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We appreciate the opportunity to respond to the International Accounting Standards Board's exposure draft ED 5 *Insurance Contracts*. This letter represents the views of the Swedish Financial Accounting Standards Council.

We welcome the Board's efforts to create a standard on accounting for insurance contracts and the ED 5 should be looked upon only as a step towards a final standard. With this in mind, we have the following comments, which are outlined below.

Question 1 - Scope

(a) The Exposure Draft proposes that the IFRS would apply to insurance contracts (including reinsurance contracts) that an entity issues and to reinsurance contracts that it holds, except for specified contracts covered by other IFRSs. The IFRS would not apply to accounting by policyholders (paragraphs 2-4 of the draft IFRS and paragraphs BC40-BC51 of the Basis for Conclusions).

The Exposure Draft proposes that the IFRS would not apply to other assets and liabilities of an entity that issues insurance contracts.

In particular, it would not apply to:

(i) assets held to back insurance contracts (paragraphs BC9 and BC109-BC114). These assets are covered by existing IFRSs, for example, IAS 39 Financial Instruments: Recognition and Measurement and IAS 40 Investment Property

(ii) financial instruments that are not insurance contracts but are issued by an entity that also issues insurance contracts (paragraphs BC115-BC117).

Is this scope appropriate? If not, what changes would you suggest, and why?

<u>Reply to (a) (i):</u> We agree that the area of application of the new standard should be limited to insurance contracts. It is not proposed that the standard should include investment assets, which, instead, are to be reported according to IAS 39. This implies that a mismatch can arise between assets and liabilities, as assets will be valued at fair value according to IAS 39 and insurance liabilities will be valued at amortised cost. It can be questioned whether it is meaningful under Phase I to create, in this manner, volatility in equity which can perhaps disappear during Phase II. There is a strong argument in seeking to avoid this situation and, instead, modify the regulations during a transitional period. This is a possibility which is further developed by EFRAG under question 13, "Other comments."

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Reply to (a) (ii): Many contracts that are issued by insurance companies can be considered as being of long-term nature. Depending on their content, these can be insurance contracts or investment contracts. We agree that pure investment contracts should not be included in the new standard for insurance contracts but should be reported according to IAS 39. Although, the long-term nature of these contracts has to be taken into consideration when reporting them under IAS 39. We wish to emphasise the importance of consistency in how these long-term contracts should be reported according to the new standard and according to IAS 39. This issue concerns the manner in which ED 5 addresses how an investment contract is to be reported. Here some "clarifications" in IAS 39 are introduced via paragraph BC117 in the Basis for Conclusions. If some of these clarifications in fact are to be considered as changes and not merely clarifications, we believe that they should be introduced in a manner that meets the requirements in paragraph 18 in the Preface to International Financial Reporting Standards.

(b) *The Exposure Draft proposes that weather derivatives should be brought within the scope of IAS 39 unless they meet the proposed definition of an insurance contract (paragraph C3 of Appendix C of the draft IFRS). Would this be appropriate? If not, why not?*

Reply: Yes.

Question 2 – Definition of insurance contract

The draft IFRS defines an insurance contract as a 'contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder or other beneficiary if a specified uncertain future event (the insured event) adversely affects the policyholder or other beneficiary' (Appendices A and B of the draft IFRS, paragraphs BC10-BC39 of the Basis for Conclusions and IG Example 1 in the draft Implementation Guidance).

Is this definition, with the related guidance in Appendix B of the draft IFRS and IG Example 1, appropriate? If not, what changes would you suggest, and why?

Reply: In spite of all of the guidance offered in Appendix B and IG, Example 1, it will be difficult to determine if a contract includes a "significant risk" or not, which is something that can reduce comparability between preparers of accounting information. The wording of Appendix B, B23, could be interpreted as when there is more than just a trivial change of the present value of the net cash flow there is a significant insurance risk. This broadens the meaning of significant compared to other standards where the word significant is used, for example IAS 1 p. 23 and IAS 8 p. 6.

Question 3 – Embedded derivatives

(a) *IAS 39 Financial Instruments: Recognition and Measurement requires an entity to separate some embedded derivatives from their host contract, measure them at fair value and include changes in their fair value in profit or loss. This requirement would continue to apply to a derivative embedded in an insurance contract, unless the embedded derivative:*

(i) meets the definition of an insurance contract within the scope of the draft IFRS; or

(ii) is an option to surrender an insurance contract for a fixed amount (or for an amount based on a fixed amount and an interest rate).

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However, an insurer would still be required to separate, and measure at fair value:

(i) a put option or cash surrender option embedded in an insurance contract if the surrender value varies in response to the change in an equity or commodity price or index; and

(ii) an option to surrender a financial instrument that is not an insurance contract.

(paragraphs 5 and 6 of the draft IFRS, paragraphs BC37 and BC118-BC123 of the Basis for Conclusions and IG Example 2 in the draft Implementation Guidance)

Are the proposed exemptions from the requirements in IAS 39 for some embedded derivatives appropriate? If not, what changes should be made, and why?

