# LIFENET INSURANCE COMPANY

IFRS 17 Study Meeting for Investors and Analysts

July 5, 2022

**[Speaker]**

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| Masanori Sakasai | Executive Expert, Corporate Planning Department |

# Presentation

**Mori:** Thank you for joining us today for our IFRS 17 study session.

As reported in our full-year financial results in May, we announced that we aim for the voluntary adoption of IFRS 17 in our financial reporting for FY2023 and the following year. We believe that this will enable us to present the periodic results and profitability of our business more appropriately to investors and shareholders, as well as to disclose more useful information.

As today is the first session, we would like to focus on this basic part in particular and Mr. Sakasai will explain it.

# Disclaimer

- The information in this document is based on our current interpretations and views of statutory accounting and International Financial Reporting Standards (IFRS).
- Other companies in the industry and other related parties may have different interpretations and views.
- For ease of understanding, some of the expressions used in this document are different from the actual accounting standards.

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**Sakasai:** I am Sakasai from the Corporate Planning Department. Thank you very much for joining us today for the IFRS 17 Insurance Contracts study session. I will now give a 30-minute presentation.

Please see page one. First, let me talk about the Disclaimer.

The information presented is based on our current interpretations and views of statutory accounting and International Financial Reporting Standards (IFRS) related to life insurance companies.

Other insurance companies and other parties may have different interpretations and views.

In addition, for ease of understanding, this document uses expressions that differ in some respects from actual accounting standards.

We hope you will take note of the above points.

# 1. About the Study Meeting

LIFENET

## ■ Purpose

**Explain the key points of IFRS prior to our voluntary adoption from FY2023**

➡ **Facilitate a smooth transition to our new financial statements and financial analysis**

**Note: This study meeting is not intended to explain specific performance forecasts at Lifenet**

## ■ Schedule (planned)

| Session | Theme | Date |
|---|---|---|
| 1st | **Basic information of IFRS 17**<br>• **Background and significance of the introduction of IFRS**<br>• **Key points of profit and loss under IFRS 17**<br>• **Importance of CSM (Contractual Service Margin)** | **July 5, 2022** |
| 2nd | Financial analysis of IFRS 17<br>• Analysis of profit, financial indicators and changes in CSM | around October 2022 |
| 3rd | Update information of IFRS 17<br>• IFRS 17 movement and QA session | around January 2023 |

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Please see page three. First, I will explain the purpose of this study session.

Under IFRS, IFRS 17 Insurance Contracts will be effective for fiscal years beginning January 2023, and in line with this, we have announced that we aim for the voluntary adoption of IFRS beginning in FY2023.

The purpose of this study session is to explain the important points of IFRS 17 prior to our voluntary adoption in FY2023, and to facilitate a smooth transition to our new financial statements and financial analysis in the coming year and beyond. We would appreciate your understanding that this study session is not intended to explain specific performance forecasts at the Company.

Next, here is the schedule we are currently considering and the proposed theme for each session. In this first session, I would like to explain the background and significance of the introduction of IFRS, as well as the key points of its profit and loss, and the importance of CSM (Contractual Service Margin) as the foundation of IFRS 17.

We would like to have a second study session around October on the financial analysis of IFRS 17. I would also like to include some supplemental information on questions we receive today or subsequently that we are not able to sufficiently answer.

We would like to have a third session around January next year, with details to be considered flexibly, but we would like to include developments in IFRS 17 at that time, as well as Q&A session on areas of particular interest. We would be grateful if you could send us your requests regarding the schedule and them in the future.

## 2. Today's Key Messages

- The adoption of IFRS will **better present** our periodic performance and profitability
- Increase in CSM* will **lead to future profit growth**
  *Contractual Service Margin
- Capital regulations and dividends will **continue to conform to the J-GAAP** even after IFRS adoption

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Please see page four. The following is a summary of the key messages of today's study session.

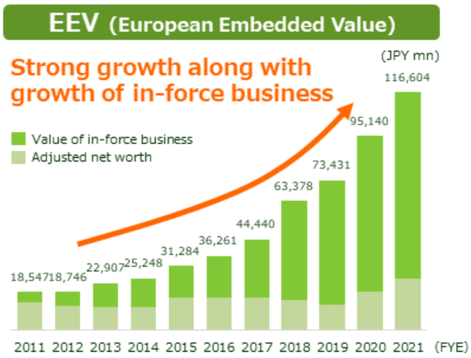
First, the adoption of IFRS will better present our periodic performance and profitability.

