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November 16, 2007

International Accounting Standards Board
30 Cannon Street
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Dear Sirs,

Comments on Discussion Paper "Preliminary Views on Insurance Contracts"

We appreciate the effort of the International Accounting Standards Board (IASB) on the insurance contracts project for many years and welcome the opportunity to comment on the Discussion Paper (DP) "Preliminary Views on Insurance Contracts." The views expressed as follows are those of the International Issues Standing Committee of the Accounting Standards Board of Japan (ASBJ).

1. General Comments

1. We agree with the objectives of the IASB's insurance contracts project to develop accounting standards which provide a consistent framework and eliminate a wide variety of existing accounting practices for insurance contracts.

2. Many of the issues addressed in the insurance contracts project are closely related to those on other projects (ex. conceptual framework, revenue recognition, fair value measurement, financial statement presentation, financial instruments). We believe that the discussions on the insurance contracts project would generate useful inputs for those other projects.

3. On the other hand, those other projects would also provide very important inputs to the insurance contracts project. As noted in paragraph 18 of the DP, we believe that insurance contracts are very complex contracts with various accounting issues. Although we understand that events that have different economic substance should be accounted for differently, we consider it might be necessary to monitor the development of other more general projects which could be a guide for the insurance contracts project.

4. We recognize that the measurement model using the three building blocks

described in the DP would be meaningful in measuring insurance liabilities to a certain extent. However, we do not believe that the adoption of the proposed measurement method is sufficiently justified. A measurement attribute should be determined based on the nature of the subject to be measured. Given that there is hardly any active market for insurance contracts, further consideration should be given to the issue of whether the proposed measurement method would provide relevant information to users, especially from the perspective of the assessment of performance of insurers, based on the future development of other related projects (the revenue recognition project, in particular).

5. We would like to make comments on the following selected questions and hope that those comments are helpful to the future deliberation process of the IASB.

2. Comments on Selected Questions

CHAPTER 3 MEASUREMENT – CORE ISSUES

Q2 Should an insurer measure all its insurance liabilities using the following three building blocks:

(a) explicit, unbiased, market-consistent, probability-weighted and current estimates of the contractual cash flows,

(b) current market discount rates that adjust the estimated future cash flows for the time value of money, and

(c) an explicit and unbiased estimate of the margin that market participants require for bearing risk (a risk margin) and for providing other services, if any (a service margin)?

If not, what approach do you propose, and why?

6. The measurement model using the above-mentioned three building blocks would provide users with relevant information about the amount, timing and uncertainty of the cash flows arising from rights and obligations under insurance contracts. We support the continuation of further discussions on this measurement model, on condition that the environment in which this measurement could be carried out with reliability (with persuasive evidence) would be ready.

7. Although this measurement model is considered meaningful in measuring liabilities on the balance sheet to a certain extent, we do not believe that the adoption of this model is sufficiently justified. We also think much of the issue of

which measurement model would be appropriate for the purpose of measuring insurers' performance. We consider further discussions are necessary from not only the asset-liability approach viewpoint, but also revenue recognition perspective. (see our comments on Q5 and Q20 as below.)

8. Furthermore, we pay attention to the viewpoint of the balance of costs and benefits. Even though a measurement model using the three building blocks would be relevant for insurance contracts, we believe that for short-duration contracts the use of unearned premiums, which may be reasonable proxy for current exit value and are readily available, should be permitted subject to a relatively simple test. Although this point is referred to in paragraph 112 of the DP, it should be further clarified. We believe that this point would be related to the future deliberations of the policyholder accounting on this project and the work on the measurement attribute for insurance contracts and that for revenue recognition (under customer consideration model).

CHAPTER 3 MEASUREMENT – CORE ISSUES

Q4 What role should the actual premium charged by the insurer play in the calibration of margins, and why?

(a) The insurer should calibrate the margin directly to the actual premium (less relevant acquisition costs), subject to a liability adequacy test. As a result, an insurer should never recognise a profit at the inception of an insurance contract.

(b) There should be a rebuttable presumption that the margin implied by the actual premium (less relevant acquisition costs) is consistent with the margin that market participants require. If you prefer this approach, what evidence should be needed to rebut the presumption?

