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STAFF PAPER

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Project	**Transition Resource Group for IFRS 17 *Insurance Contracts***		
Paper topic	Investment components within an insurance contract		

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Introduction

1. We have received a number of submissions about investment components as defined in IFRS 17 *Insurance Contracts*. The submissions question how to:
   - (a) determine whether an insurance contract includes an investment component;
   - (b) assess whether an investment component is distinct—IFRS 17 requires an entity to separate a distinct investment component from an insurance contract and to account for the distinct investment component applying IFRS 9 *Financial Instruments*; and
   - (c) determine the amount of an investment component.
2. The objective of the paper is to provide background and an accounting analysis to support discussion at the Transition Resource Group for IFRS 17 (TRG).

Structure of the paper

3. This paper includes the following:

   (a) implementation questions (paragraphs 5–6 of this paper); and

   (b) review of and staff observations on the accounting requirements relating to:

      (i) determining whether an insurance contract includes an investment component (paragraphs 7–10 of this paper);

      (ii) assessing whether an investment component is distinct (paragraphs 11–19 of this paper); and

      (iii) determining the amount of an investment component (paragraphs 20–21 of this paper).

4. Appendix A to this paper analyses some examples of insurance contracts in the light of those observations.

Implementation questions

5. The submissions provide examples of insurance contracts and question, for some or all of those examples, how to:

   (a) determine whether an insurance contract includes an investment component;

   (b) assess whether an investment component is distinct; and

   (c) determine the amount of an investment component.

6. The submissions include different views for each of the questions in paragraph 5 of this paper, considering the fact patterns of each example. Some of the examples of insurance contracts provided in the submissions are discussed in Appendix A to this paper.

Review of and staff observations on the accounting requirements

Determining whether an insurance contract includes an investment component

Definition of an investment component

7. Appendix A of IFRS 17 defines an investment component as:

> The amounts that an insurance contract requires the entity to repay to a policyholder even if an insured event does not occur.

Aspects to consider when determining whether an insurance contract includes an investment component

8. The staff observe that the definition of an investment component refers to a payment that is required 'even if an insured event does not occur'. Paragraph BC34 of the Basis for Conclusions on IFRS 17 provides further insight into this definition, explaining that the International Accounting Standards Board (Board):

    (a) decided that an investment component should be defined as the amount that the contract requires the entity to repay to a policyholder *in all circumstances*, regardless of whether the insured event occurs; and

    (b) rejected defining the investment component as 'the amount that the contract requires the entity to repay to a policyholder *when* an insured event does not occur'.

9. In the staff view, the Board's intention is that an insurance contract includes an investment component only if the contract requires the entity to repay an amount to the policyholder in all circumstances. The staff believe that reading the definition of an investment component in Appendix A of IFRS 17 with paragraph BC34 of the Basis for Conclusions on IFRS 17 makes clear the Board's intention. However, the staff believe that the words in the definition on their own can be misinterpreted. The staff plan to recommend the Board propose an annual

improvement to the definition of an investment component in Appendix A of IFRS 17 to better reflect the Board's intention and explicitly include the requirement that an amount be repaid to the policyholder in all circumstances. Thus, while insurance contracts may specify amounts that are payable to the policyholder when no insured event occurs, an insurance contract includes an investment component only if the contract requires the entity to repay an amount to the policyholder in all circumstances.

10. In determining whether the contract requires the entity to make a payment in all circumstances, the staff observe that:

    (a) paragraphs 10–13 of IFRS 17 require an entity to assess at inception whether an investment component is separated from an insurance contract. To make that assessment, the entity determines whether the contract includes an investment component at inception.

    (b) different events can trigger a payment to a policyholder under an insurance contract. For example, a payment could be due because the policyholder terminates the contract, an insured event occurs or the contract reaches its maturity. The insurance contract includes an investment component only if a payment would occur in all circumstances. For example, an uncancellable contract that requires an entity to pay an amount when the policyholder dies includes an investment component because the entity is required to pay the amount in all circumstances. The amount to be paid in this case is a claim for a future event that is certain—ie the death of the policyholder (although the timing is uncertain).[1] However, an uncancellable contract that requires an entity to pay an amount only if the policyholder survives to a specified age but does not require the entity to pay any amount if the

[1] The contract provides a death benefit for the whole of the life of the policyholder. It is certain that the policyholder will die, but the date of death is uncertain.

policyholder dies before that does not include an investment component. The amount to be paid in this case is a claim for an insured event—ie the survival of the policyholder.

