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International Accounting Standards Board
30 Cannon Street
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Comments on the Exposure Draft, *Insurance Contracts*

To the Board Members:

The Japanese Institute of Certified Public Accountants ("we" and "our") appreciates the continued efforts of the International Accounting Standard Board (IASB) on the insurance contracts project, and welcomes the opportunity to comment on the Exposure Draft (ED), *Insurance Contracts.*

While considering our comments on the IASB's Discussion Paper Preliminary Views on Insurance Contracts, we reviewed the proposals put forward in the ED, including the new perspectives in the document.

Although this proposal for the accounting for insurance contracts includes some accounting for policyholders of reinsurance contracts, as it basically addresses only the "accounting by insurer," we consider that the project is still in progress. At the same time, we understand that the purpose of the proposed requirements for "accounting by insurers" is to develop the standard to be applied for the time being. Thus, in reviewing this ED, we specifically noted that the insurance contracts are characterized by the exposure to a long-term uncertainty and that, and its economic feasibility.

In light of the above, we believe that it is certain for the ED to significantly influence insurers. On the one hand; accounting figures to be measured or their presentation for the current accounting period will inevitably be the estimated expected values. Even if the accounting figures will be the expected values, these can be relied upon to ensure comparability and reliability of financial statements, provided that these are measured based on practical and reasonable guidance. Furthermore, reduced accounting mismatch and clear reporting on economic mismatch will ensure the relevance of the financial reporting. In addition, considering that insurers are regulated by competent authorities in their respective jurisdictions, we believe it will be constructive to discuss the "accounting by insurers" by incorporating the perspectives of the authorities.

Our responses to the ED are based on the foregoing perspectives and a view to realize such measurement approaches and presentation methods that ensure the auditability and usefulness of financial statements.

（Note） In developing our comments, we have assumed the application of the current IFRS 9 *Financial Instruments*. With respect to any issues requiring actuarial deliberations, we confined the scope of our comments by simply indicating the relevant issues to be considered, as these issues are to be consulted with appropriate professional organizations.

Measurement (paragraphs 16–61, B34–B110 and BC45–BC155)

Question 1 – Relevant information for users (paragraphs BC13–BC50)

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?

Comment:

Basically, we believe that the proposed measurement model will help users to make economic decisions regarding an insurer's financial statements.

However, under this proposal, there is a possibility that any profit or loss arising from temporary changes of market conditions, which should not be attributed to the current period, may be reflected in the current year results. We are concerned that this may impact on the usefulness of the financial statements.

Assuming that IFRS 9 is to be applied, as previously stated, accounting mismatch arising from the changes in the values of insurance assets and liabilities may be reduced under the ED (BC172 to BC179). However, for example, in a case where the matching operation of the insurance assets and liabilities, in full, is difficult, the differences arising from the changes in the market values of the assets and liabilities will be recognized in profit or loss.

Insurers may manage the risk of changes arising from changes in circumstances and other events by absorbing the effect of the risk through the profit portion included in premiums or in their own equity. Based on the measurement model proposed in the ED, the change of risk adjustments and release of residual margins in profit or loss in each reporting period may represent the accounting for the portion of premiums corresponding to the risk of change.

However, as residual margins are not re-measured, there is a concern that all the approaches to the risk of change may not be fully reflected for accounting purposes. More particularly, our concern is that, when all of the changes arising from re-measurement of insurance liabilities (excluding residual margins) were to be recognized in profit or loss, the treatment of the risk of change through the profit portion included in the premiums, that is, the changes arising from the re-measurement of residual margins would need to be recognized in profit or loss. Otherwise, the usefulness of the financial statements would be impaired.

We do not believe that the situations described above should remain unresolved. Accordingly, we recommend that the IASB consider a method that proves to be practicable, appropriate, and auditable through field tests or other means, including the possibility and the method of re-measuring the residual margin.[1]

Question 2 – Fulfillment cash flows (paragraphs 17(a), 22–25, B37–B66 and BC51)

(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 fulfills 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?

Comment:

(a) We agree.

