



**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

October 25, 2013

Mr. Russell G. Golden,  
Chairman  
Financial Accounting Standard Board (FASB)  
401 Merritt 7, PO Box 5116  
Norwalk, CT 06856-5116

Dear Mr. Golden,

The General Insurance Association of Japan ("Association") appreciates an opportunity to comment on the exposure draft File Reference No. 2013-290 "Insurance Contracts (Topic 834)" ("Standard") issued in June 2013. The Association was originally established in 1917 and re-established in 1946 by all domestic non-life insurers to promote sound development of the non-life insurance industry in Japan.

In our view, the proposed Standard has incorporated various requests sent to the International Accounting Standards Board ("IASB")'s exposure draft issued back in 2010 through the joint meetings with the IASB, which improved the overall quality of the Standard. We acknowledge your dedicated efforts and determination toward the development of the Standard.

However, the failure to develop a single standard with the IASB is our disappointment. As many of the Japanese insurers have substantial operations in the U.S. territories, we request the two standard-setters to continue their effort to achieve convergence by eliminating the critical differences. Specifically, we would ask the FASB to consider taking the following points;

- Question 5-7: the premium allocation approach should be regarded as a simplified approach of the building block approach,
- Question 22: an explicit risk adjustment should be recognized as proposed by IASB,
- Question 23: the boards should agree on the coherent approach, though we primarily support your position not to adjust the contractual service margin,
- Question 25: under the two margin model we support, the contractual service margin should become zero at the end of the coverage period, and
- Question 28: the costs that did not result in obtaining a contract should be included to reflect the economic substance more properly.

As for the proposed Standard consistent with the IASB, we are concerned that, in several areas, the cost to implement the proposed requirements could be prohibitively high, and yet the users may find the prepared financial statements difficult to understand. In particular, the following points would need substantial simplification and/or improvements:

- Question 16: the effect of changes in the discount rates should be allowed to present in profit and loss,



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- Question 19: the discount rate for incurred claims should be determined at the date of loss,
- Question 32: exclusion of the deposit component from the insurance contract revenue should be limited to the contracts of which the deposit component is significant, and
- Question 44: a simple method should be allowed in estimating the contractual service margin based on the prospective approach.

The comments attached address the above issues, referring to the comments sent to the IASB which include our suggestions on how to balance the relevance and practicality. We would much appreciate it if you would take our views into consideration in preparing the Standard. If you would like to clarify any points discussed in this letter, please feel free to contact us at [g-kikaku@sonpo.or.jp](mailto:g-kikaku@sonpo.or.jp).

Yours sincerely,

A handwritten signature in black ink, appearing to read 'K. Nishino', written in a cursive style.

Kazuhiko Nishino  
Chairman  
Accounting Committee  
The General Insurance Association of Japan

## 1. Convergence with IASB

We request the FASB and IASB to continue their effort to achieve convergence.

For globally active insurance companies, differences in accounting standards between the U.S. and IASB undermine the business efficiency, and thus the convergence should be sought as much as possible.

In particular, the following differences are important for us.

**Question 5:** Do you agree that entities should apply different approaches to contracts with different characteristics, described as the building block approach and the premium allocation approach? If not, which model do you think should apply and do you think there should be any changes made to that model?

**Question 6:** Do you agree that entities should be required to apply the premium allocation approach if the coverage period of the insurance contract, considering the contract boundary guidance, is one year or less? If not, what would you recommend and why?

**Question 7:** Do you agree that entities should be required to apply the premium allocation approach if, at contract inception, it is unlikely that during the period before a claim is incurred there will be significant variability in the expected value of the net cash flows required to fulfill the contract? If not, what do you recommend and why?

We see no problem applying the building block approach to the insurance contract with the coverage period is one year or less. As such, the premium allocation approach should be regarded as a simplified approach of the building block approach, and should be allowed when the result would be a reasonable approximation of the building block approach.

In Japan, non-life insurance policies come with various coverage periods. Under the FASB proposal, the single portfolio would have to be split between the two. As far as the insurance risk is the same, the building block approach should be allowed to include both long and short duration.

**Question 22:** Do you support using a one-margin approach, as is included in this proposed guidance, or an explicit risk adjustment and a contractual service margin (as the IASB proposes)? Please explain the reason(s) for your view.

We support an explicit risk adjustment and a contractual service margin. As defined in the IASB's revised exposure draft, the risk adjustment should be regarded as "the compensation that an entity requires for bearing the uncertainty about the amount and timing of the cash flows that arise as the entity fulfils the insurance contract." It is valuable information for the financial statement users as well as for insurers reviewing the premium rate levels reflecting the underlying risks.

**Question 23:** If you support a risk adjustment and a contractual service margin, do you agree with the IASB's approach to adjust the contractual service margin for changes in estimates of cash flows? Why or why not? Do you agree with the IASB's approach to not specify acceptable approaches to determine the risk adjustment? Why or why not?

Albeit the IASB's approach to adjust the contractual service margin for changes in estimates of cash flows is consistent with the initial recognition, we are concerned that tracking those

adjustments in practice could be exorbitantly complex. We would agree with the proposal if the administration can be simplified. See our comments on Question 1 sent to the IASB (see Appendix 1).

We agree with the IASB's proposal to not specify acceptable approaches to determine the risk adjustment. The standard should clarify the definition of the risk adjustment, and allow using the best suitable technique to measure in accordance with the nature of the risk.

**Question 25:** Do you agree with the proposed method(s) of recognizing the margin (that is, as the entity is released from risk under the insurance contracts as evidenced by a reduction in the variability of cash outflows)? If not, what do you suggest and why?

We do not agree with the proposal, as we support splitting the margins in two parts. The proposal corresponds to the reduction of the risk adjustment part, but the contractual service margin part should be recognized based on the pattern of providing the services during the coverage period, and should become zero at the end of the coverage period.

**Question 28:** Do you agree that the direct acquisition costs presented with the margin should include only the costs directly related to the entity's selling efforts that result in obtaining the contracts in the portfolio and that all other acquisition costs should be recognized as expenses when incurred? If not, what do you recommend and why?

In our view, including all the costs directly attributable to acquire a portfolio (i.e. including the costs that did not result in obtaining a contract) would reflect the economic substance more properly. For example, even if the agent commission is paid only for the contracts obtained, in effect it affords the costs of agent activities that did not result in obtaining a contract.

## 2. Comments on the conclusions same as those IASB's

**Question 16:** Do you agree that an entity should segregate the effects of underwriting performance from the effects of changes in discount rates (which would reverse over time) by recognizing changes in the present value of the fulfillment cash flows due to changes in the discount rates in other comprehensive income? If not, do you think that the effect of changes in the discount rates should be presented in net income? Please explain your reasoning.

The effect of changes in the discount rates should be allowed to present in profit and loss. See our comments on Question 4 sent to the IASB.

**Question 19:** Do you agree that interest expense generally should be based on the discount rates determined at the date the portfolio of contracts was initially recognized? Why or why not? If not, what do you recommend?

The discount rate for incurred claims should be determined at the date of loss. See our comments on Question 4 sent to the IASB.

