Summary Conclusions of the First Meeting of the Advisory Expert Group on National Accounts—ISWGNA

16-20 February 2004

Washington, D.C.

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Acronyms

AEG:	Advisory Expert Group on National Accounts
EDG:	Electronic Discussion Group
UNSD:	United Nations Statistics Division
TFHPSA:	Task Force on Harmonization of Public Sector Accounting
ISWGNA:	Intersecretariat Working Group on National Accounts
BOP:	Balance of payments

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Work program for updating the *1993 SNA*

The following points were made:

- The title of the updated version of *1993 SNA* is *1993 SNA* Rev. 1. This may change later, but the title is meant to send a signal that a fundamental change is not envisaged.
- Regional consultations between meetings and exchange of e-mails are encouraged.
- The recommendations made by the AEG will be circulated to the members of the Statistical Commission for comments; comments consolidated by the ISWGNA and submitted to the AEG for further deliberations.
- It is not expected that new issues for review appear on a large scale since the whole process is based on contributions by EDGs, City Groups and other expert meetings.
- The AEG decides which issues are acceptable or not for review.
- Important to ensure widespread discussion; regional debates with users are also important.
- Work between the meetings of the AEG is organized by the ISWGNA; the ISWGNA ensures the process moves on.
- Consultations by regional commissions should be organized.

Review of the list of candidate issues for updating of the *1993 SNA*

The purpose of this session was to determine the scope of the review process in terms of the list of issues that had been identified for the SNA, for the balance of payment (BOP), and for government finance statistics (GFS).
The AEG reviewed the proposed list of issues. The issues fall in three categories:
Issues that are well defined by the various expert groups—to be discussed in the course of the first AEG meetings.

Second group of issues to be discussed by Canberra II in March 2004.

Third group of issues—not analyzed yet.

The following issues were accepted for review by the AEG:

1. Repurchase agreement:
   - **Accepted;** also discussed by the BOP Committee

2. Pension schemes:
   - **Accepted**; possible link to life insurance

3. Employee stock options; **accepted.**

4. Non-performing loans:
   - **Accepted**; to be also treated by the BOP Committee
   - An issue to be discussed in November 2004; OECD volunteered to prepare a paper on the the possible systematic inclusion of provisions in SNA
   - The TFHPSA will look at "guarantees"; provisions are not on the agenda of the TFHPSA.

5. Insurance and reinsurance: **accepted.**

6. Measurement of financial intermediation services and portfolio management: **accepted.**

7. Capital gains taxes: **accepted.**

8. Treatment of nominal holding gains (HG) and interest on financial assets under high inflation: **accepted.**
   - The ISWGNA to consider the possibility of commissioning a paper on the Relation of interest, HG and inflation.

9. Research and development: **accepted**.

10. Patented entities:
    - **Accepted**; linked to Research and Development.

11. Treatment of originals and copies: **accepted**.

12. Databases:
    - Accepted; a paper to be presented in November 2004

13. Other intangible fixed assets: **accepted**.

14. Capital services:
    - **Accepted**; recommendations expected from Canberra II.

15. Cost of ownership transfers: **accepted**.

16. Government owned assets.
    - **Accepted**; related to capital services.

17. Mineral exploration:
    - **Accepted**; some deliberations are needed even though the Canberra II Group is not expected to recommend any fundamental changes.
    - An issue that arose from the work on the Integrated Environmental and Economic Accounting (SEEA).

18. Transactions of the right to use/exploit non-produced resources between residents and non-residents and between residents:

- An issue that needs further clarification; to be developed by the Canberra II and the BOP Committee and reviewed at a later stage.

19. Consumer durables:
    - **Rejected** because the issue entails a fundamental change of the production boundary or the asset boundary.

20. Military weapons: **accepted.**

21. Treatment of land: **accepted.**

22. Contracts and leases of assets: **accepted**.

23. Goodwill and other non-produced assets:
    - **Accepted**; recognized as a complex issue.

24. Obsolescence and depreciation: **accepted.**

25. Build-Own-Operate-Transfer (BOOT) schemes:
    - **Accepted**; to be developed further by the TFHPSA and the Canberra II; need for coordination.

26. Ancillary units:
    - **Accepted**; AEG recommended to broaden the treatment of complex business structures in regional accounts, national accounts and in connection with globalization. UNSD agreed to set up an EDG on this subject.

27. Cultivated assets: rewording
    - The AEG **accepted** the proposed rewording.

28. Classification and terminology on assets: **accepted**.

29. Macro-economic aggregates:
    - The AEG agreed that the issue is not for discussion; the editor will be asked to emphasize the net measures in the SNA Rev. 1.

30. Consumer subsidies:
    - **Rejected**; an old issue rejected before in the 1993 revision process; should not be considered a candidate for updating since no change in the economic environment has emerged.

31. Amortification of tangible and intangible non-produced assets: **accepted.**

32. Assets boundary for non-produced intangible assets:
    - **Accepted**; the AEG recommended a broader review of the issue of securitization by all sectors.

- An issue to be reviewed by the TFHPSA.

33. Definition of economic assets:
    - The reliability of measurement should not be part of the general definition of an asset. However, the problem cannot be avoided in defining certain kinds of assets; clearer exposition in the SNA text is needed.

34. Valuation of water: **accepted.**

35. Other issues on the *1993 SNA* research agenda:
    a) Allocation of financial intermediation services indirectly measured (FISIM)—to be discussed in connection with financial intermediaries.
    b) Distinction between formal and informal sectors:
       - o Review the text in the *1993 SNA* since it is an important analytical issue for many developing countries.
       - o UNSD and Delhi Group to prepare a paper/recommendations on the formal versus informal sector.
    c) Illegal activities:
       - o The AEG agreed that clearer exposition is needed.

