



AASB Transition Resource Group for AASB 17 *Insurance Contracts* Submission form for potential implementation question

In addition to the form, attachments (such as memos) may be included with the submission.

Any public discussion of issues submitted will be without the identification of the submitter's name. Although the submission forms will remain private, please do not include any confidential information in your submission.

Email a PDF of the completed (including any attachments) form to standards@aab.gov.au.

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Do you wish to present to the TRG?	Yes

Potential implementation question

When, if ever, would AASB 9 Financial Instruments apply to premium receivables, rather than AASB 17 Insurance Contracts?

Paragraph of IFRS 17 *Insurance Contracts*

Various, including: AASB 17.32-35; 40; 55; and AASB 9.2.1(e).

Analysis of the question

The analysis of the question should include a detailed description of the different ways the new Standard may be applied, resulting in possible diversity in practice.

Please see attached five pages

Q1 Do you support View 1 or View 2?

Q2 Do you believe that IFRS 17 supports View 1, View 2 or both Views?

Is the question pervasive?

Explain whether the question is expected to be relevant to a wide group of stakeholders.

The issue affects most insurance industry stakeholders (both general and life).



Premium receivables – AASB TRG June 2020

For the purposes of discussion, two main views are identified involving cash flows via intermediaries such as brokers. The focus is on premium cash inflows, but the same principles would apply for reinsurance recovery cash inflows via intermediaries.

View 1 Under AASB 17, premiums to be received from any potential third party source (including policyholders or intermediaries) would be accounted for by applying AASB 17 when the group of insurance contracts to which the premiums relate has been recognised.

View 2 There would be a distinction between cases when:

- (a) the intermediary is acting on behalf of the insurer, in which case AASB 9 applies to premium receivables due from the intermediary; and
- (b) the intermediary is acting on behalf of the policyholder, in which case AASB 17 applies to premiums to be received.

Please note, case (b) is uncontroversial because, in substance, from the insurer's perspective, the policyholder remains the debtor. Case (a) is relevant to this analysis.

Depending on the view adopted, the amounts recognised as insurance liabilities and financial assets would differ and the related presentation and disclosures would differ.

View 1 AASB 9 would not apply to any insurance cash flows where the group insurance contracts has been recognised

1.1 Insurance contract cash flows, including premiums received and/or receivable, are all addressed by the measurement models (general and PAA) under AASB 17. Insurance contracts and all the related rights and obligations are scoped out of AASB 9 [AASB 9.2.1(e)].

December 2018 IASB Board meeting paper 2A *Presentation of insurance contracts on the statement of financial position*

1.2 The **December 2018 IASB Board meeting paper 2A *Presentation of insurance contracts on the statement of financial position*** considered concerns expressed by some stakeholders that the nature of premiums receivable and claims payable would be better reflected if entities were to measure and present them separately applying IFRS 9.

1.3 The IASB decided that measuring premiums receivable and claims payable separately from insurance contracts would result in internal inconsistencies in IFRS 17. The December 2018 meeting paper 2A noted that:

- (a) in principle, IFRS 17 recognises that a contract creates a single bundle of rights and obligations; and
- (b) measuring premiums to be received and claims payable separately and differently from the corresponding obligations and rights under an insurance contract is inconsistent with this principle.

1.4 The December 2018 meeting paper 2A does not specifically mention intermediaries; however, the logic of the IASB's conclusion appears applicable to any premiums to be received, for example, for the following reasons.

- (a) The AASB 17 general model involves recognising insurance assets and liabilities measured on the basis of expected future cash flows, including expected premium cash flows. Accordingly, insurance liabilities already include any relevant allowance for 'expected' credit risk (such as any risk of intermediary default), and applying another layer of impairment assessment under AASB 9 would be irrelevant.¹

¹ The Basis for Conclusions to IFRS 17 specifically identifies that the insurer's own credit risk (but not counterparty credit risk) is disregarded when measuring fulfilment cash flows. Accordingly, it is clear that credit risk other than an insurer's own credit risk is incorporated when measuring fulfilment cash flows under IFRS 17.



