

October 31, 2003

Comments on the IFRS Exposure Draft ED5 "Insurance Contracts"

The Life Insurance Association of Japan

The Life Insurance Association of Japan (LIAJ) hereby submits its comments on the Exposure Draft for the International Financial Reporting Standard (IFRS) "Insurance Contracts: Phase I."

The association would like to express its respect for the efforts made by the International Accounting Standards Board (IASB) to develop international accounting standards, as well as its appreciation for being given the opportunity to comment on the Exposure Draft.

The comments put forth here are those of the LIAJ. This association is a trade organisation composed of 41 life insurance companies. Its purposes are to promote development and public trust in the Japanese life insurance industry.

I. General Remarks

In preparing these comments, the LIAJ has taken the fundamental position that the following requirements be met even for general purpose accounting.

1. The accounting system must be useful also from the standpoints of the maintenance of the financial soundness and the protection of policyholders which are required for the insurance industry;
2. The insurance business diversifies risks through the formation of a group of insurance contracts and its business activity involves providing the service of underwriting long-term risks. Therefore, financial statements must properly reflect this business activity (that is, recognise revenue at the time an insurance company is released from the underwritten risks, not recognise future profits at inception);
3. The system must make it practically possible to recognise and measure insurance liabilities in a manner that is reliable and permits comparability;
4. The system must ensure that preparing financial statements is possible within reasonable costs and time limits considering the balance between benefits and costs.

In light of the points listed above, there are numerous problems with the contents of the IASB's study of the insurance project thus far and the Exposure Draft. The LIAJ proposes the following improvements to draft an appropriate accounting standards proposal.

[1] Regarding the Contents of the Insurance IFRS

(a) Reflecting the Unique Characters of the Insurance Business

- The Exposure Draft's definition of an insurance contract presumes that the existence of a significant insurance risk is a prerequisite. However, the essential nature of insurance is not found in the types or sizes of the risks underwritten, but in the reduction of the risk at the individual contract level by diversifying the risks over a large number of contracts and over time. By reducing risks through pooling the same types of contracts, insurers underwrite risks that policyholders could not assume individually. In other words, a unique character of the insurance business is, unlike general financial products based on exchanges of equal value, that it receives premium for providing policyholders with a service called insurance protection, by assuming individual risks through risk pooling. An insurance contract meets the definition of a financial product in the sense that it is a contract involving a monetary transaction. However, the current Board's discussion which treats insurance contracts as being the same as other financial instruments does not take the essential character of the insurance business into consideration.
- For example, if financial statements were to reflect the artificial volatility of financial markets caused by such factors as short-term fluctuations, this would result in financial statements that do not represent the actual state of the insurance business.
- Until the insurance business is recognised as the provision of the service of underwriting risks through risk diversification, it will not be possible to faithfully represent the results of its business activities.
- The Japanese Institute of Certified Public Accountants' opinion paper regarding the "IASC Insurance Issues Paper" also states that the "insurance business," is "a series of the management process by an enterprise that reduces insurance risks to an acceptable level by underwriting a large number of insurance contracts, pooling the identified possibility of loss common to like contracts between different policyholders or over time, and thereby diversifying such assumed risks stipulated by the terms of the contracts."
- TheLIAJ proposes that the scope of the Insurance IFRS should not be limited to insurance contracts alone, but that the Insurance IFRS should include insurance business accounting, which would properly represents the overall financial standing of an insurer.
- The current IAS39, when applied to assets held by an insurer, does not give adequate consideration to the long-term nature of the insurer's liabilities. In the application of IAS39 to insurers, there is a need for appropriate measures, for example, the establishment of a new category for assets held to back insurance liabilities or the relaxation of the criteria in IAS39 for classifying financial assets as held-to-maturity.

(b) Consistency with the Conceptual Framework

- The Board's deliberation contains many cases in which consistency with the conceptual framework is the basis for determining the direction to be taken. However we fear that, as a result of the Board having considered consistency with only a portion of the conceptual framework, consistency with other parts of the conceptual framework could be lost.
- For example, regarding the Insurance IFRS, based on consistency with the conceptual

framework, there is an attempt to have the asset-liability method employed, instead of the deferral-and-matching method used for insurance accounting in most countries. However, we believe that the financial statements of insurers based on the asset-liability method would result in the lack of the qualitative features ("understandability", "relevance", "reliability" and "comparability") that the conceptual framework states financial statements must satisfy.

- The LIAJ would like to suggest that in its deliberations the Board should not base its conclusions on logical consistency with only a portion of the conceptual framework or on only the superficial consistency of overall accounting standards. Instead, the LIAJ proposes that the Board should bear in mind the most important point in deliberating accounting standards, that is, whether or not the accounting standards established would provide appropriate accounting information.
- In deliberating Phase II, discussions should include a reconsideration of the question whether or not the current definitions of assets and liabilities in the conceptual framework are appropriate for insurance.

(c) The Reliability and Comparability of Fair Value

- Because the Board's discussion treats insurance contracts as being the same as other financial instruments, its deliberations are conducted based on the premise that fair value exists in the case of insurance contracts as well. However, since there is no active secondary market for insurance contracts, we do not even know now if there is a reliable method for calculating the fair value of insurance contracts.
- The phase I proposed IFRS includes no rules concerning recognition and measurement and does not stipulate anything regarding the fair value of insurance liabilities. Under these conditions, it is not possible to disclose fair value. Furthermore, even if companies disclose some sort of estimated value under the name of "fair value," it would not result in information that is useful from the perspective of comparability. Rather, it would merely confuse policyholders and other users of financial statements. Therefore, the LIAJ proposes that fair value disclosure should be discussed anew after the Phase II recognition and measurement standards have been determined.
- It should be noted that from the standpoints of the understandability, relevance, comparability and reliability, the problems listed below exist concerning fair value assessment of insurance liabilities as that concept has been deliberated to date during the Insurance Project. Although the Board currently considers fair value measurement a working hypothesis for Phase II, the LIAJ believes that the measurement of fair value is not appropriate even in Phase II and that method to measure liabilities should be studied from a much broader perspective.

Fair Value Measurement Problems:

- It would result in the recognition of unrealised fictitious profits and result in unsound financial statements.
- Since there is no active secondary market for insurance contracts, the measurements would not have sufficient objectivity and verifiability.
- Since long-term insurance liabilities would be measured based on assumptions made

at a single point in time, the measurements would be significantly influenced by conditions such as fluctuations in interest rates and therefore lacking in understandability and relevance.

- Since there are no countries implementing insurance accounting in accordance with fair value accounting as proposed by the Board and neither are verification studies being conducted, the feasibility of fair value accounting is doubtful.

[2] Due process of the Insurance IFRS

(a) The Elimination of Deliberations and Decisions Premised on the Undetermined Items

- There are portions of the Exposure Draft concerned that have treated pending items as if they were decided matters for which public agreement had already been obtained. The LIAJ proposes that appropriate revisions, such as deletion from the Exposure Draft to avoid misunderstandings, be made concerning the portions listed below.

