

Statutory Issue Paper No. 87

Other Admitted Assets

STATUS

Finalized March 16, 1998

Original SSAP and Current Authoritative Guidance: SSAP No. 21

Type of Issue:

Common Area

SUMMARY OF ISSUE

1. *Issue Paper No. 4—Definition of Assets and Nonadmitted Assets* (Issue Paper No. 4) provides the definition of admitted and nonadmitted assets.
2. Current statutory accounting guidance for admitted assets is provided throughout the Accounting Practices and Procedures Manuals for Life and Accident and Health and for Property and Casualty Insurance Companies (Life/A&H and P & C Accounting Practices and Procedures Manuals). Other admitted assets are specifically addressed in Chapter 8 of both manuals.
3. Current GAAP provides guidance relative to asset recognition and certain specific accounting and reporting requirements for assets identified within this issue paper. Such guidance is presented in *FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements* (CON 6), *FASB Statement No. 114, Accounting by Creditors for Impairment of a Loan* (FAS 114) and *FASB Technical Bulletin 85-4, Accounting for Purchases of Life Insurance* (FTB 85-4).
4. The purpose of this issue paper is to establish statutory accounting principles for admitted assets which are not specifically addressed in other issue papers.

SUMMARY CONCLUSION

5. The definition and accounting treatment for admitted assets is outlined in paragraphs 2 and 3 of Issue Paper No. 4 as follows:

For purposes of statutory accounting, an asset shall be defined as: probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events. An asset has three essential characteristics: (a) it embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows, (b) a particular entity can obtain the benefit and control others' access to it, and (c) the transaction or other event giving rise to the entity's right to or control of the benefit has already occurred. These assets shall then be evaluated to determine whether they are admitted.

As stated in the Statement of Concepts, "*The ability to meet policyholder obligations is predicated on the existence of readily marketable assets available when both current and future obligations are due. Assets having economic value other than those which can be used to fulfill policyholder obligations, or those assets which are unavailable due to encumbrances or other third party interests should not be recognized on the balance sheet*", and are, therefore, considered nonadmitted. For purposes of the Codification, a nonadmitted asset shall be defined as an asset meeting the criteria in paragraph 2 above, which is accorded limited or no value in statutory reporting and is one which is:

- a. Specifically identified within the Codification as a nonadmitted asset or
- b. Not specifically identified within the Codification as an admitted asset.

If an asset meets one of these criteria, the asset shall be reported as a nonadmitted asset and charged against surplus unless otherwise specifically addressed within the Codification. The asset shall be depreciated or amortized against net income as the estimated economic benefit expires. In accordance with the reporting entity's capitalization policy, immaterial amounts of furniture, fixtures, and equipment, or supplies, can be expensed when purchased.

6. Consistent with paragraph 5, the following assets shall be considered admitted and shall be reported in accordance with Issue Paper No. 4. These admitted assets are not addressed in other issue papers.

Collateral Loans

7. Collateral loans are unconditional obligations for the payment of money secured by the pledge of an investment and meet the definition of assets as defined in Issue Paper No. 4, and, are admitted assets to the extent they conform to the requirements of this paper. The outstanding principal balance on the loan and any related accrued interest shall be recorded as an admitted asset subject to the following further limitations:

- Loan Impairment - Determination as to the impairment of a collateral loan shall be based on current information and events. When it is considered probable that any portion of amounts due under the contractual terms of the loan will not be collected the loan is considered impaired. The impairment shall be measured based on the fair value of the collateral less estimated costs to obtain and sell such collateral. The difference between the net value of the collateral and the recorded asset shall be written off in accordance with *Issue Paper No. 5—Definition of Liabilities, Loss Contingencies and Impairments of Assets* (Issue Paper No. 5).
- Nonadmitted Asset - In accordance with *Issue Paper No. 90—Nonadmitted Assets* (Issue Paper No. 90) collateral loans secured by assets that do not qualify as investments shall be nonadmitted. Further, any amount of the loan outstanding which is in excess of the permitted relationship of fair value of the pledged investment to the collateral loan shall be treated as a nonadmitted asset.