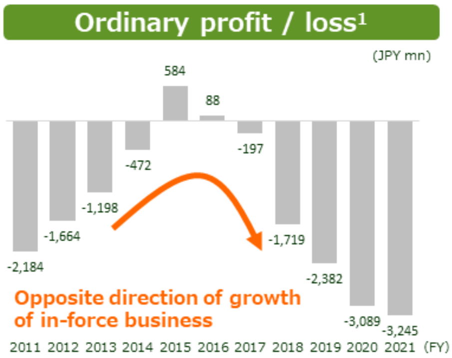
Second, CSM (contractual service margin), which is the expected future profit of insurance contracts, is an important concept in IFRS 17 financial statements, and an increase in CSM will lead to future profit growth.

Third, even after the adoption of IFRS 17, capital regulations and dividends from retained earnings will continue to conform to the statutory accounting standards.

# 3. Background of IFRS Adoption

- Mismatch between revenues and expenses under J-GAAP makes it difficult to show the actual performance while EEV, which presents the potential value of in-force business, shows strong growth




- IFRS adoption will allow us to better present our periodic performance and provide comparable financial information internationally
- Capital regulations and dividends will continue to conform to the J-GAAP even after IFRS adoption

1. The ordinary profit (loss) before amortization of deferred assets under Article 113 of the Insurance Business Act from fiscal 2011 to fiscal 2016

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Please see page five. This is the background and purpose of our IFRS adoption. The Company currently has EEV, or European embedded value, as a management indicator. EEV is a measure of the potential value of in-force business. As illustrated in the graph to the left, EEV has shown strong growth in line with the increase in our in-force business.

On the other hand, the graph on the right shows the change in ordinary profit or loss. Due to the mismatch between income and expenses in the statutory accounts, the accounting income and loss moves in the opposite direction of the growth of in-force business. Despite the steady growth of EEV, P&L as a periodic profit/loss shows rather the opposite direction. For accounting purposes, it is very difficult to understand the reality of the Company's performance. For a long time, there has been a great awareness of the challenges in this regard.

To address this issue, our adoption of IFRS 17 is intended to better present our periodic results and provide financial information that is more comparable internationally. Many may have the impression that IFRS is oriented toward B/S-oriented fair value accounting. It is true that fair value has been the focus of accounting for valuing financial investment outcomes for financial assets. However, the more fundamental idea of IFRS is to present the basic and constant financial strength of a company to users of financial information.

As we will explain in more detail later, IFRS 17 is an accounting that values insurance liabilities on a fair value basis while appropriately allocating margins in excess of that value over the insurance term. This will enable us to provide more useful information to investors in their decision-making process.

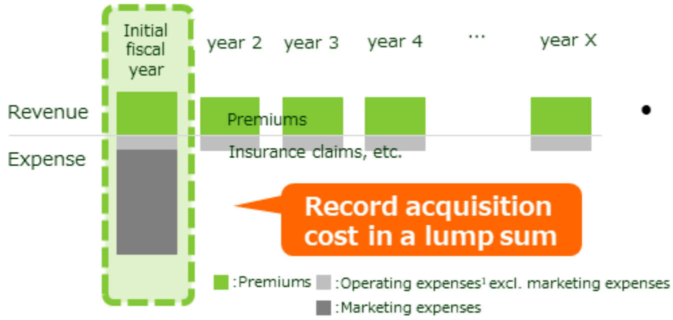
However, we would like to note that capital regulations, dividends of surplus, and dividends to shareholders will still be in accordance with the Insurance Business Law or statutory accounting even after the adoption of IFRS. One thing that should be mentioned here is that the total profit will not change regardless of which accounting standard is applied to the same insurance contracts for the same coverage. In other words, the true state of the Company does not change in any way.

The question is how to capture and report periodic performance in the structure of life insurance in-force business, which have a long-term nature. We believe that the adoption of IFRS will bring about significant improvements for our company in terms of the appropriate presentation of periodic performance.

