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Institute of Actuaries

General Insurance Study Group

EXPENSES WORKING PARTY

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CONTENTS

1. INTRODUCTION

1.1 Terms of Reference

Our terms of reference were:

'Broaden the understanding of the techniques and methods used in the treatment of expenses and their practical application'.

1.2 Purpose

The purpose of this report is to give a resume of this subject in an easily readable form. It also gives some details about what companies currently do in this area. It is hoped that the report will provide a better understanding of the subject and will provoke companies to give more attention to the analysis and allocation of expenses; also that the problems highlighted in the report will lead to a discussion of possible solutions. The report should also be of interest to the student of the General Insurance examination of the Institute.

There is an excellent reference paper on the subject entitled 'Analysis of Insurance Expenses' by I.L. Rushton which was presented to the Students' Society in 1977.

1.3 Importance of Expenses

Expenses may take up 30% or more of the premium and it is this high proportion which provokes and justifies considerable attention being devoted to expenses. In recent years the degree of competition from within the industry and from the entry into the industry by other financial organisations has intensified and this has led to attention being focused on reduction of costs and improvement in efficiency. Improved rating levels from rate increases, better risk selection and risk improvements have helped to reduce the potential claims ratio. However, actual results, particularly at the gross level, can be quite different from expected because of the highly random nature of claims, for example, the heavy costs from the hurricane of October 1987. The other element of outgo, which is under the control of an insurance operation, is the relatively stable one of expenses. Expenses do not suffer from the random fluctuations associated with claims and can be estimated with a high degree of accuracy, at least in overall terms, although there may be variations in the individual components. The difficulty within an insurance operation lies in ascertaining exactly which activity has given rise to the expense since a lot of the work falls in the overhead category. In manufacturing industry expenses often can be easily associated with the tasks being performed and this knowledge can be used to introduce cost saving measures to reduce the level of expenses. The same principle can be used in insurance in spite of the difficulty referred to above.

Insurance is a service industry and organisations have varying attitudes to what is the optimum level of service to be provided. Additional service requires higher costs and it is not easy to quantify the benefits it brings in terms of enhanced customer satisfaction, goodwill and business production. In today's financially aware society the sophisticated customer demands not only an improving service but wants it at a lower cost! What has helped the industry to provide this better service has been the explosion in computer power. This has not generally led to cost reductions from the shedding of staff, but it has brought about superior productivity and greater flexibility. However, this has not come cheap and a further cost comes from mistakes made in the development of computer systems.

A knowledge of expenses is important not only in providing a means for controlling them but also in the proper pricing of products. In recent years, price competition in personal lines has been very much in evidence, particularly in the motor market where two rate revisions in a year have not been uncommon. The insured would shop around at renewal and lapse rates in certain sectors approached 50%. In this situation a better appreciation of the expenses involved in putting new policies on the books would have been an important factor in judging whether a more favourable option was to introduce a smaller rate rise accompanied by a lower level of costs due to reduced lapses.

In a soft market a company may wish to adhere to its objective of keeping its market share to limit the adverse impact on its expense ratio. It may be that the only way of maintaining market share is by obtaining business at inadequate rating levels. However, an option open to such a company is to maintain its underwriting standards rather than its volume. This may be achieved by improved control of claims costs as a result of spending more money to achieve a better analysis or identification of risk features. A better knowledge of expenses will help in making this choice.

The way in which an insurance organisation operates has changed radically in the last few years. Increasing reliance on computers has led to tasks being performed differently and to changes in the skills required of staff. There has been a retrenchment of the branch network, and marketing and distribution methods have altered. This means that the measurement of expenses is a fluid subject which will require constant attention.

1.4 <u>Expense Categories</u>

So far no definition has been given of the items which are included in the term 'expenses'. Expenses can be grouped into the following categories:

a) <u>Administrative/Management Expenses</u>

These cover the expenses of acquiring and renewing business and cover the activities of underwriting, quotation (including sales), renewal and endorsement (plus servicing). Executive and management expenses also fall into this category.

b) Claims Expenses

These are expenses relating to the negotiation and settlement of claims. Some items like legal fees and loss adjusters' fees are directly attributed to individual claims and are treated as a part of the cost of the claim rather than as 'expenses'. Other items, like the salary costs of claims handling staff and office costs relating to these staff, cannot be directly attributed to individual claims and these are more akin to administration/management expenses.

c) Commission

This is usually a level percentage of the premium but will vary for different intermediaries/insureds. In some cases it is a flat fee. There may be volume overriders or profit commissions. Enhanced commission levels are paid to certain groups like Building Societies or to Broker Delegated Authorities because they perform some of the administration and marketing that would otherwise have been carried out by the insurer. A direct sales force may have production bonuses paid as salary whereas the equivalent payment to an intermediary would be called commission. At times it may not be possible to draw a clear distinction between these categories.

d) Investment Expenses

These relate to the buying, selling, handling and holding of investments together with related staff and office costs. These are normally deducted from investment income.

Our report deals with the first two categories (but commission is included in the DTI inter-company comparison shown in Appendix F).

1.5 Practical Applications

There is a wide range of activities to which a better understanding of expenses can be applied. These can be conveniently split into four groups: control, pricing, profitability and preparation of statutory and market information.

1.6 Structure of Report

The next three sections look at expenses from different views. Section 2 considers the various ways in which expenses can be analysed. Section 3 examines the allocation of expenses to various sectors of the business. Both sections illustrate the variety of ways in which expenses can be examined. Section 4 goes on to explore the important area of the incorporation of expenses into the pricing mechanism.

Section 5 deals with the accounting and taxation treatment of expenses. The final section gives details of actual practice and figures. It includes the results of a survey conducted amongst leading offices, confidentiality being maintained by not identifying individual companies. We would like to express our gratitude to all the participants.

2. ANALYSIS OF EXPENSES

2.1 Introduction

The methods used in analysing expenses will depend to a large extent on the purpose for which expenses are to be analysed. Different methods of analysis may be appropriate for different purposes.

2.2 Possible Expense Analyses

a) Analysis by Type of Expense

To some extent this can be seen as a step towards one of the more detailed analyses set out below. However, this can be an important aim in itself. Analysis by type of expense can be used as a method for controlling expenses.

The largest element of expenses is staff and staff related costs (e.g. mortgage subsidy etc.). It is possible to set targets/budgets in several ways:

i) Staff Head Numbers If you have a strict procedure to go through in order to recruit staff over the initial budget and have to justify the acquisition of additional staff,.you have the basis of a strict control procedure.

ii) Total Staff Costs This measure has the advantage that the "add-on" staff related expenditure is brought into the equation. The maintenance of this measure could be set as an objective for the appropriate cost centre.

iii) Ratio of Staff Costs to some other Measure The other measure could be sales or profitability. This has the advantage that if the business is growing or declining it allows directly for the changes in staff numbers required.

Much the same sort of controls could be applied to the other items of expense. The justification procedure to exceed the budgeted expenditure could encompass the need to show that the expenditure would lead to increased profitability. This can take the form of a payback period i.e. it would take 2 years to generate the additional profits and/or savings to cover the cost of the additional expenditure. This procedure is probably best suited to items of large capital expenditure.

Expenses could be analysed under the following headings:

Salaries and wages
Other staff costs
Buildings
Communications
Printing and stationery
Data Processing
Public Relations (including advertising)
Other

b) Analysis by Function

The expenses can be broken down into the various functions of the running of the insurance business. A possible split by function might be:

New Business
Claim
Renewal
Administration

It is possible that one might wish to split the New Business function into its two constituent parts, namely selling and underwriting.

There are three main ways in which this type of analysis could be used:

i) The figures could be monitored to ensure that there were no adverse trends in the cost of performing these functions.

ii) It is possible to identify those functions where costs are high and examine the scope to reduce the associated expenditure.

iii) The costs could be incorporated into the pricing mechanism.

c) Analysis into Fixed and Variable

This used to be a traditional split based on the argument that it was difficult to make adjustments to fixed expenses. It was therefore important for the various elements of the insurance business to make at least some profit contribution to the fixed expense element of the insurance company.

However, this notion may be somewhat outdated. In the short-term, none of the expenses are variable. It takes time to identify that there is an expense problem and time to reduce that expenditure. In the long-term all expenditure is variable. It may be for instance that considerable expense savings could be achieved by moving a significant part of the Head Office of a company from a high cost area to a low cost area.

d) Analysis by Direct and Indirect

This can be considered as a step on the way to a full analysis by class of business or profit centre. Essentially direct costs are self-defined in that they are the costs directly arising from the handling of a class of business. An example of this type of expense is the cost of staff directly involved in this class of business. This would comprise the salaries of the staff together with their associated costs, e.g. mortgage subsidy, pension fund contributions and National Insurance contributions. Indirect expenses then comprise the rest of the expenses. This would cover such items as the General Management of the company.

e) Analysis by Size of Policy

This is an important analysis as it enables expense contributions to be varied according to the size of the policy. This is of particular relevance when we are rating either very low or very high premium business.

It is unlikely that any of the standard analyses of expenses performed by a company will provide the information required. Special investigations will be needed.

f) Analysis by Source of Expense

If a sensible control mechanism is to be used then expenses must be analysed by source. If expenses are not analysed by source, there is no way that any control can be exercised. The sources by which the expenses would be analysed will depend upon the level of control required. A possible analysis would be by each Head Office department and by each branch.

g) Analysis by Profit Centre

To some extent this can be seen as the end product of the allocation process and this is a key reason why expenses need to be analysed. This enables an assessment to be made of the profitability of various parts of the organisation.

2.3 Recording of Expenses

A system must be set up to allow expenses to be recorded in such a way that the analyses described above may be performed. When setting up such a system it is important to consider all the purposes for which analyses will be required in order to ensure that the expenses can be provided in the required format. Most of the information will be provided from the Accounting system and this system should routinely provide information for the regular analyses. It may be necessary to have supplementary reports either on a regular or one-off basis.

The recording of the expense information will need to have detailed headings for the various items of expenses e.g. a suitable division for staff and associated expenditure might be:

Salaries
Overtime
Mortgage Subsidy
Pension Fund
National Insurance Contributions
Other Benefits
Temps and Sub-Contract Labour

Each of these headings would have a code allocated to it so that each item of expenditure processed through the system would have one of these codes associated with it.

In addition, each item of expenditure would be associated with a particular source. In this example the source could be either a Head Office department or a branch. The source would need to be the lowest denominator for which an expense analysis is required.

3. ALLOCATION OF EXPENSES

3.1 Purpose

Having ascertained its various costs of operation, over and above contractual claims payments, an insurer will next be considering the most appropriate way of allocating these costs to different sectors of the operation. There are several different purposes for which such allocations will need to be made and the likelihood is that a single basis of allocation will not be appropriate for all purposes.

The purposes for which expense allocation may be needed are:

a) Control of costs in operational units

b) Examination of profitability of products and operating units

c) Setting premium rates

d) Completion of DTI returns

e) Generation of internal management accounts

f) Completion of published accounts

In general we may summarise the purpose of allocating expenses as twofold. Firstly, to try to match sources of cost with sources of revenue, so as to minimise vulnerability to unrecovered costs and maximise contribution to cost coverage, and thereby profitability. Secondly, as a basis for understanding the commercial impact of the sources of cost, so as to arrange them structurally to minimise the level of costs. The continuous achievement of these two objectives produces minimum attainable costs, maximum profitability and minimum vulnerability to possible variations in outcome.

In pursuing these objectives three important facts will be immediately apparent. Staff related costs constitute the lion's share of operating expenses and therefore warrant the greatest amount of attention. Also most expenses are not directly related to single classes of business and we will therefore need to formulate a meaningful basis for allocating to several classes. Finally, fixed costs and variable costs are quite clear in theory, although, as the previous section described, these labels are actually a function of the time horizon being considered. In practice, some costs, particularly those for processing business which are people-related, are neither fixed nor variable. The cost can be curtailed if business drops, but not very quickly, and vice-versa. A possible decision to stop writing a particular class of business may well hinge on the question 'How quickly can we shed the related resources?'.

3.2 Levels

Let us briefly consider the various levels of allocation for a proprietary composite office. There is no generally accepted terminology for the precise meaning of 'classes', 'products', 'lines of business' etc. Each company tends to have a slightly different interpretation of these terms relative to its own range of business. In what follows, therefore, the use of these terms is described at each stage of the illustration.