Cash Value of Life Insurance Where the Reporting Entity is Owner and Beneficiary

8. The cash value of life insurance policies where the reporting entity is the owner and beneficiary is similar to a cash deposit that is realizable on demand. As such, the cash value of a life insurance policy as of the date to which premiums have been paid, less any outstanding policy loans and surrender charges, shall be reported as an admitted asset.

Receivables for Securities

9. Sales of securities are recorded as of the trade date. A receivable due from the broker is established in instances when a security has been sold, but the proceeds from the sale have not been received. Unless the receivable for securities, other than a receivable arising from the sale of a security which was acquired on a "To Be Announced" ("TBA") basis and which has yet to be actually received (see paragraph 12), meets the criteria noted in paragraph 11 below, the receivable for securities is an admitted asset to the extent it conforms to the requirements of this paper.

10. An evaluation shall be made in accordance with Issue Paper No. 5, to determine if there is an impairment. If, in accordance with Issue Paper No. 5, it is probable the balance, or any portion thereof, is uncollectible, any uncollectible receivable shall be written off and charged against income in the period the determination is made. If it is reasonably possible, but not probable, the balance or a portion of the balance is uncollectible and is not written off, disclosure requirements outlined in Issue Paper No. 5 shall be followed.

11. Receivables for securities not received within 15 days from the settlement date shall be nonadmitted, and shall be classified as other-than-invested assets.

12. Receivables arising from the secondary sale of securities acquired on a TBA basis which have not yet been received by the seller in the secondary sale transaction, may be admitted until the security is exchanged for payment. TBA securities are originally purchased well in advance of the actual date of security issuance (frequently 90 days or more). Accordingly, secondary sales of securities so acquired may occur before the date of issuance. Sales of securities so acquired always include a provision that requires simultaneous delivery of the security and receipt of consideration. Upon the secondary sale, and prior to the actual receipt, of a security acquired on a TBA basis, the seller in the secondary sale transaction records a liability for the book value of the security thus sold and a receivable for the consideration reflected in the secondary sale transaction. Profits or losses emanating from the secondary sale transaction are recorded in the same manner as profits and losses emanating from any other sale transaction involving an investment.

Other Amounts Receivable Under Reinsurance Contracts

13. Amounts receivable from Servicemen's Group Life Insurance (SGLI) or Federal Employees' Group Life Insurance (FEGLI) pools and Federal Crop Insurance programs shall be reported as admitted assets.

Guaranteed Investment Contracts

14. Guaranteed Investment Contracts (GICs) purchased for investment purposes meet the definition of assets as defined in Issue Paper No. 4, and are admitted assets to the extent they conform to the requirements of this paper.

15. Purchases for which all contractual rights and ownership of the GIC result in an investment similar to a corporate bond shall be accounted for in accordance with the guidance in *Issue Paper No. 26—Bonds, excluding Loan-backed and Structured Securities*.

16. An investment in a GIC payment stream is created when an intermediary purchases individual GICs, pools them, and sells the rights to the payment stream. These investments shall be reported as other long-term invested assets and shall be carried at amortized cost consistent with current statutory accounting.

17. If, in accordance with Issue Paper No. 5, it is probable that the carrying value of a GIC is not fully recoverable the investment shall be considered impaired. Accordingly, the cost basis of the investment shall be written down to the undiscounted estimated cash flows and the amount of the write down shall be accounted for as a capital loss. The new cost basis shall not be changed for subsequent recoveries in fair value.

State Guarantee Association Promissory Notes

18. State guarantee associations have the statutory authority to reinsure any or all of the policies of an impaired or insolvent insurer. When this is done, the assuming carrier receives assets supporting the liabilities from the insolvent company's estate and/or the responsible state guarantee association. If available, the state guarantee association transfers cash at the closing of the transaction. Promissory notes may be utilized in the event a guarantee association does not have the funds on hand or is unable to raise the funds by the closing date. These promissory notes are essentially credit risk free because the notes are backed by all member insurers of an association.

19. Promissory notes issued by state guarantee associations taken by an insurance company in connection with funding an assumption reinsurance agreement meet the definition of assets as defined in Issue Paper No. 4, are admitted assets to the extent they conform to the requirements of this paper, and shall be reported as a note receivable – other-than-invested assets.

