



THE GENERAL INSURANCE ASSOCIATION OF JAPAN

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4 September, 2013

Mr. Hans Hoogervorst
Chairman,
International Accounting Standards Board
30 Cannon Street, London EC4M 6XH
United Kingdom

Dear Mr. Hoogervorst,

ED/2013/5 Regulatory Deferral Accounts

The General Insurance Association of Japan ("Association") appreciates the opportunity to comment on the Exposure Draft *Regulatory Deferral Accounts* issued in April 2013. The Association was originally established in 1917, and reestablished in 1946, by all domestic non-life insurers with the objective to promote the sound development of the non-life insurance industry in Japan. The Association has, under its Accounting Committee, a dedicated project team for International Financial Reporting Standards ("IFRS") issues. The team is exploring how to adopt IFRS in light of the specific aspects of various Japanese insurance products, which also include rate-regulated insurance products.

As outlined in our response to the *Request for Information on Rate Regulation* issued in March 2013, we believe there exist two types of non-life insurance products that should be regarded as rate-regulated activities in the Japanese market. (For further details, please refer to our letter dated 30 May, which is attached at the end of this letter as Appendix B.) Our comments, provided as Appendix A, reflect the views of the Japanese non-life insurance industry based on the nature of these rate-regulated products. We appreciate your attention and careful consideration of our comments in the redeliberation of the interim Standard.

Please do not hesitate to contact us at g-kikaku@sonpo.or.jp should you have any questions regarding this letter.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'K. Nishino', with a stylized flourish at the end.

Kazuhiko Nishino
Chairman
Accounting Committee
The General Insurance Association of Japan

Question 2

The Exposure Draft proposes two criteria that must be met for regulatory deferral accounts to be within the scope of the proposed interim Standard. These criteria require that:

- (a) an authorised body (the rate regulator) restricts the price that the entity can charge its customers for the goods or services that the entity provides, and that price binds the customers; and
- (b) the price established by regulation (the rate) is designed to recover the entity's allowable costs of providing the regulated goods or services (see paragraphs 7–8 and BC33–BC34).

Are the scope criteria for regulatory deferral accounts appropriate? Why or why not?

We do not agree with the proposal in the Exposure Draft that requires rates to be designed to recover the entity's actual costs, and that rate-setting mechanisms that determine rates based on targeted or assumed costs, including industry averages, are not within the scope of the proposed interim Standard.

We understand that regulators often utilise industry averages in the rate-setting mechanism to encourage companies to reduce costs. Even in such cases, there will be an identifiable causal effect between the regulatory deferral account balances and the rate-setting mechanism, as long as the regulatory deferral account balances are also set up based on targeted or assumed costs. (As a result, the difference between the targeted or assumed costs and the actual costs will be recognised as profit or loss for the period.)

In short, when both rate-setting and recognition of the regulatory deferral account balances are based on targeted or assumed costs, such activities should be included in the scope of the interim Standard.

We suggest, therefore, that paragraph 8 be re-written as follows.

- 8 *The second scope criterion in paragraph 7 requires that there is an identifiable causal effect that links the regulatory deferral account balances to the rate-setting mechanism. This does not require a one-to-one matching of costs but does require that the regulatory deferral account balances are measured consistently with the rate-setting mechanisms ~~the rate-setting mechanism is designed to recover the entity's specific costs~~. Consequently, if a rate-setting mechanisms that determines rates based on targeted or assumed costs, for example, industry averages, but the corresponding regulatory deferral account balances are measured based on actual costs of the entity, without a link to the actual costs of the entity such scheme is not within the scope of this [draft] interim Standard.*

Question 6

The Exposure Draft proposes that an entity should apply the requirements of all other Standards before applying the requirements of this [draft] interim Standard. In addition, the Exposure Draft proposes that the incremental amounts that are recognised as regulatory deferral account balances and movements in those balances should then be isolated by presenting them separately from the assets, liabilities, income and expenses that are recognised in accordance with other Standards (see paragraphs 6, 18–21 and

BC55–BC62).

