*Deb Henretta*
*ABAC Chair 2011*

24 February 2011

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London, EC4M 6XH
United Kingdom

Ms. Leslie Seidman
Chairman
Financial Accounting Standards Board
301 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-05116
USA

Dear Chairman Tweedie and Chairman Seidman:

The APEC Business Advisory Council ("ABAC") is the formal private sector advisory group of the Asia-Pacific Economic Cooperation ("APEC") Forum. Representing the business communities of all 21 APEC member economies, ABAC is tasked with supporting the success of APEC by providing private sector insights on how best to achieve APEC's goals, both through APEC's own initiatives, and in dialogue with other international organizations.

In ABAC's 2010 *Report to APEC Economic Leaders*, we expressed our strong support for adoption of IFRS throughout the APEC region, as part of APEC's goal of encouraging regulatory coherence and of promoting regional economic integration. At the same time, ABAC noted that adoption of IFRS should be undertaken in a manner that minimizes impacts on real economic activities. In particular, ABAC would be concerned with any impacts of implementation on financing for activities of small and medium enterprises ("SME's"), as this is a focus area for Inclusive Growth initiatives, one of the pillars of APEC's growth strategy.

In this context, we note that IASB and FASB jointly released an exposure draft (ED) on August 17, 2010, proposing new accounting rules for treatment of lease financing, and calling for finalization of the rules by June 2011. During the public comment period ending on December 15, 2010, approximately 800 submissions were made on the ED. The IASB/FASB preliminary analysis of submissions noted that significant concerns were raised with the ED, including, as most concerns us, the potential for the rules to have a negative impact on lease financing availability for SME's. Among the concerns we share are:

- In its present form the ED would reduce the ability of businesses, particularly SMEs, to access funding, including in many APEC economies.

- The ED would artificially expand lessee balance sheets by requiring capitalisation of options and contingent rentals, thus inflating gearing ratios without any actual increase in assets or liabilities.
- As a result of the front-end loading of lease expenses, notwithstanding that the underlying financial position of lessees has not changed, financial ratios would be impaired, the risk of loan covenant breaches would increase, and lease financing would become more expensive and in many cases less available.
- The end result is that the funding ability of both lessees and lessors would be constrained, and lease financing, currently a significant component of overall liquidity available to businesses, would become scarcer.
- The negative impacts on credit availability would be particularly severe for SME's, which generally lack the alternative funding sources that may be available to larger corporations, such as through established banking relationships or access to the capital markets.
- The standard takes little account of the circumstances in much of Asia where commercial property lease terms are generally much shorter and renewal options do not create financial obligations until exercised.
- The administration involved in the application of the standard is likely to be costly and cumbersome.

While having these concerns, ABAC is encouraged by the tentative decisions taken by the IASB and FASB, at their joint meeting in London during the week of February 14, to revisit certain aspects of the ED in a way that might address some of the above concerns, including in the areas of accounting for lease renewals, and in acknowledging other types of leases besides finance leases, the details of which will be considered at a future meeting. ABAC is aware that at a technical level, it is not constituted to provide detailed financial accounting input on all aspects of the ED. We are also aware that much of this was done through the large number of submissions made through the public comment process, and will continue through the ongoing outreach endorsed at the recent joint meeting. Indeed, leasing associations in many of our APEC economies have been at the forefront of comments on how the ED will likely constrict the availability and/or raise the cost of lease financing for many users.

However, we do respectfully believe that ABAC has a duty to underscore at a higher level that the ED be implemented in a way that does not impair APEC's overarching themes of Inclusive Growth, and think this consistent with the IASB/FASB conceptual framework that implementation of accounting standards should be neutral with respect to economic impact. ABAC's Finance and Economic Working Group and Advisory Group on APEC Financial System Capacity Building have over the past two years sponsored several analytical workshops and presentations supporting APEC initiatives on the promotion of SME financing and validated the critical importance that SME access to financing has for promoting inclusive economic growth and entrepreneurship within the region. Specific language reflecting these learnings was included in the above-referenced 2010 *Report to the APEC Leaders* and in the *Report to APEC Finance Ministers*. These statements were acknowledged and adopted in large measure by the APEC Leaders' Statement issued in Yokohama and the APEC Finance Ministers' Statement issued in Kyoto in November, 2010. Against this background, it is thus appropriate that ABAC, while not addressing technical interventions on all aspects of the ED implementation, underscore that sufficient time must be allowed for an economic impact analysis of how the ED as currently drafted would affect credit availability generally and for SMEs in particular, and that any appropriate revisions be made before final adoption of the rules.

