INSURANCE - SWEDEN

Supreme Administrative Court rules on classification of insurance-based investment products

12 May 2020 | Contributed by Mannheimer Swartling

Introduction

In early 2019 the Council for Advance Tax Rulings declared that a unit-linked insurance plan where the beneficiary was entitled to 99% of the policy value on the realisation of the insured risk, without receiving any risk compensation from the insurer, did not constitute an insurance product (100-17/D of 20 February 2019). The principal matter addressed by the council was whether the product in question qualified as so-called 'endowment insurance' ('*kapitalförsäkring*') under Swedish law (roughly equivalent to a unit-linked insurance policy) (for further details please see "New guidance on classification of insurance-based investment products"). The case was appealed to the Supreme Administrative Court, which recently confirmed the council's ruling.

This article covers the Supreme Administrative Court's recent judgment and provides a brief overview of the regulation of Swedish insurance-based investment products and the previous case law relevant in this regard.

Insurance-based investment products and their classification

Swedish endowment insurance is a form of life insurance that allows the policyholder to invest a certain premium into the policy and pays out a percentage of the value of the policy on the death of the policyholder or the surrender of the policy. A key provision of the insurance policy is that the policyholder may invest the capital in underlying assets (eg, financial instruments), making it a form of unit-linked insurance policy. It is the insurer that owns any underlying assets and not the policyholder. Moreover, an endowment insurance policy is subject to an annual yield tax based on the value of the policy; thus, no tax is payable on any capital gains on the assets held under the policy.

Since the main purpose of the insurance policy typically is to serve as a form of investment vehicle for the underlying assets, not as a traditional insurance policy, the percentage of the value of the policy that the insurer will be liable to pay on the occurrence of the insured event (typically the death of the policyholder) is usually low. A question that regulators and insurers have repeatedly asked is how the policy must be structured and to what extent the insurer must assume risk in order for the product to actually constitute an insurance policy. The Supreme Administrative Court had previously found that insurance policies where the beneficiary was entitled to 99% of the policy value (in exchange for so-called 'risk compensation' from the insurer) or 101% of the policy value (in exchange for a risk premium from the insured) on the realisation of the insured risk constitute insurance products (HFD 2015 note 54 and RÅ 1994 notes 19 and 20). However, the Supreme Administrative Court also determined that a unit-linked insurance plan with a risk element of 0.1% (ie, the insured was entitled to 100.1% of the policy value on realisation of the insured risk) and a yearly premium of 1.2% was irrelevant from an insurance perspective, meaning that the Supreme Administrative Court did not consider that the contract constituted an insurance product (RÅ 2008 ref 54).

Supreme Administrative Court judgment

In the Supreme Administrative Court's recent judgment, it had to determine whether an insurance policy where the beneficiary was entitled to 99% of the policy value on the occurrence of the insured

AUTHORS

Hans Hammarbäck

Erik Schultz

Kevin Perback

event, with no risk compensation from the insurer, could be considered as an insurance product from a tax perspective (HFD case 1422-19).

Initially, the court concluded that a contract must constitute a life insurance product in order for it to be possible to categorise it as an endowment insurance policy. However, as there is no definition of 'life insurance' under Swedish tax law, the court took guidance from Swedish insurance law. By way of review of the relevant preparatory works and previous case law, the court established that in order for a contract to constitute a life insurance product, there must be a risk element that is covered by the insurance product. The court found that the core of insurance is the pooling of insurance risks within a collective of insureds. This type of risk pooling is what separates insurance products from other forms of financial product.

On the face of the contract at hand, it was the policyholder (and beneficiaries) who bore the risk of the death of the policyholder (the beneficiary would receive only 99% of the policy value on the death of the policyholder). The policyholder received no form of compensation from the insurer for bearing of this risk. Therefore, as the contract consequently could not be deemed to entail any form of risk pooling among the insureds, the court concluded that the contract did not constitute an insurance product.

Comment

The Supreme Administrative Court's recent judgment clarified that contracts where the policyholder bears the risk element without any form of risk compensation from the insurer will not be considered an insurance product. However, uncertainties remain concerning how such compensation must be structured, as well as the minimum extent of risk transfer. For example, in previous cases, the risk compensation was in the form of a direct payment from the insurer to the insured. The court did not touch on the structure of the risk compensation in the recent case, leaving it somewhat uncertain as to whether some indirect form of risk compensation would be acceptable. Nevertheless, there appears to be no clear reason why risk compensation could not be transferred indirectly from the insurer to the insured (eg, by way of reduced management fees).

In addition, in light of the previously mentioned case where the court rejected a contract with a risk element of 0.1% as an insurance product, it would appear that the risk element cannot be too insignificant (RÅ 2008 ref 54). However, in that specific case the court did not clearly elaborate on whether it is the actual size of the risk that made the contract irrelevant from an insurance perspective or whether other factors were involved. On the face of that case, the relationship between the risk element and premium level appears to have been the deciding factor, rather than the size of the risk element itself. Therefore, it seems reasonable to conclude that a risk element that is less than 1% may be possible if the premium level or risk compensation is reasonable in relation to the risk element.

Although difficult in practice, insurers and insured alike would greatly benefit if these and similar uncertainties were clarified, making the demarcation between insurance-based investment products and other investment products clear cut. Uncertainty in such an important classification between an insurance product and a financial product may lead to burdensome consequences for both insurers and insured (eg, tax, regulatory or other financial implications). Therefore, further clarification on the subject is important, a process which could be sped up through the readily available system of advance tax rulings.

For further information on this topic please contact Hans Hammarbäck, Erik Schultz or Kevin Perback at Mannheimer Swartling by telephone (+46 859 506 426) or email (hans.hammarback@msa.se, erik.schultz@msa.se or kevin.perback@msa.se). The Mannheimer Swartling website can be accessed at www.mannheimerswartling.se.