IFRS 17 Accounting Policy Paper: Scope

Date:	November 10, 2021
Approvers/ Reviewers:	Approved by: FA Accounting Committee
Subject:	Insurance Contract Scope

Disclaimer:

This accounting policy paper, which is the responsibility of the Facility Association's (FA) management, is prepared solely for the FA as administrator of certain insurance pools, namely the Facility Association Residual Market (FARM) and each of the Risk Sharing Pools (RSPs). It is intended solely for the use of the FA to document management's accounting policy determinations under IFRS 17 as part of management's internal financial reporting and governance processes as applicable to the FARM and each of the RSPs.

This accounting policy paper is being made available through the FA website to member insurance companies for general information purposes only and does not constitute advice from the Facility Association. Member insurance companies are responsible for their own assessment of IFRS 17 as applicable to their financial reporting. We disclaim any responsibility to any member insurance company who may rely on this document.

Contents

Purpose

The purpose of this paper is to document Facility Association's assessment of the requirements of IFRS 17 relating to scope, determination of contracts – more specifically insurance contracts - and identification of non-insurance components.

Entities:

Facility Association (FA) administers three types of mechanisms on behalf of its membership. This paper covers all of these mechanisms, namely:

- Facility Association Residual Market ("FARM")
- Risk Sharing Pools ("RSPs")*
- Uninsured Automobile Funds ("UAFs")

* Outside the scope of this paper are requirements relating to the direct business issued by the individual members prior to transferring the business to the RSPs. Only business assumed via the RSPs will be addressed in this memo.

Topics Covered:

The topics covered in this paper are as follows:

1. How is a 'contract' defined under IFRS 17?
2. Do the contracts transfer significant insurance risk – i.e. are they within the scope of IFRS 17?
3. Do the insurance contracts, identified in 1, contain non-insurance components? If so, are they required to be separated and accounted for in line with other IFRS standards (e.g., IFRS 15 & IFRS 9)?
    a. Embedded derivatives (within the scope of IFRS 9)
    b. Distinct investment components (within the scope of IFRS 9)
    c. Distinct non-insurance services (within the scope of IFRS 15)

Dependencies and Relationships:

The technical positions developed in this paper affect (i.e., have downstream dependency on) the conclusions of the following papers:

1. Level of aggregation
2. Initial recognition and contract boundary
3. Initial recognition and subsequent measurement (which includes qualification for the premium allocation approach (PAA) and onerous contract analysis)
4. Insurance acquisition cashflows
5. Risk adjustment
6. Discount rate
7. Transition
8. Modification and extinguishment of insurance contract

Executive Summary

FA reached the following conclusions regarding the requirements of IFRS 17 relating to scope, determination of contracts – more specifically insurance contracts - and identification of non-insurance components:

1- How does FA define a "contract" under IFRS 17?

   a. FARM: Each individual policy represents a contract as defined under IFRS 17

   b. RSPs: Each of the six risk sharing pools represent a contract as defined under IFRS 17 (i.e., one insurance contract in each of the five provinces for which FA administers a risk sharing pool, with the exception of Alberta for which there are two separate risk sharing pools)

      i. Ontario Risk Sharing Pool;
      ii. Alberta Grid Pool;
      iii. Alberta Non-Grid Pool;
      iv. New Brunswick Risk Sharing Pool;
      v. Nova Scotia Risk Sharing Pool; and
      vi. Newfoundland and Labrador Risk Sharing Pool

   c. UAFs: No contract, as defined by IFRS 17, exists under the UAF mechanism

2- Do the contracts transfer significant insurance risk?

   a. FARM: Yes, significant insurance risk is transferred and therefore, the FARM is within the scope of IFRS 17

   b. RSPs: Yes, significant insurance risk is transferred and therefore, the RSPs are within the scope of IFRS 17

   c. UAFs: As concluded in question 1, no contract, as defined by IFRS 17, exists under the UAF mechanism. As a result, the UAFs do not fall within the scope of IFRS 17 and will be excluded from the IFRS analysis beyond this memo.

3- Do the insurance contracts, identified in question 1, contain non-insurance components?

   a. FARM: No separate non-insurance components identified

   b. RSPs: No separate non-insurance components identified

   c. UAFs: Analysis not applicable

Accounting questions:

Question 1: How does FA define a 'contract' under IFRS 17?

