REINSURANCE ACCOUNTING: SCHEDULE F

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Introduction

Schedule F discloses an insurer's reinsurance transactions, for both ceded business and assumed business. Schedule F is one of the most complex schedules in the Annual Statement, and it has been extensively revised each year since 1989.

Reinsurance transactions are an important consideration in monitoring a company's financial strength, as demonstrated by the emphasis on reinsurance arrangements and collectibility in the NAIC Statement of Actuarial Opinion and in the Canadian Report of the Actuary.[1] Yet the lack of clear instructions for many sections of Schedule F makes it difficult to accurately complete the exhibits.

This paper explains the structure and purposes of Schedule F, as well as the relationship of the Schedule to other statutory statements. Particular emphasis is placed on the complex additions to the Schedule in recent years, such as the restatement of the balance sheet in Part 8 and the statutory "provisions" for overdue reinsurance recoverables and for recoverables from "slow-paying" reinsurers in Parts 6 and 7.

To aid the reader, this paper contains fully worked out illustrations of

- Completing the restated balance sheet (Part 8), and
- Calculating the statutory penalty for
  - Recoverables from unauthorized reinsurers (Part 5),
  - Overdue recoverables (Part 6), and
  - Recoverables from "slow-paying" authorized reinsurers (Part 7).

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[1] See the *Guidelines for Statement of Actuarial Opinion for Casualty Loss Reserves* by the National Association of Insurance Commissioners and the *Report of the Actuary or the Reserve Specialist on the Property and Casualty Business of 1992 Pursuant to the Provisions of the Canadian and British Insurance Companies Act or the Foreign Insurance Companies Act* by the Office of the Superintendent of Financial Institutions Canada. For further discussion, see Michael R. Lamb's "Statement Changes, NAIC Expectations Spelled Out for 1991," *The Actuarial Review*, Volume 19, No. 1 (February 1992), pages 8, 16, or his "1991 NAIC Casualty Actuarial Opinions," *Actuarial Digest*, Volume 10, No. 6 (December 1991/January 1992), pages 5 ff.

Structure of Schedule F

Schedule F serves three primary purposes:

- *Assumed and Ceded Reinsurance by Company:* Part 1 shows assumed premiums and losses and Part 3 shows ceded premiums and losses by type of reinsured or reinsurer.

- *Loss Portfolio Transfers:* Part 2 shows an exhibit of loss portfolio transfers, though the Notes to the Financial Statements now provide more information on this subject (see below).

- *Statutory "Penalties":* Part 4 shows an aging schedule for recoverables on paid losses and loss adjustment expenses. Part 5 calculates the statutory "provision" for non-secured reinsurance recoverables and for overdue reinsurance recoverables with unauthorized companies. Part 6 calculates the statutory "provision" for overdue reinsurance with authorized companies, and Part 7 calculates the statutory "provision" for recoverables from "slow-paying" authorized reinsurers.

- *Net versus Gross Balance Sheet:* Statutory accounting is on a "net of reinsurance" basis. Part 8 of Schedule F converts the statutory balance sheet from a net to a gross basis.

We begin with Part 8, the "restatement of the balance sheet," because of its newness and its importance for statutory accounting.

Part 8: Restatement of Balance Sheet

Part 8 of Schedule F was added with the 1992 Annual Statement.[2] This exhibit is particularly important because of the corresponding changes in GAAP accounting contained in SFAS 113, "Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts," issued in December 1992.[3]

Pages 2 and 3 of the statement, the statutory balance sheet, is on a "net of reinsurance" basis. For instance, line 1 of page 3, "losses," shows the loss reserves net of reinsurance recoverable on unpaid losses. Similarly, line 9 of page 2, "Agents' balances," shows the balances due from agents net of ceded premium balances due to reinsurers.

Reinsurance recoverables rarely reduce an insurer's legal liability to claimants. An insurer with a $1,000,000 unpaid loss which is fully reinsured would show a net unpaid loss liability of $0 on line 1 of page 3. Yet the insurer's obligation to the claimant is independent of the reinsurance transaction. GAAP now requires that the insurer show the full $1,000,000 loss

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[2] All the sections of Schedule F were renumbered in 1993. The 1993 Part 8 was Part 1 in 1992.

[3] A summary of SFAS 113 may be found in Aaron Halpert and Preston Kavanagh, "The Actuary and FASB #113," *the Actuarial Digest*, Volume 12, No. 3 (June/July 1993), pages 4, 12, 13.

liability, along with a corresponding $1,000,000 asset for the anticipated reinsurance recoverables. This enables readers of the financial statements to differentiate between

A. A $0 net loss liability consisting of a $0 direct loss liability and a $0 recoverable, and
B. A $0 net loss liability consisting of a $1,000,000 direct loss liability and a $1,000,000 reinsurance recoverable.

The statutory balance sheet on pages 2 and 3 of the Annual Statement remains on a net basis. Part 1 of Schedule F shows a restated balance sheet on a gross of reinsurance basis, with all recoverables from reinsurers shows as a separate asset.

An Illustration

Statutory accounting for reinsurance sometimes seems complex. So let us follow a simplified reinsurance transaction to illustrate the effects on page 2, page 3, and Schedule F, Part 8.

Suppose an insurer writes a Commercial Automobile policy with a $10,000 premium on December 31, 1992, and includes the contract under its 50% quota share reinsurance treaty with a non-affiliated authorized reinsurer. It incurs one loss for $6,000 on October 1, 1993, which it pays on July 1, 1994. It collects the recoverable from its reinsurer on March 1, 1995. For simplicity, assume that all premium is paid on the policy effective date, the primary company incurs no expenses, and there is no reinsurance commission on this treaty.

First Year – Unearned Premiums

On December 31, 1992, the primary company collects $10,000 from the insured and pays $5,000 to the reinsurer. In its 1992 Annual Statement, the company shows $10,000 of direct premiums on page 8, "Underwriting and Investment Exhibit," Part 2B, "Premiums Written," column 1. It shows $5,000 of ceded premium on page 8, Part 2B, column 3b. The "net premium written" in column 4 of this exhibit is $10,000 – $5,000, or $5,000.

Since the earned premium on December 31, 1992, is $0, the unearned premium reserve is $10,000 gross of reinsurance and $5,000 net of reinsurance. The *net* unearned premium reserve is carried to page 8, Part 2A, "Recapitulation of all Premiums," and to page 7, Part 2, "Premiums Earned."[4]

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[4] The caption for page 8, Part 2A says "Gross premium (less reinsurance) . . ." The footnote says, "By gross premiums is meant the aggregate of all the premiums written in the policies or renewals in force." In other words, the "gross" premiums in this exhibit are actually "net" of reinsurance. [The term "gross" is used in several ways in insurance accounting. It may mean "gross of reinsurance," "gross of expenses," "gross of return premiums," "gross of deductible," etc.]

Second Year – Loss Reserves

On December 31, 1993, the entire policy premium has been earned, so both the gross and the net unearned premium reserves are $0. Since a $6,000 loss was incurred on October 1, 1993, and remains unpaid as of December 31, 1993, there is a gross loss reserve of $6,000. The primary company has a 50% quota share treaty, so the net of reinsurance loss reserve is $3,000.

In Schedule P, Part 1C, the company will show $10,000 of "direct and assumed" earned premium in column 2, $5,000 of ceded earned premium in column 3, and $5,000 of net earned premium in column 4. In addition, it will show $6,000 of "direct and assumed" case basis losses unpaid in column 13, and $3,000 of ceded unpaid losses in column 14. The net unpaid loss is $3,000.

Page 10, Part 3A, "Unpaid losses and loss adjustment expenses," shows the direct loss reserve of $6,000 in column 1a, the ceded loss reserve of $3,000 in column 2, and the net loss reserve of $3,000 [= $6,000 – $3,000] in column 3. The net loss reserve flows through to page 9, Part 3, "Losses paid and incurred," column 5, "net losses unpaid."

Third Year – Paid Losses

On December 31, 1994, the primary company has paid $6,000 to the claimant, but it has not yet recovered any money from the reinsurer. Both the direct and ceded loss reserves on page 9 (columns 1a and 2, respectively) are set to zero. Page 9, column 1, "losses paid less salvage on direct business," shows $6,000, while column 3, "reinsurance recovered," shows zero. The reinsurance recoverable now appears as an asset on page 2, line 12, "Reinsurance recoverable on loss and loss adjustment expense payments," not as a contra-liability.

The gross of reinsurance unearned premium reserve is not shown on these exhibits. The gross of reinsurance loss reserve may be determined from Schedule P, except that the Schedule P definition of reinsurance differs from the Schedule F definition of reinsurance.[5]

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[5] When an insurance group has an intercompany pooling agreement among affiliated carriers, Schedule P treats the premiums and losses as direct business, not as ceded and assumed business, regardless of which company's paper the business is written on. Schedule F, however, treats the business as ceded and assumed, depending on which company issued the policy. Other exhibits in the Annual Statement follow the Schedule F definition, not the Schedule P definition.

Thus, the net figures in Schedule P equal the net figures elsewhere in the Annual Statement, but the "direct and assumed" and the "ceded" figures may not equal the corresponding figures in other exhibits. For instance, the "net earned premium" in the Schedule P, Part 1 Summary, column 4, line 11 [= current year] should equal the net premiums earned in the current year on page 7, "Underwriting and Investment Exhibit," Part 2, "Premiums Earned," column 4, line 32 [= totals]. Similarly, the net losses unpaid excluding loss adjustment expenses on page 10, Part 3A, column 5, line 32 ("total") should equal the net losses unpaid from the Schedule P,

Fourth Year – Reinsurance Recoveries

By December 31, 1995, the primary company has received payment from the reinsurer. The page 2 asset, "Reinsurance recoverable on loss and loss adjustment expense payments," is eliminated, having been replaced by cash (or other assets).

