

ANNUAL STATEMENTS

- A. What are the important differences in concept as between the new Canadian and the convention annual statement forms for life insurance companies?
- B. Are any of these differences in concept of sufficient significance to cause an undesirable lack of uniformity?
- C. What difficulties have been encountered in compiling the Canadian statement (1) by line of business and (2) by geographic subdivision?
- D. What problems may be anticipated in the preparation of annual statements by reason of Regulation No. 33 of the New York Insurance Department?

MR. RICHARD HUMPHRYS, in discussing section A, described the arrangement of exhibits in the Canadian annual statement and compared it to the convention blank. He stated that the differences between the Canadian and convention annual statement forms fall into two classes: the more important differences are those that are required by conditions peculiar to Canadian companies or Canadian insurance laws, while the second class consists of differences in the mechanical arrangement of items.

Of the first class, the most important are the portions of the Canadian statement that deal with the separation of funds. Fund accounting has long been established in Canadian life insurance companies, since most companies are stock companies and do both participating and nonparticipating business. Furthermore, the insurance laws in Canada limit the portion of profits under participating policies that may be appropriated for shareholders, and in order to administer these provisions it is necessary that companies establish separate funds for their participating and nonparticipating business and for certain other operations of the company such as staff pension funds and investment reserve funds.

Another important difference between the two statements is the Schedule of Currencies and Market Values, by means of which the balance sheet is adjusted for foreign currencies and for differences between book values and market values. The balance sheet is made up first on the basis of book values and book rates of exchange and then an adjustment is made under liabilities for the combined effect on the balance sheet of actual rates of exchange and market values. The somewhat elaborate schedule for this purpose is due to the large number of non-Canadian currencies involved.

Among the differences of the second type, probably the most important is the treatment of deferred premiums. In the new Canadian state-

ment, net deferred premiums are deducted from the actuarial reserves; this contrasts with the method of the convention blank in which net deferred premiums are shown as an asset. The method of the Canadian statement was adopted as the more theoretically correct basis. While some problems have been encountered in making the transition to the new method, it should work well in the future.

While the convention blank provides for earmarking special surplus funds apart from liabilities, the Canadian form does not provide for any subdivision of surplus but requires that, if a special reserve is needed, its purpose be stated and the reserve set up as a liability.

In discussing section B, Mr. Humphrys stated that, when the new Canadian statement form was established, every effort was made to avoid any unnecessary differences between the two statements. Some differences were inevitable, however, as a result of conditions peculiar to Canadian companies or Canadian laws.

With respect to section C, he reviewed the difficulties involved in establishing a satisfactory basis for geographic classifications.

There are two problems in this connection so far as the Canadian statement is concerned, the first dealing with the subdivision of premiums, claims, insurance effected and insurance in force by province, and the other dealing with the completion of the out-of-Canada section of the statement. As respects the provincial exhibits, the main problems seem to be whether they should be completed on the basis of current residence or residence at issue, and how to determine items of income and disbursement on a revenue basis. Current residence is probably an appropriate basis, and most companies would probably be able to produce the information by current residence easily enough. However, some companies maintain their records by province on the basis of residence at issue, so far as the business in force and the business effected are concerned.

Many companies may have difficulty in preparing a provincial distribution of revenue figures, and consequently reasonably good approximations are acceptable. It was thought preferable to adhere to the revenue basis throughout the statement, even at the expense of some approximations, rather than to have some exhibits on a cash basis.

The main difficulty with the geographical classification relates to the out-of-Canada business. Under Canadian legislation it is necessary to account for "policies in Canada," which are defined by law as policies issued by registered companies on the lives of persons resident in Canada at the date of issue. In order to secure information in the statement on "policies in Canada," the out-of-Canada portion of the statement should be completed on the basis of residence at issue and should include only policies

that were issued in jurisdictions out of Canada. If this method were followed, then the business shown in the out-of-Canada section of the statement would not agree with the business shown as "out-of-Canada" in the provincial exhibits, where the latter are completed on the basis of current residence.

A further difficulty arises in companies that collect premiums and pay claims through branch offices. The transfer of policies between branch offices gives rise to some difficulty in attempting to settle upon a uniform and logical basis of classification. The whole matter must receive further study and in the meantime the companies have been permitted to report on whatever basis they have been using hitherto.

