The Actuarial Profession
making financial sense of the future

responses

International Accounting Standards Board

Exposure Draft: Fair value measurement

Discussion Paper: Credit risk in liability measurement

September 2009

About The Actuarial Profession

The Actuarial Profession is governed jointly by the Faculty of Actuaries in Edinburgh and the Institute of Actuaries in London, the two professional bodies for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuing professional development and a professional code of conduct supports high standards reflecting the significant role of the Profession in society.

Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business's assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals, and advise on social and public interest issues. Members of the Profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.

The Profession also has an obligation to serve the public interest and one method by which it seeks to do so is by making informed contributions to debates on matters of public interest.

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www.iasb.org

28 September 2009

Dear Sir/Madam

IASB Exposure Draft *Fair value measurement* and Discussion Paper *Credit risk in liability measurement*

Thank you for offering The Actuarial Profession the opportunity to comment on these papers. Our comments are largely confined to those aspects of the Exposure Draft affecting pensions. (Please note that there is an appendix attached to this letter.)

We recognise that the intention of the project is to refine and align the measurement of fair value for assets and liabilities for which measurement at fair value is already required, rather than to address the question of which assets and liabilities should be measured at fair value. Nevertheless, as explained below, we believe that the focus of the project is misplaced, addressing discrepancies rather than the big issues, and would encourage the IASB to look at the question of consistent application of fair value measurement across all assets and liabilities.

We note that under current accounting standards, the performance statements incorporate a mix of approaches: some items are marked to market through P&L; some are marked to market but through the statement of comprehensive income, and others – which for many companies are just as large and as volatile – are not marked to market at all. The impression is given to management and investors alike that those items which are marked to market are more risky than those which are not. This influences investor pressures on management, and impacts management behaviour both directly and in response to investor pressure. There is clear risk that decisions made are as a result sub-optimal.

By comparison, the impact of the discrepancies between the different approaches taken to measurement at fair value for the assets and liabilities where this is required is relatively minor.

We have set out a number of more detailed comments in the Appendix to this letter.

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If you have any questions or would like to discuss any of these matters further, please do not hesitate to contact us. Should you wish to do so, please contact Martin Hewitt, Pensions Practice Manager on 0207 632 2185 or via martin.hewitt@actuaries.org.uk.

Yours sincerely

Robert Hails

Chairman, Consultations Group, Pensions Practice Executive Committee

Please reply to Staple Inn

Encl: Appendix

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Appendix

We note that the forthcoming fundamental pension project will consider whether and how to require that pension liabilities be measured at fair value.

A key question is from whose perspective is fair value assessed – proprietary or entity specific? For pension liabilities, taking fair value as the price that a market participant transferee would require to take over the liability, on the basis that the transferee has the same credit risk as the entity, seems like a half-way house concept and may have little practical worth accordingly. While paragraph 31 of the Exposure Draft states that a restriction on the entity's ability to transfer a liability to another party does not affect the fair value, users of accounts need understand that an approach that embeds credit risk into fair value measurement gives rise to the issues noted in the discussion paper on credit risk, and that fair value will likely not be the same as the market value of transferring the liability – indeed, for most companies, it will be less than the market value of transferring the liability.

Careful consideration would also be required for features such as discretionary benefits and the impact of future pay rises. Would the possibility of restricting future discretionary increases and/or linkage of benefits to future pay increases be treated as "non-performance risk"?

We would also suggest re-thinking the proposals in relation to bid/ask prices. As it stands, draft paragraph 55 is unhelpful, and likely to lead to variation in practice. The IASB and FASB should come to a view on whether there is a single fair value (probably mid), or potentially different entry and exit prices, and a consistent view on the appropriate treatment of transaction costs.

In relation to the incorporation of credit risk, we would make a general comment that it is important that whatever approach is agreed it is applied consistently across all assets and liabilities (and not just those currently required to be measured at fair value). For example, if credit risk is not to be reflected in fair value, then debt issued by the entity should be measured by discounting promised payments at risk free rates, not at the value of the initial issue proceeds (which would incorporate an implicit adjustment for the market's view of the credit risk of the entity at the time of issuance).

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