This illustration is used below to explain the entries in the Schedule F, Part 8 exhibit.

The Part 8 Exhibit

Schedule F, Part 8, "Restatement of Balance Sheet to Identify Net Credit for Reinsurance," allows the annual statement user to see the effects of ceded reinsurance transactions on the company's balance sheet.[6] All items from pages 2 and 3 are carried to this exhibit, though only the lines most relevant to reinsurance transactions are shown separately. Other lines are combined as "other assets" (line 5 in Schedule F, Part 8) and "other liabilities" (line 15 in Schedule F, Part 8).

Schedule F, Part 8 (page 56 of the 1993 Annual Statement) has the following entries: [The "Item" numbers refer to the line numbers on pages 2 and 3 of the Annual Statement.]

Part 1 Summary, line 12 ("totals"), columns 13 – 14 + 15 – 16. But the component pieces, the "direct and assumed" and the "ceded," may not correspond between Schedule P and Page 10 if there is an intercompany pooling agreement among affiliated carriers. In other words, Schedule P, columns 14 + 16 may not equal Page 10, columns 2 + 4c. Similarly, Schedule P, columns 13 + 15 may not equal Page 10, columns 1a + 1b + 4a + 4b. (Note that Page 10, column 1b, makes an explicit reference to Schedule F; there are no such references to the ceded amounts in Schedule P.)

[6] Cf. the *NAIC Proceedings*, 1991 Volume IIA,: Attachment Five-B: "Reinsurance Working Group of the Blanks (EX4) Task Force," February 7, 1991, page 464: "The first charge involves the development of a new exhibit to the annual statement which would recast the balance sheet (pages two and three of the annual statement) to a gross basis of reporting."

Restatement of Balance Sheet to Identify Net Credit for Reinsurance

ASSETS (Page 2)

1. Cash and invested assets (Item 8A)
2. Agents' balances or uncollected premiums (Item 9)
3. Funds held by or deposited with reinsured companies (Item 10)
4. Reinsurance recoverables on loss and loss adjustment expense payments (Item 12)
5. Other assets (Items 11 and 13 through 20)
6. Net amount recoverable from reinsurers

7. Totals (Item 21)

LIABILITIES (Page 3)

8. Losses and loss adjustment expenses (Items 1 and 2)
9. Taxes, expenses, and other obligations (Items 3 through 8)
10. Unearned premiums (Item 9)
11. Dividends declared and unpaid (Item 10)
12. Funds held by company under reinsurance treaties (Item 11)
13. Amounts withheld or retained by company for account of others (Item 12)
14. Provision for reinsurance (Item 13)
15. Other liabilities (Items 14 through 21)

16. Total Liabilities (Item 22)

17. Surplus as regards policyholders (Item 25)

18. Totals (Item 26)

For each entry, there are three columns:

1. As Reported (net of ceded)
2. Reinsurance Adjustments
3. Restated (gross of ceded)

Restatement of Liabilities

Let us begin with the "Liabilities" section of this exhibit. Line 8, "losses and loss adjustment expenses (Items 1 and 2 of page 3)," may be illustrated with the Commercial Auto example above. Column 1 of this exhibit shows the net of reinsurance amounts that are reported on page 3. Column 2 of this exhibit shows the required restatement to exclude the effects of ceded reinsurance. Column 4 of this exhibit shows the gross of reinsurance amounts. In the example, for the 1993 statement, the net 1993 losses unpaid of $3,000 would be shown in the first column, the ceded amount of $3,000 would be shown in the second column, and the gross amount of $6,000 would be shown in the third column. The figures in column 2 for these lines are generally positive amounts, since only ceded reinsurance (not assumed reinsurance) is considered.[7]

Line 10, "Unearned premiums," is similar. In the Commercial Auto example, for the 1992 statement, the net 1992 unearned premium reserves of $5,000 would be shown in the first column, the ceded amount of $5,000 would be shown in the second column, and the gross amount of $10,000 would be shown in the third column.

Line 12, "Funds held by company under reinsurance treaties," and line 13, "Provision for reinsurance," [that is, the statutory penalty for unauthorized and overdue reinsurance] are positive liabilities on page 3. If the company had no ceded reinsurance, it would have zeros on these lines. Column 2 of this exhibit therefore has negative amounts which "cancel out" any positive amounts in column 1, leaving zeros in column 3.[8]

The other lines in the liabilities section of this exhibit are less commonly used. Note that for line 17, "surplus as regards policyholders," column 2 is "X-ed out." On page 3, surplus is the balancing item; that is, it is the difference between reported assets and reported liabilities. In Schedule F, Part 8, however, line 6, "net amount recoverable from reinsurers," is the balancing item.

Restatement of Assets

On the assets section of this exhibit, line 4, "reinsurance recoverable on loss and loss adjustment expense payments (item 12 of page 2)," relates to ceded reinsurance only. The

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7 Insurance accounting differs among companies, and there are numerous exceptional situations that invalidate the general rules in the text. Thus, there are companies which show negative amounts in some of these cells. Similarly, few of the general rules mentioned later in the text are true for all companies.

8 The NAIC Annual Statement instructions, pages 56–1 and 56-2, note this "canceling out" by saying that these liabilities

> *become offsets to the overall asset "net amount recoverable from reinsurers."*

In other words, the full amount in column 1 is reversed in column 2. Since line 6, "net amount recoverable from reinsurers," is a balancing item, they are "offsets" to line 6.

column 1 entry is canceled by a negative entry in column 2, leaving a zero in column 3.[9]

Line 3, "funds held by or deposited with reinsured companies (item 10 of page 2)," relates to assumed reinsurance, not ceded reinsurance. Most companies show a zero in column 2 for this line.[10]

Line 2, "agents' balances or uncollected premiums (item 9 of page 2)," generally has a net amount in column 1 that has been reduced for ceded reinsurance transactions. This reduction is also shown on page 12, lines 9.1 and 9.2:

"after deducting ceded reinsurance balances payable of $____."

The column 2 entry should equal the amount shown on page 12. In general, the column 2 entry is positive, leaving a greater figure in column 3.

Line 1, "cash and invested assets," and line 5, "other assets," are used by some companies, while other companies show zeros in column 2 for these lines.[11]

Line 6, "net amount recoverable from reinsurers," is the balancing item. It is the amount needed so that line 7, "total assets," column 2, equals line 16, "total liabilities," column 2.

Part 1: Assumed Reinsurance

Parts 1 of Schedule F shows a listing of assumed reinsurance relationships by reinsured company. The listings are subdivided where appropriate by affiliated *versus* unaffiliated company, U.S. *versus* alien company, and type of company (mandatory pools *versus* voluntary pools *versus* other companies).[12]

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[9] The NAIC Annual Statement *Instructions*, page 56–1, note this by saying

This item (Page 2, Line 12) would become part of the asset, "net amount recoverable from reinsurers."

[10] The NAIC *Instructions* have no comment on this line, though the illustration in the NAIC *Proceedings* does show a zero entry for this line.

[11] For instance, one company shows line 1 as a balancing item to line 12 in its 1992 statement. Line 12 shows "funds held under reinsurance treaties." If there were no ceded reinsurance, the primary company would not have these funds, so "cash and invested assets" are reduced by the same amount.

[12] See the NAIC Annual Statement *Instructions*, page 49–1, "Group or Category Line Number."

Assumed reinsurance transactions are of four types:

- Losses payable to the reinsured company.
- Net premiums receivable from the reinsured company.
- Contingent commissions receivable from or payable to the reinsured company.
- Funds deposited with or letters of credited provided for the reinsured company.

Losses Payable

Losses payable to the reinsured company may be divided into four categories, shown in columns 1 through 4 of Part 1. To clarify the entries in each column, let us use a simple illustration. Suppose the company completing Schedule F provided reinsurance coverage to a ceding insurer effective January 1, 1993. Accidents occurring in 1993 and covered by the reinsurance treaty should be reflected in the company's Schedule F, Part 1.

0. Some losses will have been paid by the reinsured to the claimant and reimbursed by the company before December 31, 1993. These amounts are already paid by the assuming insurer, and they do not appear in Schedule F. [They do appear, however, in the Underwriting and Investment Exhibit on page 9 and in the Income Statement on page 4.]

1. Some losses will have been paid by the reinsured to the claimant but not yet reimbursed by the company before December 31, 1993. These amounts are reported in column 1 of Part 1 of Schedule F: "Reinsurance on paid losses and loss adjustment expenses." The total for all reinsured companies should agree with the entry on line 1A of page 3, the liability side of the statutory balance sheet: "Reinsurance on paid loss and loss adjustment expenses."[13]

2. Some losses will have been reported to the reinsured company but not yet paid by December 31. The assuming insurer can not reimburse the reinsured for unpaid losses (though it might deposit funds or provide letters of credit as security). These amounts are reported in column 2 of Part 1 of Schedule F: "Reinsurance on known case losses and LAE."

   Part 1 of Schedule F combines losses and loss adjustment expenses. The Underwriting and Investment Exhibit, page 10, "Unpaid losses and loss adjustment expenses," shows loss reserves separately for direct, assumed, and ceded business. For loss adjustment expense reserves, however, only the net amount is shown. Thus, there is no cross-check between column 2 of Schedule F, Part 1, and other exhibits in the Annual Statement.

