Towards the 2025 SNA and BPM7

Issues note on action point A.10: Treatment of holding gains/losses and capital income in the measurement of insurance output

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Introduction

Two issues at stake

- The treatment of **holding gains and losses** in the measurement of property income attributable to insurance policy holders (investment income payable on pension entitlements) and the measurement of output for the relevant insurance corporations and pension schemes
- The **inclusion, or not, of capital income derived from investing the insurer's own funds** in the measurement of insurance output

Both will be shortly discussed, starting with the second issue

Issue 2: Treatment of capital income derived from investing the insurer's own funds

- **Basically, insurance output is calculated as follows**: actual premiums earned *plus* **premium supplements (= property income attributable to insurance policy holders)** *minus* (adjusted) claims incurred
- Global Federation of Insurance Associations, however, suggested that the **capital income derived from the investment of an insurer's own funds should also be included in the calculation of output of insurance corporations,** based on the notion that all assets of an insurer serve the ultimate purpose of improving the risk-bearing capacity of an insurer — and thus the interests of policy holders
- However, **insurers will set the levels of premiums, and possibly premium supplements from investing funds allocated to insurance policy holders, in such a way that it will cover the administrative expenses and provide an adequate return to the own funds invested**
- **Imputing an income from the insurance corporation's own funds** to the measurement of output, and consequently to (gross) operating surplus, **would thus lead to a kind of double-counting**
- **It is recommended to close this research issue, and remove it from the SNA Research Agenda**

Issue 1A: Treatment of holding gains and losses

- To restrict the discussion, **only the treatment of non-life insurance is discussed**
- **For life insurance and pension schemes, the issues note basically confirms the conclusions of the AEG in its 9th meeting in 2014**:
  - **In the case of direct, one-to-one, transmission** of income earned on the investment of actuarial reserves, reserves for with-profits insurance, and pension entitlements, the **income attributable to policy holders should be calculated excluding holding gains and losses**
  - **In all other cases, all distributed income**, which is typically defined as a certain percentage of the insurance reserves or pension entitlements, either or not supplemented by bonuses, **should be treated as investment income attributable to insurance policy holders/payable on pension entitlements, disregarding the possible source/origin of this income**
- In addition, it is recommended to provide **more explicit guidance on the inclusion, or not, of holding gains and losses in the 2025 SNA**, which would relate to all holding gains and losses, not only realized ones
- Finally, it is recommended to add **simpler guidance on the calculation of output**, for example in the case of multi-employer pension schemes

Issue 1B: Treatment of non-life insurance (1)

- Surprisingly, quite some discussion on the **treatment of non-life insurance**
- **No discussion on the formula for calculating output**:

  actual premiums earned

  \+ premium supplements

  \- (adjusted) claims incurred

- … where premium supplements are **estimated from past experience**, and – given the underlying rationale – **include both investment income and holding gains and losses**
- However, no consensus about the guidance of the 2008 SNA, when it comes to the measurement of investment income attributable to insurance policy holders:
  1) **Premium supplements** included in the above formula
  2) **Income actually allocated to technical reserves**, in line with the company records
  3) **Actual investment income** derived from the investment of technical reserves
  4) **Actual income, including holding gains and losses**, from the investment of technical reserves

Issue 1B: Treatment of non-life insurance (2)

Non-life insurance corporation

Profit and loss account

Premiums earned = premiums actually recieved	150
Interest received	3
Holding gains and losses	7
Total income	**160**
Claims incurred = claims actually paid	100
Compensation of employees	30
Consumption of fixed capital	5
Total costs	**135**
Profits excluding holding gains and losses	**18**
Profits including holding gains and losses	**25**

Balance sheet	**Beginning of year**	**End of year**
Fixed asset	100	95
Currency and deposits	0	23
Other financial assets	200	207
Total assets	**300**	**325**
Own funds	100	125
Insurance technical reserves	200	200
Total liabilities and net worth	**300**	**325**

No additions to insurance technical reserves, due to differences between premiums earned/claims incurred and premiums received/claims paid.

