

# **Statutory Issue Paper No. 50**

## **Classifications and Definitions of Insurance or Managed Care Contracts In Force**

### **STATUS**

**Finalized June 23, 1998**

**Original SSAP and Current Authoritative Guidance: SSAP No. 50**

### **Type of Issue:**

**Common Area**

### **SUMMARY OF ISSUE**

1. Current statutory guidance and state regulatory requirements use many different groupings, classifications and terminologies for insurance contracts in force. The Accounting Practices and Procedures Manual for Life and Accident and Health Insurance Companies (Life/A&H Accounting Practices and Procedures Manual) groups life insurance contracts into four product type categories based on specific product or marketing attributes: ordinary, industrial, group and credit. The Life/A&H Accounting Practices and Procedures Manual separates accident and health contracts into the categories of individual, group and credit. The Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies (P&C Accounting Practices and Procedures Manual) groups property and casualty products by type of coverage only for purposes of presentation in the various Annual Statement exhibits and schedules.
2. GAAP classifies insurance contracts in force as either long-duration or short-duration based on the nature of the insurance enterprise's obligations and policyholder rights under the provisions of the contract. Long-duration contracts include contracts, such as whole life, guaranteed renewable term life, endowment, annuity, and title insurance contracts, that are expected to remain in force for an extended period. All other insurance contracts are considered short-duration contracts and include most property and liability and all credit insurance contracts.
3. The purpose of this issue paper is to provide a general framework for classifying insurance or managed care contracts into categories where the recognition of contract and policy reserves and related revenue, benefits, and claims is fundamentally different. Separate issue papers will establish the accounting principles for premium and income recognition and policy benefit and claim reserves for all contracts as defined herein, including comparisons of statutory accounting principles to GAAP.

### **SUMMARY CONCLUSION**

#### **Overview**

4. The primary purpose of insurance, including managed care coverage, is to provide economic protection from identified risks occurring or discovered within a specified period. These risks include death, disability, health benefits, outliving one's financial assets, and damage to property by an insured peril or damage or injury to the insured or third parties. The accounting for these contracts is significantly influenced by the terms of the insurance or managed care contract.
5. In order to provide for a conservative, consistent, and comparable method of accounting for insurance or managed care contracts, premiums and related benefits shall be recognized considering the policy term, premium payment requirements, risks assumed and benefits provided under the contract

using conservative assumptions as to interest, mortality, morbidity, and incurred costs for health benefits as applicable. The reserve and income recognition methods reflect the premium payment pattern and the insurance protection and/or benefits provided for in the insurance or managed care contract.

6. This issue paper establishes an overall framework for existing insurance or managed care contracts by identifying four broad categories of insurance or managed care contracts where the premium payment pattern and the protection and/or benefits provided are fundamentally different and therefore require different income recognition and reserving methods.

7. Insurance contracts providing any protection against death, disability, accident or illness in which the reporting entity assumes mortality or morbidity risk shall be classified as life or accident and health contracts, as applicable. Managed care contracts provide defined health care services to subscribers, members or policyholders, collectively referred to hereafter as subscribers, in return for fixed, periodic premiums (usually paid monthly) that are generally due at or before the beginning of the coverage period and shall be classified as health contracts. Contracts which insure against damage to property by an insured peril or damage or injury to the insured or third parties, generally over a fixed/limited period of time, shall be classified as property and casualty contracts. Contracts in which the reporting entity does not assume any mortality, morbidity, health benefit costs incurred or casualty risk and which act exclusively as investment vehicles shall be classified as deposit-type contracts. Such classification shall be made at the inception of the contract and shall not change.

### **Life Contracts**

8. The primary purpose of life insurance is to provide financial assistance to a beneficiary at the insured's death. The long period of coverage involving the risk of death, a risk which increases with age, is the distinguishing characteristic by which life insurance is set apart from other forms of insurance. Life insurance is often sold on a level premium basis under which the annual premium remains constant even though the expected policy benefits and services do not occur evenly over the duration of the contract. Premium revenue generally exceeds expected policy benefits in the early years of the contract and it is necessary to accrue, as premium revenue is recognized, a liability for costs that are expected to be paid in the later years of the contracts.

9. The liability for expected costs relating to most types of life contracts is accrued over the current and expected renewal periods of the contracts. The net valuation premium is based upon an assumed interest rate and upon the frequency of death derived from mortality tables. The net premiums collected, after deducting benefits and other costs each year, are accumulated at interest. This accumulation, when combined with future net premiums and future investment income theoretically generates a sum sufficient to pay the claims resulting from the death or disabilities of the insured.

10. The liability which corresponds to this fund is referred to as the policy reserve. These contracts are generally expected to be in-force for an extended period of time and require the performance of various functions and services for an undefined period of time and are generally not subject to unilateral changes in their provisions. The policy reserve is generally calculated 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, discounted at valuation interest and mortality.

11. Life insurance contracts shall include contracts with life contingencies, including, but not limited to:

- Whole life contracts
- Endowment contracts
- Term life contracts
- Supplementary contracts
- Group life contracts

- Franchise life contracts
- Universal life type contracts
- Variable life contracts
- Limited payment contracts
- Credit life contracts
- Annuity contracts

### **Accident and Health Contracts**

12. Health insurance policies or managed care contracts, offered by a health maintenance or similar organization, many life insurance and some property and casualty companies, may provide hospital, surgical, medical, loss of income, accidental death and dismemberment, or long-term care coverage as well as other health related benefits. The insurance protection involving economic loss resulting from a medical condition (e.g., medical care expenses or the risk of disability) is the distinguishing characteristic by which accident and health insurance or managed care contracts are set apart from other forms of insurance. Health coverage is currently furnished under group or individual contracts. Coverage sold to individuals can be subdivided according to the reporting entity's right to continue the policy, limitations on the reporting entity's right to increase premiums, as well as other factors.

13. Accident and health contracts also include risk contracts with Medicaid and Medicare whereby the reporting entity assumes insurance risk.

14. Managed care contracts are contracts that provide defined health care services to subscribers in return for fixed, periodic premiums (usually paid monthly) that are generally due at or before the beginning of the coverage period. Managed care means a system or technique(s) generally used by reporting entities to affect access to and control payment for health care services. Managed care techniques most often include one or more of the following: 1) review of medical necessity and appropriateness of services or site of services; 2) contracts with selected providers; 3) financial incentives for enrollees to use specific providers, services, or service sites; 4) controlled access to and coordination of services by a case manager; and 5) payor efforts to identify treatment alternatives and modify benefit restrictions for high cost patient care. Expenses for medical, hospital, pharmacy and other benefits are recognized based on the way the reporting entity provides for the contracted services. In some instances, this is through the payment of claims to providers as services are rendered which require a claims liability to be recorded as addressed in *Issue Paper No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses* (Issue Paper No. 55) or through capitated arrangements based on contracts with providers, where expense is recognized ratably over the contract period.