# 4. Characteristics of Profit and Loss under J-GAAP

## (1) Acquisition Costs

- Cannot be deferred




## (2) Policy Reserves

- **Calculated conservatively** for policyholder protection
  Reserve burden stage: Early-high, Later-low
- Actuarial assumptions (e.g. expected mortality rate and expected interest rate) at the time of contract issue are **fixed**

■ Drive down profits when an insurer grows

■ Not reflect the experience in the liability after the contract issue

1. Costs for policy management, payment of insurance claims and benefit claims, etc.

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Please see page six. Before we get into the details of IFRS 17, let me explain the statutory accounting standards. The statutory accounting of life insurance companies is largely characterized by the two points described here.

The first is that while premiums are earned in flat payments over time, acquisition expenses cannot be deferred and are recorded in a lump sum when expenses are incurred.

Second, the policy reserve, which is accumulated for future payments of insurance claims, etc., is based on the Insurance Business Law, which is intended to protect policyholders, and is calculated conservatively. Conservative policy reserves are valued using conservative calculation methods and conservative actuarial assumptions. The nature of conservative policy reserves is such that the reserve burden in the early stages of the contract is high, and conversely in the later stages of the contract, the reserve burden is low. Regarding policy reserves, there is also the feature that the actuarial assumptions, such as the expected mortality rate and expected interest rate, applied at the time of contract issue, are fixed over the policy period.

These two characteristics create a paradox: when a life insurer's new business performance is strong and the company is growing, it drives down profits; conversely, when it is weak, it drives up profits.

In addition, the fact that the basis rate of calculation is fixed at the time of the contract issue raises the problem that if, for example, the actual payment rate is favorable after the issue, the experience will not be reflected in the liability.

# 5. Structure of Income Statement under J-GAAP

- Full amount of premiums is recorded as revenue while provision for future payouts is recorded as expenses to policy reserve
- The stronger the recent new business results, the greater burden of provision for policy reserve and operating expenses
- Difficult to perform financial analysis based on P&L only because it's hard to identify the source of profit from J-GAAP P&L

| J-GAAP P&L |
|---|
| Ordinary income |
| Ordinary expenses |
| **Ordinary profit** |
| Extraordinary profit / loss |
| **Profit before income taxes** |

| | Major items | |
|---|---|---|
| 1 | **Premium income** | Premiums received in the period are recorded |
| 2 | **Investment income** | Interest and dividend income, gain on sales of securities, etc. |
| 3 | **Insurance claims and other** | Insurance claims and other payments made during the period |
| 4 | **Provision for policy reserves** | Change in policy reserve for the period is carried over and recognized as expenses |
| 5 | **Operating expenses** | Operating expenses (including acquisition costs) incurred during the period |
| 6 | **Investment expenses** | Interest expense, loss on sales of securities, loss on impairment of securities, etc. |

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Please see page seven. This is the composition of P&L, the income statement under statutory accounting standards. This is in stark contrast to the IFRS P&L, which will come up later, and IFRS changes not only the bottom line of P&L, but also its items and composition. It is important to keep the statutory accounting P&L in mind for comparison with and understanding of IFRS. Therefore, I will explain it here.

The green table on the left shows the major components. Profit before taxes is calculated using ordinary profit, the difference between ordinary revenues and ordinary expenses, as the core profit, to which extraordinary profit and extraordinary losses are added or subtracted.

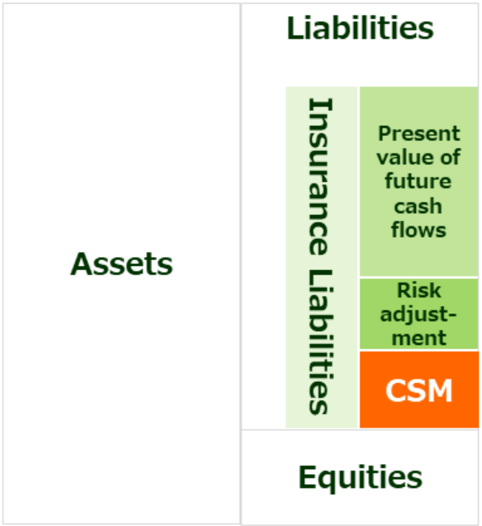
The orange table on the right shows the main items of ordinary revenues and expenses. As the top comment indicates, the major feature of the statutory accounting presentation is that while the full amount of premiums received in item one is recorded to revenues as premium income, the portion of that amount that is reserved for future payment in item four is recorded to expenses as a provision for the policy reserve. For example, for life insurance policies of a savings nature, such as single premium payments, all elements of premiums are recorded to revenue, and the amounts for payments such as future insurance claims at maturity and returns on surrender of contracts are recorded to expenses as a provision to the policy reserve.

