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Project **Insurance Contracts**

Topic **Definition of an insurance contract**

Purpose of this paper

1. The purpose of this memorandum is to analyze the definition of an insurance contract in IFRS 4, *Insurance Contracts*, with the intention of using that definition in an exposure draft on the accounting for insurance contracts.

2. The guidance from IFRS 4 on the definition of an insurance contract is included in appendix A to this paper. The IASB has also published implementation guidance accompanying IFRS 4 that illustrates the application of the definition of an insurance contract (see appendix B to this paper). The staff provides these appendices as background and will not ask the boards to discuss them during the meeting. The staff does not expect board members to study the appendices in detail.

3. We note that the Implementation Guidance accompanying IFRS 4 is not part of the standard and has no formal authority. The staff believes it still serves a useful educational purpose and that it would be useful to re-issue it, updated as necessary, with the exposure draft and the final standard. However, the boards may wish to discuss more generally how to deal with such material. The staff does not believe any of the material currently in the implementation guidance should be moved to the standard.

This paper has been prepared by the technical staff of the FASB and the IASCF for discussion at a public meeting of the FASB or the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the FASB or the IASB.

Comments made in relation to the application of U.S. GAAP or IFRSs do not purport to be acceptable or unacceptable application of U.S. GAAP or IFRSs.

The tentative decisions made by the FASB or the IASB at public meetings are reported in FASB *Action Alert* or in IASB *Update*. Official pronouncements of the FASB or the IASB are published only after each board has completed its full due process, including appropriate public consultation and formal voting procedures.

Summary of Staff recommendations

4. The staff recommends that the IFRS 4's definition of an insurance contracts and the related guidance in appendix B of IFRS 4 (appendix A to this paper) be brought forward to the forthcoming exposure draft, including the following features discussed in this paper:

   (a) *compensation* be used in the definition of an insurance contract (as opposed to indemnification)

   (b) significant insurance risk be described as in IFRS 4.

5. In agenda paper 6C (FASB Memorandum 41C), staff discusses the relevance of timing risk in the context of determining whether a contract contains insurance risk.

Structure of the Paper

6. The rest of this paper is divided into the following sections:

   (a) Background (paragraphs 7 through 9)

   (b) Definition of an insurance contract (paragraphs 10 through 14)

   (c) Differences between IFRS and U.S. GAAP (paragraphs 15 through 40)

   (d) Appendix A that includes Appendix B of IFRS 4 that describes the definition of an insurance contract.

   (e) Appendix B that includes the implementation guidance accompanying IFRS 4 that illustrates the application of the definition of an insurance contract.

Background

7. The IASB developed a definition of an insurance contract in IFRS 4. During the deliberations for IFRS 4, the IASB received feedback from constituents which generally supported the definition and scope of IFRS 4. The IASB decided to use the IFRS 4 definition of an insurance contract in its discussion paper *Preliminary Views on Insurance Contracts,* with the intention of revisiting the topic for the exposure draft.

8. On February 9, 2010, the FASB held an educational session about the definition of an insurance contract contained in IFRS 4 in preparation for a decision-making meeting in March. The IASB has not discussed this definition in a public meeting since the issuance of the discussion paper on insurance contracts.

9. This memorandum should be read in conjunction with Agenda Paper 6B (FASB Memorandum No. 41B), which analyzes the scope of IFRS 4 with the intention of using that scope for the exposure draft on insurance contracts. It should also be read in conjunction with Agenda Paper 6C (FASB Memorandum No. 41C), which discusses the relevance of timing risk in the context of determining whether a contract contains insurance risk.

Definition of an insurance contract

10. The definition of an insurance contract in IFRS 4 is:

> A contract under which one party (the **insurer**) 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.

11. IFRS 4 includes other definitions related to the definition of an insurance contract, including:

    (a) **Insured event:** An uncertain future event that is covered by an **insurance contract** and creates **insurance risk**.

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

    (c) **Financial risk:** The risk of a possible future change in one or more of 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.

12. The Discussion Paper: *Preliminary Views on Insurance Contracts* includes a list of features commonly found in insurance contracts. Paragraph 18 of that discussion paper states:

> The following features are found in many, but not all, insurance contracts. The Board considered them in developing the preliminary views in this paper.
>
> (a) In many other industries, the costs of a product or service are known before the associated revenue. However, for insurance contracts, the revenue (ie

premiums) is generally known (and received) in advance and the costs (claims and benefits) are not known until later. Some insurance contracts expose insurers to risks that will not be fully resolved for many years.

(b) By pooling the risks arising from a large number of similar contracts, an insurer acquires a reasonable statistical basis for making a credible estimate of the amount, timing and uncertainty of the cash flows arising from the contracts. If the outcome of one contract is independent of the outcome on other contracts, pooling of risks also reduces the risk of random statistical fluctuations.

(c) An insurance contract may expose the insurer to moral hazard. This is the risk that the existence of the insurance contract will increase the level of losses. For example, a policyholder may behave more recklessly than someone who is not protected by insurance. Similarly, the existence of insurance against civil liability may encourage lawsuits against the policyholder. To limit moral hazard, insurance contracts generally cover only those adverse events that are beyond the direct control of the policyholder. For similar reasons, some contracts contain features such as deductibles,[1] or other conditions designed to reduce the possibility that the policyholder may behave in a way that increases the probability or severity of an insured loss.

(d) In most cases, the policyholder pays a premium (single or recurring) before the coverage period. As a result, many contracts can be viewed as containing an implicit or explicit investment or deposit component. This component can be particularly important in some long-term contracts.

(e) Longer-term contracts often grant the policyholder valuable options to continue the contract at fixed or constrained prices even if the risk has changed or to cancel the policy. Some insurance contracts contain other embedded options, such as conversion features and guarantees of investment returns. Some contracts give the insurer options to limit coverage or change premiums.

(f) Policyholders are more likely to exercise an option if exercise is more favourable to them. For example, if a health insurance contract guarantees continued insurability over a long period, policyholders in poor health are more likely to continue to pay premiums. This tendency, known as adverse selection, means that the characteristics of a portfolio of insurance contracts are likely to deteriorate over time with an increasing concentration of policyholders who present above-average levels of risk.

(g) For some insurance contracts, the insurer incurs significant costs to originate the contract (acquisition costs).

(h) Over the life of some insurance contracts, the insurer will incur significant administrative expenses and may also provide significant services in addition to collecting premiums and paying claims. The administrative costs and servicing elements are often more significant than for many exchange-traded financial instruments, although these costs may also be significant for such financial instruments as retail deposits and some loans.

[1] A deductible requires the policyholder to pay the first part of an insured loss. The insurer pays all or part of the excess above the deductible.