15. Similar to life insurance contracts, a significant amount of accident and health contracts is sold to individuals and groups on a level premium basis under which the annual premium remains constant even though the expected policy benefits and services may not occur evenly over the duration of the contract. Premium revenue for level premium contracts generally exceeds expected policy benefits in the early years of the contracts and it is necessary to accrue, as premium revenue is recognized, a liability for costs that are expected to be paid in the later years of the contracts.

16. The liability for expected costs relating to accident and health contracts sold on a level premium basis is accrued over the current and expected renewal periods of the contracts. The net valuation premium is based upon an assumed interest rate, persistency, and the frequency of expected death and disability claims generally derived from mortality and morbidity tables. The net premiums collected, after deducting benefits and other costs each year, are accumulated at interest. Similar to life insurance, this accumulation or policy reserve, when combined with future net premiums and future investment income theoretically generate a sum sufficient to pay the claims resulting from the death or disabilities of the insured or subscriber. The reserve is generally calculated as the excess of the present value of future

benefits to be paid to or on behalf of insureds or subscribers less the present value of future net premiums, discounted at valuation interest, mortality, and morbidity.

17. Accident and health contracts shall include contracts with health benefits or disability contingencies, including, but not limited to:

- Managed care contracts
- Income replacement contracts
- Expense reimbursement contracts
- Credit accident and health contracts
- Continuing care contracts
- Long-term care contracts
- Accidental death and dismemberment contracts

### **Deposit-Type Contracts**

18. Deposit-type or investment contracts do not incorporate insurance risk. Contracts issued by insurers that do not incorporate risk from the death or disability of policyholders (mortality or morbidity risk) are more comparable to financial or investment instruments issued by other financial institutions than to insurance contracts.

19. Accounting for investment contracts issued by insurance enterprises should be consistent with the accounting for interest-bearing and other financial instruments where the reserve is either based on the accumulated amounts paid plus an income accumulation based on the contract provisions or based on the present value of future benefits, discounted at the applicable interest factor.

20. Deposit-type contracts shall include contracts without life or disability contingencies, including, but not limited to:

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

### **Property and Casualty Contracts**

21. Contracts which insure against damage to property by an insured peril or damage or injury to the insured or third parties shall be classified as property and casualty contracts. Damages shall include both physical and financial damages. Premiums from property and casualty contracts are generally recognized as earned over the exposure period of the contract in proportion to the amount of insurance protection provided.

22. The exposure to insurance risk for most property and casualty insurance contracts does not vary significantly during the duration of the contract. Premiums from property and casualty contracts shall be recognized as earned premium as discussed in *Issue Paper No. 53—Property and Casualty Contracts - Premiums*.

23. These contracts shall include but shall not be limited to:
- Traditional property and casualty insurance contracts
  - Title insurance contracts
  - Mortgage and financial guaranty contracts

## DISCUSSION

24. This issue paper establishes an overall framework for existing insurance contracts by identifying four broad categories of insurance contracts where the premium payment pattern and the insurance protection and/or benefits provided are fundamentally different and therefore require different income recognition and reserving methods. The framework established for the purposes of this issue paper differs from the SAP classifications. Additionally, this framework rejects the GAAP classifications (i.e., short-duration and long-duration) found in *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 No. 120, Accounting and Reporting by Mutual Life Insurance Enterprises and by Insurance Enterprises for Certain Long-Duration Participating Contracts* (FAS 120). However, this framework does incorporate certain elements of both SAP and GAAP. As new types of contracts are developed, based on their characteristics, the contracts can be readily classified into one of the four categories established by this issue paper. Establishing criteria for the evaluation of new products is consistent with the Statement of Concepts which states:

The regulators' need for meaningful, comparable financial information to determine an insurer's financial condition requires consistency in the development and application of statutory accounting principles. Because the market place, the economic and business environment, and insurance industry products and practices are constantly changing, regulatory concerns are also changing. An effective statutory accounting model must be responsive to these changes and address emerging accounting issues. Precedent or historically accepted practice alone should not be sufficient justifications for continuing to follow a particular accounting principle or practice which may not coincide with the objectives of regulators.

The multitude of unique circumstances and individual transactions makes it virtually impossible for any codification of accounting principles to be totally comprehensive. Application of SAP, either contained in the Accounting Practices and Procedures Manuals or defined as GAAP and adopted by the NAIC, to unique circumstances or individual transactions should be consistent with the concepts of conservatism, consistency, and recognition.

25. Distinguishing between life, accident and health, deposit-type, and property and casualty contracts is reflective of the insurer's obligations under the terms of the contract. The common attributes of insurance contracts are often readily identified with the duration of the contract, the insurer's ability to unilaterally change the terms of the contract, the premium payment pattern, as well as other factors. Based on the attributes, the following general issue papers have been developed:

<b>Issue Paper</b>	<b>Title</b>
Issue Paper No. 51	Life Contracts
Issue Paper No. 52	Deposit-Type Contracts
Issue Paper No. 53	Property Casualty Contracts - Premiums
Issue Paper No. 54	Individual and Group Accident and Health Contracts
Issue Paper No. 65	Property and Casualty Contracts

26. If additional guidance is necessary, separate issue papers will establish statutory accounting principles for specific insurance contracts as indicated below. Current statutory accounting for specific types of contracts will be evaluated for consistency with the basic concepts established in Issue Paper Nos. 51, 52, 53, 54, and 65, as well as for consistency with the Statement of Concepts. The descriptions of specific types of insurance contracts in paragraphs 2 to 52 of this issue paper are consistent with the descriptions of such contracts found in the *AICPA Audits of Property and Liability Insurance Companies* (AICPA P&C Audit and Accounting Guide) and the *AICPA Audits of Stock Life Insurance Companies* (AICPA Life Audit and Accounting Guide). A summary of those specific issue papers is as follows:

<b>Issue Paper</b>	<b>Title</b>
<i>Life Contracts</i>	
Issue Paper No. 56	Universal Life-Type Contracts, Policyholder Dividends, and Coupons
Issue Paper No. 59	Credit Life and Accident and Health Insurance Contracts
Issue Paper No. 74	Life, Deposit-Type and Accident and Health Reinsurance
Issue Paper No. 89	Separate Accounts
<i>Accident and Health Contracts</i>	
Issue Paper No. 59	Credit Life and Accident and Health Insurance Contracts
Issue Paper No. 74	Life, Deposit-Type and Accident and Health Reinsurance
<i>Property and Casualty Contracts</i>	
Issue Paper No. 57	Title Insurance
Issue Paper No. 69	Financial Guaranty Insurance
Issue Paper No. 88	Mortgage Guaranty Insurance
Issue Paper No. 75	Property and Casualty Reinsurance

27. Areas where premium, policy and claim reserves and related areas are accounted for similarly will be combined and discussed as a single topic. Those categories are as follows:

<b>Issue Paper</b>	<b>Title</b>
Issue Paper No. 55	Unpaid Claims, Losses and Loss Adjustment Expenses
Issue Paper No. 66	Accounting for Retrospectively Rated Contracts
Issue Paper No. 97	Underwriting Pools and Associations Including Intercompany Pools

### **Life Contracts**

28. The contract for ordinary life insurance is between the company and the policy owner (often the insured). Many variations of ordinary life coverages are available to a purchaser of insurance, including participating, limited-payment periods, combinations of coverages, and decreasing (or increasing) death benefits. Industrial life insurance, also called "debit" insurance, is insurance under which premiums are paid monthly or more often, the face amount of the policy does not exceed a stated amount, and the words "industrial policy" are printed in prominent type on the face of the policy. Ordinary and industrial life insurance contracts are considered life contracts and include the following types of coverage as described in the following paragraphs.

