

Group of North American Insurance Enterprises
Nippon Life Insurance Company
Dai-ichi Life Insurance Company
Sumitomo Life Insurance Company
Meiji Yasuda Life Insurance Company

July 25, 2008

Mr. Peter Clark
Director of Research
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Re: Other Comprehensive Income for Insurance Liabilities

Dear Mr. Clark

The attached comments were drafted by the Group of North American Insurance Enterprises (GNAIE) and the four Japanese Life Insurance Companies identified in the letterhead, in response to questions raised at the April Insurance Working Group meeting on the issue of other comprehensive income for insurance liabilities. (Please note we are commenting only on life insurance aspects.)

We hope that these comments will be of help to the Board in its future deliberations, and would be very happy to provide further information on any of the points raised in this letter. Representatives of each of the bodies to this letter would be willing to participate in any future discussions on the topic. Thank you for your attention.

Sincerely

Jerry M. de St. Paer
Executive Chairman
Group of North American Insurance Enterprises

Yoshinobu Tsutsui, Managing Director
Nippon Life Insurance Company

Kazuma Ishii, Director, Managing Executive Officer
Dai-ichi Life Insurance Company

Yutaka Amino, Managing Director
Sumitomo Life Insurance Company

Hiroaki Tonooka, Senior Managing Executive Officer
Meiji Yasuda Life Insurance Company

cc: Mr. Warren McGregor, Chairman, IASB Insurance Working Group
Attachment

Other Comprehensive Income (OCI) for Insurance Liabilities

1. Background

On the issue of how to present the changes in insurance liabilities, the IASB's Discussion Paper (DP) states, *Profit or loss should include all changes in the carrying amount of insurance liabilities* (paragraph 337), and also asks under Question 20, *Should the income statement include all income and expenses arising from changes in insurance liabilities? Why or why not?*

On this question, the Life Insurance Association of Japan (LIAJ) and the Group of North American Insurance Enterprises (GNAIE) respectively provided the following answers in their comment letters on the DP.

[LIAJ (CL40)]

"We recognise that IAS 39 is being revised with an aim to introduce "valuation at fair value through profit or loss" to all financial instruments. However, given the situation that any conclusion is not yet made, it is essential to introduce an approach consistent with the existing IAS 39, such as the method to recognise part of the (d) or (g) in paragraph 325 (the changes in the carrying amount of insurance liabilities) directly in equity, or the method to recognise such profits or losses arising from the changes in the other comprehensive income (OCI), separately from net income."

(Response to Question 20, paragraph 132)

[GNAIE (CL102)]

"...However, where the assets supporting the liability were on an 'available for sale' basis, the movement in liability values due to changes in interest rates should be shown in other comprehensive income, and not in earnings..."

(Response to Question 20 on page 40)

These responses are consistent with the comment made by Mr. Tanimoto at the April IASB Insurance Working Group meeting; and we believe insurers should be permitted to recognize part of the change in insurance liabilities in other comprehensive income (OCI), in order to avoid accounting mismatches on the income statement.

Other important groups including the European Insurance CFO Forum (CFO Forum), Comité Européen des Assurances (CEA), and the International Actuarial Association (IAA) have made the same point in their comment letters on the DP, as quoted below.

[CFO Forum and CEA (CL127)]

"...We believe that all assumption changes should be reflected in the insurance liability, comprising the best estimate of future cash flows and the risk margin. These changes should be accounted for in the income statement or in Other Comprehensive Income consistent with asset valuation movements. At present current IFRS standards require certain assets' valuation movements

(owner occupied property, treasury shares, investments classified as available-for-sale) to be taken outside of the income statement. Our view is that the fundamental principle should be that accounting mismatches should not be created. Therefore, the IASB should review the standards which create the asset mismatches, and permit insurers to take the related element of insurance liability movements through Other Comprehensive Income.

(Response to Question 20 on page 18 of Appendix A)

[IAA (CL97)]

“We note the concerns of the industry regarding volatility of earnings resulting from changes in discount rates. This is an important issue, since instantaneous reflection of the effect of changes in discount rates at each reporting date may not contribute to the usefulness of the financial statements and, in fact, may result in considerable confusion for the users of the financial statements. A way to resolve this concern is to identify the effects on the liabilities of changes in the discount rates in other comprehensive income. This approach would be consistent with the approach applied in IAS 39 for assets categorized as “available for sale”. This suggestion would imply that a definition of an “available for sale” category for liabilities is needed. Another argument for this treatment is that currently many insurers have adopted the classification “available for sale” for significant parts of their investment portfolio. If the movements in insurance liabilities resulting from interest rate changes are reflected in earnings, this will result in an accounting mismatch. Defining a category “available for sale” for liabilities would result in a consistent reporting of the effects of changes in interest rates.”

(Response to Question 20 on Page 40)

In addition to the above, the international survey conducted by PricewaterhouseCoopers (PWC) of the views of the investment community indicates that investors typically exclude revaluations of assets or liabilities from the definition of earnings.

