Chairman,
Ladies and gentlemen,

I will develop the point of view of insurance business in five steps. Firstly, I will remind you what insurers want or more exactly what they say they want. Then, I will detail where we are coming from. Afterwards, I will examine where we are standing. Further, I will consider where we are going on, before considering what may be the reactions of the industry and of the markets to the new environment.

1. What do insurers want?

Because of the variety of concerns expressed by European insurers about the new international accounting standards, it has sometimes been argued that they were not understandable. This was a misperception, probably biaised by ignorance of
insurance basic. What do insurers want is relatively clear and well shared around Europe.

As main investors of European markets, insurers have been fully supportive of the move toward international accounting standards. They expected from new standards five qualities that were satisfied by current national GAAPs:

- faithfulness, but avoiding dependance on one point of view on financial reality
- neutrality, but not totally ignoring management intentions
- prudence, but taking into account different views and degrees of prudence
- intelligibility, but avoiding too detailed and preserving principle based standards
- acceptability, taking into account implementability and need of minimum consensus.

This move is important for them because it will promote transparency and comparability they need all the more when competing for attracting capital. At the same time, insurers, as investors, are a bit concerned by the way the process is managed within Europe. Due to late and disputed preparation, they fear risks of significant disturbances for investors before any noticeable improvements.

When turning to their own insurance business, insurers are even more supportive, being aware of the diversity
of solutions provided by current national GAAPs. They feel an urgent need for international standardisation at first inside Europe, but also between Europe, United States and the rest of the world. More critically, insurers cannot disregard the fact that markets and investors are more and more suspicious concerning insurance stocks. Already before the 11\textsuperscript{th} september 2001 their confidence in insurance business has been falling. Difficult intelligibility and predictability of insurance balance sheets when compared to other industries induced a continuous rise of insurance risk premium versus the market and the World trade center has just added more fears concerning an increased volatility and un predictability of insurance business, as can be seen from the following graph:

\begin{center}
Risk premium gap between insurance and the market
\end{center}
At the same time, insurers are anxious to make sure that the basic of their business is sufficiently considered and assimilated by standard setters so as to enable them to provide adequate solutions referring properly their services and performances. As regard this basic, five specificities of insurance business have been underlined:

- Inverted production cycle, as a consequence of which there is no short terme liquidity constraint in insurance such as in banking
- Length of production cycle, which opens large opportunities for intertemporal mutualisation between different generation of insurance contracts
- Mutualisation of liabilities, which forbid to consider isolated liabilities but portfolio of liabilities, no one insurer accepting to underwrite one unique risk
- Asset / liability management, which is at the core of the insurance business and which should be reflected in the balance sheet
- Strong legal obligations, due to unavoidable regulatory constraints that are also at the core of the insurance business.

Insurers are rather disappointed by the painful experience of the Board’s process and more specifically by last year’s process when IAS’s board made clear it was not interested in understanding insurance business and prefered to give priority to formal satisfaction of imposing new standards, whatever they are, to everyone
rather than to give priority to quality and financial stability.

2. Where are we coming from?

The current accounting landscape is particularly diverse for insurance industry. The set of standards applied in United States is largely specific to insurance. Because of substantial differences in business, it is not immediately usable in Europe as experienced by European listed companies in United States. Current European standards are probably better adapted to European insurance practices, but at the price of a large range of diverging technical solutions, especially in life insurance, spreading from fair value accounting to historical cost or amortised cost accounting.

One may thought, it would have been easy to design more functional standards when at the same time unifying the European babel of accounting rules. Unfortunately, but not unpredictably, the board emerged as totally unable to bring about such standards. More surprisingly, it spent many years going forward and backward, without any visible rationality. The first ambitious attempt to design a brand new standard based on a full fair value approach has been a total failure of the former IAS’s Committee : the draft standard of principle, known as DSOP, proposed by the steering group chaired by Warren Mc Gregor, has
been thrown to the garbage after having been heavily criticised for its ignorance of insurance basics.

