

Statutory Issue Paper No. 154

Implementation of Principle-Based Reserving

STATUS

Finalized – December 10, 2016

Original SSAP and Current Authoritative Guidance: SSAP No. 51, SSAP No. 54, with additional revisions summarized in Exhibit C.

Type of Issue:

Life, Accident and Health

SUMMARY OF ISSUE

1. Current statutory accounting guidance for life insurance contracts is in *SSAP No. 51—Life Contracts* (SSAP No. 51). This guidance refers to existing model laws for reserving guidance which are primarily based on formulaic methodology. As directed by the Statutory Accounting Principles (E) Working Group on November 19, 2015, multiple agenda items were drafted to incorporate revisions needed for statutory accounting to facilitate the implementation of principles-based reserving (PBR).
2. This issue paper documents, for historical purposes, substantive revisions adopted in SSAP No. 51 for principle-based reserving. To facilitate timely adoption of the authoritative guidance, this issue paper was drafted subsequent to the adoption of the changes to SSAP No. 51R.
3. In addition, Exhibit C of this issue paper provides an overview of other revisions adopted to the NAIC *Accounting Practices and Procedures Manual* for principle-based reserving.

SUMMARY CONCLUSION

Substantive Revisions to SSAP No. 51

4. As shown in Exhibit A, this issue paper documents the substantive revisions to SSAP No. 51 (resulting in a substantively revised SSAP No. 51R) in order to allow principle-based reserving as specified in the *Valuation Manual*. These revisions have a January 1, 2017, effective date.

Substantive Revisions to SSAP No. 54

5. As shown in Exhibit B, this issue paper documents the substantive revisions to *SSAP No. 54—Individual and Group Accident and Health Contracts – Revised* (resulting in a substantively revised SSAP No. 54R) in order to allow principle-based reserving as specified in the *Valuation Manual*. These revisions have a January 1, 2017, effective date.

Updates to Appendix A-820

6. Updates to *Appendix A-820: Minimum Life and Annuity Reserve Standards (A-820)* were adopted in agenda item 2016-10: Changes to A-820 Standard Valuation Law for Principle-Based Reserving. The revisions incorporate relevant aspects of the 2009 revisions to the *Standard Valuation Law (Model #820)* into Appendix A-820. Revisions to A-820 were adopted on June 9, 2016, with a January 1, 2017, effective date.
7. The revisions added explicit references to the *Valuation Manual* in Appendix A-820 for life reserving guidance for policies issued on or after January 1, 2017. The existing A-820 is incorporated by referenced in the following statements: *SSAP No. 51—Life Contracts*, *SSAP No. 52—Deposit-Type Contracts*, *SSAP No. 54—Individual and Group Accident and Health Contracts*, *SSAP No. 56—Separate*

Accounts, SSAP No. 59—Credit Life and Accident and Health Insurance Contracts and the commissioners' annuity reserve valuation method is noted in *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities*.

DISCUSSION

Overview of Life Principle-Based Reserving

8. The PBR project for life and health reserving has been ongoing at the NAIC for a number of years. Currently, life insurers set aside reserves to pay insurance claims when due. Under the current system of reserving, formulas and assumptions prescribed by state laws and regulations are used to determine these reserves. The formulaic approach prescribed by current state laws and regulations must be frequently updated as new product designs are introduced. PBR alleviates this need to a great degree. Current formulas do not always accurately reflect the risks or the true cost of the liability or obligations of the insurer. For some products this leads to excessive conservatism in reserve calculations and for others it results in inadequate reserves.

9. Under PBR, companies will hold a reserve using prescribed factors plus the excess, if any, of the greater of: a) the reserve computed using a single defined economic scenario, computed using justified company experience factors for mortality, expenses and policyholder behavior; and b) the reserve based on a wide range of future economic scenarios, computed using justified company experience factors, such as mortality, expenses and policyholder behavior over the reserve using prescribed factors.

10. The *Valuation Manual* is established by Model #820 and is used to detail the reserve calculation requirements under PBR. The revised *Standard Valuation Law* and the Standard Nonforfeiture Law for Life insurance (Model #808) and the *Valuation Manual* are built to encompass requirements for all business written by life and health insurers. Initially, reserving methods will only change for specified life insurance products issued on or after the operative date of the *Valuation Manual*. However, over time, PBR is expected to be developed for other product lines.

11. The current formulaic system locks in certain assumptions, resulting in reserve inputs that do not change with fluctuations in economic conditions or as insurers accumulate actual experience. PBR adjusts reserves to reflect changes in economic conditions and insurers' credible experience. The calculation of PBR reserves will require insurers to model and assess the risks they undertake in offering products to consumers. Insurers writing complex products are exposed to various risks and should already be utilizing sophisticated actuarial models to manage those risks. Additionally, the asset adequacy analysis required of most insurers to support the opinion on reserve adequacy has used this type of modeling for more than two decades. Thus, the new modeling requirements of PBR should not represent significant challenges to those insurers. To the extent insurers do not offer products with complex risks, compliance with the new requirements will be less demanding. The *Valuation Manual* includes exclusion tests that allow less complex products to be exempted from *Valuation Manual* VM-20 stochastic and deterministic reserve calculations.

12. The PBR methodology is built with safeguards including:

- a. Prescriptive and limiting elements have been introduced into the *Valuation Manual* that will limit the extent to which reserves will be reduced from the current levels.
- b. The PBR methodology requires the booking of a reserve using prescribed factors plus the excess, if any, over this reserve of the greater of the deterministic reserve and the stochastic reserve using prescribed factors held on a per contract basis.
- c. The asset spread PBR data tables will be updated quarterly and the default cost PBR data tables will be updated on an annual basis. NAIC staff will be responsible for updating the PBR data tables.

Determining the PBR Valuation Manual Operative Date

13. The *Valuation Manual* becomes effective on January 1 of the first calendar year following the first July 1, when 42 jurisdictions, representing at least 75% of the specified premium, have adopted valuation laws with substantially similar terms and provisions of the 2009 revisions to Model #820. The Principle-Based Reserving Implementation (EX) Task Force confirmed on May 2, 2016, that the thresholds for the *Valuation Manual* to be operative have been met. NAIC Executive (EX) Committee and Plenary subsequently adopted this recommendation on June 30, 2016. As of August 1, 2016, forty six states have completed the legislative adoption process for the revised Model #820 and the Standard Nonforfeiture Law for Life Insurance (#808).

14. Once the *Valuation Manual* becomes operative on January 1, 2017, there is a three-year period before PBR would be required, which would begin January 1, 2020. Companies can implement PBR for some or all applicable business any year during the three-year period, including the year the *Valuation Manual* becomes effective.

Life Companywide Exemption

15. Not all companies will be required to apply the PBR reserving methodology. In other words, some companies will be permitted to use the Commissioners' Reserve Valuation Method (CRVM) as defined prior to the adoption of PBR. PBR includes what is termed a companywide exemption. The premium threshold for companywide exemption is \$300 million per year of ordinary life premium for the legal entity and less than \$600 million for the associated group, as long as the reporting entity meets the risk-based capital (RBC) requirements and other exemption thresholds. This exemption allows a reporting entity with premium amounts under the thresholds to continue to use CRVM as defined prior to the adoption of PBR. Therefore, not all companies will be applying the same reserving methodology.

Work of Other NAIC Groups:

16. The Life Actuarial (A) Task Force, under the supervision of the Life Insurance and Annuities (A) Committee, is the direct preparer of changes to the *Valuation Manual*. Input on health issues is provided by the Health Actuarial (B) Task Force under the supervision of the Health Insurance and Managed Care (B) Committee. The Principle-Based Reserving Implementation (EX) Task Force is coordinating the implementation process. The PBR Review (EX) Working Group is responsible for coordinating the development of financial analysis, examination and actuarial review procedures and evaluating NAIC and state insurance department actuarial staff resource requirements.