**Question 31:** Do you agree that users of financial statements would obtain relevant information that faithfully represents the entity's financial position and performance if, in net income, for all insurance contracts, an entity presents insurance contract revenue and incurred expenses, rather than only information about changes in margins (that is, the net profit)? If not, why not?

We agree. See our comments on Question 3 sent to the IASB.

**Question 32:** Do you agree that, for all contracts, revenue should exclude any amounts received that an entity is obligated to pay to policyholders or their beneficiaries regardless of whether an insured event occurs and that expenses should exclude the corresponding repayment of those amounts? If not, what do you recommend? Please specify whether your view depends on the type of contract.

The scope of the exclusion is too wide; it should be limited to the contracts of which the deposit component is significant. The judgment should be based on the characteristics of the contract, not by the types of the contracts.

We would recommend that the definition of deposit component should be "the minimum amounts that an insurance contract requires the entity to repay to a policyholder among scenarios that assume an economically rational policyholder's behavior, even if an insured event or other events such as cancellation does not occur." (Additional text to the definition of the revised proposal is underlined.) See our comment on Question 4 sent to the IASB.

**Question 44:** Do you agree that the practical expedients relating to transition included in this proposed guidance are sufficient for retrospective application (that is, are the transition provisions in this proposed guidance operable)? If not, what would you recommend and why?

Under the proposed simplification that includes adding back the cash flows that are known to have occurred, the reliable number would be difficult to obtain, or the result would not be reasonable, either.

We would recommend that, in replacement for the retrospective approach that would require tracking the past cash flows, the board should allow a simple measurement method to estimate the contractual service margin based on the prospective approach that would use the contracts in-force and the current assumptions (i.e. prospective method).

In addition, when the retrospective approach is impractical beyond reasonable efforts, the board should also allow estimating the contractual service margin as the difference between the balance reserved under the local GAAP (adjusted by eliminating equalization reserves and other major differences) and the fulfilment cash flows. See our comments on Question 5 sent to the IASB.

**Appendix1**



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October 25, 2013

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

Dear Mr. Hoogervorst,

The General Insurance Association of Japan ("Association") appreciates an opportunity to comment on the exposure draft ED/2013/7 "Insurance Contracts" issued in June 2013. The Association was originally established in 1917 and re-established in 1946 by all domestic non-life insurers to promote the sound development of the non-life insurance industry in Japan.

The comments attached represent the viewpoints of the non-life insurance industry in Japan. The Association has, under its Accounting Committee, an International Financial Reporting Standards ("IFRS") project team exploring how to adopt IFRS in light of the specific aspects of various Japanese non-life insurance products. Since the exposure draft was published in June, the team has been concentrating upon the preparation of comments to represent the position of the Association.

In our view, the proposed Standard has incorporated various requests from constituents, including ourselves, which improved the overall quality of the Standard. We acknowledge your dedicated efforts and determination toward the development of this draft since the issuance of the previous one back in 2010.

However, the failure to develop a single Standard with the FASB is our disappointment. As mentioned in the comment letter to FASB, we request the two standard-setters to continue their effort to achieve convergence by eliminating the critical differences.

As for the IASB's proposed Standard, we are concerned that, in several areas, the cost to implement the proposed requirements could be prohibitively high, and yet the users may find the prepared financial statements difficult to understand. In particular, the following points would need substantial simplification and/or improvements:

- adjustment of the contractual service margin and transition,
- definition of investment component to be excluded from insurance contract revenue,
- presentation of insurance contract revenue,

**Appendix1**



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- use of other comprehensive income for the changes in discount rates, and
- disclosure of equivalent confidence level.

The comments attached address the above issues, and include our suggestions how to balance between relevance and practicality. We would much appreciate it if you would take our views into consideration in preparing the International Financial Reporting Standard on insurance contracts. If you would like to clarify any points discussed in this letter, please feel free to contact us at [g-kikaku@sonpo.or.jp](mailto:g-kikaku@sonpo.or.jp).

Yours sincerely,

Kazuhiko Nishino

Chairman

Accounting Committee

The General Insurance Association of Japan

Question 1—Adjusting the contractual service margin

Do you agree that financial statements would provide relevant information that faithfully represents the entity's financial position and performance if differences between the current and previous estimates of the present value of future cash flows if:

- (a) differences between the current and previous estimates of the present value of future cash flows related to future coverage and other future services are added to, or deducted from, the contractual service margin, subject to the condition that the contractual service margin should not be negative; and
- (b) differences between the current and previous estimates of the present value of future cash flows that do not relate to future coverage and other future services are recognised immediately in profit or loss?

Why or why not? If not, what would you recommend and why?

1. We primarily disagree with the proposed method of unlocking the contractual service margin. Instead, the contractual service margin should be recognised as income in a systematic way, independent of the changes in the estimates of future cash flows as proposed in the 2010 ED (lock in the contractual service margin). The reasons are as follows;
  - (1) Though the definition of the contractual service margin has been changed to “the unearned profit that the entity recognises as it provides services under the insurance contract”, the nature of the margin, which is essentially a deferral account not to recognise the initial profit, is unchanged as the amount is originated from the net balance at initial recognition. Some argue that recognising profit or loss in the subsequent measurement is inconsistent with the initial recognition. However, changes in estimate represent economic changes in the cost of fulfilling a portfolio of contracts in that period, and are different in nature from the recognition of initial profit before providing services, and thus do not need to be consistent with initial recognition.
  - (2) The nature of the contractual service margin does not only represent the unearned profit, but also represents a bunch of various elements, such as compensation to the cash outflows not included in the measurement of the fulfilment cash flows. For example, the contractual service margin contains premium loading for covering indirect costs. The proposed scheme, under which the entire contractual service margin could be consumed by changes in estimate of future cash flows consisted of direct costs only, does not faithfully represent the economic substance of the pricing.
  - (3) Without the adjustments, changes in estimated future cash flows will be immediately recognised in profit or loss, which will improve transparency and enable timely performance presentation. The current proposal which accumulates adjustments to the deferred account is merely utilising the balance as a buffer to the changes in estimates, and thus lacks transparency.
2. If, however, unlocking of contractual service margin is introduced despite our comments, the operational burden should be lightened by limiting the scope of changes that are subject to adjustments, and simplifying the tracking of the adjustments for the following reasons (please see paragraph 3 for a more fundamental alternative).
  - (1) The standards should be clear in that detail tracking is not a prerequisite of the proposed adjustments of contractual service margin. Though the calculation of contractual service margin described in the revised exposure draft (paragraph 30) does not require tracking the past record,

a preliminary discussion with auditors revealed that they anticipate insurers to track records for audit purposes auditing necessity for the past adjustment records in the audit of financial statements. Also, the draft is not clear whether tracking is necessary after recognising the additional insurance liability for onerous contracts.

Should detail record tracking be required, the operation with ever more increasing data could be so cumbersome that we cannot ensure its operability.

In that sense, it would be helpful to spell out that “contractual service margin will be recognised immediately when the profitability of onerous contract is subsequently improved, regardless of the past recognised loss.”

- (2) The changes adjusted by the contractual service margin should be limited to the changes in the present value of expected future cash flows caused by the changes in assumptions (or parameters), while other changes should be recognised in profit or loss. By doing so, the adjustments stipulated in paragraph B68 (b) for “experience differences that relate to future coverage” would be simplified, as all the experience differences can be recognised in profit or loss.

