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Insurance impact of the Canterbury earthquakes on New Zealand's international accounts

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Contact

Statistics New Zealand Information Centre: info@stats.govt.nz
Phone toll-free 0508 525 525
Phone international +64 4 931 4610
www.stats.govt.nz

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1 Summary

This paper discusses the impact on the balance of payments (BOP) and international investment position (IIP) statistics of the September 2010 Canterbury earthquakes.

- The main impact of the Canterbury earthquakes on New Zealand's international accounts will be from claims by NZ-resident insurers on non-resident reinsurers.
- In New Zealand's Balance of Payments, all reinsurance claims arising from the Canterbury earthquakes will be recorded in the September 2010 quarter, the period in which the initial earthquakes occurred and resulting claims against non-resident reinsurers arose.
- The full claim amount is not yet known, so a 'best estimate' will be recorded in the September 2010 quarter.
- The estimate of the total reinsurance claim of resident insurers over non-resident reinsurers used in this paper is \$1.7 billion. This is a Statistics NZ best estimate, drawing on published information and discussions with the industry.
- The estimate that will be published in the release of September 2010 quarter BOP and IIP statistics on 22 December 2010 may differ from the \$1.7 billion estimate used in this paper.
- **The \$1.7 billion** will be recorded in **the current account as an inflow**, in the current transfers component, as the best estimate of total reinsurance claims against non-resident reinsurers arising from the Canterbury earthquakes.
- A related transaction will be recorded in the financial account, increasing financial claims over non-residents, and a resulting asset position recorded in the international investment position.
- The estimates will be revised as more information becomes available.

2 Introduction

2.1 The September 2010 earthquakes in Canterbury will impact in several ways on New Zealand's economic transactions and financial positions with the rest of the world. The impact will be reflected in the balance of payments (BOP) current account and financial account, and the related international investment position (IIP) – which is the country's balance sheet of financial assets and liabilities with the rest of the world.

2.2 The primary impact on the accounts is from reinsurance claims by New Zealand-resident insurers on non-resident reinsurers. Statistics NZ's best estimate of this is \$1.7 billion, which will be recorded as an inflow in the current account under current transfers. To the extent that the claim has not been settled, a financial account transaction increasing financial assets abroad will be recorded, along with a matching increase in the balance sheet asset position in the IIP. These transactions and positions, and the rationale behind the treatment, are the subject of this paper. Quality limitations of this estimate are discussed in paragraph 2.6 below.

2.3 The expected impact of the earthquakes on this country's cross-border transactions was summarised in the June 2010 quarter BOP and IIP Hot Off the Press. The expected impact is in respect of:

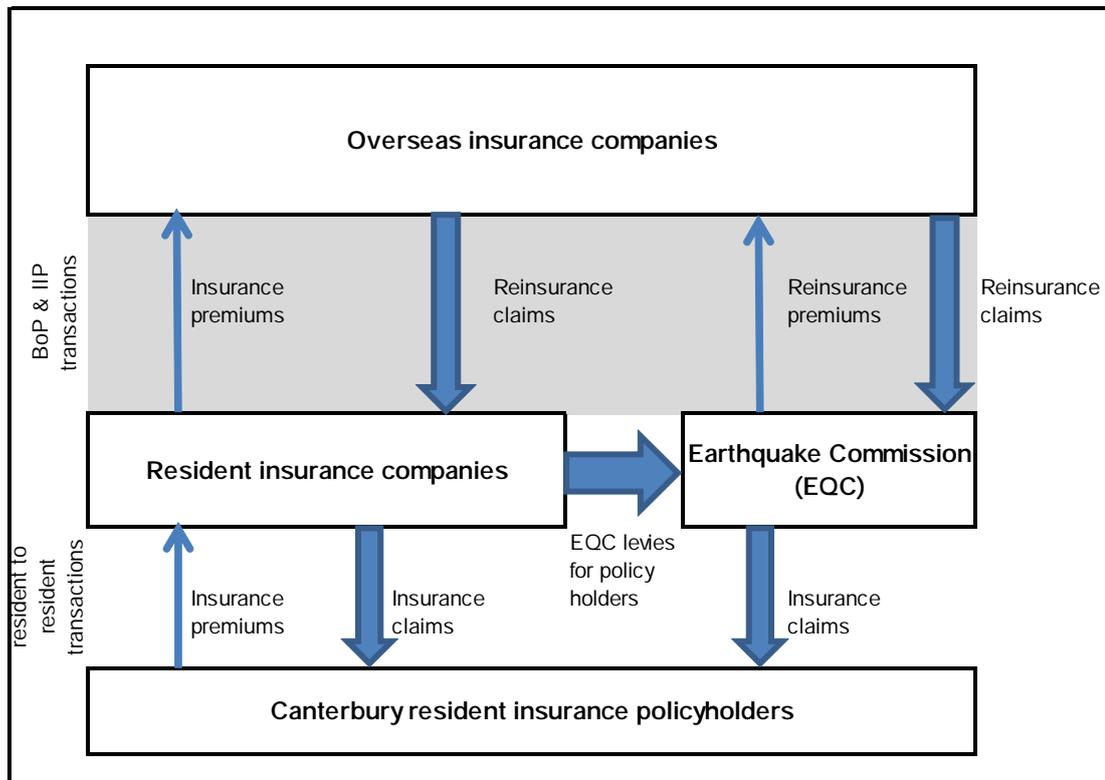
- insurance, including reinsurance
- financial assets and liabilities
- tourism and other services
- trade in goods.

