IFRS 17 issues – Balance sheet presentation
Amended draft for discussion

1 Current IASB requirements and TRG discussions

1.1 IFRS 17

1 IFRS 17.32: On initial recognition, an entity shall measure a group of insurance contracts at the total of:

(a) the fulfilment cash flows, which comprise:

(i) estimates of future cash flows (paragraphs 33–35);

(ii) an adjustment to reflect the time value of money and the financial risks related to the future cash flows, to the extent that the financial risks are not included in the estimates of the future cash flows (paragraph 36); and

(iii) a risk adjustment for non-financial risk (paragraph 37).

(b) the contractual service margin, measured applying paragraphs 38–39.

2 IFRS 17.40: 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.

3 IFRS 17.55: Using the premium allocation approach, an entity shall measure the liability for remaining coverage as follows:

(a) on initial recognition, the carrying amount of the liability is:

(i) the premiums, if any, received at initial recognition;

(ii) minus any insurance acquisition cash flows at that date, unless the entity chooses to recognise the payments as an expense applying paragraph 59(a); and

(iii) plus or minus any amount arising from the derecognition at that date of the asset or liability recognised for insurance acquisition cash flows applying paragraph 27.

(b) at the end of each subsequent reporting period, the carrying amount of the liability is the carrying amount at the start of the reporting period:

(i) plus the premiums received in the period;

(ii) minus insurance acquisition cash flows; unless the entity chooses to recognise the payments as an expense applying paragraph 59(a);

(iii) plus any amounts relating to the amortisation of insurance acquisition cash flows recognised as an expense in the reporting period; unless the entity chooses to recognise insurance acquisition cash flows as an expense applying paragraph 59(a);

(iv) plus any adjustment to a financing component, applying paragraph 56;

(v) minus the amount recognised as insurance revenue for coverage provided in that period (see paragraph B126); and

(vi) minus any investment component paid or transferred to the liability for incurred claims.

4 IFRS 17.59: In applying the premium allocation approach, an entity:

(a) may choose to recognise any insurance acquisition cash flows as expenses when it incurs those costs, provided that the coverage period of each contract in the group at initial recognition is no more than one year.

(b) shall measure the liability for incurred claims for the group of insurance contracts at the fulfilment cash flows relating to incurred claims, applying paragraphs 33–37 and B36–B92. However, the entity is not required to adjust future cash flows for the time value of money and the effect of financial risk if those cash flows are expected to be paid or received in one year or less from the date the claims are incurred.

5 IFRS 17.63: 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.

6 IFRS 17.78: An entity shall present separately in the statement of financial position the carrying amount of groups of:

- insurance contracts issued that are assets;
- insurance contracts issued that are liabilities;
- reinsurance contracts held that are assets; and
- reinsurance contracts held that are liabilities.

7 IFRS 17.79: An entity shall include any assets or liabilities for insurance acquisition cash flows recognised applying paragraph 27 in the carrying amount of the related groups of insurance contracts issued, and any assets or liabilities for cash flows related to groups of reinsurance contracts held (see paragraph 65(a)) in the carrying amount of the groups of reinsurance contracts held.

8 IFRS 17.99: An entity shall provide enough information in the reconciliations to enable users of financial statements to identify changes from cash flows and amounts that are recognised in the statement(s) of financial performance. To comply with this requirement, an entity shall:

(a) disclose, in a table, the reconciliations set out in paragraphs 100–105; and

(b) for each reconciliation, present the net carrying amounts at the beginning and at the end of the period, disaggregated into a total for groups of contracts that are assets and a total for groups of contracts that are liabilities, that equal the amounts presented in the statement of financial position applying paragraph 78.

9 IFRS 17.100: 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 69–70 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.

10 IFRS 17.101: For insurance contracts other than those to which the premium allocation approach described in paragraphs 53–59 or 69–70 has been applied, an entity shall also disclose reconciliations from the opening to the closing balances separately for each of:

(a) the estimates of the present value of the future cash flows;

(b) the risk adjustment for non-financial risk; and

(c) the contractual service margin.

