The New Treatment of Reinsurance in SNA 2008: Implementation and Impact

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Introduction

The revision of the international systems of national accounting, the System of National Accounts (SNA) of the United Nations etc. in 2008 and the European System of National Accounts (ESA) in 2010 led to a completely new concept for the treatment of reinsurance transactions in these accounting systems. Reinsurance is understood as the insurance of risks at third parties, which arises direct insurers from their business with their policy holders. If the reinsurance policy holder itself is a reinsurer, the business is called “retrocession”. Reinsurance is the insurance of insurers.

The terms active and passive reinsurance business describe the views of each transaction partner. In the case of an active reinsurance business the reinsurer takes the risks of the reinsurance policy holder, in the case of a passive reinsurance business the reinsurance policy holder transfers (cedes) his risk to the reinsurer in the business accounting sense.

Chapter 1: Institutional and functional reinsurance

In ESA 2010 a distinction is made between institutional units and establishments (see ESA 2010 par. 2.03.) Institutional units are grouped together into sectors, establishments into industries. Whereas an institutional unit (sectors) allows analyzing the relations between these entities, establishments (industries) are more used to analyze the production process and to calculate regional aggregates (see ESA 2010 par. 2.04 ff.). Here, the terms institutional and functional reinsurance are used.

All insurance enterprises (direct insurers and reinsurers), i.e. the institutional units in this case, are classified in Sector S 128 (Insurance corporations). A classification problem does not exist.

Reinsurance refers to the assumption of the underwriting risk by a third entity. Such contracts can be agreed between a direct insurer and a reinsurer, two direct insurers or two reinsurers ("retrocession"). It is carried out by specialized enterprises, which exclusively carry out this business. But reinsurance can also be carried out by direct insurers as secondary activity.

According to Nace rev.2 the activity of specialized reinsurers ("institutional reinsurers") falls within Section K, class 65.20 "reinsurance".

As regards the reinsurance business of direct insurers consideration needs to be given to the question whether this activity can be classified as an "establishment" (ESA 2010 par. 2.148). This is a prerequisite for a separate treatment of the reinsurance business of direct insurers. ESA 2010 par. 2.148 calls in this regard to calculate "for each establishment ….." However, this information is not available for the reinsurance business of direct insurers in principal. This is, because the aggregates mentioned above are not separable for the direct and reinsurance activity of a direct insurer. Merely the premiums can be separated. But this alone does not fulfill the requirements of these ESA.

Therefore the reinsurance business of direct insurers is combined with their direct insurance business.

Chapter 2: The new calculation

With the transition from ESA 95 to ESA 2010 the calculation of the output of reinsurance enterprises has to be carried out according to ESA 2010 par. 16.55 in the same manner as for Non-life insurance enterprises. The following overview explains the main differences between the treatment of reinsurance activities in business accounting, ESA 95 and ESA 2010.

Overview 1

Reinsurance in Business Accounts and National Accounts

Business Accounts	**ESA 95**	**ESA 2010**
Premiums earned	Premiums earned	Premiums earned
- Claims paid	- Claims paid	+ Premium supplements
- Change in technical reserves	= Output old	- (Change in technical reserves – holding gains/losses)
+ Property income received		
		= Output new
+/- Holding gains/losses		
		+ Property income received
- Costs		- Property income paid
		- Costs
=Profit/loss		= Operating surplus
		.
		.
		.
		Capital transfers (Holding gains/losses distributed)
		Net lending (excluding holding losses)
		Revaluation account

(Holding gains /losses)

In detail ESA 2010 par. 16.55 and 16.56 reads as follows

16.55 The formula to calculate the output of reinsurance services is analogous to that for direct insurance. However, because the primary motivation of reinsurance is to limit the direct insurer's exposure to risk, a reinsurer deals with exceptionally large claims as a matter of normal business. For this reason, and because the market for reinsurance is concentrated in relatively few large firms worldwide, it is less likely that the reinsurer will experience an unexpectedly large loss than a direct insurer does, especially in the case of excess of loss reinsurance.

