 1 losses' to be an unattractive concept that treats decisions to undertake transactions as value depleting without any evidence underpin this. By contrast, and in particular in the context of accounting

* The ABI is the voice of the UK's insurance, investment and long-term savings industry. It has over 300 members, which together account for around 90% of premiums in the UK domestic market. The UK insurance industry is the third largest in the world and the largest in Europe. Employing more than 300,000 people in the UK alone, it is an important contributor to the UK economy and manages investments of around £1.5 trillion, equivalent to around \$2.4 trillion, over 20% of the UK's total net worth.

for banking institutions, we see the FASB proposals regarding impairment as insufficiently prudent to reflect the real economics and inherent risks of the business. We await finalised IASB proposals in this regard but they seem likely to be closer to getting the balance right.

5. In considering the IASB's proposals on what is now IFRS9 we found useful the application of the business model approach to decisions on how accounting for financial instruments could be most meaningful to those who have invested in the entities carrying out those business activities. We commend this approach to FASB.
6. Investors will often find useful the provision of both fair value and cost-based numbers but providing these is not a substitute for getting the basic accounting right. In this regard we think that FASB's proposed balance sheet presentation with both amortised cost and fair values presented for some items will be unnecessarily complex and confusing.

Concluding comment

7. It is right that accounting standards setters should be proposing financial reporting standards that properly address the needs and expectations of shareholders and other investors and not, for example, those of prudential regulators of financial enterprises. However FASB's proposals appear to move further away both from accounting solutions that give investors what they do need and, as a practical consideration, from those which are likely to command support from politicians and regulators. Accordingly we strongly suggest that FASB reconsiders its current proposals and engages with its counterparts at the IASB are seeks to identify the ground on which aligned accounting for financial instruments can be constructed and the convergence project moved forward.

ABI

30 September 2010

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