CEIOPS

Committee of European Insurance and Occupational Pensions Supervisors

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Sir David Tweedie
Chairman IASB
30 Cannon Street
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United Kingdom

4 May 2007

Dear Sir David,

DISCUSSION PAPER ON FAIR VALUE MEASUREMENTS

CEIOPS welcomes the opportunity to comment on the IASB's latest proposals on fair value measurement. As you know, we have a special interest in the IASB's work both on fair value measurement and insurance contracts, particularly in the context of our own work on the EU Solvency II project. We also share the view that policies and methodologies used for financial accounting should, as far as possible, be applied for prudential purposes and we continue to support fully the objective of achieving a single set of accounting standards for both financial and regulatory reporting.

As a body of European supervisors, we fully endorse the views expressed by the IAIS in response to this discussion paper, and would also convey our support for the comments submitted by EFRAG in their comment letter.

In this response we intend to focus predominantly on those issues raised in this discussion paper which are of particular relevance and importance to the Solvency II project. It is our understanding that, although the IASB has not indicated any intention to apply fair value to insurance contracts in its insurance phase 2 project, the current exit value tentatively proposed for that project may have some similarities with the fair value described in the present discussion paper. Our comments which are attached as an Annex to this letter therefore take this assumption into account.

We hope you will find this letter a useful and relevant contribution to the fair value measurement discussion.

We remain, as always, very willing to participate in further debate on this and any other subject relevant to achieving consistency in financial and prudential reporting. Let me also confirm CEIOPS' interest in being invited to participate at one of the round-table meetings on the Discussion Paper. Our representative would be Gabriel Bernardino.

Yours

Alberto Corinti

(Secretary General)

Annex

General comments

In principle, we support the IASB's objective of improving the quality of fair value information by giving a single definition and a single source of guidance for all fair value measurement within IFRS. However, we wish to make the following observations which we consider of particular importance to the project as a whole:

- any conceptual issues raised in this paper e.g. redefinition of fair value, must ultimately be consistent with the IASB's conceptual framework project; we would strongly suggest delaying any further advancements in the fair value project until the latter has reached a stable stage;
- the fair value measurement project needs to be developed in conjunction with other measurement-related IASB projects and also to take account of the effect on all existing IFRS. This in turn could also have an impact on the framework project;
- the IASB needs to consider how fair value measurement might be applied in the context of markets other than those for which SFAS 157 has been designed (i.e. essentially for financial instruments in well developed financial markets).

We do, however, support a definition of fair value based on an exit price measurement objective, although we believe careful consideration will need to be taken as to where, within IFRSs, such a measurement principle can be appropriately applied.

We understand that, as a second stage to this project, the Board intends to review all IFRS which currently contain references to "fair value" to evaluate whether such references remain appropriate in light of the new definition (we assume the Board does not intend to extend the use of fair value beyond its existing application in current standards). Without knowing the outcome of such an exercise, it is of course difficult to provide meaningful comment on the merits of the new definition, and we assume that where the definition of "fair value" as defined in this paper is not applied to any standards currently using the term "fair value", a new measurement basis will need to be specified for each of those standards. In light of these observations, we see merit in the notion of replacing the term 'fair value' with a more relevant and descriptive term such as 'current exit price' where it is appropriate to apply such a measurement principle.

Specific responses to questions

Question 3

The approach to valuation of insurance liabilities currently envisaged under Solvency II is that of a current exit price, and to this extent we support an exit price method of valuation. At the same time we recognize that where deep and liquid markets do not exist for certain assets and liabilities, there will be a need for more detailed guidance to support the estimating approach. In the context of insurance liabilities measurement, such guidance will need to take account of the principle that profit should be recognized only when a sufficiently reliable risk margin has been included in the valuation amount.

Question 9

We believe that, in order to be consistent with a market-based exit price objective, fair value measurement of liabilities should essentially be based on a transfer notion. In this respect we fully support the views expressed by the IAIS in their response to this discussion paper, and recognise that this approach may not be fully in line with views expressed by EFRAG.

In the case of insurance contracts, any transfer of liabilities would need to be made to a regulated entity capable of both accepting the transfer and settling the obligation to the claimant/beneficiary. We therefore believe that, in the context of insurance liabilities, any transfer notion would be strongly influenced by the settlement obligations that a transferee would undertake, and that the minimum value of the liability would essentially be the cash flows relating to full settlement with the claimant or beneficiary. Indeed we believe that any transfer notion which does not take account of ultimate settlement values would not be appropriate for application to insurance liabilities.

Question 11

Where no deep and liquid market exists for the exchange of assets and liabilities, we believe there should be no recognition of profits at inception unless there is reliable evidence that such profits exist. In the case of insurance liabilities, we therefore believe that day-one profits should only be recognised where an appropriate and sufficiently reliable risk margin has been included in the value of the liabilities. We believe this to be consistent with an exit value approach and with Solvency II valuation requirements.

Question 12

In the case of insurance contracts, where assets or liabilities with similar characteristics are grouped and managed together, a portfolio-based approach is an important and relevant factor in asset and liability measurement. We would ultimately favour measurement criteria which are capable of producing consistent results when applied both at individual contract and portfolio level.

Question 16

We agree that the risk of non-performance, including credit risk, will influence the fair value of liabilities under an exit price approach. In the context of insurance accounting, the existence of guarantee schemes and other policyholder protections means that non-performance risk is often significantly reduced. However, as a general rule, under Solvency II, insurers are not permitted to take account of their own credit standing, not least because of the favourable effect this has on valuation of liabilities held by firms with a poor credit rating. Therefore (and for reasons articulated in previous discussions) we strongly oppose taking account of own credit risk when measuring insurance liabilities.