**Flexible Premium Universal Life-Type Contracts**

7. Policy reserves are generally established as the excess of the present value of future benefits to be paid to or on behalf of policyholders less the present value of future net premiums. Unlike traditional life insurance contracts, flexible premium universal life-type contracts do not have guaranteed premiums and some assumption as to future premiums is required. Appendix A-585 establishes a minimum reserving method for universal life-type contracts by providing guidance on how to estimate future premiums on flexible premium universal life-type contracts so that traditional valuation methodologies could be used. Alternative minimum reserves shall be required, if applicable, for flexible premium universal life-type contracts if the guaranteed maturity premium is less than the valuation net premium. Appendix A-585 shall be used in establishing reserves for flexible premium universal life-type contracts.

**Fixed Premium Universal Life-Type Contracts**

8. Policy reserves are generally established as the excess of the present value of future benefits to be paid to or on behalf of policyholders less the present value of future net premiums. Fixed premium universal life-type contracts shall also follow the guidance in Appendix A-585. Certain fixed premium products offer the policyholder a secondary guarantee. A secondary guarantee provides the policyholder a guaranteed set of cash values, death benefits, and maturity benefits that will be provided regardless of the performance of the policy value. Appendix A-585 requires secondary guarantees to be considered when establishing policy reserves and shall be followed in establishing reserves for fixed premium universal life-type contracts.

**Policyholder Dividend Liability**

9. A reporting entity shall accrue, as applicable, the following items relating to participating policies. They are dividends due and unpaid, dividends apportioned (or not yet apportioned) for payment in the following twelve months, and dividends left on deposit to accumulate at interest.

10. Dividends due and unpaid represent dividends payable to the policyholder in the current year but which have not been disbursed or otherwise applied at the reporting date.

11. Dividends payable in the following calendar year represent the estimated amount of all dividends declared by a reporting entity’s board of directors prior to the end of the statement year which are not yet paid or due at the end of the year (dividends apportioned for payment) as well as all dividends payable in the following calendar year that have not been declared (dividends not yet apportioned for payment). For individual insurance the amount of this liability shall be equal to the aggregate amount of the dividends estimated to be payable in the following calendar year whether or not declared or apportioned. For group insurance and pensions, the amount of liability is generally equal to the portion of the dividend payable in the following calendar year which has been earned in the current calendar year.

12. Dividends left on deposit with the reporting entity shall be recorded in the amount of the deposit and accrued interest thereon. At the balance sheet date, the interest accrued but not yet credited to the policyholders’ accounts, shall be established as part of this liability.

**Coupons**

13. Some entities issue policies that guarantee an annual return, usually evidenced by a coupon that is part of the policy and matures on the policy’s anniversary. This return represents an annual pure endowment, and is essentially a return of premium previously paid by the policyholder. For matured coupons that have been left to accumulate, the liability is determined in the same way as the liability for dividend accumulations. Interest accrued is calculated for each coupon from the date each matures. The liability for unmatured policyholder coupons shall be the face value of the coupon, discounted at interest and mortality.

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## Disclosures

14. For life and annuity reserves the financial statements shall disclose the following:

  a. A description of reserve practices concerning the following:

    i. Waiver of deduction of deferred fractional premiums upon death of insured;

    ii. Return of portion of final premium for periods beyond the date of death; and

    iii. Amount of any surrender value promised in excess of the reserve as legally computed;

  b. The methods employed in the valuation of substandard policies;

  c. The amount of insurance, if any, for which the gross premiums are less than the net premiums according to the valuation standards;

  d. The method used to determine tabular interest, tabular less actual reserves released, and tabular cost (by formula or from the basic data for such items); and

  e. The nature of significant other reserve changes.

15. 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 insurer;

      (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 (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;

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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;

(e) All others;

b. Not subject to discretionary withdrawal;

c. Total gross;

d. Reinsurance ceded;

e. Total net.

16. If the reporting entity has reported life insurance premiums and annuity considerations deferred and uncollected on policies in force as of the financial statement date, disclose separately the amounts and the loading excluded for each of the following lines of business:

a. Industrial business;

b. Ordinary new business;

c. Ordinary renewal;

d. Credit life;

e. Group life;

f. Group annuity.

