Study of Alternative Measurement Attributes with Respect to Liabilities

Subproject of the IAA Insurance Accounting Committee in response to a request of the IASB to help identifying an adequate measurement attribute for insurance contracts

Meaning of “Measurement Attribute”

A measurement attribute is the economic description of an accounting value by bringing it in a conceptual manner in relationship to economic real world phenomena. Properly disclosed together with that value, it provides an intuitive understanding of the meaning of the value to the users of the financial report.

The measurement attribute is the overriding principle for any measurement. Objective of measurement guidance is to ensure that the result represents faithfully the measurement attribute and complies consequently with the intuitive understanding resulting from its use. Measurement guidance is provided merely to improve the understanding of the measurement attribute, but as well to ensure a consistent application in cases of doubt, where there is little relationship to observable real world phenomena.

The description of a measurement attribute is most important basis of achieving a principle-based IFRS.

FASB refers in CON 1 to measurement attribute: “Attributes to be measured" refers to the traits or aspects of an element to be quantified or measured, such as historical cost/historical proceeds, current cost/current proceeds, etc. "Property" is commonly used in the sciences to describe the trait or aspect of an object being measured, such as the length of a table or the weight of a stone. But "property" may be confused with land and buildings in financial reporting contexts, and "attribute" has become common in accounting literature and is used in this Statement.”

Further, FASB describes reasons for choosing a measurement attribute in CON 5: “Items currently reported in financial statements are measured by different attributes, depending on the nature of the item and the relevance and reliability of the attribute measured.”

Existing or Potential Measurement Attributes

There are several measurement attributes already defined in IFRS or used by IASB. In some cases, a measurement attribute is provided, but without a lable referring to it. Further IFRS describe measurement in a rules based manner, without providing a measurement attribute.

- amortized cost and deferral-and-matching approaches
  IAS 39.9: “The amount at which the financial asset or liability is measured at initial recognition minus principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the
maturity amount, and minus any reduction (directly or through the use of an allowance account) for impairment or uncollectability.”

IFRSs do not define the amortized cost approach conceptually, but it is ultimately a reference to the percentage-of-completion approach which is the basis of any deferral-and-matching approach. Special cases are release-from-risk and rendering-of-services (IAS 18.20). The basic idea is that revenue should be recognized in proportion to fulfilment of the related obligation. Typically, the approach is traditionally used under the accrual principle in cases, where no information is available, how profit is associated with specific activities, consequently, profit is associated in proportion to a chosen measure of activities as identifiable. In some cases, there are mixed approaches (as e.g. in IAS 39), where some aspects of revenue are recognized in proportion to completion, other based on current information (IAS 39: cash flow assumptions are updated, while interest margins are recognized pro rata).

**value in use**

IFRS 5.A: “The present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life.”

Further guidance for measurement is provided in IAS 36.30:

“(a) an estimate of the future cash flows the entity expects to derive from the asset;
(b) expectations about possible variations in the amount or timing of those future cash flows;
(c) the time value of money, represented by the current market risk-free rate of interest;
(d) the price for bearing the uncertainty inherent in the asset; and
(e) other factors, such as illiquidity, that market participants would reflect in pricing the future cash flows the entity expects to derive from the asset.”

Consequently, the value in use is more than simply a measurement of the present value of cash flows as the definition would indicate, although the label is chosen well. It equals the definition of the current exit value, except that it refers to the cash flows expected by the entity rather than those expected by a potential acquirer. The fact that it is formulated only for assets is not relevant. It would work as well for liabilities. The margin to be applied is in any case that price which – in isolation – would be charged by a market participant for bearing the uncertainty or any other pricing aspect considered.

**fair value**

IAS 39.9: “The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.”

The IASB is currently reviewing that measurement attribute.

