Accounting Practices and Procedures Manual
As of March 2004
Volume I

This guidance is as adopted by the NAIC as of March 2004. Please note that there will be modifications to the accounting pronouncements included in this manual from year to year as such guidance is subject to the maintenance process. To address this, the NAIC has a website dedicated to providing the holder of this manual with the latest information impacting statutory accounting. The holder of this manual may enter a password-protected NAIC website and download an Issue Paper, Statement of Statutory Accounting Principles, Appendix or Interpretation finalized in 2004 that affects this manual. This website will also include the latest minutes of the Statutory Accounting Principles Working Group and the Emerging Accounting Issues Working Group. Should you wish to be notified via e-mail by the NAIC when the password-protected website is updated, you can visit the website listed below and click the link to sign up for e-mail notification of updates to the statutory accounting website. The NAIC will retain the 2003 database; therefore, if you were receiving notifications via e-mail in 2003, there is no need to resubmit your request in 2004.

Website: http://www.naic.org/frs/statutory_accounting/app_updates/index.htm
User ID: STATUTORY (enter exactly as presented – case sensitive)
Password: SAP2004 (enter exactly as presented – case sensitive)

Password Information (although not unique to user, this password should only be used by persons who have obtained the March 2004 Accounting Practices and Procedures Manual from the NAIC).
How to Use This Manual

How This Manual is Arranged …

The contents of this Manual are arranged as follows:

Volume I:
- Summary of Changes
- Table of Contents
- Preamble
- Statements of Statutory Accounting Principles
- Index to the Statements of Statutory Accounting Principles
- Glossary
- Appendix A – Excerpts of NAIC Model Laws
- Appendix B – Interpretations of the Emerging Accounting Issues Working Group
- Appendix C – Actuarial Guidelines
- Appendix D – GAAP Cross-Reference to SAP

Volume II:
- Appendix E – Issue Papers
- Appendix F – Policy Statements

The arrangement of material as indicated above is included in the Table of Contents at the front of each Volume. There is also a detailed Table of Contents covering the material within each section immediately preceding such section.

Summary of Changes:
This section provides a summary of the changes that were made to the As of March 2003 version of the Accounting Practices and Procedures Manual to create the As of March 2004 version. This summary is separated into two sections. The first section summarizes the nonsubstantive changes to the Manual. Nonsubstantive changes are characterized as language clarifications which do not modify the original intent of a SSAP, or changes to reference material. These nonsubstantive changes are depicted by underlines (new language) and strike-throughs (removed language) in the applicable SSAP and will not be shown as marked in subsequent manuals. The second section summarizes the substantive revisions to the Manual. These substantive revisions introduce original or modified accounting principles and, therefore, are depicted with new SSAPs. Should a new SSAP supersede an existing SSAP, the superseded language is noted and the reader is referred to the new SSAP. In addition, language that is superseded is shaded in the text of the SSAP.

Preamble:
Each and every user of the Manual should read this section. Many regulators consider this document one of the most important parts of the Manual as it provides the foundation for statutory accounting principles (SAP). Some of the significant topics covered in the Preamble include Codification Project Background, statement of concepts, statutory hierarchy, materiality and disclosures.

Statements of Statutory Accounting Principles:
As indicated by the Statutory Hierarchy, the Statements of Statutory Accounting Principles (SSAPs) are the primary Accounting Practices and Procedures promulgated by the NAIC. These statements are the result of issue papers that have been exposed for public comment and finalized. Finalized issue papers are in Appendix E and ARE NOT authoritative. While it is not intended that there be any significant differences between an underlying issue paper and the resultant...
How to Use This Manual

SSAP, if differences exist, the SSAP prevails and shall be considered definitive. Readers may use the NAIC website, as indicated on the inside front cover of the Manual, to keep abreast of substantive and nonsubstantive changes to the SSAPs.

