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Proposal on the CPC-insurance

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Introduction

Proposals on a classification of insurance products have been discussed at length during Eurostat-meetings in recent years. The intention is to include the classification resulting from these discussions within the CPA, the (European) classification of products by activity.

It is to be expected that a final agreement on this CPA-insurance will be reached during the next meeting of the working party on insurance services in the autumn of 1995.

Based on the existing proposal of the CPA-insurance, this document drafts a proposal on the CPC concerning insurance. It starts from the prerequisite that a solid coincidence of the CPC-insurance and the CPA-insurance should exist. Experts from other countries, both non-European and European, have been consulted on an earlier draft of this document. Their comments have been gratefully included in the present version.

The CPC is the world-wide product classification. Analogously, the CPC-insurance should be the classification to be used in global statistics on insurance, using a comparable breakdown by line in all countries. The use of a single classification, accepted world-wide, will yield results which are comparable between countries as far as possible. For example, the CPC-insurance could be used in the international statistics on insurance such as the OECD "Insurance Statistics Yearbook" to specify the insurance premium by line. Also, UNCTAD might use the CPC-insurance in its work on insurance in the developing countries. The CPC-insurance might also be applied in statistics on international trade in services. Finally, this classification could be used in enterprise statistics concerning insurance.

The nature of insurance products

When developing a product classification, it is important to have a clear picture of the nature of products involved. Arriving at such a picture is fairly simple when goods are concerned. These products normally are easily identifiable. With services in general, and insurance products in particular, the situation is much more complex. The concept of insurance products is less unequivocal and its

contents might be different depending on the context where it is used. The question concerning the kind of service the insurers provide to their clients, therefore, has no simple answer.

First, this question is discussed from the insurance market's point of view. From this perspective, a possible answer could be the policy. However, one also could qualify the policy as the description of the insurance product. Other answers, frequently given to the above question, relate to the benefits from the insurance contract or the administrative service of the insurance company. Also "security" and "coverage of risks of insured events" are frequent answers to this question.

These answers have an important feature in common: acquiring a financial benefit compensating for the consequences of the occurrence of an insured incident. From this common feature it is deducted that insurance products could be described as a bundle of services which provides financial security against the risks facing the insured. This set of services includes the payment of a benefit whenever an insured event happens, as well as the administrative service of the insurance company, i.e. organizing everything necessary to realize the payment of benefits. Non-financial aspects of insured risks, such as the emotional effects, inconvenience, etc. mostly do not play an important role. However, within some classes of insurance, the non-financial aspects of the risk are becoming increasingly important, e.g. third party insurance.

Following this line of thought, the policy should be considered as the detailed description of the set of services, especially of the conditions of the insurance service. The type of risk insured on an insurance policy is a major characteristic of the total bundle of services provided by the insurance company. A breakdown by class of risk could be used to classify the relevant aspects of the insurance service, such as the amounts paid as premiums or as claims and their number.

The second angle to discuss the nature of insurance products concerns the national accounts' point of view. From this perspective especially, aspects such as value added are important phenomena. Within the system of national accounts the "insurance service" is of a specific nature. It relates only to part of the total bundle of services as depicted in the preceding paragraphs. The insurance service does not include the transfer payment, nor other closely related transactions. The concept of the "insurance service" used in the national accounts relates only to the administrative service provided by the insurer, which enables the insurer to realize the

coverage against consequences of insured events as meant before. In other words, the activities performed by the staff of the insurer, inclusive of the operating profit from this service, are the ingredients of the insurance product in macro-economic statistics. The value of the insurance service is calculated from the difference between premiums and claims in the national accounts.

The proposed classification of insurance product mainly relates to the insurance market's point of view: i.e. the classification of the total set of services as described by the insurance policy by class of insured risk.

Because the value added of insurers and insured is independent of the class of risk, a breakdown of the national accounts' concept of the insurance service by line seems less relevant to the system and its users.

However, in compiling the national accounts it is necessary to estimate a breakdown by line of some transactions of insurers (apart from premium and benefits). These estimates are merely used within the national accounts' compilation process, i.e. are intermediate results. Aspects where the breakdown of this concept by class of risk might be relevant, relate to the sector breakdown of the insured, or the calculation of this concept in constant prices.