17. Disclose the aggregate amount of direct premiums written through managing general agents or third party administrators. For purposes of this disclosure, a managing general agent means the same as in Appendix A-225. If this amount is equal to or greater than 5% of surplus, provide the following information for each managing general agent and third party administrator:

a. Name and address of managing general agent or third party administrator;

b. Federal Employer Identification Number;

c. Whether such person holds an exclusive contract;

d. Types of business written;

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e. Type of authority granted (i.e., underwriting, claims payment, etc.);

f. Total premium written.

18. Reporting entities shall disclose the relative percentage of participating insurance, the method of accounting for policyholder dividends, the amount of dividends, and the amount of any additional income allocated to participating policyholders in the financial statements.

## DISCUSSION

### Statutory Guidance

19. The statutory accounting principles outlined in the conclusion above are consistent with current statutory accounting and Issue Paper No. 51.

### Flexible Premium Universal Life-Type Contracts

20. As discussed in Issue Paper No. 51, policy reserves are generally established as the excess of the present value of future benefits to be paid to or on behalf of policyholders less the present value of future net premiums. Traditional life insurance contracts generally provide a guaranteed set of future cash values and death benefits for a stated premium. Flexible and fixed premium universal life contracts typically develop cash surrender values that are based on a retrospective accumulation of premiums less mortality and expense charges, at a rate of interest declared by the reporting entity or based upon an index. Features such as flexible premiums and variable interest contracts are not compatible with the valuation procedures used for traditional contracts.

21. Flexible premium contracts produce a special valuation problem in that some assumption as to future premiums is required. The method of estimating the present value of future benefits to be paid to or on behalf of policyholders less the present value of future net premiums must be modified to apply to a flexible premium universal life-type contract since neither future premiums nor future benefits are known for a particular policy. The Model UL Regulation established a minimum reserving method for universal life-type contracts by providing guidance on how to estimate future premiums and related benefits on flexible universal life-type contracts so that traditional valuation methodologies could be used.

22. The Model UL Regulation provides a method for calculating reserves for flexible premium universal life contracts as the present value of future guaranteed benefits less the present value of valuation net premiums where the present value of valuation net premiums takes into account an expense allowance, multiplied by a ratio. This ratio is determined at each valuation date as the policyholder account balance divided by the Guaranteed Maturity Fund (GMF), the ratio not to exceed 1. The GMF's are an accumulation of Guaranteed Maturity Premiums (GMP) which are level gross premiums that provide for endowment at the latest permissible maturity date under the contract. Alternative minimum reserves shall be required, if applicable, for flexible premium universal life-type contracts if the guaranteed maturity premium is less than the valuation net premium, both as defined in the Model UL Regulation.

### Fixed Premium Universal Life-Type Contracts

23. Many reporting entities offer products whose cash values are calculated using universal life-type contract accumulation procedures, but which lack complete flexibility in premium payments. These products follow a similar set of valuation rules set forth in Appendix A-585. However, some of these products also offer the policyholder a secondary guarantee. A secondary guarantee provides the policyholder a guaranteed set of cash values, death benefits, and maturity benefits that will be provided regardless of the performance of the policy value.

24. Reserves for these products under Appendix A-585 are determined by computing the excess of the projected present value of future guaranteed benefits, taking into account secondary guarantees, over the present value of the future valuation net premium guaranteed at issue.

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**Policyholder Dividend Liability**

25. Ordinary life and industrial life policies may be issued either on a participating or a nonparticipating plan. Under participating plans, policyholders are entitled to policy dividends that have been declared by the reporting entity's board of directors. These dividends reflect all or a part of the difference between the premium charged for a given class of policies and the actual cost of these policies as experienced by the reporting entity based on the terms of the contract.

26. On ordinary policies, the policyholder generally may choose one of five ways of receiving or using the dividend. If no choice is made, the policy usually states which option is to be automatically used. Dividends may be either (1) paid in cash, (2) applied as a reduction of the next premium, (3) applied to buy paid-up additional insurance, (4) left on deposit with the reporting entity to accumulate at a guaranteed rate of interest, or (5) applied to purchase one-year term insurance up to the maximum specified in the agreement (generally the policy cash surrender value) with any balance of the dividend being applied under one of the four other options. Other options may also be available.

27. On industrial policies, dividends are usually paid as premium credits (applied to pay renewal premiums) or as paid-up additional insurance, as specified in the policy.