(c) The premium (less relevant acquisition costs) may provide evidence of the margin that market participants would require, but has no higher status than other possible evidence. In most cases, insurance contracts are expected to provide a margin consistent with the requirements of market participants. Therefore, if a significant profit or loss appears to arise at inception, further investigation is needed. Nevertheless, if the insurer concludes, after further investigation, that the estimated market price for risk and service differs from the price implied by the premiums that it charges, the insurer would recognise a profit or loss at inception.

(d) Other (please specify).

9. The answer to this question would depend on whether reliable and objective estimates of margins are available. If they are available, the method (c) would be appropriate from the viewpoint that measurement should be consistent with market as much as possible. However, depending on the level of their reliability, the method (a) or (b) could be more appropriate. We believe that it is necessary to further consider whether the method (c) would be appropriate to all insurance contracts for which there is no active market, as well as the problem of the feasibility. (see our comment on Q5)

CHAPTER 3 MEASUREMENT – CORE ISSUES

Q5 This paper proposes that the measurement attribute for insurance liabilities should be 'the amount the insurer would expect to pay at the reporting date to transfer its remaining contractual rights and obligations immediately to another entity. The paper labels that measurement attribute 'current exit value'.

(a) Is that measurement attribute appropriate for insurance liabilities? Why or why not? If not, which measurement attribute do you favour, and why?

(b) Is 'current exit value' the best label for that measurement attribute? Why or why not?

10. In paragraph 93 of the DP, current exit value of insurance contracts is defined as "the amount the insurer would expect to pay at the reporting date to transfer its remaining contractual rights and obligations immediately to another entity". However, in the real-world, the insurance liabilities cannot be transferred immediately to the third parties, because there is no active market for insurance liabilities.

11. We recognize that the measurement model using the three building blocks in the DP is considered meaningful to a certain extent, because it would provide users with relevant information about the amount, timing and uncertainty of the cash flows arising from rights and obligations under insurance contracts. However, given that there is no active market for insurance liabilities, we believe that it is necessary to further consider whether the recognition of profit or loss (day1 profits and profits on re-measurement) arising from the measurement based on the inputs

that are not available in the market would actually provide users with relevant information, even though such model would be meaningful to some extent in measuring insurance liabilities on the balance sheet.

12. In connection with the comment in the preceding paragraph, we believe that the nature of the subject of measurement item should decide its measurement attribute. We believe that it should be made clear in the future deliberations how the consistency between this project and the revenue recognition project could be ensured.

13. Another problem is the feasibility of the market-based measurement. The Board's preliminary views require that estimates of future cash flows, discount rates and margins, which are components of the three building blocks, should be as consistent as possible with observable market price. This model would compute the current exit value based upon the assumptions of hypothetical markets and hypothetical participants. However, some argue that in practice such computation cannot help using entity-specific inputs in many cases. If this is the case, the outputs from this model would differ little from the entity-specific value.

14. If the current exit value as consistent as possible with market is to be pursued, further consideration would be necessary about the issue of to what extent the exclusion of entity-specific estimates could be practicable in measuring the current exit value, considering that the use of the entity-specific estimates to some extent is expected by the Board (for example, as noted in paragraph 62 of the DP, the Board expects that an insurer would use estimates of its own servicing costs).

CHAPTER 4 POLICYHOLDER BEHAVIOUR, CUSTOMER RELATIONSHIPS AND ACQUISITION COSTS

Q6 In this paper, beneficial policyholder behaviour refers to a policyholder's exercise of a contractual option in a way that generates net economic benefits for the insurer. For expected future cash flows resulting from beneficial policyholder behaviour, should an insurer:

(a) incorporate them in the current exit value of a separately recognised customer relationship asset? Why or why not?

(b) incorporate them, as a reduction, in the current exit value of insurance liabilities? Why or why not?

(c) not recognise them? Why or why not?