The measurement of an insurance contract should include both the future cash outflows and future cash inflows that arise as the insurer fulfills the insurance contract, as the future cash outflows and inflows represent an integral part of the economic substance of the contract.

(b) With respect to paragraph B61 (j), we propose the following two points.

(1) As insurance liabilities are recognized in terms of the current insurance contracts, the IASB should reconsider whether payments to future policyholders should be included therein.

(2) The IASB must elaborate the notion of the estimate and so on, in more detail, as various approaches are expected to be adopted in estimating future dividend payments, and the relationship with risk adjustments and residual margins is not yet clear.

1 For example, one practical approach would be to keep insurance premiums unchanged, re-measure residual margins at the inception by applying preconditions at the end of reporting date in effect other than those related to insurance premiums, and comprehend the outstanding balances after amortization made over the passage of time up to the period end (see Q17). Another approach would be to reflect the effect of the current estimate due to the changes of preconditions in the recalculation of the residual margin and adjust for the effect through the allocation over the coverage period. Since the consideration from the viewpoint of actuaries is likely to be required, whether this proposal is appropriate or not should be determined in consultation with professional organizations, including the viewpoint of auditability.

Question 3 – Discount rate (paragraphs 30–34 and BC88–BC104)

(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 fulfillment cash flows should not reflect the risk of non-performance by the insurer?

Comment:

(a) We agree.

However, given our concern that the current guidance may lead to diversity in practice, we suggest that more specific guidance needs to be developed, such as the one developed, for example, in IAS 19 *Employee Benefits*.

(b) We do not agree.

We understand that measurement using fulfillment cash flows represents a measurement concept from an insurer's point of view, which fails to take into account the element of liquidation of insurance liabilities such as transfers (BC50 and BC51). Thus, the consideration of the illiquidity from the policyholder's point of view (BC98 and BC99) is inconsistent with this measurement concept. We also believe that the illiquidity from the policyholder's point of view may be reflected in the surrender rate. On this basis, we do not believe that the adjustments for illiquidity should be considered explicitly.

Meanwhile, more detailed guidance should be provided even when adjustments for illiquidity are to be considered. This is because the observable market inputs are often unavailable, and because there may be situations when it is difficult to distinguish illiquidity from the credit risk (credit spread) (paragraph BC100).

(c) Changes in the risk of non-performance by the insurer should not be reflected in the measurement of insurance liabilities.

To ensure consistency with the measurement based on fulfillment cash flows, changes in the risk of non-performance by an insurer should not be reflected in the measurement of insurance liabilities. The consideration of credit risks arising from the contracts (including long-duration contracts) relates to the discussion of product design or pricing, and it should be addressed in the context of the gain of an insurer.

Question 4 – Risk adjustment versus composite margin (paragraphs BC105–BC115)

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.

Comment:

We support the use of a risk adjustment and a residual margin.

The essence of insurance is to accept and manage risks. As such, the measurement of insurance liabilities should account for, not only the expected value, but also the risks (uncertainty). We believe that the risk adjustment can provide users with useful information related to the insurance contracts of an insurer by expressly indicating the risk adjustment as a significant component of insurance liabilities. Profit or loss information sourcing from the risk adjustment will provide useful information on the performance of an insurer for the comparison between periods. Furthermore, if the calculation technique is to be standardized, this information could provide useful information for the comparison between different insurers.

In addition, the explicit measurement of a risk adjustment is consistent with the notion (current estimation and risk margin) of liabilities assessment under Solvency II.

Notwithstanding the above, we believe that the simplified method should also be permitted for financial guarantees for further improved cost and benefit relationship (see Q11). With such a simplified method, it will be useful not to require explicit distinction between risk adjustment and a residual margin. Given that the ED has expanded the scope of *Insurance Contracts*, contracts such as those not previously treated as insurance contracts and contracts that effectively assign more weight to characteristics different from those in traditional insurance contracts will probably be treated also as insurance contracts under the ED. For those contracts, and in companies whose main activities are not in the area of insurance, the risks related to the contracts may not be often managed explicitly. Therefore, there may be cases in which distinguishing the risk adjustment and the residual margin may not reflect the economic substance or may not be useful in terms of costs and benefits. In such cases, we believe that an approach that does not make the distinction between the risk adjustment and the residual margin should be permitted.

