3rd Capacity Building Seminar on IFRS 17 Gurugram

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Premium Allocation Approach

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Agenda

- Overview of measurement models
- Eligibility Criteria
- Key considerations around eligibility criteria
- Close look at the models to understand sources of difference
- Case study

Overview of measurement models

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	Current GAAP	General Model	PAA
Unexpired risk	Unearned premium reserve	Contractual Service Margin Risk adjustment Discounting Expected value of future cash flows	Premium (less acquisition costs) unearned
Expired risk	Undiscounted reserves for past claims (including IBNR)	Risk adjustment Discounting Expected value of future cash flows	Risk adjustment Discounting Expected value of future cash flows

PAA measurement in detail

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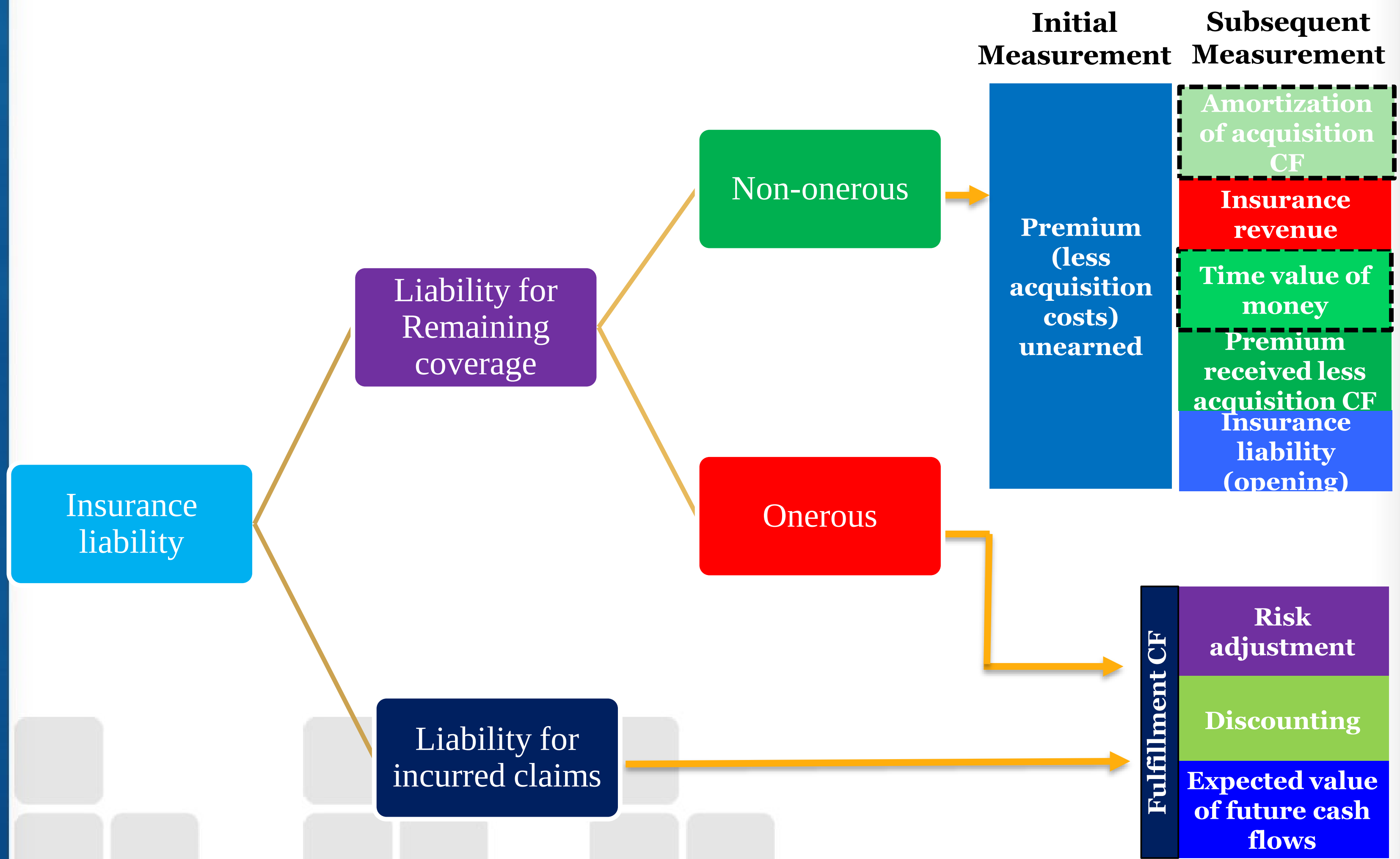