29. *Whole life contracts* provide a fixed amount of insurance coverage over the life of the insured and the related benefits are normally payable only upon the insured's death. Premiums are paid over various periods as allowed by the terms of the policy contract. Whole life insurance contracts provide for nonforfeiture values, some common types being reduced paid up insurance, extended term insurance, and cash values, and some provide for the payment of policy dividends. A level premium is usually paid for

policies of this type; and the premium may be paid in annual or more frequent modes. An ordinary life (straight-life) policy stipulates that premiums are to be paid during the life of the insured.

30. *Endowment contracts* are principally savings contracts which incorporate an element of life insurance protection. Endowment insurance contracts provide a benefit if the insured survives the endowment period or the amount is paid to a beneficiary if the insured does not survive. A pure endowment contract only provides a benefit to the insured if he/she survives the endowment period. Endowment policies mature at a specified attained age of the insured or at the end of a specified period. Premium payments for endowment contracts are made over a specified period, but may also be made under a single-premium or limited-payment plan. Both whole life and endowment policies contain nonforfeiture or similar clauses which provide for a value in cash or some other form of insurance to be available in the event of failure to continue the required premiums.

31. *Term life contracts* provide insurance over a specified period of time. If the insured dies during this term, the face amount of the policy will be paid to the beneficiary. Policies for term insurance which are written for relatively short periods of time commonly grant the policyholder the right to renew for an additional period or periods up to a maximum age, such as 60 or 65, without requiring additional evidence of insurability. Rights to convert to whole life or endowment contracts may also be included in the contract. Term contracts may also be made for a period which will end when the insured reaches a certain age (for example, age 60 or 65). Such policies do not usually provide nonforfeiture values.

32. *Supplementary contracts with life contingencies* are a type of agreement between the insurance company and either the insured or the beneficiary, usually to provide for full or partial settlement of the amount payable upon the termination of an original contract. Generally, the proceeds are paid over the lifetime of one or more beneficiaries. This differs from a supplementary contract without life contingencies under which the proceeds are paid over a definite period without regard to the life of the beneficiary.

33. *Group life contracts* are insurance on the lives of a group of persons under a single master contract. Insurance of this type is customarily written on a yearly renewable term basis although some permanent group life is sold. Group life insurance is based on a master policy which usually precludes or disallows individual selection and is for the benefit of persons other than the policyholder. The individual insured members may receive certificates of insurance which evidence the contract. The contract is made by the policyholder and the insurer; there is no contract of insurance between the policyholder and the members. State statutes vary as to what constitutes a group and as to who may be a policyholder. Some states permit only employee-employer relationships in a group contract. Others permit union members, credit union members, or similar relationships in group contracts.

34. *Franchise life contracts* usually consist of individual policies offered to all persons in a general class (usually a work profession) who are related in some way such as belonging to a certain association.

35. *Universal life and variable life contracts* include those contracts which have terms that are not fixed and guaranteed relative to premium amounts, expense assessments, or benefits accruing to the policyholder. These contracts generally provide for death benefits and nonforfeiture values and may be issued on a fixed premium basis or on a flexible premium basis where the premiums are paid at the insured's discretion.

36. *Limited-payment contracts* are contracts with terms that are fixed and guaranteed, and for which premiums are paid over a specified number of years or to a specified age. The insurance coverage continues for the remainder of the insured's life. A single-premium policy requires a lump-sum payment at the inception of the policy.

37. *Credit life contracts* are sold in connection with loans or other credit transactions not exceeding a stated duration and provide insurance protection against death. This form of insurance is generally issued in connection with the issuance of credit to an individual by a bank, retailer, finance company, or other similar organizations. This type of insurance most often protects the creditor to the extent of the unpaid balance of the loan in the form of decreasing term insurance; however, some credit life insurance is sold on a level-term basis.

38. An *annuity contract* is an arrangement whereby an annuitant is guaranteed to receive a series of stipulated amounts commencing either immediately or at some future date. A contract with a purchase rate guarantee represents a life contingency that would require an annuity contract to be classified as a life contract. Annuity contracts are issued to individuals or to groups. Group annuities are often the vehicle used to provide for a company's pension obligations to its employees. The main types of *annuity contracts with life contingencies* are discussed below.

- a. A *deferred annuity* provides for the accumulation of funds to be applied at some future period designated by the policyholder. Premium payments can be made in a lump sum amount (single premium deferred annuity), or periodically (flexible or fixed premium deferred annuity) as allowed by the policy contract. At the end of the accumulation period, the policyholder may elect to receive a lump sum distribution or may elect to receive periodic payments for life, over specific period, or some combination thereof.
- b. A *variable annuity* is an annuity which includes a provision for benefit payments which vary in accordance with the rate of return of the underlying investment portfolio selected by the policyholder. The considerations for a variable annuity are usually invested in a separate account in which the value of the contract share varies according to the performance of the separate account before the commencement of annuity payments as well as after. Premium payments can be made in lump sum amounts, or periodically as allowed by the policy contract. A minimum death benefit is often guaranteed during the annuity consideration accumulation period and these contracts are therefore classified as life contracts.
- c. A *straight-life annuity* provides for periodic payments to the annuitant as long as the annuitant lives. Death of the annuitant constitutes completion of the contract and no further payments are made by the insurance company.
- d. A *life annuity with a period certain* works essentially the same way as the straight-life annuity as the annuitant receives periodic payments for as long as the annuitant lives. However, if the annuitant dies before the end of the specified "certain" period, payments are continued to a beneficiary until the specified number of "certain" payments (i.e., the specified period in the contract) is completed.
- e. A *refund annuity* is similar to the *life annuity with a period certain* in which the annuitant receives periodic payments for as long as the annuitant lives. There are two variants of this type of annuity. Under the cash refund annuity, a lump-sum payment is made at the death of the annuitant equal to the excess, if any, of the purchase price of the annuity over the sum of the annuity payments made to date of death. The installment refund annuity provides that annuity payments are to continue to a beneficiary after the death of the annuitant until the sum of all payments made equals the purchase price.
- f. A *joint and survivorship annuity* provides for the continuation of payments after the death of one of the annuitants during the lifetime of the surviving annuitant.