3. Some losses occurring in 1993 will not have been reported to the ceding company by December 31. The ceding insurer may establish "incurred but not reported" (IBNR) loss reserves, and notify the reinsurer of the estimated amounts. The reinsurer may then establish corresponding loss reserves to cover the eventual payments to the reinsured. These amounts are reported in column 3 of Part 1 of Schedule F: "Reinsurance on IBNR losses and LAE."

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[13] Entries on the balance sheet are in dollars, whereas entries in Parts 1, 3, 4, and 5 of Schedule F are in thousands of dollars. Thus, the Part 1, column 1, total should be multiplied by 1,000 before comparison with the page 3, line 1A entry.

4. The ceding insurer may not have informed the reinsurer of all IBNR losses by December 31, for various reasons. First, there is a reporting lag: the reinsured company may set its IBNR reserves in January 1994 but not inform the reinsurer until several months later. Second, the reinsured company generally has no obligation to inform the reinsurer of its estimated IBNR losses recoverable. In fact, the reinsured company may not even have estimated how much of its gross IBNR loss reserves are covered by each reinsurance treaty.[14] Third, the ceding insurer's IBNR loss estimate may be understated, and the reinsurer's own reserve estimates may indicate higher figures.

   These additional bulk reserves held by the assuming insurer for assumed business are reported in column 4 of Part 1 of Schedule F: "Reinsurance on bulk IBNR losses and LAE." Reinsurers generally produce a single bulk reserve estimate for all reinsurance treaties combined, and would not be able to allocate this amount by ceding company. The column 4 entries for individual reinsureds are therefore "X'ed" out. A subtotal, however, is reported for all reinsured companies combined.

5. Column 5 of Part 1 of Schedule F is the sum of columns 1 through 4. For individual companies, this is the sum of columns 1 through 3, since column 4 is shown only as a subtotal for all companies combined.

Premiums and Commissions

Column 6 shows "contingent commissions payable," and column 7 shows "assumed premiums receivable." The column 7 entry is net of regular commissions, which do not appear in column 6. The column 6 entry is for contingent commissions (sometimes called "profit commissions") only, and it may be either a positive or negative figure.

For instance, suppose the company has two reinsurance treaties, both with a gross premium of $1,000,000. One treaty has a fixed commission rate of 30% of gross premiums. If no premium has yet been received, the column 7 entry would be $700,000, and the column 6 entry would be $0.

The other treaty has a sliding scale contingent commission arrangement, where the commission depends on the loss ratio of the assumed business: 30% minus one half of the difference between the actual loss ratio and 70%, or

$$30\% - 0.5 \times (\text{actual loss ratio} - 70\%),$$

bounded between 10% (for an actual loss ratio of 110%) and 50% (for an actual loss ratio of 30%). Suppose also that at the last meeting between the reinsurer and the ceding company, the loss ratio was estimated at 60%, so a 35% commission was paid. Since that time, additional

[14] The Statement of Actuarial Opinion filed by the reinsured company must note both the gross loss reserve and the net loss reserve. However, the IBNR loss estimates are determined for all business combined. The reinsured company need not allocate the recoverable IBNR loss reserves by reinsurance company.

reported losses have indicated that the true loss ratio will be 80%, so the final contingent commission should be 25%. In this case, the contingent commission still payable would be a negative 10% of $1,000,000, or –$100,000.

Funds Withheld and Letters of Credit

In many instances, a reinsurer may provide funds or letters of credit to secure the balances payable to the ceding company. If the reinsurer is not authorized to transact reinsurance business in the state of domicile of the ceding company, the ceding company's reinsurance recoverables would not be admitted to reduce its net liability unless the recoverables are secured (see Part 5 below). If the reinsurer is indeed authorized but is classified as a slow paying reinsurer, 20% of the ceding company's reinsurance recoverables would not be admitted to reduce its net liability unless the recoverables are secured (see Part 7 below).[15] Finally, even if the reinsurer is both authorized and quick-paying, the ceding company may demand letters of credit to ensure that its losses will be reimbursed.

Part 1 of Schedule F shows these securing amounts in three categories:

- Column 8 shows "Funds held by or deposited with reinsured companies." These assets, owned by the reinsurer but held by the ceding company, are shown on line 10 of page 2 of the reinsurer's balance sheet (assets) and on line 11 of page 3 of the ceding company's balance sheet (liabilities).
- Column 9 shows "Letters of credit posted." The letter of credit may be issued by a bank (or other financial institution) to secure recoverables from the reinsurer. The letter of credit would not affect the reinsurer's balance sheet. However, it would reduce the statutory provision for reinsurance on the ceding company's balance sheet (if the reinsurer is unauthorized or slow-paying).
- Column 10 shows "Amount of assets pledged or compensating balances to secure letters of credit." The commercial bank issuing the letter of credit may demand that the reinsurer hold a compensating balance in an account with the bank to secure the letter of credit.[16]

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[15] More accurately, the reinsurance recoverables reduce the statement reserves of the ceding company, whether on the balance sheet (page 3, line 1), the "Underwriting and Investment Exhibit," or Schedule P, regardless of whether the reinsurer is "authorized." However, unsecured recoverables from unauthorized reinsurers, a percentage of unsecured recoverables from slow-paying reinsurers, and a percentage of overdue reinsurance recoverables from both authorized and unauthorized reinsurers, must be reported as a statutory "provision" for reinsurance on the liability side of the balance sheet (page 3, line 13).

[16] A reinsurer may have losses payable to many ceding companies. The commercial bank may issue separate letters of credit to each reinsured company, and the reinsurer may have a single compensating balance to secure the letters of credit. Footnote (A) of Part 1 of Schedule F

Part 2: Portfolio Reinsurance

Part 2 of Schedule F shows "Portfolio reinsurance effected or cancelled during the current year." Reinsurance ceded by portfolio is shown on the top half of page, and reinsurance assumed by portfolio is shown on the bottom half of page. This part of Schedule F has not been changed in recent years (except for the addition of the NAIC company code, which has been added to all the exhibits).

Note 18 to the Financial Statements now shows more complete information about loss portfolio transfers, both those effected in the current year and those effected in prior years. The Note 18 exhibits show, separately for losses and for loss adjustment expenses,

- The initial reserves transferred,
- The consideration paid or received,
- The remaining reserves recoverable or payable, and
- The cumulative amount already recovered or paid.

The Note 18 exhibits show this information separately for each loss portfolio transfer agreement, as well as aggregate information for all loss portfolio transfers combined.

Note 18 is new with the 1992 Annual Statement. It was added to replace the information from the old Schedule P, Part 4, which was removed in 1992.

Part 3: Ceded Reinsurance

Parts 3 of Schedule F shows a listing of ceded reinsurance relationships by reinsurance company. The listings are subdivided where appropriate by affiliated *versus* unaffiliated company, authorized *versus* unauthorized company, U.S. *versus* alien company, and type of company (mandatory pools *versus* voluntary pools *versus* other companies).[17]

The columns of Part 3 show the monies owed by reinsurers to the ceding company, such as unearned premiums, loss recoverables, loss adjustment expense recoverables, and reinsurance commissions, along with offsetting amounts owed to the reinsurer by the ceding company.[18] Recoverables are shown separately for losses and loss adjustment expenses. Each of these is subdivided into

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requires disclose of such arrangements.

[17] See the NAIC Annual Statement *Instructions*, page 51-1, "Group or Category Line Number."

[18] The unearned premiums would be "owed" to the ceding company only if the reinsurer cancelled the contract.

- amounts already paid by the ceding company (columns 2 and 3),
- case reserves (columns 4 and 5), and
- bulk reserves (columns 6 and 7).

The offsetting amounts are "ceded balances payable," or reinsurance premiums owed by the ceding company to the reinsurer (column 11), and "other amounts due to reinsurers," which are miscellaneous balances (column 12). These "other amounts" do not include funds held by the ceding company to offset the statutory provision for unauthorized and overdue reinsurance, which are shown instead in column 14.

Loss and Loss Adjustment Expenses

Reinsurance recoverable on paid losses and loss adjustment expenses is an asset. The total of columns 2 plus 3 from Part 3 should equal the entry on page 2, column 1, line 12, "Reinsurance recoverables on loss and loss adjustment expense payments."[19]

Reinsurance recoverable on unpaid losses and loss adjustment expenses is a contra-liability. Part 3A of the "Underwriting and Investment Exhibit," page 10, "Unpaid losses and loss adjustment expenses," shows ceded loss reserves divided between "in process of adjustment" in column 2 (or "case reserves") and "incurred but not reported" in column 4c. The totals for all lines of business combined on page 10 for columns 2 and 4c should equal the totals for all reinsurers combined in Part 3 of Schedule F, columns 4 and 6, respectively.

For loss adjustment expenses, the "Underwriting and Investment Exhibit" shows the net amount only, not the direct, assumed, and ceded pieces. Thus, there is no formal cross-check for columns 5 and 7 of Schedule F, Part 3.[20]

Unearned Premiums

Column 8 shows "Unearned premiums." The corresponding column in 1992 was titled "Unearned premiums (estimated)" [Part 1A, Section 1, Column 4]. In 1992, for unauthorized reinsurers, the actual unearned premium had to be calculated, since this contra-liability was not an admitted asset for the primary company unless the funds are secured. When there were many authorized reinsurers involved, the unearned premium reserves associated with each

[19] Parts 1, 3, 4, and 5 of Schedule F are in thousands of dollars, whereas the balance sheet (pages 2 and 3 of the Annual Statement) and the other parts of Schedule F are in dollars. Thus, the formal cross-check is "1000 times the total of columns 2 plus 3 equals page 2, line 12."