[Measurement Methods]

When Sir David Tweedie, the chairman of the IASB, visited Japan in June, he stated at an official venue that: "No final decisions have been made regarding Phase II. Problems concerning insurance, such as fair value of insurance contracts, renewal options and participation features, have not been studied at present, but will be deliberated in Phase II. After several sessions held, I have instructed the staff to study fair valuation methods. However, most staff is involved in Phase I; and the Phase II will be discussed in or after October."

Recognition and measurement methods for insurance are in fact not decided in the Board's discussion. However, the following excerpts of the Exposure Draft make it appear that "in Phase II insurance measurement methods will be based on fair value" is a decided matter for which public agreement has already been obtained.

- "In the Board's view, fair value is the only relevant measurement basis for derivatives, because it is the only method that provides sufficient transparency in the financial statements." (Paragraph 119 of Basis for Conclusions)
- "This proposal is intended not only to give useful information to users of an insurer's financial statements, but also to encourage insurers to begin work on fair value systems to avoid the need to provide a long transition period for phase II." (Paragraph 138 of Basis for Conclusions)
- "Disclosure of the fair value of insurance liabilities and insurance assets will provide relevant and reliable information for users, and this would still be the case even if phase II does not result in a fair value model." (Paragraph 139 of Basis for Conclusions)

These statements would mislead readers to believe that there already is public consensus that "fair value is an appropriate basis for insurance measurement methods" or that "fair value of insurance liabilities provides useful information". Therefore, at the present stage when nothing has been decided regarding insurance measurement methods, these statements should be deleted.

Furthermore, there is no justification for arriving at even provisional resolution of issues without

sufficient deliberation, by abbreviating the process of comparison and study of multiple proposals and conducting discussions designed to lead to the conclusion of accepting an established course. The LIAJ believes that the IASB should not shortcut the required process in its deliberations.

[The Fair Value Disclosure Clause and Sunset Clause]

The effective dates of the two clauses noted above have been decided through a separate process, and the prerequisite is that the discussion on fair value methods or the Phase II will be completed by those dates. However the LIAJ considers it improper that, without a consensus regarding the direction for Phase II, the IASB is assuming that the discussion will be completed after a fixed period of time (the basis for this period is also unclear). Moreover, the LIAJ considers that it would be improper to establish unfeasible clauses in an accounting standard without review by the deadlines. Therefore, the LIAJ believes that the referenced clauses should be deleted.

[Use of the Term Fair Value]

Since the term "fair value" clearly includes some connotations, there is concern that using this terminology will hinder objective discussion. In other words, it can be assumed that this will lead to the argument that measurements based on "fair value" are fair and measurements based on anything other than "fair value" are not, in spite of the fact that the definition of the fair value of insurance liabilities has not been determined. Therefore, the LIAJ believes that this terminology should not be used.

Furthermore, Paragraph 136 of the Basis for Conclusions states: "given the lack of a widely agreed definition of probable maximum loss (PML), the Board concluded that it is not feasible to require disclosure of PML or similar measures." Since the lack of a widely agreed definition also applies to the fair value of insurance liabilities, the LIAJ believes that, as is the case with PML, disclosure of fair value of insurance liabilities should not be required .

(b) Reflecting the Opinions of Insurance Experts (Regulators, Industry Practitioners) in Many Countries

- The insurance business is to a great degree a public service by nature and has unique qualities. It is therefore essential that insurance experts participate adequately in the development of insurance accounting standards. However, since the situation is that the IASB members do not have sufficient expertise concerning insurance, it is necessary to adequately reflect the opinions of regulators, industry practitioners and other insurance experts in the deliberations. This, however, is not the case. For example, the LIAJ, working jointly with the insurance associations of other countries, has submitted various comment letters to the Board. However, the Board has not directly discussed the industry's comments in any open meetings and not indicated convincing reasons for not adopting the industry's recommendations in such meetings. Therefore, the industries do not know how the Board members have treated its comment letters. Rather than advancing deliberations based only on proposals prepared by a few staff members, the LIAJ believes that the Board would be closer to the goal of preparing the best accounting standards possible if, at its meetings, it directly deliberated the written comments that the insurance industries of various countries have labored greatly to prepare.
- In addition, it is necessary to establish a system to reflect useful external opinions appropriately in the deliberations. The LIAJ proposes that, for example, all important matters should be

discussed at the Insurance Advisory Committee prior to the Board meetings and that public hearings should be held regarding proposals to which there are many objections. (Regarding this issue, the LIAJ also believes that it would be an effective measure to invest the Standards Advisory Council (SAC) or a similar body with the responsibility of reviewing the manner in which the Board advances its deliberations and to make it clear that a body other than the Board (for example, the SAC or Trustees) will carry out "sunset review", the discussion about the treatments of delayed projects in the IASB.)

(c) Clear Separation of Phase I and Phase II

- Phase I is supposed to consider the existing accounting systems in the respective countries as its basis, so there would not be a need to make major changes that would require a reversal of contents when Phase II is completed. However, the Exposure Draft contains various proposals that already anticipate the undetermined direction of Phase II in advance. The LIAJ proposes that the following should be revised appropriately in order to clearly separate Phase I and Phase II.

[Definition of Insurance Contract]

What is currently accepted as an insurance contract in each country should be deemed an insurance contract under Phase I. In addition, unbundling, of which the direction in Phase II is not yet decided, should not be required during Phase I.

[Sunset Clause]

The Sunset Clause, which would require a major change in accounting standards during the Phase I period if put into application, contradicts the intent of Phase I.

[Fair Value Disclosure]

Requiring the disclosure of fair value during Phase I, which would impose a tremendous system cost burden upon the preparers of financial statements, contradicts the intent of Phase I.

[Separation of Embedded Derivatives]

This represents a substantial change in accounting standards, and therefore should not be required during the Phase I period.

[Exceptions to Application Exclusions of Hierarchy]

These points in Paragraph 10 are an integral part of accounting standards, and therefore the criteria should not be introduced during Phase I.

II. Replies to the Questions Presented

Question 1 – Scope

(a) The Exposure Draft proposes that the IFRS would apply to insurance contracts (including reinsurance contracts) that an entity issues and to reinsurance contracts that it holds, except for specified contracts covered by other IFRSs. The IFRS would not apply to accounting by policyholders (paragraphs 2-4 of the draft IFRS and paragraphs BC40-BC51 of the Basis for Conclusions).

The Exposure Draft proposes that the IFRS would not apply to other assets and liabilities of an entity that issues insurance contracts. In particular, it would not apply to:

(i) assets held to back insurance contracts (paragraphs BC9 and BC109-BC114). These assets are covered by existing IFRSs, for example, IAS 39 *Financial Instruments: Recognition and Measurement* and IAS 40 *Investment Property*.

(ii) financial instruments that are not insurance contracts but are issued by an entity that also issues insurance contracts (paragraphs BC115-BC117).

Is this scope appropriate? If not, what changes would you suggest, and why?

<Comment>

The proposal is not appropriate.

Because each local GAAP will continue to be used for measurement, it is essential for insurance accounting to remain reasonable as a whole at the time this Exposure Draft comes into force. The IASB should establish the scope of the IFRS by referring to the points above. [Exposure Draft - 2]

The treatments of assets backing insurance liabilities should not be excluded. [Exposure Draft - 3, BC9]

The LIAJ proposes that the Insurance IFRS should not limit its scope to only insurance contracts, but that it require existing insurance business accounting that would properly indicate the overall financial state of an insurer.

