The LIAJ's Comments on the ED

Insurance Contracts

25 October 2013

The Life Insurance Association of Japan (LIAJ)

Contents

1. We, The Life Insurance Association of Japan (LIAJ), would like to extend our gratitude to the International Accounting Standards Board (IASB) for providing us with an opportunity to submit our comments on the Exposure Draft, *Insurance Contracts*, published in June 2013 (hereinafter referred to as 'Revised ED', which provides revised proposals responding to comments received on the 2010 Exposure Draft, published in July 2010).

2. The LIAJ is a trade association comprised of all 43 life insurance companies operating in Japan. Our aim is to promote the sound development of the life insurance industry and maintain its reliability in Japan. We would like to respectfully request that the IASB carefully consider the comments submitted from the sole representative body of the life insurance industry in Japan, which holds the second largest life insurance market in the world accounting for around 20%[1] of all insurance premiums.

3. We welcome the decision of the IASB to re-expose Revised ED in response to the comments received on the 2010 Exposure Draft: *Insurance Contracts*, published in 2010. We also highly appreciate the IASB's efforts towards publishing Revised ED on insurance contracts, taking into account comments received from a number of interested parties including the LIAJ on the 2010 Exposure Draft.

1. General opinions on Revised ED

4. In our comments submitted to the IASB on 2010 Exposure Draft, we raised a serious concern that presenting changes in insurance liabilities assessed at a certain point of time in profit or loss would not reflect the nature of the life insurance business. As Revised ED retains an approach where any gain at inception is eliminated by recognising the CSM and includes several proposals such as recognising the changes arose from the changes in discount rates in other comprehensive income (OCI), and unlocking the CSM, we see the IASB's efforts to address the concerns raised. Besides, we understand that our concern about volume information in the statement of profit or loss and other comprehensive income is addressed to a certain extent in Revised ED. We would like to express our respect for the IASB's efforts to properly respond to the challenges in Revised ED.

5. On the other hand, when considering every proposal in Revised ED as one package and taking a comprehensive view of Revised ED as a whole standard, we recognise that, as a result of addressing each issue by an approach which segregates, measures, and presents components of insurance contracts in multiple layers and steps, this leads to the following issues:
   (a) Understandability of users and preparers of financial statements would be significantly impaired because the requirements in the standard are very complicated.
   (b) The statement of financial position would not faithfully represent the economic reality of insurers providing life insurance products, in particular, with long term coverage.

[1] Swiss Re sigma study on world insurance 2012.

6. We have attempted to summarise the aforementioned issues in the points below. We propose solutions to reduce complexity of requirements in Revised ED, and faithfully represent life insurers' financial position, in response to each question. We are deeply concerned that when the proposals in Revised ED are finalised without any amendments, it would be less practicable for preparers and less understandable for users of financial statements. Therefore, we would like to respectfully request that the Board give due consideration to proposals submitted from constituents including ours, and to make further improvements.

   (a) *Appropriateness of scope of unlocking the CSM*
   We agree with the proposal that requires an entity to recognise changes in estimates of future cash flows by adjusting the CSM in the subsequent measurement and not to recognise those changes as profit or loss for the period. However, we do not agree with the proposal in paragraph B68 of Revised ED that states 'the CSM is not adjusted for changes in estimates of cash flows that depend on investment returns'. We believe that the CSM should be fully unlocked for all the changes in fulfilment cash flows that affect the future unearned profit, not only for some changes in fulfilment cash flows. (See our comments on Question 1)

   (b) *Complexity in the measurement by decomposing specific cash flows*
   The proposal in paragraph 34 of Revised ED requires an entity to decompose fulfilment cash flows by their nature and measure each of them although these fulfilment cash flows are not required to be separated in accordance with the unbundling requirement (stated in paragraph 10(a) of Revised ED). Furthermore, in accordance with paragraph 60(h), an entity seems to be required to decompose the cash flows (paragraph BC129 and BC130). If an entity is required to measure insurance liabilities by decomposing fulfilment cash flows, this might bring about complexity in measurement, and therefore we do not agree with it. (See our comments on Question 2 and 4).

   (c) *Understandability of the statement of profit or loss and other comprehensive income*
   We agree with the proposal that requires an entity to present volume information in the statement of profit or loss and other comprehensive income, which was a challenge to be resolved in summarised margin presentation. However, we do not agree with the proposal regarding insurance contract revenue because it requires complicated calculations based on estimates, and results in less understandable presentation for stakeholders including policyholders. On the other hand, the premiums received are generally recognised as one of the key performance indicators for many stakeholders. In addition, as the senior managements of insurers pay much attention to the amount of premiums received, we believe that the amount of premiums received is critical information in performance presentation. Furthermore, we do not agree with the proposal that requires an entity to exclude from insurance contract revenue and incurred claims any investment components that are not required to be unbundled in the measurement of insurance liabilities because these investment components affect the measurement of risk adjustments and CSM (See our comments on Question 3).