15. We support the approach (b), because we believe that an insurer should incorporate expected future cash flows resulting from beneficial policyholder behaviour in measuring insurance liabilities. Since the DP takes a view that a portfolio should be a unit of account in the measurement aspect, an insurer should measure a portfolio based on future cash flows reasonably expected to arise. We believe that such reasonably expected future cash flows are the whole of the contractual rights arising from individual contracts, as far as measurement for a portfolio is accepted. (see our comment on Q7 about the criteria of "future cash flows practically expected arising from such a portfolio")

16. We do not agree with the view that "beneficial policyholder behaviour" should be treated as a customer relationship, because such a view would lead to recognition and remeasurement of the type of internally-generated intangible asset which is not allowed under IAS 38.

CHAPTER 4 POLICYHOLDER BEHAVIOUR, CUSTOMER RELATIONSHIPS AND ACQUISITION COSTS

Q7 A list follows of possible criteria to determine which cash flows an insurer should recognise relating to beneficial policyholder behaviour. Which criterion should the Board adopt, and why?

(a) Cash flows resulting from payments that policyholders must make to retain a right to guaranteed insurability (less additional benefit payments that result from those premiums). The Board favours this criterion, and defines guaranteed insurability as a right that permits continued coverage without reconfirmation of the policyholder's risk profile and at a price that is contractually constrained.

(b) All cash flows that arise from existing contracts, regardless of whether the insurer can enforce those cash flows. If you favour this criterion, how would you distinguish existing contracts from new contracts?

(c) All cash flows that arise from those terms of existing contracts that have commercial substance (ie have a discernible effect on the economics of the contract by modifying significantly the risk, amount or timing of the cash flows).

(d) Cash flows resulting from payments that policyholders must make to retain a right to any guarantee that compels the insurer to stand ready, at a price that is contractually constrained, (i) to bear insurance risk or

financial risk, or (ii) to provide other services. This criterion relates to all contractual guarantees, whereas the criterion described in (a) relates only to insurance risk.

(e) No cash flows that result from beneficial policyholder behaviour.

(f) Other (please specify).

17. We support the criterion (c). As mentioned in our comment on Q6, we believe that it is important to reflect reasonably expected future premiums in measuring insurance liabilities, but it is difficult to determine at this stage whether the criterion (a) is always applicable to any insurance products. As for this point, we consider that the criterion (c) is more generally applicable than (a). We agree that the existence of (policyholder's) guaranteed insurability concept could be one of the criteria to determine whether cash flows arising from terms of existing contracts has commercial substance (i.e. the criterion (c) is satisfied).

18. The criterion (d) involves another issue not included in the criterion (a) through (c). Adoption of the criterion (d) would result in reflecting future cash flows related to services in measurement of liabilities and therefore would raise the issue of consistency with other accounting standards. On this issue, the revenue recognition project would provide some inputs.

CHAPTER 5 MEASUREMENT – OTHER ISSUES

Q11 Should risk margins:

(a) be determined for a portfolio of insurance contracts? Why or why not? If yes, should the portfolio be defined as in IFRS 4 (a portfolio of contracts that are subject to broadly similar risks and managed together as a single portfolio)? Why or why not?

(b) reflect the benefits of diversification between (and negative correlation between) portfolios? Why or why not?

19. The essence of an insurer's business is pooling of risks (assembling a balanced portfolio of reasonably homogeneous risks to permit reasonable estimates of the behaviour of the pool as a whole). Pooling of risks is the source of profits to insurers.

20. In order to appropriately measure rights and obligations arising from books of insurance contracts sufficiently diversified by pooling of risks, it would be better to determine risk margins by portfolio than by contract.

21. However, this approach would lead to the consequence that risk margins vary depending on how to set up a portfolio. This means that portfolio restructuring could cause a change in risk margins and accordingly give rise to profit or loss. In addition, when the transaction price reflects the benefits of diversification among different portfolios or entity-specific values, a loss could be recognized at inception. In the light of these issues, further deliberations are necessary about how to define a portfolio as a unit of accounting.

CHAPTER 5 MEASUREMENT – OTHER ISSUES

Q13 If an insurance contract contains deposit or service components, should the insurer unbundle them? Why or why not?