**Accident and Health Contracts**

39. Accident and health contracts provide protection against economic losses resulting from accident, sickness, or medical condition. This coverage may be provided under individual policies, under group or franchise policies, managed care contracts, or Medicaid or Medicare risk contracts, or it may be provided under certain special types of policies, such as credit accident and health insurance.

40. The economic losses which accident and health policies cover, or the types of benefits provided, will vary with different policies. The broad categories of economic losses protected against are medical and hospital expense and income replacement. For example, payments for hospital, surgical, or medical expenses may be provided under a hospital expense policy, while under other policies, a more comprehensive form of coverage, known as major medical insurance, may be offered. Similarly, policies may provide monthly benefits for loss of income from disability, either on a short term or a long term basis, or only for disabilities due to accident. Loss of life from accident may be covered under accidental death policies, while under certain limited accident policies, only accidental death from air travel may be covered.

41. Accident and health policies may be categorized by the form of policy through which the coverage is provided; it may be categorized according to the benefits provided by the policy; or it may be categorized by the contingencies insured against. These variations in types of policies and the benefits provided must be considered in discussing the reserves for accident and health policies.

42. *Credit accident and health insurance contracts* are similar to credit life insurance except the insurance protection is in the form of disability insurance.

43. *Long-term care contracts* represent any contract or policy rider providing coverage for not less than twelve consecutive months for each covered person for one or more necessary diagnostic, preventive, therapeutic, rehabilitative, maintenance or personal care services, provided in a setting other than an acute care unit of a hospital. Under long-term care contracts, the insured event is generally the inability of the contractholder to perform certain activities of daily living as compared to medical contracts which generally provide insurance protection against accident or sickness or disabilities contracts which generally provide income replacement protection.

**Deposit-Type Contracts**

44. Under deposit-type contracts, the policyholder may assume all, some, or none of the investment risk, depending on the contract terms. Amounts can be deposited in lump sum, or periodically as allowed by the policy contract. Deposit-type contracts would include annuities certain, whose income payments have no reference to life contingencies and benefits are paid over a specified period (i.e., 10 years, 20 years, etc.)

**Property and Casualty Contracts**

45. Property and casualty contracts include a variety of types of coverage, including, but not limited to, fire, workers' compensation, automobile, multiple peril, professional and miscellaneous liability, and fidelity and surety bonds as further discussed below.

46. Types of insurance represent the perils that are insured by property and liability insurance companies and classified as property and casualty contracts. Some of the more important types of insurance are as follows:

- a. *Fire and allied lines*, which include coverage for fire, windstorm, hail, and water damage (but not floods);

- b. *Ocean marine*, which includes coverage for ships and their equipment, cargos, freight or money to be paid for use of the ships, and liability to third parties for damages. This type of insurance includes inland as well as ocean water transportation;
- c. *Inland marine*, which covers property in transit. (It also includes floaters, which are policies that cover movable property, such as a tourist's personal property);
- d. *Workers' compensation*, which compensates employees for injuries or illness sustained in the course of their employment;
- e. *Automobile*, which covers personal injury or automobile damage sustained by the insured and the related liability to third parties for losses caused by the insured;
- f. *Multiple peril*, which is a package coverage including most property and liability coverage except workers' compensation, automobile insurance, and surety bonds;
- g. *Professional liability*, which covers physicians, surgeons, dentists, hospitals, engineers, architects, accountants, attorneys, and other professionals from liability arising from error or misconduct in providing or failing to provide professional service;
- h. *Miscellaneous liability*, which covers most other physical and property damages not included under workers' compensation, automobile liability, and multiple peril policies. (Damages include death, cost of care, and loss of services resulting from bodily injury, as well as loss of use of property);
- i. *Fidelity bonds*, which cover employers against dishonest acts by employees. Blanket fidelity bonds cover groups of employees; and
- j. *Surety bonds*, which provide for monetary compensation to third parties for failure by the insured to perform specifically covered acts within a stated period. (Most surety bonds are issued for persons doing contract construction, persons connected with court actions, and persons seeking licenses and permits. Surety bonds also include financial guarantees.)

47. In addition to these types, insurance is provided by excess and surplus lines. *Excess liability* covers the insured against loss in excess of a stated amount, but only for losses as covered and defined in an underlying policy. The underlying amount is usually insured by another policy but can be retained by the insured. *Surplus lines* include coverage for risks that do not fit normal underwriting patterns, risks that are not commensurate with standard rates, or risks that will not be written by standard carriers because of general market conditions. These kinds of policies are generally written by carriers not licensed in the jurisdiction where the risk is located and generally are not subject to regulations governing premium rates or policy language.

48. Insurance is generally available to the individual as a means of protection against loss. There are instances, however, in which a person cannot obtain insurance in the voluntary insurance market. States have established *involuntary plans* to provide insurance to those with high risks who otherwise would be excluded from obtaining coverage. A common example is the Automobile Insurance Plan (formerly called the Assigned Risk Plan). Under this plan, all companies writing automobile insurance in a state are allocated a share of the involuntary business on an equitable basis. Other states use a reinsurance plan, under which each insurer accepts all applicants but may place high-risk drivers in a reinsurance pool, with premiums paid to and losses absorbed by the pool. Still another approach is a joint underwriting association, in which one or more servicing companies are designated to handle high-risk drivers. All insurers in the state may be required to participate in the underwriting results. Another example of involuntary plans includes Fair Access to Insurance Requirements (FAIR) plans. FAIR plans are federally approved, state-supervised programs established to provide coverage for property in high-risk areas. Companies that operate in the state are assessed for any underwriting losses experienced by the FAIR plan.

49. *Medical malpractice pools* were established when health-care professionals and institutions were experiencing difficulty in obtaining liability insurance in the voluntary insurance market. The pools were

established by law and currently exist in the majority of states. All insurers writing related liability insurance in such states are considered mandatory participants in the pools as a condition for their continuing authority to transact business in such states.

50. *Workers' compensation pools* are similar to FAIR plans. As with FAIR plans, companies operating in a given state are assessed a proportionate share, based on direct writings, of the underwriting results of the pool.

51. *Title insurance* insures, guarantees, or indemnifies owners of real property or the holders of liens or encumbrances thereon against loss or damage suffered by unidentified instances of defective titles, liens or encumbrances or the unmarketability of the title.

52. *Mortgage guaranty insurance* protects a lender against loss of all or a portion of the principal amount of a mortgage loan upon default of the mortgagor. This type of insurance provides no protection other than against loss due to default.

### **RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE (ONLY PERTINENT EXCERPTS ARE INCLUDED BELOW)**

#### **Statutory Accounting**

53. The Life/A&H Accounting Practices and Procedures Manual provides the following guidance with respect to the classification of life and annuity contracts:

#### CHAPTER 10 AGGREGATE RESERVES FOR LIFE AND ANNUITY CONTRACTS

##### Life Insurance

All life insurance that is written can be separated into four lines of business: ordinary, industrial, group and credit.