**recoverable amount**

IFRS 5A: “The higher of an asset's (or cash-generating unit's) fair value less costs to sell and its value in use.”
• **IAS 37** = best estimate of the expenditure required to settle the present obligation at the balance sheet date

Further guidance is provided by IAS 37.37: “The best estimate of the expenditure required to settle the present obligation is the amount that an entity would rationally pay to settle the obligation at the balance sheet date or to transfer it to a third party at that time. It will often be impossible or prohibitively expensive to settle or transfer an obligation at the balance sheet date. However, the estimate of the amount that an entity would rationally pay to settle or transfer the obligation gives the best estimate of the expenditure required to settle the present obligation at the balance sheet date.” and IAS 37.42: “The risks and uncertainties that inevitably surround many events and circumstances shall be taken into account in reaching the best estimate of a provision.”

The IAS 37 value is according the definition the more advantageous of the settlement value (assuming an immediate settlement with the counterparty) or the current exit value and in so far as well a rational value (see recoverable amount), but ignoring the possibility that the item performed orderly over time, as assumed in the value in use. It is strange that the IASB considered that possibility in case of assets, but considered in case of liabilities only direct settlement with the counterparty.

• **settlement value**

Framework 100 (c): “The undiscounted amounts of cash or cash equivalents expected to be paid to satisfy the liabilities in the normal course of business.”

Although the definition appears to a value similar to the value in use, i.e. the value based on actually performing the liability orderly, it is referred to in the Framework under the title “realizable value” together with a reference to the transfer (exit) price of an asset. The next item referred there, is the “present value”, which refers in case of assets something which appears to be the value in use, while the reference to liabilities again uses the same definition as in the settlement value before. Overall, it appears that IASB members interpret settlement value of a liability as the amount payable by the obliged party to the entitled party to achieve that the entitled party releases the obliged party from the liability immediately. That reflects as well the view applied in IAS 37, referring to such a value. The IASB does not consider anywhere an equivalent value to the value in use in case of liabilities. Interestingly, the IASB considers the possibility that the value in use deviates from the fair value, but does not consider that the counterparty of an asset might be willing to pay something different than the fair value for releasing the asset between both parties, while in case of liabilities the IASB does not consider that the
• **current cost**
  CON 5 76 (b): The current replacement cost of an asset.

  Current cost measurement attribute is conceptually similar to current entry value.

• **current exit value**
  Discussion Paper Insurance Contracts: “The amount the insurer would expect to pay at the reporting date to transfer its remaining contractual rights and obligations immediately to another entity”

  Although the current exit value is assumed to be based on entity-specific assumptions of the acquirer, rather than those of the reporting entity, the guidance in the Discussion Paper recommended as rebuttable presumption in all relevant cases (effect of claims settlement approach and administration expenses) to use the assumptions specific to the reporting entity, since in case of contracts, where a transfer is entirely fictitious in absence of an active market for such items, entity-specific features of the acquirer cannot be determined.

  The current exit value can be characterized by following features, that allows comparison with other approaches:

  • Prospective measurement: measurement only for future cash flows
  • Current notion: Measurement based on current information
  • Transfer notion: Measurement reflecting the situation at a transferee
  • Market notion: Measurement reflecting the benchmarks of a market participant

• **current entry value**
  There are two alternatives in the Discussion Paper: “The amount that the insurer would charge a policyholder today for entering into a contract with the same remaining rights and obligations as the existing contract.” and “The amount a rational insurer would charge a policyholder today for entering into a contract with the same remaining rights and obligations.” the latter seen as being merely a current exit value, since it reflects the view of another party, the rational insurer.

  • Prospective measurement: measurement only for future cash flows
  • Current notion: Measurement based on current information
  • Entity-specific notion: Measurement reflecting the situation at the insurer
  • Consumer notion: Measurement reflecting the pricing in the consumer market

• **entity-specific value**
  DSOP 3.3: “The value of an asset or liability to the enterprise that holds it, and may reflect factors that are not available (or not relevant) to other market participants. In particular, the entity-specific value of an insurance liability is the present value of the
costs that the enterprise will incur in settling the liability with policyholders or other beneficiaries in accordance with its contractual terms over the life of the liability.”

