IFRS Transition Resource Group for IFRS 17 *Insurance Contracts* (TRG)

Premium received applying the premium allocation approach (S23 in Agenda Paper 7 of the February TRG meeting)

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Introduction

At its first meeting in February 2018, the Transition Resource Group (TRG) for IFRS 17 *Insurance Contracts* raised concerns over implementation challenges identified by insurers in practically applying the requirements of IFRS 17. The IASB staff followed up with specific questions to TRG members designed to understand the issues in more detail. These questions are included in this document.

Topic 2

Premium received applying the premium allocation approach (S23 of Agenda Paper 7 of the February 2018 TRG meeting).

Issues

Under the Premium Allocation Approach ("PAA") in IFRS 17 *Insurance Contracts* paragraphs 55(a)(i) and 55(b)(i), the Liability for Remaining Coverage ("LfRC") includes only **premium received**. Paragraphs 55(a)(i) and 55(b)(i) preclude the recognition of premium receivable i.e. premium invoiced but not yet paid and future premium not yet invoiced as reiterated in the IASB TRG staff response to a submission (S23 of Agenda Paper 7 at the February 2018 TRG meeting).

The requirement to identify **premium received** by **group of insurance contracts** presents significant practical challenges for general insurers and materially increases the cost of IFRS 17 implementation for no discernible benefit.

Q1. Please describe any specific implementation challenges that you have identified as a result of applying the measurement requirements in paragraph 55(a)(i) and 55(b)(i) of IFRS 17.

The need to identify premium received by group of insurance contracts presents a significant implementation challenge as general insurance underwriting and reporting systems are not designed to identify and extract cash receipt balances at this level of granularity (i.e. groups) and cash receipts are not used as the basis of any current financial accounting, regulatory or tax reporting. Insurance accounting, in line with many other general accounting principles applied in practice, adopts an accruals basis of accounting, with cash receipts being just one component of the many transactions used to derive financial and management reports.

The following are specific examples of the areas of practical implementation challenge we have identified:

i. Premiums received data is often maintained in a separate cash management system from the policy administration system (i.e. the system where the insurance contract is recorded). The policy administration system exports premium data to credit control systems which then focus on the collection of premiums in accordance with the payment terms agreed in the insurance contract (e.g. monthly, quarterly or annual payments or via broker arrangements or binding arrangements). Credit control systems focus on the management of credit risk and tend to be aligned to distribution channel and aggregate contracts accordingly. These cash and credit control systems do not generally have the connectivity back to policy administration systems to differentiate between what is received vs receivable.

ii. Within the cash management systems, cash is not always applied at a contract level e.g. contracts may be aggregated by broker or agent with cash applied at this level. This means that premium received amounts are unlikely to be maintained at the level of granularity required to measure the group of insurance contracts.

iii. Insurers will certainly need to continue to report information based on accruals accounting principles to mitigate the loss of transparency created by the current IFRS 17 PAA LfRC requirements and the emphasis on cash received amounts. For example:

(a) Internally we consider the measurement of premium (both gross written premium and gross unearned premium (UEP)) as a key management metric which will be retained under IFRS 17. UEP represents our obligation to policyholders and is unique to risk business - an insurance contract is exposed to the full risk of loss and requirement to deliver the full service on day 1 of the contract. By comparison a regular contract to deliver service would be unlikely to be required to deliver a full year of service on the first day of the contract. This factor appears not to have been considered in the current reporting requirements of IFRS 17.

(b) Investors and prudential regulators are likely to demand information that shows insurers' full obligations to policyholders (i.e. current gross UEP) and the full extent of the reinsurance relating to those obligations (i.e. deferred reinsurance costs).

(c) Returns for tax authorities and prudential regulators are likely to remain on an accruals basis, requiring the full insurance exposure to be reflected and trade receivables to be identified.

(c) Sound business practice requires insurers to continue to manage and report on their exposure to credit risks associated with premium receivable.

(d) Insurers usually manage their business by product line, region or distribution channels and report gross written premium on this basis, as this provides the total expected revenue over the full coverage period. We expect this to continue to form the basis of internal reporting and management of our business and be included in the information we provide to investors beyond the implementation of IFRS 17.

iv. Insurers often have significant amounts of premium received that have not yet been allocated to the insurance contracts (i.e. unallocated cash). This is largely due to timing where there is early systems cut off to facilitate the actuarial reserving process or where cash received immediately prior to the balance date has not been allocated before the end of the reporting period. This adds to the difficulty of measuring the relevant “groups of insurance contracts”.

The requirement to identify premium received by group of insurance contacts effectively entails insurers having to maintain two comprehensive information systems to generate (1) information needed by stakeholders such as regulators, tax authority and internal management; and (2) the information needed solely for IFRS 17 accounting. This creates significant and unnecessary costs for insurers that will ultimately be borne by shareholders, policyholders and the wider community.

Q2. Are your observations equally relevant for life and non-life contracts issued?