In addition, the impacts of the Canterbury earthquakes on gross domestic product (GDP) were discussed in the Gross Domestic Product: June 2010 quarter Hot Off the Press.

2.4 In this paper, only the cross-border reinsurance transactions and directly resulting financial account transactions and IIP positions are discussed. The focus on reinsurance is because this is the primary impact on the BOP and IIP statistics, and arises from resident insurers offsetting risk on domestic policies with non-resident reinsurers. The impact on the BOP statistics of earthquake-related transactions in trade in goods, and the impact on services (such as tourism), cannot be readily determined. Where significant financial transactions and IIP position changes that can be directly related to the Canterbury event occur, in addition to those arising directly from the reinsurance claims, then comments will be made in the commentary to the Hot Off the Press of the relevant quarter (within the usual limits of confidentiality constraints).

2.5 Figure 1 illustrates insurance and reinsurance flows between resident policyholders and insurers, and between resident insurers and non-resident reinsurers. The latter flows are the subject of this paper (shaded area in the diagram.)

Figure 1
Flow of insurance transactions



2.6 The magnitude of the Canterbury reinsurance claim on non-residents will depend on the size of the affected domestic policyholders' claims on resident insurers, and ultimately on the amount the resident insurers draw on from their overseas reinsurers to meet the total claim. When finalising data for the September 2010 quarter BOP and IIP accounts, the process of determining the domestic policyholders' claims against their resident insurers was not yet completed. As a result, determining insurers' claims against their reinsurers is also a continuing process. The estimate used in this paper of the reinsurance claims on non-resident reinsurers is \$1.7 billion.

2.7 The \$1.7 billion figure is a Statistics NZ 'best estimate', drawing on published information and discussions with the industry up to the time of finalising this paper. The estimate that will be published in the release of September 2010 quarter BOP and IIP statistics on 22 December 2010 may differ from the \$1.7 billion estimate used in this paper. The estimate published on 22 December will be subject to revisions in later releases, as more information becomes available.

2.8 To aid identification and analysis of the Canterbury reinsurance impact on the BOP accounts, a new table has been added in the Hot Off the Press for the September 2010 quarter. The new table 7, 'Current Transfers', disaggregates the component into its parts (an example is attached as appendix 1). In the September 2010 quarter BOP accounts, to be released on 22 December 2010, the estimate of the reinsurance claims related to the Canterbury earthquakes will be included, with usual reinsurance claims, in the current transfers item 'outflow of current transfers, other sector current transfers, non-life insurance transfers' (BOPQ.S5AD1C202).

3 Measurement of insurance and related transactions in BOP and IIP statistics

3.1 New Zealand's BOP and IIP statistics are compiled in accordance with recommendations contained in statistical frameworks produced by the International Monetary Fund (IMF). These frameworks are updated periodically, to reflect changing world economic circumstances. The framework currently used by Statistics New Zealand is called *Balance of Payments Manual* Edition 5 (BPM5). An updated framework, BPM6, was published by the IMF in 2009, but has not yet been adopted by New Zealand.