11 IFRS 17.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 coverage:

(a) on the basis of the passage of time; but

(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.

12 IFRS 15.105: When either party to a contract has performed, an entity shall present the contract in the statement of financial position as a contract asset or a contract liability, depending on the relationship between the entity's performance and the customer's payment. An entity shall present any unconditional rights to consideration separately as a receivable.

1.2 TRG outreach

13 TRG staff is considering that presentation "challenges" reported by preparers via an outreach the conclusions of which have been reported to the TRG in May 2018 (TRG 2018-05 AP 06), are a mere implementation issue (e.g. not a conceptual one).

1.3 Tentative board's decisions

14 Issues relating to the balance-sheet presentation have been discussed at the December 2018 IASB Board meeting. The following amendment has been suggested

15 IFRS 17.78: An entity shall present separately in the statement of financial position the carrying amount of ~~groups~~ portfolios of:

- insurance contracts issued that are assets;
- insurance contracts issued that are liabilities;
- reinsurance contracts held that are assets; and
- reinsurance contracts held that are liabilities.

16 IASB 2018-12.AP 2A.37: On balance, the staff recommend that entities are required to offset groups at the portfolio level for presentation purposes. This means that an entity would present separately assets and liabilities for insurance contracts subject to similar risks that are managed together. The staff think that offsetting at an entity level risks a greater loss of useful information. The staff also note that in the 2010 Exposure Draft Insurance Contracts and 2013 Exposure Draft Insurance Contracts, the Board proposed presentation at a portfolio level when the unit of account was a single contract.

17 IASB 2018-12.AP 2A.50: The staff think that amending IFRS 17 to require the separate presentation of premiums receivable and claims payable from the insurance contract asset or liability could:

(a) reduce comparability between entities—the staff understand that systems currently used by entities recognise premiums receivable over different periods for different contracts. For example, one entity may only recognise premiums due in the current month that were not yet received, while another entity may reflect premiums due in the next 12 months in premiums receivable.

(b) unduly disrupt implementation already under way and risk undue delays in the effective date of IFRS 17 if the Board were to develop a consistent definition of premiums receivable and claims payable.

18 IASB 2018-12.AP 2A.51: The staff note that paragraph 55 of IAS 1 Presentation of Financial Statements permits the presentation of additional line items including by disaggregation of required line items, headings and subtotals in the statement of financial position when such presentation is relevant to an understanding of the entity's financial position. Applying that requirement, an entity may be able to present a disaggregation which shows the components of each of those line items (for example, to present the amounts of premiums receivable and claims payable included in the carrying amount of the insurance contract liability). The staff observe that requirement does not permit an entity to present premiums receivable or claims payable as separate line items, it only permits for the required line items to be disaggregated when such presentation is relevant to an understanding of the entity's financial position.

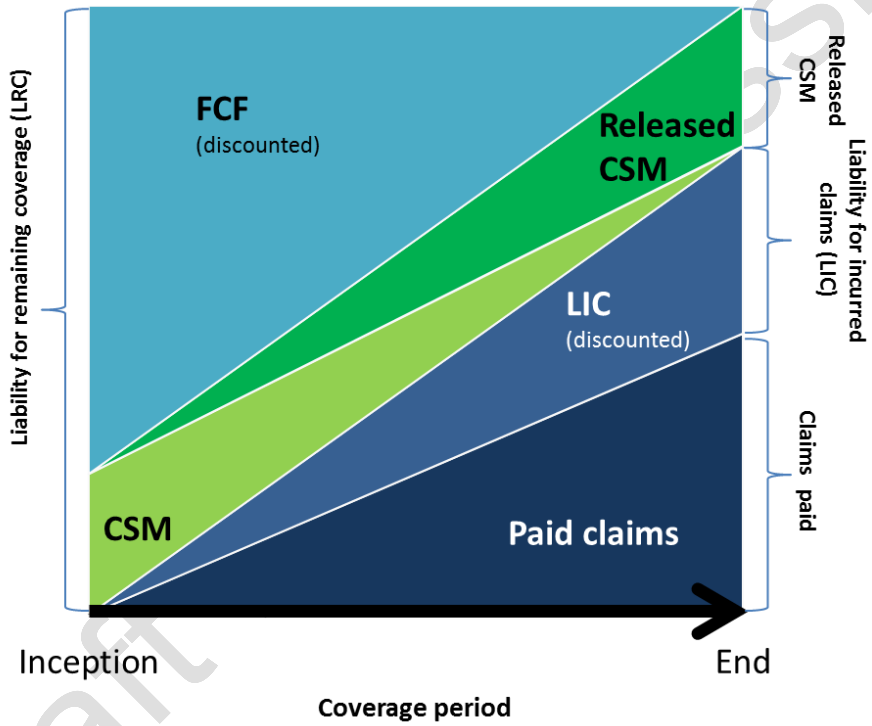
19 IASB 2019-03.AP 2H.6§7: The staff expect the Exposure Draft to propose a consequential amendment to paragraph 99 of IFRS 17 so that when an entity discloses the reconciliations required by paragraphs 100–105 of IFRS 17, the entity presents, for each reconciliation, the net carrying amounts at the beginning and at the end of the period, disaggregated into a total for portfolios (rather than groups) of contracts that are