Some additional proposals of issues to be reviewed for updating were made:

Wages and salaries in cash and in kind – some clarification is needed

Review the purposes and uses of SNA.

Multi-country accounts—monitoring economic and monetary unions.

Financial accounts—describe analytical uses of financial accounts.

Financial innovation—better clarification of financial derivatives.

Improve the SNA as a basis for comprehensive productivity analyses.

Integrate policy oriented variables.

Review SNA terminology for user-friendliness.

Special issues of quarterly national accounts (QNA).

Treatment of transport costs in basic prices.

Regional accounts.

The AEG agreed that AEG members should specify the issues proposed for review in a short paper to be sent to the ISWGNA by March 10, 2004. The AEG considered that some of the proposed issues could be better dealt with in implementation manuals.

General issues concerning the process of updating the *1993 SNA*

The debate on the updating process should be publicized through the SNA News and Notes in order to involve more people in the discussion.

Distribution and submission of papers: In principle individuals should contribute papers at earlier stages through the mechanisms already established such as EDG and city groups.

Transparency on submitted papers should be maintained—to be posted on the ISWGNA website with a close explanation that this does not mean an endorsement of the issues raised.

In cases when members of the AEG have strong views concerning the debated issues, it is advisable that these views are distributed in advance.

The AEG considered the development of list of issues that could be further clarified and elaborated. The ISWGNA was asked to develop a mechanism for dealing with this list.

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REVIEW OF THE LIST OF CANDIDATE ISSUES FOR UPDATING OF THE *1993 SNA* —SUBMISSIONS BY THE IMF COMMITTEE ON BALANCE OF PAYMENTS STATISTICS

The IMF Committee on Balance of Payments Statistics submitted to the AEG a list of candidate issues for updating of the *1993 SNA*, together with explanatory documents (SNA/M1.04/18).

AEG members emphasized the importance of maintaining the consistency of the balance of payments and national accounts statistics. The international organizations confirmed that communication would take place at all levels.

AEG members called for the preparation of a single, integrated list of issues, combining the list of candidate issues prepared by the ISWGNA (discussed by the AEG on February 16, 2004) with those on balance of payments and government finance statistics. Such an integrated list would identify particular groups that were or are working on each of the issues.

The following issues were accepted for review by the AEG. In each case, work will be done on these issues by the IMF Committee on Balance of Payments Statistics and its technical expert groups. In addition, some issues have wider implications that will be discussed by other groups.

Meaning of the national economy:

- **Accepted**; but use of "national" and "domestic" to be clarified. This is an important issue related to the concepts of residence and "domestic territory", and should be considered in those contexts.

"Change of economic ownership" as term:

- **Accepted**; but noted that this concept has implications for all macro economic statistics and it is important to use same concept across all statistics.

Assets of persons changing residence:

- **Accepted**; but noted that implications for goods brought by immigrants need to be considered as the proposed change will not provide data on movement of goods due to change in residence of individual.

Application of accrual principles to the debt in arrears: **accepted.**

"Predominant center of economic interest" as term: **accepted.**

Clarification of mobile individuals and entities with little or no physical presence:

- **Accepted**; It was noted that harmonization of the residence concept with demographic, tourism, and migration statistics should be sought and any remaining differences spelt out. This issue is also of interest to the United Nations Technical Sub-Group on the Movement of Natural Persons - Mode 4.

Treatment of multi-territory enterprises: **accepted.**

Holding companies, special purpose entities, trusts—clarification of their status as institutional units, institutional sector classification, and residence:

- **Accepted**; Overlaps with ancillary enterprises, as covered in the national accounts issues list.

Recognition of unincorporated branches: **accepted.**

Goods sent abroad for processing:

- **Accepted**; but noted that description of processing and toll processing also to be covered. It was mentioned that the current treatment of goods for processing was to facilitate input-output analysis. Therefore, any change should take into account this issue.

Merchanting: **accepted.**

Retained earnings of mutual funds, insurance companies, and pension funds: **accepted.**

Treatment of indexation adjustments on indexed debt:

- **Accepted**; It should be clarified that the issue is not limited to foreign currency but also covers indexing to price indexes, commodity prices, etc.

Interest at concessional rates: **accepted**.

- Also raised by TFHPSA.

Payments for securities lending and gold loans: **accepted.**

Treatment of activation of guarantees: **accepted**.

- Also raised by TFHPSA.

Loan valuation issues on positions and transactions: **accepted**.

- Also raised in the national accounts issues list.

Write-offs and interest accrual on impaired loans: **accepted.**

Groupings of financial instrument into "equity", "debt", and "other", adoption of the terms "equity securities" and "debt securities", mutual funds to be shown as component(s), financial derivatives splits: **accepted.**

Use of residual maturity in classification of loans: **accepted.**

Insurance and reinsurance: **accepted.**

- Also raised in the national accounts issues list.

Other

The following issues were **rejected**:

- *Retained earnings on direct foreign investment*;
- *Accrual of interest on debt securities*. (Mr. Patterson noted that this decision would be reported back to the IMF Committee on Balance of Payments Statistics).

Whether the issues of classification of “financial gold” as a financial asset should be considered by the AEG for the update of the *1993 SNA* was left to the decision of ISWGNA.

Procedures

The AEG strongly supported the synchronization of processes for the update of the *Balance of Payments Manual* and the review of the *1993 SNA* as complementary to the harmonization of concepts.
A request was made for a diagram to show all the affected groups and their interrelationships.

