

## METHOD FOR SETTING UP RESERVE TO COVER INCURRED BUT NOT REPORTED LOSS LIABILITY

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This paper is not intended as a scientific treatise of an obscure subject, but is submitted to introduce for discussion the practical side of an acknowledged liability which is of considerable consequence to insurance companies, and should be given the proper consideration. No company will deny a hidden liability in unreported claims, but there is quite a bit of dissension as to how it should be treated. This question has been considered from every angle by the Fidelity and Surety Committee of the Association of Casualty and Surety Accountants and Statisticians, and the report of that Committee is taken as the base of these remarks. That Committee particularly, and the Association generally are responsible for any consideration that may be given this subject, with the added responsibility that the writer may have included matters that do not meet with their entire approval. However, a complete discussion of the many points involved cannot help but do something toward clearing the atmosphere.

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An incurred but not reported loss liability is, as the term implies, the liability for losses which occurred on or before the end of a given period, but of which the accounting office of the company had no knowledge until after that period.

There is always a volume of such losses, as losses of different types are in the course of evolution which come to light at uncertain future dates, and incidents are occurring continually throughout the country which are not reported promptly to company representatives. Also, when losses are known in the field, they must be reported to the Home Office before they can be added to the liabilities of the company, and the period of transmission accounts for a number of these claims. This liability therefore is created by delayed notices of losses, which may be divided into two general classes, namely:—

- (a) Latent Losses; Losses occurring daily but not coming to light until a later date.
- (b) Belated Losses; notices delayed because of the time required for transmittal to the Home Office.

While this hidden liability is continually in existence, and is now being taken into consideration by many companies regardless of the date any experience exhibit is compiled, it has been, and still is to a large extent, looked upon as a calendar year item to be adjusted only at the end of each year. This can be laid to the fact that the item was introduced officially by the form of Annual Statement adopted by the convention of Insurance Commissioners in which the term "Incurred but not reported" is used. Provision is made for the inclusion of this liability in the "Losses and Claims" exhibit on page 5 and at the foot of Schedules "J" and "K".

By providing for this item without comment or instructions, the insurance departments apparently assumed that any company could show this liability without much trouble, and each company estimated the amount of such liability according to its own interpretation and judgment. Generally speaking, these estimates were passed by the insurance departments without question, until the recent investigation made by the New York department, when it was disclosed that in many instances the reserve of a previous year was inadequate in the light of a subsequent year's analysis.

However, just as it is obvious that unreported losses exist, it is equally manifest that no company can foretell, with any degree of accuracy, how much liability is involved. Large claims coming to light in one year do not necessarily imply that large sums should be put up for the next any more than small claims indicate small amounts. While it is true that the individual companies should take this liability into account in rendering periodical financial reports, different judgments have operated in the adjustment of the value thereof to such an extent, that no two estimates are comparable, and no one can tell which company has exercised the best judgment in setting up its reserve. If the actual value of delayed cases for any particular period approximated the unknown loss reserve set up for that period it would be nothing more than pure coincidence.

While the existence of certain unreported losses is acknowledged by the recognition of the incurred but not reported liability, this unknown liability, insofar as individual cases is concerned, ceases to exist after the loss is reported. The loss is then valued on a definite basis and the true liability is erected. Hence the

claim is no longer "incurred but not reported", but is a reported claim which was delayed, and must be handled as any other loss. This fact throws the unknown loss reserve into the class of a contingent reserve, which, like a catastrophe or voluntary additional reserve, is for the purpose of setting aside certain funds which otherwise would go into surplus, to provide for unforeseen incidents; with the exception that the incidents have actually occurred. A contingent reserve of this character cannot be subject to case analysis. Specific cases are not involved, therefore it cannot be measured by cases known in the future which are then automatically included in the known liabilities. This reserve is erected solely as a safety reserve for financial statement purposes only, and, therefore, instead of being expended, should be carried until it is replaced by the figure used in the next statement.

The main point for consideration is, how can an adequate reserve for this unknown liability be erected? Each company has its own ideas regarding this, and very probably, like the estimating of reserves on known cases, its method serves its individual purposes. This is true in all forms of accounting; and from the company point of view, a short form financial statement should be sufficient to indicate its degree of solvency to the insurance departments, with the checking of those statements through the periodical examinations. However, the elaborate annual statement required at the close of each calendar year has evolved from the ideas of different insurance department officials and committees to meet certain real or anticipated conditions, and it is therefore necessary to adjust this valuation so that it will meet with the approval of the insurance departments.

