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The Life Insurance Association of Japan

3-4-1, Marunouchi, Chiyoda-ku, Tokyo 100-0005 JAPAN Phone:+81-3-3286-2651 Fax:+81-3-3201-6713

October 11, 2002

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

Dear Sirs/Madams,

It is great pleasure for us, the Life Insurance Association of Japan, to send International Accounting Standards Board the following comments on the Exposure Draft, “Amendments to IAS 32 and 39, Financial Instruments”.

We feel great respect for the efforts made by IASB and would like to appreciate you for providing us with an opportunity to render our comments on the draft documents.

The following comments represent those of the Life Insurance Association of Japan consisting 42 life insurers in Japan.

Yours Sincerely,

Motoyuki Terasaka
Chairman of Current Issue Committee
The Life Insurance Association of Japan

October 11, 2002

Comments on Exposure Draft: Amendments to IAS 32 and 39 "Financial Instruments"

The Life Insurance Association of Japan

The Life Insurance Association of Japan (LIAJ) is the industry organization composed of 42 member life insurance companies, and its purpose is to strive for the sound development of the Japanese life insurance industry and the maintenance of its reliability. The LIAJ deeply appreciates the opportunity to express official opinions in response to the Exposure Draft of Proposed Amendments to IAS 32 and 39 "Financial Instruments".

The LIAJ, having great respect for the efforts of the IASB to seek better financial accounting standards, is itself striving to accomplish further improvement in the accounting system to promote the transparency and sound management of life insurance companies.

However, a proposed amendment to IAS 32 and 39 "Financial Instruments" states that "An entity should be permitted to designate any financial instrument irrevocably at initial recognition as an instrument that is measured at fair value with changes in fair value recognised in profit or loss." The LIAJ feels that this amendment could possibly impair the comparability of financial statements.

At the same time, expanding the scope of what is measured at fair value with those changes reflected in profit or loss could lead to generating the same result as the case of adopting the JWG Draft. This states that "recognition of virtually all gains and losses resulting from changes in fair value in the income statement in the periods in which they arise under the measurement of virtually all financial instruments at fair value." As a result, it is possible that this would not conform to the fundamental purpose of the income statement, which is to properly indicate business results for a single business year.

Furthermore, insurance contracts have heretofore been considered outside the scope of application of IAS 32 and 39. However, while the Exposure Draft amend that "IAS 32 and 39 target non-insurance contracts issued by an insurance company," the Draft does not amend the point that "IAS 39 applies to derivatives that are embedded in insurance contracts," and adds such derivatives to IAS 32's target of application. Matters concerning insurance contracts, including the definition of an insurance contract, should be discussed comprehensively in the Project of Insurance Contracts that is being considered, separate from the proposed amendments, by the IASB at present. Contracts issued by insurance companies, including "non-insurance contracts" and "embedded derivatives" should be deemed outside the target of application of IAS 32 and 39. In addition, the LAIJ believes that at current IAS 32 and 39 do not give ample consideration to the matter of their application to insurance companies holding assets to match the long-term nature of liabilities. Therefore, this matter needs to be examined.

Based on the above-mentioned viewpoints, the LIAJ expresses its opposition to the proposed amendments to IAS 32 and 39 as follows.

1. Conclusion

The LIAJ feels that there are many problems with the contents proposed by the current amendments to IAS 32 and 39 and opposes establishing them as Standards in their existing forms.

2. Grounds Leading to the Conclusion

(1) Regarding the Comparability of Financial Statements

The Exposure Draft proposes that "An entity should be permitted to designate any financial instrument irrevocably at initial recognition as an instrument that is measured at fair value with changes in fair value recognised in profit or loss." The current IAS 39 allows an entity to choose "directly in equity" or "in profit or loss" for the entire block of available-for-sale financial instruments in recognising gains or losses. The proposed amendment allows the choice to be made for each individual financial instrument, regardless of the management intention to hold the asset. In short, under the proposed amendment, management could arbitrarily choose accounting treatment without any restrictions, which could ruin the comparability of financial statements.

(2) Regarding the Expansion of the Scope of Use of Fair Value

The thinking of the current IAS 39 is that an instrument with no business restrictions on sale or realization is assessed at fair value with changes in fair value recognised in profit or loss. Since the properties of a financial asset held and the business purpose of a holding prescribe the actual economic conditions, financial instruments whose changes in fair value can be recognised in profit or loss should be limited to negotiable securities with high market liquidity that are held for the purpose of short-term profit-taking. Furthermore, it is believed that designating loans and financial liabilities with no market price as available-for-sale financial assets and applying fair value assessment to them will lower the credibility of financial statements, because the credibility of any fair value calculations will be low. It is for this reason that there is a problem with being able to designate loans and financial liabilities with no market price as available-for-sale financial instruments.

In addition, it is believed that there should be a clear distinction between realized profits and losses and appraisal profits and losses, excluding financial assets held on the condition that appraisal profit or loss will be realized through short-term profit-taking. Therefore, the LIAJ feels that it is appropriate to recognise changes in the variance of the estimates of available-for-sale financial assets and liabilities directly in equity and that there is a problem with the amendment of the current IAS 39 that makes it possible to reflect these changes in profit or loss through designation by an entity.

This kind of change will ultimately make it possible to carry out the same kind of accounting as put forth in the JWG Draft. This means that in spite of the many views expressed around the world opposing the JWG Draft, there is the possibility of bringing upon the same results as would be caused by adopting the JWG Draft, without solving any problems from the standpoint of properly indicating profits for a single business year.

(3) Regarding Application to "Non-insurance Contracts" and "Embedded Derivatives in Insurance Contracts"

Making "non-insurance contracts" and "embedded derivatives in insurance contracts" targets of application of IAS 32 and 39 is a problem, because the Project of Insurance Contracts has not yet established the definition of an insurance contract. Furthermore, it does not conform to the direction being considered of not separating embedded derivatives in insurance contracts.

As a result of the current amendments, an entity will be compelled to separate embedded derivatives in insurance contracts. However, as also recognised by "Basis for Conclusions" C60 of the Exposure Draft, the practical burden of separating embedded derivatives in insurance contracts is extremely great. Therefore, making embedded derivatives in insurance contracts a target of application of IAS 32 and 39 will be contrary to the aim of the current amendment to "With thousands of companies required to implement international standards in the next few years, there is an urgent need to remove uncertainty and to make it easier to implement the standards on the reporting of financial instruments."

(4) Others

Paragraphs 95 to 100 of the proposed amendments to IAS 39 prescribe considerations given for the measurement of fair value. Regarding this, Paragraph 100 stipulates the use of valuation techniques for estimates of fair value in cases where there is no active market. However, there is no solution presented to the problem of credibility in the case of using valuation techniques for financial instruments with no active market.

3. Replies to Questions

Please refer to the attachment.