The cover page of each SSAP contains a STATUS section that can affect the implementation of each SSAP. The STATUS section contains the following:

**TYPE OF ISSUE** – SSAPs designated as Common Area apply to all insurers. Although the nomenclature or terms provided in the prescribed annual statement forms may vary among different types of insurers, only one set of nomenclature or terms may have been used in the SSAP. For example, the Statement of Income found in the Property and Casualty Annual Statement shall be considered as synonymous with the Summary of Operations found in the Life and Health Annual Statement.

**ISSUED** – Date when the SSAP was adopted by the NAIC. SSAPs designated with Initial Draft were adopted by the NAIC Plenary in March 1998 as part of the Codification Project (SSAPs No. 1 to 73). The date included for SSAP No. 74, and subsequent SSAPs, denotes when the Statutory Accounting Principles Working Group adopted the SSAP.

**EFFECTIVE DATE** – Date representing when the SSAP is effective. Many times there are additional details relative to the transition provided within the SSAP.

**AFFECTS/AFFECTED BY** – Once an SSAP has been promulgated it will only be substantively amended or superseded through the issuance of a new SSAP. A useful tool for tracking of the relationships between statements is contained within this section of the SSAP. Readers are referenced to another SSAP at the “affected by” line if the SSAP has been substantively amended or superseded. Text within paragraphs substantively amended or superseded are also “shaded” to notify readers that revised guidance is available. The “affects” section is used by SSAPs that substantively amend or supersede previously issued SSAPs.

**INTERPRETED BY** – This section includes a reference to the applicable Interpretation (INT) of the Emerging Accounting Issues Working Group contained within Appendix B of the Manual provide interpretative guidance as a result of issues raised by users of the Manual or related GAAP guidance. INTs are generally effective when adopted. Readers should note that the Manual only contains the INTs finalized through December 2003 due to the fact that the Manual is published annually. Readers may use the NAIC website, as indicated on the inside front cover of the Manual, to keep abreast of recently issued INTs.

**Appendix A – Excerpts of NAIC Model Laws:**
In most cases, the source document for information included in Appendix A is an NAIC Model Regulation or Law. These Appendices are referenced by specific SSAPs and should only be used in context of the Appendix and the SSAP that references it.

**Appendix B – Interpretations of the Emerging Accounting Issues Working Group:**
The Emerging Accounting Issues Working Group (EAIWG) is responsible for responding to SAP questions that generally relate to application, interpretation and clarification. Appendix B includes the final interpretations of the EAIWG through December 7, 2003. Each of the SSAPs includes a reference to the applicable INT once it has been finalized.

**Appendix C – Actuarial Guidelines:**
The NAIC Life and Health Actuarial Task Force has been asked on many occasions to assist a particular state insurance department in interpreting a statute dealing with an actuarial topic relative to an unusual policy form or situation not contemplated at the time of original drafting of
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a particular statute. The Life and Health Actuarial Task Force, in developing its interpretation or
guideline, must often consider the intent of the statute, the reasons for initially adopting the
statute and the current situation. The Life and Health Actuarial Task Force feels that for those
situations which are sufficiently common to all states, the publishing of actuarial guidelines on
these topics would be beneficial to the regulatory officials in each state and would promote
uniformity in regulation which is beneficial to everyone. To this end, the Life and Health
Actuarial Task Force has developed certain actuarial guidelines and will continue to do so as the
need arises. The guidelines are not intended to be viewed as statutory revisions but merely a
guide to be used in applying a statute to a specific circumstance.

Appendix D – GAAP Cross-Reference to SAP:
As expressed in the Statement of Concepts, SAP utilizes the framework established by Generally
Accepted Accounting Principles (GAAP). Appendix D includes GAAP pronouncements that
have been considered in the development of SAP and include all issued pronouncements in
categories a, b and c of the GAAP Hierarchy. This listing includes GAAP pronouncements
issued through December 2003 (November 1, 2003 for Opinions of the FASB Emerging Issues
Task Force (EITF)). This Appendix is a valuable and efficient tool for readers who are interested
in the status of a particular GAAP pronouncement in the SAP model.