To do this, this reserve must be valued so that, in addition to being reasonably adequate, it will be consistent between years and uniform for all companies. While it is true that no individual company can foretell what the coming year will develop, it can be assumed that with sufficient spread, the past will give indications of the future. On the basis of this theory it is believed that every purpose will be answered by the adoption of a formula method of establishing this reserve, based upon actual past experience.

Acting upon this belief, the Fidelity and Surety Committee of the Association of Casualty and Surety Accountants and Statis-

ticians who were engaged in studying the question as it pertained to the fidelity and surety lines, considered the figures filed by each company with the New York Insurance Department, as of December 1st, 1926, covering their 1925 and previous unknown losses reported from January 1st to December 1st, 1926, as it was believed that these figures would give a considerable spread of delayed claims from which a fair indication of a reserve basis could be secured, by comparing them with certain established figures. Thereupon the Committee circularized the companies for the following:

(a) The unknown losses furnished the New York Insurance Department.

- (1) Net premiums written during the preceding year.
- (2) Net premiums in force at the end of the preceding year.
- (3) Unearned premium reserve as of December 31st of the preceding year.
- (4) Premiums earned during the preceding year.
- (5) Losses incurred during the preceding year.

This gave the Committee the relationship of a large spread of unknown losses to five different sets of established figures which were tabulated and studied by the Committee, who arrived at the following conclusions:

(a) The relationship of unknown losses to losses incurred presented such a wide variation as between companies that this basis was discarded. Moreover, because of the fluctuation of incurred losses from year to year, it was considered an unsatisfactory basis upon which to figure a ratio.

(b) The ratios of unknown losses to net writings, net premiums in force, premium reserve and unearned premiums showed about the same range of variation in the respective groups, due to the fact that these figures are more or less co-related.

(c) The group showing the narrowest range of variation was that of net premiums in force. This is due, to some extent, to the larger figures involved. Upon the theory that this group expresses more consistently than any other group the cumulated bond liability of a company, in which there is always inherent a percentage of latent loss, it is the opinion of the Committee that net premiums in force furnish the most logical and most practical basis upon which to figure the ratio for an unknown loss reserve.

In order to arrive at an average ratio, the figures of twenty-three companies writing fidelity and surety lines were combined and show the following results:—

Lines of Business	Unknown Losses	Net Premiums in Force	Ratios
Fidelity.....	3,471,292.	34,939,382.	9.94
Surety.....	1,935,379.	56,125,141.	3.45
Total.....	5,406,672.	91,064,523.	5.94

It was pointed out in the Committee's report, that net premiums in force, in addition to being the most consistent basis for the reserve, was sufficiently constant in its development to enable any Company to apply the percentage to the figure of November 30th, if the end of the year figure were not available by the time the amount of the reserve was required. The Committee then recommended as minimum practical percentages, 10% for fidelity and 3.5% for surety, which percentages closely approximate the averages shown by the tabulated figures.

While the findings of the Committee did not include the miscellaneous casualty lines, the same reasoning can apply to those lines and a similar method may be used for establishing the reserve on each. However, the problem is not so involved where those lines are concerned, as the unreported claims are practically all composed of the belated type, whereas the fidelity and surety lines are affected principally by the latent type.

This brings us to the question as to which losses should be assigned to the latent type. This question should be given serious consideration because of the convictions of some that the "incurred but not reported loss reserve" should be tested by case analysis from year to year, and the further complications which are brought about by the present arrangements of Schedules J, K, G and O.

One company has suggested the following set of rules for the assignment of delayed claims:

Fidelity	All bonds in these classifications cover the
Public Official	honesty of the principal, and are subsequent
Federal Official	claims only when the embezzlement occurs
Court (Fiduciary)	prior to the current year.

- Court Guarantees** All bonds under these classifications are court financial guarantees and the date of claims is the date on which the final court decides the case against the applicant for bond.
- Federal Contracts** The date of default is the date of claim  
**Public and Private Contracts** except when the loss is for labor or material. In such case materials purchased prior to the current year create a subsequent claim.
- License and Permit** The date of claim is the date on which the  
**Miscellaneous** act, because of which the claim arose, occurred.
- Depository** These are in default the day the bank closes.

