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*Cover Note to the revised Version of Insurance Chapter of
Eurostat's Manual on Statistics of Services*

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COVER NOTE TO THE REVISED VERSION OF THE INSURANCE CHAPTER OF EUROSTAT'S MANUAL ON STATISTICS OF SERVICES

1. INTRODUCTION.

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2. BACKGROUND TO THE INSURANCE CHAPTER.

2.1 The insurance chapter (1) is an extension of Eurostat's "General Framework". In the case of insurance, the aim is to exploit administrative sources to the utmost. These are of two interlinked kinds : the data obtained for regulation to protect policy-holders and the requirements for the provision of information to shareholders or owners. Both are linked into the basic system for the annual accounts of insurance enterprises which are now harmonized at the European level by the Directive of December 1991 on the annual accounts and consolidated accounts of insurance undertakings (the "1991 Accounting Directive", for short). However, it will not be possible to rely exclusively on administrative sources - see section 6 (a) on page 9 below.

2.2 The basic unit of observation remains the enterprise, for preference having excluded the activities of branches located in other countries. The aim is still to produce aggregates (with cross-section analysis) at the national level as well as at the level of the whole European community. There will in future be difficulty in reaching this objective on the basis of administrative sources alone - see section 7 below. Also, subdivision of all activities between life insurance and non-life insurance enterprises can create difficulties; for

(1) There will be further revisions. Two errata are listed on page 16 below.

instance, when a common staff is shared by life and non-life insurance enterprises, e.g. in data processing centres, it may be difficult to allocate labour costs, separately from non-labour costs, to the two types of enterprise. Non-operating revenue, e.g. the profits of non-resident subsidiaries, is of interest (because it is a substitute for operating revenue). In some countries, this information is not readily available at the level of the enterprise (which for productive activities is equal to the institutional unit); if so, the enterprise group, having excluded its non-resident parts, would have to be used.

- 2.3 The insurance chapter of the Manual contains advice on methodology which of itself has the status at present of guidelines. However, the question is now to be addressed of a possible EC legal act on the collection of statistical data for insurance enterprises, which would formalise the Manual's guidelines and, perhaps, provide for the collection of some additional data from the balance sheet.

3. MAJOR REVISIONS SINCE LAST YEAR

(a) Classifications

- 3.1 Revised drafts for the EC's Classification of Products According to Activities (CPA) are attached as an annex to the Insurance Chapter. That for non-life insurance has been largely accepted. The main change since last year has been to merge "freight" with "marine, aviation and other transport". It is now fully aligned with the classes required in the 1991 Accounting Directive and in the third Directive. It is also congruent with the CPC, but does not distinguish as a separate product insurance on *international* freight, which is of some relevance to balance of payments estimates.
- 3.2 The revised proposal for a classification on life insurance has not been accepted and requires further study. In the first place, there is difficulty in practice in separating the life insurance and pension funding activities, which carries over into the *product* dimension (see pp 11 - 14 of the Manual). Secondly, the classes adopted in the first life insurance directive brought together, under a single general heading, various categories of underwriting such as term insurance, other types of "whole of life" insurance (policies which mature only on death) and "endowment" insurance (policies which mature on survival or on earlier death). Thus there is no regulatory under-pinning for a subdivision by these categories of risk; nevertheless, such a subdivision seems highly relevant to the user of the statistics and has been proposed in the present draft of the CPA.

(b) Separating the output of direct insurers and of reinsurers.

3.3 This is a major revision, which appears to have been accepted. The requirements of the 1991 Accounting Directive will enable reinsurance to be separated from direct insurance, on the basis of the administrative sources (2). In its Article 34 the profit and loss account is to be shown largely both gross and net of reinsurance, and in its Article 63, and in the third Directive on non-life insurance, the variables which are to be broken down by product are defined gross of reinsurance.

3.4 The change also accords with - indeed, follows - the Canadian model indicated in the diagrams presented to the Voorburg Group last year. These matters are considered in more detail in section 4 below.

4. THE MODEL OF INSURANCE OUTPUT

(a) The basic model.

4.1 "Top-down", for both non-life and life insurance, the definition of output is as follows :-

Premiums
plus investment income on funds held for policy-holders
less claims (indemnities)
less provision for future claims (including changes in
actuarial reserves (3))
equals gross output

"Bottom-up", output is equal to the sum of the following :-

Operating surplus
plus labour costs
equals value added
plus intermediate consumption (including commissions to
independent selling agents)
equals gross output

"Bottom-up" is an illustration, not a definition, since operating surplus is not independently defined.

(2) It will be quite a major change in existing accounting practices. For instance, in the UK both published profit and loss accounts and the data required by the regulator, other than premiums and claims in most classes, are net of reinsurance.

(3) Known in the Manual and Accounting Directive as "Change in the life insurance provision".

4.2 In the table above, I have used the term "gross output". In the Manual, the same thing is called the "Value of Production". In the national accounts, it has been called, for insurance, the "insurance service charge" (4); claims and provisions for future claims are treated as transfers amongst policy-holders and/or beneficiaries. Thus premiums less claims and provisions define the service charge, which is the amount available to sustain the insurance industry's costs and to provide it with a profit. For non-life insurance, the national accounts use a somewhat confusing terminology; the amount charged to policy-holders which is allocated to meet claims and provisions is called the "net" premium (5) - not to be confused with premiums net of premiums ceded to reinsurers. Whilst, in aggregate for the insurance plus reinsurance industry, "net" premiums are equal to claims plus provisions, the identity does not hold for the sectors or industries of the policy-holders, since claims are allocated directly to beneficiaries, who may be third parties. (In the remainder of this paper "gross" means gross of reinsurance.)

4.3 In the ESA, and in the new SNA, transactions are recorded by all sectors and industries on an accruals basis, as seen by the insurance industry. Thus premiums are shown as the premiums "earned" in an insurer's accounting period, and claims as "incurred" by the insurer (including provisions for the future payment of claims). There are the usual problems of lack of congruence of accounting periods; and the policy holder does not usually recognise the concept of subdividing premiums into a service charge and a remainder - see the separate paper by Eurostat for this session.

(b) Non-life insurance : investment income.

4.4 In the new SNA, as I understand it, the investment income on the funds held by non-life insurance enterprises, on behalf of policy holders who themselves are producers, is to be treated as follows :-

In distributive transactions : an imputed transfer by
insurance enterprises to
policy-holders

In the production account : the same is returned as a
"premium supplement".

(4) But in future it will also be called "value of output of insurance services".

(5) Called in the ESA "net accident insurance premiums"

When the policy-holder is not a producer (e.g. a household or a local authority), the return of the premium supplement becomes a new charge to final consumption (6). There will be no change of treatment for life insurance, where the investment income is already regarded as transferred to the policy holder who is not a producer, but remains with him as part of his saving, being returned in the financial transactions account as part of the "increase in the net equity of households in life insurance and pension funds".

(c) The model in rather more detail.

4.5 Leaving aside for the moment the treatment of transactions between direct insurers and reinsurers (see para 4.6), the model in rather more detail becomes :-

<u>Insurance industry</u>	<u>Counterpart sectors / industries (7)</u>	
	(a) <u>Policy-holders</u>	(b) <u>Others</u>
Premiums earned (pe) : resource	Counterpart of pe : use	
Investment income on policy-holders' funds (ii): resource	Counterpart of ii : use	
Claims incurred (ci) : use		Counterpart of ci: resource(8)
Change in actuarial reserves (car) : use	Counterpart of car: resource	
<u>Total</u> = insurance service charge (isc): balance	Counterpart of isc (part)(7)	ditto
Other operating revenue of the insurance industry (9): resource		
<u>Total</u> = gross output.		

-
- (6) Closely analogous to the effect of allocating the imputed bank service charge.
- (7) Will be classified as part of intermediate consumption (for producers) or of final consumption (for non-producers).
- (8) A resource either of the policy-holder or of another beneficiary (e.g. claims paid to third parties)
- (9) For instance, amounts charged by a headquarters company for services rendered to its non-resident subsidiaries.

(d) Gross treatment of reinsurance : direct insurers.

4.6 On the gross treatment of reinsurance, all transactions with policy-holders are conducted by direct insurers (10). Direct insurers purchase a service from reinsurers; reinsurers purchase a service from retrocessionaires; and so on. Leaving aside any ancillary operating revenue, the model becomes the following :-

Direct insurers : output

Premiums earned, gross of reinsurance	Resource
Investment income on policy-holders' funds (whether held by direct insurers or by reinsurers)	Resource
Claims incurred and change in actuarial reserves gross of reinsurance	Use
<u>Total</u> : insurance service charge/gross output	Balance

Direct insurers : input

Intermediate consumption :-

(a) Value of services purchased from reinsurers	Use
(b) Other intermediate consumption (11)	Use

Balance : Value added.

-
- (10) Thus avoiding a main disadvantage of the net treatment, whereby a policy-holder has to be regarded as directly importing a reinsurance service if his direct insurer lays off part of the risk to a non-resident reinsurer.
- (11) Including commissions paid to independent selling agents.

4.7 On the input side of the direct insurer's account, the value of services purchased from reinsurers can be established as follows:-

Premiums ceded to reinsurers: reinsurers' share of the premiums earned (gross of reinsurance)	(Use)
less Commissions etc. received directly from reinsurers	(Negative use)
less Reinsurers' share of gross claims incurred	(Resource)
less Reinsurers' share of change in gross actuarial reserves	(Resource)
+/- Reinsurers' share of other transactions in the direct insurer's profit and loss account (12)	
equals Value of services purchased from reinsurers (excluding value of investment income on reinsurers' reserves due to direct insurer)	Use
plus Investment income on reinsurers' reserves due to the direct insurer	Resource(13)
equals Full value of services purchased from reinsurers	Use

The "value of services purchased from reinsurers (excluding value of investment income on reinsurers' reserves due to direct insurers)" is identical to the "Reinsurance balance" as set out in the 1991 Accounting Directive (see Article 63 - with breakdown by product).

(e) Gross treatment of reinsurance : accepting reinsurer

4.8 The accepting reinsurer may also be a direct insurer. In his profit and loss account, reinsurance premiums accepted from ceding direct insurers (which have the same definition as premiums written by the direct insurer) are separately specified. But other transactions in premiums, claims etc. may be merged with direct insurance transactions.

(12) Balancing item - see text at beginning of next page.

(13) Imputed flow, not part of the "core" of the Manual - see section 6.5 (i).

The model for these transactions is the same as in paragraph 4.7, with signs reversed. This creates a difficulty in the use of administrative sources to supply data for the model : the commissions etc. which the accepting reinsurer pays directly to direct insurers are treated as an undistinguished part of his costs in the Accounting Directive (14) but the model views them as a discount on the reinsurance premiums accepted - as a reduction in a resource, not as a use. They are paid or credited directly by the reinsurer, as producer of the service, to the direct insurer who buys the service, and are therefore unlike other commissions such as those paid by producers to third parties, for instance selling agents. The accepting reinsurer is also viewed as passing on to the direct insurer the benefit of investment income on such part of his reserves as corresponds to his liabilities to direct insurers.

5. COMPARISON WITH THE CANADIAN MODEL.

5.1 The comparison is based on the diagrams distributed to the Voorburg Group last year. The two models have become virtually identical. In the European model, the breakdown into the service and transfer components of operating revenue is done only for the total of premiums plus the investment income on policy-holders' funds, not for the two taken separately. In the case of non-life insurance, the routing of this investment income, as proposed in the SNA, appears to be effectively the same as it appears in the Canadian model. I support the SNA terminology, "premium supplement", though this is not used in the Manual. The Canadian formulation, which views it as a barter transaction between the direct insurer and his policyholder is very illuminating, but it seems to me that a barter transaction, apart from needing a monetary value (not the problem in this case), also needs to be recorded as having two sides to it - as a two-way flow. The SNA formulation achieves this and also achieves, at the cost of introducing imputed flows, a realistic valuation of output, the balance of the production account.

5.2 There may be residual differences in the definition of the value of services provided by reinsurers and if there are, they probably reflect differences between Europe and Canada in the relationships of direct insurers with reinsurers when contracts are "proportional", rather than "non-proportional".

(14) As part of acquisition costs, unless they are renewal commissions, when they are part of "administrative expenses".

In Europe, a proportional contract usually means that the reinsurer reimburses claims and perhaps claims management expenses in proportion to the premiums ceded, but not that he reimburses part of the direct insurer's general management expenses. The reimbursement of claims management costs is covered in the European model as a contribution by the reinsurer (within the "reinsurance balance") to the direct insurer's intermediate expenditure (which is to be recorded gross of any reinsurers' contribution) (15); any other financial contributions by reinsurers to direct insurers (called "reinsurance commissions and profit participations" in the Accounting Directive) are regarded as a reduction in the price of the reinsurance service, by treating them effectively as discounts on the premiums ceded by the direct insurer to the reinsurer.

6. REMAINING ISSUES.

(a) Data problems.

6.1 The minimum amount of data available through regulation is that set by the form of the profit and loss account of the Accounting Directive. When additional data are required for the model, they may :-

- (i) be available already to some, if not all, national regulators;
- (ii) be readily available in the internal accounts of insurance enterprises; or
- (iii) depend on estimates to be made in statistical offices.

When estimation in statistical offices has to be used, the estimates may have to be made at the level of the aggregate for the whole industry, either for a particular product, or if need be for all products combined. Even so, such estimates can still be carried, as averages, into a data base for individual enterprises.

6.2 Labour costs. Labour costs are not separated from intermediate expenditure in the Accounting Directive, in which the total of labour plus other costs is analysed by function. The separation of total labour costs from other costs is usually available from other information held by the enterprise, e.g. its internal cost accounting. Likewise, when

(15) It appears in the "reinsurance balance" as part of the reinsurers' share of claims incurred.

a common staff is shared by both life and non-life insurance enterprises, with charging of total (labour plus other) costs to each, the subdivision into the labour cost and other costs elements is thought to be available from internal cost accounting, especially when the enterprise employing the common staff is a member of the same enterprise group. The subdivision is needed in order to distinguish between value added in life insurance and in non-life insurance.

6.3 Claims management expenses, both external (e.g. payments to loss adjusters) and internal, are merged into "gross claims incurred" in the Accounting Directive. They should be transferred to intermediate expenditure or labour costs as appropriate, otherwise the value of production is understated. In some countries data are available to the regulator distinguishing one or both elements. Otherwise estimates should be made in statistical offices. It is suggested that occasional enquires should be made to a few insurance enterprises about the average proportion of claims management expenses to total gross claims incurred: in the case of non-life insurance, the ratios should be broken down by product, as the expenses probably vary considerably according to product. Gross non-life claims incurred by direct insurers, broken down by product, are available in Article 63 of the Accounting Directive.

6.4 Commissions payable by accepting reinsurers to direct insurers In the accounts of the accepting reinsurer, these should be transferred from costs to negative revenue (e.g. as discounts given on the reinsurance premiums accepted). Information on them may be available to the regulator. If not, they can be estimated as a proportion of reinsurance premiums accepted (which, when significant, are identified in Article 63).

6.5 Investment income on reinsurers' reserves should be attributed to the production account of direct insurers, as the policy-holders of direct insurers benefit from investment income whether or not part of the insured risk is laid-off to reinsurers.

(i) In the direct insurer's account. The liabilities side of the balance sheet (Article 6 of the Accounting Directive) shows provisions gross of reinsurance and also shows the amounts laid-off to reinsurers. Portfolio investments (assets) largely reflect the net amount of these liabilities. Therefore, on the - rather large - assumption that the rate of return on investments held by the reinsurer is the same as that on investments held by the direct insurer, the benefit to the policy-holder from the provisions laid-off to reinsurers

can be estimated. In terms of the model for direct insurers set out in para 4.6 above, the same amounts will be included in respect of investment income due from reinsurers, both as a resource (as part of investment income on policy holders' funds), and as a use (as part of the value of services provided by reinsurers - see also para 4.7).

(ii) In the accepting reinsurer's account. The value of the service provided to the direct insurer includes the investment income on the reinsurer's technical reserves (see paras 4.7 & 4.8), so no adjustment is necessary. The investment income - being treated as a "premium supplement" - is tantamount to an addition to turnover. Thus, as with turnover in general, it is not additive to an industry-wide aggregate. A simple illustration is given on page 17.

- 6.6 Investment income of direct insurers by product. Although the Accounting Directive does not specify a product breakdown for the level of technical provisions, as shown in the balance sheet, it is believed that, for non-life insurance, this information is generally available to regulators, net of reinsurance and possibly also gross of reinsurance. The collection of such information by Eurostat has been envisaged in the first draft of a possible EC Legal Act (see para 2.3 above). Investment income by product, for non-life insurance, could then be estimated from the relative size of the technical provisions. In the absence of such information, the product split of investment income could still be estimated from a simple model which accumulated premiums and claims subdivided by product, preferably accompanied by information, which is often available for classes of business such as marine, aviation and transport, on the period elapsing before claims are paid.

(b) Other issues.

- 6.7 Value of production by product. The General Framework of Eurostat's Manual on Statistics of Services specifies a product breakdown for turnover only. This is often an adequate proxy for the breakdown by product of output, but not in the case of insurance, where only a small part of turnover carries down to gross output. However, for direct non-life insurance both gross premiums earned and gross claims incurred will be broken down by product (Article 63 of the Accounting Directive). If estimates are made of investment income subdivided by product for direct non-life insurance (including therefore the benefit to policy-holders of the investment income on funds held by reinsurers), the way is open to an analysis by product of the value of production (gross of reinsurance), for non-life insurance only.

6.8 Counterpart industries or sectors. The enterprise-based model of insurance looks at the question of measuring the output of the industry. What is the output of one industry is the consumption (intermediate or final) of other industries or sectors. In the national accounts, the distinction which is seen by the insurance industry, between claims (transfers) and output, has to be carried into the accounts of the policy-holders, be they also industries or final consumers. This distinction is not usually perceived by the policy-holder. Furthermore, output will in future be measured including premium supplements (investment income on reserves due to policy-holders), an element which the policy-holders are also not directly aware of. These matters are covered in the separate paper entitled "enterprise statistics in the macro-economic framework, with reference to insurance".

7. EFFECT OF THE THIRD GENERATION DIRECTIVES

7.1 These Directives create a common market in both non-life and life insurance services throughout the EC, and potentially the whole EEA. There are two mechanisms - the right of establishment, viz. to set up a branch anywhere in the Community, and the right to provide services, for instance by mail order from the home country. In both cases, the system of regulation of the home country - the country in which the parent enterprise is located - will apply throughout the Community. Only subsidiaries set up in other Community countries will be subject to the regulation of the country in which they operate. The consequence is that a Regulator in country X cannot demand information from the branches located on its territory which belong to a parent enterprise in another Community country, say Y. The regulator in country Y will however on request provide the regulator in country X with information for the aggregate of such branches, under certain specified headings which relate to activities rather than to solvency - for non-life insurance premiums, claims and commissions, broken down by seven product classes (Article 44); and for life insurance premiums only, without product breakdown (Article 43).

7.2 In country X, therefore, administrative sources will be incomplete in so far as insurance services are produced by branches of other EC enterprises or by mail order. Aggregates for the whole EC will still be available from the administrative sources, but not as aggregates divisible into member states. For congruence with the general system of macro-economic statistics, however, aggregates for individual member states are still needed; for instance, in the case of intra-community visible trade extensive steps have been taken to ensure that country-specific aggregates, together with some information on the direction of trade, will be maintained.

- 7.3 The implications of this are to be discussed in Eurostat's Working Group on statistics of insurance services and in its Task Force. The information to be passed between regulators, if all countries made the maximum request, would cover 12 countries (in future, 18), each broken down by 11 (17) others. An alternative would be centralisation of data exchange. This could be either for both administrative and statistical purposes, or for statistical purposes only. However, at present there is some doubt whether statistical purposes are recognised as a valid use of the aggregated data obtained in the exchanges. In principle it might be possible to extend, for statistical purposes only, the range of information collected by the clearing house - provided always that all 12 regulators decide for their own national purposes to collect more than the range of information specified in Articles 44 and 43.
- 7.4 A less satisfactory alternative would be to rely on supplementary surveys for statistical purposes conducted by national statistical offices. The difficulty with non-resident branches already exists when statistical enquiries are run - at least, it does in the UK. The UK CSO run extensive statistical surveys of UK insurance companies (including the branches in the UK of foreign companies). The underlying reason for relying on statistical surveys to supplement the information collected by the regulator has to do, I believe, with the practice in the UK of obtaining information primarily on a "global" basis (meaning consolidated, world-wide). This applies both to the published annual accounts produced for shareholders and to much information supplied to the regulator (16). In the statistical surveys, information is sought on the same definitions as used by the regulator, covering both profit and loss account and balance sheet, but which relates only to the UK territory. In defining this territorial coverage the request is made to treat the non-resident

(16) This procedure reverses the timescale normally expected; thus consolidated and global information is provided first of all to the shareholder; then more detailed information, much of it also global, is provided to the regulator; and lastly "de-consolidated" information relating to the UK territory is provided to the CSO.

branches of UK parent insurance companies as if they were subsidiaries (i.e., to exclude them) (17). It is recognised, however, that the smaller non-resident branches cannot always be readily separated, and to this extent the territorial coverage departs from that which is ideally required. The requirements of Articles 44 and 43 may help to improve the situation in this regard, but only for the profit and loss account.

8. SOME THOUGHTS ON PRICES AND QUANTITIES

- 8.1 The 1991 paper has been distributed to Eurostat's Working Group, but so far there has been insufficient time to discuss it. In any event, things have moved on since then. For non-life insurance, we now have the prospect of a settled product classification and an agreed definition of the value of production both gross and net of intermediate consumption, with reinsurance treated as the purchase of a service. To carry the breakdown by products down to the level of value added also appears possible, with some estimation. (Gross operating expenses broken down by product, for direct insurance, are specified in Article 63 of the Accounting Directive). Whether the elements which need to be estimated are to be carried into a disaggregated data base for individual enterprises, which could in principle be done by further estimation in statistical offices, remains an open question.
- 8.2 Even with figures of gross and net output at current prices broken down by product, there are considerable difficulties, both conceptual and practical, in revaluing them to the constant prices of a base year. The easiest approach in practical terms appears to be "bottom up" (see para 4.1), but it suffers from various disadvantages : -
- (i) There is no conceptual basis for deflating operating surplus, which is a balancing item
 - (ii) The subdivision of value added in to labour costs and operating surplus, broken down by product, will not be directly available.

(17) However, their profits etc. are reported separately, for the balance of payments estimates.

- 8.3 An alternative would be to take the figures at current prices, broken down by product, as a base and to project or extrapolate them using indicators of "real" output. The obvious ones are the number of policies in force. The tentative proposal for an EC legal act envisages the collection of figures of the number of policies in force, broken down by product, in the case of non-life insurance. The conceptual difficulty is how to allow for quality changes - e.g. changes in policy conditions on renewal. In principle their effect at the time of the change could be estimated either from the increase in 'price' (i.e. premium rate) for unchanged policy conditions or from the expected reduction in the cost of claims with the changed policy conditions.
- 8.4 Double deflation is conceptually the best approach, but - for insurance - it appears to suffer from major practical snags. These are on the gross output side of the account. Unlike most products, there is no single "price" of the product produced, which could be used for deflation. I do not believe that it is justifiable to take changes in the premium rate for a defined package of cover as a deflator of gross output. These suffer from the difficulty that they are affected by changes in the frequency of transfers between policy holders (changes in the frequency of claims on insurers). To take a simple example, which assumes (i) a non-inflationary environment, (ii) a change in the frequency of claims and (iii) perfect knowledge on the part of the insurer :-

	Year 1	Year 2	Change
No. of policies	100	100	0
No. of claims	100	150	50%
Premium rate	100	140 *	40%
<u>Output at current prices</u> (monetary values)			
Premiums earned	1000	1400	40%
Claims incurred	800	1200	50%
Balance = gross output	200	200	0

* See "premiums earned", in the lower section of the table.

If costs and real profits remain unchanged, gross output in year 2 at the price of year 1 should remain 200. However, if the change in the premium rate is used as a deflator, the deflated figure for gross output in year 2 would become 143 (= $100/140 \times 200$). This is plainly wrong.

- 8.5 In principle it might be possible to overcome this difficulty by choosing separate product-specific deflators for premiums and claims, or by seeking some means of stripping out the above mentioned "volume" component in changes in the premium rate. There would still be the difficulty that errors in the relatively large numbers for premiums and claims, when deflated, might be magnified in the balancing figure, deflated gross output. This whole area requires further investigation and practical experimentation.

