Accounting for premium received upfront from the sale of a single legal contract comprising, in substance, several contracts for accounting purposes[1].

Background

Entity X sells yearly renewable insurance contracts with product features that include a unilateral cancellation clause that provides Entity X with the right to cancel the contract by giving to the policyholder a notice of 30 days. In addition, the entity collects a single premium upfront at the time of issuance of the legal contract. If Entity X cancels the insurance contract before the contract end date the policyholder is entitled to a premium refund calculated pro rata for the period between the cancellation date and the legal contract end date. The premium refund is not due under all circumstances. It is due only if Entity X exercises the cancellation option. If the policyholder dies, reports a claim or cancels the policy there is no refund of any premium.

The assessment of the rights and obligations of these contracts results in a contract boundary of 30 days under IFRS 17 because Entity X has the practical ability to terminate all of its substantive obligations at that point in time. This is different from the legal form of the contract, which suggests that the policyholder has purchased insurance coverage for one year. In fact, the policyholder has purchased 12 in-substance contracts with each in-substance contract having a contract boundary of at least 30 days.

Entity X has chosen to apply the Premium Allocation Approach (PAA) to measure the liability for remaining coverage of these in-substance contracts. The portion of the single premium receipt that is collected when a legal contract is sold, in substance pre-pays the purchase of the next 11 in-substance contracts before the start of the associated insurance coverage periods. In other words the policyholder has purchased and paid for 12 contracts, 11 of which have a forward starting coverage period of 30 days each.

Accounting Question

How should Entity X account for the premium received in advance relating to the future 11 accounting contracts?

View A:

An insurance contract is recognised at the earliest of three dates as required by IFRS 17:25. If there is no contractual due date, the first payment from the policyholder is deemed to be due when cash is received as defined in IFRS 17:26. Based on the given fact pattern each of the accounting contracts will be required to be recognised

[1] This document is inclusive of the author's consideration of the expected amendments to IFRS 17 as documented in the Exposure Draft and taking into account the subsequent IASB deliberations, as applicable.

at the time the premium is collected because premiums are collected when due for all of the 12 in-substance contracts and the due date for all contracts coincides with the date the first in-substance contract is issued. Accordingly, a liability for remaining coverage should be recognised at the same time for all of the 12 in-substance contracts albeit with future start dates for their respective coverage periods.

This view implies that the contract boundary of the 12 in-substance contracts will be cumulative from the first to the last i.e. the contract boundary of the first accounting contract would be 30 days, the second would be 60 days and the last would be 360 days. All of the in-substance contracts have a 30 days coverage period.

Finally this view puts all of the 12 in-substance contract in the same annual cohort and potentially in the same group if the expected profitability is the same for all of them.

Appendix 1 illustrates this graphically.

View B:

Under this view, the annual premium due relates entirely to the initial 30 day IFRS 17 in-substance contract. The other future in-substance contracts would not be recognised until the first contract ends, as Entity X does not have obligation to provide insurance service until the termination of the current 30 days coverage has passed. The liability for remaining coverage will include expected claim for the current 30 days period, as well as an estimated refund of premium, which is refundable when the current IFRS 17 contract ends or used to issue the next IFRS 17 contract.

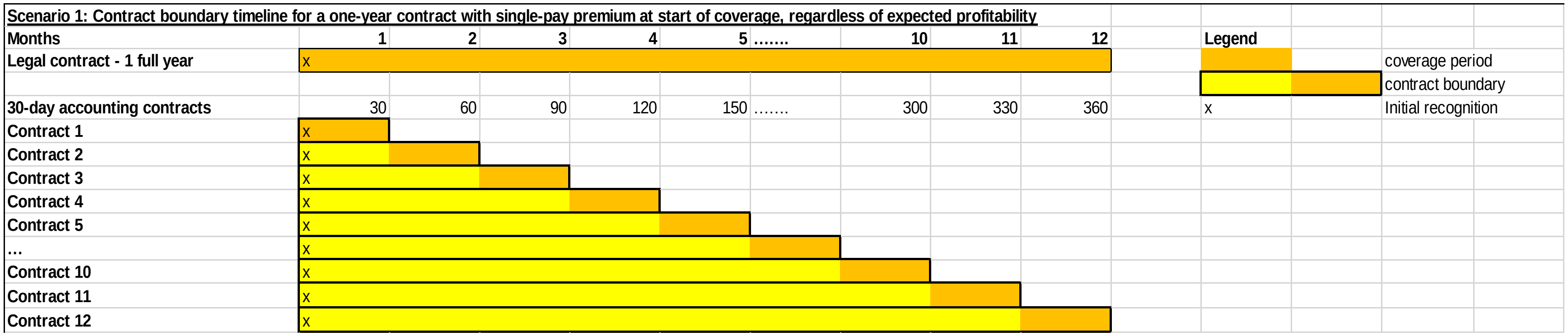
Supporters of this view argue that this is the correct application of IFRS 17:35, as the entity does not have a present obligation to provide insurance services to future IFRS 17 contracts until the termination of the current IFRS 17 contract. In this case the contracts will be likely to fall in two different annual cohorts and associated groups of contracts.