- (b) Applying AASB 9 to premium receivables involves those expected cash inflows being removed from measuring insurance assets and liabilities under AASB 17, which gives rise to the following problems.
- (i) When AASB 9 is applied to underlying contract premium receivables while AASB 17 applies to a related quota share reinsurance contract held, there would be an inconsistency between the two that could create an accounting mismatch.
 - (ii) Applying AASB 9 can create an unacceptable difference between liabilities for remaining coverage measured under the 'general model' and the 'premium allocation approach' because of the ways in which those models function, which breaks a basic tenet in AASB 17.
- 1.5 Nothing in the definition of fulfilment cash flows² restricts them to being only flows between policyholders and insurers and, accordingly, AASB 17 anticipates that fulfilment cash flows could also include cash flowing via third-party intermediaries.

May 2020 IASB Board meeting paper 2A Sweep Issues

- 1.6 The **May 2020 IASB Board meeting paper 2A** explained that an unpaid invoice for acquisition cost services from a broker relating to a group of contracts not yet recognised would be a financial liability of the insurer accounted for by applying IFRS 9. Paper 2A goes on to say that the future cash flows should be included in an asset for insurance acquisition cash flows before the recognition of the group of contracts to which the cash flows relate, **and subsequently in the fulfilment cash flows of the recognised group.**
- 1.7 At its May 2020 meeting, the Board tentatively decided to:
- (a) require an entity to include in the initial measurement of the CSM of a group of insurance contracts the effect of the derecognition of any asset or liability for cash flows related to that group that was recognised before the group is recognised; and
 - (b) require an entity, when another IFRS Standard requires it to recognise a liability for future insurance acquisition cash flows before it recognises the related group of insurance contracts, to also recognise an asset for those cash flows.
- 1.8 By analogy, premiums receivable from an intermediary would be recognised under AASB 9 only if they were to arise prior to the related group of insurance contracts being recognised {being the earlier of: (a) the beginning of the coverage period; (b) the premium due date; and (c) when contracts become onerous [AASB 17.25]}. This would be expected to be a rare set of circumstances. If the premiums remain receivable once the relevant group of contracts is recognised, the AASB 9 financial asset would be derecognised and the expected cash flows included in measuring the liability for remaining coverage under AASB 17.
- 1.9 Accordingly, the IASB's decision on accounting for acquisition cash flows incurred prior to recognising the relevant group of insurance contracts supports the view that AASB 9 never applies to premiums receivable from intermediaries once the relevant group of contracts is recognised.

IFRS 17 TRG meeting in May 2018

- 1.10 **Agenda paper 6 Implementation challenges outreach report for the IFRS 17 TRG meeting in May 2018** clarifies that (emphasis added):
- A14 ... '**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.
- 1.11 The mechanics of the general model and the PAA should result in the same outcomes (in the absence of significant variability of cash flows [AASB 17.53 & 54]). Accordingly:

² An explicit, unbiased and probability-weighted estimate (ie expected value) of the present value of the future cash outflows minus the present value of the future cash inflows that will arise as the entity fulfils **insurance contracts**, including a **risk adjustment for non-financial risk**.



- (a) if premiums held by intermediaries are regarded as having already been received for the purposes of the general model, they would need to be regarded as having been **'actually received'**³ for the purposes of the PAA; and
- (b) if premiums held by intermediaries are regarded as being receivable for the purposes of the general model, they would need to be regarded as having not been **'actually received'** for the purposes of the PAA.

View 2 AASB 9 applies when an intermediary acts on behalf of an insurer

- 2.1 If the intermediary is acting on behalf of the policyholder, premiums held by the intermediary remain payable to the insurer, which can either enforce payment by the policyholder or cancel the insurance contract. The premium receivable arises from an insurance contract and it should be accounted for in accordance with AASB 17.
- 2.2 From the insurer's perspective, the premiums are still due from the policyholder (or, in this case, from the intermediary who is acting as the policyholder's agent) and therefore represent fulfilment cash flows not yet received under AASB 17.
- 2.3 If the intermediary is acting on behalf of the insurer, the insurer is obliged to fulfil its obligations to the policyholder under the insurance contract. The receivable is from the intermediary and AASB 9 applies. 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 (since the insurer is now unconditionally obliged to fulfil its contractual obligations to the policyholder).
- 2.4 The right to receive premiums from the intermediary is a separate right not arising under an insurance contract – therefore, that right falls within AASB 9. That is, on payment by the policyholder to the intermediary, the insurer would reduce expected fulfilment cash inflows used to measure insurance assets and liabilities and would recognise a separate receivable from the intermediary.
- 2.5 Note that the legislation around the handling of client money by insurance intermediaries in Australia and New Zealand means that, in most cases, an insured paying premium to an intermediary results in the insured discharging their obligation to pay premium to an insurer. Accordingly, based on View 2, insurers in Australia and New Zealand would need to account for most premiums held by intermediaries as financial assets under AASB 9.

