

Activities and Outline of the LIAJ

A. Requesting and Representing Opinions

1. Activities Related to the International Association of Insurance Supervisors (IAIS)

Comments on *Draft Supervisory Standard on Suitable Forms of Capital*

The LIAJ submitted written comments on the “Draft Supervisory Standard on Suitable Forms of Capital” under the date of 12 March 2004 of the IAIS Solvency and Actuarial Issues Subcommittee. The outline of the comments is as follows.

a) The Treatment of Unrealized Profit and Loss (Paragraph 15)

The treatment of unrealized profit and that of unrealized loss are asymmetric and inconsistent. It is more consistent not to impose restrictions on inclusion of unrealized profit.

b) Interest Payment on the Foundation Fund (Paragraph 43)

Foundation fund, whose interest payment is strictly restricted by laws, is very similar to capital. When the supervisory authorities of each jurisdiction regulate the interest payment strictly, it is appropriate that ‘cumulative’ should be permitted in paragraph 43. Also, it is appropriate not to require prior-approval. Prior-approval should be provided as an example in paragraph 43.

Comments on *Draft Guidance Paper on Anti-Money Laundering and Combating the Financing of Terrorism*

The LIAJ submitted written comments on the draft “Guidance Paper on Anti-Money Laundering and Combating the Financing of Terrorism” under the date of 16 April 2004 of the IAIS Insurance Fraud Subcommittee. The outline of the comments is as follows.

a) Use of National Health Insurance Cards for Identification and Verification Purposes (Paragraph 51)

In Japan, a national health insurance card is delivered only to the identical person who is registered under the strict process. Therefore, it cannot be “easily obtained in any name”. It is not appropriate to exemplify a national health insurance card as a document which can be “easily obtained in any name” uniformly in any jurisdiction.

b) Risk Management Arrangements (Paragraph 82)

There is no problem that the board of directors and senior management receive reports not regularly but when a concern arises. There seems no necessity in keeping the board of directors and senior management regularly informed of all matters when there is no change in interoffice measures.

c) Record Keeping (Paragraph 86)

It is physically difficult to preserve large volume of information simply in the form of documentation. It should be clarified that other forms such as electronic media (FD, CD-R, etc.) as options to store the information are admitted.

d) Screening of Staff (Paragraph 91)

The necessity of appropriate assessment of the fit and proper requirement of key staff should be endured. However, individual human rights and privacy also should be taken into account sufficiently.

In Japan, from the viewpoint of preventive measures to protect human rights and avoid discrimination in recruiting process, the corresponding law places a certain degree of restrictions on employers when they collect the private information of their prospective employees.

Therefore, it should be ensured that each jurisdiction can introduce the measures to assess the fit and proper requirement of key employees in line with individual human rights and the legal system of the jurisdiction.

Comments on Consultation Paper on the Draft Standard on Disclosures Concerning Investment Performance and Risks for Insurers and Reinsurers

The LIAJ submitted comments on “Consultation paper on the draft standard on disclosures concerning investment performance and risks for insurers and reinsurers” under the date of 17 September 2004 of the IAIS Enhanced Disclosure Subcommittee. The comments included the ones on issues of disclosure requirements and measures.

2. Activities Related to the International Accounting Standards Board (IASB)

Comments on a Consultation Paper, *Strengthening the IASB’s deliberative processes*

The LIAJ and the American Council of Life Insurers (ACLI) jointly issued on 4 June 2004 written comments on “Strengthening the IASB’s deliberative processes” published on 24 March 2004 by the International Accounting Standards Committee (IASC) Foundation. In addition, the LIAJ submitted a separate statement on 25 June 2004, including its comments on the consultation paper. The outline of the statement is as follows.

- a) To improve the transparency of the discussions and to aid the comprehension of interested parties, we propose to open to the public the same information as given to the Board throughout the deliberation processes of the IASB.
- b) We suggest to change the deliberative processes to show on the IASB website the IASB’s position not only on the comment letters to exposure drafts or discussion papers but also on some other letters, such as a letter representing opinions of broad specialists about an issue under discussion.
- c) It is necessary to use the Working Group or existing Advisory Group more than ever.
- d) We suggest issuing discussion papers for those projects with still many issues yet to be resolved in order to collect various opinions.
- e) We believe that a big change in an approach from an exposure draft should have been re-exposed and a process to hear various opinions should have been taken.
- f) We suggest that an approval of final standards should require no less than three quarters of the IASB Board members.
- g) We believe that the IASB should give consideration to countries whose native languages are not English.