(i) There is generally no liquid and active secondary market in liabilities and assets arising from insurance contracts. Indeed, in most cases, an insurer cannot transfer its rights and obligations under an insurance contract to another party without the consent of the policyholder, insurance supervisors or both. Market prices that are available may serve as only a crude guide to market value. Such prices often reflect other factors, such as control of a company or the value of a distribution system or potential new business.

(j) Some insurance contracts (participating or with profits contracts) give policyholders the right to share in the experience of the portfolio of insurance contracts, specified assets, or both.

(k) Policyholders may suffer a devastating loss if an insurer is unable to pay valid claims. Consequently, insurance is highly regulated in many countries.

13. Current U.S. GAAP for insurance contracts does not define an insurance contract, but does provide guidance concerning the nature of insurance contracts. The guidance in paragraph 944-20-05-40 of the *FASB Accounting Standards Codification*™ is close to being a definition and is similar to the IFRS 4 definition:

> Insurance provides indemnification against loss or liability from specified events and circumstances that may occur or be discovered during a specified period. In exchange for a payment from the policyholder, an insurance entity agrees to pay the policyholder if specified events occur or are discovered.

14. Paragraph 815-10-15-55 (Derivatives and Hedging) of the Accounting Standards Codification identifies three conditions that are considered when determining whether the scope exception for insurance contracts applies to dual-trigger insurance contracts:

> A property and casualty contract that provides for the payment of benefits or claims as a result of both an identifiable insurable event *and* changes in a variable would in its entirety not be subject to the requirements of this Subtopic (and thus not contain an embedded derivative that is required to be separately accounted for as a derivative instrument) provided all of the following conditions are met:
>
> a. Benefits or claims are paid only if an identifiable insurable event occurs (for example, theft or fire).
>
> b. The amount of the payment is limited to the amount of the policyholder's incurred insured loss.
>
> c. The contract does not involve essentially assured amounts of cash flows (regardless of the timing of those cash flows) based on insurable events highly probable of occurrence because the insured would nearly always receive the benefits (or suffer the detriment) of changes in the variable.

Differences between IFRS and U.S. GAAP

15. Three significant differences exist between the definition of an insurance contract in IFRS 4 and the accounting guidance in U.S. GAAP for insurance contracts. Those differences are:
    (a) Use of ***compensation*** rather than ***indemnification*** in describing the insurance contract benefit
    (b) ***Insurance risk*** and ***financial risk***
    (c) Definition of ***significant*** insurance risk.

Compensation vs. Indemnification

16. As noted in paragraph 13, paragraph 944-20-05-40 of the Accounting Standards Codification includes a description of insurance that is very close to being a definition and is not very different from the IFRS 4 definition. However, *indemnification* is used to describe the nature of insurance in the Accounting Standards Codification and *compensation* in IFRS.

17. Paragraph 944-20-15-1B of the Accounting Standards Codification also describes an insurance or reinsurance contract based on the notion of indemnification of the insured by the insurer:

> […] to the extent that an insurance contract or reinsurance contract does not, despite its form, provide for indemnification of the insured or the **ceding entity** by the insurer or reinsurer against loss or liability, the premium paid less the amount of the premium to be retained by the insurer or reinsurer shall be accounted for as a deposit by the insured or the ceding entity.

18. Webster's New World Dictionary, Second College Edition (1982), defines indemnify as:

> 1. to protect against or keep free from loss, damage, etc.; insure 2.a) to repay for what has been lost or damaged; **compensate** for a loss, etc.; reimburse b) to redeem or make good (a loss). [emphasis added]

19. Topic 815 of the Accounting Standards Codification, which excludes certain insurance contracts from its scope, provides a consistent view of insurance contracts in paragraph 815-10-15-52, which states:

> A contract is not subject to the requirements of this Subtopic if it entitles the holder to be compensated only if, as a result of an identifiable insurable event (other

than a change in price), the holder incurs a liability or there is an adverse change in the value of a specific asset or liability for which the holder is at risk.

Staff Analysis

20. U.S. GAAP guidance uses both *compensation* and *indemnification* to describe insurance contracts. *Indemnification* provides a succinct description of the intent of insurance and differentiates insurance contracts from derivatives. Insurance provides a means for the insured that has suffered a covered loss (insurable event) to be made whole through either replacement of the insured item or its monetary equivalent. To qualify as an insurable event, the insured must suffer a loss as a result of the event. For some types of contracts the coverage does not stop after an event has occurred, which means that the insurer will suffer another loss if a similar event occurs again. In contrast, a derivative instrument allows for the purchaser (the equivalent of the insured) to potentially gain from the defined event or trigger under the contract. The derivative instrument extinguishes after the holder exercises it or it expires. Further, the purchaser of a derivative does not need to prove that the defined event or trigger will cause a loss to it (the notion of insurable interest).

21. On the other hand, *compensation* could be viewed as a broader term than *indemnification*. Out of context, *compensation* alone does not encompass the same notion of making whole the insured. Nevertheless, in the context of IFRS 4's definition of an insurance contract, the term *compensation* is accompanied by the notion of the need for *significant risk* and *a specified uncertain future event that adversely affects the policyholder*. Used in this context, *compensation* appears to be similar to indemnification (if not the same).

22. In addition, some types of insurance are difficult to view as indemnifying the policyholder. For example, a death benefit on a life insurance contract is simply an agreed-upon value of the insured's life, but does not represent a good measure of a human life. Another example is business interruption insurance, which provides business income when a catastrophic event to the insured occurs (such as a fire to the policyholder's business that requires the business to shut down for a period of time or relocate). A possibility exists that the insured could actually profit from business interruption insurance because future business income is subject to many judgments (market trends, product trends, etc.). For example, if a factory that produces a historically profitable product burns down and a week later a competitor

introduces a new product, the impact to the future profitability of the old product would be difficult to determine. However, describing those products as compensating the policyholders provides a better depiction of the transaction.

Staff recommendation

23. The staff recommends that *compensation* be used in the definition of an insurance contract for the reasons stated in the staff analysis above.

Question for the boards
Do the boards agree with the staff recommendation?

Insurance Risk and Financial Risk

24. *Insurance risk* is defined in IFRS 4 as risk other than *financial risk*. *Financial risk* is defined as the risk of a possible future change in one or more of 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 nonfinancial variable, that the variable is not specific to a party to the contract.