The first level of allocation is between Life and General business. A proprietary composite has two distinct classes of 'surplus owners', shareholders and With-Profit policyholders. In the General Fund all available surplus belongs to shareholders. In the Life Fund all but a minor part of available surplus belongs to With-profit policyholders. The allocation of expenses to the Life or the General business will directly reduce respectively either the W.P. policyholders' or the shareholders' surplus. It is therefore important to segregate operationally as many costs as possible and to scrupulously allocate directly attributable costs as accurately as possible. Care must then be taken to ensure an equitable division of other costs.

The next level of allocation is an operational one. This means essentially 'Personal' and 'Commercial' or Fire, Accident and Motor.

The next level is to classes. This means for example (Commercial) Fire, Fleet Motor, Glass, Marine and (Personal) Domestic, Private Motor, Travel, Personal Accident. The basic differences in the nature of different classes, which underlie their business separation in the first place, are reflected also in their associated expense levels and characteristics. The historical tendency to allocate expenses to classes on the basis of relative premium income is not very satisfactory in achieving the basic purposes noted above. More recent practice, reflecting the objectives better, is to allocate as many expenses directly to classes as possible. The remainder is then allocated on a variety of bases.

Within classes, we next have products. This means for example 'special' private motor, say 'for over age 50 drivers', or 'building and contents' domestic cover. There may be multi-class products and some classes may consist of a single product.

Finally, the lowest level of allocation will be within product or class. This means essentially band discrimination such as large versus small risk within a Commercial Fleet Motor class. This would, for example, result in charging a different percentage loading of premium for large and small risks.

The distinction between 'new' and 'renewed' business in General Insurance is far less clear than in Life Insurance. The fact that contracts are one-year-renewable, rather than long term, means that renewing policyholders as well as first time policyholders are to a large extent being actively 'reacquired' each year. Having said this, certain groups of staff and costs can clearly be associated with acquiring new business rather than renewing existing business and to this extent might be so allocated. However, the relative profitability of new versus renewed business is a less obvious concept than that of, say, Commercial Fire versus Commercial Motor. In practice, no distinction is made in the pricing of new versus renewing business, but a differential allocation of expenses may be relevant.

In allocating costs, different companies will go to different degrees in addressing the possible purposes listed at the beginning of this section. The survey indicates that a variety of different bases are being used by different companies to allocate costs. This reflects the practical impossibility of measuring direct resource consumption by class uniquely. At the very least, all are obliged to do something for published accounts and DTI returns. Some companies may allocate direct (or even all) costs in proportion to their business classes' relative premium income. This may be completely misleading as an indication of the true relative resources consumed. At the very least such a basis of allocation even if used in published accounts should not be used for a company's internal management accounts. It is equally inappropriate to use such a basis for setting premiums. In terms of allocating direct costs out where appropriate, it would not be expected generally that doing so on a time-sheet basis or on a functional allocation basis would give very different results. Costs will generally be recorded for cost centres and then allocated by different weightings considered appropriate as a relative measure or proxy for that resource's relative consumption at business class level.

For example, salary costs can be allocated by timesheet, function, gross written premium; premises' costs by floor area, head-count; DP costs by usage, policy numbers, transaction volumes, gross written premium. Indirect costs are even more problematical to allocate being one stage less directly associated with any particular class of business. Methods which can be used include: pro-rata by overall direct costs, by salaries, policy numbers or by gross written premium.

Allocation of total expenses will give a completely different perspective on a class' profitability than considering its contribution to fixed expenses (marginal costing). It is quite possible that a total allocation might indicate a 'trading loss' on a particular class, whereas marginally costed (i.e. after directly attributable costs) the operation was producing a healthy positive contribution to fixed expenses. The following example illustrates this situation:

	Class 1	Class 2	Total
Premium Income	100	200	300
Claims incurred	80	160	240
Direct Expenses	5	25	30
Overheads	10	20	30
U/W Result:			
Including overheads	5	(5)	-
Excluding overheads	15	15	n/a

'Fixed' costs do in practice move in <u>step</u> changes every so often when the basis is re-examined or when the ceiling of business which the fixed resource can handle has been exceeded. The marginal costing basis may therefore be misleading after such a step change. A management view on the benefits of trying to expand a volume of business by 50%, or whatever, may be altered if this necessitates a material increase in the current fixed costs in order to achieve it. Both ways (i.e. total and marginal) carry their respective dangers in particular circumstances. It is therefore essential for such proper management decisions to look at the situation both ways in the knowledge of the broad underlying picture. This is explored further in the context of pricing and profitability in Section 4.

4. PRICING AND PROFITABILITY

4.1 Costing or Pricing

The practice of expense allocation is more that of 'finding a home for the costs of running the business' or 'making adequate charges against various accounts for control purposes' than of finding the right price or optimising profit. We need to look a little further if we want profitability to drive the business.

4.2 Ex ante or ex post

How, ideally, would we price a risk? In theory, we start well. We know what losses to expect from this sort of risk; we know an arrival/run-off pattern for the claims; so we can do some Net Present Value sums on claims costs. (They will actually be Net Then Value rather then NPV's, because we are probably setting rates for some future time; but we can cope with that).

Commission is easy since most premium is received net of commission, and the rate is known or negotiated. We can make adjustments for the rate of arrival of premium, building in costs for credit terms. We can assess the variable costs of particular types of risk, be they extra postage stamps or an additional survey. Assuming that we have the information at our command, there will be little controversy over how these features should be built into the price. Hereafter, however, we run into areas for which there are not even theoretically correct solutions.

It is all very well to come along ex post and spread the fixed costs you know you have incurred amongst the business you know you have written (pro rata with premium? or policy count? or claims? or something?). It is quite another thing to agree ex ante that fixed costs (by definition payable whether a particular risk is underwritten or not) should affect the price in a particular way. And yet if no provision for fixed cost is made in pricing, doom looms.

A further complication is that many supposedly variable costs are in practice pseudo-fixed. Labour is theoretically variable (if the work increases - take on more people etc.); actually it is extremely viscous - especially in the downward direction.

And what about profit? To what extent should we build an acceptable, or desirable profit margin into the price; or simply accept that profit springs from random investment performance, or lucky errors in loss ratio prediction?

When we examine these areas we have instinctive sympathy with two apparently opposing camps. On the one hand it seems entirely reasonable to argue for financial credibility in the pricing of risks. On the other hand we see how difficult it is for marketing and sales people to operate within an inflexible environment of financial accountability - they need to 'make deals'.

In general, pricing, which by definition must be done ex ante, calls for a different philosophy from the assessment of profitability, which can only be finalised ex post. And yet the two must be compatible, and must emerge from the same generic data sources.

4.3 Pricing

If we accept that there should be a pricing philosophy complementary to that of profitability then we need to establish the fundamental purpose of pricing. That purpose is surely to secure a flow of business that will, in the long term, optimise the profit accrual of the company.

We have agreed above, however, that the profitability of business will not be known until much later on in the process, let alone the optimal path. In realistic terms, therefore, we must limit the fundamental purpose to that of securing a flow of business deemed satisfactory at the time. There is certainly no reason not to take account of the 'easy' costs - claims, commission, variable costs, but it is reasonable to take a robust attitude to the rest. Advertising budgets are very hard to judge in terms of benefit, and more or less impossible to allocate amongst products. It is quite respectable, therefore, to set them at a semi-arbitrary level and leave it at that. Under such circumstances it would clearly be inappropriate to introduce them as a critical feature of pricing. Arguably there is no more justification for the elaborate allocation of other fixed costs at the pricing stage - a flat percentage will do.

The advantage of this approach is to allow the 'salesman', face to face with the customer, maximum flexibility to produce business. Provided that he balances his prices about a norm, including a satisfactory margin for all the fixed or pseudo-fixed costs, he should be at liberty to price individual risks down to the limit of commission plus expected claims plus variable costs should the marketing conditions make it reasonable.

This argument does, of course, imply that the 'salesman' is in a flexible environment as regards pricing at the point of sale. If he is bound by a ratebook to charge a particular price, as in the case of motor insurance, say, the room for sophistication is absent. The ratebook will have made (inflexible) provision for the fixed cost elements.

4.4 Profit

At the end of the day, often a very long day, it will be evident whether the pricing achieved was profitable. As a strategic tool that statement is somewhat unhelpful, but it would take an extremely brave man in the insurance industry to predict the level of profit in a particular year. At a point in time, therefore, cost allocation must be carried out, and the profitability of each product at some date in the past assessed. This is when profitability is fed back into the pricing system through the assessment of the assumptions previously used. There may be other factors which influence pricing like the availability or current level of capital.

The critical point here is that the fixed cost assumptions may be robust in their application - a single percentage block to be manipulated at will by the 'salesman' - but they must be fully understood. The individual elements must be predicted and, ex post, judged. Furthermore, the reason for differences must be fully understood. Consider the following scenario:

Pricing is set at 15% commission, 65% claims, 5% variable costs, and a block margin of 15% for other expenses. The outcome is that everything is correct except for the block margin, which is 25%.

There are three possible reasons for this:

a) Costs have risen, and will stay higher. (Office rents have risen, reinsurance is more expensive, etc.)

b) There has been an exceptional expenditure in the year (computer blew a gasket, Head Office fell down)

c) Premium was less than expected; although costs were as predicted in absolute terms, the percentage was set too low.

In the first case it could be appropriate to raise the margin in future pricing; in the second case it would not. The third case is the most interesting. The instinct would be to raise prices (not least to recoup losses - totally illogical). Unless, however, there are reasons to believe that there have been structural changes in the market permanently reducing its size, or that there is a realistic expectation that the company will never write the same volume again, there is no reason to feed the profitability though into pricing. But we must <u>know</u>. And that can only be achieved through a process of prediction, assessment and revision. Very often this circle is not completed.

4.5 Summary

Ideally, with perfect foreknowledge, profitability and pricing would be parts of a single process. In practice pricing is travelling in hope, and profitability something you find out after you have arrived. The processes are complementary, therefore, rather than identical. As a consequence different price allocation models may be appropriate reflecting the different knowledge bases at the relevant times.

5. FINANCIAL ACCOUNTING AND TAXATION TREATMENT

5.1 Introduction

This section has been divided into six parts covering the treatment of General Insurance expenses in: UK financial statements, Department of Trade & Industry Returns, UK taxation computations, US financial statements (US GAAP), US statutory accounting and European accounting.

5.2 UK Financial Statements

a) ABI SORP

A Statement of Recommended Practice on Accounting for Insurance Business (SORP) was issued by the Association of British Insurers in December 1986. This statement is intended by the ABI to supplement Statements of Standard Accounting Practice (SSAP's) issued by the Councils of the accountancy bodies. The ABI SORP is currently an exposure draft and has not, as yet, been recognised by the accountancy bodies. It is, however, the only authoritative summary available in the UK of current best accounting practice. (Extracts from the SORP are included as Appendix A).

Certain of the requirements for expense accounting indicated by the SORP and summarised in the appendix diverge from the practices currently followed by a number of companies. The following are among the more important:

i) To comply with the accruals concept, the SORP requires the calculation of deferred acquisition expenses when using the annual and deferred annual accounting bases. It requires that an accurate method be adopted for the calculation but does not specify whether overhead expenses should be included in addition to commissions. The SORP also requires that the amount of deferred acquisition expenses and the net change in the deferred acquisition expenses incurred be disclosed.

ii) Claims handling expenses should be charged in full against the revenue of the accounting period in which the claims are incurred. The SORP recommends that expenses which are anticipated to become payable in subsequent accounting periods in relation to incurred claims should be provided for. It also recommends that they be provided for as a component of the provisions for claims outstanding figures. This seems inconsistent with the SORP requirement to disclose deferred acquisition expenses separately from the unearned premium provision.

iii) The SORP requires that a specific bad debt provision should be established for debts which are regarded as uncollectable and that this provision should be charged to expenses. It does not clarify how the bad debt component of an IBNR projection should be dealt with.

b) Companies Act 1985

The practical application of the Companies Act 1985 to expense accounting in financial statements is generally well understood. References to relevant sections and schedules of the Companies Act 1985 are included in Appendix B. The exemptions available to insurance companies can have implications for expenses. It is permissible, for example, for realised exchange gains or losses to be written off directly to reserves rather than through the profit and loss account. Greater flexibility also exists for the treatment of goodwill and preliminary expenses for example.

c) Fourth Directive

The European Commission have now prepared a draft Fourth Directive which would be applicable to insurance companies. It is likely to introduce fundamental presentational and accounting changes. As far as expenses are concerned, the key issue other than presentation concerns future availability of the exemptions referred to above.

The presentational changes are unlikely to create major difficulties. The Directive is rigid about set-off; none will be allowed. Thus separate disclosure will be required of commissions paid and commissions received and of unearned premiums and deferred acquisition costs.

