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Comments on Non-life Insurance

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1. The AEG's decisions on non-life insurance were mostly based on the issues paper, "Recommendations on the measurement of production of non-life insurance," which was presented at the first AEG meeting (Washington, February 2004). Recently the Editor and the ISWGNA have criticized one of these decisions—to treat the claims associated with major disasters as capital transfers. Anne Harrison's paper for this meeting, "Insurance," presents this criticism along with discussion of some other issues related to life insurance. Although I was not part of the OECD non-life insurance task force that prepared the first issues paper, I'm familiar with their work and unfortunately have had considerable experience dealing with the recording of major disasters such as the September 11th terrorist attacks in 2001 and Hurricane Katrina in 2005. With this background, I would like to respond to some of the points made in Anne Harrison's paper.

2. The focus of the non-life insurance task force's work was on developing practical methodologies for estimating insurance output and the transactions related to it. Because the task force did not fully explain the rationale for the capital transfers treatment, there may have been a misperception that the recommendation was ad hoc or not fully consistent with the SNA. To correct this misperception, I would like to present an explanation for the capital transfer treatment.

3. Not all non-life claims are associated with the acquisition or disposal of asset—for example, claims for car repairs after an accident, repairable damage to a dwelling following a storm, interruption of business, or "term" life insurance are examples of non-life insurance claims that are not candidates to be treated as capital transfers.

4. On the other hand, claims for the total destruction of a dwelling or non-residential structure due to a hurricane or other major disaster are examples of transfers that are "linked to the acquisition or disposal of an asset, either financial or non-financial" (SNA08, 8.38). The more precise definition says, "Capital transfers are unrequited transfers where either the part making the transfer realizes the funds involved by disposing of an asset (other than cash or inventories), relinquishing a financial claim (other than accounts receivable) or the party receiving the transfer is obliged to acquire an asset (other than cash) or both conditions are met." (8.10), With this definition, one can quibble that although most recipients of claims for the loss of a dwelling or other structure re-build the asset, the recipient is not actually required to do so. However, similar quibbles about this definition also apply to other examples of capital transfers that are specifically identified by the SNA (for example, inheritance taxes are classified as capital transfers even though the payer may not have disposed of the inherited assets; compensation for extensive damages or serious injuries not covered by insurance is classified as a capital transfer, though it may not require acquisition or disposal of an asset, etc.) We also note that disaster relief in the form of government grants for rebuilding lost property is classified as capital transfers. I conclude that the SNA's

criteria for differentiating current transfers from capital transfers suggest that claims related to major disasters are more naturally classified as capital transfers.

5. If the insurance claims related to destruction of property due to a major disaster meets the definition of a capital transfer, shouldn't claims related any destruction of a dwelling or non-residential structure also qualify as capital transfer? The household experiences the same loss, whether it results from a "minor" disaster such as a fire, or a major disaster such as a hurricane. My opinion is that the reason we should limit the capital transfer treatment to major disasters is based on the SNA's definition of consumption of fixed capital. Consumption of fixed capital includes the decline in value of an asset "as a result of…normal accidental damage." (6.240) This means that normal accidental damages are already charged as a current cost of production, so it makes sense that the insurance claims for repairing or replacing assets lost from normal accidental damage should be treated as a current resource. On the other hand, catastrophic losses—"large scale, discrete and recognizable events that may destroy a significantly large number of assets…[including] major earthquakes, volcanic eruptions, tidal wages, exceptionally severe hurricanes, drought and other natural disasters; acts of war, riots and other political events; and technological accidents such as major toxic spills or release of radioactive particles into the air" are treated as other changes in volume of assets. These losses are not recorded in the current accounts, so it seems sensible and symmetric that insurance claims related to these events should be recorded in the capital account. Thus, I see the distinction in recommended treatment for insurance claims from minor disasters versus major disasters as a natural implication arising from the SNA93 distinction between normal accidental damages and catastrophic losses.

6. Anne Harrison's paper notes that the task force did not provide guidance on "what constitutes a disaster." I think the lack of such guidance may have been related to the fact that SNA93 already included discussion of catastrophic losses; thus, countries already have had experience in identifying such events. I am not aware that the identification of any of these events as catastrophes has been controversial. Some comments have suggested that there ought to be an internationally agreed upon threshold for defining a disaster. I don't know whether a single threshold could be developed that would be applicable to all countries; I certainly wouldn't object to engaging in a discussion to see if a threshold could be developed. It is probably more important, however, that the statistical office in each country set a threshold to use to identify major disasters, so that the identification of major disasters will be based on an objective criterion. The Bureau of Economic Analysis has used such a threshold for many years.

