

# IFRS 17: Proving PAA eligibility

For non-life insurers

Gulf Actuarial Society (GAS) Members' Event  
26 June 2019



# Agenda

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Overview of PAA eligibility requirements under IFRS 17

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Practical application and key challenges

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Commonly asked questions

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Illustrative examples

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What's next?

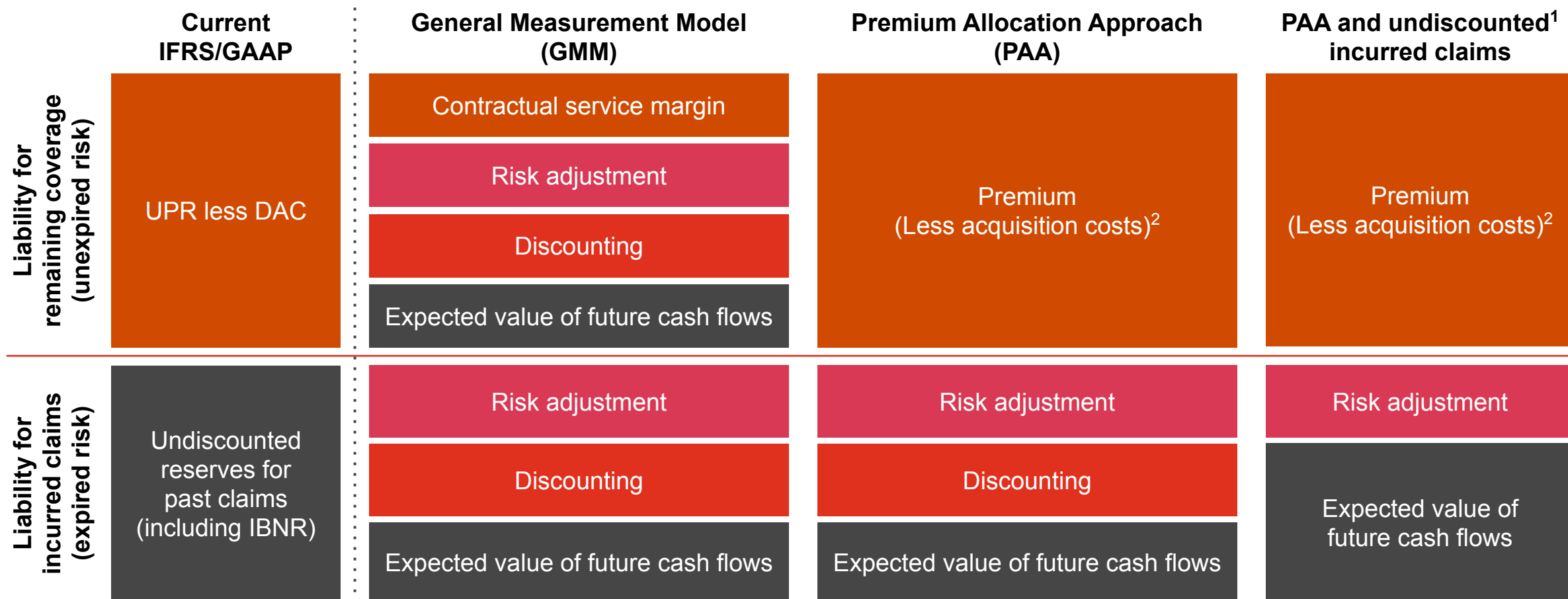
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# 1

Overview of PAA eligibility  
requirements under  
IFRS 17

# PAA is a simplified model



<sup>1</sup> No discounting is required if cash flows are expected to be received/paid within one year

<sup>2</sup> Adjustment for time value not required for unearned premium if provision of each part of coverage and premium due date is no more than a year

# PAA eligibility criteria

**Para 53:** An entity may simplify the measurement of a group of insurance contracts using the premium allocation approach if, and only if, at the inception of the group:

**a.**

The entity **reasonably expects** that such simplification would produce a measurement of the liability for remaining coverage for the group that would **not differ materially** from the one that would be produced applying the General Model; or

**b.**

The coverage period of **each contract** in the group (including coverage arising from all premium within the contract boundary determined at that date) is one year or less.