<Reasons>

Since Phase I intends to continue existing practices (accounting as practiced for the insurance business) in the respective countries and this principle should not be contradicted.

Regarding the insurance business, the fact that the simplistic application of IAS 39 to assets held to back insurance liabilities would produce artificial financial volatility was pointed out by various commentators at the 2003 Round Table. [BC9]

In addition, risk pooling by forming groups of insurance contracts is an indispensable component of measuring insurance liabilities that should be taken into consideration from the standpoint of economics. Furthermore, companies engaged in the insurance business are socially required to have a high degree of risk tolerance. Not having liabilities reflect that cost (for example, the level of legally required reserves, etc.) would result in inaccurately representing the actual figure of the business. In light of these points, the Insurance IFRS should be the standard for insurance business. [BC9]

<Proposed Revision>

Amend Paragraph 2 in order to make the scope cover the whole of insurance business.

[see the definition of insurance business proposed by the Japanese Institute of Certified Public Accountants, in the fourth paragraph of „General Remarks [1] (a) of this comment (p.2)]

Delete Paragraph 3.

(b) The Exposure Draft proposes that weather derivatives should be brought within the scope of IAS 39 unless they meet the proposed definition of an insurance contract (paragraph C3 of Appendix C of the draft IFRS). Would this be appropriate? If not, why not?

<Comment>

(No comment)

Question 2 – Definition of insurance contract

The draft IFRS defines an insurance contract as a ‘contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder or other beneficiary if a specified uncertain future event (the insured event) adversely affects the policyholder or other beneficiary’ (Appendices A and B of the draft IFRS, paragraphs BC10-BC39 of the Basis for Conclusions and IG Example 1 in the draft Implementation Guidance).

Is this definition, with the related guidance in Appendix B of the draft IFRS and IG Example 1, appropriate? If not, what changes would you suggest, and why?

<Comment>

The proposal is not appropriate.

An insurance contract should not be defined during Phase I. [BC23]

In Phase I, everything that is an insurance contract under existing practices should be within the scope of the Insurance IFRS.

If an "insurance contract" is to be defined, according to the proposed definition of insurable interest, traditional annuity insurance and fixed term pure endowment insurance could be excluded from the definition of an insurance contract, and this is not appropriate. The LIAJ believes that the cause lies in the fact that the definition of an insurance contract is being made without sufficient discussion of insurable interest. In addition, all contracts with any insurance risk should be treated as insurance contracts without questioning the significance of the insurance risk present. [Appendix A]

There are some inappropriate examples used to outline non-insurance contracts. In particular, pure endowment insurance contracts should be considered as insurance contracts. [IG2]

In addition, group insurance is another example that should not be considered as a non-insurance contract. [B18]

<Reasons>

Having the IFRS determine the definition of insurance is itself a departure from the intent of Phase I, which is based on the principle of maintaining existing accounting systems of the respective countries. [Appendix A, BC10 - 11]

The essential characteristic of insurance is that it enables a company to bear the risk that an individual could not bear alone, by diversifying the risk over many contracts and over time through the accumulation of a large number of policyholders. Therefore, any accounting systems that do not reflect these characteristics will not work. It is wrong to base all discussion on "the present value of cash flows." [B24]

The insurance business diversifies risks through the formation of groups of insurance contracts and its business activity involves providing the service of underwriting long-term risks. Therefore, it is appropriate to recognise revenue at the time when an insurance company is released from the underwritten risks. Consequently, the LIAJ is opposed to the stipulation of the definition of an insurance contract in Phase I and the creation of insurance accounting standards based on this definition. [BC23]

It is only natural that insurance contracts having the same accompanying risks would have different value, depending on whether or not the risks are diversified. That is, if there is an efficient market, then theoretically diversifiable risks will be diversified. However, if there is no market, then even if risks can be theoretically diversified, it will not necessarily be in fact diversified. As a result, the risk premium would be accordingly larger and there would be a difference in the transaction price between third parties. In other words, the formation of groups of insurance contracts has economic significance. In addition, one can say that policyholder behaviour that is not economically rational, such as the surrender of contracts, is a reflection of servicing features of insurance. [Appendix A]

Since judgment enters into the determination of whether or not a risk is significant, there is a problem from the standpoint of the objectivity of accounting. For example, B23 states "if a contract pays a death benefit exceeding the amount payable on surrender or maturity, the contract is an insurance contract unless the additional death benefit is insignificant." However, the criterion for judging whether "the additional death benefit is insignificant" is not stipulated clearly. BC28 states "The Board's intention is to make it easier, not harder, for a contract to meet the definition." However, it is doubtful whether the Board's intention can be met with these vague criteria. Such a problem would not arise if all contracts with any insurance risk are deemed to be insurance. [Appendix A, B23, BC28]

In addition, if certain contracts were reclassified as insurance contracts halfway through the term (or vice versa), the continuity of accounting would deteriorate and opportunities for accounting arbitrage would be created. This problem would not arise if all contracts with any insurance risk are deemed to be insurance. [B25, BC27]

Group insurance contracts are insurance since, if the claims of a group exceed a specified level, the insurer bears and pays for the risk. Therefore, it is inappropriate to list group insurance contracts as an example of non-insurance contract. [B18 (b)]

Pure endowment insurance is traditionally an insurance contract and it transfers the economic risk from the policyholder to the insurer, should the policyholder survive for a long duration. In addition, if the incorrect interpretation that pure endowment insurance is not insurance is combined with the Board's position regarding unbundling, it could possibly lead to the incorrect conclusion that endowment insurance should be divided into insurance against death and pure endowment, thereby

resulting in different standards being applied to these two components. [IG Example 1 - 1.4]

<Proposed Revision>

Amend Appendix A to deem that all the insurance contracts under the current business practices are recognised as insurance contracts.

Delete Appendix B.

Question 3 – Embedded derivatives

(a) *IAS 39 Financial Instruments: Recognition and Measurement* requires an entity to separate some embedded derivatives from their host contract, measure them at fair value and include changes in their fair value in profit or loss. This requirement would continue to apply to a derivative embedded in an insurance contract, unless the embedded derivative:

- (i) meets the definition of an insurance contract within the scope of the draft IFRS; or
- (ii) is an option to surrender an insurance contract for a fixed amount (or for an amount based on a fixed amount and an interest rate).

However, an insurer would still be required to separate, and measure at fair value:

- (i) a put option or cash surrender option embedded in an insurance contract if the surrender value varies in response to the change in an equity or commodity price or index; and
- (ii) an option to surrender a financial instrument that is not an insurance contract.

(paragraphs 5 and 6 of the draft IFRS, paragraphs BC37 and BC118-BC123 of the Basis for Conclusions and IG Example 2 in the draft Implementation Guidance)

Are the proposed exemptions from the requirements in IAS 39 for some embedded derivatives appropriate? If not, what changes should be made, and why?

(b) Among the embedded derivatives excluded by this approach from the scope of IAS 39 are items that transfer significant insurance risk but that many regard as predominantly financial (such as the guaranteed life-contingent annuity options and guaranteed minimum death benefits described in paragraph BC123 of the Basis for Conclusions). Is it appropriate to exempt these embedded derivatives from fair value measurement in phase I of this project? If not, why not? How would you define the embedded derivatives that should be subject to fair value measurement in phase I?

