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Introduction

1. We have received a submission about the boundary of a contract for an arrangement between an entity and an association or a bank under which the entity provides insurance coverage to members of an association or to customers of a bank.

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 *Insurance Contracts* (TRG).

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Structure of the paper

3. This paper includes the following:

   (a) background information;

   (b) implementation question; and

   (c) review of accounting requirements.

Background information

4. Paragraph 2 of IFRS 17 states:

> An entity shall consider its substantive rights and obligations, whether they arise from a contract, law or regulation, when applying IFRS 17. A contract is an agreement between two or more parties that creates enforceable rights and obligations. Enforceability of the rights and obligations in a contract is a matter of law. Contracts can be written, oral or implied by an entity's customary business practices. Contractual terms include all terms in a contract, explicit or implied, but an entity shall disregard terms that have no commercial substance (ie no discernible effect on the economics of the contract). Implied terms in a contract include those imposed by law or regulation. The practices and processes for establishing contracts with customers vary across legal jurisdictions, industries and entities. In addition, they may vary within an entity (for example, they may depend on the class of customer or the nature of the promised goods or services).

5. Paragraph 34 of IFRS 17 states:

> Cash flows are within the boundary of an insurance contract if they arise from substantive rights and obligations that exist during the reporting period in which the entity can compel the policyholder to pay the premiums or in which the entity has a substantive obligation to provide the policyholder with services (see paragraphs B61–B71). A substantive obligation to provide services ends when:

(a) the entity has the practical ability to reassess the risks of the particular policyholder and, as a result, can set a price or level of benefits that fully reflects those risks; or

(b) both of the following criteria are satisfied:

(i) the entity has the practical ability to reassess the risks of the portfolio of insurance contracts that contains the contract and, as a result, can set a price or level of benefits that fully reflects the risk of that portfolio; and

(ii) the pricing of the premiums for coverage up to the date when the risks are reassessed does not take into account the risks that relate to periods after the reassessment date.

6. Appendix A of IFRS 17 defines an insurance contract as:

> A contract under which one party (the issuer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.

7. Appendix A of IFRS 17 defines a policyholder as:

> A party that has a right to compensation under an insurance contract if an insured event occurs.

Implementation question

8. The submission describes an arrangement between an entity and an association or a bank (referred to as the 'group insurance policy' in this paper). Under a group insurance policy an entity provides insurance coverage to members of an association or to customers of a bank (members or customers that purchase insurance coverage are referred to as 'certificate holders' in this paper).

9. The entity has a right to terminate the group insurance policy at any time with a notice period of 90 days which, in turn, terminates the insurance coverage for all certificate holders.

10. The submission asks whether cash flows related to periods after the notice period of 90 days are within the boundary of an insurance contract. As part of the analysis, the submission considers whether the policyholder of an insurance contract as defined in IFRS 17 is:

    (a) the bank or association; or

    (b) the certificate holder.

11. The submission describes two different types of group insurance policies:

    (a) a group association policy; and

    (b) a group creditor policy.

12. It is assumed that for the examples in the submission the entity cannot compel the certificate holders to pay premiums.

Group association policy

13. An entity has a group association policy with an association or bank that allows the entity to market and sell insurance coverage to individuals that are members of the association (for example, members of an automobile association) or customers of a bank. The facts and circumstances are as follows:

(a) legally, the contract is between the entity and the association or bank; however, the insurance coverage for each certificate holder is priced as if it were an individual contract, considering all projected future cash flows (including claims, lapses and expenses);

(b) the insurance coverage is optional for each individual (ie the association or bank does not require them to take out the coverage);

(c) other than being a member of the association or customer of the bank, the individuals are not related to one another;

(d) the group association policies charge step-rated premiums (for example, life insurance contracts premiums increase across periods of coverage with the age of the policyholder);

(e) the entity and the association or bank each have the right to terminate the group association policy going forward at any time with a 90-day notice period, thus terminating the insurance coverage for all certificate holders;

(f) certificate holders have an expectation that the group association policy will not be terminated earlier than the end of the contract term (for example, for life insurance contracts the full term of a contract would be the lifetime of the certificate holder or until the certificate holder reaches a specified age);

(g) the entity cannot terminate coverage for a specific certificate holder (ie the entity has two options: to terminate coverage for all certificate holders or not to terminate coverage for any certificate holders);

(h) the entity cannot reprice premiums; and

(i) claims are payable directly to the certificate holder or their beneficiaries.