17. The PBR Blanks (EX) Subgroup has created a set of PBR annual statement blanks revisions and a *Valuation Manual* VM-20 PBR Reserve Supplement, which were adopted by the Blanks (E) Working Group to be effective for January 1, 2017. The PBR Review Procedures (EX) Subgroup drafted a proposed *Valuation Manual* VM-31 data collection template for reporting of company modeling and modeling assumptions. In addition, as of August 2016, the Subgroup is developing revisions to the *Financial Condition Examiners Handbook* and *Financial Analyst Handbook* as well as developing new regulatory tools.

18. Peer and quality reviews of PBR will be conducted by the new Valuation Analysis (E) Working Group (VAWG). The VAWG will operate in a manner similar to the Financial Analysis (E) Working Group, working collaboratively with state insurance regulators, responding to issues and questions, and recommending PBR requirements and interpretations.

SSAP No. 51 References to the Valuation Manual

19. The recommendations for revisions to SSAP No. 51 to reference the *Valuation Manual* were developed with input from an informal drafting group composed of regulators, industry and key stakeholders. Because the *Valuation Manual* is prospective for policy application, it was necessary for

the prior reserving guidance to remain in effect for policies written before the operative date of the *Valuation Manual*. Therefore the reserving guidance identifies guidance which is applicable to all policies and divides other sections of guidance for policies which are, and are not, subject to the *Valuation Manual*.

20. A significant amount of the life reserving guidance in SSAP No. 51 was retained in SSAP No. 51R because the net premium reserve methodology in the *Valuation Manual* incorporates many of the same concepts. In addition, the *Valuation Manual* adds additional reserve amounts based on either stochastic or deterministic methodologies if needed. References were added to the *Valuation Manual* for policies issued after the *Valuation Manual* operative date as deemed necessary.

21. Asset adequacy testing is an existing requirement which functions as an additional check of reserve adequacy by reviewing to ensure that assets will be sufficient and available to meet reserving obligations as claims become due. No changes were recommended for *Appendix A-822–Asset Adequacy Analysis Requirements (A-822)* because asset adequacy testing *under the Actuarial Opinion and Memorandum Regulation (Model #822)* have not changed.

22. Under PBR, the deferred premium asset or the need to adjust unearned premium to offset the valuation reserve method employed remains the same in the context of the net premium reserve portion of the reserve calculation. Therefore, clarifying notes were added in the mid terminal and mean reserving guidance.

23. Declared but unpaid dividends are reported as separate liabilities from the statutory reserve. The dividend liabilities will continue to be calculated as specified in SSAP No. 51R. However, SSAP No. 51R also requires that unapportioned dividends payable in the following twelve months as well as dividends left on deposit are also accrued separately from the reserves. To be clear regarding this reporting, an amendment proposal regarding *Valuation Manual VM 20 section 7C, paragraph 6* was forwarded to the Life Actuarial (A) Task Force so that the language in the *Valuation Manual* is consistent with SSAP No. 51R.

Life Change in Valuation Basis Guidance

24. On November 15, 2014, based on a recommendation of the PBR Blanks Reporting (EX) Subgroup, the PBR Review (EX) Working Group approved a request that the Life Actuarial (A) Task Force and the Statutory Accounting Principles (E) Working Group provide guidance regarding how to determine the change in valuation basis for principle-based reserving.

25. The existing guidance in SSAP No. 51 explicitly included changes in assumptions as being a change in valuation basis. Under the principle-based reserving methodology, some of the reserving assumptions are expected to be updated annually. Agenda item 2016-15: Change in Valuation Basis for Life Contracts updated the change in valuation basis guidance, resulting in a substantively-revised SSAP (SSAP No. 51R) for policies issued on or after the operative date of the *Valuation Manual* that apply principle-based reserving. In addition, existing guidance will remain relevant for policies issued prior to the operative date of the *Valuation Manual*.

26. The impact of a change in valuation basis is reported under changes to surplus in specific annual statement lines (see excerpts in Annual Statement Reporting Considerations section). The life annual statement reporting line is titled, Change in Reserve on Account of Change in Valuation Basis, (Increase) or Decrease. The health annual statement reporting line is titled, Change in Valuation Basis of Aggregate Policy and Claim Reserves. Reporting changes in valuation basis in surplus is in contrast to other changes in reserving, which are reflected as part of the determination of income.

Key Points Regarding Life Revisions to the Change in Valuation Basis Guidance

27. The language developed identifies changes, which will be reflected as a change in valuation basis (e.g. changes in methodology and new CSO tables), and “routine” changes as required by the methodology, which represent changes in estimates, and therefore, will not be reflected as a change in valuation basis (e.g., annual changes in assumptions required by the methodology).

28. The recommendations for change in valuation basis updates were developed with input from an informal drafting group composed of regulators, industry and key stakeholders. Because of the complexity of the principle-based reserving methodology, the informal drafting group provided high-level guidance with specific examples. The following summarizes key points in the adopted language:

- a. **Reporting** – Adopted guidance continued the existing reporting of the impact of a change in valuation basis in surplus in the change in valuation basis annual statement line.
- b. **Items included as a change in valuation basis** – The scope of items that were adopted to be included as a change in valuation basis for products subject to principle-based reserving under the *Valuation Manual* included items that represent changes in methodology or voluntary choices in the application of the methodology. It was noted that historically, new industry CSO mortality tables have been treated as a change in valuation basis and the proposed language recommends continuing this treatment.
- c. **Items excluded from a change in valuation basis** – The principle-based reserving methodology requires a large number of assumptions to change based on experience. Updates to reserving assumptions based on experience as required under the existing methodology will not be reflected as a change in valuation basis. For example, a change from any of the three calculated reserves types (net premium reserve, deterministic or stochastic) to another as required by the principle-based reserving methodology would not be considered a valuation basis change. In addition, periodic updates to *Valuation Manual* tables such as the industry valuation basic tables, asset spread tables and default cost tables would not be considered a change in valuation basis.
- d. **Transition Guidance** – Explicit guidance on the initial adoption and application of principle-based reserving was adopted to assist with implementation questions. The *Valuation Manual* requires prospective application, for policies issued on or after the operative date. Therefore, the change in valuation basis is not expected to result in a day one impact to surplus.

Health Updates

29. The Principle-Based Reserving (PBR) project does not change health reserving in the initial phase. However, since the 2009 changes to the Standard Valuation Law reference the *Valuation Manual* with respect to reserve standards for health insurance policies issued on or after the operative date of the *Valuation Manual*, and the *Valuation Manual* references the applicable existing health reserving guidance in Appendix A and applicable actuarial guidelines in Appendix C, of the *Accounting Practices and Procedures Manual* (AP&P Manual), revisions to SSAP No. 54 to reference the *Valuation Manual* were deemed necessary prior to the *Valuation Manual* becoming operative on January 1, 2017.

30. Revisions to SSAP No. 54, using somewhat similar concepts as the changes made to SSAP No. 51, were also made to update the change in valuation basis for health reserves to reflect the use of own company experience required in *Actuarial Guideline XLVII— The Application of Company Experience in the Calculation of Claim Reserves Under the 2012 Group Long-Term Disability Valuation Table* (AG 47) and *Actuarial Guideline L—2013 Individual Disability Income Valuation Table* (AG 50). These updates are related to the implementation of the 2012 Group Long-Term Disability Valuation Table

(2012 GLTD) and the 2013 Individual Disability Income Table (2013 IDI). AG 47 and AG 50 require use of credible own company experience for morbidity continuance. The addition of specifics related to the two *Actuarial Guidelines* is not intended to change the accepted practices relating to the use of credible experience for morbidity assumptions in effect prior to January 1, 2017; therefore, additional clarifying language regarding other uses of own company experience was also added.

Actions of the Statutory Accounting Principles (E) Working Group.

