

SINGAPORE ACTUARIAL SOCIETY
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INSURANCE CONTRACT BOUNDARIES –
HOW to APPLY to
LONG-TERM GUARANTEED RENEWABLE
PRODUCTS IN SINGAPORE?

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Insurance Act (Cap. 142) – First Schedule

4D.—(1) “**Long-term accident and health policy**” means any accident and health policy that —

- (a) may, in accordance with the terms and conditions of the policy, **be in force for more than 5 years if it is not terminated earlier by the policy owner**; and
- (b) **does not contain any term or condition which permits the insurer to terminate the policy unilaterally**, other than termination on the ground of fraud or material non-disclosure.

Questions

Valuation of Long-term Health Policies

Different reserving approaches possible

- (1) Gross premium valuation (**GPV**) or
- (2) **Max (UPR, URR)**

Contract Boundary

The **definition of contract boundary, and the interpretation thereof**, establishes the reserving approach

Long-term Health Insurance Policies in Singapore

Although a **long-term health insurance policy** is usually guaranteed renewable for the lifetime of the life insured, in practice, it is **only the insurability of the life insured which is guaranteed**.

The **insurer may change some of the terms and conditions of the policy unilaterally**, and insurers of such policies have, in the past, modified the benefits insured and the **premium rates** charged on these policies from time to time, but only on a **portfolio basis** and not on a policy-by-policy basis.

DEFINITIONS of
INSURANCE CONTRACT BOUNDARY

International Association of Insurance Supervisors (IAIS)
Risk-based Global Insurance Capital Standard
Public Consultation, 17 December 2014 [Still Under Consultation]

3.4 Contract Boundaries

*21. Any obligations, including future premiums, relating to the contract shall belong to the contract. **However, future premiums (and associated claims and expenses) relating to an existing and recognised contract beyond the following dates should not be considered in insurance liabilities, UNLESS the IAIG can demonstrate that they are able and willing to compel the policyholder to pay the premiums:***

a) The future date where the IAIG has a unilateral right to terminate the contract or reject the premiums payable under the contract

b) The future date where the insurance or reinsurance undertaking has a unilateral right to amend the premiums or the benefits payable under the contract in such a way that the premiums fully reflect the risks.

International Accounting Standards Board (IASB)

IFRS 4 Phase II: Exposure Draft – Insurance Contracts [Still Under Consultation]

Measurement

Future Cash Flows

23 Cash flows are within the boundary of an insurance contract when the *entity can compel the policyholder to pay the premiums* or has a substantive obligation to provide the policyholder with coverage or other services. A substantive obligation to provide coverage or other services ends when:

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

(b) Both of the following criteria are satisfied:

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

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

Commission of European Union

Commission Delegated Regulations (EU) 2015 / 35, 10 October 2014

Title I: Valuation and Risk-based Capital Requirements (Pillar I), Enhanced Governance (Pillar II) and Increased Transparency (Pillar III)

Chapter III: Rules Relating to Technical Provisions

Article 18: Boundary of an Insurance or Reinsurance Contract

3. Obligations which relate to insurance or reinsurance cover provided by the undertaking after any of the following dates do not belong to the contract, **UNLESS the undertaking can compel the policyholder to pay the premium** for those obligations:

(a) The future date where the insurance or reinsurance undertaking has a unilateral right to terminate the contract;

(b) The future date where the insurance or reinsurance undertaking has a unilateral right to reject premiums payable under the contract;

(c) The future date where the insurance or reinsurance undertaking has a unilateral right to amend the premiums or the benefits payable under the contract in such a way that the premiums fully reflect the risks.

Point (c) shall be deemed to apply where an insurance or reinsurance undertaking has a unilateral right to amend at a future date the premiums or benefits of a portfolio of insurance or reinsurance obligations in such a way that the premiums of the portfolio fully reflect the risks covered by the portfolio.

Insurance Contract Boundary – Definitions

On all these definitions, the **term of contract ends on the date when the insurer has the right to reassess the risk of the contract** (on its own or as part of a portfolio of similar policies) **and amend the premium such that the premium fully reflects the risks, UNLESS the insurer has the ability, and right (under IFRS 4) or willingness (under the RGICS), to compel the policyholder to pay the premium.**

If the insurer is **able (and willing) to compel the policyholder to pay the premium, all cash flows**, including cash flows on or after the date on which the insurer has the right (or ability) to amend the premium such that it fully reflects the risk of the policy, are **considered as falling within the contract.**

Contract Boundary Definitions – Interpretation with respect to Long-term Health Insurance Policies in Singapore

Two views may be taken as to whether an insurer of a long-term health insurance policy in Singapore is able and willing to compel the policyholder to pay the premium, especially after a revision of premiums which results in an increase in the premium. Hereafter, the term “can compel” shall substitute the term “able and willing to compel”, and the term “cannot compel” shall mean “unable or unwilling to compel”, for ease of reading.