(c) The draft IFRS proposes specific disclosures about the embedded derivatives described in question 3(b) (paragraph 29(e) of the draft IFRS and paragraphs IG54-IG58 of the draft Implementation Guidance). Are these proposed disclosures adequate? If not, what changes would you suggest, and why?

(d) Should any other embedded derivatives be exempted from the requirements in IAS 39? If so, which ones and why?

<Comment>

The proposals are not appropriate.

Instead of the exemption of only some embedded derivatives from the application of IAS 39's requirements, all embedded derivatives in contracts currently treated as insurance contracts should be exempt from the application of IAS 39's requirements. [Exposure Draft - 5, Exposure Draft - 6, BC34]

The disclosure of sensitivity and fair value of an embedded derivative that is not separated from its host contract should not be required in Phase I. [Exposure Draft - 29(e), IG 54 - 58]

Even if the embedded derivative is to be separated, the case IG Example 2-2.6(c), 2.11(a) (b) and 2.15 should not require separation. [IG Example 2]

<Reasons>

An insurance contract (host contract) and its embedded derivative usually cannot be separated or are difficult to separate. If they were required to be separated, it could cause major changes to existing accounting standards, result in major system changes and require tremendous labor and costs. In addition, there are also issues, such as the definition of a derivative and the scope of separation, that remain unresolved and require further deliberation until Phase II; therefore, changes may occur in Phase II. The two points noted here reveal that the separation of embedded derivatives contradicts the intent of Phase I. [BC34, BC121]

If embedded derivatives have an effect on the characteristics of liabilities, then this issue should be addressed by insurance accounting standards. Although their definition is ambiguous, whether or not embedded derivatives contained in insurance contracts have an effect on the measurement of liabilities depends on the measurement objective. This cannot be decided in Phase I. The issue should be deliberated after the recognition and measurement standards are established in Phase II, and until that time the GAAP should be followed. [BC121]

Since authorisation is required to sell insurance products, there is no inappropriate use of derivatives and it is therefore unnecessary to eliminate them through unbundling. [BC121]

It has not been decided whether it is appropriate to recognise and measure insurance liabilities at fair value. In addition, even if they are to be measured at fair value, the Board has not yet decided on the model and system to be used when calculating fair value, therefore making it difficult in practice to disclose the fair value of embedded derivatives. [Exposure Draft - 29(e), IG54-58]

In the case of the IG Example 2-2.6(c) and 2.11(a) (b), embedded derivatives have a close relationship with life-contingent options, and in the case of 2.15 the "embedded derivative" does not have leverage and does not satisfy the definition of a derivative. Therefore, these two examples are not appropriate. [IG Example 2]

<Proposed Revision>

Change the last sentence of paragraph 5 to "The above-mentioned IAS 39 provisions related to embedded derivatives do not apply to insurance contracts targeted by this [draft] IFRS."

Delete paragraph 6.

Delete paragraph 29(e).

Question 4 – Temporary exclusion from criteria in IAS 8

(a) Paragraphs 5 and 6 of [the May 2002 Exposure Draft of improvements to] IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* specify criteria for an entity to use in developing an accounting policy for an item if no IFRS applies specifically to that item. However, for accounting periods beginning before 1 January 2007, the proposals in the draft IFRS on insurance contracts would exempt an insurer from applying those criteria to most aspects of its existing accounting policies for:

(i) insurance contracts (including reinsurance contracts) that it issues;

and

(ii) reinsurance contracts that it holds.

(paragraph 9 of the draft IFRS and paragraphs BC52-BC58 of the Basis for Conclusions).

Is it appropriate to grant this exemption from the criteria in paragraphs 5 and 6 of [draft] IAS 8? If not, what changes would you suggest and why?

<Comment>

The proposals are not appropriate as a whole.

It is appropriate to grant this exemption. However, the LIAJ opposes the establishment of a deadline for it. [Exposure Draft - 9]

<Reasons>

The LIAJ understands that the intent of separating Phase I from Phase II is to seek realistic approaches with practical possibilities. If it is assumed that the application of the hierarchy of IAS 8 will have an enormous effect on practical affairs, then requiring exemption from the application of the hierarchy of IAS 8 is only natural from the standpoint of an intent to separate Phase I. At the very least, the exemption should continue while Phase I continues. It is possible that the application of the hierarchy of IAS 8 prior to Phase II would mean making major changes twice in a short period of time, thereby forcing companies to bear tremendous practical burdens. [BC 53]

Furthermore, regarding Phase II the Board has made no final conclusions regarding the date for the completion of standards and the commencement of application. At this current stage, the expiry of the exemption period in 2007 lacks any convincing rationale. [BC 57]

If Phase II has not been completed by the deadline to end the exemption, it would cause unnecessary confusion among preparers and users. [BC 57]

<Proposed Revision>

Delete the text "For accounting periods beginning before 1 January 2007" from paragraph 9.

(b) Despite the temporary exemption from the criteria in [draft] IAS 8, the proposals in paragraphs 10-13 of the draft IFRS would:

(i) eliminate catastrophe and equalisation provisions.

(ii) require a loss recognition test if no such test exists under an insurer's existing accounting policies.

(iii) require an insurer to keep insurance liabilities in its balance sheet until they are discharged or cancelled, or expire, and to report insurance liabilities without offsetting them against related reinsurance assets (paragraphs 10-13 of the draft IFRS and paragraphs BC58-BC75 of the Basis for Conclusions).

Are these proposals appropriate? If not, what changes would you propose, and why?

<Comment>

The proposal is not appropriate.

Catastrophe and equalisation provisions should not be prohibited in Phase I. Matters such as the recognition of catastrophe and equalisation provisions should be decided after adequate review of the issue of whether or not the definitions of assets and liabilities in the current "conceptual framework" are appropriate for insurance. [Exposure Draft - 10(a)]

It is difficult to apply IAS 37 to insurance contracts, and existing loss recognition test practices should be maintained in Phase I. [Exposure Draft - 12]

Furthermore, "each reporting date" for the loss recognition test should be amended to "at least once a year." [Exposure Draft - 11]

<Reasons>

[Catastrophe and equalisation provisions]

Accounting standards should be discussed based on a comprehensive balance of the whole. Therefore, eliminating only catastrophe and equalisation provisions, a portion of the whole, would destroy the overall balance. [IN4, BC52-58]

In Phase I, based on the premise that the principle for the measurement objective has not been decided, it is inappropriate to partially eliminate something that is considered necessary in the existing practical application of accounting standards. [IN4]

While established local GAAPs are not based on the "conceptual framework", the lack of consistency with the "conceptual framework" is an inadequate basis for abolishing catastrophe and equalisation provisions, a part of the GAAP.[BC 59-63]

[Loss recognition test]

In applying IAS 37, it is necessary to estimate the amount of future cash flow. However, problems similar to unresolved issues relating to fair value measurement will arise in the assessment of, for example, options held by the policyholder, such as the right of surrender and renewal. [Exposure Draft - 12]

It is possible that the application of IAS 37 in the current state will invite chaos, and it can also be

assumed that it would result in an enormous practical burden.