31. On November 19, 2015, the Working Group moved agenda item *2015-47: Principles Based Reserving SSAP* directed NAIC staff to: 1) develop an issue paper; 2) propose substantive amendments to relevant SSAPs or separate statement as needed to address PBR; and 3) continue to work with industry representatives and regulators throughout the development of these items.

- a. On April 3, 2016, the Working Group exposed substantive revisions to *SSAP No. 51—Life Contracts* to incorporate references to the *Valuation Manual* and to facilitate the implementation of principle-based reserving.
- b. On June 9, 2016, the Working Group adopted the substantive revisions *SSAP No. 51—Life Contracts* (resulting in *SSAP No. 51R*).
- c. Interested parties comments to the Working Group were supportive of adopting the revisions in agenda item 2015-47.

32. Agenda item 2016-15: Change in Valuation Basis for Life Contracts, was exposed by the Working Group on June 9, 2016.

- a. The Life Actuarial (A) Task Force was notified of the exposure. The Task Force reviewed the issue but did not provide comments. Interested parties comments to the Working Group were supportive of adopting the proposed change in valuation basis language and other amendments to *SSAP No. 51R*.
- b. On August 26, 2016, the Working Group adopted agenda item 2016-15.

33. Agenda item 2016-34: Health Valuation Updates included updates to *SSAP No. 54* and was exposed on October 17, 2016. The Working Group also exposed revisions to this issue paper to document changes to *SSAP No. 54* in Exhibit B and revisions based on comments received from interested parties and the Academy on the issue paper to refine the description of principles-based reserving. On December 10, 2016, the *SSAP No. 54* changes and this issue paper was adopted with supportive comments from industry and a technical edit.

Effective Date

34. The substantively-revised SSAP reflects the adopted Summary Conclusion of this issue paper. Users of the NAIC *Accounting Practices and Procedures Manual* should note that issue papers are not represented in the Statutory Hierarchy (see Section V of the Preamble) and therefore the conclusions reached in this issue paper should not be applied until the corresponding SSAP has been adopted by the NAIC Executive (EX) and Plenary of the NAIC. The *SSAP No. 51R* revisions from agenda items 2015-47 and 2016-15 contain an effective date of reporting periods after January 1, 2017. The revisions outlined this issue paper shall be applied on a prospective basis.

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE**Annual Statement Reporting Considerations**

35. The *Life Annual Statement Instructions* include the following in the Summary of Operations, Capital and Surplus Account:

The purpose of the Capital and Surplus Account is to delineate certain charges and credits not included in operations such as net capital gains and items pertaining to prior years and to reconcile the change in capital and surplus during the year.

Line 43 – Change in Reserve on Account of Change in Valuation Basis, (Increase) or Decrease

Column 1 should equal (Exhibit 5A, Line 9999999, Column 4) x – 1.

Include: All reserve strengthening commitments of a permanent nature.

Exclude: Any deficiency reserves.

The *Health Annual Statement Instructions* include the following in the Statement of Revenue and Expenses, Capital and Surplus Account:

Line 35 – Change in Valuation Basis of Aggregate Policy and Claim Reserves

Refer to SSAP No. 54, Individual and Group Accident and Health Contracts, for accounting guidance.

36. The *Health Annual Statement Instructions* include the following in the Statement of Revenue and Expenses, Capital and Surplus Account:

Line 35 – Change in Valuation Basis of Aggregate Policy and Claim Reserves

Refer to SSAP No. 54—*Individual and Group Accident and Health Contracts* for accounting guidance.

Valuation Manual Reference to Health Guidance

37. *Valuation Manual* section VM-25 Health Insurance Reserves Minimum Reserve Requirements provides the following:

A. Purpose

1. Reserve requirements for individual accident and health insurance policies issued on and after the *Valuation Manual* operative date and reserve requirements for group accident and health insurance certificates issued on and after the *Valuation Manual* operative date are applicable requirements found in the Accounting Practices and Procedures Manual (APPM), Appendix A, which includes A-10, and applicable requirements found in the APPM Appendix C, which includes AG28, AG44, AG47 and AG50.

Statutory Accounting

- *SSAP No. 51—Life Contracts*
- *SSAP No. 54—Individual and Group Accident and Health Contracts*

EXHIBIT A - REVISIONS TO SSAP NO. 51—LIFE CONTRACTS – REVISED**Life Contracts****SCOPE OF STATEMENT**

1. This statement establishes statutory accounting principles for income recognition and policy reserves for all contracts classified as life contracts defined in *SSAP No. 50—Classifications of Insurance or Managed Care Contracts*, except for credit insurance contracts which are discussed in *SSAP No. 59—Credit Life and Accident and Health Insurance Contracts* and separate account products which are discussed in *SSAP No. 56—Separate Accounts*.

SUMMARY CONCLUSION**Types of Premiums**

2. The gross premium is the amount charged to the policyholder and taken into operations as premium income.

3. The net premium is the amount calculated on the basis of the interest and mortality table used to calculate the reporting entity's statutory policy reserves.

4. The difference between the gross premium and the net premium is referred to as "loading." Loading generally includes allowances for acquisition costs and other expenses but also includes the differences in mortality and interest assumptions utilized for pricing and statutory reserving purposes.

Premium Income Recognition

5. Premiums shall be recognized as income on the gross basis (amount charged to the policyholder) when due from policyholders under the terms of the insurance contract. As a result, premium income shall include first year and renewal premiums, as well as any related premium adjustments (i.e., retrospective premium contracts which are discussed in *SSAP No. 66—Retrospectively Rated Contracts*) provided for by the contract. The contractual due date shall be established through the predetermined billing procedure agreed to by the parties. In addition, premium income shall include single and flexible premium amounts when received from the policyholder. Further, the recognition of premium income and the change in loading shall be consistent with the assumptions made in calculating the related policy reserve.

6. Premium income shall include dividends, coupons, guaranteed annual pure endowments, and similar benefits provided by the insurance contract when such amounts are applied by the terms of the contract to provide additional paid-up insurance, annuities, or to shorten the endowment or premium-paying period. Premiums and considerations waived by the reporting entity under disability provisions contained in its policies and contracts, and reported in operations as a disability benefit, are included in premium income.

7. Premium income shall exclude premiums that have been received by the reporting entity prior to the reporting date but which are due on or after the next policy anniversary date (i.e., advance premiums as discussed in paragraph 2729).

8. Premium income shall be reduced for premiums returned and allowances to industrial policyholders for the direct payment of premiums.

9. Premium income shall be increased by reinsurance premiums assumed and reduced by reinsurance premiums ceded. Reinsurance premiums assumed and ceded are defined and addressed in *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance*.

10. Death or other benefits used to fund new policies shall be accounted for as a benefit payment and as a new premium, another type of income, or a liability, as appropriate.

Premium Adjustments

11. In the summary of operations, the change in gross deferred and uncollected premiums is recorded as premium income. Deferred premiums are further discussed in paragraphs ~~23-25~~25-27. Since only the net premiums are included in the computation of reserves and reported as an asset, it is necessary to adjust the gross premium for an amount representing the change in loading on deferred and uncollected premiums. The change in loading is included as an expense in the summary of operations and is not shown as a reduction to premium income.

Uncollected Premium Balances

12. Gross premiums that are due and unpaid as of the reporting date, net of loading, shall be classified as uncollected premiums. Uncollected premium balances which are less than 90 days past due meet the definition of an asset, as defined in *SSAP No. 4—Assets and Nonadmitted Assets*, and are admitted assets to the extent they conform to the requirements of this statement.

Other Considerations Received

13. Considerations for supplementary contracts, dividends left on deposit to accumulate interest, and amounts deposited and accumulated for guaranteed interest and group annuity contracts shall be recognized as deposit-type funds or considerations for supplemental contracts, as appropriate. These amounts are further discussed in *SSAP No. 52—Deposit-Type Contracts*.^(INT 00-03)

Waiver of Monthly Deductions for Flexible Premium Universal Life Insurance Policies

14. Flexible premium universal life insurance policies do not require specified premiums as traditional policies do. The “waiver” benefit entities offer is a “waiver of monthly deductions” benefit as opposed to a “waiver of premium” benefit. The difference being specific premiums may or may not be required under the policy regardless of whether the insured is disabled or not. Waiver of a deduction is not to be considered revenue nor a benefit paid, therefore a calculation of the amount of the deduction need not be made for flexible premium universal life insurance policies.

