LIFENET INSURANCE COMPANY

Question and Answer Summary at IFRS 17 Study Meeting for Investors and Analysts Session 3

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[Answerers]

Ryosuke Mori	President and Representative Director
Masanori Sakasai	Executive Expert, Corporate Planning Department

Question & Answer

Question: Will financial results in the IFRS P&L be similar to those in the J-GAAP results?

Sakasai: As explained in page 6 of the material, financial results here consist of investment income and insurance financial expenses. Regarding investment income, normal interest and dividend income from fixed income assets are recorded, which is basically similar to J-GAAP. However, mutual funds, stocks, etc., are valued at fair value, and in the sense that their changes will go through the P&L, we believe that volatility in that area will increase on the investment income side.

On the other hand, the insurance financial expenses are described as interest on insurance liabilities, and as I explained, present value of future CF, CSM, and risk adjustment are offset by a large negative and a large positive, resulting in insurance policy assets of JPY21.9 billion. Since this is a relationship in which the negative and positive interest are offset in terms of scheduled interest, the net amount will not be that large. As a result, we think that changes due to fair value volatility are a major difference from J-GAAP and they will not be necessarily similar.

Question: How is interest on insurance liabilities calculated for insurance financial expenses?

Sakasai: It is calculated with discount rates for insurance liabilities, which are based on the risk-free yield curve adjusted by small illiquidity premium.

Question: What kind of gains/losses are recorded in other results?

Sakasai: As explained in page 6 of the material, other results are expenses not directly related to insurance services and gains/losses from other than insurance business.

The "expenses not directly related to insurance services" include asset management expenses, education and training expenses, and pre-launch product development expenses, which are not directly related to the insurance services provided to customers. They are called “expenses outside fulfillment cash flows”. The “gains/losses other than insurance business” are the profit and loss from our subsidiaries, etc. and in our case, gains/losses from Lifenet Mirai which is a distribution agency will be included.

Question: On page 15 of the material, the amount of capital plus CSM after tax is larger than EV. What are the factors?

Sakasai: That would be the difference in approaches for both calculations. One is the way in which risk adjustment in IFRS and non-hedgeable risk in EV are calculated is different, and the subject of the calculation itself is also different, so they will not match exactly. Also, while expenses outside fulfillment cash flows are not born in CSM calculation, all of expenses are considered in EV, and there may be some difference in that respect.

Question: On page 10 of the material, new business CSM versus value of new business in EV and adjustments due to assumption changes in IFRS versus the impact of assumption changes in EV are also large with IFRS. Is it just the tax difference?

Sakasai: The difference in tax treatment is the largest factor. Other than that, it may also be affected by the difference in risk adjustment as well as the inclusion or exclusion of the expenses outside fulfillment cash flow I mentioned earlier. However, we believe that you can see that the same sense of direction is generally being produced.

Question: Will the assumption change be made in IFRS semi- annual as in EV? Will there be an impact in H1 of the assumption change?

Sakasai: There is no specific frequency specified as to how often the assumptions should be changed in the standard. Our practice has been to review EV assumptions every six months. In terms of using best estimate, we do not think it is reasonable to use a different assumption than this, so we are currently assuming that the assumption will be changed semi-annually. Therefore, the adjustment impact of the assumption change will appear in the CSM once a half year, for both H1 and the full year.

Question: If we bear the insurance service results in FY2021 (JPY7.2 billion) in mind on page 8 of the material, is it correct to assume that the base line of the profit level would be about JPY5 billion after tax? Also, regarding financial results and other results, if we assume that there is no impact from fair value valuation, can we basically expect a positive contribution here?

Sakasai: I would refrain from commenting on the level of net income because we are not performing retrospective calculations for it, and it would be the matter that is related to the business forecast. However, as we have explained in the past, major part of our profit before tax is from insurance service results, and in addition to the nature of financial results and other results that I explained earlier, tax expenses are calculated at an effective tax rate of 28% in the EV. I consider that the level of net income will be expected by taking these factors into consideration.

Regarding the point if there is positive contribution from financial results when there is no impact from fair value valuation, it would depend on the amount net of the investment income from fixed assets and insurance financial expenses. We explained that the insurance finance expenses will be small amount as it will be netted out with negative and positive numbers. In that sense, I think it is fair to say that it will be positive under the assumption that stable interest income is secured. Regarding other results, it will be basically a negative contribution as it is mainly from expenses outside fulfilment CF. We cannot say if the combination of financial results and other results makes a positive contribution since it would depend on the situation, but it would not be a large amount in comparison with insurance service results.

Question: What is the concept of recovery of insurance acquisition cash flows (IACF) on page 8 of the material? How will marketing expenses be disclosed under IFRS voluntary adoption?

Sakasai: First, as on page 21 of the material, IACF is not capitalized on asset and not amortized to be expensed. IACF is subtracted from the CSM by that amount, which reduces future CSM amortization as revenue. Through this, we are producing the same effect as capitalizing and expensing the IA CF. Now if we were to capitalize and amortize IA CF as in US-GAAP, the amortization of the CSM shown on the right side on page 21 of the material would be larger. On the other hand, the amortization of deferred acquisition costs would come out as an expense in the P&L, similar to US-GAAP.

Returning to page 8 of the material, now if we consider item 4 (CSM amortization) and item 5 (recovery of IACF) together, that would be the number of CSM amortization if were to make IACF capitalized and amortized. And we would still see the amortization of IACF only is the figure in item 8 (amortization of IACF). I think presenting this way would also allow us to see how much of the amortization of IACF is in the P&L. I think that is some meaning of this kind of P&L structure.