(c) paragraph B18 of IFRS 17 states that an entity needs to assess the insurance risk excluding scenarios that have no commercial substance (ie no discernible effect on the economics of the transaction). Hence, for the purpose of determining if an insurance contract includes an investment component the entity needs to assess whether scenarios in which no payments are made have commercial substance. The entity does not consider a scenario for which no payment is made if that scenario has no commercial substance.

(d) in some scenarios, the amount of the payment could be zero. However, this does not necessarily mean that no investment component exists. For example, an entity would need to consider whether a scenario in which the amount of payment is zero arises from:

(i) a payment that an entity makes to the policyholder early in the coverage period that might reduce the investment component to zero later in the coverage period.

(ii) the policyholder's decision to use a payment due from the entity to settle amounts due to the entity. This might be the case when the policyholder decides to terminate a contract early in the coverage period and uses a surrender amount to pay surrender charges that are equal to or higher than the surrender amount, or when the policyholder has the option to use a surrender amount to buy insurance coverage, such as an annuity.[2] In the staff view, the fact that the

[2] As a development of the staff analysis included in Agenda Paper 2E *Recognition of the Contractual Service Margin in Profit or Loss in the General Model* for the January 2019 Board meeting, the staff

policyholder chooses to use a payment it is due to fund payments to the entity does not mean the entity is not required to make payments in all circumstances. This is because settling amounts due on a net or gross basis should not affect the outcome of the assessment of whether an investment component exists.

(e) a payment amount calibrated to reflect outstanding future periods in which a service is provided that may indicate that the policyholder is entitled to a premium refund reflecting its consumption of service over the life of the contract. In this case, the payments may represent a refund of premiums for unused coverage rather than an investment component.

Assessing whether an investment component is distinct

11. Paragraph 11 of IFRS 17 states:

> An entity shall:
>
> […]
>
> (b) separate from a host insurance contract an investment component if, and only if, that investment component is distinct (see paragraphs B31–B32). The entity shall apply IFRS 9 to account for the separated investment component.

12. Paragraph BC114 of the Basis for Conclusions on IFRS 17 explains that an entity is prohibited from separating an investment component from an insurance contract when not required to do so by paragraph 11(b) of IFRS 17 (ie when an investment component is not distinct).

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observe that an insurance contract with no guaranteed payments in the annuity phase would include an investment component if the contract had a surrender amount and the policyholder had an option to either use that surrender amount to buy an annuity or take the surrender amount.

13. Paragraph B31 of IFRS 17 states that an investment component is distinct if, and only if, two conditions are met, as follows:

> [...] An investment component is distinct if, and only if, both the following conditions are met:
>
> (a) the investment component and the insurance component are not highly interrelated.
>
> (b) a contract with equivalent terms is sold, or could be sold, separately in the same market or the same jurisdiction, either by entities that issue insurance contracts or by other parties. The entity shall take into account all information reasonably available in making this determination. The entity is not required to undertake an exhaustive search to identify whether an investment component is sold separately.

Aspects to consider when determining whether cash flows are not highly interrelated

14. The first condition (referred to as 'Condition 1' in this paper) is that the cash flows of the insurance component are not highly interrelated with the cash flows from the investment component (see paragraph B31(a) of IFRS 17). Paragraph B32 of IFRS 17 specifies when an insurance component and an investment component are highly interrelated, as follows:

> An investment component and an insurance component are highly interrelated if, and only if:
>
> (a) the entity is unable to measure one component without considering the other. Thus, if the value of one component varies according to the value of the other, an entity shall apply IFRS 17 to account for the combined investment and insurance component; or
>
> (b) the policyholder is unable to benefit from one component unless the other is also present. Thus, if the lapse or maturity of one

> component in a contract causes the lapse or maturity of the other, the entity shall apply IFRS 17 to account for the combined investment component and insurance component.