25. The definition of *financial risk* in IFRS parallels the first leg of the definition of a derivative in IAS 39:

> A *derivative* is a financial instrument or other contract within the scope of this Standard (see paragraphs 2–7) with all three of the following characteristics:
>
> (a) 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');
>
> (b) 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; and
>
> (c) it is settled at a future date. [emphasis added]

26. U.S. GAAP defines *insurance risk* as the risk arising from uncertainties about *underwriting risk* and *timing risk*. Actual or implied investment returns are not an element of insurance risk. Insurance risk is fortuitous; the possibility of adverse events occurring is outside the control of the insured. *Underwriting risk* is the risk arising from uncertainties about the ultimate amount of net cash flows from premiums, commissions, claims, and settlement expenses paid under a contract. *Timing risk* is the risk arising from uncertainties about the timing of the receipt and payments of the net cash flows from premiums, commissions, claims, and claim settlement expense paid under a contract.

Process of Determining Insurance Risk

27. Determining insurance risk using the IFRS 4 definition or the method used in U.S. GAAP both require a careful reading of the insurance contract, amendments, side agreements, correspondence, and an understanding of the cash flows. Both IFRS 4 and US GAAP apply a number of steps for determining whether a contract contains significant insurance risk. The main difference is the fact that IFRS 4 includes a step that asks whether the transferred risk is financial or not; this step is not included under US GAAP.

(a) **Determining insurance risk using IFRS 4 definition**

i. Does the contract cover a specified future event that can adversely affect the policyholder?

ii. If no, determine appropriate noninsurance accounting; for example, investment, loan, derivative, or other.

iii. If yes, is the risk transferred from the holder of the contract financial risk?

- If yes, determine appropriate accounting.
- If no, then the risk is insurance risk.

iv. Is the insurance risk significant?

- If no, determine appropriate accounting.
- If yes, use insurance accounting.

(b) **Determining insurance risk using current U.S. GAAP**

i. Does the contract cover a specified future event that can adversely affect the policyholder?

ii. If no, determine appropriate noninsurance accounting; for example, investment, loan, derivative, or other.

iii. If yes, is the risk transferred from the holder of the contract insurance risk?

- If no, determine appropriate noninsurance accounting; for example, investment, loan, derivative, warranty or other.
- If yes, is insurance risk significant?
  - If no, determine appropriate accounting.
  - If yes, use insurance accounting.

(Note: The process outlined does not consider the impact of unbundling deposits and separating embedded derivatives.)

28. IFRS 4 has the benefit of defining two types of risk: financial and insurance. If the contract transfers only financial risk and does not transfer significant insurance risk, the contract does not meet the definition of an insurance contract. Under current U.S. GAAP, the focus is on determining the elements of insurance risk, for example, underwriting risk, timing risk, mortality, morbidity, life contingencies, etc. (but we note that US GAAP does not include a definition of insurance risk). Consequently, using the IFRS 4 definition may lead to including contracts that currently are not considered insurance contracts for U.S. GAAP, such as guarantees and warranties (see Agenda Paper 6B [FASB Memorandum No. 41B] for a discussion about the scope of IFRS 4). In addition, depending on the decisions reached on measurement and other aspects of the insurance contracts project, accounting arbitrage could focus on the definition of an insurance contract, which could place significant pressure on the boundary between insurance contracts and financial instruments.

Staff Analysis

29. There are three significant issues about *insurance risk*. The first is the approach to defining the types of risk that constitute insurance risk. As noted above, US GAAP provides a list of examples. On the other hand, IFRS 4 defines *insurance risk* as risk that is not one of the

types of risk included in the IASB's definition of a derivative. IFRS 4 uses the term *financial risk* to define the latter types of risk, but that is essentially a drafting convenience and a device to simplify the description of the distinction between the types of risk. An alternative approach would be to abandon the distinction between insurance risk and financial risk, and thus rely solely on the notion of compensation for losses. The Accounting for Financial Instruments project team is currently drafting a memorandum on the scope of that project. At present, contracts that are within Topic 944 of the Accounting Standards Codification are excluded from the scope of that project. However, similar contracts (that may meet the definition of insurance) such as guarantees may be included in that project. The staff will provide an update when that memorandum is issued.

30. The second significant issue, which relates back to the first issue noted above, deals with the structure of current U.S. GAAP. IFRS divides risk into two types—insurance risk and financial risk. U.S. GAAP does not include this binary view of risk. Also, U.S. GAAP provides specific requirements for contracts that are not considered (in US GAAP) to be insurance contracts or financial instruments (such as warranties and guaranties). In addition, providing a definition of *financial risk* is not within the scope of the insurance contracts project, and the ultimate conclusions in the Accounting for Financial Instruments may differ between the FASB and the IASB. That said, the term *financial risk* was introduced in IFRS 4 for no other reason than to act as a practical label to distinguish the types of risk included in the IASB's definition of a derivative. IFRS 4 uses the definition of derivatives in IAS 39 to explain which kind of risk transfer is not relevant in the contexts of the insurance standard. The label of *financial risk* was attached to the types of risk transferred by derivatives so they could be distinguished easily from the types of risk transferred by insurance contracts.

31. The third significant issue is the fact that U.S. GAAP requires the presence of both timing **and** underwriting risk (as noted in paragraph 26 above). U.S. GAAP requires both types of risks to be present specifically to ensure that contracts with a fixed amount and uncertainty in the timing (no underwriting risk, but timing risk) are not considered an insurance contract.

32. The first two significant issues identified in the staff analysis deal with challenges that the staff will encounter (specifically the FASB staff) when drafting the exposure draft. The boards will need to be cognizant of these challenges as the staff begins drafting, but no specific decisions need to be taken during this meeting.

33. On the third significant issue, staff will bring a separate paper to this meeting that discusses how the notion of timing risk is relevant in the context of determining whether a contract contains insurance risk. In that paper we will also analyze whether, compared to the existing guidance in IFRS 4, any additional guidance is needed to incorporate the notion of timing risk (see agenda paper 6C, FASB Memorandum 41C)..

Definition of Significant Insurance Risk

34. The IFRS 4 definition of an insurance contract depends on the notion of transfer of *significant* insurance risk from the policyholder to the insurer. Paragraph B23 of IFRS 4 includes the following description of *significant insurance risk*:

> Insurance risk is *significant* if, and only if, an **insured event** could cause an **insurer** to pay *significant* additional benefits in any scenario, excluding scenarios that lack commercial substance (ie have no discernible effect on the economics of the transaction). If *significant* additional benefits would be payable in scenarios that have commercial substance, the condition in the previous sentence may be met even if the insured event is extremely unlikely or even if the expected (ie probability-weighted) present value of contingent cash flows is a small proportion of the expected present value of all the remaining contractual cash flows. [Emphasis added.]