Since the loss recognition test is closely tied to the principle of recognition and measurement, existing business practices regarding loss recognition should be maintained during Phase I, as they are similar with respect to the principle of recognition and measurement. [Exposure Draft - 12]

The LIAJ believes that performing a loss recognition test every half year or quarter is practically an excessive requirement in terms of the system's ability, labor and costs. [Exposure Draft - 11]

<Proposed Revision>

Delete paragraph 10(a).

Change the beginning of paragraph 11 from "An insurer shall carry out a loss recognition test at each reporting date" to "An insurer shall carry out a loss recognition test at least once a year."

Delete paragraph 12 and 13.

Question 5 – Changes in accounting policies

The draft IFRS:

(a) proposes requirements that an insurer must satisfy if it changes its accounting policies for insurance contracts (paragraphs 14-17 of the draft IFRS and paragraphs BC76-BC88 of the Basis for Conclusions).

(b) proposes that, when an insurer changes its accounting policies for insurance liabilities, it can reclassify some or all financial assets into the category of financial assets that are measured at fair value, with changes in fair value recognised in profit or loss (paragraph 35 of the draft IFRS).

Are these proposals appropriate? If not, what changes would you propose and why?

<Comment>

The proposals are not appropriate.

Even if there are changes in the accounting policies to improve the relevance and reliability of financial statements, changes in accounting policies that managers make arbitrarily should not be permitted in Phase I. [Exposure Draft - 14-17, Exposure Draft - 35]

It is not appropriate to permit the reclassification of the financial products indicated in the Exposure Draft when changing accounting policies. [Exposure Draft - 35]

<Reasons> [Regarding (a)]

Since the definitions of relevance and reliability are ambiguous and there is the possibility of arbitrariness in the judgment, there is the danger of inviting changes in accounting policies that are "only for the benefit of self-interest" capriciously according to the situation. Therefore, changes in the accounting policies should not be permitted in Phase I. [Exposure Draft - 14-17]

If changes are permitted, there will be the risk that respective companies will adopt different accounting policies and, as a result, comparability will be lost. [Exposure Draft - 14-17]

It would not be possible for the provisionally decided matters of Phase II, which are merely working hypotheses, to be the premises for required changes in accounting standards (in Phase I). [BC76]

[Regarding (b)]

There is a concern that insurance accounting as a whole will lose relevance if the reclassification of financial assets in only one way (i.e. the reclassification into the category for which change in fair value are recognised in profit or loss) is permitted when changing accounting policies for insurance liabilities. [Exposure Draft - 35]

Permitting the reclassification would alter the fundamental structure of the categorisation of financial assets according to the purpose of holding in IAS 39, and this would invite a lack of consistency in accounting standards as a whole. [Exposure Draft - 35]

<Proposed Revision>

Delete paragraphs 14 to 17 and 35.

Question 6 – Unbundling

The draft IFRS proposes that an insurer should unbundled (ie account separately for) deposit components of some insurance contracts, to avoid the omission of assets and liabilities from its balance sheet (paragraphs 7 and 8 of the draft IFRS, paragraphs BC30-BC37 of the Basis for Conclusions and paragraphs IG5 and IG6 of the proposed Implementation Guidance).

(a) Is unbundling appropriate and feasible in these cases? If not, what changes would you propose and why?

<Comment>

The proposal is not appropriate.

Unbundling should not be required in Phase I. [BC34]

Furthermore, the LIAJ opposes this if it assumes that there will be unbundling in the future (Phase II) for the reason that lapse risks, persistency risks and expense risks are not considered as insurance risks in the definition of insurance. [B15, B16]

<Reasons>

Although the IASB proposed that unbundling be required in the Issues Paper, the DSOP dropped this requirement as a result of a review by the Insurance Steering Committee, based on comments received from around the world on the Issues Paper. The argument presented by the Exposure Draft is far too inadequate to overturn the result of deliberations over which a considerable amount of time was spent. [Exposure Draft - 7, BC34]

As the Exposure Draft - Paragraph 8 states, the draft IFRS is not intended to require unbundling

surrender or maturity benefit provided by many types of traditional life insurance contracts. However, the unbundling conditions in the Exposure Draft - Paragraph 7 are vague and there is a danger that their interpretation will be broadened. [Exposure Draft - 7]

There will also be issues, such as the definition of what kind of contracts are required to be unbundled and what kind of parts are required to be separated from main contracts, that will remain and require further deliberation until Phase II: Therefore, there is a possibility that changes will be made in Phase II. Consequently, unbundling contradicts the intent of Phase I. Unbundling should be deliberated after the establishment of the recognition and measurement standards in Phase II. [BC34, Exposure Draft - 7]

In the first place, the entire insurance contract as a whole underwrites a single risk and therefore cannot be unbundled. Even if it were unbundled, the measured value of the overall contract would not be same as the sum of the measured value of its components after unbundling. [BC34]

The stated reason for demanding unbundling is to avoid any omissions of assets or liabilities from the balance sheet. However, the standard for the decision that unbundling is necessary is unclear, as the assets and liabilities that should be recognised and measured have not been established in Phase I. Therefore, each country continues to apply its respective accounting standards. Prior to requiring unbundling, it is necessary to have criteria for judging "omission." [BC34]

As evident from the above, there is no clear conceptual line between the cases when unbundling is required and the cases when it is not. The Board also acknowledges this fact. In other words, the Board itself already recognises that there is a great possibility that this provision would be open to accounting arbitrage. [BC35]

<Proposed Revision>

Delete paragraphs 7 and 8.

Delete IG5 and IG6 (including IG Example 3) of the Draft Implementation Guidance.

(b) Should unbundling be required in any other cases? If so, when and why?

<Comment>

The proposal is not appropriate.

The existing GAAP of respective countries should be followed and in no case should unbundling be required. [BC34]

<Reasons>

The same as (a).

<Proposed Revision>

see (a)

(c) Is it clear when unbundling would be required? If not, what changes should be made to the description of the criteria?

<Comment>

It is not clear.

Only an extremely special case is provided as an example and it does not make the criteria clear.

<Reasons>

The LIAJ believes that unbundling should not be required in any cases, because there is also the risk that its interpretation will be stretched. [Exposure Draft - 7-8]

<Proposed Revision>

The same as (a).

Question 7 – Reinsurance purchased

The proposals in the draft IFRS would limit reporting anomalies when an insurer buys reinsurance (paragraphs 18 and 19 of the draft IFRS and paragraphs BC89-BC92 of the Basis for Conclusions).

Are these proposals appropriate? Should any changes be made to these proposals? If so, what changes and why?

<Comment>

(No comment)

Question 8 – Insurance contracts acquired in a business combination or portfolio transfer

IAS 22 *Business Combinations* requires an entity to measure at fair value assets acquired and liabilities assumed in a business combination and ED 3 *Business Combinations* proposes to continue that long-standing requirement. The proposals in this draft IFRS would not exclude insurance liabilities and insurance assets (and related reinsurance) from that requirement. However, they would permit, but not require, an expanded presentation that splits the fair value of acquired insurance contracts into two components:

- (a) a liability measured in accordance with the insurer's accounting policies for insurance contracts that it issues; and**
- (b) an intangible asset, representing the fair value of the contractual rights and obligations acquired, to the extent that the liability does not reflect that fair value. This intangible asset would be excluded from the scope of IAS 36 *Impairment of Assets* and IAS 38 *Intangible Assets*. Its subsequent measurement would need to be consistent with the measurement of the related insurance liability. However, IAS 36 and IAS 38 would apply to customer lists and customer relationships reflecting the expectation of renewals and repeat business that are not part of the contractual rights and obligations acquired.**

The expanded presentation would also be available for a block of insurance contracts acquired in a portfolio transfer (paragraphs 20-23 of the draft IFRS and paragraphs BC93-BC101 of the Basis for Conclusions).