Is this separate presentation approach appropriate? Why or why not?

For the following reasons, we believe that the proposed separate presentation approach should not be required for all rate regulated activities across the board.

Firstly, presenting what is merely the difference between the regulatory deferral account balances based on the previous GAAP accounting policy and the assets and liabilities recognised under existing IFRS may not always be relevant for the economic-decision making needs of the users. In some cases, presenting the regulatory deferral account balance in its entirety as presented under the previous accounting policy will more faithfully communicate the economic substance of the activity and may be more relevant for the needs of the users.

Secondly, in certain cases, financial statements presented using the separate presentation approach could be significantly disconnected with the economic reality, when the regulatory deferral account balance under the previous GAAP accounting policy is presented net of debtors and creditors, i.e. as a single item, while, under IFRS, assets and liabilities are separately recognised in accordance with other Standards. In such cases, either the assets or liabilities will be over- or understated.

We therefore suggest that presenting the regulatory deferral account balances in accordance with previous GAAP accounting policy should be permitted if presenting them as incremental amounts significantly impairs the relevance of the financial statements, and propose to amend paragraph 6 and 18 as follows:

- 6 *This [draft] interim Standard does not address other aspects of accounting by entities that are engaged in rate-regulated activities. By applying the requirements in this [draft] interim Standard, an entity recognises, as regulatory deferral account balances in the statement of financial position, amounts that would otherwise be recognised in the current or a prior period in the statement of profit or loss and other comprehensive income as an expense or income. ~~Although rate regulators can affect the timing of the recovery of costs or the reversals of over-recoveries in rates, rate regulators do not change the characteristics of assets and liabilities that exist and would be recognised in accordance with existing IFRS. Consequently, this [draft] interim Standard is only applicable to the incremental amounts that would not otherwise be recognised as assets or liabilities in accordance with other Standards and the Conceptual Framework for Financial Reporting.~~*
- 18 *This [draft] interim Standard introduces presentation requirements, outlined in paragraphs 19–21, for regulatory deferral account balances that are recognised in accordance with paragraphs 14–15. In general, rate regulators can affect the timing of both the recovery of costs and the reversals of over-recoveries in rates, while they do not change the characteristics of the assets and liabilities that exist and would be recognised in accordance with existing IFRS. As stated in paragraph 6, regulatory deferral account balances, therefore, are the incremental amounts that are recognised in addition to the assets and liabilities that are recognised in accordance with other Standards. These presentation requirements separate the impact of recognising regulatory deferral account balances from the financial reporting requirements of other Standards. However, if the separation from the requirements of other Standards is deemed to significantly impair the relevance of the financial statements to the needs of the financial statements users, presenting the regulatory deferral account balance in accordance with the previous GAAP accounting policy, without separating its impact from the requirements of other Standards, shall be permitted.*

Question 7

The Exposure Draft proposes disclosure requirements to enable users of financial statements to understand the nature and financial effects of rate regulation on the entity's activities and to identify and explain the amounts of the regulatory deferral account balances that are recognised in the financial statements (see paragraphs 22–33 and BC65).

Do the proposed disclosure requirements provide decision-useful information? Why or why not? Please identify any disclosure requirements that you think should be removed from, or added to, the [draft] interim Standard.

Paragraph 28(a) presents an example of the level of detail usually considered to be necessary for the reconciliation of beginning and ending balance of regulatory deferral account balances, which includes a gross presentation of the amount recognised in the current period and the amount recovered, amortised or reversed in the current period. However, certain schemes of rate-regulated activities may require regulatory deferral account balance be provided only on a net basis. In that case, grossing up the net balance would be inherently arbitrary and thus could impair the relevance of the financial statements.

The IASB has collected information on various rate regulation schemes from the responses to the *Request for Information on Rate Regulation*. We assume that there are a variety of rate regulation schemes around the world, which should be thoroughly analysed before the board makes any decisions on specific disclosure formats. Otherwise such requirements may not help enhancing the understandability of the financial statements.