[20] Schedule P shows both loss and loss adjustment expense liabilities for ceded business. However, Schedule P uses a different definition of reinsurance than Schedule F does, so the figures may differ between the schedules.

company could be estimated as follows:[21]

A. Calculate the total unearned premium reserve for all reinsurers combined.

B. Calculate the unearned premium reserve for each unauthorized reinsurer. The sum of these reserves is the aggregate unearned premium reserve for unauthorized reinsurers.

C. The difference between "A" and the aggregate in "B" is the unearned premium reserve associated with authorized reinsurers.

D. Spread the aggregate unearned premium reserve for authorized reinsurers to companies in proportion to the premium in force for each reinsurer. In other words, if

   $UEPR_{com}$ is the unearned premium reserve for a given authorized reinsurer,
   $UEPR_{tot}$ is the aggregate unearned premium reserve for all authorized reinsurers,
   PIF_{com} is the premium in force for this authorized reinsurer, and
   PIF_{tot} is the aggregate premium in force for all authorized reinsurers,

then $UEPR_{com}$ may be estimated as

$$UEPR_{com} = UEPR_{tot} \times PIF_{com} \div PIF_{tot}.$$

In the 1993 Annual Statement, the word "estimated" has been removed from the column caption and the 1993 *Instructions* make no reference to estimation.[22]

Commissions

The commissions in column 9 refer to profit commissions, or contingent commissions. They may be either positive or negative amounts: positive if the reinsurance experience is favorable and the ceding company expects additional commissions, and negative if the reinsurance experience is unfavorable and the ceding company must return some of the commissions already received.

Regular commissions are netted with the ceded balances payable in column 11. In other words, the ceded balances are net of commissions. For instance, suppose the ceding company has a quota share reinsurance treaty with a 30% commission rate. If the gross premium balance is \$1,000,000, the ceding company would show \$700,000 in column 11. Amounts stemming

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[21] See the *NAIC Proceedings*, 1991, Volume IA, page 368.

[22] One should not infer from this that this estimation procedure is no longer permitted. Mr. Robert Graham of the General Reinsurance Corporation has suggested to me that theoretically justified estimates of the unearned premium reserve were permitted before 1992 and remain acceptable after 1992, despite the fact that only the 1992 Annual Statement *Instructions* made reference to an estimation method.

from profit commissions or contingent commissions, whether positive or negative, would be shown only in column 9.

Part 4: Aging of Ceded Reinsurance

Before 1989, there was no statutory penalty for authorized reinsurance, regardless of its presumed collectibility. In 1989, a statutory penalty for "overdue" reinsurance and for recoverables from "slow-paying" reinsurers was implemented, and a payment schedule was added to Part 1A of Schedule F. In 1993, the aging schedule was revised, the aging rules were changed, and the aging exhibit was made into the new Part 4.

The Due Date

One difficulty in developing an aging schedule is that many reinsurance treaties do not specify a "due date." In particular, ceding companies often do not bill their reinsurers immediately for small losses. Rather, they may wait until the recoverable losses accumulate above a certain level, such as $100,000, and then bill the reinsurer for the total amount.

To accommodate these concerns, the 1993 NAIC Annual Statement *Instructions*, page 52–1, say:

> *For purposes of completing Columns 1 through 5, a paid loss and paid loss adjustment expense recoverable is due pursuant to original contract terms (as the contract stood on the date of execution).*
>
> *Where the reinsurance agreements specifies or provides for determination of a date at which claims are to be paid by the reinsurer, the aging period shall commence from that date.*
>
> *Where the reinsurance agreement does not specify a date for payment by the reinsurer, but does specify or provide for determination of a date at which claims are to be presented to the reinsurer for payment, the aging period shall commence from that date.*
>
> *Where the reinsurance agreement does not specify or provide for the determination of either of such dates, the aging period shall commence on the date on which the ceding company enters in its accounts a paid loss recoverable which, with respect to the particular reinsurer, exceeds $50,000. If the amount is less than $50,000 it should be reported as currently due.*

Illustrations of Due Dates

In other words, the due date is determined as follows:

1. The reinsurance contract may specify a date by which time recoverables are due, such as "thirty days from the time of notice to the reinsurer." For instance, suppose

    - A loss occurs on March 15, 1993,
    - the loss is paid by the ceding company on August 15, 1993,

- the ceding company bills the reinsurer on September 15, 1993 (the date of notice),
- and the reinsurance contract specifies that recoverables are due within thirty days of the time of notice,

then the recoverable is due on October 15, 1993. If not paid by December 31, 1993, the recoverable is 75 days (two and a half months) overdue.

2. Suppose the dates of loss occurrence, payment, and billing as the same as above, but the reinsurance contract does not specify a date by which time recoverables are due. Instead, suppose the reinsurance contract says that claims are to be presented to the reinsurer for payment within 30 days of the date the loss is paid by the ceding company. Then the recoverable is due on September 15, 1993. If not paid by December 31, 1993, the recoverable is 105 days (three and a half months) overdue.

3. Suppose the reinsurance contract specifies neither the due date nor the presentation date. Moreover, suppose the loss was for $100,000, and when the ceding company paid the claim, it entered on its books a "paid loss recoverable" of $100,000. Then the aging period starts from August 15, 1993. If not paid by December 31, 1993, the recoverable is 135 days (four and a half months) overdue.

4. Finally, suppose the facts are as described in the paragraph above, but the loss was for $15,000, and it was the only loss recoverable from this reinsurer. To avoid excessive transaction expenses for small claims, the ceding company waits until several such claims have accumulated until seeking recovery from the reinsurer, and so does not bill the reinsurer in 1993. In this case, the claim would remain "current" through December 31, 1993.[23]

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[23] This differs from the previous dating rules. The 1992 NAIC Annual Statement *Instructions*, page 48–1, stated:

> *For purposes of completing Columns 1(a) through 1(e), a paid loss and paid loss adjustment expense recoverable is due pursuant to original contract terms (as the contract stood on the date of execution). In the absence of a specific contract date, it will be deemed due thirty (30) days after the date demand or proof of loss is provided to the reinsurer. In the event that reinsurance is placed through a broker or intermediary, notice to such broker or intermediary shall constitute notice to the reinsurer. Aging of overdue paid loss and paid loss adjustment expense recoverables begins the day after the due date.*

According to this definition, if a demand for payment (or proof of loss) is not presented until September 3, the recoverable would not be 90 days overdue by December 31, regardless of when the loss was paid by the ceding company or reinsurance recoverable was entered on the ceding company's books, since there are thirty additional days until the recoverables are overdue. The new definition eliminates the "30 day" period after presentation of demand or proof of loss to the reinsurer when the reinsurance contract is silent about due dates.

The Aging Schedule

Part 4 of Schedule F shows the following numerical columns:

1. Currently due recoverables
2 – 6. Overdue recoverables
   2. 1 to 29 days
   3. 30 to 90 days
   4. 91 to 120 days
   5. Over 120 days
   6. Total overdue (cols. 2 + 3 + 4 + 5)
7. Total due (cols. 1 + 6)
8. Percentage overdue (col 6. ÷ col. 7)
9. Percentage more than 120 days overdue (col. 5 ÷ col. 7)

For the statutory provision for reinsurance, the relevant ratio is the percentage more than 90 days overdue (see Part 5, column 9, and Part 6, column 1). These amounts are used to determine the statutory penalty for overdue recoverables and to determine which reinsurers should be classified as slow-paying (see below). Column 9 in Part 4, which shows the percentage more than 120 days overdue, is an informational column that is not used in the statutory calculations.[24]

Part 4 of Schedule F (as well as Parts 1 and 3) also shows the domiciliary jurisdiction of each reinsurer, which was not shown prior to 1993.

The Statutory Provisions for Reinsurance

Statutory accounting imposes "provisions" (or penalties) for certain types of reinsurance recoverables:

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[24] The column 9 ratio is included because the aging schedule for certain recoverables was speeded up by 30 days in 1993 compared to 1992 (see the preceding footnote). The industry advisory committee to the NAIC reinsurance study group recommended that the "cutoff" date for the statutory provision therefore be increased from 90 days to 120 days. The NAIC study group kept the cutoff date at 90 days, but provided columns to monitor the difference between a 90 day and a 120 day cutoff date.

In the 1992 Schedule F, information about 120 days overdue was not available. Rather, the overdue columns in the 1992, Part 1A, Section 1, column 1, were as follows:

- 1(a), "current and 1–29 days overdue,"
- 1(b), "30–90 days overdue,"
- 1(c), "91–180 days overdue," and
- 1(d), "over 180 days overdue."

The 1993 aging schedule replaced the "180 days" with "120 days."

- unsecured recoverables from unauthorized reinsurers,
- unsecured recoverables from slow-paying (authorized) reinsurers,
- overdue recoverables from both authorized and unauthorized reinsurers, and
- recoverables in dispute from both authorized and unauthorized reinsurers.

These statutory provision for reinsurance appears on line 13 of page 3 of the Annual Statement: "13. Provision for reinsurance (Schedule F, Part 7)."[25]

The provision for reinsurance does **not** *affect the loss reserves on line 1 of page 3, which are* net of all reinsurance. It does **not** affect the loss reserves in the Underwriting and Investment Exhibit or in Schedule P, where no distinctions are made between authorized and unauthorized reinsurers and between slow-paying and quick-paying reinsurers.

