

Monday, September 14, 2009

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

Sent by email

Dear Sir David:

Accounting Standards for Financial Instruments

We support the effort of the International Accounting Standards Board (IASB) to reduce complexity of accounting standards for financial instruments.

The insurance industry has a serious interest in the current discussion on reducing complexity of accounting standards for financial instruments examined by the IASB.

However, we are concerned that if IAS 39 is revised based solely on the proposals in the exposure draft on classification and measurement and insurance liabilities are to be remeasured at every reporting period as proposed in the IASB project on insurance contracts, the financial statements of insurers would become less understandable to users.

- a. Present fair value changes in other comprehensive income (OCI) broadly not only for particular equity instruments but also for bonds and similar instruments
- b. Allow the reclassification of gains and losses from OCI to profit or loss upon realization
- c. Present the realized gains and losses on all investment returns including dividends, interest income and amortisation in profit or loss

We would be pleased to discuss these concerns with you and the Board at any time. They have already formed the basis for our comments at the Insurance Working Group and our comments to the board on Financial Instruments: Classification and Measurement and in anticipation of the discussion of insurance related issues.

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
Sumitomo Life Insurance Company, Yutaka Amino, Managing Director

Presentation of financial instruments other than equity instruments in OCI

While basic elements of an alternative approach that allows an entity to present fair value changes for bonds in OCI is described in the Financial Instruments: Classification and Measurement Exposure Draft, additional description is needed.

The business model for companies writing insurance contracts is to underwrite risks over a long period and then fulfil these obligations to policyholders. This is distinguished from simply gaining profits through changes in fair value of assets and liabilities, which are held by insurers.

Presenting “unrealized profits” in Net Income would not faithfully represent the substance of insurance companies’ business. Thus, even if the assets and liabilities are measured and presented at fair value in the statement of financial position, we believe that only Realized Gains and Losses should be presented in Net Income, while Unrealized Gains and Losses from Financial Instruments Other than Equity Instruments are appropriately presented in OCI.

In the IASB project on insurance contracts, it has been tentatively decided that insurance liabilities should be remeasured at every reporting period. If this actually were applied to insurance liabilities, it could lead to accounting mismatches between assets and liabilities in those cases when fair value measurement is applied only to certain assets in the statement of financial position.

As a result, insurance companies might be in the strange position of being forced to use an optional treatment – the fair value option – as the basis of their primary statements in order to avoid accounting mismatches.

Even in this case, given that the nature of insurance business is not to gain profits from the changes in fair value of assets and liabilities which are held by insurers, financial statements presented in this manner would not be decision useful or faithfully represent the insurers’ business while, at the same time, mislead policyholders and users of the financial statements.

Net Income

For companies engaged in writing insurance contracts, the recognition of gain and loss and its connection to net income is of serious importance to the Financial Statement Presentation. On several occasions, the IASB has proposed that once an Unrealized Gains or Loss presented in OCI is recorded, it would not be permissible to take a subsequent Realized Gains and Losses to Net Income. Without permitting this recognition of realized gains and losses, there would be a significant amount of gains and losses that are not presented in Net Income, even though they are presented in Comprehensive Income. This would undermine the decision usefulness of Net Income as an indicator to evaluate an entity’s business performance.

In addition, measuring long-term financial instruments including insurance liabilities at current value and presenting the amount of changes in value of those instruments not only in Comprehensive Income but also in Net Income would lead to misunderstanding among users, as Net Income would be presented with artificially high volatility even when assumptions are slightly changed.

For this reason, 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 entity’s business performance on its regular activities. This treatment enables users of financial statements to take advantage of receiving the two different indicators providing users with broader and thus more useful information.

Presenting all realized investment returns in Net Income

Concerning equity instruments that are presented in OCI, in the Financial Instruments Classification and Measurement Exposure Draft, the Board proposed that not only the changes in stock price but also dividends to shareholders would be presented in OCI. This treatment would change the nature of Net Income significantly.

Presenting the realized gains and losses on all investment returns including dividends, interest income and amortisation in Net Income is appropriate from the perspective of retaining the nature of Net Income as a valuable indicator.
