

Potential implementation question

Quick summary of the question

To seek further clarification, as well as applicability and implication to the Hong Kong market, on the circumstances upon which IFRS 17 Insurance Contracts permits the separation of insurance components of a single legal contract for measurement purposes, following the publication of the Agenda Paper 1 ("the Paper") submitted to the Transition Resource Group ("TRG") for IFRS 17 Insurance Contracts.

Background

Insurers usually offer different types of products or coverage to policyholders in one legal contract by allowing policyholders to attach different types of riders to a contract with basic coverage. Common features / practices of riders in HK market include:

- a. Rider coverage and basic coverage are usually priced separately;
- b. Riders are usually sold at the same time when the basic coverage is sold. However, insurers also allow policyholders to add the rider coverage after the basic coverage is issued.
- c. If the basic coverage is cancelled by the policyholder, the riders have to be cancelled at the same time;
- d. Policyholders can cancel the rider coverage but keep the basic coverage. Rider and basic coverage usually have different expected duration.
- e. Certain types of coverage, like medical insurance, can be sold as basic coverage or rider coverage. This means that policyholders can have the same medical insurance coverage by a) purchasing a medical insurance basic policy, or b) adding a medical insurance rider to a basic policy with other coverage, e.g. life coverage.
- f. In some circumstances, there is interdependency between the basic coverage and rider coverage. The benefit to be provided by the basic coverage may be affected when the policyholder exercises certain right or receives any benefit from the rider coverage (or vice versa), e.g. accelerated critical illness coverage attaching on a life coverage in which claiming the critical illness benefit will reduce the basic life cover. In other circumstances, there is no interdependency between the basic coverage and rider coverage, e.g. medical insurance rider attaching on a life coverage.

Question

#2. If a contract with different rider coverage is considered as a single contract for measurement purposes, how should the coverage unit of this contract be determined? For example, how should we determine the coverage unit of a contract that offers a death benefit of CU10m and medical coverage for annual medical cost up to CU1m? For a group that contains contracts with different combination of sizes, how should we determine the coverage unit for different contracts within this group?

Paragraph of HKFRS/IFRS 17 Insurance Contracts

Separation of insurance components of a single contract

This topic has been discussed in TRG held on 6 February 2018. As mentioned in the Apenda Paper 1 of this topic, 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).

Coverage unit

IFRS 17 defines "coverage unit" in paragraph B119(a) of IFRS 17:

[The amount of CSM recognized in profit or loss in each period is determined by] (a) identifying the coverage units in the group. The number of coverage units in a group is the quantity of coverage provided by the contracts in the group, determined by considering for each contract the quantity of the benefits provided under a contract and its expected coverage duration.

Analysis of the question

Question #2

Possible ways to apply IFRS 17:

Option A - Coverage unit is determined solely based on the basic coverage.

Option B - Coverage unit is determined by combining the coverage unit of basic coverage and riders coverage. The contribution of coverage unit from basic and riders should be based on the respective contribution of CSM at initial recognition.

Option C - Coverage unit is determined by basic and riders coverage separately and applied to its corresponding CSM.

Limitation is noted for each of the options above:

Option A - Coverage unit does not reflect the characteristics of the rider coverage.

Option B - By applying this option, the contribution from basic and rider may change over time, or upon different kinds of policy change (e.g. sum insured adjustment on the basic or rider). As there will be no separate tracking of the CSM of the basic and rider, the same methodology cannot be applied to reassess the coverage unit at subsequent measurement. It would also produce counter-intuitive result when basic or riders are onerous at inception. The alternative is to keep track of the evolution of the respective CSM of basic and riders but this would highly increase the operation complexity.

Option C - While this option is operational feasible and produce intuitive result, the contract would not be evaluated in its entirety.