- h) The IASB needs to make efforts in harmonizing itself with various standard-setters.

Comments on *The Fair Value Option: Proposed Amendments to IAS 39 Financial Instruments: Recognition and Measurement*

The LIAJ submitted on 15 July 2004 written comments on the exposure draft of “The Fair Value Option: Proposed Amendments to IAS 39 Financial Instruments: Recognition and Measurement” published on 21 April 2004 by the IASB. The outline of the comments is as follows.

- a) Adoption of Fair Value Option might impair the comparability of financial statement. In addition, expanding the use of fair value for the profit/loss statement items diverts from the underlying purpose of profit and loss statement aiming at adequately displaying the business performance of a corresponding fiscal year.
- b) We agree on the direction of the proposed amendment placing some restrictions on the use of the fair value option. We are also in favour of seeking verifiability of fair value when using the fair value option.
- c) <Permitting entities to designate arbitrarily on initial recognition any financial assets or financial liabilities other than loans and receivables as one to be measured at fair value with gains and losses recognised in profit or loss> might impair the comparability of financial statements. It might also divert from the underlying purpose of profit and loss statement aiming at adequately displaying the business performance in a given fiscal year. Therefore, we oppose to this clause of the amendment.
- d) Regarding the application of the fair value option to “all” financial assets or financial liabilities that contain one or more embedded derivatives, it is desirable to strengthen the limitations.

Comments on *Actuarial Gains and Losses, Group Plans and Disclosures: Proposed Amendments to IAS 19 Employee Benefits*

The LIAJ submitted on 15 July 2004 written comments on “Actuarial Gains and Losses, Group Plans and Disclosures: Proposed Amendments to IAS 19 Employee Benefits” published on 29 April 2004 by the IASB. The outline of the comments is as follows.

- a) Current IAS 19 has certain support in practice and several countries employ similar perspectives. This proposal encompasses the risk of preventing the international efforts to converge accounting standards.
- b) We oppose to the proposal that entities recognise the actuarial gains and losses outside profit or loss and the effect of the limit on the amount of a surplus that can be recognised as an asset outside profit or loss, in statement of recognised income and expense.
- c) Recognition outside a profit or loss statement, recycling issue, and recognition within retained earnings are currently under discussion. It is thus not appropriate to stipulate amendments and handlings of such items at this stage as no conclusion has been drawn yet.

- d) The proposed requirements for disclosure and further disclosures are excessively burdensome to financial statement preparers and might result in the cost deficiency of operation.

Comments on *Combinations by Contract Alone or Involving Mutual Entities: Proposed Amendments to IFRS 3 Business Combinations*

The LIAJ submitted on 15 July 2004 written comments on the “Combinations by Contract Alone or Involving Mutual Entities: Proposed Amendments to IFRS 3 Business Combinations”, which was published by the IASB on 29 April 2004. The outline of the comments is as follows.

- a) We strongly oppose to the amendment.
- b) In the ED 3 Business Combinations, published in December, 2002, it was proposed to delay the application of IFRS 3 to business combinations involving two or more mutual entities until the IASB issued the guidance on the application of the purchase method. It is against the due process to make such a proposal in an attempt to apply IFRS 3 to business combinations, involving mutual entities, despite the guidance has not been fully developed in the subsequent discussions of the board.
- c) It would be currently impracticable and impermissible at practice level to measure fair value of insurance liability, even if it was required to apply the purchase method to such business combinations.
- d) With regard to the accounting procedure for business combinations between mutual companies, it should be considered first that thorough consideration whether the application of the purchase method to such a case would be appropriate or not. Thus, it is preferable that the former IAS 22 should continue to apply until achieving the conclusion.

Comments on *Financial Guarantee Contracts and Credit Insurance: Proposed Amendments to IAS 39 Financial Instruments: Recognition and Measurement and IFRS 4 Insurance Contracts*

The LIAJ submitted comments under the date of 8 October 2004 on “Financial Guarantee Contracts and Credit Insurance: Proposed Amendments to IAS 39 Financial Instruments: Recognition and Measurement and IFRS 4 Insurance Contracts” published by the IASB on 8 July 2004. The outline of the comments is as follows.