In addition, insurance claims made in the current period under item three and operating expenses incurred in the current period including acquisition expenses under item five, are ordinary expenses. In addition, investment income under item two and investment expenses under item six are also recorded as ordinary revenues or expenses, respectively.

As explained on the previous page, the stronger the recent new business results, the greater the burden of provision for underwriting reserves under item four and operating expenses under item five, which will put pressure on ordinary profit. Also, I am sure some of you know the three sources of earnings analysis of life insurance companies. It is difficult to understand the source of profit from this P&L information alone, and it is also difficult to perform financial analysis based on P&L alone.

# 6. Insurance Liability under IFRS 17

**IFRS Balance Sheet**




*The figure above is an illustration of IFRS 17 for the general model.

**Three components of insurance liabilities**

- **Present value of future cash flows:**
  Calculated as present value of future expenses (insurance claims, etc.) deducted by present value of future income (premiums)
- **Risk adjustment:**
  Prepared for uncertainty of future cash flows
- **CSM:**
  A liability representing future profit and amortized to profit over the insurance period

On transition to IFRS 17 (or on adoption of IFRS 17), in principle, insurance liabilities are calculated for in-force business retrospectively from the time of contract issue

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Please turn to the next page. From here, we move on to an explanation of IFRS 17. First, on page eight, we will discuss IFRS 17 insurance liabilities. The figure on the left is an image of a balance sheet, or B/S, based on IFRS 17; on the left side of the B/S, the debit is the asset. The accounting standard for financial assets is now IFRS 9, and although there are some differences from the current Japanese standard, it is generally not expected to be significantly different than the liability side.

On the right side of the B/S, the credit side is liabilities and equity, of which the major part of liabilities is insurance liabilities, which corresponds to policy reserves in statutory accounting. As commented on the right, the insurance liability is divided into three component parts. The first one is the present value of future cash flows. This one is calculated as the present value of future insurance claims and operating expenses less the present value of future premium income. As with EV, the calculation uses the best estimate assumptions based on the company's experience.

The second one is risk adjustment. The first one, PV of future cash flows, is a calculation based on best estimates and therefore inevitably involves uncertainty. To prepare for that uncertainty, a risk adjustment is calculated. The concept is similar to the cost of non-hedgeable risk in EV, although the calculation method is different.

The third one is CSM, or contractual service margin. This is a new concept not found in statutory accounting and is the core of today's study session. CSM is a liability representing future profits, which is recorded as a liability and then amortized to profit over the life of the policy. In bookkeeping terms, a decrease in liabilities and an increase in revenues are journalized to realize a profit. Page 10 will explain how CSM works.

In addition, please see the comment at the bottom right of the slide. At the time of transition to IFRS 17 in 2023, or if IFRS is adopted for the first time in 2023 or later, the insurance liability will in principle be calculated for in-force contracts as if IFRS 17 had been applied from the time of their issues retrospectively.

In our case, all contracts will be recalculated under IFRS from the time of opening business in 2008. I would also like to mention here that this is how the starting B/S for IFRS 17 will be prepared.

## 7. Key Points of IFRS 17 Profit and Loss

| IFRS P&L |
|---|
| Insurance revenue |
| Insurance service expenses |
| Insurance service results･･･1) |
| Investment income |
| Insurance finance expenses |
| Financial results･･･2) |
| Other result |
| Profit before tax |

- Presented separately as
  1) Insurance service results and
  2) Financial results
- Elements of 1) insurance service results
  - Difference between expected and actual claims
  - Risk adjustment
  - Amortization of CSM
- Increasing CSM is important for future profit growth