[“Performance statement coming together to shape the future” (PWC, December 2007)]

“Asked how they would define earnings, investment community respondents typically exclude any revaluations of assets or liabilities, both when attempting to understand the underlying earnings of the company and when building forecasts.”

(Page 15)

While we are aware that paragraph 25 of the agenda paper 2A for the February IASB Board meeting states that, Some proposed permitting or requiring insurers to use other comprehensive income (OCI) for changes in insurance liabilities to avoid accounting mismatches if insurers use the available-for-sale (AFS) category for financial assets held to back insurance contracts. Proponents of this view argued that, if this were not done, insurers would find themselves, in effect, unable to use AFS. Some also expressed concerns about volatility. Advocates of using OCI did not generally discuss whether the gains and losses would be recycled from OCI when the liability is derecognized, we believe the views provided by the industry groups which represent significant portion of the world insurance market and the actuarial group that will be required to deal with

practical aspects in insurance accounting should be given serious consideration. It should be also noted that, according to the PWC survey, investors tend to exclude revaluations of assets or liabilities from the definition of earnings and generally hold a similar view.

In addition, we note that paragraph PV5 of *Discussion Paper Preliminary views on amendments to IAS 19, Employee Benefits*, published by the IASB in March 2008 outlines several approaches to presenting post-employment benefit costs, including *Approach 2* and *Approach 3* which are similar to our proposal, and we understand that the IASB also envisages that an approach to present remeasurements arising from changes in financial assumptions in OCI could be considered as an alternative.

[“Discussion Paper Preliminary views on amendments to IAS 19, *Employee Benefits*” (IASB, March 2008)]

“Approach 2: An entity presents the costs of service in profit or loss. Entities present all other costs in other comprehensive income.

Approach 3: An entity presents remeasurements that arise from changes in financial assumptions in other comprehensive income. Remeasurements arising from changes in financial assumptions are prompted by changes in the discount rate and in the value of plan assets. An entity presents changes in the amount of post-employment benefit cost other than those arising from changes in financial assumptions (eg the costs of service, interest cost and interest income) in profit or loss.”

(Paragraph PV5)

2. Questions

In the context above, several questions were raised at the April IASB IWG meeting on practical methods to deal with our proposal (which were also partly discussed in the agenda paper for the February IASB Board meeting) and the points of the questions, in our understanding, are as follows.

(Questions)

(Q1) How can the changes in insurance liabilities arising from changes in financial assumptions be separated from changes arising from other factors?

(Q2) Will the cumulative gain or loss previously classified in OCI be reclassified from equity to profit or loss? If yes, how can the cumulative gain or loss be reclassified?

(Q3) How can the insurance liability corresponding to available-for-sale assets be specified?

3. Overview of Responses

While a practical method based on our proposal will be discussed in detail with illustrations in a later section, an overview of our response to each of the questions above is as follows. (Please note that here we attempt to present an example of a practical method, and this is not necessarily

intended to exclude other alternative methods.)

(Q1) Changes in the amount of an insurance liability other than those arising from changes in financial assumptions would be recognized in profit or loss and those that arise from changes in financial assumptions would be classified in OCI.

(Q2) Changes that have been classified in OCI under the method illustrated in (1) above would be recognized in profit or loss as they are released from risks under the contracts.

(Q3) The proposed approach is not based on the concept of hedge accounting, and therefore there is no need to establish a designated relationship between insurance liabilities and available-for-sale assets.

4. Responses

(1) The changes in the amount of an insurance liability other than those arising from changes in financial assumptions would be recognized in profit or loss and those that arise from changes in financial assumptions would be classified in OCI.

The changes in the amount of an insurance liability that arise from changes in financial assumptions can be calculated as the difference between (A) and (B) below.

(A) Changes in the amount of an insurance liability, and

(B) Changes in the amount of an insurance liability other than those arising from changes in financial assumptions (such as interest rates).

(A) would be the total change in an insurance liability which would be presented in comprehensive income as a change in a liability on the balance sheet, the detail of which is now being deliberated. (B) can be calculated by referring to the updated insurance liability (different from the balance sheet amount) which uses financial assumptions in the previous measurement (i.e. financial assumptions at the beginning of the calculation period). If the difference between the financial assumption used earlier and the current financial assumption is significant, the cumulative loss that had been recognized in OCI would be reclassified from equity to profit or loss as a result of a liability adequacy test (based on the framework of liability adequacy tests now being used in various jurisdictions).

The following illustration demonstrates the proposed calculation.