Question 5 – Risk adjustment (paragraphs 35-37, B67-B103 and BC105–BC123)

(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 fulfillment 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?

Comment:

(a) We do not agree.

Since risk adjustment is assumed to be calculated using a statistical method, and the degree of risk preference differs from one insurer to another, the bases of comparison used to derive the "maximum amount" should be clarified.

(b) We do not agree.

There is no measurement technique for making an appropriate estimate that can be universally applied to all insurance contracts or to any environment. As such, it will not be reasonable, in practice, to propose to limit estimation techniques to only one type.

On the other hand, it is reasonable to assume for management, to have applied the most reasonable approach (including a valuation technique), given the insurance contracts held by the company and the circumstances under which the company operates. On this basis, we believe that, from the viewpoint of the management approach, requiring to adopt the valuation technique used by the management for their management purposes would not undermine the comparability.

While it may be acceptable to describe these three approaches as representative model approaches for the calculation of a risk adjustment, we believe that it will not be helpful to limit the approaches to those three techniques alone, as doing so would potentially impede future research and development of better techniques. Therefore, if rebuttable, the IASB should leave the room open for development of other techniques. And in cases where an entity adopts a technique not described in the Standard, we believe that the Standard should ideally require the entity to disclose the description of the technique and the reason for adopting it.

(c) We do not agree.
As long as management adopts an adequate technique, the additional disclosure of the confidence level may cause difficulty in readers' interpretation and, likely, will not improve comparability. Given that the measurement may result in significant difficulties in practice, we do not believe that the disclosure should be required.

(e) It is not at the right level of detail. More detailed guidance needs to be provided.
It would be desirable, for example, to provide more detailed guidance on the confidence level to be used, or the cost-of-capital rate set for each technique. Even when the same technique is applied, the calculated risk adjustment is expected to differ significantly, depending on the confidence levels or cost-of-capital rates applied. We believe that detailed guidance will certainly contribute to reaching appropriate decisions and measurement results, as well as to permit comparability and auditability.

It will also be desirable to clarify whether or not the risk adjustment technique should be aligned in consolidated financial statements.

Question 6 – Residual/composite margin (paragraphs 17(b), 19–21, 50–53 and BC124–BC133)

(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?

Comment:

(a) We agree.

The essence of insurance contracts is to provide services for accepting the risks of policyholders for a certain period of time. As such, we believe it would be unreasonable to recognize gains before services are provided.

(b) We agree.

In a case of an insurance contract, where the expected present value of future cash outflows exceeds the value of cash inflows, so-called “onerous contract,” we believe it is reasonable to recognize a loss, at inception, in profit or loss.

(d) We do not agree.

Since one aspect of an insurance contract is to provide coverage services that are interdependent on other contracts within a portfolio with the passage of time, a residual margin may include the consideration for those services and revenue compensating for the expenses for every term. If the amortization referred to in paragraph 50 (b) was to be permitted, such amortization would not properly reflect the economic substance. For this reason, we believe that the release of residual margin should be made only on the basis of the "passage of time."

As discussed in our response to Q1, the re-measurement of a residual margin at the end of each reporting period should also be re-considered for further improvements.

(e) We do not agree to the adoption of the composite margin approach.

We believe that it is appropriate to use a risk adjustment and a residual margin (see our response to Q4).

(f) We do not agree.

It is not clear as to whether or not the gross-up of interest accreted on a residual margin and the release of a residual margin would provide useful information. Given the practical challenge to establish interest calculation, consistent with the discount rate used in the calculation of insurance liabilities, we see no need for accreting the interest.

Question 7 – Acquisition costs (paragraphs 24, 39 and BC135–BC140)

(a) 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?

Comment:

We basically agree.

However, the incremental acquisition costs should be determined at a portfolio level and be limited to the expenses incurred from the acquisition of new portfolio of contracts.