The draft directive suggests the following disclosure for expenses charged to the "Non-Life Insurance Business Technical Account":

Commissions and other technical charges:

- Commissions	X
- Administrative expenses	X
- Commissions and profit participation from other insurance undertakings (-)	X
- Variations in deferred acquisition costs (+ or -)	X
Net amount of commissions and other technical charges	X ==

Investment charges, split between those relating to land and buildings and "other investment management charges" will be separately disclosed in the "Non-Technical Account". These amounts will include interest. The "Non-Technical Account" will also include separate disclosure of "Non-Investment Charges", Tax and Extraordinary Charges.

d) SSAP's

Apart from the Companies Act requirements already referred to, financial statements have to comply with Statements of Standard Accounting Practice (SSAP's) to the extent that these do not override statutory exemptions. The more important Standards as far as General Insurance expense accounting are concerned are as follows:

i) SSAP 2 - particularly the four fundamental accounting concepts; going concern, accruals, consistency and prudence
ii) SSAP 6 - dealing with extraordinary items and prior year adjustments
iii) SSAP 12 - accounting for depreciation
iv) SSAP 15 - accounting for deferred tax
v) SSAP 20 - foreign currency transactions
vi) SSAP 21 - accounting for leases and hire purchase contracts
vii) SSAP 22 - accounting for goodwill

Due to the availability of statutory exemptions, the significance of SSAP's 20 and 22 are reduced for an insurance company. The remaining standards do not generally create difficulties for insurance companies and normally enable the practices followed for management accounts purposes to be adhered to for financial reporting purposes.

5.3 Department of Trade and Industry Returns

The requirement for annual returns is contained in the Insurance Companies Act 1982. Detailed requirements are specified by the Insurance Companies (Accounts and Statements) Regulations 1983. Broadly speaking, the returns provide a financial analysis of an insurance company on a break-up basis with the inclusion of statutory solvency margins. Following this doctrine, a provision is required in respect of the expenses for settling claims outstanding. Other expenses are accounted for on an incurred basis and the format of the returns encourages them to be allocated to underwriting accounts with some flexibility on the presentation. In particular, Form 20 line 72 permits "other expenditure" to be attributed to the underwriting accounts. Expenses not dealt with directly in the underwriting account or attributed to it are dealt with as management expenses on Form 16. Form 16 also deals with interest payable and taxation.

Despite the emphasis on a break-up valuation, Form 22 does permit management expenses and commission to be carried forward to the next financial year (column 3). It is worth noting, however, that a provision for unexpired risks is anticipated in the forms thereby recognising any run-off losses which are foreseen. Principles for the valuation of assets and liabilities are contained in the Insurance Companies Regulations 1981.

Regulation 52 of the 1981 Regulations requires that liabilities are formulated using "generally accepted accounting concepts, bases and policies or other generally accepted methods appropriate for insurance companies". The calculation of the various expense accruals and the unexpired risk provision is therefore governed by the same concepts which apply to financial statements.

5.4 UK Taxation Computations

A company writing General Insurance business within the charge to UK corporation tax will be liable to corporation tax on its profits from that business calculated under the normal rules of Schedule D Case I. The current rate of corporation tax is 35%.

a) Allowable expenditure

Expenditure incurred wholly and exclusively for the purposes of the General Insurance trade will normally be deductible in arriving at taxable profit. There are no rules defining allowable expenditure although there are certain items which are specifically disallowed. The trading profit or loss for Schedule D Case I purposes is the profit or loss disclosed in the accounts before taxation and allocations and distributions of profit and after making certain adjustments for tax purposes. Appendix C contains a summary of some of the more common adjustments to expenditure found in the tax computations of both General Insurance companies and other UK trading companies.

b) Allocation of a higher proportion of overhead expenses incurred by a Composite insurance company to its Life Fund

If an allocation of expenses between the Life Fund and General business fund is unreasonable then there is a risk that the Inspector will seek to adjust the allocation. The Income and Corporation Taxes Act, 1988, Section 76(2), suggests that relief in respect of management expenses would not be given if it reduces the corporation tax borne on the income and gains of its life assurance business to less than would have been paid if the company had been charged to tax under Schedule D Case I. His approach might be to restrict the deduction for management expenses in the Life Fund. As the expenses would not have been borne by the General profit and loss account it is not certain that he would make a compensating adjustment to the General Insurance profits, because the Insurance Companies Act, Section 25 prohibits the transfer of assets between the Life Fund and the General business fund, unless the transfer constitutes a reimbursement of expenditure borne by the other fund. One of the advantages of adopting a rigorous approach to expense allocation is the resultant supporting documentation for any inter-fund charges.

c) Claims handling expenses

Provisions for settlement expenses are likely to be challenged by the Inspector of Taxes on the basis that these should be allowed as management expenses for the period in which they are "incurred", which the Inland Revenue argue is the period in which the service is provided. Many companies do, however, succeed in having provisions for settlement expenses allowed; normally because this has been the treatment in the computation for a number of years. It has also been successfully argued that at least that proportion of the provision which relates to the more direct costs should be allowed; the Revenue consider that general overheads should be treated as management expenses. The need for a provision in DTI Returns and encouragement to establish one in the ABI SORP are helpful factors on the side of companies.

5.5 US Financial Statements

The preparation of US Financial Statements is broadly governed by US "Generally Accepted Accounting Practice" (GAAP), which covers a range of authorities who have issued guidance on accounting treatment, disclosure and practice. These authorities are generally taken to comprise: AICPA (American Institute of Certified Public Accountants), APB (Accounting Principles Board), SEC (Securities and Exchange Commission) and FASB (Financial Accounting Standards Board).

There is little US GAAP regulation specific to General Insurance expenses, with the exception of FAS 60 concerning "Accounting and Reporting by Insurance Enterprises". This statement, issued by FASB, establishes accounting and reporting standards for the general-purpose financial statements of property and liability insurance enterprises.

FAS 60 requires that costs incurred during the period, such as those relating to investments, general administration, and policy maintenance, that do not vary with and are not primarily related to the acquisition of new and renewal insurance contracts shall be charged to expense as incurred. Commissions and other costs that are primarily related to insurance contracts issued or renewed ("Acquisition Costs") should be capitalised and charged to expense in proportion to premium revenue recognised. Unamortised acquisition costs are classified as an asset.

Despite the absence of other regulations specific to General Insurance expenses there is a general requirement to comply with other US GAAP. Therefore accounting treatment should comply with Accounting Research Bulletins (ARB), APB Opinions, SEC Regulations and other FAS's. ARB's were issued by a committee of AICPA in a period to 1953 when ARB 43 was produced summarising the previous bulletins; much of ARB 43 and later bulletins are still relevant today. APB has issued over 30 opinions and there are about 100 FAS's in issue. In general UK GAAP and US GAAP are very similar, although FAS's tend to be more specific, rather than formulating general rules. Some of the significant differences which may be important to General Insurance expenses are as follows:

a) Extraordinary items

The criteria for extraordinary items are considerably more narrow in the US than in the UK (APB 30).

b) Pension costs

The prescriptive method of arriving at pension costs for US accounting compared with the choice of actuarial methods allowed in the UK (which largely will continue to be allowed under SSAP 24), could result in significant differences (FAS 87).

c) Freehold and long leasehold properties

In the UK, it is occasionally the practice not to depreciate freehold and long leasehold properties maintained in a state of good repair. Under US GAAP, depreciation must be charged.

5.6 US Statutory Accounting Practices (SAP)

The US insurance industry has been closely regulated by individual State insurance authorities for many decades. SAP is derived from requirements of the National Association of Insurance Commissioners (NAIC). Expenses have to be classified, allocated and aggregated according to the operating functions which generate the expense. Expense groups are specified in the NAIC Financial Condition Examiners Handbook. It provides very specific guidance on the composition of the five major expense groups which are defined:

Investment
Loss Adjustment
Acquisition, field supervision and collection
Taxes
General Expense

The Handbook then goes on to provide rules for allocation to the various lines of business which are separately accounted for. These lines of business number as many as 30 and some of those are sub-divided. These detailed accounting requirements are translated into standard forms, or exhibits, which every company must complete.

The room for managerial decision on how to allocate expenses is much reduced by these detailed reporting requirements. It also enables inter office investigations to be performed in more detail and with more reliability.

An Example of the Annual Insurance Expense Exhibit is shown in Appendix D. Part I of the Exhibit gives the allocation to expense groups and Part II the allocation to lines of business.

Like DTI Regulations, NAIC accounting and reporting requirements place an emphasis on the financial condition of an insurer; solvency and liquidity. This leads to a number of differences between SAP and GAAP for expense accounting. In particular, costs incurred in acquiring business are charged in the current accounting period for SAP. By contrast, deferred acquisition costs are recognised for GAAP to allow these expenses to be amortised in proportion to premium revenue recognition. Less significant differences may also be encountered, depending on individual circumstances, for the treatment of contingent commissions, loss expense reserves and deferred taxation.

NAIC requirements are supplemented by individual State requirements. Of particular importance is Regulation 30 of the New York State Insurance Regulations. Regulation 30 contains over 20 pages of detailed rules specifying which items should be included in and excluded from the various expense classifications. The Regulation is followed in a large number of other States.

5.7 European Requirements for Expense Disclosure and Accounting

A quick survey of requirements in other European countries reveals a wide variation:

Ireland follows SSAP's and compliance with the ABI SORP is encouraged. Regulatory returns are almost identical to DTI returns.

The format for accounts in Italy and Belgium is specified by the law; in the case of Belgium it reflects the EEC 4th Directive. Interestingly, Italy requires expenses to be classified by function (underwriting, investments, claims, overheads) while Belgium prefers a type of expenditure breakdown (personnel, services, depreciation). Belgium also requires expenses to be split over the main lines of business which are statutorily defined.

France tends to deal with expenses as overheads except for those which are directly attributable to specific claims. These are charged to claims paid and outstanding claims. An allowance is, however, made for future overhead expenses by adding 5% to the provision for outstanding claims which represents processing costs. France also has an unusual approach to deferred acquisition costs. These are reflected by establishing a provision for unearned premiums and unexpired risks by multiplying the gross unearned premiums by a combined loss ratio.

Switzerland has no specific rules but tends to adopt a more prudent attitude to deferred expenses by writing off all costs to profit and loss as soon as possible.

6. STUDY OF ACTUAL METHODS & FIGURES

6.1 Survey

a) Introduction

A survey was conducted of the practices used by UK companies in the treatment of expenses with the intention of providing confirmation or otherwise of many of the points made in the earlier sections. It would indicate the depth to which expenses are investigated, the similarity between the approaches of different companies and the common problems faced by companies. The intention was to use a simple yet comprehensive questionnaire from which we could obtain a consistent overall picture. The questionnaire is included as Appendix E.

b) Response

Twenty three companies were approached initially and asked whether they would be prepared to provide information. They included some of the leading composites, some Life companies with a significant General business operation, some medium-sized General business companies and some specialist insurers and reinsurers. Only one company did not bother to respond. Twenty one out of these twenty two companies filled in the questionnaire, the remaining one feeling unable to divulge the information.

c) Results

The questionnaire was set out along similar lines to Sections 2 to 5 of this report and the answers are summarised below. Readers are advised to refer to the questionnaire in Appendix E when reading this summary.

i) Purpose Most companies use expense analyses and allocations for all the purposes listed in Q1 viz:- control, efficiency, profitability, measurement, preparation of statutory and market information and the pricing of risks. Surprisingly, a quarter said they do not use expense investigations for pricing.

ii) Accounting Although non-mandatory and only released in December 1986, almost half the companies follow the Statement of Recommended Practice (SORP) issued by the ABI fully. The areas in which the SORP is most commonly not followed are 2 c), e) and f). A further 25% of companies intend to modify their policies to achieve full compliance in the near future. Some companies do not include relevant overhead expenses when calculating deferred acquisition costs. The main implication of the removal of exemptions from Companies Act 1985 would be to change accounting policy so that realised exchange gains and losses are disclosed through the P & L account rather than being taken directly to reserves.

iii) Analysis All companies analyse expenses by the types listed in Q8 and cars, office equipment, travel, entertainment, advertising and professional fees were given as other categories. The breakdown indicated by the responses is as follows:

	Average %	Range %
Salaries	44	40 - 50
Other Staff Costs	16	14 - 20
Premises	11	7 - 15
DP	10	6 - 10
Communications	5	3 - 5
Other	14	10 - 20
	100	

The figures in the average column give the mean for each category and those in the range column give the lower and upper quartiles for each category. Some adjustments and approximations had to be made to the submitted returns in arriving at these figures.