15. The staff observe that an entity cannot measure one component without considering the other component ('Condition 1A') when the value of one component varies according to the value of the other component. Paragraph BC10(a) of the Basis for Conclusions on IFRS 17 explains that ignoring interdependencies between components of an insurance contract would have the result that the sum of the values of the components may not always equal the value of the contract as a whole, even on initial recognition. Thus, if the value of one component varies according to the value of the other component the resulting measurement might not be meaningful for one of (or for both) the components.

16. The staff observe:

    (a) in some contracts, the nominal value of the amount an entity is required to pay in all circumstances does not vary over time. However, the value of the payment depends on whether the insured event occurs and, if so, the timing of that insured event—for example, the death of the policyholder. Paragraph BC34 of the Basis for Conclusions on IFRS 17 explains that the Board regards the insurance benefit as the additional amount that the entity would be required to pay if an insured event occurs—ie the insurance benefit is the amount in excess of the amount of the investment component. This additional amount would change over the coverage period as the amount of the investment component changes. Therefore, the staff view is that for such contracts the insurance component and the investment component are highly interrelated because they each depend on the expected timing of any payments.

    (b) the fact that an investment component and an insurance component cannot be sold separately in the market may indicate that an entity is unlikely to be able to measure one component without considering the other component.

(c) in some cases, an entity might need to allocate costs incurred in issuing and managing a contract including both an insurance component and an investment component in an appropriate manner, using reasonable and supportable information. In the staff view, the need for an entity to perform such an allocation—which might be the case for any contract including non-insurance components that IFRS 17 requires an entity to account for separately—does not necessarily mean that the entity cannot measure an insurance component and an investment component separately, as contemplated by paragraph B32(a) of IFRS 17.

17. The staff note that the policyholder cannot benefit from one component even though the other component is not present ('Condition 1B') when the lapse or maturity of one component causes the lapse or maturity of the other component. The staff observe that:

(a) the benefit provided by an insurance contract is the service provided by the contract, and not the settlement of amounts due to the policyholder. Thus:

(i) the policyholder can benefit from an insurance component when the contract provides insurance coverage (ie during the coverage period), not when the entity settles claims (ie during the settlement period); and

(ii) the policyholder can benefit from an investment component when the contract provides an investment return service or an investment-related service, for example, in some cases when the entity still has to pay an amount related to an investment component.[3]

(b) the lapse or maturity of one component causing the lapse or maturity of the other component is sufficient to conclude that the two components are highly interrelated. For example, the lapse of the insurance component causing the lapse of the investment component is sufficient to conclude that the two components are highly interrelated, even if the lapse of the investment component does not cause the lapse of the insurance component.

(c) a contractual term preventing the policyholder from cancelling the investment component or the insurance component or both may indicate that the policyholder cannot benefit from one component without the other.

Aspects to consider when determining whether an entity can sell an equivalent instrument separately in the same market or in the same jurisdiction

18. Paragraph B31(b) of IFRS 17 requires that an investment component is distinct if, and only if, the entity (or another party) can sell separately in the same market or in the same jurisdiction an investment component with equivalent terms of those of the investment component within the insurance contract (referred to as 'Condition 2' in this paper).

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[3] In January 2019 the Board tentatively decided to amend IFRS 17:

(a) so that in the general model the contractual service margin is recognised in profit or loss on the basis of coverage units that are determined by considering both insurance coverage and investment return service, if any; and

(b) to establish that an investment return service exists only when an insurance contract includes an investment component.

Refer to Agenda Paper 2E *Recognition of the Contractual Service Margin in Profit or Loss in the General Model* for the January 2019 Board meeting.

19. The staff observe that an investment component with equivalent terms must reflect all the terms of the investment component within the contract. A financial instrument paying fixed amounts for a defined period of time starting from inception would be available on the market where the entity operates. However, such an instrument would not typically include the uncertainty about the timing of payment of any amounts depending on the death of the policyholder. Hence, it is unlikely to have equivalent terms to an investment component within an insurance contract for which the timing of the payment depends on the death of the policyholder.

Determining the amount of an investment component

20. For an insurance contract that includes an investment component, IFRS 17 requires an entity to:

    (a) separate from the insurance contract any distinct investment component and apply IFRS 9 to such a component, including its measurement. This paper does not consider distinct investment components further.