As such, we propose that (i) to (iii) of paragraph 28(a) be deleted.



THE GENERAL INSURANCE ASSOCIATION OF JAPAN

Non-Life Insurance Building, 9, Kanda Awajicho 2-Chome, Chiyoda-Ku,
Tokyo 101-8335, Japan Tel : +81-3-3255-1221

May 30, 2013

International Accounting Standards Board
30 Cannon Street, London EC4M 6XH
United Kingdom

To whom it may concern,

This letter is our response to your Request for Information regarding the Rate Regulation published in March 2013. Our Association, the General Insurance Association of Japan, was originally established in 1917 and reestablished in 1946 by all the domestic non-life insurance companies. Its objective is to promote the sound development of the non-life insurance industry in Japan.

Please take this response attached as reflecting the views of the non-life insurance industry in Japan. The Association has a special project team for the International Financial Reporting Standards (hereinafter the IFRS) under its Accounting Committee. The team has been exploring how to adopt the IFRS mainly to the specific aspects of various Japanese insurance products, including rate-regulated insurance products.

Based on our analysis, we consider that two types of rate-regulated insurance products, for which the Japanese GAAP require insurers to follow specific accounting rules to recognise the economic effects of those rate regulations, should be included in the scope of the Rate Regulation project, namely;

- Compulsory Automobile Liability Insurance, and
- Earthquake Insurance on Dwelling Risks.
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We would much appreciate it if you would take our views into consideration in the discussion of Rate Regulation. If you would like to clarify any aspects described in this letter, please feel free to contact us at g-kikaku@sonpo.or.jp.

Yours sincerely,

Hirokazu Fujita
Chairman
Accounting Committee
The General Insurance Association of Japan

May 30, 2013

Response to Request for Information regarding the Rate Regulation

The following are the response from the General Insurance Association of Japan with respect to the Request for Information regarding the Rate Regulation published by the International Accounting Standards Board (IASB) staff in March 2013.

Question 1

For the types of rate regulation that you think would be useful for us to consider in the Discussion Paper (or would not be useful to consider, if applicable), what types of goods or services are subject to the rate regulation being described?

In providing this information, please also tell us:

- (a) whether you are a rate-regulator, a financial statements preparer, auditor, user or other (please specify);**

The General Insurance Association of Japan is a non-profit organization formed by non-life insurance companies, which are financial statements preparers in Japan.

- (b) what jurisdiction the rate regulation that you are describing is in;**

Japan

- (c) whether that jurisdiction is a recent adopter of IFRS; and**

It has been permitted companies which meet certain requirements to prepare their consolidated financial statements in accordance with IFRS since the fiscal year ended March 2010.

- (d) whether the main suppliers of the rate-regulated goods or services (ie the rate-regulated entities), including your company if applicable, are predominantly private-sector entities, government entities or closely related to the rate regulator.**

The main suppliers of the services are private-sector entities (Non-life insurance companies in Japan).

If the jurisdiction has not adopted IFRS, your views are still useful to us. It would be helpful if you could include information about what local GAAP is applied and how the effects of the rate-regulatory scheme are reported in accordance with that local GAAP.

We consider that following two types of rate regulated insurance in Japan should be included in

Discussion Paper.**1. Compulsory Automobile Liability Insurance**

Compulsory Automobile Liability Insurance (hereinafter referred to as 'CALI') is a liability insurance which aims to secure basic compensation for bodily injury of traffic accidents, by providing a cover to the economic liabilities owed by a party at fault in traffic accidents, and thus to protect the victims. In principle, based on Automobile Liability Security Law, no automobile shall be operated without CALI.

Under Japanese GAAP, the accounting treatment of CALI for insurance companies is as follows.

When the revenues pertaining to CALI business exceed the expenses, the surplus is reserved as the balance called 'Reserve for insurance policy liabilities' accumulated in the liability section. On the other hand, when the expenses pertaining to CALI business exceed the revenues, the balance is reversed by the amount equivalent to the deficit. Thus, the profit and loss pertaining to CALI business is set to zero.