However, if facts and circumstances indicate that a loss is expected for one or all of the 11 in-substance contracts due to the combination of the estimate of outflows for incurred claims and Entity X estimate that it will not exercise its cancellation right because at the yearly renewal date it will be able to increase the premium for the future series of in-substance contracts, then all of the IFRS 17 in-substance contract are recognised at day 1, applying IFRS 17: 25(c). In this case the contracts will all be part of the same annual cohort and group of contracts. The group of contracts will be an onerous group.

Appendix 1 illustrates this graphically.

Appendix 1 – Graphical illustration

View A



- The contract boundary of the 12 IFRS 17 contracts will be cumulative from the first to the last i.e. the contract boundary of the first IFRS 17 contract will be 30 days, the second would be 60 days and the last would be 360 days.
- The coverage period for the 12 IFRS 17 contracts will be 30 days each
- LRC balance will be recognized on day 1 for all IFRS 17 contracts.

View B – non onerous

Scenario 2: Contract boundary timeline for a one-year contract with single-pay premium at start of coverage, profitable												
Months	**1**	**2**	**3**	**4**	**5**	**.......**	**10**	**11**	**12**		**Legend**	
Legal contract - 1 full year	x											Coverage period
												(same as contract boundary, 30 days)
30-day accounting contracts	30	60	90	120	150	......	300	330	360		x	Initial recognition
Contract 1	x											
Contract 2		x										
Contract 3			x									
Contract 4				x								
Contract 5					x							
…						x						
Contract 10							x					
Contract 11								x				
Contract 12									x			

- The contract boundary of the 12 IFRS 17 contracts will be 30 days each, and recognition will only start when the prior IFRS 17 contract has terminated
- The coverage period for the 12 IFRS 17 contracts will be 30 days each
- LRC balance will be recognized on day 1 for the first IFRS 17 contracts, consists of expected claim and refund of premium. At the end of coverage period, the current IFRS 17 contracts is derecognised, the portion of premium is refunded to set up LRC for the next IFRS 17 contract, consists of expected claim for the next IFRS 17 contract and refund of premium for future IFRS 17 contracts after next IFRS 17 contract.

View B – onerous

Scenario 2: Contract boundary timeline for a one-year contract with single-pay premium at start of coverage, onerous												
Months	**1**	**2**	**3**	**4**	**5**	**.......**	**10**	**11**	**12**		**Legend**	
Legal contract - 1 full year	x											Coverage pe
												Contract bou
30-day accounting contracts	30	60	90	120	150	......	300	330	360		x	Initial recogn
Contract 1	x											
Contract 2	x											
Contract 3	x											
Contract 4	x											
Contract 5	x											
…	x											
Contract 10	x											
Contract 11	x											
Contract 12	x											

- The contract boundary of the 12 IFRS 17 contracts will be 30 days each, and recognition will start when the first IFRS 17 contract is recognised as per IFRS: 25 given it is expected that this entire legal contract is onerous, i.e. all loss for 12 IFRS 17 contract recognised day 1
- The coverage period for the 12 IFRS 17 contracts will be 30 days each

Appendix 1 – Technical references:

IFRS 17 paragraph 25

"An entity shall recognise a group of insurance contracts it issues from the earliest of the following:

a) the beginning of the coverage period of the group of contracts;
b) the date when the first payment from a policyholder in the group becomes due; and
c) for a group of onerous contracts, when the group becomes onerous."

IFRS 17 paragraph 26

"If there is no contractual due date, the first payment from the policyholder is deemed to be due when it is received. An entity is required to determine whether any contracts form a group of onerous contracts applying paragraph 16 before the earlier of the dates set out in paragraphs 25(a) and 25(b) if facts and circumstances indicate there is such a group."

IFRS 17 paragraph 35

"An entity shall not recognise as a liability or as an asset any amounts relating to expected premiums or expected claims outside the boundary of the insurance contract. Such amounts relate to future insurance contracts."