35. U.S. GAAP also requires that an insurance or reinsurance contract transfer *significant* insurance risk. In addition, reinsurance contracts must include a reasonable possibility that the reinsurer will suffer *significant* loss. Paragraphs 944-20-15-41, 944-20-15-53 and 944-20-15-59 provide guidance for reinsurance of short-duration and long-duration contracts, respectively:

> 944-20-15-41 Unless the condition in paragraph 944-20-15-53 is met, indemnification of the ceding entity against loss or liability relating to insurance risk in reinsurance of short-duration contracts exists under paragraph 944-20-15-37(a) only if both of the following conditions are met:
>
> a. Significant insurance risk. The reinsurer assumes significant insurance risk under the reinsured portions of the underlying insurance contracts. Implicit in this condition is the requirement that both the amount and timing of the reinsurer's payments depend on and directly vary with the amount and timing of claims settled under the reinsured contracts.

b. Significant loss. It is **reasonably possible** that the reinsurer may realize a significant loss from the transaction.

The conditions are independent and the ability to meet one does not mean that the other has been met. A substantive demonstration that both conditions have been met is required for a short-duration contract to transfer risk.

944-20-15-53 If, based on the comparison in paragraph 944-20-15-51, the reinsurer is not exposed to the reasonable possibility of significant loss, the ceding entity shall be considered indemnified against loss or liability relating to insurance risk only if substantially all of the insurance risk relating to the reinsured portions of the underlying insurance contracts has been assumed by the reinsurer. That condition is met only if insignificant insurance risk is retained by the ceding entity on the reinsured portions of the underlying insurance contracts. The assessment of that condition shall be made by comparing both of the following:

a. The net cash flows of the reinsurer under the reinsurance contract

b. The net cash flows of the ceding entity on the reinsured portions of the underlying insurance contracts.

If the economic position of the reinsurer relative to the insurer cannot be determined, the contract shall not qualify under the exception in this paragraph.

944-20-15-59 Indemnification of the ceding entity against loss or liability relating to insurance risk in reinsurance of long-duration contracts requires the reasonable possibility that the reinsurer may realize significant loss from assuming insurance risk.

36. For U.S. GAAP, the term *significant* is not defined. Consequently, rules of thumb were developed to determine **significance**. In April 2005, the FASB added a project to its agenda to consider risk transfer in insurance and reinsurance contracts. On June 11, 2008, the Board removed the project from its agenda and indicated it planned to address insurance accounting in a joint project with the IASB.

Staff Analysis

37. The determination of what constitutes significant insurance risk has been an issue for many years. As part of the project noted above, the FASB issued an Invitation to Comment on bifurcating insurance contracts into a deposit component and an insurance component. While the removal of the project was attributed to working jointly with the IASB on a

broader project, ironically, the explicit guidance for risk transfer in U.S. GAAP is a principle not a rule. However, practice developed a rule of thumb to limit the significant judgment necessary in applying the principle. In the period after the removal of the project, no new information or thinking has developed on the topic.

38. IFRS 4 introduces the notion of *commercial substance* to address whether a contract transfers significant insurance risk. Admittedly, the notion is appealing because it is understandable and not defined by complex calculations. However, therein lies the weakness in the notion—it is so understandable and broad that different views can evolve as to whether a contract lacks commercial substance. *Commercial substance* is defined as having no discernible effect on the economics of the transaction. Most of the contract structuring to achieve risk transfer that led to legal proceedings had an economic effect on the entity's share price—it was simply not a result of insurance.

39. However, the significant issues surrounding risk transfer arose from two weaknesses in the existing models. The first weakness was that measurement of most property and casualty insurance contracts does not incorporate the time value of money. Many of the structuring opportunities centered around the fact that the claim liability on the direct insurance was not discounted, but reinsurance of that business through a financial reinsurance contract incorporated the time value of money. However, under the proposed measurement in the insurance contracts project, one of the building blocks is the incorporation of the time value of money. The building blocks, including time value of money, would also be applied to the incurred claims liability. (The FASB plans to discuss at a future meeting whether the building block approach should be used for the claim liability for non-life insurance contracts in all cases.) The second weakness pertained to the geography in the financial statements. For statutory and analytical purposes, if a contract did not transfer risk (a deposit) and is accounted for as reinsurance, this may distort the balance sheet and income statement and related key ratios for insurance and reinsurance entities. Presumably disaggregation of the financial statements would help in exposing this weakness.

Staff recommendation

40. The staff recommends that the description of significant insurance risk contained in IFRS 4 be brought forward to the exposure draft.

Question for the boards
Do the boards agree with the staff recommendation?

IFRS 4, Appendix B
Definition of an insurance contract

Appendix A

THIS APPENDIX IS AN INTEGRAL PART OF THE IFRS.

B1 This appendix gives guidance on the definition of an insurance contract in Appendix A [of IFRS 4]. It addresses the following issues:

(a) the term 'uncertain future event' (paragraphs B2-B4);

(b) payments in kind (paragraphs B5-B7);

(c) insurance risk and other risks (paragraphs B8-B17);

(d) examples of insurance contracts (paragraphs B18-B21);

(e) significant insurance risk (paragraphs B22-B28); and

(f) changes in the level of insurance risk (paragraphs B29 and B30).

UNCERTAIN FUTURE EVENT

B2 Uncertainty (or risk) is the essence of an insurance contract. Accordingly, at least one of the following is uncertain at the inception of an insurance contract:

(a) whether an *insured event* will occur;

(b) when it will occur; or

(c) how much the insurer will need to pay if it occurs.

B3 In some insurance contracts, the insured event is the discovery of a loss during the term of the contract, even if the loss arises from an event that occurred before the inception of the contract. In other insurance contracts, the insured event is an event that occurs during the term of the contract, even if the resulting loss is discovered after the end of the contract term.

B4 Some insurance contracts cover events that have already occurred, but whose financial effect is still uncertain. An example is a reinsurance contract that covers the direct insurer against adverse development of claims already reported by policyholders. In such contracts, the insured event is the discovery of the ultimate cost of those claims.

PAYMENTS IN KIND

B5 Some insurance contracts require or permit payments to be made in kind. An example is when the insurer replaces a stolen article directly, instead of reimbursing the policyholder. Another example is when an insurer uses its own hospitals and medical staff to provide medical services covered by the contracts.

B6 Some fixed-fee service contracts in which the level of service depends on an uncertain event meet the definition of an insurance contract in this IFRS but are not regulated as insurance contracts in some countries. One example is a maintenance contract in which the service provider agrees to repair specified equipment after a malfunction. The fixed service fee is based on the expected number of malfunctions, but it is uncertain whether a particular machine will break down. The malfunction of the equipment adversely affects its owner and the contract compensates the owner (in kind, rather than cash). Another example is a contract for car breakdown services in which the provider agrees, for a fixed annual fee, to provide roadside assistance or tow the car to a nearby garage. The latter contract could meet the definition of an insurance contract even if the provider does not agree to carry out repairs or replace parts.

