

Statutory Issue Paper No. 52

Deposit-Type Contracts

STATUS

Finalized March 16, 1998

Original SSAP and Current Authoritative Guidance: SSAP No. 52

Type of Issue:

Life Specific

SUMMARY OF ISSUE

1. Current statutory accounting guidance on income recognition and policy reserves for deposit-type contracts, as defined in *Issue Paper No. 50—Classifications and Definitions of Insurance or Managed Care Contracts In Force* (Issue Paper No. 50) is addressed in Chapter 10, Aggregate Reserves for Life and Annuity Contracts, Chapter 12, Deposit Funds and Other Liabilities Without Life or Disability Contingencies, and Chapter 18, Premium Income of the Accounting Practices and Procedures Manual for Life and Accident and Health Insurance Companies (Life/A&H Accounting Practices and Procedures Manual). That guidance applies to premiums, deposit-type funds, and considerations as well as related policy reserves for all life, annuity, deposit, and other similar contracts with and without life contingencies. Under current statutory accounting, considerations on deposit-type contracts are generally recorded as income in the Summary of Operations when received as either annuity considerations, deposit-type funds, considerations for supplemental contracts without life contingencies and dividend accumulations, or coupons left to accumulate at interest, as appropriate. In addition, policy reserves must make a good and sufficient provision for all unmatured obligations guaranteed under the terms of the contracts and are generally computed based on the provisions of the NAIC Model Standard Valuation Law (SVL), the Actuarial Opinion and Memorandum Model Regulation, the Actuarial Standards of Practice promulgated by the American Academy of Actuaries, and the actuarial guidelines adopted by the NAIC; however, variations by state do exist.

2. GAAP requires insurance contracts to be classified as short-duration or long-duration contracts. Long-duration contracts include contracts, such as whole-life, guaranteed renewable term life, endowment, and annuity contracts, that are expected to remain in force for an extended period. Long-duration contracts that do not subject the insurance enterprise to risks arising from policyholder mortality or morbidity are classified as investment contracts and are accounted for in a manner consistent with the accounting for interest-bearing or other financial instruments (i.e., the balance that accrues to the benefit of the policyholder). Payments received on those contracts are not reported as revenue.

3. The purpose of this issue paper is to establish statutory accounting principles for income recognition and policy reserves for deposit-type contracts that are consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts).

SUMMARY CONCLUSION

Introduction

4. As discussed in Issue Paper No. 50, deposit-type contracts are those contracts that do not subject the reporting entity to any risks arising from policyholder mortality or morbidity. A mortality or morbidity risk is present if, under the terms of the contract, the reporting entity is required to make payments or forego required premiums contingent upon the death or disability (in the case of life and disability insurance contracts) or the continued survival (in the case of annuity contracts) of a specific individual or group of individuals.

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

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

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

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

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

Income Recognition

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

Policy Reserves

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

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

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

policy reserve for all other contracts (e.g., premium and other deposit funds, and dividend and matured coupon accumulations) shall be based on the accumulated amounts paid plus an income accumulation based on the contract provisions, less any withdrawals and applicable surrender charges.

12. Policy reserves shall be increased for reinsurance assumed and decreased for reinsurance ceded as further described in *Issue Paper No. 74—Life, Deposit-Type and Accident and Health Reinsurance*.

Structured Settlements

13. Reporting entities that have accepted an assignment of obligations under structured settlements shall record those obligations consistent with the accounting and reporting provided for structured settlements in paragraphs 16 and 17 of *Issue Paper No. 65—Property and Casualty Contracts*.

Cost Recognition

14. Interest credited to deposit-type contracts shall be recorded as an expense in the Summary of Operations when earned under the terms of the contract. Payments that represent a return of policyholder balances shall not be recorded as expenses. To the extent such payments differ from the recorded reserve, the difference shall be recorded in the Summary of Operations as a benefit expense.

Change In Valuation Basis

15. A change in valuation basis shall be defined as a change in the interest rate assumption or other factor affecting the reserve computation of policies in force and meets the definition of an accounting change as defined in *Issue Paper No. 3—Accounting Changes* (Issue Paper No. 3). Consistent with Issue Paper No. 3, any increase (strengthening) or decrease (destrengthening) in actuarial reserves resulting from such a change in valuation basis shall be recorded directly to surplus rather than as a part of the reserve change recognized in the Summary of Operations. The impact on surplus is based on the difference between the reserve under the old and new methods as of the beginning of the year. This difference shall not be graded in over time unless an actuarial guideline adopted by the NAIC prescribes a specific transition that allows for grading.

Unearned Income

16. Amounts assessed that represent compensation to the reporting entity for services to be provided in future periods and which are required to be refunded upon policy termination are not earned in the period assessed. Such amounts, if not already considered in the policy reserve, shall be reported as unearned income, a liability, and recognized as income as the related services are provided.

