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Exposure Draft ED/2010/8

Insurance Contracts

The Swedish Enterprise Accounting Group (SEAG) is a forum for the Chief Accountants from the largest Swedish listed companies outside the financial sector. SEAG is administered by the Confederation of Swedish Enterprise, to which most participating companies of SEAG are joined. Representing preparers' point of view, SEAG welcomes the opportunity to comment on the above-mentioned Exposure Draft.

We believe that the ED is a significant improvement in relation to the DP. In our opinion, the proposed expected cash flow model would – in broad terms – be possible to apply by life insurance companies and provide useful information to the readers of their financial statements. On the other hand, we believe that the simplified Premium Allocation Approach would be appropriate for most business conducted by non-life insurance companies, irrespective of the fact that some contracts might be longer than the stipulated twelve months.

One question of importance is the boundary between insurance contracts and other types of contracts (e.g. fixed fee contracts), since the accounting models are substantially different. It is important that clear guidance is given on this issue.

In the Appendix, we have answered some of the questions raised by the Board. Our focus is on questions that have relevance for companies in SEAG.

We are pleased to be at your service in case further clarification to our comments will be needed.

Yours sincerely,

CONFEDERATION OF SWEDISH ENTERPRISE

Dr Claes Norberg
Professor, Director Accountancy
Secretary of the Swedish Enterprise Accounting Group

Appendix

Question 1 – Relevant information for users (paragraphs BC13–BC50)

Do you think that the proposed measurement model will produce relevant information that will help users of an insurer's financial statements to make economic decisions? Why or why not? If not, what changes do you recommend and why?

The proposed measurement model will produce relevant information for insurers writing various insurance policies in the pension/savings area. On the other hand, is it our opinion that the model will not achieve this for property and casualty insurers. It might even be so that it will give a misrepresenting picture of the company's situation.

Question 2 – Fulfilment cash flows (paragraphs 17(a), 22–25, B37–B66 and BC51)

(a) Do you agree that the measurement of an insurance contract should include the expected present value of the future cash outflows less future cash inflows that will arise as the insurer fulfils the insurance contract? Why or why not? If not, what do you recommend and why?

(b) Is the draft application guidance in Appendix B on estimates of future cash flows at the right level of detail? Do you have any comments on the guidance?

The expected present value of future cash in- and outflows is important for savings products but of limited value for the whole group of insurance companies conducting property and casualty insurance business. Almost all policies in this area are short-duration contracts.

Question 3 – Discount rate (paragraphs 30–34 and BC88–BC104)

(a) Do you agree that the discount rate used by the insurer for non-participating contracts should reflect the characteristics of the insurance contract liability and not those of the assets backing that liability? Why or why not?

(b) Do you agree with the proposal to consider the effect of liquidity, and with the guidance on liquidity (see paragraphs 30(a), 31 and 34)? Why or why not?

(c) Some have expressed concerns that the proposed discount rate may misrepresent the economic substance of some long-duration insurance contracts. Are those concerns valid? Why or why not? If they are valid, what approach do you suggest and why?

For example, should the Board reconsider its conclusion that the present value of the fulfilment cash flows should not reflect the risk of non-performance by the insurer?

We agree with the principles. We are of the opinion that the present value of fulfillment cash flows should not reflect the non-performance risk by the insurer.

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Question 4 – Risk adjustment versus composite margin (paragraphs BC105–BC115)

Do you support using a risk adjustment and a residual margin (as the IASB proposes), or do you prefer a single composite margin (as the FASB favours)? Please explain the reason(s) for your view.

We support the proposal to use a risk adjustment and a residual margin. It is our opinion that a separate risk adjustment will better reflect the situation for the insurance industry.

Question 8 – Premium allocation approach

(a) Should the Board (i) require, (ii) permit but not require, or (iii) not introduce a modified measurement approach for the pre-claims liabilities of some short-duration insurance contracts? Why or why not?
(b) Do you agree with the proposed criteria for requiring that approach and with how to apply that approach? Why or why not? If not, what do you suggest and why?

(a) Considering that there are a great variety of insurance companies with very different business models, insurance products and capacity to deal with complex accounting requirements, it is essential that there is a modified model. We therefore conclude that a simplified model should be allowed for short-duration contracts and it should be permitted but not required, i.e. (ii), to use this model. If permitted but not required we believe each type of insurance company can find a way to account for their insurance contracts in the most appropriate way.

(b) We do agree with the proposed model as we consider that it will imply a simplification. As the proposed model is valid for insurance contracts with a coverage period equal to or less than one year, the likelihood of e.g. a claim development experience different from the expected is less compared to long-term contracts. We therefore consider that measuring pre-claims obligations at initial recognition as proposed in paragraph 57 would be appropriate for short-term contracts. However, we believe that the application of the model should be widened, so that insurance contracts with similar characteristics, meeting the condition in paragraph 54(b), should not be precluded just because their contract term exceeds twelve months.

Question 13 – Presentation

(a) Will the proposed summarised margin presentation be useful to users of financial statements? Why or why not? If not, what would you recommend and why?
(b) Do agree that an insurer should present all income and expense arising from insurance contracts in profit or loss? Why or why not? If not, what do you recommend and why?

(a) We do not believe that the summarised margin approach will be appropriate to present property and casualty insurance and that a more traditional model as outlined in paragraph 75 (a) would be preferable.

Question 14 – Disclosures

(a) Do you agree with the proposed disclosure principle? Why or why not? If not, what would you recommend, and why?

(b) Do you think the proposed disclosure requirements will meet the proposed objective? Why or why not?
(c) Are there any disclosures that have not been proposed that would be useful (or some proposed that are not)? If so, please describe those disclosures and explain why they would or would not be useful.

We believe that the disclosure requirements are too onerous and that the aim should be to focus on the minimum number of requirements that are proven to be useful for the users of financial statements. Our experience from contacts with professional analysts is that very little focus is spent on the annual report in general and on the disclosures in particular.

Question 16 – Reinsurance

(a) Do you support an expected loss model for reinsurance assets? Why or why not? If not, what do you recommend and why?
(b) Do you have any other comments on the reinsurance proposals?

It is difficult to handle the default risk of reinsurers due to the fact that reinsurance companies write very different types of portfolios with very different risk profiles. An expected loss model will probably be difficult to use in case of very low frequency but very high severity reinsurance.

Question 17 – Transition and effective date

(a) Do you agree with the proposed transition requirements? Why or why not? If not, what would you recommend and why?
(b) If the Board were to adopt the composite margin approach favoured by the FASB, would you agree with the FASB's tentative decision on transition (see the appendix to the Basis for Conclusions)?
(c) Is it necessary for the effective date of the IFRS on insurance contracts to be aligned with that of IFRS 9? Why or why not?
(d) Please provide an estimate of how long insurers would require to adopt the proposed requirements.

(a) We believe that the proposed transition requirements do not deal with the transition from an 'old' UPR model into the 'new' PAA approach in an appropriate way.

Question 18 – Other comments

Do you have any other comments on the proposals in the exposure draft?

In paragraph 4 (e), the Board proposes to exclude fixed-fee service contracts from the scope of the proposed IFRS if their primary purpose is the provision of services. Whilst we agree to exclude fixed-fee service contracts from the scope of the standard, there are other types of contracts for which guidance also is needed, e.g. spare parts contracts. According to our view, such contracts should not be classified as insurance contracts. For that reason, we suggest the following guidance.

“The Board proposes to exclude fixed-fee service contracts from the scope of the proposed IFRS if the primary purpose according to the business model of the entity is the provision of services.”