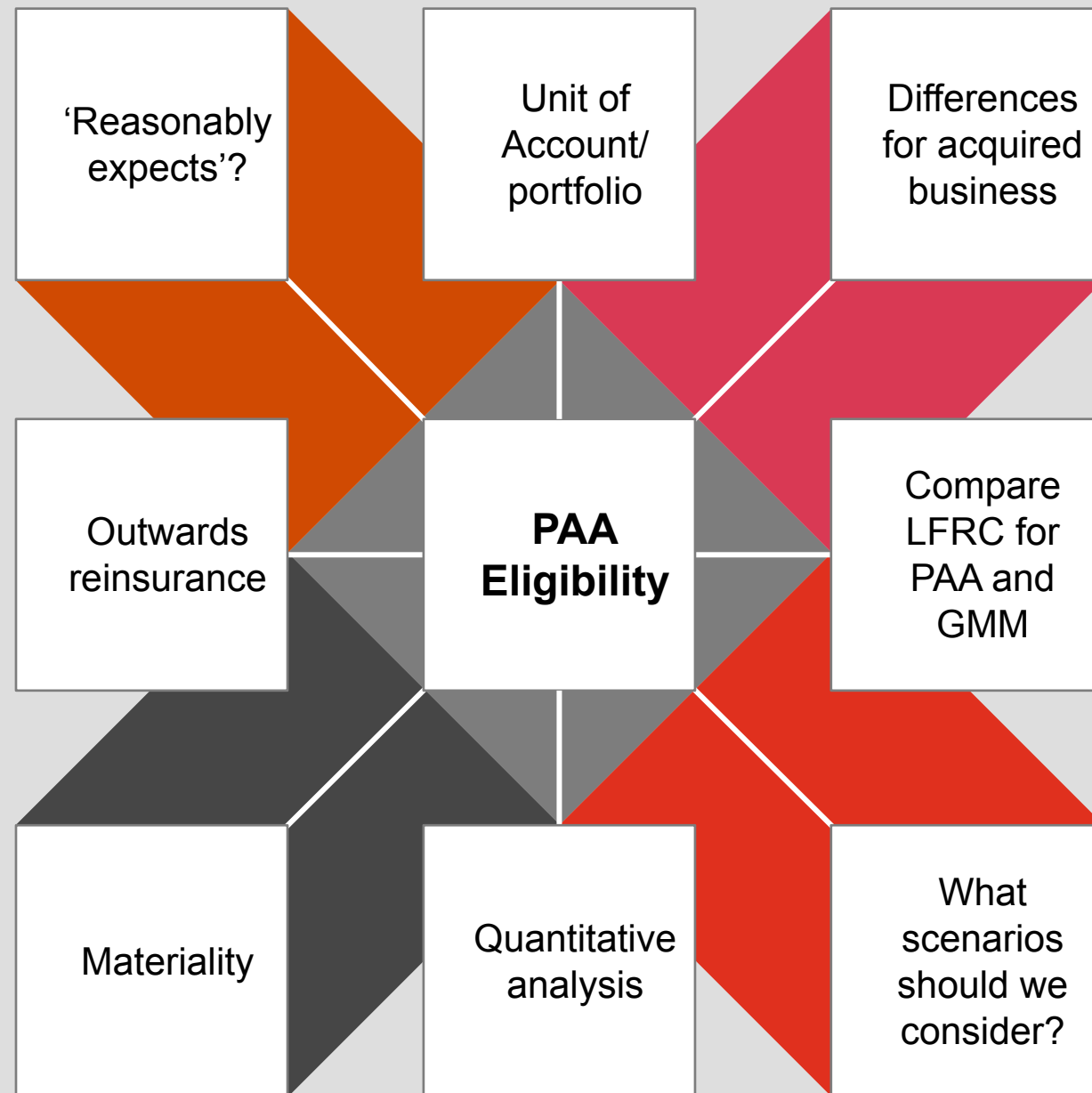
Criterion (a) above is not met if at the inception of the group an entity **expects significant variability** in the fulfilment of cash flows that would affect the measurement of the liability for remaining coverage during the period before a claim is incurred.

# Interpreting the standard for PAA eligibility testing

## The PAA may be applied when:

'The entity *reasonably expects* that such simplification would produce a measurement of the liability for remaining coverage for the group that would *not differ materially* from the one that would be produced applying the requirements in paragraphs 32–52 [the GMM]'.

The above is not met if at the inception of the group an entity **expects significant variability** in the fulfilment of cash flows that would affect the measurement of the liability for remaining coverage during the period before a claim is incurred.

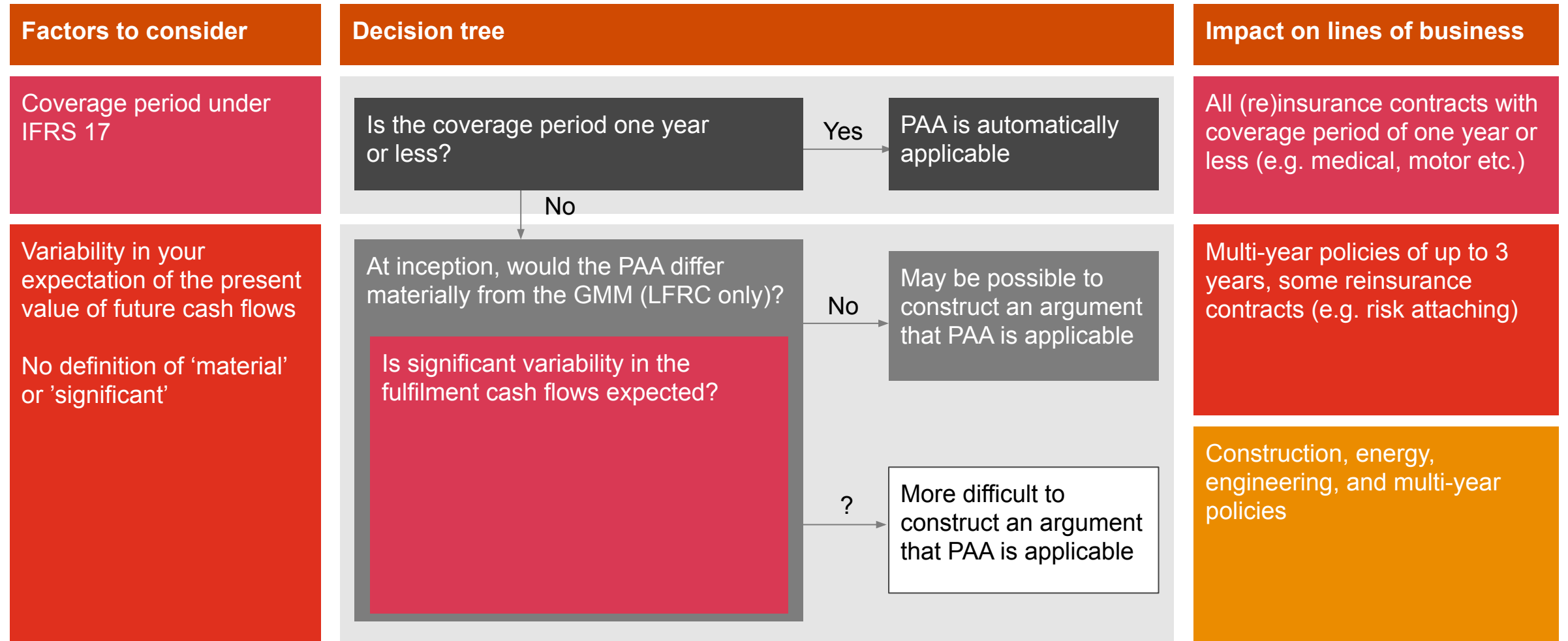


# 2

Practical application and  
key challenges

# Performing a PAA eligibility assessment

Tougher than it looks...