Policy Reserves

15. Statutory policy reserves shall be established for all unmatured contractual obligations of the reporting entity arising out of the provisions of the insurance contract. Where separate benefits are included in a contract, a reserve for each benefit shall be established as required in Appendix A-820. These statutory policy reserves have historically been ~~are 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. For policies issued on or after the operative date of the *Valuation Manual*, these formulaic calculations will be supplemented for some policies with more advanced deterministic and stochastic reserve methodologies to better reflect company experience, possible economic conditions and inherent policy risks. Statutory policy reserves meet the definition of liabilities as defined in *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* (SSAP No. 5R). The actuarial methodologies referred to in ~~the following paragraph 16~~ meet the criteria required for reasonable estimates in SSAP No. 5R.

16. The reserving methodologies and assumptions used in computation of policy reserves shall meet the provisions of Appendices A-820 and A-822, and Policies written prior to the operative of the *Valuation Manual* shall additionally follow the actuarial guidelines found in Appendix C of this Manual. Policies written on or after operative of the *Valuation Manual* shall additionally follow the *Valuation Manual* and be subject to the actuarial guidelines referenced therein. Further, policy reserves shall be in compliance with those Actuarial Standards of Practice promulgated by the Actuarial Standards Board.

~~17.~~ The preceding two paragraphs 15 and 16 of this statement summarize the general reserve requirements for all types of life contracts. Paragraphs 18-21 provide additional detail for specific products for policies that are issued prior to the operative data of the *Valuation Manual* or otherwise not subject to the *Valuation Manual*.

~~17-18.~~ In addition to these general reserve requirements, Appendix A-820 provides additional guidance with respect to certain types of accumulation annuities that have flexible features (e.g., guaranteed nonforfeiture benefits such as interest guarantees, annuitization options, bailout features, partial withdrawals) which can create varying benefit streams if elected by the policyholder. Specific policies with such flexible features include most individual and some group annuity contracts, but exclude any disability and accidental death benefits in these contracts. For benefits under these contracts, reserves shall be established according to the Commissioners' Annuity Reserve Valuation Method (CARVM). Generally under CARVM, the difference between all possible future guaranteed benefits streams, including guaranteed nonforfeiture benefits, over the future considerations is computed as of the end of each contract year. Each of these differences is discounted to the reporting date at the applicable valuation interest rate. A reserve is then recorded based on the greatest present value difference of each of the contract year calculations.

~~18-19.~~ Unlike traditional life insurance contracts, flexible premium universal life-type contracts do not have guaranteed premiums and some assumption as to future premiums is required. Appendix A-585 establishes a minimum reserving method for universal life-type contracts by providing guidance on how to estimate future premiums on flexible premium universal life-type contracts so that traditional valuation methodologies can be used. Alternative minimum reserves shall be required, if applicable, for flexible premium universal life-type contracts if the guaranteed maturity premium is less than the valuation net premium. Appendix A-585 shall be used in establishing reserves for flexible premium universal life-type contracts.

~~19-20.~~ Policy reserves for fixed premium universal life-type contracts shall also follow guidance in Appendix A-585. Certain fixed premium products offer the policyholder a secondary guarantee. A secondary guarantee provides the policyholder a guaranteed set of cash values, death benefits, and maturity benefits that will be provided regardless of the performance of the policy value. Appendix A-585 requires all guarantees to be considered when establishing policy reserves and shall be followed in establishing reserves for fixed premium universal life-type contracts.

~~20-21.~~ Statutory policy reserves for those group annuity contracts or other contracts that, in whole or in part, establish the insurer's obligations by reference to a segregated portfolio of assets not owned by the insurer shall be established in accordance with the guidance in Appendix A-695. Statutory policy reserves for those contracts with nonlevel premiums or benefits, or contracts with secondary guarantees shall be established in accordance with the guidance in Appendix A-830. Statutory policy reserves for those group life contracts utilizing a separate account that meet the requirements outlined in paragraph 1 of Appendix A-200 shall be computed in accordance with the guidance in that appendix.

22. For life and annuity policies issued on or after the operative date of the *Valuation Manual*, reserves shall use the requirements of the *Valuation Manual*. As required by Appendix A-820, reserves are required to be determined using the methodologies and processes described in the *Valuation Manual*. For policies unable to meet the *Valuation Manual* criteria for exemption from deterministic or stochastic reserves, the *Valuation Manual* supplements formulaic life insurance policy reserve methodologies with more advanced deterministic and stochastic reserve methodologies to produce reserves that better reflect company experience, possible economic conditions and inherent policy risks.

Valuation (Reserve) Method and Deferred Premiums

~~21-23.~~ Reserves shall be established for all benefits guaranteed under the terms of the policy as of the reporting date using appropriate valuation methods, interest rates, mortality and morbidity rates, as applicable. However, as a practical expedient, reserves have been generally calculated as of the policy

anniversary date (i.e., terminal reserves), not the reporting date. As a result, it is necessary to adjust the terminal reserve back to the reporting date. The components used to compute a terminal reserve shall ~~consist of~~ include an interest rate, lapse rates, a mortality and/or morbidity table, and a valuation method (e.g., net level, full preliminary term, Commissioners' Reserve Valuation Method (CRVM), or CARVM). A terminal reserve is based on the assumption that all net premiums have been received, all interest earned, and all benefits paid to the end of the policy year.

~~22-24.~~ Since terminal reserves are computed as of the end of a policy year and not the reporting date, the terminal reserve as of policy anniversaries immediately prior and subsequent to the reporting date are adjusted to reflect that portion of the net premium that is unearned at the reporting date. This is generally accomplished using either the mean reserve method or the mid-terminal method as discussed in ~~the next four~~ paragraphs 25-28. Other appropriate methods, including an exact reserve valuation, may also be used.

Mean Reserve Method

~~23-25.~~ Under the mean reserve method, the policy reserve equals the average of the terminal reserve at the end of the policy year and the initial reserve (the initial reserve is equal to the previous year's terminal reserve plus the net annual valuation premium for the current policy year). When reserves are calculated on the mean reserve basis, it is assumed that the net premium for a policy is collected annually at the beginning of the policy year and that policies are issued ratably over the calendar year.

~~24-26.~~ However, as premiums are often received in installments more frequently than annually and since the calculation of mean reserves assumes payment of the current policy year's entire net annual premium, the policy reserve is overstated by the amount of net modal premiums not yet received for the current policy year as of the valuation date. As a result, it is necessary to compute and report a special asset to offset the overstatement of the policy reserve.

~~25-27.~~ This special asset is termed "deferred premiums." Deferred premiums are computed by taking the gross premium (or premiums) extending from (and including) the modal (monthly, quarterly, semiannual) premium due date or dates following the valuation date to the next policy anniversary date and subtracting any such deferred premiums that have actually been collected. Deferred premium assets shall also be reduced by loading. Since the calculation of mean reserves assumes payment of the current policy year's entire net annual premium, deferred premium assets are considered admitted assets to compensate for the overstatement of the policy reserve. For policies subject to the *Valuation Manual* requirements, the deferred premium asset will continue to be calculated for the net premium reserve component of the total principle-based reserve.

Mid-Terminal Method

~~26-28.~~ Under the mid-terminal method, the policy reserves are calculated as the average of the terminal reserves on the previous and the next policy anniversaries. These reserves shall be accompanied by an unearned premium reserve consisting of the portion of valuation premiums paid or due covering the period from the valuation date to the next policy anniversary date. For policies subject to the *Valuation Manual* requirements, the adjustment to the unearned premium reserve will continue to be calculated for the net premium reserve component of the total principle-based reserve.