Question 2: Do the contracts transfer significant insurance risk?

Question 3: Do the insurance contracts, identified in Question 1, contain non-insurance components and if so, are they required to be separated and accounted for in line with other IFRS standards (e.g., IFRS 15 & IFRS 9)?

Background

Facility Association ("FA") is a Canadian unincorporated non-profit association whose goal is to ensure that automobile insurance is available for every owner and licensed driver of motor vehicles who require it to legally operate their vehicles. FA accomplishes its mission of ensuring automobile insurance availability primarily through the administration of three types of residual market mechanisms:

- Facility Association Residual Market ("FARM")
- Risk sharing pools ("RSP")
- Uninsured Automobile Funds ("UAFs")

FARM

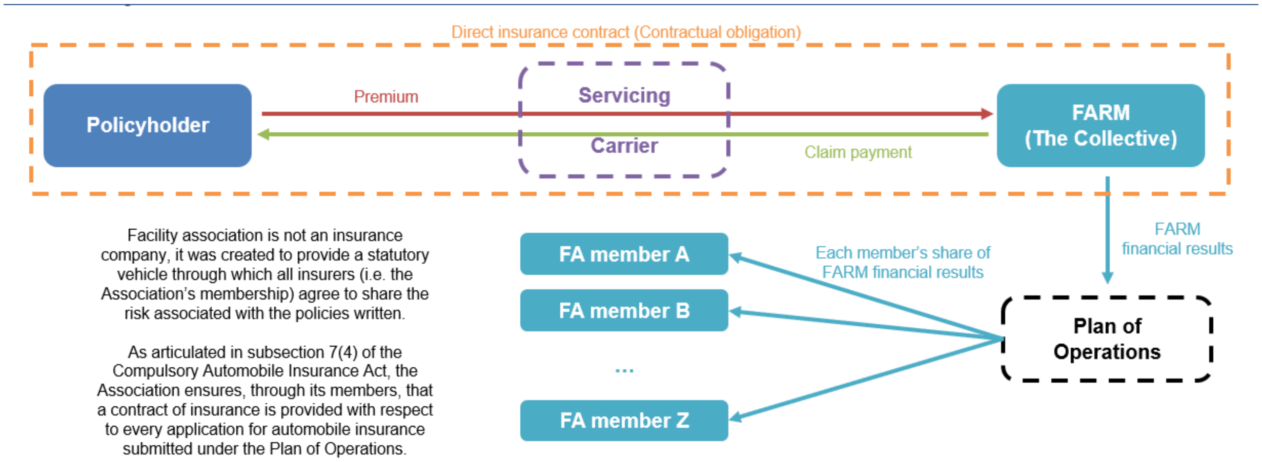
The Facility Association Residual Market ("FARM") provides a residual automobile insurance market for owners and operators of personal and commercial vehicles who may otherwise have difficulty obtaining automobile insurance. Under the FARM, agents and brokers who are unable to find automobile insurance coverage for one of their clients can contact a Servicing Carrier who will issue an automobile insurance policy for a particular client on behalf of the member insurance companies of FA (individually, a "member" and collectively the "members"). As a result, every policyholder insured by the members through the FARM knows that their insurance policy is part of the residual market.

In each jurisdiction, FA contracts with member automobile insurance companies to perform all the underwriting and claims settlement activities and to issue and administer policies on behalf of the members. These insurance companies, known as Servicing Carriers, also adjust claims on behalf of the member companies.

The FARM operates in the following jurisdictions: Alberta, Ontario, Nova Scotia, Prince Edward Island, New Brunswick, Newfoundland & Labrador, Yukon, Northwest Territories and Nunavut.

The FA's administration of the FARM can be thought of as a Managing General Agency ("MGA") model where FA acts as the MGA in performing/outsourcing the administrative operations on behalf of its members. Specifically, FA as a body does NOT have the right to the insurance premium associated with the issued contract, nor does FA itself assume the obligations arising from those contracts (this belongs to the FA members).

Similarly, FA does NOT have a contractual relationship with the policyholder as the actual rights/obligations underlying the policy as issued obligate the FA members (via the FA Plan of Operation and their share of the FARM) to assume insurance risk from the underlying policyholders.