This survey shows that total staff costs absorb 60% of all expenses as opposed to the 70% revealed in Rushton's 1977 paper. This difference may be explained partly by the increasing importance of DP costs, partly by differences in classification (e.g. salaries of DP staff may have been included within DP) and partly because this survey looks at twenty one different sized companies whereas Rushton's paper looked at the leading composites.

The wide variation amongst companies in this survey is probably more a reflection of different definitions than of different organisational structures. As an example, the ratio of salaries to other staff costs ranges from 2 : 1 to 4 : 1 (also see Section 6.3).

Besides branches and H.O. departments, other categories for source or cost centre in expense analyses are: defined cost centres, special projects and Group overheads. In addition to selling, underwriting, administration and claims some companies analyse expenses by functions described as accounts (or finance), investment and DP. Some companies do not split expenses by function.

iv) Allocation When allocating expenses virtually all companies go down at least to DTI class level. Half go further and allocate expenses to internal reporting classes with two going right down to product level. Three quarters of the companies use DTI (or slightly different) allocations for internal measurement of class profitability. Four companies say that profits are not studied by accounting class but do not specify how they are studied.

About half the companies use more than one of the three methods (time sheets, functional costing, work measurement) in allocating salary related expenses. For companies using a single method, the most popular is functional costing.

Companies use codes for individual expense types (the five mentioned above generally have sub-divisions) and expenses are often recorded at cost centre (branch, H.O. department) level. Some types are only recorded at a higher level (Life, Non-Life). At the other extreme, some types can be measured directly at the appropriate level which is generally class of business. For those types which cannot be measured directly, some weighted measure (e.g. time weighted, people weighted, salary weighted, GWP weighted) is used in allocating expenses to class of business. Examples of measures in use are:

Salary Costs	:	By use of time sheets, work measurement, functional costing
Other Staff Costs	:	As above (i.e. in proportion to salary costs)
Premises	:	Floor area, staff numbers
DP Costs	:	Usage, number of policies, number of transactions, number of policies weighted by a complexity factor, GWP, direct allocation of costs of special systems.
Travel Tele/Postage Stationery	:	Actual incurred, salary costs, staff numbers, units used, GWP, sampling

When it comes to indirect costs, these are initially split among the line departments and then allocated down to class level. The most popular method in use is to split them in proportion to the direct expenses. Other methods are: in proportion to GWP, staff numbers, policy numbers and claim numbers. Some companies use a pre-determined percentage of direct costs.

v) Operating Profitability Fourteen of the twenty one respondents have a branch structure and over half of them allocate indirect expenses to branches in the measurement of branch profitability. All apart from one allocate these expenses in proportion to branch GWP. Although almost all the companies with a branch structure measure results at branch level, only eight determine class expenses separately for each branch in this measurement.

vi) Rating About half the companies incorporate expenses explicitly into the rating structure, but only three admit to incorporating them at policy level. In the rating of individual large risks about half the companies sometimes make an allowance for direct expenses (i.e. use marginal costing) but the other half never make use of it.

vii) Overall The responses are heartening as they show that considerable attention is being devoted to the subject of expenses. Some companies are further down the road than others and this is often a reflection of the different needs of different types of organisations. Companies admit to shortcomings in their approach - some have reviews underway and others have plans in hand (or at least a long term aim) to do so. Some questions produced ambiguous answers and some respondents rightly felt that the questionnaire applied more to a direct insurer with a branch structure.

6.2 DTI Returns

This section describes an investigation into the expenses actually allocated to the DTI Accounting Classes by twenty three companies in the UK in 1986. The offices are included simply because DTI data was available for them - they are not identical to the twenty three offices who responded to the survey in Section 6.1. Ratios of expenses, including commission, to premiums are set out in Appendix F.

a) Sources of data

Data was extracted from the DTI Returns for the year ending 31st December 1986 (or earlier year-end date in 1986 if relevant). There are a number of ways in which expenses could be compared with premiums and/or claims but the method chosen was to relate expenses paid or due to be paid in a year with the premiums earned in that year. Note that in the 1980 GISG Expenses Working Party paper expenses were compared with premiums written, but more data is now available in DTI Returns. Thus the calculations were based on the fields from the DTI Returns set out below. The format for each field relates to (Form No.). (Line Nos.). (Column No.).

	Gross	Net
One-Year Classes (Accident & Health, Motor Vehicle, Property Damage, General Liability, Pecuniary Loss):		
Premiums Earned	21.(29+31).1	21.(29+31).5
Expenses	22.(21+22+23).4	22.(21+22+23).4
Commission Paid	22.24.4	22.(24-25).4
Three-Year Classes (Aviation, Ships, Goods in Transit, Treaty-Non-Proportional):		
Premiums Earned	24.(11+12).5	24.19.5
Expenses	24.31.5	24.31.5
Commission Paid	24.32.5	24.(32-33).5
Three-Year Class (Treaty-Proportional):		
Premiums Earned	27.(12+15).3	27.19.3
Expenses	27.31.3	27.31.3
Commission	27.32.3	27.(32-33).3

b) Calculations

Ratios of expenses and commission, separately and combined, were calculated for each accounting class for the 23 companies (if they transacted that class). Combined results for all classes were also obtained. The companies were then divided into three groups Small, Medium and Large according to their overall net premiums in all classes combined. Average results within each size band were also calculated for each accounting class. The detailed results for each class within each company on a net basis are set out in Appendix F. It was felt that net results were a more accurate indication of business volume and efficiency than the corresponding gross figures, but some comments are given below on the gross results.

c) Comments on results

i) There are some mathematically peculiar results:

- Timing differences (and accounting adjustments) can mean that in some smaller classes expenses or commission are a disproportionate percentage of premiums earned.

- Because the figures are net of reinsurance there are anomalies where either the net premiums or the net commission can be negative. This mainly arises in the "Small Group" of companies. In particular the Aviation class of Crusader has a large negative net premium which distorts the results of the Aviation class for the whole of the Small Group.

- Rounding to one decimal place can mean that "Commission/premiums" and "Expenses/premiums" do not add up exactly to the "Total" percentage.

ii) Some economies of scale would appear to be demonstrated by the figures. The overall combined commission and expense ratios for the Large, Medium and Small groups are 32.3%, 33.6% and 38.8% respectively. Study of the size group results for each class shows the same order of economies of scale in most classes. Correlation co-efficients and tests for significance have not been attempted!

iii) On the Gross basis (detailed figures not given in Appendix F) the overall combined ratios for the Large, Medium and Small groups are 30.3%, 30.4% and 35.3% respectively. Most of this reduction of 2 or 3 percentage points takes place in the Expense part of the ratio, as is fairly obvious. The closeness of the overall result for Large and Medium groups is caused by the fact that the Medium group have a higher proportion of Gross premiums in the 3-Year Accounting classes where expense ratios are significantly lower.

6.3 Interstat

One source of comparison of expense distribution between companies is the ABI Interstat interchange. The most illuminating comment it makes on the subject is how very difficult it is to make such comparisons. Despite close and careful definition of expense categories by type, the output (shown as percentages of written premium) varies so dramatically between companies that one can only assume differences in classification.

One example shows how difficult classification can be: Computer Software may in one company be bought in from external consultants, in another developed in house. In the latter case much (most) of the cost will be lost in staff salaries.

The categories identified are:

Salaries
Pensions, Ordinary Funding
Pensions, Topping-up
National Insurance
Staff Mortgage
Other Staff Costs
Property
Computer Hardware
Computer Software
Telephone, Telex, and Postage
Printing and Stationery
Motor Fleet Costs
Other Travel Expenses
Other Expenses
Total Expenses

Despite the problem mentioned above, the data are useful for some comparisons, and for identifying trends from year to year.

The 1987 Larger Companies Interstat return shows a similar percentage breakdown by expense type to the one revealed in our survey.

BIBLIOGRAPHY-RECOMMENDATIONS FOR FURTHER READING

1. I L Rushton.

Analysis of Insurance Expenses - Institute of Actuaries Students Society 1977.

A comprehensive summary of all aspects of cost allocation including a detailed set of forms and working sheets.

2. A K Thompson etc.

General Insurance Study Group - Expenses Working Party 1980. (Later presented as a paper to Stratford-Upon-Avon Seminar 1982).

Articles on four separate topics 1) Loadings, Costing and Rating 2) Claim Settlement 3) GI expenses in a Home Service Office 4) Marginal Costing. Plus a summary of commission and expenses for ten large (but unnamed) offices expressed as ratios of written premiums by class from 1978 D.O.T. Returns.

3. N A Doherty.

The Measurement of Output and Economies of Scale in Property/Liability Insurance - Journal of Risk and Insurance vol. 48. no. 3 September 1981.

An attempt to measure "output", for which claim payments are concluded to be the best measure rather than premium income. Output is then correlated against expenses to demonstrate some economies of scale. This paper contains an extensive (mainly US) bibliography as at that time on efficiency of insurers and their distribution systems.

4. P Praetz.

A note on Economies of Scale in the United Kingdom Property/Liability Insurance Industry - Journal of Risk and Insurance June 1985.

One of a series of articles by Praetz on economies of scale in a number of countries. Using data for 60 UK companies in 1980, expense ratios are shown to decrease for each class as volume increases

5. Swiss Re.

International Comparison of the Development of Operating Costs in Non-Life Insurance 1963-1982 - Sigma newsletter of Swiss Re (UK) - February 1985.

Shows the trends of management expenses as percentages of (i) premiums, (ii) total operating costs and (iii) total costs i.e. including claims. The statistics cover the industry wide position in 9 countries (but not for all tables) for periods varying from 10 to 20 years ending in 1982. Uniformly on an international basis they show a trend away from commission to internal expenses.

6. R Wade.

Expense Analysis in Ratemaking and Pricing - Proceedings of Casualty Actuarial Society Vol LX - 1973.

7. D Childs.

Expense Allocation in Insurance Ratemaking - Casualty Actuarial Society Discussion Program - 1980.

8. R Foster.

A system for Planning and Controlling Expenses - Proceedings of Casualty Actuarial Society - Vol LIII - 1966.

The above 3 references are the standard US works on the subject of expenses, apart from the C.A.S. course study notes.

9. J Lemaire.

An Application of Game Theory: Cost Allocation - Astin Bulletin Vol-14 - 1984.

Shows how allocation of costs between classes by traditional methods does not necessarily satisfy some basic criteria i.e. some classes do not "benefit" from the co-operative venture. Goes on to recommend some new techniques. Mathematics is not too heavy for an ASTIN article!

(The above Bibliography has been extracted from Reading Lists available in the Institute of Actuaries and Chartered Insurance Institute libraries and from US Sources. Obviously other titles are covered in those lists but the above are the recommended first sources).

APPENDIX A

STATEMENT OF RECOMMENDED PRACTICE ON ACCOUNTING FOR INSURANCE BUSINESS (SORP) - EXPENSE ACCOUNTING AND DISCLOSURE REQUIREMENTS

As far as General Insurance expenses are concerned, the SORP recommends the following (references in brackets are to the relevant paragraphs of the SORP).

Accounting

a) A clear distinction should be made between capital and revenue expenditure. (21.2)

b) Expenses should be accounted for on an incurred basis. (21.6)

c) An accurate method of calculating deferred acquisition expenses should be adopted. (22.2)

d) Under the fund accounting basis expenses should be charged on an incurred basis. (22.5)

e) Under the annual or deferred annual accounting basis claims handling expenses should be charged in full against the revenue of the accounting period in which the claims are incurred. (23.1)

f) Investment expenses should be deducted from investment income and separately disclosed. (24.1)

g) Corporate expenses should be charged either to the revenue account or to the profit and loss account as considered to be appropriate by the enterprise. (25.1)

h) The amortisation of capital expenditure will be in accordance with SSAP 12. (26.1)

i) If necessary a bad debt provision should be established and charged to expenses. (27.1)

j) Provision should be made for all claims outstanding, whether notified or not, and related claims handling expenses. (13.2)

Disclosure

The SORP also recommends that the following should be disclosed with regard to expenses:

a) The amount of deferred acquisition expenses. (22.3)

b) The basis adopted for assessing deferred acquisition expenses. (22.4)

c) The net change in deferred acquisition expenses. (22.4)

d) The amount of investment expenses deducted from investment income. (24.1)

e) The policy adopted for capitalising expenditure. (28.1)

The SORP also provides a "possible classification of expenses".