Appendix E – Issue Papers:
This section includes all of the issue papers associated with SSAPs adopted by NAIC Plenary
through March 2004. The issue papers are used as the first step in developing new SSAPs and
contain a recommended conclusion, discussion and relevant literature section. Issue Papers DO
NOT constitute an authoritative level of statutory accounting, as supported by the statutory
hierarchy, and should only be used as reference material. Nevertheless, issue papers are an
important part of the Manual because they reference the history and discussion of the related
SSAP. The Relevant Statutory Accounting and GAAP Guidance section of the issue paper
contains excerpts of accounting guidance in place at the time the Statutory Accounting Principles
Working Group considered (but not necessarily adopted) in forming the conclusions reached in
the resultant SSAP.

Appendix F – Policy Statements:
This section includes the NAIC Policy Statements applicable to SAP. These statements provide
the basis by which SAP is maintained, documentation of the agenda process and other important
issues that affect this Manual.

How to Use this Manual …

... to account for a certain item under NAIC SAP
As the SSAPs represent the highest level of NAIC statutory authority, readers should begin their
search there. The Index to SSAPs is a useful tool to identify which SSAP(s) address the issue.
Once the pertinent SSAP has been identified, it can be used to locate other documents that may
also address the issue. On the SSAP cover page, readers will be referred to other SSAPs if there
have been substantive changes made to it or INTs if there have been interpretations of the SSAP.
Within the body of the SSAP, readers may be referred to Appendix A or C for further guidance.
There is a reference located at the end of each SSAP to issue paper(s) used in the development of
the SSAP. The DISCUSSION section of the issue paper provided documentation supporting the
conclusions reached in the SSAP. As supported by the statutory hierarchy, readers should only
utilize the issue papers as support to the SSAP as they ARE NOT authoritative. The Statutory
Hierarchy contains a detailed listing of levels of authoritative literature.

... to compare SAP to GAAP for a particular issue
Appendix D is an excellent reference for users who are interested in determining how SAP
addresses an issue that has been adopted by GAAP. Appendix D provides a reference to the
SSAP or INT that addresses a particular GAAP pronouncement. As indicated in the Preamble, users should not utilize GAAP until and unless adopted by the NAIC. Within the body of the applicable SSAP or INT, readers will find documentation as to the reason for adoption, rejection, or adoption with modification of a particular GAAP pronouncement.

... to identify the relationship between the Manual and State law
Once a reader has identified the accounting treatment for a particular transaction or issue within the Manual, one must consider the effect of state law. That is, this Manual is not intended to preempt states’ legislative and regulatory authority. It is intended to establish a comprehensive basis of accounting recognized and adhered to if not in conflict with state statutes and/or regulations, or when the state statutes and/or regulations are silent. For instance, if a state prohibits the admission of goodwill, insurers domiciled in that state are required to nonadmit all goodwill instead of following the NAIC guidance contained within SSAP No. 68—*Business Combinations and Goodwill*. Insurers should refer to their state laws and regulations regarding deviations from this Manual.

... to obtain updates to the latest published Manual
This Manual contains information as of December 2003. Please note that there will be modifications to the accounting pronouncements included in this Manual from year to year, as such guidance is subject to the maintenance process. To address this, the NAIC has a website dedicated to providing the holder of this Manual with the latest information impacting statutory accounting. The holder of this Manual may enter a password-protected NAIC website and download an Issue Paper, Statement of Statutory Accounting Principles, Appendix or Interpretation that affects this Manual. This website will also include the latest minutes of the Statutory Accounting Principles Working Group and the Emerging Accounting Issues Working Group. Further details can be found on the inside front cover of this Manual.

... to learn how changes get made to the Manual and how to stay abreast of such changes
Appendix F contains several NAIC Policy Statements that document the process by which this Manual will be modified. It also outlines the process by which the Statutory Accounting Principles and the Emerging Accounting Issues Working Groups will conduct their business. Readers are able to track the development of SAP by attending the quarterly meetings of the working groups or through use of the NAIC website. Further details regarding the website can be found at www.naic.org.