ERRATA IN THE INSURANCE CHAPTER

(Version 1.4 of April 1993, as attached to this cover note)

Page

- 5 "Explanation of the symbols" : the double line ('tram-line') should read "border of the enterprise group, having excluded its non-resident elements". There will be parallel changes to page 24 of the Insurance Chapter, and to references to the institutional unit, *passim*.
- 86 &
88 The heading "commissions and profit participations received" (heading 3(a), Code 83a) should be transferred to become a new heading 7 (c) - as part of "services received from reinsurers" - on pages 87 and 89 respectively. The existing heading 7 (c) on pages 87 and 89, "remainder of the reinsurance balance", should be renumbered as 7 (d). There will also be a change to the familiar net of reinsurance model (page 90), in which reinsurance commissions received (part of heading 3) should become a deduction from "outward reinsurance premiums" (heading 1 (b)).
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Re : EURJW 169

ILLUSTRATION

INVESTMENT INCOME ON RESERVES DUE TO POLICY-HOLDERS : TREATMENT IN ACCOUNTS OF DIRECT INSURERS AND REINSURERS (NON-LIFE INSURANCE)

		<u>DIRECT INSURER</u>	<u>ACCEPTING REINSURER</u>	<u>TOTAL (COMBINED)*</u>
GROSS OF REINSURANCE				
PREMIUMS :-				
Actual premiums earned	50)			
	50)	100	50	150
Premium supplements (investment income)	10)			
	10)	<u>20</u>	<u>10</u>	<u>30</u>
		120	60	180
CLAIMS INCURRED	45)			
	45)	-90	-45	-135
		---	---	----
BALANCE : VALUE OF PRODUCTION, GROSS OF REINSURANCE		30	15	45
		---	---	----
INPUTS :-				
VALUE OF SERVICES FROM REINSURERS :				
Actual premiums ceded		50		
Premium supplem- ents ceded		<u>10</u>		
		60		
Reinsurers' share of claims		<u>-45</u>		
= VALUE		15		15
OTHER INTERMEDIATE COSTS		5	5	10
LABOUR COSTS		5	5	10
		--	--	---
BALANCE = PROFIT		5	5	10
		--	--	---

* Duplication in all headings except the last three.

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STATISTICAL OFFICE OF THE EUROPEAN COMMUNITIES

**METHODOLOGICAL MANUAL
OF STATISTICS ON SERVICE ENTERPRISES**

CHAPTER "INSURANCE"

**Version : 1.4 Preliminary
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I. INTRODUCTION

1.1 Objectives

800. This chapter on insurance aims to complement the General Framework and take account of the special features of insurance. It should not be seen as a programme but as a set of methodological guidelines to assist member states.
801. Although the manual is only for guidance, its General Framework gives standardized definitions of the statistical units of observation, of activity classifications and of the economic variables. This chapter adapts these definitions to the circumstances appropriate to insurance, and adds definitions of economic variables which are specific to insurance. These definitions are also based on, or reconciled with, the definitions used in other information systems for insurance, in particular the statistics prepared by the OECD Insurance Committee and the layout of the profit and loss account of insurance enterprises, contained in the Council Directive 91/674/EEC of 19 December 1991 on the annual accounts and consolidated accounts of insurance undertakings ⁽¹⁾, hereafter referred to as the 1991 Accounting Directive.

1.2 General description of the insurance sector

802. The term insurance covers a number of different activities, which are destined to satisfy different needs and to perform various functions in the economy. Two elements characterize the activities of insurance: the diversification of risks, and the allocation of financial resources.
803. The main economic function is to transfer risks to specialized companies which assure risks to a certain amount through the collection of a payment (premium). However, there are differences between types of insurance: the basic underlying principle of non-life insurance is the 'mutualization of risks' transferred by a wide range of insured persons or institutions; in life insurance, there are two functions: the mutualization of risks and financial intermediation (the management and investment of savings). Reinsurance has as its objective the distribution and compensation of mainly large risks.
804. Insurance companies, especially life-insurance companies, are also financial institutions (although not in the technical sense of the 1991 Accounting Directive) which play a very important role in the allocation of resources. The large amounts of money regularly received in the form of premiums have to be properly invested in various types of assets to ensure the necessary solvency and liquidity to meet claims: part of these amounts has to be invested in assets as determined by legislative technical provisions. In this respect, insurance is subject to economic policy.

(1) 91/674/EEC Official journal L 374 of 31 December 1991, p.7

805. Life and non-life insurance can be further divided into different classes. Life insurance embraces operations based on capitalization, of which there are a great variety: survival or death insurance, annuities, supplementary insurance against special personal injury or sickness, permanent health insurance, capital redemption operations, management of pension funds, etc. Non-life insurance business can be divided into a number of classes: accident and sickness, motor insurance, transport, fire and natural forces, civil liability of all kinds (motor, industrial, professional, etc.) credit and suretyship, financial losses, legal expenses, etc.
806. The different classes of insurance also vary, as a result of the unique requirements of the industry that is being insured. For example, reinsurance and transport insurance are, by far, the most internationally traded businesses. Transport insurance is a necessary complement to transportation and it is customarily provided by the seller under the usual terms of international trade.

2. THE ENTERPRISE AS THE BASIC STATISTICAL UNIT IN THE SECTOR

2.1 Potential statistical units in the sector

807. The General Framework lists and defines four types of statistical unit, in accordance with NACE 70.

- the enterprise,
- the group of enterprises,
- the local unit,
- the kind-of-activity unit.

As far as statistics on the insurance sector are concerned, these units are of varying significance, as discussed in the following paragraphs.

808. It is suggested that in the case of insurance, as for other financial service activities, the statistical unit should generally be the "enterprise". It is the lowest level of unit which is legally autonomous, which keeps a separate and complete set of accounts and which is assessed for taxes on income.

809. In many member states existing statistical enquiries directed to insurance undertakings are likely to have been designed on the basis that the "enterprise" is the statistical unit; and the situation may well be the same, at present, in respect of returns required by most national supervisory bodies. But in some member countries, where consolidation of published accounts is already the norm, statistical enquiries will have been designed taking the group of enterprises, with non-resident subsidiaries de-consolidated, as the unit.

810. In some member states the legally autonomous enterprises may not qualify as separate "institutional units" (as defined in ESA 212-216) because they do not have autonomy of decision with respect to income distribution and financing. Where the enterprise and institutional unit are not identical, the latter may be the only feasible unit for reporting certain variables - see para 815 below. For preference, the degree of aggregation of the enterprises should still be only to the lowest level at which there is autonomy of decision. So the enterprise is the preferred unit.

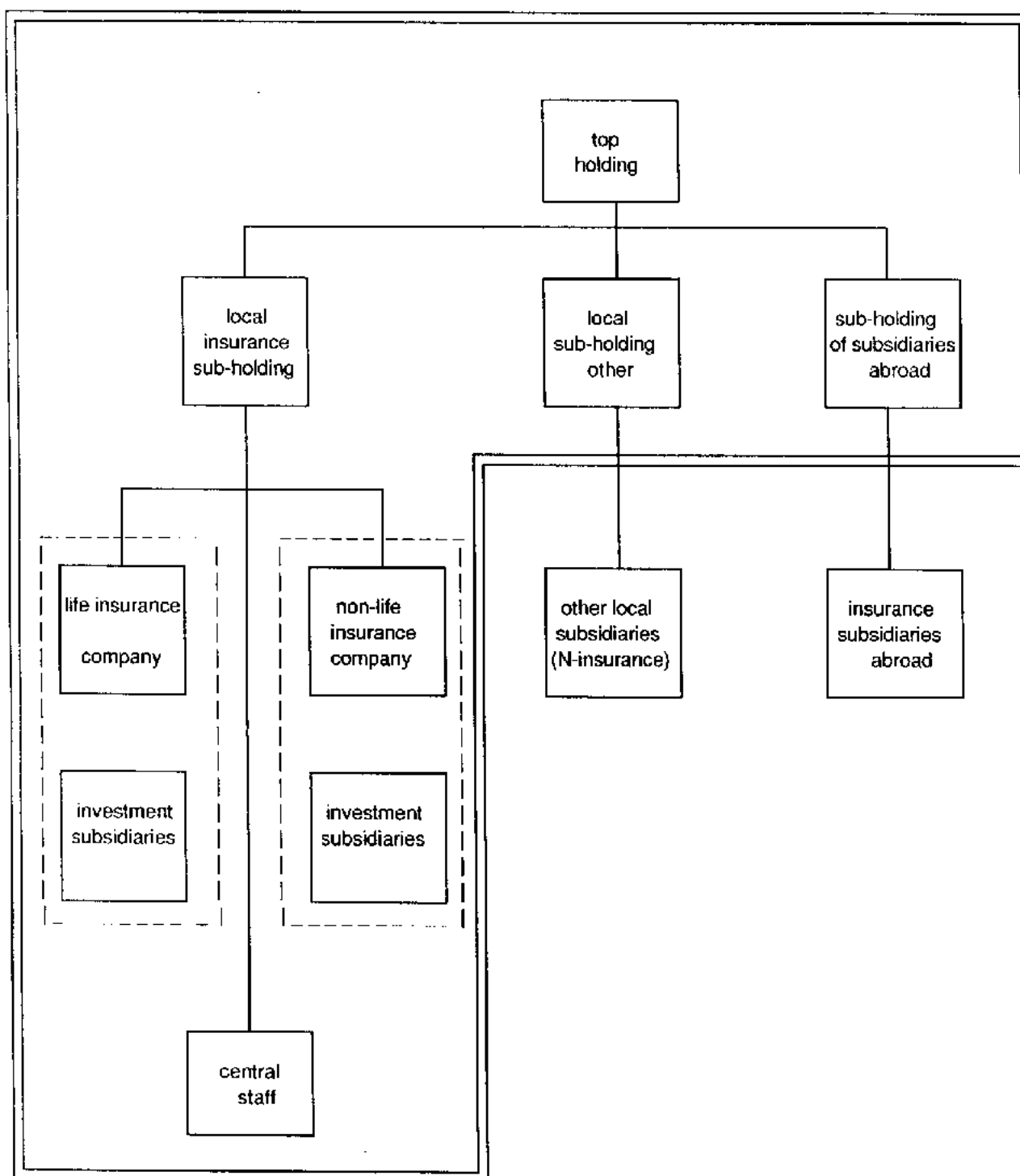
811. The arguments against an even lower level of unit (such as the "local unit") seem compelling, in the case of insurance. The underwriting of risks is a centralized function; so is the investment of funds. The sale of insurance is often done by mail or through independent intermediaries (brokers), so that in most countries insurance enterprises have few local offices. There is little point, therefore, in collecting separate figures for the few local offices of insurance companies.

812. The arguments against taking the group of enterprises as the unit are not quite as conclusive. The 1991 Accounting Directive puts emphasis on the consolidated accounts implying that separate accounts for the constituent undertakings may have less importance than hitherto, and may not even be published separately. The group of enterprises could therefore be considered as a potential unit.

2.2 Structure of enterprises in the sector

813. In general, the structure of the enterprises corresponds to the structure of the activities. Enterprises specialize in life insurance or in non-life insurance. Some specialize in reinsurance but reinsurance is also conducted by enterprises mainly engaged in direct insurance. Lloyds' of London also specializes in reinsurance; in form it is an association of underwriters but it appears to qualify as a quasi-corporate enterprise (as defined in ESA 223.1 and 235e). In a number of member countries, there exist "composite" insurance enterprises which conduct both life and non-life business and pool their costs. In other countries, whilst life and non-life insurance enterprises are legally separate, they have only a small staff and purchase the services of a separate enterprise, which provides common administrative services to both life and non-life enterprises.
814. In some member states the organization of a typical group of insurance enterprises has the structure of the diagram on page 5, in which non-resident subsidiaries are not owned directly by resident insurance enterprises, and in which the "institutional unit" brings together both life and non-life insurance activities. A further characteristic of the institutional set-up in these and possibly other member states is that certain statistical data (variables) may have to be obtained on the basis of the enterprise as the unit, and others (eg. central staff costs) on the basis of the "institutional unit".
815. In the diagram on page 5, the top holding unit is included within the insurance institutional unit, since the institutional unit is used in describing the process of income distribution and financing and the underlying legal units do not have autonomy with regard to this process. Secondly, when (as in some countries) subsidiaries located in foreign countries are owned directly by the top holding unit, the institutional unit excluding the top does not possess information about these subsidiaries.

Figure 1 - The structure of a typical insurance group



Source: CBS, Netherlands

Explanation of the symbols

- _____ border of the legal units
- border of the enterprise
- ===== border of the institutional unit

2.3 Advantages and disadvantages of the enterprise as the basic statistical unit in the sector

816. Analytical advantages and disadvantages: in section 2.1 the tentative conclusion was drawn that, in the case of insurance, the enterprise was preferable as the unit of observation for analytical purposes.
817. If insurance undertakings market subsidiary products, the insurance activity will be accompanied by these subsidiary activities wherever no separate enterprise is established, but this problem would be exacerbated by taking a wider unit of observation. Examples are : insurance broking, the letting and management of real property and the financing of the construction of real property.
818. Advantages and disadvantages in data collection: It is common for a financial institution to engage in financial activities other than the mainstream ones. For instance, it is common for credit institutions to offer insurance to their customers from within the same company group. But a separate insurance subsidiary is usually set up for the purpose - that is, a separate enterprise, with its own accounts; indeed, national regulation of insurance may demand this. This phenomenon points to an advantage of taking the enterprise as the unit; the figures for the credit institutions based on the enterprise unit would then show separately their profits derived from ancillary activities such as insurance.
819. In some countries, however, the regulation of insurance, and the requirements for the publication of accounts, relate to the group. The 1991 Accounting Directive also relates to consolidated accounts, i.e. to accounts for the group of enterprises. In these cases data relating to the constituent enterprises of the groups would have to be obtained separately, as they would not appear in the published accounts.
820. There are serious disadvantages to the use, for economic indicators, of data taken only from the consolidated accounts of groups of enterprises:
 - a) Such consolidated data cover group transactions whether in the reporting country, in other member states or in non-member states; but it is fundamental to macro-economic statistics that subsidiaries and branches situated in other countries should be separated from their parents.
 - b) The groups may be conglomerates: e.g. banks which own insurance companies.
 - c) The coverage of the company group may well change over time.
 - d) Generally, data taken from a unit at a high level of aggregation is less informative than that taken from units at a lower level of aggregation.

821. One alternative, where published figures are used as the primary source, is to de-consolidate partially by obtaining separately only figures for those enterprises within the group which are located outside the domestic territory; this is necessary in any event, in order to compile figures for the balance of payments. The result will be to obtain a figure consolidated at the level of the domestic territory, in which only transactions with subsidiaries and branch offices located outside the domestic territory will be treated as transactions with separate enterprises. This may be adequate for macro-economic statistics but is only a second best for other analytical purposes: for instance, the partially consolidated figures relating to the domestic territory would not show separately transactions between direct insurers and any specialist reinsurer which, although a separate enterprise, was part of the same company group. The resulting institutional unit will not be wider in its scope than the resident part of a company group, since by definition institutional units always exclude non-resident entities; also, as with statistics based on the company group, the resident parts of non-resident entities should be included, as "notional resident units", ESA 214.
822. Also, for consistency with the definitions used in the balance of payments and national accounts, the activities of the enterprise should cover only those activities which are conducted on the domestic territory. It may be necessary to adjust the figures in the annual profit and loss account of the parent enterprises, which may include the activities of their branches (as opposed to subsidiaries) resident in other countries. Most multinational activity is however conducted through subsidiaries, which by definition are separate enterprises with separate accounts.
823. A different situation occurs when the principal activity of a financial institution is combined with other kinds of subsidiary activities. In these cases any figures based on group accounts would include both the subsidiary and principal activities. When the subsidiary activities cross the boundary between insurance and monetary intermediation or other financial intermediation, de-consolidation of group figures will be necessary. In that situation, the whole group would be divided into separate institutional units and the top holding unit would then form an institutional unit by itself.
824. Another phenomenon is that of the life insurance company which owns one or more Unit Trusts (or in french SICAV - société d'investissement à capital variable). These may well be set up as separate subsidiaries. The reverse phenomenon, that of the Unit Trust which owns a life insurance subsidiary, for instance in order to qualify for tax relief on pension business, also exists. This clearly illustrates the difficulty of taking figures only at group level. A unit trust will be classified to another heading of the activity classification (probably NACE/Rcv.1 67.12), so that, if it owns a life insurance subsidiary and figures are only obtained for the whole group headed by the unit trust, it would be necessary to breakdown the group figures into those relating to the primary activity (unit trust) and those relating to the secondary activity (life insurance). If, however, the life insurance business is conducted through a separate subsidiary established for that purpose, figures compiled at enterprise level will distinguish the two activities without further adjustment. Conversely, when an insurance undertaking owns separate investment subsidiaries, it may be convenient to regard both these subsidiaries and the parent undertaking as forming a single "enterprise" (in the sense of a statistical unit), even if the investment subsidiaries take the form of unit trusts (see diagram on page 5).

3. **SCOPE AND STRUCTURE OF THE SECTOR**

3.1 **Main activities of the sector**

825. Insurance is generally understood as being the accepting (or "underwriting") and spreading of risks, with the provision of an indemnity in monetary form on the occurrence of specified events. The contract between insurer and insured is set out in a "policy"; the insured person pays, usually annually, a specified "premium" to secure the indemnity or indemnities specified in the policy. Often the insurer lays off, or reinsures, part of the risk with another insurer or with a specialist reinsurer, particularly in the case of large risks which are to be insured against casualty or accident. Premiums received from policy holders are known as "direct" insurance, as distinct from premiums accepted from other insurers for reinsurance. There is a main distinction between life and non-life (accident and casualty) insurance.
826. In several EC countries life insurance enterprises now do much deferred annuity business ("pension funding") in which payment of an indemnity on death is secondary, and the main purpose is the provision of a pension, on survival to a specified retirement age. This is the main method of provision of private ("occupational") pensions in some countries and is a development of two earlier variants of life insurance proper - "endowment" insurance (payment of a capital sum on survival to a specified age) and annuities (payment, in exchange for a capital sum, of an annuity so long as the annuitant survives). In NACE/Rev.1, pension funding is shown separately from other life insurance.
827. In the case of life insurance and pension funding, where the insured events occur in the long-term, the activity of insurance enterprises is to a large extent the investment of the funds received as premiums, to the policy-holder's best advantage. It therefore overlaps with the parallel activity of other financial intermediaries - banks, investment funds managed by intermediaries such as stockbrokers, unit trusts and investment trusts.
828. Such intermediaries also engage, for example, in funding for pension provision. So do large companies (both non-financial and financial) on behalf of their own employees. The companies appoint independent "trustees" to manage the pension fund. Sometimes the trustees themselves manage the investments of the fund; sometimes they hand investment management over to a financial intermediary, which could be an insurance enterprise. When they take the former course, the fund can be called a "self-administered" pension fund.
829. Investment intermediation is classified in NACE/Rev.1 either to 65.23 ("other financial intermediation n.e.c.; ISIC/Rev.3 6599") or to 67.12 ("security dealing activities" within which the draft CPC has 81323 "portfolio management services"). In the present state of affairs, however, it is only realistic to regard life insurance as a single activity; and to continue to accept the convention which gives the mutualization of risks precedence over investment intermediation and so classifies the integral activity of a life insurance "enterprise" to one activity heading. This is the approach of NACE and ISIC (NACE/Rev.1: 66.01-66.02; NACE/70: 822).
830. Non-life insurance is included as a single activity in the international classifications (NACE/Rev.1 66.03). The breakdown by types is a matter for the product classification.

831. The activity of insurance and pension funding is accompanied by auxiliary activities (NACE/Rev.1 67.20). The main one is insurance broking - independent agents who act for the insured person, advise him on competing insurers and place business on his instructions. They are remunerated by a commission from the insurer who gets the business. Loss adjusting - the negotiation on the value of the indemnity, when a claim is made in respect of non-life (casualty and accident) risks - is another activity which appears to be auxiliary to insurance. The loss adjuster is both employed and remunerated by the insurer; his remuneration may be on a time basis or on a commission basis. Other activities identified as auxiliary are: insurance and pension consultancy services; independent actuarial services and salvage administration services.

3.2 Activity classifications

832. The way in which the services described in 3.1. above relate to the international classifications can be seen in the table below, which relates to the EC activity classification NACE/Rev.1, and in Annex 2. This Annex does two things :
- a) it compares, for insurance services, the *activity* classifications NACE/70, NACE/Rev.1 and ISIC/Rev.3 ;
 - b) it develops the activity classification NACE/Rev.1 into a *product* classification called "Classification of Products according to Activities" (CPA). CPA is the Community version of the UN's CPC. See the commentary on CPA for insurance in paragraphs 850-51 below.

TABLE 1. Activity classification in Insurance NACE/Rev.1

NACE/Rev.1

66	INSURANCE AND PENSION FUNDING, EXCEPT COMPULSORY SOCIAL SECURITY
66.0	Insurance and pension funding, except compulsory social security
	This group includes:
	- long and short term risk spreading with or without a savings element
66.01	Life insurance
	This class includes:
	- life insurance and life reinsurance, with or without a substantial savings element
66.02	Pension funding
	This class includes:
	- the provision of retirement incomes
	<i>This class excludes:</i>
	- <i>non-contributory schemes where the funding is largely derived from public sources cf. 75.12</i>
	- <i>compulsory social security schemes cf. 75.30</i>
66.03	Non-life insurance
	This class includes:
	- insurance and reinsurance of non-life business;
	. accident, fire
	. health
	. property
	. motor, marine, aviation, transport
	. pecuniary loss and liability insurance
67.2	Activities auxiliary to insurance and pension funding
67.20	Activities auxiliary to insurance and pension funding
	This class includes:
	- activities involved in or closely related to insurance and pension funding other than financial intermediation;
	. activities of insurance agents
	. activities of insurance risk and damage evaluators

833. Units engaged in several types of insurance. Except in the case of reinsurance, the so called "composite" undertakings exist in only seven member countries - Belgium, Greece, Italy, Luxembourg, Portugal, Spain and the United Kingdom; in many of these countries new "composite" companies cannot be set up. They were treated as a separate activity group in NACE/70 where they were classified under heading 821 but NACE/Rev.1 requires their business to be split between the 3 types: life, pension funding and non-life. This will cause difficulty. The OECD statistics indicate that for most countries the split of their premiums (turnover) between life and non-life is available. But data, on their investment income, on their costs and on the numbers of their employees cannot usually be split between the three types of business. However, the 1991 Accounting Directive does envisage that, in the profit and loss account, investment income and total administrative expenses should always be split between life and non-life business.
834. For units formerly classified in NACE/70 821, it is proposed that, so long as the whole activities of these units cannot be allocated integrally to the three categories in NACE/Rev.1, the approach should be to split the variables between life and non-life wherever possible.
835. Reinsurance - treatment in activity classifications. The term "reinsurance" is used when part or all of the risks underwritten by one insurer are transferred to a reinsurer on payment of a reinsurance premium, the reinsurer accepting responsibility for that part of the risk so transferred. The reinsurer may be a specialist undertaking, or may conduct both direct insurance and reinsurance. Much reinsurance is done for the so-called "large" risks, e.g. the insurance of ships, aircraft and oil rigs and of the civil liability attaching to their operation. This indicates that reinsurance is mainly important for the non-life insurance sector, as is supported by OECD statistics. Reinsurance is similar to the process of sub-contracting. It seems appropriate to confine the term to the transfer (or sub-contracting) of underwriting risks, and not to use it when the management of investments is transferred to another enterprise, eg. by a pension scheme to a life insurance enterprise. In such a case, the life insurance enterprise usually only acts as the agent of the pension scheme.
836. In both NACE/70 and NACE/Rev.1, reinsurance is included with direct insurance. Thus NACE/Rev.1 differs from NACE/70 in introducing, as an integral part of the classification, the process of subdividing the reinsurance business accepted by "composite" insurers between life and non-life.⁽²⁾ The 1991 Accounting Directive also envisages that the reinsurance component should be subdivided between life and non-life, as part of the calculation of both earned premiums and of claims incurred; separate "technical" accounts for life and non-life are to be shown within the profit and loss account.
837. Life insurance and pension funding - treatment in activity classifications. NACE/Rev.1 differs from NACE/70 in introducing a sub-division between life insurance and pension funding. There may be practical difficulties in making this distinction when both activities are conducted by a life insurance undertaking which does not set up separate enterprises for the two activities. This difficulty could arise in two ways:

(2) With respect to premiums (turnover), the same process is followed through in the OECD statistics, in arriving at "net written premiums".

- a) the allocation of the whole, undivided, undertaking to the appropriate activity class (66.01 or 66.02 of NACE/Rev.1 : see paragraphs 843-846),
- b) Irrespective of the activity class, the subdivision of key variables (notably turnover, Code 8) between direct life insurance premiums and pension contributions (see para 847).

It is proposed that the subdivision should be based on the nature of the contracts between the life insurance/pension funding enterprise and its policy holders/contributors.

- 838. Types of contracts. Most single premium contracts (eg the purchase of an annuity for a capital sum, or capital redemption contracts) should be regarded as part of the life insurance activity.
- 839. Contracts which are appropriate to ordinary life insurance (Class 66.01 of NACE/Rev.1) are those where the major part of the benefit to the policy holder, on maturity, may be taken as a capital sum. If the option exists - at the outset - to convert this capital sum, in whole or in part, into an annuity, the contract should still be regarded as ordinary life insurance, because the maturity value may still be taken mainly as a capital sum. Naturally, contracts which mature only on death should be classified as ordinary life insurance, because the maturity value is available as a capital sum and is only optionally converted to an annuity to the beneficiaries of the deceased person's estate. Contracts which mature on survival for a specified period, or on survival to a specified age, will also be classified as ordinary life insurance, if the option exists to take the main part of the maturity value as a capital sum.
- 840. Contracts which are appropriate to pension funding (Class 66.02 of NACE/Rev.1) are those where it is inherent in the nature of the contract that the main part of the benefit on maturity must be taken in the form of a pension or annuity ("the provision of retirement incomes"). Often a restriction of this nature is placed upon the contract, to satisfy the requirements of direct tax authorities, who then allow more generous tax privileges (typically, deductibility of all contributions from taxable income, and tax exemption of all the investment income and capital gains of the fund). The direct tax authorities may also demand that the contract specifies no surrender value before maturity and that the contract may not mature before a specified age (typically 55). They may allow a minor proportion of the benefit to be taken as a capital sum (typically 25%), provided that the main part of the benefit is taken as a retirement income for the beneficiary or his/her spouse; this will be taxed as income in the years in which it is received. The concept is that of deferred income.
- 841. It is not necessary that the pension should be obtained from the same financial intermediary as that which manages the savings up to the time of retirement - it is only necessary that the main part of the benefit on maturity should be taken in the form of a pension payable up to death. Also, it is not necessary that the contributions and benefits should be obtained through a group (whether a group of employees or of the members of profession). In the United Kingdom, and possibly in other member states, it is provided by law that membership of group schemes should not be made compulsory as part of an employment contract, and private pension schemes for individuals are actively marketed by financial intermediaries. The contracts will then specify what share the individual contributor has in a pension fund set up by the financial intermediary. It may specify the conditions under which the maturity value may be converted to a pension.