Additional Reserves Not Included Elsewhere

17. Additional actuarial liabilities are commonly held for such items as:

- a. Surrender values in excess of reserves otherwise required or carried
- b. Additional reserves required based on cash flow testing and/or asset/liability matching requirements.

Disclosures

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

- a. A description of reserve practices including the amount of any surrender value promised in excess of the reserve as legally computed;
- b. The method of determination of tabular interest on funds not involving life contingencies; and
- c. The nature of significant other reserve changes.

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

- a. Subject to discretionary withdrawal:
 - i. With market value adjustment, where withdrawal of funds is payable at all times, or prior to specified maturity dates where such dates are more than one year after the statement date and;
 - (a) In a lump sum with adjustments to reflect general changes in interest rates, or asset values since receipt of funds by the reporting entity; and
 - (b) In installments over five years or more, with or without a reduction in the interest rate during the installment period.
 - ii. At book value less current surrender charge, where the withdrawal of funds is payable at all times, or at any time within one year from the statement date in a lump sum subject to a current fixed surrender charge of 5% or more and it does not contain a meaningful bail out rate as described in subparagraph v.(d) below;
 - iii. At market value, where the withdrawal of funds is payable at current market value of the assets supporting the liabilities, the assets are stated at current market value, and the liabilities are stated at the current market value or per unit value of the assets supporting the liabilities. These liabilities are for contracts where the customer bears the entire investment risk;
 - iv. Total with adjustment or at market value;
 - v. At book value without adjustment (minimal or no charge or adjustment), where the withdrawal of funds is either payable at all times, or at any time (including a withdrawal on a scheduled payment date) within one year from the statement date and:
 - (a) In a lump sum without adjustment;
 - (b) In installments over less than five years, with or without a reduction in interest rate during the installment period;
 - (c) In a lump sum subject to a fixed surrender charge of less than 5%;
 - (d) In a lump sum subject to surrender charge, but such charge is waived if the credited rate falls below a specified "bail out" rate and the "bail out" rate is more than the maximum statutory valuation rate for life insurance policies for more than 20 years for new issues; and
 - (e) All others.
- b. Not subject to discretionary withdrawal;
- c. Total gross;
- d. Reinsurance ceded;
- e. Total net.

DISCUSSION

SAP Considerations

20. The statutory accounting principles outlined in the conclusion above regarding income recognition and policy reserves for deposit-type contracts are consistent with the Statement of Concepts which states:

Conservatism

Financial reporting by insurance enterprises requires the use of substantial judgments and estimates by management. Such estimates may vary from the actual amounts for numerous reasons. To the extent that factors or events result in adverse variation from management's accounting estimates, the ability to meet policyholder obligations may be lessened. In order to provide a margin of protection for policyholders, the concept of conservatism should be followed when developing estimates as well as establishing accounting principles for statutory reporting.

Conservative valuation procedures provide protection to policyholders against adverse fluctuations in financial condition or operating results. Statutory accounting should be reasonably conservative over the span of economic cycles and in recognition of the primary responsibility to regulate for financial solvency. Valuation procedures should, to the extent possible, prevent sharp fluctuations in surplus.

Consistency

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 marketplace, 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.

Recognition

Liabilities require recognition as they are incurred. Certain statutorily mandated liabilities may also be required to arrive at conservative estimates of liabilities and probable loss contingencies (e.g., interest maintenance reserves, asset valuation reserves, and others).

21. Except as discussed in next two paragraphs, the statutory accounting principles outlined in the conclusion above regarding income recognition and policy reserves for deposit-type contracts are consistent with current statutory accounting.

22. Current SAP require amounts received on annuity and supplemental contracts without life contingencies and dividend and coupon accumulations to be recorded in the Summary of Operations as income. This issue paper changes current SAP to require that amounts received on deposit-type contracts be recorded directly to policy reserves and not recorded as income. This change was made to reflect that cash inflows (premiums) on deposit-type contracts do not result from providing insurance and are therefore not considered revenue. Similarly, payments to policyholders that represent a return of policyholder balances are not considered expenses. Revenues and expenses arise from the investment of amounts received from policyholders and interest credited to their accounts, respectively.

23. Consistent with Issue Paper No. 51, recording unearned income and other similar amounts as deferred income and recognizing the amounts as income only as the earnings process is completed is consistent with the objectives of the Statement of Concepts.

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

GAAP Literature

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

Drafting Notes/Comments

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

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE (only pertinent excerpts are included below)

Statutory Accounting

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

CHAPTER 10 AGGREGATE RESERVES FOR LIFE AND ANNUITY CONTRACTS

Annuity and Pure Endowment Contracts

Whereas life insurance provides protection from the loss arising from dying too soon, an annuity protects against the loss from living too long. An annuity can be in either an accumulative (premium paying or paid-up deferred) period or a payout period. The company's obligation in each period is different and is described in detail in the annuity contract.