Advance Premiums

~~27-29.~~ Advance premiums are those premiums that have been received by the reporting entity prior to the valuation date but which are due on or after the next policy anniversary date. The policyholder may remit one or more premiums in advance of specific due dates. Where premiums are remitted sufficiently far in advance, the premiums charged to the policyholder may be reduced or discounted to reflect the time value of money. The difference between the gross and discounted premium is ratably charged as interest in the summary of operations from the date of payment to the premium due date. At the premium due

date, the amount received from the policyholder plus the accumulated interest equals the gross premium necessary to fund the policy. The total amount of such advance premiums, less any discount as of the valuation date, is reported as a liability in the statutory financial statement and is not considered premium income until due. The gross premium, not the net valuation premium, is recorded as the advance premium in recognition of the reporting entity's liability to refund such premiums in the event the policy is terminated.

Policyholder Dividend Liability

~~28-30.~~ A reporting entity shall accrue, as applicable, the following items relating to participating policies. They are dividends due and unpaid, dividends apportioned (or not yet apportioned) for payment in the following twelve months, and dividends left on deposit to accumulate interest.

~~29-31.~~ Dividends due and unpaid represent dividends payable to the policyholder in the current year but which have not been disbursed or otherwise applied at the reporting date.

~~30-32.~~ Dividends payable in the following calendar year represent the estimated amount of all dividends declared by a reporting entity's board of directors prior to the end of the statement year which are not yet paid or due at the end of the year (dividends apportioned for payment) as well as all dividends payable in the following calendar year that have not been declared (dividends not yet apportioned for payment). For individual insurance the amount of this liability shall be equal to the aggregate amount of the dividends estimated to be payable in the following calendar year whether or not declared or apportioned. For group insurance and pensions, the amount of liability is generally equal to the portion of the dividend payable in the following calendar year which has been earned in the current calendar year.

~~31-33.~~ Dividends left on deposit with the reporting entity shall be recorded in the amount of the deposit and accrued interest thereon. At the balance sheet date, the interest accrued but not yet credited to the policyholders' accounts shall be established as part of this liability.

Coupons

~~32-34.~~ Some entities issue policies that guarantee an annual return, usually evidenced by a coupon that is part of the policy and matures on the policy's anniversary. This return represents an annual pure endowment and is essentially a return of premium previously paid by the policyholder. For matured coupons that have been left to accumulate, the liability is determined in the same way as the liability for dividend accumulations. Interest accrued is calculated for each coupon from the date each matures. The liability for unmatured policyholder coupons shall be the face value of the coupon, discounted at interest and mortality.

Reserve Recognition

~~33-35.~~ The difference between the policy reserves for life contracts at the beginning and end of the reporting period shall be reflected as the change in reserves in the summary of operations, except for any difference due to a change in valuation basis.

Change in Valuation Basis

~~36.~~ ~~34.~~ A change in valuation basis for reserves determined under paragraphs 17-21, except for reserves defined under *Actuarial Guideline XLIII—CARVM For Variable Annuities (AG 43)*, as detailed in *Appendix C*, shall be defined as a change in the interest rate, mortality assumption, or reserving method (e.g., net level, preliminary term, etc.) or other factors affecting the reserve computation of policies in force and meets the definition of an accounting change as defined in *SSAP No. 3—Accounting Changes and Corrections of Errors (SSAP No. 3)*.

37. Changes in reserves developed under paragraph 22 or AG 43, should be reviewed to determine whether the change represents a change in valuation basis and if it meets the definition of a change in accounting as defined in SSAP No. 3.

- a. Changes in principle-based reserving assumptions are often the result of updating assumptions and other factors required by the existing reserving methodology. Reserve changes resulting from the application of principle-based reserving methodology including, but not limited to, updating assumptions based on reporting entity, industry or other experience, and having the reported reserve transition between net premium reserve, deterministic reserve or stochastic reserve, as required under existing guidance, shall not be considered a change in valuation basis. These types of changes also include, but are not limited to, periodic updates in *Valuation Manual* tables, such as industry valuation basic tables, asset spread tables and default cost tables.
- b. A change in valuation basis for principle-based reserves shall include cases where the required reserve methodology has changed or the insurer makes a voluntary decision to choose one allowable reserving method over another. These types of changes include, but are not limited to, new standardized mortality tables such as Commissioners Standard Ordinary tables and regulatory changes in methodology.

34-38. Consistent with SSAP 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 (under changes to surplus in the change in valuation basis annual statement line) rather than as a part of the reserve change recognized in the summary of operations.

39. 37.—The impact of a change in valuation basis on surplus is based on the difference between the reported reserve under the old and new methods as of the beginning of the year. This difference shall not be graded in over time unless this statement ~~an actuarial guideline adopted by the NAIC~~ prescribes a new method and a specific transition that allows for grading. Some changes will meet the definition of a change in accounting as defined in SSAP No. 3 and a change in valuation basis as described in paragraphs 36-38, but the adjustment to surplus will be zero. This can happen when the change in valuation basis is prospective and only applies to new policies and reserves meaning that policies in force for the prior year-end are not affected, or situations in which the change in reserving methodology did not change the reserves reported in the financial statements. The changes remain subject to the disclosures prescribed in SSAP No. 3. The *Valuation Manual* is effective prospectively for policies written on or after the operative date. Therefore, upon the initial prospective adoption of principle-based reserving, the change in valuation basis reflected as an adjustment to surplus will be zero. After initial adoption of the *Valuation Manual*, changes in valuation basis will need to be evaluated to determine the amount of any surplus adjustments.

Supplemental Benefits

35-40. In addition to the basic policy benefit, the insurance contract may provide supplemental benefits. Supplemental benefits include, but are not limited to, accidental death benefits and waiver of premium benefits. If the terms of the contract provide for these benefits, appropriate reserves shall be established in accordance with the applicable standards within the *Accounting Practices and Procedures Manual*.

Unearned Income

36-41. 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.

Accelerated Benefits

37.42. Accelerated benefits are benefits payable under a life insurance contract to a policyholder or certificateholder during the lifetime of the insured, in anticipation of death or upon the occurrence of specified life-threatening or catastrophic conditions as defined by the policy or rider. These benefits reduce the death benefit otherwise payable under the life insurance contract and are payable upon the occurrence of a single qualifying event which results in the payment of a benefit amount fixed at the time of acceleration. When benefits are provided through the acceleration of benefits under group or individual life policies or riders to such policies, policy reserves shall be determined in accordance with Appendices A-820 and A-620. Reserves for such benefits in the aggregate shall be sufficient to cover policies upon which no claim has yet arisen as well as policies upon which an accelerated claim has arisen. Accounting guidance for accelerated benefit payments made in the form of a loan are addressed in *SSAP No. 49—Policy Loans*. In addition, accelerated benefit payments, for those accelerated benefits that reduce the policy, shall not be deferred but shall be charged to the summary of operations as a benefit expense when paid to the policyholder.

Additional Reserves Not Included Elsewhere

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

- a. Provision for either nondeduction of deferred fractional premiums or return of premiums at death of the insured; and
- b. Surrender values in excess of reserves otherwise required or carried.

Disclosures

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

- a. A description of reserve practices concerning the following:
 - i. Waiver of deduction of deferred fractional premiums upon death of insured;
 - ii. Return of portion of final premium for periods beyond the date of death; and
 - iii. Amount of any surrender value promised in excess of the reserve as legally computed;
- b. The methods employed in the valuation of substandard policies;
- c. The amount of insurance, if any, for which the gross premiums are less than the net premiums according to the valuation standards;
- d. The method used to determine tabular interest, tabular less actual reserves released, and tabular cost (by formula or from the basic data for such items); and
- e. The nature of significant other reserve changes.