(d) *Impracticability, comparability and verifiability of the transition*

When the proposals in Revised ED are finalised as an IFRS, accounting practices for insurance contracts would be significantly changed in many jurisdictions. In order to avoid confusion due to the implementation of a new accounting standard for insurance contracts, careful consideration needs to be given to transition, ensuring the understandability for users, as well as practicability for preparers. In particular, as whole life insurance is one of the major life insurance products in Japan, Japanese insurers would be required to measure insurance liabilities retrospectively over a long-term period. It is anticipated that the comparability would be significantly impaired when less objective and, hence, less consistent data is used in measurements among insurers. Accordingly, in the transition proposals in Revised ED, such an additional approach should be allowed, where insurers determine the amount of CSM by using the present value of future cash in-flows and out-flows at the date of transition for insurance contracts in force at the date of transition (See our comments on Question 5).

(e) *Faithful presentation of life insurers' financial position*

We are deeply concerned about failing to faithfully represent life insurers' economic reality in their statement of financial position, as the changes in both interest rates and assumed frequency of the insured events are inappropriately separated and presented in OCI and CSM respectively because both of these assumptions have an impact on profitability of life insurers. This problem would materialize substantially when life insurers, which sell the products with long-term coverage, apply proposed standards over a long period prospectively or retrospectively. In order to resolve this problem, the dividing line between OCI and the CSM should be reconsidered, or OCI and the CSM should be integrated. (See our comments on Question 6).

7. Furthermore, we recognise some material differences between Revised ED and the Proposed Accounting Standards Update: Insurance Contracts (Topic 834) of the Financial Accounting Standards Board (FASB), published separately for comments. We believe that, in light of comparability of information provided for users of financial statements and the cost on preparers, it is critical for the both Boards to achieve sufficient convergence between these accounting standards for insurance contracts. Accordingly, we would like to request that the IASB should continue deliberations with the FASB and make effort to achieve further convergence.

2. Comments on Questions in Revised ED

Question 1—Adjusting the contractual service margin
Do you agree that financial statements would provide relevant information that faithfully represents the entity's financial position and performance if differences between the current and previous estimates of the present value of future cash flows if: (a) differences between the current and previous estimates of the present value of future cash flows related to future coverage and other future services are added to, or deducted from, the

contractual service margin, subject to the condition that the contractual service margin should not be negative; and

(b) differences between the current and previous estimates of the present value of future cash flows that do not relate to future coverage and other future services are recognised immediately in profit or loss?

Why or why not? If not, what would you recommend and why?

8. We agree with the proposed principle that differences between the current and previous estimates of the present value of future cash flows related to future coverage and other future services are recognised in profit or loss over the remaining coverage period through the contractual service margin ("CSM"), rather than recognising them immediately in profit or loss.

9. However, we are concerned that the requirements of subsequent measurement of the CSM at the end of the reporting period in paragraph 30 of Revised ED may excessively reduce flexibility of practices in calculation. We are of the view that accounting standards should be principle based. We understand that even if the requirements in paragraph 30 are set out in the final standard, it is just an example of how to achieve the principle of Revised ED, and thus, other calculation to satisfy the principle should be permitted.

10. In addition, as the future cash flows in insurance business need to be measured over an ultra-long period such as several decades, retaining related data for such a long period would impose significant burden on insurers. Therefore, as an approach suitable for the nature of insurance business, a prospective remeasurement of the CSM, like measurements at initial recognition should also be allowed. In this approach, the entity prospectively remeasures the CSM at the end of the reporting period and recognises in profit or loss the change in the amount of the CSM during the period. Among these changes, the portion related to estimates of future profit would be offset by adjusting the CSM, and recognised in profit or loss over the remaining coverage period. In the remeasurement of the CSM, we believe that calculating the difference between the amount of insurance liabilities based on the fixed assumptions which enables no gain at inception, and the amount of those based on the current assumptions, would be one of the alternative approaches. We believe this calculation is also an effective approach from the cost-benefit perspective.

11. We also believe that the CSM should be considered as unearned profit and consistently measured at initial recognition and in all subsequent reporting periods. In order to do this, the CSM should be fully unlocked for changes in the fulfilment cash flows that affect the unearned profit. Thus, we do not agree with the proposal to restrict an entity to unlock the CSM only for changes in some fulfilment cash flows. For example, paragraph B68 of Revised ED states that the CSM is not adjusted for changes in estimates of the future cash flows that depend on investment returns because such changes do not relate to future coverage and services provided under the contract. However, the changes in estimates of cash flows arising from the changes in the value of the underlying items would affect the level of future services provided to

policyholders through the payments of benefits. Therefore, these changes in estimates of the future cash flows should be reflected in unearned profit by adjusting the CSM. We are strongly concerned that requiring an entity to unlock the CSM only for partial changes in cash flows would result in failing to faithfully represent financial position in insurance liabilities.

12. We are of the view that capturing the effect of changes in discount rates and changes in cash flows together would be an effective solution for the purpose of achieving faithful representation of life insurers' financial positions. Please refer to our comments on Question 6, which provide proposals on alternative approach.

