

< Appendix 2 >

The LIAJ's Comments on the IASB Exposure Draft
Financial Instruments: *Classification and Measurement* (General opinions)

1 General opinions on the exposure draft

1. The Life Insurance Association of Japan (LIAJ) is a trade association comprised of all 46 life insurance companies currently operating in Japan, with combined assets exceeding \$2 trillion at the end of fiscal 2008. Its aim is to promote the sound development of the life insurance industry and maintain its reliability in Japan.
2. We sincerely appreciate the efforts of the International Accounting Standards Board (IASB) to meet the request from G20 leaders that 'accounting standard setters should take action by the end of 2009 to improve and simplify the requirements for financial instruments' by publishing the exposure draft, *Financial Instruments: Classification and Measurement*. We also thank the IASB for providing us with an opportunity to submit our comments on the exposure draft.
3. Although our understanding is that the exposure draft has been developed considering the input received from many interested parties, we believe, from the standpoint of life insurance companies, the requirements proposed in this draft should be discussed further and improved. We are concerned that if the proposed requirements for the classification and measurement of financial assets and financial liabilities are applied, the financial statements of life insurers would become less understandable to users including policyholders and investors.

1.1 Proposals for improvement to appropriately represent the nature of life insurance business

4. The nature of life insurance business is to underwrite risks over a long period and therefore life insurers are required to firmly fulfil obligations to policyholders, instead of gaining profits through changes in fair value of financial assets and liabilities. We think life insurers need to appropriately represent the nature of their business to users of the financial statements, and we are concerned that presenting in profit or loss "unrealised gains and losses", e.g. changes in fair value of equity instruments held for a long period, will cause misunderstanding among users. Therefore, even if the financial assets and liabilities are presented at fair value in the statement of financial position, we believe that changes in fair value should be appropriately presented in profit or loss when realised.
5. As stated in our comment letter to the IASB dated 17 July, we believe that our proposed improvements would enable the accounting for financial instruments to appropriately represent the nature of life insurance business, while retaining the concepts of the draft to improve and simplify accounting requirements, in other words, retaining the current simplified proposals to measure financial assets or financial liabilities at amortised cost or fair value:
 - To allow presentation of subsequent fair value changes in other comprehensive income (OCI) not only for equity instruments that are not held for trading but also for such financial instruments as debt instruments
 - To recognise in profit or loss the fair value changes that have been presented in OCI, on derecognition of the instruments
 - To present in profit or loss all the realised gains and losses on investments including dividends from stocks, interest income and gains or losses from settlements of debt instruments, such as loans and bonds (even when subsequent changes in fair value are presented in OCI)

6. Our detailed comments to the exposure draft, including the key proposals mentioned above, are stated below along with the questions in the draft. (The LIAJ's responses to the questions set out in the exposure draft are omitted.)

1.2 The relationship between the proposed amendments and the measurement of insurance liabilities

7. It is important to consider the relationship between the proposed amendments to IAS 39 and the measurement of insurance liabilities which account for most of a life insurer's liabilities. In the IASB's project on insurance contracts, it has been tentatively decided that insurance liabilities should be remeasured at every reporting period. If this is actually applied to insurance liabilities without incorporating our proposed improvements to the IASB's exposure draft, it might lead to accounting mismatches between the insurance liabilities and the loans and bonds to which amortised cost measurement is applied in the statement of financial position. As a result, insurance companies will virtually be forced to use the fair value option and to recognise changes in fair value of bonds and loans in profit or loss (and OCI) in order to avoid accounting mismatches in the statement of financial position; on the other hand other financial institutions will be permitted to recognise gains and losses in profit or loss on the basis of amortised cost.

We think that requiring only the insurance industry to recognise almost all changes in fair value of its assets and liabilities in profit or loss might result in different types of "profit or loss" depending on industries, and thus, the comparability of said performance measure across industries, which is of greatest importance to users for assessing the performance of an entity, would be clearly undermined. For example, at the Insurance Working Group meeting in June 2009, the majority of users emphasised the need for comparability across industries. In addition, the US Financial Accounting Standards Board decided to retain the requirement to disclose the "EPS (earnings per share)" only in "net income."

8. The main point of our comments is, as we have stated repeatedly in relation to the insurance contract project, that allowing the presentation of changes in the insurance liabilities in OCI would be needed besides incorporating our proposed improvements in order to appropriately represent the nature of life insurance business, that is, "to underwrite risks over a long period and to firmly fulfil obligations to policyholders." We believe that distinguishing comprehensive income clearly from the "profit or loss", which represents the performance of an entity excluding unrealised gains and losses, and then disclosing the two different measures would provide users with useful information.