assets and a total for portfolios (rather than groups) of contracts that are liabilities, that equal the amounts presented in the statement of financial position applying paragraph 78 of IFRS 17. The staff also expect the Exposure Draft to propose a consequential amendment to paragraph 79 of IFRS 17 about the presentation of portfolios (rather than groups) of insurance contracts in the statement of financial position.

1.4 Current understanding of the accounting treatment

Presentation of the different IFRS 17 components

20 Presentation follows the approach retained for measurement purposes (fulfilment cash flows (FCF), contractual service margin (CSM), liability for incurred claims (LIC)). Liability for incurred claims is an additional liability. See simplified diagram below.



Measurement and presentation based on cash-flows

21 Applying the general model (IFRS 17.32-37), a group of insurance contracts recorded as a liability or an asset (e.g. reinsurance contracts) is measured including all future expected cash flows at the date of measurement. The standard is based upon a pure future cash-flows approach.

22 Consequently, the future cash flows aggregate a number of assets and liabilities the nature of which may differ from the liability for remaining coverage. For example and principally: liability for incurred claims (including IBNR), premium receivables, reinsurance collateral …

23 Recognition, measurement and presentation according to the VFA are based upon the same "expected" cash-flow basis.

24 Recognition, measurement and presentation according to the PAA (IFRS 17.55 and IFRS 17.59) are based upon a pure premium received and liability for remaining coverage approach.

Recognition and measurement of PAA contracts for which premium is not yet received

25 PAA recognises and measures insurance contracts when the premium has been received, even if the coverage has already started.

26 When the premium has not yet been paid, the accounting treatment is not explicit but derives from:

- IFRS 17.55 (b)(v) that refers to "the amount recognised as insurance revenue for coverage provided" according to IFRS 17.B126;
- IFRS 17.B126 that further indicates that "insurance revenue for the period is the amount of expected premium receipts […] allocated to the period".

27 Therefore, PAA insurance revenue has to be recognised even if the premium has not been received since only the expected premium receipts matters. In that case, revenue is recognised against a credit in the insurance liability, e.g. against an asset representing the receivable on the policyholder.

2 Issue

2.1 Issue 1: Separate presentation of accruals in the balance sheet

Cash basis approach

28 Standards are generally adopted on the basis of rights and obligations and recorded accordingly on an accrual basis and not on a cash basis.

29 From a general standpoint, balance sheet presentation is deemed to be useful when the following principles are met:

- providing insights on the nature and level of reliability of the recorded amounts in terms of valuation and liquidity of assets or liabilities;
- excluding offsetting of assets and liabilities exposed to different risks and commitments, or counterparties (beneficiaries may differ from the policyholder);
- reflecting the volume of or the relationship to activities;
- being informative and predictive.

