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30 November 2010

International Accounting Standards Board
30 Cannon Street
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Dear Sir or Madame,

Comment on the Exposure Draft *Insurance Contracts*

We appreciate the longstanding efforts of the International Accounting Standards Board (IASB) on the Insurance Contracts project and welcome the opportunity to comment on the Exposure Draft *Insurance Contracts* (hereinafter referred to as the "ED").

General Comments

1. We support the objective of the project to provide a single principle-based guidance to account for all types of insurance contracts. We believe that the ED would improve financial reporting by insurers because it would recognise, measure and present life and non-life insurance contracts and direct insurance and reinsurance contracts in a consistent and comparable manner.

2. We appreciate the IASB's adoption of the measurement at the fulfilment cash flows, changing from the proposal in the discussion paper *Preliminary Views on Insurance Contracts* (measuring insurance contracts at current exit value), as a result of considering comments made by respondents to the discussion paper. We also appreciate the IASB's decision not to recognise a day 1 gain, consistently with the proposals in the exposure draft *Revenue from Contracts with Customers* (hereinafter referred to as "the Revenue ED").

3. We are of the view that the measurement of an insurance contract using the building blocks proposed in the ED provides users of financial statements with relevant information about the amount, timing and uncertainty of future cash flows. However, we consider it inappropriate to recognise immediately all changes in estimates in profit or loss. In particular, if changes in the insurance liability arising from short-term changes in market interest rates are recognised in profit or loss, an insurer's profit or loss would significantly fluctuate each period and then it could diminish the usefulness of profit or loss as a performance measure of the insurance

business.

4. We have a concern about the proposal to require an insurer to present the statement of comprehensive income on the basis of a summarised margin approach. We believe that the summarised margin approach would result in providing less useful information to users of financial statements than other approaches for presentation because it would not present important financial information such as premium revenue, claims and benefits and other expenses related to insurance contracts in the statement of comprehensive income.

Comments on questions

Our comments on the questions set out in the ED are provided below.

Question 1 – Relevant information for users

Do you think that the proposed measurement model will produce relevant information that will help users of an insurer's financial statements to make economic decisions? Why or why not? If not, what changes do you recommend and why?

5. We believe that the proposed measurement model provides users of financial statements with relevant information about the amount, timing and uncertainty of future cash flows that will help make economic decisions.

Question 2 – Fulfilment cash flows

(a) Do you agree that the measurement of an insurance contract should include the expected present value of the future cash outflows less future cash inflows that will arise as the insurer fulfils the insurance contract? Why or why not? If not, what do you recommend and why?

(b) Is the draft application guidance in Appendix B on estimates of future cash flows at the right level of detail? Do you have any comments on the guidance?

6. We agree that the measurement of an insurance contract should include the expected present value of the future cash outflows less future cash inflows that will arise as the insurer fulfils the insurance contract, for the reasons described in paragraphs 7 to 9 below.

7. Insurers typically intend to settle insurance contract liabilities by fulfilling their obligations by themselves, rather than transferring those liabilities to third parties in the middle of the contract. Measurement of an insurance contract based on the fulfilment cash flows as proposed in the ED is consistent with the insurers' intention.

8. Insurance contracts create a bundle of rights and obligations that work together to generate a

package of cash inflows and outflows. Therefore it is appropriate to measure them by netting future cash outflows and inflows.

9. We believe that discounted amounts of estimated future cash flows will provide users with useful information for the insurance liabilities that are settled over a period of time.

10. However, it is not appropriate to recognise immediately in profit or loss all income and expense arising from changes in the measurement of insurance contracts. Please refer to our comment to Question 13 (b) for details.

11. The draft application guidance in Appendix B on estimates of future cash flows is at the right level of detail.

Question 3 – Discount rate

(a) Do you agree that the discount rate used by the insurer for non-participating contracts should reflect the characteristics of the insurance contract liability and not those of the assets backing that liability? Why or why not?

(b) Do you agree with the proposal to consider the effect of liquidity, and with the guidance on liquidity (see paragraphs 30(a), 31 and 34)? Why or why not?