General Remarks

IASB requires entities to use the same accounting for similar financial instruments. While credit insurance is an insurance product which possesses insurance risk, a financial guarantee contract is simply a credit transaction, hence the nature of each differs widely. Therefore, it is not appropriate to comprehensively apply the same accounting to them within the scope of IAS 39.

IASB ensured that we would defer detailed reviews of general issues to discussion on Phase II and restrict the provisional change in the process of developing IFRS 4 in order to avoid causing unnecessary paperwork, change

of system, and accompanying expense for insurers. In fact, the discussion on Phase II has already started. Therefore, the accounting treatment for credit insurance should remain intact at this point and be the same as the one used for insurance contract.

Individual Issues

- a) The proposed scope is not appropriate.

We consider that there is a fundamental difference between credit insurance and financial guarantee contracts. While credit insurance is the insurance product with the function of diversifying risk, financial guarantee contract is a simple credit transaction. Specifically, the former rests on the premise that it protects the debtors as a group against risk, and the latter basically protects individual or particular debtors.

Credit insurers manage credit risk by using theory of probability or pooling individual risk within a portfolio. This risk diversification method is a characteristic of insurance business, which should be appropriately reflected in financial statements, is also one of the key issues to be discussed in Insurance Contract Phase II. Therefore, we should not determine how the credit insurance is treated in IFRS at this point.

- b) The proposal on subsequent measurement is not appropriate.

Credit insurance should be measured in the same way as other insurance contracts.

- c) The proposed effective date and transition are not appropriate.

In principle, any new proposals should not be applied retrospectively. Issues of credit insurance should be discussed in Insurance Contract Phase II.

Joint letters on *Guiding Principles: Phase II of IASB's Insurance Project*

The LIAJ jointly developed with insurance associations in the United States and Europe the "Guiding Principles: Phase II of IASB's Insurance Project," a set of guidance and principles that specify the nature of the insurance business and promote the development of sound accounting standards for the business. The outline of the joint letter, which was submitted on 11 October 2004, is as follows.

- a) The accounting standard should reflect the reality of the insurance business.
- b) The accounting standard should be consistent with or even contribute to "sound (internal) risk management and control" practices in insurers. Accordingly, they should provide a neutral, prudent, relevant and reliable framework for the generation of high quality accounting information.
- c) The accounting standard should facilitate market discipline by promoting transparent financial reporting of insurers' financial position and performance, as well as its risk management activities. In this context, accounting volatility should be avoided.
- d) The accounting standard should not only have a sound theoretical foundation, but also be workable in practice.
- e) The accounting standard should not be overly complex. Understandability and the ability to audit are essential.

- f) The accounting standard should generate consistent measurements of similar or related items.
- g) The accounting standard should be sufficiently precise to ensure consistent application.
- h) Disclosures should be sufficiently comprehensive and meaningful for an assessment of an insurer's financial position and performance, as well as risk management activities.

Comments on *ED 7 Financial Instruments: Disclosures*

The LIAJ submitted on 22 October 2004 written comments on "ED 7 Financial Instruments: Disclosures," which proposed improvement in disclosures of financial instruments in financial statements, published on 22 July 2004 by the IASB. The outline of the comments is as follows.

- a) Regarding the disclosure of the fair value of collateral and other credit enhancements, the LIAJ is opposed to the proposed requirement for disclosure of the fair value of collateral and other credit enhancements.
- b) The LIAJ is opposed to the proposed disclosure of a sensitivity analysis.
- c) Regarding the capital disclosures, the proposal is not applicable to a financial institution under supervision by regulatory authorities.
- d) The LIAJ is opposed to disclosing risks arising from financial instrument as a part of financial statements.
- e) Regarding the consequential amendments to IFRS 4, the LIAJ is opposed to amending risk disclosure requirements in IFRS 4.
- f) Regarding the Implementation Guidance, it is a concern that the part of the examples illustrated in the Implementation Guidance might cause misunderstanding for users, if disclosed, therefore it is not appropriate to do so.