The problem must also be considered in the light of the requirements for British and foreign companies doing business in Canada. They must record in their Canadian statement all of their "policies in Canada" regardless of current residence. Thus it seems to be a practical necessity to have the policy exhibit and the liability page completed on the basis of residence at issue, and this may differ from the basis used for the reporting of income and expenditure. These latter are frequently on the basis of current residence. However, some companies have found it possible to adhere to the residence-at-issue basis throughout.

MR. J. S. THOMPSON, JR., stated that the new annual statement forms adopted by the Dominion authorities follow the approach used in the current convention blank to a certain degree. For instance, (a) balance sheet items are shown only in total for important categories of liabilities, with detail relegated to supporting exhibits, (b) instructions for completion of the statement blank are quite exhaustive and are separate from the statement itself and (c) the statement of income is on the revenue basis. There are, however, a few differences in concept between the two statements.

The deduction of net deferred premiums from the policy reserve in the Canadian statement, while uncollected premiums less the cost of collection are set up as an asset, implies that premiums are not incurred until they fall due. In the convention blank, on the other hand, it is assumed that a full annual premium is incurred on policy anniversaries, since both deferred and uncollected premiums are taken as assets.

Exhibit 11 of the new Canadian blank is a reconciliation of reserves for funds on deposit at the end of the year with deposits, withdrawals and reserves at the beginning of the year. A reconciliation of this type, which does not have a counterpart in the convention blank, can serve as a useful check on the valuation and can also be the basis for determining gains or losses. The acceptance of funds for deposit is subject to a gain or loss

from interest and, when the valuation interest basis differs from the contractual basis, there is a further source of gain or loss from withdrawal. Accordingly, it appears that Exhibit 11 in the Canadian statement can serve a useful purpose.

There are several other differences between the Canadian and U.S. statements although generally basic concepts are not involved. Some of these differences are the following:

1. The accident and sickness business of a life insurance company is reported in its life statement in the United States, but in Canada the accident and sickness business is reported in a separate casualty statement.
2. While the Canadian and U.S. statements call for substantially similar treatment of settlement annuities involving life contingencies, there are differing points of view on the proper treatment of the instalment types of settlement contracts without life contingencies. In the Canadian statement, such contracts are grouped with supplementary contracts with life contingencies in the Valuation Summary and the annuity exhibit. In the U.S. statement, on the other hand, all supplementary contracts without life contingencies are excluded from the annuity exhibit and the policy reserve liability. The "interest only" types of settlement contracts are treated essentially alike in the two statements: reserves for such contracts are reported separately from the policy reserve liability and they are excluded from the annuity exhibits.
3. The state distribution of premiums in Schedule T of the U.S. statement is normally based on cash premiums. The corresponding exhibit in the Canadian exhibit is required to be on the revenue basis.

MR. G. F. S. CLARKE, in discussing section A, compared the similarities of the Canadian and U.S. statements. As for differences between the two statement forms, he noted the following:

1. Unlike the U.S. statement, the Canadian statement is on the revenue basis throughout and thus does not impose any restrictions on the use of modern accounting systems.
2. The deduction of net deferred premiums from the actuarial reserve reduces both assets and the actuarial reserve compared to the comparable items in the U.S. statement.
3. The actuarial reserve in the new Canadian form includes the accrued liability under disability claims. The accrued liability is shown separately as an outstanding benefit in the convention blank.
4. The revenue account has a single entry for policyholders' funds on deposit, namely interest credited to such funds. The income and disbursement items appear in a supporting exhibit rather than in the revenue account as in the convention blank.
5. In the new Canadian form, premiums waived on account of death or disability are excluded from premium income.

In discussing section B, Mr. Clarke stated that it is unfortunate that the two annual statement forms are not strictly comparable with respect to the major items.

With respect to section C, he pointed out that there is some question as to whether settlement annuities should be grouped with ordinary annuities or classified according to the contracts from which the settlement annuities originate. A similar question exists with respect to disability annuity benefits.

The geographic distributions required by the Canadian statement may create some difficulties in most companies. Optional methods were permitted in the 1954 statement, however.