40.45. Disclose the amount of annuity actuarial reserves and deposit liabilities by withdrawal characteristics for the categories of general account, separate account with guarantees, separate account nonguaranteed and the total as follows:

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

- (a) In a lump sum with adjustments to reflect general changes in interest rates, or asset values since receipt of funds by the insurer;
 - (b) In installments over five years or more, with or without a reduction in the interest rate during the installment period;
- ii. At book value less current surrender charge, where the withdrawal of funds is payable at all times, or at any time within one year from the statement date in a lump sum subject to a current fixed surrender charge of 5% or more and it does not contain a meaningful bail out rate as described in paragraph ~~4045~~4045.a.v.(d);
 - iii. At fair value, where the withdrawal of funds is payable at current fair value of the assets supporting the liabilities, the assets are stated at current fair value, and the liabilities are stated at the current fair 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 fair 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;
 - b. Not subject to discretionary withdrawal;
 - c. Total gross;
 - d. Reinsurance ceded;
 - e. Total net.

~~41-46~~. If the reporting entity has reported life insurance premiums and annuity considerations deferred and uncollected on policies in force as of the financial statement date, disclose separately the amounts and the loading excluded for each of the following lines of business:

- a. Industrial business;
- b. Ordinary new business;
- c. Ordinary renewal;
- d. Credit life;

- e. Group life;
- f. Group annuity.

42-47. Disclose the aggregate amount of direct premiums written through managing general agents or third party administrators. For purposes of this disclosure, a managing general agent means the same as in Appendix A-225. If this amount is equal to or greater than 5% of surplus, provide the following information for each managing general agent and third party administrator:

- a. Name and address of managing general agent or third party administrator;
- b. Federal Employer Identification Number;
- c. Whether such person holds an exclusive contract;
- d. Types of business written;
- e. Type of authority granted (i.e., underwriting, claims payment, etc.);
- f. Total premium written.

43-48. Reporting entities shall disclose the relative percentage of participating insurance, the method of accounting for policyholder dividends, the amount of dividends, and the amount of any additional income allocated to participating policyholders in the financial statements.

44-49. Reporting entities shall disclose if the reserve amount calculated on the state prescribed or permitted valuation basis is materially different from the reserve amount calculated on the A-820 valuation basis¹. Although the A-820 standard is viewed as a minimum one, it represents the baseline from which deviations are measured. The determination of whether difference meets the standard of materiality is subjective. Refer to the Preamble regarding further guidance on the criterion of materiality.

45-50. Refer to the preamble for further discussion regarding disclosure requirements.

Relevant Literature

46-51. This statement incorporates the requirements of Appendices A-225, A-235, A-585, A-620, A-641, A-695, A-812, A-815, A-817, A-820, A-821, A-822, A-830, the Actuarial Standards Board *Actuarial Standards of Practice*, and the actuarial guidelines found in Appendix C of this Manual.

47-52. This statement rejects *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 120, Accounting and Reporting by Mutual Life Insurance Enterprises and by Insurance Enterprises for Certain Long-Duration Participating Contracts*, *AICPA Practice Bulletin No. 8, Application of 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*, *to Insurance Enterprises*, the *AICPA Audit and Accounting Guide—Audits of Stock Life Insurance Companies*, *AICPA Statement of Position 95-1, Accounting for Certain Activities of Mutual Life Insurance Enterprises* relating to accounting and reporting for policy reserves for short and long duration contracts, and *FASB Interpretation No. 40, Applicability of Generally Accepted Accounting Principles to Mutual Life Insurance and Other Enterprises, an interpretation of FASB Statements No. 12, 60, 97, and 113*.

¹ This issue applies to contracts issued January 1, 2001, and thereafter.

Effective Date and Transition

53. This statement is effective for years beginning January 1, 2001. Contracts issued prior to January 1, 2001 shall be accounted for based on the laws and regulations of the domiciliary state. State laws and regulations shall be understood to include anything considered authoritative by the domiciliary state under the individual state's statutory authority and due process procedures. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with SSAP No. 3. The guidance in paragraph 14 was originally contained within *INT 00-30: Application of SSAP No. 51 Paragraph 6 to Waiver of Deduction on Flexible Premium Universal Life Insurance Policies* and was effective December 4, 2000. The guidance in paragraph 44-49 was originally contained within *INT 01-26: SSAP No. 51 and Reserve Minimum or Required Amount* and was effective January 1, 2001.

48-54. Substantive changes that reference the *Valuation Manual* in this statement are effective for January 1, 2017 and thereafter. However, the *Valuation Manual* provides for a 3-year period, starting from the operative date, during which companies are able to continue using the current reserve methodologies, as described in paragraphs 18-21.

REFERENCES**Other**

- NAIC Financial Condition Examiners Handbook
- Actuarial Standards Board Actuarial Standards of Practice

Relevant Issue Papers

- *Issue Paper No. 51—Life Contracts*
- *Issue Paper No. 56—Universal Life-Type Contracts, Policyholder Dividends, and Coupons*
- *Issue Paper No. 110—Life Contracts, Deposit-Type Contracts and Separate Accounts, Amendments to SSAP No. 51—Life Contracts, SSAP No. 52—Deposit-Type Contracts, and SSAP No. 56—Separate Accounts*
- *Issue Paper No. 154—Implementation of Principle-Based Reserving*

EXHIBIT B - REVISIONS TO SSAP NO. 54—INDIVIDUAL AND GROUP ACCIDENT AND HEALTH CONTRACTS – REVISED

Individual and Group Accident and Health Contracts

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for income recognition and policy reserves for all contracts classified as individual and group accident and health contracts as defined in *SSAP No. 50—Classifications of Insurance or Managed Care Contracts*, except for credit accident and health contracts which are discussed in *SSAP No. 59—Credit Life and Accident and Health Contracts*.

SUMMARY CONCLUSION

Premium Income Recognition

2. Premiums shall be recognized as income on the gross basis (amount charged to the policyholder or subscriber exclusive of copayments or other charges related to the receipt of health care services) when due from policyholders or subscribers, but no earlier than the effective date of coverage, under the terms of the contract. Due and uncollected premiums shall follow the guidance in *SSAP No. 6—Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers* (SSAP No. 6), to determine the admissibility of premiums and related receivables. Premiums waived by the reporting entity under disability provisions contained in its policies and contracts, and reported in operations as a disability benefit, are included in premium income.

3. Premium income shall exclude premiums that have been received by the reporting entity on or prior to the valuation date but which are due after the valuation date (i.e., advance premiums as discussed below).

4. Premium income shall be reduced for premiums returned and allowances to industrial policyholders for the direct payment of premiums.

5. Premium income shall be increased by reinsurance premiums assumed and reduced by reinsurance premiums ceded. Reinsurance premiums assumed and ceded are defined and addressed in *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance*.

6. Advance premiums are those premiums that have been received by the reporting entity prior to or on the valuation date but which are due after the valuation date. The total amount of such advance premiums is reported as a liability in the statutory financial statements and is not considered premium income until due. The gross premium, not the net valuation premium, is recorded as the advance premium in recognition of the reporting entity's liability to refund such premiums in the event the policy is terminated.

7. As discussed in *SSAP No. 47—Uninsured Plans* (SSAP No. 47), amounts received on behalf of uninsured plans or the uninsured portion of partially insured plans shall not be reported as premium income. Administrative fees for servicing the uninsured plans shall be deducted from general expenses. Conversely, income relating to the insured portion of any plan shall be reported as premium income.

8. Specific funds to be received under the Medicare Part D program received as premiums for coverage that is not retrospectively rated should be accounted for under this Statement. These funds include 'Beneficiary Premium (supplemental benefit portion)', as these payments are considered to be standard premium payments that do not meet the definitions under SSAP No. 47 or *SSAP No. 66—Retrospectively Rated Contracts* (SSAP No. 66). Refer to *INT 05-05: Accounting for Revenues Under Medicare Part D Coverage* for additional information and definitions of terms specifically related to Medicare Part D business.