One set of rules may be as good as any other if they are universally accepted and adopted, but it is generally acknowledged that conditions arise in many bond claims which make it practically impossible to assign them by established rules, and furthermore, the conditions, if given, are stated very often in such a way that a thorough reading of the file is required to get all the facts. Even when all the facts are readily available there are differences of opinions which make it a common occurrence for two authorities in the same company to disagree on the same case, and there have been instances where one authority has reversed himself on two cases of the same type. A number of examples (as furnished by another company) are listed below, which make an interesting questionnaire, and serve to show the impracticability of assigning cases without an involved set of rules which no two companies would give the same consideration:

FIDELITY BONDS

1. \$5,000 fidelity bond—year April 1, 1925 to April 1, 1926; April 1, 1926 to April 1, 1927. (Liability non-cumulative.) June 1, 1927 notice of loss \$15,000. Paid June 15, 1927—penalty of bond \$5,000. Stealings: April 1, 1925 to December 31, 1925 \$5,000; January 1, 1926 to December 31, 1926 \$5,000; January 1, 1927 to April 1, 1927 \$5,000.

There was a \$5,000 loss in 1925, \$5,000 in 1926 and \$5,000 in 1927. The 1925 loss and the 1926 loss are previous and the 1927 loss is current. The current loss exhausts the penalty of the

bond. Which loss is paid by our settlement, the current loss or the previous loss; or is it to be considered that our payment covers  $33\frac{1}{3}\%$  of each of the years' stealings?

2. On the same statement of facts, suppose that, in addition, the principal makes good \$10,000 of the loss. Then, is our payment of \$5,000 which we would be obliged to make, on account of the current loss or the previous loss?

3. Fidelity bond of \$5,000 covering for calendar years 1925, 1926 and 1927. Principal steals \$5,000 in 1925, is not discovered. In 1926 steals \$5,000, uses it to make good the stealings of 1925. In 1927 steals \$5,000 and uses it to make good the stealings of 1926. Afterwards in 1927 he is discovered \$5,000 short. In what year did the loss occur?

4. Suppose bond for year 1925 was carried by "A" Company; for the year 1926 "B" Company wrote exactly the same form of bond with superseded suretyship rider for 1926 and 1927. The bond of "A" Company contained two-year limitation for discovery of loss. Principal steals \$5,000 in 1925, which is not discovered. In 1926 he steals \$2,000 and applies it as a credit on his shortage of \$5,000 in the previous year. In 1927 he steals \$2,000 and applies \$1,000 as a credit against shortage of 1925 and \$1,000 as a credit against shortage of 1926. The total shortage of \$5,000 is discovered in 1927. To what years is the loss to be charged?

5. Suppose on the above statement of facts the principal pays \$2,000 salvage before the surety companies settle their liability and the net loss paid to the obligee company by the sureties is \$3,000. Is the payment of \$3,000 by the sureties current or previous?

6. We have a \$10,000 fidelity bond on a bank employee, which was in force during the years 1926 and 1927. In June 1927 the principal is discovered short exactly \$10,000 and investigation discloses there were no manipulations or false entries on the books but that he merely abstracted from the cash drawer at different times a total of \$10,000 in cash. There is no way to tell whether he abstracted the money in 1926 or 1927 or previous to 1926 when he was not under bond. Are we to assume that the \$10,000 or any portion of it is to be charged as a current loss or are we to assume that any part of it is to be charged to previous loss?

7. "A" company has an individual fidelity bond executed February 1, 1920 and renewed up to February 1, 1927. The bond contains a six months' limitation for discovery of loss. On February 1, 1927 we wrote a bankers blanket bond to which was attached superseded suretyship rider. The six months' limitation under the fidelity bond would expire August 1st. On September 1st a \$10,000 shortage was discovered, all of which occurred prior to the date of the bankers blanket bond but was discovered subsequent to the six months' limitation in the fidelity bond. In this case the liability of course is under the blanket bond and the loss will be paid thereunder. Is this charged as a current or previous loss? If as a previous loss, will it not show a loss paid under a bond which was not in force at the time the loss occurred?