The measurement guidance for the entity-specific value is broadly consistent with that of the current exit value, except that assumptions specific to the reporting entity are used by principle rather than as rebuttable presumption. Further, DSOP is not consistent in defining the measurement guidance for the margin. In 5.23-27 the margin is described consistent with that for the current exit value, i.e. as measurement of the price element from market participants’ view point, while in 3.20 (b)-(f) it is described merely as an amount reflecting the views of the management of the reporting entity, i.e. more similar to the measurement under IAS 37. Obviously, the “value in settlement with the policyholder” as defined in DP 102, equals the entity-specific value using market margins, and DP 103 explained that the only difference is using entity-specific assumptions of the reporting entity rather than those of an acquirer as the underlying principle, although the latter is practically given up in the practical measurement guidance for a current exit value.

- Prospective measurement: measurement only for future cash flows
- Current notion: Measurement based on current information
- Entity-specific notion: Measurement reflecting the situation at the insurer
- Market notion: Measurement reflecting the benchmarks of a market participant

A suitable starting point for identifying measurement attributes is to check the list for gaps, especially if certain values exist for assets but no corresponding value is defined for liabilities.

Examples are:

Replacement value: It is similar to the current entry-value, but not entirely. An insurance contract has a certain use for an insurer, considering the risk equalization in a portfolio. Consequently, an insurer intending to replace a contract need identify a price (premium minus acquisition cost) at which a new contract with the same remaining terms could be concluded in the current situation. The replacement value would especially consider the imperfections in the consumer market.

Value in use: The value in use is conceptually consistent with the entity-specific value, using the market margin.

Fair value: The fair value is conceptually consistent with the current exit value.

Settlement value: There is interestingly no equivalent to the settlement value as applied to liabilities for assets. It is obviously not assumed that anybody would pay more for being acquiring back a right granted before than the market value of that right.

Recoverable amount: The equivalent would be the lower of the entity-specific value with a market margin and the current exit value. However, to be complete, as well the settlement value (which is not assumed to exist for assets) needs to be considered. Further, an improvement to be realistic and consequently to be more relevant, each of those values should only be considered, if
it is a realistic alternative. In that case, the measurement attribute would focus entirely on the information needs of the investor and leads therefore to the

**Investor-Oriented Value**

**Introduction**

Target of general purpose financial reports is to provide decision-useful information for present or potential capital providers with a claim to the residual resources of the reporting entity, especially regarding acquisition, retention or disposal of securities of the reporting entity. To be decision-useful, the amounts reported need to be relevant for that purpose and reliably (faithfully) representing the value according to users’ expectations as resulting from the conceptual description of that what the value purports to be, i.e. the measurement attribute.

**Investor-oriented Value**

The investor-oriented value is defined as the “*amount for which the incremental part of the ownership right*¹ in the reporting entity related to an asset or liability could be exchanged between knowledgeable, willing parties in an arm’s length transaction*”.

The investor-oriented value would be broadly equal in case of assets to the recoverable value as defined in IAS 36 and as such include a margin based on market participants view (IAS 36,30 (d)-(e)) but requiring an explicit margin (while IAS 36.A18 permits an implicit margin). In case of liabilities, it would be broadly equal to the lower of the entity-specific value as defined in DSOP and the current exit value. It should be noted that DSOP is inconsistent regarding the measurement attribute of the margin, comparing DSOP 3.20 (b)-(f), applying a management view, and DSOP 5.23-27, applying a market view. To comply with the definition above, the market view is to be applied.

Further, the settlement value, or in case of an asset, the amount which the counterparty would be willing to pay in settling the obligation immediately, would be considered if resulting in a higher asset or a lower liability.

However, to be realistic and consequently more relevant, in all cases alternatives would only be considered if there is actually an identifiable possibility to make use of the alternative. Alternatives which are not actually available would not be considered.

Subsequently, it is always assumed that the item is a liability. If it is an asset, a comparison between amounts would as well always choose the more advantageous amount in a rational choice.

