OCI treatment for hybrid products

Situation
Hybrid product which allows to combine

- unit-linked,
- saving with guarantee and
- protection insurance.

The components are highly interrelated, hence unbundling of the components is prohibited (or at least discouraged by the standard).

The corresponding portfolio does not allow for VFA application (the conditions are not met). As consequence, the general model is applied.

The assets backing traditional part (saving with guarantee + protection) are primarily bonds with P&L measurement driven by amortised purchase price (AFS / SPPI).

PROBLEMs
a) Is there IFRS 17 compliant treatment of the insurance finance income which corresponds to the economic reality of such contract?

b) Possible impact on the mutualisation among portfolios.

SIMPLE EXAMPLE

Extremely simplistic:
PVFCF = Value of Funds; RA = CSM = 0;
No cash-flows, no lapses, no operating variance;
100% match between assets and liabilities
remaining duration of the group = 5 years

Beginning of the year:

ASSETS			LIABILITIES
Assets backing UL	1000	1000	Unit Linked PVFCF
Assets backing Traditional	1000	1000	Traditional PVFCF

Market return on assets (both categories) +10%, i.e. **end of year***:*

Assets backing UL	1100	1100	Unit Linked PVFCF
Assets backing Traditional	1100	1100	Traditional PVFCF

- *profit from UL-backing assets = 100*
- *(new) OCI from Traditional provisions = 100*

POSSIBILITY 1 - Insurance financial revenue and expense immediately in P&L (*i.e. 88 (a)****)***

	Profit	OCI
Profit from assets backing UL	100	
Profit from assets backing Trad		100
Finance Expense on UL part	-100	
Finance Expense on Trad part	-100	
TOTAL	**-100**	**100**

ASSETS			LIABILITIES
		-100	Profit
		100	OCI
Assets backing UL (FV PL)	1100	1100	Unit Linked PVFCF
Assets backing Traditional (AFS)	1100	1100	Traditional PVFCF

POSSIBILITY 2 - Insurance financial revenue and expense allocated at constant rate (*i.e. B132 (a)(i)****)***
allocation over the remaining duration of the group (5 years)

	Profit	OCI
Profit from assets backing UL	100	
Profit from assets backing Trad		100
Finance Expense on UL part	-20	-80
Finance Expense on Trad part	-20	-80
TOTAL	**60**	**-60**

ASSETS			LIABILITIES
		60	Profit
		-60	OCI from Traditional
Assets backing UL (FV PL)	1100	1100	Unit Linked PVFCF
Assets backing Traditional (AFS)	1100	1100	Traditional PVFCF

POSSIBILITY 3 - Insurance financial revenue and expense allocated when credited to client (*i.e. B132 (a)(ii)****)***
132 (a)(ii): for contracts that use a crediting rate to determine amounts due to the policyholders
-> not applicable for contracts without profit-sharing on the traditional part

	Profit	OCI
Profit from assets backing UL	100	
Profit from assets backing Trad		100
Finance Expense on UL part	-100	
Finance Expense on Trad part		-100
TOTAL	**0**	**0**

POSSIBILITY 4 – Different approach to Traditional and UL part

*would applicable also for contracts without profit-sharing … **but is it compliant with IFRS 17 ?***

B131 (accordingly to discount curve) might be required in case of traditional without profit-sharing

	Profit	**OCI**	
Profit from assets backing UL	100		
Profit from assets backing Trad		100	
Finance Expense on UL part	-100		*Allocated when credited (B132 (a)(ii))*
Finance Expense on Trad part	-20	-80	*Allocated at Constant Rate (B132 (a)(i))*
TOTAL	**-20**	**20**	

88 Unless paragraph 89 applies, an entity shall make an accounting policy choice between:

(a) including insurance finance income or expenses for the period in profit or loss; or

(b) disaggregating insurance finance income or expenses for the period to include in profit or loss an amount determined by a systematic allocation of the expected total insurance finance income or expenses over the duration of the group of contracts, applying paragraphs B130–B133

B129 Paragraphs 88–89 require an entity to make an accounting policy choice as to whether to disaggregate insurance finance income or expenses for the period between profit or loss and other comprehensive income. An entity shall apply
its choice of accounting policy to portfolios of insurance contracts. In assessing the appropriate accounting policy for a portfolio of insurance contracts, applying paragraph 13 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, the entity shall consider for each portfolio the assets that the entity holds and how it accounts for those assets.

B130 If paragraph 88(b) applies, an entity shall include in profit or loss an amount determined by a systematic allocation of the expected total finance income or expenses over the duration of the group of insurance contracts. In this context, a systematic allocation is an allocation of the total expected finance income or expenses of a group of insurance contracts over the duration of the group that:

(a) is based on characteristics of the contracts, without reference to factors that do not affect the cash flows expected to arise under the contracts. For example, the allocation of the finance income or expenses shall not be based on expected recognised returns on assets if those expected recognised returns do not affect the cash flows of the contracts in the
group.

(b) results in the amounts recognised in other comprehensive income over the duration of the group of contracts totalling zero. The cumulative amount recognised in other comprehensive income at any date is the difference between the carrying amount of the group of contracts and the amount that the group would be measured at when applying the systematic allocation.

B131 For groups of insurance contracts for which changes in assumptions that relate to financial risk do not have a substantial effect on the amounts paid to the policyholder, the systematic allocation is determined using the discount rates specified in paragraph B72(e)(i).

B132 For groups of insurance contracts for which changes in assumptions that relate to financial risk have a substantial effect on the amounts paid to the policyholders:

(a) a systematic allocation for the finance income or expenses arising from the estimates of future cash flows can be determined in one of the following ways:

(i) using a rate that allocates the remaining revised expected finance income or expenses over the remaining duration of the group of contracts at a constant rate; or

(ii) for contracts that use a crediting rate to determine amounts due to the policyholders—using an allocation that is based on the amounts credited in the period and expected to be credited in future periods.

(b) a systematic allocation for the finance income or expenses arising from the risk adjustment for non-financial risk, if separately disaggregated from other changes in the risk adjustment for non-financial risk applying paragraph 81, is determined using an allocation consistent with that used for the allocation for the finance income or expenses arising from the future cash flows.

(c) a systematic allocation for the finance income or expenses arising from the contractual service margin is determined:

(i) for insurance contracts that do not have direct participation features, using the discount rates specified in paragraph B72(b); and

(ii) for insurance contracts with direct participation features, using an allocation consistent with that used for the allocation for the finance income or expenses arising from the future cash flows.