Case for PAA

- Liability for remaining coverage is simpler and is similar to the current UPR approach
  - No need to set and maintain CSM over term of the contract
  - Allows practical expedients
    - Time value of money
    - Expense acquisition cash flow
- Onerous contract test is simpler
  - the entity shall assume no contracts in the portfolio are onerous at initial recognition
  - Unless fact and circumstances indicate otherwise
- Lesser disclosure requirement
- Consistency

PAA eligibility test

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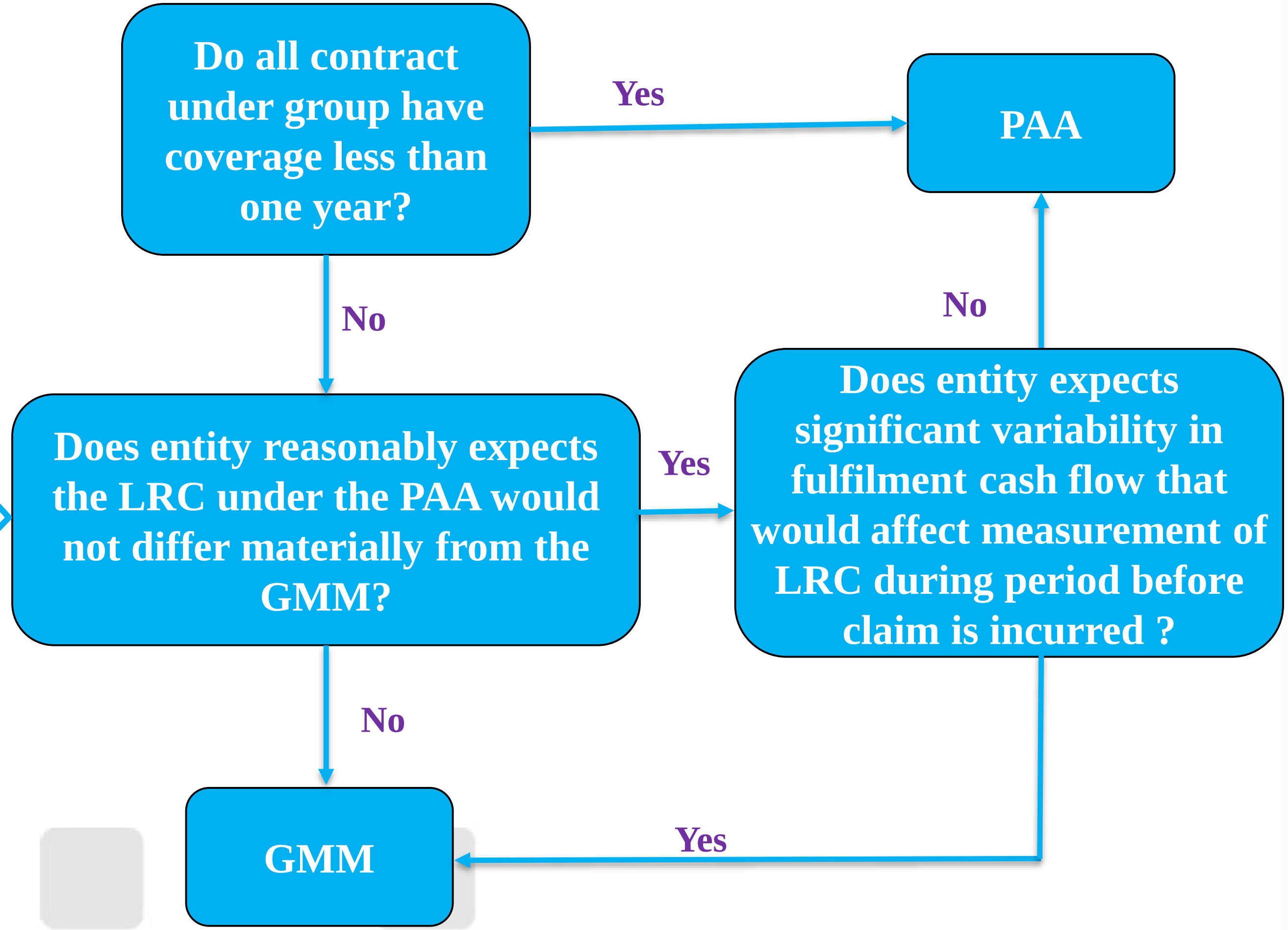
- Need to define what ‘reasonably expects’ and ‘differs materially’ means for the reporting entity.
- May require modelling of future stresses/scenarios to demonstrate immateriality in a range of outcomes.



