1. Introduction[1]

IFRS 17 establishes principles for the recognition, measurement, presentation, and disclosure of insurance contracts. The purpose of this draft educational note is to provide actuaries with practical application guidance on assessing whether a group of insurance contracts meets the required eligibility criteria for use of the premium allocation approach (PAA) to measure the liability for remaining coverage (LRC) under IFRS 17 *Insurance Contracts* (IFRS 17). This draft educational note is relevant to the valuation of all insurance contract groups, including property & casualty (P&C) and life & health (L&H) groups potentially eligible for measurement under the PAA.

References to specific paragraphs of IFRS 17 are denoted by IFRS 17.XX, where XX represents the relevant paragraph number, except that direct quotes from the IFRS 17 standard are as shown in the standard (i.e., paragraph XX).

Under IFRS 17, the general measurement approach (GMA) is the default approach applicable to LRC, as described in IFRS 17.32:

> 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.

The PAA is a simpler and less costly approach to apply than the GMA, as there is no need to estimate fulfilment cash flows under the PAA, nor is it necessary to identify and amortize a contractual service margin (CSM). Instead, the LRC is measured as described in paragraph 55:

> 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 recognize the payments as an expense applying paragraph 59(a); and
>
> (iii) plus or minus any amount arising from the derecognition at that date of:

[1] Acknowledgement: In developing this draft educational note, the Committees referred to limited sections of a position paper developed by the Insurance Bureau of Canada (IBC), in consultation with their member companies, audit firms and regulatory authorities. We wish to thank the IBC for making this work available to us.

1. any asset for insurance acquisition cash flows applying paragraph 28C; and
2. any other asset or liability previously recognized for cash flows related to the group of contracts as specified in paragraph B66A.

The valuation of the Liability for Incurred Claims (LIC) for groups eligible for the PAA is also subject to a minor simplification in respect of discounting, as indicated in IFRS 17.59(b). The LIC simplification is not addressed in this draft educational note, as it is out of scope for assessing PAA eligibility.

2. Decision Points

In determining PAA eligibility for insurance and reinsurance contracts, refer to IFRS 17.53–54 (emphasis added):

53 **An entity may simplify the measurement of a group of insurance contracts using** the premium allocation approach set out in paragraphs 55–59 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 requirements in paragraphs 32–52; or

(b) the coverage period of each contract in the group (including insurance contract services arising from all premiums within the contract boundary determined at that date applying paragraph 34) is one year or less.

54 The criterion in paragraph 53(a) is not met if at the inception of the group an entity **expects significant variability in the fulfilment cash flows** that would affect the measurement of the liability for remaining coverage during the period before a claim is incurred. Variability in the fulfilment cash flows increases with, for example:

(a) the extent of future cash flows relating to any derivatives embedded in the contracts; and

(b) the length of the coverage period of the group of contracts.

The following decision tree illustrates the various decision points in determining PAA eligibility. Eligibility is assessed as at the inception date of the group of contracts.