Under this approach, we assume that the entity would instead adjust the balance of contractual service margin in accordance with the changes in the policy in force caused by cancellation or lapse, and then would recognise them in profit or loss (similar to the adjustment described in the former 2010 ED paragraph 53, but this adjustment would allow increase as well).

3. Furthermore, if the IASB is willing to accept more fundamental alternative than paragraph 2, we strongly recommend that the IASB consider a calculation method of estimating the future profit based on the latest assumptions in the same manner as estimating the expected cash flows and the risk adjustments, which is best suitable if the contractual service margin is defined as the future unearned profit (prospective method).
  - (1) If the contractual service margin represents the future unearned profit, the estimate using the latest assumptions which reflects the past, present, and future situations would be consistent with the assumptions used in estimating the fulfilment cash flows, and would best fit to calculate the expected present value.
  - (2) Under the prospective method, the entire liability amount would be remeasured at the end of each period, which would not require any tracking of the past calculation.
  - (3) By adopting the prospective method, changes in risk adjustments can be absorbed by the contractual service margin, which is different from paragraph 30 of the proposed Standards. However, it is more consistent with the initial recognition, and the measurement model will be simpler and easier to understand for the users of financial statements. Though BC37 states that recognising changes in risk adjustment in profit or loss would provide more transparent information changes in future cash flows margin are equally important as changes in risk adjustment. Therefore, if changes in future cash flows are adjusted in the contractual service margin, it is appropriate to adjust changes in risk adjustment as well.
4. As examples of the prospective method, we would present the following methods (see Appendix 2 ).
5. First, it would be possible to measure the contractual service margin in the same manner as the initial recognition in each accounting period.
  - (1) Using the policies in-force at measurement date, estimate the present value of expected future cash flows, risk adjustments, and the contractual service margin, starting from the initial recognition.
  - (2) Using the contract information currently in-force and the latest assumptions, estimate the

premiums, claims and expense payments in the past period backward as well.

- (3) The re-measured contractual service margin at initial recognition will be adjusted by the amount that should have been recognised in profit or loss by present, according to paragraph 32.
- (4) Calibrate the calculated result to the current policies in-force.

Under this method, changes in the estimate of future cash flows would be reflected through the remeasurement, instead of the cumulative adjustments to the initial estimate of the contractual service margin. The difference between the current estimate of the remeasured contractual service margin and the previous estimate will be recorded in profit or loss.

- 6. As a one-step further simplification, we suggest the IASB also consider a method that treats as if there were a portfolio transfer at the beginning of each period, and then apply the above calculation; treat the beginning balance as the consideration for the portfolio transfer, and then estimate the cash flows of the past period based on the policies in-force at the end of the period.
  - (1) Based on the definition of the insurance liability as the sum of the present value of fulfilment cash flows and the unearned profit, it is a reasonable assumption to treat the beginning balance as an appropriate consideration for the entity.
  - (2) Recalculating the past results using the latest assumptions each time could be regarded as continuously restating the past results. The issue can be avoided by treating the beginning balance as the consideration for the portfolio transfer.
  - (3) The calculation method may require tracking, but adding and subtracting each element is not needed.
- 7. We suggest that, in replacement of paragraph 30 and B68, a measurement principle such as the examples above should be established, allowing alternative methods if the result would be a reasonably approximation, as various recalculation methods for measuring the contractual service margin could exist.

<p>Question 2—Contracts that require the entity to hold underlying items and specify a link to returns on those underlying items</p>
<p>If a contract requires an entity to hold underlying items and specifies a link between the payments to the policyholder and the returns on those underlying items, do you agree that financial statements would provide relevant information that faithfully represents the entity’s financial position and performance if the entity:</p> <ul style="list-style-type: none"> <li>(a) measures the fulfilment cash flows that are expected to vary directly with returns on underlying items by reference to the carrying amount of the underlying items?</li> <li>(b) measures the fulfilment cash flows that are not expected to vary directly with returns on underlying items, for example, fixed payments specified by the contract, options embedded in the insurance contract that are not separated and guarantees of minimum payments that are embedded in the contract and that are not separated, in accordance with the other requirements of the [draft] Standard (ie using the expected value of the full range of possible outcomes to measure insurance contracts and taking into account risk and the time value of money)?</li> <li>(c) recognises changes in the fulfilment cash flows as follows:                     <ul style="list-style-type: none"> <li>(i) changes in the fulfilment cash flows that are expected to vary directly with returns on the underlying</li> </ul> </li> </ul>

items would be recognised in profit or loss or other comprehensive income on the same basis as the recognition of changes in the value of those underlying items;

(ii) changes in the fulfilment cash flows that are expected to vary indirectly with the returns on the underlying items would be recognised in profit or loss; and

(iii) changes in the fulfilment cash flows that are not expected to vary with the returns on the underlying items, including those that are expected to vary with other factors (for example, with mortality rates) and those that are fixed (for example, fixed death benefits), would be recognised in profit or loss and in other comprehensive income in accordance with the general requirements of the [draft] Standard?

Why or why not? If not, what would you recommend and why?

### <Underlying pool of insurance contracts>

8. We basically agree with the intent of the proposal, but it is inappropriate that the proposal can be interpreted that the cash flows applicable to paragraph B66(k) that should be included in the measurement of insurance contracts are restricted to “the insurance contract requires the entity to hold underlying items and specifies a link to returns on those underlying items”.
9. Compulsory Automobile Liability Insurance (hereinafter referred to as ‘CALI’) in Japan is a scheme with a reinsurance pool system formed by all insurers participating in CALI. Though the insurers do not recognise the underlying items explicitly in their balance sheets, the scheme returns the specified profit of CALI to the future policyholders through revisions of the premium rate. We therefore intend to apply to the CALI contracts paragraph B66(k) stating that “payments arising from existing contracts that provide policyholders with a share in the returns on underlying items (see paragraph 33), regardless of whether those payments are made to current or future policyholders”.
10. However, paragraph 34(a) referred in paragraph 33 quoted in paragraph B66(k) states that the “entity ... measure the fulfilment cash flows that are expected to vary directly with returns on underlying items by reference to the carrying amount of the underlying items (meaning that paragraphs 18–27 do not apply)”, and thus the way to measure the contracts is unclear when those underlying items are not recognised in the balance sheet.
11. Therefore, we suggest specifying that, when those underlying items are not recognised in the balance sheet, “the entity shall measure the contracts in accordance with the contract terms (including those implied in the contract by regulatory or legal requirements) that provides policyholders with participation in the underlying items.”

### Question 3—Presentation of insurance contract revenue and expenses

Do you agree that financial statements would provide relevant information that faithfully represents the entity’s financial performance if, for all insurance contracts, an entity presents, in profit or loss, insurance contract revenue and expenses, rather than information about the changes in the components of the insurance contracts?

Why or why not? If not, what would you recommend and why?

### <Earned premium approach presentation>

12. Basically, we agree that presenting insurance contract revenue and expenses in profit or loss would provide relevant information. Earned premium presentation is a reasonable approach that is

consistent with the objective to present the profitability of the entity for the period. Meanwhile, we do not preclude the presentation of additional line items in the statement of comprehensive income to help the understanding of users.