The classification of insurance products

Before discussing the classification of insurance products, some aspects of the borderline between insurance and other financial products should be elaborated.

Especially, both life assurance and banking products are important vehicles for saving. The distinguishing feature between banking and insurance products concerns the risk element included in insurance products, even if this element is small compared to the savings aspect. In most countries, law requires that products which include any coverage - however small - against risks related to the life or the death of a human being be provided only by insurance companies. They, however, might be a subsidiary of a bank. Also, complex saving and lending products which also contain an element of risk coverage are sold by banks. Here, the bank obligatorily insures the risk element with an insurance company in most countries. So, the bank provides the saving service whilst the insurer provides the risk coverage in these cases.

A frequently made distinction of insurance products is along two lines:

- the distinction between life and non-life insurance;
- the distinction between direct insurance and reinsurance.

Within life insurance it is important to distinguish between pensions and other life insurance. The combination of these criteria results in the following classes of insurance:

- direct life insurance products;
- direct pension insurance products;
- direct non-life insurance products;
- reinsurance products.

The separation of life and pension insurance products on the one hand and non-life insurance products on the other hand reflects the different nature of the insured risks. In life and pension assurance policies, the risks relate to the life or the death of a human being. Non-life insurance covering all other types of risks.

The separate class concerning pension products is restricted to group pension schemes. Individual pension schemes are classified as life assurance policies. It appears rather difficult to distinguish between the individual pension products and the other individual life assurance products, especially with respect to annuities. In other words, how could a borderline between annuities and individual pensions be drawn? This borderline probably depends largely on national (tax) legislation.

Group pension schemes and individual pension schemes have some elements in common. Both might include a combination of an old age pension, a pension for surviving relatives and a disablement pension. The difference between group policies and individual pension policies is rather clear, though. It does not only concern the number of insured persons but also the contents of the total set of services involved; especially the administrative service and the insurance risk differ. These latter differences lead to distinct costs: group pension policies are cheaper. From the perspective of the individual insured, the difference between these contracts could be considered as ready-made versus tailor-made contracts. Finally, the contracting party differs. In group schemes, normally, the employers (as an element of the labour conditions) or the professional organizations conclude the contract, whereas the insured acts as the contracting party in individual schemes.

The separate classification of direct life, pension and non-life insurance products and indirect (reinsurance) policies reflects the different types of contract. Direct insurance contracts concern the insurance products sold to an individual person, family or separate enterprise. So, the insurer provides coverage against the risks of the individually insured person or enterprise. The indirect insurance products, on the other hand, relate to the insurance services which the reinsurer sells to direct life, pension or non-life insurance enterprises. Reinsurance, therefore, covers the risks of the direct insurers.

Whereas in direct business a separation between life and non-life insurance is generally accepted, this distinction is less important in reinsurance. Therefore, this distinction is only included as a breakdown within reinsurance products¹⁾.

In addition to the main types of risk an ancillary class of risks is often insured on an individual policy. So a non-life insurance risk might be included in a life assurance policy as a secondary risk (e.g. disablement risk within a life insurance policy). The reverse exists as well (accident insurance including benefits on death). It is often impossible to classify the ancillary risks separately. They are just components of one single transaction. Therefore, ancillary risks have to be classified with the main risk of the policy.

The problem of ancillary risks exists when distinguishing life and non-life insurances. Comparable problems exist between subclasses of life and non-life insurance products.

The sub-classification of life insurance products

The class of life insurance products does not include permanent health insurance, contrarily to the Anglo-Saxon legislation. This class of insurance products does not relate to the life or the death of human beings, but to illness or disablement of the insured. So, permanent health insurance is classified as a non-life insurance product.

Within the class of life insurance, some separate sub-classes seem important. The following breakdown is proposed.

- non-linked life insurance products with a large savings element;
- non-linked life insurance products without a large savings element;
- (unit) linked and tontine life insurance products;
- other life insurance products.

¹⁾ Eurostat intends to propose a separate classification of direct and indirect insurers within NACE; i.e. 66.01 - 66.03 on direct insurers and 66.04 on reinsurers.

Firstly, a distinction is made between non-linked, (unit) linked and other life insurance products. The non-linked life insurance policies relate to all life policies where the future benefit is defined as an amount of money. With linked and tontine insurance policies, the benefit is defined as a proportion of the value of a portfolio of investments. The money-value of the benefits of this class of policies, therefore, is uncertain until the moment of payment of the benefit.