16.56 The output of reinsurance is measured in the same way as the output of direct non-life insurance. However, there are some payments peculiar to reinsurance. Such payments are commissions payable to the direct insurer under proportionate reinsurance and profit sharing in excess of loss reinsurance. Once these are taken into account the output of reinsurance is calculated as:

premiums earned less commissions payable

plus premium supplements

minus both adjusted claims incurred and profit sharing.

As regards the output of non-life insurance ESA 2010 states in par. 16.21:

16.21: The insurance company accepts a premium from a client and holds it until a claim is made or the period of the insurance expires. In the meantime, the insurance company invests the premium and the investment income is an extra source of funds from which to meet any claim due. The insurance company sets the level of the premiums to be such that the sum of the premiums plus the investment income earned on them less the expected claim will leave a margin that the insurance company can retain; this margin represents the output of the insurance company. The output of the insurance industry is measured reflecting the premium setting

policies of the insurers. To that end, four separate items need to be defined. These are:

(a) premiums earned;

(b) premium supplements;

(c) claims incurred, or benefits due;

(d) insurance technical reserves.

Each of these is discussed in turn before discussing the measurement of output for direct non-life insurance, direct life insurance and reinsurance respectively.

These individual items are discussed in ESA 2010 par. 16.22 to 16.45 in detail and discussed here below.

In ESA 2010 par.16.46 to 16.49 the output of insurance is defined. For non-life insurance the definition is as follows:

16.50 The output of the insurer is the service provided to the beneficiaries.

16.51 If an expectations approach is being used, the formula to calculate output is:

premiums earned

plus premium supplements

minus adjusted claims incurred;

where adjusted claims incurred is corrected for the volatility in claims using historical data or accounting data on changes in the equalisation reserves and own funds. Premium supplements are less volatile than claims, and no adjustment for volatility is necessary. In estimating adjusted claims, information is broken down by product, for example motor insurance, buildings insurance, etc.

If the necessary accounting data are not available and the historical statistical data are not sufficient to allow reasonable average estimates of output to be made, the output of non-life insurance may be estimated as the sum of costs (including intermediate costs, labour and capital costs) plus an allowance for 'normal profit'.

German reinsurers operate under the control of the Federal Financial Supervisory Authority (BaFin). They have to present an annual report (Balance sheets, profit and loss statement and additional records) which explain the data. The calculations here are based mainly on the profit and loss statement of the reinsurers and specific records on “Income and expenses for capital assets/NW 201” and “Cost types included in specific expense types/NW 202”.

At this point the difference between insurance business accounting and the concepts of national accounts has to be explained. In insurance business accounting in the gain- and loss accounts a distinction is made between a technical and a non- technical account. All income and expenses directly linked to the insurance business are recorded in the “technical account” all other income and expenses in the “non-technical account”. In the technical and the non-technical accounts, income and expenses are classified according to functions (expenses for the administration of capital assets etc.) not by type of costs (wages, purchases of goods and services etc.)

The link between expenses by function and by type of costs is given by the record “Cost types included in specific expense types” mentioned above. The sum of cost by function and cost by type are identical in principal.

The calculation of the single aggregates follows the rules of the new ESA given above using the data provided by the BaFin. All calculations refer to 2010.

Premiums earned differ from premiums received by the “accrual principal”. Whereas premiums received are recorded when actually paid, premiums earned are allocated to the insurance period under review. This difference is reflected in the “Change of premium reserves”. In respect of reinsurance provisions ESA 2010 states:

16.83 Commissions payable by reinsurers to the insurer as the reinsurance policyholder are treated as reductions in the premiums payable to the reinsurers. Profit sharing payable by the reinsurer to the direct insurer is recorded as a current transfer. Although they are recorded differently, both commissions payable and profit sharing reduce the out- put of the reinsurer.

As in the German legislation reinsurance provisions and profit sharing are not distinguished, the whole item is deducted. The point is that reinsurance provisions are not intermediate consumption of the reinsurer and not (additional) output of the policy holder (direct insurer).