RSP

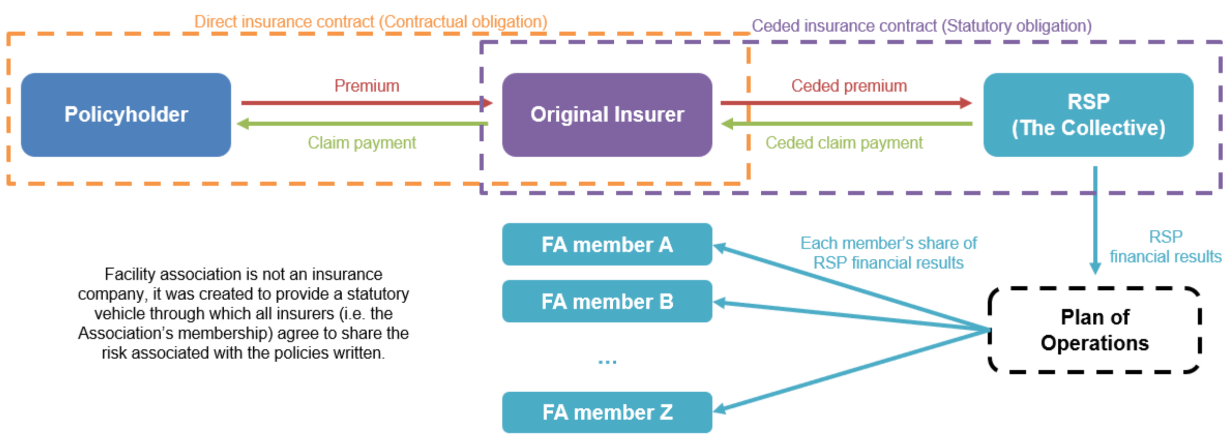
The risk sharing pools ("RSPs") allow automobile insurance companies to transfer certain of their personal automobile (i.e., private passenger vehicles) insurance exposures to an industry-wide pool. As such, the RSPs essentially act as industry-wide reinsurance mechanisms.

RSPs operate in Ontario, Alberta, New Brunswick, Nova Scotia and Newfoundland and Labrador. In each of these jurisdictions, member companies underwrite individual policies according to their own rates and rules (or at a regulated maximum rate level where applicable). For risks that qualify for a RSP, individual members issue insurance policies on their own accounts and may transfer the whole of the policy or a portion thereof through the applicable RSP to the members in accordance with the transfer rules set out in the FA Plan of Operation.

As such, the RSPs provide a means for individual members to cede risk to the insurance pools under administration.

As a first step, the transferring member issues an insurance contract to a policyholder, agreeing to the rights and obligations arising from that contract. As a second and distinct process, the member transfers some or all of the insurance risk arising from the underlying insurance contract to the FA membership, through the RSPs.

Like the FARM, FA's role is solely administrative, facilitating the transaction between the transferring member and the FA membership.

