

increasing their loss reserves by a percentage equal to what experience shows the underestimate to have been in previous years. It is not a very scientific method, but is the best that is at present available.

The loss reserves of credit companies have been given considerable attention both by the Massachusetts Department and that of the State of New York. The occasion for it was a joint examination by the two departments of the American Credit Indemnity Company of New York. In the absence of any statutory rule, and under the general authority to charge a proper liability for losses, the two departments worked out and adopted a rule which the Massachusetts department has since applied to the reports of all credit insurance companies transacting business in Massachusetts. This rule is set forth in the report of the examination of the American Credit Indemnity Company which *inter alia* contains as follows:—

The so-called "reserves" usually charged as liabilities in financial statements of credit companies may be classified as follows:—(1) "Unearned premiums"—frequently called a "reserve" for unearned premiums and which is determined by statutory requirements; (2) "Reserve" for unpaid claims under policies expiring more than three months prior to the date of the examination or statement, which is determined by estimating the probable payment to be made on each claim; (3) "Reserve" for unpaid claims or policies expiring during the three months next preceeding the date of the examination or statement, which by common consent has for several years been estimated to be 50 p.c. of the *alia* contains the following:—

The liability on expired policies, computed as indicated above, will under normal conditions be adequate if good judgment has been used in estimating the claims on policies expiring more than three months prior to the date of the examination or statement, and the liability on expired policies may therefore be eliminated from further consideration in this connection. Hence it becomes evident that the deficiency in the foregoing "reserves" is on account of existing policies, and that the only liability heretofore charged on account of such policies is the statutory liability for unearned premiums, which is not a proper measure of the liability on existing policies.

In determining the amount of funds which a credit company should at all times have on hand to meet outstanding liabilities it becomes expedient to consider the following contingencies, viz.:—(a) The amount required to reinsure the policies in force; (b) The amount required to discharge the liability by liquidation if the contracts are not carried to maturity; (c) The amount required to discharge the liability, as a "going concern."

As regards (a) credit companies are required to charge as a liability for unearned premiums 50 p.c. of the premiums on the policies in force at the date of the annual returns. It has been contended, and, to a certain extent, generally understood, that this item represents the liability which the company will eventually be required to pay for losses and claims on policies in force at the date of the statement. This theory, however, is in-

correct, for the reason that by the laws of the several States such companies are required to include in their financial statements as a liability for unearned premiums on policies in force 50 p.c. of the gross premiums thereon or the *pro rata* unearned portion thereof. The law of New York makes it mandatory upon the Superintendent of Insurance to charge this liability on a *pro rata* basis. The effect of such statutes is to require credit companies to have on hand 100 p.c. of the unearned premiums on policies in force, which is practically 50 p.c. of the gross premiums on such policies, and the statutory liability under this item is computed on the same basis as the liability for unearned premiums of fire and casualty companies. This item in the financial statements of fire and casualty companies is also supposed to and usually does represent the amount for which the company could reinsure each and every risk for the unexpired term of the policy, but it does not represent the amount a credit company would be required to pay for the reinsurance of its policies.

The examiners' report goes on to point out that the peculiar nature of credit insurance precludes reinsurance as it is practised in the case of fire or casualty. In a fire or casualty company the claims are paid as they accrue, but in a credit company the amount of the loss cannot be ascertained until after the expiration of the policy, and consequently no payments are or can be made until after the contract expires. It would, therefore, appear, say the examiners, and is so conceded by credit underwriters that if a credit company desired to reinsure its outstanding risks, it would be necessary to reinsure each and every risk from the date of the policy to its termination, and for the reinsuring company to assume liability for all losses on such policies. The amount required to reinsure the outstanding risks of the ceding company, if such reinsurance could be effected, would, therefore, depend upon the commission to be allowed by the reinsuring company. Assuming this commission is 25 p.c. which the examiners believe is as large as can safely be allowed, then 75 p.c. of the premiums on policies in force would be required to reinsure the outstanding risks.

As regards (b), the examiners argue that a similar result is reached if it is considered that at any time it may become necessary to cancel contracts by liquidation. Losses will have been accruing from month to month, yet will not have been paid; indeed, by the terms of the contract cannot be definitely ascertained or paid until some time in the future. Hence in case of the termination of the contracts by liquidation as well as by reinsurance 75 p.c. of the gross premiums on policies in force is required to discharge the liability of a credit company, viz.: (1) Return to policy-holders 100 p.c. of the unearned premiums, which is practically 50 p.c. of the gross premiums; (2) pay accrued claims on policies in force which are estimated at 50 p.c. of the earned premiums on such policies or 25 p.c. of the gross premiums thereon.....

Still further, as regards point (c) the examiners proceed, it must be conceded that the lia-