2. Earthquake Insurance on Dwelling Risks

Earthquake Insurance on Dwelling Risks (hereinafter referred to as 'Earthquake Insurance') is a voluntary property insurance which covers the damage due to fire, destruction, burial or being carried away in a flood, resulting directly or indirectly from an earthquake or a volcanic eruption, or tsunami following those events. It is required to apply for this insurance with the host fire insurance in a set, and is not allowed to apply separately. Based on the Act on Earthquake Insurance, private insurance companies and the Japanese government share the responsibility through reinsurance.

Under Japanese GAAP, the accounting treatment of the Earthquake Insurance for insurance companies is as follows.

When the revenues pertaining to Earthquake Insurance business exceed the expenses, the surplus is reserved as the balance called 'Contingency reserve' accumulated in the liability section. On the other hand, when the expenses pertaining to Earthquake Insurance business exceed the revenues, the balance is reversed by the amount equivalent to the deficit. The total maximum responsibility of the insurance companies is set up so as not to exceed the total amount of the 'Contingency reserve' with the provision of the governmental reinsurance cover.

The following are the comments to Question 2 ~ 5 regarding CALI.

Question 2

What are the objectives of the rate regulation and how do they influence the interaction between the rate regulator, the rate-regulated entity and customers?

In providing this information, please tell us:

(a) what are the high-level objectives of the rate regulation (for example, to restrict prices or to influence the levels of supply and demand or to restrict or encourage competition); and

The high-level objectives are to restrict prices and competition. In Automobile Liability Security Act, there are articles as shown below, which stipulate the main objective of this system is to supply a minimum compensation to traffic accident victims at a low-priced premium.

- This act, by establishing a system for securing compensation for damage in the case of death of or bodily injury to person caused by the operation of automobile, aims to protect the victims and also to contribute to sound development of transportation by automobiles (Automobile Liability Security Act Article1).
- Premium rates of the liability insurance shall be as low as possible within the range of compensating reasonable cost under the efficient management (Automobile Liability Security Act Article25) .

(b) how these objectives are reflected in the nature of the rate-setting mechanism? For example, to what extent:

(i) is the rate-setting mechanism designed to give the rate-regulated entity a 'fair rate of return' (for example, a cost-plus mechanism) or is the focus more on reducing the cost to customers (for example, a price-cap or other incentive-based mechanism);

The rate-setting mechanism focuses on reducing the cost to customers. The premium rate of CALI does not contain the profit for the insurers; it consists of the pure premium rate to fund the claims payments, and the 'loading' to fund the operating expenses, the loss adjustment expenses and the agent commissions.

(ii) are there incentives to meet targets that are not directly related to the cost-rate relationship (for example, efficiency, service levels, infrastructure investment, increased supply capacity

or reliability, use of alternative resources or reduction in customer demand or usage);

The investment income and the operating expenses of each company pertaining to CALI are determined based on the average of all the companies participating in the CALI business. As a result, each company has incentives to increase efficiency of the investment and operation.

(iii) does the rate regulation fix the price per unit or does it provide some flexibility for the entity to set prices (for example, through price ranges or caps, based on either unit prices or total revenue or total profitability); and

CALI premium rates are calculated by General Insurance Rating Organization of Japan (hereinafter referred to as 'GIROJ'), and are filed with the Financial Services Agency (hereinafter referred to as 'FSA'). All the CALI insurers use those rates examined by FSA. Therefore, the premium is the same among any insurers, if the contract terms are the same. GIROJ is an organization that develops premium rates for non-life insurance risks from a fair point of view, and then provides them to the non-life insurance companies.

(iv) are there other aspects of the rate-setting mechanism that reflect any specific objectives not envisaged above?

N/A

Question 3

What sort of rights or obligations does the regulation create?

In providing this information, please consider:

(a) whether the rate-regulated entity has an exclusive right to operate in the market;

There is no exclusive right to operate the CALI business, as long as entities acquire the license of non-life insurance business and the authorization of CALI business from FSA.