- What is the Coverage period
- Definition of materiality

- Meaning of reasonably expects
- Significant variability in FCF

Coverage period: Contract boundary

Cash flows are within the boundary of an insurance contract if they arise from substantive rights and obligations that exist during the reporting period in which the entity:

- Can **compel** the policyholder to pay the premiums; or
- In which the entity has a **substantive obligation** to provide the policyholder with services.

A substantive obligation to provide services ends when:

- the entity has the **practical ability** to reassess the risks and, as a result, **can set a price or level of benefits that fully reflects those risks;** and
- the pricing of the premium for coverage up to the date when the risk are reassessed **does not take into account risk related to period after reassessment date**

Materiality Assessment

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IFRS Materiality Definition (IAS 1) -effective 1 Jan 2020

Information is material if omitting, misstating or obscuring it could reasonably be expected to **influence the decisions that the primary users of general purpose financial statements make** on the basis of those financial statements, which provide financial information about a specific reporting entity.

The primary users of general purpose financial reporting are present and potential investors, lenders and other creditors, who use that information to make decisions about buying, selling or holding equity or debt instruments, providing or settling loans or other forms of credit, or exercising rights to vote on, or otherwise influence, management's actions that affect the use of the entity's economic resources.

Reasonably expects…

At inception

- Range of scenario of reasonable possibility of occurrence may be considered at the inception.
- Reasonably expects may imply consideration should be given to the likelihood (probability) of occurrence of scenarios
- Reasonable Scenarios should not show a material difference of LFRC between PAA and GMM

Future changes

- Even though the assessment is performed at inception, consideration of future expected changes in the liability may need to be considered by the entity in making the assessment.

Significant variability of FCF

- Following examples are provided in the standard for increase in volatility of fulfillment cashflow:
  - the extent of future cash flows relating to any derivatives embedded in the contracts; and
  - the length of the coverage period of the group of contracts.

- Historic variability in the ultimate claim cost could be considered, in such a case, definition of significance and measure of variability could be of importance
  - Measure : e.g. standard deviation or percentile
  - Significance : relative (percentage of profit, CoV < x%, etc) or absolute (less than INR 5 crores)

Potential sources of difference

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Initial measurement

PAA		GMM	
Premium (less acquisition costs) unearned	Acquisition cost deductible is not applicable if entity opted to recognize directly in P&L	Contractual Service Margin	CSM set to make day 1 profit to zero
		Risk adjustment	
		Discounting	
		Expected value of future cash flows	

