3. Revision of methodology for the insurance corporations sector

To bring it into line with ESA 1995 rules, the methodology applied to insurance corporations has been completely revised. The best part of this reform concerns insurance corporations covered by the BFIC's oversight system. Neverthelesss, in order to give a full picture of the methodology used for the insurance corporations sector, the estimate of net equity of households in Luxembourg insurance companies will also be briefly explained.

3.1 Brief description of the old methodology

The methodology used before the reform was based on partial data. On the asset side, only assets that were representative of technical reserves were included. On the liability side, the range of data registered was wider, although still incomplete. All technical reserves of the life insurance classes were booked under item AF.61 «net equity of households in life insurance reserves and in pension funds reserves», while all technical reserves of the non-life insurance classes were listed under item AF.62 «prepayments of insurance premiums and reserves for outstanding claims». On the asset side, amounts were broken down between the different instruments and counterparties depending on the information received from the BFIC and on the basis of certain internal hypotheses. Financial transactions were equal to the change in amounts outstanding, with the exception of Class 23[1] for which transactions were derived from outstanding amounts, taking account of price and exchange rate changes.

Under the methodology used up to now, the financial balance and the net financial wealth of this sector were regarded as nil by assumption, as was the case for other categories of financial corporations. To respect this assumption, the difference between the registered assets and liabilities was recorded in other accounts receivable (AF.7).

3.2 Main features of the new methodology

The reform, which applies to data from the end of 1998 onwards, aims to:
- widen the scope of data registered in the financial accounts to cover all financial assets and liabilities of insurance corporations, by valuing them fully at market prices;
- model the definition of item AF.6 «insurance technical reserves» on the definition recommended by ESA 1995;
- take account of price and exchange rate changes in calculating the formation of financial assets by insurance corporations and, for financial instrument AF.6 on the liability side, take into direct consideration inflows and outflows of funds during the period under consideration using data from the profit and loss accounts.

3.2.1 Consideration of all financial assets and liabilities at market prices

Full coverage of the insurance corporations sector in the financial accounts implies the need to consider all their financial assets and liabilities and not just some of them, as was the case under the old methodology. Moreover, according to ESA 1995 rules, all these entries must be valued at market prices. The data collected by the BFIC (quarterly balance sheets and supplementary tables) now enable a full quarterly balance sheet to be drawn up (assets and liabilities) at market value. This new methodology has brought about a revision of the figures previously estimated at market value using less precise techniques. In addition, for some financial instruments, information on counterpart sectors is available. The missing counterparties are estimated on the basis of other indirect sources of information. In future, the collection of information should be further improved by the new system for gathering data on insurance corporations' investment portfolios, security by security.

It should also be noted that replacement of data on assets representative of technical reserves by balance sheet data makes it impossible to distinguish between the life insurance sub-sector and that for non-life insurance, given the importance of mixed insurers in Belgium and the fact that there is no separate balance sheet for each of their activities. In actual fact, this disadvantage does not seem to be a major problem since the importance of the separation of these two sub-sectors lies more at the level of instrument AF.6 on the liability side.

1. Life insurance contracts where the insurance company's performance is linked to an investment fund and the investment risks are borne by the policy-holders and not by the insurance company itself.

3.2.2 Definition of financial instrument AF.6 «insurance technical reserves»

As mentioned above, up until now, all technical reserves of life insurance classes came under instrument AF.61 and all technical reserves of non-life insurance classes were recorded under instrument AF.62. In order to bring the financial account methodology into line with ESA 1995 rules, the nature of the different technical reserves is from now on being taken into account instead of the classes of origin. Only reserves constituted in the context of life insurance contracts, including those for which the investment risk is borne by the policy-holder (Class 23), and reserves for profit-sharing and refunds, are now booked under instrument AF.61.

All other reserves come under financial instrument AF.62. This is primarily prepayments of insurance premiums and reserves for outstanding risks, that is, the proportion of gross premiums issued that have to be allocated to the next accounting year owing to the fact that insurance premiums must be paid at the beginning of the period of cover, which does not normally coincide with the actual accounting year. These reserves are calculated on a *pro rata temporis* basis for the remaining duration of the contract. Secondly, financial instrument AF.62 includes reserves for outstanding claims, which represent the estimated total final cost of settling all claims, whether they have been put in or not, following realisation of risks occurring up until the end of the accounting year, after deducting amounts already paid out under these claims. Lastly, reserves for provisions for equalisation and catastrophes and other technical reserves are also included.

In order to meet users' needs, a more detailed distinction than the ESA 1995 of instrument AF.61 «net equity of households in life insurance reserves and in pension funds reserves» has been made in the financial accounts database. So, under financial instrument AF.61 are now distinguished net equity of households in individual life insurance reserves, broken down according to whether the risk is assumed by the insurance policy-holder or the insurance company, net equity of households in group insurance reserves, also broken down according to the agent assuming the risk, and net equity of households in pension funds reserves. It should be noted that these detailed figures are still not published separately, but are available to any interested party upon request.