Anticipated (and actual) mortality experience is different for persons purchasing annuity contracts than for persons who purchase life insurance. Mortality rates of annuitants are lower as a result of selection by the annuitants. For this reason, separate annuity mortality tables have been developed for the valuation of annuity contracts.

Pure endowments, also, are insurance contracts against living too long. A pure endowment benefit is exactly the opposite of term life insurance because the benefits are paid only if the insured survives the term of the contract. No benefit is paid if the insured dies before the end of the term. Sales of pure endowments are somewhat unusual—the typical endowment contract

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

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

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

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

Miscellaneous Reserves

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

Changes in Valuation Bases

Where the interest rate, mortality basis, reserving method (e.g., net level, preliminary term, etc.), or other basis affecting reserve computation of in force business is changed during the year, any increase or decrease in actuarial reserves resulting from this change in valuation basis must be charged directly to surplus rather than as a part of the reserve increase item in the summary of operations. For various reasons, any change in valuation bases which produces an increase in reserves (reserve strengthening) or decrease in reserves (reserve destrengthening) may require the approval of the applicable regulatory authority. Procedures and timing for such approval vary from state to state.

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

CHAPTER 12 DEPOSIT FUNDS AND OTHER LIABILITIES WITHOUT LIFE OR DISABILITY CONTINGENCIES

Liability for Premium and Other Deposit Funds

When a company receives premiums over one year prior to their due date, such premium deposits are usually recorded as a liability. A premium deposit fund is not considered to be discounted premiums; instead, interest at contracted rates is credited annually to each individual account. The terms of the fund (interest rate, disposition, and so forth) are specified in the policy or in a separate endorsement. A liability is established in the statutory financial statement for the balance of such premium deposits and accrued interest to the valuation date.

Guarantee investment contracts and other deposit funds of generally similar nature will give rise to statement liability. The terms of such contracts including provisions for early term or surrender of the contracts, must be considered in establishing the appropriate statement liability.

The statutory financial statement differentiates this category of deposit items in the following manner:

1. Premium deposit funds represent deposits made by policyholders to pay premiums in considerations at some future date. The deposits will not, however, be credited to premium or consideration income accounts until the premium due dates. The liability should include any interest declared and credited or accrued.
2. Guaranteed interest contracts (GICs) provide that the contractholder place one or more deposits with the insurance company in exchange for repayment of those deposits plus interest at a guaranteed rate(s). Both the deposits and the repayments are made according to a schedule provided in the contract. Other features common to GICs are:
 - (a) The GIC contractholder is typically the sponsor or trustee of an employee benefit plan (pension, profit-sharing, thrift, savings, etc.)
 - (b) The guaranteed interest rate on GICs is closely associated with new money rates at the time of contract issue. Lower guaranteed rates may apply to deposits made after the date of issue.
 - (c) GICs often contain guarantees which limit insurance company administrative expense charges.
 - (d) GICs are usually nonparticipating, that is, the contractholder does not share in good or bad investment experience of the insurance company. Some GICs base the guaranteed rate on an investment or economic index.
 - (e) GICs normally contain penalties for failure of the contractholder to make scheduled deposits. In addition, penalties and/or restrictions on early or unscheduled withdrawals of funds are common.

The liability for GICs is subject to standard valuation law. Generally speaking, the minimum liability is equal to the future scheduled payments discounted back to the valuation date at the applicable valuation rate of interest. The minimum liability may exceed the amounts deposited accumulated at the guaranteed rates.

3. Other deposit items not otherwise included on Page 3.

Supplementary Contracts Without Life Contingencies

A supplementary contract is an agreement between the company and either the insured or the beneficiary, usually arrived at upon the termination of an original benefit contract, to provide for full or partial settlement of the amount payable under the original contract. However, such an agreement can be called a supplementary contract only when it is made for the payment of proceeds of a contract that has been written by the company. If the proceeds are to be paid over a definite period without regard to the life of the beneficiary, or are to be left at interest, the contract is termed a supplementary contract without life contingencies. (See Chapter 10).

Since supplementary contracts involve the payment of interest, the following terms become important. The "contract rate of interest" is the rate stated in the original policy or contract and is the minimum rate which may be paid on the amounts left under the option selected. If a company elects to establish a rate higher than the original contract rate as a minimum interest rate, this new rate becomes a "guaranteed rate." In practice, some companies have established such guaranteed rates because of higher returns on investments than those anticipated when the original contracts were issued.