B7 Applying the IFRS to the contracts described in paragraph B6 is likely to be no more burdensome than applying the IFRSs that would be applicable if such contracts were outside the scope of this IFRS:

(a) There are unlikely to be material liabilities for malfunctions and breakdowns that have already occurred.

(b) If IAS 18 *Revenue* applied, the service provider would recognise revenue by reference to the stage of completion (and subject to other specified criteria). That approach is also acceptable under this IFRS,

which permits the service provider (i) to continue its existing accounting policies for these contracts unless they involve practices prohibited by paragraph 14 and (ii) to improve its accounting policies if so permitted by paragraphs 22-30.

(c) The service provider considers whether the cost of meeting its contractual obligation to provide services exceeds the revenue received in advance. To do this, it applies the liability adequacy test described in paragraphs 15-19 of this IFRS. If this IFRS did not apply to these contracts, the service provider would apply IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* to determine whether the contracts are onerous.

(d) For these contracts, the disclosure requirements in this IFRS are unlikely to add significantly to disclosures required by other IFRSs.

DISTINCTION BETWEEN INSURANCE RISK AND OTHER RISKS

B8 The definition of an insurance contract refers to insurance risk, which this IFRS defines as risk, other than *financial risk*, transferred from the holder of a contract to the issuer. A contract that exposes the issuer to financial risk without significant insurance risk is not an insurance contract.

B9 The definition of financial risk in Appendix A includes a list of financial and non-financial variables. That list includes non-financial variables that are not specific to a party to the contract, such as an index of earthquake losses in a particular region or an index of temperatures in a particular city. It excludes non-financial variables that are specific to a party to the contract, such as the occurrence or non-occurrence of a fire that damages or destroys an asset of that party. Furthermore, the risk of changes in the fair value of a non-financial asset is not a financial risk if the fair value reflects not only changes in market prices for such assets (a financial variable) but also the condition of a specific non-financial asset held by a party to a contract (a non-financial variable). For example, if a guarantee of the residual value of a specific car exposes the guarantor to the risk of changes in the car's physical condition, that risk is insurance risk, not financial risk.

B10 Some contracts expose the issuer to financial risk, in addition to significant insurance risk. For example, many life insurance contracts both guarantee a minimum rate of return to policyholders (creating financial risk) and promise death benefits that at some times significantly exceed the policyholder's account balance (creating insurance risk in the form of mortality risk). Such contracts are insurance contracts.

B11 Under some contracts, an insured event triggers the payment of an amount linked to a price index. Such contracts are insurance contracts, provided the payment that is contingent on the insured event can be significant. For example, a life-contingent annuity linked to a cost-of-living index transfers insurance risk because payment is triggered by an uncertain event—the survival of the annuitant. The link to the price index is an embedded derivative, but it also transfers insurance risk. If the resulting transfer of insurance risk is significant, the embedded derivative meets the definition of an insurance contract, in which case it need not be separated and measured at fair value (see paragraph 7 of this IFRS).

B12 The definition of insurance risk refers to risk that the insurer accepts from the policyholder. In other words, insurance risk is a pre-existing risk transferred from the policyholder to the insurer. Thus, a new risk created by the contract is not insurance risk.

B13 The definition of an insurance contract refers to an adverse effect on the policyholder. The definition does not limit the payment by the insurer to an amount equal to the financial impact of the adverse event. For example, the definition does not exclude 'new-for-old' coverage that pays the policyholder sufficient to permit replacement of a damaged old asset by a new asset. Similarly, the definition does not limit payment under a term life insurance contract to the financial loss suffered by the deceased's dependants, nor does it preclude the payment of predetermined amounts to quantify the loss caused by death or an accident.

B14 Some contracts require a payment if a specified uncertain event occurs, but do not require an adverse effect on the policyholder as a precondition for payment. Such a contract is not an insurance contract even if the holder uses the contract to mitigate an underlying risk exposure. For example, if the holder uses a derivative to hedge an underlying non-financial variable that is correlated with cash flows from an asset of the entity, the derivative is not an insurance contract because payment is not conditional on whether the holder is adversely affected by a reduction in the cash flows from the asset. Conversely, the definition of an insurance contract refers to an uncertain event for which an adverse effect on the policyholder is a contractual precondition for payment. This contractual precondition does not require the insurer to investigate whether the event actually caused an adverse effect, but permits the insurer to deny payment if it is not satisfied that the event caused an adverse effect.

B15 Lapse or persistency risk (ie the risk that the counterparty will cancel the contract earlier or later than the issuer had expected in pricing the contract) is not insurance risk because the payment to the counterparty is not contingent on an uncertain future event that adversely affects the counterparty. Similarly, expense risk (ie the risk of unexpected increases in the administrative costs associated with the servicing of a contract, rather than in costs associated with insured events) is not insurance risk because an unexpected increase in expenses does not adversely affect the counterparty.

B16 Therefore, a contract that exposes the issuer to lapse risk, persistency risk or expense risk is not an insurance contract unless it also exposes the issuer to insurance risk. However, if the issuer of that contract mitigates that risk by using a second contract to transfer part of that risk to another party, the second contract exposes that other party to insurance risk.

B17 An insurer can accept significant insurance risk from the policyholder only if the insurer is an entity separate from the policyholder. In the case of a mutual insurer, the mutual accepts risk from each policyholder and pools that risk. Although policyholders bear that pooled risk collectively in their capacity as owners, the mutual has still accepted the risk that is the essence of an insurance contract.

EXAMPLES OF INSURANCE CONTRACTS

B18 The following are examples of contracts that are insurance contracts, if the transfer of insurance risk is significant:

(a) insurance against theft or damage to property.

(b) insurance against product liability, professional liability, civil liability or legal expenses.

(c) life insurance and prepaid funeral plans (although death is certain, it is uncertain when death will occur or, for some types of life insurance, whether death will occur within the period covered by the insurance).

(d) life-contingent annuities and pensions (ie contracts that provide compensation for the uncertain future event—the survival of the annuitant or pensioner—to assist the annuitant or pensioner in maintaining a given standard of living, which would otherwise be adversely affected by his or her survival).

(e) disability and medical cover.

(f) surety bonds, fidelity bonds, performance bonds and bid bonds (ie contracts that provide compensation if another party fails to perform a contractual obligation, for example an obligation to construct a building).