The provision for reinsurance is not necessarily a proxy for uncollectible reinsurance. For instance, the Statement of Actuarial Opinion must discuss reinsurance collectibility if it is pertinent to an assessment of loss reserve adequacy. The estimate of uncollectible reinsurance is distinct from the statutory provision for reinsurance: there may be a large provision for reinsurance despite no anticipated reinsurance collectibility problem.[26]

Note 16 to the Financial Statements discloses "uncollectible reinsurance written off during the past year." The amount of such write-offs is not related to the provision for reinsurance.

GAAP financial statements have no "provision for reinsurance." Instead, GAAP statements reduce the assets or increase the liabilities for expected uncollectible amounts, just as for other receivables. Similarly, the A. M. Best rating agency removes the provision for reinsurance from net liabilities when calculating its "adjusted" leverage ratios.[27]

On the statutory balance sheet, reinsurance recoverable on paid losses is shown as an asset (line 12 of page 2). Reinsurance recoverable on unpaid losses is shown as a contra-liability to unpaid losses (line 1 of page 3). Ceded unearned premium reserves are shown as a contra-liability to unearned premium reserves (line 9 of page 3). The provision for reinsurance is a

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[25] The 1992 Annual Statement had three lines for the statutory provisions for reinsurance:

13a. Provision for unauthorized reinsurance
13b. Provision for overdue authorized reinsurance as per Schedule F, Part 2B, Section 2
14. Provision for reinsurance (Items 13a + 13b).

Only the total provision is now shown on the balance sheet.

[26] The reverse is not true. If the primary insurer foresees greater uncollectible amounts than are provided for in the provision for reinsurance, it should increase the provision for reinsurance to cover the expected uncollectibles. See the "Other Issues" section below.

[27] See the introduction to Best's *Key Rating Guide.*

liability that relates to all three of these items.

Part 5: Unauthorized Reinsurers

Part 5 of Schedule F calculates the statutory penalty for reinsurance with unauthorized companies. The penalty consists of three parts:

- Unsecured recoverables,
- A percentage of overdue recoverables, and
- A percentage of recoverables in dispute.

Before 1991, the only statutory penalty for unauthorized reinsurance was for unsecured recoverables. There was a penalty for overdue recoverables for authorized reinsurers, even if the recoverables were secured. Authorized reinsurers noted that they were penalized more harshly than unauthorized reinsurers, if all recoverables were secured, so the penalty for overdue recoverables was added to unauthorized reinsurers as well.

Recoverables in dispute were not considered overdue, since the cause for non-payment was questions about the reinsurer's liability, not simple tardiness. Regulators noted, however, that a ceding company could avoid the penalty for overdue recoverables by classifying the recoverables as "in dispute." A penalty for recoverables in dispute was therefore added in 1993.

Penalty for Unsecured Recoverables

Part 5 shows the following figures for unauthorized reinsurers.

- Column 1 shows total recoverables, consisting of net unearned premiums, all loss recoverables, and contingent commissions. This figure should agree with the corresponding entry in column 10 of Part 3 of Schedule F.

Columns 2 through 6 show the funds securing the recoverables, consisting of

- funds held by the company under reinsurance treaties (column 2),
- letters of credit (column 3),
- ceded balances payable (column 5), and
- miscellaneous balances (column 6).

Column 7 shows the sum of these amounts. The amount of securitizing funds is capped at the amount of recoverables; that is, column 7 may not exceed column 1. Column 1 minus column 7, shown in column 8, is the amount of unsecured recoverables from unauthorized reinsurers.[28]

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[28] In the 1989 through 1992 versions of Schedule F, these amounts were termed "debits" and "credits." The "debits," or the amounts held by unauthorized reinsurers for the account of the primary company, were those items which appeared as assets on line 12 of page 2 of the statutory balance sheet or as contra-liabilities on lines 1 and 9 of page 3. The "credits"

Overdue Recoverables

"Overdue recoverable" in Part 5 are those recoverables from unauthorized reinsurers that are at least 90 days overdue, as shown in the aging schedule in Part 4. The amount of overdue recoverables *not in dispute* are shown in column 9 of Part 5: "Recoverable paid losses and LAE expenses over 90 days past due not in dispute."

Twenty percent of the amount of overdue recoverables are an additional statutory penalty, but this penalty may not exceed the amount of funds securitizing the total recoverables. To see the reason for this, suppose that there are $100 million of recoverables from an unauthorized reinsurer, $50 million of which are "overdue," and there are letters of credit totaling $5 million. The amount of unsecured recoverables is $95 million [= $100 million – $5 million], and twenty percent of the overdue amount is $10 million. The total penalty would be $105 million, which is unreasonable since the total recoverables are only $100 million. The penalty for overdue recoverables is therefore limited to the amount of securitizing funds, so the total penalty in this case is $100 million [= $95 million + $5 million]. The penalty is shown in column 11: "Smaller of col. 7 or col. 10 [=20% of the amount in column 9]."

Amounts in Dispute

Amounts in dispute are not included in column 9, the "overdue recoverables," but are included in column 1, the "total recoverables." Dispute is defined as litigation, arbitration, or notification, where notification means "a formal written communication from a reinsurer denying the validity of coverage" (NAIC 1993 *Instructions to the Annual Statement*, page 53-1). The treatment of amounts in dispute is the same as the treatment of overdue recoverables: 20% of the amounts in dispute are a statutory penalty, but this figures is limited by the amount of securitizing funds. The penalty is shown in column 12: "Smaller of column 7 of 20% of amount in dispute included in col. 1."

Column 13 shows the sum of the three penalties: unsecured recoverables, 20% of overdue recoverables, and 20% of amounts in dispute. This sum is limited by the total recoverables. Column 13 reads:

> "Total provision for unauthorized reinsurance: smaller of col. 1 or cols. 8 + 11 + 12."

- Column 2 is the total recoverables.
- Column 8 is the unsecured recoverables.

(offsetting balances) were those items which appeared as liabilities on line 11 of page 3.

The subdivision by type of credit was new with the 1992 Annual Statement. Securing agreements are not fail-safe. The subdivision allows the reader to better analyze the types of securing funds held by the primary company on behalf of unauthorized reinsurers. For an example of potential problems with letters of credit, see Howard W. Greene, "Retrospectively-Rated Workers Compensation Policies and Bankrupt Insureds," *Journal of Risk and Insurance*, Volume 7, No. 1 (September 1988), pages 52-58.

- Column 11 is 20% of the overdue amounts.
- Column 12 is 20% of the amounts in dispute.

This penalty is carried to footnote (6) of Part 7: "Provision for unauthorized reinsurance: Schedule F - Part 5, column 13."

Part 6: Overdue Authorized Reinsurance

Part 6 of Schedule F calculates the statutory penalty for overdue recoverables from authorized reinsurers. For each reinsurer, the ratio is calculated of (i) recoverables more than 90 days overdue to (ii) all recoverables on paid losses and loss adjustment expenses plus amounts received in the prior 90 days. This ratio is shown in column 4. If the ratio is 20% or greater, the reinsurer is classified as "slow-paying"; otherwise, the reinsurer is not "slow-paying."[29]

"Overdue recoverables" shown in column 1 and total recoverables are shown in column 2. Amounts in dispute are excluded from both the overdue recoverables and from the total recoverables. Thus the overdue recoverables in column 1 of Part 6 equal the sum of the entries in Part 4, column 4 ["91 to 120 days overdue"] and Part 4, column 5 ["Over 120 days overdue"], minus amounts in dispute (see footnote A). The total recoverables in column 2 of Part 6 equal the sum of the entries in Part 3, column 2 ["Recoverables on paid losses"] and Part 3, column 3 ["Recoverables on paid LAE"], minus amounts in dispute (see footnote B).

For instance, suppose that

- The primary company collected $5 million in loss and loss adjustment expense payments from a reinsurer between October 1, 1993, and December 31, 1993.

- The remaining recoverables on paid losses and loss adjustment expenses on December 31, 1993, from this reinsurer are $35 million.

- Of these recoverables, $15 million are classified as "overdue".[30]

The ratio in column 4 of Part 6 is [$15 million ÷ ($35 million + $5 million)] = 37.5%. This reinsurer would therefore be classified as "slow-paying."

For reinsurers that are *not* slow-paying, the overdue amounts in column 1 are carried to

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[29] The Annual Statement itself provides no terms to differentiate "slow-paying" authorized reinsurers. Robert Graham has noted to me that the industry advisory committee to the NAIC reinsurance study group has used the term "a triggering company" to indicate a company that exceeds the 20% test and triggers an additional statutory provision for reinsurance.

[30] The aging schedule depends on the reinsurance treaty provisions, as discussed in the section on "Part 4: Aging of Ceded Reinsurance." The illustration assumes that the "due dates" for these $15 million of recoverables were prior to October 3.

column 5. For these reinsurers, amounts in dispute that are excluded from the total recoverables in column 2 are carried to column 6. Twenty percent of the column 6 amount is reported in column 7. To this figure is added 20% of the overdue amount in column 5, and the sum is reported in column 8.[31] This penalty is carried to footnote (4) on Part 7.

Part 7: Slow-Paying Authorized Reinsurers

Reinsurers that *are* slow-paying are treated like unauthorized reinsurers, except that the *statutory penalty is the greater of 20% of the unsecured recoverables and 20% of the overdue* amounts. Column 8 is the total unsecured recoverables and column 9 is the "greater of column 8 or Schedule F, Part 6, column 1, which is the overdue amount." The column 9 total is carried to footnote (1), 20% of which is carried to footnote (3).[32]

The Provision for Reinsurance

The footnotes in Part 7 show the provisions for reinsurance.

