THE MEASUREMENT APPROACHES OF IFRS 4 PHASE II AND SOLVENCY II FOR THE VALUATION OF INSURANCE CONTRACTS

According to the 2013 ED, the key features of IFRS 4 Phase II are to:

- measure an insurance contract using a current value approach that incorporates all of the available information in a way that is consistent with observable market information;
- present insurance contract revenue to depict the transfer of promised services arising from an insurance contract in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those services, and to present expenses as the entity incurs them; and
- require the application of the IFRS 4 Phase II measurement model to an insurance contract, reinsurance contract and investment contract, with a discretionary participation feature as defined under the current text of IFRS 4 with very limited amendments to the current scope of IFRS 4.

These features produce an accounting model that has been described as a current fulfilment value model, to contrast it with the current exit value model the IASB considered in 2007, and that has remained the basis for Solvency II. The features of the current fulfilment value model noted above will require the accounting for insurance contracts to be based on the specific insurer’s estimate of the current value of fulfilling the residual rights and obligations towards the policyholder at the reporting date. The insurer-specific approach is mitigated by the requirement to maintain consistency with observable market information.

Extracts from "The Solvency II Handbook; Practical Approaches to Implementation", chapter 4, page 98. Written by Francesco Nagari and Derek Haynes and published by Risk Books