

Appendix D: Situations where PAA is Unlikely to be a Reasonable Approximation to GMA

Scenario	Reasoning
Patterns of the expected incurred claim costs and the release of the risk adjustment are significantly different during the coverage period.	The PAA approach reduces the LRC in line with the pattern for incurred claim costs only.
The pattern of expected incurred claim costs is strongly uneven and the CSM is significant under the GMA and the coverage period is more than one year.	The CSM is released in accordance with the insurance service provided which is based on coverage units for the duration of coverage. If the coverage provided by a contract is even over the coverage period then the CSM would be expected to be amortized evenly. For the PAA, a strongly uneven pattern of expected incurred claims would result in an uneven pattern of premium allocated to each period. The size of the CSM would then determine the significance of this difference.
The longer the expected payout pattern is for the coverage and/or the higher the interest rate environment.	Significant variability in the cash flows may occur during the coverage period if the time value of money is significant in the GMA. For long claim payment periods, even a small change in interest rates could significantly change the value of the LRC. In a high interest rate environment, interest rates tend to be more volatile, and discounting can make up a significant portion of the LRC even for shorter claim payment periods.
In a high interest rate environment and there is no significant financing component and the premium is due within a year of providing the relevant coverage.	In this situation an entity is not required under the PAA to reflect the time value of money in the LRC but would be required to do so under the GMA.
There is a significant investment, service, or other non-insurance component to the contract, or there is a significant profit-sharing component.	These are complications in which PAA might be less likely to provide a reasonable approximation to the GMA.
The cost of any embedded options or derivatives is significant.	See IFRS 17.54(a).

Scenario	Reasoning
Coverage is deferred.	While the PAA would likely require the LRC to accrete interest, the longer the deferral period the greater the mismatch is likely to occur between the GMA and the PAA. The GMA would continue to update expectations of future cash flows while the PAA would only adjust for changes in the timing for incurred claims in the coverage period per IFRS 17.B127.
Longer duration contracts generally.	For many reasons already highlighted, the longer the coverage period, the greater the variability in the fulfillment cash flows under the GMA.
Cancellation of policies within the coverage period are significant or lapses through non-payment of future premiums are an issue, when premium has been paid upfront.	Under the PAA, premium is allocated based on the passage of time or incurred claims if the expected pattern of release from risk is significantly different from the passage of time; there is no reflection of cancellations or return of premium. The GMA on the other hand, reflects expected return of premiums and expected lapses and changes in them during the coverage period for the LRC.