The expenses incurred from the acquisition of new contracts are normally expected to be recovered through insurance premiums. Thus, the portion of premium revenue corresponding to the acquisition costs expensed as incurred are considered to be included in the residual margin. As a result, a mismatch arises between the timing when the expenses are incurred and when these are recovered. As the cash inflows arising from the premium revenue are reflected in the measurement of the insurance liabilities, it is consistent to include all the acquisition costs in contractual cash flows.

However, there may be acquisition costs that use revenue from prior periods or use equity capital as a preceding investment, or there may be other acquisition costs to acquire insurance contracts in the future (including the current period), rather than expecting to be recovered via direct links to newly issued contracts during the current period. Also, from the viewpoint of prudence, we believe that it will be appropriate to expense these costs as incurred.

It will be impractical to divide acquisition costs by fully reflecting these characteristics. Given the characteristics of insurance contracts where revenue is generated through a formation of certain size of portfolio of the contracts, by limiting the scope of the acquisition costs only to the newly incurred expenses for the acquisition of the portfolio, we believe that the economic substance of the contracts will be reflected more properly than by what has been proposed in the ED, while ensuring prudence.

At the same time, from the perspective of comparability, a more detailed guidance should be provided to distinguish incremental acquisition costs from other acquisitions costs. Also the Standard should clarify the accounting for acquisition costs when these are unbundled.

Short-duration contracts (paragraphs 54–60 and BC145–BC148)
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?

Comment:
(a) The modified measurement approach for the pre-claim liabilities of short-duration insurance contracts should be permitted, but should not be required.
We believe that the principle-based measurement technique provides the most accurate measurement of liabilities for all insurance contracts. Accordingly, any technique that can provide more accurate measurement should not be precluded, as it will certainly

enhance the comparability, if not impede it.

(b) We basically agree with the approach, but suggest that the following should be re-considered.

(1) Given that insurance liabilities are measured at a portfolio level, an insurer should also be allowed to consider the coverage period at a portfolio level, not at an individual contract level.

(2) In cases where the characteristics of the insurance contract are similar to an insurance contract with a coverage period expected to be one year or less, or the results do not materially differ from those derived using the original method, the premium allocation approach should be permitted for improved cost and benefit relationship, even when the coverage period of an insurance contract is more than about one year (paragraph BC146).

(3) Because policyholders may surrender short-duration insurance contracts, the exercise of surrender options may have an impact on cash flows. The IASB should clarify whether or not the surrender option may prevent the application of the premium allocation approach.

Cash flows that arise from future premiums (paragraphs 26–29 and BC53–BC66)
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?

Comment:
We agree.
An insurer is obliged to continue to accept risks from policyholders as required, until it becomes entitled to exercise the right to reject. As such, it is reasonable for the insurer to measure the liabilities arising from the obligation based on the contractual cash flows up to that point.

On the other hand, we have concerns over the current guidance, and propose that the following issues be re-considered:

(1) The proposed principle defines the boundary as the point at which an insurer “has the right or the practical ability to re-assess the risk of the particular policyholder,

and, as a result, can set a price that fully reflects that risk." We are concerned that entities may arbitrarily claim the continuity of a contract by avoiding to fully reflect these risks. We should focus on reflecting substantive risks, rather than fully reflecting the risks.

(2) The current proposal does not clearly provide for the accounting of insurance contracts with premiums set by government or similar authorities. We propose that the IASB clarify whether or not a contract with a premium set by government or a similar authority may also meet the conditions for the contract boundary.

Participating features (paragraphs 23, 62–66, BC67–BC75 and BC198–BC203)

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?

Comment:

(a) We agree.

We believe that the discussion of the IASB is appropriate (paragraph BC70).

(b) They should be within the scope of the IFRS on insurance contracts.

We agree with the reasons presented in paragraph BC198. The reference to "discretionary participation features" is appropriate, since the evaluation of the participation features by measurement of insurance liabilities is consistent with the measurement of insurance contracts with similar characteristics.

(c) We do not agree.

We cannot clearly interpret the notion underlying the reference to "….provided that there also exist insurance contracts that provide similar contractual rights to participate in the performance of the same insurance contracts, the same pool of assets, or the profit or loss of the same company, fund, or other entity" (Appendix A). This appears to suggest that unless there are any other similar insurance contracts, the definition of "discretionary participation features" would not be satisfied. If so, we recommend that the IASB highlight characteristics of the "discretionary participation features" and develop a related common accounting treatment.

