

# Valuation in insurance and financial crisis

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*In the course of the recent financial crisis, the issue of asset valuation has regularly moved to center stage, due both to the sharp fluctuations observed in numerous assets, making economic measurement difficult, but also to the impact that fluctuations can have on the behavior of economic agents that are required to submit annual financial statements –or even interim or quarterly ones. While this issue has not been seen as the cause of the latest crisis, it has nonetheless been considered as a potential source of its increasing magnitude, even though –at the time of this writing (early July)– we have not yet seen any massive sell-offs of major asset classes (equities or bonds, corporate issues in particular).*

*The question of asset and liability valuation is of particular concern for the insurance industry. Because of the specific characteristics of this industry, valuation poses specific problems which, far from being fully different compared to the other sectors –the banking industry in particular– in fact tend to be magnified. In fact, it is no accident that the only sector to be granted a transition regime in the application of new international accounting standards is the insurance industry, due to difficulties encountered by the International Accounting Standards Board (IASB) in finding a workable solution for the valuation of insurance liabilities. Similarly, it is no accident that the Internet meltdown was suddenly aggravated in 2002-2003 by the massive move on the part of insurance and reinsurance companies to liquidate their equity portfolios when, once a certain downward price threshold had been surpassed, they decided it was time to sell rather than face the consequences of further depreciation in equity prices on their balance sheets and their solvency margins. The memory of this last event, which without any warning whatsoever took on the proportions of a systemic risk for the global financial sector, recently came to mind when the fall in equity prices picked up speed globally in light of soaring oil prices and an uptick in inflation. Accordingly, the issue of insurance asset and liability valuation does not just pose a microeconomic problem in terms of assessing the financial strength of insurance and reinsurance companies. It also poses a macroeconomic problem in terms of financing the economy and ensuring financial stability.*

*In the rest of this article, we will examine the economic problems posed by the valuation of insurance and reinsurance assets and liabilities. Then, we will analyse the relevance of today's competing accounting standards, concluding that they offer a very imperfect resolution to the challenges of insurance valuation. Finally, we will analyse the consequences of these problems for financial stability –in terms of the solvency of companies, the financing of the economy, and the ability to absorb shocks to the system. We will conclude that they are significantly greater than is often imagined.*

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