# The LIAJ’s Comments on the Request for Information

## *Post-implementation Review*

***IFRS 9 Financial Instruments***
***Classification and Measurement***

**28 January 2022**

**The Life Insurance Association of Japan (LIAJ)**

**Contents**

## I. General comments on the Request for Information

1. We, The Life Insurance Association of Japan (or the "LIAJ"), would like to extend our gratitude to the International Accounting Standards Board (or the "Board") for providing us with the opportunity to submit comments on the *Request for Information, Post-implementation Review, IFRS 9 Financial Instruments, Classification and Measurement* (hereinafter referred to as the "RFI"), published in September 2021.

2. The LIAJ is a trade association comprised of all 42 life insurance companies operating in Japan. Its goals are to promote the sound development of the life insurance industry in Japan, maintain its trustworthiness, and thereby contribute to improving the quality of life in Japan. The LIAJ would like to respectfully request the Board to carefully consider the comments submitted from the sole representative body of the life insurance industry in Japan, which accounts for approximately 11%[1] of the world's life insurance premiums.

3. The LIAJ understands that the objective of publishing the RFI is to review if the requirements in IFRS 9 work as the Board intended to. However, from the perspective of life insurers, there may be some requirements in those for current classification and measurements of financial instruments that might cause misunderstanding among users of life insurers' financial statements. Thus, the LIAJ believes that the Board further needs to revise IFRS 9. As for particularly important issues, please refer to the comments below.

<Expanding the scope of assets to be measured at fair value through other comprehensive income (FVOCI)>

4. Firstly, the LIAJ would like to note the basic concept of accounting for life insurance industry. The nature of life insurance business is to underwrite risks over a long period and it requires insurers to firmly fulfil the obligations to policyholders, instead of gaining profits through short-term changes in fair value of financial assets and liabilities they hold. Therefore, the LIAJ believes that recognising such short-term changes in fair value in profit or loss in the financial statements of life insurance business would not provide useful information for users of financial statements.

5. In addition, life insurers aim at long-term stable asset management, due to their characteristic of business model, and their portfolio is generally with significant feature consisting of a wide range of assets including foreign currency bonds, equities and investment trusts. Assets backing life insurance business should be assessed consistently with portfolio as a whole, and recognising short-term changes in fair value of those assets in profit or loss does not reflect the business model of life insurers, also cause misunderstanding among users of financial statements.

6. From the above mentioned perspectives, the LIAJ believes that the Board should allow entities to measure wider range of assets using FVOCI measurement category currently limited to equity and certain types of debt instruments.

[1] Swiss Re Institute, *sigma* No 3/2021.

<Reviewing the treatment for non-recycling of equity instruments>

7. While for debt instruments categorised in FVOCI measurement, amounts presented in OCI are allowed to be recycled in profit or loss at the time of sale, as for equity instruments selected to use OCI option in measuring them, the entity would not be permitted to recycle gains or losses accumulated in OCI. The LIAJ believes that these inconsistent treatments should be reviewed.

8. The LIAJ believes that recycling should be allowed for all assets measured at fair value through OCI measurement category upon realisation, since the profit or loss is an important benchmark for users in presenting entities' profitability. Thus, the LIAJ believes that all assets should be recognised in profit or loss upon realisation without exception.

9. Given that the *Conceptual Framework* revised in 2018 set out principles concerning recycling, the LIAJ would like the Board to review the IFRS 9 to ensure consistent treatment under the principles.

<Valuation of equity instruments that do not have a quoted market price at fair value>

10. According to IFRS 9, an entity is required to measure all unquoted equity instruments at fair value, except under limited circumstances. However, in general, it would be difficult for entities to reliably measure such instruments at fair value, leading to concern about usefulness of information since entities may measure financial instruments with strong arbitrariness. Furthermore, since such fair value measurement may pose significant practical burden on preparers, the LIAJ believes that this treatment should be reviewed.