(c) Some have expressed concerns that the proposed discount rate may misrepresent the economic substance of some long-duration insurance contracts. Are those concerns valid? Why or why not? If they are valid, what approach do you suggest and why? For example, should the Board reconsider its conclusion that the present value of the fulfilment cash flows should not reflect the risk of non-performance by the insurer?

12. We agree that the discount rate used by the insurer for non-participating contracts should reflect the characteristics of the insurance contract liability and not those of the assets backing that liability. There is no linkage between the claims and benefits paid by the insurer in a non-participating contract and the cash flows arising from the assets held by the insurer. Therefore, measurement of an insurance liability should not reflect the expected return on the assets backing that liability.

13. We agree with the proposal to consider the effect of liquidity (ie to use the discount rate that includes a liquidity premium in addition to a risk-free rate). Measurement of insurance liabilities should reflect the fact that insurance contracts generally lack liquidity.

14. The guidance on liquidity is not sufficient and insurers might face some difficulties in determining the adjustment for liquidity. However, we understand the IASB's view that, in its

principle-based approach, it is not appropriate to provide detailed guidance on an adjustment for liquidity or to require the usage of a rate of return on a high quality corporate bond.

15. It is not a valid concern that the proposed discount rate may misrepresent the economic substance of some long-duration insurance contracts. We believe that the risk of non-performance by the obligor should not be reflected in measurement of liabilities in general and this also applies to insurance contracts.

Question 4 – Risk adjustment versus composite margin

Do you support using a risk adjustment and a residual margin (as the IASB proposes), or do you prefer a single composite margin (as the FASB favours)? Please explain the reason(s) for your view.

16. We support the composite margin approach for the following reasons:
    (a) It is difficult to reliably estimate the risk adjustment.
    (b) Under the risk adjustment approach, differences in techniques or parameters used for estimating the risk adjustment would impede comparability.
    (c) The composite margin approach is consistent with the proposals in the Revenue ED in that a margin would be excluded in the onerous contract test at inception.

Question 5 – Risk adjustment

(a) Do you agree that the risk adjustment should depict the maximum amount the insurer would rationally pay to be relieved of the risk that the ultimate fulfilment cash flows exceed those expected? Why or why not? If not, what alternatives do you suggest and why?

(b) Paragraph B73 limits the choice of techniques for estimating risk adjustments to the confidence level, conditional tail expectation (CTE) and cost of capital techniques. Do you agree that these three techniques should be allowed, and no others? Why or why not? If not, what do you suggest and why?

(c) Do you agree that if either the CTE or the cost of capital method is used, the insurer should disclose the confidence level to which the risk adjustment corresponds (see paragraph 90(b)(i))? Why or why not?

(d) Do you agree that an insurer should measure the risk adjustment at a portfolio level of aggregation (ie a group of contracts that are subject to similar risks and managed together as a pool)? Why or why not? If not, what alternative do you recommend and why?

(e) Is the application guidance in Appendix B on risk adjustments at the right level of detail? Do

you have any comments on the guidance?

17. We disagree with the proposal that the risk adjustment should depict the maximum amount the insurer would rationally pay to be relieved of the risk that the ultimate fulfilment cash flows exceed those expected. The phrase "the maximum amount the insurer would rationally pay" implies settling an obligation by payment to the third party and therefore it does not appropriately describe the measurement of an insurance liability that should be based on the assumption that an insurer fulfils its own obligation. In addition, what "maximum" means is not clear. We do not consider it necessary to explain the risk adjustment in a wording similar to the measurement objective in the exposure draft *Measurement of Liabilities in IAS 37*.

18. As noted in paragraph BC116 of the ED, techniques may evolve over time and thus new ones more suitable than the three techniques might be developed in future. Therefore, we believe that the choice of techniques for estimating risk adjustments should not be limited.

19. We disagree with the proposal that if either the CTE or the cost of capital method is used, the insurer should disclose the confidence level to which the risk adjustment corresponds. Requiring that disclosure could be as burdensome as requiring calculation of two types of risk adjustments. In addition, disclosure of the confidence level to which the risk adjustment corresponds would be inappropriate because it might give an impression that the confidential level technique is the most desirable.