7. Anne Harrison's comment that the task force gave no guidance about "what proportion of the large claims should be treated as capital transfers" is incorrect. Recommendation 11 of the issues paper recommended that in the case of a major disaster, the full difference between net non-life insurance premiums and net claims should be treated as a capital transfer. This approach provides an estimate of the above-normal claims related to the disaster and is closely related to the task force's recommendations for measuring output. On the other hand, in the United States we have observed that the insurance industry has been willing to provide detailed information on claims related to major disasters. BEA has had to adjust these data to remove claims for repairable damages and to add claims from government insurance enterprises, but these estimates are reliable and are available

on a timely basis. Therefore, my recommendation is to use data from insurance companies on disaster-related claims when possible, and a statistical approach when such data are not available.

8. The next major point is whether the "net saving" figures for insurance companies are reasonable. The SNA notes that "some cash transfers may be regarded as capital by one party to the transaction and as current by the other…In an integrated system of accounts such as the SNA, however, it is not feasible to have the same transaction classified differently in different parts of the SNA. Accordingly, a transfer should be classified as capital for both parties if it clearly involves a transfer of an asset for one of the parties." (8.40) Consequently, even if the payment of disaster-related claims seem like current transfers from the point of view of the insurance company, the fact that it is a capital transaction from the point of view of the policyholder implies that the claims must be classified as capital transfers for the System as a whole.

9. The SNA's definitions of saving and disposable income differ from the concepts used by most users of the accounts. Economists generally use the "Haig-Simons" concept, which defines saving as the change in real net worth and disposable income as consumption plus the change in real net worth. (Many non-economists might use a similar definition, except counting the nominal change in net worth.) Thus, compared to the SNA, the Haig-Simons definition includes receipts less payments of capital transfers, real holding gains or losses, and other changes in volume of assets. For financial corporations, these components may all be important—loan losses of banks and other financial institutions are included in SNA income and saving, while holding gains are excluded. Also, reserve accounting causes additional differences between the SNA and figures from business accounting. As national accountants we regularly have to explain that the income and saving figures for financial corporations are not intuitive, but are defined as necessary for the consistency of the system.

10. Anne's paper next suggests that capital transfers need to be balanced in the long run; therefore, she suggests classifying a portion of premiums as capital to balance the expected capital claims. This is certainly a novel interpretation; I am not aware that anyone has previously suggested a requirement that capital transfer receipts ought to be balanced against payments in the long run. For example, governments may receive capital taxes (such as inheritance taxes) and pay capital transfers (such as investment grants), but I'm not aware of any suggestion that these flow need to be balanced against one another. I don't see any reason that we can't simply acknowledge that some saving from current income must be allocated for future payment of capital transfers for claims related to disasters.

11. The discussion of "long-tail" business raises some difficult measurement issues. In order for a claim to be recorded, an event must occur and there must be a recognition that a claim is payable. For some events, such as asbestos exposure, the recognition may occur years after the event (exposure) took place. To avoid implausible revisions many years later, such cases clearly need to be exceptions to the general rule of recording the claim at the time of the event and should be recorded at the time of the recognition of the claim. While these cases are difficult in practice, they require only a minor amendment to the general principles regarding recording.

12. Regarding reinsurance, in accord with the recommendations of the task force, we should follow the same principles as for direct insurance, including the classification of capital transfers. That is, reinsurance associated with major disasters should be recorded as a capital transfer, regardless of whether the reinsurance company views the transaction as capital. This consistency in classification is obviously necessary for the consistency of the overall system.

13. Finally, as was noted after the first AEG meeting, there is a possible inconsistency between countries in balance of payments, in which one country records a flow as capital and another records the same flow as current. In practice, information about the largest disasters is likely to be known internationally. Also, as Pete Harper noted, it may be useful to look at reconciling the combined current + capital flows of insurance claims, rather than each flow separately. While these flows are occasionally quite large, in general they are small enough that they are not likely to be one of the more important causes of international discrepancies in balance of payments statistics.