Question 2—Contracts that require the entity to hold underlying items and specify a link to returns on those underlying items
If a contract requires an entity to hold underlying items and specifies a link between the payments to the policyholder and the returns on those underlying items, do you agree that financial statements would provide relevant information that faithfully represents the entity's financial position and performance if the entity: (a) measures the fulfilment cash flows that are expected to vary directly with returns on underlying items by reference to the carrying amount of the underlying items? (b) measures the fulfilment cash flows that are not expected to vary directly with returns on underlying items, for example, fixed payments specified by the contract, options embedded in the insurance contract that are not separated and guarantees of minimum payments that are embedded in the contract and that are not separated, in accordance with the other requirements of the [draft] Standard (ie using the expected value of the full range of possible outcomes to measure insurance contracts and taking into account risk and the time value of money)? (c) recognises changes in the fulfilment cash flows as follows: (i) changes in the fulfilment cash flows that are expected to vary directly with returns on the underlying items would be recognised in profit or loss or other comprehensive income on the same basis as the recognition of changes in the value of those underlying items; (ii) changes in the fulfilment cash flows that are expected to vary indirectly with the returns on the underlying items would be recognised in profit or loss; and (iii) changes in the fulfilment cash flows that are not expected to vary with the returns on the underlying items, including those that are expected to vary with other factors (for example, with mortality rates) and those that are fixed (for example, fixed death benefits), would be recognised in profit or loss and in other comprehensive income in accordance with the general requirements of the [draft] Standard? Why or why not? If not, what would you recommend and why?

13. We understand that measuring insurance contracts by reference to the carrying amount of the underlying items would appropriately represent the economic nature of those contracts, where

no economic mismatch arises between fulfilment cash flows and the underlying assets.

14. However, we understand that paragraphs 34 of Revised ED requires an entity to decompose the cash flows into fulfilment cash flows that are expected to vary directly with returns on the underlying items and the other cash flows (such as embedded derivatives and fixed cash flows), whereas these cash flows were not required to be separated in accordance with paragraph 10. This would result in adding excessive complexity to the standard. In particular, we are skeptical about the rationality of the requirement to decompose the cash flows related to embedded derivatives that was not separated from insurance contracts.

15. Besides, future unearned profit from insurance contracts could be significantly affected by the changes in fulfilment cash flows arising from changes in estimates as well as changes in fulfilment cash flows due to fluctuation of interest rates. Therefore, as we stated in the comments on Question 1, further improvements would be needed in order to appropriately reflect the economic reality of those changes by measuring them consistently and in an integrated manner.

Question 3—Presentation of insurance contract revenue and expenses
Do you agree that financial statements would provide relevant information that faithfully represents the entity's financial performance if, for all insurance contracts, an entity presents, in profit or loss, insurance contract revenue and expenses, rather than information about the changes in the components of the insurance contracts? Why or why not? If not, what would you recommend and why?

<Presentation of premium>

16. We agree with the proposal in Revised ED which requires an entity to present volume information in the statement of profit or loss and other comprehensive income, instead of summarised margin presentation in the 2010 Exposure Draft. The summarised margin presentation would be difficult for managements of insurers, as well as stakeholders, to understand because such presentation is not based on the objective information about cash flows arising from insurance business. Therefore, we strongly recommend the IASB not to revert back to summarised margin presentation.

17. However, with regard to the volume information to be presented, we do not agree with the approach proposed in Revised ED. We think that there are the following problems in measuring insurance contract revenue as the sum of the estimates of the expected claims and expenses, the changes in the risk adjustment, and the release of the CSM in the period:

    (a) The insurer's obligations and services are to provide policyholders with protection over the life of insurance contracts, and as the claims payment is only a part of these obligations, it is not appropriate to define the fulfilment of insurer's obligations and services as claims

payment only.

(b) As the insurance contract revenue increases in conjunction with the increases of expected claims and expenses, it might induce insurer's management to inappropriately overestimate expected claims and expenses when they would like to increase the top line.

(c) The insurance contract revenue is presented as an artificially calculated revenue item that is summed up the amount of summarised margin and expected claims payment, etc. Given that insurers have various types of stakeholders including individual policyholders, we do not believe that such insurance contract revenue provides those stakeholders with enough useful information to justify their efforts to try to fully understand it.

18. We believe that the premiums received should be presented on the top of the statement of profit or loss and other comprehensive income rather than the insurance contract revenue proposed in Revised ED. This is because presenting the premiums received in the top line is generally accepted among many stakeholders including policyholders, and the senior managements of insurers pay much attention to the amount of premiums received.

19. According to paragraph 79 of Revised ED, for example, an entity is required to disclose a reconciliation from premiums received in the period to the insurance contract revenue recognised in the period. We think that requiring an entity to include such a reconciliation in the statement of profit or loss and other comprehensive income could contribute to the improvement on presentation to a certain extent. It is important that the statement of profit or loss and other comprehensive income describes insurance business profile directly and objectively, and it should aim to provide users and individual policyholders with more accessible information.

<Exclusion of investment components>

20. We do not agree with the proposal that requires an entity to exclude any investment components from insurance contract revenue and incurred claims. We are also concerned that assuming that surrender value of insurance contracts is defined uniformly as an investment component, the financial statements may not faithfully represent the economic reality of insurers, and thus, could be misleading for users of the financial statements. In measuring an insurance contract, as an investment component that is not unbundled from the host insurance contract would affect the measurements of risk adjustment and CSM, exclusion of the investment components in the presentation of financial statements might impose excessive burden on preparers while failing to provide useful information for users. We believe that the measurement unit for insurance contracts should be consistent with presentation.

