STAFF PAPER

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Project	**Insurance Contracts**		
Paper topic	Unbundling of Investment Components		

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What is the purpose of this paper?

1. The purpose of this paper is to ask the boards to determine a principle to identify investment components that should be unbundled from an insurance contract.
2. This paper does not address the allocation of premiums to individual accounting periods. The staff plans to address that topic in a separate paper.
3. Agenda paper 2F/83F includes a summary of the boards' tentative decisions to date on separating components (e.g., embedded derivatives, goods and services, and investment components) within an insurance contract.

Summary of Staff Recommendation

4. The staff recommend:
    a. If both the investment component and insurance component are distinct, an insurer shall unbundle the investment component and apply the applicable IFRSs or U.S. GAAP in accounting for the investment component.
        i. Except as specified in the following paragraph, a component is distinct if the insurer or a third party regularly separately sells

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contracts in the same market and jurisdiction that are essentially equivalent to that component.

ii. Notwithstanding the requirements in the previous paragraph, an investment component or an insurance component in an insurance contract is not distinct and the insurer shall therefore account for the investment component together with the insurance component under the insurance contracts standard if the investment component is highly interrelated with the insurance component. An indicator that an investment component is highly interrelated with an insurance component is a lack of possibility for one of the components to lapse or mature without the other component also lapsing or maturing.

Background

5. During the 21 March 2012 joint board meeting, the boards tentatively decided that:

   a. an investment component in an insurance contract is an amount that the insurer is obligated to pay the policyholder or a beneficiary regardless of whether an insured event occurs.

   b. in the statement of financial position, insurers should not be required to present investment components separately from the insurance contract. However insurers should disclose both:

      i. The portion of the insurance contract liability that represents the aggregated portions of premiums received (and claims/benefits paid) that were excluded from the statement of comprehensive income; and

      ii. The amounts payable on demand.

6. In addition, the IASB tentatively decided that insurers should exclude from the aggregate premium presented in the statement of comprehensive income the present value of the amounts that the insurer is obligated to pay to policyholders

or their beneficiaries regardless of whether an insured event occurs, determined consistently with measurement of the overall insurance contract liability. The FASB did not vote on the measurement of the premium to exclude from the statement of comprehensive income and requested the staff provide further information about possible interpretations of the wording proposed by the staff and tentatively decided upon by the IASB.

7. In addition to the decisions reached at the March meeting, the boards directed the staff to consider limited *unbundling* for investment components that are sufficiently distinct from the insurance component. Unbundling would require the investment component to be recognized and measured separately from the insurance component applying the financial instrument standard, rather than the insurance contracts standard.

8. In reaching their tentative decision not to unbundle investment components, the boards considered several factors:

    a. Insurers currently do not separately manage or report on the different contractual components of many products for regulatory or financial reporting purposes.

    b. Some question whether the costs would outweigh the benefits. Specifically, some believe the measurement of the unbundled component would be similar to a building block approach measurement if it were to be measured at fair value. Additionally, some users look at insurance products as a single contract rather than as an aggregation of multiple components.

    c. The investment component and insurance coverage in many contracts are interdependent and therefore allocation of revenue and expenses, as would be required under unbundling, would be subjective and complex. To minimize this subjectivity and complexity, the tentative decisions instead exclude a portion of the premium associated with the investment component from the income statement.

    d. Measuring the two components together under the insurance contracts standard ensures the use of updated assumptions in the measurement of

certain options and guarantees (e.g., guaranteed minimum income benefit features), which was a desired improvement to current U.S. GAAP.

e. The boards' tentative decisions would exclude from the income statement a portion of the premium associated with the investment component, but would measure the two components together under the insurance contracts standard. This results in a measurement model where the sum of the parts equals the whole. In other words, the measurement of each of the individual components mathematically adds up to the measurement of the total insurance contract. Accordingly, there is less pressure placed on the identification of separate components and there is less motivation for product structuring aimed at accounting arbitrage.