Appendix A includes examples of the journal entries that would arise when acquisition cash flows are incurred, or premiums are receivable, prior to recognising the relevant group of insurance contracts.

³ As per the IASB's Agenda paper 6 *Implementation challenges outreach report* for the IFRS 17 TRG meeting in May 2018.



Appendix A

Examples:

- A1 acquisition cash flows incurred prior to recognition of the group of insurance contracts**
A2 premiums received by intermediaries

Acquisition costs example – picked up in recent sweep issues

- A.1 Insurer Z has been invoiced for \$100 of commissions (acquisition costs) in November 20X0, and the relevant group of contracts is first recognised on 1 January 20X1. Insurer Z has not paid the invoice by 1 January. The journal entries would be as follows.

November 20X0

Debit	Asset for acquisition costs incurred prior to contract recognition – within the insurance liability	100	
Credit	Commissions payable – IFRS 9 financial liability		100

When insurance contract recognised on 1 January 20X1

Derecognise the asset and include the effect of de-recognition in the initial measurement of the CSM – this is what the IASB decided at its May 2020 meeting.

Debit	Liability for remaining coverage – affects CSM	100	
Credit	Asset for acquisition costs incurred prior to contract recognition – within the insurance liability		100

At that point, the liability falls within IFRS 17 because it is a future cash outflow that is attributable to a group of insurance contracts.

Debit	Commissions payable – IFRS 9 financial liability	100	
Credit	Liability for remaining coverage (fulfilment cash flows)		100

This would be consistent with the current application of IFRS 17 in a case when an insurer incurs commissions once the relevant group of contacts has already been recognised.

Premium receivables example

- A.2 Assume an insurance contract has been recognised from 1 November 20X0 being the day premiums are due. The policyholder pays premiums of \$100 to an intermediary in November 20X0 and the intermediary has not yet remitted those premiums to the insurer by year end (31 December 20X0). From the perspective of the insurer the following amount is recorded in the balance sheet at 31 December 20X0:

31 December 20X0

		Insurance liability: LfRC		
Debit	LfRC – Fulfilment cash flows (FCF)	100		Included within the measurement of the FCF as a future expected cash inflow
Credit	LfRC – CSM		100	Included in the measurement of the CSM

*Note: same outcome if applying PAA as total LfRC = 0 as no premiums have actually been received at 31 December 20X0



Option 1 – the premiums are treated as an expected future inflow for insurance liability measurement (i.e. not yet received) as they have not yet been received by the insurer – aligns with View 1 above

When the intermediary pays the insurer, the insurer will Dr Cash Cr LfRC – FCF to reflect premiums actually received:

Debit	Cash	100		Cash received of \$100 from intermediary
<i>Insurance liability: LfRC</i>				
Credit	LfRC – FCF		100	Premiums received

Option 2 – the premiums are treated as received for the insurance liability measurement (as the intermediary works on behalf of the insurer) and a separate IFRS 9 asset is recognised to present the premiums receivable from the intermediary – aligns with View 2 above

Debit	IFRS 9 receivable	100		The premium receivable from the intermediary is recognised as an IFRS 9 asset
<i>Insurance liability - LfRC</i>				
	LfRC - FCF	0		Deemed 'received', and therefore, not included in expected future cash flows for measurement of the LfRC-FCF
Credit	LfRC - CSM		100	Included in the measurement of the CSM

**Note: if applying PAA, this option will result in total LfRC = 100 being premiums 'deemed received'

When the intermediary pays the insurer, the insurer will Dr Cash Cr IFRS 9 asset:

Debit	Cash	100		Cash received of \$100 from intermediary
Credit	IFRS 9 receivable		100	De-recognise the IFRS 9 receivable