DISCUSSION

20. For those items specifically addressed within this issue paper the principles established are consistent with current statutory accounting practices except as follows:

- a. With respect to the principles outlined in paragraph 7, collateral loans, the conclusion modifies current statutory accounting to require the evaluation and recording of an impairment in value of collateral loans. The method of evaluating and recording an impairment of value is consistent with FAS 114 which was adopted in *Issue Paper No. 37—Mortgage Loans*.
- b. With respect to the principles outlined in paragraph 11, receivables for securities, the conclusion modifies current statutory accounting to require that amounts not received within 15 days from the settlement date be nonadmitted. Issue Paper No. 4 states that an asset not readily available to satisfy policyholder obligations “*shall be recorded as a nonadmitted asset and charged against surplus.*” This is consistent with the Statement of Concepts, which states that an insurer’s “*ability to meet policyholder obligations is predicated on the existence of readily marketable assets available when both current and future obligations are due.*” Receivables for securities not received within 15 days from the settlement date are not considered readily available to satisfy policyholder obligations. Nonadmitting such receivables is also consistent with the conservatism concept of the Statement of Concepts.
- c. With respect to the principles outlined in paragraph 17, guaranteed investment contracts, the conclusion modifies current statutory accounting to require the write-off of the portion of the asset not expected to be recoverable in accordance with Issue Paper No. 5.
- d. Deposits in suspended depositories are considered nonadmitted assets as provided for in Issue Paper No. 90 as the amounts are not available to satisfy obligations to policyholders.

By requiring reporting entities to reflect impairments in the value of other admitted assets, the conclusions reached above are consistent with other issue papers on invested assets and specifically with Issue Paper No. 5. It is also more conservative than allowing a reporting entity to carry such impaired assets at a value in excess of that which may be realizable.

21. Current statutory accounting, as outlined in Chapter 8 of the P&C Accounting Practices and Procedures Manual, lists certain other assets that may be considered admitted assets should “sufficient subsidiary records to provide detail for the annual statement schedule of other invested assets” exist. The examples provided are investments not considered to be prevalent or significant in industry and as such have not been included in this issue paper.

22. This issue paper adopts FTB 85-4 with modification. FTB 85-4 permits recognition of the cash surrender value of life insurance where the reporting entity is either the owner or beneficiary; whereas this issue paper requires that the reporting entity be both the owner and beneficiary. The cash values of life insurance policies meet the definition of assets defined in Issue Paper No. 4. When the reporting entity is not the owner of the policy, the cash value is not readily available to satisfy policyholder obligations and, therefore, is a nonadmitted asset.

23. The statutory accounting principles discussed above are consistent with the concepts of conservatism and recognition as outlined in the Statement of Concepts.

Conservatism

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.

Recognition

The ability to meet policyholder obligations is predicated on the existence of readily marketable assets available when both current and future obligations are due. Assets having economic value other than those which can be used to fulfill policyholder obligations, or those assets which are unavailable due to encumbrances or other third party interests should not be recognized on the balance sheet but rather should be charged against surplus when acquired or when availability otherwise becomes questionable.

Drafting Notes/Comments

- *Issue Paper No. 5—Definition of Liabilities, Loss Contingencies and Impairments of Assets*, discusses and outlines the appropriate treatment for the impairment of assets.
- *Issue Paper No. 26—Bonds, Excluding Loan-Backed and Structured Securities*, discusses and outlines the appropriate recording and valuation of bonds.
- *Issue Paper No. 37—Mortgage Loans*, discusses and outlines the appropriate recording and valuation of mortgage loans.
- *Issue Paper No. 43—Loan-Backed and Structured Securities*, discusses and outlines the appropriate recording and valuation of structured securities.
- Specific other admitted assets discussed in current statutory guidance excerpted below but not addressed in this issue paper are discussed in other issue papers.
- The NAIC Annual Statement Instructions regarding Receivables for Securities were adopted by the Blank's Task Force on October 14 and 15, 1996, to be effective beginning with 1998 Annual Statements.

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE

Statutory Accounting Guidance

24. Chapter 8 of the Life/A&H Accounting Practices and Procedures Manual provides the following guidance:

The various states specify certain assets, all or portions of, which may be admitted in determining statutory unassigned surplus. This chapter discusses some of the more common assets that are not discussed in other chapters. Each company should consult the laws and regulations of their state of domicile regarding other admitted assets.