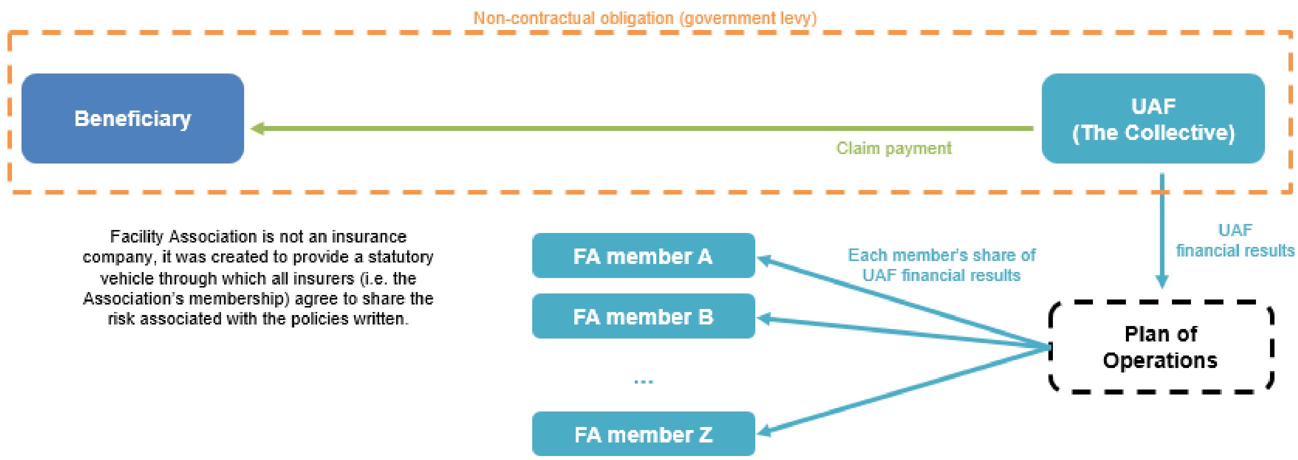


UAF

In the four Atlantic provinces (New Brunswick, Newfoundland & Labrador, Nova Scotia, and Prince Edward Island), FA also administers funds that provide financial compensation for damages to persons who cannot obtain satisfaction for their damages under a contract of automobile insurance and where there is no other insurance or the other insurance is inadequate with respect to the damages claimed.

The UAFs are governed by the respective provincial Insurance Acts. The responsibilities of the Association are to administer claims recording, claims adjustment, and payment processes; to allocate to members their share of the experience; and to assess members to fund deficits. Members share in the experience of the UAFs in accordance with their participation ratio, reflecting their share of the market by jurisdiction and accident year in accordance with relevant provisions of the Plan.

FA monitors the investigation, defense and final settlement of these claims through the assistance of designated law firms and insurance companies. As such, like the other mechanisms, FA only plays an administrative role in managing the funds and does not assume any risk or obligation.



Question 1: How is a 'contract' defined under IFRS 17?

Technical References and Guidance

IFRS 17 Standard

2. 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 (i.e. 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).

3. An entity shall apply IFRS 17 to:
(a) insurance contracts, including *reinsurance contracts*, it issues;
(b) reinsurance contracts it holds; and
(c) *investment contracts with discretionary participation features* it issues, provided the entity also issues insurance contracts.

TRG Staff Paper February 2018 – Review of accounting treatment

16. IFRS 17 identifies a contract as an agreement that creates enforceable rights and obligations. IFRS 17 does not provide specific requirements on separating enforceable rights and obligations of a contract except with respect to non-insurance components. Therefore, the staff observe that the lowest unit of account that is used under IFRS 17 is the contract that includes all insurance components.

20. It is expected that entities would usually design contracts in a way that reflects their substance. Therefore a contract with the 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.

22. The staff view is that overriding the contract unit of account presumption by separating insurance components of a single insurance contract involves significant judgment and careful consideration of all relevant facts and circumstances.

23. The staff view is that combining different types of products or coverages that have different risks into one legal insurance contract is not, in itself, sufficient to conclude that the contract does not reflect the substance of its contractual rights and contractual obligations.

24. Similarly, the staff view is that a reinsurance contract held covering underlying contracts that are included in different groups is not in itself, sufficient to conclude that the reinsurance contract held does not reflect the substance of its contractual rights and contractual obligations.

<u>Technical Analysis</u>

FARM

Servicing carriers issue insurance contracts to policyholders on behalf of FA's members. Every policyholder insured by members through the FARM knows that their insurance policy is part of the residual market.

Members assume the risk and share in the experience of the FARM in accordance with their participation ratio, reflecting their share of the market by:

- Jurisdiction;
- Business segment; and
- Accident year.

As such, the insurance contracts issued by servicing carriers through the FARM are considered to be direct written business for each member company and the substantive obligations are not passed on to the member companies of FA until a policy has been issued to a policyholder by a servicing carrier.

The "IFRS 17 Contract" is each individual policy issued through the FARM by a servicing carrier.

RSP

Unlike traditional reinsurance arrangements, no legal contract exists between the individual originating insurer and the collective of members who participate in the financial results of the RSPs.

IFRS 17 identifies a contract as "an agreement that creates enforceable rights and obligations".

Specifically, IFRS 17.2 requires an entity to

> *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).*

FA's Plan of Operation is not a contract between the FA and its members. The Plan of Operation was established pursuant to subsection 7 (3) of the Insurance Act, pursuant to which every member of FA is obligated to comply with the Plan of Operation (along with FA's articles of association, by-laws, rules and resolutions) this is a statutory obligation, not a contractual one.