... to contact the NAIC regarding questions about the Manual
The following NAIC staff persons may be contacted regarding questions about this Manual:

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<th>Name</th>
<th>Title</th>
<th>Issue</th>
<th>Phone</th>
<th>Email</th>
</tr>
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<tbody>
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</tr>
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<td>816/783-8400</td>
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Summary of Changes to the As of March 2003 Version of the Accounting Practices and Procedures Manual included in the As of March 2004 Version

The following represents a summary of the changes that were made to the As of March 2003 version of the Accounting Practices and Procedures Manual to create the As of March 2004 version. This summary is separated into two sections. The first section summarizes the nonsubstantive changes to the Manual. Nonsubstantive changes are characterized as language clarifications which do not modify the original intent of a SSAP, or changes to reference material. These nonsubstantive changes are depicted by underlines (new language) and strike-throughs (removed language) in the applicable SSAP and will not be shown as marked in subsequent manuals. The second section summarizes the substantive revisions to the Manual. These substantive revisions introduce original or modified accounting principles and, therefore, are depicted with new SSAPs. Should a new SSAP supersede an existing SSAP, the superseded language is noted and the reader is referred to the new SSAP.

Nonsubstantive Modifications

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<td>SSAP No. 3</td>
<td>Paragraph 15 was modified to reject FASB Interpretation No. 46: Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51 (FIN 46)</td>
</tr>
<tr>
<td>SSAP No. 13</td>
<td>Modified the SSAP to note FASB Statement No. 148: Accounting for Stock-Based Compensation – Transition and Disclosure – an amendment of FASB Statement No. 123 (FAS 148) is rejected for statutory accounting purposes.</td>
</tr>
<tr>
<td>SSAP No. 18</td>
<td>Paragraph 25 was modified to provide guidance on the reporting of fees from securities lending transactions.</td>
</tr>
<tr>
<td>SSAP No. 21</td>
<td>Paragraphs 15 and 16 were modified to allow loans to state guaranty associations as admitted assets.</td>
</tr>
<tr>
<td>SSAP No. 22</td>
<td>References to FASB Statement No. 13, Accounting for Leases paragraph 38b were deleted and replaced by references to paragraph 9c.c. of FASB Statement No. 145, Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13 and Technical Corrections.</td>
</tr>
<tr>
<td>SSAP No. 24</td>
<td>Modified the SSAP to note FASB Statement No. 146, Accounting for Costs Associated with Exit or Disposal Activities is rejected for statutory accounting purposes.</td>
</tr>
<tr>
<td>SSAP No. 59</td>
<td>Paragraphs 11 and 12 were modified to clarify how to calculate unearned premium for credit accident and health insurance.</td>
</tr>
<tr>
<td>SSAP No. 61</td>
<td>Paragraph 40 was modified to clarify the reporting of interest on funds held reinsurance.</td>
</tr>
<tr>
<td>SSAP No. 62</td>
<td>Paragraphs 35 and 42 were modified to clarify the reporting of interest on funds held reinsurance.</td>
</tr>
<tr>
<td>SSAP No. 70</td>
<td>Added guidance on the classification of expenses for health insurers provided.</td>
</tr>
<tr>
<td>SSAP No. 72</td>
<td>Paragraph 12. o. clarifies, consistent with SSAP No. 89, that the change in the additional minimum pension liability is in the other category of unassigned funds.</td>
</tr>
<tr>
<td>SSAP No. 86</td>
<td>SSAP No. 86 – EXHIBIT C, Specific Hedge Accounting Procedures for Derivatives was modified to provide additional guidance for situations when a derivative is redesignated into another effective hedging relationship.</td>
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<tr>
<td>Section</td>
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<tr>
<td>Index</td>
<td>Index to the Manual was updated. These updates have not been “marked” as changes.</td>
</tr>
<tr>
<td>A-440</td>
<td>Deleted paragraphs 8, 9 and 10, and a related drafting note. These paragraphs were not referred to and confused some readers.</td>
</tr>
<tr>
<td>Appendix B</td>
<td>Updated to include interpretations finalized by the Emerging Accounting Issues Working Group through December 8, 2003. The new INTs include: INT 01-32 as amended; INT 02-18; INT 02-22; and INT 03-01 through INT 03-18 (except for INT 03-09 and INT 03-17, and as these were not finalized). This year INT 99-24, INT 01-17 and INT 02-18 were nullified by SSAP No. 89. These updates have not been “marked” as changes in the appendix.</td>
</tr>
<tr>
<td>Appendix C</td>
<td>Actuarial Guideline XXXIV has been revised, and Actuarial Guideline XL has been added as a result of approval by the NAIC Life and Health Actuarial Task Force. The Appendix to the Actuarial Guidelines has also been updated. These updates have not been “marked” as changes in the appendix.</td>
</tr>
<tr>
<td>Appendix D</td>
<td>Listing updated to reflect current status of GAAP pronouncements as of December 2003 (May 25, 2003 for Opinions of the FASB Emerging Issues Task Force). These updates have not been “marked” as changes in the appendix.</td>
</tr>
<tr>
<td>Appendix E</td>
<td>Reflects nonsubstantive modifications made to Issue Paper No. 99 for GAAP guidance rejected by the Statutory Accounting Principles Working Group as not applicable to statutory accounting through December 8, 2003.</td>
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**Substantive Modifications**