We understand from discussions with life insurance companies in our local market that this is a broad issue covering both life and general insurance in that all entities expect to retain trade receivables as a relevant metric under IFRS 17. Please note that the paper submitted by the Insurance Council of Australia on this topic received the endorsement of the AASB TRG which comprises Life, Health and General Insurers as well as members of the AASB, users of financial statements, Regulators and the Australian Tax Office.

In addition, we have been in fact finding discussions with external systems providers and consultants, and we have yet to identify any systems solutions that have determined how to resolve the issue of identifying a cash basis of accounting for insurance business given the accruals based accounting approach is the widely adopted norm.

Q3. Are your observations relevant equally in applying the general measurement model instead of the optional premium allocation approach?

Given that the PAA is a simplification of the general model and the PAA requires the LfRC to include only “**premiums received”,** we infer that the general model also assumes a cash receipts basis albeit the general model refers to future cash flows. Our understanding from discussions with local life insurers who will be using the general model is that there is an issue also in the general model with use of cash receipt information as this is also not readily available for their products and they also consider trade receivables a relevant metric.

QBE has small components of business which will adopt the general model, and we see that the issues related to collection of premium and recognition of cash receipts described above are equally applicable. We therefore consider there is an equally difficult implementation issue with the need to identify cash receipts in the general model.

As noted above the paper submitted by the Insurance Council of Australia on this topic received the endorsement of the AASB TRG which comprises a wide spectrum of preparers including those using the general model and PAA.

Q4. If those challenges arise from identifying amounts actually received for each contract, please explain how you currently identify those amounts at each reporting date.

Currently the unit of measurement for presentation of the balance sheet is **legal entity level** and the general ledger financial reporting systems aggregate all insurance premiums receivable from the underlying source systems to legal entity level, often supported by an extensive data warehouse for detailed analysis of transactions at a more granular level. Premium received (cash) data is currently required for our “movement over time” analysis (i.e. the reconciliation of opening balance sheet amount to closing balance sheet amounts similar to those included in IFRS 17) and for statutory cash flow statements at the level of the legal entity and not below. There are no other requirements to produce premium cash receipt information at a more granular level.

At an operational level, on payment of a claim there would generally be a requirement to verify that the premium has been received – but this would be only one of many protocols and controls around claims assessment and clearly only relevant to policies where a claim is reported and not to all policies.

Shown below is an extract of the current financial statements balance sheet and debtor disclosures.

Current Balance Sheet

	NOTE	2016 US$M
Assets		
Cash and cash equivalents	5.2	847
Investments	3.2	24,374
Derivative financial instruments	5.6	151
Trade and other receivables	2.6	4,831
Current tax assets		51
Deferred insurance costs	2.5	1,965
Reinsurance and other recoveries on outstanding claims	2.3	4,540
Other assets		8
Assets held for sale	7.1.2	85
Defined benefit plan surpluses	8.6	27
Property, plant and equipment		257
Deferred tax assets	6.2	778
Investment properties		14
Investment in associates		28
Intangible assets	7.2	3,627
Total assets		41,583

The current balance sheet is presented at an entity level and includes the insurance receivables within the Trade and other receivables.

	2016 US$M
Trade debtors	
Premium receivable [1]	2,149
Reinsurance and other recoveries [2]	984
Unclosed premium	955
Other trade debtors	123
	4,211
Other receivables	620
Trade and other receivables	4,831
Receivable within 12 months	4,775
Receivable in greater than 12 months	56
Trade and other receivables	4,831

Potential solutions

We believe that premiums receivable under the terms of the contracts issued should be included when measuring the LfRC.

Current generally accepted insurance practice in major global markets adopts this approach by recognising trade receivables (reinsurance payables) that the insurer is expected to receive (pay) based on contracts which have incepted and the associated LfRC representing the obligation to provide cover. This view is a more faithful representation of the obligation an insurer has to provide coverage to policyholders (noting that the insurer could be called on to deliver the full service of risk protection from inception and the credit risk exposure the entity has in relation to collection of premiums.

To reduce complexity with the current drafting of IFRS 17, consideration should be given to replacing the term “premium received” with “premiums receivable”.

If also required, premiums receivable could be identified as trade receivables under IFRS 9 and therefore remove them from the scope of IFRS 17. This would mean that the LfRC is a more transparent measurement of our obligation to policyholders and eliminates the need for major changes to IFRS 17. IFRS 9 adopts an expected loss model for impairment consistent with basic insurance principles.

Overall the amendment of IFRS 17 to allow recognition of premiums receivable when measuring the LfRC would ensure:

(a) there is consistency with the requirements of other IFRS Standards;

(b) transparency is maintained for the users of financial statements and the obligations of the entity to provide insurance cover are disclosed; and

(c) insurers are relieved of the significant costs associated with system changes necessitated for IFRS 17 reporting only and which may not be used for any other internal or external reporting.

Disclaimer

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