    (b) consider whether the remainder of the insurance contract requires the entity to pay any amounts to the policyholder in all circumstances (after separating the distinct investment component, if any). Paragraph 85 of IFRS 17 requires the entity to exclude those amounts from the insurance revenue and insurance service expenses presented in profit or loss. Paragraph BC34 of the Basis for Conclusions on IFRS 17 explains that the Board decided that an entity should identify investment components that are not separated for measurement purposes only at the time insurance revenue and incurred claims are recognised.[4]

[4] In January 2019 the Board tentatively decided to amend IFRS 17 so that in the general model the contractual service margin is recognised in profit or loss on the basis of coverage units that are determined by considering both insurance coverage and investment return service, if any. Therefore, for some contracts, an entity might also need to determine whether an insurance contract includes a non-distinct

21. IFRS 17 does not specify how to determine the amount of non-distinct investment components that an entity is required to exclude from insurance revenue and insurance service expenses. The staff note that there could be circumstances when these amounts are not explicitly identified by the contractual terms or where these amounts vary over time. The staff observe that an approach for determining the amount of an investment component that is based on a present value basis as at the time of making this determination would be consistent with the requirements of paragraph B21 of IFRS 17. Paragraph B21 of IFRS 17 expands on the definition of insurance. It states that when an insured event could cause the entity to pay additional amounts that are significant in any single scenario those additional amounts are determined relative to the present value of any amount that would be payable if no insured event had occurred. The additional amounts referred to in paragraph B21 of IFRS 17 thus result in the contract being defined as an insurance contract and, in the staff view, therefore the present value of the additional amounts comprise the insurance component of the contract. For these purposes, the amounts that would be payable if no insurance event had occurred are determined on a present value basis, and the staff consider that it would therefore be consistent with paragraph B21 of IFRS 17 to determine the investment component on a present value basis too.

TRG Discussion

Question to TRG members

What are your views on the implementation question presented above?

investment component at inception for the purpose of recognition of the contractual service margin in profit or loss.

Appendix A—Examples of insurance contracts provided by the submissions and other fact patterns provided to the staff

Example 1—Life cover contract

A.1 The fact pattern provided to the staff is that, in exchange for a single premium upfront of CU1,000, the life cover contract promises to pay an amount of CU2,000 if the policyholder reaches 80 years old or dies before reaching 80 years old.[5]

A.2 This example assumes that:

(a) the policyholder cannot terminate the contract; and

(b) when the contract is written, the policyholder is 60 years old.

Does the contract include an investment component?

A.3 The staff view is that the life cover contract includes an investment component. The staff observe that the contract requires the entity to make a payment to the policyholder in all circumstances—ie whether the policyholder reaches 80 years old or dies before reaching 80 years old.

Is the investment component distinct?

A.4 The staff observe that the value of the insurance component varies according to the value of the investment component because the insured event in this example is the timing of death. Although the payment of CU2,000 is certain, it is uncertain when the policyholder will die and, therefore, whether the entity will pay the

[5] In this paper amounts are denominated in currency units (CU).

amount of CU2,000 before the policyholder reaches 80 years old and how soon that may be after the inception of the contract.[6]

A.5 Therefore, the staff view is that the entity cannot measure the insurance component without considering the investment component and that Condition 1A discussed in paragraph 15 of this paper is not met. As a result, the investment component within this contract is not distinct and the entity cannot separate it from the insurance contract.

A.6 Although further analysis of the criteria for separation is not required, the staff observe that, in this contract, the policyholder cannot benefit from one component when the other component is not present because both components lapse together. In addition, the staff observe that the assessment of whether the entity (or another party) can sell separately an investment component with equivalent terms of those of the investment component within this contract in the same market or in the same jurisdiction is limited because of the inherent interdependency between the components in this contract.

What is the amount of the investment component?

A.7 The staff observe that because the timing of the amount payable under the contract is uncertain, an approach for determining the investment component based on the present value of the investment component at the time of making the determination would be consistent with IFRS 17.