Other admitted assets not discussed in this chapter include premium notes, reinsurance receivables, deferred and uncollected premiums, tax refunds, investment income due and accrued, and investment settlements pending. In no event should a specifically described nonadmitted asset be recorded as an admitted asset or be used to defer an expense that has been incurred and has no liquidating value, e.g., material used in previous advertising campaigns or supplies that are not resalable.

Collateral Loans

Collateral loans are unconditional obligations for the payment of money secured by the pledge of an investment. The various states regulate a life insurance company's investment in collateral loans. Generally, these regulations deal with the legal form of the assignment and the relationship of the market value of the pledged investment to the collateral loan. The amount of the loan in excess of the permitted relationship is customarily nonadmitted. Also, the collateral loan may be admissible only if the collateral itself is an authorized investment. In some

jurisdictions the collateral must be combined with the like securities held directly in determining if maximum investment limitations are being exceeded.

Guaranteed Investment Contracts (GICs)

Absent specific statutory authority, the purchase of a guaranteed investment contract by an insurer for investment purposes, either directly or in the secondary market, should be considered the purchase of a direct corporate obligation of the issuer and such asset should be considered a bond and should be reported in Schedule D. This treatment applies only when the purchaser acquires all contractual rights and ownership of the guaranteed investment contract.

Absent specific statutory guidance, the purchase by an insurer of a payment stream in the secondary market should be reported in Schedule BA as "Other Long-Term Invested Assets."

The normal NAIC valuation procedures apply.

State Guarantee Association Promissory Notes

State guarantee associations have the statutory authority to reinsure any or all of the policies of an impaired or insolvent insurer. When this is done, the assuming carrier receives assets supporting the liabilities from the insolvent company's estate and/or the responsible state guarantee association. If available, the state guarantee association transfers cash at the closing of the transaction. Promissory notes may be utilized in the event a guarantee association does not have the funds on hand or is unable to raise the funds by the closing date.

These promissory notes are essentially credit risk free because the notes are backed by all member insurers of an association. Funds to transfer the obligations via assumption reinsurance are obtained through assessments of solvent companies doing business in the state. If the maximum assessment allowed in any one year does not provide the necessary funds, additional assessments are made as soon thereafter as permitted by the guaranty association act.

Promissory notes issued by state guarantee associations taken by an insurance company in connection with funding an assumption reinsurance agreement shall be reported on the asset page, aggregate write-ins for other-than-invested assets line, as a note receivable-miscellaneous asset. Interest income shall be recorded in the Summary of Operations on the line entitled aggregate write-ins for miscellaneous income.

All promissory notes issued subsequent to the effective date of this guidance are subject to the following condition. The note must contain a clause which stipulates that in the event the state guarantee association fails to fulfill its obligations on the promissory note, the note and the related liabilities assumed by the insurance company will revert back to the state guarantee association.

This guidance is effective June 7, 1995.

The following paragraphs are addressed in other issue papers and as such the Chapter 8 discussion is not excerpted here.

- Partnerships and Joint Ventures
- Amounts Due From Affiliated Companies
- Investments in Real Estate, Equipment and Other Assets Involving Leases
- Electronic Data Processing and Related Equipment
- Foreign Exchange Adjustment
- Deposits on Interest Rate Futures Contracts
- Amounts Receivable Relating to Uninsured Accident and Health Plans
- Derivative Instruments
- Insurance Futures and Insurance Futures Options
- Reverse Mortgages

25. Chapter 8 of the P & C Accounting Practices and Procedures Manual provides the following guidance:

The various states specify certain assets that may be admitted in determining statutory unassigned surplus. This chapter discusses some of the more common assets that are not discussed in other chapters. Each company should consult the laws and regulations of its state of domicile regarding limitations on admissibility and a more specific description of other admitted assets.