- Footnote 3 shows the provision for slow-paying authorized reinsurers.
- Footnote 4 shows the provision for authorized reinsurers that are not slow-paying.
- Footnote 5 shows the total provision for authorized reinsurers [= footnotes 3 + 4].
- Footnote 6 shows the provision for unauthorized reinsurers.
- Footnote 7 shows the total provision for reinsurance [= footnotes 5 + 6], which is carried to page 3, line 13.

Other Estimates

The primary company may believe that more than 20% of the overdue amounts from certain reinsurers, or more than 20% of the recoverables from slow-paying reinsurers, or more than 20% of the amounts in dispute, may be uncollectible. The NAIC Annual Statement instructions, pages 53-2, 54-1 and 55-1 note that "<u>If the company's experience indicates that a higher amount should be provided such higher amount should be entered.</u>" In other words, the statutory

[31] In other words, the penalty is 20% of the sum of the overdue amounts and the amounts in dispute.

[32] The subtitle for Part 6 reads "Provision for overdue authorized reinsurance," and the subtitle for Part 7 reads "Provision for overdue reinsurance." The Part 7 exhibit in the Annual Statement does not indicate that only slow-paying authorized reinsurers are to be included. However, the NAIC *Instructions to the Annual Statement* have the more complete subtitle: "Provision for overdue reinsurance (authorized over 20%)."

penalty is a minimum.[33]

Residual Markets

The NAIC *Instructions* regarding Part 4 note that "all recoverables from mandatory pools should be reported . . . as being current" (page 52-1). Servicing carriers for residual market pools, as are used for workers' compensation, commercial automobile, and Massachusetts personal automobile, cede the involuntarily written business to the pool. Pools are often slow payers, since they may make only quarterly transactions with servicing carriers and with pool members. The servicing carriers may find that much of the recoverables are more than 90 days overdue and would not be admitted on the statutory financial statements. This would be a disincentive for insurers to act as servicing carriers, thereby exacerbating availability problems in these lines of business. To avoid such problems, the NAIC imposes no statutory reinsurance penalties for business ceded to residual market pools.

Illustrations

Many of the exhibits in Schedule F are new, complex, and only sparsely documented in the NAIC *Instructions to the Annual Statement*. An unfortunate result is that many of the 1992 statutory statements were replete with errors in Schedule F.

The explanations in the preceding sections of this paper are abstract. The following sections present several examples, to familiarize the practicing actuary with the mechanics of completing these schedules.

I. Restatement of Balance Sheet

Assume that you are the actuary for a medium size commercial lines insurer that has substantial reinsurance transactions. You have been asked to complete Schedule F, Part 8, of the 1993 Annual Statement. You have filled in the entries in the first column, using the figures from pages 2 and 3 of the statutory blank, as shown on the exhibit on the following page. The reinsurance accounting department in your company provides you with the following additional information:

1. Line 9.1 on page 12 reads: "Premiums and agents' balances in course of collection (after deducting ceded reinsurance balances payable of $5,000,000)"

2. The total reinsurance recoverables on paid and unpaid losses are $160,000,000.

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[33] In addition, the appointed actuary must comment on potential uncollectibility of reinsurance recoveries in the statement of actuarial opinion. The statement of opinion relates to loss reserves *before* the addition of the statutory penalty for unauthorized and overdue recoverables. That is, it relates to statement reserves, not statutory reserves.

3. The unearned premium reserves are $50,000,000 on direct business and $10,000,000 on assumed business.

In particular, your company's management asks you what figures will appear in the boxes labeled A, B, C, and D in the third column ("restated") on the exhibit:

A. Recoverable from reinsurers.
B. Total assets.
C. Total liabilities.
D. Surplus as regards policyholders.

Primary Insurance Company Schedule F, Part 8	Restatement of Balance Sheet To Identify Net Credit for Reinsurance		
ASSETS	As Reported	Adjustments	Restated
1. Cash and invested assets	200,000,000		
2. Agents' balances or uncollected premiums	10,000,000		
3. Funds held by or deposited with reinsured companies	30,000,000		
4. Reinsurance recoverable on loss and LAE payments	40,000,000		
5. Other assets (per page 2 lines 11 & 13-20 inclusive)	20,000,000		
6. Net amount recoverable from reinsurers			A
7. Total assets	300,000,000		B
LIABILITIES			
8. Losses and loss adjustment expenses	100,000,000		
9. Taxes and other expenses (per page 3 lines 3-8 inclusive)	5,000,000		
10. Unearned premiums	40,000,000		
11. Dividends declared and unpaid	5,000,000		
12. Funds held by company under reinsurance treaties	20,000,000		
13. Amounts withheld or retained by company for account of others	1,000,000		
14. Provision for reinsurance	15,000,000		
15. Other liabilities (per page 3 lines 14-20 inclusive)	4,000,000		
16. Total liabilities	190,000,000		C
17. Surplus as regards policyholders	110,000,000		D

Solution

The completed exhibit is shown below, along with full explanation of each entry. We proceed line by line, stating the assumptions and showing the derivation of the values.

Certain adjustments depend upon the particularities of each case, for which there is insufficient information in this example (e.g., lines 1, 5, 9, and 11 below). For simplicity, we assume that no adjustments are needed for these lines.

For certain other items, there are differences of opinion among insurance accountants about the proper adjustments to make. The illustration here should not be taken to imply that other methods of completing this exhibit are necessarily "wrong."

Assets

1. Line 1 in the exhibit, "Cash and invested assets," need have no adjustment. The entry in column 3 should be $200,000,000.

2. The first piece of information provided by the reinsurance accounting department is that line 9.1 on page 12 shows "ceded reinsurance balances payable of $5,000,000." This amount is the "adjustment" for line 2 of the exhibit, "Agents' balances or uncollected premiums." The "restated" amount on this line in column 3 is $15,000,000.

3. Line 3 in the exhibit, "Funds held by or deposited with reinsured companies," relates to assumed reinsurance, not ceded reinsurance. Your company provides reinsurance to other carriers, as shown by the $10,000,000 of unearned premium reserves on assumed business. Since Part 1 of Schedule F relates to ceded reinsurance only, there is no adjustment on this line, so the "restated" entry is $30,000,000.[34]

4. Line 4 in the exhibit, "Reinsurance recoverable on loss payments," is the recoveries from reinsurers on losses that we have already paid. This entry will be "zeroed out" by an adjustment of –$40,000,000, yielding a zero in the "restated" column. [The whole amount will be offset by an opposite entry in line 6, "Net amount recoverable from reinsurers."]

5. Line 5 in the exhibit, "Other assets," are not affected by ceded reinsurance transactions except in exceptional circumstances. We assume that no such exceptions are involved here, so we enter a zero for the adjustment and $20,000,000 in the "restated" column.

6. Line 6 in the exhibit, "Net amount recoverable from reinsurers," is the balancing item. We can not determine it until we have completed the "liabilities" portion of this exhibit.

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[34] Several people have asked me: "If this asset pertains only to assumed reinsurance, not to ceded reinsurance, why is it shown separately in this exhibit?" One wag has suggested that perhaps the NAIC is concerned that some companies have placed the wrong entries in line 12 of page 2 of the balance sheet, so Schedule F, Part 1, gives them a chance to correct the error.

7. Line 7 is the total assets. This is the sum of lines 1 through 6. Since line 6 is not yet known, we skip line 7 as well.

Liabilities

8. The second piece of information provided by the reinsurance accounting department is that "the total reinsurance recoverables on paid and unpaid losses are $160,000,000." The recoverables on paid losses are $40,000,000 (line 4), so the recoverables on unpaid losses (line 8) must be $120,000,000. We enter $120,000,000 as the adjustment on line 8, and $220,000,000 as the "restated" amount.

9. Most of the items included in line 9 (lines 3 through 8 of page 3) are not directly affected by reinsurance transactions. For instance, line 5 on page 3, "taxes, licenses, and fees" is based on direct premium written, not on net premium written. Similarly, income taxes, borrowed money, and interest (lines 6, 7, and 8 on page 3) are not directly related to reinsurance transactions. Contingent commissions (line 3 on page 3) may sometimes be affected by reinsurance transactions. Since we are given no information about this, we assume that no adjustment is needed here. So we enter a zero for the "adjustment," yielding $5,000,000 in the "restated" column.

10. Line 10 in this exhibit shows $40,000,000 of net unearned premium reserves. Since the direct unearned premium reserve is $50,000,000 and the assumed unearned premium reserve is $10,000,000 (the third piece of information provided by the reinsurance accounting department), the ceded unearned premium reserve is $20,000,000, which is the "adjustment" for this line. The entry in the "restated" column is $60,000,000.

11. Line 11 in this exhibit, "dividends declared and unpaid," relates generally to direct business, not net business. The adjustment for this line is zero, and the restated amount is $5,000,000.[35]

12. Line 12 in this exhibit, "Funds held under reinsurance treaties," are monies owned by reinsurers but held by the primary company. They are "zeroed out" by an adjustment of –$20,000,000, leaving a zero in the "restated" column.

13. Line 13 in this exhibit, "Amounts withheld for account of others," is generally not related to

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[35] In some instances, particularly on some quota share treaties, the reinsurer will pay a part of the policyholders' dividend. In other treaties, there is no policyholders' dividend liability incurred by the reinsurer. Rather, the "dividend" may be included in the ceding commission, it may be paid to the primary company (not to the policyholders), or it may be included in a sliding scale commission arrangement. For simplicity, this illustration assumes that there is no "ceded" portion of the policyholders' dividend liability.

reinsurance transactions.[36] We enter a zero for the adjustment, leaving 1 million in the "restated" column.