- (1) The amount that should be recognised as insurance contract revenue in each period is the amount of the total premium receivable allocated to each period on the basis of expected claims. This approach is consistent with the premium allocation approach, and would enable insurers to provide a single presentation of insurance contract revenue for the two approaches (building block approach and premium allocation approach) on a combined basis.
  - (2) On the other hand, for long-term contracts, the earned premium presentation may cause misunderstandings concerning the growth potential of the entity, which is one of the important roles of volume information. Therefore, presenting premiums received and changes in insurance liabilities as components of the insurance contract revenue would be beneficial to users.
13. However, it is very difficult to exclude the investment component from the insurance revenue practically and theoretically. Moreover, the proposed scope of investment component is too broad that such component can be found in almost any insurance contract. Therefore, if the definition of investment component is not improved as proposed hereafter, it would be difficult to put the earned premium presentation in to practice. In that case, we would need to revert to the summarised margin approach.
14. In addition, the wording of paragraph B90(a) “excluding those recognised immediately in profit or loss in accordance with paragraphs 60(a) and 60(d)” should be revised as “excluding those recognised immediately in profit or loss in accordance with paragraph 60(d) but including the portion over the contractual service margin.”
- (1) It is rational to treat additional liability recognised in excess of the contractual service margin as a shortfall of revenue because the cash inflows of an insurance contract precede cash outflows. Therefore, it is reasonable to present the additional liability as negative insurance contract revenue rather than an insurance contract expense.
  - (2) Paragraph B88 clearly states that “amounts that are recognised immediately in profit or loss in accordance with paragraphs 60(a) and 60(d)” are changes in insurance liability that do not relate to “coverage or other services for which the entity expects to receive consideration”. However, according to (1) above, the amount of initial loss and additional liability exceeding contractual service margin included in the amount recognised immediately in profit or loss will be released subsequently in the following periods, and would finally become zero. Hence, including these amounts in insurance contract revenue would provide results that are equal to the actual premiums received, adjusted for the time value of money. Therefore, whether including these amounts in insurance contract revenue or not should be considered as an issue of the timing of revenue recognition.
  - (3) In addition, subsequently recognising the entire amount of liability (including additional liability) released as revenue would enable users to compare these amounts to expenses, such as claims paid. This would improve the transparency of financial statements to the users.
  - (4) Also, from a practical point of view, the revised proposal to exclude additional liability recognised for onerous contracts from the insurance contract revenue would require tracking of historical data. We are very concerned about this because that would be extremely cumbersome. This means that entities would be required to hold previous estimates used when the onerous contract was recognised besides the estimates used for the current measurement, and to perform two calculations until the contract ends (expires or surrenders).

**<Excluding investment components>**

15. If the amount of investment component is not objectively identifiable, it is both theoretically and practically unreasonable to exclude the investment component which is inseparable from insurance contract revenue. We have doubts about treating investment components similarly as deposits, given that, for instance, investment components affect the cost of options and guarantees through changes in lapse rates and surrender charges, both of which depend on interest rate scenarios.
16. If the IASB, nonetheless, maintains the proposed requirement to exclude investment components for the benefit of users, the scope of exclusion should be limited to the extent that it is beneficial for users. Our view is that the proposed definition is too broad for the purpose.
- (1) Under the proposed Standard, any return premiums (i.e. unexpired part of the premium that will be returned on cancellation for most insurance contracts) could be construed as investment components. We believe that treating such return premiums as investment components does not reflect the economic nature of the contracts for which an insurer does not expect to pay out claims to the majority of policyholders.
- Also, when policies do not lapse despite of claim payments, there will be no return premiums and hence no investment components. It seems irrational that whether there is an investment component in a claim payment depends on whether the contract lapses or not.
- (2) If the return premium of insurance contracts is regarded as investment component, the accounting practice becomes extremely complicated. To limit the scope of investment component will mitigate practical burden.
17. Therefore, the application of paragraph 58 should be limited to contracts with clearly segregated policyholder's account balances and contracts with significant deposit components that are beneficial for users to exclude. Contracts with significant deposit components will include the following:
- (1) contracts with maturity refunds and annuity insurance contracts;
- (2) contracts which insured event will definitely occur; and
- (3) contracts for which surrendering the contract to receive the return premium is expected, from inception, to be an economically rational behaviour for the policyholder.
18. Though there are many kinds of insurance products in each country, it would be practically feasible to classify contracts according to the alternative definition proposed below.

**<Alternative definitions of investment component>**

19. We would recommend modifying the definition of an investment component as follows.
- (1) An investment component should be defined as "the minimum amount that an insurance contract requires the entity to repay to a policyholder among scenarios that assume an economically rational policyholder's behaviour, even if an insured event or other events such as cancellation does not occur." (Additional text to the definition of the revised proposal is underlined.)
- (2) As a simplified approach, if a contract provides a policyholder's account balance or the investment component is distinct in pricing, the account balance or deposit premiums should be allowed to be regarded as investment components.
20. The alternative definition above aims to be generally applicable to all types of payments in judging whether all payments to policyholders such as return premiums as well as claims paid are in the scope of investment component by comparing them with other scenarios, including scenarios in

which the contract would have not lapsed.

21. By defining the investment component as the minimum amount paid among scenarios that assume an economically rational policyholder's behaviour, it will be possible to conclude that no investment component is included in an insurance contract that, under an ordinary scenario, will be held until maturity with no benefits payable, as the minimum amount paid is zero.
22. On the other hand, for contracts with maturity benefits, contracts that always pay out benefits (e.g., whole life insurance), and contracts that is expected to be surrendered from inception, the minimum amount paid among scenarios that assume an economically rational policyholder's behaviour will be equivalent to the return premium payable when a payment event occurs. As a result, contracts with significant investment components will be captured as they would be in accordance with the proposed requirement.
23. When payments are made without lapse of the contract, a decrease of the minimum amount, if any, is appropriate for the investment components.
24. When the investment component is not separately identifiable in pricing, the weighted average of expected cash flows for each scenario, estimated based on the definition above, should be excluded as investment components from the insurance contract revenue at the beginning of each period. In practice, we assume that the investment component could be determined by comparing the two points of time; when an insured event or surrender event occurs and when the contract matures, for each type of insurance.

Question 4—Interest expense in profit or loss

Do you agree that financial statements would provide relevant information that faithfully represents the entity's financial performance if an entity is required to segregate the effects of the underwriting performance from the effects of the changes in the discount rates by:

(a) recognising, in profit or loss, the interest expense determined using the discount rates that applied at the date that the contract was initially recognised. For cash flows that are expected to vary directly with returns on underlying items, the entity shall update those discount rates when the entity expects any changes in those returns to affect the amount of those cash flows; and

(b) recognising, in other comprehensive income, the difference between:

(i) the carrying amount of the insurance contract measured using the discount rates that applied at the reporting date; and

(ii) the carrying amount of the insurance contract measured using the discount rates that applied at the date that the contract was initially recognised. For cash flows that are expected to vary directly with returns on underlying items, the entity shall update those discount rates when the entity expects any changes in those returns to affect the amount of those cash flows?

