

October 27, 2009

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street, First Floor
London EC4M 6XH

sent by email

Dear Sir David:

OCI for insurance liabilities

In July 2008 and February 2009, the Group of North American Insurance Enterprises (GNAIE) and the four Japanese Life Insurance Companies identified in this letter head submitted comment letters regarding other comprehensive income (OCI) for life insurance liabilities. This comment letter intends to clarify our points, taking into account subsequent matters after the submission of our previous comment letters, including the discussions at the IASB Board meetings.

We hope the Board finds our comments helpful in developing its preliminary views on OCI for life insurance liabilities, and we would be pleased to provide any further information you may require on any of the points raised in this letter. Representatives of each signing body in this letter would be willing to participate in any future discussions on the topic.

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- The nature of life insurance business is to underwrite risks over a long period and fulfil these obligations to policyholders without fail. Life insurance business should be distinguished from the business model that intends to simply gain profits through changes in fair value of assets and liabilities. Presenting all the “unrealized profits” in profit or loss (net income) would not faithfully represent the substance of insurance companies’ business as these gains/losses may not be realised for many years due to the long term nature of life insurance obligations.
- Measuring long-term financial instruments and insurance liabilities at current value with all those changes presented entirely in profit or loss (or net income) will cause misunderstanding among users, as profit or loss would have high volatility even when assumptions change only slightly.
- Therefore, we believe that we should distinguish comprehensive income – which represents all gains and losses including unrealized gains and losses – from the net income that represents an entity’s business performance on its regular activities. This distinction enables users of financial statements to take advantage of the two different measures providing them with broader and thus more useful information.

It should be noted that, in order to avoid an accounting mismatch, presentation of changes in insurance liabilities should be consistent with the accounting standard for financial instruments. We are aware that IASB and FASB have initiated a joint project to develop a common standard within a short period of time for the purpose of reducing complexity in financial instruments reporting, and that various views have been expressed on the Exposure Draft, “Financial Instruments: Classification and Measurement”. We would like the Board to make a careful review of both projects, and not simply exclude the use of OCI for insurance liabilities before the completion of the financial instrument project. By doing so, insurance liabilities and financial assets can be treated in a consistent manner.

We believe that accounting for insurance liabilities should be consistent with the business model of the life insurance Company.

More specifically;

- An insurer should be allowed to designate insurance portfolios for which their gains and losses are recognized entirely in profit or loss, and other portfolios which utilize OCI to present the gains and losses as outlined more fully in the attached Q&A. The designation of which treatment to afford a portfolio should be based on the characteristics of each portfolio and its management approach. In particular, the accounting basis for the assets underlying each portfolio is critical since the treatment of the assets and liabilities should be consistent.
- Recycling of the changes of insurance liabilities that are recognized in OCI will be implemented using the same mechanism as currently used for recycling for the Available-For-Sale securities under IAS 39. (Please refer to our letter of July 2008 for specific details)

For answers to questions about other practical aspects of using OCI for insurance liabilities that have been raised at the Board meetings, etc., we have attached our previous letters and a new question and answer document.

As explained in our previous letters, there is broad support for the need for OCI for remeasurements of insurance liabilities. It should be also noted that in the Discussion Paper on the Financial Statement Presentation Project, a distinction between “profit or loss (net income)” and “OCI” was maintained based on reaffirmation of already prevailing information value of those measures. The implication of this decision for Phase II of the Insurance Contracts Project should be taken into account.

Moreover, we would like to draw the Board’s attention to the issue of lack of consistency, between insurers and other IFRS preparers such as banks that would arise if the concept of OCI for insurance liabilities is rejected. Insurers will be virtually forced to use the fair value option and recognize changes in fair value of almost all the assets and liabilities in profit or loss in order to avoid accounting mismatches; on the other hand other financial

institutions will be permitted to apply amortized cost measurement to most of their assets and liabilities. We therefore ask the Board to allow for use of OCI for insurance liabilities.

Sincerely,

Group of North American Insurance Enterprises

Jerry de St. Paer, Executive Chairman
Douglas Wm. Barnert, Executive Director

Japanese Life Insurance Companies

Nippon Life Insurance Company, Yoshinobu Tutsui, Senior Managing Director
Dai-ichi Life Insurance Company, Kazuma Ishii, Director, Managing Executive Officer
Meiji Yasuda Life Insurance Company, Hiroaki Tonooka, Senior Managing Executive Officer
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The following Q&As are intended to present our views on OCI for insurance liabilities. Some of the Q&As are based on the assumption that fair value through OCI with reclassification to profit or loss on realization (FVTOCI) will be permitted for financial instruments other than equity instruments, as proposed in our comment letter on the Exposure Draft, “Financial Instruments: Classification and Measurement”.

[General Ideas]

1 Should insurers be permitted or required to use Other Comprehensive Income (OCI) for remeasurements of insurance liabilities?

1.1 Insurers should not be required to use OCI for remeasurement of insurance liabilities. Rather, insurers should be able to determine whether to use OCI or not depending on the characteristics of each portfolio. For example, for an insurance portfolio where the corresponding assets are classified as “at fair value through profit or loss” and the changes are directly reflected in policyholders’ account values, it is not appropriate to force the use of OCI in order to avoid an accounting mismatch.

