Australian Government
Australian Accounting Standards Board

ATT2

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@aasb.gov.au.

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Do you wish to present to the TRG?	Yes

Potential implementation question

Should the impact of credit losses on premium receivables be presented within: (1) insurance revenue; or (2) insurance expenses; or (3) insurance finance income and expense; or (4) based on an accounting policy choice within either (1), (2) or (3)?

Paragraph of IFRS 17 *Insurance Contracts, etc.*

Various, including, in particular: (a) AASB 17 paragraphs 47, 63, 103 and 124 and paragraphs B120 to B126; (b) IFRS 17 Basis for Conclusions paragraph BC309; and (c) AASB 15 Revenue from Contracts with Customers paragraphs 46, 64 and 73.

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 refer to attachment [6 pages]

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

The issue is pervasive – it potentially affects any insurer, particularly when premium is receivable for expired coverage.

Credit losses on premium receivables

AASB 17 *Insurance Contracts* TRG March 2021

This is an attachment to a QBE submission to the AASB 17 Transition Resource Group on the following issue:

> Should the impact of credit losses on premium receivables be presented within: (1) insurance revenue; or (2) insurance expenses; or (3) insurance finance income and expense; or (4) based on an accounting policy choice within either (1), (2) or (3)?

For the purposes of discussion, three main views are identified involving premiums received and/or receivable that relate to coverage that has already been provided.

View 1 Credit losses on premium receivables should be adjusted against insurance revenue and be presented within the insurance service result.

View 2 Credit losses on premium receivables should be presented as an expense within the insurance service result.

View 3 Credit losses on premium receivables should be presented within insurance finance income and expense.

View 4 An accounting policy choice is available under AASB 17 to present credit losses on premium receivables based on View 1, View 2 or View 3.

This paper does not separately discuss premium receivables for unexpired coverage versus premium receivables for expired coverage; however, the distinction is alluded to in discussing View 1 and View 2 below. The working assumption in this paper is that we are focused on credit losses in respect of expired coverage because the impact of credit losses in respect of unexpired coverage would adjust the contractual service margin under the fulfilment cash flows model [AASB 17.B37 and B38].

Some stakeholders consider that there may be circumstances in which premiums receivable from intermediaries should be classified as financial assets under AASB 9 *Financial Instruments*. This paper does not address this topic. Specific requirements on the presentation of credit losses on financial assets are included in other Standards.[1]

View 1 Credit losses on premium receivables should be adjusted against insurance revenue and presented within the insurance service result

Expected amount of premium

1.1 AASB 17.B120 and B126 say (emphasis added):

> B120 The total **insurance revenue for a group of insurance contracts is** the consideration for the contracts, ie **the amount of premiums paid to the entity**:
>
> (a) adjusted for a financing effect; and
>
> (b) excluding any investment components.
>
> B126 When an entity applies the premium allocation approach in paragraphs 55–58, **insurance revenue for the period is the amount of expected premium receipts** (excluding any investment component and adjusted to reflect the time value of money and the effect of financial risk, if applicable, applying paragraph 56) allocated to the period. **The entity shall allocate the expected premium receipts** to each period of insurance contract services:
>
> (a) on the basis of the passage of time; but

1 For example: AASB 101 *Presentation of Financial Statements*, paragraph 82(ba).

> (b) if the expected pattern of release of risk during the coverage period differs significantly from the passage of time, then on the basis of the expected timing of incurred insurance service expenses.

1.2 A possible implication of these paragraphs is that revenue is measured as the amount of premiums the insurer actually receives or expects to receive. That is, an insurer that expects not to receive some of the premiums for a group of contracts due to credit losses, would need to adjust credit losses against premium revenue so that premium revenue for given period is the amount expected to be received.

1.3 More generally, supporters of this view might argue that adjusting credit losses against premium revenue is consistent with the fulfilment cash flows approach in AASB 17. 'Fulfilment cash flows' are defined as (emphasis added):

> 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.

An 'expected value' would presumably include expectations about credit losses.

1.4 A change in view about expected credit losses, which would change the expected premium fulfilment cash flows, would be treated as an experience adjustment. This is consistent with the definition of 'experience adjustment' (emphasis added):

> A **difference between**:
>
> (a) for premium receipts (and any related cash flows such as insurance acquisition cash flows and insurance premium taxes)—the estimate at the beginning of the period of **the amounts expected in the period and the actual cash flows in the period**; or
>
> (b) for insurance service expenses (excluding insurance acquisition expenses)—the estimate at the beginning of the period of the amounts expected to be incurred in the period and the actual amounts incurred in the period.