842. Pension contracts may include additionally rights to a pension and/or capital sum on premature death or invalidity. The proportion of contributions required to obtain these benefits is typically small, and typically the contract does not allow any choice about obtaining these benefits, or any option to use a separate intermediary. Thus, when the contract is a "package" including (mainly) a retirement income, but also (secondarily) rights to premature benefits on early death or invalidity, the contract is still a pension contract.
843. Allocation of enterprises to the appropriate activity class. Many pension funds (66.02 of NACE/Rev.1) have no activity other than pension funding (as defined above). These include pension schemes set up by employers or professional associations. Those set up by large employers may be self-administered. When for a group the management of investments, and/or the insuring of risks of premature death and invalidity, is handed over to a financial intermediary acting as agent - which may be a life insurance enterprise, but may be a unit trust or a bank - the pension funding activity is that of the group scheme and should be regarded as remaining in 66.02 of NACE/Rev.1. Likewise for pension schemes where a financial intermediary offers pension contracts to individuals.
844. Activity Class 66.02 excludes, as stated, non-contributory pension schemes - whether funded or not - set up by public sector employers and (if funded) financed entirely by employer contributions. Any other pension schemes which are not funded are also excluded - notably the "régime de répartition" in France. Pension schemes for civil servants and other public sector employees will, however, be included if they are both funded and contributory; that is, if the employee also makes a contribution. However, the contributory schemes for some public sector employees in the United Kingdom which are not funded, even though the employee contributions are calculated on an actuarial basis (known as "notionally funded" schemes) are not included, because there is in reality no fund.
845. Often a life insurance enterprise will mix ordinary life insurance with pension funding, without establishing separate enterprises for each. The normal criterion for determining which activity is primary and which secondary is the contribution of each to value added, for which turnover is often taken as a proxy. However, there are various reasons for proposing, in this case (exceptionally), that the enterprise should remain classified to class 66.01, unless the proportion of ordinary life contracts is minimal (say under 10% of premium/contribution income).
These reasons are:
- a) Supervision of ordinary life insurance may be different from that of pension funding. It is useful to have all enterprises covered by life insurance supervision classified to NACE/Rev.1 66.01.
 - b) The proportion of each activity may be close to 50:50, thus creating the danger of instability of classification.
846. A life insurance enterprise classified to NACE/Rev.1 66.01 would thus very often have pension funding as a secondary activity (class 66.02 of NACE/Rev.1). The distinction between the two would be made in the key variable (turnover). It may not be practical to make the same distinction for investment income - often assets are pooled, and this is allowed under the 1991 Accounting Directive.
847. Allocation of variables to the appropriate activity class. As regards turnover, the distinction between the life insurance premiums and the pension contributions received by mixed activity enterprises would be made on the basis of the nature of the contracts (see paras 838-842 above). The following schema would result:

<u>Variables</u>	<u>Activity class</u>	
	66.01	66.02
	<u>Life insurance</u>	<u>Pension funding</u>
Direct Life Insurance Premiums	x	-
Pension Contributions	x	x
848.	When pension contributions are handed over in their entirety to a single insurance enterprise, which both manages the investments and accepts the underwriting risk for premature death, it is unlikely to be possible - when the insurance company rather than the pension scheme is the source of information - to break down the sum transferred between the pension contribution proper and the insurance of premature death etc. In that case the total is better recorded as a pension contribution rather than as a life insurance premium. Double counting of the pension contribution must be avoided.	
849.	<u>Life insurance and pension funding - treatment of reinsurance.</u> Self administered pension schemes, while managing their own investments, usually (but not always) insure risks such as "death in service" with an insurance company; that process should be regarded as the purchase of an insurance service by the pension scheme, not as reinsurance. The reason for this is that a self-administered pension scheme will be classified, by its primary activity, to NACE/Rev.1 66.02 "Pension Funding", which at fourth digit level is separate from NACE/Rev.1 66.01 "Life insurance", the activity appropriate to the insuring of a risk such as "death in service". It might be appropriate to regard it as reinsurance if both the enterprise contracting to provide the pensions and the separate enterprise contracting to insure the risk of premature death had been classified, by reference to their primary activity, to NACE/Rev.1 66.01 "Life Insurance".	
3.3	<u>Product classifications</u>	
850.	This section deals with the relation between the new activity classification and the draft classification by products. In principle a product classification is not just a subdivision of the activity classification, since any activity which has a principal product can be accompanied by subsidiary products which, when they are principal products, fall within another heading of the activity classification. But, it does not appear feasible to subdivide life insurance (considered as a product), between risk spreading (underwriting proper) and investment intermediation. This means that generally the headings of a product classification for insurance will be no more than subdivisions within the insurance activity; but they are very useful as such. The easiest way to study the extent to which the same financial services (products) are carried out by financial institutions (enterprises) falling into different headings of the activity classification, would be to obtain designatory data on the structure and ownership of both insurance enterprises and other financial enterprises.	
851.	Suggestions are given in Annex 2 for the classification of insurance and pension products. For life insurance and pension funding the identified products relate to the First Council Directive for life insurance ⁽³⁾ . The non-life insurance products relate to the First Council Directive for non life insurance ⁽⁴⁾ ; also if appropriate, they take into account the categories as distinguished in the Second Council Directive for non-life insurance ⁽⁵⁾ and the 1991 Accounting Directive.	

(3) 79/267/EEC Official Journal N° L63, 13.03.1979 p.1

(4) 73/239/EEC Official Journal N° L228, 16.08.1973 p.3

(5) 88/357/EEC Official Journal N° L172, 04.07.1988 p.1

4. ECONOMIC VARIABLES IN THE SECTOR

852. A number of variables are common to all services sectors. They are defined in the "General Framework" but some are adapted to the circumstances of insurance and other variables are specific to insurance ; these are included in the following table and defined in Annex 1.
853. As mentioned in paragraph 814, institutional differences between countries are such that, in some countries, some variables can only be obtained for institutional units (ESA 211-216), and some - notably employment variables - only for a combination of life and non-life enterprises. Table 2 on page 24 sets out the various possibilities; when reporting data it is important that member states identify the variables for which a unit other than the enterprise has been used.
854. Annex 3 includes a tabular presentation for accounting variables on the units; a tabular presentation is helpful in illustrating how the main balances (value of production, gross value added and gross operating surplus) are derived. The annex also shows how investment income and capital gains are treated and indicates how the variables can be adapted for insurance auxiliaries.
855. Treatment of reinsurance in the variables. In the 1991 Accounting Directive, there is emphasis on showing the main elements of the profit & loss account and balance sheet gross of reinsurance, as well as net of reinsurance. The definition gross of reinsurance is that used for the supplementary information, to be shown in the Notes to the Accounts, in particular the analysis by products. The same definition is used in Article 44 of the Third Directive (1992) on Non-life Insurance, and in Article 43 of the Common Position (1992) for a Third Directive on life insurance.
856. In this manual, the primary presentation of the variables is also so far as possible gross of reinsurance. The "Value of production" of insurance enterprises (otherwise known as their gross output) is primarily defined as gross of reinsurance. Transactions between an insurer acting as a direct insurer and an insurer acting as a reinsurer are treated as the provision of a service by the reinsurer (part of its output) to the direct insurer (part of its input, or costs). However, a secondary definition of the "Value of production", net of reinsurance, is also shown.
857. The main advantages of a generally gross basis of recording are the following:
- (i) Variables align with the definitions in Article 63 of the 1991 Accounting Directive (which gives an analysis by products) and with those in the Third Directives (1992).
 - (ii) Separation of direct insurance and reinsurance gives more information at a disaggregated level about the operations of both parts of the insurance plus reinsurance industry.

- (iii) It facilitates reconciliation with the national accounts basis, which requires transactions between resident direct insurers and non-resident reinsurers (or vice versa) to be de-consolidated (ESA 714c) ⁽⁶⁾. As an illustration of this, consider the case where a resident direct insurer takes on a risk from a resident policy-holder, but reinsures part of the risk with a non-resident reinsurer : the gross and national accounts treatments show all transactions affecting the policy-holder as being between him and the resident direct insurer, whilst the net treatment (when applied to all transactions, including those between residents and non-residents) implies that the resident policy-holder directly imports reinsurance services from the non-resident reinsurer. For a fuller exposition, see Annex 7. Incidentally, the gross basis is also preferable if it is desired to compile regional estimates of GDP, since insurers and reinsurers may be resident in different regions.

858. The main advantages of a net treatment are the following:

- (i) It is closer to the treatment in Article 34 of the 1991 Accounting Directive of the sub-totals and balances, which are net. As regards the balances, however, this does not affect the closest connection, which is that between "gross operating surplus" and the balance on the technical account.
- (ii) It is the same as the definition in the General Framework, where the "Value of Production" of an enterprise is defined net of the value of sub-contracted services. However, the case for departing from the General Framework in this regard is that few other industries sub-contract across national boundaries to the same extent as the insurance industry.

(6) In general, there is also a preference for de-consolidation throughout, though an exception is made at present for insurance "for practical reasons".

4.1. Structural characteristics of the units

859.

Variables on the enterprises	General Framework variables	Variables specific to or adapted to the Insurance sector
1 Number of enterprises (or local units)	X	X
2 Number of local units	X	Not included
3 Variables concerning the characteristics and demography of the enterprises (or local units)	X	X
4a Division of the units according to the number of persons employed or the number of salaried hours worked	X	X
4b Division of the enterprises according to class of value added	X	Not included
4c Division of the units according to size of technical provisions (life-insurance)		X
4d Division of the units according to the size of gross written premiums (non-life insurance)		X
6 Variables relating to market share and internationalization	X	X

4.2. Accounting data on the units

860.

Variables on the enterprises	General Framework variables	Variables specific to or adapted to the Insurance sector	
		Non-Life	Life
8 Gross premiums written and pension contributions (turnover)	X	X	X
8(i) Outward reinsurance premiums, otherwise known as premiums ceded to reinsurers (part of 13c)	X	X	X
8(ii) Net written premiums plus pension contributions (8 less 8(i))	X	X	X
8a Turnover by product (part of 8)	X	X	X
8b Intra-/extra EC exports (part of 8)	X	X	X
8c(i) Imports: premiums written ceded to non-resident insurers	X	X	X
9 Prices of products sold	X	*	*
10 Labour costs (sum of 10a and 10b)	X		
10a Gross wages and salaries (part of 10)	X		
10b Employers' voluntary social security contributions and other labour costs (part of 10)	X		
13 Purchases of goods and services	X	X	X
13c Value of services received from reinsurers (reinsurance balance)		X	X
14 Immaterial investments	X	Not included	

* to be discussed

Variables on the enterprises	General Framework variables	Variables specific to or adapted to the Insurance sector	
		Non-Life	Life
15 Fixed production	X	Not included	
16 Tangible investments	X	See 88b	See 88b
17 Disposals of fixed assets	X	See 88b	See 88b
18 Leasing used by the units	X	See 88b	See 88b
28 Duties and taxes other than VAT	X	#	#
29 Operating subsidies	X	Not included	
30 Change in stocks	X	Not included	
<u>Variables calculated</u>			
20 Gross value added at market prices	X	X	X
20a Gross value added at factor cost	X	X	X
21 Value of production, gross of reinsurance	-	X	X
21a Value of production (net of reinsurance)	X	X	X
31 Gross operating surplus	X	X	X

See comments to Codes 20 and 20a

4.3 Variables on employment of the units

861.

Variables on the enterprises	General Framework variables	Variables specific to or adapted to the Insurance sector *
22 Number of persons employed (part of 22)	X	
22a Number of wage and salary earners (part of 22)	X	
22b Number of persons employed on part-time basis (part of 22)	X	
22c Number of female persons employed (part of 22)	X	
23 Number of salaried hours worked	X	
24 Variables relating to personnel qualification levels	X	Not included

* The sub-division between life insurance and non-life insurance is not included because in some countries a central staff is used - see diagram on page 5.

4.4 Sector specific variables

862.

Variables on the enterprises	General Framework variables	Variables specific to or adapted to the Insurance sector	
		Non-Life	Life
81a Gross premiums written: direct insurance (part of 8)		X	X
81b Gross premiums written: reinsurances accepted (part of 8)		X	X
81c Pension contributions: schemes for individuals (part of 8)		-	X
81d Pension contributions: schemes for groups (part of 8)		-	X
81e Gross life-insurance premiums written, periodic premiums (life insurance and pension funding only) (part of 8)		-	X
81f gross life-insurance premiums written, single premiums (part of 8)		-	X
81g Change in provision for unearned premiums (gross of reinsurance)		X	X
81g(i) Change in provision for unearned premiums (reinsurers' share)		X	X
81g(ii) Change in provision of unearned premiums (net amounts)		X	X
82a Gross portfolio investment income on technical provisions (including portfolio investment income of pension funds)		X	X
82b Other portfolio investment income		X	X
83a Reinsurance Commissions received and profit participation received		X	X
83a (aa) Reinsurance commissions and profit participations received from non-residents (exports)		X	X
83b(ii) Other technical income (net of reinsurance)		X	X

4.4 Sector specific variables (continued)

Variables on the enterprises	General Framework variables	Variables specific to or adapted to the Insurance sector	
		Non-Life	Life
83c Amounts receivable from affiliates for services rendered		X	X
83c (aa) Amounts receivable from non-resident affiliates (exports)		X	X
83d Other operating revenue		X	X
84 Claims incurred, gross of reinsurance		X	X
84(i) Claims incurred, reinsurers' share		X	X
84(ii) Claims incurred, net of reinsurance		X	X
84a Claims paid, gross amount		X	X
84a(i) Claims paid: amounts recoverable from reinsurers		X	X
84a(ii) Claims paid : net of reinsurance		X	X
84b Claims paid as pensions and annuities (part of 84a)		-	X
84c Other claims paid (part of 84a)		X	X
84e Change in provision for claims (gross of reinsurance)		X	X
84e(i) Change in provision for claims, reinsurers' share		X	X
84e (ii) Change in provision for claims, net of reinsurance		X	X
85a Capital gains net of losses, realized and unrealized, credited to the technical account		-	X
85b Change in life insurance provision, gross of reinsurance		-	X
85b(i) Change in life insurance provision, reinsurers' share		-	X
85b(ii) Change in life insurance provision, net of reinsurance		-	X

4.4 Sector specific variables (continued)

Variables on the enterprises	General Framework variables	Variables specific to or adapted to the Insurance sector	
		Non-Life	Life
85c(ii) Change in other technical provisions (net of reinsurance) and in the equalisation provision		X	X
86a Commissions payable to agents (part of 89d)		X	X
86b Other external expenditure on goods and services (part of 89d)		X	X
87a Profits receivable from direct investments in other countries *		X	X
87b Profits receivable from domestic subsidiaries and trade investments *		X	X
<u>Merged variables</u>			
88b Net change in fixed capital (sum of 16,17 and 18)		X	X
<u>Calculated variables</u>			
89b Net written premiums : exports (8b less 8c i)		X	X
89c Gross premiums earned plus pension contributions		X	X
89c (i) Gross premiums earned, reinsurers' share		X	X
89c (ii) Net earned premiums, plus pension contributions		X	X
89d External expenditure on goods and services, other than services provided by reinsurers (total of 86a and 86b)		X	X
<u>Memo. item:</u>			
89f Adjustment item, which converts net of reinsurance variables, merged and in total, to a gross of reinsurance basis, non-life insurance		X	
89g Adjustment item, which converts net of reinsurance variables, merged and in total, to a gross of reinsurance basis, life insurance			X

* In some countries, the institutional unit which owns direct investments in other countries and/or domestic subsidiaries will cover both life and non-life insurance activities (see page 5); if so the appropriate subdivision between life and non-life insurance will relate to the activity of the subsidiaries.

863. **Table 2 Variables and the statistical unit**

Type of variable	Type of statistical unit				
	Enterprise level only	Enterprise or Institutional unit level (1)	Clusters of enterprises with a combined staff (2)	Composite companies: Life and non-life:- Distin- Not guished distin- guished	
Structural variables					
Number of enterprises	X	X	E		X
Number of institutional units		X	-		X
Characteristics (ownership)		X	-		X
Division by:					
number of persons employed		X	C		X
class of value added		X	E		X
Market share and internationalization		X	-		X
Accounting data					
Production account (credits) and Value of production		X	E	X	-
Production account (debits) and other balances		X	E(3)	(4)	X
Profit and loss account - income from direct investments		X	?E	(4)	X
Capital account - net change in fixed capital		X	E	(4)	X
Employment variables (5)					
All		X	C		X

- (1) When there is a choice, the enterprise level is to be preferred; for instance, credits and debits in the production account may be available at enterprise level, even if data on ownership and on income from direct investments are only available at the level of the institutional unit.
- (2) When certain data can be reported at enterprise level (E), but others only for the whole cluster (C).
- (3) Where a single charge for services rendered is made to an insurance/enterprise by the service company which employs the combined staff, it should be possible to estimate the sub-division of that charge between the labour costs and the other services received by the insurance enterprise.
- (4) No sub-division hitherto, but the eventual sub-division is envisaged in both NACE/Rev.1 and the 1991 Accounting Directive.
- (5) As regards employment data, the reporting unit should be the enterprise, a cluster of enterprises with a centralized staff or the institutional unit, in that order of preference.

ANNEX 1

ECONOMIC VARIABLES SPECIFIC TO OR ADAPTED
TO THE INSURANCE SECTOR

Code: 1

Name: Number of enterprises (or other units)

Definition:

Enterprise. As in the General Framework.

Cluster of enterprises A group of enterprises, not forming an institutional unit, which shares a central staff.

Institutional units. In general, a resident unit is said to be institutional if it keeps a complete set of accounts and enjoys autonomy of decision in respect of its principal function.

- In order to be said to keep a complete set of accounts, a unit must keep accounting records concerning all its economic and financial transactions carried out during the accounting period, and also a balance sheet of assets and liabilities.
- In order to be said to enjoy autonomy of decision in respect of its principal function, a unit must be free to decide, within the institutional framework within which it finds itself, how to use its own current, capital and financial resources.

[Source: ESA, 212]

See Figure 1 (page 5), for the relationship between the enterprise and the institutional unit.

Comments:

When some economic variables relate to "institutional units", the number of these units should also be given - see Table 2 on page 24. When employment variables relate to clusters of enterprises with a central staff, the number of these should also be reported.

Note:

The institutional unit consists of only resident units, and in this respect differs from the company group, even when the group has only one principal function.

Code: 3

Name: Variables concerning the characteristics and demography of the enterprises.

Comments:

On the assumption that data for individual reporting units will be held on one or more computerized data base, there will be great value in obtaining a set of 'designators' for each reporting unit, more particularly when these are "enterprises", but also if the "institutional unit" has to be used as the reporting unit. Cross analyses of activity indicators with the designatory indicators would then be possible.

The designators may be regarded as falling within Code 3.

Code: 3d**Name:** Legal status of the enterprise.

This can be subdivided as follows:

1. Enterprise (owned by shareholders, excluding 2 and 3 below)
2. Enterprise owned or controlled by the state
3. Enterprise owned or controlled by a parent enterprise (see Codes 3d (i) and (ii) below)
4. Branch office controlled by a non-resident parent company (see Codes 3d (i) and (ii) below)
5. Non-profit making undertaking (e.g. mutual or provident association)
6. Association of underwriters (viz., Lloyd's of London)
7. A pension fund for a group.

The phrase "owned or controlled" is used to indicate that the 'parent' organization can exert an effective influence on the policy and activity of the 'subsidiary' organization; this is a fairly wide definition of "control".

Ownership of 50 % or more of the equity capital is usually regarded as conferring control. When less than 50 % of the equity capital is owned, there may still be effective control, e.g. through the power to appoint directors or through the existence of shares with priority voting rights (OJ L 395 of 30 December 1989). If "golden shares" are held by a Government in order to have power to prevent a takeover of a domestic concern by a foreign concern, they should not be regarded as conferring control on the Government, unless in practice control is exercised in non-takeover situations.

Thus control is the predominant criterion, and ownership is primarily an indicator of whether or not control exists. As a matter of practice, Member States may well wish to use the same criteria or guide-lines here as in their balance of payments statistics. The definition of control as taken here is not quite as wide as the criterion of "effective voice in management" used in the IMF Balance of Payments Manual to establish the concept of "direct investment" in non-resident subsidiaries, branches and affiliates.

To take control as the predominant criterion is consistent with Article 3(b) of the Council Regulation on Concentration which refers to "rights or contracts which confer a determining influence on the composition, deliberations or decisions of the organs of an enterprise".

Code: 3d (i) & (ii)

Further analysis for reporting units in categories 3 and 4 of Code 3d.

Code 3d(i)

The parent enterprise of the reporting unit is either:

1. Resident
2. Non-resident, located in an EC country
3. Non-resident, located in a non-EC country

Code 3d (ii)

The primary activity of the reporting unit's parent enterprise is:

- (a) An insurance undertaking
- (b) A "monetary intermediary" (NACE/Rev. 1 6512)
- (c) An "Other financial intermediary" (NACE/Rev. 1 652)
- (d) An enterprise which specializes in "Security dealing activities" (NACE/Rev. 1 6712)
- (e) A non-financial enterprise
- (f) Other (specify)

It may be necessary to combine categories (b), (c) and (d).

When there is a chain of ownership -viz, A owns B, and B owns C - the phrases "parent enterprise" and "subsidiary" should be regarded as referring to the next link in the chain, provided that it is active in itself (or is the world-wide top holding). Thus, suppose that insurance enterprise B is the subsidiary of bank A but is the parent enterprise of insurance enterprise C. Enterprise C would then be classified to category (a) - not (b) - of Code 3d (ii) above. It is B which would be classified to category (b).

Code:3i

Name: Relations with subsidiaries and affiliates in which the reporting unit has a controlling interest.

Comments:

The reporting unit is assumed to embrace resident branch offices. (Non-resident branch offices are separate units which, like non-resident subsidiaries, cause the reporting unit to be classified to items 4, 5 & 6).

1. None
2. Only resident, all insurance (NACE/Rev. 1 66.0)
3. Only resident, insurance and/or other (e.g. auxiliaries, NACE/Rev.1 67.2)
4. Resident and/or non resident - only in EC countries
5. Resident and/or non resident - only in non-EC countries
6. Resident and/or non resident - in both EC and non-EC countries

Code: 3j

Name: Reinsurance activities of the enterprise

Comments:

The following may not be collected already, but seem highly relevant and useful if data are collected taking the "enterprise" as the unit.

1. Unit conducts only reinsurance
2. Unit conducts both insurance and reinsurance
3. Unit conducts no reinsurance

If the unit has to be the institutional unit, the item designated, where there is any reinsurance, is likely to be N° 2. If, however, reinsurance transactions are generally conducted through specialist subsidiaries of the reporting parent enterprise, it would be valuable if possible to de-consolidate also the resident subsidiaries specializing in reinsurance, for comparability with data obtained at the level of the "enterprise" as the reporting unit.

Code: 4a

Name: Division of the enterprises (or other units) according to the number of persons employed or the number of salaried hours worked.

Comments:

For insurance this may relate to enterprises, clusters of enterprises, or to institutional units, according to the institutional framework and data collection practices in the various Member States. See Table 2 on page 24

Code : 4c

Name: Division of the units according to the size of technical provisions (life insurance)

Definition:

For the purpose of the analysis of Code 4c, technical provisions consist of the total of items below:

<u>Definition</u>	<u>Reference to 1991 Accounting Directive</u>
1. Provision for unearned premiums	Article 25
2. Life insurance provision	Article 27
3. Claims outstanding	Article 28
4. Provision for bonuses and rebates (unless shown under 2.)	Article 29
5. Other technical provisions (usually included in the provision for unexpired risks*)	Article 26
6. Technical provisions for life-insurance policies where the investment risk is borne by the policy holders	Article 31

* If not, under unearned premiums

Note: The equalisation provision (Article 30) is apparently not a technical provision proper, even though in Article 34 it is to be included above the balance on the technical account.

The following size-classes are proposed:

	Up to	600.000	ECU
600.000	up to	2.000.000	ECU
2.000.000	up to	5.000.000	ECU
5.000.000	up to	20.000.000	ECU
20.000.000	up to	50.000.000	ECU
50.000.000	up to	100.000.000	ECU
100.000.000	up to	200.000.000	ECU
200.000.000	up to	1.000.000.000	ECU
1.000.000.000	Ecus or more		

Code : 4d

Name: Division of the units according to the size of gross premiums written (non-life insurance)

Definitions:

For the purpose of the analyses of Code 4d, gross written premiums consist of the total of the items below:

Gross premiums written: direct insurance -	(Code 81a)
Gross premiums written: reinsurances accepted -	(Code 81b)

The following size-classes are proposed:

	Up to	120.000	ECU
120.000	up to	400.000	ECU
400.000	up to	1.000.000	ECU
1.000.000	up to	4.000.000	ECU
4.000.000	up to	10.000.000	ECU
10.000.000	up to	20.000.000	ECU
20.000.000	up to	40.000.000	ECU
40.000.000	up to	200.000.000	ECU
200.000.000	ECU or more		

Code: 6

Name: Variables relating to market share and internationalization.