Also no additions to insurance technical reserves due to income attributed to policy holders

Assuming expected income is 15, output can be calculated 150 + 15 – 100 = 65.

Issue 1B: Treatment of non-life insurance (2)

	(1)	(2)	(3)	(4)
Output	65	65	65	65
Compensation of employees	-30	-30	-30	-30
Operating surplus (gross)	**35**	**35**	**35**	**35**
Consumption of fixed capital	-5	-5	-5	-5
Operating surplus (net)	**30**	**30**	**30**	**30**
Property income received	3	3	3	3
Investment income attributable to insurance policy holders	-15	0	-3	-10
Primary income (net)	**18**	**33**	**30**	**23**
Net non-life insurance premiums	100	85	88	95
Non-life insurance claims	-100	-100	-100	-100
Disposable income (net) = Saving (net) = Changes in net worth due to saving and capital transfers	**18**	**18**	**18**	**18**
Consumption of fixed capital	5	5	5	5
Net lending/borrowing	**23**	**23**	**23**	**23**
Transactions in financial assets (currency)	23	23	23	23
Transactions in liabilities	0	0	0	0
Changes in net worth due to holding gains and losses	**7**	**7**	**7**	**7**
Total changes in net worth	**35**	**35**	**35**	**35**

(1) **Premium supplements** included in output (15)

(2) **Income actually allocated to technical reserves**, in line with the company records (0)

(3) **Actual investment income** derived from the investment of technical reserves (3)

(4) **Actual income, including holding gains and losses**, from the investment of technical reserves (10)

Net premiums = premiums earned (150) + investment income allocated to policy holders (??) – output (65)

Issue 1B: Treatment of non-life insurance (1)

- **Option (4) disqualified**: would include holding gains and losses in primary incomes; may also lead to negative investment income in period of negative stock markets
- **Option (1)** :
  - advantage of already **arriving at an income concept in line with profits according to business accounting at the level of primary income**
  - **equality of net premiums and claims** in the secondary distribution of income account, although this equality is considered less relevant, because in the case of catastrophic events net premiums and claims will differ anyhow
  - However, **investment income attributable to policy holders driven by expectations**
- **Option (2)**: advantage of being **in line with annual reporting** by non-life insurance corporations
- **Option (3)**:
  - may better reflect the **underlying economic reality**, if one assumes that households indeed gain a benefit from reduced premiums by way of premium supplements.
  - some would add that the SNA is quite clear that there should be investment income payable to policyholders — **issue at stake is only whether this should include holding gains**

Summary of recommendations (1)

- **Two viable options for non-life insurance, for consideration by the AEG**:
  - use the property income actually allocated to the insurance technical reserves
  - use the property income earned on the investment of funds which are available to the insurer through the insurance technical reserves
- For **reinsurance and standardised guarantee schemes**, it is confirmed that the measurement should be done in line with the recommendations for non-life insurance
- For **life insurance**, it is recommended to **treat all income which is allocated to the life insurance policy holders as property income**, whether or not this income originates from investment income or from holding gains (or losses), with the possible exception for with-profits life insurance where all returns on investment, after a reduction for the services provided by the insurer, are allocated one-to-one to the policy holder, thereby basically transferring all risks and rewards to the policy holder

Summary of recommendations (2)

- For **defined contribution pension schemes and defined benefit pension schemes**, it is recommended to **formally endorse the conclusions of the 9th meeting of the AEG**: in the former case, exclude holding gains and losses from investment income payable on pension entitlements; in the latter case, use the discount rate for winding down the entitlements
- For **multi-employer pension schemes**, it is recommended to provide **simpler guidance for the measurement of output, in line with the sum-of-costs**, or the fees paid to the insurance corporation managing and/or administering the pension scheme
- On the issue whether or not holding gains and losses should only refer to realized ones, it is recommended to **include, where relevant, all holding gains**
- Add **further clarifications to the 2025 SNA**, in line with the above
- Finally, it is recommended to **exclude capital income from the investment of the insurer's own funds in the measurement of non-life insurance output**, and to remove this issue from the SNA Research Agenda

Thank you for your attention!