

Statutory Issue Paper No. 49

Policy Loans

STATUS

Finalized March 16, 1998

Original SSAP and Current Authoritative Guidance: SSAP No. 49

Type of Issue:

Life Specific

SUMMARY OF ISSUE

1. Current statutory accounting guidance for policy loans is provided in the Accounting Practices and Procedures Manual for Life and Accident and Health Insurance Companies (Life/A&H Accounting Practices and Procedures Manual). GAAP guidance is limited but is provided in the AICPA Audit and Accounting Guide: Stock Life Insurance Companies. Current statutory and GAAP guidance are consistent.
2. The purpose of this issue paper is to establish statutory accounting principles for policy loans that are consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts).

SUMMARY CONCLUSION

3. A policy (or contract) loan shall be defined as a loan to a policyholder, under the provisions of an insurance contract, that is secured by the cash surrender value or collateral assignment of the related policy or contract. Policy loans shall include:
 - a. Cash loans, including loans resulting from early payment benefits or accelerated payment benefits, on contracts when the terms of the contract specify that such payments are policy loans secured by the policy and
 - b. Automatic premium loans, which are loans made in accordance with policy provisions whereby delinquent premium payments are automatically paid from the cash value at the end of the established grace period for premium payments.
4. Policy loans meet the definition of assets defined in *Issue Paper No. 4—Definition of Assets and Nonadmitted Assets* and meet the criteria for admitted assets, except as specified in paragraphs 6 and 7 of this issue paper. Policy loans are readily available to satisfy policyholder obligations as the terms of the policy loan allow the reporting entity to offset an outstanding policy loan balance against the cash surrender value of the policy.
5. Policy loans shall be carried at the unpaid balance of the loan. The unpaid balance of the loan shall include any unpaid principal plus any accrued interest which is 90 days or more past due.
6. If the unpaid balance of the loan exceeds the cash surrender value or policy reserves established for the policy, the policy generally shall lapse. Cash surrender value shall be defined as the cash value of the basic policy plus cash value of any policy accumulations such as paid-up additions. The excess of the unpaid balance of the loan over the cash surrender value shall be evaluated for collectibility. If the amount is considered uncollectible, it shall be written off as a reduction of investment income in the statement of operations during the period it is determined to be uncollectible. Except for collateral

assignment loans, all other amounts in excess of the cash surrender value shall be considered nonadmitted assets. The change in this nonadmitted asset shall be recorded as an unrealized capital gain or loss as applicable.

7. A loan resulting from early payment benefits or accelerated payment benefits and secured by an assignment of the policy to the reporting entity as collateral for the loan shall be an admitted asset, except that any loan (including accrued interest) in excess of the policy reserve for that policy shall be nonadmitted. Upon death, the entire death benefit is recorded as a death benefit expense. The policy proceeds shall be used to repay the loan. Any proceeds in excess of that needed to repay the loan are payable to the named beneficiary.

8. Interest income on policy loans shall be recorded as earned and included in investment income consistent with *Issue Paper No. 34—Investment Income Due and Accrued*. For interest received before it is earned, unearned interest income shall be recorded as a liability in accordance with *Issue Paper No. 5—Definition of Liabilities, Loss Contingencies and Impairments of Assets*.

9. Accrued interest income on policy loans that is past due 90 days or more shall be reclassified from Investment Income Due and Accrued and included in the unpaid balance of the policy loan as defined in paragraph 5 above.

DISCUSSION

10. The statutory principles described in the conclusion above are consistent with current statutory guidance except for the following:

- a. The definition of policy loans includes certain early payment benefits or accelerated payment benefits that by the terms of the applicable policy are policy loans. Existing statutory guidance does not specifically address such loans in the guidance on policy loans. The accounting treatment adopted in paragraph 7 above allows a loan resulting from an early payment benefit or an accelerated payment benefit to be an admitted asset if the loan amount plus accrued interest is less than the policy reserve and the loan is secured by the full assignment of the policy benefits to the reporting entity.

Automatic Premium Loans

An automatic premium loan (APL) is one which is made in accordance with the provision in some policies for automatically paying a delinquent premium from the cash value at the end of the grace period. A special loan agreement is not required because the policy owner previously requested the APL option. In some states the policy owner must specifically elect this provision for it to be effective.

The purpose of the APL provision is that, in the event of inadvertent nonpayment of premium or temporary inability to pay the premium, the policy is kept in full force. If the policy were allowed to lapse and the nonforfeiture options of reduced paid-up or extended term insurance were effective, the policy owner would then be required to comply with the reinstatement procedures, such as furnishing evidence of insurability.

