5. As in universal life-type contracts, as discussed in *Issue Paper No. 56—Universal Life-Type Contracts, Policyholder Dividends, and Coupons,* deposit-type contracts frequently grant policyholders significant discretion over the amount and timing of deposits and withdrawals. Reporting entities are frequently granted significant discretion over amounts that accrue to or that are assessed against policyholders.

6. Due to the absence of mortality and/or morbidity risk and the discretionary characteristics noted in the preceding paragraph, the accounting principles for income recognition and policy reserves for deposit-type contracts differ from the accounting for life contracts set forth in *Issue Paper No. 51—Life Contracts* (Issue Paper No. 51), accident and health contracts established in *Issue Paper No. 54—Individual and Group Accident and Health Contracts*, and credit insurance contracts as discussed in Is*sue Paper No. 59—Credit Life and Accident and Health Insurance Contracts*.

7. This issue paper prescribes the income recognition and policy reserve requirements for all contracts without life or disability contingencies. Contracts that generally do not subject the reporting entity to risks arising from policyholder mortality or morbidity include, but are not limited to certain types of the following policy categories:

- Supplemental contracts
- Lottery payouts
- Structured settlements
- Guaranteed interest contracts
- Income settlement options
- Annuities certain
- Dividend and coupon accumulations
- Premium and other deposit funds

As discussed in Issue Paper No. 50, subsequent issue papers, where needed, will establish specific statutory accounting principles that are applicable to unique characteristics of certain deposit-type contracts (e.g., separate accounts).

8. Contracts issued by a reporting entity that do not incorporate mortality or morbidity risk shall not be accounted for as insurance contracts. Amounts received as payments for such contracts shall not be reported as revenues but shall be recorded directly to an appropriate policy reserve account.

9. The reserving methodologies and assumptions used in computation of policy reserves shall meet the provisions of Appendices A-820 and A-822, and the actuarial guidelines found in Part 9 of the NAIC Financial Examiners Handbook. Further, policy reserves shall be in compliance with those Actuarial Standards of Practice promulgated by the Actuarial Standards Board.

10. Policy reserves shall be established for all contractual obligations of the reporting entity arising out of the provisions of the contract. Where separate benefits are included in a contract, a reserve for each benefit shall be established as required in Appendix A-820. Statutory policy reserves meet the definition of liabilities as defined in *Issue Paper No. 5—Definition of Liabilities, Loss Contingencies and Impairments of Assets* (Issue Paper No. 5). The actuarial methodologies referred to in the following paragraph meet the criteria required for reasonable estimates in Issue Paper No. 5.

11. The policy reserve for contracts without life contingencies where the future benefits are fixed and guaranteed (e.g., supplemental contracts, lottery payouts, structured settlements, guaranteed interest contracts, income settlement options, annuities certain, and unmatured coupon accumulations) shall be based on the present value of the future guaranteed benefits discounted at the valuation interest rate. The

policy reserve for all other contracts (e.g., premium and other deposit funds,

19. Disclose the amount of annuity actuarial reserves and deposit liabilities by withdrawal characteristics as follows:

a. Subject to discretionary withdrawal:

i. With market value adjustment, where withdrawal of funds is payable at all times, or prior to specified maturity dates where such dates are more than one year after the statement date and;

(a) In a lump sum with adjustments to reflect general changes in interest rates, or asset values since receipt of funds by the reporting entity; and

(b) In installments over five years or more, with or without a reduction in the interest rate during the installment period.

ii. At book value less current surrender charge, where the withdrawal of funds is payable at all times, or at any time within one year from the statement date in a lump sum subject to a current fixed surrender charge of 5% or more and it does not contain a meaningful bail out rate as described in subparagraph v.(d) below;

iii. At market value, where the withdrawal of funds is payable at current market value of the assets supporting the liabilities, the assets are stated at current market value, and the liabilities are stated at the current market value or per unit value of the assets supporting the liabilities. These liabilities are for contracts where the customer bears the entire investment risk;

iv. Total with adjustment or at market value;

v. At book value without adjustment (minimal or no charge or adjustment), where the withdrawal of funds is either payable at all times, or at any time (including a withdrawal on a scheduled payment date) within one year from the statement date and:

(a) In a lump sum without adjustment;

(b) In installments over less than five years, with or without a reduction in interest rate during the installment period;

(c) In a lump sum subject to a fixed surrender charge of less than 5%;

(d) In a lump sum subject to surrender charge, but such charge is waived if the credited rate falls below a specified "bail out" rate and the "bail out" rate is more than the maximum statutory valuation rate for life insurance policies for more than 20 years for new issues; and

(e) All others.

b. Not subject to discretionary withdrawal;

c. Total gross;

d. Reinsurance ceded;

e. Total net.