The Statutory obligation is created on a province-by-province basis (for each of the RSPs). The counterparty to the reinsurance treaty is the RSP and each FA member is obligated to participate in their share/premiums, claims and expenses in accordance with the Plan of Operation.

The RSPs therefore, represent treaty reinsurance on a facultative-obligatory basis: the RSPs cover the specified share of all insurance policies issued by the ceding company (or originating insurer) that the ceding company chooses to cede.

As no legal contract exists, there is no presumption that the legal form of a single contract would generally be considered a single contract in substance.

A contract exists for each province in which the RSP operates and two contracts exist for Alberta (grid vs non-grid) as a result of the RSPs functioning similar to a facultative-obligatory reinsurance treaty written on a losses-occurring-during basis.

UAFs

As defined under paragraph 2, a contract is *"an agreement that creates enforceable rights and obligations"*.

For the UAFs, there is no "policyholder" until an accident has occurred – the fund is for individuals who do not have proper insurance and is legislated by provincial laws. The members of the UAFs are governed by the Plan of Operation that dictates each member's share of any resulting financial obligations.

As such, there is a statutory obligation for the FA members to pay their portion of the claims as they arise, but no actual contract nor policyholder exists. This is only a charge to the members when a claim occurs and as such, the mechanism is more like a levy or a tax. Therefore, no contract, as defined by IFRS 17, exists under the UAF mechanism.

As such no contract exists for UAFs as defined in IFRS 17

<u>Technical Position</u>

Mechanism	Technical Position
FARM	Each individual policy issued by the servicing carriers represents a contract as defined under IFRS 17 between the policyholder and the collective members of the FARM
RSPs	Each pool of insurance policies issued by the individual member company represents a contract as defined under IFRS 17 (Alberta has two contracts being Grid and Non-Grid) between the policyholder and the collective members of the applicable RSP.
UAFs	No contract exists

Question 2: Do the contracts transfer significant insurance risk?

Technical References and Guidance

IFRS 17 Appendix A:

Insurance contract: 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**

Insurance contract services: The following services that an entity provides to a policyholder of an insurance contract:
(a) coverage for an insured event (insurance coverage);
(b) for insurance contracts without direct participation features, the generation of an investment return for the
policyholder, if applicable (investment-return service); and
(c) for insurance contracts with direct participation features, the management of underlying items on behalf of the policyholder (investment-related service).

Insurance risk: Risk, other than **financial risk**, transferred from the holder of a contract to the issuer.

Insurance event: An uncertain future event covered by an **insurance contract** that creates **insurance risk**.

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

Financial risk: The risk of a possible future change in one or more of a specified interest rate, financial instrument price, commodity price, currency exchange rate, index of prices or rates, credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract.

IFRS 17

3. An entity shall apply IFRS 17 to:
   (a) insurance contracts, including *reinsurance contracts*, it issues;
   (b) reinsurance contracts it holds; and
   (c) *investment contracts with discretionary participation features* it issues, provided the entity also issues insurance contracts.

4. All references in IFRS 17 to insurance contracts also apply to:
   i. reinsurance contracts held, except:
      a) for references to insurance contracts issued; and
      b) as described in paragraphs 60–70A.

ii. investment contracts with discretionary participation features as set out in paragraph 3(c), except for the reference to insurance contracts in paragraph 3(c) and as described in paragraph 71.

8A. Some contracts meet the definition of an insurance contract but limit the compensation for insured events to the amount required to settle the policyholder's obligation created by the contract (for example, loans with death waivers). If such contracts are not excluded from the scope of IFRS 17 by paragraphs 7(a)–(h), an entity shall choose to apply IFRS 17 or IFRS 9 to such contracts that it issues. The entity shall make that choice for each portfolio of insurance contracts, and the choice for each portfolio is irrevocable.

B18. Insurance Risk is significant if, and only if, an insured event could cause the issuer to pay additional amounts that are significant in any single scenario, excluding scenarios that have no commercial substance (ie no discernible effect on the economics of the transaction). If an insured event could mean significant additional amounts would be payable in any scenario that has commercial substance, the condition in the previous sentence can be met even if the insured event is extremely unlikely, or even if the expected (ie probability-weighted) present value of the contingent cash flows is a small proportion of the expected present value of the remaining cash flows from the insurance contract.