Definition:

Either "Part of production carried out by units under majority control by residents as a proportion of the total domestic production of products"

or

"Part of the apparent consumption of products which has been produced by units under majority control by residents".

The General Framework gives the first definition, but the text also suggests the second. The text also refers to the importance of production carried out by subsidiaries established in the rest of the world.

Schematically, if turnover (or turnover less purchases of goods for resale) is taken as a proxy for "production" we have:

Sales of domestically produced products:	Producing units under majority control by residents	Producing units under majority control by non-residents
To residents	A_1	A_2
To non-residents (exports)	B_1	B_2
Total	$A_1 + B_1$	$A_2 + B_2$
Imports	C	
Definition 1	$A_1 + B_1 / \text{sum of } (A_1 + B_1 + A_2 + B_2)$	
Definition 2	$A_1 / \text{sum of } (A_1 + A_2 + C)$	

All this is difficult to apply to insurance. Firstly, turnover (gross written premiums) is a rather inadequate proxy for the "Value of production". Net written premiums are slightly better as a proxy, but even so, the ratio of claims to premiums can vary widely according to the class of business. Secondly, imports and exports of insurance services have usually been confined, hitherto, to reinsurance and "large" commercial risks. In other cases, in place of direct imports or exports, production is conducted through subsidiaries or branches established in other countries, when the return is in the form of profits.

Annex 4 surveys the way in which international insurance business is conducted, in more detail. As regards both direct exports or imports and profits there is difficulty in formulating a criterion for establishing what constitutes international trade in insurance services - see Annex 4. Generally, the criterion in the IMF Balance of Payments Manual, whereby the residence or non-residence of a economic unit is established by reference to the "Centre of economic interest", should be followed.

The table on the last two pages of Annex 4 gives a few clues as to how the ratios indicated above might be compiled. As regards the definition 1, the Value of Production of resident insurers is given by Code 21. The production of those units controlled by residents and non-residents respectively could be obtained by cross-analysis with Codes 3(d) and 3d(i). As regards definition 2, if turnover is taken as a proxy for "production", sales of domestically produced services to residents could be obtained as Code 8 less Code 8b. As things are at present proposed, there would be no information, except from other countries, on direct imports of insurance services, other than re-insurance (Code 13b).

However, when (within the EC) an insurance enterprise takes advantage of the new freedom, under the 1992 Directive, to operate in another EC country (or countries) under the supervisory rules appropriate to its own country, it will be obliged to provide information to the supervisory authorities of each importing country, and probably this information could be used eventually.

As regards profits, a comparison can be made between the total gross operating surplus of resident units (Code 31), the profits of the non-resident subsidiaries of domestic (institutional) units (Code 87a), and that part of the gross operating surplus of resident units (Code 31) which is due to non-resident parent enterprises. The latter could be obtained by cross analysis (Code 3(i), 2 or 3).

All this can only be regarded as very tentative.

Code: 8

Name: Gross premiums written and pension contributions (*turnover*)

Definition:

The total of:

Gross premiums written: direct insurance	Code 81a
Gross premiums written: reinsurances accepted	Code 81b
Pension contributions: schemes for individuals	Code 81c
Pension contributions: schemes for groups	Code 81d

Comments:

See Tables 1-3 in Annex 3.

Code: 8a

Name: Gross premiums written and pension contributions (*turnover*), analysed by product categories

Comments:

The product categories are those of the CPA at 5 digit level, which are defined in Annex 2.

Code: 8b

Name: Intra-/extra-EC exports

Comments:

These will mostly be direct insurance premiums written on large commercial risks (eg. ships, aircraft or cargo used by non-residents) or reinsurances accepted from non-resident insurers. See Annex 4, for a more detailed discussion of international trade in insurance services.

Code: 8(i)

Name: Outward reinsurance premiums, otherwise known as premiums ceded to reinsurers (part of 13c).

Definition:

Outward reinsurance premiums shall comprise all amounts paid and payable in respect of outgoing reinsurance contracts entered into by the insurance undertaking. Portfolio entries payable on the conclusion or amendment of outward reinsurance contracts shall be added; portfolio withdrawals receivable must be deducted. [Source Article 36 of 1991 Accounting Directive].

Comments :

In Annex 3, this item now appears in Table 3, which shows the production account net of reinsurance. In this table, outward reinsurance premiums are the link between gross and net written premiums.

In Tables 1 and 2 of Annex 3, outward reinsurance premiums are part of the reinsurers' share of earned premiums, shown at item 7a of these tables (Code 89c (i)). The other part of Code 89c is the reinsurers' share of the change in the gross provision for unearned premiums (Codes 81g (i), reinsurers' share, and 81g, gross)

Code 8(i) forms part of Code 13c - see definition of that code.

Code: 8(ii)

Name: Net written premiums plus pension contributions (8 less 8(i))

Definition:

Turnover (Gross premiums written and pension contributions (*turnover*))

Less

Work Subcontracted to third parties (outward reinsurance premiums, otherwise known as premiums ceded to reinsurers (part of 13c).

Code: 8c (i)

Name: Imports: premiums written ceded to non-resident insurers

Definition:

Outward reinsurance premiums ceded to non-resident insurers

Comments:

See Annex 4, for a more detailed discussion of international trade in insurance services.

Code: 9

Name: Prices of products sold

Comments:

The prices of insurance products remains on unsolved issue. A solution for this problem will be discussed with the representatives of the National Statistical Offices. The current state of the discussion is reflected in the documents S2/92/07-S2/92/08 and S2/92/09 as presented during the meeting of the task force of the working group "insurance services" of 21/22 January 1992.

Code: 10a

Name: Gross Wages and Salaries (part of 10)

Comment:

1. In the profit and loss account indicated in the 1991 Accounting Directive, labour costs generally are not distinguished, being part of "administrative expenses" (Article 34, I 7 and II 8) and of certain other items in Article 34. Another source would have to be used. Plainly it is preferable that this source should obtain data at the individual reporting unit level (enterprise or institutional unit) rather than for the aggregate of the appropriate NACE/Rev.1 classes 66.01, 66.02, 66.03 and 67.20).
2. The obligatory social security contributions included in this Code should include employers' contributions to their own (group) pension schemes, even when these are self-administered, that is, if the assets are not held by insurers, but are held either as book reserves of the employer, or by trustees appointed to represent the interests of both the employer and the employees.
3. Where a single charge for services rendered is made to the insurance enterprise by the service company which employs the combined staff of a group of insurance enterprises, it should be possible to estimate the sub-division of that charge between the labour costs and the other services received by the insurance enterprise. The aggregate of labour costs for the whole enterprise group will be unaffected by attribution of the costs to the component enterprises. When a service company is employed by the insurance enterprise which lies outside the same enterprise group, the labour costs will remain with that service company, and the costs paid by the insurance enterprise will be allocated, in total, to Code 86b.

Code: 10b

Name: Employers' voluntary social security contributions and other labour costs (part of 10)

Definition:

As in the General Framework.

Code: 13

Name: Purchases of Goods and Services

Definition:

The value of services received from reinsurers (reinsurance balance) - Code 13c on page 45 - plus external expenditure on goods and services, other than services provided by reinsurers -see Code 89d (page 77).

Comments:

For a discussion of the treatment of reinsurance, see paragraphs 855-8 on pages 15 and 17.

The treatment of amounts payable to service companies - part of Code 13 - is explained in the comments to Codes 11 and 89d.

Code: 13c

Name: Value of services received from reinsurers (reinsurance balance)

Definition:

The net total of the reinsurers' share in all elements of the profit and loss account.

Comment:

1. The figure is to be shown in the notes to the accounts (Article 63 of the 1991 Accounting directive, item I 5 for non-life insurance, and II 2 for life insurance).
2. The main components are those shown in Annex 3, tables 1 & 2, namely the reinsurers' share of:

	<u>Gross Amount</u>	<u>Reinsurers' Share</u>
- gross earned premiums (Code 89c i)	89c	89c i
- gross claims incurred (Code 84 i)	84	84 i
- change in the gross life insurance provision (Code 85b i)	85b	85b i
- other components are listed in the definition to, and comments on, Codes 89f (non-life) and 89g (life). For those components listed in the definition to these Codes, the reinsurers' share is specified ; for the other components listed in the comments, it is known only in total - as the balance leading up to Code 13c, but the amount of these unspecified components is thought to be small.		

3. Subject to the question of the benefit which the direct insurer receives indirectly from investment income deriving from premiums ceded to reinsurers and invested as part of the latter's technical provisions, the reinsurance balance represents the value of the reinsurers' service to the direct insurer, whether the terms of his contracts with the reinsurer are proportional or non-proportional.

Codes: 20 and 20a

Name: Gross value added at market prices and at factor cost.

Definition:

The value of production, gross of reinsurance (Code 21), less the value of services received from reinsurers (Code 13c), less commissions payable to agents (Code 86a) less other external expenditure on goods and services other than from reinsurers (Code 86b), less (in the case of gross value added at factor cost) duties and taxes other than VAT (less subsidies).

Comments:

See Table 1 and 2 in Annex 3, on pages 86-89.

These Codes can also be defined using the value of production, net of reinsurance (Code 21a), in place of Codes 21 and 13c. See Table 3 in Annex 3, on pages 90-91.

The "duties and taxes other than VAT" exclude taxes or charges levied with premiums, which are deducted from "gross premiums written" (Code 81a, see definition of that Code), in conformity with the definitions used in the 1991 Accounting Directive, the 1989 Council Regulation on Concentration, and the OECD Insurance Committee. This does mean, it can be argued, that Code 20 is not in this respect at market prices; Code 20a at factor cost is unaffected.

Codes: 21 & 21a

Name: Value of production, gross and net of reinsurance

Definition:

		Code	
		Non-life	Life
	Gross earned premiums plus pension contributions	89c	89c
plus	Gross portfolio investment income	82a	82a
plus	Commissions and profit participations received	83a	83a
plus	Other technical income (net)	83b ii	83b ii
plus	Other operating revenue	83c & d	83c & d
less	Gross claims incurred	84	84
plus	Capital gains (net) credited to the technical account	--	85a
less	Change in life insurance provision	--	85b
less	Increase in other technical provisions (net) (decrease+)	85c ii	85c ii
+/-	Adjustment item	89f	89g
Equals	Value of production, gross of reinsurance	21	21
less	Value of services received from reinsurers (reinsurance balance)	13c	13c
Equals	Value of production, net of reinsurance (7)	21a	21a

Comments:

1. See Annex 3, Tables 1 & 2. For a comparative statement of the characteristics of Codes 21 and 21a, see paragraph 7 below.
2. These are derived variables. The second definition (net of reinsurance) is consistent with that of the "Value of production" in the "General Framework" - services received from reinsurers are analogous to purchases of a sub-contractor's services.
3. Insurance has a special feature : it consists of two elements - the spreading, or transfer of risks, and the incurrence of the costs (including profit) of providing the service. The first element - that of transferring risks - is of course germane to the service, but the value of the service is generally regarded as what it costs (including profit) to provide. The claims incurred - ie. the value of the risks transferred - are therefore deducted from premiums in valuing the generation of the service in the national accounts and - for further consistency with the recent change in the national accounts definition - the value generated also includes gross portfolio investment income on technical provisions. These are in effect regarded as an amount made available by the policy holders collectively, in lieu of a supplement to premiums.

(7) When claims management costs are re-allocated from "claims incurred" to "external expenditure on goods and services", Code 21a remains gross of the reinsurers' share of these costs. See comments on Codes 84 and 86a, and on page 61.

4. The deduction of claims incurred in evaluating the generation of the service is quite consistent with the practice of the insurance industry in statistics which they publish. Note, however, that the terms "underwriting result" or "profit/loss on underwriting", as used by the insurance industry in statistics for non-life insurance, may differ in two respects from the "Value of production": firstly, the term "underwriting result" does not include the investment income on technical provisions which is, however, usually shown separately and alongside it, and secondly - in some countries at least - not only claims incurred but also operating costs are set against premium income in arriving at the "underwriting result". When this is so, the term "underwriting result" is close to, if not the same as, "Gross trading surplus" (Code 31).
5. For preference, claims incurred should exclude an estimate of claims management costs, which would be transferred to Code 86b. See comments on Code 84.
6. Note that some operating revenue, viz. Codes 83c and 83d, does not arise as the direct result of underwriting risks for policy-holders or of reinsuring these risks. To this extent the "Value of Production" is wider than the "Value of insurance services provided" as this is understood in the national accounts (sometimes known as the 'service charge'). In the national accounts the services referred to are understood to be entirely underwriting services, so that the routing of their value counterparty transactors is on the basis that they are all policy-holders (see ESA 452, on "net accident insurance premiums").
7. Following is a comparison of the characteristics of Code 21, in comparison to those of Code 21a:

(a) Gross of reinsurance (Code 21)	<ol style="list-style-type: none"> (i) Variables align best with Article 63 of the Accounting Directive and with Article 44 of the third Directive. (ii) Facilitates reconciliation with the national accounts basis (see paragraph 858 (iii) on page 16). (iii) Avoids presentational difficulty when reinsurance services are imported or exported (see para 858 (iii)). (iv) Facilitates eventual compilation of regional estimates of economic activity. (v) Better aligned to an analysis by product.
(b) Net of reinsurance (Code 21a)	<ol style="list-style-type: none"> (i) Despite Article 63 of the Accounting Directive, in Article 34 the balances are shown net of reinsurance, hence Code 21a is closer to the "balance on the technical account". (ii) In the General Framework, Code 21 is defined net of sub-contracted services. However, in insurance subcontracting has special characteristics - for instance, in other industries sub-contracting across national boundaries is less common than in insurance.

Code: 31

Name: Gross operating surplus

Definition:

The gross operating surplus thus measures:

Gross value added at factor cost (see comments on Code 20)

Less Labour costs (Code 10)

= Gross operating surplus (Code 31)

The gross operating surplus is said to be "gross" because it includes the cost of capital usage (depreciation costs).

[Source : based on ESA, p.200]

Comments:

The gross operating surplus measures the result of production (loss or gain) during the reference period.

Code: 81a**Name:** Gross premiums written: direct insurance (part of 8)**Definition:**

Gross premiums written shall comprise all amounts due during the financial year in respect of insurance contracts regardless of the fact that such amounts may relate in whole or in part to a later financial year, and shall include inter alia:

- (i) premiums yet to be written, where the premium calculation can be done only at the end of the year;
- (ii) -single premiums, including annuity premiums,
-in life assurance, single premiums resulting from bonus and rebate provisions in so far as they must be considered as premiums on the basis of contracts and where national legislation requires or permits their being shown under premiums;
- (iii) additional premiums in the case of half-yearly, quarterly or monthly payments and additional payments from policy holders for expenses borne by the insurance undertaking;
- (iv) in the case of co-insurance, the undertaking's portion of total premiums;
- (v) reinsurance premiums due from ceding and retroceding insurance undertakings, including portfolio entries,

after deduction of:

- portfolio withdrawals credited to ceding and retroceding insurance undertakings, and
- cancellations.

The above amounts shall not include the amounts of taxes or charges levied with premiums.
[Source: Article 35 of the 1991 Accounting Directive]

Gross premiums written: direct insurance, include all gross premiums written other than reinsurances accepted (See Code 81b).

Comments:

The deduction of premium taxes, charges, levies etc (see definitions above) is consistent with the Council Regulation of Concentration (OJ L 395 on 30 December 1989).

The definition taken from the 1991 Accounting Directive is consistent with that used by the OECD Insurance Committee, which is as follows:

"Gross premiums are total premiums, excluding any premium taxes or other charges, but before deduction of commission or reinsurance outwards". [Source: Note 3 to OECD, Insurance Committee questionnaire, AS(89) 4, 17th January 1990]

In the case of non-life insurance, rebates (part of item I(6) of article 34 of the 1991 Accounting Directive) should be deducted and if rebates cannot be distinguished from bonuses (the other part of the same item), the total should be deducted.

Code: 81b**Name:** Gross premiums written: reinsurances accepted (part of 8)**Definition:**

Reinsurances accepted are reinsurance premiums written in respect of business acquired from ceding insurance companies.

Comments:

Facultative reinsurance may be included under "direct insurance" or "reinsurances accepted" according to procedure in the reporting country.

In the 1991 Accounting Directive, reinsurances accepted are distinguished only if they are more than 10% of total gross premiums written, but in this Manual it is preferable to distinguish them whatever their size, as in the practice in the statistics collected by OECD Insurance Committee.

Code: 81c**Name:** Pension contributions: schemes for individuals (part of 8)**Definition:**

Single or regular contributions received by pension schemes classified to NACE/Rev.1 66.02 (Pension Funding), or by life insurance enterprises (66.01) in respect of their secondary activity, whenever the assets of the fund are held in the names of individuals in their capacity as beneficiaries of the fund.

Comments:

Funded pension schemes with assets held in the names of individuals exist for the self-employed and for employees. Pension schemes for individuals may be supplementary to group schemes or may replace group schemes, in which case the employer may contribute as well. The contributions received should include any employer contributions.

Since most such schemes hold their assets with a financial intermediary in the form of claims on a unitized fund, care should be taken to avoid double counting with direct insurance premiums (Code 81a), when the intermediary is an insurance company. The intermediary may however be an insurance type subsidiary set up by a unit trust (SICAV); or even a fund run by a bank or a stockbroker, with separate reinsurance of early death risks.

For enterprises classified to NACE/Rev.1 66.01, the distinction between direct life insurance premiums and pension contributions should be based on the nature of the contracts with the assured/beneficiaries (see paragraphs 837 to 838).

Code: 81d

Name: Pension contributions: schemes for groups (part of 8)

Definition:

Single or regular contributions received by pension schemes classified to NACE/Rev. 1 66.02 (Pension Funding), or by life insurance enterprises (66.01) in respect of their secondary activity, pension funding, whenever the assets of the funds are not held in the names of individuals, in their capacity as beneficiaries of the fund, but are held for the benefit of a group of employees, or of professional persons who work on their own account.

Comments:

The contributions received should be the total of employer and employee contributions. Funded pension schemes for groups of employees may be "money purchase" (where pension benefits are related to the assets in the fund) or "final salary" (where pension benefits are related to the period of contribution and near-final or revalued average salary). Contributions to both types of fund should be included in this Code and the two types need not be distinguished. (As regards Code 8a, they are distinguished at 6-digit level in the CPA).

Funded pension schemes for groups may invest their assets in the form of:

- (a) insurance policies,
- (b) claims on a unitized fund managed by a financial intermediary (insurance enterprise or other),
- (c) assets held in the name of the employer or of "Trustees", appointed to look after the interests of employees, and administered by the employer or "Trustees" ("Self-administered funds"),
- (d) the general assets of the employer's business, with matching liabilities to the pension fund ("book reserves").

Types (b) to (d) may reinsure separately risks such as that of early death.

Since insurance companies are active in pension business (types (a) and (b)), it is important to avoid double counting between this Code and Code 81a.

For enterprises classified to NACE/Rev.1 (66.01) the distinction between direct life insurance premiums and pension contributions should be based on the nature of the contracts with the assured/beneficiaries - see paragraphs 838 and 847.

Code: 81e

Name: Gross life-insurance premiums written, periodic premiums: (life insurance and pension funding only) (part of 8)

Definition:

The difference between policies involving periodic premiums and those involving single premiums is generally understood in the insurance industry. With periodic premium policies, the benefit obtained or the risk underwritten requires the payment of more than one premium, usually annually.

Comments:

Periodic premiums may vary from year to year and some pension contracts for the self employed allow the premium amount to be varied at the choice of the policy holder. The distinction is provided for in Article 63 II, 1 b of the 1991 Accounting Directive.

Code: 81f

Name: Gross life-insurance premiums written, single premiums

Definition:

The difference between policies involving regular premiums and those involving single premiums is generally understood in the insurance industry. With single premium policies, a benefit at a future date is secured by payment of one premium paid at the time the contract is entered into.

Comments:

Single premium policies are usually life policies, the benefit being secured on or during survival for a defined period; on survival or on earlier death; or on death only. Annuities - the receipt of an income during survival in exchange for a single premium - are a main example. Various "bonds" - where a capital sum is invested on which interest is paid, the capital sum being repayable on survival for a fixed period or on earlier death - are also common. The distinction is provided for in Article 63 II, 1 b of the 1991 Accounting Directive.

Code: 81g

Name: Change in provision for unearned premiums (gross of reinsurance)

Definition:

Change in the amounts of premiums pre-paid between the beginning and the end of the insurance undertaking's accounting year.

Comments:

Pre-payments of premiums arise because most insurance contracts are annual contracts on which the annual premium is payable in advance. Individual contracts are for a whole spectrum of 12-month periods, so that at the insurance undertakings' account date, part of the annual premium pre-paid in respect of each individual contract will relate to risks which may occur after the insurance undertaking's accounting date but before the next renewal date of the individual contract.⁽⁸⁾

Unearned premiums are part of technical provisions - see definition of Code 4c.

The change in provision for unearned premiums is also required for consistency with the ESA (315 K, note 2, and 578).

Further analyses which is possible

Non-life insurance only

<u>Code</u>	<u>Definition</u>	<u>Reference to Art.34 of 1991 Accounting Directive</u>
81g i	Change in the provision for unearned premiums, reinsurers' share (+/-)	I, 1 (d)
81g ii	Change in the provision of unearned premiums (net amounts) (+/-)	I 1 (c), I 1 (d), II 1 (c)

In the case of life insurance, the change in provision for unearned premiums is only shown net of reinsurance in the 1991 Accounting Directive (Art.34, II 1 (c)), but for this Manual it is preferable to make an estimate of the amount gross of reinsurance. The estimate can be based on the gross premiums written and ceded, and on the net change in the provision for unearned premiums. By making such an estimate, the estimated gross amount of premiums earned can be derived, in the same way as for non-life insurance, so that the analysis of the main components of the reinsurance balance (Code 13c) becomes the same for life insurance as for non-life insurance.

See Tables 1 and 2 in Annex 3.

(8) See Articles 24, 25 and 26 in the 1991 Accounting Directive.

Code: 82a

Name: Gross portfolio investment income on technical provisions (including all portfolio investment income of pension funds)

Definition:

Portfolio investment income - see Code 82b

Units appropriate to NACE/Rev.1 66.01 - technical provisions: see Code 4c.

Pension funds are all the units appropriate to NACE/Rev.1 66.02, whose main activity is pension funding. In the case of pension funds, all income arising from the investment should be regarded as portfolio investment income.

"Gross" means before deducting investment management charges.

Comments:

See Annex 3, for a description of the methodology for separating portfolio investment income on technical provisions from other portfolio investment income.

Code: 82b

Name: Other gross portfolio investment income

Definition:

Portfolio investment income is income on all assets other than:

1. Direct investment assets - see Codes 87a and 87b
2. Fixed assets used for administration or underwriting (eg. offices, plant and office machinery).

Comments:

Portfolio investment income is not confined to income on financial assets (bonds, shares etc.). It includes income on land and buildings (real property) held as a portfolio investment, ie. other than for the purposes of administration or underwriting.⁽⁹⁾ It excludes profits receivable from direct investment assets (subsidiaries, branch offices etc.) even though these appear in the balance sheet as financial assets (shares held in subsidiaries etc.).

"Gross" means before deducting investment management charges .

For the treatment of interest paid on deposits received from reinsurers - see (ii) on page 96. In essence, the assets, from which portfolio investment income is derived, are regarded as being net of these particular liabilities. Therefore it is the income, net in this narrow sense, which is divided between that arising on the investment of technical provisions (liabilities to policy-holders) and that arising on the investment of other reserves.

(9) In this respect the definition of the corresponding capital is wider than that of "portfolio investment" in the IMF Balance of Payments Manual (194), and includes what there is defined as "other capital" (195).

Code: 83**Name:** Commissions received and profit participation received.**Definition:**

Commissions received from reinsurers and others; participations in the profit of reinsurers, other insurers and selling agents.

Comments:

Commissions are often received by insurers from reinsurers. In the 1991 Accounting Directive, they are treated as a deduction from net operating expenses (I 7(d) and II 8(d)) but in this Manual they are treated as operating revenue. "Profit participations" are also included.

Further analysis which might be possible (life and non-life insurance)

<u>Code</u>	<u>Definition</u>	<u>Reference Article 34 of 1991 Accounting Directive</u>
83a	Reinsurance commissions and profit participation received:other	}
		}
		} within I 7(d) and II 8(d)
83a (aa)	Reinsurance commissions and profit participation received from non-residents (exports)	}
		} Not distinguished

The distinction would improve information on resident/non-resident transactions.

Code: 83b (ii)

Name: Other technical income (net of reinsurance)

Definition: Items I 3 (non-life) and II 4 (life) in the 1991 Accounting Directive.

Code: 83c

Name: Amounts receivable from affiliates for services rendered

Definition:

These are amounts charge for headquarters or other services which the reporting enterprise has performed for other affiliated enterprises (parent, daughter or sister). Unlike dividends and undistributed profits, they are amounts appropriate to the operating accounts of the relevant enterprise (for the reporting enterprise, a credit; for the affiliated enterprise a debit). When the affiliated enterprise is non-resident, these amounts should be included in the "services" section of the balance of payments ; the information is usually collected as part of the complex of statistics on international direct investment.