(b) Among the embedded derivatives excluded by this approach from the scope of IAS 39 are items that transfer significant insurance risk but that many regard as predominantly financial (such as the guaranteed life-contingent annuity options and guaranteed minimum death benefits described in paragraph BC123 of the Basis for Conclusions). Is it appropriate to exempt these embedded derivatives from fair value measurement in phase I of this project? If not, why not? How would you define the embedded derivatives that should be subject to fair value measurement in Phase I?

(c) The draft IFRS proposes specific disclosures about the embedded derivatives described in question 3(b) (paragraph 29(e) of the draft IFRS and paragraphs IG54-IG58 of the draft Implementation Guidance). Are these proposed disclosures adequate? If not, what changes would you suggest, and why?

(d) Should any other embedded derivatives be exempted from the requirements in IAS 39? If so, which ones and why?

<u>Reply to (a)-(c):</u> Yes.

<u>Reply (d):</u> No.

Question 4 – Temporary exclusion from criteria in IAS 8

(a) Paragraphs 5 and 6 of [the May 2002 Exposure Draft of improvements to] IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors specify criteria for an entity to use in developing an accounting policy for an item if no IFRS applies specifically to that item. However, for accounting periods beginning before 1 January 2007, the proposals in the draft IFRS on insurance contracts would exempt an insurer from applying those criteria to most aspects of its existing accounting policies for:

(i) insurance contracts (including reinsurance contracts) that it issues; and

(ii) reinsurance contracts that it holds.

(paragraph 9 of the draft IFRS and paragraphs BC52-BC58 of the Basis for Conclusions).

Is it appropriate to grant this exemption from the criteria in paragraphs 5 and 6 of [draft] IAS 8? If not, what changes would you suggest and why?

(b) Despite the temporary exemption from the criteria in [draft] IAS 8, the proposals in paragraphs 10-13 of the draft IFRS would:

(i) eliminate catastrophe and equalisation provisions.

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(ii) require a loss recognition test if no such test exists under an insurer's existing accounting policies.

(iii) require an insurer to keep insurance liabilities in its balance sheet until they are discharged or cancelled, or expire, and to report insurance liabilities without offsetting them against related reinsurance assets (paragraphs 10-13 of the draft IFRS and paragraphs BC58-BC75 of the Basis for Conclusions).

Are these proposals appropriate? If not, what changes would you propose, and why?

Reply to (a): Yes.

Reply to (b): Yes.

Question 5 – Changes in accounting policies

The draft IFRS:

(a) proposes requirements that an insurer must satisfy if it changes its accounting policies for insurance contracts (paragraphs 14-17 of the draft IFRS and paragraphs BC76-BC88 of the Basis for Conclusions).

(b) proposes that, when an insurer changes its accounting policies for insurance liabilities, it can reclassify some or all financial assets into the category of financial assets that are measured at fair value, with changes in fair value recognised in profit or loss (paragraph 35 of the draft IFRS).

Are these proposals appropriate? If not, what changes would you propose and why?

Reply: Yes.

Question 6 – Unbundling

The draft IFRS proposes that an insurer should unbundle (ie account separately for) deposit components of some insurance contracts, to avoid the omission of assets and liabilities from its balance sheet (paragraphs 7 and 8 of the draft IFRS, paragraphs BC30-BC37 of the Basis for Conclusions and paragraphs IG5 and IG6 of the proposed Implementation Guidance).

(a) Is unbundling appropriate and feasible in these cases? If not, what changes would you propose and why?

(b) Should unbundling be required in any other cases? If so, when and why?

(c) Is it clear when unbundling would be required? If not, what changes should be made to the description of the criteria?

Reply to (a): Yes, during Phase I it is feasible to propose that unbundling shall take place in the cases in question. Although, from BC34 in Basis for Conclusions, it can be seen that the issue of determining which components are to be unbundled and reported according to IAS 39 is to be the subject of further assessment and discussion during Phase II. If the Board can

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foresee that Phase II will imply that a number of components will be transferred from the standard regarding insurance contracts to IAS 39, this may cause an undesired number of changes in the financial reporting from the present situation to Phase II. Investment contracts and certain unbundling would be addressed during Phase I and further unbundling would be addressed in Phase II.

Reply to (b): No, not during Phase I.

Reply to (c): Yes.

Question 7 – Reinsurance purchased

The proposals in the draft IFRS would limit reporting anomalies when an insurer buys reinsurance (paragraphs 18 and 19 of the draft IFRS and paragraphs BC89-BC92 of the Basis for Conclusions).

Are these proposals appropriate? Should any changes be made to these proposals? If so, what changes and why?

Reply: Yes. We believe that there is no major reason to wait with all of the issues regarding reinsurance until Phase II.