- (a) The amount fairly estimated as recoverable on cash deposited in a closed bank or trust company is an admitted asset, if qualifying under the provisions of the various states prior to the suspension of such bank or trust company.
- (b) Collateral loans are unconditional obligations for the payment of money secured by the pledge of an investment. The accounting is similar to that for mortgage loans. If the individual loan exceeds the excess of the permitted relationship of the market value of the pledged investment to the collateral loan, the excess is customarily treated as a nonadmitted asset. Also, the collateral loan is admitted only if the collateral itself is an authorized investment.

- (c) Guaranteed Investment Contracts (GICs)

Absent specific statutory authority, the purchase of a guaranteed investment contract by an insurer for investment purposes, either directly or in the secondary market, should be considered the purchase of a direct corporate obligation of the issuer and such asset should be considered a bond and should be reported in Schedule D. This treatment applies only when the purchaser acquires all contractual rights and ownership of the guaranteed investment contract.

Absent specific statutory guidance, the purchase by an insurer of a payment stream in the secondary market should be reported in Schedule BA as "Other Long-Term Invested Assets."

- (e) Other invested assets that do not fall within the scope of previous chapters require sufficient subsidiary records to provide detail for the annual statement schedule of other invested assets. Examples of such assets which may be admissible:
 1. Loan on or investments in oil and gas production payments, except those considered securities and listed in the schedule of stocks;
 2. transportation equipment;
 3. timber deeds;
 4. mineral rights;
 5. equipment trusts;
 6. deposits relating to interest rate futures contracts;
 7. any other admitted investment not clearly includable in other schedules.

The statutory method for accounting for lease and sale leaseback arrangements is governed largely by the form of the agreement to which the insurance company is party. The Financial Accounting Standards Board statements (FASB) 13, 28 and 66 are commonly used as guidelines where not in conflict with statutory accounting practices. Conservatism and policyholder protection are the objectives.

- (o) Cash value of life insurance policies where the company is beneficiary is somewhat analogous to a cash deposit that is realizable on demand. The admissibility of the cash value of life insurance policies is based on general business practice. The admitted amount is the cash value as of the date to which premiums have been paid. (See Chapter 16 Other Income.)

The following paragraphs are addressed in other issue papers and as such the Chapter 8 discussion is not excerpted here.

- (d) Partnerships and Joint Ventures
- (f) Funds held by or deposited with reinsured companies
- (g) Bills receivable taken for premiums
- (h) Reinsurance recoverable on loss payments
- (i) Federal income taxes recoverable
- (j) Electronic Data Processing Equipment
- (k) Interest, Dividends and Real Estate Income Due and Accrued
- (l) Amounts due from affiliated companies
- (m) Equities and deposits in pools and associations
- (n) Amounts Receivable Relating to Uninsured Accident and Health Plans (See Chapter 13 - Other Liabilities.)
- (p) lease-purchase transactions

Derivative Instruments

Insurance Futures and Insurance Futures Options

Reverse Mortgages

26. The NAIC Annual Statement Instructions for Life and Accident and Health and for Property and Casualty Insurance Companies specify that the following be classified as Other-Than-Invested Assets:

Amounts not received within 15 days of the end of the period that are due from brokers when a security has been sold, but the proceeds have not yet been received.

Generally Accepted Accounting Principles

27. Asset recognition is governed by CON 6. An asset is defined in paragraphs 25 and 26 of CON 6 as follows:

Assets are probable¹⁸ future economic benefits obtained or controlled by particular entity as a result of past transactions or events.

An asset has three essential characteristics: (a) it embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows, (b) a particular entity can obtain the benefit and control others' access to it, and (c) the transaction or other event giving rise to the entity's right to or control of the benefit has already occurred.

¹⁸ *Probable* is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in FASB Statement No. 5, *Accounting for Contingencies*, par. 3), and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved (Webster's *New World Dictionary of the American Language*, 2d college ed. [New York Simon and Schuster 1982], p. 1132). Its inclusion in the definition is intended to acknowledge that business and other economic activities occur in an environment characterized by uncertainty in which few outcomes are certain (pars. 44-48).

28. Accounting for the impairment of a loan is contained in FAS 114, as amended by *FASB Statement No. 118, Accounting by Creditors for Impairment of a Loan—Income Recognition and Disclosures* (FAS 118). Pertinent excerpts are as follows:

8. A loan is impaired when, based on current information and events, it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement.