MR. HENRY BRADSHAW, in discussing sections A and B, pointed out that the Canadian and convention statements are now alike in more respects than at any time in the past. The differences between the two statements may be classified in four groups, according as they are required by differences in the insurance laws or represent differences of opinion, and also according as they represent significant or insignificant differences.

Mr. Bradshaw, focusing his attention on the differences between the two statements that do not appear to be mandatory, outlined the following significant differences, in addition to the difference in treatment of net deferred premiums which had already been mentioned:

1. Net outstanding premiums are obtained from the gross by deducting loading in the case of the U.S. blank and estimated cost of collection in the Canadian. A similar difference used to exist for deferred premiums but this has now been eliminated. In addition, the U.S. blank requires a liability to be set up for any cost of collection in excess of loading on both outstanding and deferred premiums, thus in effect requiring each company to adopt the more conservative of the two approaches.
2. The convention blank permits holding as special surplus funds such items as reserve for contingencies, asset fluctuations, etc., whereas in Canada these must be shown as liabilities.
3. In the convention blank, the reserve for unreported and unpaid disability claims must be split into accrued and unaccrued with the latter being included in actuarial reserves. This split is quite arbitrary and has been eliminated in the Canadian statement by including the provision for unreported disability claims in actuarial reserves and the unpaid claim liability in outstanding payments.
4. On page 4, the Canadian blank provides a single entry for amounts on deposit—namely, the interest credited during the current year. The U.S. statement is less consistent in that it follows this method for premium deposit funds only.

5. The Canadian Department of Insurance will not permit premiums waived on account of disability to be shown as a cross-entry in premiums and claims. In the U.S., however, this cross-entry is not only required but is unavoidable because of the fact that disability is regarded as a separate line of business on page 5.
6. The convention blank makes provision for the reporting of furniture on a depreciation basis in the Summary of Operations. In the Canadian statement the entire cost of furniture must be charged as an expense in the year of purchase.
7. An inconsistency exists between the policy exhibits of the two statements. In the United States and formerly in Canada, group insurance contracts shared by several companies have been treated in the same manner as ordinary reinsurance: the principal company has carried the full amount in its statement while the other companies have carried their portion only. The Canadian Department of Insurance has ruled that this type of arrangement is not reinsurance in the normal sense but is simply a sharing of the business. Hence each company, including the so-called principal company, must show only its share of all group business. This method has introduced a difference in the basis of quoting total placed and in force figures in Canada and the United States. On the other hand, the Canadian Department requires that each company participating in a shared group report the total number of certificates in its policy exhibit. This produces some anomalous results as between number of certificates and amounts of insurance.

In closing, Mr. Bradshaw expressed the wish that an effort might be made to reconcile the differences that still exist between the Canadian and convention blanks.

MR. R. G. ESPIE stated that the new Canadian blank represents an improvement over the U.S. form in that the former has completely dropped the expressions admitted and nonadmitted assets. The Canadian form has also omitted the concept of ledger assets as compared to non-ledger assets.

The principal difference of approach of the two statements is that Canada still requires a separate statement for accident and health business in a form designed for casualty insurance. This approach, however, does not appear to place an undue burden on life insurance companies reporting their accident and health business in Canada.

The requirement that Canadian companies report data for operations out of Canada separately from their Canadian business is not paralleled by similar requirements in the convention blank. This gives rise to difficulties in defining business geographically and some of these difficulties are reflected in the forms that U.S. companies are required to file in Canada.

Mr. Espie commented on the difference between the two statements with respect to the line-of-business distributions that are required. While the Canadian statement does not require separations of disability benefits, double indemnity benefits and supplementary contracts in its line-of-business analysis, it does ask domestic Canadian companies that participating business be kept separate from nonparticipating. Staff pension funds are also required to be kept separate. These requirements are more appropriate for Canadian companies with their predominance of mixed companies, which are the exception among U.S. companies.

On the asset page the Canadian statement still restricts amortization to central government issues and provincial issues. In the analysis of operations, the Canadian blank stipulates that unusual or nonrecurring items that would disturb comparisons are to be shown only in the surplus reconciliation block. This contrasts with the philosophy of New York Regulation 33 which, for example, says the "recovery of extraordinary amounts of taxes and expenses paid in prior years" should be in the Summary of Operations. In the expense exhibit the Canadian blank makes no distinction between claim and acquisition categories. Legal fees for defending policy claims are merged with other legal fees; medical examination fees for policy issue are similarly combined with other examination fees.