[6] Paragraph B20 of IFRS 17 states that if an insurance contract requires payment when an event with uncertain timing occurs and if the payment is not adjusted for the time value of money, there may be scenarios in which the present value of the payment increases, even if its nominal value is fixed. An example is insurance that provides a fixed death benefit when the policyholder dies, with no expiry date for the cover (often referred to as whole-life insurance for a fixed amount). It is certain that the policyholder will die, but the date of death is uncertain. Payments may be made when an individual policyholder dies earlier than expected. Because those payments are not adjusted for the time value of money, significant insurance risk could exist even if there is no overall loss on the portfolio of contracts. Similarly, contractual terms that delay timely reimbursement to the policyholder can eliminate significant insurance risk. An entity shall use the discount rates required in paragraph 36 of IFRS 17 to determine the present value of the additional amounts.

A.8 Thus, an approach to determine the amount of the investment component that is based on the present value of the amount that would have been paid had the policyholder reaches 80 years old could be acceptable, because such an approach would result in higher insurance service expenses when the policyholder dies earlier in the coverage period and a lower insurance service expenses when the policyholder dies later in the coverage period.[7]

A.9 Alternatively, an acceptable approach would determine the amount of the investment component as the amount of the premiums received (CU1,000) increased by the amount of interest accreted until the entity pays the investment component to the policyholder.[8]

A.10 The staff do not think that it would be appropriate for the entity to determine the amount of the investment component equal to:

(a) the premiums received (CU1,000). This is because the difference between the amount paid of CU2,000 and the investment component of CU1,000 would be allocated to insurance service expenses, irrespective of when death occurs. That difference would not reflect the uncertainty in the timing of the payment. Incurred claims would therefore be overestimated, unless they occur immediately.

(b) the nominal amount of the payment due in all circumstances (CU2,000). This is because the entire amount paid would be considered relating to an investment component, rather than partially to an investment component and partially to the insurance service expenses created by

[7] The entity would need to determine an appropriate discount rate to determine the present value of an investment component. Paragraph B20 of IFRS 17 states that an entity shall use the discount rates required in paragraph 36 of IFRS 17 to determine the present value of the additional amounts that the entity is required to pay if the insured event occurs. In this example, a risk-free rate may be appropriate given the amount paid to the policyholder does not vary with returns on underlying items.

[8] The entity would need to determine an appropriate discount rate for the accretion of interest.

the uncertainty in the timing of the payment, unless the payments occur on maturity.

Example 2—Whole-life insurance contract

A.11 The fact pattern provided to the staff is that, in exchange for a single premium upfront, the whole-life insurance contract promises to pay a fixed amount to the beneficiaries of the policyholder when the policyholder dies.

A.12 This example assumes that the policyholder cannot terminate the contract.

Does the contract include an investment component?

A.13 The staff view is that the whole-life insurance contract includes an investment component. The staff observe that the contract requires the entity to pay a fixed amount in all circumstances—ie when the policyholder dies. It is certain that the policyholder will die, but the date of death is uncertain.

Is the investment component distinct?

A.14 Similar to Example 1 the insured event in this example is the timing of death. Although the payment of a fixed amount is certain, it is uncertain when it will occur and therefore it is uncertain what the value of the life cover will be on death of the policyholder.

A.15 The staff observe that the analysis made for Example 1 to assess whether the investment component within the contract is distinct is also relevant for Example 2. Similar to Example 1, the investment component within the contract in Example 2 is not distinct and the entity cannot separate it from the insurance contract.

What is the amount of the investment component?

A.16 The staff think that the observations made in paragraphs A.7–A.10 of this paper for Example 1 also apply to Example 2. The amount of the investment component within the contract described in Example 2 could be determined using different methods. For example, in the light of the fact pattern provided, the amount of the investment component could equal to:

(a) the amount of the premiums received at the inception of the contract increased by the amount of interest accreted until the entity makes a payment on the death of the policyholder; or

(b) the fixed amount paid on the death of the policyholder discounted from the latest possible date the entity could be required to make a payment on the death of the policyholder—ie the lowest possible value should the policyholder die late.

A.17 The staff do not think that it would be appropriate for the entity to determine the amount of the investment component equal to the premiums received or the fixed amount due on death of the policyholder for the reasons discussed in paragraph A.10 of this paper.

