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Statutory Accounting Principles (E) Working Group
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
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Sent via email to:

Re: Informational submission — Kerper–Bowron Method and comments on the unearned-premium tests in SSAP No. 65

Dear Members of the Working Group:

I write to you for two reasons. First, I want to comment on SSAP 65 and suggest improvements. Second, I want to bring to your attention a peer-reviewed actuarial method that produces contract-level expected future losses and cancellations usable in the SSAP No. 65 unearned-premium tests, and to offer comments on how those tests are structured.

The comments are directed at SSAP No. 65 business generally. Service contracts are used as the illustration because that is the setting of the paper, not because the points are limited to that market.

SSAP No. 65 establishes statutory accounting for property and casualty contracts. For long-duration contracts—coverage periods of 13 months or longer that the insurer cannot cancel—the unearned premium reserve is subject to three tests: refund, proportional, and future losses and expenses. The tests are applied to the most recent three policy years and to the aggregate of older policy years, and the required reserve for each grouping is the maximum of the three tests. Section 5.1 of the paper cited below summarizes this framework and notes that projected future losses under the proportional test are selected by the actuary using methodology appropriate to the data, and that expenses in that test generally include cancellations.

The service-contract market is large, but only a small share of that premium is written directly by NAIC reporting entities. Most of the related reserve sits outside the statutory blank, in administrator, dealer, trust, or other obligor structures, and what is written by an insurer is commonly ceded. Of the long-duration business that does appear on NAIC companies, most is not the underlying service contract itself. It is a failure-to-perform (contractual liability) policy,

which responds if the obligor fails, and which has an earning pattern different from the underlying contract. That distinction is discussed in the paper. Applying the SSAP 65 tests as if the insurer had written the service contract, rather than a failure-to-perform cover with its own timing of exposure, misstates both the earning base and the loss provision.

The Kerper–Bowron Method (patent-pending) replaces a single block-level earning curve with month-by-month probabilistic projections of expected claims and expected cancellation refunds for each contract. The projections are built from point-of-sale data and are updated as experience emerges. Exposures are measured only while the contract is on risk. In Kerper and Bowron, Risks 2026, 14(3), 44, the authors state that these contract-level streams can populate the proportional and future-loss tests under SSAP 65 without changing the refund test. The same projections are described as aligning with ASC 606 and IFRS 17 and as matching, for finite predictable risks, the probability-weighted future cash-flow form in Solvency II Article 77(2).

The method is offered here as an actuarial technique for estimating the amounts that enter the SSAP 65 tests, not as a proposed amendment to the statement. The relevant discussion is in Section 5.1 and in the later sections that define the future-loss and cancellation estimates and the difference in earning pattern between the underlying contract and the failure-to-perform policy.

We also offer the following comments on the tests. They apply to long-duration business under SSAP No. 65 generally.

1. Policy-year grouping. The tests are performed by policy year (the latest three years separately, and older years in aggregate). That grouping does not appear to have a clear economic basis. Unearned premium, expected losses, and expected cancellations are functions of remaining exposure and of the terms written, not of the calendar year of issue. A cleaner approach would be to drop the policy-year segmentation for the three tests and instead require the actuary to disclose earned premium (or earned exposure) by future year. That disclosure would still show the runoff pattern, without forcing the reserve to be the maximum of three tests inside artificial cohorts.

2. Proportionality fixed at inception. The proportional pattern should rest on the assumptions that applied when the policy was written—the expected timing of exposure and loss relative to premium at issue. Later calendar-year effects, such as an inflation surge, change the amount of expected loss, not the shape in which premium was intended to be earned. Those effects belong in the future-loss provision, not in a revision of the earning pattern.

3. Expenses inside the proportional test. Including losses, cancellations, and expenses in the proportional test spreads front-loaded acquisition and administrative costs over the life of the contract. That treatment sits uneasily with statutory accounting, which generally recognizes those costs as incurred rather than amortizing them into the unearned-premium liability. If the proportional test is meant to measure unearned premium on an exposure basis, mixing loss and expense emergence into the earning formula blurs that measurement and can produce a reserve that is partly an implicit deferral of expenses already paid.