Review of the list of candidate issues for updating of the *1993 SNA*

—Submission by the Task Force on Harmonization of Public Sector Accounting (TFHPSA)

Harmonization between the SNA and Government Finance Statistics Manual is to be maintained in the future. While statistical guidelines and public sector accounting standards have different purposes, the need for further convergence was recognized along with the need to clarify for users the relationship between statistical and financial information. The objective of the task force is to propose a new chapter (or special annex) of the SNA on general government and public sector accounts.
The AEG reviewed the proposed list of issues:

- Government transactions with public corporations – **accepted**
  -Recognition of earnings (reinvested earnings and dividends)
  -Funding (dividends and capital injections) -
- Privatization / restructuring agencies, special purpose vehicles (SPVs) – **accepted**; noted that seizures should be dealt with under privatizations
  -Privatization flows
  -Privatization agencies, bad banks and other SPVs
  -Securitization
- Tax revenues, uncollectible taxes, and credits – **accepted**
- Private/public/government sector delineation – **accepted,** noted that the recommendations of the UN Handbook on non-profit institutions (NPIs) be taken into account.
  -Public vs private: the definition of control (including Build-Own-Operate-Transfer - BOOT schemes)
  -Government vs other public sector: the market / non market criterion
- Guarantees and loan partitioning – **accepted** – also raised by the IMF BOP Committee
  -Guarantees and loan partitioning

In each case, work will be undertaken on these issues by teams established under Working Group II of the TFHPSA. Submissions on Topics 1 and 2 and a preliminary paper on Topic 3 will be prepared for the November 2004 AEG meeting. A final paper on Topic 3 and submissions on Topics 4 and 5 will be prepared for the November 2005 AEG meeting.

TREATMENT OF TAXES ON HOLDING GAINS IN THE SNA

- The group agreed to continue treating taxes on holding gains as current taxes on income and wealth (D51).

- As far as possible, taxes on holding gains should be shown as a special sub-category within D51.

- The group considered the possibility of developing alternative concepts of household income. However, this is potentially a big undertaking and is not a priority for the present SNA review.

MILITARY WEAPON SYSTEMS AS FIXED ASSETS

Following an intensive discussion, the group voted[1] to include expenditure on military weapon systems as gross fixed capital formation. In accordance with the procedures of the AEG, the proposal will be sent for consultation to countries; the ISWGNA will collect the replies and bring them back to the AEG.

In the discussion the following points were made:

- The AEG agreed that the paper be revised to take into account the various comments before being circulated to countries for comments and to incorporate findings presented at the April 2003 meeting of the Canberra Group. The revised paper should be widely distributed to give more explanation of the issue.

- Be careful about drawing similarities between military equipment and other equipment.

- There was general agreement that defense gross fixed capital formation (GFCF) for defense equipment should be presented separately from other types of GFCF.

- Keep in mind that it is the economic activity that is to be measured and not wellbeing.

[1] 15 members voted in favor, 4 members voted against, and 2 members abstained.

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TREATMENT OF EMPLOYER RETIREMENT PENSION SCHEMES

The AEG found the discussion on the issue paper very informative. The author of the paper, Mr. Philippe de Rougemont, was commended for the vast work that was done in preparing such a comprehensive paper.

A number of opinions were expressed.

1. In the 1993 SNA, the focus is on assets of funded schemes. The tendency today is to shift the focus to liabilities for future pensions, regardless of whether there are segregated assets associated with those liabilities.

2. The principle of recording a liability for unfunded schemes and the principle of a sound actuarial basis for the value of the liability and for the "imputed" contributions was broadly welcomed, but subject to many caveats.

3. A key issue is whether the promises of future benefits are sufficiently strong to be considered liabilities in the case of (a) government employer pension funds or (b) social security schemes.

4. There were concerns about whether national accountants value the government liability if the government is not already making these calculations. Similarly, national accountants could not do actuarial calculations for funded schemes unless company accountants do so. However, it is noted that the current development of public and private accounting standards is consistent with actuarial approach.

The proposals made in the issue paper are quite far-reaching and complex. The AEG agreed that they need further clarification and discussion through the EDG that was established by the IMF. The EDG moderator, in a bid to gather views and help prepare the new document on pension, will circulate by April a questionnaire to AEG members to be responded by June 2004.

The AEG agreed to further discuss the issue at its November 2004 meeting and eventually come to a conclusion. The author of the issue paper was asked to develop a new paper and focus on core issues and avoid the more secondary issues, which could be dealt with in a separate Manual or other mechanism.

EMPLOYEE STOCK OPTIONS (ESOS)

The AEG approved the four main recommendations presented in the issue paper.

- The AEG was in favor of the first recommendation to show ESOs as compensation of employees.

- The majority of the AEG members favored spreading the value of ESOs between the grant and vesting dates if possible.

- All members of the AEG agreed that the ESOs should be valued at market price, or by using a suitable option pricing model.

- Some members of the AEG expressed reservations with regard to the recording of the ESOs in the financial accounts as financial derivatives. The AEG accepted in principle the fourth recommendation with the expectation that an instrument category will be introduced entitled "financial derivatives and employee stock options," with the subcategories of (1) financial derivatives and (2) employee stock options.

The AEG agreed that the issue paper should be circulated to countries for consultation.

COST OF OWNERSHIP TRANSFER ON NON-FINANCIAL ASSETS

Of the five recommendations in the issue paper only the first two were addressed in the meeting:

- Cost of ownership transfer (COT) of non-financial assets should continue to be recorded as fixed capital formation.

- COT incurred on the acquisition of an asset should be written off over the period the owner expects to hold the asset (the SNA currently says: over the entire life of the asset).

The AEG accepted the two recommendations.

The ISWGNA decided to refer the three other recommendations back to the Canberra II group for further discussion and consultation.

Summary Conclusions of the First Meeting of the Advisory Expert Group on National Accounts—ISWGNA (February 19, 2004)

MEASUREMENT OF THE PRODUCTION OF NON-LIFE INSURANCE

The AEG reviewed the set of questions put forward by the Task Force on the measurement of non-life insurance.

There was general agreement to replace the formula currently recommended in the *1993 SNA* to estimate the production of insurance services by a formula using adjusted claims and adjusted premium supplements.