30 In the balance sheet presentation of insurance business, the emphasis is currently put on:

- separating assets and liabilities in accordance with their respective nature and underlying key risks: credit risk on premium due, insurance risk on liabilities for remaining coverage, valuation risk on liabilities for incurred claims, liquidity risk and profitability on deposits;
- reflecting the asset/liability management key characteristics.

31 By contrast IFRS 17 (i) is based upon a cash basis approach for recognition, measurement and presentation purposes and (ii) aggregates assets and liabilities of a different nature in a combined amount for each and every group of contracts.

The decisions taken to elaborate IFRS 17 have the following consequences in terms of B/S presentation:

32 – **Premium receivables** (corresponding to a coverage period that has already started but for which payment has not yet been received) are not shown separately. This information is key for a proper understanding of the activity and risks involved. Generally, in case of non-payment, the coverage will remain in force for a period of time, i.e. until the contract is terminated following certain legally/contractually organised procedures. Following termination, the insurer is entitled to the payment of the premium up to that date and will have to cover any claim incurred during the coverage period.

Illustrative example 1: presentation of premium due in the general model

33 Assuming a one-year motor insurance policy is issued on 15 December N that covers third party liability. On 31 December N, the policyholder has still not paid the insurance premium of 240 CU. Under the local jurisdiction, not paying premium at the exact moment when due does not invalidate the insurance coverage. The estimates of future outflows relating to future claims and costs amount to 192.

34 As of 31 December N, applying IFRS 17.32-37, a liability for remaining coverage is recognised and measured as the difference between the premium due (240 CU), the other fulfilment cash flows relating to expected claims (192 CU) and the CSM (48*345/360=46 CU). Finally, the amount presented for that insurance contract will be an asset amounting to 2 CU. The usefulness of information conveyed by the amount presented on the balance sheet and resulting from offsetting different components is questionable.

35 – **Liabilities for claims incurred and liabilities for remaining coverage** are not shown separately. This information is key for a proper understanding of the activity and risks involved. When an insured event occurs, there is a fundamental change in nature from liability for remaining coverage (LRC) to liability for incurred claim (LIC). The key factor for the former is the probability of occurrence in the future, the key factor for the latter is the quality of estimates (from very simple estimates to more complex ones and IBNR).

36 – **Collateral deposits related to reinsurance accepted and held** are not shown separately. This information is key for a proper understanding of the activity and risks of the reinsurer as well as of the cedant. The information on the liability for remaining coverage of the reinsurer does not depend on the nature of the guaranty provided by the reinsurer (deposit in cash, assets pledged or third party guarantee). This issue is the same for the insurer and the insurance contract held. Accordingly, deposits made or received are considered within the boundaries of the reinsurance contract.

Conceptual basis

37 From a conceptual standpoint IASB considers that:

- absent a claim, rights and obligations in an insurance contract are with the same counterpart even if sometimes the insurer acts as an agent on behalf of the policyholder. A separation could not be contemplated at group level.
- amounts recorded in liability and as a receivable generally depend from each other since the insurance commitment may lapse if the premium is not paid in due course.

38 We are of the view that presenting separately premium receivables, liabilities for remaining coverage, contractual service margin, liabilities for incurred claims and collaterals is useful information. In addition, it reflects the way the business is managed and information systems are organised.

39 In addition (when possible) relevant information shall rather be presented in the balance sheet instead of being disclosed in the notes (IFRS 17.100 on liabilities for remaining coverage and for incurred claims; IFRS 17.101(c) on the CSM).

<u>Premium receivables</u>

40 IFRS 17 does not require information on premium receivables in the balance sheet or in the notes. A definition of “premium receivables” should clarify whether they encompass “due and payable” (expected cash flows) or only “due and payable and enforceable” amounts (expected enforceable cash flows).

41 A common definition of a receivable shall not depend on the payment schedule i.e. be different when settled in one payment upfront compared with 12 instalments.

42 The impact of separately presenting premium receivables on the simplifications offered by the premium allocation approach has to be assessed in balance with the IT complexity raised by the current standard (See also § 49).