Example 3—Immediate annuity contract with a guarantee payment period

A.18 The submissions state that, in exchange for premiums, the immediate annuity contract with a guarantee payment period promises to make regular payments to:

(a) the policyholder for the remainder of the policyholder’s life; or

(b) the estate of the policyholder for a remaining guaranteed period if the policyholder dies before the end of the guaranteed period (for example, if the guaranteed period is three years and the policyholder dies at the end of Year 1, the estate will continue to receive regular payments for two years).

A.19 This example assumes that the policyholder cannot terminate the contract.

Does the contract include an investment component?

A.20 The staff view is that the immediate annuity contract with a guarantee payment period includes an investment component. The staff observe that the contract requires the entity to make a payment in all circumstances—ie regular payments to the policyholder or to the estate of the policyholder for a guaranteed period.

Is the investment component distinct?

A.21 In this contract:

(a) the investment component is the regular payments that are guaranteed to the policyholder or to the estate of the policyholder.

(b) the insurance component is the regular payments made if the policyholder survives to the end of the guaranteed period, until the death of the policyholder. The staff note that the insurance component is similar to a deferred annuity contract.

A.22 The staff observe that the payments for the guaranteed period are not dependent on the possible additional payments that the entity will make if the policyholder survives until the end of the guaranteed period, either in amount nor in timing. The staff note that there could be circumstances in which in the event of the death of the policyholder the beneficiaries will receive, instead of the guaranteed payments over the rest of the guaranteed period, the present value of the remaining guaranteed payments[9] or a different amount that is based on the premiums of the contract. The staff observe that in these circumstances an entity

[9] If the amount payable on death is not determined on a present value basis, the insurance component reflects timing risk and a different analysis would apply.

needs to apply judgment to consider whether the value of the investment component can be measured independently.

A.23 In assessing whether the policyholder is unable to benefit from one component unless the other is also present, the staff observe that the policyholder benefits from:

(a) the investment component during the guaranteed period; and

(b) the insurance component from the end of the guaranteed period until the death of the policyholder.

A.24 However, the policyholder is not able to access the insurance component unless the policyholder has benefited from the investment component during the guaranteed period. Therefore, the staff observe that the policyholder is not able to benefit from one component in the absence of the other component and Condition 1 discussed in paragraph 14 of this paper is not met. As a result, the investment component within this contract is not distinct and the entity cannot separate it from the insurance contract.

A.25 The staff note that, according to the fact pattern provided by the submissions, the policyholder cannot terminate the contract. The staff observe that any termination terms (with commercial substance) would be relevant in this assessment. A termination term that only permits the termination of the entire contract, or does not permit the termination of the contract at all, would suggest that the policyholder is unable to benefit from one component unless the other is also present. Conversely, a termination term that permits the policyholder to terminate only one of the components while retaining the other would suggest the policyholder is able to benefit from one component in the absence of the other component.

A.26 Although further analysis of the criteria for separation is not required, the submissions mention that a financial instrument making regular payments for a guaranteed period (for example, for three years) would typically be available on the market where the entity operates. This instrument would have equivalent terms of the investment component within the contract in Example 3. Condition 2 discussed in paragraph 18 of this paper would therefore be met.

What is the amount of the investment component?

A.27 The staff observe that the entity determines the amount of the non-distinct investment component when the entity makes regular payments for the guaranteed period either to the policyholder or to the estate of the policyholder. For example, if the guaranteed period is three years, the entity excludes from insurance revenue and insurance service expenses the payments the entity makes during the three-year period.

Example 4—Deferred annuity contract

A.28 The submission states that the deferred annuity contract promises:

(a) if the policyholder dies or terminates the contract before reaching 60 years old, to pay a surrender amount to the policyholder;[10] or

(b) if the policyholder reaches 60 years old, to make regular payments to the policyholder for the remainder of the policyholder's life. In addition, if the policyholder dies before reaching 80 years old, the contract requires the entity to pay an amount at least equal to the amount accumulated by the policyholder through deposits less payments already made.

[10] The staff have assumed that the surrender amount is the amount accumulated by the policyholder through deposits. A surrender fee might also be applied.

A.29 The staff have assumed that:

(a) if the policyholder reaches 80 years old, the regular payments received between the ages of 60 years old and 80 years old at least equal the amount accumulated through deposits.

(b) the amount accumulated by the policyholder through deposits does not accrue interest after the policyholder reaches 60 years old.