Are these proposals appropriate? If not, what changes would you suggest and why?

<Comment>

These proposals are not appropriate.

The application of IAS 22 *Business Combinations* would create problems, as no method has been established so far to measure fair value of insurance assets and liabilities [Exposure Draft - 20-23].

<Reasons>

IAS 22 *Business Combinations* presupposes the use of the purchase method based on fair value, but there is no established method of measuring the fair value of insurance liabilities. Therefore, it is inappropriate at present to apply IAS 22 *Business Combinations* to insurance contracts [BC93-98].

<Proposed Revision>

In paragraph 20, replace the words “does not exclude” in the first sentence with the word “excludes” and delete the second sentence.

Delete paragraph 21.

In paragraph 22, change the words “the intangible assets described in paragraph 20 and 21” to the following expression; “the intangible assets recognised as a result of acquiring insurance contracts in a business combination or portfolio transfer.”

Delete paragraph 23.

Question 9 – Discretionary participation features

The proposals address limited aspects of discretionary participation features contained in insurance contracts or financial instruments (paragraphs 24 and 25 of the draft IFRS and paragraphs BC102-BC108 of the Basis for Conclusions). The Board intends to address these features in more depth in phase II of the project.

Are these proposals appropriate? If not, what changes would you suggest for phase I of this project and why?

<Comment>

These proposals are not appropriate.

The paragraphs related to discretionary participation features should be deleted altogether [Exposure Draft - 24, 25].

<Reasons>

It is inappropriate to prematurely establish any standards in phase I on a matter that has not been

fully discussed and for which no consensus has been built in either the former Insurance Steering Committee or in the present IASB. The matter in question should be subject to deliberations in preparation for Phase II of the project. Current practice should be maintained in Phase I [Exposure Draft - 24, 25].

The LIAJ is opposed to the separation of embedded derivatives [BC108].

<Proposed Revision>

Delete paragraphs 24 and 25.

Question 10 – Disclosure of the fair value of insurance assets and insurance liabilities

The proposals would require an insurer to disclose the fair value of its insurance assets and insurance liabilities from 31 December 2006 (paragraphs 30 and 33 of the draft IFRS, paragraphs BC138-BC140 of the Basis for Conclusions and paragraphs IG61 of the draft Implementation Guidance).

Is it appropriate to require this disclosure? If so, when should it be required for the first time? If not, what changes would you suggest and why?

<Comment>

It is not appropriate to require such disclosure.

We are opposed to the disclosure of the fair value of insurance contracts [Exposure Draft - IN9, 30, 33].

<Reasons>

All proposals in phase I should be based on current accounting practices. Thus, the scope of disclosure should be limited to the extent that is possible within the framework of current practice [Exposure Draft - 30].

The fair value of insurance contracts does not exist as concept in Phase I, since no provisions have been made for recognition and measurement. Disclosure of fair value should only be discussed after the standards for recognition and measurement are established in Phase II. As indicated in Paragraphs BC139 and BC140, the IASB must first resolve several issues about fair value in Phase II. It is out of sequence to require disclosure of fair value before the many problems relating to measurement are resolved in Phase II [Exposure Draft - IN9, 30, 33].

Issues relating to the reliability of evaluating the fair value of insurance liabilities have not been resolved due to the lack of active secondary markets. We are concerned that requiring disclosure of such fair value may cause unnecessary confusion to the users of financial statements [Exposure Draft - IN9].

In practice, it is impossible to calculate fair value when there are no rules for recognition and measurement. The temporary conclusions on the principles of recognition and measurement (hastily drawn in the IASB meeting in January) do not make it practical to conduct this calculation.

Disclosure of fair value should be considered only after further guidance, as provided for in paragraph IG60, has been developed. Disclosure of fair value will be impossible unless such guidance is provided [Exposure Draft - IN9, 30, 33, IG60].

Even in the case of financial instruments with active trading markets, the requirement of evaluation of (disclosure of) fair value will be limited in scope, at least in 2005. Therefore, it is not deemed equitable to require disclosure of fair value only for insurance contracts [Exposure Draft - 30].

Paragraph BC138 states that the proposal to require an insurer to disclose the fair value of its insurance liabilities and insurance assets is intended “also to encourage insurers to begin work on fair value systems to avoid the need to provide a long transition period for phase II.” This intention is erroneous, for it means encouraging the development of specific standards for recognition and measurement even before the establishment of such standards in phase II. Moreover, Paragraph BC139 notes, “this would still be the case even if phase II does not result in a fair value model.” This statement is unreasonable. A requirement to disclose fair value on such weak and inappropriate grounds would also be a violation of due process [Exposure Draft - 29, BC138, BC139].

The judgment in Paragraph BC139 differs from the conclusion of the IASB on PML (in Paragraph BC136). The latter should be deemed appropriate [BC139].

As no concrete guidance exists on how to measure fair value, it is extremely difficult to develop by the end of 2006 an approach to calculate fair value, which will require large-scale system development. It will also require costs and resources that would be unbearable to the preparers of financial statements [Exposure Draft - 33].

<Proposed Revision>

Delete Paragraphs 30 and 33.

Question 11 – Other disclosures

- (a) **The Exposure Draft proposes requirements for disclosures about the amounts in the insurer’s financial statements that arise from insurance contracts and the estimated amount, timing and uncertainty of future cash flows from insurance contracts (paragraphs 26-29 of the draft IFRS, paragraphs BC124-BC137 and BC141 of the Basis for Conclusions and paragraphs IG7-IG59 of the draft Implementation Guidance).**

Should any of these proposals be amended or deleted? Should any further disclosures be required? Please give reasons for any changes you suggest.

To a large extent, the proposed disclosures are applications of existing requirements in IFRSs, or relatively straightforward analogies with existing IFRS requirements. If you propose changes to the disclosures proposed for insurance contracts, please explain what specific attributes of insurance contracts justify differences from similar disclosures that IFRSs already require for other items.

<Comment>

The proposals are not appropriate.

Many of the proposed disclosures would give almost worthless information to the users of financial statements. The following changes should be made:

- (a) Delete requirements for the disclosure of confidential proprietary information;
- (b) Change the requirements for disclosures relating to risk management so that the various techniques used by insurers for risk management may be incorporated; and
- (c) Delete the disclosure requirements for fair value information and those premise fair value measurement [Exposure Draft - 27, BC124].

Disclosures should not be based on estimated future cash flows, but on past experiences in the current accounting practice. Hence, consideration should be given to the disclosure items required in each country and by each insurer.

