

October 30th 2003

Sir David Tweedie
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
England

Dear Sir David Tweedie,

Comments on “Exposure draft ED 5 Insurance contracts.”

The Swedish Insurance Federation is the trade association for insurance companies.

We have recently concluded discussions within the Federation regarding the impact of ED 5 on the financial statements of insurance companies. Most of our comments are included in the comment letter from the *Comité Européen des Assurances*. However, on **Question 9, Discretionary participation features**, we would like to highlight an issue that is important for most life insurance companies in Sweden.

In paragraph 24 (b) in the ED5 it is stated that unallocated surplus arising from discretionary participation features shall be classified as either liability or equity. Therefore an entity can choose to classify these items as liabilities in case this outweighs some of the volatility arising from the measurement of financial instruments at fair value. We therefore understand that there is a need to classify funds stemming from discretionary participation features as liabilities.

Most Swedish life insurance companies have a Bonus reserve in the balance sheet. The reserve consists of accumulated surpluses that have been allocated to an account value as well as unallocated surpluses. The company can allocate these bonuses at discretion with regards to the actual policyholders receiving them as well as to when the bonuses are distributed. Thus, the discretionary reserves are classified as equity under Swedish GAAP. Since most Swedish life insurers operate under the principle of mutuality, their solvency is to a large extent based on these Bonus reserves.

The need for caution in classification of these reserves is explained by the fact that traditional life insurance in Sweden operates with a system where the link between the individual policyholders actual claim and his possible part of the surplus on the one side and the balance sheet proper on the other is a shadow balance sheet. Here the concept of “allocated bonus” which is credited to the individual policyholder and comes out of the annual bonus rate is accounted for. However the amounts that have been allocated are discretionary in the sense that the insurer can retract these amounts when they are not feasible. This right is not only a theoretical right. Swedish life insurers have retracted preliminarily “allocated bonuses” from the policyholders as a result of the decline in the financial markets.

We would therefore like to emphasise the need for the option that the IASB has suggested in the ED5, it is vital that unallocated surplus arising from discretionary participation features shall be classified as either liability or equity. We would also like to underline that the classification must be carefully evaluated under phase II of the insurance project.

Yours sincerely

Annika Lundius