The sub-class "other life insurance policies" includes especially policies where the benefit is in terms of a package of services (e.g. funeral insurance), or the benefit is depending on non-actuarial factors (capital redemption insurance: a lottery combined with life insurance).

Within the non-linked life assurance products separate classes are proposed concerning saving products and term-insurance policies. The first class of life insurances involve large technical provisions, whereas the latter only involve small provisions. Even with pure term insurance, some saving will be involved. This happens if the premium of a term-insurance policy remains constant over the full maturity of the policy, whilst the risk increases.

So, within the non-linked life insurance products, a separation into policies with or without a large savings element is made. The first subclass includes, amongst others, non-linked individual pension and annuity policies.

The linked life insurance policies usually contain a large savings element, so no further sub-division, as for non-linked products, is proposed.

Both linked and non-linked include policies maturing entirely as a capital sum. Also, individual pension policies may be payable as a capital sum (often called lump sum) at retirement. An annuity or pension clause might be included in some countries, transforming the capital sum into an annual or monthly payment.

The sub-classification of pension insurance products

Group pension products might be offered by life insurance companies, autonomous (funded) pension funds or employers (non-autonomous funded or non-funded schemes). A further breakdown is not proposed in the CPC.

On the other hand, the SNA suggests a breakdown of these products into defined benefit and defined contribution schemes. Whether this

qualifies as an important feature of group pension contracts is unknown. The relative importance of each potential subclass might be decisive.

The sub-classification of non-life insurance products

The following breakdown of the non-life insurance policies is proposed:

- accident and health insurance products;
- motor vehicle insurance products;
- marine, aviation and transport insurance products;
- fire and other damage to property insurance products;
- general liability insurance products;
- credit and surety insurance products;
- other non-life insurance products.

The coverage of the first-mentioned class of non-life policies (which includes permanent health insurances) relates to medical treatment, income replacement in case of inability to earn a living due to illness or accident or (predetermined) benefits in case of accidents. A single policy could cover both the insurance against the costs of medical treatment and the insurance of income replacement. Though relevant, a breakdown of the subclass of health insurance contracts into these two components is practically infeasible in these cases.

This subclass includes individually concluded policies and group policies. Part of group policies are an element of the total labour contract. Both group insurance against costs of medical treatment and group insurances concerning income replacements are often important elements of social security in a country as defined by the SNA/ESA. A breakdown of health insurance policies into individual and group contracts, therefore, might be relevant.

Motor vehicle insurance products include compulsory third party liability insurance and other classes of motor vehicle insurance such as expenses due to loss or damage of the insured vehicle. Excluded are insurance of goods in transport, railway rolling stock etc.

Marine, aviation and transport insurance include insurances of the means of transport (excluding motor vehicles), of the goods in transport, and third party liability insurance (excluding motor vehicles).

The insurance product class "fire and other damage to property" covers all expenses due to loss or damage of property (other than motor vehicles, railway rolling stock, vessels, aircrafts etc.) due to fire, explosion, storm, hail, theft etc.

General liability insurance products covers all third party liability other than those mentioned above.

Credit and surety insurance products include the coverage against expenses due to insolvency, credit, surety etc.

Other non-life insurance products include assistance insurance (insurance for persons during traveling), legal expenditure insurance (against the cost of legal questions), miscellaneous loss insurance (e.g. costs of unemployment, bad weather) and other insurances.

As already indicated above, a non-life insurance policy might include ancillary risks. For example travel insurances - part of other non-life insurances - cover a bundle of risks belonging to several classes of non-life insurance. These policies should be classified according to the main risk category.

The sub-classification of reinsurance products

Reinsurance might be offered by specialist reinsurers and by direct life or non-life insurers. The relevant breakdown seems to be according to the three main classes of direct insurance products. A further breakdown along the lines of direct insurance products might be considered.

A comparison of the proposed CPC with the SNA

In the field of insurance, the SNA includes a distinction between social insurance and other insurance, other insurance meaning all classes of insurance not classified as social insurance. So, other insurance largely coincides with life and non-life insurance.