Question 4—Interest expense in profit or loss
Do you agree that financial statements would provide relevant information that faithfully represents the entity's financial performance if an entity is required to segregate the effects of the underwriting performance from the effects of the changes in the discount rates by:

(a) recognising, in profit or loss, the interest expense determined using the discount rates that applied at the date that the contract was initially recognised. For cash flows that are expected to vary directly with returns on underlying items, the entity shall update those discount rates when the entity expects any changes in those returns to affect the amount of those cash flows; and

(b) recognising, in other comprehensive income, the difference between:

(i) the carrying amount of the insurance contract measured using the discount rates that applied at the reporting date; and

(ii) the carrying amount of the insurance contract measured using the discount rates that applied at the date that the contract was initially recognised. For cash flows that are expected to vary directly with returns on underlying items, the entity shall update those discount rates when the entity expects any changes in those returns to affect the amount of those cash flows?

Why or why not? If not, what would you recommend and why?

21. We agree with the proposal that requires an entity to recognise changes in insurance liabilities arising from changes in discount rates in OCI, because it could be an effective solution to avoid recognising in profit or loss the changes caused by fluctuation of interest rates.

22. In determining and presenting interest expense on insurance contract liabilities, our understanding is that an entity is required to decompose cash flows in order to meet the requirement in paragraph 60(h) of Revised ED (in accordance with the requirements in paragraphs BC129 and BC130 of Revised ED). If it means that an entity is required to apply separate discount rates to each cash flow, we do not agree with such a requirement because there is a strong concern that this would result in additional practical burden on preparers and less understandability of users.

23. Besides, we are of the view that presenting the changes in discount rates due to the fluctuation of interest rates and changes in interest-sensitive cash flows in a consistent manner would be an effective solution for the purpose of achieving faithful representation of life insurers' financial positions. Please refer to our comments on Question 6, which provide our proposals about alternative approaches.

Question 5—Effective date and transition

Do you agree that the proposed approach to transition appropriately balances comparability with verifiability?

Why or why not? If not, what do you suggest and why?

<Transition>

24. We believe that proposed transition requirements need further improvement. It is impractical for

life insurers in Japan to fully apply retrospective approach to all insurance contracts that exist at the date of transition because of the ultra-long term nature of our life insurance contracts, and even if the modified retrospective approach were applied to those contracts, Japanese life insurers would not be able to ensure the comparability and the verifiability.

<Impracticability in applying full retrospective approach>

25. The proposal in the 2010 Exposure Draft required an entity to recongnise no CSM for the contracts in force at the beginning of the earliest period presented. We appreciate that this requirement has been modified in Revised ED. However, most life insurers in Japan would not be able to reliably measure the expected cash flows and the risk adjustment at the date of initial recognition, because the duration of insurance contracts they hold is very long and the number of contract in force is huge. Thus, we believe that it is not practical to apply the proposal in Revised ED, which requires an entity to apply retrospective calculation in accordance with IAS 8.

<Challenges in applying modified retrospective approach>

26. We appreciate that the IASB proposes practical expedient (modified retrospective approach) in paragraphs C5 and C6 of Revised ED, taking into account the impracticality of a fully retrospective approach. However, as an entity has to measure insurance contracts by using a number of estimates when it applies the modified retrospective approach, the measurement error[2] arising from the choice of those estimation methods would be a problem in terms of comparability and verifiability. In particular, life insurers in Japan sell a wide range of products with ultra-long coverage period, and in the application of the modified retrospective approach, we are concerned that the aforementioned problem would be amplified, and impair comparability and verifiability.

<Impracticality>

27. In order to correctly measure the CSM of an insurance contract portfolio at initial recognition and calculate the subsequent amortised amount, an entity has to identify the effects of future cash flows of all insurance contracts at initial recognition, including the historical cash flows arsing from terminated contracts, on the amortised amount of the CSM. Accordingly, the entity needs to identify the historical cash flows of both the contracts in force and terminated contracts at insurance portfolio level in order to calculate the insurance contracts retrospectively.

28. Life insurers in Japan typically sell life insurance products with an ultra-long coverage and also various types of products, which means that they hold a huge number of insurance cohorts. In order to retrospectively measure the insurance contracts, they have to identify the historical cash flows including those arose from terminated contracts in a huge number of insurance cohorts. However, life insurers in Japan have not recognised the need to identify such data for their management purpose and thus, do not hold such data.

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[2] We are making an inference on the measurement error in light of comparing the theoretical results of full retrospective approach with that of modified retrospective approach.

<Features of interest rates in Japanese bond market and challenges arising from them>

29. It should be noted that the Japanese bond market lacks historical data related to bonds with ultra-long duration. As for the thirty-year government bond, for example, data exists only after 1999 on a continuing basis. With regard to the modified retrospective approach, Revised ED proposes that, in cases where sufficient data is not available in the market, the entity shall determine an average spread using average interest rates over at least three years, and apply the spread in estimating the yield curve that applied at the date of initial recognition. The proposed approach would provide some accuracy in the retrospective measurement for the relatively short term. On the other hand, at transition, Japanese life insurers hold a lot of contracts in force for which a very long time has passed since the initial recognition, and the structure of interest rates has changed significantly over the period. Therefore, we are concerned that the entity would not able to reliably estimate interest rate structure at the date of initial recognition, even if the entity applies the proposed approach. Furthermore, as there would be potentially a huge measurement error due to long-term retrospective calculations, we are seriously concerned that it would not be acceptable in terms of global comparability.