# Is the coverage period one year or less?

Direct contracts

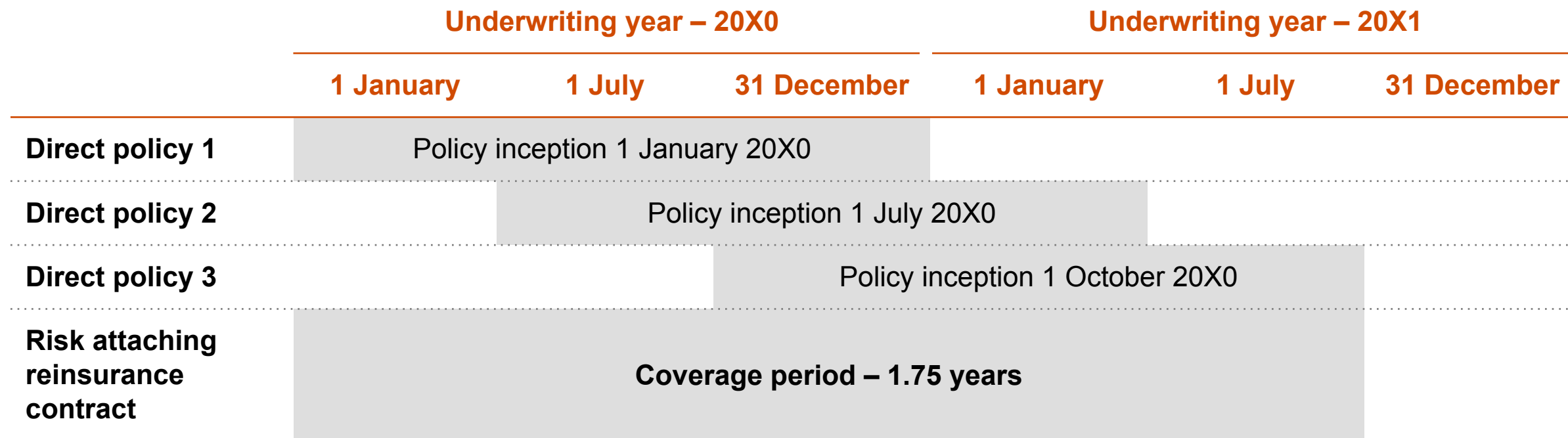
|                   | Underwriting year – 20X0        |                              |             | Underwriting year – 20X1          |        |             |
|-------------------|---------------------------------|------------------------------|-------------|-----------------------------------|--------|-------------|
|                   | 1 January                       | 1 July                       | 31 December | 1 January                         | 1 July | 31 December |
| <b>Contract 1</b> | Policy inception 1 January 20X0 |                              |             |                                   |        |             |
| <b>Contract 2</b> |                                 | Policy inception 1 July 20X0 |             |                                   |        |             |
| <b>Contract 3</b> |                                 |                              |             | Policy inception 31 December 20X1 |        |             |

All 3 contracts within the group are annual contracts

In the example above, despite the coverage period of the group being 2 years, the group of contracts is automatically **eligible** for PAA because **each contract** in the group has a one year coverage period.

# Is the coverage period one year or less?

Reinsurance contracts



In the example above, despite the coverage period of the underlying direct contracts being annual, the risk attaching reinsurance contract is **not automatically eligible** for PAA because the **coverage period** of the reinsurance contract is **greater than one year**.

# Is significant variability in the fulfilment cash-flows expected?

## Potential drivers of variability between the PAA and GMM

Length of coverage period

Non uniform risk release pattern  
e.g. engineering

Length of claims payment pattern

Differences in interest accretion between PAA and GMM

Unique product features (e.g. extension clauses)

Smaller portfolios or run-off portfolios

## Considerations for defining materiality

- **Not** the same as financial statement materiality.
- Evaluate LFRC at **each future reporting period** within the coverage period.
- **Percentage threshold** and/or **absolute threshold?**
- Materiality guidelines detailed in entity's **accounting policy**.

# Is significant variability in the fulfilment cash-flows expected?

## Potential reasonably expected scenarios (future changes in assumptions)



## Considerations for reasonably expected scenarios

- PAA eligibility assessment is performed only at **initial recognition** but must consider potential **future changes in assumptions at different points in time**.
- Test PAA eligibility on a **range of scenarios/assumptions**.
- Judgement will be required in determining the definition of reasonably expected scenarios.
- Scenarios may be interpreted as covering **'probable'** scenarios but excluding **'remote'** scenarios.
- Not eligible **if one or more** (reasonably expected) scenarios have a materially different LFRC.

