

Statement of Statutory Accounting Principles No. 51

Life Contracts

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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 and Definitions of Insurance or Managed Care Contracts—In Force*, 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 27).
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. 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 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. 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 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 the actuarial guidelines found in Appendix C of this Manual. Further, policy reserves shall be in compliance with those Actuarial Standards of Practice promulgated by the Actuarial Standards Board.

17. The preceding two paragraphs summarize the general reserve requirements for all types of life contracts. 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. 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. 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. 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.

Valuation (Reserve) Method and Deferred Premiums

21. 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 an interest rate, 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. 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. Other appropriate methods, including an exact reserve valuation, may also be used.

Mean Reserve Method

23. 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. 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. 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.

Mid-Terminal Method

26. 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.

Advance Premiums

27. 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. 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. 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. 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. 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. 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. 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

34. A change in valuation basis 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). 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 rather than as a part of the reserve change recognized in the summary of operations. The impact on surplus is based on the difference between the reserve under the old and new methods as of the beginning of the year. This difference shall not be graded in over time unless an actuarial guideline adopted by the NAIC prescribes a new method and a specific transition that allows for grading.

Supplemental Benefits

35. 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. 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. 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. 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. 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. 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 40.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. 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. 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. 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. 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. Refer to the preamble for further discussion regarding disclosure requirements.

Relevant Literature

46. 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. 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

48. 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 was originally contained within *INT 01-26: SSAP No. 51 and Reserve Minimum or Required Amount* and was effective January 1, 2001.

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*

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