Ordinary life insurance is the most common type of the four lines, and it may consist of whole life, term, or endowment coverages. The contract is between the company and the insured (or the owner, if different). The payment of the premium by the insured/owner usually is sent directly to the home office of the company and not to a company agent.

Many modifications of whole life, term, and endowment coverages are available to the insurance buyer. Such variations include limited payment periods, combinations of coverages, and decreasing (or increasing) death benefits. In addition, some policies, notably universal life policies, offer the insurance buyer the option to vary, or even suspend, premium payments over the life of the policy.

Also considered as ordinary insurance is franchise insurance. It usually consists of individual policies offered to all persons in a general class (usually a work profession) who are related in some way such as belonging to a certain association. Some states require that this relationship be other than through the purchase of insurance.

Industrial life insurance, also called debit insurance, can be defined as insurance under which premiums are paid weekly, or under which the premiums are payable monthly or more often if the face amount of the insurance provided in the policy does not exceed a stated amount and the words "industrial policy" are printed in prominent type on the face of the policy.

Group life insurance is insurance on the lives of a group of members, the minimum number of which may be specified by statute. Group insurance is based on a master policy which usually precludes or disallows individual selection and is for the benefit of persons other than the policyholder. The individual insured members may receive certificates of insurance which evidence

the contract. The contract is made by the policyholder and the insurer; there is no contract of insurance between the policyholder and the members. The various state statutes vary as to what constitutes a group and as to who may be a policyholder. Some states permit only employee-employer relationships in a group contract. Others permit union members, credit union members, or similar relationships in group contracts.

The fourth line of life insurance is credit. Credit insurance may be either individual or group. All life and all accident and health insurance that is sold in connection with loans or other credit transactions not exceeding a stated duration is to be reported as credit insurance.

54. The Life/A&H Accounting Practices and Procedures Manual provides the following guidance with respect to the classification of accident and health contracts:

#### CHAPTER 13

#### AGGREGATE RESERVES FOR ACCIDENT AND HEALTH POLICIES

Accident and health insurance provides protection against economic losses resulting from accident and/or sickness. This insurance may be provided under individual policies, under group or franchise policies, or it may be provided under certain special types of policies which bear unique titles such as credit insurance. The economic losses which accident and health insurance policies cover, or the types of benefits provided, will vary with different policies. For example, reimbursement for hospital, surgical, or medical expenses may be provided under a hospital expense policy, while under other policies, a more comprehensive form of coverage, known as major medical insurance, may be offered. Similarly, policies may provide monthly benefits for loss of income from disability, either on a short term or a long term basis, or only for disabilities due to accident. Loss of life from accident may be covered under accidental death policies, while under certain limited accident policies, only accidental death from air travel may be covered. Therefore, accident and health policies may be categorized by the form of policy through which the coverage is provided; it may be categorized according to the benefits provided by the policy; or it may be categorized by the contingencies insured against. These variations in types of policies and the benefits provided must be considered in discussing the reserves for accident and health insurance policies.

Accident and health policies are offered by life companies, casualty companies, fraternal benefits societies, and certain specialty companies. While the coverage originated with casualty companies, it is now the life insurance companies which provide the majority of accident and health insurance. The history of the business is important because many of the concepts currently used originated from casualty insurance practices and use casualty terminology. Since the life insurance companies began writing this insurance, the form of the policies and the concept of coverages have changed, which also produced changes in reserving practices.

#### Individual Accident and Health Policies

Individual accident and health policies, other than credit insurance, are separated for reserve reporting purposes in the statutory financial statement into six classifications. The definitions are included in the instructions for the statutory financial statement and are based principally on the renewal agreement of the policy. There is some variation in the reserve requirements which apply to the different renewal classifications of policies but most reserve requirements apply to all individual policies.

#### Group Policies

All organizations that qualify to purchase group life insurance may also, by most state laws, purchase accident and health insurance. In many states, the definition of what constitutes an eligible group for accident and health insurance is entirely left up to any set of good underwriting practices established by the insurance company.

### Credit Insurance

Credit accident and health insurance is insurance on a debtor to provide indemnity for payments becoming due on a specific loan or other credit transaction while the debtor is disabled as defined in the policy. Credit policies are limited to issues of 120 months or less in most states. Some states limit such policies to 60 months.

Credit accident and health insurance is sold as either individual or group coverage, and the reserves are included in the annual statement. Because of the significant growth in recent years of credit insurance coverages of 120 months or less are now reported as a separate line of business in the annual statement.

The premium payment methods of credit insurance may be single premium or monthly premium on the outstanding balance. Outstanding balance rates, used only for group coverage, are determined by multiplying a monthly rate times the amount of outstanding insured indebtedness. The premium so determined is remitted on each monthly due date to the insurer by the group creditor. Under single premium credit insurance, the premium rate is applied to the initial amount of insurance and generally is included in the debt. Creditors usually remit the single premium for each new insured once a month.

Although credit insurance may be written on an individual or a group basis, the major portion of credit insurance that is written today is group. The two types differ only in form, not in substance. Consequently, they are treated here as one, unless otherwise noted.

55. The P&C Accounting Practices and Procedures Manual and the Accounting Practices and Procedures Manual for Health Maintenance Organizations do not contain relevant guidance related to the classification and definitions of types of policies.

### **Generally Accepted Accounting Principles**

56. FAS 60, as amended by FAS 120, provides the following guidance on definitions and classification of insurance contracts:

#### Summary

Insurance contracts, for purposes of this Statement, need to be classified as short-duration or long-duration contracts. Long-duration contracts include contracts, such as whole life, guaranteed renewable term life, endowment, annuity, and title insurance contracts, that are expected to remain in force for an extended period. All other insurance contracts are considered short-duration contracts and include most property and liability insurance contracts.

Premiums from short-duration contracts ordinarily are recognized as revenue over the period of the contract in proportion to the amount of insurance protection provided. Claim costs, including estimates of costs for claims relating to insured events that have occurred but have not been reported to the insurer, are recognized when insured events occur.

Premiums from long-duration contracts are recognized as revenue when due from policyholders. The present value of estimated future policy benefits to be paid to or on behalf of policyholders less the present value of estimated future net premiums to be collected from policyholders are accrued when premium revenue is recognized. Those estimates are based on assumptions, such as estimates of expected investment yields, mortality, morbidity, terminations, and expenses, applicable at the time the insurance contracts are made. Claim costs are recognized when insured events occur.