Table 1: Calculation of premiums earned by institutional reinsurers

	Item	Mill. EUR	Source/Note
(1)	Premiums received	43307	P&L account
(2)	Minus reinsurance commissions	11041	NW202
(3)	Minus change in premium reserves	688	P&L account
(4)	Specific insurance technical incomes	17	P&L account
(5)	Fire brigade tax	67	P&L account
(6)= (1)-(2)-(3)+(4)-(5)	**Premiums earned**	**31528**	calculated

Premium supplements are the income earned from the investment of the insurance technical reserves of the insurer, which represent liabilities towards the policy holder (ESA 2010 par.16.27). The net operating surplus especially from rent is an additional element of these premium supplements (ESA 2010 par.16.30). The premium supplements exclude the share of the total property income which has to be allocated to the investment of own funds. This share is calculated as the relation between own funds and balance sheet total (47,4 %).

Table 2: Calculation of premium supplements

	Item	Mill. Euro	Source/Note
(1)	Interest received (D.41)	2783	NW 201
(2)	Dividends (D.421)	7600	NW 201
(3)=(1) +(2)	Property income (D.4)	10383	NW 201
(4)	Rent	169	NW201
(5)	Interest paid	785	P&L account
(6)= (4)-(5)	Net operating surplus (Rent)	- 616	calculated
(7)=(3)+(6)	Property income plus Net operating surplus from rent	9767	calculated
(8)=(7)-(9)	Income from the investment of own funds	5137	calculated
*(9)=(7) * 47,4%*	**Premium supplements (D.44)**	**4630**	calculated

The sum of premiums earned and premium supplements are the gross premiums within the meaning of National Accounts (NA).

Table 3: Calculation of Gross premiums within the meaning of NA

	Item	Mill. Euro	Source/Note
(1)	Premiums earned	31528	Table 1 (6)
(2)	Premium supplements (D.44)	4630	Tabelle 2 (9)
(3)=(1) + (2)	**Gross premiums within the meaning of NA**	**36158**	calculated

In order to calculate the output of reinsurers adjusted claims incurred have to be deducted from gross premiums within the meaning of National Accounts (NA).

The term “Adjusted claims incurred” is defined in ESA 2010:

par.16.34: Claims incurred refer to the amounts due from insured risks that have been realized in the year. Whether the policyholder has reported the corresponding event is irrelevant. Part of the claims will be paid in the next year or even later. On the other hand claims that are the effect of events that have occurred in previous years are paid in the current year. The unpaid part of the claims incurred is added to the reserve for claims outstanding.

par.16.35 Non-life insurance claims incurred in the calendar year take the following form:

claims paid

less the reserve for claims outstanding at the beginning of the accounting year

plus the reserve for claims outstanding at the end of the accounting year.

Or presented differently, they take the form of:

claims paid

plus the change (plus increase or less decrease) in the reserves for claims outstanding.

In business accounting of insurers claims handling costs (actually paid and provisioned) are part of the expenses for claims in the technical part of the gain- and loss account. Insofar as it concerns claims handling costs paid they are included in intermediate consumption. The value of claims handling costs paid is part of NW 202. Handling costs provisioned are expected expenses but not realized. In the meaning of NA they represent financial claims of the policyholders and financial liabilities of the reinsurers.

In respect of the treatment of these handling costs and claims ESA 2010 states:

16.36 Any claims-related costs undertaken by the insurer, either external or internal, are not included in claims incurred. Such costs may consist of: costs of acquisition, policy management, investment management, and claims handling. Some costs might not be separately identifiable in the accounting source data. The external costs include expenditure for works that the insurer commissioned to another unit, thus recorded in the accounts as intermediate consumption. The internal costs include expenditure for works performed by the insurers' own employees, thus recorded in the accounts as labour costs.

16.39 The estimate for adjusted claims incurred may be derived statistically in an expectations approach based on previous experience of the level of claims. In considering the past history of claims payable, however, allowance must be made for the share of such claims that is met under the terms of the direct insurer's reinsurance policy. For example, when the direct insurer has an excess of loss reinsurance, known as non-proportionate reinsurance, it sets the level of premiums to cover losses up to the maximum loss covered by its reinsurance policy plus the reinsurance premium it must pay. Under a proportionate reinsurance policy, it sets its premiums to cover the proportion of claims it has to pay plus the reinsurance premium.

16.40 An alternative method of adjusting claims incurred for volatility is to use accounting data on change in own funds and in equalization reserves. The equalization reserves are amounts that insurers set aside in compliance with legal or administrative requirements to cover irregular or unforeseeable large claims in the future. Such amounts are included within non-life insurance technical reserves (AF.61).