COMPANIES ACT 1985 - RELEVANT SECTIONS AND SCHEDULES

The financial statements of UK companies have to comply with the Companies Act 1985. Requirements for the accounts of insurance companies, meaning insurance companies to which Part II of the Insurance Companies Act 1982 applies, are dealt with in Sections 257 - 262 of the Companies Act 1985. These Sections state that:

a) Insurance company accounts have to comply with Schedule 9 of the Act rather than Schedule 4. This arises because insurance and other special category companies were excluded from the European Community Fourth Directive which is reflected in UK law by Schedule 4.

b) Certain exceptions to Schedule 9's requirements are noted in Part III of Schedule 9.

c) Where a company has availed itself to the benefits of any of the provisions of Part III of Schedule 9, the audit report no longer has to state that the financial statements give a "true and fair view".

UK TAXATION COMPUTATIONS - COMMON ADJUSTMENTS TO EXPENDITURE

a) Entertainment - not allowable unless reasonable and in respect of staff entertainment.

b) Expenditure of a capital rather than of an income nature.

c) General provisions for bad debts. Relief will be allowed in the year in which a debt becomes bad or is specifically estimated to be bad.

d) Charges on income - certain annual interest payments and other annual payments are not allowed as a deduction in arriving at the Schedule D Case I result but are allowed as a "charge on income" in computing the total taxable profits of the company from all sources. Relief for such charges on income is given on the amount paid in the accounting period and not by reference to the amount accrued. Thus tax relief for accruals at the year end of such items is postponed until the following period.

e) Depreciation and amortisation, including profits or losses on sales of fixed assets is excluded from the tax computation. However, certain items will qualify for tax capital allowances. The most common items qualifying for capital allowances to a financial services company would be:

Office furniture, equipment and some fittings	25% writing down allowance on a reducing balance basis
Cars costing £8,000 or less	ditto
Cars costing more than £8,000	Writing down allowance restricted to the greater of £2,000 or 25% of the written down balance

(If the sale proceeds of an asset exceed the original cost then, depending on the precise circumstances, a taxable capital gain may arise).

f) If a car costing more than £8,000 is leased by the company then there will be a restriction in the amount of the lease rental deductible.

INSURANCE EXPENSE EXHIBIT – 1985

APPENDIX D

FOR THE YEAR ENDED DECEMBER 31, 1985

OF THE ST. PAUL FIRE AND MARINE INSURANCE COMPANY (CONSOLIDATED) INSURANCE COMPANY

ADDRESS (CITY STATE AND ZIP CODE) 385 WASHINGTON STREET ST. PAUL, MN 55102

NAIC GROUP CODE 164 NAIC COMPANY CODE 01643

[illegible]

ST. PAUL FIRE AND MARINE INSURANCE COMPANY
ST. PAUL MERCURY INSURANCE COMPANY
ST. PAUL GUARDIAN INSURANCE COMPANY
THE ST. PAUL INSURANCE COMPANY
THE ST. PAUL INSURANCE COMPANY OF ILLINOIS
ST. PAUL SURPLUS LINES INSURANCE COMPANY
ST. PAUL LLOYDS
ATHENA ASSURANCE COMPANY
ST. PAUL INDEMNITY INSURANCE COMPANY
ST. PAUL PROPERTY AND CASUALTY INSURANCE COMPANY
ST. PAUL FIRE AND CASUALTY INSURANCE COMPANY
ST. PAUL INSURANCE COMPANY OF NORTH DAKOTA
[illegible] INSURANCE COMPANY
SEABOARD SURETY COMPANY
SEABOARD SURETY COMPANY OF CANADA

GENERAL INSTRUCTIONS (TO BE FILED NOT LATER THAN APRIL 1, 1986)

(1) REFER TO INSTRUCTIONS FOR UNIFORM CLASSIFICATIONS OF EXPENSES FOR DEFINITIONS OF EXPENSE GROUPS AND INSTRUCTIONS FOR ALLOCATION OF EXPENSES TO LINES OF BUSINESS.
(2) COMPUTE ALL RATIOS TO NEAREST THIRD PLACE AND EXPRESS AS PERCENTAGES, E.G., 48.3.
(3) THERE SHOULD BE SUBMITTED WITH THIS EXHIBIT A DETAILED STATEMENT OR FOOTNOTE WITH RESPECT TO ANY ITEM OR ITEMS REQUIRING SPECIAL COMMENT OR EXPLANATION.
(4) REPORT ALL AMOUNTS TO THE NEARER THOUSAND OR THROUGH TRUNCATION OF DIGITS BELOW A THOUSAND. (EXAMPLE: $602,503 MAY BE REPORTED AS $603 BY ROUNDING OR AS $602 BY TRUNCATION.
(5) AN INDIVIDUAL COMPANY EXPENSE EXHIBIT MUST BE SUBMITTED. POOLED EXPENSE EXHIBITS WILL NOT BE ACCEPTED. THE INDIVIDUAL EXPENSE EXHIBIT MUST RECONCILE TO THE INDIVIDUAL COMPANYS ANNUAL STATEMENT.

PART I - ALLOCATION TO EXPENSE GROUPS

OPERATING EXPENSE CLASSIFICATIONS	1 LOSS ADJUSTMENT EXPENSES	OTHER UNDERWRITING EXPENSES: 2 ACQUIS, FIELD SUPERVISION & COLLECTION EXP	OTHER UNDERWRITING EXPENSES: 3 GENERAL EXPENSES	OTHER UNDERWRITING EXPENSES: 4 TAXES, LICENSES AND FEES	5 INVESTMENT EXPENSES	6 TOTAL EXPENSES
1. CLAIM ADJUSTMENT SERVICES:						
A. DIRECT	260,576					260,576
B. REINSURANCE ASSUMED	15,306					15,306
C. REINSURANCE CEDED	24,419					24,419
D. NET CLAIM ADJUSTMENT SERVICES (A+B-C)	251,462					251,462
2. COMMISSION AND BROKERAGE:						
A. DIRECT	336,793					336,793
B. REINSURANCE ASSUMED		89,646				89,646
C. REINSURANCE CEDED		110,763				110,763
D. CONTINGENT - NET		21,834				21,834
E. POLICY AND MEMBERSHIP FEES						
F. NET COMMISSION AND BROKERAGE (A+B-C+D+E)		337,511				337,511
3. ALLOWANCES TO MANAGERS AND AGENTS		1,741				1,741
4. ADVERTISING		877				877
5. BOARDS, BUREAUS AND ASSOCIATIONS	744	6,810	10,443			17,998
6. SURVEYS AND UNDERWRITING REPORTS		70	2,587			2,657
7. AUDIT OF ASSUREDS RECORDS			805			805
8. SALARIES	51,745	37,420	94,780		3,085	187,031
9. EMPLOYEE RELATIONS AND WELFARE	3,785	2,519	8,276		147	14,729
10. INSURANCE	271	187	2,205		44	2,708
11. DIRECTORS FEES			16			16
12. TRAVEL AND TRAVEL ITEMS	4,969	3,936	6,072		125	15,104
13. RENT AND RENT ITEMS	8,046	5,904	14,946		21	28,919
14. EQUIPMENT	1,081	804	18,421		135	20,442
15. PRINTING AND STATIONERY	446	360	5,639		44	6,491
16. POSTAGE, TELEPHONE, TELEGRAPH, AND EXPRESS	4,369	3,194	7,894		127	15,584
17. LEGAL AND AUDITING	185	164	787		240	1,378
17A. TOTALS (ITEMS 3 TO 17)	75,445	63,992	173,956		3,973	316,367
18. TAXES, LICENSES AND FEES:						
A. STATE AND LOCAL INSURANCE TAXES				57,035		57,035
B. INSURANCE DEPT LICENSES AND FEES				1,101		1,101
C. PAYROLL TAXES	3,452	2,458	6,169	1,623	145	13,848
D. ALL OTHER (EXCL FED, FORGN & REAL ESTATE)				454	75	530
E. TOTAL TAXES, LICENSE & FEES (A+B+C+D)	3,452	2,458	6,169	60,213	221	72,515
19. REAL ESTATE EXPENSES					1,658	1,663
20. REAL ESTATE TAXES					1,693	1,693
21. MISCELLANEOUS (ITEMIZE):						
A. INCOME OR EXPENSES FOR SERVICES	5,723	9,007	-14,487	-299	2,937	2,880
B. CHG IN UNALL LOSS EXP ADJ EXP RSV/INTEREST	12,530	-39	135		97	12,721
C. MISCELLANEOUS			-26		3	-23
22. TOTAL EXPENSES INCURRED	348,873	412,930	164,741	59,914	10,584	996,993

AFFIDAVIT

STATE OF MINNESOTA

COUNTY OF RAMSEY

ROBERT K. OYBEAL, (NAME) VICE PRESIDENT AND TREASURER (TITLE)* AND DONALD J. SWANSON, (NAME) CONTROLLER (TITLE)*

OF ST. PAUL FIRE AND MARINE INSURANCE COMPANY (CONSOLIDATED) (HEREINAFTER CALLED THE INSURER), BEING DULY SWORN, EACH FOR HIMSELF DECLARES:

1. THAT HE IS FAMILIAR WITH THE MATTERS TO WHICH THE WITHIN EXHIBITS, THE ANSWERS, AND THE INFORMATION, IF ANY, REFER.
2. THAT HE IS DULY AUTHORIZED TO MAKE, AND DOES MAKE, THE FOLLOWING DECLARATION ON BEHALF OF THE INSURER.
3. THAT THE WITHIN EXHIBITS, THE ANSWERS, AND THE INFORMATION, IF ANY, ARE FULL AND TRUE STATEMENTS OF THE MATTERS RESPECTIVELY DESCRIBED HEREIN, ACCORDING TO HIS BEST KNOWLEDGE, INFORMATION AND BELIEF.

SUBSCRIBED AND SWORN TO BEFORE ME THIS

19 DAY OF MARCH, 1986

D W. Preuss

O. W. PREUSS
Notary Public, Ramsey County, MN
MY COMMISSION EXPIRES
February 4, 1987

Robert K Oybeal

Donald J Swanson

*AT LEAST ONE SIGNATORY MUST BE AN OFFICER OF THE INSURER.

A. PREMIUMS, LOSSES, EXPENSES AND NET INCOME, AND RATIOS TO EARNED PREMIUMS	1 FIRE AMOUNT	%	2 ALLIED LINES AMOUNT	%	3 FARMOWNERS MULTI PERIL AMOUNT	%	4 HOMEOWNERS MULTI PERIL AMOUNT	%	5 COMMERCIAL MULTI PERIL AMOUNT	%	8 OCEAN MARINE AMOUNT	%	9 INLAND MARINE AMOUNT	%
1. NET PREMIUMS WRITTEN (ANNUAL STATEMENT PG. 8, PART 2C, COL.4)	191,949	XXX	88,629	XXX	6,132	XXX	104,693	XXX	102,303	XXX	64,351	XXX	137,405	XXX
2. NET PREMIUMS EARNED (ANNUAL STATEMENT PG. 7, PART 2, COL.4)	172,259	100.0	80,685	100.0	12,277	100.0	143,134	100.0	95,152	100.0	56,673	100.0	124,643	100.0
3. NET LOSSES INCURRED (ANNUAL STATEMENT PG. 9, PART 3, COL.7)	96,616	56.1	47,233	58.5	10,454	85.1	104,343	72.9	58,694	61.7	37,829	66.7	62,025	49.8
4. LOSS ADJUSTMENT EXPENSES INCURRED (PART 1, COL. 1, LINE 22)	7,032	4.1	5,096	6.3	1,278	10.4	13,627	9.5	10,757	11.3	6,565	11.6	8,934	7.2
5. COMMISSIONS AND BROKERAGE INCURRED (PART 1, COL. 2, LINE2(F))	50,253	29.2	16,904	21.0	1,316	10.7	19,357	13.5	18,772	19.7	10,931	19.3	27,769	22.3
6. OTHER ACQ, FLD SUPERVN AND COLLECT EXP INC (PART 1, COL. 2, LINE 22 MINUS LINE 2(F))	4,601	2.7	3,039	3.8	304	2.5	5,002	3.5	3,674	3.9	1,231	2.2	4,929	4.0
7. GENERAL EXPENSES INCURRED (PART 1, COL. 3, LINE 22)	13,160	7.6	7,928	9.8	580	4.7	15,419	10.8	9,036	9.5	4,935	8.7	12,318	9.9
8. TAXES, LICENSES AND FEES INCURRED (PART 1, COL. 4, LINE 22)	4,182	2.4	2,208	2.7	165	1.3	4,968	3.5	3,112	3.3	663	1.2	3,513	2.8
9. TOTAL EXPENSES INCURRED (LINES 4,5,6,7 AND 8)	79,230	46.0	35,177	43.6	3,645	29.7	58,375	40.8	45,353	47.7	24,327	42.9	57,464	46.1
10. NET INVESTMENT GAIN/LOSS & OTHER INCOME** (SUM OF ITEMS 9A AND17, PAGE 4 OF A/S)	10,411	6.0	4,634	5.7	597	4.9	10,682	7.5	7,520	7.9	8,703	15.4	7,331	5.9
11. DIVIDENDS TO POLICYHOLDERS (ITEM 18A PAGE 4 OF ANNUAL STATEMENT	106	0.1	25	-	0	0.0	0	0.0	-52	-0.1	0	0.0	77	0.1
12. NET INCOME BEFORE FED AND FORGN INC TAXES (LINE 2+10-3,9,11=ITEM 18B PG.4 OF A/S)	6,717	3.9	2,883	3.6	-1,224	-10.0	-8,902	-6.2	-1,322	-1.4	3,220	5.7	12,407	10.0