(d) We do not agree.

In fact, financial instruments with discretionary participation features can be said to merely represent the provision of the asset management services. These services do not necessarily relate to the passage of time, nor depend on the fair value pattern of assets under management. Therefore, it will be most reasonable to adopt an approach consistent with the asset management services such as the release of the residual margin.

Definition and scope (paragraphs 2–7, B2–B33 and BC188–BC209)

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?

Comment:

(a) We basically agree. However, in view of diversity in the types of insurance contracts, we also recommend, that it will be useful to increase and expand examples through field tests or other means.

Certain insurance contracts in Japan are substantially controlled by the government. Under the current definition of an insurance contract, it is unclear as to whether or not these special government-controlled contracts meet the definition of an insurance contract like conventional insurance contracts. Before the Standard is finalized, we believe that the IASB should carry out additional field tests and so on, to clarify the definition of insurance contracts and expand and improve illustrative examples and notions of insurance contracts.

(b) We agree, provided that the discussion on “accounting by policyholders” is promptly commenced.
We now see varieties of accounting treatments for insurance contracts held by many companies. “Accounting by insurers” is closely related to “accounting by policyholders.” We believe that this issue should be addressed promptly with a view to improving the comparability and developing a clearer accounting by the IASB.

(c) We agree. However, we suggest that the following two issues need to be discussed.

(1) With respect to the salvage or subrogation provisions characteristic of financial guarantee contracts, more detailed explanations should be provided than those described in the proposed paragraph B61.

    Financial guarantee contracts often include salvage and subrogation (receivables) obtained from the payment of claims. The description in paragraph B61 (i) appears insufficient. In particular, if subrogation (receivables) is anticipated in any future cash inflows, it is not clear as to whether it can be recognized as a financial instrument, or whether any negative insurance liabilities are allowed to be recognized, when the payment of insurance claim has been completed. In addition, it is not certain as to whether we would be able to acknowledge the period up to the extinguishment of subrogation (receivables) as a coverage period in the first place.

(2) We believe that there may be cases where the substance of financial guarantee contracts is inconsistent with the insurance accounting model. These contracts should be identified through field testing, and other models, including the consideration of the premium allocation approach.

    According to the proposal made under the ED, the scope of financial guarantee contracts accounted for as insurance contracts will be significantly expanded. As the financial guarantee contracts meet the proposed definition of an insurance contract, it may be rational, in a sense, to recognize them as insurance contracts. However, given that the financial guarantees come in various forms, there may be cases where it would be inappropriate to apply the proposed insurance accounting model. For example, the proposed insurance accounting model would be inappropriate when the characteristics different from those of insurance contracts are given more weight in order to better reflect their economic substance. Also it would be inappropriate from the perspective of costs and benefits when the main activities of the company are not in the area of insurance.

Therefore, potentially there may be cases where the measurement of insurance liabilities using risk adjustment and so on, as proposed in the ED, will not fit for those contracts, or may not be useful in terms of costs and benefits. With this in mind, we recommend that these contracts should be identified through field testing, and other models including the consideration of the premium allocation approach. .

Unbundling (paragraphs 8–12 and BC210–BC225)

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?

Comment:

We agree.

Components subject to unbundling exist in insurance contracts. We believe, however, that when those components are interdependent with the insurance itself, it is impracticable to separate the components from the insurance.

We therefore agree with the proposal requiring the unbundling of components not closely related to the insurance coverage.

However, the proposed description of the notion of "closely related" may vary in practice. Therefore, the concept should be aligned with that in IAS 39 *Financial Instruments: Recognition and Measurement*. Also, further guidance should be provided to clarify the assumptions built into the concept of "account balance."

Presentation (paragraphs 69–78 and BC150–BC183)

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?

Comment:

(a) We believe that the expanded margin approach or summarized margin approach with the volume of the operating activities is appropriate. The relevancy among account items should be reviewed, for example, by further segmenting the current account items and presenting the changes in insurance liabilities and those in matching assets in the same category.