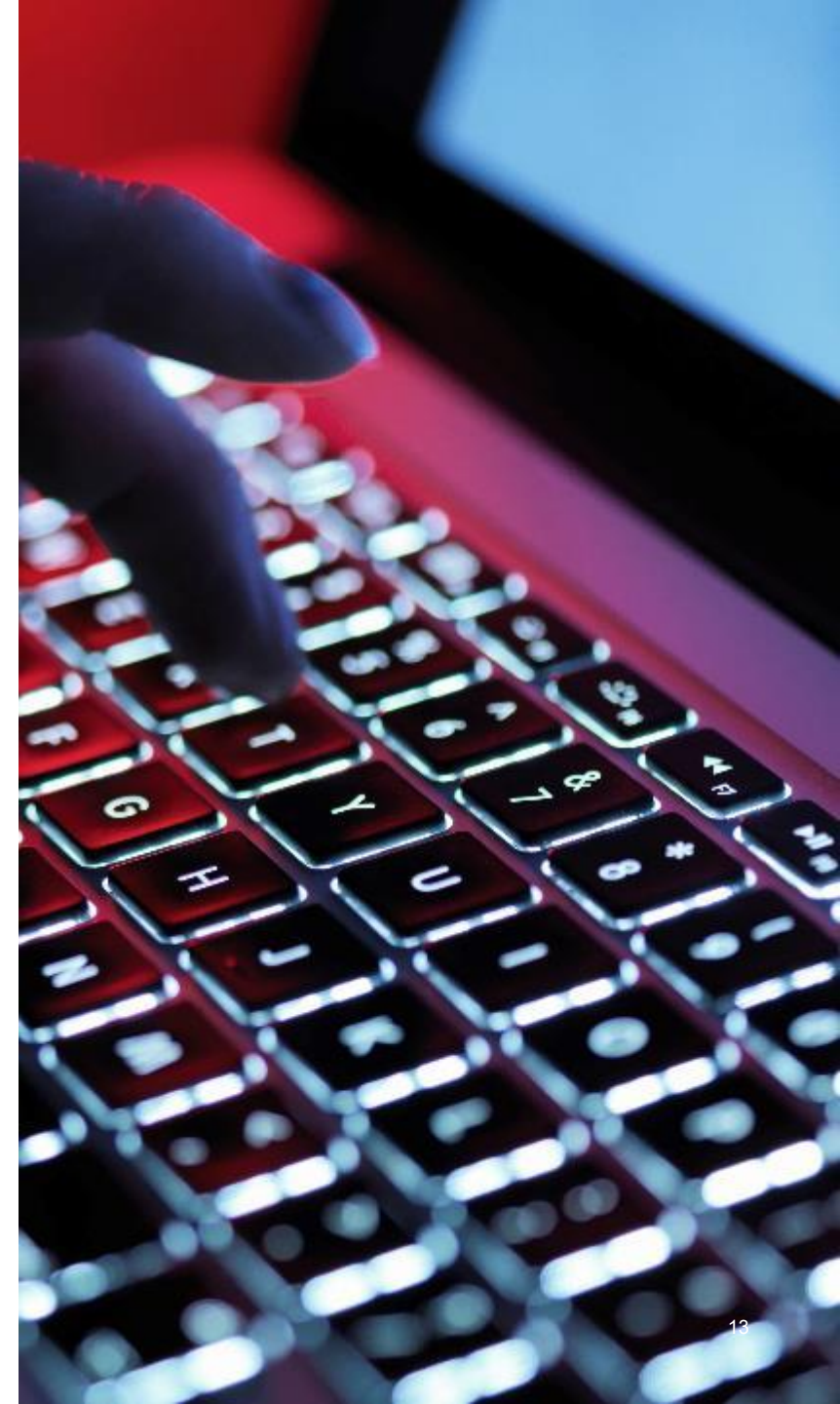
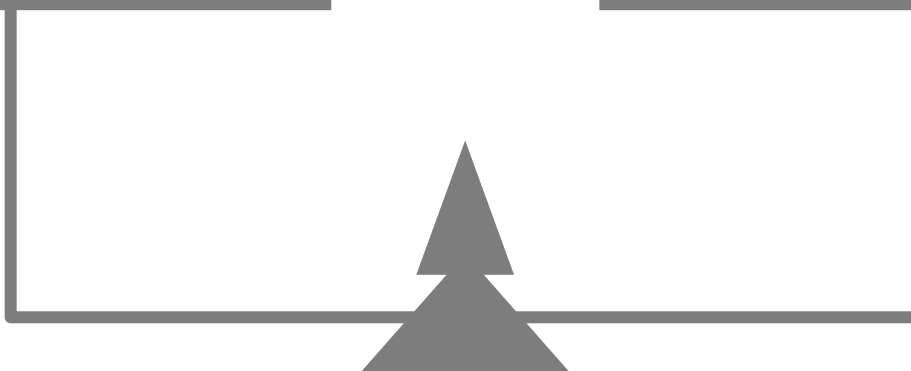
# Should you use the PAA model?

## Advantages of using the PAA over the GMM

- Simpler LFRC calculation
- Fewer and simpler disclosures
- Closer alignment with current approach

## Practical benefits of GMM over PAA

- Possible inconsistency in measurement between portfolios and operational requirement to manage multiple measurement models
- Greater insights into profitability for key stakeholders (e.g. CSM)
- Change in circumstances may result in a need to use the GMM



# 3

Commonly asked questions

# Commonly asked questions

When is a quantitative test needed to determine the eligibility for the PAA?

1

What amounts are compared in PAA eligibility assessment?

2

Can onerous contracts (at inception or subsequent measurement) still apply the PAA?

3

Can onerous contracts and non-onerous contracts be grouped together under the PAA?

4

Do we need to convert to underwriting years for our actuarial valuation?

5

What type of contracts are likely to not meet PAA eligibility?

6

In performing the PAA eligibility analysis, how should 'reasonably expects' be interpreted?

7

Does PAA eligibility need to be (re)assessed at each subsequent measurement?

8

4

Illustrative Examples



# PAA eligibility assessment

What thresholds could I consider for assessing eligibility?