The amount of IACF will appear in the disclosure of notes to the financial statement, in the section of the new business CSM. We would consider separately whether to continue the disclosure of marketing expenses that we have been explaining.

Question: Do you have any plan to disclose reconciliation analysis between J-GAAP and IFRS financial statements?

Sakasai: At this point, we do not have any specific ideas, but as there will be a big difference in amounts, so I think some kind of explanation will be necessary especially for insurance liabilities.

Question: Can you explain how you calculated the risk adjustment amount of JPY32.0 billion on page 12 of the material?

Sakasai: Risk adjustment is calculated using the cost of capital method in our IFRS reporting. Although the risks covered here are risks related to insurance services and do not include operational risk, etc., considered risks are similar to the non-hedgeable risks of EV. Then we multiplied them by the cost of capital rate and discount them to calculate risk adjustment.

Question: On page 8 of the material, amortization of IACF is JPY2.7 billion in FY2021. Operating expenses under J-GAAP in FY2021 was approximately JPY12 billion, then can I understand the difference of about JPY10 billion is the effect of the deferral as a result? Or is any portion included in item 7(actual claims)?

Sakasai: Since JPY2.7 billion of amortization of IACF is an amortized amount for a single year out of the accumulated IACF, it is not a part of JPY12 billion of total operating expenses under J-GAAP. Maintenance expenses other than IACF are included in item 7 (actual claims). Please note that both item 2 (expected claims) and item 7 (actual claims) include expected maintenance expenses and actual maintenance expenses.

Question: I think the IFRS profit has a strong non-cash character. What are your thoughts on the relationship with future dividends? Do you simply multiply IFRS profits by the dividend payout ratio or do you use any cash-based idea?

Mori: First of all, the change in accounting standards will have no impact on our policy of not planning to pay dividends for the time being. The cash flow has always been positive for our company and the flow of the cash and accounting losses in J-GAAP have been in opposite directions. On the other hand, IFRS profit and cash flow are both positive numbers, but the numbers themselves are not necessarily the same.

Although we believe that the cash base will continue to accumulate further in the future, as I explained at the financial results briefing, even after the adoption of IFRS, capital adequacy and dividends from retained earnings will continue to be regulated by the statutory accounting standards (J-GAAP). Therefore, retained earnings under IFRS will not immediately go to dividends. The retained earnings under statutory accounting are still negative and we expect the Company's single year's earnings will turn into positive in late 2020s. Regarding paying dividends, it will be a few years at the earliest after we turn into positive.

Question: Equity has accumulated considerably on an IFRS basis, and then ROE would look low. If shareholders requests to pay dividends, would you give the same explanation (the above answer)?

Mori: Basically, yes. I believe that we will respond to that question in two ways: first, based on what we can and cannot do under the regulations; and second, what is our intention based on the growth investment opportunities.

Question: Which accounting standards will you be disclosing for the first quarter of FY2023 on?

Sakasai: We will continue to disclose J-GAAP results every quarter. In addition, we will make a decision on whether to implement IFRS for the first quarter of FY2023, with a sufficient review of whether double GAAP can be done in real time. Including that point, we are currently working toward making an internal decision by the end of this fiscal year.

Question: In calculating risk adjustment, what percentage of the cost of capital rate is used in the cost of capital method? Also, the cost of non-hedgeable risk in EV was JPY24.4 billion as of March 2022, so, is its pre-tax amount similar to JPY32.0 billion of risk adjustment in IFRS?

Sakasai: I would like to refrain from answering what is our cost of capital rate because we have not disclosed that of EV calculation as well. The difference in the treatment of tax effect is large between non-hedgeable risk and risk adjustment but as I explained briefly, please note that the subject matters are not necessarily the same, since there are also differences in operational risk and other factors.

Question: Will you not disclose your cost of capital rate in the future as well? I suppose you will need to explain the relevance with the cost of capital rate you will use in the calculation of economic based solvency regulation once it is introduced.

Sakasai: We would like to consider its disclosure based on the situation including economic based solvency regulation.

Question: Can you tell us to what extent you plan to disclose the breakdown of items, e.g., breakdown of insurance claims and operating expenses in expected claims and actual claims, gross incomes and gross losses in investment income (net)?

Sakasai: Details to some extent will be disclosed in the notes to financial statement as per the standard, but the breakdown of insurance claims and operating expenses in expected claims and actual claims and gross incomes and gross losses in investment income (net) are not required to disclose in detail. We would consider to what extent we disclose the details which is beyond the required level in the notes.

<The summary of additional Q&A >

Here we post an additional Q&A which we received after the 3rd IFRS study session related to the explanation in the session.

Question: Can you explain why the recovery and the amortization of IACF are the same amount? Why is such an accounting treatment made?

Sakasai: We explained that insurance revenue is not premium income itself. However, insurance premiums are the consideration from customers and the source of revenue. In IFRS, insurance revenue is realized by allocating premium income to periods appropriately. If we look at the example on page 14 of the material, the present value of premium income on the left side of figure (2) is the source of items on the right side, and expected claims: 60 every year, IACF recovery: 10 every year, risk adjustment release: 10 every year and CSM amortization: 20 every year are recorded as revenue during the insurance period. They correspond to the present value of premium income: 1,000 in 10 years total. It means premium is allocated to these 4 items to recognize as revenue.

It is the concept of IFRS 15 which is the general revenue recognition standard to allocate customer consideration to periods and recognize it as revenue. It can be speculated that also in IFRS 17, by recording both recovery and amortization of IACF with the same amount, it makes the total of revenues corresponding to the amount of premiums which is customer consideration, and show the information about how much the single year's amortization is on P&L. However, it should be noted that investment component in

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