Accounting for premiums due after the end of the coverage period

Background

The amendments to IFRS 17 changed the definitions of the liability for remaining coverage (LfRC) and the liability for incurred claims (LIC).

Liability for remaining coverage [1]
An entity's obligation to:

a) *investigate and pay valid claims under existing insurance contracts for insured events that have not yet occurred (ie the obligation that relates to the unexpired portion of the insurance coverage); and*
b) ***pay amounts under existing insurance contracts that are not included in (a) and that relate to:***
   i. ***insurance contract services not yet provided*** *[emphasis added] (ie the obligations that relate to future provision of insurance contract services); or*
   ii. *any investment components or other amounts that are not related to the provision of insurance contract services and* ***that have not been transferred to the liability for incurred claims****. [emphasis added]*

Liability for incurred claims [2]
An entity's obligation to:

a) *investigate and pay valid claims for insured events that have already occurred, including events that have occurred but for which claims have not been reported, and other incurred insurance expenses; and*
b) ***pay amounts that are not included in (a) and that relate to:***
   i. ***insurance contract services that have already been provided*** *[emphasis added]; or*
   ii. *any investment components or other amounts that are not related to the provision of insurance contract services and that are not in the liability for remaining coverage.*

This paper presents a case where a transfer from the LfRC to the LIC may be necessary and proposes alternative views on how it should be accounted for under IFRS 17.

This case is when there is a clause in an insurance contract to collect premiums (or part of the premiums receivable from the policyholder) beyond the end of the coverage period. This is a clause usually found in quota-share reinsurance contracts.

Many reinsurance contracts contain net settlement agreements according to which the difference between premiums and claims is paid or received as one net payment or receipt after the information on the actual volume of underlying insurance contracts covered by the reinsurance contract has been received from the cedant. This is a typical clause for quota-share reinsurance contracts but it may also be found in insurance contracts that protects a large set of commercial risks whereby

[1] The original definition was "An entity's obligation to investigate and pay valid claims under existing insurance contracts for insured events that have not yet occurred (ie the obligation that relates to the unexpired portion of the coverage period)."
[2] The original definition was "An entity's obligation to investigate and pay valid claims for insured events that have already occurred, including events that have occurred but for which claims have not been reported, and other incurred insurance expenses."

the policyholder and the insurer agrees on similar terms for setting and settling the premiums due under the contract.

This means that premiums receivable are due when they are settled together with claims payables that are also due. For instance, the cedant provides the actual volume of underlying insurance contracts that would be covered under a reinsurance contract in the month following the end of the period in which reinsurance coverage is provided.

At inception, the expected premiums and claims are estimated based on a number of non-financial variables such as information about the cedant's past volume of underlying insurance contracts that were reinsured and expected volume of underlying insurance contract that will be covered in the upcoming reinsured coverage period.

The recognition of insurance revenue does not depend on the timing or settlement of the actual cash flows but it shall depict instead the provision of coverage and other services arising from the group of reinsurance contracts. This is done by measuring an amount that reflects the consideration to which the reinsurer expects to be entitled in exchange for those services in accordance with IFRS 17:83.

A subsequent change in the premium amount due to changes in the actual volume of business written by the cedant is an experience adjustment to be recognised as an adjustment to insurance revenue in accordance with IFRS 17:106(a)(iv).

Accounting question
How will the reinsurer account for premiums that are not yet due/collected (outstanding premiums receivable, either due or past due) but relate to past service?

View 1 – As part of the liability for remaining coverage (LfRC)
At the end of the reporting period, the premiums remain to be recognised as part of the LfRC.

Supporters of this view argue that, according to IFRS 17:100, each of the net liabilities (or assets) for the remaining coverage component i.e. the LfRC, as well as the LIC are to be reconciled from the opening to the closing balances separately. This implies that including the outstanding premiums in the LfRC and the outstanding claim payments in the LIC fairly represents the exposure of a reinsurer on a gross basis and provides useful information. This is because the uncollected premiums are shown separately and are not reduced by the obligations arising from incurred claims even if the reinsurer and the cedant determine to net settle the two amounts.

Supporters also argue that presenting the outstanding premiums as part of the LfRC is aligned with the requirement of IFRS 17:B120, whereby the total insurance revenue in a group of contracts is equal to the amount of premiums received by the reinsurer from that group, after excluding the investment component.

View 2A – As part of the liability for incurred claims (LIC) to the extent insurance services have already been provided
Supporters of this view argue that the outstanding premiums relating to past services should be recognised as part of the LIC because they represent an amount that relates to insurance contract services that have already been provided.

At the end of each reporting period, the portion of the LfRC pertaining to the outstanding premiums relating to insurance contract services provided during the period is reclassified to LIC even if a LfRC balance continues to exist for the remaining coverage yet to be fulfilled.

This accounting treatment is aligned with the requirements of IFRS 17:40(b) which provides that the liability for incurred claims is comprised of fulfilment cash flows relating to past service.