In the 1991 Accounting Directive, these amounts are probably included in the non-technical account ("other income", III 7). They do not appear appropriate to the "investment income" headings.

Further analysis which might be possible (life and non-life insurance)

Code: 83c (aa) Amounts receivable from non-resident affiliates (exports)
83c (bb) Amounts receivable from resident affiliates

Code: 83d

Name: Other operating revenue

Definition:

Revenue from ancillary (non-insurance) operations which are not conducted by separate enterprises and are not appropriate to other headings.

Comments:

Certain operating revenue ancillary to underwriting proper will be included in other headings, for instance reinsurance commissions received (Code 83a) and amounts chargeable to affiliates for services rendered (Code 83c). The other ancillary activities might include the provision of computer services to a related insurance enterprise, the operation of real estate agencies (ancillary to lending to policy-holders secured by mortgages), or the operation of consumer credit (lending to policy holders who opt to pay an annual premium by monthly instalments). If these activities are conducted by separate enterprises (affiliated undertakings or participating interests), the income derived from them is non-portfolio investment income (Codes 87a and 87b); but if the activities are conducted directly by the reporting enterprise, the operating revenue which they generate should be included here.

In the 1991 Accounting Directive, such revenue from ancillary activities not conducted by separate enterprises is probably part of item III 7 (other/non-technical income), in Article 34.

Code: 84

Name: Claims incurred, gross of reinsurance

Definition:

a) *Before adjustment for claims management costs.*

Claims incurred shall comprise all payments made in respect of the financial year plus the provision for claims but minus the provision for claims for the preceding financial year.

These amounts shall include annuities, surrenders, entries and withdrawals of loss provisions to and from ceding insurance undertakings and reinsurers, external and internal claims management costs and charges for claims incurred but not reported such as referred to in Article 60 (1) (b) and (2) (a).

Sums recoverable on the basis of subrogation and salvage within the meaning of Article 60 (1) (b) and (2) (a). [Source: Art.38 para.1 of the 1991 Accounting Directive]

In Article 34 of the 1991 Accounting Directive, part (a) of this code is the sum of Items I 4 (a) (aa) and I 4 (b) (aa) for non-life insurance, and the sum of items II 5 (a) (aa) and II 5 (b) (aa) for life insurance.

b) *After adjustment for claims management costs*

To make this adjustment, the estimated amount of claims management costs should be deducted and re-allocated to Code 86b (see paragraph 5 of comments below):

Comments:

1. Article 39 of the 1991 Accounting Directive makes it clear that claims management costs - both external and internal - are included in "claims incurred". They are also included in claims paid (Code 84a) as and when they are paid. In principle, these should not be deducted from the Value of production of the insurance sector (Code 21), but should be treated as a cost of production, i.e., as part of Codes (86b, for the external costs, and 10, for the internal costs. This becomes clear when one considers the counter-party to the transactions - claims receivable by insured persons are transfers, but the amounts receivable from insurers by loss adjusters, salvors etc are part of their output and should therefore be treated as part of the intermediate costs of the insurers.
2. It is recommended that, if possible, an estimated deduction for claims management costs should be made, based (when precise information is not already available) on occasional enquiries to insurance enterprises about the proportion of claims management costs, on average, to gross claims incurred. Generally speaking, claims management costs are significant for most classes of non-life insurance, but not for life insurance. The gross claims incurred will be analysed by product classes of direct non-life insurance (Article 63 of the 1991 Accounting Directive).
3. The estimated deduction should include any element of claims management costs which is recoverable from reinsurers. In this way, what is left in Code 84 is the gross amount of claims transferable to policy-holders.

4. On the gross of reinsurance basis, the element of claims management costs which is recoverable from reinsurers will be treated as part of the insurer's costs of operation (Codes 86b and possibly 10), in the same way as the element of the costs not recoverable from reinsurers. (It is thought that usually only external claims management costs are recoverable from reinsurers). The refund from reinsurers will appear as part of the reinsurance balance (Code 13c).
5. The reason for allocating the gross claims management costs entirely to Code 86b (external expenditure on good and services other than commissions), rather than in part to Code 10 (labour costs), is that any source used for Code 10, independently of the Accounting Directive, will already include the labour costs devoted internally to the management of claims. Thus, it is correct to add gross claims management costs to the total of the following item in Article 34: "administrative expenses", "acquisition costs" & "investment management charges", and then to sub-divide the resulting total between labour costs (Code 10) and external expenditure on goods and services (Code 86a and 86b); but not to sub-divide an amount excluding claims management costs between labour costs (which include the internal element of these costs) and a balancing figure. See the comments on Code 86b.
6. The additional note which follows gives a illustration of the treatment of claims management costs, both for the gross of reinsurance basis and for the net of reinsurance basis.

Further analysis which is possible (for definition (a) only).

<u>Code</u>	<u>Definition</u>	<u>Reference to Article 34 of the 1991 Accounting Directive</u>	
		<u>Non-life</u>	<u>Life</u>
84 i	Claims incurred, reinsurers' share	I 4 (a) (bb) & I 4 (b) (bb)	II 5 (a) (bb) & II 5 (b) (bb)
84 ii	Claims incurred, net of reinsurance	Sub-total, Codes 84 & 84 i	Sub-total, Codes 84 & 84 i

Additional Note to Comments on Code B4 (heading (b))

Illustration of the treatment of claims management costs

DATA	Gross	Reinsurers' share *	Net	*	Reinsurance balance:
-----	-----	-----	-----	-----	-----
Premiums	+150	-60	+90		
Claims:					-60
transfer element	-85	+40	-45		+40
costs element	-20	+5	-15		+5

					-15

Production accounts (part)					
(a) Net of reinsurance		Before Adjustment	Reclassification, to costs side of the accounts, of claims management costs		After Adjustment
		-----	-----		-----
Net premiums		+90	--		+90
Net claims:					
Transfer element	-45	---			- 45
Costs element	-15	+ 15			---
		-----	-----		-----
		-60	+15		- 45
Value of production (net of all reinsurance) #		+30	+15		+ 45
Adjustment : addition to external & internal costs (debits)		---	-15		- 15
		-----	-----		-----
(b) Gross of reinsurance					
Gross premiums		+150	---		+150
Gross claims:					
Transfer element	-85	---			-85
Costs element	-20	+20			---
		-----	-----		-----
		-105	+20		-85
Code 21: Value of Production (gross of reinsurance)		+45	+20		+65
Code 13c: Reinsurance Balance		-15	---		-15
		-----	-----		-----
Code 21a: Value of Production (net of reinsurance, other than the reinsurer's share of costs)		+30	+20		+50
Adjustment: addition to costs:					
borne by reinsurers (external)		---	-5		- 5
borne by the direct insurer (external & internal)			-15		-20
		-----	-----		-----

Not included in this Manual, see Code 21a in part (b) of this Annex.

Code: 84a**Name:** Claims paid, gross amount**Definition:****a) Before adjustment for claims management costs**

See Article 34 of the 1991 Accounting Directive, items I 4 (a) (aa) and II 5 (a) (aa).

b) After adjustment for claims management costs

The estimated claims management costs should be deducted.

Comments:

See comment on Code 84 regarding the payment of claims settlement expenses to loss adjusters etc, which are included in this item in Article 34 of the 1991 Accounting Directive. The deduction for claims management costs should include any element recoverable from reinsurers. It will probably suffice to estimate it using the same average proportions as for Code 84 (claims incurred).

Code: 84b**Name:** Claims paid as pensions and annuities (part of 84a)**Definition:**

Amounts paid by life companies and from pension schemes as annual sums, rather than as capital sums.

Comments:

Capital sums ("Lump sums") paid by pension schemes when a person retires are included in Code 84c.

Code: 84c**Name:** Other claims paid (part of 84a)**Definition:**

Claims paid, other than those included in Code 84b.

Comments:

All claims paid on non-life insurance policies are included here. Part of item I 6 (Article 34 of the 1991 Accounting Directive) is appropriate to this Code -where claims paid are increased by bonuses; if this part cannot be identified, the total of I 6 should be allocated to Code 81 (rebates to premiums).

Code: 84a (i)

Name: Claims paid: amounts recoverable from reinsurers (part of 84a)

Definition:

See Article 34 of the 1991 Accounting Directive, items I 4 (a) (bb) and II 5 (a) (bb), where the item is called the "reinsurers share". The item can be left on the definition (a) basis that is before adjustment for claims management costs.

Code: 84c

Name: Change in provision for claims (gross of reinsurance)

Definition:

a) Before adjustment for claims management costs

See Article 34, items I 4 (b) (aa) and II 5 (b) (aa). Article 28 defines the provision for claims outstanding as "the total estimated ultimate cost to an insurance undertaking of settling all claims arising from events which have occurred up to the end of the financial year, whether reported or not, less the amounts already paid in respect of such claims".

b) After adjustment for claims management costs

By comparison between Codes 84 and 84a, on the definition **(b)** basis.

Comments:

These are technical provisions - see Code 4c.

Further analysis which is possible (life and non-life insurance), on the definition (a) basis.

<u>Code</u>	<u>Definition</u>	<u>Reference to Article 34 of the 1991 Accounting Directive</u>
84e (i)	Reinsurers' share	I 4b (bb) + II 5b (bb)
84e (ii)	Net amounts	Sub-totals

Code: 85a

Name: Capital gains (net of losses), realized and unrealized, credited to the technical account (life insurance only)

Definition:

The total of the following items in the life insurance business technical account of the 1991 Accounting Directive:

<u>Description</u>	<u>1991 Accounting Directive Article 34</u>
1. Investment income, value re-adjustments on investments	II 2(c)
2. Investment income, gains on the realization of investments	II 2(d)
3. Unrealized gains on investments	II 3
4. Investment charges, value adjustments on investments	II 9(b)
5. Investment charges, losses on the realization of investments	II 9(c)
6. Unrealized losses on investments	II 10

Comment:

There is a detailed discussion in Annex 3. The implication of Articles 42 and 44 of the 1991 Accounting Directive is that items II 2(c) and (d) and II 9(b) and (c) will comprise all changes in balance sheet values, whereas items II 3 and 10 will, depending on the rules adopted by Member States, include either all, or part, or none of the balance sheet changes. Whilst there can be no precision, the implication is that the changes carried into the profit and loss account are mostly offset as charges in the life insurance provision (Code 85b), or in claims on life insurance policies (Code 84); however it is always possible that some changes, albeit carried into the technical account, are offset in the allocated investment return transferred to the non-technical account (item II 12), or are allowed to carry through to the technical result ("balance on the technical account life insurance business"), which feeds through to the profit or loss for the financial year, and hence to changes in "capital and reserves" in the balance sheet.

These problems are not avoided by starting with a figure of profits (gross operating surplus) and working upwards, unless it is evident that the starting figure of profits excludes all capital gains.

Code : 85b

Name: Change in life insurance provision, gross of reinsurance

Definition: The total of the changes in the following elements of the technical provisions:

<u>1991 Accounting Directive</u> <u>Article 6</u>	
1. Life insurance provision, gross of reinsurance	C 2 (a)
2. Provision for bonuses and rebates gross of reinsurance, life insurance only;	C 4 (a)
3. Variation in the fund for future appropriations, life insurance only (see Article 22);	Ba
4. Bonuses and rebates paid, net of reinsurance, life insurance only	<u>Article 34</u> II 7

Comment:

Changes in the fund for future appropriations (life insurance) may eventually finish up as part of capital and reserves, rather than as part of the technical provisions, but most are likely to be appropriate to the life insurance provision^(*).

Bonuses appearing as debits in the life insurance technical account (item II 7) are likely to be more important than the rebates (deductions of premiums) included in the same heading; some bonuses may be paid directly to insured persons, when Code 84 would be appropriate, but possibly the majority are reflected in technical provisions. The description in Article 39 of the 1991 Accounting Directive suggests that this is a transitional heading, showing the route by which amounts are allocated to individual policy holders rather than the reserves held for policy holders generally.

^(*) To take a simple example:		Year1	Year2	Year3
1. Allocations into fund for future appropriations		<u>+90</u>	<u>+100</u>	<u>+110</u>
2. Allocations out of fund for future appropriations				
from the previous year - to policy holders (change in life insurance provision)	0		-81	-90
3. - to shareholders	0		-9	-10
4. Total		<u>0</u>	<u>-90</u>	<u>-100</u>
5. Net change in fund for future appropriations (Article 6, Ba)		<u>+90</u>	<u>+10</u>	<u>+10</u>

The allocation of the net change in the fund to policy holders anticipates, for the most part, the future allocation as part of the life insurance provision.

Further analysis which is possible (life insurance only).

<u>Code</u>	<u>Definition</u>	<u>Article 34, 1991 Accounting Directive</u>
85b (i)	Reinsurers' share	II b(a) (bb)
85b (ii)	Net amounts	II b Sub-total, II 7

Any variation in the fund for future appropriations, allocated to this Code, can be treated as part of both gross amounts and net amounts.

Code: 85c ii

Name: Change in other technical provisions (net of reinsurance) and in the equalisation provision

Definition:

The total of the changes in the following elements of technical and other provisions:

<u>1991 Accounting Directive, Article 6</u>		
	<u>Non-life insurance</u>	<u>Life insurance</u>
1. Equalisation provision	C 5	-
2. Other provisions (including provision for unexpired risks)	C 6	C 6
3. Fund for future appropriations, non-life only (See Art.22)	Ba*	-

Comments:

In Article 34 of the 1991 Accounting Directive, the items appear as I 9, I 5 or II 6 (b), and II 12a. II 12a routes the total of the variation in the fund for future appropriations back to the non-technical account. In this Manual, the life insurance element (which is the major part or possibly the whole) is treated as part of the change in the life assurance provision (see Code 85b).

* Note: It may be that this item occurs only in life insurance (see Article 22 of the 1991 Accounting Directive); in Article 34 it is treated as an item in the life technical account (II 12a).

Code: 86a

Name: Commissions payable to agents (part of 89d)

Definition:

"Commissions shall comprise all amounts paid or payable for the conclusion of insurance contracts which constitute a fee paid, otherwise than by virtue of a contract of employment, for services rendered in respect of business introduced to the insurance undertaking. They include amounts paid to agents and brokers but exclude amounts paid to employees (such as members of the direct sales force) acting in the ordinary course of their service to the undertaking". This definition, which was contained in the proposals stage of the 1991 Accounting Directive, can be taken to apply to the amounts specified in Article 64.

Comments:

In Article 34 of the 1991 Accounting Directive, Commissions on new business are part of "acquisition costs"; renewal commissions are part of "administrative expenses".

See also Article 64 of this Directive, which requires that the Notes to the Accounts should specify the total of acquisition, renewal, collection and portfolio management commissions. (For composite insurance enterprises, NACE/70 821, the split of this figure between life business and non-life business would have to be estimated).

Code: 86b

Name: Other external expenditure on goods and services

Definition:

Current operating costs other than commissions payable to agents and labour costs.

Comment:

- a) In terms of the 1991 Accounting Directive, the amount is equivalent to the net total of the following sub-items:

<u>1991 Accounting Directive</u> <u>Article 34</u>			
	<u>Non-life</u>	<u>Life</u>	<u>Comment</u>
1. Acquisition costs and change in deferred acquisition costs	I 7(a)+(b)	II 8(a) +(b)	-
2. Administrative expenses	I 7(c)	II 8(c)	(d)
3. Investment management charges, not including interest	III 5(a) adj	II 9(a) adj	-
4. Plus, for preference, an estimate of claims management costs gross of reinsurance (see comments on Code 84 and page 59)	separate estimate	separate estimate	(e) (f)
5. Other charges, not including valuation adjustments in so far as these relate to investments but including other valuation adjustments	III 8 adj	III 8 adj	(b)
6. Less Depreciation on fixed assets which are for own use	separate estimate	separate estimate	(g)
7. Total of above sub-items	-----	-----	(e)
8. Less Labour costs	Codes 11+12	Codes 11+12	(c)
9. Less commissions payable to agents	Code 86a	Code 86a	-
10. Balance = other external expenditure on goods and services	Code 86b	Code 86b	(c)

The adjustments to be made for interest paid, in arriving at sub-item 3 above, should be based on the value of the liabilities, as shown in the balance sheet (see note on investment income in Annex 3, pages 96-97).

- b) Any adjustments to sub-item 5, to exclude valuation adjustments on investments (which are included in III 8), could only be based on independent information.
- c) There are two situations to be considered when payments are made to service companies. If the service company is part of the same enterprise group the payments made to it should be allocated to both labour costs (Codes 11 and 12) and to other external expenditure on goods and services (this Code). If the services company is not part of the same enterprise group, the total payment made to it should be allocated to this Code.
- d) Payments made to affiliates for services provided by them should be included in this Code.
- e) It should be noted that sub-item 7 (the total of costs, items 1-6) needs to include item 4 (estimated claims management costs) before it can be subdivided into sub-items 8, 9 and 10.
- f) The balance (sub-item 10) includes any element of claims management costs which is receivable from reinsurers, if that element is also included in sub-item 4.
- g) Code 31 (gross operating surplus) includes the cost of capital usage of fixed assets used for operations (depreciation), but in the Accounting Directive "administrative expenses" include depreciation provisions in respect of office furniture and equipment (Article 41). If possible, therefore, an estimate of this depreciation should be excluded from Code 86b.

Code: 87a

Name: Profits receivable from direct investments in other countries

Definition:

As in the IMF Balance of Payments Manual; paragraphs 295, 408-418. The underlying concept is that the purpose of the investment is "to obtain an effective voice in the management of the enterprise" in which the direct investment takes place (408). The operational criteria that can be used relate to ownership and control; majority ownership can be said to afford control but, depending on the circumstances, control can be exercised with less than majority ownership. The term "direct investment" refers to both branches and subsidiaries located in other countries. The profits include undistributed profits as well as those distributed.

Comments:

This item lies outside the production account and hence outside a strict definition of the "production" of insurance services. However international business is important and at present most of it is conducted through subsidiaries set up in other countries whose profits do not count as part of "production" in the "home" country. The effect of the common market may well be to enable more of it to be conducted either through branch offices in other EC countries - these would still count as part of "direct" investment in other countries - or by the Head office in the "home" country itself taking premiums directly from customers resident in other EC countries - a route now opened up by the third Directives. It is suggested therefore that the profits of business conducted through non-resident subsidiaries and branch offices are needed, as a special variable. It is also suggested that this variable should be split between EC and non-EC countries, as with direct exports (Code 8b). A further variable, which might be considered, is the profits receivable by a parent enterprise from domestic subsidiaries and trade investments.

The item is defined as in the balance of payments, that is it relates to the profits of both subsidiaries and branch offices in other countries, and includes the undistributed portion of the profits as well as the distributed one.

See Annex 4, for a more detailed discussion of international trade in insurance services.

In Article 34 of the 1991 Accounting Directive, the corresponding item - in so far as the figures relate to non-resident affiliates - is "income from affiliated undertakings", which is to be indicated separately within the two items "income from participating interests" and "income from other investments". There are two points at which these accounting figures may not accord exactly with those in the balance of payments:

1. Branch offices in other countries: In the balance of payments and also in the national accounts, the turnover and costs of a branch office set up in another country are excluded from the figures of production in the "home" country, and the profit of the non-resident branch office is shown instead, in the figures of income transferred to the "home" country. But the annual commercial accounts for an enterprise located in the "home" country may include also the turnover and costs of branch offices located in other countries.

2. If the term "affiliated undertaking" in Article 34 refers to undertakings in which the parent undertaking has a controlling interest, or sufficient interest to exert effective control, the definition is parallel to that in the balance of payments. Income received from undertakings in which the parent undertaking has an investment, but not one affording it effective control, should be treated like other income from portfolio investments.

It seems unlikely that these two elements of possible difference will have a major impact on the variable, if the source used for it are the figures in the annual accounts of insurance undertakings. But evidently consistency should be sought with the balance of payments figures if any different source, such as special enquiries, are used for these.

A further difficulty could arise if the only source used is the published accounts of a group of enterprises and these are consolidated to cover the world-wide activities of the group, including therefore - as part of world-wide turnover and costs - those of both subsidiaries and branch offices located in other countries. There would then be a difference arising from the use of a different unit: the group, rather than the enterprise. It is important to note that the 1991 Accounting Directive applies to the "annual accounts and consolidated accounts" of insurance undertakings. Before it is possible to prepare consolidated accounts for a group of enterprises, full accounts have to be prepared for all the constituent enterprises forming the group. Thus it should be possible to obtain the data, even if not published, relating to the constituent enterprises.

When the enterprise is taken as the unit of observation, only dividends paid by subsidiaries are likely to be shown in the accounts of the parent enterprise, which is likely to be one designated as a holding company. In this particular case, "profits" would have to be replaced by "dividends". If any analysis of internationalization is desired, this would not be very informative (see Code 6).

When the institutional unit (including only resident components) is taken as the unit of observation, the figures available for non-resident subsidiaries are likely to be their profits, both distributed and undistributed. This is a much more informative variable.

Code: 87b (doubtful item)

Name: Profits receivable from domestic subsidiaries and trade investments.

Definition: See comments below.

Comments:

This item would emerge as the balance, if the source of figures is in line with the 1991 Accounting Directive, when the enterprise rather than the group of enterprises is taken as the reporting unit (i.e. taking figures before consolidation). But it is unlikely to be as simple as this in practice, and the case for including this as a variable is not strong. It might provide a better basis for a study of concentration in the industry, by identifying those enterprises which are not singletons and are not themselves subsidiaries of a domestic parent company (see Codes 3d, i and j) and aggregating the reporting unit's gross trading surplus and that of its domestic and (possibly) non-resident subsidiaries. Such an analysis could equally well be done in terms of premiums.

Code: 87c (doubtful item)

Name: Total profits available for distribution (before taxes on income).

Definition: The total of Codes 87a and 87b.

Code: 88b

Name: Net change in fixed capital (sum of Codes 16, 17 and 18)

Definition:

Tangible investments
Less
Disposals of fixed assets
plus
Leasing used by the units

Comments:

"Fixed assets" means physical assets used by an insurance undertaking for its own activities. In the 1991 Accounting Directive, the relevant items on the assets side of the balance sheet are C1 (part): "Land and buildings occupied by an insurance undertaking for its own activities", and F1 "tangible assets and stocks, other than land and buildings...". Other investments can be called portfolio investments (from which portfolio investment income, Code 82, derives) or investments in affiliated undertakings and participating interests. Changes in these investments are not part of Code 88b. Depreciation on tangible investments is shown in the 1991 Accounting Directive as part of "administrative expenses". See comment (g) on Code 86b ; in Article 41 of the Accounting Directive it is described as "depreciation in respect of office furniture and equipment".

Leased assets used by insurance undertakings are also tangible investments (C1 or F1), not other kinds of investments.

Code: 89b

Name: Net written premiums : exports (Code 8b less Code 8c i)

Definition:

Intra-extra-EC exports

Less

Imports : premiums ceded to non-resident insurers

Comments:

The intra-extra - EC exports (Code 8b) are of gross written premiums and pension contributions in respect of contracts with non-residents. The premiums ceded to non-resident insurers (Code 8c i) will be in respect of insurance contracts with both residents and non-residents, but the balance between these two elements does show how turnover, after allowing for sub-contracting, affects the foreign exchange position.

Code: 89c

Name: Gross premiums earned plus pension contributions (Code 8 plus or minus Code 81g).

Definition:

Gross written premiums plus pension contributions.

Plus

a reduction in the provision for unearned premiums (gross of reinsurance)

or Minus

an increase in the provision for unearned premiums (gross of reinsurance)

Comment:

See Comment on Code 81g: "further analysis which is possible". It is proposed to estimate the gross amount of premiums earned, in the case of life insurance, even though not all components of this figure are specified in the 1991 Accounting Directive.

Further analysis which is possible

<u>Code</u>	<u>Definition</u>
89c i	Earned premiums, reinsurers' share (Code 8i +/- Code 81g i)
89c ii	Net earned premiums plus pension contributions (Code 8 ii +/- Code 81g ii)

Code: 89d

Name: External expenditure on goods and services, other than services provided by reinsurers

Definition:

The total of Codes 86a and 86b

Comments:

This total consists of purchases of goods and services, less subcontracting work from third parties. The components of this total are: commissions payable to agents, rent chargeable and other administrative expenses (other than labour costs) and other external current expenditure on goods and services (claims management costs, acquisition costs other than commissions, and investment management charges).

For the treatment of amounts payable to service companies, see comment (c) to Code 86b (page 69).

Code:89f

Name: Adjustment item, which converts net of reinsurance variables, merged and in total, to a gross of reinsurance basis, non-life insurance.

Definition:

With sign reversed, the difference between the reinsurance balance (Code 13c, non-life) and the total of the following Codes (non-life) :

8 i	(gross premiums written, reinsurers' share)
81g i	(change in provision for unearned premiums, reinsurers' share)
83a	(commissions and profit participations received from reinsurers *)
84a i	(claims paid, reinsurers' share)
84e i	(change in provision for claims, reinsurers' share)

Put in another way, the Code is **derived** from the following equations:

- a) Reinsurers' share:
Total of above five variables + x = reinsurance balance
- b) Transfer: x (reinsurers' share) - x (gross transactions) = 0

Comments:

+ x (see above) is the reinsurers' share, in total, of the following variables which are shown only net of reinsurance in the 1991 Accounting Directive:

81a	(part) Bonuses and rebates (part of I 6 in the Directive - rebates)
83c	Other technical income (I 3 in the Directive)
84	(part) Bonuses and rebates (part of I 6 in the Directive - bonuses)
85c	Change in other technical provisions and in the equalisation provision (I 5 in the Directive)
86b	(part) Other technical charges (I 7 in the Directive).