22. We believe that an insurance component and a deposit component in an insurance contract should be unbundled only when they have no or only little interdependence between them and otherwise they should not be unbundled.

CHAPTER 5 MEASUREMENT – OTHER ISSUES

Q14

(a) Is the current exit value of a liability the price for a transfer that neither improves nor impairs its credit characteristics? Why or why not?

(b) Should the measurement of an insurance liability reflect (i) its credit characteristics at inception and (ii) subsequent changes in their effect? Why or why not?

23. We disagree that any changes of own credit risks should be reflected in measuring not only insurance liabilities but also any other liabilities.

24. Even though changes in credit risks of debtors are conceptually part of changes in the "fair value" of a liability, we believe that those effects should not be reflected in the carrying amount of the liability, except for the very limited cases where an active market for the liability exists.

25. We have the following concerns about reflecting entity's own credit risks in re-measuring liabilities in general.

- Measurement based on the entity's own creditworthiness would be inconsistent with the fact that entities intend to satisfy all liabilities in full on the premise of the going concern.

- A decline in an entity's creditworthiness would generally occur at the same time as a deterioration in the value of an unrecognized asset (i.e. internally generated goodwill). Because the deterioration in their value is not reported as an expense, it would be misleading to recognize only income relating to the effect on liabilities.
- Adjustments for own creditworthiness are irrelevant unless an entity can realize gain by transferring the liabilities to the third party. For example, in the case of a non-marketable loan payable, we cannot suppose a situation where gain from a decrease in its fair value due to an increase of credit risk could be realized.
- In many cases, adjustments for own creditworthiness are not reliably measurable.

CHAPTER 5 MEASUREMENT – OTHER ISSUES

Q15 Appendix B identifies some inconsistencies between the proposed treatment of insurance liabilities and the existing treatment under IAS 39 of financial liabilities. Should the Board consider changing the treatment of some or all financial liabilities to avoid those inconsistencies? If so, what changes should the Board consider, and why?

26. We note that the IASB establishes a long-term goal that all financial instruments should be measured at fair value with changes in fair value recognized in profit or loss. However, we disagree that the treatment of financial liabilities should be changed based on the discussions on insurance liabilities.

27. We consider that the conclusion about whether treatments of insurance liabilities should be consistent with those of financial liabilities depends on the view of what is the nature of differences between insurance contracts and other financial instruments. If their natures are considered to be not different enough to justify different measurement attributes, the treatment of insurance liabilities should be considered from the perspective of consistency with those of financial liabilities, awaiting the input from the financial instruments project.

CHAPTER 7 CHANGES IN INSURANCE LIABILITIES

Q20 Should the income statement include all income and expense arising from changes in insurance liabilities? Why or why not?

28. As mentioned above, we acknowledge that the measurement model using the three building blocks (the current value approach) is meaningful to a certain extent, because it would provide users with relevant information about the amount, timing and uncertainty of the cash flows arising from rights and obligations under insurance contracts. However, at this stage, we disagree that all changes in insurance liabilities arising from the application of this model should be included in profit or loss for assessment of performance, even if reliable measurement based on this model would be possible and the current value approach would be appropriate as the measurement on the balance sheet.

29. We do not believe that it would be appropriate to include all of changes in insurance liabilities in profit or loss, unless the insurance liabilities have available market value or they are indexed to the market value of the backing assets.

30. We believe that the issue of how changes in insurance liabilities, for which there is no active market, should be recognized as income or expense needs thorough deliberations in the light of consistency with the discussions in the revenue recognition project and the accounting for financial liabilities, as well as from the viewpoint of the objective of financial statements, that is, to provide useful information to users.

OTHER MATTERS
Q21 Do you have other comments on this paper?

31. The treatment proposed in the DP would significantly change the existing accounting practice and therefore we believe that it must be accompanied by the development of practical measurement techniques for insurance liabilities by experts such as actuaries, which can become de facto standards, and that sufficient field tests should be made at an appropriate timing prior to the finalization as the standard.

We hope that our comments will contribute to the future deliberations of the IASB.

Sincerely yours,

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Chairman, International Issues Standing Committee
Chairman, Accounting Standards Board of Japan