## Percentage

The difference in LFRC under the PAA and GMM models, as a percentage of the LFRC under the GMM model, at each future reporting period

$$\frac{\text{LFRC}_{\text{GMM}} - \text{LFRC}_{\text{PAA}}}{\text{LFRC}_{\text{GMM}}} \leq \pm \text{Percentage Threshold}$$

## Absolute

The difference in LFRC under the PAA and GMM models, compared to an absolute amount set with reference to the group/ portfolio, at each future reporting period

$$\text{LFRC}_{\text{GMM}} - \text{LFRC}_{\text{PAA}} \leq \pm \text{Absolute Threshold}$$

# Example 1 – Contract with *even* premiums earning pattern

## Example 1 base case assumptions

### Example 1 - key assumptions

- Premium earned evenly over coverage period
- Contractual service margin amortised evenly over coverage period

### Example 1 - additional assumptions

- **Premium:** \$1000 (single premium paid at inception of policy)
- **Contract length:** 5.75 years
- **Policy inception:** 1st Jan 2018
- **Loss ratio:** 80%
- **Directly attributable expenses:** 20% of premium
- **Risk adjustment:** 8% of claims
- **Discount rate:** 5% p.a.
- **Onerous at inception:** No

## Illustrative reasonably foreseeable scenarios

1. Discount Rate - 2%

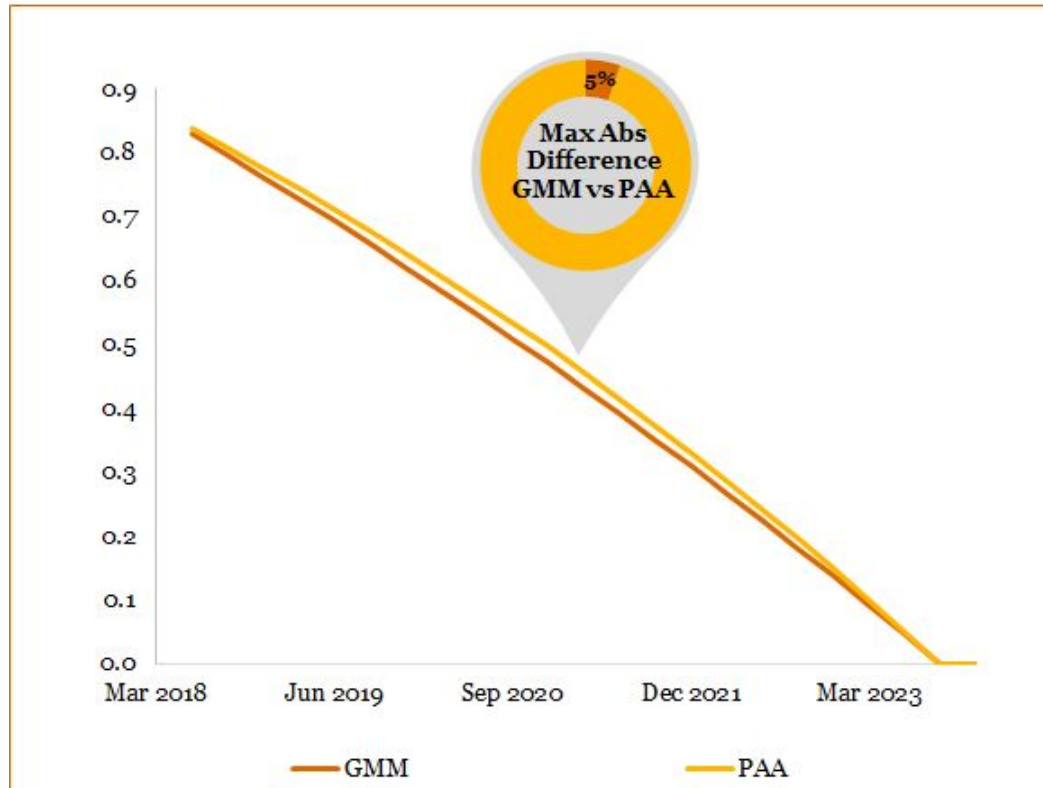
2. Ultimate Loss Ratio - 25%

Note the assumption changes above are applied **partway** through the coverage period of the contract