It is thought that x will be a small amount.

Note

* Item which relates only, or mainly, to transactions between the reporting insurer and reinsurers.

Code: 89g

Name: Adjustment item, which converts net of reinsurance variables, merged and in total, to a gross of reinsurance basis, life insurance.

Definition:

With sign reversed, the difference between the reinsurance balance (Code 13c, life) and the total of the following Codes (life):

8 i	(gross premiums written, reinsurers' share)
81g i	(change in provision for unearned premiums, reinsurers' share: estimate, see comment below)
83a	(commissions and profit participations received from reinsurers *)
84a i	(claims paid, reinsurers' share)
85b i	(change in the life insurance provision, reinsurers' share).

Put in another way, the Code is derived from the following equations:

- a) Reinsurers' share:

$$\text{Total of above five variables} + x = \text{reinsurance balance}$$
- b) Transfer: $x (\text{reinsurers' share}) - x (\text{gross transaction}) = 0$

Comments:

+ x (see above) is the reinsurers' share, in total, of the following variables which are shown only net of reinsurance in the 1991 Accounting Directive:

81a	(part) Bonuses and rebates (part of II 7 in the Directive - rebates)
83c	Other technical income (II 4 in the Directive)
84	(part) Bonuses and rebates (part of II 7 in the Directive - bonuses)
85c	Change in other technical provisions (II 6(b) in the Directive)
86b	(part) Other technical charges (II 11 in the Directive).

It is thought that x will be a small amount.

In the 1991 Accounting Directive, the change in provision for unearned premiums (life insurance) is also shown only net of reinsurance. It is desirable to estimate the gross amount and the reinsurers' share, for an improved presentation of the production account for life insurance on the gross of reinsurance basis (and for better congruence with the ESA). The estimate can be based on the relationship between Codes 8, 8 i and 8 ii (premiums written, gross, ceded to reinsurers and net-shown in the Accounting Directive as items II 1(a) and (b)).

Note

* Item which relates only, or mainly, to transactions between the reporting insurer and reinsurers.

ANNEX 2**COMPARISON OF THE CLASSIFICATIONS NACE/70, NACE/REV.1,
ISIC/REV.3 AND CPA FOR THE SECTOR**

NACE/70				NACE/Rev.1				ISIC/Rev.3				CPA			
Class	Grp	Sbgrp	Description	Div.	Group	Class	Description	Div.	Group	Class	Description	Div.	Class	Subclass	Description
82			Insurance, except for compulsory social insurance	66			Insurance and pension funding except compulsory social security	66			Insurance and pension funding except compulsory social security	66.0			Insurance and pension funding services, except compulsory social security services
	821		Units engaged in several types of insurance, except for compulsory social insurance												
				6601			Life insurance	6601			Life insurance	66.01			Life insurance services (see below)
				6602			Pension funding	6602			Pension funding				
				6603			Non-life insurance	6603			Non-life insurance				
								.			.	66.02			Pension funding services (see below)
								.			.	66.03			Non-life insurance services (see below)
	822		Units engaged in life insurance except for compulsory social insurance	6601			Life insurance	6601			Life insurance	66.01			Life insurance services
												66.01.1			Underwriting and investment services where the policies mature only on death of the policy holder, excluding reinsurances accepted
												66.01.11			Contracts where the maturity value is specified at the outset ("bonus contracts")
												66.01.12			Contracts where the maturity value is affected by bonuses, not specified at the outset ("bonus contracts")
												66.01.2			Underwriting and investment services where the policies mature on survival of the policy holder, or of a named person or persons, to a specified age (or on earlier death), permanent health insurance policies
												66.01.21			Contracts where the maturity value is specified at the outset ("non-bonus contracts")
												66.01.22			Contracts where the maturity value is affected by bonuses, not specified at the outset ("bonus contracts")
												66.01.23			Contracts where the maturity value depends entirely on the performance of a segregated fund, in which premiums are invested ("contracts where the investment risk is borne by the policy holder")

NACE/70			NACE/Rev.1		ISIC/Rev.3		CPA				
Class	Grp	Sbgp	Description	Div.	Group	Class	Description	Div.	Class	Subclass	Description
822			Units engaged in life insurance except for compulsory social insurance	6602		Pension funding	6602	Pension funding	66.01.3		Underwriting and investment services related to the sale of annuities, permanent health insurance policies
									66.01.4		Underwriting and investment services related to the sale of annuities, permanent health insurance policies
									66.01.5		Investment and underwriting services related to capital redemption policies, permanent health insurance policies
									66.01.6		Other underwriting and investment services belonging to activity 66.01 excluding pension funding (66.02) when this is a secondary activity, permanent health insurance policies
									66.01.7		Reinsurances accepted on life risks
									66.02		Pension funding services
									66.02.1		Schemes for individuals: the investment and underwriting services of a financial intermediary which offers contracts intended to provide retirement incomes for named individuals (or married couples)
									66.02.11		Bonus and non-bonus contracts
									66.02.12		Contracts where the pension depends entirely on the value of a segregated and unitized fund managed by the intermediary
									66.02.2		Schemes for groups: the investment and underwriting services of a pension fund established to provide retirement incomes for a group
									66.02.21		"Money purchase" (or "defined contribution") type: bonus and non-bonus contracts with a life insurance enterprise
									66.02.22		"Money purchase" (or "defined contribution") type: contracts where the funds is unitized and is managed by a financial intermediary
									66.02.23		"Final salary" (or "defined benefit") type: the pension depends final salary (or revalued average salary) and on length of contributions

NACE/70				NACE/Rev.1				ISIC/Rev.3				CPA			
Class	Grp	Sbgrp	Description	Div.	Group	Class	Description	Div.	Group	Class	Description	Div	Class	Subclass	Description
	823		Units engaged in health casualty, injury and accident insurance, except for compulsory social insurance	6603			Non-life insurance	6603			Non-life insurance	66 03			Non-life insurance services
														66.03.1	Accident and health insurance services
														66.03.2	Motor vehicle insurance services, third party liability
														66.03.3	Motor vehicle insurance services, damage or loss
														66.03.4	Marine, aviation and other transport vehicle insurance services including freight insurance services
														66.03.5	Fire and other property damage or loss
														66.03.6	General liability insurance services
														66.03.7	Assistance (including travel)
														66.03.8	Legal expenses
														66.03.9	Credit and suretyship
														66.03.10	Other non-life insurance services n.e.c.
														66.03.11	Reinsurance premiums accepted on non-life risks n.e.c.
83	832		Activities auxiliary to insurance	6720			Activity auxiliary to insurance and pension funding	6720			Activity auxiliary to insurance and pension funding	67.2	67. 20		Services auxiliary to insurance and pension funding
														67.20.1	Insurance brokers and agency services
														67.21.10	Services auxiliary to insurance and pension funding

ANNEX 3

**ACCOUNTING VARIABLES ON THE UNITS : TABULAR
PRESENTATIONS : TREATMENT OF INVESTMENT INCOME AND CAPITAL
GAINS ; AND ADAPTATION FOR INSURANCE AUXILIARIES**

Introduction

In section 4.4 and in Annex 1, the variables are listed in order of the General Framework (Codes 1 to 31). The insurance - specific variables then follow (Codes 81 to 89). The variables 89a to 89g are variables derived from other variables in this chapter. In section 4.4, Table 2 on page 24 deals with the interaction between the variables and the unit of observation and specifies the combinations of variable and of unit which may be necessary, in practice.

This Annex covers four aspects of the accounting variables on the units (Code 8 onwards):-

1. A tabular presentation of these variables, given in Tables 1 to 3 of this Annex, on pages 86 to 91. These tables are in the form of a production account : part I of each table shows the generation of the Value of production (Code 21), and part II shows the costs of production and balances such as gross value added and gross operating surplus. In addition, part III of each table shows certain other items appearing in the profit and loss account and in the capital account.
Table 1 shows non-life insurance transactions so far as possible gross of reinsurance, and Table 2 does the same for life insurance. Table 3 shows transactions net of reinsurance; it can be sub-divided into non-life and life insurance.
2. An explanation of the treatment of portfolio investment income (pages 92 to 97).
3. An explanation of the treatment of capital gains in life insurance (pages 98 to 100).
4. An adaptation for insurance auxiliaries (NACE/Rev.1 6720) of part I of the tables in this Annex; part II would remain the same (page 104).

TABLE 1

**NON-LIFE INSURANCE : ACCOUNTING VARIABLES ON THE UNITS :
TABULAR PRESENTATION :GROSS OF REINSURANCE**

Item number in this Table	Code	Variable listed in Article 63
I. PRODUCTION ACCOUNT		
Credits (mostly gross)		
1. Premiums		
(a) Gross premiums written:		
(i) Direct insurance	81a	Yes
(ii) Reinsurances accepted	81b	Yes
(iv) Total	8	
of which: - Exports	8a/b	
(b) Change in provision for unearned premiums (gross of reinsurance) (+ or -)	81g	
(c) Gross earned premiums	89c	Yes
2. Gross portfolio investment income on technical provisions \$	82a	
3. (a) Commissions and profit participations received	83a	
(b) Other revenue:		
(i) Other technical income (net of reinsurance)	83b ii	
(ii) Amounts receivable from affiliates for services rendered	83c	
(iii) Other operating revenue (from ancillary activities)	83d	
4. Less Claims		
(a) Claims paid #	84a	
(b) Change in provision for claims (gross of reinsurance) (increase -/ decrease +) #	84e	
(c) Gross claims incurred	84	Yes
5. Provisions		
-/+ Change in other technical provisions (net of reinsurance) (increase -/ decrease +)	85c ii	
... Adjustment item (non-life)	89f	
6. Total = Generation of the Value of Production, gross of reinsurance (balance carried down)	21	

\$ Gross of investment charges

Adjusted to exclude claims management costs, paid or provided for.

TABLE 1 (continued)
NON-LIFE INSURANCE : ACCOUNTING VARIABLES ON THE UNITS :
TABULAR PRESENTATION : GROSS OF REINSURANCE

Item number in this Table	Code	Variable listed in Article 63
II. COSTS OF PRODUCTION AND BALANCES		
6. Value of Production, gross of reinsurance (balance brought down)	21	
7. Services received from reinsurers:- Reinsurers' share of:		
(a) Gross premiums earned	89c i	
(b) Gross claims incurred	84 i	
(c) Remainder of the reinsurance balance	...	
Total = Value of services received (Reinsurance balance)	13c	Yes
8. Total 6 + 7 = Value of Production, net of reinsurance (balance carried down)	21a	
Debits (continued)		
8. Value of Production, net of reinsurance (balance brought down)	21a	
9. External expenditure on goods and services other than from reinsurers:		
(a) Commissions payable to agents	86a	Yes (Art. 64)
(b) Other external expenditure on goods and services	86b	
Total	86d	
10. Balance = Gross value added #	20/20a	
Debits (continued)		
11. Labour costs:		
(a) Gross wages and salaries @	10a	
(b) Employers' voluntary social security contributions and other labour costs...	10b	
Total	10	
12. Balance = Gross operating surplus at factor cost	31	
III. REMAINDER OF PROFIT AND LOSS ACCOUNT (PART)		
13. Other gross portfolio investment income	82b	
14. Profits receivable from direct investments in other countries	87a	
15. Profits receivable from domestic subsidiaries and trade investments (doubtful item)	87b	
16. Balance = Total available for distribution (before taxes on income) (doubtful item)	87c	
IV. CAPITAL ACCOUNT (PART)		
17. Net change in fixed capital	88	
Memo item		
18. Turnover adjusted to include gross portfolio investment income (Codes 8 + 82a)	89e	

@ Including employers' contributions to compulsory social security schemes; also including contributions to own (group) pension schemes

See comments to the definition of these Codes; it is assumed that taxes and duties related to production, other than those on premiums, and subsidies, are negligible.

TABLE 2

**LIFE INSURANCE : ACCOUNTING VARIABLES ON THE UNITS :
TABULAR PRESENTATION : GROSS OF REINSURANCE**

Item number in this Table	Code	Variable listed in Article 53
I. PRODUCTION ACCOUNT		
Credits (mostly gross)		
1. Premiums		
(a) Gross premiums written:		
(i) Direct insurance	81a	Yes
(ii) Reinsurances accepted	81b	Yes
(iii) Pension contributions:		
Schemes for individuals	81c	
Schemes for groups (from employers & employees)	81d	
(iv) Total		
of which: - Regular premiums and contributions	81e	
Single premiums and contributions	81f	
of which:- Exports	8a/b	
(b) (estimated) Change in provision for unearned premiums (gross of reinsurance) (+ or -) *		
	81g	
(c) Gross earned premiums plus pension contributions		
	89c	
2. Gross portfolio investment income on technical provisions (including investment income of pension funds) \$		
	82a	
3. (a) Commissions and profit participations received		
	83a	
(b) Other revenue:		
(i) Other technical income (net of reinsurance)	83b ii	
(ii) Amounts receivable from affiliates for services rendered	83c	
(iii) Other operating revenue (from ancillary activities)	83d	
4. Less Claims		
(a) Claims paid #		
of which: pensions and annuities	84a	
Other °	84b	
Other °	84c	
(b) Change in provision for claims (gross of reinsurance) (increase -/ decrease +) #		
	84e	
(c) Gross claims incurred		
	84	

* An estimate to be based on the gross premiums written and ceded, and on the net change in the provision; see comments on the definition of this code (page 55) and of Code 89g (page 79).

\$ Gross of investment charges.

Adjusted to exclude claims management costs, paid or provided for.

° Including capital sums paid from pension schemes and on maturity of life policies.

TABLE 2 (continued)
LIFE INSURANCE : ACCOUNTING VARIABLES ON THE UNITS :
TABULAR PRESENTATION : GROSS OF REINSURANCE

Item number in this Table	Code	Variable listed in Article 63
5. Capital gains and provisions		
(a) Capital gains (net of losses), realized and unrealized, credited to the technical account	85a	
(b) Less change in the gross life insurance provision	85b	
(c) +/- change in other technical provisions (net of reinsurance) (Increase - / decrease +) *	85c ii	
Adjustment item (life) (excluding the estimate of item 1 (b) above)	89g	
6. Total = Generation of the Value of Production, gross of reinsurance (balance carried down)	21	
II. COSTS OF PRODUCTION AND BALANCES		
Debits		
6. Value of Production, gross of reinsurance (balance brought down)	21	
7. Services received from reinsurers Reinsurers' share of:		
(a) Gross premiums earned (estimated, see 1(b) above)	89c i	
(b) Gross claims incurred	84 i	
(c) Gross change in the life insurance provision	85b i	
(d) Remainder of the reinsurance balance	..	
Total = Value of services received (Reinsurance balance)	13c	Yes
8. Total 6 + 7 = Value of Production, net of reinsurance (balance carried down)	21a	
Debits (continued)		
8. Value of Production, net of reinsurance (balance brought down)	21a	
9. External expenditure on goods and services other than from reinsurers		
(a) Commissions payable to agents	86a	Yes (Art.64)
(b) Other external expenditure on goods and services	86b	
Total	89d	
10. Balance = Gross value added #	20/20a	
Debits (continued)		
11. Labour costs:		
(a) Gross wages and salaries @	10a	
(b) Employers' voluntary to social security contributions and other labour costs	10b	
Total	10	
12. Balance = Gross operating surplus at factor cost	31	
III. REMAINDER OF PROFIT AND LOSS ACCOUNT (PART)		
13. Other gross portfolio investment income	82b	
14. Profits receivable from direct investments in other countries	87a	
15. Profits receivable from domestic subsidiaries and trade investments (doubtful item)	87b	
16. Balance = Total available for distribution (before taxes on income) (doubtful item)	87c	
IV. CAPITAL ACCOUNT (PART)		
17. Net change in fixed capital	88	
Memo item		
18. Turnover adjusted to include gross portfolio investment income (Codes 8 + 82a)	89e	

* Including surpluses of pension funds

@ (as page 87)

(as page 87)

TABLE 3

INSURANCE : ACCOUNTING VARIABLES ON THE UNITS : TABULAR PRESENTATION : NET OF REINSURANCE

Item number in this Table	Code	Of which: Exports (and code)	(For NACE/70 821) Split life/non-life
I. PRODUCTION ACCOUNT			
Credits (net)			
1. Premiums			
(a) Gross premiums written:			
(i) Direct Insurance	81a	No	Yes
(ii) Reinsurances accepted	81b	No	Yes
(iii) Pension contributions:			
- Schemes for individuals	81c	No	Yes
- Schemes for groups (from employers and employees)	81d	No	Yes
(iv) Total	8	Yes: (8b)	Yes
of which: - Regular premiums and contributions	81e	No	Yes
- Single premiums and contributions	81f	No	Yes
(b) less Outward reinsurance premiums (premiums ceded to reinsurers)	8 i	Yes: (8c i)	Yes
(c) equals Net written premiums plus pension contributions	8 ii	Yes: (89b)	Yes
(d) Change in provision for unearned premiums (net of reinsurance) (+ or -)	81g ii	No	Yes
(e) equals Earned premiums plus pension contributions	89c ii	No	Yes
2. Gross portfolio investment income (on technical provisions: including Investment income on pension funds)			
	82a	No	Yes
3. Commissions received and other operating revenue (aa)			
	83a, 83b ii, 83c, 83d	Yes: (83a (aa))	Yes
4. (a) Less Net claims incurred (-) (bb)			
(b) of which:	84 ii	No	Yes
- Claims paid (-)	84a	No	Yes
(c) of which: - Pensions & annuities	84b	No	Yes
(d) - Other (cc)	84c	No	Yes
(e) - Amounts recoverable from reinsurers (+)	84a i	No	Yes
(f) Change in provisions for claims, net of reinsurance (incr-)*	84e ii	No	Yes

TABLE 3 (Continued)

INSURANCE : ACCOUNTING VARIABLES ON THE UNITS : TABULAR PRESENTATION : NET OF REINSURANCE

Item number in this Table	Code	Of which: Exports (and code)	(For NACE/70 821) Split life/non-life
5.(a) (Life insurance only). Capital gains, realized and unrealized, credited to the technical account	85a	No	Yes
(b) Less (life insurance only) - Change in life insurance provision (net of reinsurance) (Incr.-)	85b ii	No	Yes
(c) Less change in other technical provisions (net of reinsurance) and in the equalisation provision (Incr.-) (dd)	85c ii	No	Yes
8. Total = Generation of the "Margin" (or value of production of insurance services)	21a	No	Yes

NOTES:

Item numbers in the table 6 and 7 do not appear on the net of reinsurance basis.

Item numbers 9 to 17 are the same as on page 87.

* Incr. = Increase

(aa) Including other technical income and amounts receivable from affiliates for services provided, if separately identified

(bb) For preference, excluding an estimate of claims management costs

(cc) Including capital sums paid from pension schemes and on maturity of life policies.

(dd) Including surpluses of pension funds; and the change in provision for unexpired risks.

Accounting variables on the units: treatment of portfolio investment income

Portfolio investment income, excluding capital gains ⁽¹³⁾, is included as an integral part of the production account. "Investment income" means the income on all portfolio investments, and therefore includes the rental income from property held as a investment but does not include the income from subsidiaries, trade investments or direct investments in foreign countries. The inclusion of portfolio investment income follows the proposed change in the definition of the insurance service charge in the ESA/SNA. In the case of life insurance and pension funding, the change is only one of clarification; insurance companies have always been regarded as holding life funds, in effect, as trustees for the beneficial owners, the policy holders, who are generally located in the household sector. The current surpluses of the funds are therefore regarded as part of the saving of the household sector.

When, as for instance is often the case with the pension funds, the managers charge a fee for administering the funds (which will include a profit element if they act commercially), the matter is quite straightforward - the fee is the "insurance" service charge. With much life insurance, however, e.g. "with profits" insurance, the financial assets (investments) of the life insurance companies and the income from these assets do not belong wholly to the policy holders; the income and capital gains are therefore partitioned between the major part, which is due to policy holders, and the minor part, which is treated as part of the profit of the insurance company and so as being distributable to its shareholders. For all life insurance, a minimum level of provisions has to be kept to meet future liabilities to policy holders.

The mechanism for separating and safeguarding policy holders' funds is through the separation of a "technical" part of the profit and loss account. In Article 34 of the 1991 Accounting Directive, the treatment of investment income is quite different for life insurance than it is for non-life insurance. With life insurance, the investment income on all investments is credited to the "technical" part of the account. Most, however, does not swell the result of the "technical" account, because it is offset as an increase in technical provisions (provisions to meet future liabilities to policy holders); but some may be taken as a management charge, or may even be included in the technical result and thereby transferred to the non-technical part of the account.

As there will be lack of uniformity in this accounting treatment, the preferred method in the new ESA/SNA will be to partition the investment income on all portfolio investments between that arising on the investment of technical provisions and that arising on the investment of other reserves, estimating the split from the data on the liabilities side of the balance sheet. The investment income arising on the investment of technical provisions would then be carried into the production account and largely, if not wholly, offset as an element of the increase in the accounting period in these technical provisions.⁽¹⁴⁾

(13) For the treatment of capital gains; see page 96.

(14) See paper presented to the working party on National Accounts (April 1989) Doc. CN 118; items 24 to 29 of the "Summary and conclusions" of the meeting of the SNA Group of Experts 23-27 January 1989 (Doc CN 123), and Doc Eurostat B2/CN/128c)

The side of the production account showing the generation of income therefore consists of premiums earned, claims incurred, commissions received, investment income on the investment of technical provisions, any capital gains credited to the profit and loss account and the increase in the technical provisions - see part I of the tables in this annex. The increase in technical provisions will fall short of the net balance of the other five items; the difference represents the amount available to meet administrative expenditure and the profit on the operation. As calculated in this way, the profit will be different from the "balance on the technical account", as shown in Article 34, whenever the amount of investment income arising from the investment of technical provisions is not exactly the same as total investment income less the amount transferred to the non-technical account.

A major change is proposed in the treatment of investment income in the case of non-life insurance, where the ESA/SNA previously regarded the insurance service charge (the production of services) as premiums earned less claims incurred. This figure was low or even negative, because in effect the investment income on the various technical provisions was also used to meet administrative costs, rather than as being regarded as distributable to shareholders. Clearly it should not be regarded as so distributable, since the provisions are technical, and are held to meet future claims.

It is now proposed in the ESA/SNA that the investment income on the technical provisions of non-life insurance enterprises should, in effect, be regarded as a supplement to premiums, on the basis that this income serves to keep premiums at a lower level than they would be, were it not for the existence of these reserves. Note that the individual policy holder usually enters into an annual contract and pays his premiums in advance; and that the events giving rise to claims take place later, the settlement of claims being even later. Thus the insurance company has the use of the individual policy holder's money in these periods; and by extension, all the technical provisions can be regarded as held for the benefit of non-life policy holders collectively, just as for life policy holders.

In the new ESA/SNA the investment income on technical provisions will be regarded as distributed by the insurance companies to the policy holders (collectively) who then return it. The balance between premiums, the investment income on technical provisions and claims incurred is reflected in the insurance service charge, that is in administrative expenses and profit.

In practice, it may not be possible to make a precise distinction between the investment income arising on technical provisions and that arising on other reserves; in some countries the assets (portfolio investments) corresponding to technical provisions may be segregated from other portfolio investments, but in most countries there is no such segregation of assets. It may therefore be necessary to treat all portfolio investment income of non-life companies as a proxy for the investment income on technical provisions.

If this is done, there may be slight overstatement of the value of the insurance service charge (insurance production). But this simplified method has the advantage that the balancing figure which appears as variable 31 (gross operating surplus) is then much the same as the total profit, before depreciation, of the insurance enterprise as this is defined in the enterprise's own accounts.

In partitioning investment income on all portfolio investments, there are two stages of estimation:-

- (a) identify the total gross portfolio investment income
- (b) estimate the partition of gross portfolio investment income between that arising on the investment of technical provisions and that arising on other liabilities (notably on the investment of capital and reserves, or of long-term debt).

a) Total Gross Portfolio Investment Income and Investments (assets)

In terms of the 1991 Accounting Directive, these can be defined as follows:-

	<u>Article 34</u>		<u>Article 6</u> ^(14a)
	Life (15)	Non-Life (15)	(Assets)
Land and buildings	II 2(b)(aa)	III 3(b)(aa)	C I
Participating interests, other than affiliated undertakings	II 2(a)	III 3(a)	C II, 3 & 4
Other financial investments	II 2(b)(bb)	III 3(b)(bb)	C III & IV D G I
Sub-totals	of above		of above
Less interest on deposits by reinsurers ⁽¹⁶⁾	Estimate from liabilities	Liabilities, F	
Grand totals	of above		of above

(14a) Including non-portfolio investments see page 95.

(15) Excluding the "separate indication of [income] derived from affiliated undertakings".

(16) See explanation at (ii) on page 95.

- b) Partitioning portfolio investment income between that arising on the investment of technical provisions and that arising on the investment of other reserves

The method is based on the liabilities side of the balance sheet, after certain prior adjustments. It is intended to be practicable using either data for individual enterprises (or for the resident part of enterprise groups), or aggregated balance sheet data, whether consolidated or combined.

Prior adjustments to the balance sheet (Life and Non-Life)

- (i) Adjustments to exclude assets which one would expect to be financed by the enterprise's own capital and reserves; the same amount is to be excluded from both assets and liabilities.