Interpretation A

One interpretation is that the insurer CAN compel the policyholder to the pay premium at all times, as otherwise the policyholder will not be able to continue enjoying the benefits of the policy. The policyholder has no option under the contract to continue the contract without paying the premium the insurer charges.

If this interpretation is taken, **the term of the policy will be taken as the term to the natural termination of the policy, i.e. the death of the life insured.** As such, a long-term health insurance policy will then be regarded as a whole of life contract.

There is also a **view that “compel” may be construed as a policyholder himself choosing to renew the policy despite premium increases** due to the want and need of maintaining his/her existing insurance coverage (which may be relevant for the Shield type plans).

Interpretation B

However, another interpretation may be taken that the insurer CANNOT compel the policyholder to pay the premium after a revision which results in an increase, if the increase in premium is not justifiable.

Future revised premiums are not “contractual premiums” that the policyholder must always agree to pay. Although the contract allows the insurer to revise the premium upward, there is an implied understanding that any increase will only bring the premium up to a level that is justifiable.

If this interpretation is taken, **all cash flows on or after the date on which the insurer has the right to revise the premiums which fully reflect the risks of the policy will be considered as falling outside the contract.** This date will then be the contract boundary.

European Insurance and Occupational Pensions Authority (EIOPA)

Guidelines on Contract Boundaries (effective 01 Apr 2015)

Guideline 3 – Ability to compel

1.10 Insurance or reinsurance undertakings should recognise their ability to compel a policyholder to pay a premium **only if the policyholder's payment is legally enforceable.**

Guideline – Full reflection of the risk

1.11 When determining whether premiums are fully reflecting the risks covered by a portfolio of insurance or reinsurance obligations, insurance and reinsurance undertakings should assess whether, at the moment at which either premiums or benefits can be amended, **under all circumstances the undertaking has the right to amend premiums or benefits such that the expected present value of the future premiums exceeds the expected present value of the future benefits and expenses payable under the portfolio.**

Singapore Actuarial Society Guidance Note
GN L02 Guidance Note for Appointed Actuaries on
Valuation of Policy Liabilities for Life Insurance Business
[Adopted on 01 Nov 2011]

3. Methodology

The Actuary should **calculate the policy liabilities in accordance with the discounted prospective cash-flow method** prescribed in the Insurance (Valuation and Capital) Regulations 2004. Further elaboration of the method can be found in the MAS Notice 319.

3.1 Term of the Liabilities

3.1.1 The starting point to derive the term of a policy's liabilities is the contractual term of the policy. The Actuary should then take account of any options in the contract when deciding whether the term of a policy's liabilities should be extended beyond the contract term.

3.1.2 The term of a policy's liabilities takes account of all the adjustments made to the policy on renewal before the valuation date. Depending on the circumstances, that term may also take account of the adjustment to be made on one or more renewals after the balance sheet date.

3.1.3 If the term of the liabilities is not evident, and if selection of a longer term would reduce policy liabilities, then the Actuary would be cautious in making such a selection. On the other hand, if selection of a longer term would increase those liabilities, then the Actuary would usually select the longer term. Substance would supersede form in the selection.

Discussion Points (Page 1 of 2):

Do the definitions of insurance contract boundaries make sense to you? Are these definitions unambiguous for the majority of insurance contracts?

In particular, how will you interpret the phrase “insurer is able to compel the policyholder to pay the premium” in general? How will you interpret the phrase “insurer is able AND willing to compel the policyholder to pay the premium” in general?

How will you interpret these phrases with respect long-term health insurance (LTHI) policies in Singapore?

If Interpretation A (CAN compel) is adopted and LTHI policies are treated as whole of life policies, how will you make assumptions about future management action when conducting a valuation of liabilities?

If Interpretation B (CANNOT compel) is adopted and LTHI policies have contract terms of 1 year or shorter, should the actuary be allowed to extend the terms of the liabilities beyond the contract terms?

Discussion Points (Page 2 of 2):

How will you extend your arguments to **long-term critical illness or disability income policies, which are also guaranteed renewable but on which premiums are not guaranteed**? Are there grounds for treating these contracts differently from LTHI policies?

Stand-alone critical illness and disability income policies are accident and health policies. Critical illness policies where the CI benefits are advanced payment of death benefits are harder to define.

Are there general insurance policies which are similar to these policies in terms of the guarantee of renewability and non-guarantee of premiums? If so, how should these policies be treated?

If a common definition of the contract boundary is adopted (whichever definition), **should there be a consensus as to how the definition is interpreted for each class of insurance products in Singapore**? Or should the insurer and its actuary be allowed to interpret for themselves, with justification?

Link to ERM

Management decisions based on reliable estimation of the liabilities of the insurer or the reinsurer

Does management understand the implications of the selection of the contract boundary on the estimation of the liabilities of the insurer or reinsurer?

Is management made aware of the impact of their decisions on the liabilities of the insurer or reinsurer?