Consistency with reinsurance recoveries

1.5 Treating credit losses as adjustments to premium receivables, would appear to be consistent with the treatment afforded to credit losses on recoveries from reinsurance contracts held. AASB 17.63 says (emphasis added):

> 63 In applying the measurement requirements of paragraphs 32–36 to reinsurance contracts held, to the extent that the underlying contracts are also measured applying those paragraphs, the entity shall use consistent assumptions to measure the estimates of the present value of the future cash flows for the group of reinsurance contracts held and the estimates of the present value of the future cash flows for the group(s) of underlying insurance contracts. In addition, the entity shall **include in the estimates of the present value of the future cash flows for the group of reinsurance contracts held the effect of any risk of non-performance by the issuer of the reinsurance contract**, including the effects of collateral and losses from disputes.

Specific credit losses not 'finance expenses'

1.6 To be included in 'insurance finance income and expense', credit losses would need to be regarded as resulting from 'financial risk'. However, 'financial risk' is defined as relating to: "The risk of a possible future change in one or more of a specified interest rate, financial instrument price, commodity price, currency exchange rate, index of prices or rates, credit rating or credit index or other variable, …".

1.7 Financial risks relate to financial variables, not the collectability of premiums. Accordingly, a credit loss relating to an insurance contract premium is not 'finance income and expense'.

View 2 Credit losses on premium receivables should be presented as an expense within the insurance service result

Entitlement to premium

2.1 AASB 17.83 says (emphasis added):

> 83 An entity shall present in profit or loss insurance revenue arising from the groups of insurance contracts issued. **Insurance revenue** shall depict the provision of services arising from the group of insurance contracts at an amount that **reflects the consideration to which the entity expects to be entitled** in exchange for those services. Paragraphs B120–B127 specify how an entity measures insurance revenue.

'Entitled' indicates the amount of premiums the insurer has the right to receive under insurance contracts, which would mean the (gross) amount of premiums unadjusted for credit losses.

2.2 Revenue recognition based on the entitlement to revenue is consistent with the way in which AASB 15 *Revenue from Contracts with Customers* approaches revenue recognition, and the Basis for Conclusions to IFRS 17 says the revenue accounting in IFRS 17 and IFRS 15 are consistent (emphasis added):

> BC28 In contrast, IFRS 17 requires entities to present **revenue for insurance contracts determined in a way that is broadly consistent with the general principles in IFRS 15**. Consistent with that Standard, an entity depicts revenue for the transfer of promised coverage and other services at an amount that reflects the consideration to which the entity expects to be entitled in exchange for the services. …

2.3 AASB 15.46 says (emphasis added):

> 46. When (or as) a performance obligation is satisfied, an entity shall **recognise as revenue the amount of the transaction price** (which excludes estimates of variable consideration that are constrained in accordance with paragraphs 56–58) that is allocated to that performance obligation.

and 'Transaction price' is defined as:

> **The amount of consideration to which an entity expects to be entitled** in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties.

2.4 Collectability of consideration is used in AASB 15 as a criterion in identifying a contract with a customer [paragraph 9(e)], not as a basis for measuring consideration. Accordingly, the consideration (premiums) recognised for providing insurance services should be the gross amount of premiums and any credit losses would need to be presented within insurance expenses to account for the reduced amount of premium to be received.

Premium for expired coverage

2.5 An insurer that becomes aware of premium in respect of expired coverage that is unlikely to be collectable is not in a position to withdraw the insurance services because they have already been provided. In this case, it is entirely appropriate that the premium is not adjusted because the expired insurance services have already been provided (that is, the premium has been 'earned').

2.6 The amount of revenue recognised should represent the services provided. For example, AASB 17.41 says (emphasis added):

> 41 An entity shall recognise income and expenses for …
>
> (a) insurance revenue —for the reduction in the liability for remaining coverage **because of services provided** …

Accordingly, the credit losses would need to presented within insurance expenses to account for the reduced amount of premium to be received.

Difference from reinsurance recoveries

2.7 Credit losses on reinsurance contracts held recoveries are included in the measurement of those recoveries, and appear to be distinguished from credit losses as adjustments to premium receivables. AASB 17.63 says (emphasis added):

> 63 In applying the measurement requirements of paragraphs 32–36 to reinsurance contracts held, to the extent that the underlying contracts are also measured applying those paragraphs, **the entity shall use consistent assumptions to measure the estimates of the present value of the future cash flows for the group of reinsurance contracts held and the estimates of the present value of the future cash flows for the group(s) of underlying insurance contracts**. **<u>In addition</u>, the entity shall include in the estimates of the present value of the future cash flows for the group of reinsurance contracts held the effect of any risk of non-performance by the issuer of the reinsurance contract**, including the effects of collateral and losses from disputes.