Exclusions from assets

**Reference, Article 6
of the Council Directive**

Tangible assets and stocks

F I

Land and buildings occupied by the enterprise for its own activities ⁽¹⁷⁾

C I (part)

Affiliated undertakings: shares in, debt securities issued by, and loans to

C II 1 and 2

Exclusion from liabilities

Capital and reserves, total (including profit for the year)

Total of above assets,
to be excluded from
liabilities A+I - H (assets)

The above assets are linked to share capital and reserves, and do not contribute to portfolio investment income ⁽¹⁷⁾. Profits from affiliates are not part of gross operating surplus.

- (ii) Certain portfolio investments exist because reinsurers make deposits, and do not therefore reflect policy-holders' funds

Reinsurance affects portfolio investments in two ways. First, if part of a premium is ceded to a reinsurer, it is not available to be invested by the direct insurer, whose net technical provisions are also reduced by the reinsured amounts. Secondly, reinsurers make deposits to the ceding insurer, particularly in non-life insurance, and these are available to be invested, but deposit interest has to be paid to the reinsurer.

Rather than introducing the complication of a three-way split of portfolio investment income, between that arising on liabilities to (a) policy-holders, (b) reinsurers and (c) shareholders or owners, it seems preferable to deal with this phenomenon on a net basis, by excluding these liabilities (and the corresponding assets) before making the partition, and correspondingly by deducting the interest on the deposits from gross portfolio investment income.

⁽¹⁷⁾ This element of land and buildings is separately identified in Article 6. It should be excluded only if there is no corresponding portfolio investment income (actual or nominal) in the profit and loss account of the enterprise. The preferable accounting method would be to include such "income" in the profit and loss account, offset in operating expenses (and hence contributing to the value of production of insurance services).

The interest on deposits to reinsurers is treated differently, in the 1991 Accounting Directive, from interest on other debt. It is part of "investment management charges", which have the same location as "investment income" in the profit and loss account. This also speaks for the net treatment of the deposit interest; plainly it has nothing in common with the other costs of investment management, nor is it regarded as equivalent to interest on other debt. See also comment on Code 82b, at the foot of page 55.

Exclusion from liabilities

Reference, Article 6 of the Council Directive

Deposits received from reinsurers

F

Exclusions from assets

Portfolio investments

Exclude F (liabilities)
from total of C I⁽¹⁸⁾, C II 3 and
4, C III, C IV, D, G I

It should be noted that the only adjusted figures that need to be used are those on the liabilities side of the balance sheet; it is not assets that are partitioned, but the income arising from them, based on liabilities. However, for the sake of clarity, the rearranged balance sheet takes the following form:-

Group Liabilities

Reference, Article 6 of the Council Directive

A Capital and Reserves, adjusted

Liabilities A + I - H (assets)
less Assets F I, C I (part),
C II 1 and 2

B Technical Provisions

Liabilities, C, D

C Long-term debt

Liabilities, G III

Sub-total, which is allocated

Sub-total of amounts indicated
above

Other provisions, other creditors etc

Liabilities B, E, G I&II
G IV and V, H

Adjusted total, Liabilities

Total, less F, less assets F I, C I
(part), CII 1 and 2, H

Assets

Portfolio investments

Assets, C I(7), C II 3 & 4, C III, C IV,
D, G, I

Miscellaneous

Assets, A, B, E, FII-IV, GII + III

Total = adjusted total of liabilities

Total of items indicated above

Result

The proportion to be applied to portfolio investment income⁽¹⁹⁾ can then be estimated as B divided by A+B+C where A,B,C are the groups of liabilities indicated above.

(18) Where appropriate, after deducting land and buildings occupied by the enterprise for its own activities.

(19) After deducting deposit interest paid to reinsurers, which can be estimated from the amount of the liabilities.

Note that group B (Technical provisions), on the liabilities side, may be higher or lower than portfolio investments. They might be expected to be higher, unless a substantial proportion of assets is held in short-term form (viz assets, E 1 1 and 2). However, it appears reasonable to do the allocation with data on the liabilities side, when the liabilities have been adjusted and sub-totalled, as shown, to exclude the short-term items. Indications are that the proportion of total portfolio investment income attributed to technical provisions will be [over 90%] for life insurance, and in the region of [70-80%] for non-life insurance.

Investment Management Charges

In addition to excluding deposit interest paid, from investment management charges (part of Code 86b, "other external expenditure on goods and services" and of Code 11 & 12 "labour costs"), it might be thought necessary to partition the management charges in the same way as the gross portfolio investment income.

Only part of gross portfolio investment income, that arising on policy holders' funds (technical provisions), is treated as a credit to the operating account of insurance enterprises, having been regarded as notionally distributed, from their income and outlay account, to policy holders, who then return it, as if it were a supplement to premiums.

However, all investment management charges must be regarded as a debit to the operating account; if paid externally, they are also credited to the operating account of those who give advice about investments.

To partition the management charges notionally might be illuminating in the following sense: it would lead to one element of gross operating surplus (a negative amount) which would represent the charges arising on the investment of shareholder's funds, and the remainder which, so far as investment income and charges was concerned, would relate only to policy holders' funds. Such a sub-division of gross operating surplus would however be unconventional.

Accounting data on the units: treatment of capital gains (Life Insurance only).

Part of the investment return appears in the form of capital gains (whether realized or not) and the funds held for the generality of policy holders include the capital gains. However, capital gains and losses - particularly unrealized gains and losses - are not usually allocated formally to policy holders as and when they occur. Particularly when investments are valued at current market value in the balance sheet, there will be short-term fluctuations in their value which will not be matched immediately by changes in funds formally allocated to policy holders (the "technical provisions").

The exception is the unit-linked type of contract (Class D, Assets, in Article 6 of the 1991 Accounting Directive), in which the policy holder's claim on the insurance enterprise is measured against a varying numeraire - the value of the units in a segregated fund. In these contracts, revaluation adjustments are, in effect, continually allocated to the individual policy holders.

In the national accounts and other economic statistics, the rule is that capital gains on financial investments are to be shown in a separate "reconciliation" account, which completes the link between the opening balance sheet and the closing balance sheet, so that capital gains are always excluded from the balance of the production account (the value of production) and from "Gross operating surplus".⁽²⁰⁾

In Article 34 of the 1991 Accounting Directive, provision is made for the capital gains of life insurance enterprises to be carried through the life technical account. Articles 42 and 44 suggest that all realized capital gains should be carried through the technical account, but that, in the case of unrealized capital gains, all, part or none may be carried through the life technical account.

Unfortunately those arising on the unit linked type of contract are not distinguished.

The possible offsets to the capital gains, realized and unrealized, carried into the life technical account are the following:-

	<u>Code</u>
(a) Part of a claim	84
(b) Part of the change in the life insurance provision	}
(c) Part of transfers to and from the fund for future appropriations (see Article 22) ⁽²¹⁾	} 85 b
(d) Part of the change in "other technical provisions"	}
(e) Part of investment management charges or of other operating expenses	85 c
(f) Part of "gross operating surplus"	86b, 11, 12
	31

In terms of Article 34 of the 1991 Accounting Directive, (f) could be in two places: (f) (i), part of the "allocated investment return transferred to the non-technical account" ⁽²²⁾; or (f) (ii), part of the "balance on the life technical account".

(20) In macro economic statistics, but not necessarily in enterprise - based statistics, capital gains on physical assets are also excluded, in the form of what is known as "stock appreciation", or as "the inventory valuation adjustment".

(21) The reasons for showing these in the same Code as the change in the life insurance provision are essentially to avoid short term fluctuations carrying through to the balance of the production account (Code 21, the Value of Production). See comments on Code 85b, page 66.

(22) In the Council Directive, the "variation in the fund for future appropriations" is shown alongside, but see note 21 above.

The (f) type items, in the above paragraph, reflect capital gains which are held in general reserve (Liabilities A III, "Revaluation reserve"), or are to be formally allocated to shareholders, perhaps as part of the dividend. If unrealized gains on investments are not carried through the profit and loss account, they would be reflected directly, on the liabilities of the balance sheet, in A III, or in Ba (see Article 22).

There is therefore a difficulty if, to any material extent, the capital gains which have been carried into the technical account, are not fully offset in the (a) to (e) type items, so that they carry through to "gross operating surplus". The difficulty is most serious if what carries through to "gross operating surplus" reflects short-term unrealized fluctuations in the value of investments, but most of these are probably of type (c). Apart from type (c), the allocations to the "life insurance provision" and to "other technical provisions" are likely to be based on actuarial techniques, which are cautious and aim to smooth out short term fluctuations.

It should be noted that these difficulties are not avoided by estimating the "value of production" using the "bottom up" approach, that is by starting with operating profit and adding it to labour costs and external expenditure on goods and services. That is, the difficulties are not avoided if figures compiled according to Article 34 are used, since "Gross operating surplus" would need to be defined in terms of adjustments, eg for differences in the treatment of investment income, to the "balance of the life technical account". This balance appears to suffer from exactly the same problems, so far as capital gains are concerned, though again certain short-term fluctuations are excluded, through item II 12 (a), see Article 22.

Nor can the difficulty be avoided by separately estimating those capital gains which arise on unit-linked contracts, which are directly offset in the life insurance provision. (This is apparently proposed in ESA and SNA). The fact remains that the changes made in the life insurance provision, for other types of contract, will also reflect capital gains as well as premiums and investment income, but not as directly.⁽²³⁾

If capital gains, other than those arising on unit linked contracts, were to be excluded completely from the production account, it would be necessary to obtain information on what part of the change in the life insurance provisions was due to capital gains, and to exclude this also. It is doubtful if such information is available in the basic records of life insurance enterprises.

It makes no difference if the presentation of the production account for life insurance enterprises shows capital gains as a separate item above the "line" of the value of production, or if it does not. The presentation in earlier drafts did not show capital gains, because they were deducted, in total, from the "change in the life insurance provision". The effect on the balances of the account is precisely the same.⁽²⁴⁾

(23) In Code 85b, transfers to and from the fund for future appropriations are also included, see footnote 21 above.

(24) An alternative presentation, with the same overall effect, would be as follows:

Code 85a - Capital gains, realized and unrealized, credited to the life technical account.

Less Variations to and from the fund from the fund for future appropriations (item II 12a).

Equals Code 85a, adjusted.

Code 85b Change in the life insurance provision, net of reinsurance: re-define to exclude variations to and from the fund for future appropriations. (See definition of the Code, on page 66).

This presentation would imply that the variations to and from the fund for future appropriations mostly represent, in fact, unrealized capital gains.

Therefore, it is therefore unavoidable to base the estimates on the assumption that any capital gains which do carry through to "Gross operating surplus" (see page 49 above) are a reasonable indication of the undistributed component of profits, which may include amounts to be held in the revaluation reserve, pending later allocation to policy holders as technical provisions. Short term fluctuations due to unrealized gains, other than for the unit - linked policies, would only appear in the profit and loss account, if Member States permit this to be done, and the life insurance enterprise decides to do so (see Article 44); and if they do, they are largely offset in item II 12 (a) - see Article 22 of the 1991 Accounting Directive.

Schematic analysis of treatment of capital gains and losses (Life Insurance only)

The table on the next page analyses the various components of capital gains and shows separately how they are treated in this Chapter of the manual and in Article 34 of the 1991 Accounting Directive. The table sets out the inter-connections schematically. The figure which can be most readily identified from Article 34 of the Accounting Directive - also shown as the totals of the first three columns of the Table - are the following:-

	<u>Code</u>
1. Total capital gains and losses, realized and unrealized (In Article 34, this is the net total of items II 2 (c) & (d), II 3, II (b) & (c) and II 10)	85a
2. Variations to or from the fund for future appropriations	Element 3* of code 85b
3. Total of other elements of Code 85b (change in life insurance provision)	Elements 1,2 & 4* of Code 85b

The total of the next two columns of the Table represent amounts of capital gains which enter into the balances of the Manual and the profit and loss account (Article 34) respectively. In the case of the Manual, it is theoretically inappropriate for any capital gains to be included in the balance (the "Value of Production") but it is thought that these amounts - capital gains taken through the profit and loss account and allocated to shareholders or other owners - are likely to be small. Unfortunately these totals cannot be identified from Article 34.

The total of the sixth column can be identified and its treatment in the Manual is as explained on page 65 and in footnote 00 below.

The components of capital gains and losses which lead to these totals are labelled "part 1....part 9" in the Table. (They are numbered in sequence of the first column in the Table). Most of the individual parts are not identifiable separately, but various groupings are identifiable, as follows:

- (i) The total of A (i) to (iii) in the Table is the net total of items II 2 (d) and II 9 (c) in Article 34.
- (ii) The total of B 3 (b) (i) & (ii) in the Table is the net total of items II 2 (c) and II 9 (b) in Article 34.
- (iii) The total of B 2 plus B 3 (a) (i) to (iii) in the Table is the net total of items II 3 and II 10 in Article 34.
- (iv) The total of A (iii) and of B (iii) in the Table is the same as item II 12 (a) in Article 34 (see Article 22).
- (v) Although B 2 in the Table is not separately identified, nothing gets into the balances - the amount included in Code 85a is by definition the same as the amount included in Code 85b.

* See the elements of the definitions of the Code page 65.

- (00) The proposed treatment of realized and unrealized gains taken through the profit and loss account but then held in a holding reserve assumes that they all finish up in the life insurance provision, even though some will eventually be allocated - probably on an actuarial basis which smoothes out short term fluctuations - to shareholders or owners. The essential feature of the proposed treatment is that it neutralises the gains within the production account so that they do not affect the "Value of Production". They are treated in the same way as gains on policies where the investment risk is borne by the policyholder. If it is desired to keep the erratic fluctuations out of the gross figures in the production account, an alternative presentation would be to redefine Code 85a so as to exclude these short term fluctuations, by deducting them (the total of A (ii) and B 3 (a) (iii) in the Table) from Code 85a, and likewise to exclude them from Code 85b.

	CREDIT	DEBIT		BALANCES		
	CODE 85a	CODE 85b (1)				
		Elements (2), 1,2,4	Element (2) 3	Value of Pro- duction (part)		
IN ACCOUNTING EFFECTIVE	Investment Return (part)	Change in Life insurance Provision (part)		Balance on life technical account (part): Allocated Investment return (part)	Transfers to & from fund account (part): for future appropri- ations	
A. REALIZED GAINS & LOSSES						
(i) Allocated to policyholders (3)	Part 1	Part* 1				
(ii) Allocated to owners	Part 2			Part* 2	Part* 2	
(iii) Held in a holding reserve (3)	Part 3		Part* 3			Part* 3
B. UNREALIZED GAINS AND LOSSES						
1. Total of policy holding reserve	--	--	--	--	--	--
2. Policies where the investment risk is borne by the policyholder	Part 4	Part* 4				
3. Other policies (bonus & non-bonus) (a) Reflecting periodic changes in asset valuations where assets are valued at market value						
(i) Allocated to policyholders	Part 5	Part* 5				
(ii) Allocated to owners	Part 6			Part* 6	Part* 6	
(iii) Held in a holding reserve (4)	Part 7		Part* 7			Part* 7
(c) Reflecting periodic revaluations to book values & other reasons (5):						
(i) Allocated to policyholders	Part 8	Part* 8				
(ii) Allocated to owners	Part 9	Part* 9				
TOTALS	Code 85a (=Sum of parts 1-9)	Total of Elements 1, 2,4 of Code 85b (identified)	Element 3 of Code 85b (identified)	Total (6)	Unidentified Total (part of these balances)	Identified Amount - See Article 22

* The parts are those of Code 85a, see the first column; mostly figures are not identities.

(1) normally, gains may be allocated to policyholders as part of claims (see page 100).

(2) See the elements of the definition of this code page 86.

(3) Including all realized gains in respect of policies where the investment risk is borne by the policy holder.

(4) An alternative presentation would be define both Code 85a and Code 85b so as to exclude the total of these two components (parts 3 & 7).

(5) For instance, due to variations in exchange rates.

(6) This total is theoretically inappropriate to the "Value of Production".

Accounting variables on the units: adaptation for insurance auxiliaries

An adaptation appears necessary for the credit side of the production account

**Table Insurance auxiliaries: adaptation of tabular presentation
(Table I, part I, of this annex)**

<u>Net credits</u>		<u>Code</u>
1.	Commissions, fees and other trading income receivable	8
	Of which:	
	a. Receivable from resident insurers	balance
	b. Receivable from non-resident insurers	8b(exports)
2.	Less Commissions, fees etc. due to other enterprises for sub-contracted work	13a
	Of which:	
	a. Due to resident enterprises	balance
	b. Due to non-resident enterprises	13b (imports)
3.	Total = Generation of the margin (or production of auxiliary services)	21 (See Table I of this annex)

In the debit side of the table (part II on the second page), item 13 and item 9a would not be relevant, but the other variables would remain unchanged; fees paid for specialist advice would be included in item 8b (other external expenditure on goods and services).

It is important to note that, on the gross basis of recording of premiums and commissions, the total premium received from a non-resident insured person is treated as being the export of the resident insurer; the commission payable to the agent is a transaction between residents. The resident insurer is assumed to know - indeed, to need to know - the residence of the insured person, ie. that he is non-resident; this is a matter of significance to the insurer, but not to the broker. Strictly, the currency in which the premium is paid is irrelevant, though it could provide an indication of non-residence, in default of other information.

It may well be that the broker (independent agent) collects the premium from the non-resident insured person and passes it on the resident insurer, after deducting his commission. But if this commission were to be scored as the broker's export whilst at the same time the gross premium is scored as the insurer's export, there would be double counting. To score the commission as a export of the auxiliary, whilst avoiding double counting, would require net recording by insurance enterprises of all premiums and commissions, which would be less informative and would also be inconsistent with the usual basis of insurance enterprise accounts.

Commissions received by resident insurance auxiliaries from non-resident insurers are truly exports of the auxiliaries and if possible should be identified as such.

ANNEX 4

INTERNATIONAL INSURANCE TRANSACTIONS

INTERNATIONAL INSURANCE TRANSACTIONS

These can be complex. The underlying principle for determining what is an international insurance transaction, and what is not, should be consistent with that adopted in the balance of payments statistics: that is, an international (or cross-border) transaction is one between a resident economic agent and a non-resident economic agent ⁽²⁵⁾. What constitutes residence, and distinguishes residence from a temporary visit (of an individual) is laid down in the IMF Balance of Payments Manual. The criterion is that of the "centre of economic interest".

This criterion, used in international economic statistics, appear to be consistent with the definitions in EC Legislation (eg Article 1 of the Third Directive on non-life insurance, 1992), in relation to basic concepts such as "branch"; "subsidiary" and "control", and in relation to the location of "head office of an insurance undertaking", "branch" and "subsidiary".

So far as insurance and reinsurance are concerned, there are various forms in which resident/non-resident transactions take place. And the transactions are of various types (sales, purchases, profits etc.)

I. International Direct Investment Transactions

Usually, both parties to the transaction are located in the activity classes 66.01 - 66.03 and form part of the same international family of enterprises. A transaction, in which both parties are acting as insurers, may be between a parent enterprise in one country and its subsidiary enterprise in another, or between two "sister" enterprises. The criterion of what constitutes direct investment - "an effective voice in management" - is that given in the IMF Balance of Payments Manual. Clearly possession of over 50 per cent of voting shares meets this criterion, but smaller shareholdings may also do so, depending on the circumstances of each case.

The term "enterprise" is here used to cover both subsidiaries and branches which are wholly owned by a parent enterprise in another country, without being incorporated - the latter are called "notional resident units" in the ESA (214).

Types of transactions within category I

- (a) The principal type of current account international transaction is the parent company's share (according to its shareholding) in the total profit (whether distributed or undistributed) of the subsidiary or branch. This is provided for in the Insurance Chapter of Eurostat's Manual on Services - Code 87a. This Code only applies to transactions which are international direct investment transactions; they lie outside the scope of the "production" account. The reason, for including it, is that institutional arrangements have, hitherto, obliged much international activity by insurers to take this form.
- (b) Another type of current account transaction, which is again specific to the international direct investment situation, is the charge which is made by a parent/daughter enterprise located in one country for services which it provides to its "related" enterprise located in another country. These are imports or exports of services, and so do form part of the "production" account. They are provided for in Codes 83 and 86b, but are not separately distinguished within these Codes. (Code 83c includes also non-consolidated resident affiliates)

(25) "Agent" is here used in the sense of someone who conducts an economic activity, and not in the sense of "representative" or "selling agent".

- (c) A third type is the following: an insurance enterprise located in one country may well act as reinsurer, in whole or in part, to a "related" enterprise located in another country. These transactions are included, but not separately distinguished, within the transactions shown in Tables 1,2 of Annex 3, when parts of risks are respectively accepted or ceded.
- (d) Finally it is possible that a branch located in one country passes all the premiums it collects on certain types of policy say the "large" risks - to its parent enterprise located in another country, so that direct insurance premiums and claims pass internationally, between branch and parent. This type of operation may well become more common, under the recent EC Directive which requires that the prudential supervision done in one Member State must satisfy the requirements of other Member States. However, it is arguable that the branch is then acting as no more than an agent for its parent enterprise, in respect of certain types of business which it does not underwrite itself, so that the appropriate categories would be 3 or 4 (see below). If the branch does not itself underwrite any business, it is not really a branch, but only a selling agent.

Measurement of international direct investment transactions.

The most satisfactory method is to measure them through a special statistical survey which aims to obtain figures on the same basis as is shown in enterprises' accounts. Such a survey will cover all international direct investment, not just direct investment by insurance enterprises. The figures obtained, in so far as they relate to insurance undertakings, will eventually be compiled according to the EC Directive on the annual accounts of insurance undertakings. Types (a) and (b) above should be identifiable, within such an all-embracing statistical enquiry, as insurance transactions, by reference to the activity group of the parent company, or of the subsidiary company, in question. In types (c) and (d), transactions which are with non-resident subsidiary or parent companies will not necessarily be distinct, in the statistical sources, from other international transactions of the same type.

II Direct Selling of insurance services across borders

There are three categories of direct selling across borders:

1. Insurance or reinsurance between two non-related insurance enterprises located in different countries.
2. Direct insurance of "large" risks (non-life).
3. Direct insurance of large risks (non-life) or life insurance.

Introductory comment on direct selling of insurance services (categories 1-3).

In general, the criterion of what constitutes an international insurance transaction remains that of the resident transactor and the non-resident transactor. In categories 2 and 3, one transactor will be a direct insurer and the other will be a policy holder. International reinsurance - including the reinsurance of the risks falling in categories 2 & 3 - falls into category 1. Generally, but particularly in category 2, care must be taken to distinguish between the principal transactor (the underwriter) and his selling agent or broker. Take the following case, by way of example: a premium on a "large" risk is received by a broker in Country A, the policy holder being located in country B; the broker deducts his commission and passes on the balance to an underwriter in Country A. The international transaction is the gross premium written by the underwriter in Country A; the broker's commission is a resident/resident transaction. The same principles apply to the more complicated situation where underwriter, broker and policy holder are located in 3 separate countries.

It should be noted that international trade within the EC will be liberalised by the 1992 Directives, but the same does not apply to international trade with non EC Countries. The terms "large risks" and "mass risks" used below are superseded in regard to trade within the EC, but are useful, qualitatively, in considering extra-EC trade in insurance services.

1. Insurance or reinsurance between two non-related insurance enterprises located in different countries

The concept of cross-border selling is here quite simple. The transactions can be any of the types listed in Table 3 of Annex 3. They are included within the respective Codes, but it is only proposed to distinguish the international component of gross receipts, in three items (see Table 3 of Annex 3):

	<u>Code</u>
Gross premiums written, exports (including reinsurances accepted)	8b
Outward reinsurance premiums (imports)	8c i
Commissions received (exports)	83a (aa)

Broadly, this follows the General Framework in concentrating on turnover less sub-contracted turnover. "Gross premiums written, exports" would here be reinsurances accepted. Commissions received (exports) would include charges to non-resident affiliates as well as commissions from other insurers.

Much reinsurance is placed internationally particularly on "large" risks. It falls into this category because both the direct insurer and reinsurer fall into the same activity class. "Gross premiums written, exports" (Code 8b) include but do not distinguish reinsurance premiums accepted by a resident insurer. Code 13b relates exclusively to reinsurance premiums ceded by a resident insurer to a non-resident reinsurer.

2. Direct Insurance of "large" risks (non-life)

There are various situations, as regards the transactions and the form in which international trade in insurance services (if any) takes place.

- (i) The most simple case is the situation where an enterprise insures its activities and/or assets located in one country with an insurer located in another country. Clearly in this case international trade in insurance services takes place.
- (ii) Things became more complicated when the insured assets are moving from one place to another (ie. ships, aircraft or transported goods). The insured enterprise, however, is still located in a country different from that of the insurer. Sometimes the insured assets therefore might be within the country of the insurer. At other times they will be outside that country. This situation implies that transactions between the insured enterprise and the insurer will be recorded in the balance of payments. (26)
- (iii) More complications arise when the enterprise is a multi-national one, which takes central decisions regarding the insurance of the assets and activities located in various countries. Some of the assets of the insured multi-national enterprise might be located within the country of the insurer. Part or most of the multi-national enterprise, however, is still located in a different country (or countries) from that of the insurer. This situation implied that transactions between parts of the multi-national enterprise and the insurer will be recorded in the balance of payments.

If the insured assets are located in countries A,B,C,...N and the insurer is located in Country A, there will be transactions between the insured parts of the multi-national enterprise located in B,C,... N, and the insurer located in A. They should be regarded in that light, even if all premiums and claims are channelled through a headquarters company located, say, in Country B; this is on the basis that the constituent parts of the multi-national enterprise should be regarded as independent economic agents in the countries in which they are located.