## II. Responses to the questions

| **Question 1 —Classification and measurement** |
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| **Do the classification and measurement requirements in IFRS 9:**<br><br>**(a) enable an entity to align the measurement of financial assets with the cash flow characteristics of the assets and how the entity expects to manage them? Why or why not?**<br><br>**(b) result in an entity providing useful information to the users of the financial statements about the amount, timing and uncertainty of future cash flows? Why or why not?**<br><br>Please provide information about the effects of the classification and measurement changes introduced by IFRS 9, including the ongoing costs and benefits in preparing, auditing, enforcing or using information about financial instruments.<br><br>This question aims to help the Board understand respondents' overall views and experiences relating to the IFRS 9 classification and measurement requirements. Sections 2–8 seek more detailed information on the specific requirements. |

11. As mentioned in the general comments on the request for information, the LIAJ believes that classification of investment trusts and foreign currency bonds required under current IFRS 9 would not provide users of the financial statements with useful information. The main reason for this is that presenting such short-term changes in fair value in profit or loss would not appropriately represent the business model of life insurers. The LIAJ believes that the Board should expand the use of option, which allows entities to present changes in fair value in OCI, to these financial instruments, currently limited to equity and certain types of debt instruments.

12. Pursuant to the classification of the liability and equity components in IAS 32, *Financial Instruments: Presentation*, the investment trusts will be treated as fair value through profit or loss (FVPL) under IFRS 9, however, from the holders' perspective, the investment trusts have economic profile similar to equity to which entities are allowed to use the OCI option. The LIAJ would like the Board to eliminate such an inconsistent treatment among financial instruments with similar economic profile.

13. As for foreign currency bonds, their measurement and translation contain elements of interest rate risk and exchange risk that are interrelated, leading to significant adverse effects due to inconsistency in the treatment of both elements. In terms of continuing appropriate diversified investments of life insurers, the LIAJ would like the Board to allow entities to present currency exchange fluctuation of foreign currency bonds in the OCI.

14. In IFRS 17, *Insurance contracts,* given that entities are allowed to use OCI option for policy obligation, the LIAJ believes that assets subject to FVOCI should be expanded to other assets in terms of avoiding accounting mismatch.

**Question 3 —Contractual cash flow characteristics**

**(a) Is the cash flow characteristics assessment working as the Board intended? Why or why not?**

Please explain whether requiring entities to classify and measure a financial asset considering the asset's cash flow characteristics achieves the Board's objective of entities providing users of financial statements with useful information about the amount, timing and uncertainty of future cash flows.

If, in your view, useful information could be provided about a financial asset with cash flows that are not SPPI applying IFRS 9 (that is, an asset that is required to be measured at fair value through profit or loss applying IFRS 9) by applying a different measurement approach (that is, using amortised cost or fair value through OCI) please explain:

(i) why the asset is required to be measured at fair value through profit or loss (that is, why, applying IFRS 9, the entity concludes that the asset has cash flows that are not SPPI).

(ii) which measurement approach you think could provide useful information about the asset and why, including an explanation of how that approach would apply. For example, please explain how you would apply the amortised cost measurement requirements to the asset (in particular, if cash flows are subject to variability other than credit risk). (See Section 7 for more questions about applying the effective interest method.)

**(b) Can the cash flow characteristics assessment be applied consistently? Why or why not?**

Please explain whether the requirements are clear and comprehensive enough to enable the assessment to be applied in a consistent manner to all financial assets within the scope of IFRS 9 (including financial assets with new product features such as sustainability-linked features).

If diversity in practice exists, please explain how pervasive the diversity is and its effect on entities' financial statements.

**(c) Are there any unexpected effects arising from the cash flow characteristics assessment? How significant are these effects?**

Please explain the costs and benefits of the contractual cash flow assessment, considering any financial reporting effects or operational effects for preparers of financial statements, users of financial statements, auditors or regulators.

In responding to (a)–(c), please include information about **financial instruments with sustainability-linked features** (see Spotlight 3.1) and **contractually linked instruments** (see Spotlight 3.2).

15. In recent years, practical burden on entities to assess asset's cash flow characteristics under

IFRS 9 is increasing due to diversified financial instruments. The LIAJ is concerned that practical burden on entities in the prior assessment before the start of investment and subsequent review after the start of investment might substantially impede flexible investment activities and in some cases, causing diversity in practice.