# Example 1 – Contract with *even* premiums earning pattern

## Base scenario

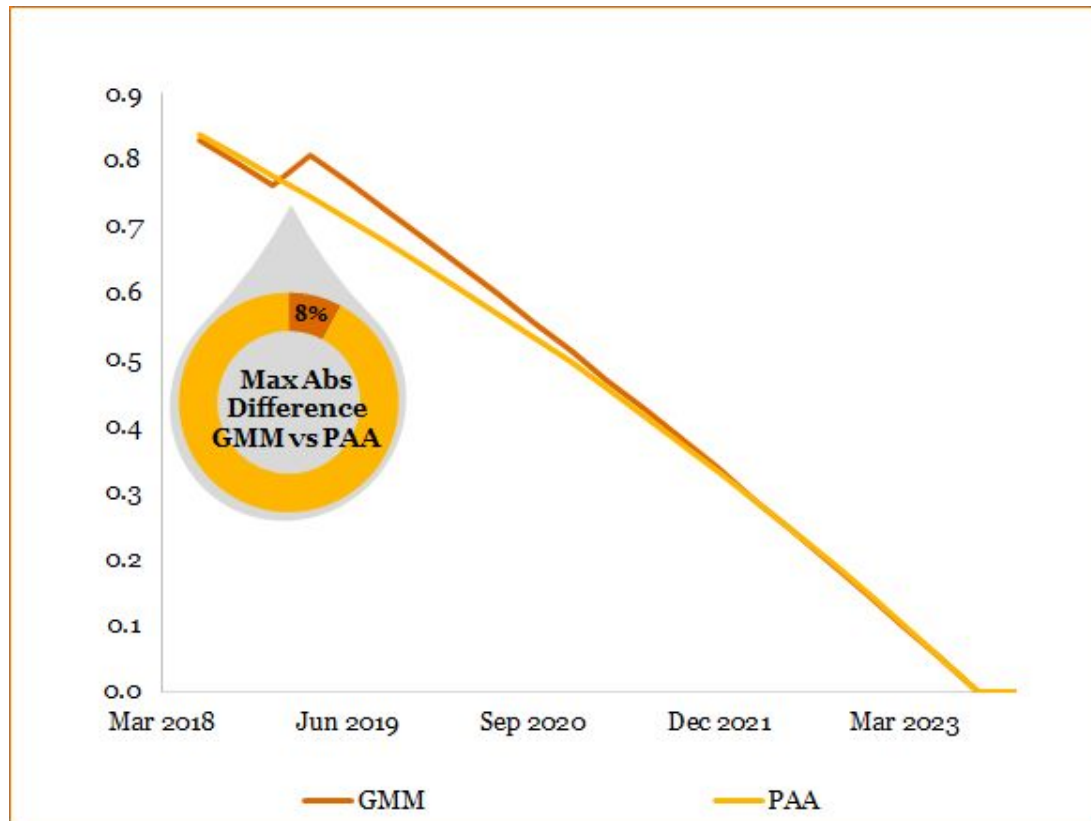
### Liability for Remaining Coverage Over Time – GMM vs PAA



# Example 1 – Contract with *even* premiums earning pattern

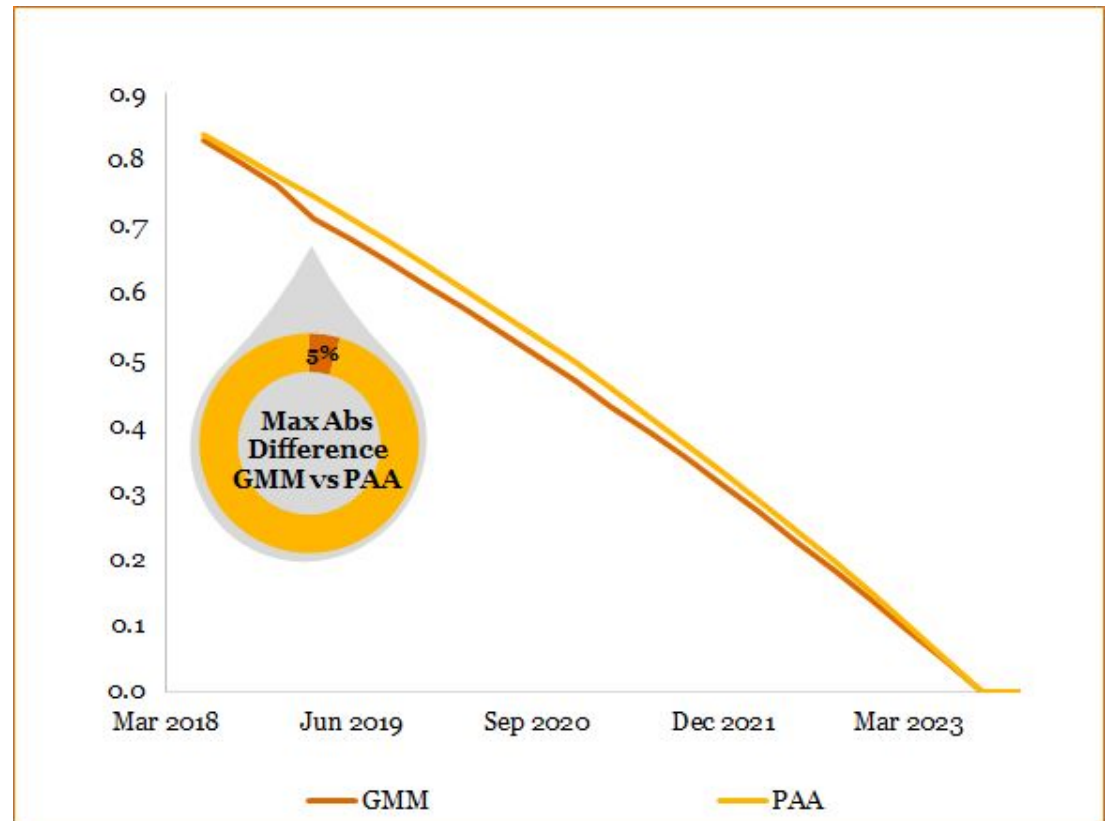
## Scenario 1

Decrease Discount Rate by 2% – Comparison of LFRC



## Scenario 2

Decrease Loss Ratio by 25% – Comparison of LFRC



# Example 2 – Contract with *uneven* premiums earning pattern

## Example 2 assumptions

### Example 2 - key assumptions

- Premium **not** earned evenly over coverage period
- Contractual service margin amortised evenly over coverage period

### Example 2 - additional assumptions

- **Premium:** \$2000 (single premium paid at inception of policy)
- **Contract length:** 7.5 years
- **Policy inception:** 1st Jan 2018
- **Loss ratio:** 80%
- **Directly attributable expenses:** 20% of premium
- **Risk adjustment:** 8% of claims
- **Discount rate:** 5% p.a.
- **Onerous at inception:** No