30. In addition, as a result of retrospective measurements, changes in discount rates due to interest-rate movements will be presented in accumulated OCI, and the effects of changes in cash flows due to interest-rate movements will be separately presented through the accumulated adjustments of the CSM. With this in mind, we are concerned that the statement of financial position at the date of transition will not faithfully represent the economic realities of Japanese life insurers, and this will impair the global comparability.

31. Taking all these things into account, even if life insurers in Japan apply modified retrospective approach proposed in Revised ED in measuring their insurance contracts, it would be almost impossible to ensure the comparability and verifiability of their financial statements. That is, the statement of financial position prepared by applying the proposed approach does not necessarily faithfully represent the economic realities of life insurers in Japan, and is misleading for users of the financial statements. We conclude that the benefits of applying such an approach are not likely to outweigh the costs, taking into account the above issue as well as the significant costs imposed on preparers.

<Our proposals on alternative approach>

32. In order to address the aforementioned concerns, we believe that an entity should be allowed to recognise the net present value of future cash inflows and outflows at the date of transition as the CSM, where the entity can remeasure the future cash inflows and outflows of an insurance portfolio at the date of transition, instead of applying the modified retrospective approach.

33. The term 'contractual service margin' is defined as representing the future unearned profit in Revised ED. Therefore, we think that the present value of future cash inflows and outflows at the date of transition is conceptually consistent with the CSM.

34. A specific potential approach is to recognise the difference between the amount of insurance

liabilities at the date of transition calculated using assumptions locked in at the level not to recognise any gain at inception (the present value of future cash flows) and the amount of future cash flows remeasured at the date of transition as the CSM. For example, life insurers in Japan usually manage their insurance liabilities (premium reserved) calculated by using assumptions (such as future mortality rate) used for pricing the premium. In this case, the amount of insurance liabilities is the difference between the present value of future outflows and the present value of premium inflows based on the assumption used for pricing the premium, and, insurers do not recognise any gain at inception. The difference between the insurance liabilities calculated by using assumption used for pricing the premium and the fulfilment cash flows would be the same amount as the present value of future profits. This alternative approach could be regarded as the treatment that assumes an insurer is entering into portfolio transfer, where it will receive consideration in the form of the insurance liabilities.

35. Besides, on the grounds that "If it is impracticable for an entity to apply retrospectively the effective interest method, the fair value of the financial asset at the date of transition to IFRSs shall be the new amortised cost of that financial asset at the date of transition to IFRSs", stated in paragraph D19C of the IFRS 1: First-time Adoption of International Financial Reporting Standards, we believe that at least an entity that applies IFRSs for the first time should be allowed to use the interest rate at the date of transition as the interest rate at inception, if they found the problems noted above[3] in applying discount rate retrospectively.[4]

36. In this alternative approach, verifiability would be tremendously improved as any elements of estimation would be excluded at transition. Furthermore, it would enhance the comparability of the statement of financial position as it faithfully represents the economic realities of life insurers in Japan, contributing to increasing benefits for users. Besides, because the cost for preparers would be significantly reduced, considerable improvement would be achieved from a cost-benefit perspective.

<Effective date>

37. We believe that the Standard for insurance contracts and IFRS 9 should be implemented at the same time and a sufficient lead time should be provided.

38. Although the IASB proposes that the Standard would be effective approximately three years after it publishes the final standard, entities need to carry out necessary system development and large-scale administrative infrastructure changes as there are significant differences between the standards proposed in Revised ED and the current practices. Accordingly, we insist that approximately five years for the lead time would be needed.

39. As the accounting standards for financial instruments applied to a large part of life insurers' assets, amendments to IFRS 9 is currently under deliberation. As a result, together with the

[3] For example, concerns stated in paragraph 29 of our comments.

[4] Although our proposals stated in paragraph 34 and 35 are seeking to achieve the same effect, our objective is to understand the relationship between other proposals in Revised ED and requirements in other IFRSs in pantoscopic way.

amendment to the standard proposed in Revised ED, there is a concern that insurers would be required to make two large changes on asset side and liability side. Besides, accounting mismatches might arise in the measurement of financial assets and insurance liabilities due to the different implementation dates. Therefore, we believe that the effective date of IFRS 9 for entities that are likely to apply this Standard for insurance contracts should be set at the later effective date of either IFRS 9 or this Standard.

Question 6—The likely effects of a Standard for insurance contracts
Considering the proposed Standard as a whole, do you think that the costs of complying with the proposed requirements are justified by the benefits that the information will provide? How are those costs and benefits affected by the proposals in Questions 1–5? How do the costs and benefits compare with any alternative approach that you propose and with the proposals in the 2010 Exposure Draft? Please describe the likely effect of the proposed Standard as a whole on: (a) the transparency in the financial statements of the effects of insurance contracts and the comparability between financial statements of different entities that issue insurance contracts; and (b) the compliance costs for preparers and the costs for users of financial statements to understand the information produced, both on initial application and on an ongoing basis.