The policy exhibit in the Canadian statement requires that increases under group insurance be separated into those due to new certificates and those due to increases under existing certificates. Terminations of coverage are separated into those with conversion and those without. This latter subdivision does not seem to serve any useful purpose.

Mr. Espie offered the opinion that the Canadian Insurance Department had done an excellent job in its revision of the annual statement blank and had reduced to comparatively minor proportions the differences between U.S. and Canadian reporting standards.

In discussing section D, Mr. Espie stated that in general he does not anticipate his company will have any serious mechanical difficulties in fulfilling the requirements of Regulation 33, since their Expense Analysis Department has had considerable experience with Regulation 30 of the New York Insurance Department, which is the uniform accounting regulation in the fire and casualty business. There are, however, two aspects of Regulation 33 that may create some difficulties:

1. Regulation 33 requires that rent paid directly from the Home Office for general agencies be classified in the rent line of the expense exhibit. Moreover, such rent must be reclassified as agency expense in the footnotes of the expense exhibit. This method requires considerably more work than the

practice of assigning such rents to agency expense allowance and appears to be both inefficient and pointless.

2. Regulation 33 specifies the method of reporting expenses of personnel or facilities used in common or otherwise shared by two or more companies. This requirement has been taken virtually verbatim from Regulation 30 and, while it does have meaning for fire and casualty companies where pooled management and the operation of company fleets are quite common, it does not appear to have any real purpose to the life insurance business. The operation of company fleets and the practice of pooled management is so uncommon in the life insurance business as to put this problem in the class of a rarity which has no place in the convention blank. Mr. Espie felt that this problem could be handled more appropriately as a part of the routine examination than by specifying methods of reporting in the annual statement.

MR. W. H. KELTON, discussing section A, described the Canadian statement form filed by British and foreign companies. This form develops no gain or loss from Canadian operations and there is no development of earnings by lines of business. Some of the provisions in the Canadian form which differ from corresponding provisions in the convention form are:

1. The entire increase in cost of collection on outstanding premiums is included with incurred commissions, although portions belong with taxes and general expenses. In the convention blank the increase in cost of collection is not carried to incurred expenses.
2. The entire liability for incurred but unreported disability claims is included in the reserve liability.
3. Premium and claim exhibits omit the development from the paid basis to the revenue basis which is included in the convention blank. There is an exhibit of outstanding claims and the investment and expense exhibits show due and accrued items at the end of the year; otherwise, only final revenue figures are called for.
4. Annuity payments must be shown separately for death benefits, disability benefits and annuity payments. This is a troublesome adjustment for a company which debits all payments under annuity contracts to annuity payments as required by the convention form.
5. The Exhibit of Annuities is similar to the Exhibit of Policies, resulting in a much more detailed analysis of annuities than required in the convention blank. The Canadian Exhibit of Annuities also contains columns for Settlement Annuities and Disability Annuities.
6. In the case of a shared Group case, the instructions require a company to enter the total number of certificates but only its share of the amount of insurance or annuities. Detailed information is required for each shared Group contract.
7. The Canadian form contains an Exhibit of Disability Benefits in force, both

before and after occurrence of disability. The value of this exhibit is questionable and some trouble is involved in completing it.

MR. G. H. DAVIS, in discussing section D, stated that one problem arising from inconsistencies between the official instructions for the annual statement and New York's Regulation 33 is due to the provision of the New York statute that requires the promulgation of a change in the regulations at least six months in advance of the year for which it is to apply. The promulgation may only be after notice and hearing. Consequently, it is impossible for New York to adopt a change in the instructions except after a lag of one or possibly two years. The National Association of Insurance Commissioners customarily adopts changes in the annual statement blank and the instructions for the current year at its June meeting after the changes are decided upon by its Committee on Blanks at a meeting in March or early April. Should New York decide to adopt a change made by the N.A.I.C., it cannot do so for the current year, and on the rare occasions when the N.A.I.C. Blanks Committee changes are not finally decided upon until June, a two year lag is made almost inevitable.