(g) credit insurance that provides for specified payments to be made to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due under the original or modified terms of a debt instrument. These contracts could have various legal forms, such as that of a financial guarantee, letter of credit, credit derivative default product or insurance contract. However, these contracts are outside the scope of this IFRS if the entity entered into them, or retained them, on transferring to another party financial assets or financial liabilities within the scope of IAS 39 (see paragraph 4(d)).

(h) product warranties. Product warranties issued by another party for goods sold by a manufacturer, dealer or retailer are within the scope of this IFRS. However, product warranties issued directly by a manufacturer, dealer or retailer are outside its scope, because they are within the scope of IAS 18 *Revenue* and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

(i) title insurance (ie insurance against the discovery of defects in title to land that were not apparent when the insurance contract was written). In this case, the insured event is the discovery of a defect in the title, not the defect itself.

(j) travel assistance (ie compensation in cash or in kind to policyholders for losses suffered while they are travelling). Paragraphs B6 and B7 discuss some contracts of this kind.

(k) catastrophe bonds that provide for reduced payments of principal, interest or both if a specified event adversely affects the issuer of the bond (unless the specified event does not create significant insurance risk, for example if the event is a change in an interest rate or foreign exchange rate).

(l) insurance swaps and other contracts that require a payment based on changes in climatic, geological or other physical variables that are specific to a party to the contract.

(m) reinsurance contracts.

B19 The following are examples of items that are not insurance contracts:

(a) investment contracts that have the legal form of an insurance contract but do not expose the insurer to significant insurance risk, for example life insurance contracts in which the insurer bears no significant

mortality risk (such contracts are non-insurance financial instruments or service contracts, see paragraphs B20 and B21).

(b) contracts that have the legal form of insurance, but pass all significant insurance risk back to the policyholder through non-cancellable and enforceable mechanisms that adjust future payments by the policyholder as a direct result of insured losses, for example some financial reinsurance contracts or some group contracts (such contracts are normally non-insurance financial instruments or service contracts, see paragraphs B20 and B21).

(c) self-insurance, in other words retaining a risk that could have been covered by insurance (there is no insurance contract because there is no agreement with another party).

(d) contracts (such as gambling contracts) that require a payment if a specified uncertain future event occurs, but do not require, as a contractual precondition for payment, that the event adversely affects the policyholder. However, this does not preclude the specification of a predetermined payout to quantify the loss caused by a specified event such as death or an accident (see also paragraph B13).

(e) derivatives that expose one party to financial risk but not insurance risk, because they require that party to make payment based solely on changes in one or more of 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 (see IAS 39).

(f) a financial guarantee contract (or letter of credit, credit derivative default product or credit insurance contract) that requires payments even if the holder has not incurred a loss on the failure of the debtor to make payments when due (see IAS 39).

(g) contracts that require a payment based on a climatic, geological or other physical variable that is not specific to a party to the contract (commonly described as weather derivatives).

(h) catastrophe bonds that provide for reduced payments of principal, interest or both, based on a climatic, geological or other physical variable that is not specific to a party to the contract.

B20 If the contracts described in paragraph B19 create financial assets or financial liabilities, they are within the scope of IAS 39. Among other things, this means that the parties to the contract use what is sometimes called deposit accounting, which involves the following:

(a) one party recognises the consideration received as a financial liability, rather than as revenue.

(b) the other party recognises the consideration paid as a financial asset, rather than as an expense.

B21 If the contracts described in paragraph B19 do not create financial assets or financial liabilities, IAS 18 applies. Under IAS 18, revenue associated with a transaction involving the rendering of services is recognised by reference to the stage of completion of the transaction if the outcome of the transaction can be estimated reliably.

SIGNIFICANT INSURANCE RISK

B22 A contract is an insurance contract only if it transfers significant insurance risk. Paragraphs B8-B21 discuss insurance risk. The following paragraphs discuss the assessment of whether insurance risk is significant.

B23 Insurance risk is significant if, and only if, an insured event could cause an insurer to pay significant additional benefits in any scenario, excluding scenarios that lack commercial substance (ie have no discernible effect on the economics of the transaction). If significant additional benefits would be payable in scenarios that have commercial substance, the condition in the previous sentence may be met even if the insured event is extremely unlikely or even if the expected (ie probability-weighted) present value of contingent cash flows is a small proportion of the expected present value of all the remaining contractual cash flows.

B24 The additional benefits described in paragraph B23 refer to amounts that exceed those that would be payable if no insured event occurred (excluding scenarios that lack commercial substance). Those additional amounts include claims handling and claims assessment costs, but exclude:

(a) the loss of the ability to charge the policyholder for future services. For example, in an investment-linked life insurance contract, the death of the policyholder means that the insurer can no longer perform investment management services and collect a fee for doing so. However, this economic loss for the insurer does not reflect insurance risk, just as a mutual fund manager does not take on insurance risk in relation to the possible death of the client. Therefore, the potential loss of future investment management fees is not relevant in assessing how much insurance risk is transferred by a contract.

(b) waiver on death of charges that would be made on cancellation or surrender. Because the contract brought those charges into existence, the waiver of these charges does not compensate the policyholder for a pre-existing risk. Hence, they are not relevant in assessing how much insurance risk is transferred by a contract.

(c) a payment conditional on an event that does not cause a significant loss to the holder of the contract. For example, consider a contract that requires the issuer to pay one million currency units if an asset suffers physical damage causing an insignificant economic loss of one currency unit to the holder. In this contract, the holder transfers to the insurer the insignificant risk of losing one currency unit. At the same time, the contract creates non-insurance risk that the issuer will need to pay 999,999 currency units if the specified event occurs. Because the issuer does not accept significant insurance risk from the holder, this contract is not an insurance contract.

(d) possible reinsurance recoveries. The insurer accounts for these separately.

B25 An insurer shall assess the significance of insurance risk contract by contract, rather than by reference to materiality to the financial statements.[1] Thus, insurance risk may be significant even if there is a minimal probability of material losses for a whole book of contracts. This contract-by-contract assessment makes it easier to classify a contract as an insurance contract. However, if a relatively homogeneous book of small contracts is known to consist of contracts that all transfer insurance risk, an insurer need not examine each contract within that book to identify a few non-derivative contracts that transfer insignificant insurance risk.

[1] For this purpose, contracts entered into simultaneously with a single counterparty (or contracts that are otherwise interdependent) form a single contract.

B26 It follows from paragraphs B23-B25 that if a contract pays a death benefit exceeding the amount payable on survival, the contract is an insurance contract unless the additional death benefit is insignificant (judged by reference to the contract rather than to an entire book of contracts). As noted in paragraph B24(b), the waiver on death of cancellation or surrender charges is not included in this assessment if this waiver does not compensate the policyholder for a pre-existing risk. Similarly, an annuity contract that pays out regular sums for the rest of a policyholder's life is an insurance contract, unless the aggregate life-contingent payments are insignificant.