(b) if the entity's right to operate in the market is established by licence:

(i) is there a cost to acquire the licence; and

The authorization of CALI requires no particular costs. However, when an entity acquires the license of non-life insurance business, it costs the entity to meet the certain capital requirements and to

establish its insurance business operations such as underwriting and loss adjustment.

(ii) can the licence be revoked, renewed or transferred;

The authorization can be revoked (or voluntarily returned by the entity). Renewal is not required once the entity acquired the authorization. It cannot be transferred to other entities.

(c) how competition is excluded or encouraged;

As described in 2(b)(iii), competition is excluded by having all the insurers use the same premium rates. According to the Insurance Business Act, Anti-Monopoly Law shall not apply to CALI business (Insurance Business Act Article101).

(d) how the rights and obligations are expressed, for example, as a cap on the rate of return, as the right to recover entity-specific costs, as a right to recover an allowed level of costs (whether or not incurred by the entity), or as a right to recover specific types of costs without limit if and when incurred; and

The insurers assume obligations to provide their insureds with the automobile liability insurance coverage for a specific amount of compensation for bodily injury liability, without obtaining any profit from CALI business. On the other hand, as the right of the insurers, they are allowed to recover the amount equivalent to the claims payments and the expenses through future revision of CALI premium rates made by the mechanism described in 4(a).

(e) whether the entity can choose to stop providing the goods or services that are subject to rate regulation and, if so:

(i) how is this achieved; and

As described in 3(b)(ii), the insurers are allowed to stop providing CALI by returning the authorization.

(ii) what are the consequences for the entity?

It is required to settle (either pay or receive) the amount equivalent to the 'Reserve for insurance policy liabilities' with the companies participating in the CALI business at the time when the company withdraws. Therefore, even if the company withdraws from the business, recovery of the cost and return of the profit are accomplished.

Question 4

For the rights and obligations identified in response to Question 3, how does the rate-regulated entity enforce its rights, or how does the rate regulator enforce the settlement of the rate-regulated entity's obligations?

In providing this information, please tell us:

- (a) does the rate regulation provide for retrospective recovery or reversal of under- or over-recoveries of allowable costs? If so, how is this achieved, for example through cash payments or other asset transfers to or from parties outside the rate-regulated entity (such as individual customers or groups of customers, the rate regulator or the government);**

The recovery or reversal of under- or over-recoveries of costs is achieved as follows.

The underwriting and investment surplus pertaining to the CALI business are accumulated as the balance of 'Reserve for insurance policy liabilities'. The balance is returned to the future policyholders through future revision of the premium rate, and thus the CALI rates are determined in consideration of the balance accumulated in the companies.

- (b) are the rights and obligations separable from the business; and**

The rights and obligations are not separable from the CALI business.

- (c) what happens to the rights or obligations when the entity ceases to provide the rate-regulated goods or services?**

As described in 3(e)(ii), it is required to settle the amount equivalent to the 'Reserve for insurance policy liabilities' with the companies participating in the CALI business at the time when the company withdraws.

Question 5

How does the rate regulation ensure the recovery or reversal of under- or over-recoveries of allowable costs (ie variance amounts) (if applicable)? Are these mechanisms effective in recovering or reversing those amounts within the targeted time frame?

In providing this information, please tell us:

(a) what is the mechanism for tracking the recovery or reversal of such variance amounts;

As described in 4(a), the recovery or reversal of the variance amounts is tracked through the balance of 'Reserve for insurance policy liabilities'.

(b) how does the rate-setting mechanism adjust for unexpected changes in demand for the rate-regulated goods or services;

CALI is an insurance product, so the premium rate is determined without consideration of the supply and demand.

(c) has there been a recent trend whereby the balances of the variance amounts have been increasing? If so:

The balance of the variance amounts (net credit position) has been decreasing.

(i) is this caused by an increase or a decrease in the demand of the rate-regulated goods or services;

It is not based on a change in demand.