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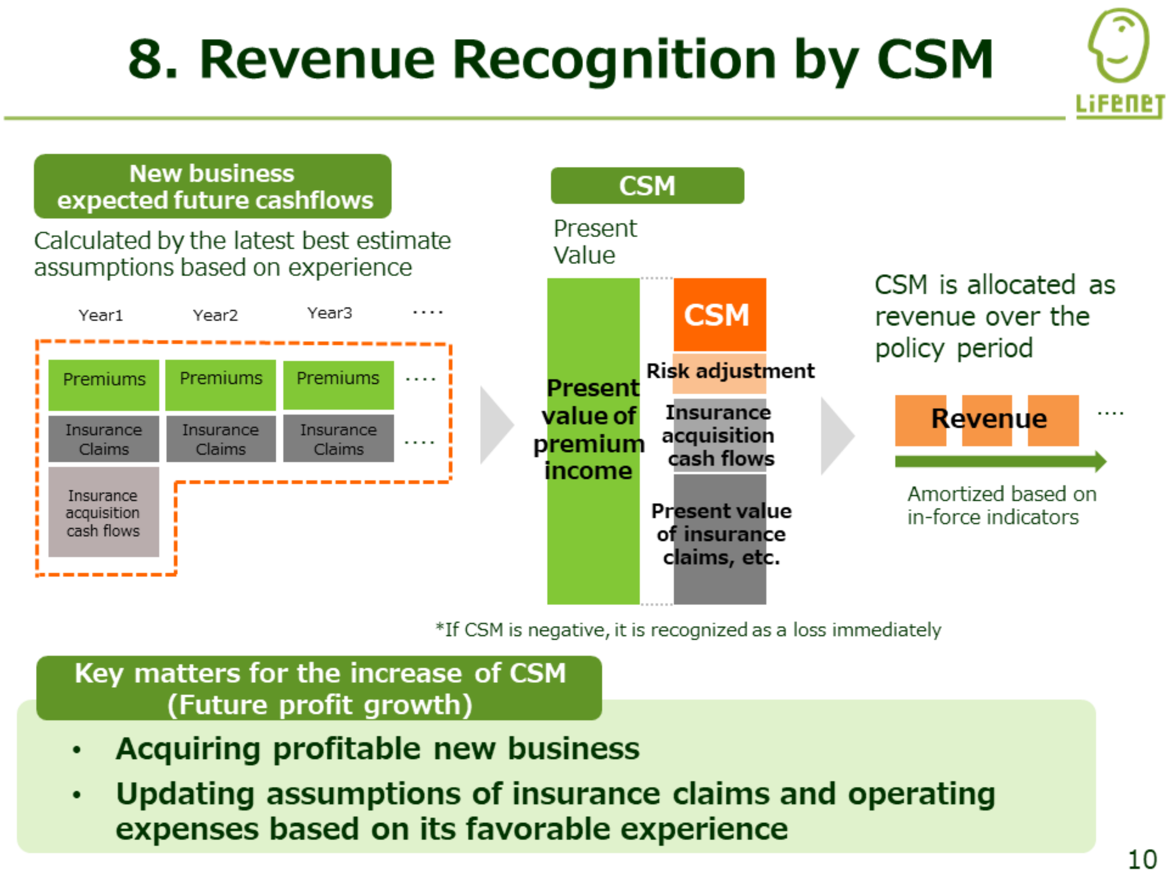
Please see page nine. I will explain in detail on the next page and beyond, but first, I would like to show the key points of profit and loss when IFRS 17 is applied here.

The green table on the left shows the IFRS P&L structure. Under statutory accounting, the major components of P&L were ordinary profit, extraordinary income, and extraordinary losses, but under IFRS 17, P&L is largely insurance service results and financial results.

For a company such as Lifenet that focuses on protection type products, the bulk of its profits will come from the insurance service results. This insurance service results would be broken down into three components: the difference between expected and actual insurance claims, risk adjustment releases, and CSM amortization. Since the expected insurance claims are calculated based on the latest best assumptions, if there is no deviation between the expected and actual results, the risk-adjusted release and CSM amortization will be the profit.

While the situation will vary from company to company, in many cases, CSM amortization will be the primary source of insurance service results. Therefore, as I mentioned on page four, increasing CSM will be important for future profit growth.




Next, please see page 10. This page explains revenue recognition by CSM. Again, CSM is a liability representing future profits.

Please look at the left figure. The starting point for the CSM calculation is the point of a new contract. First, we calculate the expected future cash flows for a given group of new policies by product, by issue cohort, etc., using the latest best estimate assumptions based on experience. This includes premiums as revenue and insurance claims, operating expenses, and insurance acquisition cash flow as expenditure. The insurance acquisition cash flow here refers to acquisition expenses that can be deferred under IFRS 17, which are explained on the next page.