13. When a loan is impaired as defined in paragraph 8 of this statement, a creditor shall measure impairment based on the present value of expected future cash flows discounted at the loan's effective interest rate, except that as a practical expedient, a creditor may measure impairment based on a loan's observable market price, or the fair value of the collateral if the loan is collateral dependent. Regardless of the measurement method, a creditor shall measure impairment based on the fair value of the collateral when the creditor determines that foreclosure is probable. A loan is collateral dependent if the repayment of the loan is expected to be provided solely by the underlying collateral. The creditor may choose a measurement method on a loan by loan basis. A creditor shall consider estimated costs to sell, on a discounted basis, in the measure of impairment if those costs are expected to reduce the cash flows available to repay or otherwise satisfy the loan. If the present value of expected future cash flows (or, alternatively, the observable market price of the loan or the fair value of collateral) is less than the recorded investment in the loan (including accrued interest, net deferred loan fees or costs, and unamortized premiums or discounts), a creditor shall recognize an impairment by creating a valuation allowance with a corresponding charge to bad-debt expense or by adjusting an existing valuation allowance for the impaired loan with a corresponding charge or credit to bad-debt expense.

29. Accounting for purchases of life insurance is contained in FTB 85-4. Pertinent excerpts are as follows:

1. How should an entity¹ account for an investment in life insurance?

¹ The provisions of this Technical Bulletin apply to all entities that purchase life insurance in which the entity is either the owner or beneficiary of the contract, without regard to the funding objective of the purchase. Such purchases would typically include those intended to meet loan covenants or to fund deferred compensation agreements, buy-sell agreements, or postemployment death benefits. Purchases of life insurance by retirement plans that are subject to FASB Statement No. 35, *Accounting and Reporting by Defined Benefit Pension Plans*, are not addressed by this Technical Bulletin.

Response

2. The amount that could be realized under the insurance contract as of the date of the statement of financial position should be reported as an asset. The change in cash surrender or contract value during the period is an adjustment of premiums paid in determining the expense or income to be recognized under the contract for the period.

Effective Date And Transition

3. The provisions of this Technical Bulletin are effective for insurance policies acquired after November 14, 1985.

Appendix

Background

4. In November 1970, the AICPA issued an Accounting Interpretation entitled "Accounting for Key-Man Life Insurance." That Accounting Interpretation identified the cash surrender value method as generally accepted accounting for purchases of life insurance. New

types of life insurance contracts, new provisions in traditional contracts, and changes in the insurance industry have led some to question the 1970 Accounting Interpretation. In October 1984, the AICPA's Accounting Standards Executive Committee (AcSEC) approved an Issues Paper entitled "Accounting for Key-Person Life Insurance." In the Issues Paper, AcSEC reaffirmed support of the cash surrender value method as the only generally accepted method. The AcSEC position differed from the position of the AICPA Insurance Companies Committee, which supported use of a different method in certain circumstances. AcSEC was concerned that diversity would develop in practice because of the difference between those positions and requested that the FASB consider the matter.

5. A premium paid by a purchaser of life insurance serves a variety of purposes. A portion of the premium pays the insurer for assumption of mortality risk and provides for recovery of the insurer's contract acquisition, initiation, and maintenance costs. Another portion of the premium contributes to the accumulation of contract values. The relative amounts of premium payment credited to various contract attributes change over time as the age of the insured party increases and as earnings are credited to previously established contract values.
6. An insurance contract is significantly different from most investment agreements. The various attributes of the policy could be obtained separately through term insurance and purchase of investment. The combination of benefits and contract values could not, however, typically be acquired absent the insurance contract. Continued protection from mortality risk and realization of scheduled increases in contract accumulation usually requires payment of future premiums.
7. The payment of insurance premiums may take a number of different forms. The insurance contract may be purchased through payment of a single premium, as opposed to the typical series of future premiums. Alternatively, the premium payments may be made through loans from the insurance company that are secured by policy cash surrender values. The pattern of premium payments is a decision that does not alter the underlying nature of the insurance contract.