Reserve Requirements

9. The aggregate reserve for individual and group accident and health contracts generally consists of a policy reserve and a claim reserve as well as certain other miscellaneous reserves discussed in paragraph 24. The aggregate reserve reflects the future liabilities arising under accident and health policies. Policy reserves have traditionally been referred to as active life reserves and include unearned premium reserves. Policy reserves reflect that premiums cover future liabilities in addition to current claim costs and expenses. Claim reserves, sometimes referred to as disabled life reserves, are required on claims which involve continuing loss. The reserve in this case is a measure of the present value of future benefits or amounts not yet due as of the statement date (the unaccrued portion) which are expected to arise under claims which have been incurred as of the statement date. The aggregate reserve for individual and group accident and health contracts does not include claim liabilities which are the amounts payable at the reporting date (the accrued portion) and reflect the reporting entity's liability for benefits due as of the statement date. Claim liabilities are further discussed in *SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses*.

10. Policy reserves for individual and group accident and health contracts shall include an unearned premium reserve and, as applicable, an additional or contract reserve where constant or level premiums are assumed for certain noncancelable or guaranteed renewable contracts. The claim reserve shall consist of a reserve for the present value of amounts not yet due.

11. Statutory policy reserves shall be established for all unmatured 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. A prospective gross premium valuation is the ultimate test of reserve adequacy as of a given valuation date. Statutory reserves meet the definition of liabilities as defined in *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* (SSAP No. 5R). The actuarial methodologies referred to in the following paragraph 12 meet the criteria required for reasonable estimates in SSAP No. 5R.

12. The reserving methodologies and assumptions used in calculating individual and group accident and health reserves shall meet the provisions of A-010, A-641, A-820, and A-822 (as applicable), the Valuation Manual and the actuarial guidelines found in Appendix C of this Manual (as applicable). Further, policy reserves shall be in compliance with those Actuarial Standards of Practice promulgated by the Actuarial Standards Board.

Policy Reserves

13. Unearned premium reserves shall be required for all accident and health contracts for which premiums have been reported for a period beyond the date of valuation other than premiums paid in advance. The minimum unearned premium reserve that applies to the premium period beyond the valuation date shall be based on the valuation net modal premium if contract reserves are required and the gross modal unearned premium reserve if contract reserves are not required. If premiums due and unpaid are carried as an asset, such premiums must be treated as premiums in force, subject to unearned premium reserve determination. The value of unpaid commissions, premium taxes, and the cost of collection associated with due and unpaid premiums must be carried as an offsetting liability. In no event shall the aggregate policy reserve for all contracts be less than the unearned gross premium under such contracts. Additionally, the reserve shall never be less than the expected claims for the period beyond the valuation date represented by the unearned premium reserve, to the extent not provided for elsewhere.

14. Contract or additional reserves on accident and health contracts shall be recorded when premiums and benefits are not earned or incurred at the same incidence over the policy period (e.g., contracts having premiums determined on an issue-age basis where premiums and related morbidity, risk of loss, and the cost of coverage are not evenly matched). This evaluation may be applied on a rating block basis if the total premiums for the block were developed to support the total risk assumed and expected expenses for

the block each year, and a qualified actuary certifies the premium development (e.g., community-rated contracts). The additional reserves shall be set aside from the early years' level premiums to pay the claims that experience indicates will be incurred as the policy continues in force. The fact that the reporting entity may have the right to increase premiums or to decline renewal of the policies for certain reasons has no bearing on whether or not a contract or additional reserve should be held. These reserves shall apply regardless of whether or not benefits are currently being received and are in addition to unearned premium reserves discussed in paragraph 13.

15. Contract or additional reserves shall also be recorded where, due to the gross premium structure, the future benefits exceed the future net premiums (e.g., group conversion policies) or where the contract provides for the extension of benefits after the termination of the coverage (e.g., deferred maternity and other similar benefits).

16. A terminal reserve for accident and health contracts is the policy reserve at the end of a policy year to cover the assumed difference between future benefits and future net premiums. The components used to compute a terminal reserve shall consist of an interest rate, a mortality and/or morbidity table, and a valuation method (e.g., net level, one-year full preliminary term, and two-year full preliminary term) and where allowed, other assumptions. A terminal reserve is based on the assumption that all net premiums have been received, all interest earned, and all benefits paid to the end of the policy year.

17. Since terminal reserves are computed as of the end of a policy year and not the reporting date, the terminal reserve as of policy anniversaries immediately prior to and subsequent to the reporting date are adjusted to reflect that portion of the net premium that is unearned at the reporting date. This is generally accomplished using either the mean reserve method or the mid-terminal method as discussed in paragraphs 23-26 of *SSAP No. 51—Life Contracts*. Other appropriate methods, including an exact reserve valuation, may also be used.

18. For individual and group accident and health contracts, negative reserves on any benefit shall be offset against positive reserves for other benefits in the same policy but the mean reserve on any policy shall never be taken as less than one-half the valuation net premium. The majority of group accident and health policies are written in conjunction with group life or other policies. If these policies are an experience rated package, positive or favorable margins on one of the contracts can offset the need to establish additional reserves on the other contracts.

Additional Reserves (Premium Deficiency Reserves)

19. When the expected claims payments or incurred costs, claim adjustment expenses and administration costs exceed the premiums to be collected for the remainder of a contract period plus any contract reserve, a premium deficiency reserve shall be recognized by recording an additional liability for the deficiency, with a corresponding charge to operations. For purposes of determining if a premium deficiency exists, contracts shall be grouped in a manner consistent with how policies are marketed, serviced and measured. A liability shall be recognized for each grouping where a premium deficiency is indicated. Deficiencies shall not be offset by anticipated profits in other policy groupings. Such accruals shall be made for any loss contracts, even if the contract period has not yet started.

Claim Reserves

20. Claim reserves shall be accrued for estimated costs of future health care services to be rendered that the reporting entity is currently obligated to provide or reimburse as a result of premiums earned to date and that would be payable after the reporting date under the terms of arrangements, regulatory requirements or other requirements if the insured's or subscriber's illness or disability were to continue. It shall include a reserve for disability benefits covered under premium waiver provisions. For individual and group disability claims with a duration of less than two years, reserves may be based on the reporting entity's experience, if credible, or other methods, as appropriate. Generally, reserves for disability income claims with durations of greater than two years shall be determined based on a tabular method using the

age of the insured at the date of disablement, the number of months the insured already has been disabled, and the number of months remaining in the benefit period.

Reserve Recognition

21. The difference between the aggregate reserve for accident and health contracts at the beginning and end of the reporting period shall be reflected as the change in reserves in the summary of operations, except for any difference due to a change in valuation basis.

Change In Valuation Basis

22. A change in valuation basis shall be defined as a change in the interest rate, mortality and morbidity assumptions, or reserving method (e.g., net level, preliminary term, etc.) or other factors affecting the reserve computation of policies in force and meets the definition of an accounting change as defined in *SSAP No. 3—Accounting Changes and Corrections of Errors* (SSAP No. 3). Changing morbidity assumptions regarding the length of claim continuance based on regularly updated credible experience as required for products subject to *Actuarial Guideline XLVII—The Application of Company Experience in the Calculation of Claim Reserves Under the 2012 Group Long-Term Disability Valuation Table* (AG 47) and *Actuarial Guideline L—2013 Individual Disability Income Valuation Table* (AG 50) are not considered a change in valuation basis. Other uses of regularly updated credible experience required to be used for morbidity assumptions by Appendix A-010 regarding continuing claim payments are generally not considered a change in valuation basis. Consistent with SSAP 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 (under changes to surplus in the change in valuation basis annual statement line for life accident and health and health reporting entities) 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. Some changes will meet the definition of a change in accounting as defined in SSAP No. 3 and a change in valuation basis as described in this paragraph, but the adjustment to surplus will be zero. This can happen when the change in valuation basis is prospective and only applies to new policies and reserves meaning that policies in force for the prior year-end are not affected, or situations in which the change in reserving methodology did not change the reserves reported in the financial statements. The changes remain subject to the disclosures prescribed in SSAP No. 3. This difference shall not be graded in over time unless ~~an~~ actuarial guideline adopted by the NAIC ~~this statement~~ prescribes a new method and a specific transition that allows for grading.

