



Svenska Aktuarieföreningen

31 October 2003

Peter Clark Esq.
Senior Project Manager
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Comments of Svenska Aktuarieföreningen regarding Exposure Draft 5 Insurance Contracts

Dear Mr Clark,

We have pleasure in enclosing our comments to Exposure Draft 5 Insurance Contracts ("ED 5") on behalf of Svenska Aktuarieföreningen (the Swedish Society of Actuaries).

Svenska Aktuarieföreningen supports the development of international financial reporting standards based on a fair value approach and the principles included in ED 5.

Having stated the above, we would like to express our concerns regarding a few issues addressed in ED 5.

Overall, Svenska Aktuarieföreningen believes that in order to represent an important advance in the development of international standards, the coming IFRS should, to the extent possible, be based on principles rather than detailed rules. We believe that a principle based approach gives the best route to develop pragmatic solutions, without affecting the quality of the reporting standard as such. This may prove crucial in light of the proposed timetable, which is another area of concern for Svenska Aktuarieföreningen. We would like to stress the importance of pragmatic approaches both in phase I and phase II in order to avoid extensive and detailed implementation work for companies with the likely outcome being only minor influence on the accounts.

We propose that in cases where the principle-based approach is in our view not fully adopted in ED 5, the move towards such approach should be the first priority. Thus, for the reasons outlined above, we propose the issue of unbundling be thoroughly considered and resolved prior to implementation. **We therefore suggest that it should be postponed to phase II.**

Below we summarise our comments on a few items we would like to address in particular.

Discretionary participation features/performance linkage

We do not support the view of unallocated surplus from a discretionary participation feature constituting either an equity or a liability. In order to support our opinion we give a brief description of the Swedish bonus system for participating business.

Swedish life insurance companies operating on mutual lines¹ calculate smoothed asset shares on a non-guaranteed basis (that is, giving the company the right to withdraw it in certain circumstances). The smoothed asset shares are typically calculated for individual policies. Based on these, a bonus is paid on claims and/or maturities, similarly to the UK terminal bonus. The policyholders are informed of the development of the smoothed asset shares and of the terminal bonus that they might lead to (and also of the fact that the smoothed asset share and the hypothetical terminal bonus might decrease in case of unfavourable developments of the asset values). The difference between the market value of assets and the sum of the guaranteed liabilities and the smoothed asset shares is kept as buffer capital. During the latest period of depressed financial markets the companies have started to exercise the above mentioned right to momentarily withdraw parts of the smoothed asset shares in order to restore the buffer capital. Many of them have introduced market value adjustments at surrender. This proves that the smoothed asset shares may be transferred to buffer capital and thus can not be regarded as liability.

We could also imagine a mutual life insurer in a run-off state, where all assets belong to the present policyholders and should be distributed to them over the lifetime of the company and the policies. We are afraid that, with the suggested rules, all assets have to be linked to corresponding liabilities and that therefore, by definition, a mutual company could never show solvency capital under IAS.

Based on the above, we suggest that **the option to classify unallocated surplus as either liability or equity should be left in the final IFRS.**

¹ By far the majority of the traditional business in Sweden with SEK 958 billion of assets under management.

Minimum deposit floor

The application of a deposit floor, as stated in ED 5 Basis of Conclusions paragraph 117 e), under a fair value measure would typically imply that an insurer would report significant losses during the issue year of the contract. The requirement as such we believe is contradictory to the fair value concept and not in line with common pricing techniques for financial instruments. We suggest the paragraph be deleted as it introduces performance reporting on an unnecessarily prudent basis.

Regarding other issues addressed in ED 5 we strongly support the views of the International Actuarial Association (IAA) as expressed in its draft comments as of 20 October 2003, with the exception of additional comments set out below:

1. We support the view of the IAA that weather derivatives used to hedge weather risk should be accounted for within the insurance rules. We would like to point out that there are other types of risks where the same type of problem might appear. One example is contingency insurance: assume that a football club purchases an insurance against winning a game (insurable interest: bonus payable to the players). This is an example of an insurance contract that could be hedged on the gambling market. In order to avoid accounting anomalies, such a hedge should be accounted for according to insurance principles. Generally, the principle could be that a contract written in order to hedge insurance risk should be accounted for as insurance contracts, even if it is written outside the insurance market.
2. According to the suggested rules, the risk of loss of future earnings from a contract at surrender does not make the contract an insurance contract. This principle is supported by the IAA even though IAA does not wish to use the "insurable interest" criterion as such. We understand this view in the context of the direct contract, but would like to point out that the situation might be different in the following step. A block of contracts might be protected against losses at surrender of future earnings by means of a contract with a reinsurer. Such a contract protects the insurer against losses from possible future events and therefore fulfils the requirements for being an insurance contract. As it is written by a reinsurer and would be defined as reinsurance in most legislations, the practical view is that it should be accounted as reinsurance within the IAS framework.
3. The IAA wisely points out that following strict rules often leads to extensive effort with minor effects on the final result. We suggest an inclusion of some kind of general materiality rule in order to specify that detailed calculations requiring extensive efforts without material effect on the final result do not have to be carried out, and that approximations should be allowed if they give results that do not materially differ from the results of more precise calculations.

Yours faithfully,

A handwritten signature in dark ink, appearing to read 'Jan Hagberg', with a stylized, sweeping flourish at the end.

Jan Hagberg
President