Reserves for supplementary contracts without life contingencies are reported as separate liability in the statutory financial statement. The reserve includes any interest credited or accrued to the

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

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

CHAPTER 18 PREMIUM INCOME

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

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

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

Cost of Collection in Excess of Loading

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

Premiums Received in Advance

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

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

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

Premium and Other Deposit Funds

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

the provisions of the policy or in a separate endorsement. An explanation of other deposit funds can be found in Chapter 12.

Amounts deposited and accumulated for guaranteed interest contracts may be included in this classification. Finally, other deposit items of a generally similar nature may also be included herein.

Withdrawals from deposit accounts to pay premiums are credited to the appropriate income account. Provision is made in the statutory financial statement for reporting the balance of such deposits as of the balance sheet date.

Annuity Contracts

Certain annuity contracts, usually group pension contracts, frequently provide for the payment to the company of amounts other than premiums or considerations to be accumulated at interest for the purpose of providing pensions for employees at retirement and similar benefits. Amounts withdrawn from the fund to purchase annuity benefits reduce "Annuity and other fund deposits" and increase premium and annuity considerations.

Uncollected and deferred annuity considerations are calculated on deferred annuity contracts other than single payment contracts. The asset item is recorded net of loading.

Considerations for Supplementary Contracts

The Summary of Operations includes as income all policy proceeds which have been left with the company during the year under optional modes of settlement to provide beneficiaries or the policyowner with periodic income under a supplementary contract. Supplementary contracts may provide for an income payable for the lifetime of the payee(s), in which case the considerations would be reported as "Considerations for supplementary contracts with life contingencies." A supplementary contract may also provide for the payment of a periodic income for a specified number of years or for payments of a specified amount until the funds with interest earnings are exhausted. The considerations for such supplementary contracts are reported separately as "Considerations for supplementary contracts without life contingencies."

These considerations arise from proceeds retained at death, disability, surrender, or maturity of policies and annuity contracts. The amount of these retained proceeds is included in the amount reported in the Summary of Operations for policy and contract benefits.

Considerations for Dividend Accumulations

Another income item in the Summary of Operations is "Consideration for dividend accumulations." The accounting treatment for dividend accumulation deposits, dividend accumulation payments, and the change in the liability is similar to accounting for life insurance. Consideration for dividend accumulations represents the amount of policy dividends left on deposit with the company during the year to accumulate at interest. This amount would normally agree with the amount reported in the Dividends and Coupons to Policyholders exhibit of the annual statement as being left on deposit with the company.

Generally Accepted Accounting Principles

29. FAS 97, as amended by FAS 120, provides the following guidance with respect to deposit-type 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 1970's. 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.

APPLICABILITY AND SCOPE

6. This Statement applies to all insurance enterprises to which Statement 60 applies. The Statement establishes standards of financial accounting and reporting for three classes of long-duration contracts issued by those insurance enterprises and for reporting realized investment gains and losses. Those contracts are referred to in this Statement as investment contracts, limited-payment contracts, and universal life-type contracts. The accounting for long-duration contracts not otherwise addressed by this Statement is prescribed in Statement 60 and *FASB Statement No. 120, Accounting and Reporting by Mutual Life Insurance Enterprises and by Insurance Enterprises for Certain Long-Duration Participating Contracts*.

7. Long-duration contracts that do not subject the insurance enterprise to risks arising from policyholder mortality or morbidity are referred to in this Statement as investment contracts. A mortality or morbidity risk is present if, under the terms of the contract, the enterprise is required to make payments or forego required premiums contingent upon the death or disability (in the case of life insurance contracts) or the continued survival (in the case of annuity contracts) of a specific individual or group of individuals. A contract provision that allows the holder of a long-duration contract to purchase an annuity at a guaranteed price on settlement of the contract does not entail a mortality risk until the right to purchase is executed. If purchased, the annuity is a new contract to be evaluated on its own terms.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Investment Contracts

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

Universal Life-Type Contracts

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

- a. The balance that accrues to the benefit of policyholders at the date of the financial statements⁴

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

- b. Any amounts that have been assessed to compensate the insurer for services to be performed over future periods (paragraph 20)
- c. Any amounts previously assessed against policyholders that are refundable on termination of the contract
- d. Any probable loss (premium deficiency) as described in paragraphs 35-37 of Statement 60.

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

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

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

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 12, Deposit Funds and Other Liabilities Without Life or Disability Contingencies and Chapter 18, Premium Income
- *Issue Paper No. 3—Accounting Changes*
- *Issue Paper No. 50—Classifications and Definitions of Insurance or Managed Care Contracts In Force*
- *Issue Paper No. 51—Life Contracts*
- *Issue Paper No. 54—Individual and Group Accident and Health Contracts*
- *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*
- Minutes of the Study Group on Accounting and Reporting Deposit-Type Business of the Accounting Practices and Procedures (EX4) Task Force from December 2, 1990 through March 6, 1994

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*

State Regulations

- No additional guidance obtained from state statutes or regulations.

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