We respectfully urge IASB and FASB to extend the June 2011 timeline for finalizing the ED. This extension would allow for ample consideration of the many comments received to date, as well as the additional input likely to be made based on the proposals issued at the recent joint meeting. It would also allow the Boards time to consider further appropriate changes to ensure that the ED implementation does not undercut the important goals of promoting SME financing, entrepreneurship and regional economic growth. We would be happy to continue a dialogue with you on these matters.

Yours respectfully,

Deb Henretta

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| Deborah Henretta | John W. H. Denton |
| ABAC Chair 2011 | Chair, ABAC Finance & Economics Working Group |

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*ABAC Chair 2011*

25 August 2011

**Mr. Hans Hoogervorst**
Chairman
International Accounting Standards Board
30 Cannon Street
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United Kingdom

**Ms. Leslie Seidman**
Chairman
Financial Accounting Standards Board
401 Merritt 7
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Dear Chairman Hoogervorst and Chairman Seidman:

The APEC Business Advisory Council (ABAC) is the formal private sector advisory group of the Asia-Pacific Economic Cooperation (APEC) Forum. Representing the business communities of all 21 APEC member economies, ABAC is tasked with supporting the success of APEC by providing private sector insights on how best to achieve APEC's goals, both through APEC's own initiatives, and in dialogue with other international organizations.

In ABAC's 2010 *Report to APEC Economic Leaders*, we expressed our support for adoption of International Financial Reporting Standards (IFRS) throughout the APEC region as part of APEC's goal of encouraging regulatory coherence, enhancing the development of regional capital markets and promoting sustainable economic growth. At the same time, ABAC noted that implementation of IFRS should be undertaken in a manner that does not significantly distort reporting of real economic activities and that reflects each economy's business practices.

The insurance industry plays an important role in the development of the Asia-Pacific region. However, insurance companies in the region face unique challenges and circumstances and we are concerned that the adoption of an IFRS for insurance contracts based on the tentative conclusions to date of the IASB and FASB could have significant negative impacts on the industry. Such negative impacts include non-economic volatility in earnings and shareholder equity along with a lack of transparency in the reported results of insurance companies in the region. In addition, there may be a reduced availability and/or increase in the price of many long-duration insurance products that are particularly important for economies in the region with aging populations. We are confining this letter to four issues that are of primary concern to us, namely: 1) the discount rate to be used in the valuation of life insurance liabilities; 2) the use of

Other Comprehensive Income for reporting of market value fluctuations in insurance company assets and liabilities; 3) the presentation of life insurance company financial statements; and 4) the proposed changes in the measurement of short-duration insurance contracts, primarily for property and casualty insurance companies.

## 1) Determination of discount rates

Following consideration of the concerns expressed by many stakeholders, the IASB and FASB have tentatively decided to permit the use of either a bottom-up or a top-down approach to determine the discount rate to be used in the valuation of life insurance liabilities. The bottom-up approach outlined in the exposure draft released in July 2010 prescribes that the discount rate shall reflect the yield curve in the appropriate currency for instruments that expose the holder to no or negligible credit risk, with an adjustment for illiquidity. The tentative top-down approach decided by the IASB and FASB prescribes that the insurer may base its determination of the yield curve for insurance contract liabilities on a yield curve that reflects current market returns for an actual or reference portfolio of assets with characteristics similar to those of the insurance contract liabilities.

We support the use of a top-down approach in determining the discount rate for insurance liabilities but are concerned that our view of a top-down approach may be significantly different from that of the IASB and FASB. We believe that a top-down approach should take into account the following:

- The discount rate needs to reflect the characteristics of the liabilities and the business model of the insurer. It should also be consistent with the fulfillment model of insurers under which insurers must fulfill the contractual obligations they have to their policyholders.