Comments on *Amendments to IAS 39 and IFRS 4: Financial Guarantee Contracts and Credit Insurance*

The LIAJ and the German insurance association, GDV, jointly submitted on 2 November 2004 opinions on the exposure draft "Amendments to IAS 39 and IFRS 4: Financial Guarantee Contracts and Credit Insurance." The outline of the comments is as follows.

- a) It is important to understand that credit insurance contracts and financial guarantees are two different issues. Whereas financial guarantees are financial instruments, credit insurance contracts are insurance contracts meeting the definition of an insurance contract in IFRS 4. It is not consistent for credit insurance contracts to be within the scope of IAS 39.
- b) One cannot develop a single set of high quality and understandable accounting standards on the one hand, and, on the other hand, require contracts to be outside the scope of a standard although the standard covers all types of those contracts.

- c) IFRS 4 as the resulting Standard of Phase I introduces just limited changes and we welcome this approach. However, IASB intends to exclude credit insurance contracts from this approach. It is IASB's idea to introduce major changes to the accounting of credit insurance contracts. The consequence is that contracts with identical characteristics, i.e. credit insurance contracts and all other insurance contracts, are treated in different ways. From our perspective, an approach distinguishing between credit insurance contracts and all other contracts is arbitrary and useless. We will return to this point.

Comments on IASC Foundation's Consultation Paper, *Proposals for Change: Review of the Constitution*

The LIAJ submitted on 23 February 2005 comments on "Proposals for Change: Review of the Constitution," the consultation paper published on 23 November 2004 on IASC Foundation's review of the constitution. The outline of comments is as follows.

a) The Oversight Role of the Trustees

The constitution should clearly provide that the Trustees have the power to require the IASB to start again from the beginning if inappropriate deliberative process and due process are found in the standard-setting process on the IASB review of the compliance of such processes.

b) The Composition of the IASB

To secure the diversity in the background of the Board members, specific upper limits should be set for specific elements (e.g. the proportion of the people from a particular country should be limited to a certain percentage, 25% for instance).

c) The Appropriateness of the IASB's Existing Formal Liaison Relationships

As an effort to get international accounting standards accepted in the capital markets around the world, at least, those board members who are responsible for liaising with standard setters in the main capital markets of the world, e.g. Japan, U.S., Europe and Canada, should be stipulated.

d) Consultative Arrangements of the IASB

Non-mandatory procedures of the IASB, including public hearings and on-site verification, should be, in first place, mandatory procedures, in terms of ensuring both validity and efficacy in practice and transparency in deliberation processes. The Sunset Review should be conducted by parties other than direct participants to the project under review to improve the efficacy.

e) Voting Procedures of the IASB

As in the IASC deliberation process, any final standard should require the approval of no less than three quarters of the IASB Board members in order to be adopted.

f) Others

When developing standards, public interest and understandability and enforceability of accounting standards should have priority to the Conceptual Framework.

3. Comments on the draft on “Revision of Funding Rules of Policy Reserve Relating to Variable Annuities, Etc.” by the Cabinet Office

The Financial Services Agency issued a draft on “Revision of Funding Rules of Policy Reserve Relating to Variable Annuities, Etc.” for public comments on 10 August 2004. While policyholders are to assume investment risks for particular products including variable annuities, the minimum amount equivalent to the premiums paid is generally guaranteed upon the death of the insured or the inception of the annuity payment. For such reasons, the revision of Cabinet Office rules and notices related to these products was drafted to lay down the rules to allow proper funding of policy reserves taking into account the minimum guarantee risks of products owned. Following the publication of the draft, the LIAJ submitted the comments outlined below to the Financial Services Agency.

- a) It is required for the life insurance business to manage risks properly through such activities as funding of enough policy reserves that correspond to the level of risks, as the coverage is for a long time.
- b) In recent years, risks associated with underwriting, which are assumed by insurance companies, are expanding as companies have been developing and providing new types of products in response to the diversification of customer needs. It is very important to lay down proper rules about risk management for such products in an effort to secure the soundness of insurance companies and to develop customer confidence.
- c) Under such circumstances, rules have been introduced or are being considered in several countries, as insurers assume the minimum guarantee risk or, in other words, they are required to bear the shortfall in guaranteed minimum caused by a deterioration in investment environment.
- d) Thus, we believe that it is very meaningful for the life insurance business to keep developing an environment that contributes to the protection of policyholders and to stable profits by ensuring the sound operation of insurance companies.
- e) We request your continuous review on the operating environment of life insurance companies for sound development of the business.