Staff Analysis

9. Based on tentative decisions noted above in the background section, investment components that are part of an insurance contract would *not* be unbundled but would rather be accounted for as part of the overall insurance contract. Some are concerned about using the insurance contracts standard to account for the whole of a contract that combines an investment component with an insurance component when the two components operate separately. Accordingly, the staff considered whether any investment components are sufficiently distinct from the insurance component that the insurer should recognize and measure them separately applying the financial instrument standard, rather than the insurance contracts standard. In considering this topic, the staff considered the following alternatives:

(a) Alternative (a): Unbundle contractual components that were combined for reasons lacking commercial substance.

(b) Alternative (b): Unbundle investment components that would be deemed distinct from the insurance components (in accordance with criteria similar to those used for unbundling goods and services).

Alternative (a): Unbundle contractual components that were combined for reasons lacking commercial substance

10. The concept of unbundling components that were included in the insurance contract for reasons lacking commercial substance was a part of the unbundling proposal in the IASB ED[1] but only applied to goods or services. Although the broader unbundling proposals included in the ED related to the "closely related" criterion were considered problematic by many comment letter respondents (and have since been rejected by the boards), some respondents recommended that a lack of commercial substance should be the only criterion for unbundling. By excluding some terminology (i.e., "closely related") and focusing on commercial substance, Alternative (a) might be a viable option.
11. Commercial substance was defined in the ED (used for defining the insurance contract) as having a discernible effect on the economics of the contract. This notion of commercial substance is also included in paragraph 25 of IAS 16, *Property, Plant and Equipment*. This standard states that in order to determine whether a transaction has commercial substance, an entity should consider the extent to which the configuration (risk, timing and amount) of the future cash flows is expected to change as a result of the transaction. Similarly, in the revenue recognition ED, a contract has commercial substance when the risk, timing, or amount of the entity's future cash flows is expected to change as a result of the contract. Accordingly under this alternative, when components are combined for reasons that have no commercial substance, they should be unbundled if combining those components into a single bundled contract did not change the amount, risk or timing of the cash outflows resulting from the contract.
12. Alternative (a) is probably the simplest and most understandable of the two alternatives discussed in this paper. Accounting for contracts that bundle together an insurance contract and an investment contract for reasons lacking commercial substance as one contract under the insurance contracts standard would be

[1] This concept was included in the ED as an example of non-insurance components that are not "closely related" to the insurance coverage. Specifically, the ED example was as follows: "non-insurance services or goods that are not closely related to the insurance coverage but have been combined in a contract with the insurance coverage for reasons that have no commercial substance."

considered by many constituents as counterintuitive. A failure to unbundle such contracts could have a material effect on the financial statements if the investment component is a significant part of the contract or if there is a duration difference between the investment and insurance components (e.g., a one year term life contract bundled with a five year deposit). Because a majority of investment components included in insurance contracts are likely combined for reasons that do have commercial substance, the unbundling of investment components under this alternative would likely be rare though. However, this should serve to mitigate opportunities for circumventing the scope of other standards by adding insurance risk to non-insurance products.

13. The staff considered each of the pros and cons to unbundling of investment components identified in paragraph 8 in evaluating Alternative (a). For the particular investment components that would meet the Alternative (a) criteria, the arguments for not unbundling are either not applicable or are less relevant than they are for other investment components. Specifically, when investment components are incorporated into an insurance contract for reasons that have no commercial substance:
    a. The two components probably are managed separately;
    b. The allocation of expenses and income is not likely to be subjective or complex given the two components could have otherwise been sold separately (i.e., it should be as easy to unbundle as it was to bundle the components together);
    c. There would be less relevance to ensuring that the aggregate measurement of the components equalled the measurement under the insurance contracts standard (i.e., given one of the components is largely unrelated to insurance); and
    d. There are unlikely to be any meaningful interdependencies between the two components.
14. As for disadvantages, this alternative would not unbundle insurance contracts for which the commercial substance to packaging together with an investment component is limited to convenience or administrative efficiency. Examples could

include a stand-alone savings account, mortgage or pension product issued at the same time as a life insurance contract is issued[2]. Another disadvantage is that some respondents had problems with understanding how to apply the commercial substance notion to insurance contracts and goods or services components. Some believe that the respondent concerns regarding how to apply the guidance could be overcome with the inclusion of application guidance in the standard. Although there are hypothetical examples that would represent an obvious combination of components for reasons lacking commercial substance, for common existing contracts, it is less clear whether unbundling might be required.