[Case I : Interest Rate Increasing]

Balance Sheet

	X	X+1	(Difference)	
Insurance Liability	1,200	1,000	(▲200)	=(A)
[Insurance Liability] (without financial assumptions update)	[1,200]	[1,100]	(▲100)	=(B)

Statement of Comprehensive Income

	X	X+1	
Net Income	—	+100	←(B)
Other Comprehensive Income (OCI)	—	+100	←(B)–(A)
Comprehensive Income		+200	←(A)

[Case II : Interest Rate Falling]

Balance Sheet

	X	X+1	(Difference)	
Insurance Liability	1,200	1,300	(+100)	=(A)
[Insurance Liability] (without financial assumptions update)	[1,200]	[1,100]	(▲100)	=(B)

Statement of Comprehensive Income

	X	X+1	
Net Income	—	+100	←(B)
Other Comprehensive Income (OCI)	—	▲200	←(B)–(A)
Comprehensive Income		▲100	←(A)

It should be noted that the above treatment is consistent with IAS 39. More specifically, paragraph 55 of IAS 39 states that interest calculated using the effective interest method for an available-for-sale bond purchased at a price different from the redemption price is recognized in profit or loss, and we are proposing that gain or loss other than that arising from changes in financial assumptions would be recognized in profit or loss.

In the case of an available-for-sale bond whose interest is calculated using the effective interest method, the changes in the fair value at the end of each balance sheet date would reflect the release of the amortized amount from OCI and therefore the cumulative gain or loss previously recognized in OCI would become zero at maturity. Similarly, we are proposing an approach where the changes in the carrying amount of an insurance liability at the end of each balance sheet date would reflect the release of gain and loss that arise from changes in financial assumptions and therefore the cumulative gain or loss from an insurance liability previously recognized in OCI would become zero at maturity.

(2) The changes that have been classified in OCI under the method illustrated in (1) above would be recognized in profit or loss as they are released from risks under the contracts.

When an insurance contract continues and terminates at maturity, cumulative gain or loss previously recognized in OCI becomes zero at maturity under the method described in (1) above. A simplified illustration for this process is provided below based on the assumption that interest rates at the end of each balance sheet date fluctuate and gain or loss classified in OCI would have been recognized in profit or loss by the time an insurance liability amount becomes zero at maturity.

Balance Sheet

	X	X+1	X+2	X+3	X+4	X+5
(Interest Rate Fluctuation)	[−]	[↑]	[↓]	[↑]	[↓]	[−]
Insurance Liability	1,000	700	600	300	200	0
[Insurance Liability] (without financial assumptions update)	[1,000]	[800]	[600]	[400]	[200]	[0]

Statement of Comprehensive Income

	X	X+1	X+2	X+3	X+4	X+5	[Total]
Net Income	—	+200	+200	+200	+200	+200	[+1,000]
Other Comprehensive Income (OCI)	—	+100	▲ 100	+100	▲ 100	—	[±0]
Comprehensive Income		+300	+100	+300	+100	+200	[+1,000]

The above treatment is consistent with the treatment of available-for-sale assets. The illustration below demonstrates the structure for such process based on the assumption that the only payment would be a maturity benefit (without gain or loss from factors such as death benefits or operating expenses). As long as the duration of the insurance liability and corresponding bond is matched, OCI amounts on the insurance liability and bond would offset each other in each period. In addition, OCI amounts cumulatively classified on the insurance liability and those on the bond would become zero at each maturity.

Balance Sheet

	X	X+1	X+2	X+3 (before adjustm ents)	X+3
(Interest Rate Fluctuation)	[−]	[↑]	[−]	[−]	
(Discount)Bond	850	800	900	1,000	0
[(Discount)Bond] (amortized cost method)	[850]	[900]	[950]	[1,000]	[0]
Insurance Liability	850	800	900	1,000	0
[Insurance Liability] (without financial assumptions update)	[850]	[900]	[950]	[1,000]	[0]

Statement of Comprehensive Income

	X	X+1	X+2		X+3	[Total]
Profit from Redemption	—	+50	+50		+50	
Benefit Payment	—	0	0		▲ 1,000	
Transfer to Insurance Liability	—	▲ 50	▲ 50		▲ 50	
Reversal of Insurance Liability	—	0	0		+1,000	
Net Income	—	±0	±0		±0	[±0]

Change in Bond	—	▲ 100	+50		+50	
Change in Insurance Liability	—	+100	▲ 50		▲ 50	
Other Comprehensive Income(OCI)	—	±0	±0		±0	[±0]
Comprehensive Income		±0	±0		±0	[±0]

When an insurance contract is derecognized on the payment of a death benefit or cancellation, cumulative gain or loss from an insurance liability previously recognized in OCI would be reclassified from OCI as a reclassification adjustment. This treatment is consistent with the approach described under paragraph 55 of IAS 39 where gain or loss from available-for-sale assets is reclassified from OCI as a reclassification adjustment.

(3) The proposed approach is not based on the concept of hedge accounting, and therefore there is no need to establish a designated relationship between insurance liabilities and available-for-sale assets.

It is worth noting that the proposed approach is not based on the concept of hedge accounting, and therefore there is no need to establish a designated relationship between assets and liabilities. It should be emphasized that, as a matter of hierarchy, financial assets have a greater affinity for the fair value concept than insurance liabilities, and therefore if the OCI presentation is permitted for changes in financial assets, it should be also permitted for changes in insurance liabilities.

If the OCI presentation is permitted for changes in insurance liabilities as well, accounting mismatches on the income statement could be mitigated in the context of available-for-sale securities category already in use on the asset side.