The following table compares the differences in the coverage of assets and liabilities between the old and the new methodology:

TABLE 4 COVERAGE OF ASSETS AND LIABILITIES

	Old methodology	New methodology
ASSETS		
Assets representative of technical reserves	Yes	Yes
Other assets	No	Yes
LIABILITIES		
Own funds	Yes	Yes
Insurance technical reserves	Yes	Yes
Life insurance classes		
Technical reserves linked to life insurance contracts	*AF.61*	*AF.61*
Other technical reserves	*AF.61*	*AF.62*
Other insurance classes	*AF.62*	*AF.62*
Deposits of reinsurers	Yes	Yes
Loans granted by credit institutions	Yes	Yes
Other liabilities	No	Yes

Source: NBB

3.2.3 Calculation of transactions

As far as insurance corporations' assets are concerned, their valuation is liable to be affected by price and exchange rate changes. Under the old methodology, only Class 23 assets were subject to consideration of these revaluation effects for calculating transactions. Currently, for all the insurance classes, the formation of financial assets is derived from data on outstanding amounts, while taking account of potential price and exchange rate changes.

Moreover, for the AF.6 instrument on the liability side, ESA 1995 says that financial transactions must include all inflows (premiums, income from interest, etc.) and outflows of funds (payment of claims, etc.) made during the period under consideration, with the exception of holding gains and losses, which have to be recorded in the revaluation account. Thanks to the technical accounts and the quarterly profit and loss accounts currently being collected by the BFIC, an estimate of the evolution of quarterly transactions can be made. This estimate is revised when the final annual figures are published.

3.3 Comparison of results between the old and new methodology

The reform that has been put in place mainly affects the balance sheet (outstanding amounts), with the financial account (transactions) also being modified, although without calling into question the trends observed using the old methodology.

The following table summarises the changes recorded as at 31 December 2005:

TABLE 5 **FINANCIAL BALANCE SHEET OF INSURANCE CORPORATIONS**

(total outstanding at end 2005, million of euro)

		Before the reform	After the reform	Difference
Financial assets				
AF.2	Currency and deposits	7,263	12,275	5,011
AF.3	Securities other than shares	91,760	99,825	8,065
AF.4	Loans	4,660	10,050	5,390
AF.5	Shares, other equity and mutual fund shares	47,303	57,993	10,690
AF.6	Insurance technical reserves	0	5,151	5,151
AF.7	Other accounts receivable	24,289	3,472	-20,048
	of which statistical adjustments	*22,048*	*0*	*-22,048*
Total financial assets		**175,274**	**188,765**	**13,491**
Liabilities				
AF.2	Currency and deposits	2,687	2,687	0
AF.3	Securities other than shares	0	771	771
AF.4	Loans	4,716	7,467	2,751
AF.5	Shares, other equity and mutual fund shares	16,801	20,503	3,702
AF.6	Insurance technical reserves	151,071	156,864	5,793
AF.61	*Net equity of households in life insurance reserves and in pension funds reserves*	*128,663*	*129,718*	*1,055*
AF.62	*Prepayments of insurance premiums and reserves for outstanding claims*	*22,408*	*27,146*	*4,738*
AF.7	Other accounts payable	0	4,297	4,297
Total liabilities		**175,274**	**192,589**	**17,315**

Source: NBB

The assets and liabilities of insurance corporations have been raised by the extension of the information census. Moreover, dropping the practice of having the net financial wealth in a nil position allows for the suppression of the statistical adjustments item in the new methodology.

3.4 Investment by individuals in foreign insurance corporations

The net financial wealth of Belgian individuals not only includes technical insurance reserves taken out with companies falling under BFIC surveillance, but should also include reserves taken out with companies based abroad. Owing to a lack of information, the latter amounts are nevertheless not recorded in Belgian financial accounts, with the exception of transactions in Luxembourg, estimated on the basis of data given in the annual report of the Luxembourg Supervisory Body. This report contains, *inter alia*, life insurance premiums by country, including Belgium, total life insurance benefits as well as the total outstanding life insurance technical reserves recorded as liabilities on the balance sheet of Luxembourg insurance corporations. Based on these data it is possible to estimate the net equity of Belgian households in life insurance reserves of Luxembourg insurance corporations. The financial transactions are calculated on the basis of payments of premiums adjusted according to an estimate of benefits that have been paid out to Belgian insurance policy-holders. The outstanding amounts are the result of the difference between the amount of cumulated premiums, adjusted for possible holding gains or losses, and the total amount of benefits paid out. It should be noted that the data published by the Luxembourg Supervisory Body are annual data which are converted into quarterly figures by taking account of the evolution of price and exchange rate changes as calculated for the insurance corporations under the surveillance of the BFIC.