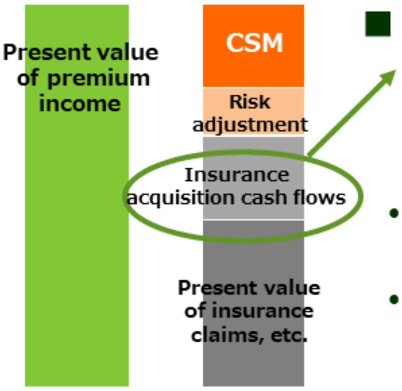
Next, we derive the present value of each item from the expected future cash flows, as shown in the middle figure. CSM, shown in the orange box, is calculated as the present value of premium income less the present value of insurance claims, less the insurance acquisition cashflows, and less the risk adjustment for uncertainty in future cash flows.

From this calculation, we can say that the CSM at the time of the new contract is the present value of the future profits of the new contract, a concept very similar to the value of new business in EV. Note that, as indicated by the asterisk, if the CSM is negative, it means that the contract is a loss for the total insurance period, and the negative amount is recognized as a loss immediately.

As shown in the figure on the right, CSM at the time of this new policy is then allocated as revenue over the subsequent policy period. In other words, by amortizing, an accounting profit is realized. This amortization is based on the balance of some in-force indicator like sum of insured, so the concept is that the insurance company recognizes revenue as it provides the service of insurance coverage. This concept of recognizing revenue as services are provided by the entity is consistent with IFRS 15, the general revenue recognition standard in IFRS.

Thus, CSM is a very important concept, and its increase will lead to future profit growth. As noted at the bottom of the slide, it will be important for the Company to increase its future profits, or CSM, by acquiring a large number of profitable new contracts, managing insurance claims and operating expenses well, and updating assumptions based on its favorable experience.

# 9. Insurance Acquisition Cash Flows




- **Cost directly attributable to the increased acquisition of insurance contract groups**
  - **Cost which is increased due to an increase in new contracts**
  - **Cost that increases new contracts by increasing costs**

**Example of IACF**

*Individual and specific determination should be made

- ✓ Commissions for sales representatives and agents
- ✓ Expenses related to the acquisition, conclusion, and underwriting of new policies
- ✓ Advertising expenses to promote insurance products

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Next, please see page 11. This section explains the insurance acquisition cash flow.

Insurance acquisition cash flow is the cost directly attributable to the increased acquisition of insurance contract groups. In short, I hope you can think of it as a cost that is increasing due to an increase in new contracts, or conversely, a cost that increases new contracts by increasing costs.

Specific examples are shown here. In addition to commissions as compensation for solicitation and personnel and property expenses related to the acquisition, conclusion, and underwriting of new policies, we believe that advertising expenses to promote insurance products are likely to fall under IFRS 17's insurance acquisition cash flow.

Please note, however, that whether or not the cash flow actually qualifies as an insurance acquisition cash flow is a matter of individual and specific determination.

Deferrals may be made if it is determined that the cash flow is an insurance acquisition cash flow. Some of you may be familiar with US-GAAP deferred acquisition costs, or DAC, which we hope you will consider similar.

## 10. Structure of Income Statement under IFRS

- Insurance revenue is not recorded directly from actual premium, but is released from insurance liability
- Insurance service results can be divided into difference between expected and actual claims, risk adjustment release and amortization of CSM
- Insurance service results and financial results corresponds to the sources of profits and IFRS P&L is structured to facilitate profit analysis

| IFRS P&L |
|---|
| Insurance revenue |
| Insurance service expenses |
| Insurance service results |
| Investment income |
| Insurance finance expenses |
| Financial results |
| Other result |
| Profit before tax |

| | Major items | |
|---|---|---|
| 1 | Expected claims | Expected insurance claims and operating expenses (Deduct the savings component) |
| 2 | Risk Adjustment release | Decrease or release of risk adjustment during the period |
| 3 | Amortization of CSM | Amortization of CSM during the period |
| 4 | Actual claims | Actual insurance claims and operating expenses (Deduct the savings component) |
| 5 | Investment income (loss) | Net Income and expenses from asset investment |
| 6 | Insurance finance expenses | Interest on insurance liabilities |

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Next, please see page 12. This is the structure of the IFRS income statement, or P&L. The green table on the left, which is also shown in the profit and loss points of IFRS 17 on page nine, shows that net income before taxes consists of insurance service results and financial results. The main items of insurance revenue and insurance service expenses, which make up insurance service results, and investment income and insurance finance expenses, which make up financial results, are explained in the orange table on the right.