<Proposals on addressing problems of practical burdens due to complexity and of the faithful presentation of financial position>

40. In Revised ED, it is proposed that changes in the insurance contract liability should be measured and presented as follows:
    (a) presenting in OCI the changes in insurance contract liabilities based on the changes in discount rates due to interest-rate movements
    (b) adjusting the CSM for the effects of changes in future cash flows

    We observe improvements in Revised ED in that it would not present changes in insurance liabilities assessed at a certain point of time in profit or loss. However, considering every proposal in Revised ED as one package, the costs of complying with the proposed requirements are not justified by the benefits from the information obtained.

41. We believe that the IASB needs to further improve the proposed requirements, as there would be concerns that the statement of financial position may not faithfully represent the financial position of life insurers because of a conceptual issue in terms of insurance liabilities in addition to the practical burden as stated below.

<Significant practical burden >

42. We are of the view that separating the effect of changes in the future cash flows from the effect

of changes in the discount rates due to the fluctuation of interest rates, and then adjusting CSM for them is likely to bring about significant burden on preparers, as follows:

(a) *Difficulty in keeping historical data*
It would be necessary for entities to retain historical data, such as discount rates and expected future cash flows over the lifetime of contracts from initial recognition, in order to separate the effect of each change. The practical burden would be the worst in the measurements of cash flows related to, for example, guarantees and options embedded in an insurance contract where multiple discount rate scenarios are required to be set.

(b) *Difficulty in retrospective application*
With regard to the retrospective measurements of the CSM and the OCI at the date of transition, the difficulty for an entity to obtain information at contract inception, also bring about significant practical burden.

(c) *Accumulated measurement errors*
Revised ED (paragraph 30) proposes that an entity shall measure the remaining amount of the CSM at the end of the reporting period by adding to or deducting from the carrying amount at the start of the reporting period. According to this approach, measurement errors for each period would be structurally accumulated. There is a possibility that the accumulated errors are not eliminated even when the related portfolio vanishes because these errors are not necessarily corrected along with the termination of the insurance portfolio. This implies that there would be room for further improvement on the proposed requirements.

<Conceptual issue in terms of insurance liabilities>

43. While the effects of changes in discount rates due to interest-rate movements increase or decrease the amount of insurance liabilities in the statement of financial position, the effects of changes in the future cash flows do not increase or decrease the amount of insurance liabilities in the statement.[5] We are concerned that the amount of insurance liabilities presented in the statement of financial position is likely to reasonable meaning, when an entity accounts for the effects of changes in discount rates due to interest-rate movements and the effects of changes in the future cash flows separately in the assessment of interest-sensitive cash flows.

44. For example, even if interest rates rise and future cash out flows are expected to increase due to the increase of surrender, the increase in future cash flows are to be offset by the decrease in the CSM. This means that only the effect of the increase in discount rates is reflected by decreasing the insurance liabilities in the statement of financial position.

45. We think that the treatment described above is not consistent with the measurement of a 'floating rate note', which is a financial instrument with interest-sensitive cash flows. In the case of a

[5] The effects that exceed the amount absorbable by CSM will increase the amount of insurance contract liability in the statement of financial statement through profit or loss.

floating rate note, the theoretical price would be neutral for the fluctuation of interest rates, because the future cash flows would increase in accordance with the increase in interest rates, while the discount rate would also rise in line with the interest rates. Therefore, in the measurement of insurance liabilities, if the effects of increase (decrease) in discount rates and the effects of increase (decrease) in future cash flows are reflected in different line items, we are concerned that this would not faithfully represent the economic realities of the insurance liabilities.

46. Revised ED proposes that an entity should measure and present the effects of changes in future cash flows and the effects of changes in discount rates in a consistent manner under limited circumstances.[6] For the purpose of providing users of financial statements with useful and relevant financial information, we think that one of the possible approaches is to measure and present the each effect of all interest-sensitive cash flows in a consistent manner.

<Changes in interest rates may affect the future unearned profit>

47. In Revised ED, the definition of CSM is clarified as 'the unearned profit that the entity recognises as it provides services under the insurance contract' (in Appendix A: Defined terms).

48. However, we are concerned that the future 'unearned profit' is not faithfully represented in the financial statements, as the effects of changes in discount rates due to the fluctuation of interest rates would never reflected in the CSM in subsequent measurements. This is because the changes in investment return due to the fluctuation of interest rates could affect the future 'unearned profit'.

49. Besides, Revised ED assumes that changes in discount rates due to the fluctuation of interest rates could affect the 'unearned profit' in the measurement at initial recognition. This is clearly supported by the notion that the CSM at initial recognition is affected by the level of discount rates at initial recognition (paragraph 25(a) of Revised ED). Therefore, this implies that an inconsistency potentially exists between the measurements at initial recognition and the subsequent measurements.

<Consistency with how insurers manage their business>

50. Those insurers, who manage the profitability of insurance contracts and risk of insurance business in a comprehensive manner, manage the risk arising from the fluctuation of interest rates, insurance risk, and risk buffers that support those risks, as a whole. We are concerned that requiring an entity to present CSM in liabilities and an accumulated OCI in net assets separately would fail to appropriately represent how those insurers run their business.