Alternative (b): Unbundle investment components deemed distinct from the insurance components (in accordance with criteria similar to those used for unbundling goods and services)

15. At the 27 February 2012 joint board meeting, the boards tentatively decided on criteria for unbundling goods and services. The staff suggest the following edits to those criteria to keep the general principles underlying those criteria, but make them applicable to investment components of insurance contracts (added text is underlined and deleted text is ~~struck out~~). The explanations for the edits are included in paragraphs 16 through 21.

    (a) ~~An insurer shall identify whether any promises to provide goods or services in an insurance contract would be performance obligations as defined in the Exposure Draft, *Revenue from Contracts with Customers*.~~ If both the investment component and insurance component are ~~a performance obligation to provide goods or services is~~ distinct, an insurer shall unbundle the investment component and apply the applicable IFRSs or U.S. GAAP in accounting for the investment component ~~that performance obligation~~.

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[2] Although the subject of this paper is unbundling of some investment components, Alternative (a) could be applied more broadly to ensure unbundling of all components that were included in the insurance contract for reasons lacking commercial substance. For example, this might address circumstances such as the sale of a car together with motor insurance (although such a transaction would already be unbundled if the "insurer" regularly sold cars without motor insurance).

(b) ~~A performance obligation is a promise in a contract with a policyholder to transfer a good or service to the policyholder. Performance obligations include promises that are implied by an insurer's customary business practices, published policies, or specific statements if those promises create a valid expectation by the policyholder that the insurer will transfer a good or service. Performance obligations do not include activities that an insurer must undertake to fulfill a contract unless the insurer transfers a good or service to a policyholder as those activities occur. For example, an insurer may need to perform various administrative tasks to set up a contract. The performance of those tasks does not transfer a service to the policyholder as the services are performed. Hence, those promised setup activities are not a performance obligation.~~

(c) Except as specified in the following paragraph, a component ~~a good or service~~ is distinct if either of the following criteria is met:

   (i) The insurer regularly separately sells contracts that are essentially equivalent to that component ~~the good or service separately~~.

   (ii) A third party regularly separately sells in the same market and jurisdiction contracts that are essentially equivalent to that component. ~~The policyholder can benefit from the good or service either on its own or together with other resources that are readily available to the policyholder. Readily available resources are good or service that are sold separately (by the insurer or another entity), or resources that the policyholder has already obtained (from the insurer or from other transactions or events).~~

(d) Notwithstanding the requirements in the previous paragraph, an investment component or an insurance component ~~a good or service~~ in an insurance contract is not distinct and the insurer shall therefore account for the investment component ~~good or service~~ together with the insurance component under the insurance contracts standard if ~~both of the following criteria are met:~~

~~(i)~~ the investment component ~~The~~ ~~good or service~~ is highly interrelated with the insurance component ~~and transferring them to the policyholder requires the insurer also to provide a significant service of integrating the goods or service into the combined insurance contract that the insurer has entered into with the policyholder~~. An indicator that an investment component is highly interrelated with an insurance component is a lack of possibility for one of the components to lapse or mature without the other component also lapsing or terminating.

~~(ii) The good or service is significantly modified or customized in order to fulfill the contract.~~

16. **Subparagraphs (a) and (b)**. In the edits reflected in the previous paragraph, the deletion of the first sentence in subparagraph (a) and the entirety of subparagraph (b) are on account of having already defined investment component and because that term is more appropriate than the concept of a performance obligation (given that unbundled investment components will be subject to financial instrument guidance rather than the revenue recognition standard). The proposed language for the criterion in subparagraph (a) requires *both* components to be distinct. Although the revenue recognition ED does not explicitly state that both the unbundled component and the remaining component need to be distinct, paragraph 29 of the FASB DP (22 of the IASB ED) notes that:

> If an entity promises to transfer more than one good or service, the entity shall account for each promised good or service as a separate performance obligation *only* if it is distinct. If a promised good or service is not distinct, an entity shall combine that good or service with other promised goods or services until the entity identifies a bundle of goods or services that is distinct. In some cases, that would result in an entity accounting for all the goods or services promised in a contract as a single performance obligation. [*emphasis* added]

17. The staff interpret this language to require an entity to only account for performance obligations separately if *each* of those performance obligations are distinct (i.e., if there are two components they both need to be distinct) and if the good or service can't be divided into distinct performance obligations it should be

accounted for as a single performance obligation. Notwithstanding this interpretation of the proposals in the revenue recognition ED, the staff think that the importance of both components being distinct is greater in the insurance contracts standard because the consequence of unbundling is that two separate measurement models will be applied (i.e., versus use of a common revenue recognition standard for measurement of the two components).

18. **Subparagraph (c)(ii)**. The replacement of paragraph 15(c)(ii) is intended to maintain the basis behind the original criterion but recognize that it might not be an appropriate criterion for insurance and investment components. The original criterion would likely apply to a significant percentage of investment and insurance components (i.e., policyholders would likely be able to benefit from the cash flows of any investment component and of many insurance components, including for traditional whole life insurance contracts as an example). A policyholder would not be able to benefit from a guaranteed minimum death benefit (GMDB) (i.e., a guarantee that the death benefit protection won't lapse even if the cash surrender value is insufficient to cover monthly cost of insurance charges) on a variable universal life insurance contract absent the existence of the insurance component the guarantee applies to. Such an insurance component might reasonably be concluded to *not* be distinct. However, an insurance component for which the policyholder benefits are not affected by an investment component subject to variable market returns would likely be able to benefit the policyholder regardless of the existence or value of the investment component. An example would be a variable universal life contract structured such that the insurance coverage is independent of changes in the account balance. Accordingly, inclusion of the original subparagraph (c)(ii) in the definition of distinct would be inconsistent with each of the reasons the boards tentatively decided for not unbundling (i.e., the reasons summarized in paragraph 8, which would be exacerbated due to the pervasiveness of unbundling pursuant to this criterion) and would also result in an arbitrary distinction between insurance products with similar economics.

19. On the other hand, the addition of the new criterion included within paragraph 15(c)(ii), focuses on whether the component is reflective of a meaningful "real" product that is sold in the same market and jurisdiction as the insurer sold the contract in. This criterion looks past the insurer's unwillingness to sell the two components separately (i.e., criterion (c)(i)) and, therefore, might offer additional comparability between insurers (i.e., one who sells the components separately and one who doesn't). The rationale behind this criterion is that the availability of a sufficient volume and frequency of observable market transactions for each of the investment and insurance components suggests that the unbundled components would each be representative of a "real" product rather than one component that is only a hypothetical product. Such a distinction that focuses on actual products prevalent in the marketplace might provide relevant information regarding an insurer's business. Furthermore, this distinction is considered by the staff to be consistent with the "capable of being sold separately" concept behind the determination of distinct performance obligations included in the revenue recognition ED[3] (i.e., it is consistent with the *principle* behind the original (~~stricken out~~) criterion included in paragraph 15**Error! Reference source not found.**).

20. Additionally, there would be a basis for the distinction in measurement between the two components. If transactions regularly occur for each component separately, in a market with a reasonable frequency and volume of transactions, it implies that two distinct components exist (and that might be able to be reliably measured separately by leveraging market data). The sufficiency of frequency and volume of similar transactions is a key concept in this alternative. An insurer might reasonably be willing to sell any insurance or investment component as a

[3] The specific "capable of being sold separately" clause was removed from the revenue recognition ED because of some respondent feedback regarding potential implications. Specifically, some respondents commented that (1) the experience of other entities, including entities that operate in other markets or other jurisdictions, could be costly to obtain and would not be relevant for determining whether an entity should account separately for a promised good or service and (2) using this as the sole criterion would not reflect the economics of those transactions because many performance obligations are highly interrelated and interdependent. The staff think that the first comment has been addressed through the incorporation of the "same market or jurisdiction" language in the staff's criterion and the second is addressed through retention of the boards' subsequent addition of the "highly interrelated" criterion.

separate product for a high enough price. A small volume of market transactions, however, would not likely indicate that a component is representative of a realistic or meaningful product nor would it provide much reliable information to be used to overcome the concerns that led to the boards' tentative decisions to not unbundle most investment components included in insurance contracts.