8. All of these questions involving fidelity coverage arise in still more complicated fashion where blanket bonds and successive blanket bonds are involved. In the blanket bonds there is in addition to the fidelity protection against other forms of loss, as for instance, misplacement. Suppose in a particular case a security or bond was known to have been in its proper place in June or July 1926 and search for it in May 1927 failed to disclose it. When was it misplaced? Claim is made under the misplacement coverage. When paid is it a current or previous loss?

9. Bank holds \$100,000 bankers blanket bond written in 1925. In April 1927 loss of \$250,000 discovered. Loss occasioned by stock dealings and upon closing account of employee recoveries aggregating \$164,000 effected and applied as a credit. Net loss to surety \$90,000. No way of determining what portion of loss occurred in 1926 and what portion in 1927, though a loss occurred those two years. Is loss to be charged current or previous.

10. Underlying fidelity schedule, coverage \$50,000 primary blanket bond, \$25,000 excess blanket \$25,000. Total loss \$754,000 extending over period of two years. The only way to determine date of loss is date entries covering peculations were made in books of bank. These entries undoubtedly note dates when money stolen because of various discoveries made in course of investigation. Loss paid \$100,000. How charge—current or previous? In this case recoveries from closed accounts with stock brokers aggregated \$170,000.



11. Bond of \$25,000 primary, \$75,000 excess. \$25,000 primary dated 1924—excess \$75,000 dated 1924 cancelled December 1926.

Beginning in 1926 a customer of the bank overdraw his account several thousand dollars. This loss made good by depositing checks in a larger amount drawn on eastern banks (obligee bank being located on the Pacific Coast). While these checks were clearing he would withdraw from his account the difference between his previous overdrafts and the amount of the deposit. Upon these checks being returned by the eastern banks marked "insufficient funds" the customer would deposit additional checks on eastern banks in the excess amount of his then overdraft. While these checks were being cleared he would draw out the difference between the previous overdrafts and the latest deposit. This occurred almost weekly during 1926, with the knowledge of the president of the bank, who O. K.'d checks on the eastern bank for deposit to the credit of the customer. Early in February 1927 checks were deposited to the customer's credit to a total of about \$800,000, which would have covered his overdraft and probably left him a substantial deposit to his credit. Before these checks were reported on the bank closed. Claim is made under the above bonds because of the president's alleged connivance. If loss is sustained and paid should it be charged current or previous?

#### PUBLIC OFFICIAL BONDS

##### 1. *Class—City Treasurer.*

Term—May 1924 to May 1928.

Principal dies May 1st, 1927.

(In 1924 a bank deposited bearer bonds with principal as collateral to secure principal's official deposit in that bank. The bearer bonds have not been located. As principal stole other amounts it is assumed he stole the bonds as well. The bonds, therefore, disappeared between May, 1924, and May 1, 1927.) Should reserve be current or previous or divided? How divided and why?

##### 2. *Class—Sheriff and Tax Collector.*

Term—December 1924 to December 1928.

Principal resigns June 1927, having failed to collect some 1925

taxes and 1926 taxes, but in fact used 1927 tax proceeds with which he made settlement for 1925 taxes. Is this current or previous in June 1927?

*3. Class—Tax Collector.*

Term—1924 to 1928.

November 1926, principal receives tax list which he is to collect. He is obliged to settle with the county February 1927. He dies in March 1927, whereupon it becomes the **duty** of the surety to collect the taxes, but the law gives the surety one year from the death of the principal to settle. In 1927 the surety posts a reserve against estimated uncollectible taxes. Is this current or previous?

*4. Class—County Treasurer.*

Term—This principal continuously in office 16 years.

F. and D. is on bond 1909 to 1913, 1917 to 1921, 1925 to 1929.

X Company is on bond 1913 to 1917, 1921 to 1925.

Principal resigned June 1, 1927.

The facts were that the principal did not keep any books and destroyed the books of his predecessor. From miscellaneous sources the total amount of taxes he had for collection were determined and the amount of warrants paid by him definitely ascertained. Claim was made jointly on the two sureties for \$50,000 which the F. and D. settled by paying 10/16ths and the X Company 6/16ths. Was this payment current or previous and why?

*5. Class—Tax Collector.*

Term—December 1924 to December 1928.

February 1927 surety is advised that auditors are working on books of principal who has disappeared and who is believed short \$40,000. February 1927 auditors report shortage \$6500, which principal collected in December 1926 and January 1927. March 1927 claim made for \$128,437.45, covering taxes collected and not remitted and covering taxes not yet collected, but for which principal does not have to make settlement until May 1927. Is this current or previous?