¹ The term „ownership right“ refers to the entire range of ownership rights, including entrepreneurial stewardship. It is not just a limited right to share in net resources or profits. It includes especially the right of disposal, e.g. to decide whether to hold it in the reporting entity, to sell it or to settle it immediately with the counterparty.
Consequently, the investor-oriented value equals observed market prices in active markets, if the item cannot be assumed to provide a special better value for the reporting entity, since transfer is the rational use of the item. Pre-condition is that there is a possibility to sell the item, the presence of an active market is just one necessary condition, another is that the entity is as well entitled, especially under regulatory rules, to proceed that transfer. In all other cases, the investor-oriented value equals the entity-specific value, i.e. if the entity-specific value results in a lower liability than the market price, if the entity-specific value result in a higher liability than the market price but the entity is not permitted to transfer the item, or if there is no active market at all.

In some cases, direct settlement with the counterparty might be a realistic alternative, especially in case of long tail claims reserves. In such cases, especially the otherwise necessary risk margins, the expected settlement price with the counterparty might result in a lower liability.

The entity-specific value has to be determined based on a valuation technique, considering capital providers expectations regarding entity’s cash flows in making use of the item (considering all realistic alternatives rationally, including transfer) and capital providers’ (market participants’) assessment of the required price for inherent risks, imputed entrepreneurial profit and any other pricing aspect as described e.g. in IAS 36.30 (e).

Consequently, the investor-oriented value is the economically assessed value of the item which applies to any capital provider for the reporting entity and could be seen therefore as the real “fair value”, however, for avoiding confusion, the term fair value is used here applying the current definition as found in IFRSs.

The investor-oriented value, as a concept, does not principally exclude initial gains or subsequent recognition of gains based on changes in assumptions and is in a similar situation as fair value. The investor-oriented value does not solve any recognition issue, since as well the investor-oriented value refers to (recognizable) assets and liabilities, i.e. measures only rights and obligations under the contract.

- Prospective measurement: measurement only for future cash flows
- Current notion: Measurement based on current information
- Entity-specific or transfer notion: Measurement reflecting the situation at the insurer or the transferee, depending on more advantageous realistic outcome
- Market notion: Measurement reflecting the benchmarks of a market participant

**Comparison of Fair Value and Investor-oriented Value**

The investor-oriented value and the fair value have the same measurement guidance for the margin, while the cash flows in the first case are determined as those specifically applicable to the reporting entity – and consequently actually affect any capital provider – and in the second case those available for any (average?) market participant (consequently affecting the capital provider only in the case of actual transfer of the item).
Diversification benefits as available to market participants are considered in the margin for both measurement attributes equally. It can be assumed that diversification benefits achievable for a specific entity are never better than those achievable for a market participant in the entire market. Market participants do not have any limitation of making use of diversification abilities in markets. Consequently, both, investor-oriented and fair value would consider the same level of diversification, that available to a market participant.

A peculiarity arises in case of the special production approach as used pre-dominantly in insurance business, pooling. Pooling benefits (for differentiation between diversification and pooling see RMWG-paper), are not actually available for market participants but can only be achieved specifically by the reporting entity. However, the IASB proposed to choose as unit of account the portfolio for purposes of determining the current exit value. Consequently, as well here fair value and investor-oriented value would consider the same pooling benefits.

The fair value of assets issued by an entity with impaired credit standing is reduced. Arguably, as well the fair value of an obligation of an entity with impaired credit standing is reduced. However, the latter is merely a highly fictitious view point, since a transfer of liabilities is typically subject to legal restrictions. The investor-oriented value of assets issued by entities with impaired credit standing is as well reduced, since that reduces both, any transfer price and the internal use of that asset to the reporting entity. The investor-oriented value of a liability is not affected by a change in credit standing of the entity, except in those rare cases, where the liability is traded in active markets and the entity can consequently make use of the lower value of the liability by selling it at the lower price in markets. That ultimately means that the credit standing is only recognized if market evidence is available for that.

Relevance

To be decision-useful, reports need to provide information for a capital provider regarding especially regarding acquisition, retention or disposal of securities of the reporting entity. To provide information about individual items in the reporting entity in a sterile, isolated manner, without considering the items within their entity environment produces a pseudo-neutrality and pseudo-objectivity which eliminates exactly those peculiarities of the reporting entity, which are the main basis for those decisions in favour or against a specific entity.