Valuation

Policy loans are reported as admitted assets in the statutory financial statement. They are carried at the unpaid balance of the loan provided the unpaid balance does not exceed either the cash surrender value of the policy or the policy reserves. The cash surrender value generally consists of the cash value of the basic policy plus cash value of any policy accumulations such as paid-up additions.

In cases where the policy indebtedness exceeds the cash surrender value, the excess is a nonadmitted asset. The change in this nonadmitted asset is reflected as an unrealized capital gain or loss as applicable.

Interest

14. The NAIC Annual Statement Instructions provide the following guidance related to Policy Loans:

EXHIBIT 4 - UNREALIZED CAPITAL GAINS AND (LOSSES) ON INVESTMENTS

Line 5 - Premium Notes, Policy Loans and Liens

Include: In Column 3, the net change in the excess of premium notes, policy loans and other policy assets over net value and other policy liabilities on individual policies. (See Exhibit 14, Line 9.)

EXHIBIT 13 - ASSETS

Lines 5 & 6 - Policy Loans and Premium Notes

Include: In Column 3 premium notes, policy loans, and other policy assets in excess of net value and of other policy liabilities on individual policies.

Exclude: Interest due and accrued (include in Line 16).

Premium extension agreements (include in Line 14).

Policy liens under reinsurance agreements.

Line 5 plus Line 6, Column 3 should agree with Exhibit 14, Line 9, Column 2.

EXHIBIT 14 - ANALYSIS OF NON-ADMITTED ASSETS AND RELATED ITEMS

Line 9 - Premium Notes, etc., in Excess of Net Value and Other Policy Liabilities on Individual Policies

The change for the year should be included in Exhibit 4, Column 3, Line 5.

Generally Accepted Accounting Principles

15. The *AICPA Audit and Accounting Guide: Stock Life Insurance Companies* provides the following guidance in Chapter 4, Investment Operations:

Policy Loans*

The Glossary provides the following definitions:

Automatic premium loan - A loan made under a provision in a life insurance policy that a premium not paid by the end of the grace period will be automatically paid from the proceeds of a policy loan made by the company if there is sufficient loan value.

Policy loan - A loan made by a life insurance company to a policyholder on the security of the cash surrender value of his policy.

OTHER SOURCES OF INFORMATION

16. NAIC Technical Resource Group Proposed Draft Life Codification provides the following guidance in Chapter 20, Policy and Contract Benefits, related to early payment benefits or accelerated payment benefits:

Early Payment or Accelerated Payment Benefits

When an insurer offers the insured/policyowner an option to receive benefit payments early, typically when the insured is diagnosed with a terminal illness, accounting for the payments must be consistent with the terms of the contract. Either the loan method or policy reduction method shall be used to account for the payments.

Loan Method:

When the terms of the contract recognize payments to be a loan on the policy with the policy serving as collateral, and interest is charged on the loan amount, all payments are reported as policy loans and included as an admitted asset of the insurer. Interest and fees (if any) are recorded when earned. Upon death or lapse (policy loan plus accrued interest equals the face amount), the policy is accounted for as a claim payment.

Policy Reduction Method:

When the payments result in a reduction in the amount of insurance, the payments are recorded as benefit payments with a corresponding release of a pro-rata portion of the policy reserve.

RELEVANT LITERATURE

Statutory Accounting

- Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy
- *Issue Paper No. 4—Definition of Assets and Nonadmitted Assets*
- *Issue Paper No. 5—Definition of Liabilities, Loss Contingencies and Impairments of Assets*
- *Issue Paper No. 34—Investment Income Due and Accrued*
- Accounting Practices and Procedures Manual for Life and Accident and Health Insurance Companies, Chapter 7, Policy Loans, and Chapter 19, Investment Income and Net Realized Gains
- NAIC Annual Statement Instructions, Exhibit 4, Unrealized Capital Gains and Losses on Investments, Exhibit 13, Assets, Exhibit 14 - Analysis of Non-Admitted Assets and Related Items

Generally Accepted Accounting Principles

- *AICPA Audit and Accounting Guide: Stock Life Insurance Companies, Chapter 4, Investment Operations*

State Regulations

- No additional guidance obtained from state statutes or regulations.

Other Sources of Information

- NAIC Technical Resource Group Proposed Draft Life Codification, Chapter 20, Policy and Contract Benefits