Despite such difficulties and against the unanimous request of the profession, expressed by the CEA, the European insurance companies’ association, the European Union took the hasty decision to go forward quickly and to make IFRS compulsory starting 2005. Moreover, it took this decision without having checked what was ready to be implemented and what would be available in due time. Considering the deadline of 2005, the industry urged the board to provide a standard for July 2003 at latest. This happened to be impossible. The only way out was therefore to introduce an interim period for insurance. But, the board wasted another period of 2 years by refusing to simply leave things as they stood and by trying to design an interim standard that would anticipate some changes (credit insurance, reinsurance, life insurance considered as investment).

As a consequence, the insurance standard IFRS 4 has been issued only at end of March 2004 and the financial standard IFRS 39 that was supposed to be amended and completed is still under discussion. Unanimous proposals of insurance industry, such as the special category of assets covering insurance liabilities, have been rejected without real discussion on them.

3. Where do we stand?
What is the content of IFRS 4 and IFRS 39, having in view insurance industry concerns?

**IFRS 4 handles the interim period for insurance, that is phase I.** It imposes accounting for insurance liabilities at current GAAPs and insurance assets at fair value, with due application of IAS 39. In order to smooth the transition, IFRS 4 has taken over a number of amendments provided by insurance industry. Therefore, the glass is half empty half filled:

- no “sunset” clause nor fair value disclosure is imposed;
- participating investment contracts are excluded from the application of IAS 39;
- reinsurance is kept as usually;
- large windows, i.e. options, are open in order to mitigate the mismatch introduced by the differing philosophies applied to assets versus liabilities accounting during the interim period.

This last question, which refers to the combined application of IFRS 4 and IFRS 39, raises two big issues that have been emphasized by EFRAG in the comments annexed to its position paper on the endorsement of IFRS 4 and IFRS 39:

- the equity mismatch: because of differing accounting standards for assets and liabilities, the net equity value will give no coherent financial information as illustrated by the following graph that illustrates the effect of higher interest rates on
the french life insurance companies under different accounting hypothesis; as can be seen from this graph, phase I far from being a transition, will move insurance balance sheets dramatically away from phase II:

- the deposit floor: it violates the principle of mutualisation on which insurance business is based; it removes any significance to the fair value option of life insurance liabilities; more generally, it will impair the content of phase II; we can only hope that the current discussion we, insurers and banks, we have with the commission in order to know if the deposit floor is limited to strictly speaking isolated liabilities, will end positively and constructively for us; this would help recognize one
of the major five specificities of insurance business we have detailed before.

One has to add to these questions that the large options opened by the board introduce a lot of flexibility but at the expense of comparability not only between countries or industries but also, what is new for us, inside national insurance industry.

It is therefore not difficult to understand why the European insurance industry, which is sole concerned by an interim period, is clearly and unanimously not satisfied with its content. The critics of the industry so as its counter-proposals for temporary exemption or special insurance category have been set aside by the board without discussion. But, because it needs a standard for 2005, the majority favours a quick endorsement of IFRS 4, even if identified issues are not yet resolved. The point is that the industry wants the board to solve these controversial issues as soon as possible, as a matter of priority.

Concerning financial instruments, the standard does exist. It is IFRS 39. One has to underline that this standard, which has been described as the flag of IAS revolution, contains everything excluding a conceptual revolution. It is more modestly an innovativeless translation from US GAAPs. Not exactly in line with the framework, rule based rather than principle based, it has been a real deception for those who, from the
beginning on, have supported the new approach initially sold by the board.

Endorsement of IFRS 39 by European Union has been delayed for two main reasons:
- the request of the European Central Bank to delete or limit the fair value option for financial liabilities,
- critics of banking industry concerning the right hedge accounting.

Curiously, the European Commission seems to have deliberately decided to ignore insurance industry’s concerns and to concentrate at short term on banking critics. The insurance industry has not been associated to the last discussions on IFRS 39 despite the fact that insurance industry concerns are not substantially different from banking industry concerns. Concerns of the two industries point to the recognition of portfolios and hedging when accounting for assets and liabilities at fair value. In fact, IFRS 39 seems to be very controversial as confirmed by the positions of EFRAG and of the European Banking Federation and by the proposition of the European Commission to carve out the provisions of IFRS 39 on the provisions relating to hedge accounting.