In this report the "alternative" method according to ESA 2010 par. 16.40 was chosen, because in Germany these data are available and a strict link between business accounting and NA is ensured.

The complex derivation of NA data from business accounting data is not presented here.

In principle the derivation is based on the distinction between claims and handling costs on the one side and paid and provisioned on the other side.

In table 4 the results of these calculations are presented.

Table 4: Claims paid and provisioned

Item	Mill. Euro	Source/Note
Claims paid	27963	P&L account
Change in provisions for claims and claims handling costs	2173	P&L account
= Adjusted claims incurred	30136	calculated
Other changes in insurance technical reserves	166	
Total	30302	

Special attention has to be given to holding gains/losses. Regarding Life insurance ESA 2010 states:

16.54 In the calculation of output, holding gains and losses must not be included.

This principle is applied to all kinds of insurance in Germany and therefore holding gains (in 2010) are deducted from “adjusted claims incurred”.

Holding gains (and losses) are calculated using data from the gain- and loss accounts. The result of this calculation is presented in table 5.

Table 5: Holding gains and losses

Item	Mill. Euro	Source/Notes
Holding gains	5287	P&L account
Holding losses	4430	P&L account
Balance	857	calculated

From table 3, 4 and 5 now the service charge for reinsurance can be calculated.

Table 6: Service charge of reinsurers

Item	Mill. Euro	Source/Note
Gross premiums within the meaning of NA	36158	See table 3
Adjusted claims incurred	30302	See table 4
Holding gains/losses	857	See table 5
Service charge	6713	calculated

Up to this point the calculations are based on the specific rules for the treatment of (re-) insurance in NA. The remaining items of the sequence of accounts for (re-) insurers do not differ from the corresponding item of other institutional units from a conceptual point of view. The calculation of these remaining items is again based on the gain and loss accounts and the specific records mentioned above.

At the end of the complete reconciliation of the data of the gain- and loss account (and the additional records) of the reinsurers in to the sequence of accounts of NA the completeness of the reconciliation can be checked (“zero control”).

Table 7: Link between Net lending (B.9 NA) and annual net profit after tax (business accounting) for reinsurers 2010

Item	Mill. Euro
B.9 Net lending	218
+ D.99 Other capital transfers	888
Subtotal I	**1106**
Annual net profit after tax	5553
+ own account software	50
./. D.421 Dividends paid	4450
./. P.51 Gross fixed capital formation (including own account software)	146
+ consumption of fixed capital/depreciation	99
Subtotal II	**1106**

In NA capital gains (in this case 857 Mill. Euro, see table 5) reduce the adjusted claims incurred (see table 6). It thus appears that ceteris paribus the service charge rises. This higher service charge is cancelled out by an "Other capital transfer" (D.99) from the reinsurer to the policy holders. However, in the case of ESA par.4.165 g (D.99) explicitly realized capital gains and losses are mentioned. As in 2010 the "non realized holding losses "were 31 Mill. Euro, in total an "Other capital transfer" of 888 Mill. Euro (= 857 Mill. Euro + 31 Mill. Euro) has to be recorded.

As just mentioned, holding gains/losses are recorded as a capital transfer (D.99) from the reinsurer to the policy holders. Also in business accounting these amounts lower the net profit because they are (implicitly) transferred to the policy holders in the form of higher changes in technical reserves. However, in business accounting they are also recorded as receipts. Therefore in business accounting receipts and expenditures cancel out. In NA no receipts are recorded. Holding gains and losses are part of the "Revaluation account" and not of the "non-financial accounts" which finally result in "net lending/borrowing" (B.9) In

order to compare both accounting systems D.99 (Mill. Euro) has to be added to net lending (B.9). The comparative figure is therefore 1106 Mill. Euro (Subtotal I)

Starting with the “Annual net profit after tax” own account software must be added, because this item is not included in the business gain- and loss accounts. Dividends paid and Gross fixed capital formation are in principal not subject of gain- and loss accounts. For comparison purposes therefor they have to be deducted.