- The starting rate should be consistent with the basis on which the assets are held on the insurer's balance sheet. The starting rate may be a blend of different rate bases as the actual or reference portfolio of assets may include assets that are held at different measurement bases (e.g., fair value or amortized cost).

- The discount rate should be based on the insurer's expectations, including projected future yields on assets currently owned and investments to be made from future net cash inflows. The projection of future yield rates should be determined based on current yield curves after full reflection of investment expenses, expected future default costs and other asset risks retained by the insurer.

- The application guidance for unobservable (non-investable) points on the discount rate yield curve should allow the use of Level 3 estimates for unobservable market inputs. In addition, the IASB and FASB should clarify that the use of returns (including appreciation) on non-fixed income investments, with appropriate adjustments for risk, is acceptable. This will result in a more stable discount rate at longer durations, and will be consistent with the insurer's actual returns and investment strategy.

## 2) Use of Other Comprehensive Income

The nature of the life insurance business is to underwrite risks over a long period of time, while diversifying such risks through portfolios of insurance contracts, as well as to securely fulfill the obligations to policyholders. Life insurance companies do not primarily intend to gain profits through the timing of changes in the fair value of financial assets and liabilities they hold. We believe that an IFRS for insurance contracts should reflect these fundamental business principles and therefore believe that:

- Changes in the valuation of assets and liabilities based on financial assumptions, such as interest rates, should be presented in Other Comprehensive Income and not in the income statement since they do not represent actual economic events. Instead, changes in the valuation of assets and liabilities should be recycled through the income statement when actual gains or losses are realized.

- Other changes, such as changes in mortality and morbidity experience, should be reported directly in the income statement.

Reflecting changes in the valuation of assets and liabilities in Other Comprehensive Income is not only consistent with the business model of insurers, but is also wholly consistent with the goal of having financial statements provide investors and financial markets with an accurate picture of an insurer's performance. Further, it helps avoid non-economic volatility, such as short-term mark-to-market movements resulting from illiquid markets that can be misleading and destabilizing.

**3) Presentation of life insurance company financial statements**

The exposure draft proposes to eliminate the existing presentation model that presents premiums earned as income and claims paid as cost. The new model proposed to replace the existing model is a margin approach which directly presents the sources of profit and requires insurers to disclose premiums earned, claims paid and benefits in the financial statements. As the proposed margin approach requires excessively complex calculations, we are deeply concerned about its feasibility including auditability. Thus, we propose that the existing presentation model be maintained, instead of introducing the margin approach.

**4) Measurement of short-duration insurance contracts**

The financial reporting for property and casualty insurance contracts that is currently used in most of the region is working well, and generally should be maintained. In particular, the measurement approach in place in most of the Asia-Pacific region is time-tested, well-understood, and presents a transparent view of the financial results of property and casualty insurers. We are pleased to see that the IASB and FASB are moving in the direction of a measurement approach for pre-claims liabilities of property and casualty insurance contracts that is generally consistent with the current unearned premium approach.

However, we are concerned with the recommendation that discounting should be required for post-claim liabilities. We believe that discounting will not provide decision-useful information since payout patterns for many liabilities are long and speculative, and reliable estimates cannot be made. Financial statement users rely primarily on ultimate (i.e., undiscounted) values, that enable users to understand the accuracy of estimates of ultimate claim amounts that management makes over time. We hope the IASB and FASB will reconsider the need for discounting for short-duration insurance contracts and related claim reserves.

At present, international accounting changes remain in flux and there are still important issues that need to be decided. We believe that any new standards that are implemented must take into account the business principles and unique challenges of different industries, including the insurance industry. Given the potentially adverse impact an IFRS for insurance contracts may have on insurance companies in the APEC region, we hope that the IASB and FASB will take into careful consideration the concerns and recommendations we have provided. We would be happy to continue a dialogue with you on these matters.

Sincerely,

Deb Henretta

**Deb Henretta**
ABAC Chair 2011

**John W. H. Denton**
Chair, ABAC Finance & Economics Working Group