B19. In addition, a contract transfers significant insurance risk only if there is a scenario that has commercial substance in which the issuer has a possibility of a loss on a present value basis. However, even if a reinsurance contract does not expose the issuer to the possibility of a significant loss, that contract is deemed to transfer significant insurance risk if it transfers to the reinsurer substantially all the insurance risk relating to the reinsured portions of the underlying insurance contracts.

B20. The additional amounts described in paragraph B18 are determined on a present-value basis. If an insurance contract requires payment when an event with uncertain timing occurs and if the payment is not adjusted for the time value of money, there may be scenarios in which the present value of the payment increases, even if its nominal value is fixed. An example is insurance that provides a fixed death benefit when the policyholder dies, with no expiry date for the cover (often referred to as whole-life insurance for a fixed amount). It is certain that the policyholder will die, but the date of death is uncertain. Payments may be made when an individual policyholder dies earlier than expected. Because those payments are not adjusted for the time value of money, significant insurance risk could exist even if there is no overall loss on the portfolio of contracts. Similarly, contractual terms that delay timely reimbursement to the policyholder can eliminate significant insurance risk. An entity shall use the discount rates required in paragraph 36 to determine the present value of the additional amounts.

B22. An entity shall assess the significance of insurance risk contract by contract. Consequently, the insurance risk can be significant even if there is minimal probability of significant losses for a portfolio or group of contracts.

Technical Analysis

Transfer of uncertainty (or risk) is the essence of an insurance contract. Therefore, for a contract to be an insurance contract, uncertainty is required at the contract's inception over at least one of the following:

- the probability that an insured event will occur;
- when it will occur; or
- how much the insurer will need to pay if it occurs. [IFRS 17.B3]

A contract transfers significant insurance risk only if there is a scenario that has commercial substance in which the issuer has the possibility of incurring a loss on a present value basis. However, even if a reinsurance contract does not expose the reinsurer to the possibility of a significant loss, it is still deemed to transfer significant insurance risk if it transfers substantially all of the insurance risk relating to the reinsured portions of the underlying insurance contracts to the reinsurer. [IFRS 17.B19]

In TRG Staff Paper AP09 Industry pools discussion by the IASB staff in September 2018, some key interpretations were discussed which is very relevant to FA – see extracts below

16. IFRS 17 applies to insurance contracts within the scope. 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

17. In some cases, the parties to the contract are clear from the legal form of the contract. In other cases, the terms of the contract require analysis to identify the substance of the rights and obligations – including who is the issuer of the contract. For example, for insurance contracts in an industry pool the issuer could be:
a) the individual member entity that writes the contracts;
b) each member entity for its respective share of each contract in the pool; or
c) the collective of all member entities

FARM

In order to better analyze this question, it is important to understand the role and responsibilities of each parties involved in the FARM mechanism.

Insurance contract issued	
Policyholder	**FA membership (The Collective)**
Asset for benefit payment *Right to receive service*	Insurance contract liability (direct) *Obligation to provide the service*

Based on the mechanism illustrated above, the issuer of the insurance contract is in fact the "Collective" and therefore, similar to a direct business, the member companies of the FARM are obligated to provide the service.

The service under the FARM is to provide coverage to the policyholder for insured events (insurance coverage) – as defined in Appendix A of IFRS 17. As such, as per IFRS 17, an insurance risk exists at the inception of the contract since uncertainty surrounding the probability of the insured event occurring, timing of such event and the costs related to this event are unknown at that time.

Therefore, the insurance risk is transferred to the FA membership (The Collective) as the issuer of the contract.

As defined in paragraph B19 above, a contract transfers significant insurance risk only if there is a scenario that has commercial substance in which the issuer has a possibility of a loss on a present value basis. This is the case for FARM as the membership is liable for the payments of claims incurred and therefore, there is a possibility of a loss being incurred. This is further supported by the fact that over the 2018 – 2020 accident years, the average cost per claim ranges from $16,800 to $21,500, which exceeds the average written premium for those years ranging from $2,800 to $3,800.

The contracts issued by the FA membership through the FARM transfer significant insurance risk

RSPs

In order to better analyze this question, it is important to understand the role and responsibilities of each parties involved in the RSP mechanism.