(ii) has the trend resulted in a net debit position (ie under-recovery of costs) or a net credit position (ie over-recovery of costs); and

Although the tendency for the net credit position to decrease has continued, it has not resulted in the net debit position.

(iii) what are the main components of the variance amounts (ie what are the main categories of cost or income variances)?

Because the rate-reduction aiming to return the surplus to policyholders took place in April 2008, the tendency of revenues to be less than expenses has continued. However, net credit position may increase because of the rate-increase made in April 2013.

The following are the comments to Question 2 ~ 5 regarding Earthquake Insurance.

Question 2

What are the objectives of the rate regulation and how do they influence the interaction between the rate regulator, the rate-regulated entity and customers?

In providing this information, please tell us:

- (a) what are the high-level objectives of the rate regulation (for example, to restrict prices or to influence the levels of supply and demand or to restrict or encourage competition); and**

The high-level objectives are to restrict prices and competition. In Act on Earthquake Insurance, there are articles as shown below, which stipulate the main objective of this system is to broadly supply a certain level of compensation for damages caused by an earthquake at a low-priced premium, the risk of which would be too large to be covered by private companies.

- The purpose of this Act is to promote the dissemination of earthquake insurance by having the governments reinsure the earthquake liabilities of insurance companies, etc. thereby helping to contribute to the stability of the lives of disaster victims of an earthquake, etc (Act on Earthquake Insurance Article1) .
- The premium rates for earthquake insurance contracts pertaining to the government reinsurance must be as low as possible, subject to the balance of income and expenses (Act on Earthquake Insurance Article5) .

- (b) how these objectives are reflected in the nature of the rate-setting mechanism? For example, to what extent:**

- (i) is the rate-setting mechanism designed to give the rate-regulated entity a 'fair rate of return' (for example, a cost-plus mechanism) or is the focus more on reducing the cost to customers (for example, a price-cap or other incentive-based mechanism);**

The rate-setting mechanism focuses on reducing the cost to customers. The premium rate of Earthquake Insurance does not contain the profit for the insurers; it consists of the pure premium rate to fund the claims payments and the 'loading' to fund the operating expenses, the loss adjustment expenses and the agent commissions.

- (ii) are there incentives to meet targets that are not directly related to the cost-rate relationship (for example, efficiency, service levels, infrastructure investment, increased supply capacity or reliability, use of alternative resources or reduction in customer demand or usage);**

N/A

- (iii) does the rate regulation fix the price per unit or does it provide some flexibility for the entity to set prices (for example, through price ranges or caps, based on either unit prices or total revenue or total profitability); and**

The Earthquake Insurance premium rates are calculated by GIROJ, and are filed with the FSA. All the insurers use those rates examined by FSA. Therefore, the premium is the same among any insurers, if the contract terms are the same.

- (iv) are there other aspects of the rate-setting mechanism that reflect any specific objectives not envisaged above?**

N/A

Question 3

What sort of rights or obligations does the regulation create?

In providing this information, please consider:

- (a) whether the rate-regulated entity has an exclusive right to operate in the market;**

There is no exclusive right to operate the Earthquake Insurance business, as long as entities acquire the license of non-life insurance business and the authorization of Earthquake Insurance from FSA.

- (b) if the entity's right to operate in the market is established by licence:**

- (i) is there a cost to acquire the licence; and**

The authorization of Earthquake Insurance requires no particular costs. However, when an entity acquires the license of non-life insurance business, it costs the entity to meet the certain capital requirements and to establish its insurance business operations such as underwriting and loss adjustment.

(ii) can the licence be revoked, renewed or transferred;

The authorization can be revoked (or voluntarily returned by the entity). Renewal is not required once the entity acquired the authorization. It cannot be transferred to other entities.

(c) how competition is excluded or encouraged;

As described in 2(b)(iii), competition is excluded by having all the insurers use the same premium rates. According to the Insurance Business Act, Anti-Monopoly Law shall not apply to the Earthquake Insurance business (Insurance Business Act Article101).

