Dear Dennis,

IASB Interpretations Committee (the Committee)
Outreach request—Insurance contract premiums receivable from an intermediary - November 2022

Thank you for the opportunity to participate in your outreach on this important topic in our Australian jurisdiction.

The issue of insurance contract premiums receivable from an intermediary has been the subject of considerable debate in our Australian Accounting Standards Board Transition Resource Group (AASB TRG), with papers on this topic discussed at two separate meetings.

The AASB TRG includes preparers of financial statements who are representatives of large insurers in the Australian market, including some with overseas reach, and the "Big 4" accounting firms as well as representatives from other areas of the industry, including industry bodies and regulators.

As a result of your outreach we convened a special meeting of the AASB TRG on 14 November 2022 for impacted members to provide their feedback. I have set out below your questions and a summary of the collated views from these discussions.

1. ***Question: Are insurance contracts sold through an intermediary (for which the insurer must fulfil its obligations to the policyholder under the insurance contract even if it has not received the insurance premium from the intermediary) common? If 'yes', are they common only in particular jurisdictions or for particular insurance policies? Please provide details of those jurisdictions or policies*.**

   Yes, insurance contracts sold through an intermediary, for which the insurer must fulfil its obligations to the policyholder under the insurance contract even if it has not received the insurance premium from the intermediary, are common in the Australian and New Zealand jurisdictions. We are also aware that such contracts are also significant in the UK and Canadian sectors.

   These types of contracts are predominantly found in the General Insurance sector, and to a lesser extent in the Reinsurance sector. They are not prevalent in the Life Insurance sector due to the nature of the contracts which requires premiums to be received by the insurer before policies are considered to be enforceable.

   Appendix A provides some background as to the legislative requirements covering obligations to policyholders.

2. ***Question: If insurance contracts sold through an intermediary are common:***
   Note, this section has been answered for the General Insurance sector and Reinsurance sector only given the particular relevance of the topic of outreach in these sectors, as noted in the response to Q1.

- ***are the premiums receivable from an intermediary typically material for the insurer at the end of a reporting period?***

   Yes, they are very material to the General Insurance sector.

   Feedback from our largest General Insurers indicates a range of 70% - 20% of Australian business being intermediated depending on the type of business being underwritten. This represents a significant proportion of the market.

Within the Reinsurance sector, there is a significant portion of business transacted through intermediaries (e.g. Brokers). Monies may be handled through intermediaries, as well as directly between cedant and reinsurer, and therefore the issue of IFRS 17 vs IFRS 9 applied to accounting for premiums receivable from intermediaries also arises in this sector.

- ***how are insurers implementing the requirements in IFRS 17 and IFRS 9 to premiums receivable from an intermediary?***

  Feedback from the General Insurance sector, and some participants of the Reinsurance sector, is that at this point they are currently planning to account for all cash flows receivable from an intermediary as IFRS 17 cash flows and believe this is a correct interpretation of IFRS 17 requirements. However, they are aware of the differences of opinion regarding this issue as we have debated the issue of premiums receivable from intermediaries twice in the AASB TRG (in June 2020 and in September 2020).

  In the AASB TRG discussions, preparers of Financial Statements had a consensus view that all premiums due from intermediaries should be accounted for as IFRS 17 cash flows. Some of the Big 4 held an alternative view.

  Should General Insurers be faced with a need to calculate the IFRS 9 component of premiums receivable from intermediaries, in order to separately present this in the balance sheet, they expected to apply a "top down" approach using high level assumptions (e.g. based on contractual payment terms) to estimate amounts intermediaries have received from policyholders but not yet transferred to insurer.

  A "top down" approach is considered unavoidable because the insurers do not have access to up-to-date intermediary data showing the point at which cash has been received by the intermediary as this information is not typically provided to insurers. Changing systems to identify cash reporting in the records of the intermediary is considered operationally very complex, if not impracticable, and is not considered to add value to the insurance business. Accessing intermediary data may also expose insurers to sensitive information regarding Brokers systems and practices, assuming the Brokers do allow for access to the information required.

- ***how are insurers implementing the requirements in IFRS 17 and IFRS 9 to other fulfilment cash flows that, at a point in time, become receivable from or payable to a party other than the policyholder (for example, amounts payable to a service provider to settle insurance claims in kind (paragraph B6 of IFRS 17) or to an intermediary (for example, to settle insurance claims or commissions))?***

  Claims payments are largely made directly to the policyholders and not via intermediaries, although it is not uncommon for claims to be paid via intermediaries (e.g. when amounts are net settled). Commission payments to intermediaries are accounted for under IFRS 17 based on the requirements of IFRS 17.B65. Therefore, if some premiums receivable are required to be accounted for under IFRS 9 there would be a disconnect between the accounting for payables and receivables.