Most intangible assets are not recognized, but for lack of reliable measurement. However, where the effects of those unrecognized intangible assets to recognized items are reliably measurable such effects should be recognized as being relevant. Without considering effects of intangible assets where reliably possible, the report would loose its predictive and confirmatory value. It is understood that a decision about recognition needs to be made in a manner based on categories of intangible assets, rather than item by item, since users are assuming generally that intangible assets are not considered except in well-known exemptions.

However, performance obligations do not exist in isolation. The counter party agreed with the reporting entity that the reporting entity performs the obligation, all its peculiarities and abilities in mind, not that an obligation is performed by anybody. The customer might have had good reasons to choose actually the reporting entity and the performance obligation is per se not
transferable, since it is a specific obligation of the reporting entity and in so far actually entity-
specific by its legal and economic nature.

The observed market price in an active market is not relevant since it is the market price but
since it reflects the value, which a capital provider who is as well a market participant, would
associate with that item both, when owning the item directly and as part of the reporting entity,
assuming that the reporting entity cannot make any special use of the item but sell it any time at
that price, i.e. realize that value actually. Relevant is whether the market price of an item is as
well associated by the capital provider with the item, if the item is hold by the reporting entity
rather than directly by the capital provider, in those cases, where the reporting entity can make
special use of it. That is a distinguishing criterion in the decision, whether to acquire, retain or
dispose ownership interest in the reporting entity since it affects the capability of the entity to
generate returns to the capital provider.

That applies as well, if it is doubtful, whether the item can be transferred, since there is no active
market or there are transfer restrictions, as often in case of performance obligations. An active
market, as defined in IAS 36.6, requires homogeneity of items, sufficient offer and demand at
any time and observable prices. In absence of such a market the (estimated) market price might
be irrelevant to the capital provider since there will be never a benefit from it. Transfer
restrictions are a peculiarity of the item in the case of the reporting entity, not a peculiarity of the
entity itself are to be considered as relevant information.

Fair values were never soundly defined in case of items without just one clearly identifiable
active market. The market available specifically for the reporting entity is considered, since the
market, where the capital provider is expected to act in is not relevant. The available market is
not a characteristic of the item but of the reporting entity.

Reliability

Where the item is traded in an active market and the investor-oriented value is best represented
by the observed market price, it is as reliably determinable as the fair value. If the investor-
oriented value does not equal the fair value although the item is traded in an active market, since
the reporting entity can make special use of the item or there are transfer restrictions, the
investor-oriented value might not be as reliably determinable as the observed market price.

If the item is not traded in active markets, both the fair value and the investor-oriented value are
estimated using valuation techniques. However, the fair value measurement is based on
assumptions about fictive, often even impossible transactions while the investor-oriented value is
determined making use of data actually observed in the reporting entity or to some extent in
other similar entities. Consequently, the investor-oriented value needs to be conceptually be
more reliably determinable in such cases, since there is no indication at all, whether the fictive
assumptions for the fair value comply actually with those would have been used in an actual
transfer. The information observed in the reporting entity would be expected by users of the
report as reflecting the investor-oriented value and used as well in their assessments of the value
and are consequently reliable in the sense of that term.
Fair values for performance obligations cannot be described reasonably without considering the entity-specific environment. The profitability might very often depend from equipment, techniques, sophistication and approaches of the performing entity. Economy of scales is important in the case of any servicing item. To determine the value for just one item requires assumptions about the available degree of economy of scales and consequently of future volume of similar business. Any measurement must consider consequently the presence of intangible assets to some extent, i.e. their effect to the item measured, not the measuring the intangible asset itself. Negligence and care executed in performing services, e.g. in case of claims handling in non-life insurance determines the actual cost of providing the service, care is expensive but reduces claims ratios and negligence is cheap but increases claims ratios. To cope with the lacking reliability in current exit values of measurement aspects unavoidably specific to the entity performing the obligation, the Discussion Paper deviated from the principle and recommended to apply actually assumptions specific to the reporting entity as default. That is a significant violation of faithful representation. If a current exit value cannot be provided without that, there is something wrong with the concept.