Why or why not? If not, what would you recommend and why?

**<Allowing to recognise the effects of the changes in interest rates in profit or loss>**

25. We do not support requiring the use of OCI. Insurers should be allowed to avoid accounting mismatches by recognising the effect of the changes in interest rates for both the assets and liabilities in profit or loss, provided that an insurer can demonstrate that it consistently adopts a business model of integrating the management of assets and liabilities, aiming for minimising interest

rate risks embedded in insurance contracts.

26. Requiring the presentation of the effects of the changes in discount rates on the insurance contract liability in OCI could exacerbate accounting mismatches depending on how the insurer manages interest rate risks. The use of OCI, in its own right, is already complex and it would not provide users with relevant information if it could result in an increased accounting mismatches.
27. Judging from the reasoning that led the IASB to require insurers to present the effect of the discount rate changes in OCI, we assume that the only reason to disallow recognising the effect in profit or loss is to avoid arbitrariness even when the use of OCI exacerbates the accounting mismatches.
28. It would be sufficient to avoid such arbitrariness by requiring insurers to objectively demonstrate the continuity of their business models through documentation describing the segregation of assets and liabilities, the periodical monitoring, and the decision making processes, etc.
29. Also, for most non-life insurers, the effect of changes in interest rates is relatively insignificant, and therefore for users, the benefit from presenting the effect in OCI would be limited. If non-life insurers are required to present such impact on a fraction of their business such as long-term non-life insurance contracts or contracts with investment components, the costs would outweigh the benefit to the users. This issue is avoidable by allowing insurers to recognise the effect of the changes in interest rates in profit or loss when insurers satisfy certain requirements.
30. If insurers can choose the accounting for changes in discount rates based on their business model, both presentations could coexist within a group, and the resulting financial statements would more faithfully depict the way insurers manage interest rate risks.<sup>7</sup>

**<Discount rate for incurred claims>**

31. The interest expense presented in profit or loss for incurred claim liabilities should be based on the rate at the date of loss. The reasons are as follows.
  - (1) The interest rate risk of claims reserve arises when the claim is incurred and therefore the interest expense presented in profit or loss should be based on the rate at the date of loss.
  - (2) If the rate that applied when the contract was initially recognised is used, the insurer needs to recognise in OCI a catch-up adjustment which is not intuitive and hard to understand.
  - (3) As an insurer has more information about incurred claims than the about pre-claim liabilities, and as the source of uncertainty is different between the two, they should be dealt separately.
  - (4) As non-life insurers usually do not carry the contract date in their incurred claims database, it would be burdensome to derive the discount rate that applied at initial recognition.
32. Also, if the effect of changes in discount rate is insignificant, insurers should be allowed to recognise the effect of changes in discount rate for incurred claims liabilities in profit or loss.
  - (1) The benefit of using OCI to present the effect of changes in discount rate for incurred claims is limited, as changes in cash flow estimates occur quite frequently in terms of both nominal amount and timing.

- (2) For non-life insurers whose business is mainly property insurance in particular, claims will be usually paid out within a few years. The effect presented in OCI will therefore likely to be limited and the cost to record it in OCI will outweigh the benefit.

Question 5—Effective date and transition
Do you agree that the proposed approach to transition appropriately balances comparability with verifiability?
Why or why not? If not, what would you recommend and why?

**<Suggestion of a simplified approach using the remeasurement method>**

33. Under the proposed simplification that include adding back the cash flows that are known to have occurred (as mentioned in paragraph C6(a)), the reliable number would be difficult to obtain, or the result would not be reasonable, either.
- (1) The retrospective application of the Standards would be difficult to produce useful results for the expected burden to do so because the method tracking the known cash flows up to the date of initial recognition would end up estimating the “known” cash flows, though the extent would depend on the entity.
  - (2) The burden of identifying the past “known” cash flows to be added to the future cash flows on the date of the earliest period presented might be significant. This is because we have not managed the past cash flows on a portfolio basis. In particular, a very long-term contract type would be problematic.
  - (3) Even if the past “known” cash flows are identified, all the past experience differences recognised in profit or loss would be adjusted to the contractual service margin, and the effect that are not relevant to the future profitability would remain prolonged, reducing the comparability between the contracts existed on the date of transition and the contracts obtained after the date of transition.
34. In replacement for the retrospective approach that would require tracking the past cash flows, the IASB should allow a simple measurement method to estimate the contractual service margin based on the prospective approach that would use the contracts in-force and the current assumptions (i.e. recalculation method as explained in Q1).
- (1) If the contractual service margin represents the unearned profit, the prospective approach calculating from the contracts in-force and the current assumptions would fit to the definition compared to the retrospective approach that would require revisiting the past elapsed contracts.
  - (2) The estimates based on the latest assumptions that reflect the past experience and the future forecast, rather than based on the retrospective approach that requires the past actual results, would be consistent with the requirements of the fulfilment cash flows which “shall reflect all of the available information at the measurement date”.
  - (3) The burden for estimation would be reduced as the calculation can be based on current information, without the past actual results.
35. In addition, when the retrospective approach is impractical beyond reasonable efforts, the IASB should also allow estimating the contractual service margin as the difference between the balance reserved under the local GAAP (adjusted by eliminating equalisation reserves and other major

differences) and the fulfilment cash flows. Because there could be a situation that any simplification is extremely difficult to apply to the policies issued decades ago, such alternative should be allowed, provided that the reserve under the old standards would meet certain conditions.

**<Effective date>**

36. Regarding the mandatory effective dates of IFRS 4 and IFRS 9, the dates should be the same in principle.
- (1) Should the mandatory effective dates of IFRS 4 and IFRS 9 not be the same, the preparer would have to bear a heavy burden to apply the two measure changes within a short period, while it is doubtful to provide useful information to the users of financial statements. Thus, the cost to comply would not be justified by the benefit to provide information.
  - (2) After all, when the IFRS 9 (2009) was published, BC93 stated “The Board will consider delaying the effective date of IFRS 9 ... if the new IFRS on insurance contracts has a mandatory effective date later than 2013, to avoid an insurer having to face two rounds of changes in a short period.” That is part of the reason why the IASB postponed the mandatory effective date in November 2011. Therefore, if the development of IFRS 4 is further delayed, the mandatory effective date of IFRS 9 should again be postponed.
37. Should the mandatory effective dates of IFRS 4 and IFRS 9 be difficult to link, the IASB should allow insurers a simultaneous application as a special treatment, in consideration for a very large impact on the insurance industry caused by the time lag between the two standards.
38. Should this also be difficult to adopt, the IASB should allow insurers a full reclassification of the financial instruments when adopting IFRS 4, provided that there would be accounting mismatches.

Question 6—The likely effects of a Standard for insurance contracts

Considering the proposed Standard as a whole, do you think that the costs of complying with the proposed requirements are justified by the benefits that the information will provide? How are those costs and benefits affected by the proposals in Questions 1–5? How do the costs and benefits compare with any alternative approach that you propose and with the proposals in the 2010 Exposure Draft?

Please describe the likely effect of the proposed Standard as a whole on:

- (a) the transparency in the financial statements of the effects of insurance contracts and the comparability between financial statements of different entities that issue insurance contracts; and
- (b) the compliance costs for preparers and the costs for users of financial statements to understand the information produced, both on initial application and on an ongoing basis.