20. The statutory accounting principles outlined in the conclusion above regarding income recognition and policy reserves for deposit-type contract

24. Significant differences exist between life and deposit-type contracts. Life contracts provide insurance protection against death while deposit-type contracts do not provide for mortality risk but act exclusively as investment vehicles. Unlike life contracts, deposit-type contracts frequently grant significant discretion over the amount and timing of payments by policyholders as well as the amounts that accrue to or that are assessed against policyholders by the reporting entity. As a result of these differences, the accounting requirements also vary. Premium income on life contracts is generally recognized on the gross basis (amount charged to the policyholder) when due from policyholders under the terms of the insurance contract (e.g., single, renewal premiums, and any related premium adjustments) while income on deposit-type contracts is recorded based on the underlying performance of the invested assets. Due to these differences, the accounting for life and deposit-type contracts has been discussed in separate issue papers.

25. Consistent with Issue Papers Nos. 50 and 51, the GAAP literature, specifically *FASB Statement No. 60, Accounting and Reporting by Insurance* Enterprises (FAS 60), *FASB Statement No. 97, Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments* (FAS 97), and *FASB Statement 120, Accounting and Reporting by Mutual Life Insurance Enterprises and by Insurance Enterprises for Certain Long-Duration Participating Contracts* (FAS 120), for deposit-type contracts is rejected.

- Issue Paper No. 50 addresses Classifications and Definitions of Insurance or Managed Care Contracts In Force.
- Issue Paper No. 51 addresses Life Contracts.
- Issue Paper No. 53 addresses Property and Casualty Contracts – Premiums.
- Issue Paper No. 54 addresses Individual and Group Accident and Health Contracts.
- Issue Paper No. 55 addresses Unpaid Claims, Losses and Loss Adjustment Expenses.

26. The Life/A&H Accounting Practices and Procedures Manual provides the following guidance with respect to policy reserves on deposit-type contracts:

> CHAPTER 10
> AGGREGATE RESERVES FOR LIFE AND ANNUITY CONTRACTS
>
> <u>Annuity and Pure Endowment Contracts</u>
>
> Whereas life insurance provides protection from the loss arising from dying too soon, an annuity protects against the loss from living too long. An annuity can be in either an accumulative (premium paying or paid-up deferred) period or a payout period. The company's obligation in each period is different and is described in detail in the annuity contract.
>
> Anticipated (and actual) mortality experience is different for persons purchasing annuity contracts than for persons who purchase life insurance. Mortality rates of annuitants are lower as a result of selection by the annuitants. For this reason, separate annuity mortality tables have been developed for the valuation of annuity contracts.
>
> Pure endowments, also, are insurance contra

also includes some type of life insurance and, consequently, is valued as life insurance. Mortality tables for annuities also are used in reserving for pure endowment benefits.

Annuities and pure endowments can be sold either as individual contracts or as group contracts.

If there are interest rate guarantees on group annuity funds, additional reserves may be required by the statutes and regulations of the various states.

Reserves for group pension (group annuity) business involves more complex considerations, and a considerable degree of variation is permitted or prescribed by state regulations and statutes.

Miscellaneous Reserves

Since the actuarial liabilities must include provision for any contingent benefit or right which may arise, statutory statements provide for estimates of a number of miscellaneous reserve items. For example, state laws or regulations may require minimum reserves when valuation net premiums exceed gross premiums. The additional reserve needed to meet the minimum may appear separately as a miscellaneous reserve or may be included with the life reserve in accordance with the applicable state regulations. Similarly, provision for either nondeduction of deferred fractional premiums or return of premiums at death of the insured may be made as a separate reserve or as part of the life reserve. Approximate reserving methods are accepted and frequently used to estimate such items. Another minimum reserve which must be provided for is a reserve for surrender values in excess of reserves otherwise required or carried. There are other miscellaneous items commonly encountered, The statutory financial statement differentiates this category of deposit items in the following manner:

1. Premium deposit funds represent deposits m

statement date. For contracts being paid in installments, the reserve is the present value of the future payments.

28. The Life/A&H Accounting Practices and Procedures Manual provides the following guidance with respect to premium income recognition on deposit-type contracts:

CHAPTER 18
PREMIUM INCOME

Premiums are generally recorded in the company's general ledger when received. This necessitates adjustments as of the balance sheet dates for premiums received in advance of their due date, for premiums which are due but have not yet been received, and for "deferred" premiums. Premium income reported in the Summary of Operations includes reinsurance assumed and is reduced by reinsurance ceded.