20. We agree that a portfolio level of aggregation of contracts which are subject to broadly similar risks and managed together as a single pool will provide relevant information for users at reasonable cost.

21. As noted above, we disagree with the proposal to limit the choice for estimating the risk adjustment to only three techniques. However, at the present time many insurers will use those three techniques and accordingly describing their outlines would enhance understandability to users as well as preparers. From this viewpoint, the application guidance in Appendix B on risk adjustments is at the right level of detail.

Question 6 – Residual/composite margin

(a) Do you agree that an insurer should not recognise any gain at initial recognition of an insurance contract (such a gain arises when the expected present value of the future cash outflows plus the risk adjustment is less than the expected present value of the future cash inflows)? Why or why not?

(b) Do you agree that the residual margin should not be less than zero, so that a loss at initial

recognition of an insurance contract would be recognised immediately in profit or loss (such a loss arises when the expected present value of the future cash outflows plus the risk adjustment is more than the expected present value of future cash inflows)? Why or why not?

(c) Do you agree that an insurer should estimate the residual or composite margin at a level that aggregates insurance contracts into a portfolio of insurance contracts and, within a portfolio, by similar date of inception of the contract and by similar coverage period? Why or why not? If not, what do you recommend and why?

(d) Do you agree with the proposed method(s) of releasing the residual margin? Why or why not? If not, what do you suggest and why (see paragraphs 50 and BC125–BC129)?

(e) Do you agree with the proposed method(s) of releasing the composite margin, if the Board were to adopt the approach that includes such a margin (see the Appendix to the Basis for Conclusions)? Why or why not?

(f) Do you agree that interest should be accreted on the residual margin (see paragraphs 51 and BC131–BC133)? Why or why not? Would you reach the same conclusion for the composite margin? Why or why not?

22. We agree that an insurer should not recognise any gain at initial recognition of an insurance contract. Insurance contracts are contracts with customers and in most cases insurers settle obligations by their own fulfilment. Therefore, any gain should not be recognised before fulfilling the obligations, like the proposal in the Revenue ED.

23. We agree that a loss at initial recognition of an insurance contract should be recognised immediately in profit or loss. Recognising a loss when a contract is onerous is consistent with the proposal in the Revenue ED.

24. Assuming the usage of proposed method(s) of releasing the residual margin or composite margin, we understand the rationale for the proposal that an insurer should estimate the residual or composite margin at a level that aggregates insurance contracts into a portfolio of insurance contracts and, within a portfolio, by similar date of inception of the contract and by similar coverage period. However, practicability of such aggregation should be carefully considered, since some constituents point out practical difficulties.

25. We suggest that the residual margin should be released always on the basis of the passage of time. The ED proposes that it should be recognised on the basis of the expected timing of incurred claims and benefits, if that pattern differs significantly from the passage of time. However, we believe that it would be enough to always require recognition on the basis of the

passage of time, from the viewpoint of costs and benefits consideration. Even when the pattern of expected timing of incurred claims and benefits differs significantly from the passage of time, its impact would be reflected in releasing the risk adjustment to a considerable extent.

26. With regard to the composite margin, the proposed pattern of releasing might be approximate to the actual pattern of risk reduction in some cases but might not in other cases. Whether there can be a better method should be further considered, also taking account of the viewpoint of costs and benefits.

Question 7 – Acquisition costs

Do you agree that incremental acquisition costs for contracts issued should be included in the initial measurement of the insurance contract as contract cash outflows and that all other acquisition costs should be recognised as expenses when incurred? Why or why not? If not, what do you recommend and why?

27. We agree that incremental acquisition costs for contracts issued should be included in the initial measurement of the insurance contract as contract cash outflows. Since acquisition costs are integral costs to contracts and incorporated in the pricing of premiums, those acquisition costs should be included in measurement of the insurance contract as contract cash outflows. Recognition of incremental acquisition costs as expenses when incurred would not provide useful information, because its consequence would be that the more the number of new insurance contracts is, the more initial losses would be recognised.