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<td>SSAP No. 8</td>
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<td>SSAP No. 89</td>
<td>New SSAP that provides statutory accounting guidance for accounting for pensions.</td>
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<td>IP No. 123</td>
<td>New issue paper that provides background information and support for SSAP No. 89.</td>
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Statutory Accounting Principles

Preamble

I. Accounting Practices and Procedures Promulgated by the NAIC

1. The NAIC, through its committees and working groups, facilitates many projects of importance to the insurance regulators, industry, and users of statutory financial information. That is evidenced by the mission statement and charges of the NAIC Accounting Practices and Procedures (EX4) Task Force of the Financial Condition (EX4) Committee (Accounting Practices and Procedures Task Force).

2. The mission of the Accounting Practices and Procedures Task Force is to identify, investigate and develop solutions to accounting problems with the ultimate goal of guiding insurers in properly accounting for various aspects of their operations and to modify the NAIC Accounting Practices and Procedures Manuals for Property and Casualty Insurance Companies, for Life, Accident and Health Insurance Companies, and for Health Maintenance Organizations (Accounting Practices and Procedures manuals) to reflect changes necessitated by task force action and to study innovative insurer accounting practices which affect the ability of regulators to determine the true financial condition of insurers.

3. To carry out the mission, the Accounting Practices and Procedures Task Force is charged with carrying out the following initiatives:

   • Provide authoritative guidance to insurance regulators on current statutory accounting issues.

   • Continue evaluation of statutory accounting principles for purposes of development, expansion and codification.

   • Extend evaluation of statutory accounting principles to address areas specific to health entities.

   • The Codification of Statutory Accounting Principles Working Group (Statutory Accounting Principles Working Group as of January 1, 2000) will maintain codified statutory accounting principles by providing periodic updates to the guidance which address new statutory issues and new generally accepted accounting principles (GAAP) pronouncements as they develop.

4. This comprehensive guide to Statutory Accounting Principles, composed of the Preamble, the Statements of Statutory Accounting Principles (SSAPs), and the Appendices, is intended to respond to the initiatives noted above. The guide and interpretations of the Emerging Accounting Issues Working Group shall be referred to as the Accounting Practices and Procedures Manual - version effective January 1, 2001 (during the transition period until the 1998 version is no longer maintained and updated by the NAIC). The 1998 version of the Accounting Practices and Procedures Manual will be maintained and published until December 31, 2000. However, this Manual is not intended to preempt states’ legislative and regulatory authority. It is intended to establish a comprehensive basis of accounting recognized and adhered to if not in conflict with state statutes and/or regulations, or when the state statutes and/or regulations are silent.

