Results of the AEG's written consultation on insurance

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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.

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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.

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.

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.

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)

[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.

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 measured) 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.