Insurance Contract Issued		**Reinsurance Contract Held (RCH) / Insurance Contract Assumed**	
Policyholder	**Original Insurer**	**Original Insurer**	**FA Membership (The Collective)**
Asset for benefit payment *Right to receive service*	Insurance contract liability (direct) *Obligation to provide the service*	RCH asset (ceded) *Right to receive the service*	Insurance contract liability (assumed) *Obligation to provide the service*

As illustrated above, the RSPs are a risk sharing mechanism whereas the members issue insurance contracts directly with policyholders (based on their own terms and conditions) and then some or all of the insurance risk arising from the underlying insurance contract is transferred to the FA membership, through the RSPs.

The counterparty to the contract ceded by the originating insurer to the RSP is the Collective and therefore, the members of each of the RSPs. As such, the RSPs represent treaty reinsurance on a facultative-obligatory basis: the RSPs cover the specified share of all insurance policies issued by the ceding company (or originating insurer) that the ceding company chooses to cede.

As such, as per IFRS 17, an insurance risk exists at the inception of the contract since uncertainty surrounding the probability of the insured event occurring, timing of such event and the costs related to this event are unknown at that time.

Similar to a reinsurer, the FA members of each RSP are liable for any future claims covered by the insurance contract assumed by the pool and therefore, we conclude that there is an insurance risk being transferred.

As per paragraph B19 above, even if a reinsurance contract does not expose the issuer to the possibility of a significant loss, that contract is deemed to transfer significant insurance risk if it transfers to the reinsurer substantially all the insurance risk relating to the reinsured portions of the underlying insurance contracts. As such, the criteria is met for RSPs as explained above.

The RSP transfers significant insurance risk

UAF

No analysis required as no contract exists – refer to question 1.

Technical Position

Mechanism	Technical Position
FARM	Each contract, as defined in question 1, meets the definition of insurance contract with significant insurance risk.
RSP	Each contract, as defined in question 1, meets the definition of insurance contract with significant insurance risk.
UAF	No analysis required – not a contract

Question 3: Do the insurance contracts, identified in Question 1, contain non-insurance components and if so, are they required to be separated and accounted for in line with other IFRS standards (e.g., IFRS 15 & IFRS 9)?

This is determined by assessing the following questions:
1. Does the contract contain an embedded derivative and if so, is it required to be separated?
2. Does the contract contain a distinct investment component and if so, is it required to be separated? and
3. Does the contract contain a promise to transfer a distinct product or non-insurance services and if so, is it required to be separated?

Technical References and Guidance

Separating components from an insurance contract

IFRS 17

10. An insurance contract may contain one or more components that would be within the scope of another Standard if they were separate contracts. For example, an insurance contract may include an investment component or a non-insurance service component (or both). An entity shall apply paragraphs 11–13 to identify and account for the components of the contract.

11. An entity shall:
- apply IFRS 9 to determine whether there is an embedded derivative to be separated and, if there is, how to account for that derivative.
- separate from a host insurance contract an investment component if, and only if, that investment component is distinct (see paragraphs B31–B32). The entity shall apply IFRS 9 to account for the separated investment component unless it is an investment contract with discretionary participation features (see paragraph 3(c)).

12. After applying paragraph 11 to separate any cash flows related to embedded derivatives and distinct investment components, an entity shall separate from the host insurance contract any promise to transfer to a policyholder distinct goods or services other than insurance contract services applying paragraph 7 of IFRS 15. The entity shall account for such promises applying IFRS 15. In applying paragraph 7 of IFRS 15 to separate the promise, the entity shall apply paragraphs B33–B35 of IFRS 17 and, on initial recognition, shall:
- apply IFRS 15 to attribute the cash inflows between the insurance component and any promises to provide distinct goods or services other than insurance contract services; and
- attribute the cash outflows between the insurance component and any promised goods or services other than insurance contract services accounted for applying IFRS 15 so that:
- cash outflows that relate directly to each component are attributed to that component; and
- any remaining cash outflows are attributed on a systematic and rational basis, reflecting the cash outflows the entity would expect to arise if that component were a separate contract.

13. After applying paragraphs 11–12, an entity shall apply IFRS 17 to all remaining components of the host insurance contract. Hereafter, all references in IFRS 17 to embedded derivatives refer to derivatives that have not been separated from the host insurance contract and all references to investment components refer to investment components that have not been separated from the host insurance contract (except those references in paragraphs B31–B32).