5. The principles established by this Manual are effective January 1, 2001. Accounting changes adopted to conform to the provisions of these statements shall be reported as adjustments to unassigned funds (surplus) in the period of the change in accounting principle; however, specific effective dates, and transition or grandfathering rules, if any, are contained in each SSAP.
II. Background

A. An Accounting Environment for Insurance Companies

6. Accounting is the process of accumulating and reporting financial information about an economic unit or group of units. Relative to commercial enterprises, the users of accounting information include management, investors, potential investors, lenders, investment analysts, regulators, and customers. Although customers of most commercial enterprises have no direct financial interest therein and generally are only concerned with the price to be paid for the product or service purchased, they may use accounting information to make choices as to the entity with which they engage in a business transaction. This is particularly relevant to purchases of insurance products inasmuch as insurance contracts involve a promise to pay which may extend years into the future. Insurance products may provide benefits well in excess of the purchase price or premium. The benefits ultimately received are almost always greater than the price (premium) paid and can only be estimated at the time the product (policy) is purchased.

7. Insurance is regulated on a state by state basis in the United States. Each state has its own regulatory framework generally led by an insurance commissioner. Insurance commissioners are charged with overseeing the financial condition of insurance companies doing business in their jurisdictions and they require meaningful financial, statistical, and operating information about the companies. This financial oversight is designed to help ensure that policyholders and claimants receive the requisite benefits from the policies sold, often times such products having been sold years or decades prior to when the benefits are due. Frequently, this regulatory perspective differs markedly from the perspectives of other users of insurers’ accounting information. In recognition of these special concerns and responsibilities, statutory accounting principles have been established by statute, regulation, and practice.

B. Statutory Accounting Principles (SAP)

8. In simplest terms, SAP has been those accounting principles or practices prescribed or permitted by an insurer’s domiciliary state. Statutory accounting practices have been interspersed in the insurance laws, regulations, and administrative rulings of each state, the Accounting Practices and Procedures manuals, the Annual Statement Instructions, the NAIC Financial Condition Examiners Handbook, the NAIC Purposes and Procedures of the Securities Valuation Office manual, and NAIC committee, task force, and working group minutes. In addition, there are many statutory practices widely accepted by both insurers and regulators which have never been codified.

9. SAP is conservative in some respects but not unreasonably conservative over the span of economic cycles, or in recognition of the primary statutory responsibility to regulate for financial solvency. SAP attempts to determine at the financial statement date an insurer’s ability to satisfy its obligations to its policyholders and creditors.

C. Comparison Of GAAP And SAP

10. The objectives of GAAP reporting differ from the objectives of SAP. GAAP is designed to meet the varying needs of the different users of financial statements. SAP is designed to address the concerns of regulators, who are the primary users of statutory financial statements. As a result, GAAP stresses measurement of emerging earnings of a business from period to period, (i.e., matching revenue to expense), while SAP stresses measurement of ability to pay claims in the future. This difference is illustrated by the fact that statutory policy reserves are intentionally established on a conservative basis emphasizing the long-term nature of the liabilities. Under GAAP, the experience expected by each company, with provision for the risk of adverse deviation, is used to determine the reserves it will establish for its policies. GAAP reserves may be more or less than the statutory policy reserves.
Preamble

11. Some other differences between SAP and GAAP have included:

- GAAP has recognized certain assets which, for statutory purposes, have been either nonadmitted or immediately expensed. Policy acquisition costs are expensed as incurred under SAP since the funds so expended are no longer available to pay future liabilities. Insurance company financial statements prepared in accordance with GAAP defer costs incurred in the acquisition of new business and amortize them over the premium recognition period.

- Deferred income taxes have, historically, not been recognized under SAP.

- The methods of accounting for certain aspects of reinsurance under GAAP may have varied from SAP, e.g., credit for reinsurance in unauthorized companies.

D. Purpose of Codification

12. The purpose of the codification of statutory accounting principles is to produce a comprehensive guide to SAP for use by insurance departments, insurers, and auditors. Statutory accounting principles, as they existed prior to codification did not always provide a consistent and comprehensive basis of accounting and reporting. The prescribed or permitted statutory accounting model resulted in practices that could have varied from state to state. Insurance companies were sometimes uncertain about what rules to follow and regulators were sometimes unfamiliar with the accounting rules followed by insurers in other states. As a result, insurers’ financial statements were not always prepared on a comparable basis.