The AEG supported the inclusion in the SNA of several solutions to estimate adjusted claims: the expectation approach (which uses statistical smoothing of past data), the accounting approach, and the sum of cost + normal profit approach.

The AEG also supported the extension of technical provisions to equalization provisions and other special provisions. The use of the term "provisions" was discussed at some length. The AEG agreed that it be used in future, but with qualifications to distinguish it from the common term "provisions" used in other business accounts.

There was some unease about the inclusion of income from own funds as an item additional to premium supplements in the formula to estimate the output of non-life insurance and about their inclusion in D44 distributed to policy holders. It was noted that there may be a problem in including the income from own funds in output without reflecting who consumes it. In that context, the AEG felt that a numerical example is needed to help understand the issue better, and asked the authors of the issue paper to run through a few examples. The outcome of this work should be discussed in the EDG and within the ISWGNA. The result of these discussions will be distributed to the AEG through written consultation and the results presented in the next meeting.

The AEG supported the proposal conceptually but noted in practice the possibility to use adjusted premium supplements in future rather than observed (actual) premium supplements in the calculation of output.

The members of the AEG broadly accepted the proposal of decoupling net insurance premiums (D71) and actual non-life insurance claims (D72) with the idea that in some cases, such as catastrophic events, the difference between adjusted and non-adjusted claims can be treated as a capital transfer. The AEG agreed with the proposed changes in terminology for "technical reserves" to be called "technical provisions" and for "claims due" to be called "claims incurred."

The AEG supported the proposal for a new treatment of reinsurance, where all reinsurance flows are treated gross and the same formulae are used as for direct insurance. The AEG recommended that the proposal be forwarded to the BOP Committee for its view.

It is recommended that profit sharing and bonuses be justified and circulated to AEG members.

Members of the AEG agreed that the issue paper presented at the first AEG meeting be revised into a short, streamlined paper before distributing it for wider consultation.

PROVISIONAL RECOMMENDATIONS ON THE MEASUREMENT OF THE PRODUCTION OF (NON-INSURANCE) FINANCIAL SERVICES

The AEG reviewed the provisional recommendations of the OECD Task Force. It was noted that the recommendations should be regarded as work-in-progress.

Three recommendations were submitted:

- A new definition of financial corporations
- The principle of non-exclusion of own funds in the measurement of output
- A reference rate approach for the measurement of financial intermediation services indirectly measured (FISIM).

The Group discussed the definition at some length. The following comments were made:

- The new definition is broader than the present 1993 SNA treatment, which is a good development.
- The term “financial intermediation” should not disappear from the definition.

The AEG invited the OECD Task Force to produce a comprehensive presentation of all the inter-related issues of sector and industry definition, valuation of output, allocation of output to users, role of own funds, treatment of unincorporated money lenders, and ancillary units such as companies’ treasury departments, etc. A small group of AEG members led by Mr. Kulshreshtha will submit a specific proposal to the AEG members on (informal) money lenders in developing countries.

The treatment of Islamic banks should be clarified. The IMF agreed to propose the text.

The AEG agreed that own funds should not be excluded as a source of funds for the provision of financial servics. However, the AEG recommended that the Task Force elaborate further on that.

There was large support for using the reference rate approach in measuring FISIM, although not necessarily using a single rate. Nevertheless, the AEG agreed there is a need to consider alternative approaches as well, since the reference rate approach may not be applicable in many developing countries. The issue of not allocating FISIM will be decided in another AEG meeting.

MEASUREMENT OF THE OUTPUT OF CENTRAL BANKS

The AEG reviewed the recommendation made by the ISWGNA in 1995 on the measurement of the output of central banks.

The Group agreed that, because of the unique functions that may be performed by central banks, the value of their output obtained by the method recommended by the *1993 SNA* (the difference between property income receivable less interest payable) may sometimes be exceptionally large or small or even negative. In such cases the output of central banks or at least part of it could be measured at cost. Further work is needed to clarify these cases. This does not imply reclassifying the central bank to the government sector. Clarification is needed of which sectors consume the output of the central bank.

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Accounting for Interest under High Inflation

The group recommends that SNA93 rev.1 should include in Annex B of Chapter 19 guidance on compiling and presenting national accounts in conditions of inflation. It would cover the whole range of issues from the goods and services account, through income and financial accounts, to balance sheets.

It was noted that even moderate rates of inflation have an impact on the conventional SNA aggregates and thus an alternative, satellite set of accounts is useful in many circumstances.

Specifically, for the treatment of interest, the next text should reflect both Hill and Vanoli approaches.

The ISWGNA will seek a suitable person or persons to make concrete proposals; several participants agreed to participate in the reflection (US, UK, ALA, NL).

LIST OF ACTIONS

The First Meeting of the Advisory Expert Group on National Accounts—ISWGNA (February 20, 2004)

1. Summary conclusions of the February meeting of the AEG will be posted on the UN webpage. A page will be created for contributed comments (such as the Vanoli's paper).

2. Moderators of the following issues: taxes on holding gains, military equipment, employee stock option, cost of ownership transfer, non-life insurance prepare a short (few pages) text titled DECISION OF THE AEG ON ---- before March 10 and transmitted to the UNSD.

   The UNSD will transmit these documents and attach them with (possibly) revised AEG issue papers to all statistical agencies and central banks in the world for comments before July 2004.

   The ISWGNA will consolidate the comments and present them in the next meeting of the AEG.

3. The moderator of the pension scheme prepares a questionnaire to the AEG members for response before June 2004. Prepares a paper based on responses.

4. The moderator of non-life insurance will circulate an example concerning premium supplements.

5. AEG members who have proposed new issues included in the summary conclusions of February 16 have to send a short background paper before March 10 to the UNSD. The ISWGNA will meet on March 15-16 and will merge the issues into a list submitted to the next AEG meeting for decision.