  General Insurance participants highlighted that treating these other fulfilment cash flows as non-IFRS 17 cashflows would create substantial complexity for the following three reasons:

  (i) It may imply that an insurer would need to assess on a case-by-case basis which IFRS Standard applies to any of the various amounts receivable from, or payable to, any party other than a policyholder, which will vary depending on when payments are made between the insurer/policyholder and the third parties, for example amounts payable to third-party loss adjusters [IFRS 17.B65(f)].

  (ii) It is common for cash flows between intermediaries and insurers to be settled on a net basis. For example, an intermediary might forward premiums to an insurer net of commissions and/or claims. Accordingly, if some premium receivables were to be accounted for under IFRS 9, consideration would need to be given to whether it applies on a gross or net basis, or whether IFRS 9 applies only to some components of the net cash flows and not to others.

  (iii) Insurers typically are not in a position to determine the information that would be needed to differentiate between premiums receivable from policyholders vs those due from intermediaries. In

particular, intermediaries are generally not able to provide information to insurers about premiums received from policyholders on a timely basis.

- ***If an insurer accounts for premiums receivable from an intermediary differently from other receivables from or payables to a party other than the policyholder, please explain the basis for this treatment with reference to the requirements in IFRS Accounting Standards.***

We are aware of discussion regarding potential different treatment of transaction taxes payable, including consideration of whether these amounts will be included in IFRS 17 balances, however there is no stated basis treatment at this stage.

We have had AASB TRG discussions on the treatment of IFRS 9 cash flows particularly expenses which relate collectively to both insurance and non-insurance activities. Refer discussion of AASB 9 cash flows.

Other examples include payments under share-based payment schemes and employee entitlements where there has been discussion around whether these amounts are considered effectively "paid" once incurred under the originating standard. Given these amounts have:

- measurement and presentation requirements clearly defined under the originating standard;
- a benefit to users of the financial statement in retaining one collective balance sheet presentation; and
- operational simplicity,

these amounts are considered appropriately accounted for under the originating standard with relevant costs "attributed" to the insurance result once expenses are incurred under the originating standard.

As a final point to note, many companies are well advanced in their implementation programmes and a change as fundamental as the potential outcomes in this submission could lead to companies having to make significant changes at this very late stage. As such we consider that allowing for an accounting policy choice would be a sensible approach.

Kind regards, Anne Driver

Chair AASB TRG
Please note that the views expressed in this letter are those of the AASB TRG members and do not necessarily reflect those of the Australian Accounting Standards Board or staff

Appendix A – background information on jurisdiction requirements

Set out below is a summary of the rules relating to the Australian jurisdiction:

In Australia, insurance intermediaries must operate using an Australian Financial Services Licence (AFSL), regulated under the Australian *Corporations Act 2001*. Intermediaries may operate under their own AFSL or an insurer's AFSL.

Intermediaries operating under an insurer's AFSL ordinarily do not handle client money.

For intermediaries who operate using their own AFSL, under the Corporations Act section 985B *Status of amounts paid to financial services licensees in respect of contracts of insurance*, the following applies:

- 985B(1) – payment to the intermediary by the insured under the contract is a discharge, as between the insured and the insurer, of the liability of the insured in respect of that money;
- 985B(2) – payment to the intermediary by an intending insured in respect of a contract of insurance to be arranged by the intermediary with an insurer is a discharge, as between the insured and the insurer, of any liability of the insured in respect of that money;
- 985B(3) – payment by an insurer to an intermediary of money payable to an insured, whether in respect of a claim, return of premiums or otherwise, does not discharge any liability of the insurer to the insured in respect of that money.

When a policyholder pays premiums to the intermediary, under sections 981A and 981B of the *Corporations Act 2001*, the premiums are considered 'client money' and must be held in a trust account separate from the intermediary's daily operating accounts. It is important to note that intermediaries:

- can use client money only for specified purposes, which would generally be paying premiums to insurers, paying claims to policyholders, paying itself a contractually-agreed commission (which is regarded as discharging an obligation of a policyholder or insurer to pay commission);
- cannot use client money as working capital; and
- are trustees of the client money acting on behalf of the beneficiaries, which are policyholders and insurers.

In the event that an intermediary ceases to trade, the Australian Securities and Investments Commission would assume control of the client money account and, in accordance with the Corporations Act (section 981F and regulation 7.8.03), payments would be made in the following order:

(a) any payment necessary to repay money placed into the account in error;
(b) any payment owed to insureds (for example, for claims or refunds); and
(c) any payment to each person who is entitled to be paid from the account, which would include insurers that have a right to the premium.

If the money in the account is insufficient, it is paid in proportion to each party's entitlement in respect of (a), (b) and (c).