1.3 Asset management of the life insurance industry in Japan

9. Without incorporating our proposed improvements to the IASB's exposure draft, requirements on the classification and measurement of financial instruments would be significantly changed. We are concerned that this change might have a great impact on the asset management strategies of life insurance industry in Japan.
10. According to the exposure draft, for instance, all changes in the fair value of equity instruments shall be recognised in profit or loss, or in OCI together with dividends from investments in those instruments (if not held for trading). Many Japanese life insurers usually invest in equity instruments in order to gain returns earmarked for insurance liabilities arising from underwriting risks over a long period (Table 1). Table 2 shows that the dividends as fruits from the investments account for a large part of the interest and dividend revenue, and life insurers in Japan play an important role and have a great impact on the Japanese equity market (Table 3). Therefore, we are concerned that not to present dividends from one of the main investment choices of Japanese life insurers in profit or loss would significantly change the nature of profit or loss as a measure of life insurers' business performance. We strongly urge the IASB to accept the recognition of dividends in profit or loss.
11. In addition, under the current IAS 21 *The Effects of Changes in Foreign Exchange Rates* and IAS 39 *Financial Instruments: Recognition and Measurement*, changes in the value of a non-monetary available-for-sale financial asset (such as an equity instrument) are recognised in OCI including foreign exchange gains and losses. As for a monetary available-for-sale financial asset (such as a debt instrument), changes in fair value on a foreign-currency basis are recognised in OCI, and fair-value changes attributable to changes in foreign exchange rate are recognised in profit or loss. Under this exposure draft, even in the case the monetary financial assets are measured at amortised cost, changes attributable to changes in foreign exchange rate are to be recognised in profit or loss. We think it is preferable that all the subsequent changes in the fair value of those financial instruments, as well as equity instruments that are not held for trading, are presented in OCI, since a number of Japanese life insurers invest in foreign bonds as shown in Table 1.

Table 1: Asset Breakdown of Life Insurers in Japan (As of 31 March 2009)¹

	Amount (¥ 100 million)	Ratio	Amount (\$ 1 million) ²
Cash, Deposits and Savings, Call-Loans	50,680	2.5%	51,593
Monetary Claims Purchased	33,616	1.6%	34,222
Monetary Trusts	21,796	1.1%	22,189
Securities	1,468,820	71.6%	1,495,287
(Of which: Domestic Stocks)	(156,318)	(7.6%)	159,135
(Of which: Foreign Bonds [*])	(298,003)	(14.5%)	303,372
(Of which: Foreign Stocks)	(93,523)	(4.6%)	95,208
Loans	327,762	16.0%	333,668
Tangible Fixed Assets	66,021	3.2%	67,210
Other Assets	82,722	4.0%	84,213
Total	2,051,420	100.0%	2,088,385

Foreign Bonds include currency-hedged bonds e.g. by forward exchange contracts. The hedging level will vary depending on investment conditions including the level of hedge cost.

Table 2: Interest and Dividend Revenue Breakdown of Life Insurers in Japan (Fiscal 2009)³

	Amount (¥ 100 million)	Ratio	Amount (\$ 1 million)
Interest on Deposits	183	0.4%	187
Interest and Dividends on Securities	33,457	73.1%	34,060
(Of which: Public Bond Interest)	(13,295)	(29.0%)	13,534
(Of which: Dividend)	(3,779)	(8.3%)	3,847
(Of which: Foreign Securities Interest Dividend)	(15,795)	(34.5%)	16,080
Interest on Loans	7,416	16.2%	7,550
Rental Income of Real Estate	3,773	8.2%	3,841
Other Interest and Dividends	941	2.1%	958
Total	45,774	100.0%	46,598

¹ Source: *Summary of Life Insurance Business*, The Life Insurance Association of Japan. Total figures of 44 Japanese life insurers, excluding Yamato Life Insurance Co. and Japan Post Insurance Co., Ltd.

² Converted by using the rate (\$/¥ 98.23) of 31 March 2009; the same applies to Table 2 and Table 3.

³ Source: *Summary of Life Insurance Business*, The Life Insurance Association of Japan. Total figures of 44 Japanese life insurers, excluding Yamato Life Insurance Co. and Japan Post Insurance Co., Ltd.

Table 3: Stockholdings by Sectors in Japan* (As of 31 March 2009)⁴

	Total of all Sectors			
		Of which: Financial Institutions		
			Of which: Domestically Licenced Banks	Of which: Life Insurance Companies
Balance of Stockholdings (¥ Trillion)	264.94	62.88	12.93	12.93
(Ratio to the Total of all Sectors)	100.0%	23.7%	4.9%	4.9%
(Ratio to the Total of Financial Institutions)	-	100.0%	20.6%	20.6%
Balance of Stockholdings (\$ Billion)	2,697	640	131	131

* This table only shows the balance of listed stocks. The balance is not equal to that of the line item "Domestic Stocks" in Table 1, since the latter includes unlisted stocks.

12. We believe that various asset management strategies should be allowed in order to cover underwriting risks over a long period. We know that the strategies of life insurance companies vary depending on the country/jurisdiction in which they operate, and that a number of insurers in Europe and the United States share the views expressed in these comments. For example, the Group of North American Insurance Enterprises (GNAIE) submitted its comments on 15 June requesting that the available-for-sale category be retained, and the Fédération Française des Sociétés d'Assurances also submitted similar comments on 1 July. Furthermore, we have learned that in addition to French insurers, many insurance companies in Europe have similar opinions. We are concerned that if our proposed improvements are not accepted, the management strategies of life insurance companies not only in Japan but also in other countries/jurisdictions may be changed and lead to unforeseeable market turmoil.

⁴ Source: *Flow of Funds Accounts*, Bank of Japan.