Group creditor policy

14. An entity has a group creditor policy with a bank that allows the entity to market and sell insurance coverage to individuals that are customers of the bank. The facts and circumstances of the group creditor policy are similar to the group association policy and the facts and circumstances described in paragraph 13(a)–(h) of this paper also apply to the group creditor policy. The differences between the group association policy and the group creditor policy are that for the group creditor policy:

    (a) the insurance coverage provided to the certificate holder is linked to the remaining outstanding balance of any loan or mortgage issued by the bank to the certificate holder (for example, the contract duration is limited to the earlier of the date that the loan is paid off or the certificate holder reaches a specified age); and

    (b) if the certificate holder had not taken out the insurance coverage, the certificate holder or their beneficiaries would be liable to pay the outstanding balance of any loan or mortgage to the bank. However, with the insurance coverage provided to the certificate holder by the entity, the entity pays the remaining outstanding balance directly to the bank when an insured event occurs.

Review of accounting requirements

Identifying the policyholder

15. IFRS 17 defines an insurance contract as a contract under which one party (the issuer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder. The policyholder is defined as a party that has a right to compensation under an insurance contract if an insured event occurs, ie the beneficiary.

16. IFRS 17 defines a policyholder by its right to compensation if it is adversely affected by an insured event. The staff observe that this is the case regardless of whether that compensation is received directly or indirectly by paying amounts on its behalf.[1] Therefore, for both group insurance policies described in the submission, the certificate holder is a policyholder for the purpose of applying IFRS 17.

17. For the group creditor policy, the submission questions whether the bank is the policyholder to an insurance contract because claims are paid directly to the bank. The staff observe that the fact that the bank is paid directly if a specified future event occurs does not mean that the bank is the policyholder for the purpose of applying IFRS 17. This is because the bank is being paid amounts due to it on behalf of its customer, rather than being compensated for a loss event. It is the customer that benefits from the coverage because the customer's debt is paid.

Identifying the insurance contract

18. The legal form of a group insurance policy as described in the submission is a single contract between an entity and an association or a bank. A contract with the legal form of a single contract would generally be considered to be a single contract for the purpose of applying IFRS 17. However, there might be circumstances in which the legal form of a single contract does not reflect the substance of its contractual rights and obligations.[2]

19. For group insurance policies, as described in the submission, an entity should consider whether the arrangement reflects a single insurance contract (with all certificate holders) or multiple insurance contracts (with each certificate holder).

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[1] This is similar to, for example, death cover for which claim amounts are paid out to the beneficiaries of the policyholder.

[2] Agenda Paper 1 *Separation of insurance components of a single contract* was discussed at the February 2018 TRG meeting.

20. Consistent with previous TRG discussions, the staff observe that overriding the contract unit of account presumption by separating components of a single contract involves significant judgement and careful consideration of all facts and circumstances. The staff view is that, for both types of group insurance policy described in the submission, the following facts and circumstances are indicative that the arrangement reflects multiple insurance contracts (ie an insurance contract with each certificate holder) for the purpose of applying IFRS 17:

    (a) the insurance coverage is priced and sold separately;

    (b) other than being members of the association or customers of the bank the individuals are not related to one another; and

    (c) purchasing the insurance coverage is an option for each individual.

21. The staff view is that the rights of the entity and the association/bank to terminate the group insurance policy does not, in itself, indicate that the arrangement is a single contract for the purpose of applying IFRS 17.

Determining the boundary of an insurance contract

22. The submission asks whether, applying paragraph 34 of IFRS 17, the boundary of the contract reflects the entity's substantive right to terminate the group insurance policy at any time with a 90-day notice period which, in turn, terminates the insurance coverage for all certificate holders.

23. The staff observe that an entity should assess the boundary of each insurance contract with each certificate holder based on the outcome of the analysis discussed in paragraphs 18–21 of this paper. Paragraph BC160(a) of the Basis for Conclusions on IFRS 17 explains that the outer limit of an existing contract is the point at which the entity is no longer required to provide coverage. In accordance with paragraph 34 of IFRS 17, the staff view is that an entity's substantive obligation to provide services under a contract ends at the point that the entity can terminate the contract. Therefore, for the examples in the submission, the entity's substantive obligation ends after 90 days and cash flows within the contract

boundary are those related the obligation to provide service over the period of 90 days.[3]

24. The staff observe that the certificate holder's expectation that the group insurance policy will not be terminated earlier than the end of the contract term is not relevant to the assessment of the contract boundary applying paragraph 34 of IFRS 17.

TRG discussion

Question to TRG members What are your views on the implementation question presented above?

[3] The subsequent treatment for cash flows that are outside the contract boundaries is discussed in Agenda Paper 5 *Cash flows that are outside the contract boundary at initial recognition* of the September 2018 TRG meeting.