4. Postal Privatization Related Activities

On 10 September 2004, the Council on Economic and Fiscal Policy finalized the “Basic Policy on the Privatization of the Japan Post,” and the policy was approved at the special cabinet meeting on the same day. Further, a promotion headquarters headed by the prime minister was set up to carry forward the postal privatization efforts, including the preparation of related bills and presentation thereof to the Diet.

On the same day, the Chairman of the LIAJ issued a statement on the Basic Policy, the outline of which is as follows.

Concerning the Basic Policy, we have the following five requests as it still contains several points of concern that may prevent a level playing field from being achieved.

- a) Upon privatization of Japan Post in 2007, not only should the governmental guarantees be abolished and the same tax obligations be imposed as private life insurance companies, but also the insurance business of the privatized company should be completely governed by the Insurance Business Law and placed under the oversight of the Financial Services Agency.
- b) The privatized company should be completely separated and independent from the government, not taking the form of a government-linked special corporation or a holding company.
- c) The profit/loss resulting from the accounts of Japan Post after the termination of its operation should not be mixed with that of the privatized company; instead, it should be allotted to existing policyholders. Further, the new company should maintain the client information accumulated by the pre-privatized governmental organization with considerable stringency and take preventive measures against the use of such information in soliciting new contracts.
- d) The governmental involvement in the postal insurance business including government funding, which is in substance a government guarantee, should be dissolved at an early stage.
- e) Until a level playing field is fully achieved and during the preparatory period up to the initiation of the privatization in 2007, the line of postal insurance products should not be expanded and the maximum amount of insurance benefits allowed for a policyholder should be lowered rather than being maintained.

In addition, the LIAJ together with eight other private-sector financial organizations placed on 28 February 2005 a joint advocacy ad in five major national newspapers, requesting an equal footing of the privatized postal company.

On 4 April 2005, the government decided the outline of six postal privatization related bills. On 27 April 2005, the six bills were approved at the fourth meeting of the promotion headquarters, decided at a special cabinet meeting on the same day, and submitted to the ordinary diet session for deliberation. The outline of the bills is as follows.

a) Location of Post Offices (Consideration for Resident Accessibility)

- (1) The placement of Post Offices to universally render services for the people will be legally obliged. (Specific criteria will be provided in a ministerial ordinance.)
- (2) The current level of the post office network will be retained for under-populated areas.

b) Consideration for Unified Operations

- (1) Form of organizations
 - (a) The postal savings company and the postal life insurance company will be operated as general companies under the commercial laws, not as government-linked special corporations. Their shares will be disposed of in phases.
 - (b) In essence, all of their shares will be disposed of before the privatization is completed.

(2) Cross-shareholdings

- (a) After the transitional period for the privatization, postal units will be allowed to cross-hold their shares based on their business judgments as other private financial institutions, taking their characteristics as government-linked special corporations into account.
- (b) During the transitional period, unified operation of the postal units will be secured by legally obliging agency contracts between the over-the-counter services network unit and other units and by the holding shares of the postal savings company and postal insurance company by the holding company.

(3) Universal postal savings and postal insurance services

- (a) When deemed licenses are issued to the postal savings bank and postal insurance company, these companies will be obliged to maintain solid agency agreements until they become independent.
- (b) The over-the-counter services network unit and the postal services unit will develop a “regional contribution business plan” and “social contribution business plan.” It will be legally obliged that the network unit respect the opinions of local intellectuals in the process. Part of the gain on sales of shares of the postal savings company and the postal insurance company and dividend income will be appropriated to a “regional social contribution fund” created within the holding company.

c) Degree of Operational Freedom during the Transitional Period

In the beginning of the transitional period, the extent is the same as the public corporation. It will increase in phases until the companies can finally operate as private-sector companies.

d) Response to System Risk

Systems will be prepared for the new operational structure by April 2007. In preparation for potential system risk, a risk correspondence scheme will be set up, whose introduction can be put off by up to six months (up to October 2007) as necessary.

e) Official Certificate

For special mail-delivery services of the current Japan Post, including the delivery of content-certified mails, new official certificates will be required after the privatization in order to ensure the confidence of customers.

f) Defense Measures against Hostile Takeover

Defense measures will be taken against hostile takeover by utilizing the stipulations in the common business laws (i.e. the privatized companies will issue class shares with the provision of forcible conversion of such shares into shares without voting rights).

g) Taxation

Necessary measures will be taken to ensure a smooth transition to the new entities.