Set out below is a summary of the rules relating to the NZ jurisdiction:

In New Zealand, insurance intermediaries (which includes brokers) must comply with the Insurance Intermediaries Act 1994 which requires:

- Section 4 – payment to the insurance intermediary by the insured in respect of a contract of insurance that has been, or is to be, arranged or effected by the insurance intermediary with an insurer is a discharge, as between the insured and the insurer, of any liability of the insured in respect of that money.
- Section 5 – payment by an insurer to an insurance intermediary of money payable to an insured, whether in respect of a claim, return of premiums or otherwise, does not discharge any liability of the insurer to the insured in respect of that money.

Section 14(1) requires brokers to establish and maintain one or more insurance broking client accounts, which is a separate account from the broker's daily operating accounts.

Section 14(4) requires brokers to ensure the following monies are paid immediately after they are received into an insurance broking client account:

- all money received from or on behalf of an insured for or on account of an insurer in connection with a contract of insurance arranged or to be arranged by the broker;
- all money received from or on behalf of an insurer for or on account of an insured;
- any money by way of realisation of investments that is to be paid into the account in accordance with section 15; and
- any other money that is required by regulations made under that section to be paid into the account.

Section 14(5) requires brokers to ensure that no money is paid out of an insurance broking client account except:

- for making a payment required or authorised by the Act;
- for making an investment in accordance with the Act;
- for withdrawing money paid into the account in error; and
- otherwise in accordance with regulations made under the Act.

In the event that a broker becomes insolvent, money in an insurance broking client account, and property in which money has been invested, shall be treated as though it was subject to a trust in favour of the persons entitled to the money or property, as the case may be. Money from such an account shall be paid in the following order:

(a) first, money that has been paid into the account in error shall be withdrawn from the account;

(b) secondly, insureds shall be paid the amounts they are entitled to receive from the money in the account in respect of claims made pursuant to contracts of insurance;

(c) thirdly, insureds shall be paid the amounts (other than amounts to which paragraph (b) applies) that they are entitled to receive from the money in the account; and

(d) fourthly, after all payments have been made under paragraphs (b) and (c), insurers shall be paid the amounts they are entitled to receive from the money in the account.

If the money in the account is insufficient, it is paid in proportion to each party's entitlement in respect of (b), (c) and (d).

…

Attachment A – Premiums receivable via intermediaries

1. Two main approaches have been identified.

    (a) Apply IFRS 17 to account for premiums receivable in all circumstances.

    (b) Apply IFRS 17 to account for premiums receivable, except premiums receivable via intermediaries once the policyholders have satisfied their obligation to pay premiums by paying the intermediary, in which case IFRS 9 *Financial Instruments* applies.

Background: premiums receivable in the context of insurance contract measurement

2. Under the general model, insurance contracts are measured as the sum of the fulfilment cash flows and a contractual service margin [IFRS 17.32].

3. The measurement of the fulfilment cash flows comprises "all future cash flows within the boundary of each contract in the group" [IFRS 17.33] which would include, to the extent not yet received, "premiums (including premium adjustments and instalment premiums) from a policyholder and any additional cash flows that result from those premiums" [IFRS 17.B65(a)] (or 'premiums receivable').

4. When applying the premium allocation approach (PAA), the measurement of the liability for remaining coverage is based on premiums received minus amounts recognised as insurance revenue for services provided [IFRS 17.55], which can also be derived as the sum of the unearned premium applied under existing practice and premiums receivable (IASB PAA educational material).

Approach 1: Apply IFRS 17 to account for premiums receivable in all circumstances

Insurance contract cash flows include all cash flows that 'relate directly to the fulfilment of the contract'

5. All the cash flows an insurer expects to receive that 'relate directly to the fulfilment of' insurance contracts are cash flows within the scope of IFRS 17 [IFRS 17.B65] and are required to be included in the measurement of a group of insurance contracts [IFRS 17.33].

6. IFRS 17.B65 does not distinguish between cash inflows or outflows from policyholders or intermediaries, and is not limited to cash flows that arise directly from the insurance contracts issued to policyholders. In particular:

    (a) IFRS 17.B65 describes the cash inflows within the boundary of an insurance contract as including "premiums (including premium adjustments and instalment premiums) from a policyholder". All premiums, regardless of whether they flow directly or via an intermediary are 'from a policyholder'.

    (b) IFRS 17.B65 requires the inclusion of cash flows that arise from contracts with intermediaries or other third parties (separate legal contracts from the insurance contract with the policyholder) such as insurance acquisition costs (e.g. sales commissions) [IFRS 17.B65(e)], "recurring commissions that are expected to be paid to intermediaries" [IFRS 17.B65(h)] and salvage and subrogation recoveries [IFRS 17.B65(k)].