### INTRODUCTION

1. The primary purpose of insurance is to provide economic protection from identified risks occurring or discovered within a specified period. Some types of risks insured include death,

disability, property damage, injury to others, and business interruption. Insurance transactions may be characterized generally by the following:

- a. The purchaser of an insurance contract makes an initial payment or deposit to the insurance enterprise in advance of the possible occurrence or discovery of an insured event.
  - b. When the insurance contract is made, the insurance enterprise ordinarily does not know if, how much, or when amounts will be paid under the contract.
2. Two methods of premium revenue and contract liability recognition for insurance contracts have developed, which are referred to as short-duration and long-duration contract accounting in this Statement. Generally, the two methods reflect the nature of the insurance enterprise's obligations and policyholder rights under the provisions of the contract.
3. Premiums from short-duration insurance contracts, such as most property and liability insurance contracts, are intended to cover expected claim<sup>1</sup> costs resulting from insured events that occur during a fixed period of short duration. The insurance enterprise ordinarily has the ability to cancel the contract or to revise the premium at the beginning of each contract period to cover future insured events. Therefore, premiums from short-duration contracts ordinarily are earned and recognized as revenue evenly as insurance protection is provided.

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<sup>1</sup> Terms defined in the glossary (Appendix A) are in boldface type the first time they appear in this Statement.  
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4. Premiums from long-duration insurance contracts, including many life insurance contracts, generally are level even though the expected policy benefits and services do not occur evenly over the periods of the contracts. Functions and services provided by the insurer include insurance protection, sales, premium collection, claim payment, investment, and other services. Because no single function or service is predominant over the periods of most types of long-duration contracts, premiums are recognized as revenue over the premium-paying periods of the contracts when due from policyholders. Premium revenue from long-duration contracts generally exceeds expected policy benefits in the early years of the contracts and it is necessary to accrue, as premium revenue is recognized, a liability for costs that are expected to be paid in the later years of the contracts. Accordingly, a liability for expected costs relating to most types of long-duration contracts is accrued over the current and expected renewal periods of the contracts.

5. Title insurance contracts provide protection for an extended period and therefore are considered long-duration contracts. Premiums from title insurance contracts ordinarily are recognized as revenue on the effective date of the contract because most of the services associated with the contract have been rendered by that time. Estimated claim costs are recognized when premium revenue is recognized because the insurance provides protection against claims caused by problems with title to real estate arising out of ascertainable insured events that generally exist at that time.

#### APPLICABILITY AND SCOPE

6. This Statement establishes accounting and reporting standards for the general-purpose financial statements of stock life insurance enterprises, property and liability insurance enterprises<sup>2</sup>, and title insurance enterprises, mutual life insurance enterprises, assessment enterprises, and fraternal benefit societies. Except for the sections on premium revenue and claim cost recognition and acquisition costs (paragraphs 9-11, 13-18, and 20-31), this Statement applies to mortgage guaranty insurance enterprises. FASB Statement 120, Accounting and Reporting by Mutual Life Insurance Enterprises and by Insurance Enterprises for Certain Long-Duration Participating Contracts, addresses the accounting for certain long-duration participating life insurance contracts.

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<sup>2</sup> Property and liability insurance enterprises, for purposes of this Statement include stock enterprises, mutual enterprises, and reciprocal interinsurance exchanges.  
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## STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

### General Principles

7. Insurance contracts, for purposes of this Statement, shall be classified as short-duration or long-duration contracts depending on whether the contracts are expected to remain in force<sup>3</sup> for an extended period. The factors that shall be considered in determining whether a particular contract can be expected to remain in force for an extended period are:

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<sup>3</sup> In force refers to the period of coverage, that is, the period during which the occurrence of insured events can result in liabilities of the insurance enterprise.  
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- a. Short-duration contract. The contract provides insurance protection for a fixed period of short duration and enables the insurer to cancel the contract or to adjust the provisions of the contract at the end of any contract period, such as adjusting the amount of the premiums charged or coverage provided.
- b. Long-duration contract. The contract generally is not subject to unilateral changes in its provisions, such as noncancelable or guaranteed renewable contract, and requires the performance of various functions and services (including insurance protection) for an extended period.

8. Examples of short-duration contracts include most property and liability insurance contracts and certain term life insurance contracts, such as credit life insurance. Examples of long-duration contracts include whole life contracts, guaranteed renewable term life contracts, endowment contracts, annuity contracts, and title insurance contracts. Accident and health insurance contracts may be short-duration or long-duration depending on whether the contracts are expected to remain in force for an extended period. For example, individual and group insurance contracts that are noncancelable or guaranteed renewable (renewable at the option of the insured), or collectively renewable (individual contracts within a group are not cancelable), ordinarily are long-duration contracts.

57. FAS 97, as amended by FAS 120, provides the following guidance on definitions and classifications of insurance contracts:

### Summary

This Statement establishes standards of accounting for certain long-duration contracts issued by insurance enterprises, referred to in this Statement as universal life-type contracts, that were not addressed by *FASB Statement No. 60, Accounting and Reporting by Insurance Enterprises*. The Statement also establishes standards of accounting for limited-payment long-duration insurance contracts and investment contracts and amends Statement 60 to change the reporting of realized gains and losses on investments.

New life insurance contracts have evolved since the development of specialized insurance industry accounting principles and practices in the early 1970s. Many of those new life insurance contracts have different provisions than do the life insurance contracts to which Statement 60 applies. Those new life insurance contracts are characterized by flexibility and discretion granted to one or both parties to the contract. Statement 60 identifies but does not address those contracts, noting that the

accounting was under study by the insurance industry and the accounting and actuarial professions.

This Statement requires that the retrospective deposit method be used to account for universal life-type contracts. That accounting method establishes a liability for policy benefits at an amount determined by the account or contract balance that accrues to the benefit of the policyholder. Premium receipts are not reported as revenues when the retrospective deposit method is used. The Statement also requires that capitalized acquisition costs associated with universal life-type contracts be amortized based on a constant percentage of the present value of estimated gross profit amounts from the operation of a "book" of those contracts. Any gain or loss resulting from a policyholder's replacement of other life insurance contracts with universal life-type contracts is recognized in income of the period in which the replacement occurs.

This Statement requires that long-duration contracts issued by insurance enterprises that do not subject the enterprise to risks arising from policyholder mortality or morbidity (investment contracts) be accounted for in a manner consistent with the accounting for interest-bearing or other financial instruments. Payments received on those contracts are not reported as revenue.

This Statement also addresses limited-payment contracts that subject the insurance enterprise to mortality or morbidity risk over a period that extends beyond the period or periods in which premiums are collected and that have terms that are fixed and guaranteed. This Statement requires that revenue and income from limited-payment contracts be recognized over the period that benefits are provided rather than on collection of premiums.