## Illustrative reasonably foreseeable scenarios

1. Discount Rate - 2%

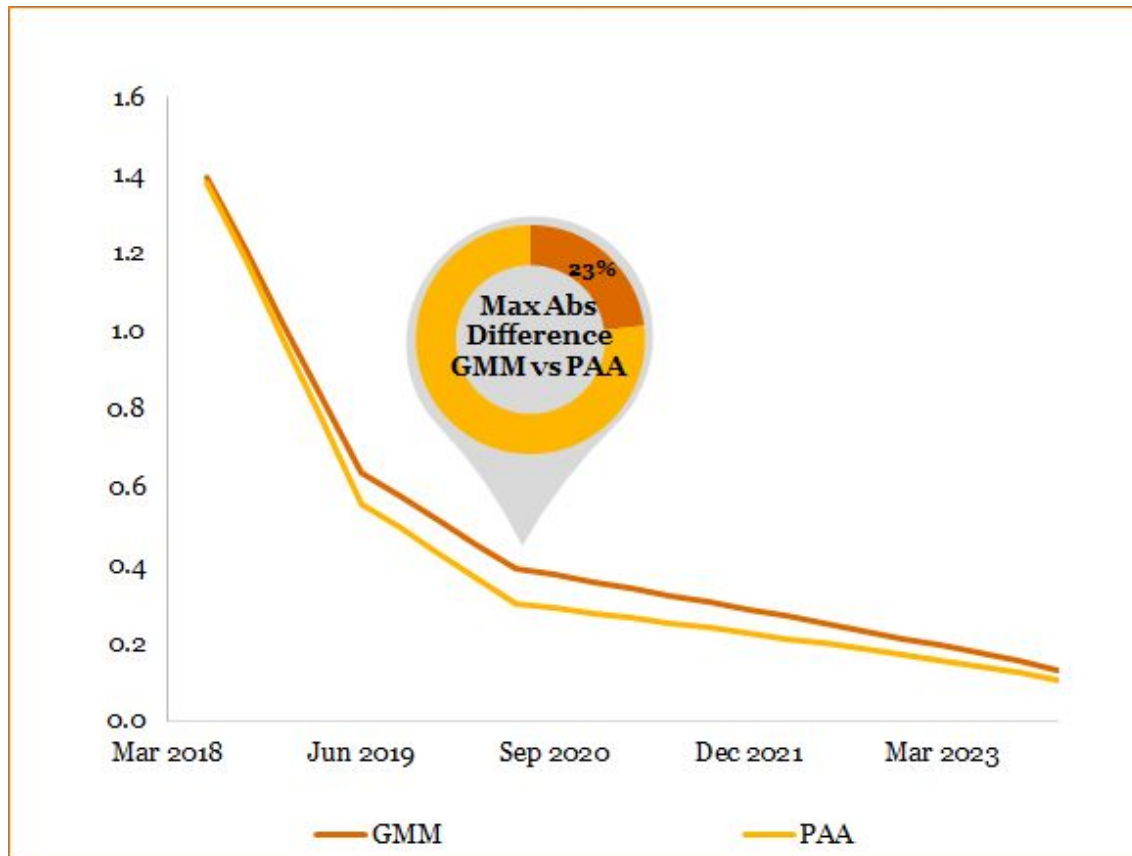
2. Ultimate Loss Ratio + 15%

Note the assumption changes above are applied **partway** through the coverage period of the contract

# Example 2 – Contract with *uneven* premiums earning pattern

## Base scenario

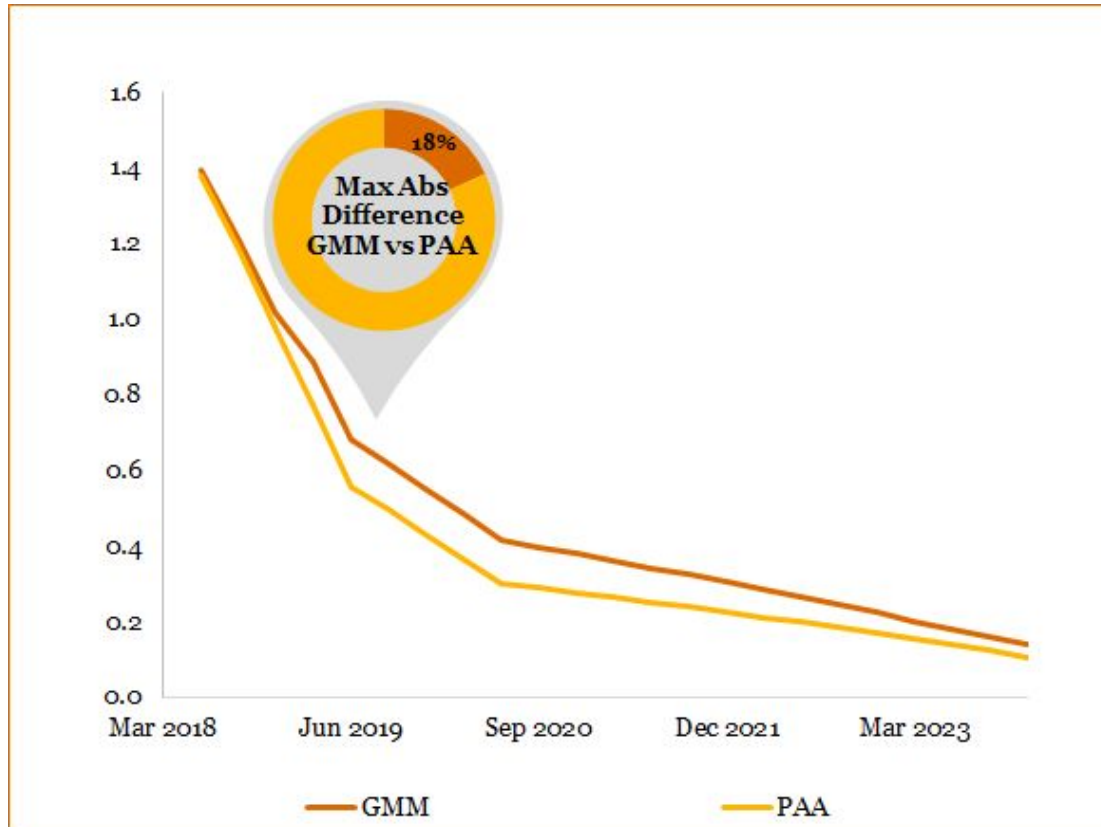
### Liability for Remaining Coverage Over Time – GMM vs PAA