The indexes indicating operating activities (premiums, claims and so on,) have been widely used as useful information for understanding the operating activities of an insurance company. And, given that claims are not necessarily paid to every policyholder who pays premiums, we can see that the relationship between the premium revenue and the claim payment is quite similar to the relationship between the sales and the cost of sales, rather than the relationship between the receipt and payment of deposits. Meanwhile, turning our focus to the proposed measurement approach (margin approach), it also seems reasonable to consider the changes of risk adjustments and the release of residual margins as the essence of revenue. Thus, we support that the expanded margin approach with the volume of the operating activities should be adopted in this context, the account items and categories should be further segmented and reviewed to better facilitate the understanding of the correlation between account items.

In addition, we propose that the following issues be considered:

- the presentation on the financial statements of entities where main activities are not in the area of underwriting of insurance contracts; and
- whether the differences, if any, between the initial estimate of the claim and the actual record of performance should be included in the underwriting margin in the premium allocation approach.

(b) We will agree to the proposal, on the assumption that the current IFRS 9 will be applied.

To improve the accounting by the insurer, we believe that it is critical to apply an accounting treatment that is consistent with the actual record of performance both in the statement of the financial position and the income statement. On the assumption that the current IFRS 9 will be applied, previously stated, the proposals of the IASB are relevant from the viewpoint of the insurance business model, provided, however, that the IASB addresses the issues we noted in our response to Q1.

Disclosures (paragraphs 79–97, BC242 and BC243)

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.

Comment:

(b) We believe that the proposed disclosure requirements basically meet the proposed objective, subject to the following suggested amendments to the requirements.

(1) We propose that the term “When practicable” needs to be deleted, and that the requirement should be amended to read: “Critical inputs are required to be disclosed.”
Since the disclosure of critical inputs appears to be useful, the disclosure should be required irrespective of its practicability.

(2) We propose that the second sentence in paragraph 90 (b) (i) needs to be deleted, as the additional disclosure of the confidence level is inappropriate (see our response to Q5(c)).

(3) The description of paragraph 90(d) is quite abstract. This requirement should be revised to illustrate more clearly the type of information to be disclosed.

(4) In the disclosure of liquidity risk (paragraph 95), the cash flow information on reinsurance assets is useful. On the other hand, we propose that the disclosure of

liquidity risk arising from insurance liabilities should not be required, since this will not be consistent with the measurement concept (see our response to Q3 (b)).

(c) We believe that it will be useful to disclose each of the following four issues.

(1) Assuming that a summarized margin presentation is to be applied, the disclosure of any index indicating the volume of the operating activities would have to be considered. The current income statement discloses information showing the volume of the operating activities, and the disclosure of such information is prevalent in the current practice. As this useful information will not be available in a summarized margin presentation, we propose that the following points should be required to be disclosed to show the volume of the operating activities to the users of financial statements.

(Example)

Life insurance:	Premium of new contracts, annualized premium, insurance coverage, payment of claims, and others
Non-life insurance:	Underwriting premium, claims paid, and others

(2) In cases when there will be any changes in the measurement method, we propose a requirement to disclose the change.

Reinsurance (paragraphs 43–46 and BC230–BC241)

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?

Comment:

(b) We propose as follows.

(1) The proposal does not provide any modification for the measurement of reinsurance assets of a cedant similar to that for insurance liabilities of short-duration insurance contracts. Because of this, different measurement method is applied to a direct insurance contract and to a reinsurance contract when an insurer enters into the reinsurance contract for a short-duration contract, and the risk management of the insurer may not be reflected appropriately. If the application of the modified measurement model for a short-duration contract is mandatory, a similar requirement should be provided for a reinsurance contract.

(2) The recognition of gain at inception of a reinsurance contract by a cedant should be limited to the extent that a direct insurance contract incurs an initial loss.

(3) Paragraph B28 states “for that purpose, contracts entered into simultaneously with a single counterparty, or contracts that are otherwise interdependent, form a single contract.” When this description is applied to a fronting arrangement (in particular when applying this to a fronting arrangement for a single group), it could result in in different application in practice. Improved guidance should be provided on the interpretation of the description of paragraph B28.