As per the top comment, insurance revenue is not recorded from actual premiums earned, as in the statutory accounting standard, but is released from the three component parts of insurance liability and is recorded through a journal entry with a decrease in liability. These are, respectively, expected claims in item one, risk adjustment releases in item two, and CSM amortization in item three. Here, with respect to expected claims, some of you may feel strange a little with the fact that the item named as insurance claims is income. It may be understandable if you think the portion of the amount of insurance claims expected in the current period is reversed from liability and released as income. With respect to these expected insurance claims, the portion of the savings component, such as the amount corresponding to surrender value, is excluded from revenue. Therefore, it does not result in the recording of a large amount of revenue that includes the savings portion, such as the premium income of statutory accounting in a company that sells primarily savings products.

Insurance service expenses, on the other hand, are recorded as actual insurance claims and operating expenses incurred in item four. As with the expected insurance claims in item one, the savings component is excluded from this item as well. These subtractions result in insurance service results. Thus, insurance service results can be broken down into the difference between expected and actual insurance claims, or item one minus item four, risk adjustment releases, or item two, and CSM amortization, or item three. In item five, financial results, investment income is reported as income from asset investment, but the net amount is shown here when any expenses, such as losses on the sale of securities, are present. On the other hand, item six, insurance finance expenses, will include interest on insurance liabilities. These subtractions result in financial results. Thus, insurance service results and financial results correspond to the sources of profit, and the IFRS P&L is structured to facilitate profit analysis for its users.

# 11. Purposeful Periodic Performance

- **Depending on the accounting standard, there are different emphasizing points on how to present performance**

| | IFRS17 | J-GAAP (Statutory accounting) | Embedded Value |
|---|---|---|---|
| Emphasizing Points | Recognition of revenue based on the retention of in-force business | Ensure financial soundness as the first priority | Potential value of future profits from new business |

- **Under IFRS, revenue is recorded based on the retention of in-force business (≒ fulfillment of the coverage responsibility), thus it is highly suitable as periodic performance**
- **Understanding CSM is important as it is an intermediary item to periodic performance**