- (iv) The last situation to consider equals the previous one except that the multi-national has a specialist branch or subsidiary, within the country of the insurer, through which it channels all or most of its insurance transactions. This branch or subsidiary therefore acts as the counterpart of the insurer in concluding the various insurance policies or a single "block" policy and in arranging in the payment of the premiums.

In this case most of the transactions between the multi-national enterprise and the insurer will not be recorded in the balance of payments; but the flow of remittances (premiums and claims) will appear, at one remove, as changes in the inter-company balances between the specialist branch or subsidiary and the other component parts of the multi-national group. The latter will be included as non-insurance transactions in any all-embracing statistical survey of international direct investment transactions.

-
- (26) The situation refers, so far as insurance of the import/or export of goods is concerned, to the owner of the goods during transit. Depending on the terms of the contracts, this could be the exporter or the importer. There are complications if the importer is the owner, but the goods do not arrive, and the insurer is located in the same country as the exporter. (See IMF Balance of Payments Manual).

In the above mentioned situations relating to "large" risks, (i) to (iv), care should be taken to avoid the use of inappropriate criteria to determine what is, and what is not, an international insurance transaction. It appears that the appropriate criterion remains registration of the transactions in the balance of payments, viz depending on the location (and residence) of the insured enterprise and of the insurer. The following criteria appear inappropriate:-

- (a) the location of the beneficiary of the insurance policy
- (b) the location of the risks
- (c) the place where the policy is signed.

As regards (a), it was mentioned in (iv) above that a single "block" policy, or a number of policies, might be concluded through a specialist non-insurance enterprise or branch located in the same country as the insurer, but the beneficiaries of the policy or policies will be in other countries.

Care is also needed when a broker acts as intermediary. The broker might appear to be acting in the same way as the specialist branch or subsidiary (situation (iv) above), in that he collects premiums and negotiates claims. But he is not acting as principal, he does not determine the risks to be insured, nor does he conclude negotiations on the settlement of a claim. The branch or subsidiary referred to in (iv) above does have this quality, and therefore acts as principal in concluding the contract with the insurer. The broker, however, remains only an agent acting for another principal.

As with category 2 mentioned above, the types of direct insurance transactions involved may be any of those shown Table 1 of Annex 3, and only three of them would be distinguished in the Manual (see page 105).

3. Direct insurance of mass (non-life) risks, and life insurance

In the case of the direct insurance of mass (non-life) risks and of life insurance risks (both of which are not allowed at the moment in most countries) the same criteria as mentioned above are needed to classify any policy as being cross border selling of insurance services. Regarding life insurance it is in these situations also important to take into account whether the insurance company or the insured took the initiative to conclude a policy. This type of business will become more important within the EC, as a result of the recent EC Directive referred to at (d) above, on page 104. Again the types of direct insurance transactions involved might be any of those shown in Tables 1 and 2 of Annex 3. In the Insurance Chapter of the Manual, they would be included only as a indistinguishable part of "Gross premiums written, exports" (Code 8b).

Summary

The above is summarized, in tabular form, on this page and the next page.

<u>Category</u>	<u>Country A</u>	<u>Code</u>	<u>Countries B,C,...N</u>
	AS EXPORTER		AS IMPORTER
	Gross premiums written, direct insurance:		
1(d)	Parent company		Branch or agent in Country B,
3	Large risks (non life)		
(i)	Insurer, static assets		Single insured enterprise, Country B, non-insurance activity.
(ii)	Insurer, moving assets		The same
(iii)	Insurer, static or moving assets		Component parts of a multi-national group, Countries B,C...N, non-insurance activity.
4	Mass risks (non life), and life insurance		Single insured individual or enterprise, Country B.
	Total of the above	8b	
	AS IMPORTER		AS EXPORTER
	Outward reinsurance premiums:		
1(c)	Ceding branch or subsidiary of a foreign insurer		Accepting parent insurer. Country B
2	Ceding non-related insurer		Accepting non-related insurer
	Total, outward reinsurance	8c i	

<u>Category</u>	<u>Country A</u>	<u>Code</u>	<u>Countries B,C....N</u>
	AS EXPORTER		AS IMPORTER
	International direct investment transactions (Insurance enterprises only):		
1(b)	Exports of Services By parent, subsidiary sister company or branch	83c (part)	Imports of Services By parent, subsidiary sister company or branch, Country B
1(b)	Imports of Services By parent, subsidiary sister company or branch	86b (part)	By parent, subsidiary sister company or branch, Country B
1(h)	Profits Of subsidiary, debit	31*	Of parent, derived from subsidiary, credit, Country B
1(a)	Of parent, credit	87a	Of subsidiary, due to parent, debit, Country B

* When the enterprise resident in Country A falls within category 3(d) (i) 2 or 3, see Code 3(d).

Acknowledgement I am indebted to the CBS Netherlands for many of the ideas contained in this Annex, and indeed some of the text has been borrowed from them. The responsibility for any errors or omissions in the analysis is, however, mine.

ANNEX 5**SOURCES OF INFORMATION**

SOURCES OF INFORMATION

The role of administrative sources

Registers

For insurance enterprises, a system of regulation is thought to exist in all Member States. This will provide a register of insurance undertakings, though not necessarily based on the enterprise as the unit. In countries where regulation relates to the group of enterprises, a supplementary enquiry to company groups may be necessary, in order to compile a register of enterprises. Equally, an enquiry to undertakings may be necessary to compile a register of non-resident branch offices and subsidiaries of resident insurance enterprises. The latter is likely to have been done already, for the balance of payments statistics.

The reinsurance activities of resident insurance enterprises may not be subject to the same degree of regulation as direct insurance activities, or may not be regulated at all. If so, an enquiry directed to insurance enterprises may be necessary in order to compile a register of specialist reinsurers which are resident. Lloyd's of London is a special case in this category.

Insurance auxiliaries, of the types set out in paragraph 831, may not be subject to regulation. If so, an enquiry using trade registers or directed to insurance enterprises may be necessary, in order to compile a register of insurance auxiliaries.

Variables

Most of the variables are also included in Article 34 of the 1991 Accounting Directive on accounts of insurance enterprises. To the extent that national systems of prudential regulation, and/or national requirements regarding the publication of annual accounts, are aligned to the structure of the 1991 Accounting Directive, it should be unnecessary to collect variables through separate statistical enquiries. There are, however, various potential problems in the use as variables of data obtained in the process of regulation or for the annual accounts, as set out in the paragraphs below.

Member States where regulation and/or annual accounts relate to company groups: The preferable solution is to compile a register of enterprises and to tap the accounting data at the stage before it is consolidated (i.e. when it still relates to enterprise units). The alternative is to adjust the consolidated data for the groups of enterprises in respect of (a) non-resident subsidiaries and (b) specialist reinsurance subsidiaries - that is, to 'de-consolidate' these.

When the accounting periods do not relate to the calendar year, little can probably be done, other than to take the accounting period ending nearest to 31 December.

Outline of Additional Data Collection Possibilities

In the case of non-regulated (or "self regulated") specialist reinsurers, it is likely that a statistical enquiry following the framework of the variables will be needed. However, the information is also needed for the national accounts and balance of payments, so an enquiry may already exist. Lloyd's of London is a special case in this category.

For self-administered pension funds, a statistical enquiry may also be necessary if the data does not emerge as a by-product of regulation. The need for clearance of tax relief by the direct tax authorities can provide the basis of a register and - probably - some of the variables as well.

Other pension schemes usually hand over the contributions which they receive to insurance companies, which manage the investments as agents of the pension scheme. The most likely source of information is then the insurance company. It is nevertheless preferable that these amounts should be recorded as pension contributions, rather than as direct insurance premiums. There are considerable differences between the pension business and the other business of life insurance enterprises.

For composite insurance companies, which were formerly classified under NACE/70 821, the breakdown of data between life and non-life insurance, as set out in Tables 1 and 2 of Annex 3, may require a separate statistical enquiry. However, such an enquiry would only anticipate the requirements of regulation once the 1991 Accounting Directive comes into force.

For the variables on the characteristics of enterprises as described in Code 3 of Annex 1, obtaining the designatory data may require a special enquiry of enterprises, updated say every five years.

Turnover (premiums) by product (Code 8b): For non-life insurance, a breakdown of premiums by product, according to the list in Annex 2, may require a special statistical enquiry, but it may be that a breakdown by type (products) of non-life premiums according to the categories in the EC Directive 73/239 is already available. Moreover, the same classification is already being used for reporting data to OECD. Also Art. 63 of the 1991 Accounting Directive requires a breakdown of premiums, for direct insurance transactions. In some countries the insurance industry publishes its own breakdown of premiums by type, but if these data relate to premiums collected by groups of enterprises world-wide, they will need adjusting to exclude those collected by non-resident subsidiaries etc.

For life insurance, the suggested list of products is in Annex 2. The obtaining of premiums broken down by these categories might require a special statistical enquiry, but these suggestions are tentative.

The investment income on technical provisions can be estimated without additional data collection whenever balance sheet data for enterprises are available, as described in Annex 3.

Labour costs: If the annual accounts of enterprises are used as the primary source for the variables, a separate source would be needed to identify that component of "administrative expenses", as shown in the annual accounts, which represents labour costs.

Aggregate data on employment may be available from economy-wide labour force enquires if these distinguish the appropriate categories in NACE/Rev.1.

Direct investment income due from non-resident subsidiaries and branch offices: As for the balance of payments, a special enquiry directed to resident enterprises is usually needed to obtain the variables, both on income and on capital flows. On the assumption that the data obtained for the balance of payments in this respect is adequate, no additional enquiry would be needed. However, one has to identify which of the enterprises participating in balance of payments enquiries are insurance enterprises.

ANNEX 6

**DEFINITION OF THE PRODUCTION ACCOUNT IN TERMS OF
THE 1991 ACCOUNTING DIRECTIVE, ARTICLE 34 AND ARTICLE 63**

TABLE 1

PRODUCTION ACCOUNT - NON-LIFE INSURANCE

Item N° in the Table*	Credits (generally gross)	Code	Sign +/-	Accounting Directive	
				Art.34	Art.63
1a	Gross premiums written: Direct insurance	81a	+	..	x
	Reinsurances accepted	81b	+	..	x
	Total	8	+	I 1(a)	↑
	of which, exports	8b	+	..	..
1b	Change in provision for unearned premiums (gross of reinsurance)	81g	-/+	I 1(c)	..
1c	Gross premiums earned	89c	+	↑	x
2	Gross portfolio investment income (1) (2) (on assets corresponding to the technical provisions of the reporting insurer)	82a	+	III 3(a) III 3(b) (3)	..
3a	Commissions & profit participations received	83a	+	I 7(d)	..
3b	Other revenue:				
3b	Other technical income, net of reinsurance	83b ii	+	I 3	..
3c	Amounts receivable from affiliates for services rendered	83c	+	Part of III 7	..
3d	Other operating revenue (ancillary activities)	83d	+	Part of III 7	..
Less 4a	Claims paid (4)	84a	-	I 4(a) (aa) (4)	..
4b	Change in provisions for claims (gross of reinsurance) (4)	84b	-/+	I 4(b) (aa) (4)	..
4c	Gross claims incurred (4)	84	-	↑	x
5	Change in other technical provisions, net of reinsurance, and in the equalisation provision	85c ii	-/+	I 5, I 9	..
	Adjustment item, which converts items 3(b), 5 and 7(d) (part), in total, to a "gross of reinsurance" basis - See page 117	89f	+ or -	See See page 118	..
6	Total = Value of production, gross of reinsurance	21	+	↑	..

Notes

* Annex 3, Table 1.

↑ Means that the item can be calculated from items listed above.

(1) Here, "gross" means gross of investment charges. Also, see also page 119.

(2) For the partition between income arising on the investment of technical provisions and other portfolio investment income, see Annex 3, pages 94 to 97. Also see last two paragraphs of page 93.

(3) Excluding income from affiliated undertakings.

(4) Adjusted to exclude claims management costs, paid or provided for.

TABLE 1 (Continued)
PRODUCTION ACCOUNT - NON-LIFE INSURANCE (Continued)

Item N° in the Table*		Code	Sign +/-	Accounting Directive
6	Value of Production, gross of reinsurance B/F	21	+	↑
	Debits			
7	Value of services received from reinsurers (= reinsurance balance)	13c	generally, -	Art. 63
8	Balance = Value of production, net of reinsurance	21a	+	↑
	Debits (continued)			
	Goods and services from external sources:			
9a	Commissions payable to agents	86a	-	Art. 64 (5)
9b (part)	External element of claims management costs)	86b	-	
9b (part)	Other external expenditure on goods & services)		-	See Manual, Code 86b, (6)
	Total, goods + services from non-reinsurers	89b	-	
10	Balance=gross value added			
	Debits (continued)			
11	Labour costs (7)	11 + 12	-	
12	Balance = gross operating surplus at factor cost	31	-	
	↓ as before			

Notes

General : All balances on this sheet are after crediting gross portfolio investment income.

* Annex 3, Table 1.

(5) In Art. 34, part of I 7 (a), part of I 7 (c) and part of II 5 (a).

(6) In principle, in addition to the charges in Art. 34 identified in the Manual, this should include any element of "other charges" (III 8) which is associated with operating revenue not included in the technical account (viz. 3c + 3d on page 114).

(7) These include the labour element of claims management costs, as deducted from gross claims incurred (4c on page 114).

TABLE 2

NON-LIFE INSURANCE
INTER-RELATIONSHIPS BETWEEN THE MANUAL, AND THE ACCOUNTING DIRECTIVE
(Articles 34, 63 and 64), and the Third Directive Article 44)

	Manual (Code)	Art. 34	Accounting Directive		Third Directive
			Articles 63/64 Reinsurances Accepted (1)	Direct Insurance (2)	Art. 44 Direct Insurance (3)
Gross premiums written:					
Direct insurance	81a)	11 (a)	{ --	x	x (4)
Reinsurances accepted	81b)		{ x	-	--
Gross premiums earned	89c	11(a) Less 11 (c)	x	x	x (4)
Gross claims incurred	84	14 (a) (aa) +/- 14 (b) (aa)	x	x	x
Reinsurance balance	13c	--	x	x	--
Commissions payable to agents	86a	--	↓ Art. 64		x
Gross operating expenses (5)	Part of 86a, 86b, 11, 12	17 (a) to (c)	x	x	--

Notes

- (1) Only distinguished in Art. 63, if more than 10% of gross premiums written.
(2) With analysis by 10 products; in the Manual also for premiums ceded.
(3) With analysis by 7 products.
(4) It is not clear whether the reference to "premiums" is to gross premiums written or to gross premiums earned; both are specified in Art. 63.
(5) Article 34 describes the total of items 17 (a) to (d) as "net" operating expenses. The term "gross" operating expenses in Article 63 is not defined, but it is likely to mean the total of items 17 (a) to (c).

TABLE 3

**DEFINITION OF THE "ADJUSTMENT ITEM" (1)
(Non-Life Insurance, gross of reinsurance)**

**IN ARTICLE 34 OF THE ACCOUNTING DIRECTIVE, THE FOLLOWING HEADINGS
ARE SHOWN BOTH GROSS AND NET OF REINSURANCE (2)**

Item N° in Table*	Description	Headings in Article 34		
		Gross	Reinsurers' Share	Net
1a	Gross premiums written, total	I 1(a)	I 1 (b)	I 1 (a) / (b)
1b	Change in provision for unearned premiums	I 1(c)	I 1(d)	I 1 (c)/(d)
4a	Claims paid	I 4(a) (aa)	I 4(a) (bb)	I 4 (a)
4b	Change in provision for claims	I 4(b) (aa)	I 4 (b) (bb)	I 4 (b)
3a	Commissions and profit participations received	--	I 7	I 7
The following items are only shown net of reinsurance:				
3b	Other technical income	..	..	I 3
1a or 4a	Bonuses and rebates	..	..	I 6
5 (part)	Change in other technical provisions	..	..	I 5
9b (part)	Other technical charges	..	..	I 7
The total of the above four items can be derived as a residual (3)		<u>Balance X</u>		
Reinsurance Balance		Article 63		
Balance X (see above), with sign reversed, is the "adjustment item"				

Notes

* Annex 3, Table 1.

(1) The adjustment item which converts items only shown net of reinsurance,

(2) Or relate only to transactions with reinsurers (heading I 7)

(3) This total is likely to be a small figure.

Comment on item 2 in Table 1 of this Annex, "Gross portfolio investment income"

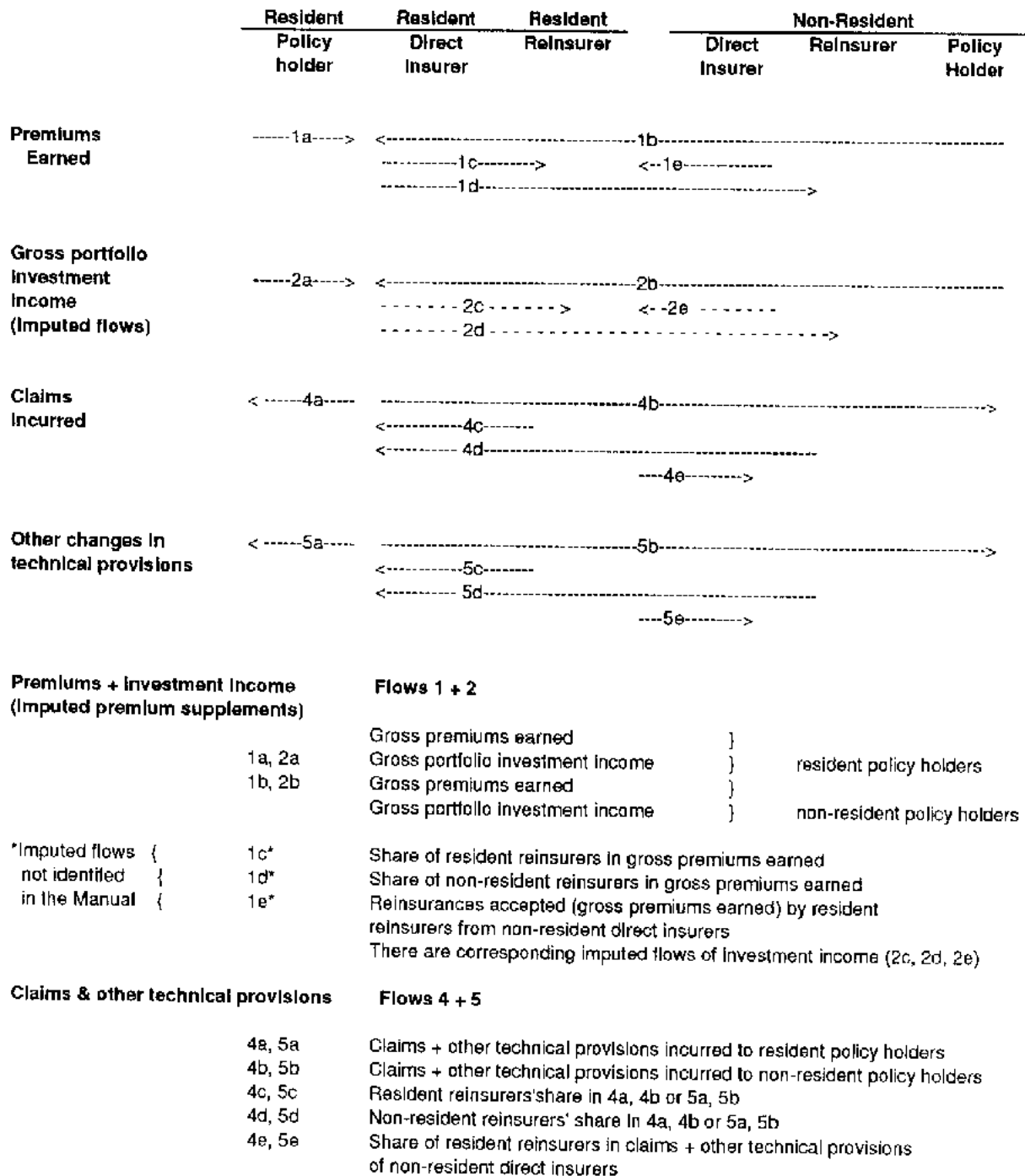
For definition, see Manual. The item remains defined as the income of the reporting insurer (direct insurer or accepting reinsurer) on his portfolio assets (corresponding to his technical provisions). It does not allow for the benefit which the direct insurers's policy-holders get from the investment income on the assets of the reinsurer to whom the direct insurer cedes premiums. A complete estimate should allow for the reduction in the direct insurer's investment capacity due to reinsurance, in other words for the income received by the reinsurer on assets corresponding to the gross technical provisions of the direct insurer, for which the reinsurer is responsible. This would be shown as a increase to item 2, offset by an increase to item 8a. (Item numbers as in Table 1 of this Annex).

At the level of aggregates for the whole insurance plus reinsurance activity, at least in a closed economy, item 2 without adjustment is the same as item 2 increased and offset by an increase to item 8a. It is not the same for open economies, particularly if the economy is a substantial net importer, or net exporter, of reinsurance services. See Annex 7 on the national accounts concepts page 122.

To compile these further estimates of the imputed flows of investment income between direct insurers and reinsurers would require estimation, not additional data collection. For instance, a standard rate of return, derived from Article 34 and the total of Articles 6, C, 1b, 3b, 4b, 6c. But it becomes more difficult if it is desired to introduce estimation which allows for the differing proportions of the various products which are reinsured, and for the differing importance of claims outstanding according to the product. A refinement of this kind might well be necessary if there is a substantial amount of export, or import, of reinsurance services.

ANNEX 7**RELATIONSHIP BETWEEN THE VARIABLES AS DEFINED**
IN THE MANUAL AND THE NATIONAL ACCOUNTS

**A - Diagrammatic exposition of
Relationship with national accounts concepts
(Non-life Insurance)**



Flows type c (only) disappear on consolidation of the resident direct insurance plus reinsurance activity.

**B. Tabular exposition of
Relationship with national accounts concepts, continued
(by flows, as numbered in A)
(Non-life Insurance)**

Item (N° + Description)	Gross Amounts	Reinsurers' share			Total of resident insurance/reinsurance Activity on National Accounts Basis
		Resident	Non-Resident	Total	
		Reinsurers	Reinsurers		
	(i)	(ii)	(iii)	(iv)	(v) = (i) less (ii)
1. Premiums earned (direct insurance plus reinsurances accepted)	1a Σ 1b 1e	1c	1d	---	1a + 1b + 1e Σ less 1d less 1c (1)
2. Gross portfolio investment income	Σ 2a Σ 2b	..	..	..	Σ 2a(2) Σ 2b
4. Gross claims incurred:	Σ 4a }				
-on direct insurance	Σ 4b }				
-on reinsurance accepted	4c }				
	Σ 4e }				
- Total	Σ 4a (3) }				
	4b }	4c	4d	---	Σ 4a } Σ 4b } less 4d 4e }
	4e }				
5. Other technical income, other technical provisions	Σ 5a (2) Σ 5b 5e	5c	5d	---	Σ 5a Σ 5b less 5d 5e
6. Balance = Service charge to policy-holders (resident + non resident)					

Notes**N° of Imputed Flows**

- (1) Flow which disappear on consolidation of the resident insurance plus reinsurance activity (1c being recorded both as premiums ceded and reinsurances accepted).
- (2) Not allowing for the following imputed flows: the "share" of resident direct insurers in the investment income of non-resident reinsurers and the "share" of non-resident reinsurers in the investment income of resident insurers who accept reinsurances.
- Imputed flow which disappears on consolidation.
- (3) Flows 4c + 5c disappear on consolidation.

2a

2d

2c

**C. Identification in the Manual of the "Cells" in Sheet B
(relationship with national accounts concepts, continued)
[showing Code Nos in the Manual]
(Non-life insurance)**

Item (N° + Description)	Gross Amounts	Reinsurers' share			Total of resident Insurance/reinsurance Activity on National Accounts Basis
		Resident	Non-Resident	Total	
		Reinsurers	Reinsurers		
	(i)	(ii)	(iii)	(iv)	(v) - (i) less (ii)
1. Premiums earned (direct insurance plus reinsurances accepted)	Code 89c	Balance	Code 89c i	Code 89c i	As aside
2. Gross portfolio investment income (2)	82a	---	---	---	82a
4. Gross claims incurred:					
- on direct insurance	Art. 63	..	..	..
- on reinsurance accepted	Art. 63	..	..	..
- Total	Code 84	Balance (3)	..	Code 84 i	As aside (3)
5. Other technical income, other technical provisions, adjustment item	Codes 83b (ii), Σ 85c ii, 89f,	Balance (3)	..	Code 89f	As aside (3)
6. Balance = Service charge to policy-holders (resident + non resident)	Balance of above (4)				Balance of above (4)
Other revenue items					
3a Commissions + profit participations from reinsurers	83a				
3b Amounts receivable from affiliates for services rendered	83c				
3c Other operating revenue (eg ancillary activities)	83d				
7. Balance = Value of Production:					
gross of reinsurance	21				
net of reinsurance					21a

Notes

- (1) Using written premiums ceded to non-resident reinsurers as a proxy.
 (2) See note (2) in Sheet B.
 (3) Not precise, as no figure is identified in column (iii). Precisely it would be - Code 84 (col (i) less col (iv) plus ... col (iii)).
 (4) This sub-total is not shown in Table 3 of Annex 3. The point is that the balances in rows 6 + 7 of this table are not the same. The balance in row 6, column (v), as needed for the national accounts, is closer to Code 21a than to Code 21, since it is net of transactions with resident reinsurers, (but should be gross of transactions with non-resident reinsurers).