B27 Paragraph B23 refers to additional benefits. These additional benefits could include a requirement to pay benefits earlier if the insured event occurs earlier and the payment is not adjusted for the time value of money. An example is whole life insurance for a fixed amount (in other words, insurance that provides a fixed death benefit whenever the policyholder dies, with no expiry date for the cover). It is certain that the policyholder will die, but the date of death is uncertain. The insurer will suffer a loss on those individual contracts for which policyholders die early, even if there is no overall loss on the whole book of contracts.

B28 If an insurance contract is unbundled into a deposit component and an insurance component, the significance of insurance risk transfer is assessed by reference to the insurance component. The significance of insurance risk transferred by an embedded derivative is assessed by reference to the embedded derivative.

CHANGES IN THE LEVEL OF INSURANCE RISK

B29 Some contracts do not transfer any insurance risk to the issuer at inception, although they do transfer insurance risk at a later time. For example, consider a contract that provides a specified investment return and includes an option for the policyholder to use the proceeds of the investment on maturity to buy a life-contingent annuity at the current annuity rates charged by the insurer to other new annuitants when the policyholder exercises the option. The contract transfers no insurance risk to the issuer until the option is exercised, because the insurer remains free to price the annuity on a basis that reflects the insurance risk transferred to the insurer at that time. However, if the contract specifies the annuity rates (or a basis for setting the annuity rates), the contract transfers insurance risk to the issuer at inception.

B30 A contract that qualifies as an insurance contract remains an insurance contract until all rights and obligations are extinguished or expire.

Appendix B

Guidance on implementing IFRS 4 Insurance Contracts

This guidance accompanies, but is not part of, IFRS 4.

Definition of insurance contract

IG2 IG Example 1 illustrates the application of the definition of an insurance contract. The example does not illustrate all possible circumstances.

IG Example 1: Application of the definition of an insurance contract	
Contract type	*Treatment in phase I*
1.1 Insurance contract (see definition in Appendix A of the IFRS and guidance in Appendix B).	Within the scope of the IFRS, unless covered by scope exclusions in paragraph 4 of the IFRS. Some embedded derivatives and deposit components must be separated (see IG Examples 2 and 3 and paragraphs 7-12 of the IFRS).
1.2 Death benefit that could exceed amounts payable on surrender or maturity.	Insurance contract (unless contingent amount is insignificant in all scenarios that have commercial substance). Insurer could suffer a significant loss on an individual contract if the policyholder dies early. See IG Examples 1.23-27 for further discussion of surrender penalties.

1.3 A unit-linked contract that pays benefits linked to the fair value of a pool of assets. The benefit is 100 per cent of the unit value on surrender or maturity and 101 per cent of the unit value on death.	This contract contains a deposit component (100 per cent of unit value) and an insurance component (additional death benefit of 1 per cent). Paragraph 10 of the IFRS permits unbundling (but requires it only if the insurance component is material and the issuer would not otherwise recognise all obligations and rights arising under the deposit component). If the insurance component is not unbundled, the whole contract is an investment contract because the insurance component is insignificant in relation to the whole contract.
1.4 Life-contingent annuity.	Insurance contract (unless contingent amount is insignificant in all scenarios that have commercial substance). Insurer could suffer a significant loss on an individual contract if the annuitant survives longer than expected.
1.5 Pure endowment. The insured person receives a payment on survival to a specified date, but beneficiaries receive nothing if the insured person dies before then.	Insurance contract (unless the transfer of insurance risk is insignificant). If a relatively homogeneous book of pure endowments is known to consist of contracts that all transfer insurance risk, the insurer may classify the entire book as insurance contracts without examining each contract to identify a few non-derivative pure endowments that transfer insignificant insurance risk (see paragraph B25).

1.6 Deferred annuity: policyholder will receive, or can elect to receive, a life-contingent annuity at rates guaranteed at inception.	Insurance contract (unless the transfer of insurance risk is insignificant). The contract transfers mortality risk to the insurer at inception, because the insurer might have to pay significant additional benefits for an individual contract if the annuitant elects to take the life-contingent annuity and survives longer than expected (unless the contingent amount is insignificant in all scenarios that have commercial substance).
1.7 Deferred annuity: policyholder will receive, or can elect to receive, a life-contingent annuity at rates prevailing when the annuity begins.	Not an insurance contract at inception, if the insurer can reprice the mortality risk without constraints. Within the scope of IAS 39 unless the contract contains a discretionary participation feature. Will become an insurance contract when the annuity rate is fixed (unless the contingent amount is insignificant in all scenarios that have commercial substance).
1.8 Investment contract*[2] that does not contain a discretionary participation feature.	Within the scope of IAS 39.
1.9 Investment contract containing a discretionary participation feature.	Paragraph 35 of the IFRS sets out requirements for these contracts, which are excluded from the scope of IAS 39.
1.10 Investment contract in which payments are contractually linked (with no discretion) to returns on a specified pool of assets held by the issuer.	Within the scope of IAS 39. Payments denominated in unit values representing the fair value of the specified assets are measured at current unit value (see paragraph AG33(g) of Appendix A of IAS 39).

(1) The term 'investment contract' is an informal term used for ease of discussion. It refers to a financial instrument that does not meet the definition of an insurance contract.

1.11 Contract that requires specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due under the original or modified terms of a debt instrument. The contract may have various legal forms (eg insurance contract, financial guarantee or letter of credit).	Insurance contract. Within the scope of the IFRS, unless the contract was entered into or retained on the transfer of financial assets or financial liabilities within the scope of IAS 39. If the issuer's accounting policies do not require it to recognise a liability at inception, the liability adequacy test in paragraphs 15-19 of the IFRS may be particularly relevant. The legal form of the contract does not affect its recognition and measurement.
1.12 A financial guarantee that does not, as a precondition for payment, require that the holder is exposed to, and has incurred a loss on, the failure of the debtor to make payments on the guaranteed asset when due. An example of such a contract is one that requires payments in response to changes in a specified credit rating or credit index.	Not an insurance contract. Within the scope of IAS 39.
1.13 Guarantee fund established by contract. The contract requires all participants to pay contributions to the fund so that it can meet obligations incurred by participants (and, perhaps, others). Participants would typically be from a single industry, eg insurance, banking or travel.	The contract that establishes the guarantee fund is an insurance contract (see IG Example 1.11).
1.14 Guarantee fund established by law.	The commitment of participants to contribute to the fund is not established by a contract, so there is no insurance contract. Within the scope of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