28. Group life may also be issued on a participating or a nonparticipating basis. If the contract is nonparticipating, it may provide for refunds or premium adjustments through a variety of experience ynterSeicc 0.4Div2dend Liabil6perieahe dir

## Universal Life Type Contracts, Policyholders Dividends, and Coupons

Dividend Accumulations

If the policyholder elects to leave the dividend on deposit with the company, the company must record an appropriate liability. This liability is for the amount of the deposit and accrued interest thereon. Interest usually is credited annually on the policy anniversary at the rate stated in the policy or at a rate declared by the company if greater than the stated contract or guaranteed rate. At the balance sheet date, the interest accrued but not yet credited to the policyholders' accounts, must be established as part of this liability.

Coupons

Some companies issue policies that guarantee an annual return, usually evidenced by a coupon that is part of the policy and matures on the policy's anniversary. This return represents an annual pure endowment, and is essentially a return of premium previously paid by the policyholder. Some states prohibit or strictly regulate policies with such provisions. To collect the return, in most cases, the policyholder must submit the coupon to the company. If the coupon is not submitted for payment, it should be treated as a deposit (accumulation) and accrue interest at the stated rate.

Coupons may be presented for cash, be used to reduce the premium, or left at interest. If the company permits, a coupon also may be used to purchase paid-up additional insurance.

The liability for unmatured coupons is generally carried as part of the policy reserve or as a separate policy liability. No matter how the liability is presented, it generally is the same as that for a one-year pure endowment policy in the amount of the face value of the coupon.

For matured coupons that have been left to accumulate, the liability is determined in the same way as the liability for dividend accumulations. Interest accrued is calculated for each coupon from the date each matures.

32. The Life/A&H Accounting Practices and Procedures Manual, Chapter 20, Policy and Contract Benefits, provides the following guidance with respect to policy and contract benefits including policyholder dividends:

Other Benefits

Other contract benefits reported in the Summary of Operations are:

1. Coupons, guaranteed annual pure endowments, and similar benefits.

2. Surrender benefits. These are amounts payable on termination of a policy other than by death or maturity. Such surrender benefits, where available, are guaranteed in the policy. The surrender value of additional insurance purchased by application of dividends is included in this item as well as amounts applied to repay any existing policy loan.

3. Interest on policy or contract funds. Included here are incurred interest payments made on deferred benefit payments and interest credited on premium and other deposit funds after deducting the discount allowed on policy proceeds paid in advance. Excluded from this item are interest on supplementary contracts, dividend accumulations and accumulations of coupons, and guaranteed annual pure endowments which do not exceed the annual premium and similar benefits.

4. Payments on supplementary contracts with life contingencies. In addition to the periodic payments incurred this would include the commuted value of any remaining guaranteed payments upon termination of the contract by death or surrender.

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5. Payments on supplementary contracts without life contingencies and of dividend accumulations. The commuted value of any remaining payments upon termination of supplementary contracts without life contingencies by death or surrender would also be included.

6. Accumulated coupon payments.

Dividends to Policyholders

Individual life and health insurance policies may be issued either on a participating or a nonparticipating plan. Under the participating plan, policyholders are entitled to policy dividends that have been declared by the company's board of directors. These dividends reflect the difference between the premium charged for a given class of policies and the actual cost of these policies as experienced by the company. Under t

the amount of surplus attributable to participating policies that may be transferred to the benefit of the stockholders.

Individual life insurance policies that will participate in the operating gains of the company are almost always sold as such. Occasionally,

34. SOP 95-1 provides the following guidance on policy reserves for participating contracts issued by mutual life insurance enterprises, fraternal benefit societies and stock life insurance subsidiaries of mutuals or fraternals:

> Liability for Future Policy Benefits
>
> 15. A liability for future policy benefits relating to participating life insurance contracts should be equal to the sum of --
>
> a. The net level premium reserve for death and endowment policy benefits.
>
> b. The liability for terminal dividends.
>
> c. Any probable loss (premium deficiency) as described in paragraphs 35 to 37 of FASB Statement No. 60.
>
> 16. The net level premium reserve should be calculated based on the dividend fund interest rate, if determinable, and mortality rates guaranteed in calculating the cash surrender values described in the contract. If the dividend fund in