7. Agenda Paper 2A *Presentation of insurance contracts on the statement of financial position* for the IASB meeting in December 2018 makes clear that an insurance contract creates a single bundle of rights and obligations. Consistent with this principle, all the obligations and rights under an insurance contract, including premiums to be received (from all sources), claims and other costs directly attributable to fulfilling insurance contracts, would all need to be accounted for under IFRS 17.

Received means 'actually received'

8. The IASB clarified in Agenda Paper 6 *Implementation challenges outreach report* for the IFRS 17 TRG meeting in May 2018 that (emphasis added):

> Premiums, if any, received, as included in paragraphs 55(a)(i) and 55(b)(i) of IFRS 17 **means premiums actually received** at the reporting date. It does not include premiums due or premiums expected [paragraph A14].

9. The application of Approach 2 would result in the following once the premiums have been remitted to the intermediaries by the policyholder (refer to the Example section further below):
   (a) treatment of these cash flows as 'received' within the IFRS 17 liability for remaining coverage, increasing the liability; and
   (b) the recognition of a separate IFRS 9 receivable asset until the premiums are actually received by the insurer from the intermediary.

10. This treatment[1] is contradictory to the clarification provided in the IFRS 17 TRG agenda paper above that premiums are accounted for as 'received' within the IFRS 17 liability for remaining coverage only once they are 'actually received'.

11. As premiums held by an intermediary have not been 'actually received' by the insurer, it would still be considered 'receivable' by the insurer. The premiums remain receivable by the insurer under an insurance contract until passed on by the intermediary to the insurer. Accordingly, IFRS 9 cannot apply to premiums receivable via an intermediary because it would be illogical to treat premiums as received under IFRS 17 but as still being receivable under IFRS 9.

Consistency with amounts payable via intermediaries

12. It is clear that amounts such as claims payable to policyholders via intermediaries are within IFRS 17 because:
   (a) an insurer derecognises an insurance contract when, and only when it is extinguished, that is, when the obligation specified in the insurance contract expires or is discharged or cancelled; or any of the conditions in IFRS 17.72 (relating to modifications) are met [IFRS 17.74]; and
   (b) a contract that meets the definition of an insurance contract remains an insurance contract until all rights and obligations are extinguished (that is, discharged, cancelled or expired) [IFRS 17.B25].

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[1] Dr Premium receivable asset – IFRS 9; Cr Insurance liability LFRC – IFRS 17

13. To achieve consistency between the accounting for amounts receivable and amounts payable via intermediaries, it is necessary for all cash flows via intermediaries that relate to insurance contracts to be accounted for within the scope of IFRS 17.

14. Consistency in this regard seems important since the one service arrangement between an insurer and intermediary could give rise to receivables and payables and because amounts under the arrangement in respect of the same insurance contracts can change, for example, from being receivables at one reporting date to being payables at a subsequent reporting date. For example, amounts of premiums receivable and commissions payable are often settled net between insurers and intermediaries. It would be wrong (and generally impracticable) for an insurer to switch back and forth between applying IFRS 17 and IFRS 9 in respect of amounts outstanding under the one agreement for the same group of insurance contracts.

15. Since it is routine for amounts due to an intermediary (such as commissions) to be set off against premiums receivable, and for the net amounts to be paid/received, the accounting for the net cash flow due to or from an intermediary under IFRS 17 would best reflect the amounts an insurer would eventually match to the receipt or payment of cash.

Scope exclusions and exclusions

16. IFRS 9 does not apply to any cash flows associated with insurance contacts on the basis that:

    (a) IFRS 9 notes that insurance contracts and all the related rights and obligations are scoped out of IFRS 9 [IFRS 9.2.1(e)]; and

    (b) the scope of IFRS 17 contrasts with the scopes of IFRS 15 *Revenue from Contracts with Customers* and IFRS 16 *Leases*, which each have an explicit reference to the application of IFRS 9 to customer/lease receivables [IFRS 15.108; and IFRS 16.77].

Approach 2: Apply IFRS 17 to some premiums receivable and IFRS 9 to others

17. In some circumstances[2], the payment of the premium by the policyholder to the intermediary discharges the insurer's right to payment from the policyholder under the insurance contract and the insurer is now unconditionally obliged to fulfil its contractual obligations to the policyholder.

18. In these circumstances, premiums receivable from the intermediary are no longer the subject of an enforceable right under an insurance contract. This is because the insurer has no right of recourse to the policyholder for the payment of the premium, it only has recourse to the intermediary who holds the premium and this right is enforceable under the contract between the insurer and intermediary. Therefore, the right to receive the premium from the intermediary is a separate right not arising under an insurance contract.