39. The revised exposure draft incorporates significant changes from the 2010 exposure draft. We have presented our comments on the individual changes as stated above. Viewing the changes in the context of the entirety of the exposure draft, however, we feel that the accounting has become exponentially complex and also increasingly prone to accounting mismatches. For example, changes in insurance contract liabilities are now presented in three different places, namely contractual service margin, profit or loss and OCI. We are not only deeply concerned about the costs that insurers will incur in preparing the financial statements in accordance with the proposed requirements, but also about the difficulties for the users to understand the financial statements.
40. We urge the IASB to pay utmost care during the redeliberation not to make the requirements even

more complex, and take bold actions to simplify the requirements and to minimise accounting mismatches by taking into account the alternative approaches we have proposed. We also strongly suggest that the IASB provide more guidance and educational materials for both preparers and users so that the requirements are adequately understood.

41. In addition, we have serious concerns about the following three issues with respect to transparency, comparability and costs.

**<Disclosure of Equivalent Confidence Level>**

42. Disclosure of an equivalent confidence level as stated in paragraph 84 will not improve comparability, but could rather cause users' misunderstanding. The requirement is not appropriate for both aspects of cost/benefit and comparability.

- (1) Disclosure of equivalent confidence levels for those risks that should not be calculated using the confidence interval method will mislead users and are therefore harmful. For example, if a life insurer and a non-life insurer cover the same 90 percentile in their risk adjustments, users will likely interpret that the risk adjustments are equally prudent. However, the risk characteristics exceeding the 90 percentile confidence level between the mortality risks of life contracts and the natural catastrophe risks of non-life contracts are completely different. As such, disclosing the equivalent level for the risks that have different tail risks will provide false comparability to users and thus is harmful.
- (2) It will be difficult for users to understand the equivalent confidence level. It is highly likely that users may understand risk adjustments as a buffer to cover adverse changes in future cash flows and interpret that the higher the confidence level, the more conservative the risk adjustment, while that is a totally different interpretation from the definition in the ED, i.e. the compensation that an entity requires for bearing the uncertainty about the amount and timing of the cash flows that arise as the entity fulfils the insurance contract. According to the definition, a higher confidence level indicates that the insurer feels that the risk is higher.
- (3) Due to the practice in risk calculation process of most insurers, it is impracticable to translate risk adjustment based on, for example, a cost of capital method to a confidence level. Under the cost of capital method, various categorised risks (by type, by geography, by entity, etc.) are aggregated using various techniques. In most cases, it would be feasible to translate a risk adjustment into a confidence level for each risk, but not for the aggregated risks.

43. Comparability should be secured through disclosure of insurance risks rather than through disclosure of equivalent confidence level.

- (1) The adequacy of risk adjustment can only be assessed in conjunction with quantitative information of the insurance risks. Such information will enable users to compare one company to another.
- (2) We suggest that the IASB add a requirement in paragraph 89 to disclose the amount of

insurance risks at a confidence level that covers almost all of distribution curve (such as 99.5 percentile). The amount of insurance risks that covers almost all of distribution curve would be comparable across any shapes of risk curves, regardless of the calculation technique.

- (3) In addition to the above, disclosing the cost of capital used (for insurers using a cost of capital method) or the confidence level used (for insurers using a confidence level method) will provide comparable and relevant information at reasonable cost.

44. Should the IASB retain the disclosure requirement of equivalent confidence level, we request the IASB clearly state that the translation to confidence level shall be "based on a methodology that an insurer deems reasonable" etc. so as to lessen the practical burden of insurers.

#### **<Policy Loans>**

45. Policy loans should be separately recognised as independent assets. Especially, we strongly disagree with including future new loans in the cash flow projection. The reasons are outlined below.

- (1) Although the cash flow of policy loans is interconnected with the cash flow of the main insurance contract, the interest income on the policy loans does not affect the main insurance contract cash flow. Also, the policy loans producing interest income meet the definition of assets, and should not be netted against insurance contract liabilities.
- (2) Risks arising from policy loans are financial risks and therefore policy loans do not meet the definition of insurance contracts. If policy loans are nevertheless included in the cash flow projection, expected interest income on future loans will be included in insurance contract liabilities and the current period estimate of interest income will be recognised as insurance contract revenue. It will create an accounting mismatch with the interest expense on the insurance contract liability presented as a separate expense and compared against investment income.
- (3) If policy loans are made independent of an insurance contract, we understand that they are treated as financial instruments although the economic characteristics will be the same.
- (4) If future new loans are included in the cash flow projections, it will always increase future cash inflows, the contractual service margin and insurance contract revenue. However, the estimation of cash flows that are dependent on the behaviour of the policyholders which are difficult to predict is not reliable and impairs the transparency and comparability of the financial statements.
- (5) Information on policy loans are usually maintained in different systems from the actuarial systems. Including cash flows relating to policy loans therefore will be costly.

46. For the reasons stated above, we suggest that the IASB add a requirement in paragraph 10 stating that policy loans shall be separated as financial instruments and shall be excluded from the measurement of insurance contract liabilities.

**<Accounting mismatches between underlying contracts and reinsurance contracts in recognition of profit or loss>**

47. If a negative contractual service margin is recognised for reinsurance contracts, we are concerned that the financial statements might not provide users with relevant information and that it may not faithfully represent the entity's financial performance. For reinsurance contracts that cover the losses of a portfolio of underlying contracts on a proportionate basis, gains should be immediately recognised in profit or loss rather than deferred as negative contractual service margins.
48. The Exposure Draft (paragraph BCA140) describes the reason of recognising the negative contractual margin stating that "the apparent gain at contract inception represented a reduction in the cost of purchasing reinsurance, and that it would be appropriate to recognise that reduction in cost over the coverage period as services are received".
49. This reason assumes cases where the terms of the reinsurance contracts is determined independently from those of the underlying contracts, but that would not be applicable to cases where the terms follow the underlying contracts.
50. Reinsurance contracts are designed to either cover the losses of a portfolio of underlying contracts on a proportionate basis, or cover the aggregate losses arising from a portfolio of underlying contracts over a specified amount. The terms of the former type is generally determined based on the terms of the underlying contracts, and thus cash flows in such reinsurance contracts are expected to be symmetric with the underlying contracts.
51. If asymmetric accounting treatments are required between the underlying contracts and the reinsurance contracts that cover the losses on a proportionate basis, we are concerned that the economic substance would not be reflected, accounting mismatches would arise, and thus the financial statements would not provide the users with relevant information.
52. We therefore suggest that an accounting treatment that entities recognise gains immediately in profit or loss rather than defer them as negative contractual service margins should be required in reinsurance contracts that cover the losses on a proportionate basis.

Question 7—Clarity of drafting

Do you agree that the proposals are drafted clearly and reflect the decisions made by the IASB?

If not, please describe any proposal that is not clear. How would you clarify it?

**<Fixed-fee service>**

53. We propose the IASB clearly state that paragraph 7 (e) does not apply to fixed-fee service that insurers provide to customers bundled with insurance contracts if the service is purchased from third parties. The reasons are as follows.