For example, most insurers have already disclosed important management indicators such as the amount of business in force, which are very useful for financial statement users. More attention should be paid to such information. It is deemed appropriate that the second principle require disclosures of such information [IG59, Exposure Draft - IN8, 1].

In preparing examples of disclosures, consideration should be given to the Joint Position Paper of 17 September 2002, submitted by the Japanese, U.S. and German insurance associations, which provides proposals on disclosure requirements and examples [BC124].

Disclosure of details concerning future cash flows, required by the second disclosure principle, is not appropriate. Even in applying existing disclosure requirements in other IFRSs to insurance, care should be taken to avoid disclosure of items that will impose excessive burden on insurers [Exposure Draft - 28].

The conclusion of the IASB on PML (paragraph BC136: "... given the lack of a widely agreed definition of PML, the Board concluded that it is not feasible to require disclosure of PML or similar measures") should apply to other disclosure requirements. In other words, other disclosure requirements are not appropriate given the lack of an unanimous definition. Thus, requirements for disclosures should be completely reconsidered [BC136].

« Comments on individual requirements»

Paragraphs IG7 (b), (c), (e), (f), (g), IG8 and IG16 are inappropriate and should be deleted [IG7, IG8, IG16].

Disclosure of assumptions is based on the recognition and measurement practice prevailing in each country. It is therefore inappropriate to require any across-the-board disclosure of the process and value used in making assumptions. Such process and value vary substantially according to the method of recognition and measurement [Exposure Draft - 27(c)].

The process of developing assumptions is highly technical. Its disclosure may mislead users and is therefore deemed inappropriate [BC128].

Paragraph IG20 requires the disclosure of information that goes far beyond the scope of notes in financial statements. No accounting standard should require disclosure of such information [IG20].

Paragraph IG28 requires disclosure for “all prior periods” for which it reports “full comparative information.” Any requirement for disclosure of information relating to past periods should be limited by practical considerations [IG28].

As no method of measurement has been established thus far, disclosure about the timing and uncertainty of future cash flows, even if they could be calculated, may only provide information that lacks the qualitative characteristics of financial statements, such as relevance, usefulness, reliability and understandability [Exposure Draft - 28].

Paragraph IG33 suggests that it may be appropriate to report separate information about life insurance and annuities. This suggestion is not always appropriate, as life insurance and annuities are integrated as a single business in many cases [IG33].

Information on risk management policies, mentioned in paragraph 29(a), the amount, timing and uncertainty of future cash flows, mentioned in paragraph 29(b), and information about insurance risk, mentioned in paragraph 29(c), are not deemed appropriate as disclosure items [Exposure Draft - 29(c)].

Requiring disclosures that attempt to ensure that investors can make an assessment “through the eyes of management” would be asking for too much [IG40].

It is impractical to disclose the information mentioned in paragraph IG40(c) and (d), as no definition has been established for such items [IG40].

It is inappropriate to require disclosure of information about sensitivity and concentrations of insurance risk [IG41, IG44].

It is inappropriate to require disclosure of individual items regarding claims development [Exposure Draft - 29].

<Reason>

Recognition and measurement models impact the estimation of future cash flows. Disclosure of future cash flows lacks comparability and is thus misleading when no recognition or measurement models are established. Therefore, information about past experiences which is common under any recognition or measurement approaches employed should be disclosed. Any requirements for such disclosures should be based on current practice, because Phase I of the project is not supposed to create any additional work load [Exposure Draft - IN8].

The current insurance accounting system in each country has been developed so as to make sense in its entirety. It should be borne in mind that even a partial revision may undermine the reasonableness of the current system as a whole [Exposure Draft - 1].

Although Paragraph BC125 states, “in the Board’s view, the proposed disclosure requirements are all essential and should be part of the financial statements,” the proposals in this Exposure Draft go far beyond the scope of disclosures in financial statements [BC125].

To prepare disclosure information under this Exposure Draft would almost amount to preparing two sets of financial statements (on a current practice basis and on a fair value basis). This may not only impose excessive burden on the preparers of financial statements but also mislead and confuse users [BC125].

Paragraph BC126 states, “the Board expects that both these principles will remain largely unchanged for Phase II.” This statement is inappropriate, because it might give readers an impression that conclusions in Phase II have already been drawn, whereas nothing should have been decided yet [BC126].

The items mentioned in Paragraphs IG7, IG8 and IG16 go beyond the level of explanation of the monetary amounts presented in financial statements, and thus step outside the scope of the first disclosure principle. The first principle only requires disclosure of the explanation of monetary amounts in financial statements, prepared in Phase I based on current practice in each country. Therefore, it can never require disclosures that are impossible under current practice. Disclosure requirements under the second principle should also consider current practices of recognition and measurement and should not go far beyond the scope of such practices [IG7, IG8, IG16].

In Paragraph IG7, items (b) “fees or other charges made to policyholders” and (c) “acquisition costs” (including a description of the nature of these costs) are confidential data, closely related to the management policy of each insurer. Disclosing such information would have harmful effects. Information mentioned in paragraph 27(d) and (e), information concerning risk management policies, mentioned in Paragraph 29(a), and information mentioned in Paragraph 29(c) also represent confidentiality [IG7, Exposure Draft - 27].

No definition or calculation method has been established for “risk and uncertainty,” mentioned in Paragraph IG7(e), “embedded options and guarantees,” mentioned in Paragraph IG7(f), and “discretionary performance features and investment-linking features,” mentioned in Paragraph IG7(g). Disclosures about these items are therefore impractical [IG7].

As regards Paragraph IG8 of the draft Implementation Guidance, the fair value of insurance contracts does not exist as a concept, for no rules are established on recognition and measurement in Phase I. Indeed, it is impractical to calculate fair values without established rules for recognition and measurement. Thus, this provision is unnecessary [IG8].

Disclosures about the effect of changes in assumptions may mislead users, and are deemed inappropriate [Exposure Draft - 27(d), BC129].

Disclosure of detailed information on future cash flows amounts to disclosures of insurer's trade secrets. Moreover, we can find no reason why disclosure of cash flow information should be required specifically of insurers, while other business entities are not required to disclose such information in general. If the proposed IFRS should require disclosure of cash flow information,

it would not be regarded as a fair and appropriate accounting standard unless similar disclosure is required for all products and transactions, rather than solely for insurance transactions. Many of the disclosures would also fail the test of cost effectiveness [Exposure Draft - 28].

Information relating to risk management policies, mentioned in Paragraph 29(a) of the draft IFRS, represents the management policies of the insurer. Disclosure of such information goes beyond the scope of financial statements. Moreover, it is impossible to carry out an audit thereon. Disclosure of such information would therefore run counter to the objective of the second principle, namely to “disclose information that enables users to understand the estimated amount, timing and uncertainty of future cash flows from insurance contract” [Exposure Draft - 29].

The amount, timing and uncertainty of future cash flows, mentioned in Paragraph 29(b) of the draft IFRS, may vary depending on the assumptions used. Disclosure of such forecasts would mislead users. Unlike financial instruments with fixed settlement dates and conditions, appropriate disclosure of terms and conditions is difficult for insurance contracts, due to the high degree of uncertainty about the timing of payments. Disclosure of such terms of conditions would be modeled on figures including a great number of factors. Such forecasts may differ substantially from actual cash flows and are thus deemed inappropriate as indicators of future profits [Exposure Draft - 29].