# Example 2 – Contract with *uneven* premiums earning pattern

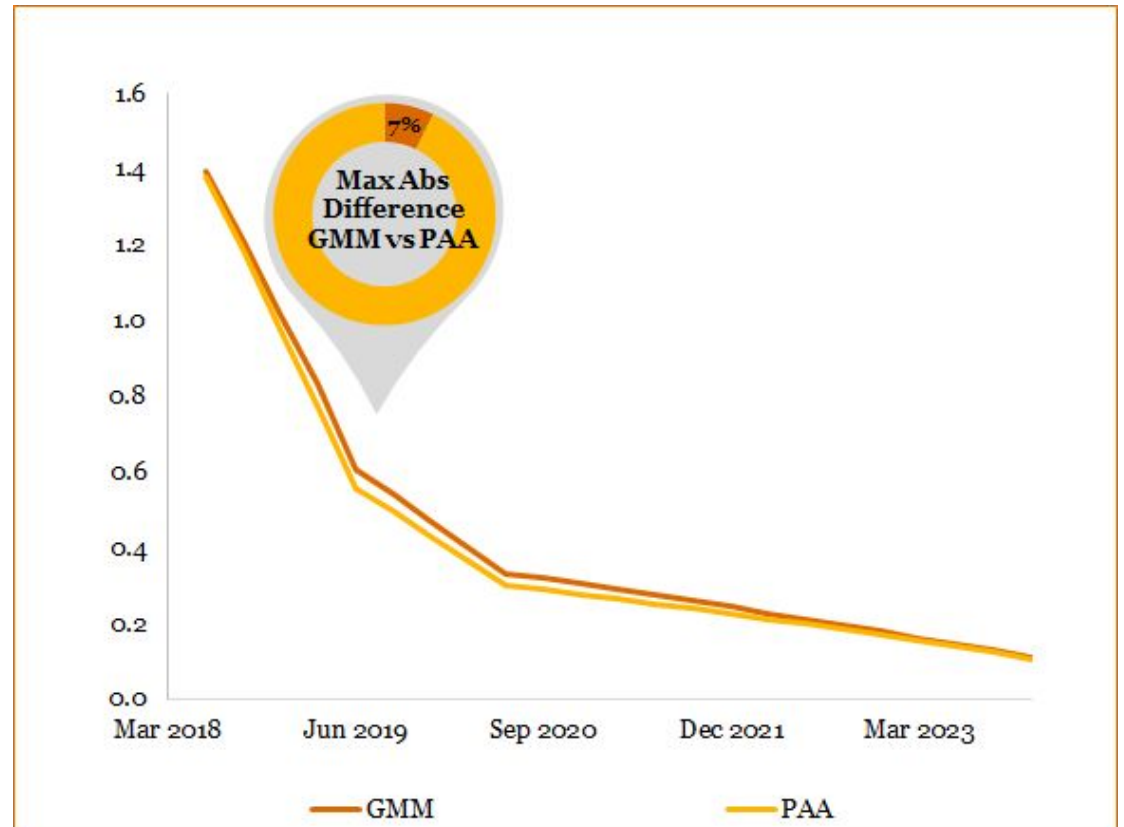
## Scenario 1

Decrease Discount Rate by 2% – Comparison of LFRC



## Scenario 2

Increase Loss Ratio by 15% – Comparison of LFRC



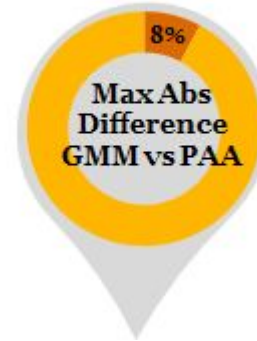
# Results from each example scenario

## Example 1

### Base case



### Scenario 1

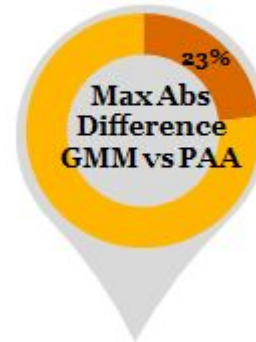


### Scenario 2

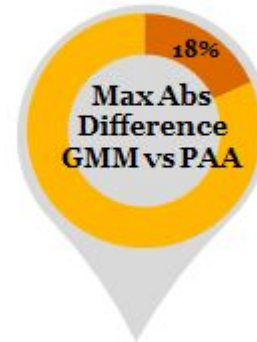


## Example 2

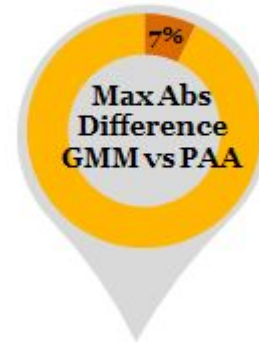
### Base case



### Scenario 1



### Scenario 2





5

What's next?

# What should you be doing next?

Perform a **financial impact analysis** and **PAA eligibility assessment** to understand the impacts on your business

1

Think about qualitative and quantitative definitions for key **PAA eligibility conditions** (e.g. 'differ materially', 'reasonably expects') and incorporate into **Accounting Policy**

2

Assess the **use of the PAA** for your business by considering the **practical implications**

3

# Questions?



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