4. Refund test at 100 percent. The refund test, applied as a full potential-refund reserve, is more conservative than the cancellation right supports. Only the policyholder can cancel; the insurer cannot. Reserving 100 percent of the contractual refund on every in-force policy therefore holds capital for cancellations that are not expected to occur. A more consistent measure would be a proportional (exposure-based) reserve, plus any expected refunds that exceed that reserve. Expected excess refunds can be estimated from underlying experience, so the additional amount is an explicit, experience-based margin rather than a blanket 100 percent hold.

5. The minimum as a substitute for a reasonable estimate. SSAP No. 65 does not ask for the actuary's best estimate of the unearned premium. It sets a floor: for each of the three most recent policy years the gross unearned premium shall be no less than the largest of the three tests, and for older years no less than the largest of the three tests taken in aggregate. A minimum of that kind conflicts with the actuarial standard that a reserve be reasonable. A reasonable estimate can sit below the largest of the three tests when the tests measure different things—full contractual refund, an earning pattern that spreads expenses, and a discounted deficiency—and the largest of them is not the expected cost of the remaining obligation. Because the statement requires the larger number, a company can hold a reserve that is uneconomically conservative and still be in compliance. For example, an insurer could reserve 100% of the premium and then fully earn on the expiration date, regardless of the underlying claims pattern.

   A better standard would be the actuary's reasonable estimate of the remaining obligation, with the refund obligation and any premium deficiency disclosed separately rather than imposed as an automatic minimum.

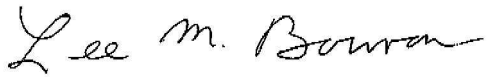
6. Test 3 and the premium-deficiency reserve. The relationship between Test 3 and the premium-deficiency reserve in SSAP No. 53 is unclear, and the two can be applied in a way that double-counts or under-counts the same shortfall. Test 3 is the projected future gross losses and expenses over the unexpired term, with a permitted provision for investment income, reduced by the present value of future guaranteed gross premiums. It functions as a deficiency test, but it is housed inside the unearned premium reserve and is taken as the maximum of the three tests by policy-year group. SSAP No. 53, paragraph 17, requires a separate additional liability when anticipated losses, loss-adjustment expenses, commissions and other acquisition costs, and maintenance costs exceed the recorded unearned premium reserve and future installment premiums. Acquisition costs already expensed need not be considered. Grouping under SSAP No. 53 follows how policies are marketed, serviced, and measured, and a deficiency in one group may not be offset by anticipated profits in another. Neither statement says that satisfying Test 3 discharges the SSAP No. 53 test, or that the SSAP No. 53 reserve is reduced by the amount by which Test 3 has already increased the unearned premium. The investment-income offset allowed in Test 3 also has no counterpart in the SSAP No. 53 wording.

   A cleaner arrangement would keep the unearned premium as an exposure or refund measure and record any excess of expected future costs over that unearned premium and

future premiums once, as a premium-deficiency liability under SSAP No. 53, with one grouping rule and one expense convention. Test 3 would then be unnecessary.

We would be happy to provide additional comments or assistance to the Working Group or its staff. I have not filed an SAPWG Maintenance Agenda form for these issues.

Respectfully,



Lee M. Bowron, ACAS, MAAA

References:

Peer-reviewed papers

Kerper, J.; Bowron, L. "The Kerper–Bowron Method: A Foundational Change for Service Contract Claim Estimation and Accounting." Risks 2026, 14(3), 44. https://www.mdpi.com/2227-9091/14/3/44

Bowron, L.; Kerper, J.; Lightfoot, A.; Bowron, W. "The Kerper–Bowron Method: Additional Notes on Manufacturer's Warranties and Collateralization Applications." Risks 2026, 14(9), 213. https://www.mdpi.com/2227-9091/14/9/213

Substack

Lee Bowron, "A New Model for a Hidden $350 Billion Financial Market." https://leebowron.substack.com/p/a-new-model-for-a-hidden-350-billion