<u>Measurement of premium receivables and liabilities for incurred claims</u>

43 The nature of premium receivables and liabilities for incurred claims may put them under IFRS 9. It remains to be demonstrated that the risks covered under IFRS 9 (in particular related to premium receivables) are properly taken into account in the estimated FCF following IFRS 17.32 and IFRS 17.40.

44 We are of the view that there is no need for changing *measurement*, i.e. referring to IFRS 9 and therefore strongly suggest restricting the issue raised to the *presentation* of accruals in the balance sheet.

2.2 Issue 2: Presentation as an asset or a liability at group level

45 According to IFRS 17.78, each group of insurance contracts has to be presented in the balance sheet either as an asset or a liability. A presentation at this level of granularity does not provide useful information since it derives from accounting principles rather than from a business or conceptual approach. Groups may move from a liability to an asset position or the other way around without such information being meaningful.

46 In addition, from an accounting standpoint, offsetting the presentation of assets and liabilities of different nature and with different counterparts appears to be in contradiction with the conceptual framework.

47 Moreover, such presentation requirements would generate a burdensome complexity in providing net amounts at group or portfolio level where IT systems are on a “due-date” basis not on a cash basis.

2.3 Operational issues: modifying IT and management systems

48 Information systems of insurance companies generally distinguish:

- Underwriting, premium income and premium collection,
- Claims, claims occurrence, claims handling, claims payments and claims estimates,
- Actuarial estimates and models, in particular for the determination of the remaining coverage and, from a business perspective for the determination of pricing conditions.

49 The first two IT systems operate on an accrual basis reflecting risks and obligations. The third one reflects a number of assumptions and, in order to ensure consistency, is reconciled with the other two on a “due-date” basis (not on a cash-basis). The IT systems reflect a management structure organised to regroup competencies and promote efficiency. Modifying this typical structure and the related IT systems (e.g. from due-date to cash basis) may prove costly and may be a challenge to efficiency.

2.4 Illustration in the EU case study

<u>Separating the presentation of certain assets and liabilities would provide a more understandable and relevant information</u>

50 It is common practice to present components from insurance contracts in different financial statement line items. Some of these items are assets (e.g. premium receivables, deferred acquisition costs) others are liabilities (i.e. unearned premium reserve, loss reserve, aggregate policy reserve…). Each line item in the balance sheet addresses a specific information requirement that may be different from one component to the other.

<u>Presenting insurance contract groups in aggregate does not provide understandable and relevant information and generates undue costs</u>

51 Under IFRS 17, a presentation organised around groups of insurance contracts requires connecting accounting-, claim- and cash- management systems which are currently running separately and reconciled at a higher level (TRG 2018-05 AP 6.27).

52 This not only provides difficult to understand and irrelevant information for business purposes but is also very complex and costly. Costs may consequently exceed benefits.

<u>Consistency of IFRS 17 with internal and regulatory reporting</u>

53 For steering purposes, reconciliation between IFRS 17 and Solvency II in the future closing process is useful because both frameworks have conceptual similarities. The approach retained for the presentation of insurance contracts in the balance sheet under IFRS 17 would complicate such reconciliation.

2.5 Consistency with other IFRS standards

54 IFRS 15.105 requires that a separate presentation of a receivable defined as “any unconditional rights to consideration”.

2.6 Consistency with regulatory reporting (Solvency II)

55 According to Solvency II, the best estimate liability is based on a cash flow basis, but the regulation requires recognising certain accruals as separated assets and liabilities.

56 EIOPA Guideline 68 on the valuation of technical provisions states that “Insurance and reinsurance undertakings should establish the future premium cash-flows contained within the contract boundaries at the valuation date and include within the calculation of its best estimate liabilities those future premium cash flows which fall due after the valuation date. Insurance and reinsurance undertakings should treat premiums which are due for payment by the valuation date as a premium receivable on its balance sheet until the cash is received”.

3 Suggested solution (tentative)

3.1 Issue 1: Separate presentation of accruals in the balance sheet

57 Removing or offsetting current information commonly used by analysts on accruals would obscure relevant information. Such information actually required in the notes would be better presented on the face of the balance sheet.