Consumption of fixed capital /depreciations are a “cost factor” in both accounting systems. In business accounting they lower profit. Whereas in NA they are additionally shown as a source for financing gross fixed capital formation. Therefore consumption of fixed capital has no impact on net lending. For this reason they have to be added to profit for comparison purposes. These adjustments of annual net profit result in Subtotal II which again is 1106 Mill. Euro. The transition from the business accounting data in NA categories is thus complete.

Chapter 3: Link between ESA 95 and ESA 2010

Gross value added of reinsurers according to ESA 2010 with a value of 3514 Mill. Euro is 5532 Mill. Euro higher than according to ESA 1995 (-2018 Mill. Euro). The components of this change are explained.

Table 8: Output of reinsurers according to ESA 1995 and ESA 2010 in 2010

	Item	Mill. Euro
(1) P.11.a	**Service charge from reinsurance activity (ESA 1995)**	**11513**
P.11 b	Other output	1089
P.12	Non market production	50
P.1	**Output ESA 95**	12652
(2)	Commissions for reinsurance	11041
(3)	Premium supplement	+4630
(4)	Balance of passive reinsurance transactions	+709
(5)	Holding gains and losses	+857
(6)	Other insurance technical expenditures	+138
(7)	Other insurance technical receipts	93
(8)=(1)-(2)+(3)+(4)+(5)+(6)-(7)	**Service charge from reinsurance activity (ESA 2010)**	**6713**
P.11 b	Other output	1089
P.12	Non market production	50
P.1	**Output ESA 2010**	7852

The service charge from reinsurance activities itself decreased from 11513 Mill. Euro to 6713 Mill. Euro. The latter figure was affected in particular by the fact that reinsurance commissions (11041 Mill. Euro) are now directly deducted from premiums and no more treated as intermediate consumption. The premium supplement (4630 Mill. Euro) is specific for NA, i.e. they are not recorded in business accounting. Consequently they were not included in the previous value. As mentioned before, in business accounting holding gains (857 Mill. Euro) are cancelled out by higher benefits allocated to policy holders. In NA holding gains/losses are merely recorded in the revaluation account. The reduction of the change in insurance technical reserves results in a higher service charge because now benefits are lower. Other technical receipts and expenditures are now included. As regards Other output (P.11.b) 1089 Mill. and nonmarket production (P.12) 50 Mill. Euros there are no changes.

Table 9: Intermediate consumption of reinsurers according to ESA 1995 and ESA 2010 in 2010

	Item	Mill. Euro
(1) P. 2	**Intermediate consumption ESA 1995**	**14670**
(2)	Commissions for reinsurance	11041
(3)	Balance of passive reinsurance transactions	709
(4)=(1)-(2)+(3)	**Intermediate consumption ESA 2010**	**4338**

Intermediate consumption, too, is significantly lower than before. The main reason again is the exclusion of reinsurance commissions.

Table 10: Gross value added of reinsurers according to ESA 1995 and ESA 2010 in 2010

	Item	Mill. Euro
(1) B.1.g	Gross value added ESA 1995	-2018
(2) B.1.g	Gross value added ESA 2010	3514
(3)=(1)-(2)	**Difference**	**+ 5532**

Besides the symmetric exclusion of reinsurance commissions from output and intermediate consumption and the – now explicit - recording of the balance passive of reinsurance transactions the difference in gross value added (+5532 Mill. Euro) is exactly the sum of premium supplements (4630 Mill. Euro), holding gains (857 Mill. Euro) and the balance of other insurance technical expenditures (138 Mill. Euro) and - receipts (93 Mill. Euro).

Chapter 4: Cross border reinsurance transaction

ESA 2010 mentions cross border reinsurance business in par. 16.79 and 18.54:

16.79 The whole of the output of the reinsurer is intermediate consumption of the direct insurer holding the reinsurance policy. As noted above, many reinsurance policies are between insurers resident in different economies. Thus, the value of the output in such cases represents imports by the insurer taking out the reinsurance policy and exports by the reinsurer.

18.54 Insurance flows, especially flows relating to reinsurance, can be important internationally. The transactions between the direct insurer and the reinsurer are recorded as an entirely separate set of transactions and no consolidation takes place between the transactions of the direct insurer as issuer of policies to its clients, on the one hand, and the holder of a policy with the reinsurer on the other.