Question 8 - Insurance contracts acquired in a business combination or portfolio transfer

IAS 22 Business Combinations requires an entity to measure at fair value assets acquired and liabilities assumed in a business combination and ED 3 Business Combinations proposes to continue that long-standing requirement. The proposals in this draft IFRS would not exclude insurance liabilities and insurance assets (and related reinsurance) from that requirement. However, they would permit, but not require, an expanded presentation that splits the fair value of acquired insurance contracts into two components:

(a) a liability measured in accordance with the insurer's accounting policies for insurance contracts that it issues; and

(b) an intangible asset, representing the fair value of the contractual rights and obligations acquired, to the extent that the liability does not reflect that fair value. This intangible asset would be excluded from the scope of IAS 36 Impairment of Assets and IAS 38 Intangible Assets. Its subsequent measurement would need to be consistent with the measurement of the related insurance liability. However, IAS 36 and IAS 38 would apply to customer lists and customer relationships reflecting the expectation of renewals and repeat business that are not part of the contractual rights and obligations acquired.

The expanded presentation would also be available for a block of insurance contracts acquired in a portfolio transfer (paragraphs 20-23 of the draft IFRS and paragraphs BC93-BC101 of the Basis for Conclusions).

Are these proposals appropriate? If not, what changes would you suggest and why?

Reply: Yes.

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Question 9 – Discretionary participation features

The proposals address limited aspects of discretionary participation features contained in insurance contracts or financial instruments (paragraphs 24 and 25 of the draft IFRS and paragraphs BC102-BC108 of the Basis for Conclusions). The Board intends to address these features in more depth in phase II of this project.

Are these proposals appropriate? If not, what changes would you suggest for phase I of this project and why?

Reply: Yes, with the following comment. On the basis of paragraph 24, a company can choose to report the fixed element together with the discretionary participation feature and the unallocated surplus can either be classified as a liability or as equity. However, we are of the opinion that it should be clarified that the portion which the company is committed to pay (its contractual liability) should always be reported as a liability.

Question 10 – Disclosure of the fair value of insurance assets and insurance liabilities

The proposals would require an insurer to disclose the fair value of its insurance assets and insurance liabilities from 31 December 2006 (paragraphs 30 and 33 of the draft IFRS, paragraphs BC138-BC140 of the Basis for Conclusions and paragraphs IG60 and IG61 of the draft Implementation Guidance).
Is it appropriate to require this disclosure? If so, when should it be required for the first time? If not, what changes would you suggest and why?

Reply: At this stage, ie in Phase I, we believe that entities should be encouraged rather than required to disclose the fair value of insurance assets and insurance liabilities, and, if they do, require them to disclose how they have defined the fair value. We do not believe that a requirement to disclose the fair value of insurance assets and insurance liabilities is appropriate as long as there is no definition on how the fair value is to be determined.

Question 11 – Other disclosures

(a) The Exposure Draft proposes requirements for disclosures about the amounts in the insurer's financial statements that arise from insurance contracts and the estimated amount, timing and uncertainty of future cash flows from insurance contracts (paragraphs 26-29 of the draft IFRS, paragraphs BC124-BC137 and BC141 of the Basis for Conclusions and paragraphs IG7-IG59 of the draft Implementation Guidance).
Should any of these proposals be amended or deleted? Should any further disclosures be required? Please give reasons for any changes you suggest.
To a large extent, the proposed disclosures are applications of existing requirements in IFRSs, or relatively straightforward analogies with existing IFRS requirements. If you propose changes to the disclosures proposed for insurance contracts, please explain what specific attributes of insurance contracts justify differences from similar disclosures that IFRSs already require for other items.

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(b) The proposed disclosures are framed as high level requirements, supplemented by Implementation Guidance that explains how an insurer might satisfy the high level requirements.
Is this approach appropriate? If not, what changes would you suggest, and why?

(c) As a transitional relief, an insurer would not need to disclose information about claims development that occurred earlier than five years before the end of the first financial year in which it applies the proposed IFRS (paragraphs 34, BC134 and BC135).
Should any changes be made to this transitional relief? If so, what changes and why?

Reply: The proposed disclosure requirements will, according to our opinion, provide the market with improved information regarding the accounting of insurance contracts and regarding the companies' risks.

Question 12 – Financial guarantees by the transferor of a non-financial asset or liability

The Exposure Draft proposes that the transferor of a non-financial asset or liability should apply IAS 39 Financial Instruments: Recognition and Measurement to a financial guarantee that it gives to the transferee in connection with the transfer (paragraphs 4(e) of the draft IFRS, C5 of Appendix C of the draft IFRS and BC41-BC46 of the Basis for Conclusions). IAS 39 already applies to a financial guarantee given in connection with the transfer of financial assets or liabilities.

Is it appropriate that IAS 39 should apply to a financial guarantee given in connection with the transfer of non-financial assets or liabilities? If not, what changes should be made and why?

Reply: Yes.

Question 13 – Other comments

Do you have any other comments on the draft IFRS and draft Implementation Guidance?

Reply: No.

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The Swedish Financial Accounting Standards Council

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