58. AICPA P&C Audit and Accounting Guide provides the following definitions of types of insurance contracts:

#### Kinds of Insurance

1.04. Kinds of insurance, generally referred to as lines of insurance, represent the perils that are insured by property and liability insurance companies. Some of the more important lines of insurance are --

- Fire and allied lines, which include coverages for fire, windstorm, hail, and water damage (but not floods).
- Ocean marine, which includes coverage for ships and their equipment, cargos, freight or money to be paid for use of the ships, and liability to third parties for damages. (Ocean marine is perhaps the oldest form of insurance, dating back to at least 600 years to the days of the Venetian traders.)
- Inland marine, which covers property being transported other than transocean. (It also includes floaters, such as for personal property, jewelry, and furs.)
- Workers' compensation, which compensates employees for injuries or illness sustained in the course of their employment.
- Automobile, which covers personal injury or automobile damage sustained by the insured and liability to third parties for losses caused by the insured.
- Multiple peril, which is a package coverage including most property and liability coverages except workers' compensation, automobile insurance, and surety bonds.
- Professional liability, which covers physicians, surgeons, dentists, hospitals, engineers, architects, accountants, attorneys, and other professionals from liability arising from error or misconduct in providing or failing to provide professional service.



- Miscellaneous liability, which covers most other physical and property damages not included under workers' compensation or automobile liability policies. (Damages include death, cost of care, and loss of services resulting from bodily injury, as well as loss of use of property.)
- Fidelity bonds, which cover employers against dishonest acts by employees. Blanket fidelity bonds cover groups of employees.
- Surety bonds, which provide for monetary compensation to third parties for failure by the insured to perform specifically covered acts within a stated period. (Most surety bonds are issued for persons doing contract construction, persons connected with court actions, and persons seeking licenses and permits. Surety bonds also include financial guarantees.)
- Accident and health, which covers loss by sickness or accidental bodily injury. (It also includes forms of insurance that provide lump-sum or periodic payments in the event of loss by sickness or accident, such as disability income insurance and accidental death and dismemberment insurance.)

1.05. In addition to these lines, insurance is provided by excess and surplus lines. Excess liability covers the insured against loss in excess of a stated amount, but only for losses as covered and defined in an underlying policy. The underlying amount is usually insured by another policy but can be retained by the insured. Surplus lines include coverage for risks that do not fit normal underwriting patterns, risks that are not commensurate with standard rates, or risks that will not be written by standard carriers because of general market conditions. Policies are written by carriers not licensed in the jurisdiction where the risk is located and generally are not subject to regulations governing premium rates or policy language.

1.06. The lines and premium volume that may be written by a company are generally restricted by state insurance regulations. For example, total written premiums may be limited to a ratio of the company's statutory basis equity. (This and other insurance regulations developed by the National Association of Insurance Commissioners (NAIC) are discussed further in paragraphs 2.05 and 2.06 "NAIC Insurance Regulatory Information System.")

1.07. Insurance written by property and liability insurance companies may be broadly classified as personal lines, which consist of insurance policies issued to individuals, and commercial lines, which consist of policies issued to business enterprises. Personal lines generally consist of large numbers of relatively standard policies with relatively small premiums per policy. Examples are homeowner's and individual automobile policies. Commercial lines involve policies with relatively large premiums that are often retroactively adjusted based on claims experience. The initial premium is often only an estimate because it may be related to payroll or other variables. Examples are workers' compensation and general liability. Many large insurance companies have separate accounting, underwriting, and claim-processing procedures for these two categories.

1.08. Insurance is generally available to the individual as a means of protection against loss. There are instances, however, in which a person cannot obtain insurance in the voluntary insurance market. States have established programs to provide insurance to those with high risks who otherwise would be excluded from obtaining coverage. Following are some of the more common programs that provide the necessary coverage:

- Involuntary automobile insurance. States have a variety of methods for apportioning involuntary automobile insurance. The most widely used approach is the Automobile Insurance Plan (formerly called the Assigned Risk Plan). Under this plan, all companies writing automobile insurance in a state are allocated a share of the involuntary business on an equitable basis. Each automobile insurer operating in the state accepts a share of the undesirable drivers, based on the percent of the state's total auto insurance that it writes. For example, a company that writes 5 percent of the voluntary business in a state may be assigned 5 percent of the involuntary applicants. It is then responsible for collecting the premiums and paying the claims on the policies issued to these applicants. Other states use a reinsurance plan, under which each insurer accepts all applicants but may place high-risk drivers in a reinsurance pool, with premiums paid to and losses absorbed

by the pool. Still another approach is a joint underwriting association, in which one or more servicing companies are designated to handle high-risk drivers. All insurers in the state may be required to participate in the underwriting results.

- FAIR plans. FAIR (Fair Access to Insurance Requirements) plans are federally approved, state-supervised programs established to provide coverage for property in high-risk areas. Companies that operate in the state are assessed for any underwriting losses experienced by the FAIR plan.

- Medical malpractice pools. These pools were established when health-care professionals and institutions were experiencing difficulty in obtaining liability insurance in the voluntary insurance market. The pools were established by law and currently exist in the majority of states. All insurers writing related liability insurance in such states are considered mandatory participants in the pools as a condition for their continuing authority to transact business in such states.

- Workers' compensation pools. These pools are similar to FAIR plans. As with FAIR plans, companies operating in a given state are assessed a proportionate share, based on direct writings, of the underwriting results of the pool.

59. *AICPA Life Audit and Accounting Guide, Chapter 3, Insurance Operations*, provides the following definitions of types of insurance contracts:

#### Types of Policies and Contracts

3.02. Policies and contracts usually issued by a life insurance company may generally be designated by the following broad classifications:

1. Life insurance policies.
2. Annuity contracts.
3. Accident and health contracts.

In addition, certain life insurance companies may issue policies which incorporate features of two or three of the broad categories shown above (e.g., an insurance-with-annuity policy). Each of the types of policies is commonly issued both on a participating and on a nonparticipating basis.

3.03. Life Insurance Policies. Life insurance coverage consists of the following basic classes:

1. Whole life.
2. Endowment.
3. Term.
4. Other.

3.04. Whole life policies provide insurance over the insured's entire life and the proceeds (face amount) are paid only upon death of the insured. A level premium is usually paid for policies of this type; and the premium may be paid in annual or more frequent modes. An ordinary-life (straight-life) policy stipulates that premiums are to be paid during the life of the insured. A limited-payment policy is one for which premiums are payable over a stipulated period of time (10, 20, 30 years, etc.). A single-premium policy requires a lump-sum payment at the inception of the policy.

3.05. Endowment policies provide insurance protection over the term of the endowment (i.e., from inception of the policy to the maturity date). Such contracts stipulate payment of the face amount of

the policy to a beneficiary if the insured dies during the endowment period. However, if he is still living at the maturity date, the insured will receive the face amount of the policy. Endowment contracts can mature at a specified age of the insured or at the end of a specified period of time. The premiums for contracts of this nature are usually payable over the endowment period, but the premiums can be on a single-payment or limited-payment plan.

3.06. Both whole life and endowment policies contain nonforfeiture or similar clauses which provide for a value in cash or some other form of insurance to be available in the event of failure to continue the required premiums.