Consideration of Comments Received on Proposed Technical Bulletin

8. A proposed Technical Bulletin, Accounting for Business-Owned Life Insurance, was released for comment on June 28, 1985. Forty-seven letters of comment were received on the proposed Technical Bulletin. Certain of the comments received and consideration of them are discussed in the following paragraphs.
9. Some respondents view the dominant objective of a life insurance contract to be investment. Subject to certain criteria evidencing an intent to continue the contract, they maintain that the contract meets the definition of an asset established in paragraph 19 of Concepts Statement 3, which states, "Assets are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events" (footnote reference omitted). Those who hold this view suggested that such contracts should be accounted for using methods that result in reporting the investment in life insurance at amounts different from those stipulated in the contract.
10. This Technical Bulletin does not take that view. The current capacity to realize contract benefits is limited to settlement amounts specified in the contract. Additional amounts in excess of cash surrender value, which would be reported as assets under the various alternative accounting methods suggested, are created by future events, which typically include premium payments and earnings credited to contract amounts.
11. Paragraph 123 of Concepts Statement 3 discusses the occurrence of past events and the role of future events in the recognition of assets.

Since the transaction or event giving rise to the enterprise's right to the future economic benefit must already have occurred, the definition excludes from assets items that may in the future become an enterprise's assets but have not yet become its assets. An enterprise has no asset for a particular future economic benefit if the transactions or events that give it access to and control of the benefit are yet in the future.

12. Some respondents asserted that reporting an insurance investment at its realizable value represents an accounting based on liquidation values. Those respondents suggested that the entity acquiring an insurance contract is, in many cases, economically or contractually committed to maintain the contract in force. They maintained that such a commitment virtually assures that benefits in excess of premiums paid would be realized and that the policy should be reported on a basis other than its cash surrender value.
13. This Technical Bulletin does not accept that view. The amount realizable under an insurance investment represents settlement values agreed to by an independent buyer and seller. The variety of yields and contract accumulation patterns available in the insurance marketplace provides the buyer and seller a variety of insurance and settlement options. There is no compelling justification to depart from the recording of such contracts based on agreed provisions. The commitment referred to by respondents is, in the staff's view, a commitment to ensure that assets are available to meet contractual obligations. The presence of such a commitment does not change the measurement of the asset that is expected to satisfy the obligation.
14. Some respondents asserted that policy features, most notably the business exchange rider, were significant factors in determining the proper accounting for the policy. The business exchange rider allows a company to use values in an existing policy to insure a different employee when the originally insured employee leaves the company. They maintain that this feature gives the employer the ability to transfer the contract freely and enhances the employer's ability to realize the future value of the investment. They further maintain that the increased probability of realizing future values should lead to the reporting of amounts in excess of cash surrender value.
15. This Technical Bulletin rejects that view. The business exchange rider is a significant development in the design of business insurance products and reduces additional policy costs if a covered employee leaves the company. Such a provision does not affect the realization of future benefits under the insurance contract, nor does it change the traditional underwriting decisions involved in insuring a new life. Instead, the provision only reduces the cost of obtaining those benefits by allowing a new employee to be insured without the costs that are typically associated with obtaining a new policy.

RELEVANT LITERATURE

Statutory Accounting Practices and Procedures

- Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy
- Accounting Practices and Procedures Manual for Life and Accident and Health Insurance Companies, Chapter 8
- Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies, Chapter 8
- NAIC Annual Statement Instructions for Life and Accident and Health and for Property and Casualty Insurance Companies
- *Issue Paper No. 4—Definition of Assets and Nonadmitted Assets*
- *Issue Paper No. 5—Definition of Liabilities, Loss Contingencies and Impairments of Assets*
- *Issue Paper No. 26—Bonds, Excluding Loan-Backed and Structured Securities*
- *Issue Paper No. 37—Mortgage Loans*
- *Issue Paper No. 68—Business Combinations and Goodwill*
- *Issue Paper No. 90—Nonadmitted Assets*

Generally Accepted Accounting Principles

- *FASB Statement No. 114, Accounting by Creditors for the Impairment of a Loan*
- *Accounting Principles Board Opinion No. 21, Interest on Receivables and Payables*
- *FASB Emerging Issues Task Force No. 88-5, Recognition of Insurance Death Benefits*
- *FASB Technical Bulletin 85-4, Accounting for Purchases of Life Insurance*

State Regulations

- No additional guidance obtained from state statutes or regulations.