**Solvency-Oriented Value**

**Introduction**

The purpose of IFRS financial reports is to provide decision-useful information to investors and other creditors, which is relevant for such purposes and reliably (faithfully) representing the value according to the conceptual description in the report. Solvency financial reports focus primarily on the information needs of regulators. “The main objective of (re)insurance regulation and supervision is adequate policyholder protection. Other objectives such as financial stability and fair and stable markets should also be taken into account but should not undermine that main objective.” However, as part of the Solvency approach as well public forces, including those of capital markets, are utilized to ensure an adequate financial behavior of insurers. Consequently, as well Solvency reporting guidance attempts to provide information which is similar in intent as IFRS reporting. Further, information which is needed by regulators is as well desired to some extent by investors, other creditors, rating agencies and management, especially about reserves adequacy, solvency capital requirements, risks exposure, asset–liability matching and its corresponding capital requirement, risk mitigation vehicles effect and compliance with solvency models assumptions. To utilize the valuation of insurance contracts for Solvency purposes as well for IFRS purposes would result in significant simplification of work, synergy effects but as well avoid contradicting messages sent out to the public.

**Solvency-oriented Value**

The solvency-oriented value is defined by “(a) assets shall be valued at the amount for which they could be exchanged between knowledgeable willing parties in an arm's length transaction; (b) liabilities shall be valued at the amount for which they could be transferred, or settled, between knowledgeable willing parties in an arm's length transaction. When valuing liabilities, no adjustment to take account of the own credit standing of the insurance or reinsurance undertaking shall be made.”
In particular, the calculation of technical provisions:
1. Should reflect its current exit value, defined as the amount an insurance or reinsurance undertaking would expect to have to pay today if it transferred its contractual rights and obligations immediately to another undertaking. The use of current exit value does not imply that an (re)insurance undertaking could, would or should actually transfer those obligations.
2. Must be market-consistent, using undertaking specific information only so far as that information enables (re)insurance undertakings to better capture the characteristics of the underlying insurance portfolio.

Although that definition complies with that of a current exit value, the difference is that Solvency II does see it as an overriding principle. It is merely the Framework used by the European Commission to develop measurement guidance to be applied. In so far, parts of the measurement guidance might not be in compliance with general market views but reflect specific intentions of the European Commission. Further, such a rules-based approach causes a significant reliance on the adequacy of the rules to any issue which might arise world-wide. In Solvency II, there is usually an institution, the local regulator, who is authorized to provide specific guidance regarding application of the rules to products or situation, which were not foreseen by the rules, while in IFRS such an institution does not exist.

The solvency-oriented value would equal, in case of assets to the amount for which they could be exchanged between knowledgeable willing parties in an arm’s length transaction, i.e. the fair value. In case of liabilities, it would equal sum of:

(1) The best estimate, that shall be equal to the probability-weighted average of future cash flows, taking account of the time value of money (expected present value of future cash-flows), using the relevant risk-free interest rate term structure. The calculation of the best estimate shall be based upon current and credible information and realistic assumptions and be performed using adequate actuarial methods and statistical techniques. The cash-flow projection used in the calculation of the best estimate shall take account of all the cash in-and out-flows required to settle the insurance and reinsurance obligations over the lifetime thereof. The best estimate shall be calculated gross, without deduction of the amounts recoverable from reinsurance contracts and special purpose vehicles.

(2) The risk margin that shall be such as to ensure that the value of the technical provisions is equivalent to the amount insurance and reinsurance undertakings would be expected to require, in order to take over and meet the insurance and reinsurance obligations.