6. As soon as possible, the ISWGNA will announce to the AEG members the name of the project manager and the editor.

7. The ISWGNA will discuss the procedure to enhance the participation of regional commissions and experts in the process of the SNA updating. A presentation will be made of the updating at the IARIW conference in Cork, Ireland, August 2004. Other activities are scheduled, for example, at UNECD in April 2004.

8. Next meeting of the Canberra II Group on Non-financial assets: 17-19 March, Washington, DC.

9. Next meeting of the TFHPSA: September 2004.

Draft Agenda of the AEG meeting in November 2004

IMF-EDG	Pension scheme
TFHPSA	Tax revenue/credits Privatization and SPVs Earnings and funding of public corp.
Canberra II	Ownership transfer costs II Treatment of originals and copies Databases Mineral exploration Cost of capital services: production account Cost of capital services: government-owned assets Treatment of land Cultivated assets Definition of economic assets (clarification)
IMF	Repurchase agreements (for information)
IMF-EDG	Non-performing loans
OECD	A paper on provisions (for information)

ANNEX

DECISION OF THE AEG ON THE MEASUREMENT OF INSURANCE AND REINSURANCE IN THE SNA 1993 rev 1.

The task force on the measurement of insurance in the context of catastrophes (moderator: OECD) presented its recommendations to the February 2004 meeting of the AEG. The AEG has decided to adopt these recommendations for implementation in the SNA 1993 rev 1, except for two (see at the end) that will be finalized using a written consultation. The AEG recommended that the proposal be forwarded to the BOP Committee for its view. The full report of the task force (revised version after AEG meeting) is attached to the present decision. It includes a complete set of redrafted paragraphs for the 1993 rev 1 SNA.

Background.

Catastrophic events such as the 11 September terrorist attack, a major storm in France and in other European countries in 1999, hurricanes and major fires in Australia, or similar events in other countries, generate massive claims for non life insurance companies. The mechanical use of the current SNA recommendation leads, particularly in these cases, to absurd movements of the production and, therefore, of the consumption, of insurance services at current price in the national accounts. There is therefore a strong need to change this situation. This change will be welcome by users of national accounts.

Main recommendations.

The first recommendation of the task force was to propose to set as a general principle that the production of insurance services does not occur when the risk occurs. The concept of insurance service is the service of covering for the risk. As such, its measurement should not be affected by the volatility of the occurrence of the risk. Neither the volume nor the price of insurance services is directly affected by the volatility of claims.

The task force proposed to continue to use a formula based on the difference between premium (plus premium supplements) and claims, but to use *adjusted* claims and, optionally, *adjusted* premium supplements in this formula in order to correct for the volatility of observed flows. **The AEG accepted this recommendation.**

The recommended formula for the measurement of output of non life insurance in the SNA 1993 rev 1 will therefore be: [Actual premiums earned [i.e. premiums receivable less changes in the reserves due to pre-payment of premiums] + Adjusted premiums supplements - Adjusted claims incurred. **The AEG proposed that the recommendation regarding the adjustment of premium supplements remains optional.**

There are three practical solutions to implement this general recommendation. The expectation approach (which uses statistical smoothing of past data), the accounting approach, and the sum of costs plus “normal” profit approach. **The AEG approved the reference to these three solutions in the new SNA.**

The *expectation approach* consists in replicating the *ex-ante* model used by insurers to price their premiums, on the basis of their expectations. When accepting risk and setting premiums, insurers consider both their expectation of loss (claims) and of income (premium supplements). This expected margin (premiums plus expected premium supplements minus expected claims) is a much better measure of the concept of insurance service than the current formula applied ex-post. Its extreme version would be to use effectively the micro data transmitted by insurers. In the absence of this data, the proposal is to simulate this approach by (1) using macro statistics, and, (2) using smoothed past data to forecast the macro expected claim and/or macro expected premium supplement. In this case, the SNA formula becomes: *Formula (2) [Actual premiums earned [i.e. premiums receivable less changes in the reserves due to pre-payment of premiums] + Expected premiums supplements - Expected claims due.* In this formula, expected claims and expected premium supplements are estimated using past smoothed data, and applying a special treatment in the case of major catastrophes. Description of statistical methods to derive a good estimate of expected claims and expected premium supplements will be included either in the new special annex on insurance or an implementation manual.

The *accounting approach* consists in (1) extending the scope of the technical reserves (called "technical provisions" in the new SNA), (2) apply an extended formula including, when necessary, changes in own funds : *Formula (4): [Premiums earned + premium supplements] – [claims due + addition to, less withdrawal from, equalization provisions + addition to, less withdrawal from own funds, when necessary].* Contrary to the expectation approach, the accounting approach uses ex-post data, thus observed claims incurred. However, the volatility of claims incurred is expected to be compensated by the movements of the equalisation provisions and, in the case of catastrophes, of own funds. It is to be noted that if changes in own funds are introduced in one given period to dampen the volatility of a claim in case of catastrophe, the rebuilding of own funds after this period will also intervene (with an inverse sign) in the formula for the next periods.

The AEG approved the extension of the SNA definition of provisions for unearned premiums, and provisions for bonuses and rebates, and in the SNA definition of provisions for claims outstanding the provisions for incurred but not (enough) reported incidents and equalisation provisions. These extended technical provisions will be considered assets of policyholders or beneficiaries, depending whether they are classified as provisions for unearned premiums or provisions for outstanding claims. All income from these provisions will be considered as premium supplements.

The *sum of costs plus "normal" profit* approach consists in obtaining a measure of output as the sum of costs (a variable which is generally well mastered) plus an estimation of "normal" profit. The estimate of "normal" profit generally implies the use of smoothed past actual profits. Thus this approach is, in practice, similar to the expectation approach. "Normal" profit is indeed equal to premiums + adjusted premium supplements – adjusted claims – costs.