5. Regulatory Reform Related Activities

During the 2004 business year, two administrative bodies were set up to promote regulatory reform in Japan. One is the Council for the promotion of regulatory reform and opening to the public-private partnership (the Council) and the other is the Office for the promotion of regulatory reform and opening to the public-private partnership (the Office). The Council was established under the Cabinet Office on 1 April 2004 at the request of the prime minister, and consists of 13 experts from the private sector and the Office was established under the Cabinet on 25 May 2004. The promotion of regulatory reform and opening to the public-private partnership by the government has thus been commended to the two organizations.

Representing the life insurance industry, the LIAJ has submitted requests for the regulatory reform to the Council and to Japan Business Federation.

Our main requests for the 2004 business year are as follows.

- a) The ban on fiduciary services and related clerical services commissioned by insurance companies to be lifted.
- b) The ban on the conclusion of contracts by life insurance companies to upkeep the deposit upon issuance of advance payment type certificates to be lifted.
- c) The ban on financial advisory services by subsidiaries of insurance companies for real estate investment to be lifted.
- d) The Income Dependency Regulation regarding subordinate business carried out by subsidiaries of insurance companies to be relaxed.
- e) Special accounts to be secured upon bankruptcy of insurance companies.
- f) Rules for policyholder protection related to the operations of mutual aid association (Kyosai) to be established.

- Item b), "The ban on the conclusion of contracts by life insurance companies to upkeep the deposit upon issuance of advanced payment type certificates to be lifted," was approved on 10 September 2004 for reflection in the Three-Year Program for Promoting Regulatory Reform and Privatization, and the implementation was ensured.
- Japan Business Federation published on 16 November 2004 its requests on the regulatory reform for the 2004 business year. The requests include five of the six items above (except Item b), which had been enacted by then).
- The Three-Year Program for Promoting Regulatory Reform and Privatization was decided on 25 March 2005 at a cabinet meeting. Four of the six requests above (except Item b) and item e), which had been enacted by then) have been included in the Program.
- The requested item d), "The Income Dependency Regulation regarding subordinate business carried out by subsidiaries of insurance companies to be relaxed," and item e), "Special accounts to be secured upon bankruptcy of insurance companies," have been reflected in the revised Insurance Business Law published on 22 April 2005.

6. Tax Reform Related Activities

As Japan transforms into a rapidly aging society, the combined use of the public social security system and private coverage such as life insurance and individual annuity by people's voluntary self-help efforts has been indispensable in order to realize a vibrant welfare society for the aging population.

To promote a favourable tax system for life insurance and individual annuities, which can efficiently cover various types of insurance needs including "the bereaved," "medical," "nursing care," and "retirement" coverage through the mechanism of mutual aid, and to encourage such efforts of the people, the LIAJ submitted on 17 September 2004 to the related parties a paper containing the following requests concerning tax law changes for the 2004 business year. The substantial issues addressed are:

- Increase in the tax-deductible limit for life insurance premium payments to ¥100,000 for individual income tax;
- Increase in the tax-deductible limit for individual annuity premium payments to ¥100,000 for individual income tax; and
- Addition of the sum of (¥5,000,000 of death benefit received by the spouse) plus (¥5,000,000 of the death benefit received by a dependent legal heir underage) x (the number of such dependent heirs) to the existing exemption limit for inheritance tax applicable to sums payable at death under insurance contracts.

Moreover, as an effort to realize those requests, the LIAJ, in collaboration with the National Federation of Life Insurance Workers' Unions of Japan, carried out a one-month questionnaire survey on the internet from 26 July through 27 August 2004.

The tax-deductible limit for premiums was left unchanged for the 2005 business year.