13. In engaging this project, it was necessary to revisit principles that had been developed over a long period of time and to consider recently identified accounting issues not currently addressed by SAP. In many cases, previously available choices of accounting methods were eliminated. Also considered was the current state of the regulatory environment and the tools more recently developed, such as risk-based capital (RBC). These new financial analytical tools allowed for a reconsideration of the level of conservatism necessary to achieve regulatory objectives.

14. The Codification project will result in more complete disclosures and more comparable financial statements, which will make the insurance departments’ analysis techniques more meaningful and effective. The project will provide examiners and analysts with uniform accounting rules against which companies’ financial statements can be evaluated. RBC, an important tool used by the states to measure solvency of insurers, will be reported more consistently with the benefit of codification.

E. History of Codification

15. In 1989, the NAIC adopted a Solvency Agenda designed to enhance the ability of state regulators to protect insurance consumers from the financial trauma of insurer insolvency. In recognition of the fact that enhancement of solvency regulation is an ongoing process, the agenda was updated in 1991. Since 1991, most major initiatives of the 1991 Solvency Agenda have been accomplished. They include: 1) revision of the NAIC Financial Condition Examiners Handbook, 2) development of a risk-based capital approach to define required levels of capital and surplus, 3) development of a model law on authorized insurer investments, 4) creation of a centralized financial analysis unit to perform comprehensive analysis of insurance companies who may be troubled, 5) development of computerized analytical routines for use by state insurance departments, and 6) creation of an NAIC education fund.

16. The codification project is also a direct result of the 1991 Solvency Agenda. The goal was “evaluation of existing statutory accounting principles as presently outlined in the Accounting Practices and Procedures Manual for purposes of further development, expansion, and codification.”
17. Beginning in 1994, the NAIC’s efforts to codify SAP were strengthened and reorganized recognizing the need for expediency. There was both a commitment of substantial financial resources as well as the selection of a team of dedicated regulators who were willing to commit the time and effort necessary to accomplish one of the most significant undertakings that has been faced by the NAIC.

18. Recognition of this effort was given by the AICPA when in 1995 they issued Statement of Position 95-5—Auditor’s Report on Statutory Financial Statements of Insurance Enterprises (SOP 95-5) so that an auditor’s opinion on a “prescribed or permitted” basis could continue until codification was completed. SOP 95-5 states “The codification is expected to result in a hierarchy of statutory accounting practices that will provide a comprehensive basis of accounting that can be applied consistently to all insurance enterprises.” At that time, it was believed that once Codification was effective, in order for certified public accountants (CPAs) to issue opinions on statutory statements, SAP had to be considered an “Other Comprehensive Basis of Accounting” (OCBOA) by the American Institute of Certified Public Accountants (AICPA).

19. Codification is not intended to preempt state legislative and regulatory authority. While Codification is expected to be the foundation of a state’s statutory accounting practices, it may be subject to modification by practices prescribed or permitted by a state’s insurance commissioner. Statutory financial statements will continue to be prepared on the basis of accounting practices prescribed or permitted by the states. As a result, in 1998 the AICPA’s Insurance Companies Committee determined that it will not be necessary for the Auditing Standards Board to grant the Codification status as an OCBOA since it will not be the sole basis for preparing statutory financial statements. Further, auditors will be permitted to continue to provide audit opinions on practices prescribed or permitted by the insurance department of the state of domicile.

F. Scope of Project

20. The conceptual framework used in developing and maintaining statutory accounting principles for insurance companies is summarized in the Statutory Accounting Principles Statement of Concepts. The application of the concepts of conservatism, consistency and recognition assure that guidance developed and codified as part of this project is consistent with the underlying objectives of statutory accounting.