Investment components

B31. Paragraph 11(b) requires an entity to separate a distinct investment component from the host insurance contract. An investment component is distinct if, and only if, both the following conditions are met:

- the investment component and the insurance component are not highly interrelated.
- a contract with equivalent terms is sold, or could be sold, separately in the same market or the same jurisdiction, either by entities that issue insurance contracts or by other parties. The entity shall take into account all information reasonably available in making this determination. The entity is not required to undertake an exhaustive search to identify whether an investment component is sold separately.

B32. An investment component and an insurance component are highly interrelated if, and only if:

- the entity is unable to measure one component without considering the other. Thus, if the value of one component varies according to the value of the other, an entity shall apply IFRS 17 to account for the combined investment and insurance component; or
- the policyholder is unable to benefit from one component unless the other is also present. Thus, if the lapse or maturity of one component in a contract causes the lapse or maturity of the other, the entity shall apply IFRS 17 to account for the combined investment component and insurance component.

Promises to transfer distinct goods or non-insurance services

B33. Paragraph 12 requires an entity to separate from an insurance contract a promise to transfer distinct goods or non-insurance services to a policyholder. For the purpose of separation, an entity shall not consider activities that an entity must undertake to fulfil a contract unless the entity transfers a good or service to the policyholder as those activities occur. For example, an entity 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 tasks are performed.

B34. A good or non-insurance service promised to a policyholder is distinct if the policyholder can benefit from the good or service either on its own or together with other resources readily available to the policyholder. Readily available resources are goods or services that are sold separately (by the entity or by another entity), or resources that the policyholder has already got (from the entity or from other transactions or events).

B35. A good or non-insurance service that is promised to the policyholder is <u>not</u> distinct if:

- the cash flows and risks associated with the good or service are highly interrelated with the cash flows and risks associated with the insurance components in the contract; and
- the entity provides a significant service in integrating the good or non-insurance service with the insurance components.

B10. Under some contracts, an insured event triggers the payment of an amount linked to a price index. Such contracts are insurance contracts, provided that the payment contingent on the insured event could be significant. For example, a life-contingent annuity linked to a cost-of-living index transfers insurance risk because the payment is triggered by an uncertain future event—the survival of the person who receives the annuity. The link to the price index is a derivative, but it also transfers insurance risk because the number of payments to which the index applies depends on the survival of the annuitant. If the resulting transfer of insurance risk is significant, the derivative meets the definition of an insurance contract, in which case it shall not be separated from the host contract (see paragraph 11(a)).

IFRS 9

4.3.3. If a hybrid contract contains a host that is not an asset within the scope of this Standard, an embedded derivative shall be separated from the host and accounted for as a derivative under this Standard if, and only if:

a. the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host;
b. a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and
c. the hybrid contract is not measured at fair value with changes in fair value recognised in profit or loss (ie a derivative that is embedded in a financial liability at fair value through profit or loss is not separated).

IFRS 9 Appendix A

Derivative: A financial instrument or other contract within the scope of this Standard with all three of the following characteristics.

4. its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (sometimes called the ‘underlying’).
5. it requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors.
6. it is settled at a future date.

Technical Analysis

FARM

Based on the assessment performed of the technical references stated above (no other services included in the contracts, no financial component, no initial investments, etc.), there is no non-insurance component within each insurance contract that would fall under other IFRS standards (e.g. IFRS 9 *Financial Instruments* or IFRS 15 *Revenue from contracts with customers*). As such, FA determined that there is no component in the FARM mechanism which would require separation.

The applicable lowest unit of account is each contract as defined under Question 1

(no separate component identified)

RSP

Based on the assessment performed of the technical references stated above (no other services included in the contracts, no financial component, no initial investments, etc.), there is no non-insurance component within each insurance contract that would fall under other IFRS standards (e.g. IFRS 9 *Financial Instruments* or IFRS 15 *Revenue from contracts with customers*). As such, FA determined that there is no component in the FARM mechanism which would require separation.

The applicable lowest unit of account is each contract as defined under Question 1
(no separate component identified)

Technical Position

Mechanism	Technical Position
FARM	No separate component identified
RSP	No separate component identified
UAF	No analysis required – not a contract