A.30 The submission states that the policyholder cannot terminate the contract after reaching 60 years old.

Does the contract include an investment component?

A.31 The staff view is that the contract includes an investment component. The staff observe that the deferred annuity contract requires the entity to make a payment in all circumstances, either:

(a) a surrender amount, if the policyholder dies or terminates the contract before reaching 60 years old; or

(b) an amount that is equal to the amount accumulated by the policyholder through deposits, if the policyholder reaches 60 years old.

Is the investment component distinct?

A.32 In this contract:

(a) the investment component is:

(i) a surrender amount if the policyholder dies or terminates the contract before reaching 60 years old; or

(ii) an amount that is equal to the amount accumulated by the policyholder through deposits, if the policyholder reaches 60 years old.

(b) the insurance component is the possible payments exceeding the amount accumulated by the policyholder through deposits.

A.33 The staff observe that if the policyholder dies after reaching 60 years old and before reaching 80 years old, the entity makes a payment reflecting the amount accumulated by the policyholder through deposits. The timing of that payment depends on the death of the policyholder. Therefore, for Example 4, the staff view is that the entity cannot measure the insurance component without considering the investment component and Condition 1A discussed in paragraph 15 of this paper is not met. As a result, the investment component within this contract is not distinct and the entity cannot separate it from the insurance contract.

A.34 Although further analysis of the criteria for separation is not required, the staff observe that the death of the policyholder causes the maturity of both:

(a) the insurance component in the contract (ie the possible payments exceeding the amount accumulated by the policyholder through deposits); and

(b) the investment component in the contract (ie the surrender amount or the amount accumulated by the policyholder through deposits).

A.35 The staff note that, according to the fact pattern provided by the submission, the policyholder cannot terminate the contract after reaching 60 years old. A termination term that does not permit the termination of the contract suggests that the policyholder is unable to benefit from one component unless the other is also present.

A.36 Therefore, for Example 4, the staff view is that the policyholder cannot benefit from the investment component without the insurance component also being present and Condition 1B discussed in paragraph 17 of this paper is not met.

A.37 The staff observe that any financial instrument typically available on the market would not link the timing of payment to the death of the policyholder. Condition 2 discussed in paragraph 18 of this paper would therefore unlikely be met.

What is the amount of the investment component?

A.38 The staff observe that the entity determines the amount of the non-distinct investment component when the entity pays a surrender amount or makes regular payments to the policyholder. The following scenarios might occur:

(a) the policyholder dies or terminates the contract before reaching 60 years old. The entity pays a surrender amount. The staff view is that the entity excludes that amount from insurance revenue and insurance service expenses when the surrender amount is paid.

(b) the policyholder reaches 60 years old. The entity makes regular payments that could exceed the amount accumulated by the policyholder through deposits. The staff view is that the entity excludes the amount accumulated through deposits from insurance revenue and insurance service expenses when regular payments are made up to the amount accumulated through deposits by the policyholder. Amounts exceeding the amount accumulated through deposits represent incurred claims for the entity.

Example 5—Pure protection contract

A.39 The fact pattern is that, in exchange for premiums, the pure protection contract promises to pay:

(a) a fixed amount of CU1,000 to the policyholder on the death of the policyholder, if the policyholder dies within a 5-year coverage period; or

(b) a variable surrender amount to the policyholder.

A.40 The following table provides a summary of payments that the contract requires the entity to make:

	Y0	Y1	Y2	Y3	Y4	Y5
Death benefit	1,000					
Surrender amount	50	40	30	20	10	0

Does the contract include an investment component?

A.41 The staff view is that the contract does not include any investment component. The staff observe that this contract:

(a) requires the entity to pay a fixed amount of CU1,000 on the death of the policyholder or to pay a variable surrender amount to the policyholder if the policyholder opts to terminate the insurance contract before the end of Year 4.

(b) does not require the entity to pay any amount to the policyholder if the policyholder keeps the contract to Year 5 and the policyholder survives. This means that no amount is paid in all circumstances.

A.42 The staff observe that a surrender amount decreasing over the duration of the contract is economically similar to a refund for unused coverage, which is recurrent in non-life insurance contracts. For example, an entity typically refunds part of a premium received upfront for a car insurance contract when the policyholder terminates the contract before maturity.