The change of the measure of production necessitates an adjustment in the distribution accounts. **The AEG supported the recommendation of the task force to decouple net insurance premiums (D71) and non life insurance claims incurred (D72) in the distribution accounts.** The latter would not change in the SNA. D71 would be still calculated as Premiums earned + Premium Supplements – Output but the change in the calculation of output will result in its disconnection with D72. It will now represent adjusted claims plus (optionally) the difference between actual premium supplements and adjusted premium supplements. The positive or negative difference between D72 and D71 will represent a transfer from insurance companies to policy holders. **The AEG agreed that, in exceptional cases, such as catastrophes, part of this transfer is classified as a capital transfer (D99).**

The task force made a recommendation to adopt a new treatment of reinsurance in the national accounts, where all reinsurance flows are treated gross and the same formulae (using adjusted variables) are used as for direct insurance. **The AEG supported this recommendation**.

The AEG requested some clarification before deciding on two other proposals of the task force: (1) the inclusion of income from own funds in the calculation of production, (2) the treatment of profit sharing and bonuses. A consultation of the AEG is in process on these two detailed points. A revised version of this decision will be disseminated in May 2004, taking into account the view of the AEG regarding these two points.

Results of the AEG's written consultation on insurance.

Following the decision of the February 2004 meeting of the AEG (see Annex 2), François Lequiller, as moderator of the task force on insurance, conducted a consultation of the AEG on issues regarding insurance that remained unresolved. The present memo gives the results of this consultation and proposes a conclusion which will be presented for confirmation at the next meeting of the AEG[1].

Four questions were asked of AEG members:

1/ Does the AEG support the inclusion of income from own funds in the formula for the calculation of non life insurance output?

2/ If the response is yes to the previous question, which option (described in the background paper that was attached) would the AEG support?

3/ Does the AEG accept to classify commissions and rebates as negative premiums and profit sharing and bonuses as other income transfers?

4/ Does the AEG confirm that the SNA should allow an option permitting the treatment of some catastrophic claims as capital transfers rather than current transfers?

The table in the next page summarizes the responses to these four questions.

Based on these results, the moderator proposes that the AEG endorses the following statement, which will amend the February decision of the AEG as presented in Annex 2:

The AEG was consulted through a questionnaire on the issues that remained unresolved at its first meeting.

The consultation showed a significant majority against the inclusion of income from own funds in the calculation of the output measure of non life insurance. This proposal is therefore abandoned. Therefore the issue of which option is to be used to take into account this change in the institutional sector accounts becomes irrelevant.

In contrast, the AEG confirmed by a large majority the proposal made by the task force on commissions and rebates (treat as negative premiums) and profit sharing and bonuses (treat as other income transfers).

Finally, despite its possible impact on the discrepancies of BOPs' current balances at the international level, the AEG confirmed by a very large majority the option to treat transfers resulting from exceptional claims as a capital transfer rather than, as in normal cases, a current transfer.

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[1] This consultation was conducted prior to the installation of the web-voting procedures on the UN website. This is why it is conducted in the present "manually operated" format.

Results of the written consultation

	Question 1	Question 2	Question 3	Question 4
Yes	6	9	12	16
No	11	2	5	2
Abstain	1		1	

*Of which three “no” agreed partially.

A summary of comments justifying these votes is included as Annex 1. I am sending the full responses and comments to the UNSD for inclusion in the AEG web site.

François Lequiller

Paris, 29/6/2004

ANNEX 1

Summary of comments made by members in the questionnaire.

The original responses and full comments will be available on the UN web site. The objective of this annex is only to give some very limited extracts to entice readers to read the full and very interesting comments of the AEG members.

Question 1

Many of the experts who are against the change used the argument that the SNA should be consistent and should avoid exceptions: one does not include income from own funds in other industries to compile output, we should not therefore do it for insurance (Heller, Kulshreshtha, Tvarijonaviciute, Ramos). Other experts against the proposal are not convinced that insurance companies based their premium prices on incomes from own funds (Wilson), or are not convinced that the rationale of the SNA linking property income and assets should be abandoned (IMF[2]). For the UNSD, "the level of insurance services should not depend on the size of own funds that the owners want to contribute voluntarily or are obliged to contribute legally." Finally, Magniez and Moulton are not convinced by the link between income from own funds and the measure of premiums and output.

Experts agreeing to the proposal are in favour for both conceptual and practical reasons. Prinsloo confirms that South African insurance companies include income from own funds in the picture when setting premium prices. He raises also the simplification introduced by this proposal as income is, in practice, difficult to attribute to policy holders or to own funds. Van de Ven thinks that insurance fix their profits and it is immaterial to them whether these profits come from the output of insurance services or from investment income. In that sense, he agrees with the proposal, but, at the same time, thinks it should not be systematically implemented.

Question 3

A large majority agreed without discussion to the proposals, but several members (Tvarijonaviciute, Van de Ven, Bloem) remarked that for simplicity and even conceptually it would be better to treat profit sharing and bonuses as a reduction of premium supplements, in a similar way to commissions and bonuses.

On question 4, nearly all experts made their decision on the option to treat the difference between claims incurred and adjusted claims as a capital transfer without comment, despite the possible implications for BoP discrepancies. Magniez advocates that when the discrepancy is small, insurers can finance it by reducing their profits or allocating part of their income from own funds, but when it is large, this is not possible. To include a large difference in the current accounts would distort the income picture of households and other policy holders. Some experts advocate that BoP consistency can be reached by better coordination (Magniez, Harper). To ensure that, some propose the very practical solution of creating a special category of capital transfers to cover those cases (Berner, Cover)

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[2] The IMF remarks that the background paper erroneously presumes that the proposal was consistent with the one on pension schemes.