19. The right to receive the premium from the intermediary is an enforceable right under the contract between the intermediary and the insurer, which is a service contract and not an insurance contract. The premium receivable is therefore within the scope of IFRS 9.

[2] This is typically the case in jurisdictions with strong consumer protection laws.

20. Supporters of Approach 2 argue that it is important to apply the IFRS 9 expected credit loss model to receivables that are subject to an agreement between an insurer and intermediary so that credit losses are explicitly identified and presented, rather than subsumed within the measurement of expected fulfilment cash flows under IFRS 17. [They hold this view, despite the IASB's consideration of the issue in Agenda paper 2A *Presentation of insurance contracts on the statement of financial position* at its December 2018 meeting (noted above).]

21. Supporters of Approach 2 argue that, when the payment of premiums by the policyholder to the intermediary discharges the insurer's right to payment from the policyholder, the insurer has effectively received the premium. This leaves the receivable from the intermediary to be accounted for under IFRS 9.

Example

Insurance contracts commence on 1 October 20X1 and **policyholders pay their premiums to an intermediary** on that date. **None of the premiums are forwarded to the insurer** prior to 31 December 20X1. Claims are incurred evenly over the coverage period. Coverage period = 1 year.	Premiums	$2,400
	Claims	($1,800)
	Risk adjustment	($120)
	CSM	($480)

Approach 1: Apply IFRS 17 to account for premiums receivable in all circumstances.

General model *– Liability for remaining coverage – as at 31 December 20X1*

	IFRS 17 (Asset)/Liability	Comment
Cash inflows	($2,400)	**Expected from intermediary**
Cash outflows	$1,350	$1,800 x (9/12 months)
Risk adjustment	$90	$120 x (9/12 months)
Fulfilment cash flows	**($960)**	
CSM	**$360**	$480 x (9/12 months)
Insurance (asset)/liability (A/LFRC)	**($600)**	

***PAA** – Liability for remaining coverage – as at 31 December 20X1*

	IFRS 17 (Asset)/Liability	Comment
Premiums received	-	
Amounts earned to insurance revenue	($600)	$2,400 x (3/12 months)
Insurance (asset)/liability (A/LFRC)	**($600)**	

Approach 2: Apply IFRS 17 to some premiums receivable and IFRS 9 to others

***General model** – Liability for remaining coverage – as at 31 December 20X1*

	IFRS 17 (Asset)/Liability	IFRS 9 (Asset)	Comment
Cash inflows	-	($2,400)	**Deemed received under IFRS 17 and recognised as an asset under IFRS 9**
Cash outflows	$1,350		$1,800 x (9/12 months)
Risk adjustment	$90		$120 x (9/12 months)
Fulfilment cash flows	**$1,440**	($2,400)	
CSM	**$360**		$480 x (9/12 months)
Insurance (asset)/liability (A/LFRC)	**$1,800**	**($2,400)**	

PAA *– Liability for remaining coverage – as at 31 December 20X1*

	IFRS 17 (Asset)/Liability	IFRS 9 (Asset)	Comment
Premiums received	$2,400	($2,400)	**Deemed received under IFRS 17 and recognised as an asset under IFRS 9**
Amounts earned to insurance revenue	($600)		$2,400 x (3/12 months)
Insurance (asset)/liability (A/LFRC)	**$1,800**	**($2,400)**	

Suggested agenda item: Insurance contract premiums receivable via intermediaries

1. It has come to our attention that there are diverse views on the accounting for insurance contracts when the expected premium cash inflows are receivable via intermediaries which operate between the insurer and the policyholder.

2. We seek clarification from the IFRS Interpretations Committee on whether the premium due to an insurer from an intermediary should be accounted for under IFRS 17 or IFRS 9. The submission focuses on a scenario where the insurer must fulfil its obligations to the policyholder under the insurance contract because the policyholder has paid the premium to the intermediary.

BACKGROUND

3. Intermediaries operate by assisting insurers to sell their insurance contracts and policyholders to buy them. Often the intermediary has the responsibility to collect, on behalf of the insurer, the policyholder's premiums. The question arising is whether the insurer should account for premiums that have been collected by an intermediary but not yet remitted to the insurer applying:

   (a) IFRS 17, as expected cash inflows not yet received; or

   (b) IFRS 9, as a financial asset receivable from an intermediary.

4. The focus of this submission is on the situation in which an insurer must fulfil its obligations to the policyholder under the insurance contract even if it has not received the insurance premium from the intermediary. Such arrangements are prevalent and the insurer’s obligation can be the result of either the application of law or the contractual terms between the insurer, the intermediary and the policyholder.