When calculating technical provisions, insurance and reinsurance undertakings shall take account of the following:

(1) all expenses that will be incurred in servicing insurance and reinsurance obligations;
(2) inflation, including expenses and claims inflation;
(3) all payments to policyholders and beneficiaries, including future discretionary bonuses, which insurance and reinsurance undertakings expect to make, whether or not these payments are contractually guaranteed.
The risk margin shall be calculated by determining the cost of providing an amount of eligible own funds equal to the Solvency Capital Requirement for the relevant regulator of the entity, necessary to support the insurance and reinsurance obligations over the lifetime thereof. The rate used in the determination of the cost of providing that amount of eligible own funds (Cost-of-Capital rate) shall be the same for all insurance and reinsurance undertakings. The Cost-of-Capital rate used shall be equal to the additional rate, above the relevant risk-free interest rate, that an insurance or reinsurance undertaking holding an amount of eligible own funds, as set out in Section 3, equal to the Solvency Capital Requirement would incur to hold those funds.

When calculating amounts recoverable from reinsurance contracts and special purpose vehicles, insurance and reinsurance undertakings shall take account of the time difference between recoveries and direct payments. The result from that calculation shall be adjusted to take account of expected losses due to default of the counterparty. That adjustment shall be based on an assessment of the probability of default of the counterparty and the average loss resulting therefrom (loss-given default).

Solvency-oriented financial information must be the necessary and sufficient to make the insurance and reinsurance undertakings able to demonstrate the appropriateness of the level of their technical provisions, as well as the applicability and relevance of the methods applied, and the adequacy of the underlying statistical data used.

Consequently, the solvency-oriented value is not a principle-based value, where the underlying measurement attribute, the “current exit value”, is the overriding principle, but based on technical prescriptions, significantly subject to the national (or in case of Solvency II supra-national) regulator, ultimately disregarded whether there is market evidence, even if there is market evidence to the contrary in the individual case. Further, the concept of “recognition” is unknown to that approach. The decision regarding consideration in measurement is based on arbitrary chosen examples, which do not comply with principles applicable to other industries. Solvency II is an industry-specific approach which does not care for consistency with other industries.

The solvency-oriented value, as a concept, does not principally exclude initial gains or subsequent recognition of gains based on changes in assumptions.

- Prospective measurement: measurement only for future cash flows
- Current notion: Measurement based on current information
- Transfer notion: Measurement reflecting the situation at the transferee
- Regulatory notion: Measurement reflecting the benchmarks as determined by regulators

**Comparison of Fair Value and Solvency-oriented Value**

The solvency-oriented value and the fair value have only on a surfacial level the same measurement guidance for the margin. Actually, the solvency-oriented value prescribes the use of a specific technical approach to determine the margin, the cost of capital approach, ignoring any imputed entrepreneurial profit which would be charged by a market participant, limited to a
measurement of the deviation risks inherent in the contract. Further, there are clear prescriptions regarding the parameters to be used for determining the margin, disregarded whether there is market evidence, even if there is market evidence to the contrary in the individual case. As a consequence, the solvency-oriented value might deviate from the principle-based fair value in the individual case. Regarding the current estimate, both require an unbiased estimate of the mean value of cash flows. Both require to measure contract parts, for which market prices are observable, to apply those.

Diversification benefits as available to market participants are considered in the margin for both measurement attributes equally. Solvency is keen to ensure that insurance obligations for the individual contract are measured independently from any aspect which would not be applicable in a potentially acquiring insurer. That includes both, diversification and pooling effects. Consequently, diversification effects are considered as market participants would consider those. While it is not clear, how pooling effects would be considered in a fair value, the IASB Discussion Paper proposes to consider pooling specifically in the “current exit value”, there is some tendency to consider pooling effects in solvency-oriented values not in a portfolio-specific manner. It is proposed to consider the pooling effect which is achieved in a fictive portfolio of a “reference insurer”, whose characteristics presumably are to be determined by the local regulator. Consequently, both, solvency-oriented and fair value would consider the same level of diversification, that available to a market participant, but possibly different levels of pooling effects.

