

BERMUDA MONETARY AUTHORITY

INSURANCE DEPARTMENT

GUIDANCE NOTE #18

ACCOUNTING FOR INVESTMENTS IN AFFILIATES

December 2008

GUIDANCE NOTE #18: ACCOUNTING FOR INVESTMENTS IN AFFILIATES

Application

1. This guidance is issued to assist all insurers registered under the Insurance Act 1978 (as amended) who report an amount on Line 4 of the Statutory Balance Sheet: Investment in and Advances to Affiliates in accordance with the Insurance Accounts Regulations 1980 (“the Regulations”); and sets out the Authority’s views on accounting regarding investments in affiliates.

Guidance

2. Currently the Regulations require insurers to account for their subsidiaries and other investments in affiliates (collectively “affiliates”) either by the cost method of valuation or the equity method of valuation, provided that if the equity method valuation is lower than cost then the equity of method must be used. There is also an overriding requirement that if, in the opinion of the directors, the fair value of the investment determined in good faith is lower than the cost or equity method valuations, then this lower value must be used.
3. The issue arises because the Regulations are silent on which basis of accounting an affiliate must use in determining its equity valuation. Thus, if the equity value of the affiliate is calculated using generally accepted accounting principles (US, Canadian, IAS or UK), the value could be overstated due to the inclusion of certain assets that are not admitted under the Act (eg. deferred acquisition costs, prepaid expenses) or exclusion of certain liabilities that are required to be booked under the Regulations (eg. letters of credit/guarantees issued by the affiliate not in support of its insurance operations).
4. An insurer, when calculating the value of an investment in an affiliate using the equity method, whether for the purpose of determining the equity value at which to carry it, or when comparing cost to equity to check for impairment, must exclude those assets considered “non-admitted” as defined in the Regulations. Further, any additional liabilities that would be required under the Act must be recognized, e.g. the affiliate’s balance sheet must be prepared in accordance with the provisions of the Act in determining its equity value. This would include any letters of credit or guarantees issued by the affiliate not in support of its or its parent’s insurance operations.
5. Appendix A attached hereto sets out an example for valuing investments in affiliates.

If you have questions in relation to this or other guidance issued by the Authority, please email policy@bma.bm. Please include the wording “Insurance Guidance” in the title of your email.

Appendix A:

At the start of 2007 InsuranceCo, a Bermuda domiciled reinsurer, capitalizes an insurance subsidiary, InsuranceSub, in the USA with \$1 million of cash. At the end of 2007 InsuranceSub's balance sheet is as follows, under US GAAP:

Cash and investments	\$ 3,000,000
Premiums receivable	500,000
Deferred acquisition costs	300,000
Total assets	<u>\$ 3,800,000</u>
Outstanding losses	\$ 1,600,000
Unearned premiums	1,000,000
Total liabilities	<u>\$ 2,600,000</u>
Share capital	\$ 1,000,000
Retained earnings	200,000
Total equity	<u>\$ 1,200,000</u>

What is the value that InsuranceCo should record on line 4 of its statutory balance sheet for its investment in InsuranceSub?

In this case the deferred acquisition costs are a non-admitted asset under the Regulations and thus the maximum value that InsuranceCo can record on line 4 is \$900,000 (equity of \$1,200,000 less the \$300,000 in non-admitted assets). As the equity value of the affiliate for the purposes of the Statutory Return is \$900,000, which is less than cost, it must be recorded in line 4 at the equity value even if InsuranceCo's accounting policy is to record investments in affiliates at cost.