28. We share the concern mentioned in paragraph BC139(b) that the definition of incremental acquisition costs is too narrow to reflect adequately the various sales structures of insurers (eg external agents versus direct writing) –for instance, it may result in different answers for sales structures that have the same cost level but use different channels. Accordingly, we are of the view that fixed salaries of direct sales staff and fees determined on the basis other than the per contract basis, to the extent that those are directly related to successfully acquired contracts, should also be included as contract cash outflows.

Question 8 – Premium allocation approach

(a) Should the Board (i) require, (ii) permit but not require, or (iii) not introduce a modified measurement approach for the pre-claims liabilities of some short-duration insurance contracts? Why or why not?

(b) Do you agree with the proposed criteria for requiring that approach and with how to apply that approach? Why or why not? If not, what do you suggest and why?

29. An unearned premium approach should be permitted but not be required. That approach is a practical short cut of the fundamental measurement method (ie present value of fulfilment cash flows plus a residual margin). It is unreasonable to require the short cut and to disallow the fundamental method.

30. The ED explains that it proposes to require (not merely permit) the modified measurement approach to ensure comparability. However, we believe that permitting alternatives would not largely impair comparability, because the modified approach is a reasonable approximation of the fundamental measurement method.

Question 9 – Contract boundary principle

Do you agree with the proposed boundary principle and do you think insurers would be able to apply it consistently in practice? Why or why not? If not, what would you recommend and why?

31. We agree with the proposed boundary principle. It is reasonable to determine a contract boundary based on the insurer's ability to reassess the risk presented by a policyholder and accordingly set a price that fully reflects that risk.

Question 10 – Participating features

(a) Do you agree that the measurement of insurance contracts should include participating benefits on an expected present value basis? Why or why not? If not, what do you recommend and why?

(b) Should financial instruments with discretionary participation features be within the scope of the IFRS on insurance contracts, or within the scope of the IASB's financial instruments standards? Why?

(c) Do you agree with the proposed definition of a discretionary participation feature, including the proposed new condition that the investment contracts must participate with insurance contracts in the same pool of assets, company, fund or other entity? Why or why not? If not, what do you recommend and why?

(d) Paragraphs 64 and 65 modify some measurement proposals to make them suitable for financial instruments with discretionary participation features. Do you agree with those modifications? Why or why not? If not, what would you propose and why? Are any other modifications needed for these contracts?

32. We agree with that the measurement of insurance contracts should include participating benefits on an expected present value basis. In the measurement model based on the estimation of

future cash flows arising from insurance contracts, measurement of insurance contracts should include the participating benefits in the same way as any other benefits. Since some participating benefits are interdependent with other cash flows (eg less participating benefits would increase surrenders), including only cash flows other than the participating benefits in the measurement of liabilities would not represent the economic substance.

Question 11 – Definition and scope

(a) Do you agree with the definition of an insurance contract and related guidance, including the two changes summarised in paragraph BC191? If not, why not?

(b) Do you agree with the scope exclusions in paragraph 4? Why or why not? If not, what do you propose and why?

(c) Do you agree that the contracts currently defined in IFRSs as financial guarantee contracts should be brought within the scope of the IFRS on insurance contracts? Why or why not?

33. We agree with the definition of an insurance contract and related guidance as well as the scope exclusions, in that they are reasonable and give little impact on the current practice, except for financial guarantee contracts.

34. It is appropriate to include financial guarantee contracts issued by insurance companies within the scope of this IFRS.

35. We are of the opinion that applying this IFRS to financial guarantee contracts issued by entities other than insurance companies should be withheld. The accounting treatment proposed in the ED is more advanced and complex than other standards and would be overly burdensome and confusing to entities other than insurance companies. The benefits of applying the IFRS on insurance contracts to financial guarantee contracts issued by entities other than insurance companies would not outweigh the costs.

Question 12 – Unbundling

Do you think it is appropriate to unbundle some components of an insurance contract? Do you agree with the proposed criteria for when this is required? Why or why not? If not, what alternative do you recommend and why?

36. It is appropriate to unbundle non-insurance components from an insurance contract. Such unbundling would improve transparency and comparability with other contracts or financial instruments and thus provide useful information.

