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Mrs Ludmila Vebrova
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Na padesátém 81
CZ – 100 82 Praha 10

Subject: Classification of joint stock companies administrating compulsory public health insurance

Ref.: Your letter dated 09/01/2008

Dear Mrs Vebrova,

Following your letter of 9 January 2008, I am in a position to give you our preliminary advice on the appropriate statistical classification of the envisaged joint stock companies administrating compulsory public health insurance.

The accounting issue for which a clarification is requested

The ex-ante issue for which an advice is being sought concerns the sector classification of the envisaged joint stock companies administrating compulsory public health insurance, following a foreseen amendment of legal acts on public health insurance, on health insurance companies and on the health insurance supervisory authority.

Documentation provided

The letter dated 9 January 2008 was accompanied by a short analysis on the classification of the health insurance companies concerned, carried out by the Czech Statistical Office (CSO).

Description of the case

As stated in the document provided by the CSO, amended legal acts on public health insurance, on health insurance companies and on the health insurance supervisory authority are likely to be submitted to Parliament by the Czech government in the course of 2008.

Participation in public health insurance would remain compulsory and the scheme would cover the entire society according to the proposed legal act. However, the legal status of health insurance companies would be changed: they would become joint stock companies and could be owned by public, as well as by private entities.

The principal activity of the health insurance companies will be administering public health insurance. The licence and authorisation for entitling of public health insurance administration will be granted by the Health Insurance Supervisory Authority, which is established as a central government unit.

As we understand, the new health insurance system would also offer a non-compulsory supplementary health insurance. By law, health insurance scheme should be funded, and, to this effect, health insurance companies should create separate reserves.

For the moment, there are only public health insurance companies which are classified in the social security funds subsector in national accounts.

Methodological analysis by Eurostat

After an examination of the analysis provided by CSO, Eurostat has reached the following views.

Applicable accounting rules

The Council Regulation 2223/96 incorporates the national accounts concepts and definitions of the European System of Accounts (ESA95) in Community Legislation. ESA95 paragraphs 1.41, 2.74 and 4.88 and Annex III on insurance are applicable in this case.

Availability of national accounting analysis

The view of the Czech statistical authorities is that health insurance companies, being joint stock companies under private legal statutes, are to be classified in the sub-sector of social security funds of the general government (S. 1314). This view is based on the proposed legal act stipulating that participation in the public health insurance remains compulsory, that the scheme covers the entire society and that the level of contributions and benefits are settled and approved by government.

Analysis

Eurostat based its preliminary opinion on the limited information concerning the proposed legal acts that is available to CSO for the time being. Two options are considered: classifying the health insurance companies in question in the financial corporation sector or, alternatively, in the general government sector.

Legal form of the entity and ESA95 classification rules

It should be recalled that the legal status of an entity defined by national legislation is generally not an overriding or even a key criterion for determining the sector classification of the entity. For example, entities with "commercial" legal status (e.g. joint stock company) would be classified in the general government sector when they are public owned non-market entities, following the rules on sector classification defined by the ESA95 and by the ESA95 Manual on Government Deficit and Debt (MGDD).

Depending on nationally based legal form, the concerned entities follow the relevant business accounting rules. In this case, the health insurance schemes in the Czech Republic have to be funded and, accordingly, the envisaged joint stock health insurance companies proposed by the amended national law will be obliged to create reserves. However, Eurostat understands that such

insurance technical reserves are not necessarily a genuine liability against beneficiaries and do not represent insurance technical reserves in ESA95 terms.

Classification of social insurance schemes and supporting units

ESA95 distinguishes amongst insurance schemes those that are so-called "social insurance", amongst which social security schemes. Thus, a first step is to establish the nature of the health insurance scheme set up by the Czech legislation. This determination is related but not same with the sector classification of institutional units involved.

Insurance, social insurance and social security schemes

ESA95 Annex III on insurance states in paragraph 7 on Other insurance (classified in financial corporation sector): "... *Other insurance policies held by households may cover the same risks or needs as those covered by social insurance schemes. However, other insurance policies held by households are distinguished from social insurance policies by the fact that they are taken out on the individual households' own initiative and for their own benefit, independently of their employers or government* ".