B. ADJUSTED DIRECT PREMIUMS AND EXPENSES (SEE NOTE C) AND RATIOS TO ADJUSTED DIRECT PREMIUMS WRITTEN*

	FIRE AMOUNT	%	ALLIED LINES AMOUNT	%	FARMOWNERS MULTI PERIL AMOUNT	%	HOMEOWNERS MULTI PERIL AMOUNT	%	COMMERCIAL MULTI PERIL AMOUNT	%	OCEAN MARINE AMOUNT	%	INLAND MARINE AMOUNT	%
13. DIRECT PREMIUMS WRITTEN (ANNUAL STATEMENT PAGE 8, PART 2C, COL. 1)	139,728	XXX	101,604	XXX	6,638	XXX	108,628	XXX	118,875	XXX	72,430	XXX	163,381	XXX
14. ADJUSTED DIRECT PREMIUMS WRITTEN (SEE NOTE C)	139,728	100.0	101,604	100.0	6,638	100.0	108,628	100.0	118,875	100.0	72,430	100.0	163,381	100.0
15. ADJUSTED DIRECT PREMIUMS EARNED	134,886	100.0	94,999	100.0	12,790	100.0	147,069	100.0	110,443	100.0	66,013	100.0	152,736	100.0
16. ADJUSTED DIRECT LOSSES INCURRED	50,739	36.3	55,164	54.3	10,483	157.9	106,741	98.3	60,531	50.9	47,464	65.5	65,457	40.1
17. ADJUSTED DIRECT LOSS ADJUST EXPENSES INC	6,092	4.4	5,443	5.4	1,318	19.9	19,575	18.0	10,878	9.2	5,989	8.3	8,093	5.0
18. DIRECT COMMISSIONS AND BROKERAGE INCURRED (PART 1, LINE 2A + DIRECT CONT COMMISSION AND POLICY AND MEMBERSHIP FEES)	31,328	XXX	18,274	XXX	1,318	XXX	19,406	XXX	21,495	XXX	10,010	XXX	31,321	XXX
19. ADJ DIRECT COMMISSION AND BROKER INCURRED (SEE NOTE C)	31,328	22.4	18,274	18.0	1,318	19.9	19,406	17.9	21,495	18.1	10,010	13.8	31,321	19.2

A. PREMIUMS, LOSSES, EXPENSES AND NET INCOME, AND RATIOS TO EARNED PREMIUMS	19.1,19.2 AUTO LIAB PRIV PASS AMOUNT	%	19.3,19.4 AUTO LIAB COMMERCIAL AMOUNT	%	21.1 AUTO PHY DAM PRIV PASS AMOUNT	%	21.2 AUTO PHY DAM COMMERCIAL AMOUNT	%	22 AIRCRAFT (ALL PERILS) AMOUNT	%	23 FIDELITY AMOUNT	%	24 SURETY AMOUNT	%
1. NET PREMIUMS WRITTEN (ANNUAL STATEMENT PG. 8, PART 2C, COL.4)	85,854	XXX	120,716	XXX	72,705	XXX	46,100	XXX	14,973	XXX	34,531	XXX	52,815	XXX
2. NET PREMIUMS EARNED (ANNUAL STATEMENT PG. 7, PART 2, COL.4)	70,153	100.0	109,891	100.0	60,820	100.0	46,976	100.0	13,971	100.0	25,029	100.0	49,692	100.0
3. NET LOSSES INCURRED (ANNUAL STATEMENT PG. 9, PART 3, COL.7)	61,808	88.1	83,586	76.1	39,697	65.3	25,087	53.4	8,991	64.4	10,723	42.8	11,364	22.9
4. LOSS ADJUSTMENT EXPENSES INCURRED (PART 1, COL. 1, LINE 22)	11,677	16.6	14,782	13.5	7,382	12.1	4,564	9.7	1,004	7.2	1,006	4.0	2,928	5.9
5. COMMISSIONS AND BROKERAGE INCURRED (PART 1, COL. 2, LINE2(F))	13,236	18.9	17,877	16.3	11,659	19.2	7,248	15.4	3,194	22.9	6,766	27.0	12,629	25.4
6. OTHER ACQ, FLD SUPERVN AND COLLECT EXP INC (PART 1, COL. 2, LINE 22 MINUS LINE 2(F))	2,968	4.2	5,277	4.8	2,139	3.5	1,774	3.8	54	0.4	2,528	10.1	7,825	15.7
7. GENERAL EXPENSES INCURRED (PART 1, COL. 3, LINE 22)	5,667	8.1	11,655	10.6	4,620	7.6	4,659	9.9	131	0.9	3,449	13.8	7,476	15.0
8. TAXES, LICENSES AND FEES INCURRED (PART 1, COL. 4, LINE 22)	1,249	1.8	3,148	2.9	1,011	1.7	1,092	2.3	670	4.8	1,015	4.1	2,461	5.0
9. TOTAL EXPENSES INCURRED (LINES 4,5,6,7 AND 8)	34,799	49.6	52,741	48.0	26,813	44.1	19,339	41.2	5,055	36.2	14,767	59.0	33,321	67.1
10. NET INVESTMENT GAIN/LOSS & OTHER INCOME** (SUM OF ITEMS 9A AND17, PAGE 4 OF A/S)	7,855	11.2	22,210	20.2	2,039	3.4	1,499	3.2	793	5.7	3,321	13.3	1,837	3.7
11. DIVIDENDS TO POLICYHOLDERS (ITEM 18A PAGE 4 OF ANNUAL STATEMENT		-	168	0.2	0	0.0	103	0.2	0	0.0	1	-	1,101	2.2
12. NET INCOME BEFORE FED AND FORGN INC TAXES (LINE 2+10-3,9,11=ITEM 18B PG.4 OF A/S)	-18,598	-26.5	-4,392	-4.0	-3,650	-6.0	3,945	8.4	716	5.1	2,858	11.4	5,742	11.6

B. ADJUSTED DIRECT PREMIUMS AND EXPENSES (SEE NOTE C) AND RATIOS TO ADJUSTED DIRECT PREMIUMS WRITTEN*

	AUTO LIAB PRIV PASS AMOUNT	%	AUTO LIAB COMMERCIAL AMOUNT	%	AUTO PHY DAM PRIV PASS AMOUNT	%	AUTO PHY DAM COMMERCIAL AMOUNT	%	AIRCRAFT (ALL PERILS) AMOUNT	%	FIDELITY AMOUNT	%	SURETY AMOUNT	%
13. DIRECT PREMIUMS WRITTEN (ANNUAL STATEMENT PAGE 8, PART 2C, COL. 1)	83,887	XXX	128,905	XXX	72,368	XXX	44,727	XXX	28,512	XXX	40,737	XXX	86,349	XXX
14. ADJUSTED DIRECT PREMIUMS WRITTEN (SEE NOTE C)	83,887	100.0	128,905	100.0	72,368	100.0	44,727	100.0	28,512	100.0	40,737	100.0	86,349	100.0
15. ADJUSTED DIRECT PREMIUMS EARNED	68,291	100.0	116,768	100.0	60,599	100.0	45,700	100.0	28,006	100.0	29,921	100.0	80,492	100.0
16. ADJUSTED DIRECT LOSSES INCURRED	59,470	70.9	87,825	68.1	38,261	52.9	23,225	51.9	18,285	64.1	12,901	31.7	28,798	33.4
17. ADJUSTED DIRECT LOSS ADJUST EXPENSES INC	8,799	10.5	15,826	12.3	5,146	7.1	4,523	10.1	1,178	4.1	1,155	2.8	4,928	5.7
18. DIRECT COMMISSIONS AND BROKERAGE INCURRED (PART 1, LINE 2A + DIRECT CONT COMMISSION AND POLICY AND MEMBERSHIP FEES)	13,384	XXX	19,180	XXX	11,589	XXX	7,047	XXX	6,734	XXX	6,695	XXX	25,239	XXX
19. ADJ DIRECT COMMISSION AND BROKER INCURRED (SEE NOTE C)	13,384	16.0	19,180	14.9	11,589	16.0	7,047	15.8	6,734	23.6	6,695	16.4	25,239	29.2

*Expenses other than commission and brokerage can be developed from Section A

NOTE C — To relate equitably expenses incurred to premiums where pooling agreements or similar arrangements exist between companies within a group and where companies operate, through pools or associations and each company participates in the expenses on a basis of a fixed percentage, each company's direct premiums, for the purpose of this exhibit shall be adjusted to produce its participation in the aggregate direct premiums of the group and further adjusted by substituting for the actual direct premiums on business written through associations, the participation of the company in the aggregate direct premiums of all members of each such association. No adjustment shall be necessary where the premiums of any syndicate or pool, included in direct premiums written (Annual Statement Page 8, Part 2C, Column 1) for any line of business, amount to less than 2% of the total direct premiums written in that line of business.

Adjusted Direct Premiums Earned (Line 15) may be obtained by assuming the same ratios to Line 14 as earned to written ratios on a net basis.

NOTE that commissions shall be adjusted to correspond with the adjusted premiums.

NOTE D—Change in reserve for deferred maternity and other similar benefits to be reflected in Net Premiums Earned or

Net losses incurred.

**Instructions for Allocating Net Investment Gain or Loss and ... her Incom

A Adjusted mean invested assets - Annual Statement Pa... 2 Lines ...
B Adjusted investment income - Annual Statement Page ... Part 1 Co...
C Adjusted Acquisition Expenses - IEE Part II Lines 5 ... 8 plus ...
D Written Premium - IEE Part II Line 1 for the appropriate ... e of busi...
E Agents balances - Annual Statement Page 2, Lines 8 1 ... 8 2 - 9
F Unearned premiums - Annual Statement Page 3, Line ...
G Adjusted mean unearned premiums attributable to each ... e of busin...

11 MEDICAL MALPRACTICE		12 EARTHQUAKE		13 GROUP ACCID AND HEALTH (SEE NOTE D)		14 CREDIT ACCID AND HEALTH (GRP & INDV)		15 OTHER ACCID AND HEALTH (SEE NOTE D)		16 WORKERS' COMPENSATION		17 OTHER LIABILITY		
AMOUNT	%	AMOUNT	%	AMOUNT	%	AMOUNT	%	AMOUNT	%	AMOUNT	%	AMOUNT	%	
551,486	XXX	1,477	XXX	0	XXX	0	XXX	639	XXX	199,418	XXX	353,018	XXX	1.
466,757	100.0	1,390	100.0	0	100.0	0	100.0	521	100.0	209,879	100.0	286,678	100.0	2.
402,566	86.2	-36	-2.7	0	0.0	0	0.0	247	47.4	212,279	101.1	230,903	80.5	3.
134,607	28.8	12	0.9	0	0.0	0	0.0	18	3.5	29,454	14.0	87,499	30.5	4.
43,141	9.2	214	15.4	-83	0.0	0	0.0	-143	-27.6	14,238	6.8	61,470	21.4	5.
5,943	2.1	87	6.3	0	0.0	0	0.0	37	7.2	8,623	4.1	11,072	3.9	6.
18,484	4.0	221	15.9	83	0.0	0	0.0	250	48.1	16,698	8.0	27,244	9.5	7.
13,875	3.0	53	3.8	0	0.0	0	0.0	18	3.6	8,393	4.0	7,822	2.7	8.
220,052	47.1	589	42.4	0	0.0	0	0.0	181	34.9	77,408	36.9	195,110	68.1	9.
110,448	23.7	37	2.7	0	0.0	0	0.0	47	9.0	52,843	25.2	95,528	33.3	10.
110		-	0.1	0	0.0	0	0.0	0	0.0	17,600	8.4	321	0.1	11.
-45,522	-9.8	875	62.9	0	0.0	0	0.0	139	26.8	-44,565	-21.2	-44,128	-15.4	12.
583,187	XXX	2,197	XXX	3,354	XXX	0	XXX	9,321	XXX	221,055	XXX	394,846	XXX	13.
583,187	100.0	2,197	100.0	3,354	100.0	0	100.0	9,321	100.0	221,055	100.0	394,846	100.0	14.
492,278	100.0	2,107	100.0	3,521	100.0	0	100.0	10,057	100.0	226,593	100.0	320,335	100.0	15.
426,278	73.1	-4	-0.2	2,224	66.3	0	0.0	5,966	64.0	239,648	108.4	239,446	60.6	16.
134,523	23.1	10	0.5	24	0.7	0	0.0	55	0.6	29,757	13.5	94,052	23.8	17.
48,460	XXX	368	XXX	470	XXX	0	XXX	1,620	XXX	18,315	XXX	63,813	XXX	18.
48,460	8.3	368	16.8	470	14.0	0	0.0	1,620	17.4	18,315	8.3	63,813	16.2	19.