37. We agree with the proposed criteria for unbundling an embedded derivative. The proposal that a surrender option is not unbundled would be appropriate because unbundling such an option would bring an excessive complexity.

38. We consider that the cases of unbundling deposit elements would be very limited because in many insurance contracts deposit elements and insurance coverage are closely related with each other (eg once a death benefit is paid, a maturity benefit will not be paid). However, not unbundling some deposit elements that form large proportions of premiums would be problematic from the viewpoint of comparability with the accounting for financial instruments issued by entities other than insurance companies. Further consideration should be given to whether it is possible to develop criteria that would require unbundling of such significant deposit elements.

39. It appears that paragraph 8 (a) in the ED would require an investment component in unit-linked contracts to be unbundled in principle. However, for some unit-linked contracts, an investment component is closely related to an insurance component. The wording should be amended to clarify how to treat those contracts.

Question 13 – Presentation

(a) Will the proposed summarised margin presentation be useful to users of financial statements? Why or why not? If not, what would you recommend and why?

(b) Do you agree that an insurer should present all income and expense arising from insurance contracts in profit or loss? Why or why not? If not, what do you recommend and why?

(a) Summarised margin presentation

40. The proposed summarised margin presentation would be inappropriate as a presentation format of the statement of comprehensive income because it is contrary to the principle of IAS 1 that income and expense should be presented on the gross basis. Premium revenue, claims and benefits and other expenses related to insurance contracts should be presented in the statement of comprehensive income, because they are essential items for analysing performance of insurers.

41. The premium allocation approach is an approach currently applied mainly to non-life insurance contracts and it is consistent with the presentation of revenue from non-insurance contracts with customers. However, assuming the proposed criteria for unbundling would be applied, that approach is inappropriate because it would result in overstatement of revenue for insurance contracts containing significant deposit elements that are not unbundled.

42. We are of the view that the expanded margin approach should be further considered. Since this approach would present revenue in a relatively similar manner to revenue from non-insurance contracts with customers, it may be able to provide useful information for users of financial statements. Although we acknowledge that there are some problems in the expanded margin approach, it seems that the IASB has not considered that approach enough. The IASB should consider further to develop a method that is practicable and least troublesome.

(b) Presentation in profit or loss

43. We disagree with recognising all changes in estimates of discount rates and future cash flows immediately in profit or loss, except for unit-linked contracts. We believe that those changes should be presented in other comprehensive income and recycled to profit or loss in subsequent periods.

44. Many consider that profit or loss as a performance measure is useful in evaluating entity's ability to generate cash flows. Recognising all the changes in estimates in profit or loss immediately would significantly mislead users of financial statements, particularly for entities that issue many long-term insurance contracts.

45. We believe that the effect of changes in discount rates should not be recognised in profit or loss, for the following reasons:

    (a) Short-term changes in interest rates should not be reflected in profit or loss, because insurance liabilities are typically settled by insurers' fulfilment of obligations, rather than transferring those liabilities to third parties in the middle of the contract.

    (b) Insurance companies intend to earn profits from undertaking and properly managing insurance risk, not from short-term changes in interest rates. However, according to the proposal in the ED, profit or loss of insurance companies underwriting long-term insurance contracts would be affected by short-term changes in market interest rates much more than by earnings from undertaking insurance risk. Profit or loss determined as such would not be useful as a performance measure of the insurance business.

46. We believe that changes in estimates of future cash flows, except for claims liabilities, should not be recognised in profit or loss immediately but recognised over future periods, for the following reasons:

    (a) From a viewpoint of consistency with the Revenue ED and the exposure draft on leases, those changes in estimates related to future periods should not be immediately reflected in profit or loss unless the contract is onerous.

(b) Reflecting those changes in estimates immediately in profit or loss would not be consistent with the treatment at inception (in which day 1 gain is not recognised and the recognised residual margin is released over future periods). Recognising changes in estimates of expenses arising in the future in profit or loss over future periods would be consistent with the measurement approach in the ED, in which the margin arising from an insurance contract is released over future periods.