ANNEX 2

DECISION OF THE AEG ON THE MEASUREMENT OF INSURANCE AND REINSURANCE IN THE SNA 1993 rev 1.

The task force on the measurement of insurance in the context of catastrophes (moderator: OECD) presented its recommendations to the February 2004 meeting of the AEG. The AEG has decided to adopt these recommendations for implementation in the SNA 1993 rev 1, except for two (see at the end) that will be finalized using a written consultation. The AEG recommended that the proposal be forwarded to the BOP Committee for its view. The full report of the task force (revised version after AEG meeting) is attached to the present decision. It includes a complete set of redrafted paragraphs for the 1993 rev 1 SNA.

Background.

Catastrophic events such as the 11 September terrorist attack, a major storm in France and in other European countries in 1999, hurricanes and major fires in Australia, or similar events in other countries, generate massive claims for non life insurance companies. The mechanical use of the current SNA recommendation leads, particularly in these cases, to absurd movements of the production and, therefore, of the consumption, of insurance services at current prices in the national accounts. There is therefore a strong need to change this situation. This change will be welcome by users of national accounts.

Main recommendations.

The first recommendation of the task force was to propose that a general principle be established to the effect that the production of insurance services does not occur when the event being insured against occurs. The concept of insurance service is the service of covering for the risk. As such, its measurement should not be affected by the volatility of the occurrence of the risk. Neither the volume nor the price of insurance services is directly affected by the volatility of claims.

The task force proposed to continue to use a formula based on the difference between premium (plus premium supplements) and claims, but to use *adjusted* claims and, optionally, *adjusted* premium supplements in this formula in order to correct for the volatility of observed flows. **The AEG accepted this recommendation.**

The recommended formula for the measurement of output of non life insurance in the SNA 1993 rev 1 will therefore be: [Actual premiums earned [i.e. premiums receivable less changes in the reserves due to pre-payment of premiums] + Adjusted premiums supplements - Adjusted claims incurred. **The AEG proposed that the recommendation regarding the adjustment of premium supplements remains optional.**

There are three practical ways of implementing this general recommendation. The expectation approach (which uses statistical smoothing of past data), the accounting approach, and the sum of costs plus "normal" profit approach. **The AEG approved the reference to these three solutions in the new SNA.**

The *expectation approach* consists in replicating the *ex-ante* model used by insurers to price their premiums, on the basis of their expectations. When accepting risk and setting premiums, insurers consider both their expectation of loss (claims) and of income (premium supplements). This expected margin (premiums plus expected premium supplements minus expected claims) is a much better measure of the concept of insurance service than the current formula applied ex-post. Its extreme version would be to use effectively the micro data transmitted by insurers. In the absence of these data, the proposal is to simulate this approach by (1) using macro statistics, and, (2) using smoothed past data to forecast the macro expected claim and/or macro expected premium supplement. In this case, the SNA formula becomes: *Formula (2) [Actual premiums earned [i.e. premiums receivable less changes in the reserves due to pre-payment of premiums] + Expected premiums supplements - Expected claims due.* In this formula, expected claims and expected premium supplements are estimated using past smoothed data, and applying a special treatment in the case of major catastrophes. A description of statistical methods to derive a satisfactory estimate of expected claims and expected premium supplements will be included either in the new special annex on insurance or an implementation manual.

The *accounting approach* consists of (1) extending the scope of the technical reserves (called "technical provisions" in the new SNA), (2) applying an extended formula including, when necessary, changes in own funds : *Formula (4): [Premiums earned + premium supplements] – [claims due + addition to, less withdrawal from, equalization provisions + addition to, less withdrawal from own funds, when necessary].* Contrary to the expectation approach, the accounting approach uses ex-post data, thus actual claims incurred are used. However, the volatility of claims incurred is compensated by movements of the equalisation provisions and, in the case of catastrophes, of own funds. It is to be noted that if changes in own funds are introduced in one given period to dampen the volatility of a claim in case of catastrophe, the rebuilding of own funds after this period will also intervene (with an inverse sign) in the formula for the next periods.

The AEG approved the extension of the SNA definition of provisions for unearned premiums, and provisions for bonuses and rebates, and including in the SNA definition of provisions for claims outstanding the provisions for incurred but not (enough) reported incidents and equalisation provisions. These extended technical provisions will be considered assets of policyholders or beneficiaries, depending on whether they are classified as provisions for unearned premiums or provisions for outstanding claims. All income from these provisions will be considered as premium supplements.

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The change of the measure of production necessitates an adjustment in the distribution accounts. **The AEG supported the recommendation of the task force to decouple net insurance premiums (D71) and non life insurance claims incurred (D72) in the distribution accounts.** The latter would not change in the SNA. D71 would be still calculated as Premiums earned + Premium Supplements – Output but the change in the calculation of output will result in its disconnection with D72. It will now represent adjusted claims plus (optionally) the difference between actual premium supplements and adjusted premium supplements. The positive or negative difference between D72 and D71 will represent a transfer from insurance companies to policy holders. **The AEG agreed that, in exceptional cases, such as catastrophes, part of this transfer is classified as a capital transfer (D99).**

The task force made a recommendation to adopt a new treatment of reinsurance in the national accounts, where all reinsurance flows are treated gross and the same formulae (using adjusted variables) are used as for direct insurance. **The AEG supported this recommendation**.

The AEG requested some clarification before deciding on two other proposals of the task force: (1) the inclusion of income from own funds in the calculation of production, (2) the treatment of profit sharing and bonuses. A consultation of the AEG is in process on these two detailed points. A revised version of this decision will be disseminated in May 2004, taking into account the view of the AEG regarding these two points.

DECISION OF THE AEG ON THE TREATMENT OF TAXES ON HOLDING GAINS IN THE SNA 1993 rev 1.