(1) Paragraph 7 (e) is designed to exempt companies specialised in roadside assistance

programmes and other services from the scope of the proposed Standard (paragraph BCA 181-183), but not to exclude cases where insurers provide them as a supplementary cover.

- (2) Separating the fixed fee service component from the insurance contracts should be limited to cases where an insurer mainly provides the service by its own business in the same manner as a company specialised in roadside assistance does. In a case where an insurer mainly provides the service by purchasing it from third parties, the service should be treated in the same manner as a claim payment.
- (3) Separating the commonly provided free supplementary services from premiums and commissions would require significant assumptions that would make the result unreliable.
- (4) Even if an insurer manages to exclude the fixed-fee service, the revenue recognition would produce the same pattern as the premium-allocation approach. The process of exclusion requires cumbersome effort with no benefit to users. ("Changing the existing accounting for these contracts would impose costs and disruption for no significant benefit" as stated in BCA122 would also apply to insurers as well.)

54. To be specific, we propose to modify paragraph 7 (e) (ii) "the contract compensates customers by providing a service, rather than by making cash payments" by adding "to customers or to third parties".

55. Also, we feel that it is not clear which of the two paragraphs, paragraph 7 (e) and paragraph 10 (c), has priority over the other. It would be helpful to specify that the judgement of paragraph 7 (e) comes first before the judgement of paragraph 10 (c), for the following reasons:

- (1) Supplementary services bundled with insurance contracts would not meet the definition of paragraph 7 (e) because it is obvious that the main purpose of the insurance contract is not to provide supplementary services, and that the insurance risks transferred by the contract arises mainly from the insurance component.
- (2) If we assume that paragraph 10 (c) has priority over paragraph 7 (e), the provision could be read as the above judgement is to be made after the separation, and as a result, the separated fixed-fee service component would meet the definition of 7 (e) and be excluded from the scope of the insurance contracts.
- (3) On the other hand, if we assume that paragraph 7 (e) has priority over paragraph 10 (c), there would be no case where paragraph 10 (c) is applicable to the supplemental fixed-fee service which is treated as insurance. As such, companies specialised in roadside assistance would be exempt from the application of the Standard, while insurers would be able to treat the whole contract as an insurance contract.

#### **< Liability for incurred claims in Building Block Approach >**

56. It should be made clear that the simplification provision of paragraph 39 is applicable not only to the simplified approach, but also to the building block approach. Paragraph 39 prescribes that "the entity

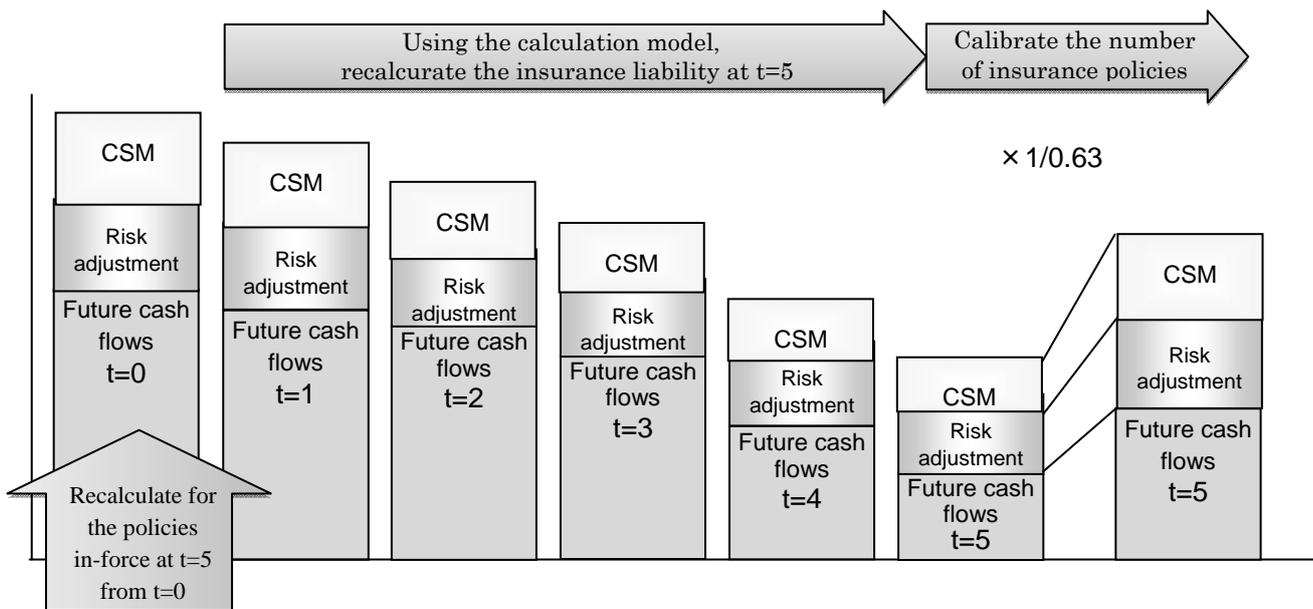
need not adjust future cash flows for the time value of money if those cash flows are expected to be paid or received within one year". Essentially, the intention to allow the simplification of the liability for incurred claims is supposed to have no correlation to whether the liability for the remaining coverage is calculated under the simplified approach or not.

## Prospective method to estimate the contractual service margin

We deem the following prospective method as the alternative of “Question 1—Adjusting the contractual service margin” and the simplification of “Question 5—Effective date and transition”.

### 1. Outline of a prospective method

- (1) This method uses a calculation model applied to measure the insurance liability in accordance with the proposed Standard, current portfolio of contracts, and the latest assumptions; there is no need to take into account the contracts cancelled or lapsed before.  
 As an example, we demonstrate the calculation of the insurance liability at t=5 in this paper, but the insurance liability at any point of time can be calculated in the same manner.
- (2) Using the calculation model of the portfolio of insurance contracts, recalculate for the policies in-force at t=5 starting from t=0 to obtain the insurance liability at t=5.
  - The mortality and cancellation rates used are the latest, but the assumptions dependent of time, such as policyholder age, are adjusted to t=0.
  - The contractual service margin is released in a way that reflects the pattern of service transfer in accordance with the proposed Standard.
- (3) Suppose one policy at t=0 decreased to 0.63 through the calculation (2). Then calibrate the calculated amount of insurance liabilities by multiplying ( $1/0.63 \doteq 1.58$ ) because the actual number of policies in-force is one at t = 5.
- (4) Recognise ‘the differences between the current estimate of the re-measured contractual service margin and the previous estimate’ and ‘changes in the fulfilment cash flows’ in profit or loss.