The request made by the European Central Bank to delete the fair value option is more controversial from the point of view of the insurance business because this option is the only one mean that helps mitigate the asset
liability mismatch introduced by IFRS 4. The point does not concern “unit linked” life products that can be accounted for at fair value following the current European insurance directives. It concerns mainly life products in Euro. It is absolutely necessary that the carve out does not end in deleting this option or limiting it in such a way that it is no more usable by insurers. For this, it is all the more important that the industry should be associated to the current discussions concerning this point that cannot be finalised with the sole European Central Bank.

In this context, European insurance industry will have to preserve a position that has to be balanced between the urgent need for a standard and the need to improve the adequacy of the current IFRS 4 and 39. Surely, partial endorsement, as it is, cannot be a satisfactory solution for the insurance industry.

4. Where do we go?

Short term perspectives bound to phase I are not rosy. The 1st January 2005 is tomorrow and the final drafts are not yet available. We are very late in the time frame. One has to add that, if the above mentioned provisions are effectively carved out from the endorsement, they will probably not be amended before mid-2005. How to manage correctly so many significant changes in a so constrained time frame?
Moreover, number of issues contained in IFRS 4 and 39 are not well prepared and we are progressively discovering the magnitude of latent unsolved problems. How many are concerned? We don’t even know. Moreover, the implementation of IFRS has been made a lot more complex by European securities regulators. Those have adopted a lot of recommendations that are largely impossible to respect correctly. At the same time, many European insurance supervisory bodies have made clear that they will not accept consolidated balance sheets accounted for at fair value that makes use of some or all the options allowed by the IFRS 4. As a consequence the adjusted solvency margin of groups and conglomerates will be made on the basis of fragmented accounting standards: consolidated balance sheets for supervisory bodies will differ greatly from those for the market and will differ depending on the headquarter country of the group, further fragmenting the European insurance market and limiting the level playing field on which insurance companies are competing.

The consequence is that we are far from an orderly implementation process and that we are at risk to be confronted with huge market frustrations, if not with short term financial instability. This will made things even more complex to manage for insurance companies.

But, as mentioned above, we are not at the end of the game. For the insurance industry, the 1\textsuperscript{st} of January
2005 is only a first step corresponding to phase I. A second revolution is already foreseen with phase II that will define the standard for insurance liabilities and for investment liabilities with participating features. The board of IAS has set up a working party that includes industry participants, mainly CFO profiles proposed by the industry, and supervisors, a strategic “input” in view of the insurance solvency reform considered by the European Commission.

Considering the current difficulty to open a constructive dialogue with the board of IAS and the complexity of the problems to be solved for phase II, one has to fear the consequence of the decision of the board that plans to have a common work at the same time with the American FASB. Probably things will be made more difficult and it will take a long time to deliver the future insurance standard for phase II. We are therefore facing a risk of recurrent confrontation with the board and of an endless interim period.

On the other hand, it will be very difficult to get a constructive and objective technical contribution of EFRAG because of the strong resistance from auditors and accountants. At the same time, ARC, the European accounting regulatory body, even if improving the quality of its work, spends a lot of time to political negotiations between national regulators. Finally, it is the Commission that seems to have understood what is
really at stakes. But its growing unsatisfaction has been caught by the deadline it has set itself.

On the side of the insurance industry, the main requests for a satisfactory phase II standard are largely consensual:
- the standard should allow to take into account the strong asset-liability linkage that characterizes insurance balance sheet;
- it should also take into account portfolios of assets or liabilities and allow for assets to hedge insurance liabilities, depending on their respective durations;
- it should not neglect prudential concerns whose solvency rules play a huge role in the financial strategy of insurance companies;
- required information should be in line with management information system and easily readable to users.