Deductions should be made for premiums and annuity considerations returned and allowances to industrial policyholders for direct payment of premiums. Commissions and allowances on reinsurance premiums assumed and ceded may not be deducted.

Single premiums and considerations include dividends, coupons, guaranteed annual pure endowments, and similar benefits applied to provide paid-up additional insurance or annuities. Renewal premiums collected are to include dividends and coupons applied to pay renewal premiums and to shorten the endowment or premium-paying period.

Cost of Collection in Excess of Loading

A liability should be provided for the cost of collection on premiums and annuity consideration deferred and uncollected in excess of total loading thereon if the company deems the loading to be inadequate. The increase in this item and the increase in loading on deferred and uncollected premiums are both recorded in the same line in the Summary of Operations. Provisions for cost of collection should include commissions, collection fees, and taxes contingent upon the collection of the deferred and uncollected premiums.

Premiums Received in Advance

Premium income reported in operations must exclude premiums that have been received by the company prior to the valuation date but which are due on or after the next policy anniversary date. The accounting treatment is the same for both life and accident and health premiums.

A policyholder may remit one or more premiums in advance of specific due dates. Where premiums are remitted sufficiently far in advance, the premiums may be discounted for interest from their due dates to the date of payment. The total amount of such gross premiums, less any discount as of the valuation date, is reported as a liability in the statutory financial statement. The gross premium less any discount is recorded as the advance premium, not the net valuation premium, in recognition of the company's liability to refund such premiums in the event the policy is terminated.

Advance premiums must be recorded for industrial as well as ordinary and group policies. Advance premiums received on group policies may be reported in the liability for premiums received in advance or as a 100% unearned premium reserve.

Premium and Other Deposit Funds

A company may also receive premiums over one year prior to their due date and include them in a premium deposit fund. These amounts are not reported as income. The premium deposit fund may or may not represent payment of specific future premiums. Interest at contracted rates is credited annually to each individual account. Interest on such funds must be accrued to the balance sheet date. The terms of the fund (interest rate, disposition, and so forth) are specified in

contracts and investment contracts and amends Statement 60 to change the reporting of realized gains and losses on investments.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Investment Contracts

15. Investment contracts issued by an insurance enterprise, as defined in this Statement, do not incorporate significant insurance risk as that concept is contemplated in Statement 60 and shall not be accounted for as insurance contracts. Amounts received as payments for such contracts shall not be reported as revenues. Payments received by the insurance enterprise shall be reported as liabilities and accounted for in a manner consistent with the accounting for interest-bearing or other financial instruments.

Universal Life-Type Contracts

17. The liability for policy benefits for universal life-type contracts shall be equal to the sum of:

a. The balance that accrues to the benefit of policyholders at the date of the financial statements[4]

[4] Accounting methods that measure the liability for policy benefits based on policyholder balances are known as retrospective deposit methods.

b. Any amounts that have been assessed to compensate the insurer for services to be performed over future periods (paragraph 20)

c. Any amounts previously assessed against policyholders that are refundable on termination of the contract

d. Any probable loss (premium deficiency) as described in paragraphs 35-37 of Statement 60.

18. Amounts that may be assessed against policyholders in future periods, including surrender charges, shall not be anticipated in determining the liability for policy benefits. In the absence of a stated account balance or similar explicit or implicit contract value, the cash value, measured at the date of the financial statements, that could be realized by a policyholder upon surrender shall represent the element of liability described in paragraph 17.a. Provisions for adverse deviation shall not be made.

19. Premiums collected on universal life-type contracts shall not be reported as revenue in the statement of earnings of the insurance enterprise. Revenue from those contracts shall represent amounts assessed against policyholders and shall be reported in the period that the amounts are assessed unless evidence indicates that the amounts are designed to compensate the insurer for services to be provided over more than one period.

20. Amounts assessed that represent compensation to the insurance enterprise for services to be provided in future periods are not earned in the period assessed. Such amounts shall be reported as unearned revenue and recognized in income over the period benefited using the same assumptions and factors used to amortize capitalized acquisition costs. Amounts that are assessed against the policyholder balance as consideration for origination of the contract, often referred to as initiation or front-end fees, are unearned revenues.

- Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy
- Accounting Practices and Procedures Manual for Life and Accident and Health Insurance Companies, Chapter 10, Aggregate Reserves for Life and Annuity Contracts, Chapter 12, Deposit Funds and Other Liabilities Without Life or Disability Contingencies and Chapter 18, Premium Income
- *Issue Paper No. 3—Accounting Changes*
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