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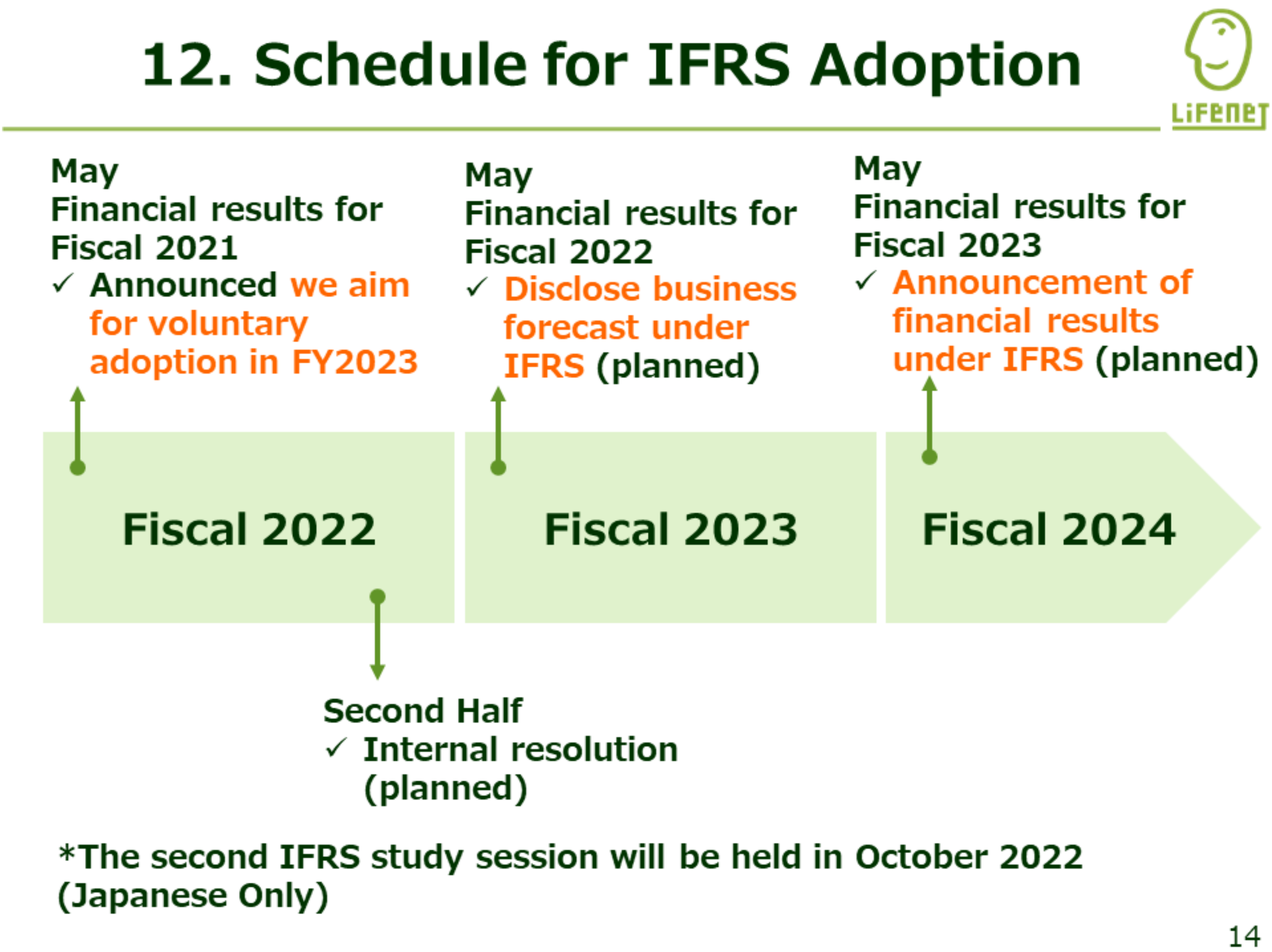
Please see page 13. Let me talk about what is purposeful periodic performance.

Depending on the accounting standard applied, there are different perspectives on performance that are emphasized. As the table shows, IFRS 17 is an accounting standard under which revenue is recognized based on the retention of in-force business. Revenue is recognized based on the level of coverage provided to the customers, or the fulfillment of the coverage responsibility for the in-force policies during the period. Therefore, we believe that this is highly suitable as periodic performance.

Of course, statutory accounting, which focuses on ensuring soundness as the primary financial performance, and value of new business of EV, which measures how much potential value is created as a result of a company's sales activities, are also meaningful indicators, so it is important to look at each in a mutually complementary way.

And in IFRS 17, CSM is an intermediary item, so to speak, to periodic performance, so understanding CSM is very important. We believe that financial analysis is required to analyze the movement of CSM and evaluate how profit is emerging in the current period and how much future profit growth is possible, in a manner linked to financial accounting. We will let that be one of the messages this time, and we will connect it with the next study session.




Finally, please see page 14. This is the future schedule for the application of IFRS.

In May of this year, in the announcement of our FY2021 financial results, we announced that we would aim to adopt this accounting standard on a voluntary basis beginning in FY2023. A formal internal resolution is planned for H2 of this fiscal year.

As part of our response, this fiscal year we will finalize specific accounting policies, and at the same time, as I mentioned in my presentation today, we will perform retrospective calculations of insurance liabilities for in-force policies.

We then hope to disclose our forecast for FY2023 under IFRS in May 2023. In the first year of IFRS adoption, comparative financial statements for the previous year will also be disclosed. Therefore, in May 2023, we would like to disclose at the same time the expected amount of profit for FY2022 under IFRS. However, please understand that these are estimates and will be unaudited figures.

Then, in May 2024, when we announce our financial results for FY2023, we would like to present the financial figures under the voluntary application of IFRS.

As I mentioned at the beginning, we would like to hold the second study session around October of this year. The theme will be financial analysis of IFRS 17, and we hope you will join us again.

This concludes my explanation.