(4) As it is not clear whether or not any simplified measurement approach can be applied to a reinsurance contract on a risk-attaching basis underwritten for 12 months, this should also be clarified.

Transition and effective date (paragraphs 98–102 and BC244–BC257)

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.

Comment:

(a) We do not agree.

We suppose that the proposal can be highly valued in that it focuses on the difficulties being experienced during the transition. Yet, the proposal is also too simple, which gives rise to the following problems.

(1) It is inconsistent with the notion of avoiding any Day-one gain;

(2) “Future profit arising from a contract,” which is not a prime component of retained earnings, will be included in the retained earnings; and

(3) while general overheads arise after the transition date, the profit gained from the corresponding residual margin is included in the retained earnings beforehand. Thus, an accounting mismatch takes place in the income statement.

Instead, as examples, we propose the following approaches.
- approach to measure residual margins assuming at inception of the insurance contract by applying preconditions other than insurance premiums as of the end of the reporting period, and determined the outstanding balance depreciated based on the passage of time up to the reporting period end (see our response to Q1); or
- determine preliminary residual margins by applying the approach used to make retrospective calculations, to the maximum extent (and disclose that extent).

(b) We do not agree with the adoption of composite margin. hence do not make any comment here.
The approach proposed by the FASB is a transitional provision which is in conflict with the notion that a risk margin cannot be reasonably determined. As such, we consider it unreasonable.

(c) The effective date should be aligned with that of IFRS 9.
We believe that any accounting mismatch between assets and liabilities should be avoided. Therefore, the effective dates for the two standards, IFRS 9 and the Standard for insurance contract should be aligned. The re-designation of a financial asset should be conducted once.

Other comments

Question 18 – Other comments

Do you have any other comments on the proposals in the exposure draft?

Comment:
(1) Cash flows related to loans against insurance policies
With regard to the accounting for a loan against insurance policies (policy loans and premium loans), the Standard should clarify whether the loan is to be recognized as a separate financial instrument to ensure comparability ,or to be included in the cash flows of the insurance contract.

(2) Accounting for insurance contracts acquired in a business combination
Regarding the accounting in relation to a business combination provided in paragraph

42, the Standard should clearly describe the relationship between the Standard and IFRS 3 *Business Combination*, in terms of a more detailed explanation of IFRS 3 in the Standard or replacement of some references.

(3) Accounting for the transfer of a portfolio of insurance contracts under common control

The Standard should clearly state that if any portfolio of insurance contracts is transferred between insurance companies under the common control, the transfer does not need to be accounted for under paragraph 40 or other requirements.

(4) Creation of simplified accounting

We have concerns over the requirements if the approach proposed in the ED is applied to insurance contracts where risks are not managed at a portfolio level, or to companies where the main activities are not insurance, since such treatment may not properly reflect the economic substance, or the costs may exceed the benefits.

The IASB should consider creating a simplified approach to practically address these issues, such as the modified measurement approach permitted for a short-duration contract.

Benefits and costs (paragraphs BC258–BC263)

Question 19 – Benefits and costs

Do you agree with the Board's assessment of the benefits and costs of the proposed accounting for insurance contracts? Why or why not? If feasible, please estimate the benefits and costs associated with the proposals.

Comment:

We basically agree.

The proposed accounting model appears to basically represent more faithful representation of the management substance of an insurance company. It is also consistent with the insurance regulatory approach, and therefore helps to enhance comparability.

On the other hand, as we have already noted in this comment letter, some of the descriptions or treatments described in the ED are insufficient. If these remain unchanged, we are concerned that it may take some time before the accounting practice will be developed, and insurance companies may not sufficiently benefit from the proposed accounting model during such period. The proposed model may potentially overlook certain issues that should be considered, including the accounting for residual margins.

Since this is a proposal for a new accounting model, there are concerns over its feasibility. The IASB should strive to further enhance the benefits and reduce the costs, by verifying of the sufficiency and feasibility of the descriptions and factors to be considered. This can be done through a field testing, by not only targeting preparers specialized in insurance, but also involving other relevant parties.

Yours faithfully,

Keiko Kishigami
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