That is, consistent assumptions must be used between the underlying contracts and the related reinsurance contracts, but there is an additional requirement to include non-performance risk in measuring reinsurance recovery receivables that does not apply to premium receivables.

2.8 The Basis for Conclusions to IFRS 17 only refers to the accounting for 'credit losses' in the context of cash flows for reinsurance contracts held [paragraphs BC307 to BC309].

Specific credit losses not 'finance expenses'

2.9 Refer to paragraphs 1.6 and 1.7 above.

View 3 Credit losses on premium receivables should be presented within insurance finance income and expense

Analogy with AASB 15

3.1 AASB 15.107 and 108 say (emphasis added):

> 107 If an entity performs by transferring goods or services to a customer before the customer pays consideration or before payment is due, the entity shall present the contract as a contract asset, excluding any amounts presented as a receivable. **A contract asset is an entity's right to consideration in exchange for goods or services that the entity has transferred to a customer**. **An entity shall assess a contract asset for impairment in accordance with AASB 9**. An impairment of a contract asset shall be measured, presented and disclosed on the same basis as a financial asset that is within the scope of AASB 9 (see also paragraph 113(b)).
>
> 108 **A receivable is an entity's right to consideration that is unconditional**. A right to consideration is unconditional if only the passage of time is required before payment of that consideration is due. For example, an entity would recognise a receivable if it has a present right to payment even though that amount may be subject to refund in the future. **An entity shall account for a receivable in accordance with AASB 9**. Upon initial recognition of a receivable from a contract with a customer, any difference between the measurement of the receivable in accordance with AASB 9 and the corresponding amount of revenue recognised shall be presented as an expense (for example, as an impairment loss)

3.2 Accordingly, under AASB 15, credit losses are treated separately from the customer contracts by being accounted for under AASB 9 *Financial Instruments*. Although AASB 17 does not include the same cross-references to AASB 9, by analogy, a similar approach should be adopted. That is, the credit losses should be considered separately from the insurance service result, which logically means they would instead be presented as 'finance income and expense'.

3.3 AASB 101 *Presentation of Financial Statements*, paragraph 82 says (emphasis added):

> 82 In addition to items required by other Australian Accounting Standards, the profit or loss section or the statement of profit or loss shall include line items that present the following amounts for the period: …
>
> (b) finance costs;
>
> (ba) impairment losses (including reversals of impairment losses or impairment gains) determined in accordance with Section 5.5 of AASB 9; …

Accordingly, there is strong precedent for presenting credit losses separately from the other impacts of an entity's underlying business activities.

Insurance contract services

3.4 AASB 17 defines 'insurance contract services' as:

> The following services that an entity provides to a policyholder of an insurance contract:
>
> (a) coverage for an insured event (insurance coverage);
>
> (b) for insurance contracts without direct participation features, the generation of an investment return for the policyholder, if applicable (investment-return service);
>
> (c) for insurance contracts with direct participation features, the management of underlying items on behalf of the policyholder (investment-related service).

3.5 The insurance service result should reflect only the entity's performance in providing services to policyholders. The entity's performance in collecting premium receivables is not a part of insurance contract services.

Examples

E.1 Facts:

- Premium receivables of $1,000 for expired coverage – 97% ($970) expected to be recoverable
- Insurance service expenses (unrelated to credit losses) of $700
- Reinsurance contract held (30% treaty) – $300 premium ceded – recoveries $280 – 95% ($266) expected to be recoverable
- Finance expenses (unrelated to credit losses) of $100.

E.2 Under View 1 the $30 of credit losses on premium receivables would be adjusted against insurance revenue and be presented within the insurance service result.

Insurance revenue	($970)	
Insurance service expenses	$700	**($270)**
Ceded to reinsurer	$300	
Reinsurance recoveries	($266)	**$34**
Insurance service result		**($236)**
Finance expenses from insurance contracts issued		$100
Net insurance result		**($136)**

E.3 Under View 2 the $30 of credit losses on premium receivables would be adjusted against insurance service expenses within the insurance service result.

Insurance revenue	($1,000)	
Insurance service expenses	$730	**($270)**
Ceded to reinsurer	$300	
Reinsurance recoveries	($266)	**$34**
Insurance service result		**($236)**
Finance expenses from insurance contracts issued		$100
Net insurance result		**($136)**

E.4 Under View 3 the $30 of credit losses on premium receivables would be adjusted against insurance finance income and expense.

Insurance revenue	($1,000)	
Insurance service expenses	$700	**($300)**
Ceded to reinsurer	$300	
Reinsurance recoveries	($266)	**$34**
Insurance service result		**($266)**
Finance expenses from insurance contracts issued		$130
Net insurance result		**($136)**