58 IASB recalls that IAS 1 and IFRS 17 do not preclude a more detailed presentation of the liabilities, e.g. by presenting accruals (such as liability for remaining coverage, liability for incurred claims or even premium receivables as a debit) within the liability.

59 Amending the standard in order to require for a separate presentation of the main accruals would however significantly improve understandability. It would also improve relevance. From an operational standpoint, implementation would be simplified and costs would be saved.

60 In addition to the modifications to the standard suggested below, amendments to IFRS 17.79 and disclosure requirements (IFRS 17.98-109) have to be revised consequently. As mentioned in the IASB tentative decisions in March 2019, changes in the unit of account for presentation purpose also induce similar changes in the unit of account for disclosure requirements (amending IFRS 17.99).

61 It is also necessary that a non-ambiguous definition of certain accruals (such as premium receivables) is clarified in order to provide comparative and useful information on them.

62 We suggest supplementing appendix A with a common definition of premium receivables that could be based on the IFRS15.105 definition of the “unconditional rights to consideration” taking into account the effective (not the theoretical) period before policyholder’s rights (to coverage) actually lapse.

3.2 Issue 2: Asset/liability presentation

63 IASB has suggested to aggregate assets and liability at portfolio level instead of at group level. At portfolio level, virtually all insurance contracts will then be presented as liabilities which would be very similar to presenting assets and liabilities at entity level.

64 We therefore support the IASB amendment, provided the assessment of whether the remaining operational issues are acceptable. Indeed presentation at portfolio level may still require disaggregating / allocating certain positions (e.g. commissions due to distribution agents that may relate to several portfolios).

65 We therefore still prefer removing the reference to groups instead of replacing it by portfolios.

3.3 Other matters

66 According to IFRS 17.79, “an entity shall include any assets or liabilities for insurance acquisition cash flows recognised applying paragraph 27 in the carrying amount of the *related* groups of insurance contracts issued”. However, IFRS 17.27 addresses acquisition cash flows before their attribution to groups of insurance contracts issued.

3.4 Suggested modifications to the standard

67 We suggest amending the presentation requirement in order to:

- Remove the aggregated presentation at group level;
- Introduce direct requirements to present the main accruals in the face of the balance sheet (instead of in the notes).

68 IFRS 17.78: An entity shall present separately in the statement of financial position the carrying amount of~~groups of~~:

(a) ~~insurance contracts issued that are assets~~ premium receivables related to insurance contracts,

(b) liabilities for remaining coverage (including contractual service margin) related to insurance contracts,

(c) liabilities for incurred claims related to insurance contracts,

(d) premium receivables (reinsurer) and payables (insurer) related to reinsurance contracts,

(e) liabilities for remaining coverage (reinsurer) and asset for reinsurance contracts held (insurer) for reinsurance contracts,

(f) liabilities for incurred claims (reinsurer) and assets for reinsurance contracts held (insurer) for reinsurance contracts,

(g) liabilities for deposits received (insurer) and assets for deposits made (reinsurer) related to reinsurance contracts.

~~(b) insurance contracts issued that are;~~

~~(c) reinsurance contracts held that are assets;~~.

~~(d) reinsurance contracts held that are liabilities.~~

69 IFRS 17.99: An entity shall provide enough information in the reconciliations to enable users of financial statements to identify changes from cash flows and amounts that are recognised in the statement(s) of financial performance. To comply with this requirement, an entity shall:

(a) disclose, in a table, the reconciliations set out in paragraphs 100–105; and

(b) for each reconciliation, present the net carrying amounts at the beginning and at the end of the period, disaggregated into ~~a total for groups of contracts that are~~ assets and ~~a total for groups of contracts that are~~ liabilities, that equal the amounts presented in the statement of financial position applying paragraph 78.

70 Appendix A: Premium receivable: represents the unconditional right of the entity to consideration for the coverage to be provided. It takes into account the effective, not the theoretical, period before policyholder's rights to coverage actually lapse.