47. As mentioned in paragraph 6, we support measuring an insurance contract based on the expected present value of its future cash flows and agree that changes in estimates should be reflected in the statement of financial position. Therefore, consequence of our suggestions described above is that changes in estimates except for claims liabilities would be presented in other comprehensive income and recycled to profit or loss over the subsequent periods.

48. Without recycling, profit or loss would represent only releases of margin determined on the basis of the estimates at inception and no longer reflect actual cash flows. Usefulness of profit or loss determined as such would be seriously impaired because it would not faithfully represent the performance of insurers. Therefore, changes in estimates once presented in other comprehensive income should be subsequently recycled to profit or loss.

Question 14 – Disclosures

(a) Do you agree with the proposed disclosure principle? Why or why not? If not, what would you recommend, and why?

(b) Do you think the proposed disclosure requirements will meet the proposed objective? Why or why not?

(c) Are there any disclosures that have not been proposed that would be useful (or some proposed that are not)? If so, please describe those disclosures and explain why they would or would not be useful.

49. We agree with the proposed disclosure principle.

50. We consider that the proposed disclosure requirements will meet the proposed objective. The proposed disclosure requirements are consistent with IFRS 7 *Financial Instruments: Disclosures* and the Revenue ED and generally appropriate.

51. As commented in paragraph 19 above, we consider it unnecessary to disclose the confidence level to which the risk adjustment corresponds when either the CTE or the cost of capital method is used.

Question 15 – Unit-linked contracts

Do you agree with the proposals on unit-linked contracts? Why or why not? If not what do you recommend and why?

52. We agree with a separate presentation of assets, liabilities, income and expense related to unit-linked contracts from those of other insurance contracts, because the benefits (risk) arising from the performance of assets underlying unit-linked contracts are received (assumed) by policyholders.

53. Please see our comment on question 12 for unbundling of investment components in unit-linked contracts.

Question 16 – Reinsurance

(a) Do you support an expected loss model for reinsurance assets? Why or why not? If not, what do you recommend and why?

(b) Do you have any other comments on the reinsurance proposals?

54. We support an expected loss model for reinsurance assets, because it is consistent with measurement of insurance and reinsurance contracts based on the expected present value of future cash flows.

Question 17 – Transition and effective date

(a) Do you agree with the proposed transition requirements? Why or why not? If not, what would you recommend and why?

(b) If the Board were to adopt the composite margin approach favoured by the FASB, would you agree with the FASB's tentative decision on transition (see the appendix to the Basis for Conclusions)?

(c) Is it necessary for the effective date of the IFRS on insurance contracts to be aligned with that of IFRS 9? Why or why not?

(d) Please provide an estimate of how long insurers would require to adopt the proposed requirements.

55. We agree with measuring insurance contracts at the beginning of the earliest period presented, because it is difficult to retrospectively determine the residual margin at contract inception.

56. However, we consider that there is a drawback in the proposed transition method. According

to the proposal, the residual margin for existing contracts would be determined as zero and their residual margin attributable to the future periods would be transferred to retained earnings on transition. Consequently, reported profit would be less than it should be until all the existing contracts expire. Meanwhile, we acknowledge that an approach in which the residual margin on transition would be determined using the carrying amount under the previous GAAP would not be appropriate as noted in paragraph BC249.

57. We suggest that the deemed residual margin should be determined on transition in some way. For example, there would be a method that compares a portion of premium revenue (including that received in the past) that is attributable to future periods with the expected present value of future cash outflows plus risk adjustments.

58. Retrospective application should be permitted if entities can do so.

59. Regarding question 17(b), if the composite margin approach is to be adopted, the deemed composite margin should be determined similarly to our suggestion in paragraph 57 above.

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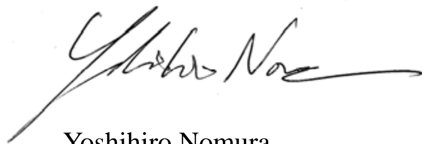
We hope that our comments will contribute to the forthcoming deliberations in the project.

Yours sincerely,



Yoshihiro Nomura
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