Supporters of this view also believe that the reconciliation required under IFRS 17:B120 is complied with because the test requires the alignment of insurance revenue with premium receipts (as adjusted under B120 requirements). They would also argue that if the reinsurer subsequently changes the estimate of expected inflows due to the non-performance risk of the cedant they would account for the adjustment to be against the insurance revenue line. This is required to comply with IFRS 17:B120 and because of the analogy that can be drawn from the accounting treatment of past service premium experience variances in IFRS 17:B96(a), IFRS 17:B97(b) and (c).

View 2B - As part of the liability for incurred claims (LIC) when there is no remaining coverage under the contract

Similar to View 2A above, supporters of this view argue that the outstanding premium relating to past services should be recognised as part of the LIC because it represents an amount that relates to insurance contract services that have already been provided.

However, unlike View 2A, this view requires an entity to reclassify the entire outstanding premium to LIC when there are no longer any insurance contract services that remain to be provided under the contract. When there is no remaining coverage, all outstanding fulfilment cash flows have to be reflected in the LIC, regardless of whether these fulfilment cash flows are outflows (i.e. claims) or inflows (i.e. premiums). The supporters of this view note that the LfRC would be zero at this point.

In a scenario where no claims arise but the premium payment relating to the reinsurance coverage already provided is still outstanding, there would be a transfer from the LfRC to the LIC because there is no remaining coverage. In this scenario the LIC could be an asset that includes amounts due to the reinsurer for insurance contract services that have already been provided as explained in the definition of LIC contained in IFRS 17 Appendix A.

Supporters of this view agree with View 2A on the presentation in P&L of changes in assumptions and experience variance after the amounts are transferred from the LfRC to the LIC.

Appendix – Technical references

IFRS 17 paragraph 40

The carrying amount of a group of insurance contracts at the end of each reporting period shall be the sum of:

- *(a) the liability for remaining coverage comprising:*
  - *(i) the fulfilment cash flows related to future service allocated to the group at that date, measured applying paragraphs 33–37 and B36–B92;*
  - *(ii) the contractual service margin of the group at that date, measured applying paragraphs 43–46; and*
- *(b) the liability for incurred claims, comprising the fulfilment cash flows related to past service allocated to the group at that date, measured applying paragraphs 33–37 and B36–B92.*

IFRS 17 paragraph 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.

IFRS 17 paragraph 100

An entity shall disclose reconciliations from the opening to the closing balances separately for each of:

- *(a) the net liabilities (or assets) for the remaining coverage component, excluding any loss component.*
- *(b) any loss component (see paragraphs 47–52 and 57–58).*
- *(c) the liabilities for incurred claims. For insurance contracts to which the premium allocation approach described in paragraphs 53–59 or 69–70A has been applied, an entity shall disclose separate reconciliations for:*
  - *(i) the estimates of the present value of the future cash flows; and*
  - *(ii) the risk adjustment? for non-financial risk.*

IFRS 17 paragraph 106

For insurance contracts issued other than those to which the premium allocation approach described in paragraphs 53–59 has been applied, an entity shall disclose an analysis of the insurance revenue recognised in the period comprising:

- *(a) the amounts relating to the changes in the liability for remaining coverage as specified in paragraph B124, separately disclosing:*
  - *(i) the insurance service expenses incurred during the period as specified in paragraph B124(a);*
  - *(ii) the change in the risk adjustment for non-financial risk, as specified in paragraph B124(b);*
  - *(iii) the amount of the contractual service margin recognised in profit or loss because of the transfer of insurance contract services in the period, as specified in paragraph B124(c); and*

(iv) other amounts, if any, for example, experience adjustments for premium receipts other than those that relate to future service as specified in paragraph B124(d).

(b) the allocation of the portion of the premiums that relate to the recovery of insurance acquisition cash flows (see paragraph B125).

IFRS 17 paragraph 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.

IFRS 17 paragraph B96(a)

For insurance contracts without direct participation features, paragraph 44(c) requires an adjustment to the contractual service margin of a group of insurance contracts for changes in fulfilment cash flows that relate to future service. These changes comprise:

(a) experience adjustments arising from premiums received in the period that relate to future service, and related cash flows such as insurance acquisition cash flows and premium-based taxes, measured at the discount rates specified in paragraph B72(c);

IFRS 17 paragraph B97

An entity shall not adjust the contractual service margin for a group of insurance contracts without direct participation features for the following changes in fulfilment cash flows because they do not relate to future service:

[…]

(b) changes in estimates of fulfilment cash flows in the liability for incurred claims;
(c) experience adjustments, except those described in paragraph B96(a).

IASB May 2020 Agenda Paper 2C paragraph 27

"Some respondents said that the proposed definitions reflect some, but not all, of an entity's obligations arising from insurance contracts. For example, an entity might have an obligation to pay other amounts relating to the provision of insurance contract services—such as refunds of premiums to the policyholder or expenses payable to third parties. In addition, an entity might have an obligation to pay amounts not related to the provision of insurance contract services—such as some types of investment components. The carrying amount of a group of insurance contracts is the sum of the liability for remaining coverage and the liability for incurred claims, and the measurement reflects all of an entity's obligations arising from the group of insurance contracts (see paragraph 40 of IFRS 17). Some respondents suggested the Board amend the definitions of the liability for remaining coverage and the liability for incurred claims for completeness to reflect all

obligations arising from insurance contracts issued by an entity, consistent with the requirements for measuring those liabilities."