The SNA defines social insurance as schemes in which employees, self-employed, non-employed or employers on behalf of their employees pay the premium (social contribution) to secure entitlement of their employees, their dependents or survivors to benefits in the current or subsequent periods with regard to six classes of risks. Whether

government or a private insurer organizes the social insurance scheme is unimportant²⁾.

This SNA-distinction is not fully incorporated into the present proposal of the CPC. The borderline between life insurance and pension insurance is not strictly according to this SNA-criterion. There is, however, a large parallel. Group pension products will normally be classified within social insurance in the SNA. Some individual pension policies, classified as life assurance products in the CPC, on the other hand, might also be classified as social insurance. Especially if the employer facilitates the individual pension contracts (e.g. pays part of the premium) the SNA will classify this type of life insurance products as social insurance schemes³⁾.

Analogously, the same applies to health insurance policies. Here, as well a distinction between individual and group policies is relevant from the SNA context, as well. A further breakdown of these policies would bring the CPC more in line with the SNA.

Secondly, term-life assurance products are classified in the same grouping as non-life insurance in the SNA definition of the production of insurers. This SNA-proposal is only taken into account partially. Most term-life assurance products are separately classified as "non-linked life insurance products without a large savings element". In this respect a transformation between the proposed CPC on insurance and the SNA is possible to a large extent.

Thirdly, the SNA includes a separate treatment of defined benefit and defined contribution pension schemes. Presently, this breakdown is not included in the proposed CPC. This should be part of further study.

²⁾ See System of National Accounts 1993, New York, 1993, par. 8.55 - 8.83.

³⁾ The contribution of the employers to an individual pension scheme might be indirect, i.e. go through the government budget. Unclear is whether this indirect contribution qualifies the contract as a social insurance scheme.

Annex 1 Overview of the proposed CPC on insurance

812 Insurance products**8121 direct life insurance products**

- 81211 non-linked life insurance products with a large savings element
- 81212 non-linked life insurance products without a large savings element
- 81213 linked and tontine life insurance products
- 81214 other life insurance products.

8122 direct pension insurance products**8123 direct non-life insurance products**

- 81231 accident and health insurance products
- 81232 motor vehicle insurance products
- 81233 marine, aviation and transport insurance products
- 81234 fire and other damage to property insurance products
- 81235 general liability insurance products
- 81236 credit and surety insurance products
- 81237 other non-life insurance products.

8124 reinsurance products

- 81241 life reinsurance products
 - 81242 pension reinsurance products
 - 81243 non-life reinsurance products
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Annex 2 The CPC and the CPA

CPC-class	CPA-class	
812	66.	Insurance products
8121	66.01	direct life insurance products
81211	66.01.11/2	non-linked life insurance products with a large savings element ¹⁾
81212	66.01.13/4	non-linked life insurance products without a large savings element ¹⁾
81213	66.01.20	linked life insurance products
	66.01.30	tontine life insurance products
81214	66.01.40	capital redemption insurance products
	66.01.50	other life insurance products ²⁾
8122	66.02	direct pension insurance products
8123	66.03	direct non-life insurance products ³⁾
81231	66.03.11	accident insurance products
	66.03.12	health insurance products
	66.03.13	permanent health insurance products
81232	66.03.2	motor vehicle insurance products
	66.03.21	motor vehicle insurance products, third party liability
	66.03.22	motor vehicle insurance products, other classes
81233	66.03.3	marine, aviation and transport insurance products
81234	66.03.4	fire and other damage to property insurance products
81235	66.03.5	general liability insurance products
81236	66.03.6	credit and surety insurance products
81237	66.03.7/8	other non-life insurance products
	66.03.71	assistance insurance products
	66.03.72	legal expenses insurance products
	66.03.73	miscellaneous financial loss insurance products
	66.03.8	other non-life insurance products ²⁾
8124	66.04	reinsurance products
81241	66.04.1	life reinsurance products
81242	66.04.2	pension reinsurance products
81243	66.04.3	non-life reinsurance products

1) The CPA distinguishes within this class policies paying an annuity and those paying a capital sum.

2) This class is restricted to national peculiarities in the CPA (lines of insurances where the European insurance directives not apply).

3) A proposal to amend the breakdown of CPA on accident and health insurance will be discussed at the next meeting of the Eurostat Insurance Service Working Party.