Supplemental Benefits

23. In addition to the basic policy benefit, the contract may provide supplemental benefits. Supplemental benefits include, but are not limited to, accidental death benefits, dental and waiver of premium benefits. If the terms of the contract provide for these benefits, appropriate reserves shall be established in accordance with the applicable standards within the *Accounting Practices and Procedures Manual* and the *Valuation Manual*.

Reserve Adequacy

24. As discussed in Appendix A-010, a prospective gross premium valuation is the ultimate test of the adequacy of a reporting entity's accident and health reserves as of a given valuation date and shall be determined on the basis of unearned premium reserves, contract reserves, ~~or~~ additional reserves, claim reserves (including claim liabilities), and miscellaneous reserves combined; however, each component shall be computed separately.

Additional Reserves Not Included Elsewhere

25. Reserves for experience-rating refunds or the dividend liability in group policies are discussed in SSAP No. 66.
26. Additional actuarial or other 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 asset adequacy analysis as discussed in Appendix A-822; and
 - c. Additional reserves for policies which contain conversion privileges or future contingent benefits.

Contracts Subject to Redetermination

27. This statement also applies to other contracts which are subject to redetermination such as Federal (and State) Groups – subject to rate adjustments through audits by the Office of Personnel Management (OPM). Reporting entities are required to give Federal Groups the lowest rates that are being charged to similar groups.

28. Amounts due from insureds or subscribers and amounts due to insureds or subscribers under contracts subject to redetermination meet the definitions of assets and liabilities as set forth in *SSAP No. 4—Assets and Nonadmitted Assets* and SSAP No. 5R, respectively.

29. Contract redeterminations shall be estimated based on the experience to date. The method used to estimate the liability shall be reasonable based on the reporting entity's procedures, and consistent among reporting periods. An examination of contract requirements in relation to the rates being charged and the current status of applicable audits (e.g., OPM, Centers for Medicare and Medicaid Services (or such other name that this entity shall be known as) and other Federal, state or government department) is a common method used to estimate such contract redeterminations.

30. Premium adjustments for contracts subject to redetermination are estimated for the portion of the policy period that has expired and shall be considered an immediate adjustment to premium. Accrued premium adjustments shall be recorded in premium and considerations receivable with a corresponding entry to written premiums. Accrued return premium adjustments shall be recorded as a liability with a corresponding entry to written premiums, the annual statement liability lines will vary by the type of annual statement the reporting entity files. Managed care/accident and health reporting entities report as aggregate health policy reserves; life and accident and health reporting entities report as aggregate reserves for accident and health contracts; property and casualty reporting entities report as aggregate write-ins for liabilities.

31. If, in accordance with SSAP No. 5R, it is probable that the additional premium adjustment is uncollectible, any uncollectible premium shall be written off against operations in the period the determination is made and the disclosure requirements outlined in SSAP No. 5R shall be made.

32. Premium adjustments for contracts subject to redetermination shall be determined and billed or refunded in accordance with the policy provisions or contract provisions. If such premiums are not billed in accordance with the policy provisions or contract provisions, or the policy provisions or contract provisions do not address the due date of such premiums, the accrual shall be nonadmitted. This is consistent with the guidance for audit premiums established in SSAP No. 6.

Disclosures

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

- a. Name and address of managing general agent or third party administrator;
- b. Federal Employer Identification Number;
- c. Whether such person holds an exclusive contract;
- d. Types of business written;
- e. Type of authority granted (i.e., underwriting, claims payment, etc.); and
- f. Total premium written.

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

35. If a premium deficiency reserve is established in accordance with paragraph 19, disclose the amount of that reserve. If a reporting entity utilizes anticipated investment income as a factor in the premium deficiency calculation, disclosure of such shall be made in the financial statements.

36. The financial statements shall disclose the method used by the reporting entity to estimate premium adjustments for contracts subject to redetermination. The amount of net premiums that are subject to such adjustments, as well as the corresponding percentage to total net premiums, shall be disclosed.

37. Management's policy for providing charity care,¹ as well as the level of charity care provided, shall be disclosed in the financial statements. Such disclosure shall be measured based on the provider's direct and indirect costs of providing charity care services. If costs cannot be specifically attributed to services provided to charity care patients (for example, based on a cost accounting system), management may estimate the costs of those services using reasonable techniques with the method used to identify or estimate such costs disclosed. Funds received to offset or subsidize charity services provided (for example, from gifts or grants restricted for charity care or from an uncompensated care fund), also shall be disclosed.

38. Refer to the preamble for further discussion regarding disclosure requirements.

Relevant Literature

39. This statement adopts the definition of charity care and adopts with modification the disclosure within *ASU 2010-23, Health Care Entities, Measuring Charity Care*, as applicable.

40. This statement incorporates the requirements of A-010, A-225, A-641, A-820, A-822 (as applicable), the *Valuation Manual*, the Actuarial Standards Board *Actuarial Standards of Practice* and the actuarial guidelines found in Appendix C of this manual (as applicable).

¹ Charity care represents health care services that are provided but are never expected to result in cash flows. Charity care is provided to a patient with demonstrated inability to pay. Each entity establishes its own criteria for charity care consistent with its mission statement and financial ability.

41. This statement rejects *FASB Statement No. 60, Accounting and Reporting by Insurance Enterprises* relating to accounting and reporting for individual and group accident and health contracts.

Effective Date and Transition

42. This statement is effective for years beginning January 1, 2001. Contracts issued prior to January 1, 2001 shall be accounted for based on the laws and regulations of the domiciliary state. State laws and regulations shall be understood to include anything considered authoritative by the domiciliary state under the individual state's statutory authority and due process procedures. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with SSAP No. 3. The disclosure related to charity care shall be applied prospectively beginning June 17, 2015. Application of references to the *Valuation Manual* is effective January 1, 2017.

REFERENCES

Other

- *NAIC Financial Condition Examiners Handbook*
- *Actuarial Standards Board Actuarial Standards of Practice*

Relevant Issue Papers

- *Issue Paper No. 54—Individual and Group Accident and Health Contracts*
- *Issue Paper 154—Implementation of Principle-Based Reserving*

EXHIBIT C – SUMMARY PRINCIPLE-BASED RESERVING IMPLEMENTATION

Agenda Item	Accounting Manual Section	Status	Adopted Date
2015-47	<i>SSAP No. 51—Life Contracts,</i>	Exposed 2016 Spring National Meeting	SSAP No. 51 – June 9, 2016
2015-47	<i>Issue Paper No. 154—Implementation of Principle-based Reserving</i>	Exposed 2016 Summer National Meeting including SSAP No. 51 changes Revisions exposed Oct. 17, 2016	Issue Paper No. 154- Dec. 10, 2016
2016-10	<i>A-820 Minimum Life And Annuity Reserve Standards</i>	Exposed at 2016 Spring National Meeting to incorporate 2009 Standard Valuation Law changes.	June 9, 2016
2016-15	<i>Change in valuation basis in SSAP No. 51</i>	Exposed SSAP No. 51 changes on June 9, 2016.	August 26, 2016
2016-34	<i>SSAP No. 54—Individual and Group Accident and Health Contracts,</i>	Exposed on Oct. 17, 2016	Dec. 10, 2016
2016-17	<i>A-010 Minimum Reserve Standards for Individual and Group Health Insurance Contracts</i>	Exposed at 2016 Summer National Meeting to incorporate 2013 Individual Disability Income Valuation Table	Nov. 3, 2016

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