14. Line 14 in this exhibit, "Provision for reinsurance," is the statutory penalty for recoverables from unauthorized reinsurers, overdue recoverables, and recoverables from slow-paying reinsurers. The entire amount is eliminated on a "gross of reinsurance" basis, so we enter –$15,000,000 as the adjustment and a zero in the "restated" column.

15. Line 15 in this exhibit, "Other liabilities," generally do not relate to reinsurance transactions. This entry is comprised of the following items from page 3:

- Excess of statutory reserves over statement reserves.
- Net adjustments to assets and liabilities due to foreign exchange rates.
- Drafts outstanding.
- Payable to parent, subsidiaries, or affiliates.
- Payable for securities.
- Liability for amounts held under uninsured accident and health plans.
- Aggregate write-ins for liabilities.

We enter a zero for the "adjustment," leaving $4,000,000 in the "restated" column.

16. Line 16 in this exhibit, "Total liabilities," is the sum of line 8 through 15. For the adjustments, we have (in millions of dollars)

$$120 + 0 + 20 + 0 - 20 + 0 - 15 + 0 = \$105 \text{ million},$$

and for the restated column we have

$$220 + 5 + 60 + 5 + 0 + 1 + 0 + 4 = \$295 \text{ million}.$$

17. Line 17 in this exhibit, "surplus as regards policyholders," is not affected by this calculation. Column 2, the adjustment," is "X-ed out" in the blank, so the "restated" amount is the same as the reported amount: $110,000,000.

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[36] Peter Borowski, "Other Liabilities, Capital and Surplus", in Insurance Accounting and Systems Associations, Inc., *Property-Liability Insurance Accounting* (Durham, NC, 1991), chapter 6, page 6-9, describes the two major components of this liability:

- Deductions from employees or agents for payroll taxes, group insurance premiums, pensions, and similar items.
- Policyholder or claimant funds held by the company (e.g., uncashed checks).

These are generally unrelated to ceded reinsurance transactions. The NAIC *Instructions to the Annual Statement*, page 56-2, simply say for this line: "This item should be adjusted for any balances created by ceded reinsurance arrangements."

Balancing Items

We now return to the two lines that we did not complete in the asset section of this exhibit. Since the total liability adjustment is $105,000,000, the total asset adjustment must also be $105,000,000 (column 2 of line 7). The total asset adjustment is the sum of the individual asset adjustments. The two asset adjustments already entered are +$5,000,000 on line 2 (agents' balances) and –$40,000,000 on line 4 (reinsurance recoverable on loss payments). A balancing adjustment of

$140,000,000 [= $105,000,000 – $5,000,000 – (–$40,000,000)]

is entered for line 6 (net amount recoverable from reinsurers).

The entries in the "restated" column are the sum of the entries in the "reported" and "adjustment" columns. For the cells labeled A, B, C, and D, we have

A. For line 6 (recoverable from reinsurers), the "restated" amount is

$0 + $140,000,000 = $140,000,000.

B. For line 7 (total assets), the "restated" amount is

$300,000,000 + $105,000,000 = $405,000,000.

C. For line 16 (total liabilities), the "restated" amount is

$190,000,000 + $105,000,000 = $295,000,000.

D. For line 17 (surplus as regards policyholders), the "restated" amount is

$110,000,000 + $0 = $110,000,000.

The completed Part 1 exhibit is shown on the following page.

Primary Insurance Company Schedule F, Part 8	Restatement of Balance Sheet To Identify Net Credit for Ceded Reinsurance		
ASSETS	As Reported	Adjustments	Restated
1. Cash and invested assets	200,000,000		200,000,000
2. Agents' balances or uncollected premiums	10,000,000	5,000,000	15,000,000
3. Funds held by or deposited with reinsured companies	30,000,000		30,000,000
4. Reinsurance recoverable on loss and LAE payments	40,000,000	-40,000,000	0
5. Other assets (per page 2 lines 11 & 13-20 inclusive)	20,000,000		20,000,000
6. Net amount recoverable from reinsurers		140,000,000	140,000,000
7. Total assets	300,000,000	105,000,000	405,000,000
LIABILITIES			
8. Losses and loss adjustment expenses	100,000,000	120,000,000	220,000,000
9. Taxes and other expenses (per page 3 lines 3-8 inclusive)	5,000,000		5,000,000
10. Unearned premiums	40,000,000	20,000,000	60,000,000
11. Dividends declared and unpaid	5,000,000		5,000,000
12. Funds held by company under reinsurance treaties	20,000,000	-20,000,000	0
13. Amounts withheld or retained by company for account of others	1,000,000		1,000,000
14. Provision for reinsurance	15,000,000	-15,000,000	0
15. Other liabilities (per page 3 lines 14-20 inclusive)	4,000,000		4,000,000
16. Total liabilities	190,000,000	105,000,000	295,000,000
17. Surplus as regards policyholders	110,000,000		110,000,000

II. Provision for Unauthorized Reinsurance

We now turn to several illustrations of the provision for reinsurance, beginning with a single, unauthorized reinsurer with no securitization of the recoverables and proceeding to more complex illustrations involving payment schedules and overdue receivables.

Assume that you are the actuary for the Fledgling Insurance Company, a small, newly capitalized personal automobile insurer. All your business is 100% reinsured with the Risky Reinsurance Company, which is not licensed or authorized in your domiciliary state.

Written premium in 1993 was $50 million, and earned premium was $40 million. The unearned premium reserve at December 31, 1993, is $20 million. All these amounts are 100% reinsured by Risky Reinsurance.

You have $25 million of reported but unpaid losses, along with $6 million of unpaid allocated loss adjustment expenses associated with these claims. You also report $10 million of incurred but not reported losses, along with $4 million of unpaid allocated loss adjustment expenses associated with these claims. All these amounts are 100% reinsured by Risky Reinsurance.

You have paid $35 million to claimants this past year, along with $10 million in associated allocated loss adjustment expenses. For these amounts, you are still awaiting recovery of $15 million in losses and $5 million in allocated loss adjustment expenses from Risky Reinsurance.

Risky Reinsurance has denied liability for $5 million of these losses. Fledgling Insurance expects a full recovery, and the matter is in litigation.

Risky Reinsurance has not provided Fledgling Insurance with any security, whether letters of credit, trust agreements, or funds withheld.

Fledgling assumes no reinsurance business from other primary writers, and it cedes no business to other reinsurers (besides Risky Reinsurance).

You have been asked to complete the entries for the following items on Fledgling's 1993 balance sheet (pages 2 and 3 of the Annual Statement):

Page 2:

Line 10	Funds held by or deposited with reinsured companies
Line 12	Reinsurance recoverables . . .

Page 3:

Line 1	Losses
Line 1A	Reinsurance payable . . .
Line 2	Loss adjustment expenses
Line 9	Unearned premiums

Line 11 Funds held by company under reinsurance treaties
Line 13 Provision for reinsurance

What are the appropriate entries for each of these lines?

Solution

Since Risky Reinsurance is not authorized and provides no offsetting funds or letters of credit, all recoverables from Risky are included in the provision for reinsurance. Thus, there is no need for a payment schedule to determine "overdue" amounts.

In general, all balance sheet items, except line 13, are net of reinsurance, with no differentiation between authorized and unauthorized reinsurers, slow-paying and quick-paying reinsurers, and overdue amounts versus non-overdue amounts. Line 13 shows the aggregate provision for reinsurance, relating to recoverables on paid losses, recoverables on unpaid losses, and unearned premium reserves.

In this illustration, because Fledgling is 100% reinsured, it has no net liabilities. Because Risky Reinsurance is unauthorized and provides no security, all recoverables show up in the provision for reinsurance. Proceeding line by line . . .

Page 2, line 10, "Funds held by or deposited with reinsured companies," refers to funds owned by Fledgling that are being held by primary companies that have ceded business to Fledgling. Since Fledgling does not assume any reinsurance, it has not deposited funds with any ceding companies, so this amount is $0.

Page 2, line 12, "Reinsurance recoverables, on loss and loss adjustment expense payments," relates to recoverables from Risky Reinsurance on losses and loss adjustment expenses already paid by Fledgling. This amount is $20 million, or $15 of loss plus $5 of allocated loss adjustment expenses.[37]

Page 3, line 1, shows loss reserves net of reinsurance, whether the reinsurance is authorized or not. This entry is $0, since all of Fledgling's business is reinsured.

Page 3, line 1A, "Reinsurance payable on paid losses," shows Fledgling's liabilities for assumed reinsurance losses. Since Fledgling assumes no business from other primary carriers, this entry is $0.

Page 3, line 2, shows loss adjustment expense reserves net of reinsurance, whether the reinsurance is authorized or not. This entry is $0, since all of Fledgling's business is reinsured.

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[37] Risky's "unauthorized" status does not affect this asset. Similarly, Risky's denial of liability does not affect this asset item, as long as Fledgling indeed expects to receive it. In any case, the full asset is offset by a corresponding liability on line 13 of page 3. In GAAP statements, which do not include this "provision for reinsurance," Fledgling may have to disclose in a footnote the disputed amount.

Page 3, line 9, shows unearned premium reserves net of reinsurance, whether the reinsurance is authorized or not. This entry is $0, since all of Fledgling's business is reinsured.