<Proposals on alternative approach>

51. In order to address the aforementioned concerns, it would be possible for the IASB to reconsider the dividing line between OCI and the CSM, or to integrate OCI and CSM into a single line item for future 'unearned profit'.

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[6] The insurance contracts that require entity to hold underlying items and specifies a link to returns on those underlying items.

52. These proposals aim to reflect the effects of changes in discount rates due to the fluctuation of interest rates and the effects of changes in future cash flows consistently from the viewpoint that the CSM should faithfully represent the future 'unearned profit'.

53. In particular, we believe that integrating CSM into OCI is likely to be a prospective solution in terms of consistency with the measurements set out in the IFRS 9: Financial Instruments.

54. Furthermore, when integrating CSM into OCI, the difference between the amount of future 'unearned profit' at the end of previous and current period is presented uniformly in the OCI of the statement of profit or loss and other comprehensive income. Besides, the remaining amount of the future 'unearned profit' at the end of current period is presented as the accumulated ‘integrated OCI' in the statement of financial position. We believe that remeasuring the value[7] of future 'unearned profit' at the end of reporting period and then presenting or disclosing it would contribute to substantial improvement in understandability for users of financial statements.

55. The natural recycling of the accumulated OCI is achieved as the future 'unearned profit' necessarily becomes zero when an insurance portfolio vanishes.

56. Even in the case of the aforementioned solutions, we believe that the level of information for users would be sufficiently ensured by providing attribution analysis of the differences between the amount of the future 'unearned profit' at the end of previous and current period in the note to financial statements.

<Needs to simplify disclosure>

57. As we have noted the benefits from information provided are not likely to outweigh the cost to comply with the proposed requirements, and we would like to request several improvements on the presentation requirements as follows.

58. We believe that Revised ED requires overly detailed disclosure. We could agree with the necessity of detailed disclosures in Phase I of the insurance contracts project where each national standard on recognising and measuring insurance liabilities was permitted, because it was important to provide supplementary information to ensure comparability and transparency. However, in Phase II where a single standard will apply, the IASB should aim at such disclosures that enable users to grasp overall picture of the entity's business, balancing the materiality with the relevance of information, rather than requiring excessively detailed disclosures. Therefore, we suggest that disclosure items should be simplified considering the following viewpoints:

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[7] The candidates of such values are, for example, as follows:

- The differences between the present value of the future cash flows as an assumption for calculating insurance premium and the present value of the future cash flows based on the estimate at the assessment date.
- The differences between the supervisory/regulatory insurance liabilities and the present value of the future cash flows based on the estimate at the assessment date.
- The value of policy in force based on embedded value disclosure.

(a) The cost for insurers to provide the information for disclosures should not outweigh the benefits for users from the disclosures.
(b) The important information should not be buried in an excessive amount of information for disclosures.
(c) The disclosed information should be reasonably auditable.
(d) Insurers should not suffer from a competitive disadvantage as a result of their compliance with the proposed disclosure requirements.

As illustrated in the following paragraphs, we are concerned that some of the disclosure requirements might not meet these viewpoints. Therefore, we would like to request that the IASB should:

- Reconsider disclosure requirements taking into account the four viewpoints mentioned above.
- Provide disclosure requirements, not in a standard itself, but in an application guidance, avoiding too many mandatory requirements.

59. The disclosure that is likely to include confidential information such as the breakdown of premiums does not meet (b) through (d) of our viewpoints. For example, paragraph 83 requires an entity to disclose ‘the methods used to measure insurance contracts and the processes for estimating the inputs to those methods’. Such disclosure should not be disclosed because it could include confidential information such as breakdown of premiums, and on top of that, relevant information could be buried in an excessive amount of information for disclosure. In addition, we are concerned about practicability, including auditability, of such disclosure.

60. Furthermore, the paragraph 84 of Revised ED requires that ‘If the entity uses a technique other than the confidence level technique for determining the risk adjustment, it shall disclose a translation of the result of that technique into a confidence level a translation of the result of that technique into a confidence level’, which we do not think meets our viewpoint (a). While such a disclosure would impose practical burden on insurers, ‘the translated confidence level’ would not exactly represent a view of an insurer on the related risks, and thus fail to provide users with useful information. Accordingly, as it could be difficult to achieve an objective of enhancing comparability by disclosing translated confidence level, such disclosure should not be required.

61. The Institute of Chartered Accountants of Scotland (ICAS) and the New Zealand Institute of Chartered Accountants (NZICA) published joint report 'Losing the excess baggage - reducing disclosures in financial statements to what's important' in July 2011, requested by the IASB. In this report, the ICAS and NZICA recommended that disclosure requirements should be amended to disclose only 'what is important', and to eliminate any part of disclosures which are too much detailed or considered to be overlapping with IFRS 1: Presentation of Financial Statements.

62. Besides, in July 2012, the European Financial Reporting Advisory Group (EFRAG) published a discussion paper 'Towards a Disclosure Framework for the Notes', and the Financial Accounting Standards Board (FASB) published a discussion paper 'Disclosure Framework' for invitation to

comment. It should be noted that both of these papers seek to improve disclosure effectiveness by eliminating unnecessary disclosures.

