PAPER: 05A

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Potential implementation question

Question:
Whether the lowest level of the unit of account used in IFRS17 must be the legal form of the contract after separating non-insurance components?

Background:
IFRS17 and TRG 2018 Feburary Meeting Agenda Paper 1 state that the company shall not separate the of insurance components of a single insurance contract for measurement purpose. This implies that the lowest level of the unit of account is the legal form of the contract after separting non-insurance components.

Reasons for raising the question:
We argue that the requirement is impractical and the cost & benefit of this requirement is unjustified. And the TRG Feburary Meeting Agenda Paper 1 was unclear that whether company has the right to make assessment based on principle of contract actual substances of rights and obligations.

Paragraph of HKFRS/IFRS 17 *Insurance Contracts*

Paragraph 2 of IFRS17 states that a contract is an agreement between two or more parties that creates enforceable rights and obligations.

Paragraphs 10-13 of IFRS17 set out the requirements on separating non-insurance components from the contracts. After separating non-insurance components IFRS17 applies to all remaining components of the host insurance contract.

There is no paragraph in IFRS 17 that requires or permits separating insurance components of an insurance contract. That is, the lowest level of the unit of account used in IFRS 17 is a contract, or a host insurance contract after separating non-insurance components (when relevant).

Paragraph 9 of IFRS 17 sets out the requirements on combining a set or a series of insurance contracts with the same or related counterparty that may achieve or be designed to achieve an overall commercial effect. Combination of contracts may be necessary in order to report the substance of such contracts. Applying paragraph 9 therefore may result in a combination of two or more contracts to form a contract for the purpose of applying IFRS 17.

A portfolio of insurance contracts is defined as insurance contracts subject to similar risks and managed together. Paragraph 14 of IFRS 17 requires entities to identify portfolios of insurance contracts. Paragraphs 16-24 of IFRS 17 are then applied to divide portfolios into groups of insurance contracts.

Paragraph 33 of IFRS 17 states that an entity shall include in the measurement of a group of insurance contracts all the future cash flows within the boundary of each contract in the group. Paragraph 34 of IFRS 17 sets out the requirements on the cash flows within the boundary of an insurance contract.

Paragraph 16 - 20 of TRG Feburary Meeting Agenda Paper 1 states that TGR staff think that a contract with legal form of a single contract, unless artificially constructed this way, would generally be considered a single contract in substance. The staff observe that this is consistent with the contract being the lowest unit of account used under IFRS 17.

Paragraph 21-22 of TRG Feburary Meeting Agenda Paper 1 states that TRG staff acknowledge that there is possibility of overriding the contract unit of account presumption by separating insurance components of a single insurance contract. And the override can be implemented based on careful consideration of all relevant facts and circumstances.

Appendix A of TRG Feburary Meeting Agenda Paper 1 gives an example of a contract that includes a number of insurance risks and the three criterion TRG staff used to assess the lowest unit of account used under IFRS17 for this particular example.

Analysis of the question

We observe following business practices in China market which may result in impractical implementation when applying the legal form of contract as lowest level unit of account under IFRS17.

Example 1. A new whole life participating contract with one-year accidental rider
Example 2. A new 20-year term life contract also with same one-year accidental rider
Example 3. A 20-year term life (already inforce for 10 years) newly attached same one-year accidental rider

The following phenomenons has been observed:
1. The one-year accidental rider is sold at same price in each example.
2. The rider can be added or cancelled any time, and the lapse for the rider showed different experience comparing with main component.
3. The rider can be attached to any type of contracts sold within the company.

According to the IFRS17 and TRG Feburary Meeting Paper 1, the lowest level of unit account should be the legal form of the contract (e.g. whole life participating with rider should be measured together).

We concerns that this requirement of IFRS17 will cause the difficulties and impractibility during the actual implementation process.

1. Different valuation model used different components under same contract (e.g. participating

compoment uses VFA, rider uses BBA or PAA) makes implementation impractical or diversity.

2. Company manages the different components under same contract in different accounts (e.g. participating component managed in participating account and rider managed in general account).

3. The required analysis dimension under IFRS17 (e.g. each example will be whole new analysis dimension) is very different comparing with current experience analysis dimension; and it will impose a lot of additional work on company for the inforce businesses (e.g. reassess the portfolio/group/BE set up basis and etc); the granularity level will be increased enormously, so the cost of doing it.

4. Internal business review is not based on IFRS17 proposed measurement dimensions; and current valuation method (e.g. unit of account) also presents faithful and accurate financial information. The cost of redefining the measurement/review dimension using the IFRS17 approach outweighs the benefit of it can provide.

ADDITIONAL INFORMATION PROVIDED BY SUBMITTER

- A one year accidental rider can be attached several base products, e.g. whole life par product, term insurance, or products that have been inforce for several years. In the last case, it means that the base and rider came in at different period but could end at the same time.
- By legal form, the rider can be added or cancelled any time, but usually the policyholder may not be aware it and will keep the riders with the base policy. In fact, we didn't do the experience study at that level, thus we still need time to investigate if the lapse pattern is close.
- The rider is renewable and can be repriced. If the base is cancelled, the rider will also be cancelled.
- The interdependency of risk is assessed to be weak for the base and rider in the examples given.
- We are not quite sure if standalone price means the price of the rider attached is the same as the price independently priced. If yes, our case may not comply with it, because we do price a rider with lower cost assumptions and may not be the same if it is priced as a base.