5. This submission does not consider the situation in which the insurer is not required to fulfil its obligations to the policyholder under the insurance contract if it has not received the insurance premium from the intermediary. There appears to be general agreement that IFRS 17 applies in such situations.

6. In addition, this submission does not distinguish between whether the intermediary is acting on behalf of the policyholder or the insurer because this is not considered to be a factor in determining whether the insurer is required to fulfil its obligations from contracts under IFRS 17. For example, we are aware of jurisdictions where the insurer is required to fulfil their obligations under the insurance contract even though cash is held by an intermediary who acts of behalf of a policyholder. We are also aware of jurisdictions in which premium monies may be held by an intermediary in trust accounts that are not under the control of the intermediary and to which both policyholder and insurer have beneficial rights. This submission is based on the following fact pattern:

An insurer issues 1,000 travel insurance policies sold to policyholders through an intermediary on 1 December 2020. The coverage period for those policies is from 15 December 2020 to 14 December 2021, inclusively. There is a single premium payment due.

The policyholders paid the full amount of premiums due under the insurance contracts to the insurer's intermediary on 15 December 2020. The intermediary received the premium on the same day in its bank account.

The intermediary has not remitted any of the premiums to the insurer as at the year-end 31 December 2020 because the agreement with the insurer stipulates that the remittance will be made on 28 February 2021 when it will only remit the amount of the premium less a 9% commission that the intermediary is entitled to retain for its services to both the insurer and the policyholder. The insurer has included the commission in the fulfilment cash flows under IFRS 17 and has classified it as an insurance acquisition cash flow. The intermediary recognised the amounts received from policyholder in its 31 December 2020 financial statements as cash.

The bank account into which the policyholders pay the premiums is not controlled by the insurer (i.e. before remittance by the intermediary, the insurer does not control the cash to which it is entitled).

In case of default by the intermediary, the insurer is not entitled to recover the premiums from the policyholders.

All amounts payable to the intermediary relate to recognised insurance contracts and there are no pre-coverage assets or liabilities.

The insurance policies are within the same portfolio and are all in a profitable group. Thus, the 1,000 insurance policies issued on 1 December 2020 are all within the same group of insurance contracts as they are all issued in December 2020.

On 31 December 2020, the group of insurance contracts is not onerous.

The insurer applies the Premium Allocation Approach (PAA) to account for this group of insurance contracts.

7. This submission considers 2 scenarios:

   (a) Scenario 1: the intermediary remits the cash for premiums (net of commission) collected to the insurer on 28 February 2021.

   (b) Scenario 2: after 31 December 2020, the intermediary suddenly and unexpectedly goes bankrupt and does not remit any of the premiums (net of commission) collected.

8. The Question remains equally applicable irrespective of whether commission due from the insurer to the intermediary are netted against premiums due from the intermediary to the insurer. The netting of commission is included in the example as it is common practice.

QUESTION

On 31 December 2020, are the premiums due to the insurer from its intermediary within the scope of IFRS 17 or IFRS 9?

VIEW 1: WITHIN THE SCOPE OF IFRS 17

9. The premiums to be received from the intermediary have arisen from a group of insurance contracts and they should be accounted for in accordance with IFRS 17:33. The premiums receivable are future fulfilment cash inflows not yet received and within the boundary of each contract in the group.

10. IFRS 9:2.1(e) is clear that the rights and obligations arising under insurance contracts are outside the scope of IFRS 9, except for the items listed in (i) to (v). The insurance contracts described above do not fall into any of the scope inclusions listed in IFRS 9:2.1(e)(i) to (v).

11. Applying IFRS 17:25 to the travel insurance policies described in this submission, the group of insurance contracts is recognised on 15 December 2020 as this is the earliest of (i) the beginning of the coverage period of the group (15 December 2020), (ii) the date when the first payment from a policyholder in the group becomes due (15 December 2020), and (iii) the date when the group becomes onerous (not applicable in this case since the group was not onerous).

12. Under this view, the premiums received and held by the intermediary continue to form part of the insurer's liability for remaining coverage. This is because the term 'premiums received' means premiums actually received in cash at the reporting date and does not include premiums receivable, that is, premiums invoiced but not yet received and future premiums not yet invoiced. This conclusion was noted by the Transition Resource Group for IFRS 17 *Insurance Contracts* in February 2018 in the IASB staff response to Submission S23 of Agenda Paper 7 *Reporting on other questions submitted.*

13. This conclusion applies under the general model, variable fee approach and PAA.

14. At its December 2018 meeting, the IASB considered and rejected a proposal that IFRS 17 should be amended to require the separate presentation and measurement of premiums receivable and claims payable under IFRS 9. Paragraph 47 or the agenda Paper 2A *Presentation of insurance contracts on the statement of financial position* noted that:

> … [t]he principle of IFRS 17 recognises that a contract, and by extension groups of contracts, create a single bundle of rights and obligations. Measuring premiums receivable and claims payable separately and differently from the corresponding obligations and rights is inconsistent with this principle that measuring premiums receivable and claims payable separately from insurance contracts would result in internal inconsistencies in IFRS 17.