63. With these initiatives in mind, the IASB has launched a new research project on presentation and disclosure in IFRS. We believe that the IASB should also make sure that in developing disclosure requirements applied to insurance contracts, unnecessary disclosures are avoided. To this end, the standard on insurance contracts should clearly state that, as a principle, an entity shall consider the materiality of each disclosure item to avoid less material disclosures, and should clarify that the proposed disclosure items in Revised ED are only examples and are not necessarily required.

64. Other than those mentioned above, we identify the following requirements whose costs are unlikely to be justified by the benefits from information provided. For details, please also refer to our comments to each question.

- Requiring an entity to decompose changes in cash flows into those adjusted for CSM and those not adjusted for CSM (paragraphs 31 and B68 of Revised ED).
- Requiring an entity to decompose cash flows into those measured by updated discount rates and those not measured by updated discount rates (paragraph 60(h) of Revised ED).
- Requiring an entity to decompose changes in insurance liabilities into those adjusted through OCI and those not adjusted through OCI (paragraph 64 of Revised ED).
- Measurement of decomposed embedded derivative component (paragraph 34 of Revised ED).
- Retaining a huge volume of data for the subsequent measurement of CSM (paragraph 30 of Revised ED).
- Excluding any investment components from insurance contracts in the presentation (paragraph 58 of Revised ED).
- Retrospective application over ultra-long duration in transition (Appendix C of Revised ED).

Question 7—Clarity of drafting
Do you agree that the proposals are drafted clearly and reflect the decisions made by the IASB? If not, please describe any proposal that is not clear. How would you clarify it?

<Measurement of fulfilment cash flows that are expected to vary with returns on the underlying items>

65. In the measurement of fulfilment cash flows of an insurance contract that are expected to vary with returns on the underlying items, we are concerned that it is difficult to understand it as a whole because there is lack of clarity about the relationship between each paragraph. Paragraphs 33, 34 and 66 of Revised ED explicitly set out how an entity shall measure and present those cash flows. However, we are of the view that, the treatment for some contracts, which are affected by return on underlying items to some extent and still do not fall into the conditions of

the above paragraphs, needs to be clarified, as they have not been thoroughly deliberated at past IASB board meetings. In clarifying such measurement and presentation, we would like the IASB to give due consideration to this matter, following effective communication with a number of stakeholders.

<Determining OCI>

66. In our view, although paragraph 64 of Revised ED describes the determination of the amount recognised and presented in OCI, the amount determined in accordance with the paragraph would be the accumulated OCI in equity, not OCI recognised for the period.

<Mutual insurers>

67. Considering paragraph BCA62 of Revised ED which describes the treatment for insurance contracts issued by mutual entities, our understanding is that this paragraph explains an exceptional treatment only when the contract provides policyholders with the right to participate in the whole of any surplus of the issuing entity, as stated in paragraph 33 of Revised ED. In other words, it is obvious that there are no differences in the requirements of Revised ED on the basis of the legal form of the issuing entity. We believe that there is no need to use phrases such as 'no equity remaining in mutual entities' and 'no profit reported in any accounting period'.

68. Although the IASB does not set out questions on the following issues in Revised ED, we would like to present our views on those other requirements in Revised ED.

    (a) Separating components from an insurance contract

    As stated in paragraphs 10 and 11, as well as paragraphs B31 through B35, an entity is required to separate a non-insurance component from the host insurance contract unless the insurance component and non-insurance component are highly interrelated, and then measure it in accordance with accounting standards other than those for insurance contracts. We argued that 'where some components are closely related to insurance coverage, they should not be unbundled,' in our comments submitted to the IASB on 2010 Exposure Draft. Thus, we appreciate the amendments in Revised ED made in light of our arguments.

    However, we do not agree with the IASB's conclusion stated in paragraph BCA208 that it would not permit an entity to unbundle policy loans when not required by this Exposure Draft because, if permitted, this would raise a concern that the entity may measure the components on an arbitrary basis. We are of the view that there are some services provided by insurers, for which different measurements and presentations from insurance liabilities are believed to provide useful information in light of the economic realities. Therefore, separation of those components should be permitted, with some rules to address the IASB’s concern about arbitrage.

    (b) Risk adjustment

    Although we are of the view that the single margin approach and the two margin approach have their own merits and demerits respectively, in assuming that an entity applies the risk

adjustment, we support the decision by the IASB that it would not limit the type of techniques for measuring the risk adjustment. However, we do not agree with the IASB's view that if the entity applies a technique other than the confidence level technique, it shall disclose a translation of the result of that technique into a confidence level. This is because we believe that such disclosure is unnecessary if the entity provides appropriate disclosures on each technique. As the translated confidence level varies depending on the characteristics of insurance contracts and/or other factors, it would be difficult to achieve aimed comparability, resulting in only imposing burden on insures. Under such circumstances, the confidence level technique might be more preferred by insurers in order to avoid unnecessary practical burden, and this potential consequence is inconsistent with the IASB's intention.

(c) Contract boundary

In applying the contract boundary proposed in Revised ED, our understanding is that an entity shall take into account the economic realities of the insurance contracts given that there are various types of insurance contracts in each jurisdiction. For example, for life insurance contracts with renewable options which are common in Japan, an entity should determine the contract boundary of those contracts, considering the probability of their renewal.