3.2 In both BPM5 and BPM6 a distinction is made between life and non-life insurance. Non-life insurance is treated differently because its primary purpose is to pool risk and it pays benefits only if an insured event occurs. Life insurance incorporates a significant saving element for the policyholder. (**Note:** term life insurance is treated in the same way as non-life insurance, because it pays a benefit if an insured event occurs).

3.3 Non-life insurance premiums comprise service and risk elements, while life insurance typically has a saving element instead of a risk element. In the BOP and IIP accounts measuring cross-border insurance transactions, the service element of the premium is recorded in the current account component services, and for non-life insurance the risk element is recorded in current transfers. This effectively treats the claim as a return of funds to the policyholder. The saving element of life insurance is a financial item.

3.4 The BPM5-recommended treatment for direct insurance and reinsurance differs. A net flows basis is recommended for reinsurance (ie premiums less claims) rather than the separation into service and risk elements for direct insurance. Consequently, where large non-life insurance claims against non-residents arise, the likely result in the accounts for direct insurance is a large negative debit entry in current transfers, whereas for reinsurance a large negative insurance services debit results (premiums paid less claims received).

3.5 Please note that BPM6 provides the option of treating part of exceptionally large insurance claims as capital, rather than current, transfers, if necessary for consistency with their treatment in the national accounts. This option has not been adopted in this case. The option of treating part of exceptionally large insurance claims as capital, rather than current, transfers is a new feature for both BPM6 and the 2008 System of National Accounts, international frameworks that have yet to be adopted by Statistics NZ. This option will be assessed during Statistics NZ's process of implementing these frameworks.

3.6 Table 1 (overleaf) summarises the recommended treatments for insurance and reinsurance for both BPM5 and BPM6, and the practical application of the recommendations in New Zealand's BOP and IIP statistics.

Table 1
Frameworks for the measurement of insurance

	BPM5	BPM6	
Topic	Theoretical framework for insurance and related transactions		Application in the New Zealand accounts
Time insurance is recorded	While BPM5 is not specific in respect of insurance transactions, the general principle of the framework is that accrual accounting principles apply. For example transactions in goods are recorded when ownership changes, or when services are rendered; and for financial items, when claims and liabilities are recognised in transactors' accounts.	Accrual accounting principles continue to apply. BPM6 is more specific on time when insurance and reinsurance transactions are recorded. In respect of claims, the whole claim (agreed and settled plus expected) arising from an insured event is to be recorded in the period in which the insured event takes place.	Accrual accounting principles apply. In respect of reinsurance claims arising from the Canterbury event, the whole claim (agreed and settled plus expected) is recorded in the September 2010 quarter.
Insurance; services and transfers; life and non-life insurance	The BPM5 recommended treatment for direct insurance and reinsurance differs. A net flows basis is recommended for reinsurance (ie premiums less claims) rather than the separation into service and risk elements used for direct insurance.	BPM6 recommends the same treatment for both direct insurance and reinsurance (ie separating the premiums into service and risk elements, and recording claims against non-resident insurers and reinsurers as current transfers, negative debits).	Separation of premiums into service and risk elements was adopted for all non-life insurance in the New Zealand statistics from September 1999. This approach was adopted due to the inconsistency of the BPM5 recommendations. Therefore, the New Zealand methodology for reinsurance has effectively been on a BPM6 basis since 1999.
Current transfers	For direct insurance – the risk element of the premium paid is recorded as a current transfer; claims are recorded as a negative value. For reinsurance – no entry; net claims are recorded as 'insurance services'.	For both direct insurance and reinsurance claims – the risk element of the premium paid is recorded as a current transfer; total claims are recorded as a negative value in the period in which the insured event occurs.	Consistent with BPM6.

	BPM5	BPM6	
Topic	Theoretical framework for insurance and related transactions		Application in the New Zealand accounts
Financial account and IIP	BPM5 is not specific on the treatment of outstanding reinsurance claims. However, claims and liabilities arising from ongoing trade in goods and services are classified to trade credits in the financial account and IIP.	The outstanding claims are classified within Other investment as 'Non-life insurance technical reserves' in the financial account, and in the IIP.	The 'total claims net of settlements' in the period is recorded in the financial account in 'New Zealand investment abroad, Other investment, Trade credits', with a corresponding IIP asset position in the same category.