Relevance

To be decision-useful, general purpose financial reports need to provide information for:

A capital provider about reasons to invest, retain an investment in the reporting entity or dispose it. However, performance obligations do not exist in isolation. The counter party agreed with the reporting entity that the reporting entity performs the obligation, all its peculiarities and abilities in mind, and the performance obligation is per se not transferable, since it is a specific obligation of the reporting entity and in so far actually entity-specific by its legal and economic nature. Consequently, the solvency-oriented value is not actually meeting the relevance criterion. To see the contract in isolation from the viewpoint of an entirely fictive acquiring (licensed) insurer as predetermined by the local regulator, does not describe properly the future effects of the contract to the investor or other creditor to the reporting entity. Further, the use of parameters subject to the decision of the national (or supra-national) regulator rather than reflecting actually the specific individual situation of the entity might not be relevant for investors. It is for investors not determinable, whether the parameters are actually adequate for the individual situation and whether they would have used a similar assessment for the same issue. It is especially not generally clear, what triggered the decisions of the regulators, which could have been subject to political influence, e.g. to reduce the capital burden from insurers.

The observed market price in an active market is relevant since it reflects the value, which a capital provider who is as well a market participant, would associate with that item both, when owning the item directly and as part of the reporting entity.
Reliability

If the item is not traded in active markets, both the fair value and the solvency-oriented value are estimated using valuation techniques. In that case, reliability of the solvency-oriented value is doubtful, since the measurement attribute is not used as an overriding principle but actually replaced by a rules-based and regulatory guided measurement technique. It is not clear whether that measurement technique actually faithfully represents what the term “current exit value” purports to be. An alternative could be to refer clearly to the regulators’ influence in describing the measurement attribute. In that case, a kind of “regulatory-oriented value”, the amount would faithfully represent the measurement attribute. However, it would be necessary to identify the relevant local regulator. The parent company of a consolidated group might be located in a jurisdiction without regulator, or were insurance regulation of that jurisdiction does not apply to that entity (if the parent is no insurer). If the subsidiaries are located in many different jurisdictions, it would not be clear, which regulations of a jurisdiction were applicable. Further, considering the requirement of uniform accounting policies in the entire consolidated group, it would be necessary to apply the regulations of one jurisdiction to business written in all other jurisdictions, although the respective regulator might not have provided guidance for products which are only sold in other jurisdictions.

CFO-Forum Approach

Introduction

The CFO-Forum approach is based on the understanding of insurance business as an ongoing service. Further, it is assumed that the margins in the premium as assessed at outset reflect the actual and relevant information about margins required for the risk profile of the contract. As a consequence, the CFO-Forum proposes an approach which is similar to the IAS 39 amortized cost approach, but by not associating the margin in the inherent interest to periods. Here, the margin for risk is distributed over the contract duration.

CFO-Forum Approach

The CFO-Forum proposes: “The insurer should assess the anticipated pattern of risk and uncertainty inherent in the insurance contracts (the risk profile). This risk profile determines the pattern of profit recognition.”

Except that, the estimate of cash flows, as in the IAS 39 amortized cost approach is based on current information, including the discount rate. Just the margin, the difference between premium and initial current estimate of cash flows, is allocated in a locked-in pattern over time, although a proof of changes in risk profile would result in a prospective unlocking.

As a consequence, the approach is to some extent a deferral-and-matching approach, while just the cash flows and the discounting are based on current information. The volatility of cash flows affects the performance of the entity.
• Partly prospective measurement: measurement only for future cash flows, but margins based on historic margin
• Partly current notion: Measurement based on current information, but margin locked until proof to the contrary
• Entity-specific notion: Measurement reflecting the situation at the insurer
• Historic notion: Measurement reflecting the benchmarks as used at pricing

**Comparison of Fair Value and CFO-Forum approach**

Ignoring the differences arising from a deviating recognition approach, the main measurement difference is here that the margin is not determined on a fresh start approach but on a historic, cost-based deferral-and-matching approach. The cash flow estimation approach is the same, except that entity-specific information is used.

**Relevance**

The CFO-Forum approach appears to provide information which is not less relevant than that of the fair value, assuming that margins cannot be determined in a reasonable manner in any case.

**Reliability**

Regarding the current estimate of cash flows, the concerns apply as in case of the fair value, although here entity-specific assumptions are used.