The Actuarial Society of Hong Kong

WORKSHOP : CONTRACT BOUNDARIES

2017 Insurance IFRS Seminar

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Session 4

ACTUARIAL SOCIETY of HONG KONG
香港精算學會

Wellness Program

An entity recently rolled out a critical illness product with a lump-sum benefit paid upon diagnosis of any covered diseases. The product also offers a temporal 10% increase in CI benefit for the month when prescribed monthly fitness goals are reached

Should the CI benefit addition be separated from the insurance contract?

The cash flows and risks associated with the benefit addition are highly interrelated with the cash flows and risks associated with the insurance components in the contract, therefore the benefit addition is not distinct and shall not be separated from the host contract.

Whole-life Contract

An entity issues a traditional whole-life contract that promises to pay, for a premium of 1,000:

- death benefit of 5,000 whenever the policyholder dies
- cash surrender value that initially equals 100 and increases by 1% annually.

The entity has a claims processing department to process the claims received and an asset management department to manage its investments.

Should the claims processing services, the asset management services or the cash surrender value be separated from the insurance contract?

For claims processing services and asset management services, the entity does not transfer a good or service to the policyholder because the entity performs those activities.

The right to death benefits provided by the insurance coverage either lapses or matures at the same time as the cash surrender value, thus they are highly inter-related and thus not separable.

Equity Indexed Annuity

An entity issues a special annuity contract with following features:

- single premium of 1,000,000
- monthly cash payment of 2,000 in the first ten years regardless of whether annuitant is alive
- an account value (AV) initially equals 800,000 and grows at the rate tied to Hang Seng Index. AV will be annuitized into a plain vanilla life annuity at the tenth year end based on relevant assumptions at the point.
- AV or 800,000, whichever is larger, will be paid upon death of the annuitant.
- no surrender is allowed.

Should the monthly cash payment in the first decade be separated from the insurance contract?

Should the future cash flows beyond the point of annuitisation be included in the measurement of the contract?

Equity Indexed Annuity (cont.)

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Should the monthly cash payment in the first decade be separated from the insurance contract?
Should the future cash flows beyond the point of annuitisation be included in the measurement of the contract?

The monthly cash payments can be readily measured on a standalone basis and are paid regardless of whether annuitant is alive, thus it is not highly inter-related with the host contract and should be separated.

The annuity payments are not prescribed, but would be calculated based on the relevant assumptions at the point of annuitisation. The cash flows beyond which should be considered as related to a future contract and therefore not be included in the measurement.

Questions: contract boundaries

Determine the contract boundary for the following insurance contract:

1. 30-year level term life product, with benefits payable upon death of insured, and premiums reviewable every 10 years at discretion of insurer (reassessments will be based on risk characteristics of individual insured, e.g. health status, driver record, etc).

10-year. Although the pricing reflects the whole 30 year period, the reassessment is based on the risks of a particular insured.

2. 30-year flexible premium universal life product, with premium payable at policyholder's discretion after the first deposit.

30-year. Although the entity can not compel policyholders to pay premiums, it has a substantive obligation to provide services or coverage within the period.

Questions: non-forfeiture options

Given the following non-forfeiture options, determine whether the future cash flows, beyond the date when policyholder exercises the options, arise **from the existing contract or a future contract** (i.e. whether these cash flows shall be included in the measurement of the existing contract)

1. Extended term insurance, with length of the extension determined at the date when policyholder exercises the option based on relevant assumption then.

> Since the entity has discretion on deciding the benefit to reflect relevant risk factors, the ETI shall be considered as a future contract, and therefore cash flows arising from which shall not be included in the measurement.

2. Recued paid-up insurance, with reduced amounts prescribed at issuance of the contract.

> The measurement of the group of insurance contracts shall reflect the fact that the RPU benefits are prescribed at issuance and the entity has a substantive obligation to provide the policyholder with the coverage if the option was exercised, therefore cash flows arising from the RPU are within the boundary of the original contract, and shall be included in the measurement.

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Thank You

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