21. **Subparagraph (d)(i)**. As noted in paragraph BC78 of the Exposure Draft, *Revenue from Contracts with Customers*, the boards developed the criterion underlying subparagraph (d) to clearly identify the circumstances in which an entity promises goods or services as a bundle and the goods or services are not distinct because the risks of providing the bundle of goods or services are largely inseparable. The staff think that, in light of the differences between investment components and goods and services, the amount of customization of the investment component is not as relevant for determining whether an investment component is separable from the insurance contract (i.e., as noted earlier, policyholders would likely be able to benefit from the cash flows of any investment component and, therefore, the investment component is much more likely to be deemed separable). Additionally, the revenue recognition ED notion of transferring the product to the customer is considered harder to understand in the context of investments than it is in the context of goods services and, as such, the staff believe its inclusion in the criteria wouldn't help clearly identify the circumstances in which the investment and insurance components are distinct. In its place the staff identified the suggested indicator that an investment component is highly interrelated with an insurance component (and thus *not* distinct) included above in paragraph 15(d)(i).

22. Implicit in the tentative decision regarding unbundling goods and services is that there would be no unbundling of services that were integral to providing insurance. This alternative (Alternative (b)) is intended to similarly not unbundle investment components that are integral to providing insurance. Alternative (b) would enhance consistency not only within the insurance contracts model, but also with the revenue recognition standard. Similar guidance for unbundling of good/services and investment components should help minimize complexity. That

said, this alternative is more operationally complex than Alternative (a). Most investment components that might be packaged together for reasons lacking commercial substance (i.e., those identified under Alternative (a)) are likely to also be sold separately by the insurer or third parties. Accordingly, Alternative (b) would similarly serve to mitigate opportunities for circumventing the scope of other standards by adding insurance risk to non-insurance products.

23. The staff believe that a distinct component (as defined in paragraph 15) of a bundled contract would also fulfil the criteria for commercial substance (alternative a)) set out in paragraph 11(if combining this component into a single bundled contract did not change the amount, risk or timing of the cash outflows resulting from this component and from the other components of the contract). Said another way, all of the investment components that would be unbundled under alternative (a) would likely be unbundled under alternative (b).

24. The staff also considered each of the pros and cons to unbundling of investment components identified in paragraph 8. Investment components that require unbundling under Alternative (b) are slightly more likely than those unbundled under Alternative (a):

    a. To be managed together with the insurance component; and

    b. To require additional subjectivity and complexity in the allocation of expenses and income (e.g., there would be more cash flows which do not relate clearly to one component therefore would need to be allocated to both components).

Example 1 – contract evaluation

An insurer sells a variety of insurance and savings products, including each of the following:

Product 1 – Immediate Annuity with Life Contingency but Term Certain – This particular contract provides the policyholder with regular periodic payments beginning immediately after the policyholder makes an initial purchase payment. The payments are guaranteed over the life of the policyholder. However, if the policyholder dies before the 10 year anniversary of the initial purchase payment, payments are made to the designated beneficiary until the end of the 10 year term. The policyholder has no right to any balance upon surrender.

Product 2 – Traditional Whole Life Insurance – This particular contract is a permanent life insurance contract with a fixed amount of insurance coverage over the entire life of the insured, provided that premiums are paid as

specified in the contract. Premiums remain level over the life of the insured. The premiums accumulate and build a cash value against which the policyholder can withdraw and borrow. Any amount withdrawn and still outstanding at the time of death is deducted from the death benefit paid.

Product 3 – This particular contract provides the policyholder a fixed annual rate of return on the account balance for up to 20 years and also provides a death benefit of a fixed amount should the policyholder die within 10 years of contract issuance. The policyholder can withdraw up to the entire account balance, subject to a surrender charge in the first 10 years and without an effect on the death benefit. The annual rate of return and the surrender charge were established, in part, based on the cost of the term insurance protection (i.e., the rate of return credited to the contract holder is reduced by the annual cost of insurance).