1.15 Residual value insurance or residual value guarantee. Guarantee by one party of the fair value at a future date of a non-financial asset held by a beneficiary of the insurance or guarantee.	Insurance contract within the scope of the IFRS (unless changes in the condition of the asset have an insignificant effect). The risk of changes in the fair value of the non-financial asset is not a financial risk because the fair value reflects not only changes in market prices for such assets (a financial variable) but also the condition of the specific asset held (a non-financial variable). However, if the contract compensates the beneficiary only for changes in market prices and not for changes in the condition of the beneficiary's asset, the contract is a derivative and within the scope of IAS 39. Residual value guarantees given by a lessee under a finance lease are within the scope of IAS 17 *Leases*.
1.16 Product warranties issued directly by a manufacturer, dealer or retailer.	Insurance contracts, but excluded from the scope of the IFRS (see IAS 18 *Revenue* and IAS 37).
1.17 Product warranties issued by a third party.	Insurance contracts, no scope exclusion. Same treatment as other insurance contracts.
1.18 Group insurance contract that gives the insurer an enforceable and non-cancellable contractual right to recover all claims paid out of future premiums, with appropriate compensation for the time value of money.	Insurance risk is insignificant. Therefore, the contract is a financial instrument within the scope of IAS 39. Servicing fees are within the scope of IAS 18 (recognise as services are provided, subject to various conditions).
1.19 Catastrophe bond: bond in which principal, interest payments or both are reduced if a specified triggering event occurs and the triggering event does not include a condition that the issuer of the bond suffered a loss.	Financial instrument with embedded derivative. Both the holder and the issuer measure the embedded derivative at fair value.

1.20 Catastrophe bond: bond in which principal, interest payments or both are reduced significantly if a specified triggering event occurs and the triggering event includes a condition that the issuer of the bond suffered a loss.	The contract is an insurance contract, and contains an insurance component (with the issuer as policyholder and the holder as the insurer) and a deposit component. (a) If specified conditions are met, paragraph 10 of the IFRS requires the holder to unbundle the deposit component and apply IAS 39 to it. (b) The issuer accounts for the insurance component as reinsurance if it uses the bond for that purpose. If the issuer does not use the insurance component as reinsurance, it is not within the scope of the IFRS, which does not address accounting by policyholders for direct insurance contracts. (c) Under paragraph 13 of the IFRS, the holder could continue its existing accounting for the insurance component, unless that involves the practices prohibited by paragraph 14.
1.21 An insurance contract issued by an insurer to a defined benefit pension plan covering the employees of the insurer, or of another entity consolidated within the same financial statements as the insurer.	The contract will generally be eliminated from the financial statements, which will include: (a) the full amount of the pension obligation under IAS 19 *Employee Benefits*, with no deduction for the plan's rights under the contract. (b) no liability to policyholders under the contract. (c) the assets backing the contract.

1.22 An insurance contract issued to employees as a result of a defined contribution pension plan. The contractual benefits for employee service in the current and prior periods are not contingent on future service. The insurer also issues similar contracts on the same terms to third parties.	Insurance contract within the scope of the IFRS. If the employer pays part or all of the employee's premiums, the payment by the employer is an employee benefit within the scope of IAS 19. See also IAS 19, paragraphs 39-42 and 104-104D. Furthermore, a 'qualifying insurance policy' as defined in IAS 19 need not meet the definition of an insurance contract in this IFRS.
1.23 Loan contract containing a prepayment fee that is waived if prepayment results from the borrower's death.	Not an insurance contract. Before entering into the contract, the borrower faced no risk corresponding to the prepayment fee. Hence, although the loan contract exposes the lender to mortality risk, it does not transfer a pre-existing risk from the borrower. Thus, the risk associated with the possible waiver on death of the prepayment fee is not insurance risk (paragraphs B12 and B24(b) of Appendix B of the IFRS).
1.24 Loan contract that waives repayment of the entire loan balance if the borrower dies.	This contract contains a deposit component (the loan) and an insurance component (waiver of the loan balance on death, equivalent to a cash death benefit). If specified conditions are met, paragraph 10 of the IFRS requires or permits unbundling. If the insurance component is not unbundled, the contract is an insurance contract if the insurance component is significant in relation to the whole contract.

1.25 A contract permits the issuer to deduct a market value adjustment (MVA) from surrender values or death benefits to reflect current market prices for the underlying assets. The contract does not permit an MVA for maturity benefits.	The policyholder obtains an additional survival benefit because no MVA is applied at maturity. That benefit is a pure endowment (see IG Example 1.5). If the risk transferred by that benefit is significant, the contract is an insurance contract.
1.26 A contract permits the issuer to deduct an MVA from surrender values or maturity payments to reflect current market prices for the underlying assets. The contract does not permit an MVA for death benefits.	The policyholder obtains an additional death benefit because no MVA is applied on death. If the risk transferred by that benefit is significant, the contract is an insurance contract.

1.27 A contract permits the issuer to deduct an MVA from surrender payments to reflect current market prices for the underlying assets. The contract does not permit an MVA for death and maturity benefits. The amount payable on death or maturity is the amount originally invested plus interest.	The policyholder obtains an additional benefit because no MVA is applied on death or maturity. However, that benefit does not transfer insurance risk from the policyholder because it is certain that the policyholder will live or die and the amount payable on death or maturity is adjusted for the time value of money (see paragraph B27 of the IFRS). The contract is an investment contract. This contract combines the two features discussed in IG Examples 1.25 and 1.26. When considered separately, those two features transfer insurance risk. However, when combined, they do not transfer insurance risk. Therefore, it is not appropriate to separate this contract into two ‘insurance’ components. If the amount payable on death were not adjusted in full for the time value of money, or were adjusted in some other way, the contract might transfer insurance risk. If that insurance risk is significant, the contract is an insurance contract.

1.28 A contract meets the definition of an insurance contract. It was issued by one entity in a group (for example a captive insurer) to another entity in the same group.	If the entities present individual or separate financial statements, they treat the contract as an insurance contract in those individual or separate financial statements (see IAS 27 *Consolidated and Separate Financial Statements*). The transaction is eliminated from the group's consolidated financial statements. If the intragroup contract is reinsured with a third party that is not part of the group, the reinsurance contract is treated as a direct insurance contract in the consolidated financial statements because the intragroup contract is eliminated on consolidation.
1.29 An agreement that entity A will compensate entity B for losses on one or more contracts issued by entity B that do not transfer significant insurance risk.	The contract is an insurance contract if it transfers significant insurance risk from entity B to entity A, even if some or all of the individual contracts do not transfer significant insurance risk to entity B. The contract is a reinsurance contract if any of the contracts issued by entity B are insurance contracts. Otherwise, the contract is a direct insurance contract.