ESA95 Annex III states in paragraph 1: "...*Social insurance may be subdivided into a) social security schemes of government, b) private funded social insurance schemes, and c) unfunded social insurance schemes operated by employers* ".

Since participation in the public health insurance will remain compulsory and the insurance scheme concerns a so called social risk (health) and covers the entire society (according to the proposed legal act), it would seem that the health insurance (compulsory section) are to be classified within *social insurance* schemes and cannot be classified within *other insurance* schemes.

A determination of the kind of social insurance is based on the consideration of the information provided by CSO. The health insurance companies (under new commercial status) seem to be participating to a social insurance scheme of a social security nature rather than private funded social insurance schemes, or unfunded social insurance schemes operated by employers.

ESA95 paragraph 4.88 states: "...*Social insurance schemes may be classified according to the following types: (a) social security schemes, covering the entire community, or large sections of the community, that are imposed, controlled and financed by government units; ...*".

Also, ESA95 paragraph 2.74 states: "*The subsector social security funds includes all central, state and local institutional units whose principal activity is to provide social benefits and which fulfil each of the following two criteria:*

(a) by law or by regulation certain groups of the population are obliged to participate in the scheme or to pay contributions;

(b) general government is responsible for the management of the institution in respect of the settlement or approval of the contributions and benefits independently from its role as supervisory body or employer (see paragraph 4.89).

There is usually no direct link between the amount of the contribution paid by an individual and the risk to which that individual is exposed."

The law organizes a framework where an insurance scheme is imposed on the entire community or large sections of the community, as all individuals will be obliged to be insured, though

individually, irrespective of the fact that the insurance providers will be various and in competition.

It is government that sets or approves the health insurance policy concerning the level of contributions and benefits, and not the companies themselves. In particular, the social benefits will not depend on a return on accumulated assets (case regulated by the Eurostat Decision of 2 March 2004 relating to "defined contributions funded scheme for which there does not exist any government guarantee for the risk of defaulting payments"). Thus, Eurostat understands that government controls the scheme, according to ESA 2.74, being in control of both contributions and benefits levels.

The scheme in question is mainly financed from contributions. However, it should be clarified who is bearing risks and rewards relating to compulsory health insurance: health insurance companies, policy holders or the state? It is not clear, for the time being, whether health insurance companies will be entitled to receive transfers or other support from government in case of financial difficulties; and whether companies will be able to distribute to their owners gains arising from the scheme itself.

Furthermore, it seems that within the institutional framework, most if not all aspects of the policy of health insurance bodies, either under private or public legal statutes, are to be regulated by the same law.

Based on these considerations and conditional on clarifications of the previous point, a preliminary view would be that public owned health insurance companies operate a social security scheme, being a social insurance scheme covering the entire community, or large sections of the community, that is imposed, controlled and financed by government.

Social security schemes and social security funds

In ESA95, units dedicated to managing or supporting the flows associated to social security schemes are called social security funds, and grouped in a specific subsector of general government (S.1314 social security fund) when deemed institutional units.

SNA93 paragraphs 4.111 and 4.112 states: "*Social security funds constitute special kinds of institutional units....*", and: "*Social security funds may be distinguished by the fact that they are separately organized from the other activities of government units and hold their assets and liabilities separately from the latter. They are separate institutional units because they are autonomous funds, they have their own assets and liabilities and engage in financial transactions on their own account. However, institutional arrangements in respect of social security differ from country to country and in some countries they may become so closely integrated with the other finances of government as to bring into question whether they should be treated as a separate sub-sector. The amounts raised, and paid out, in social security contributions and benefits may be deliberately varied in order to achieve objectives of government policy that have no direct connection with the concept of social security as a scheme to provide social benefits to members of the community. They may be raised or lowered in order to influence the level of aggregate demand in the economy, for example. Nevertheless, so long as they remain separately constituted funds they must be treated as separate institutional units in the System.*"

In this context, the health insurance companies with commercial statutes foreseen by Czech national legislation would seem to be social security funds to be classified in the general government sector S.13. They will have decision making autonomy, keep a complete set of accounts, and maintain separately constituted funds.

Private owned health insurance companies

According to ESA95 rules, private owned companies cannot be classified within the general government sector given that general government only comprises public nonmarket units.

On first inspection, there would seem a contradiction between the social security fund classification and the private ownership that seems possible for health insurance companies with commercial statutes foreseen by Czech national legislation.

