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Consultation response

European Financial Reporting Advisory Group

Considering the Effects of Accounting Standards

August 2011

About the Institute and Faculty of Actuaries

The Institute and Faculty of Actuaries is the chartered professional body for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuous 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' 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 offer comment 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.

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30 August 2011

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Dear Sir/Madam

Considering the Effects of Accounting Standards – discussion paper

Thank you for the opportunity to comment on your discussion paper Considering the Effects of Accounting Standards.

The Actuarial Profession does not wish to comment in detail on the issues raised in the consultation paper. However, there is one issue which we wish to draw to your attention in relation to how accounting standard setters look at the effects of a proposed change to an accounting standard.

In looking at a proposed change to an accounting standard, it is natural to compare the new accounting standard with the old accounting standard, and consider whether the effects of the proposed change are appropriate. For example, if the accounting standard relating to a category of financial liabilities is to be changed to alter the measurement basis from historic cost to fair value, one effect will be to make investors look more carefully at the impact of changes in fair value for that category of liability. This effect (in isolation) might be considered appropriate.

We suggest, however, that it is also important for accounting standard setters to look at the effect of creating or maintaining differences in accounting treatment between the accounting standards applied in different areas, but to similar assets, liabilities or transactions. For instance, in relation to the example considered above, this change in measurement basis from historic cost to fair value for one category of financial liability might be implemented whilst leaving unchanged the measurement basis for some other categories of financial liability that are economically similar, with fair value moving in response to the same financial market drivers. Considered in isolation, the effect of making investors look more carefully at the impact of changes in fair value for that category of liability might (as noted above) be considered appropriate. However, investors will also, as a consequence of making the change for this category of financial liability in isolation:

- pay more attention to the impact of changes in fair value for that category of liability than for other economically similar financial liabilities;

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- perceive this category of financial liability as being more risky and therefore more onerous than other economically similar financial liabilities;

- drive down the value of entities with financial liabilities within the category affected relative to the value of other entities with an equivalent value of financial liabilities in a category that will continue to be measured at historic cost; and

- influence management of those entities to work harder to avoid or reduce their exposure to such liabilities than to other economically similar liabilities.

These relative effects (arising from the treatment of this category of financial liability being different from that of other economically similar financial liabilities) would not appear to be appropriate.

However, these relative effects do not appear to have been considered by accounting standard setters to date.

For example, accounting standard setters do not generally appear to have considered the effect of moving the measurement of pension liabilities onto a mark to market basis, while leaving economically similar financial liabilities to be measured on the basis of historic cost or amortised cost (on the effective interest method). Examples of financial liabilities that are economically similar to pension liabilities but can still be measured on the basis of historic cost or amortised cost include:

- the entity's own debt;

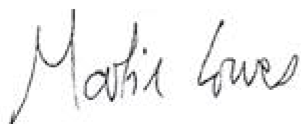
- bank deposit book; and

- commitments under lease arrangements.

The effect has been that investors see pension liabilities as being riskier than those other categories of financial liability, with very obvious behavioural consequences.

We would be very happy to discuss this issue in more detail if that would assist. Please contact Kirstin Lambert, Pensions Communities Manager on 0207 632 2168 or via Kirstin.Lambert@actuaries.org.uk.

Yours sincerely



Martin Lowes
On behalf of the Consultations Group, Pensions Practice Executive Committee