3.07. Term policies provide insurance over a specified period of time. If the insured dies during this term, the face amount of the policy will be paid to his beneficiary. Policies for term insurance which are written for relatively short periods of time commonly grant the policyholder the right to renew for an additional period or periods up to a maximum age, such as 60 or 65, without requiring additional evidence of insurability. Rights to convert to whole life or endowment contracts may also be included in the contract. Term contracts may also be made for a period which will end when the insured reaches a certain age (for example, age 60 or 65). Since the premium for term insurance provides for neither maturity benefits nor higher death rates at advanced ages, such policies do not usually accumulate cash surrender values. Collection of premiums for individual insurance may be by mail, where a notice of premium due is sent to the payor, or may be on the debit basis whereby an agent regularly calls at the home of the insured to collect small premium amounts. Usually, the more popular plans of debit life insurance are industrial plans paid up at age 65 or 70 or 10-pay or 20-pay life. Ordinary plans may also be administered on the debit basis.

3.08. In addition to individual policies, life insurance companies offer group life insurance, which insures lives of a group of persons under a single master contract. Insurance of this type is customarily written on a yearly renewable term basis although some permanent group life is sold.

3.09. In addition to the policies and contracts for life insurance mentioned above, there are other life insurance contracts which are becoming more prominent, such as credit life insurance. This form of insurance is generally issued in connection with the issuance of credit to an individual by a bank, retailer, finance company, or other similar organizations. This type of insurance most often protects the creditor to the extent of the unpaid balance of the loan in the form of decreasing term insurance; however, some credit life insurance is sold on a level-term basis.

3.10. In addition to the wide variety of whole life and endowment policies which are available from life insurance companies, the basic policies can be supplemented by the use of riders which are attached to and made a part of the contract. It is fairly common to provide for waiver of premiums through the use of a rider in the event of disability of the insured or for an accidental death benefit. The typical accidental death benefit is often referred to as double indemnity which means that the company will pay twice the amount of the policy if the insured dies through accidental means.

3.11. Annuity Contracts. An annuity contract is an arrangement whereby an annuitant is guaranteed to receive a series of stipulated amounts commencing either immediately or at some future date. Annuity contracts are issued to individuals or to groups. Group annuities are often the vehicle used to provide for a company's pension obligations to its employees.

3.12. The main types of annuities are the following:

3.13. Straight-life annuity -- The straight-life annuity provides for periodic payments to the annuitant as long as he lives. Death of the annuitant constitutes completion of the contract and no further payments are made by the insurance company.

3.14. Life annuity with a period certain -- The life annuity with a period certain works essentially the same way as the straight-life annuity, except that if the annuitant dies before the end of the specified period, payments are continued to a beneficiary until the specified number of payments is completed.

3.15. Refund annuity -- The refund annuity is similar to the annuity certain. There are two variants of this type of annuity. Under the cash refund annuity, a lump-sum payment is made at the death of the annuitant equal to the excess, if any, of the purchase price of the annuity over the sum of the annuity payments made to date of death. The installment refund annuity provides that annuity payments are to continue to a beneficiary after the death of the annuitant until the sum of all payments made equals the purchase price.

3.16. Joint and survivorship annuity -- The joint and survivorship annuity provides for the continuation of payments after the death of one of the annuitants during the lifetime of the surviving annuitant.

3.17. Variable annuity -- At present, variable annuities for individuals or groups are being introduced throughout the life insurance industry. A variable annuity is an annuity which includes a provision for benefit payments which vary in accordance with investment experience. The considerations for a variable annuity are usually invested in a separate account in which the value of the contract share varies according to the performance of the separate account before the commencement of annuity payments as well as after. Some variable annuities provide for a guaranteed minimum death benefit during the annuity consideration accumulation period.

3.18. Accident and Health Insurance Contracts. There is a great variety of accident and health contracts which life insurance companies may issue, but most contracts can be generally categorized as follows:

1. Protection against loss of income through partial or total disability.
2. Reimbursement of expenses
  - a. Hospital expenses, laboratory services, drugs, and so forth.
  - b. Surgical or medical expenses.

3.19. Much of the above coverage is currently being furnished under group contracts. Coverage furnished under individual contracts can be further subdivided according to the insured's right to continue his policy and the limitations on the insurer's right to increase premiums.

60. The *AICPA Audit and Accounting Guide: Health Care Organizations* provides the following guidance:

#### Health Care Contracting

1.18 Contracts between a health care provider and a payor based on anything other than full charges requires the provider to accept some financial risk. The nature and degree of risk for the provider varies depending on the contract terms (for example, the definition of the unit of service or the basis for payment). In planning the audit of the health care provider, the auditor considers the audit risk associated with the entity's health care contracts. For example, contracts with payments for services based on a discount from the provider's established rates may have different risks than contracts with payments for services based on a capitated arrangement.

1.19 Generally, capitation payments are made at the beginning of each month and obligate the provider to render covered services during the month. Revenue is earned as a result of agreeing to provide services to qualified beneficiaries and not as a result of actually providing the care. If the provider's accounting system records patient charges and establishes patient receivables as services are rendered, appropriate valuation allowances or adjustments should be recorded so only the amount of contract revenue is recorded.

1.20 A capitation contract may obligate the provider to assume the risk of physician referrals and other outside services. In this case, a liability for unpaid claims, including incurred but not reported claims, should be established. A lag analysis may be helpful in estimating the liability.

1.21 In addition to the capitation payments, the amount of contract revenue may be affected by factors such as reinsurance recoveries, deductibles, coinsurance, and risk pool adjustments. risk pool adjustments may be based on factors such as utilization or cost targets.

1.22 Sometimes health care providers enter preferred provider arrangements with self-insured employers whereby the provider guarantees that the employer's health care cost will not increase over a specified amount or percentage. In substance, these providers may have provided aggregate stop-loss insurance to the self-insured employer, and a material liability to the provider may exist. *FASB Statement No. 5, Accounting for Contingencies*, provides guidance on accounting for these contingencies. *FASB Statement No. 10, Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, provides guidance on accounting for contingencies by governmental enterprises.

## RELEVANT LITERATURE

### Statutory Accounting

- 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 13, Aggregate Reserves for Accident and Health Policies
- Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies

### Generally Accepted Accounting Principles

- *FASB Statement No. 60, Accounting and Reporting by Insurance Enterprises*
- *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*
- *FASB Statement No. 120, Accounting and Reporting by Mutual Life Insurance Enterprises and by Insurance Enterprises for Certain Long-Duration Participating Contracts*
- *AICPA Audit and Accounting Guide: Audits of Property and Liability Insurance Companies, Chapter 1, Nature, Conduct, and Regulation of the Business*
- *AICPA Audit and Accounting Guide: Audits of Stock Life Insurance Companies, Chapter 3, Insurance Operations*
- *AICPA Audit and Accounting Guide: Health Care Organizations, Chapter 1, Unique Considerations of Health Care Organizations*

### State Regulations

- No additional guidance obtained from state statutes or regulations.

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