*6. Class—City Commissioner.*

Term—May 1924 and ending indefinite.

June 1927 claim made for \$11,621.90 for improper disbursements between July 1926 and March 1927. Is this current or previous?

7. *Class—Sheriff and Tax Collector.*

Term—December 1924 to December 1928.

In May 1927 claim is made for the difference between total taxes to collect and remittances made by principal. Principal's records were partly missing, but enough were left to show he had used the collections for one tax year to pay the taxes of another year, which latter taxes in fact he had not collected. The amount of the liability was easy to determine and that it came within the bond period was easy to determine. The liability was settled. Was this current or previous?

8. *Class—County Treasurer.*

Four bonds covering four year periods each in penalty of \$60,000.

Bond Term—Last bond January 1913 to 1917.

Claim filed March 1, 1917 for \$50,000.

Bond liable for taxes collected and uncollected. Claim for \$50,000 based on the difference between taxes to be collected over the sixteen year period less amount paid by principal to State covering State taxes and warrants paid by principal as disbursements from County taxes. The claim made in lump sum without designating total of warrants paid in one calendar year and total of amount paid State in that year against tax levy for that year. Reserve posted in full when claim was made and claim paid in full after verification. Was this current or previous and why?

9. *Class—Reinsurance to another corporate surety.*

Term—April 8, 1926 to June 18, 1927.

June 10, 1927 the reinsured company advises us that the audit of principal's accounts for fiscal year ending March 31, 1927, shows deficit of \$9,000 and the reinsured company is posting full reserve. F. and D., therefore, has to post reserve covering its portion. Quære: How can the F. and D. know whether to charge all or part of this to losses which have occurred and not reported when the reinsured company has not that information itself?

## JUDICIAL BONDS

1. A guardian qualified in 1915. In 1916 he files an account taking credit for a loss on the sale of some property. In 1925 the ward becomes of age, excepts to the guardian's final account, and among other things, objects to the credit taken in the 1916 report. When did the loss occur?

2. A guardian is appointed by the court in 1918, the two wards being his sons. In 1919 he invested the assets in a mortgage secured by farm property. This investment was approved by the court and he thereafter made his yearly accountings in accordance with the local law. In November 1926, the guardian died and the wards, being 21 and 22 years respectively made claim against the surety in April 1927, alleging depreciation in mortgage security and loss to the estate as result of neglect on the part of the guardian in not keeping in touch with investment. Is this loss current?

3. Party died and was alleged to have guaranteed the payment of certain bonds. In order that the estate might be administered upon, a refunding bond was written guaranteeing that if there was a failure on the part of the company on whose behalf the bonds were issued to pay them when due, and if, furthermore, there was as established liability on the part of the estate, that the surety would assume payment of same. The original bond was executed in 1920. Demand was made on the estate in 1926, but was not made on the surety until March 1927 and suit was filed in May 1927. What date did the loss occur, for the purpose of reserve?

4. When does liability arise under a release attachment bond when verdict was rendered against the principal in November 1926, a new trial was granted in February 1927 and verdict in the new trial was handed down against the principal in May 1927? Was this a current or previous loss?

5. Replevin bond is written. Judgment goes against the principal who takes an appeal. On appeal the judgment of the lower court is reversed with a new hearing on the grounds that there is inadmissible evidence in the record. Verdict on appeal is handed down in 1926 which is three years after the original judgment of the lower court. Principal in the meanwhile is bankrupt and the surety finances the defense. Judgment goes against the principal in the lower court proceeding in May 1927. On what date should reserve be charged?

6. On December 10, 1926 judgment was handed down against the principal on an attachment bond and appeal was instituted and only a cost bond on appeal filed. There was a failure to prosecute the appeal and demand was made under the attachment bond in May 1927. Should this be entered as a 1927 reserve, surety having no knowledge of the judgment which was handed down in December 1926?

7. An administrator was bonded in the State of Virginia in 1920. In 1926 he died and a new administrator was appointed. During the interim, certain administration fees had been allowed the old administrator each year but the new administrator takes the position that the failure to wind up the administration of the estate was through negligence on the part of the old administrator and that under the statutes of Virginia, the old administrator was not entitled to any administration fees, this question being raised in 1927. When did the loss occur?