25 GLASS		26 BURGLARY AND THEFT		27 BOILER AND MACHINERY		28 CREDIT		29 INTERNATIONAL		30 REINSURANCE		31 TOTAL UNDERWR OPERATIONS (COLS. 1-30)		32 CAPITAL AND SURPL ACCTS	33 GRAND TOTAL (COLS 31+32)
AMOUNT	%	AMOUNT	%	AMOUNT	%	AMOUNT	%	AMOUNT	%	AMOUNT	%	AMOUNT	%	AMOUNT	AMOUNT
1,367	XXX	4,006	XXX	413	XXX	124	XXX	166	XXX	96	XXX	2,235,376	XXX	0	2,235,376
1,448	100.0	4,042	100.0	339	100.0	107	100.0	166	100.0	100	100.0	2,032,796	100.0	0	2,032,796
335	23.2	729	18.0	2	0.8	41	38.5	3	2.4	1,169	NMF	1,506,701	74.1	0	1,506,701
58	4.1	343	8.5	170	50.1	1	1.3	6	3.7	12	12.2	348,822	17.2	0	348,822
246	17.0	726	18.0	-135	-39.9	-70	-65.2	-29	-17.5	17	17.4	337,511	16.6	0	337,511
76	5.3	175	4.3	15	4.6	9	9.0	17	10.5	8	8.4	75,418	3.7	0	75,418
172	11.9	376	9.3		0.3	26	24.3	133	79.8	7	7.3	164,741	8.1	0	164,741
31	2.2	91	2.3	129	38.2	28	26.7	1	1.2	2	2.9	59,914	2.9	0	59,914
586	40.5	1,713	42.4	180	53.2	-4	-3.9	129	77.6	48	48.2	986,408	48.5	0	986,408
48	3.4	150	3.7	34	10.2	4	4.5	21	12.9	159	158.6	348,765	17.2	153,610	502,375
4	0.3	-4	-0.1	3	1.1	0	0.0	0	0.0	0	0.0	19,566	1.0	0	19,566
571	39.4	1,754	43.4	187	55.2	75	69.9	54	32.9	-957	NMF	-131,114	-6.4	153,610	22,496
1,379	XXX	4,030	XXX	4,530	XXX	2,553	XXX	2,832	XXX	0	XXX	2,426,066	XXX	0	2,426,066
1,379	100.0	4,030	100.0	4,530	100.0	2,553	100.0	2,832	100.0	0	100.0	2,426,066	100.0	0	2,426,066
1,459	100.0	4,079	100.0	4,531	100.0	2,503	100.0	3,998	100.0	0	100.0	2,220,186	100.0	0	2,220,186
331	24.0	719	17.8	1,264	27.9	591	23.2	52	1.9	0	0.0	1,581,866	65.2	0	1,581,866
58	4.3	343	8.5	147	3.2	-5	-0.2	16	0.6		0.0	357,935	14.8	0	357,935
249	XXX	733	XXX	583	XXX	311	XXX	440	XXX	0	XXX	358,395	XXX	0	358,395
249	18.1	733	18.2	583	12.9	311	12.2	440	15.5	0	0.0	358,395	14.8	0	358,395

Lines of Business for Line 10

4 - 5 - 6 1 - 6 2 - 7 for current and prior years, divided by 2
Lines 10-11-12-2 1-2 11-2 2-2 21
x 7, for the appropriate line of business

$\frac{1}{2}(1 - \frac{C}{D}\frac{E}{F})$) x (Annual Statement Page 7, Part 2, Columns 2 + 3 for

the appropriate line of business. If negative, set equal to zero. Limit to a maximum of ½ Page 7, Part 2, Columns 2 + 3

H Adjusted mean loss and loss expense reserves attributable to each line of business = (½ Annual Statement Page 10 Columns 5 + 6) + (½ Annual Statement Page 9, Column 6) + (½ previous Annual Statement Page 10, Column 6), for the appropriate line of business

I Investment income attributable to each line of business = (G + H) x B ÷ A

J Investment income attributable to capital and surplus accounts = Annual Statement Page 4, Line 8, less the sum of I for all lines of business

K Realized capital gains attributable to capital and surplus accounts = Annual Statement Page 4, Line 9

L Other Income attributable to each line of business = Annual Statement Page 4, Lines (5 + 17) x (Annual Statement Page 4, Line 1) x (Annual Statement Page 7, Part 2, Column 4) for the appropriate line of business

Interrogatory. Has Line 10 above been completed in accordance with these instructions. Answer ____Yes____ If not, explain

** "Business not exceeding 120 months duration.

APPENDIX E

QUESTIONNAIRE

Expenses Working Party: Institute of Actuaries - General Insurance Study Group

Purpose

1. Which of the following purposes do you use expense analyses and allocations for?

a) As part of a control mechanism (eg budgets)	Yes	No	
b) If yes then does the control mechanism involve setting agreed targets for items of expense?	Yes	No	
c) Evaluating the efficiency of your existing structure	Yes	No	
d) Assessing profits for internal purposes			
- at class or product level	Yes	No	
- at operating unit level	Yes	No	N/A
e) Preparing statutory/market information			
- Company Accounts	Yes	No	N/A
- DTI returns	Yes	No	
- Taxation computations	Yes	No	
- Market schemes	Yes	No	
f) Pricing of risks	Yes	No	

ABI SORP

2. Please indicate whether your organisation follows the Statement of Recommended Practice issued by the ABI in December 1986 with respect to the following (references in brackets denote SORP paragraph numbers).

a) A clear distinction should be made between capital and revenue expenditure (12.1)	Yes	No	N/A
b) Expenses should be accounted for on an incurred basis (12.2)	Yes	No	N/A
c) An accurate method of calculating deferred acquisition expenses should be adopted (12.3)	Yes	No	N/A
d) Under the fund accounting basis expenses should be charged on an incurred basis (12.4)	Yes	No	N/A
e) Under the annual or deferred annual accounting basis claims handling expenses should be charged in full against the revenue of the accounting period in which the claims are incurred (12.5)	Yes	No	N/A

f) Investment expenses should be deducted from investment income and separately disclosed (12.6) — Yes No N/A

g) Corporate expenses should be charged either to the revenue account or to the profit and loss account as considered to be appropriate by the enterprise (12.7) — Yes No N/A

h) The amortisation of capital expenditure will be in accordance with SSAP 12 (12.8) — Yes No N/A

i) If necessary a bad debt provision should be established and charged to expenses (12.9) — Yes No N/A

j) Provision should be made for all claims outstanding, whether notified or not, and related claims handling expenses (13.2) — Yes No N/A

3. For "No" answers to Q.2; do you plan to modify any of your existing accounting policies to comply with the above? (ring as appropriate)

   a b c d e f g h i j

4. For "No" answers to Q.2 and where you do not plan to adopt the SORP requirement; what is the main reason for not changing? Please tick as appropriate:

   a) Compliance with overseas parent company accounting policies

   b) Disagreement with SORP approach

   c) Preference not to make any changes until the SORP is better established

   d) Other

   Please expand on your answer as appropriate

5. Do you include relevant overhead expenses as well as commissions when calculating deferred acquisition costs? — Yes No N/A

6. Would the removal of exemptions from Companies Act 1985 requirements applicable to insurance companies (detailed in Part III of Schedule 9 to Companies Act 1985) have any implications for accounting policies adopted by your company? (eg taking realised exchange gains and losses directly to reserves rather than through the profit and loss account, treatment of goodwill and preliminary expenses). Yes No

Please specify:

Analysis
----

7. Are expenses analysed by type? Yes No

8. If yes, which categories are used?

a) Salaries	Yes	No
b) Other Staff costs (Pensions, N.I, House Subsidy etc)	Yes	No
c) Premises	Yes	No
d) D P	Yes	No
e) Communications	Yes	No
f) Other (please specify)	Yes	No

9. Could you indicate the approximate percentage of expenses that fall into the categories below?

	%
a) Salaries (including salaries of employees involved with c) to f) below)	
b) Other Staff Costs	
c) Premises	
d) D P	
e) Communications	
f) Other	
	100

10. Are expenses analysed by source/cost centre? Yes No

11. If yes, which categories are used?

a) Branch	Yes	No	N/A
b) H.O. Departments	Yes	No	
c) Other (please specify)	Yes	No	

12. Are expenses analysed by function? Yes No

13. If yes, which categories are used?

a) Selling	Yes	No
b) Underwriting	Yes	No
c) Administration	Yes	No
d) Claims	Yes	No
e) Other (please specify)	Yes	No

Allocation
----

14. Does your organisation allocate expenses between

a) UK and Non-UK business?	Yes	No	N/A
b) Life and Non-Life business?	Yes	No	N/A

15. To what level are allocations carried out?
    (in order of increasing fineness) Please tick one

    a) Non-Life

    b) Fire & Accident, Reinsurance, Marine

    c) Department (e.g. Commercial/Personal
       or Fire/Accident)

    d) DTI Classes
       (e.g. Motor Vehicle)

    e) Internal Reporting Classes
       (e.g Private Motor, Motor Fleet, Motor Cycle)

    f) Products
       (e.g. Protected Discount Motor Policy)

16. DTI Returns

    a) Are expenses allocated to DTI Form 16 Line 21? Yes No

    b) If yes, what do they represent?

    c) How have they been apportioned?

17. Are the DTI allocations used for internal measurement
    of profitability of each accounting class? Please tick

    a) Yes

    b) Slightly different allocations used

    c) Some overheads not allocated for profit studies

    d) Profit not studied by accounting class

    e) Other (please detail)

18. What methods are used for allocating salary related expenses?

a) Time Sheets

b) Functional Costing

c) Work Measurement

d) Other (please specify)

19. When allocating DIRECT expenses, which of these categories are used, at what level are expenses allocated (see Q.15) and what basis is used in allocating them?

Category	Used (Y/N)	Level of Allocation	Basis of Allocation
a) Other Staff Costs			
b) Premises			
c) D P Costs			
d) Travel			
e) Entertaining			
f) Tele/Postages			
g) Stationery			
h) Other (please specify)			

NB. Direct expenses are those arising from the handling of the individual class of business.
Examples of bases of allocation are:
by GWP, by NWP, by Computer Usage, by Staff Numbers, by No of policies, by floor area, in proportion to direct expenses.

20. When allocating INDIRECT expenses, which of these categories are used, at what level are expenses allocated (see Q.15) and what basis is used in allocating them?

Category	Used (Y/N)	Level of Allocation	Basis of Allocation
a) Salary Costs			
b) Other Staff Costs			
c) Premises			
d) D P Costs			
e) Travel			
f) Entertaining			
g) Tele/Postages			
h) Stationery			
i) Other (please specify)			

Operating Profitability

21. Do you have a branch structure? Yes No

22. If yes, do you use allocated indirect expenses in the measurement of branch profit? Yes No

23. If yes, please specify bases used in allocation (e.g. proportion to Branch GWP)

24. Are branch results sub-divided by class/product? Yes No N/A

25. If yes, are class/product expenses determined separately for each branch? Yes No

Rating
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26. Are expenses incorporated explicity into the rating structure?

    a) at class level   Yes   No

    b) at product level   Yes   No

27. Are expenses incorporated at policy level?   Yes   No

28. If yes, which bases are used and for which classes?

Basis	Y/N	Classes
a) Fixed policy charge		
b) Size Measure - premium		
c) Size - other than premium (please specify)		
d) Other (please specify)		

29. When rating large risks, is the principle of marginal costing used? (i.e. as far as expenses are concerned do you incorporate only the direct expenses into the premium). Please tick

    a) Never

    b) Only on new business

    c) Sometimes

    d) Frequently

    e) Always

Comments

Please give below comments

a) on the questions asked and

b) on any matters which are not adequately covered in the questionnaire.

