

INSURANCE COMPANIES' STATEMENTS

Book Values of Bonds and Debentures—Loans on Policies

III.

Assets of insurance companies in relation to the government returns were discussed in the address of Mr. W. H. Gilliland and Mr. A. N. McTavish, of the department of insurance, Ottawa, before the Toronto Insurance Institute recently. A portion of their remarks on that phase of the subject were printed in *The Monetary Times* last week. The address is continued below:—

In connection with this item the question arises as to what is to be regarded as the book value of a bond at date of purchase and in the interval elapsing between that date and the date of the first interest payment. The purchase price of a bond will usually include accrued interest, and there are the following three methods of dealing with this accrued interest. (1) Carry it to a separate ledger account, "Amount paid for accrued interest on bonds purchased," and when the first interest on the bond is paid, apply a part of it to wipe out the balance in this account. (2) Charge the accrued interest directly to the interest account. (3) Carry the accrued interest in the bond account until the first interest payment after purchase is made on the bond. If the first method is followed the accrued interest on the bond shown in the non-ledger assets will be the interest accrued from date of purchase to the end of the year; if the second method is followed the accrued interest to be shown in the non-ledger assets will be simply the interest accrued from the date of the last interest payment on the bond; if the third method is followed it must be borne in mind that the market price of a bond is a firm price, that is, a seller of such a bond would, in addition to the market price, be entitled to the full interest accrued from the date of the last interest payment made on the bond and it will therefore be necessary, if the total assets represented by the bond is to be correctly returned, that the full interest accrued from the date of the last interest payment on the bond be shown in the non-ledger assets. There may be a slight objection to this, however, as the interest shown as earned on the bond before the first interest due date after purchase will be over-stated. Some companies which have adopted the third method have added the accrued interest at purchase to the market value of the bond, but this practice is objectionable, as the price placed upon the bond cannot be reconciled with that furnished by the department of insurance. The first method described is perhaps theoretically correct, but probably the second method will be more practicable and very little objection can be taken to it.

Purchase and Sale Price.

The half-yearly statements of securities require the purchase and sale prices of bonds to be shown. In order that comparisons, made from the returns, may not be vitiated it would be well to exclude all accrued interest from these prices.

When a bond, repayable at par at the end of a definite period, is purchased at a premium or at a discount, the amortization method of dealing with the account value should be followed so that at the date of maturity it will equal the par value. The account values of securities should not be made to agree from year to year with the market values, the adjustment in this connection being made by a separate item in the non-ledger assets. Gains or losses of a definite character should nevertheless receive special treatment.

In speaking of the item in the non-ledger assets which takes care of the difference between the total account and market values of securities we might refer to the fact that the market value of a stock usually includes accrued dividend and in such cases no credit should be taken in the assets for accrued dividends. In those cases, however, where the quotations are ex-dividend, it is of course proper to take credit for the amount of the dividends declared. Where the interest on the securities of a company is in default the values supplied by the insurance department include all interest due and accrued.

Loans on the Security of Policies.

Policy loans, which now form a considerable part of the assets of life companies, are for the purposes of the annual statement divided into the following three classes:—

- (1) Cash loans.
- (2) Advances under automatic non-forfeiture provisions.
- (3) Premium obligations.

The non-forfeiture provisions of some companies are, as you know, more liberal than those of others, and due regard should be had to those provisions in determining what premiums should be debited to the non-forfeiture loan account. As an example of an incorrect method of treating this account we would cite the following case:—The policies of the company in question provided against forfeiture only after premiums for three years had been paid, but at the end of the calendar year they put through a journal entry debiting policy loans and crediting renewal premiums with premiums due in the third policy year and unpaid at the end of the calendar year. Their defense of the practice was that another company followed the same course, but it was found that this defense broke down as the policies of the other company provided against forfeiture by advancing the premiums after premiums for two full years had been paid. When the days of grace allowed for the payment of a premium have not expired the premium should not, in our opinion, be debited to the non-forfeiture loan account.

Premium Obligations.

"Premium obligations on policies in force" is a vague expression and open to misinterpretation. About the only items to be included here are advances made under policies issued on the part credit premium plan, that is, under policies where, instead of the full regular premium being payable, only a part is payable in cash by the assured, the remainder being advanced by the company and charged with interest against the policies. One company made the mistake of including in premium obligations all renewal premiums that were covered by note.

It may not be out of place here to mention that care should be exercised, when putting through cancellations of policies whose loan values have been exhausted, to write the policy loans out of the assets by a debit to "Surrender values paid."

Cash on Hand and in Banks.

In the examination of statements we have come across some very liberal interpretations of the word "cash." We sometimes find that cash includes post-dated cheques, discounted notes and drafts on agents. In a great many cases these cheques, notes and drafts are not met when due and are charged back early in the new year. We have always discouraged this practice and have more recently adopted the plan of taking these items out of the cash and charging them back to the accounts to which they belong.

Another practice followed by some companies is that of keeping the cash book open for several days after the close of the year in order that collections can be made on accounts of the preceding year. There is no serious objection to a company keeping its books open for two or three days after the close of the year but we have always impressed upon the companies the desirability of closing the books promptly with the close of the year. Some of our largest companies close their books on the last day of the year, and there does not appear to be any good reason why the majority of our companies cannot follow this practice.

Due From Other Companies for Losses or Claims on the Company's Policies Reinsured.

Under this heading should be shown amounts due from reinsuring companies in connection with claims or losses which have been paid by the company. In cases where there are reinsurances recoverable on claims which are outstanding against the company the amount of these reinsurances are deducted from the gross amount of the claims and the net figure carried into the liabilities.

Interest Due and Accrued.

This item in the statement of assets does not require much consideration. The practice of capitalizing interest due on loans secured by mortgages, bonds or stocks has the effect of misrepresenting the condition of these loans and on this account it has been objected to by the department. On the other hand there is no good reason why interest due on policy loans should not be capitalized as the security for policy loans is necessarily absolute.

Net Amount of Outstanding and Deferred Premiums.

Under this heading the gross amount of outstanding new and renewal premiums less the amount of reinsurance premiums due with the deduction for commission payable is to be shown. One important point to remember is that deferred and outstanding premiums on reinsurances must here be deducted. Although, the statement in its present form,