8. We bonded an operating receiver who carried on a mercantile business. The original bond was executed in 1922. In 1926 he was removed on the grounds that the business had been showing a substantial loss, although this fact was not shown in his reports to the court. It is disclosed in the hearing that in order to keep his job, the receiver has charged the losses of the business against the stock on hand and that instead of having \$20,000 in stock, as the receiver's accounts would disclose, he has only \$8,000 in stock on hand. His testimony shows that this is true and that he had continuously lost money in the business since his appointment. There is nothing to indicate just how much money was lost each year as the stock inventories submitted to the court were padded. He disputes his liability and demand is made on the Surety in February 1927. When did the loss occur?

9. A bail bond was executed in Indiana in 1923. In 1924 the principal entered his appearance at the trial and the verdict being against him, an appeal was taken. No new bail bond was procured pending the appeal and no order of court was rendered discharging the old bail bond. A judgment on appeal was rendered in favor of our principal reversing the lower court, same being handed down in July 1926. In May 1927 demand was made under the original bail bond. Defense was put up that the judgment on appeal had operated in favor of our principal. We were then faced with the allegation that under the Indiana

statute, a decision on appeal must be certified to the lower court within six months after rendition; otherwise, same is void and liability still exists in the lower court proceeding. To what year should the loss be charged while fighting out the issue?

10. Bail bond issued in February 1926. In December 1926 case set for trial and principal failed to appear. Ten days thereafter in December 1926 formal forfeiture was entered up. Subsequently, in December, 1926 principal's attorney secured a stay of forfeiture until June 1927 at which time principal fails to appear and final forfeiture entered. Does the stay proceeding operate to suspend liability until 1927?

11. Receiver qualified under our bond in 1923 in California court. In March 1927 demand for damages is made on grounds that court had no jurisdiction to appoint receiver. Should this be termed 1923 liability?

12. A trustee was bonded in 1921 and died in 1923. The succeeding trustee made claim under the bond and a loss of \$700 was paid upon which the old trustee's account was closed of record. In 1927 the succeeding trustee reopened the matter, stipulating certain credits were allowed on livestock which did not belong to the estate. If a reserve is to be entered, why is same not current?

#### CONTRACT BONDS

1. Bond guaranteeing performance of a public contract under which surety is liable to furnishers who comply with statutory requirements as to notice, etc. In October 1926 we received from furnisher of material notice in accordance with statute, which notice specifically states it is not a claim under the bond but merely a compliance with the statutory requirements as to notice. In April 1927 contractor defaults in performance, and surety pays loss on account of excess cost of completion, also pays labor and material furnishers including the one who gave notice in 1926. The labor and material bills include those incurred in 1926, and those incurred in 1927, and those incurred both in 1926 and 1927. How will this loss be charged?

2. Contract bond includes a guaranty against damages for the infringement of a patent. The contractor uses the patented process during 1926 and 1927. Claim made on the bond for the infringement of the patent in 1927, which alleges the quantity of

the patented process used and upon which the damages are based, and alleges that the infringement was between October 1926 and July 1927.

3. In October 1926 we received notice from obligee that our principal, a contractor for the construction of a state highway, is financially involved. Conferences looking to adjustment continue until December, 1926 when work is closed down for the winter. There is no default. April 1, 1927 contractor admits his inability to proceed with the work. Loss is sustained on completion. To what year is the loss chargeable?

4. Contractor defaults in 1925. Surety waives completion, and owner completes on assumption that he has more than sufficient to cover cost of completion. The cost of completion is paid by the owner out of funds in his hands which are exhausted in February 1927, and contract is completed in March 1927 at an excess of \$8000 which the surety pays as a loss. Is this current or previous?

5. A paving contract is started in November 1926, and completed in April 1927. The bond guarantees maintenance due to defects in construction. In May 1927 a claim is made to maintain a portion of the street.

6. Contract contains clause guaranteeing against defects in workmanship for one year. Contract is completed June 1926. Claim for defects in workmanship made May 1927. When loss is paid, is it current or previous?

7. Contract bond among the provisions of which is one guaranteeing efficiency of heating plant. The building is completed and accepted in September 1926. First opportunity to test plant in zero weather, as required by specifications, occurred in February 1927 when plant found to be inefficient. Surety repairs same at loss in 1927. To what year is loss chargeable?