However, a decisive question would be the exact exposure of private shareholders: to variations in social contributions received and social benefits paid? Or only to the "volume" of activity conducted by the health insurance company? In that latter case, the private shareholder is exposed to risks and rewards of the management in successfully attracting a sufficient volume of activity for a given costs. In the former case, the private shareholder would be at risk in case benefits paid would be larger than anticipated.

In the latter case, it would seem that the health insurance company would be acting as an agent, collecting fees based on a volume of activity, and the flows of contributions and benefits would generally not be recorded in its accounts.

Recognizing the principal party in an operation under ESA95

Health insurance companies (private or public) may perhaps be seen managing the social insurance scheme on behalf of government, and the ESA95 would then invite recognizing that general government is the principal in the arrangement.

ESA95 paragraph 1.38 states: *"The system's treatment of most transactions is straightforward; that is, the transactions are recorded in the same way as they appear to the institutional units involved. However, some transactions are rearranged in order to bring out the underlying economic relationships more clearly. Transactions can be rearranged in three ways: rerouting, partitioning and recognising the principal party to a transaction"*.

According to paragraph 1.41: *"When a unit carries out a transaction on behalf of another unit, the transaction is recorded exclusively in the accounts of the principal. As a rule, one should not go beyond this principle and try, for instance, to allocate taxes or subsidies to ultimate payers or ultimate beneficiaries under the adoption of assumptions"*.

Thus, the health insurance companies would only perform an intermediary function as far as compulsory health insurance is concerned. An option would be to record revenues from compulsory social contributions and social benefits as well as associated assets and liabilities in the accounts of general government, and to record other flows relating to operating activities (compensation of employees, fees collected etc.) outside general government – at least for private entities.

Consequently, the health insurance companies (at least the private owned companies) would be classified in the corporation sector assuming that they fulfil ESA95 criterion for market producers, except for the flows and stocks relating to compulsory social security scheme.

Conclusion

On the basis of the above considerations, Eurostat agrees with CSO proposal to classify public health insurance companies in the institutional sector general government (S.13) as these are

involved in social security schemes, covering the entire community, or large sections of the community, that are imposed, controlled and financed by government units.

Concerning private health insurance companies, Eurostat preliminary view is that they would be classified in the corporation sector except for the flows and stocks relating to compulsory social security scheme, assuming that they fulfil ESA95 criterion for market producers.

Eurostat based its preliminary conclusion on the limited information concerning the proposed legal acts that are available to CSO for the time being.

Open issues

It should be clarified who is bearing risks and rewards relating to compulsory health insurance: health insurance companies, policy holders or the state? It is not clear, for the time being, whether health insurance companies will be entitled to receive transfers or other support from government in case of financial difficulties; and whether companies will be able to distribute to their owners gains arising from the scheme itself.

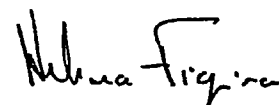
Procedure

There is no explicit Community legislation which governs a procedure by which Eurostat gives its views on operations which have not yet been enforced. Nevertheless, Eurostat is prepared to give a preliminary view on the statistical classification of such operations provided that it is in possession of all of the necessary background information. The preliminary view is given in accordance with the guidelines for ex-ante advice published on the Eurostat web-site.

This preliminary view of Eurostat is based on the information provided by the country authorities. If this information turns out to be incomplete, or the implementation of the operation differs in some way from the information presented, Eurostat reserves the right to reconsider its view. To this end Eurostat would request to be informed of the final details of the operation (contract and accompanying papers where relevant) when they are available, or (should this be the case) information that the planned operation has been abandoned.

In this context, we would like to remind you that Eurostat is committed to adopting a fully transparent framework for its decisions on debt and deficit matters in line with the amended Council Regulation 3605/93 and the note on ex-ante advice, which has been presented to the CMFB and cleared by the Commission and the EFC. Eurostat intends, therefore, to publish all future official methodological advice (ex-ante and ex-post) given to Member States, on the Eurostat web site. In case you have objections concerning this specific case, we would appreciate if you let us know. In any case (regardless of whether you have objections or not) we would like to receive an answer from you on the issue no later than 28 July 2008.

Yours sincerely,



Maria-Helena Figueira
Acting Director