Sir David Tweedie, Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

ED 5 Insurance Contracts

Dear Sir David,

Finansinspektionen (FI), the financial supervisory authority in Sweden, has previously commented on the ED5. We did not make any specific comments regarding question 7 – Reinsurance. Since then we have learned that important commentators such as EFRAG, in general recommend that the treatment of all aspects of reinsurance accounting be addressed in phase II and not in phase I. EFRAGS's line of reasoning is relevant, though we believe that some guidance in the standard is necessary in order to attain a transition under orderly conditions of insurance companies' accounting practices. We therefore would like to offer some additional comments and suggestions on the matter of accounting for cedants (i.e. an insurer that is a policyholder under a reinsurance contract).

Our suggestions

We suggest an interim standard for ceded reinsurance in three parts: an explicit requirement to classify contracts in accordance with the principle of substance over form, an explicit impairment test and a specific disclosure requirement. If a classification of life insurance contracts is introduced in phase I, this interim standard should also apply to life business reinsurance. A standard could read as follows.

Substance over form

If a contract has the legal form of a reinsurance contract but a different economic substance, the contract should be accounted for in accordance with the economic substance.

Impairment test

A cedant shall recognise a loss if the carrying amount of a reinsurance contract is significantly greater than the estimated recoverable amount under the reinsurance contract. The recoverable amount of a reinsurance contract is the net present value of future cash inflows (+), cash outflows (–), and the reinsurance premium the market would charge (+) for the future reinsurance protection. The calculation must be done on the basis of recognised actuarial methods. Cash flows shall be discounted if, and only if, discounting was used when calculating the provision for the ceded insurance contracts.

The loss shall reduce the value of the reinsurance asset. If the recoverable amount is negative, and the loss thus cannot be fully met by reducing the value of the reinsurance asset, a provision shall be recognised. The amount of the loss shall be included in the profit or loss for the period.

Subsequently, if there is a significant change in the assumptions used when calculating the recoverable amount, the loss shall be reversed. The reversal may not result in a higher carrying amount for the reinsurance asset than if the loss originally had not been recognised. The amount of the reversal shall be included in the net profit or loss for the period.

Disclosure requirement

If an insurance company reinsures incurred claims for which that technical provisions have been made, the company should disclose how the reinsurance affects the balance sheet, the profit and loss statement and relevant key ratios.

Comments

A proper application of the proposed definition of an insurance contract would probably in most cases result in a correct classification of contracts that allegedly are insurance contracts. However, we believe that the occasionally multifaceted nature of reinsurance contracts justifies an explicit requirement to classify them in accordance with their substance. We are particularly concerned with the possibility that contracts that in substance are loans will be given the form of retrospective reinsurance of incurred claims. The reason we suggest a specific disclosure requirement, is to capture such retrospective reinsurance.

Sincerely,

Gent Jansson

Finansinspektionen