*The core of the debate will center on the model that will be selected.* We have the choice between two models. The first one is an asset based model. The second one is a liability based model. Each one requires some compromise in order to correctly account for insurance liabilities at fair value. At first glance, this second model seems more IAS compatible in the sense that it is more coherent with IAS framework. But, at the same time, the board feels no more constrained by the framework that it does not hesitates to leave aside when needed. From this point of view, perspectives are more
open than some experts are thinking. Five main points in balance when considering the advantages of the two models:

- portfolio or standalone principle for valuation of insurance liabilities
- recognition of future margin and articulation with embedded value
- adaptation of deposit floor principle to insurance liabilities
- room left to entity or industry specific value and company’s proprietary data on policyholder behavior when no market exists for the concerned liability
- on going concern or run off concern
- calibration of risk market margin.

Other standards will be simultaneously developed concerning revenue recognition, performance reporting, if not the framework itself. More critically, one has to bear in mind that IAS 39 and IFRS 4 cannot be modified independently from each other in order to achieve consistency and continuity and avoid pure accounting arbitrages between the two standards for pure convenience reasons.

For designing properly phase II standards, it is probably necessary to take some distance with existing financial and insurance standards to be sure that assets, which will be accounted for at IAS 39, and liabilities, which will remain accounted for at national GAAPs during
5. How will insurers and markets adapt?

Far from reducing financial risks, *IFRS 4 and IFRS 39 will constitute for the next years, as long as phase I standard will last, a source of major risks as underlined by Commissioner in charge of internal market, Fritz Bolkestein:*

- the combination of phase I and phase II will impose two successive costly big bangs that will disturb the market and that will have a counterproductive impact on the image of IFRS and on its track record;

- the asset / liability mismatch will induce a pure accounting volatility without any links with the financial and economical situation of the companies and will make more difficult the financing of insurance companies by the market;
- the overall effect on the financial markets stability will be counterproductive, probably raising the risk premium and the cost of capital for the industry;
- uncertainty about final time frame raises the overall level of risk of the transition period.

Knowing these incertitudes and financial risks induced by phase I but not knowing how long phase I will last, insurers will probably adapt their business model. Higher balance sheet’s volatility due to the pure accounting mismatch between assets and liabilities will have to be partially compensated by more stringent underwriting strategies, because of perhaps not full but partial accounting illusion. Insurers will lower the level of risk of the overall portfolio of insurance liabilities. The service supplied to clients will be reduced and risk will be transferred to households that do not have to comply with phase I. For example, pluriannual more constraining contracts combined with reduced insurance components will be encouraged in life sector. At the same time and for the same reason, insurers will adapt their asset management strategy for phase I. They will probably be encouraged to exit from stocks, as observed in United States. Strategies should either keep existing asset / liability with no translation in accounting figures or deteriorate the cover of liabilities for regaining accountant balance.

But, we are clearly disappointed by the current outputs and we have the duty to wave the flag of warning. Not
only are IFRS 4 and 39, as they stand, a likely source of noise for the market, but moreover they might well change the current insurance business model from customer driven products and services to accounting compatible ones. Such an evolution could have huge potential consequences on the overall financial and macroeconomic system. Insurers and bankers might be transformed from shocks and volatility absorber to shocks and volatility transmitters, if not amplifier. We have to correct as quickly as possible this aspect of IFRS that is able to derail IAS project for insurance during phase I.

What is striking is that, when asked by the academic Geneva Association, no insurance manager around the world answers that he considers to use phase I standards for its own management needs. One should take this answer very seriously not only when considering phase I implementation but also when facing the agenda of phase II.

When considering the whole project, as well as its by-products such as the European reform of insurance solvency, one has also to ask what kind of financial information we do want. And behind this question you have the three following questions that remain open:

- what kind of relationships with auditors do we want?
- how to agree quantitatively and qualitatively on the informations required for auditors’ work within the framework principle based standards with
portfolio of options and without detailed implementation guidance?
- what kind of relationship with investors do we want?
  how to make sure that investors will extract intelligible information during phase I and will be able to assimilate all informations from new disclosures?
- how far to give public information?
  how to improve transparency and at the same time protect strategic information in an industry where there is no intellectual rights protection and what to do with subjectivity when giving to the market extensive informations well beyond available objective informations and data?

Thank for your attention.