Assume that the insurer regularly sells savings products that provide a fixed rate of return and duration commensurate to the investment components of each of Products 1, 2, and 3. Accordingly, the insurer concludes that the investment components of Products 1, 2, and 3 are essentially equivalent to savings products it regularly sells.

However, if the insurer (or other market participants) do not regularly sell any deferred annuity products for which it does not also manage (as part of the same contract) the policyholder funds in the accumulation phase, it concludes that the insurance component of Product 1 is not distinct. Similarly, if the insurer (or other market participants) does not sell any term life insurance (i.e., without a cash surrender value) of durations essentially equivalent to those of its whole life contracts, it also concludes that the insurance component of Product 2 is not distinct.

Assume that the insurer does regularly sell 10 year term life insurance contracts. Because of that fact and because the insurance and investment components of Product 3 are *not* highly interrelated (e.g., it *is* possible both for the investment component to be fully withdrawn while the insurance coverage remains fully in effect and for the insurance component to terminate while the investment component continues), the insurer concludes that the investment component and the insurance component of Product 3 are distinct.

As a result of the insurer’s conclusions, it would unbundle the investment component of Product 3 only.

25. The staff think that Alternative (b) would be narrow in scope because many insurance and investment components are highly interrelated and because we believe that, for many common insurance products, it will be somewhat rare that both of the insurance and investment components will be separately available in the market and jurisdiction where the products are sold. Consistent with the boards’ prior tentative decisions, this alternative would not make any distinction

between explicit and implicit account balances[4] (i.e., the staff believe it will be rare for both explicit and implicit account balances to be unbundled). Furthermore, the staff anticipate that the evaluation of whether an investment component requires unbundling would, generally, be able to be done at a product level, without a large cost or effort, rather than at an individual contract level, except perhaps for some highly structured products.

Interaction between unbundling investment components and investment management services

26. Some have questioned whether and how the unbundling tentative decisions would be applied to investment management services. Some argue that the fees for the investment management services should be unbundled from fees for the insurance component and accounted for using the guidance for revenue recognition. This could alleviate the insurers' need to calculate the expected value of the fees (or cash inflows) which many times are based on the daily value of the account balance, for example, 0.0025% of the account balance per day. Although the amount of investment management services of a contract vary based on products, relative to the size of the investment component, the amount of investment management services provided to the policyholder is minimal when the policyholder is directing the insurer on investing its premium (i.e., as opposed to the insurer actively managing the investments on behalf of the policyholder); this is often the case when the liability is directly linked to a specific portfolio of assets. However, if the investment component is not directly linked to a specific portfolio, the return of the investment component to the policyholder is paid from the general fund investments actively managed by the insurer, and in these cases the investment management services tend to be more significant. Under the revenue recognition guidance the insurer would recognize the fee income and the expenses associated with investment management services when they are incurred.

[4] As discussed in the 21 March 2012 Agenda Paper 2G/81G, the staff do not believe that economically similar contracts should not be accounted for differently based on whether an account balance is explicit or implicit.

27. One counterargument to unbundling of investment management fees is that fees for investment management services typically are not explicit and therefore an insurer would need to determine how to split the investment management fee. For example, the investment management fee may be commingled with charges for administrative expenses and mortality and expense risks, all of which are typical expenses for activities to fulfil an insurance contract. Another counterargument is that, in applying the boards' tentative decision to measure the insurance contract liability using the expected cash flows, if an insurer did unbundle investment management services, both the amount of the cash inflow (i.e., explicit or implicit fees) and the expected cash outflow (i.e., cost of providing those services) would be unbundled from the insurance contract liability, thus often resulting in a nominal net effect on the liability measurement.
28. The staff believe investment management activities, to the extent that the activities benefit the policyholder, are a service. However, whereas the activities of managing assets sometimes directly benefit the policyholder (e.g., as likely would be the circumstances where there is an unbundled investment component), they generally also benefit the insurer. The need to manage investments (purchased with insurance contract premium) in order to meet the insurer's obligations to pay out claims is integral to the economics of many insurance contracts. The economic results of effective or poor investment management (or at least some of the results) in these circumstances is assumed by the insurer in the form of higher or lower profitability.
29. The application of the goods and services unbundling criteria to investment management services requires a determination as to whether these services are distinct from the other components of the insurance contract (i.e., the contract after unbundling of any other components). Accordingly, in analyzing whether investment management services are unbundled, an insurer needs to first determine whether the related investment component is accounted for as part of the insurance contract (i.e., not unbundled).
30. In contrast to the effect of unbundling investment components, the exclusion of a portion of the premium and claims associated with the investment component