4 Impact in the September 2010 and future quarters

4.1 Table 2 shows the impact of the reinsurance claims arising from the Canterbury earthquakes on the BOP and IIP statistics for the September 2010 quarter, and future quarters until all reinsurance claims are finalised and settled. The process of New Zealand insurers and their Canterbury clients determining claims continues. At the time of the release of the September 2010 quarter BOP and IIP statistics, this process is expected to continue for some time – the ultimate value of insured loss, and therefore of the reinsurance claims on non-resident reinsurers, is not yet known.

4.2 The reinsurance claims' value used in the accounts for the September 2010 quarter release are the best estimates supplied by the industry. These estimates will be updated by the industry over time and passed on into the published statistics. This means that the current account, the financial account, and the IIP, will be revised each quarter that the estimates are significantly updated. This is a departure from the usual revisions policy, but is deemed warranted given the significance and interest in this information. As reinsurance claims on non-resident reinsurers are settled, entries will be made in the financial account; the IIP position will change to reflect changes in the level of unpaid claims as at the end of each quarter.

Table 2

Impact of reinsurance claims on BOP and IIP statistics

September 2010 quarter		
Current account	Financial account	IIP statement
The total reinsurance claim figure will be recorded in 'current transfers, non-life insurance transfers debits' (BOPQ.S5AD1C202). The value will be -\$1.7 billion (a negative debit, an inflow in the current account). This value represents the total reinsurance claims on non-resident reinsurers arising from the Canterbury event, whether actually lodged or still expected to be lodged; settled or not.	'New Zealand other investment abroad, Trade credits', \$1.7 billion (BOPQ.S5AC2B301, increasing assets transaction). This represents the total reinsurance claims on non-resident insurers, and assumes that none of the claims had been settled at 30 September 2010.	'New Zealand other investment abroad (assets), trade credits', \$1.7 billion (IIPQ.S5AAA31). This is the estimated balance sheet value, at 30 September 2010, of the outstanding claim (actual and expected) of New Zealand-resident insurers over their non-resident reinsurance counterparties arising from the Canterbury earthquakes.
After the September 2010 quarter		
Current account	Financial account	IIP statement
The September 2010 quarter total claim estimate of \$1.7 billion will be revised as necessary, using updated information from the industry.	Revisions will be made as necessary to the September 2010 quarter estimate of \$1.7 billion, 'New Zealand other investment abroad, trade credits', \$1.7 billion (BOPQ.S5AC2B301).	Revisions will be made as necessary to the September 2010 quarter estimate of \$1.7 billion 'New Zealand other investment abroad, trade credits', \$1.7 billion (IIPQ.S5AAA31).

Settlement of reinsurance claims

4.3 As claims are settled, this will result in financial account transactions reducing assets (other investment abroad, trade credits negative debits) in these periods (eg December 2010 quarter). The counterpart entry to these reducing asset transactions is settlement transactions through the banking system. These settlements are implied through the measurement of changes in bank nostro/vostro account balances, measured each quarter in the Quarterly International Investment Survey, and are represented in the item 'other investment, deposits' (BOPQ.S5AD2B303). As reinsurance claims are settled, the outstanding balance sheet value of unsettled claims carried as an asset in the IIP will fall, reflecting the financial account transactions.

Appendix: New Hot Off the Press table

Table 7
Current transfers⁽¹⁾⁽²⁾
 Quarter ended
 NZ\$(million)

	Series ref: BOPQ	Quarter					
		2009			2010		
		Jun	Sep	Dec	Mar	Jun	Sep
Actual							
Inflow of current transfers	S5AC1C						
General government current transfers	S5AC1C1						
Other sector current transfers	S5AC1C2						
Other sector other current transfers	S5AC1C201						
Non-life insurance transfers ⁽³⁾	S5AC1C202						
Outflow of current transfers	S5AD1C						
General government current transfers	S5AD1C1						
Other sector current transfers	S5AD1C2						
Other sector other current transfers	S5AD1C201						
Non-life insurance transfers ⁽³⁾	S5AD1C202						
Balance on current transfers	S5AC3B2						
Trend⁽⁴⁾							
Inflow of current transfers	S5TC1C						
Outflow of current transfers	S5TD1C						
Balance on current transfers	S5TC3B2						

⁽¹⁾ Data may not sum to stated totals due to rounding.

⁽²⁾ Current transfers are not seasonal, so no separate seasonally adjusted series is produced.

⁽³⁾ Includes non-life insurance transfers of all sectors, including general government entities.

⁽⁴⁾ The trend series is the smoothed actual series.