Page 3, line 10, "Funds held by company under reinsurance treaties," would show any funds owned by Risky Reinsurance that are held by Fledgling as security for its recoverables. Since Risky Reinsurance has provided no security to Fledgling, this entry is $0.

Page 3, line 13, "Provision for reinsurance," includes all the recoverables from Risky Reinsurance, since Risky is unauthorized and has provided no security to Fledgling. The recoverables relate to

• the unearned premium reserve	$20 million
• paid losses	15 million
• paid allocated loss adjustment expenses	5 million
• unpaid reported losses	25 million
• unpaid IBNR losses	10 million
• unpaid allocated loss adjustment expenses	10 million
Total	$85 million

The entry for line 13 is $85 million.

III. Overdue Reinsurance

The Stable Insurance Company, a commercial fire carrier specializing in large risks, has a 100% quota share reinsurance treaty with the Secure Reinsurance Company, which is licensed to conduct business in Stable's domiciliary state. During the past year, Secure has denied liability for two large claims and has been slow in paying on several other claims. Stable has asked Secure for a letter of credit of $40 million, which Secure provided on November 15, 1993. The letter of credit covers recoverables on paid losses, recoverables on unpaid losses, and unearned premiums, but not the two claims for which Secure has denied liability.

The reinsurance payment schedule from Secure Reinsurance Company is shown below. Claim amounts are in thousands of dollars. For instance, the second line shows a claim with an accident date of January 12, 1993, for which Safety paid the claimant $1.6 million on March 3, 1993, and received reimbursement from Secure on July 17, 1993.[38]

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[38] The table shows 14 claims for amounts between $1 million and $12 million, and no claims for amounts less than $1 million. This is not realistic, even for a commercial fire carrier writing large risks. In practice, Schedule F payment schedules would be compiled from a broader set of claims.

Reinsurance Payment Schedule (figures in thousands of dollars)

Amount of Claim	Accident Date	Payment Date (Safety → Claimant)	Payment Date (Secure → Safety)
12,000	11/14/92	12/15/92	(unpaid; Secure denies liability)
1,600	01/12/93	03/03/93	07/17/93
1,500	02/26/93	07/20/93	(unpaid)
4,400	03/09/93	06/02/93	08/01/93
6,500	03/10/93	04/14/93	(unpaid; Secure denies liability)
3,000	04/16/93	05/17/93	10/29/93
3,500	05/08/93	06/13/93	09/29/93
2,500	06/03/93	07/19/93	(unpaid)
1,000	06/08/93	06/28/93	12/12/93
4,000	08/22/93	11/04/93	(unpaid)
6,000	08/09/93	(unpaid)	(unpaid)
10,000	09/02/93	10/21/93	(unpaid)
11,200	11/18/93	(unpaid)	(unpaid)
3,800	12/05/93	(unpaid)	(unpaid)

Safety has filed suit to recover the $12 million relating to the November 14, 1992, claim, and the case is currently in litigation. Safety is discussing the March 10, 1993 claim with Secure, but no suit has yet been filed. Safety also has $8 million of unearned premium reserves ceded to Secure.

The "due date" for recoverables depends on contract provisions. If the reinsurance treaty does not define the due date or the date on which claims are to be presented to the reinsurer for payment, then recoverables are assumed to be due when the paid loss recoverable is entered on the ceding company's books. For simplicity, assume that this is done when the ceding company pays the claim.

What provision for reinsurance must Safety hold on its balance sheet (line 13 of page 3) at December 31, 1993?

Solution

For authorized reinsurers, there are several possible statutory provisions. If the reinsurer is not slow-paying, then the provision is 20% of the overdue amount, with no offset for funds withheld or letters of credit. If the reinsurer is slow-paying, then the provision is 20% of the larger of the total recoverables, with an offset for funds withheld or letters of credit. For both types of reinsurers, there is an additional provision of 20% of the amounts in dispute.

We must first determine whether Secure is a slow-paying reinsurer. To do so, we divide the claims into the following categories:

A. Claims for which reinsurance recoveries were received more than 90 days prior to the Statement Date.
B. Claims for which reinsurance recoveries were received within the 90 days preceding the Statement Date.
C. Claims paid by Safety for which the reinsurance recoverables are less than or equal to 90 days overdue.
D. Claims paid by Safety for which the reinsurance recoverables are more than 90 days overdue.
E. Claims in dispute.
F. Claims still unpaid by Safety.

To determine whether Secure is a slow-paying reinsurer, we must examine the ratio

$$D \div (B + C + D).$$

This is the ratio of the amounts more than 90 days overdue to (the total amount receivable on paid claims plus the amounts received in the past 90 days).[39] The reinsurer is classified as slow-paying if this ratio exceeds 20%.

Using the payment schedule shown above, we have

A. $1.6 million + $4.4 million + $3.5 million = $5.1 million (January 12, March 9, and May 8 claims).
B. $3 million + $1 million = $4 million (April 16 and June 8 claims).
C. $4 million + $10 million = $14 million (August 22 and September 2 claims).
D. $1.5 million + $2.5 million = $4 million (February 26 and June 3 claims).
E. $12 million + $6.5 million = $18.5 million (November 14, 1992, and March 10, 1993, claims).
F. $6,000 million + $11.2 million + $6.8 million = $24 million (August 9, November 18, and December 5 claims).

The ratio of D to (B + C + D) equals $4 million ÷ ($4 million + $14 million + $4 million) = 18.2%. Since this ratio is less than 20%, Secure is not a slow-paying reinsurer.

Of the overdue recoverables, 20% is included in the provision for reinsurance. In this example, 20% of $4 million = $800,000. In addition, there are $18.5 million of recoverables in dispute, 20% of which is $3.7 million. The total provision for reinsurance is therefore $4.5 million [= $0.8 million + $3.7 million].

The letter of credit provided by Secure does not affect the statutory provision for overdue amounts or for amounts in dispute. Thus, the provision for reinsurance which appears in the

[39] Note that an insurer may have reinsurance recoverables on paid claims that are not yet due, or "current" receivables.

Schedule F, Part 7, footnote and on line 13 of page 3, is $4,500,000.[40]

IV. Slow-Paying Reinsurers

The final illustration concerns the provision for reinsurance for recoverables from a slow-paying authorized reinsurer. Assume that the Schedule F, Part 4, entries for the Tardy Reinsurance Company at the 1993 Statement Date are as shown below. Tardy is licensed to conduct reinsurance business in the domiciliary state of the primary insurance company.

Schedule F, Part 4 (figures in millions of dollars)

Name of Reinsurer	(1)	(2)	(3)	(4)	(5)
Tardy Reinsurance	40	25	50	20	55

The captions for the columns labeled (1) through (5) are as shown below.

1 Current recoverables
2 Recoverables 1-29 days overdue
3 Recoverables 30-90 days overdue
4 Recoverables 91-120 days overdue
5 Recoverables over 120 days overdue

On Part 3 of Schedule F, the entries for Tardy Reinsurance are as follows:

Column 1, "Reinsurance premium ceded," $210 million.
Column 2, "Recoverables on paid losses," $175 million.
Column 3, "Recoverables on paid LAE," $15 million.
Column 4, "Recoverables on known case loss reserves," $160 million.
Column 5, "Recoverables on known case LAE reserves," $20 million.
Column 6, "Recoverables on IBNR loss reserves," $100 million.
Column 7, "Recoverables on IBNR LAE reserves," $10 million.
Column 8, "Unearned premiums," $75 million.
Column 9, "Commissions," $5 million.

[40] In this example, the total provision for reinsurance is $4,500,000, whereas the amounts in dispute are $18.5 million. It is possible that the expected uncollectible amount exceeds the provision for reinsurance determined by the statutory formula. If so, the statutory provision for reinsurance should be increased to cover the expected uncollectible amounts. If this is not done, Safety should at least disclose the potential effects of an adverse outcome of these disputes in the Notes to the Financial Statements.

In the past 90 days, Tardy has made payments of $75 million for losses and loss adjustment expenses. Tardy has provided a letter of credit for $200 million to secure its recoverables.

What is the provision for reinsurance for the Tardy Reinsurance Company?

Solution

Since Tardy is authorized, we must first determine whether Tardy is a slow-paying reinsurer. We consider the ratio of the amounts more than 90 days overdue to (the total amount receivable on paid claims plus the amounts received in the past 90 days). Tardy would classified as slow-paying if this ratio exceeds 20%.

The information provided above shows

- $75 million more than 90 days overdue,
- $190 million of total recoverables on paid losses and loss adjustment expenses, and
- $75 million of recoverables received in the past 90 days.

The ratio is $75 million ÷ ($190 million + $75 million) = 28.3%, and the Tardy Reinsurance Company is classified as a slow-paying reinsurer.

The total recoverables from Tardy are

- $190 million of recoverables on paid losses and loss adjustment expenses,
- $180 million of recoverables on unpaid "case basis" losses and LAE,
- $110 million of recoverables on unpaid IBNR losses and LAE,
- $75 million of ceded unearned premium reserves, and
- $5 million of ceded unearned premium reserves,

for a total of $560 million.

Tardy Reinsurance has provided a letter of credit to secure $200 million of these recoverables, so the unsecured recoverables are $360 million. The $360 million exceeds the amount which is overdue ($75 million). The provision for reinsurance is therefore $360 million ÷ 5, or $72 million.

* * *

Schedule F forms a logical structure. Unfortunately, the complexity of the exhibits and the lack of clear instructions has confused many actuaries and accountants preparing this Schedule and has led to numerous errors in actual 1992 Annual Statement submissions. This paper should ease the task of industry personnel completing this Schedule and should result in more accurate submissions in the future.