(d) how the rights and obligations are expressed, for example, as a cap on the rate of return, as the right to recover entity-specific costs, as a right to recover an allowed level of costs (whether or not incurred by the entity), or as a right to recover specific types of costs without limit if and when incurred; and

The insurers assume obligations to provide their insureds with the property insurance coverage up to the amount fixed at the time of a contract without obtaining any profits from Earthquake Insurance business. On the other hand, as the right of the insurers, they are allowed to recover the amount equivalent to the claims payments and the expenses by the mechanism described in 4(a).

(e) whether the entity can choose to stop providing the goods or services that are subject to rate regulation and, if so:**(i) how is this achieved; and**

As described in 3(b)(ii), the insurers are allowed to stop providing Earthquake Insurance by returning the authorization.

(ii) what are the consequences for the entity?

It is required to settle only the unexpired responsibility and unpaid claims with the companies participating in the Earthquake Insurance business at the time when the company withdraws. Therefore, if the company withdraws from the business, recovery of the cost and return of the profit will not be accomplished because the accumulated expired portion of the 'Contingency reserves' is reversed and is recognised as profit.

Question 4

For the rights and obligations identified in response to Question 3, how does the rate-regulated entity enforce its rights, or how does the rate regulator enforce the settlement of the rate-regulated entity's obligations?

In providing this information, please tell us:

- (a) does the rate regulation provide for retrospective recovery or reversal of under- or over-recoveries of allowable costs? If so, how is this achieved, for example through cash payments or other asset transfers to or from parties outside the rate-regulated entity (such as individual customers or groups of customers, the rate regulator or the government);**

The recovery or reversal of under- or over-recoveries of costs is achieved as follows.

The underwriting and investment surplus pertaining to the Earthquake Insurance business are accumulated as the balance of 'Contingency reserve' in preparation for the event of a future earthquake. If expenses such as claims payments exceeding revenues are incurred by a large earthquake, the exceeded expenses are offset by reversing the balance. The Earthquake Insurance has a cap on the total claims payments per earthquake, and so if the earthquake claims exceed the cap, claims payments are proportionally reduced at the rate of the cap to the total claim payments.

- (b) are the rights and obligations separable from the business; and**

The rights and obligations are not separable from the business.

- (c) what happens to the rights or obligations when the entity ceases to provide the rate-regulated goods or services?**

As described in 3(e)(ii), it is required to settle only the unexpired responsibility and unpaid claims with the companies participating in the Earthquake Insurance business at the time when the company withdraws.

Question 5

How does the rate regulation ensure the recovery or reversal of under- or over-recoveries of allowable costs (ie variance amounts) (if applicable)? Are these mechanisms effective in recovering or reversing those amounts within the targeted time frame?

In providing this information, please tell us:

(a) what is the mechanism for tracking the recovery or reversal of such variance amounts;

As described in 4(a), the recovery or reversal of the variance amounts is tracked through the balance of 'Contingency reserve'.

(b) how does the rate-setting mechanism adjust for unexpected changes in demand for the rate-regulated goods or services;

Earthquake Insurance is an insurance product, so the premium rate is determined without consideration of the supply and demand.

(c) has there been a recent trend whereby the balances of the variance amounts have been increasing? If so:

By the Great East Japan Earthquake in March 2011, the balance of the variance amounts (net credit position) decreased sharply from fiscal year 2010 to 2011.

(i) is this caused by an increase or a decrease in the demand of the rate-regulated goods or services;

It is not based on a change in demand.

(ii) has the trend resulted in a net debit position (ie under-recovery of costs) or a net credit position (ie over-recovery of costs); and

Although the net credit position decreased sharply, it has not resulted in the net debit position.

(iii) what are the main components of the variance amounts (ie what are the main categories of cost or income variances)?

It is due to the large amount of payment of claims caused by the Great East Japan Earthquake in March 2011. At present, the net credit position tends to increase because of the rise in participation rate to the Earthquake Insurance and no occurrence of large earthquake in 2012.