2 Insurers already have the fair value option for assets as a means of avoiding an accounting mismatch. What’s the problem with it?

2.1 Although insurers do have the fair value option for assets as a means of avoiding accounting mismatch, a new accounting standard should not be developed on the premise of the mandatory use of such option.

2.2 If insurers may not use OCI for remeasurement of insurance liabilities, insurers would be virtually forced to use the fair value option for their existing assets that are not already valued at fair value through profit or loss, and as a result the use of the fair value option becomes mandatory.

2.3 This would result in a lack of comparability with other industries such as banking, where assets and liabilities are not all held at fair value.

3 Is the OCI approach based on the concept of hedge accounting, given its purpose of avoiding an accounting mismatch?

3.1 No, it is not based on the concept of hedge accounting.

4 Is OCI for insurance liabilities needed solely for the purpose of avoiding an accounting mismatch?

4.1 One of the primary objectives is to avoid an accounting mismatch on financial statements.

4.2 However, the objective of insurance business in general is to provide long-term risk protection service to policyholders. Therefore, an insurer should recognize

profits only when they are realized, not when they are uncertain.

5 Should the use of OCI be limited for those insurance liabilities which are supported by FVTOCI assets?

- 5.1 The management should be able to designate the insurance liabilities for which OCI is used, based on the characteristics of each portfolio and its business model, just as financial assets are classified into several categories based on the contractual terms of instruments and the business model.
- 5.2 For example, for the insurance portfolio where corresponding assets are classified as “at fair value through profit or loss” and the changes are directly reflected in policyholders’ account values, an entity should be able to avoid an accounting mismatch by designating the liability as “through profit or loss” rather than “through OCI”.
- 5.3 As a result, the insurance liability to which OCI is applied tends to be supported by FVTOCI assets, although a strict hedging relationship is not required.

6 What are the advantages of the OCI approach, when compared to the fair value approach (i.e. the use of the fair value option)?

- 6.1 To avoid an accounting mismatch and reveal an economic mismatch, an insurer can use “the fair value option” to recognize all asset changes in profit or loss (net income). If all changes in liabilities are also recognized in net income, there would thereby be no accounting mismatch. This would, however, deny to insurers representing their profit or loss (net income) in a consistent manner with banks and other financial institutions.
- 6.2 Our proposed approach is able to avoid an accounting mismatch while revealing an economic mismatch based on the characteristics of each portfolio.
- 6.3 The financial statements would show OCI and “profit or loss (net income)” (excluding OCI) separately, a presentation that is consistent with conclusions reached in the IASB’s discussion of OCI on October 22, 2009”

[Practical Issues]

7 For what types of remeasurements should insurers be allowed to use OCI?

- 7.1 A possible approach is to use OCI for the portion of liability changes arising from changes in financial assumptions such as interest rates.
- 7.2 According to our understanding of the likely Phase II standard, the significance of changes in non-financial inputs are evaluated by the management and generally remeasurement will not be made based on short-term fluctuations of these items. However, until the insurance contracts project is completed and the bases that will be allowed or required for updating inputs becomes more clear, the possibility should be retained to present changes in non-financial inputs through OCI.

8 How does an insurer identify an insurance liability for which OCI is used in terms of remeasurements? In other words, for what types of insurance portfolio is OCI used in terms of remeasurements?

- 8.1 A possible approach is to designate insurance portfolios for which OCI is used, based on the asset characteristics of each portfolio.
- 8.2 For example, for an insurance portfolio where corresponding assets are classified as “at fair value through profit or loss” and the changes are directly reflected in policyholders’ account values, there is no need to apply OCI.
- 8.3 On the other hand, if assets are held at FVTOCI, changes in the liability due to changes in interest rates would pass through OCI.

9 How does an insurer trace the cumulated OCI amounts for each insurance liability?

- 9.1 Changes in the amount of an insurance liability arising from changes in financial assumptions (such as interest rates) are recognized in OCI. By comparing the discount rate at inception with the current discount rate, the cumulative OCI amount can be determined.

10 Should the gains and losses from remeasurements be reclassified from OCI to profit or loss (net income)? If yes, when?

- 10.1 As we stated previously, the change in liability due to changes in interest rate determined the part of the liability change that goes through OCI. This process automatically recycles the cumulative OCI amount into earnings over time.

[Interaction with other projects]

11 Is the basis for the OCI approach still valid, after a joint project has been initiated in an attempt to replace the current IAS 39?

- 11.1 While we are aware of the project, a decision to exclude the use of OCI for remeasurements of insurance liabilities should not be made before any conclusion is reached at the project.

[Other issues]

12 Is the argument; “An accounting mismatch should be avoided” consistent with the other argument; “The concept of hedge accounting is not needed”?

- 12.1 *Background Information and Basis for Conclusions for FAS 115* (paragraphs. 92-95) indicates that the existing mixed-attribute model for financial assets was introduced because fair valuation for liabilities was not introduced at the time

12.2 This shows that an approach need not require a hedging relationship between assets and liabilities as a means to avoid an accounting mismatch.

13 In the insurance business, the investment performance, whether it is a realized one or unrealized one, is the result of management's decision, and therefore should be reflected in profit or loss (net income).

13.1 Although the investment performance is the result of management's decision, the unrealized part of such performance should not be recognized in profit or loss (net income) since it is an estimation of the performance to be realized in the future.