**MODULE 10: PREMIUM ALLOCATION APPROACH**

**Introduction**

This module provides an in-depth overview of the Premium Allocation Approach (PAA) under **IFRS 17.**

The Premium Allocation Approach (PAA) is a simplified measurement model for insurance contract liabilities under IFRS 17.

It is typically used for short-duration contracts (generally 12 months or less) such as motor, travel, health, and other general insurance products.

PAA is similar in concept to the unearned premium reserve (UPR) approach under IFRS 4.

Contracts must be grouped into portfolios with similar risk and management practices.

Then further split into:

1. Onerous at inception
2. No significant risk of becoming onerous
3. Profitable contracts

Contracts issued more than 12 months apart cannot be grouped together**.**

**Eligibility Criteria**

According to the standard, PAA can be applied under these two conditions:

1. If the coverage period of each contract in the group is one year or less, or
2. If the entity reasonably expects that using the PAA would produce a measurement of the liability for remaining coverage (LRC) that does not differ materially from the General Measurement Model (GMM).

**Measurement Under PAA**

Start assessment

Coverage period one year

Compare LRC under PAA and GMM

Difference material

Does not qualify for PAA

Apply PAA

No

Yes

Yes

No

There are two components:

1. Liability for Remaining Coverage (LRC)
2. Opening LRC balance: Starting point for the period.
3. Add: Premium Received: Additional premiums collected during the period.
4. Less: Amortization of Insurance Time value of money and financial risks: Amortized acquisition costs deducted.
5. Less**:** Insurance Revenue: Revenue recognized over time as insurance services are provided.

* LRC = Opening LRC + Premium received – Earned Premium – Change in DAC
* And Premium received = GWP + Prior premium receivables – Current premium receivables.

1. Liability for Incurred Claims (LIC)
2. Measured similarly to GMM:

* Present value of future cash flows
* Risk adjustment for non-financial risk

**Acquisition cashflow treatment**

Entities can choose to expense acquisition costs immediately if the coverage period of contracts is one year or less.

Otherwise, acquisition costs can be deferred and amortized over the coverage period.

Deferring acquisition costs reduces LRC but may increase loss recognition for onerous contracts.

**Discounting and Risk Adjustment**

Discounting of LRC is not required unless there is a significant time lag between receiving the premium and providing services.

Riskadjustment is only applicable to the liability for claims incurred, not LRC.

**Onerous Contracts**

Even under PAA, entities must assess whether contracts are onerous at initial recognition or subsequently.

If onerous, a loss component must be recognized immediately in P&L.

Revenue Recognition

Revenue is recognized over the coverage period in line with the pattern of transfer of services (typically straight-line).

Comparison of PAA and GMM

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| |  |  |  | | --- | --- | --- | | **Feature** | **PAA** | **GMM** | | Complexity | Low | High | | Intended for | Short-term contracts | All types | | Discounting | Usually not required for LRC | Required | | Risk Adjustment | Only for incurred claims | Required for all liabilities | | Onerous contract test | Required | Required | |  |  |

Disclosure Requirements

IFRS 17 requires:

1. Clear presentation of revenue, incurred claims, and movements in liabilities.
2. Disclosure of confidence levels used in measuring liabilities.
3. OCI option for presenting changes in discount rates.

Practical Application Examples

Ideal for group life, group credit, and general insurance with short coverage.

Can also apply to reinsurance contracts held, provided the same eligibility rules are met.