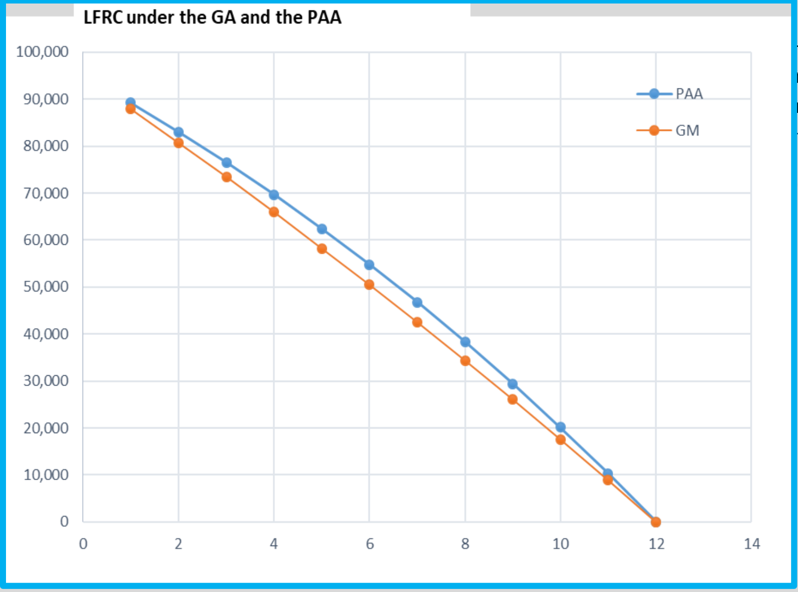
Subsequent measurement

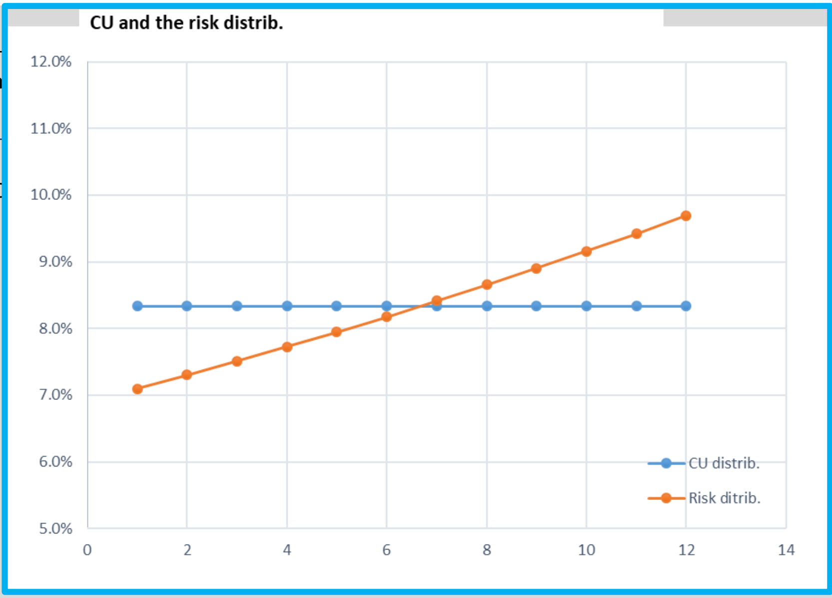
PAA		GMM		
Amortization of acquisition CF	To each period in a systematic way on the basis of the passage of time.	Contractual service margin	Accretion of interest	Locked in discount rate at inception
Insurance revenue	Allocation based on ✓ Passage of time or ✓ Expected LIC		Change related to future service	Change in PV of CF at discount rate at inception Change in RA
Time value of money	Locked in discount rate at inception		Insurance service provided – Recognized in P&L	Based on coverage unit ✓ Quantity of benefits ✓ Expected coverage period
Premium received less acquisition CF	Premium less acquisition CF for contract added in group	Risk adjustment		PV of CF at discount rate at Valuation date with current assumption
Insurance liability (opening)		Discounting		
		Expected value of future cash flows		

Case study : Base scenario

Case parameters
- ✓ Premium – 100,000
- ✓ Term – 3years
- ✓ Discounted LR – 75%
- ✓ Acq. Cost – 5%
- ✓ Risk Adjustment – 15%
- ✓ Discount rate – 10%
- ✓ Premium frequency – single upfront