15. Supporters of View 1 also point to IFRS 17:2, which explains that any substantive rights and obligations that arise from entering into an insurance contract whether they are from a contract, law, or regulation fall within the scope of IFRS 17.

16. Supporters of View 1 also argue that, as noted in Agenda Paper 2A (IASB meeting of December 2018), applying IFRS 9 to premiums receivable via intermediaries is not workable in an IFRS 17 context for two key reasons:

    (a) it would involve presenting amounts from an IFRS 17 perspective as if they had been received when they have not, as IFRS 17 requires the premium to be actually received in cash by the entity to be considered received under IFRS 17; and

(b) the accounting for premiums receivable via intermediaries may then be inconsistent with the accounting for amounts payable to the same intermediaries (e.g., for the insurance acquisition cash flows due to the intermediary for the sale of the insurance contracts) creating operational complexity and potentially creating internal inconsistency between IFRS 17 assets and liabilities .

17. If IFRS 9 is applied to the premiums receivable from intermediaries, those amounts would presumably need to be presented as if they had been actually received in the reconciliation required by IFRS 17:105(a)(i). This would be misleading since the money has not have been actually received. This would also be confusing in the context of the presentation of a cash flow statement prepared using the direct method. Cash cannot be actually received under IFRS 17 and remain receivable under another IFRS Standard.

18. Finally, supporters of View 1 note that when commissions due to an intermediary are set off against premiums receivable as is the case in this example, and so net amounts are paid/received, accounting for the net cash flow due to or from an intermediary under IFRS 17 would naturally keep together the elements that the insurer would eventually match to the receipt or payment of cash.

Applying View 1 to the fact pattern presented in this submission

Initial recognition (on 15 December 2020)

19. The right to receive insurance premiums from the intermediary has arisen from a group of insurance contracts and is accounted for in accordance with IFRS 17.

20. In this scenario, the receipt of premiums by the intermediary on 15 December 2020 does not affect the date of initial recognition of the group of insurance contracts. This is because 15 December 2020 is the premium due date for the first policy in the group which is the earliest recognition date in accordance with IFRS 17:25.

21. Under the PAA, as no cash has been received as at 15 December 2020, the liability for remaining coverage is nil. This reflects the fact that IFRS 17:55(a)(i) requires the carrying amount of the liability to be recognised at initial recognition only for the premiums received.

At year-end (on 31 December 2020)

22. Applying IFRS 17:55(b)(v), ‘insurance revenue’ is recognised for services provided in the period (from 15 December 2020 to 31 December 2020) with the same amount recognised as an ‘asset for provided coverage’, effectively the asset side of what IFRS 17 defines as the liability for remaining coverage, only that at this date the asset relates to the coverage already provided. This asset is an IFRS 17 asset.

Subsequent to year-end

<u>Scenario 1: The intermediary remits the cash for premiums collected to the insurer on 28 February 2021.</u>

23. Applying IFRS 17:55(b)(i), the receipt of cash by the insurer for the insurance premiums collected and remitted by the intermediary is recognised as an adjustment to the carrying amount of the insurance asset.

24. Note that if the group of insurance contracts was measured under the general model instead of the PAA, a similar result would be achieved. This is because at initial recognition the group is expected to be profitable, the contractual service margin (CSM) balance is equal and opposite to the net fulfilment

cash inflows, and the initial measurement of the group is nil (IFRS 17:32). At year-end, insurance revenue is recognised for the services provided for the period and a corresponding reduction in liability for remaining coverage is recognised resulting in an asset as per IFRS 17:41(a). Note that for simplicity's sake, the accounting for time value of money and the release of risk adjustment have been ignored and it is assumed that no claims are expected before 1 March 2021.

25. Upon receiving insurance premiums on 28 February 2021, the fulfilment cash flows of the insurance contract carrying amount are adjusted per IFRS 17:40(a)(i)).

Scenario 2: After 31 December 2020, the intermediary suddenly and unexpectedly goes bankrupt and does not remit any of the premiums collected.

26. Under the PAA, because these are single premium contracts and none of the premiums on those issued contracts paid to the intermediary by 28 February 2021 have been remitted to the insurer, the group has become onerous. Applying IFRS 17:57 and 58, the insurer recognises the extent to which the group is onerous as a loss in profit or loss and a loss component which is an increase in the liability for remaining coverage.

27. Note that if the group of insurance contracts was measured under the general model instead of the PAA, a similar result would be achieved.