APPENDIX F

1986 DTI RETURNS EXPENSE RATIOS - LARGE OFFICES

1986 Commission and Expenses as a percentage of Premiums Earned. Large Group.

		A.& H.	Motor	Prop.	Liab.	P.Loss	Av.	Ships	Goods	Treaty-NP	Treaty-P	Total
C.U.	Premiums	39176	156694	262728	65522	24111	18499	129642	29837	31767	40354	798530
	Comm/premiums	33.9	13.8	18.2	17.5	16.7	6.9	15.5	18.0	2.4	38.0	17.7
	Expenses/premiums	7.3	15.9	22.7	19.8	19.5	3.1	2.4	3.4	2.2	4.4	14.1
	Total	41.2	29.7	40.9	37.3	36.2	10.0	17.9	21.4	4.6	42.3	31.7
Eagle S.	Premiums	4413	182093	204483	90141	58795	5104	20651	11640	24948	78959	681427
	Comm/premiums	18.7	10.7	19.4	11.1	35.5	0.0	0.0	0.0	7.7	27.5	16.8
	Expenses/premiums	30.0	18.9	24.0	19.5	18.4	13.6	19.7	12.8	4.4	1.1	17.8
	Total	48.7	29.6	43.4	30.6	53.9	13.6	19.7	12.8	12.2	28.6	34.6
G.R.E.	Premiums	6713	231383	211494	96152	17743	10951	22639	21048	21747	39769	679639
	Comm/premiums	22.5	10.0	20.1	13.0	19.3	7.8	5.6	13.2	0.6	36.0	15.1
	Expenses/premiums	16.9	17.2	14.5	9.1	14.6	4.1	7.4	15.4	5.1	5.3	13.5
	Total	39.4	27.2	34.6	22.1	33.9	11.9	13.0	28.6	5.7	41.3	28.5
Norwich	Premiums	19725	234800	125173	25268	12751	7320	7221	11066	590	0	443914
	Comm/premiums	8.7	8.9	19.6	13.9	16.0	0.0	0.0	0.0	13.1		12.2
	Expenses/premiums	15.6	13.9	19.6	21.5	25.2	7.0	5.6	17.2	0.5		16.2
	Total	24.3	22.8	39.2	35.5	41.3	7.0	5.6	17.2	13.6		28.3
Prudent.	Premiums	6386	160387	225761	48620	8664	7217	25354	8616	1346	18567	511318
	Comm/premiums	20.8	11.8	15.9	18.8	14.8	0.0	0.0	0.0	8.6	33.9	14.3
	Expenses/premiums	18.3	25.1	27.5	24.7	36.7	10.8	4.8	6.8	14.6	3.8	23.9
	Total	39.1	36.9	43.4	43.4	51.6	10.8	4.8	6.8	23.2	37.7	38.2
Royal	Premiums	34925	240012	433143	74459	45982	15769	7330	23330	22165	96509	993644
	Comm/premiums	27.0	10.0	20.9	16.6	25.8	19.9	17.5	20.7	8.9	37.3	19.7
	Expenses/premiums	10.4	14.0	17.6	17.7	14.8	4.5	10.5	13.3	6.3	5.6	14.6
	Total	37.4	24.0	38.5	34.4	40.6	24.4	28.0	34.0	15.2	42.8	34.2
Sun All.	Premiums	44061	244554	523017	109024	57684	28353	58711	40468	4801	291378	1402651
	Comm/premiums	23.0	12.8	13.5	16.3	13.8	0.0	0.0	0.0	1.8	17.7	13.5
	Expenses/premiums	10.7	16.8	22.4	14.9	21.0	6.8	7.9	10.9	10.1	14.9	17.6
	Total	33.7	29.7	35.9	31.2	34.8	6.8	7.9	10.9	11.9	32.6	31.1
Large Average	Comm/premiums	24.6	11.0	17.7	15.1	22.8	5.6	8.3	8.9	4.7	25.9	15.8
	Expenses/premiums	11.5	17.0	21.1	16.9	19.2	6.1	5.9	10.8	4.6	9.6	16.5
	Total	36.1	28.0	38.8	32.0	42.0	11.7	14.2	19.7	9.4	35.5	32.3

APPENDIX F

1986 DTI RETURNS EXPENSE RATIOS - MEDIUM OFFICES

1986 Commission and Expenses as a percentage of Premiums Earned. Medium Group

		A.& H.	Motor	Prop.	Liab.	P.Loss	Av.	Ships	Goods	Treaty-NP	Treaty-P	Total
Co-op.	Premiums	4169	89910	163546	5952	1714	184	205	226	687	6965	273558
	Comm/premiums	13.4	1.2	9.6	6.7	33.7	7.6	12.7	16.8	12.1	35.3	7.7
	Expenses/premiums	15.8	30.2	21.9	26.8	39.5	25.0	25.4	25.2	1.3	1.1	24.2
	Total	29.1	31.4	31.6	33.5	73.2	32.6	38.0	42.0	13.4	36.4	31.9
Cornhill	Premiums	14187	102918	45451	14091	3312	2059	11309	4670	1287	2820	202104
	Comm/premiums	28.3	11.4	18.6	18.3	17.1	13.8	13.8	12.5	16.6	38.4	15.4
	Expenses/premiums	8.9	15.0	38.7	23.9	34.0	5.2	8.6	12.3	5.9	5.8	20.1
	Total	37.2	26.4	57.3	42.1	51.2	19.0	22.5	24.8	22.5	44.2	35.5
Excess	Premiums	19158	2268	3016	1081	10666	3731	25093	10161	50004	50752	175930
	Comm/premiums	34.9	20.9	27.6	34.2	34.3	23.7	21.3	22.5	17.0	33.4	26.1
	Expenses/premiums	4.4	33.0	21.6	15.5	4.5	4.4	4.5	3.8	5.8	6.7	6.2
	Total	39.3	53.9	49.1	49.8	38.8	28.2	25.7	26.3	22.7	40.1	32.3
Iron Tr.	Premiums	1365	50054	5518	13707	654	0	0	0	0	4953	76871
	Comm/premiums	0.5	12.1	17.9	16.3	14.4					16.6	13.4
	Expenses/premiums	5.5	9.7	38.8	15.6	62.9					0.2	12.9
	Total	6.0	21.9	56.8	31.9	77.3					16.7	26.3
L.& G.	Premiums	864	36620	123467	9042	-112	164	129	520	32	3708	174434
	Comm/premiums	19.4	12.6	12.3	18.8	2398.2	0.0	0.0	0.0	3.1	33.4	11.6
	Expenses/premiums	23.7	17.7	25.6	18.6	-1416.1	15.2	76.7	33.8	71.9	9.5	24.2
	Total	43.2	30.3	37.9	37.4	982.1	15.2	76.7	33.8	75.0	43.0	35.8
Minster	Premiums	52	73500	10151	4292	474	14516	9145	2956	1783	2010	118879
	Comm/premiums	23.1	15.5	17.7	27.8	30.2	-5.8	-4.1	-3.3	-2.1	26.0	11.5
	Expenses/premiums	40.4	18.0	35.8	26.9	46.2	6.9	13.0	10.3	12.1	20.6	18.0
	Total	63.5	33.6	53.6	54.7	76.4	1.1	8.9	6.9	10.0	46.6	29.6
Pearl	Premiums	1873	18223	51082	3760	2152	4237	12559	2700	2397	3207	102190
	Comm/premiums	15.5	11.2	15.6	16.0	19.6	0.0	0.0	0.0	0.7	76.8	13.5
	Expenses/premiums	42.1	29.4	28.0	42.3	26.1	9.2	5.5	5.6	10.0	31.1	24.5
	Total	57.6	40.6	43.6	58.4	45.6	9.2	5.5	5.6	10.7	107.9	38.0
Provin.	Premiums	2497	75827	54064	10688	3916	3	27	103	6617	2521	156263
	Comm/premiums	11.2	13.1	26.3	18.9	25.3	0.0	-37.0	-5.8	15.3	27.1	18.6
	Expenses/premiums	27.4	16.1	17.4	31.5	41.8	66.7	863.0	109.7	18.6	2.1	18.5
	Total	38.6	29.3	43.7	50.4	67.1	66.7	825.9	103.9	34.0	29.2	37.2
Medium Average	Comm/premiums	27.2	10.5	14.3	17.7	16.5	1.4	11.2	13.1	15.6	34.1	14.5
	Expenses/premiums	10.3	19.0	25.3	24.0	29.7	7.0	7.5	8.2	7.4	7.1	19.2
	Total	37.5	29.6	39.6	41.8	46.2	8.4	18.7	21.4	23.0	41.2	33.6

APPENDIX F

1986 DTI RETURNS EXPENSE RATIOS - SMALL OFFICES

1986 Commission and Expenses as a percentage of Premiums Earned. Small Group

		A.& H.	Motor	Prop.	Liab.	P.Loss	Av.	Ships	Goods	Treaty-NP	Treaty-P	Total
Blk. Sea	Premiums	14	1501	372	51	60	650	912	571	0	138	4269
	Comm/premiums	0.0	17.0	-12.9	11.8	23.3	12.6	13.9	-13.8		9.4	8.7
	Expenses/premiums	28.6	25.2	56.1	17.6	21.7	16.9	15.1	23.8		2.2	23.6
	Total	28.6	42.2	45.2	29.4	45.0	29.5	29.1	10.0		11.6	32.3
Brit'nic	Premiums	92	4325	13202	724	89	0	0	0	0	0	18432
	Comm/premiums	-3.3	0.0	-1.1	0.0	-22.5						-0.9
	Expenses/premiums	50.0	40.8	45.7	46.5	65.2						44.7
	Total	46.7	40.8	44.6	46.5	42.7						43.8
Crusader	Premiums	13866	10254	11801	794	296	-2591	2	26	0	-60	34388
	Comm/premiums	5.1	14.2	21.0	20.7	23.3	-0.6	350.0	23.1		-20.0	14.3
	Expenses/premiums	10.5	18.8	22.3	19.8	55.6	-5.3	0.0	0.0		0.0	19.2
	Total	15.6	33.0	43.3	40.4	118.9	-5.9	350.0	23.1		-20.0	33.5
Dominion	Premiums	0	0	0	0	0	1219	1346	1664	2441	1884	8554
	Comm/premiums						0.0	0.0	0.0	12.5	34.4	11.2
	Expenses/premiums						28.9	22.9	25.2	17.7	17.4	21.5
	Total						28.9	22.9	25.2	30.2	51.8	32.6
Economic	Premiums	211	1539	3925	1147	985	50	-200	267	82	424	8430
	Comm/premiums	14.7	14.4	23.7	16.7	11.5	0.0	0.0	0.0	9.8	42.7	20.2
	Expenses/premiums	38.4	31.8	34.9	38.6	43.2	6.0	15.5	28.1	-1.2	-1.7	33.5
	Total	53.1	46.2	58.6	55.3	54.7	6.0	15.5	28.1	8.5	41.0	53.7
Nat.Emp.	Premiums	1150	25683	18732	18694	365	195	1148	44	3888	3331	73230
	Comm/premiums	31.1	8.3	15.4	16.9	41.4	15.4	28.9	47.7	4.9	50.7	15.0
	Expenses/premiums	51.3	24.9	29.8	27.7	93.7	10.8	7.8	6.6	9.0	5.4	25.6
	Total	82.4	33.2	45.2	44.6	135.1	26.2	36.7	54.5	13.9	56.1	40.6
Norman	Premiums	2354	11411	5112	254	0	0	0	0	0	797	19928
	Comm/premiums	3.0	15.5	20.8	21.3						37.1	16.3
	Expenses/premiums	9.5	15.6	21.2	24.4						6.8	16.1
	Total	12.5	31.1	42.0	45.7						43.9	32.4
U.Stand.	Premiums	91	4158	2766	1	-1	0	0	0	0	6	7063
	Comm/premiums	27.5	14.1	18.9	0.0						0.0	16.1
	Expenses/premiums	34.1	23.4	34.5	4300.0						50.0	28.8
	Total	61.5	37.5	53.4	4300.0						50.0	44.9
Small Average	Comm/premiums	6.7	10.9	13.7	16.6	18.2	-26.8	14.5	-2.0	7.9	43.6	13.3
	Expenses/premiums	13.7	23.3	32.0	28.7	62.3	-130.6	15.7	24.6	12.5	8.6	25.5
	Total	20.4	34.2	45.7	45.2	80.5	-157.4	30.2	22.6	20.4	52.2	38.8