For those who may still wish to analyze delayed claims, it would not be far amiss to suggest that each claim supervisor use his own judgment, as whatever the results may be, they would equally answer any purpose. However, if the results so obtained are considered from all angles it will be found that for the individual company this analysis is burdensome, unreliable and of no value for the next year's reserve estimate and, therefore, would not justify the expense involved; consequently it should be avoided. The formulary method of arriving at this reserve

is suggested with the hope that the insurance departments will recognize its value for all practical purposes, and it is strongly recommended for company use.

The formula basis submitted in the aforementioned Committee's report combines the judgment of twenty-three companies, therefore gives the average percentage of varying methods of treating what cannot be considered other than vague matters, and can be accepted as true enough for all practical purposes. The volume is sufficient to make the percentage substantial and it can be assumed that the reportings of cases received during the eleven months of 1926 which were incurred prior to that year, represent an average period. There may be some company officials, and possibly some of the insurance departments who are not satisfied with a formula which cannot be checked so it can be changed with the trend of times. The inadvisability of the individual company using the delayed cases of one year to indicate the reserve for the following year is strongly stressed and it is further contended that if a check is desired it still can be made without the labor of delayed claim analysis.

That is to say, each insurance department in the periodical examination of companies, ascertains the value of delayed cases as they pertain to the statement being examined, and it would not be difficult to accumulate these amounts with the corresponding premiums in force so any change in trend will be indicated. This examination is helpful to the individual company, as it gives them the comparison at regular intervals without necessitating an expensive system of yearly analyzation.

If in such a test by the insurance department the formulary ratio in any particular company should not prove adequate, there still remains another factor which is recognized in all periodical examinations by insurance departments and due credit given therefor, but which is not provided for in the annual statement, namely, those recoveries which are actually made by all companies in the year succeeding the annual statement year. This constitutes a factor of safety, inasmuch as both the unreported claims and the uncollected recoveries relate to an unknown quantity. Hence, if a company is required to set up a safety reserve for a totally unknown and unascertainable liability, by the same token it should be allowed credit for that equally unknown asset, recoveries on closed claim cases.

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Under the present annual statement requirements, it is necessary for each company to itemize its known bonding claims in schedules "J" and "K", and the new unknown reserve is included in schedule "K" to make the total estimated liability prove with the financial exhibit, and consequently the old unknown reserve is carried into schedule "J" and therefore is included in the total reserve entered in schedules "G" and "O".

As Schedules "G" and "O" were obviously originally designed for the purpose of comparing the original reserves with the subsequent developments, the real value of such a test would be on known cases. As the unknown reserve is also included, two reserves are represented in the total reserve column, but developments are posted as they apply to the known reserve only, and consequently an over-estimation should result.

If the assignment of latent losses were practicable, this inconsistency could be remedied in one of two ways:

1st. The descriptive headings of Schedules "J" and "K" could be changed so as to assign to Schedule "J" all cases reported during the current year but on which the date of loss was in a prior year, thereby combining the unknown cases with the known cases in Schedules "G" and "O".

2nd. A supplementary Schedule "J" could be adopted for the listing of delayed losses, the reserve for which could be tested out in additional columns in Schedules "G" and "O".

The first would confuse the real purposes of these schedules by vitiating the comparison of the reserve on known cases with developments. The second would tend to lessen their value by throwing the actual reserve on delayed cases out of the total reserve; otherwise these cases would have to be followed through in two sets of schedules, the developments being posted against the incurred but not reported claim reserve in the first instance, and again against the reserve after it is put up. Either method would add considerably to the work on the schedules, for the sole purpose of determining how accurately a formula reserve answered the purposes of the individual company. Any company that desires to make this test can do so just as advantageously in its own system, but there is not sufficient matter involved to make this analysis an annual statement requirement.

Therefore, neither of these remedies should be considered, and the inconsistency now existing should be eliminated by

dropping the incurred but not reported reserve from all the schedules.

It is submitted that the formulary method of setting up this reserve should be universally adopted, thereby placing all companies upon the same plane as to this reserve, and eliminate any concern as to whether one or the other is mistaken in its individual judgment. That by so uniformly requiring every company to put up what seems a reasonably adequate reserve for a contingency which is never known, the subject can be dropped without further worry, and the schedules of the annual statement can be confined to the complete analysis of reported known losses which can be definitely valued.