VIEW 2: WITHIN THE SCOPE OF IFRS 9

28. Once policyholders remit the premiums to the intermediary in cash, the insurer has in effect received the premium payments, given that, in the event of default by the intermediary, the insurer must still fulfil its obligations to the policyholders. As such, the policyholders have effectively paid the premiums to the insurer. The right to receive insurance premiums from the intermediary is a separate contractual right not arising under an insurance contract and the scope exemption in IFRS 9:2.1(e) does not apply.

29. In this scenario, the receipt of premiums by the intermediary on 15 December 2020 does not affect the date of initial recognition, because 15 December 2020 is the earliest recognition date in accordance with IFRS 17:25. However, applying this view, the premiums received by the intermediary are considered to have been received by the insurer and the liability for remaining coverage is adjusted by the same amount. As no cash has been received, an IFRS 9 receivable is recognised as due from the intermediary, and the expected credit loss model is applied to the receivable to reflect the credit risk the insurer has assumed in respect of the default risk of the intermediary.

30. In the event of non-payment of the premiums to the insurer by the intermediary as in scenario 2, insurance revenue and/or profitability of the group would be unaffected. Instead, an impairment loss would be recognised in respect of the financial receivable in accordance with IFRS 9.

31. The same conclusion applies under the general model, variable fee approach and PAA.

32. Even though the amount of premiums due from the intermediary would reduce in the “IFRS 17 receivable” and a separate receivable from the intermediary recognised under IFRS 9, any amounts payable to intermediaries (e.g., insurance acquisition cash flows, in this case the 9% commission) are expected to remain fulfilment cash flows within the scope of IFRS 17.

33. Note that if the group of insurance contracts was measured under the general model instead of the PAA, the expected payment of insurance acquisition cash flows would form part of the liability for remaining coverage at initial measurement (IFRS 17:33 and B65(e)) and the IFRS 9 financial asset would only be recognised for the expected amount of premium receivable from the intermediary. The subsequent remittance of the net amount from the intermediary (i.e., net of premium receipts and acquisition costs) would result in derecognition of the IFRS 9 financial asset and a debit to the IFRS 17 liability for remaining coverage, without any impact in profit or loss.

34. Unlike View 1, the group of insurance contract is not reported as onerous, which reflects that the insurance risk has not increased unexpectedly, nor has the calculation of premiums become insufficient to absorb the insurance risk transferred from the policyholders to the insurer. Instead, the recognition of expected credit losses fairly represents that the insurer has assumed credit risk in respect of the intermediary (which has materialised in scenario 2) and should be presented as impairment loss outside insurance service result.

Applying View 2 to the fact pattern presented in this submission

Initial recognition (on 15 December 2020)

35. The right to receive insurance premiums from the intermediary is a separate right not arising from issued insurance contracts. It arises instead from a service agreement between the insurer and the intermediary. That is, on payment by a policyholder to the intermediary, expected fulfilment cash inflows would be reduced and a separate receivable from the intermediary recognised under IFRS 9. On 15 December 2020, the insurer recognises the full amount of the insurance premiums paid by the policyholders to the intermediary as an IFRS 9 receivable and the same amount would be recognised as a liability for remaining coverage as if the premiums were received by the insurer.

36. Note that the receivable from the intermediary would be subject to the expected credit loss model. The effect of the application of the ECL model is ignored for the sake of simplicity.

At year-end (on 31 December 2020)

37. Insurance revenue would be the same as in View 1 with the presentation in the statement of financial position that is described above adjusted for the reported revenue amount.

Subsequent to year-end

Scenario 1: The intermediary remits the cash for premiums collected to the insurer on 28 February 2021.

38. The insurer would debit cash received, derecognise the IFRS 9 receivables recognised and debit the IFRS 17 liability for remaining coverage for the commission on 15 December 2020.

Scenario 2: After 31 December 2020, the intermediary suddenly and unexpectedly goes bankrupt and does not remit any of the premiums collected.

39. An impairment loss is recognised on the receivable and presented in a separate line in profit of loss [IAS 1.82(ba)]. Subsequently, the group of insurance contracts continues to be measured as profitable with the release of the CSM as services are provided.

40. The insurer does not change the accounting for the group of insurance contracts (the group is not reported as onerous). Insurance revenue is recognised until the end of the coverage period as if the premium had been received in full.

REASONS FOR THE COMMITTEE TO ADDRESS THE ISSUE

We believe that this accounting issue is prevalent in the global insurance market. We have observed differing views being applied as part of the ongoing implementation of IFRS 17. This issue is not related to a Board project that is expected to be completed in the near future.

For these reasons, we believe that this issue is urgent and meets the criteria for acceptance into the Committee's agenda.