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Loss reserve

An estimate of the amount of money the insurer expects to pay in the future for losses that have already occurred and been reported, but are not yet settled.

Loss adjustment expense reserves

Estimates of the future expense that an insurer expects to incur to investigate, defend, and settle claims for losses that have already occurred.

The principal liabilities are **loss reserves**, **loss adjustment expense reserves**, and the unearned premium reserve. Reinsurance recoverables for unpaid losses and loss adjustment expenses are netted from the loss reserves and loss adjustment expense reserves. Unsecured recoverables and penalties for overdue recoverables from reinsurers are included under a liability account called “provision for reinsurance.”

Surplus can be classified into three major parts: contributed surplus, unassigned surplus, and treasury stock. Contributed surplus is money that has been invested in the firm by outside parties. See the exhibit “Principal Elements of an Insurer Annual Statement (SAP) Balance Sheet.”

Statement of Income

The Statement of Income (income statement) measures the insurer’s earnings over the course of the year and serves as the basis for determining the insurer’s federal income tax liability. The summary values reported in the income statement are supported by numerous pages of detail on the source of the premiums, expenses, and investment income for the year. The income statement breaks down earnings into three main categories:

- Underwriting income
- Investment income
- Other income

Underwriting income is measured as the difference between premiums earned and losses and expenses incurred during the period. If the number is positive, it is a net underwriting gain; otherwise, it is a net underwriting loss.

Changes in premium and loss reserves from prior years affect the current-year results. Earned premium is reported on a calendar-year basis and calculated as the sum of this year’s written premiums plus the unearned premium reserve at the beginning of the year, less the unearned premium reserve at the end of the year. Losses and loss adjustment expenses are also reported on a calendar-year basis as the sum of losses and loss adjustment expenses paid during the year, plus ending reserves, minus beginning reserves.

Investment income has two components: net investment income and net realized capital gains. Net investment income is the interest, dividends, and real estate income earned on invested assets during the year, minus expenses incurred in conducting investment operations. Net realized capital gains are the gains or losses realized from selling invested assets during the year. The value of an invested asset held by the insurer through the year may rise or fall during the year, but until an investment is actually sold, these changes in value do not flow through the income statement.

Other income consists of revenues and expenses that are not related to either underwriting or investment activities. Examples include charge-offs of outstanding receivables from agents, dividends to policyholders, and finance and



Principal Elements of an Insurer Annual Statement (SAP) Balance Sheet

Assets	Current Year		
	Assets	Nonadmitted Assets	Net Admitted Assets
Bonds (Schedule D)	33,525,000		33,525,000
Preferred stocks (Schedule D)	265,000		265,000
Common stocks (Schedule D)	3,750,000	50,000	3,700,000
Real estate (Schedule A)	1,900,000		1,900,000
Cash (Schedule E)	5,250,000		5,250,000
Other invested assets (Schedule BA)	310,000	190,000	120,000
Subtotal cash and invested assets	45,000,000		44,760,000
Uncollected premium	4,200,000	150,000	4,050,000
Amounts recoverable from reinsurers	1,750,000	25,000	1,725,000
Furniture and equipment	415,000	415,000	0
Other assets	2,050,000		2,050,000
Totals	53,415,000	830,000	52,585,000

Liabilities, Surplus, and Other Funds	Current Year
Losses	22,165,000
Loss adjustment expenses	2,250,000
Reinsurance payable (Schedule F)	2,510,000
Commissions payable	1,800,000
Unearned premiums	8,400,000
Provision for reinsurance (Schedule F)	1,200,000
Total liabilities	38,325,000
Common capital stock	2,000,000
Gross paid in and contributed surplus	5,250,000
Treasury stock	(1,500,000)
Unassigned funds (surplus)	8,510,000
Surplus as regards policyholders	14,260,000
Totals	52,585,000

Note: The above illustration does not include all the information contained in the NAIC Annual Statement blank.

Adapted from the NAIC Annual Statement blank. [DA06251]



service charges not included in premiums. See the exhibit “Principal Elements of an Insurer Annual Statement (SAP) Income Statement.”

Principal Elements of an Insurer Annual Statement (SAP) Income Statement

Statement of Income		Current Year
Underwriting Income		
Premiums earned		10,000,000
– Losses incurred		5,960,000
– Loss adjustment expenses incurred		1,210,000
– Other underwriting expenses incurred		2,500,000
Net underwriting gain (loss)		330,000
Investment Income		
+ Net investment income earned		900,000
+ Net realized capital gains (losses)		(59,000)
Net investment gain (loss)		841,000
Other Income		
+ Other income (expense)		220,000
– Policyholder dividends		360,000
Net income before income taxes		1,031,000
– Federal and foreign income taxes		231,000
Net income		800,000

Note: The above illustration does not include all the information contained in the NAIC Annual Statement blank.

Adapted from the NAIC Annual Statement blank. [DA06252]

Capital and Surplus Account

The Capital and Surplus Account exhibit, which is included in the Statement of Income, provides details of changes in the policyholders’ surplus during the year. Net income directly affects the level of policyholders’ surplus. Other surplus changes flow from changes in balance sheet accounts. The principal balance sheet-related elements leading to changes in policyholders’ surplus are changes in nonadmitted assets, net unrealized capital gains, net unrealized foreign exchange capital gains, net deferred income taxes, changes in the provision for reinsurance, and contributions to and withdrawals from contributed capital accounts.