from the statement of comprehensive income should not have any effect on whether investment management services are unbundled. The determination as to whether any premiums are excluded from the statement of comprehensive income has no effect on the insurance contract, which the insurer needs to determine whether the investment management services are distinct from. The staff think this consequence is appropriate, in part, because the basis for the staff recommendation behind the tentative decision to exclude those amounts from the statement of comprehensive income (i.e., as a means to determine meaningful premiums amounts) isn't applicable to investment management services (e.g., none of the investment management service fees are returned to the policyholder in the way that an investment component is returned to a policyholder).

31. The staff believe that when an insurer unbundles an investment component, it is more likely that application of the good and services unbundling criteria to the related investment management services would result in unbundling of those services from the insurance contract. For example, in these circumstances, the investment management services might often be deemed to not be "highly interrelated" (i.e., as they are instead largely related to the unbundled investment component). On the other hand, the staff believe that when an insurer does not unbundle an investment component, it is more likely that application of the good and services unbundling criteria to the related investment management services would not result in unbundling of those services from the insurance contract. Specifically, in these circumstances, the investment management services might often be deemed to meet the highly interrelated criterion. For the reasons stated in paragraph 26, the staff think that unbundling of investment components based on the staff recommendation would be somewhat rare. Accordingly, application of the goods and services unbundling criteria to investment management services would also likely result in infrequent unbundling.

32. Some argue that these investment management services should automatically follow the fate of the investment component and not need to be run through the unbundling goods and services criteria. Said another way, if the investment component is unbundled, the investment management services should similarly be

unbundled; if the investment component is not unbundled, the investment management services should similarly not be unbundled. Although the staff believe these result will generally be consistent with application of the goods and services unbundling criteria, the staff think that introducing such an exception for one type of service would add unnecessary complexity.

Staff Recommendation

33. The staff recommend Alternative (b) because we believe it best balances the objectives of measuring investment and insurance components similarly to other financial instruments and insurance contracts, respectively, together with the operational and other concerns regarding unbundling that led to the boards' previous tentative decisions not to unbundle most investment components but instead to exclude a portion of the premium associated with the investment component from the income statement. The staff think that using the criteria recommended by the staff for unbundling investment component:
    a. Is consistent with the principle used for unbundling goods and services (albeit with changes to make the guidance specific to these types of components) and, thus, minimizes complexity and subjectivity and results in more useful information than unbundling any further investment components.
    b. Is consistent with the "capable of being sold separately" concept behind the determination of distinct performance obligations included in the revenue recognition ED.
    c. Is narrow in scope because many insurance and investment components are highly interrelated.

Question – Principle to Identify Investment Components for Unbundling
Do the boards agree that: a. If both the investment component and insurance component are distinct, an insurer shall unbundle the investment component and apply the applicable IFRSs or U.S. GAAP in accounting for the investment component. b. Except as specified in the following paragraph, a component is distinct if the insurer or a third party regularly separately sells in the same market and jurisdiction contracts that are essentially equivalent to that component. c. Notwithstanding the requirements in the previous paragraph, an investment component or an insurance component in an insurance contract is not distinct and the insurer shall therefore account for the investment component together with the insurance component under the insurance contracts standard if the investment component is highly interrelated with the insurance component. An indicator that an investment component is highly interrelated with an insurance component is a lack of possibility for one of the components to lapse or mature without the other component also lapsing or maturing.