posing of the problem, I am in agreement. As I see it, the extremely difficult problem of loss reserves is one which must be subject to constant and intensive study. There is no panacea. For carriers of at least reasonable integrity and competence, which probably includes all of the companies selected by Mr. Otteson, the results achieved are, on a percentage of adequacy basis, about what would be expected. The problem, however, is acute with some of the companies *not* included in the tabulation.

It has long been my feeling that the annual statement is badly in need of revision on the important matter of the exhibiting of loss data. Such revision would permit not only retrospective evaluation of loss reserves but prospective evaluation, even though the latter would of necessity be limited. So far as Schedule P is concerned, I am somewhat disappointed that Mr. Otteson's talents were not devoted to a more fundamental consideration as to the value of the parts preceding Part 5. Isn't somewhat more radical surgery indicated?

The remaining item which requires comment is that of Unearned Premiums and Prepaid Expenses. These items are not only not the same thing but either one is extremely difficult to define, let alone measure, in an annual statement which is the same for all types of carriers. More importantly, recognition in the annual statement of either item is, in the opinion of this reviewer, fundamentally unsound. Mr. Otteson's discussion, and his presentation of estimated liquidating values and market prices, points up the fact that investors constitute a set of legitimate claimants to information which is based on, but is *supplementary* to, the data contained in the annual statement. Public accountants constitute another set of legitimate claimants. There are others. Here, consideration should be given to the part that the annual statement plays in the supervision and regulation of insurance carriers, particularly the question of actual or imminent insolvency. It would appear that the introduction into the annual statement of judgment or controversial items not relating to statutory solvency would enormously complicate the supervisory and regulatory problem, without any compensatory gain.

AUTHOR'S REVIEW OF DISCUSSION BY MR. LINDER

The first paragraph of Mr. Linder's review evaluates the paper on a "complete, total" basis in a very positive manner and tone.

Various parts of the paper are then considered individually and in these considerations the differences in viewpoint between the reviewer and the author appear less "complete" than the general evaluation in the first paragraph would suggest.

CONSOLIDATED STATEMENTS

There is no difference of opinion between the author and reviewer as to the proper carrying value of a subsidiary company stock in the parent company balance sheet. Also, the reviewer agrees to the advocacy of consolidated financial statements when all the companies are multiple line.

The difference in viewpoint between the author and the reviewer concerning the basic underlying philosophy of consolidated financial statements is revealed in paragraph 5 of the review.

> "I am simply unable to understand the pertinence of Mr. Otteson's remarks where a multiple line company is the parent of a life company or, for that matter where a life company is the parent of a multiple line company. Except for the accident and health coverages, there can be no inter-relationship of premiums between multiple line companies and life companies (acceptances, cessions, pooling, etc.). To this reviewer, such possible inter-relationship, rather than ownership or common management, is one of the chief reasons for consolidation."

The author's viewpoint is that the need for consolidated statements arises through the ownership of one company by another company and that the importance of premium inter-relationships is secondary.

Consolidated statements are of unusual importance and significance for insurance companies because of the risk element inherent in the business. A great deal of significance and importance is attached to the "surplus as regards policyholders—premium volume" relationship. This relationship affects company policy decisions and the attitude of state regulatory authorities toward individual insurance companies. When one company owns another company a consolidated financial statement is the only way in which it is possible to gauge the true relationship between surplus as regards policy-holders and the true volume of risk assumed by the companies making up the economic entity. A casualty company owning a life company represents an economic entity in the same manner as a casualty company owning another casualty company. Life insurance operations need a surplus margin of protection and the parent company surplus *only* must be considered as the surplus protection for all companies (casualty and life) in the economic entity.

Premium inter-relationship is of significance in that it provides a mechanism by which companies can manipulate this "surplus-volume" relationship by corporate entity through reinsurance. By increasing the capital investment and ceding reinsurance to a subsidiary a parent company can improve this ratio on a non-consolidated basis without really improving its financial capacity.

The reviewer's viewpoint is pertinent and appropriate in analysis of operating results by line of business; in this respect the consolidated statement combines all experience for each line written by the individual companies in the group into a single composite.

VALUATION OF INVESTMENT SECURITIES

The reviewer agrees that "consideration should be given to the establishment of an appropriate capital gains tax reserve against unrealized appreciation." He fears "considerable opposition, with some validity."

More specific information as to the source of and reason for the opposition would make this observation more meaningful. Also, it would be interesting to know how to read proper meaning to the term "some validity."

The reviewer favors the present practice of valuing higher grade bonds on an amortized basis as "only a small part of the bond portfolio would require 'forced' liquidation."

In contrast, the author believes that when insurance companies purchase long term obligations they are assuming the risk of changes in interest rates in the general market as well as the risk of receiving the principal amount at maturity date. Their financial statements should rightfully reflect this element of risk which they have chosen to take. The current market price bases the value of the bond on interest rates prevalent at the statement date considering both the present value of *prospective earnings* and the present value of a *principal amount* receivable at some future date. Therefore, current market should represent the appropriate valuation basis regardless of whether the company sells the bonds or holds them to maturity.

Accumulation of a mandatory securities valuation reserve would solve the problem only if the amount of reserve was based upon the difference between market value and book value. The life company reserve is determined on an entirely different basis.

SCHEDULE P

The reviewer suggests more drastic surgery than the proposals contained in the paper. The paper suggests that Schedule P reserves be removed from the liability section of the balance sheet and transferred to the "below the line" section and that voluntary amounts be stated separately from the amounts required by the statutory formula; this is believed to be *very* drastic surgery.

GENERAL COMMENT

The last paragraph expresses the reviewer's viewpoint concerning the annual statement in relation to the total financial information problem. It is exceptionally pertinent and meaningful and very well presented.