Method 1: Balance allocation





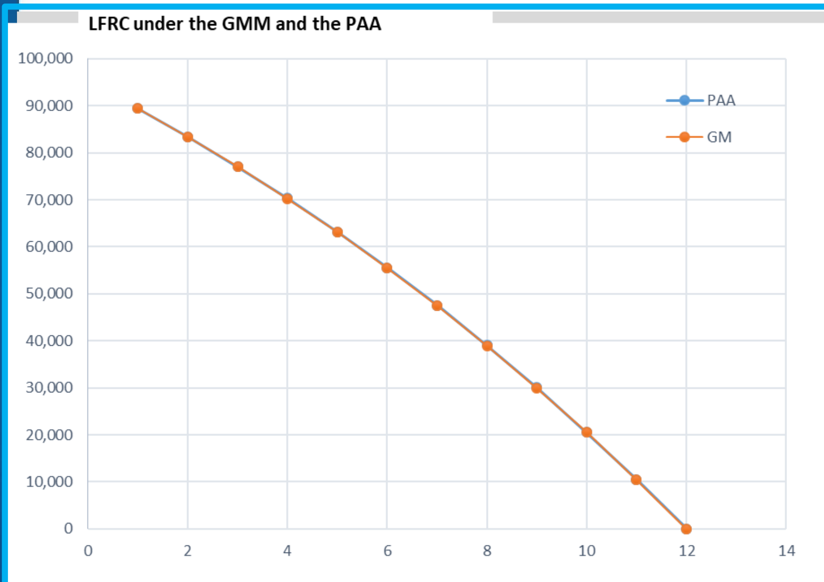
Differences on the LFRC: PAA vs GMM		
Average difference	2,642.6	5.4%
Maximum difference	4,001.0	13.7%

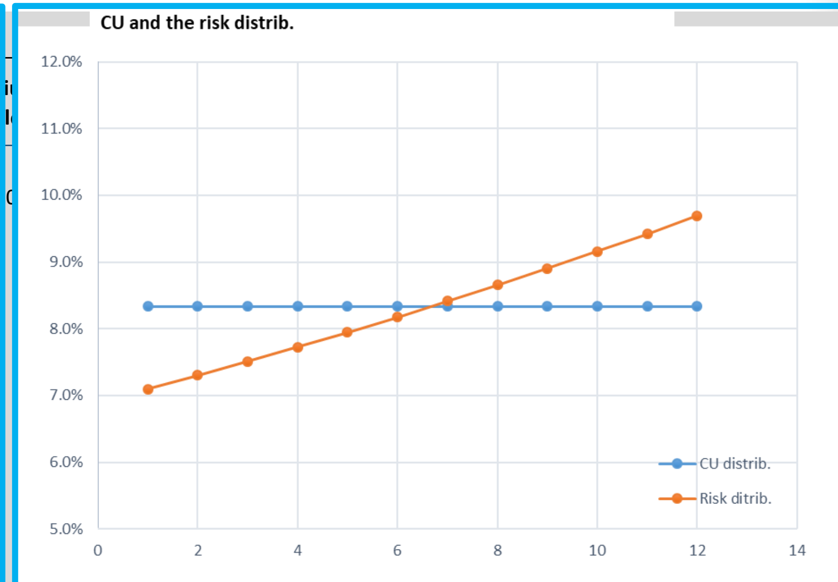
Case study : Base scenario

Case parameters

- ✓ Premium – 100,000
- ✓ Term – 3years
- ✓ Discounted LR – 75%
- ✓ Acq. Cost – 5%
- ✓ Risk Adjustment – 15%
- ✓ Discount rate – 10%
- ✓ Premium frequency – single upfront

Method 2: Equated allocation





Differences on the LFRC: PAA vs GMM		
Average difference	45.3	0.1%
Maximum difference	69.0	0.2%

Summarizing eligibility for PAA

- Contract boundary
- Need to set up both models
- Agree materiality definition with auditors or users of accounts
- Carry out LFRC calculations under different scenarios
- May need to demonstrate similar LFRC from both models from time to time

Thank You!