### 2. Features of the calculation results

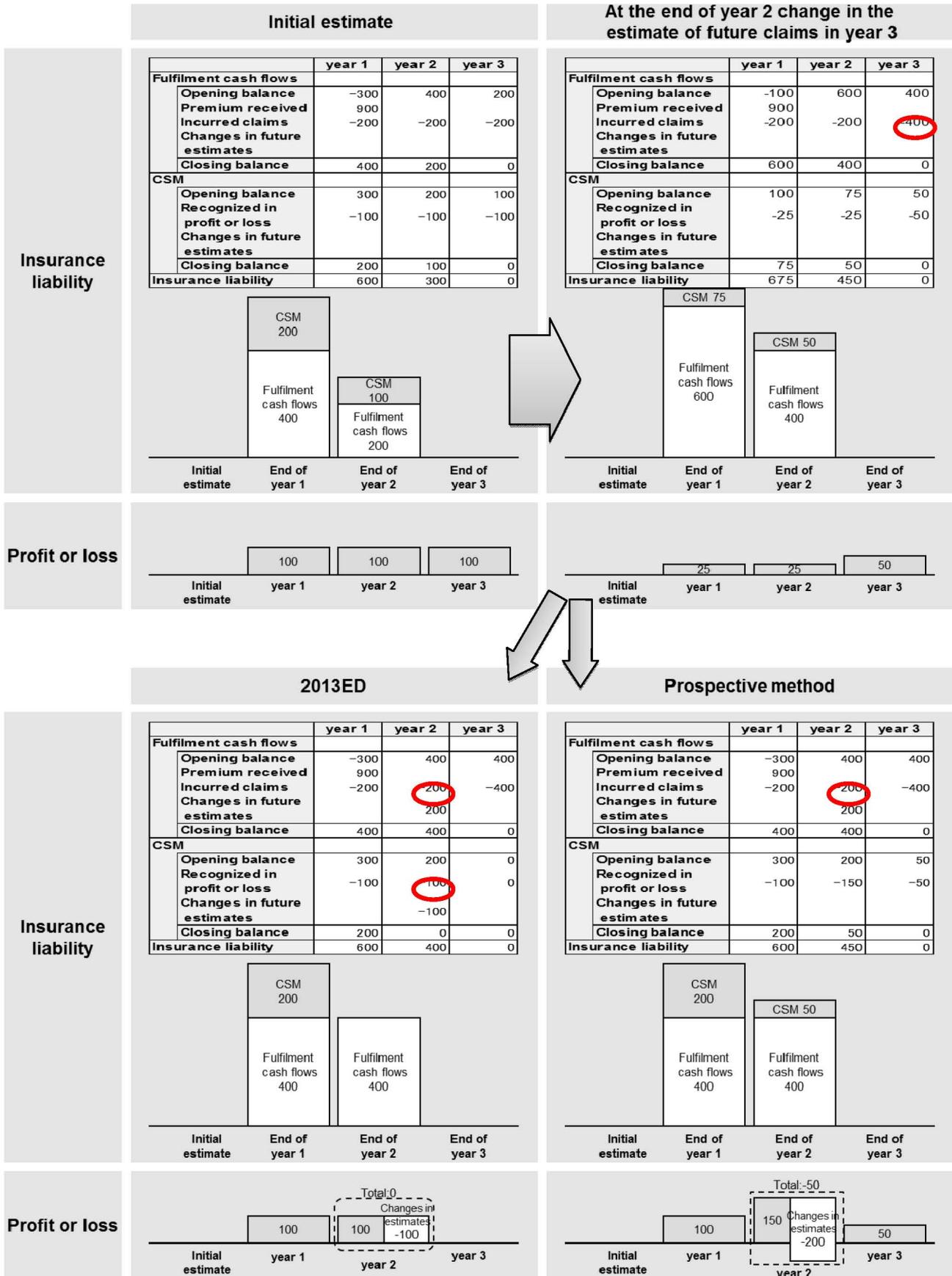
- Using the latest assumptions, the re-measured contract service margin will absorb the changes in future cash flows and in the risk adjustments caused by changes in assumptions.
- The volatility of the insurance liability will be higher than those calculated in accordance with the proposed Standard. This is because the effects of changes in the assumptions for the passed years are reflected in the re-measurement of insurance liabilities through the recalculation from t=0 and those are reflected to the changes in the insurance liabilities and hence to profit or loss.

### 3. One-step further simplification

It can be calculated in the same way as if there were a portfolio transfer at the beginning of each period (treat the opening balance as consideration of the portfolio transfer and calibrate the result of the recalculation made from the beginning of the period). If this method could be allowed, the calculation load will be reduced, the degree of calibration will be minimised, and thus predictability will be improved.

The example of recalculation from the beginning of the contract

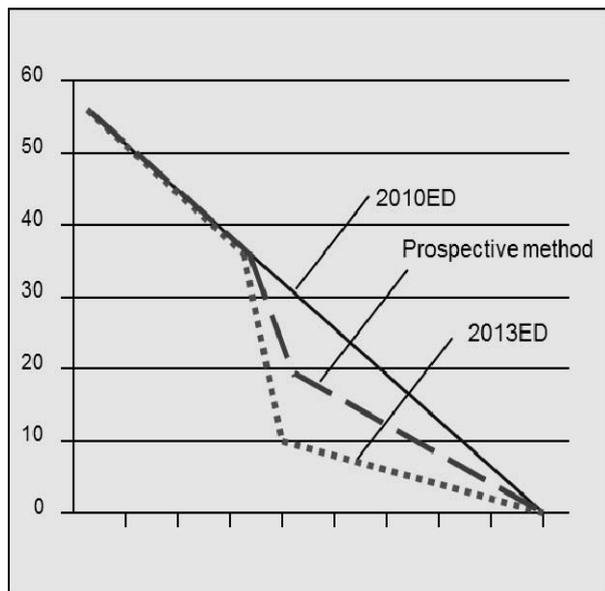
When the entity changes the estimate of future claim in year 3 from 200 to 400 at the end of year 2, the insurance liability and profit or loss will become as follows.



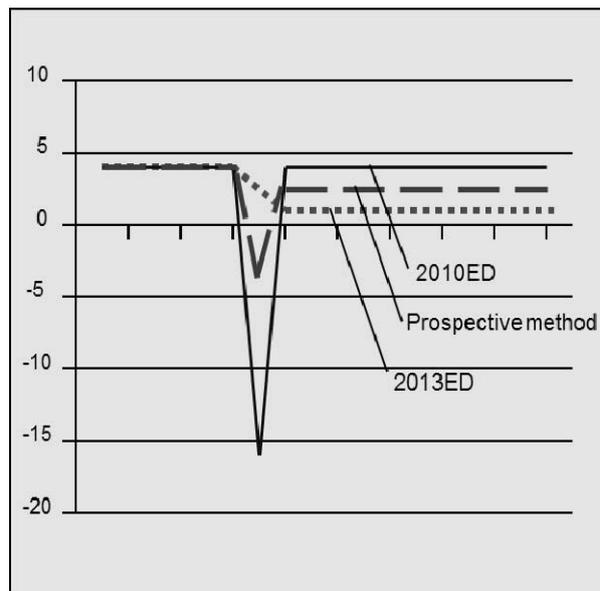
### Comparison of the three methods

The following graphs depict the difference among the three methods; 2010ED, 2013ED, and the prospective method.

1. Balance of contractual service margin



2. Profit or loss



1. The calculation of the prospective method will always produce the theoretical balance of insurance liability based on the latest assumptions.
  
2. When the entity changes the estimate, the differences between the current estimate of the re-measured contractual service margin and the previous estimate are recognised in profit or loss. Therefore, the amount recognised in profit or loss from the following period corresponds to the latest estimate.