Information about insurance risks is usually outside the scope of the notes in financial statements, and should not be addressed by an accounting standard. Public disclosure of such information would be misleading, and is therefore deemed inappropriate [Exposure Draft - 29(c)].

Requiring disclosures about sensitivity and concentrations of insurance risk is inappropriate due to (i) the lack of definition, (ii) excessive burden on preparers, (iii) the possibility to mislead users, and (iv) their confidential nature [IG41, IG44].

Important items that substantially impact claims development should be subject to analytical disclosure as in the case of MD&A. It is deemed inappropriate to require disclosure of individual items [Exposure Draft - 29].

Disclosures are required about material exposures to interest risk or market risk under embedded derivatives contained in a host insurance contract that is not measured at fair value. However, there is no sense in measuring only a portion of insurance contracts at fair value (without any consideration of their correlation with insurance risks, etc.). Disclosing such information may even mislead users. Requiring any disclosure about fair value is not only inappropriate in itself but also impractical, when nothing has been decided regarding the measurement of insurance contracts at fair value. Requiring disclosure about the sensitivity of embedded derivatives is also inappropriate for the same reason for insurance liabilities. Although insurance contracts have features similar to financial instruments, they should be treated separately in conducting measurements [Exposure Draft - 29(e), IG54-IG58].

<Proposed Revision>

The proposed disclosures should be thoroughly revised, based on the Joint Position Paper of September 2002, submitted by the Japanese, U.S. and German insurance associations.

- (b) **The proposed disclosures are framed as high level requirements, supplemented by Implementation Guidance that explains how an insurer might satisfy the high level requirements.**

Is this approach appropriate? If not, what changes would you suggest, and why?

<Comments>

The adopted approach is not appropriate.

Although we see no problems in supplementing the disclosure standard with the Implementation Guidance, the latter should only present minimum number of examples and leave the decision on further disclosures to preparers [BC124].

<Reasons>

The proposed disclosures are all brand-new. It is difficult to understand them without illustrative guidance [BC124].

In order to ensure the comparability and transparency of financial statements, it is appropriate to present disclosure examples that are not excessively detailed but provide users with an appropriate amount of meaningful information [BC124].

For preparers, it is more advantageous to prepare financial statements based on reasonable examples currently prevailing in individual countries, than to bear unnecessary burden through trial and error [BC124].

By giving examples, it may be expected that the objectives of disclosure requirements will be understood more easily [BC124].

Since items to be disclosed, as well as appropriate forms and contents of disclosure, may vary according to the feature of each insurance contract, only a minimum number of examples should be provided, leaving preparers room to select appropriate forms of disclosure [BC124].

<Proposed Revision>

(None)

- (c) **As a transitional relief, an insurer would not need to disclose information about claims development that occurred earlier than five years before the end of the first financial year in which it applies the proposed IFRS (paragraphs 34, BC134 and BC135).**

Should any changes be made to this transitional relief? If so, what changes and why?

(No comment)

Question 12 – Financial guarantees by the transferor of a non-financial asset or liability

The Exposure Draft proposes that the transferor of a non-financial asset or liability should apply IAS 39 *Financial Instruments: Recognition and Measurement* to a financial guarantee that it gives to the transferee in connection with the transfer (paragraphs 4(e) of the draft IFRS, C5 of Appendix C of the draft IFRS and BC41-46 of the Basis for Conclusions). IAS 39 already applies to a financial guarantee given in connection with the transfer of financial assets or liabilities.

Is it appropriate that IAS 39 should apply to a financial guarantee given in connection with the transfer of non-financial assets or liabilities? If not, what changes should be made and why?

(No comment)

Question 13 – Other comments

Do you have any other comments on the draft IFRS and draft Implementation Guidance?

<Comment>

Closer consultations should be made with the industry in future deliberations, through expanded use of the Advisory Committees, etc. [Exposure Draft - 7].

<Reasons>

In elaborating accounting standards, the IASB often gives priority to theoretical consistency, to the detriment of feasibility and efficiency (cost effectiveness). This leads to serious disputes with practitioners in insurance, as well as in other industries. This is because sufficient consideration is not given to the comments of preparers and the current accounting practice in the due process of the IASB [BC7].

<Proposed Revision>

(None)

<Comment>

Measures to avoid mismatches between assets and liabilities (including assets held to back insurance liabilities) should be reconsidered.

<Reasons>

Mismatches in measuring assets and liabilities represent a major issue. IAS 39 should not be applied without modification to the financial assets held by insurers, until a reasonable solution has been found. For example, in Phase I, exceptions should be permitted in applying IAS 39, to assets held to back insurance liabilities.

The category of “assets held to back insurance liabilities” does play an essential role in Japan. Apparently, full consideration has not been given to this category. The Basis for Conclusions does not provide any convincing reasons why the IASB has rejected the creation of this category [BC110 (b)].

<Proposed Revision>

Create the new category of “assets held to back insurance liabilities” in the text or Appendix C of the draft IFRS.

<Comment>

The IASB made an appropriate commitment to completing Phase II after it has thoroughly investigated all relevant questions and completed a full and extensive due process.

In so doing, the following arguments regarding the tentative conclusions should be fully considered.

- Renewed attention should be paid to comments and proposed approaches obtained from practitioners on the occasion of field visits to Japan and other countries.
- The asset-and-liability approach should be considered in light of the characteristics of insurance, and should not be treated as a given for establishing a framework for insurance accounting.
- The lack of market transactions impacts the measurement of insurance contracts as a whole. This issue cannot be resolved by merely permitting to use entity-specific assumptions.
- It is unreasonable to require risk adjustments that would be demanded by market participants, while recognising the lack of market transactions.
- The reflection of creditworthiness may create an unsound accounting standard for regulatory purposes. Given the variety of financial statement users, the measurement of an insurance contract should not reflect its creditworthiness.
- Two issues should be borne in mind before requiring the incorporation of policyholders’ behaviour into measurements. First, any such incorporation is not credible in itself. Second, policyholders’ behaviour is not rational in nature (e.g. policyholders do not buy insurance contracts in the expectation of positive cash flows) and is not necessary consistent with financial theory [BC6].

<Reasons>

The tentative conclusions in paragraph BC6 were built upon the “agreement to prepare a model with the following features (mentioned in the tentative conclusions)” reached at the IASB meeting in January 2003 (January UPDATE), and does not have any binding effect on future discussions. However, focusing attention on the consideration of a model “with the features mentioned in the tentative conclusions” should not eclipse the essential objective of the project to establish accounting standards “in light of the characteristics of insurance” [BC6].

The above comments include those intended for deliberations in Phase II, and do not necessarily concern this Exposure Draft [BC6].

As regards the use of market-based information, it should be noted for instance that although interest rates are observed in market transactions, no market transactions exist for assumed interest rates (discount rates) incorporated into insurance contracts [BC6].

It remains unresolved how to measure insurance contracts at fair value, when they are not subject to market transactions. Entity-specific value and fair value have only one thing in common: they both represent estimates of future cash flows [BC8].

Insurance products differ from other financial instruments solely intended for asset transactions. This difference should be considered in reflecting creditworthiness [BC6].

<Proposed Revision>

(None)

End.