The ISWGNA had included the treatment of taxes on holding gains in its list of issues to be discussed in the context of the review of the SNA. This discussion was moderated by the OECD who presented a report to the February 2004 meeting of the AEG. **The AEG has decided to adopt the recommendations proposed by the moderator.**

Background.

During the second part of the 90s, important (potential as well as realized) holding gains were made by households. However, the SNA definition of income excludes holding gains, and was therefore not affected by these (potential or effective) revenues. On the contrary, as (realized) holding gains are taxed and included in the SNA's category "taxes on income", taxes on holding gains affected negatively the SNA measure of income. This situation clearly misled some users of the accounts.

Main recommendations.

One obvious solution to resolve the contradiction would be have been to integrate holding gains in the definition of income. However, two arguments led the moderator to avoid proposing such a change: (1) it would be a too ambitious change of the structure of the SNA, at least in respect of the issue raised on taxes on holding gains; (2) many economists may not want to include holding gains in income, as they are very volatile. **The AEG confirmed this view.**

One alternative solution was to re-classify taxes on holding gains as capital transfers, thus eliminating their impact on income. Classifying taxes on holding gains as capital taxes is consistent with the fact that many households view these taxes as being as exceptional as the holding gains themselves. However, from the point of view of the government, these taxes are a definitely current income.

On top of this, the main problem in re-classifying the tax appeared to be a practical one. In most countries, the tax on holding gain is completely embedded in the income tax (simply because realized holding gains are considered revenues…). It is therefore very difficult to distinguish this item from the overall amount. **The AEG therefore agreed not to change the SNA regarding the classification of taxes on holding gains: they will continue to be classified as current taxes on income and wealth (D51).**

However, taxes on holding gains should be shown as a special sub-category within D51.

The AEG considered the possibility of discussing in some paragraphs of the SNA alternative concepts of household income. However, the AEG considered that this is not a priority for the present SNA review.

DECISION OF THE AEG ON THE TREATMENT OF COST OF OWNERSHIP TRANSFERS IN THE SNA 1993 rev 1.

The ISWGNA had included the treatment of cost of ownership transfer in its list of issues to be discussed in the context of the review of the SNA. This discussion was moderated by the Canberra II group (chair: Peter Harper, ABS, and secretariat: Charles Aspden, OECD). A first report was presented on this issue to the February 2004 meeting of the AEG. **The AEG has decided to adopt the first two recommendations proposed by the moderator.** The three other recommendations will be considered in the next meeting of the AEG (November 2004).

Background.

In the current SNA, cost of ownership transfers (COT) of non financial assets are included in the price of GFCF and are written off in parallel with the consumption of fixed capital of the underlying asset. But assets change hands frequently, often earlier than the life time of the asset. The current SNA proposes to write-off the remaining COT as an “other change in volume”. This may be considered to lead to an overestimation of net operating surplus.

Main recommendations.

The discussion in the Canberra II group centered around three options. The first of these was to treat all COT as current expenditure. The second option was to treat them all as capital expenditure but with changes in the time of recording so that there would be no need in normal circumstances to have entries in the other changes in volume accounts. The third option was to treat the COT on acquisition for the first owner as capital but all subsequent COT as current expenditure.

The group considered that it was essential to preserve the link between the value of an asset to an enterprise and the value of the services to be rendered by the asset over the length of time it is held. This implies maintaining COT to be treated as capital formation. **The AEG approved this recommendation not to change the SNA on this point.**

However, the group considered that rather than depreciate the COT over the lifetime of the underlying asset as proposed by the current SNA, the cost of ownership transfer should be written off over the period during which the acquirer expects to hold the asset. If expectation is met, this means that the COT will be entirely depreciated when the asset is resold, thus resolving the issue raised of overestimating operating surplus. **The AEG approved this recommendation to change the SNA.**

DECISION OF THE AEG ON THE CLASSIFICATION OF MILITARY WEAPON SYSTEMS AS FIXED ASSETS

The Canberra II Group on the Measurement of Non-financial Assets presented its recommendations to the February 2004 meeting of the AEG. Their principal recommendation was to drop the current SNA's distinction regarding military weapon systems and treat them as fixed assets. This recommendation proved to be somewhat controversial, so a vote was taken and the proposal was approved; 15 members voted in favor, 4 members voted against, and 2 members abstained.

Background

In the current SNA, a distinction is drawn between military weapon systems that are designed for combat, which are treated as intermediate consumption, and durable goods that are used in much the same way as civilian assets, which are treated as fixed assets. However, military weapon systems are now maintained for long periods of time and decision makers in many countries wish to use capital budgeting techniques to plan for the eventual replacement of these systems. Furthermore, there is interest in harmonization with new international standards for public sector accounting that call for treating weapon systems as property, plant, and equipment.

Main recommendations

The Canberra II Group examined the economic processes of production in the provision of defense services. Military weapon systems were seen to be used continuously in the production of those services, even if their peacetime use is simply to provide deterrence. The Group reach a near unanimous decision concluding that military weapon systems should be classified as fixed assets. The AEG accepted the recommendation that classification of military weapon systems as fixed assets should be based on the same criteria as other fixed assets—that is, produced assets that are themselves used repeatedly, or continuously, in processes of production for more than one year. Moreover, military weapon systems in general are seen to meet these criteria because they are used continuously in providing defense services to the nation's residents, protecting their liberty and property.

The following related recommendations were also accepted. Expendable durable military goods, such as bombs, torpedoes, and spare parts, should be treated as inventories. The classification of assets should be modified so that gross fixed capital formation (GFCF) for weapons can be separately identified and presented. The implications of the recommendation for the *Balance of Payments Manual* and for *Government Finance Statistics* also need to be examined.

The AEG noted that there are important differences between military equipment and other equipment. There was general agreement that presentations of GFCF by type of asset should separately identify defense equipment. Finally, the AEG noted that it is necessary to keep in mind that the production accounts measure economic activity and not well being.