16. Therefore, the LIAJ would like expect the Board to work on reducing practical burden on entities, for example, by aggregating the assessment results of cash flow characteristic by various types of financial instruments and the formats applied, and making them accessible for preparers of financial statements as reference examples.

**Question 4 —Equity instruments and other comprehensive income**

**(a) Is the option to present fair value changes on investments in equity instruments in OCI working as the Board intended? Why or why not?**

Please explain whether the information about investments in equity instruments prepared applying IFRS 9 is useful to users of financial statements (considering both (i) equity instruments measured at fair value through profit and loss; and (ii) equity instruments to which the OCI presentation option has been applied).

For equity instruments to which the OCI presentation option has been applied, please explain whether information about those investments is useful considering the types of investments for which the Board intended the option to apply, the prohibition from recycling gains and losses on disposal and the disclosures required by IFRS 7.

**(b) For what equity instruments do entities elect to present fair value changes in OCI?**

Please explain the characteristics of these equity instruments, an entity's reason for choosing to use the option for those instruments, and what proportion of the entity's equity investment portfolio comprises those instruments.

**(c) Are there any unexpected effects arising from the option to present fair value changes on investments in equity instruments in OCI? How significant are these effects?**

Please explain whether the requirements introduced by IFRS 9 had any effects on entities' investment decisions. If yes, why, how and to what extent? Please provide any available evidence supporting your response which will enable the Board to understand the context and significance of the effects.

In responding to (a)–(c), please include information about **recycling of gains and losses** (see Spotlight 4).

17. As commented in the response to Question 1, the LIAJ believes that expanding the use of option to present fair value changes on investments in OCI for other type of instruments, without limiting for equity instruments, would enhance the usefulness of information.

18. With regard to recycling, there are different treatments between debt instruments and equity

instruments, causing problems such as inconsistent practice among assets, and lack of reasonable and coherent explanation about those inconsistency. The LIAJ would like to expect the Board to work on reviewing the treatment of recycling required under IFRS 9, in terms of principles concerning recycling set out in the revised *Conceptual Framework*.

19. The LIAJ believes that entities should be required to recycle all assets presented in OCI upon realisation, in order to retain the feature of profit or loss as the benchmark for presenting entities' profitability.

| **Question 5 —Financial liabilities and own credit** |
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| **(a) Are the requirements for presenting the effects of own credit in OCI working as the Board intended? Why or why not?**<br><br>Please explain whether the requirements, including the related disclosure requirements, achieved the Board's objective, in particular, whether the requirements capture the appropriate population of financial liabilities.<br><br>**(b) Are there any other matters relating to financial liabilities that you think the Board should consider as part of this post-implementation review (apart from modifications, which are discussed in Section 6)?**<br><br>Please explain the matter and why it relates to the assessments the Board makes in a post-implementation review. |

20. As mentioned above, the LIAJ believes that entities should be allowed to recycle all assets presented in OCI upon realisation, however, as for the amount presented in OCI due to the effects of own credit, entities are not allowed to recycle such amount. In this context, entities should be allowed to recycle the amount in this case without exception.

| **Question 9—Other matters** |
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| **(a) Are there any further matters that you think the Board should examine as part of the post-implementation review of the classification and measurement requirements in IFRS 9? If yes, what are those matters and why should they be examined?**<br><br>Please explain why those matters should be considered in the context of the purpose of the post-implementation review, and the pervasiveness of any matter raised. Please provide examples and supporting evidence when relevant.<br><br>**(b) Considering the Board's approach to developing IFRS 9 in general, do you have any views on lessons learned that could provide helpful input to the Board's future standard-setting projects?** |

21. As mentioned in the general comments on the request for information, the LIAJ believes that

in general, it would be difficult for entities to reliably measure unquoted equity instruments at fair value. It may be worth to explore how useful the information on the fair value of such instruments would be, and whether the benefits of measuring them at fair value outweigh the costs in the post-implementation review.