The value of export of reinsurance services is part of the output of the domestic reinsurers. The part which should be allocated to export can be calculated by using the ratio between domestic and foreign premium receipts.

This is also proposed by BPM6ed. par.10.113:

10.113 For exports of nonlife insurance services, the service charge can be estimated from total nonlife insurance output by multiplying the gross premiums earned from nonresidents by the ratio of service charge to gross premiums earned for all nonlife insurance operations. (This calculation is illustrated in Box 10.4, Example 2.) The same prorating technique can be used for life insurance, annuities, pension funds, and standardized guarantees. To the extent that these ratios vary for different lines of business (reinsurance, marine, term life, etc.), the calculations should be made separately. Similarly, if it is known that there are different margins between resident and nonresident customers, data from the operations most relevant to nonresident policyholders should be used. The ratios should be calculated according to the

formula for output in paragraph 10.111, so they take into account premium supplements and claims volatility. (See Box 10.4 for an example of calculations.)

In the case of import reinsurance services a calculation is strictly speaking not possible, because most of the relevant data are unknown to the importing policy holder. These policy holders do not know the premium supplements, the change in insurance technical reserves and holding gains of their reinsurer.

BPM6ed alludes the problem:

10.114 For imports of nonlife insurance services, the available information is less complete than that for exports. For reinsurance, the only customers are insurance companies, so data on premiums payable and claims receivable may be readily available from them. However, premium supplements are not observable.

In order to calculate this import, BPM6ed proposes

10.114(b) Ratios from the resident insurance industry may be considered. In some economies, there may be equivalent lines of business;

This proposal is followed here.

The relations needed are taken from the table below.

Table 11: Calculation of gross border transactions (export) 2010 in Mill. Euro

Item	Total	Share of foreign policy holders (75,3%)	In % of premiums earned
Service charge	6713	5055	15,8
Premium supplements	4630	3486	10,9
Net premiums claims	29445	22172	69,1
Capital transfers paid	888	669	2,1
Memorandum item: Premiums earned	42619	32100	100

These relations are now applied on premiums earned by foreign reinsurers from domestic policy holders (7577 mill. Euro).

Table 12: Calculation of gross border transactions (import) 2010 in Mill. Euro

Item	In % of premiums earned	Import
Reinsurance service charge	15,8	1197
Premium supplement	10,9	826
Net premiums /claims	69,1	5236
Capital transfers received	2,1	159
Memorandum item: Premiums earned	100	7577

Chapter 5: Impact on GDP and GNI

Cross border reinsurance transactions (export and import) have an impact on GDP, whereas domestic transactions do have not because they have to be classified as intermediate consumption in each case.

In the table below the quantitative effect is shown.

Table 13: Comparison reinsurance services export and import according to ESA 95 and ESA 2010 in Mill. Euro

Item	ESA 95	ESA 2010	Difference
Export Reinsurance service	4017	5055	+ 1038
Import Reinsurance service	1932	1197	- 735
Balance	2085	3858	+ 1773

GDP in 2010 was 2495,0 bn Euro according to ESA 95 and now 2496,8 bn Euro (+ 1,8 bn Euro) according to ESA 2010. This represents an increase of 0,1 %.

A contrary impact results for the cross border balance of primary income, because a relative higher active cross border reinsurance business (export) means at the same time higher cross border premium supplements paid than received.

Table 14: Comparison cross border premium supplements paid and received according to ESA 95 and ESA 2010 in Mill. Euro

Item	ESA 95	ESA 2010
Premium supplements received	Not calculated until now	826
Premium supplemets paid	Not calculated until now	3486
Balance		-2660

According to ESA 95 the cross border balance of primary income in 2010 was 54,4 bn Euro. According to ESA 2010 it is now 2,7 bn Euro lower, i.e. 51,7 bn Euro.

The two items together present the following picture.

Table 15: Impact of the new concept on GDP and GNI in 2010 in bn Euro

Item	ESA 95 (1)	ESA 2010 (2)	Absolute Difference (3)=(2)-(1)	Relative Difference (4)= (3)/(1) in %
GDP	2495,0	2496,8	+ 1,8	+ 0,1
Cross border balance of primary income	54,4	51,7	- 2,7	- 5,0
GNI	2549,4	2548,5	- 0,9	- 0,04