21. This Guide has been developed using the body of statutory accounting principles as prescribed in the statutory hierarchy of accounting guidance, which is incorporated into the Statement of Concepts. This hierarchy provides the guidance for judging the presentation of statutory financial statements in conformance with statutory accounting principles.
III. Statutory Accounting Principles Statement of Concepts

Purpose of Statement of Concepts for Statutory Accounting Principles

22. This document states the fundamental concepts on which statutory financial accounting and reporting standards are based. These concepts provide a framework to guide the National Association of Insurance Commissioners (“NAIC”) in the continued development and maintenance of statutory accounting principles (“SAP” or “statutory basis”) and, as such, these concepts and principles constitute an accounting basis for the preparation and issuance of statutory financial statements by insurance companies in the absence of state statutes and/or regulations.1

23. The NAIC and state insurance departments are primarily concerned with statutory accounting principles that differ from GAAP reflective of the varying objectives of regulation. Recodification of areas where SAP and GAAP are parallel is an inefficient use of limited resources.

24. SAP utilizes the framework established by GAAP.2 This document integrates that framework with objectives exclusive to statutory accounting. The NAIC’s guidance on SAP is comprehensive for those principles that differ from GAAP based on the concepts of statutory accounting outlined herein. Those GAAP pronouncements that are not applicable to insurance companies will not be adopted by the NAIC. For those principles that do not differ from GAAP, the NAIC may specifically adopt those GAAP Pronouncements to be included in statutory accounting. GAAP Pronouncements do not become part of SAP until and unless adopted by the NAIC.

25. The body of statutory accounting principles is prescribed in the statutory hierarchy of accounting guidance. This hierarchy provides the framework for judging the presentation of statutory financial statements in conformance with statutory accounting principles.

26. Statutory requirements vary from state to state. While it is desirable to minimize these variations, to the extent that they exist it is the objective of NAIC statutory accounting principles to provide the standard against which the exceptions will be measured and disclosed if material.

Objectives of Statutory Financial Reporting

27. The primary responsibility of each state insurance department is to regulate insurance companies in accordance with state laws with an emphasis on solvency for the protection of policyholders. The ultimate objective of solvency regulation is to ensure that policyholder, contract holder and other legal

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1As stated in the NAIC’s constitution, the NAIC is an association of chief insurance regulatory officials of the 50 states, the District of Columbia, American Samoa, Guam, Puerto Rico, and the Virgin Islands whose objective is to serve the public by assisting several state insurance supervisory officials, individually and collectively, in achieving the following fundamental insurance regulatory objectives:

1. Maintenance and improvement of state regulation of insurance in a responsive and efficient manner;

2. Reliability of the insurance institution as to financial solidity and guaranty against loss;

3. Fair, just, and equitable treatment of policyholders and claimants.

2The GAAP framework applicable to insurance accounting is set forth in Statements of Financial Accounting Concepts One, Two, Five, and Six. These documents, promulgated by the Financial Accounting Standards Board, set forth the objectives and concepts which are used in developing accounting and reporting standards.
obligations are met when they come due and that companies maintain capital and surplus at all times and in such forms as required by statute to provide an adequate margin of safety. The cornerstone of solvency measurement is financial reporting. Therefore, the regulator’s ability to effectively determine relative financial condition using financial statements is of paramount importance to the protection of policyholders. An accounting model based on the concepts of conservatism, consistency, and recognition is essential to useful statutory financial reporting.

28. Statutory reporting applies to all insurers authorized to do business in the United States and its territories, and requires sufficient information to meet the statutory objectives. However, statutory reporting as contained in this guide is not intended to preempt state legislative and regulatory authority. The SAP financial statements include the balance sheet and related summary of operations, changes in capital and surplus, and cash flow statements. Because these basic financial statements cannot be expected to provide all of the information necessary to evaluate an entity’s short-term and long-term stability, management must supplement the financial statements with sufficient disclosures (e.g., notes to financial statements, management’s discussion and analysis, and supplementary schedules and exhibits) to assist financial statement users in evaluating the information provided.

Concepts

Conservatism

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

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

Consistency

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

Recognition

32. The principal focus of solvency measurement is determination of financial condition through analysis of the balance sheet. However, protection of the policyholders can only be maintained through continued monitoring of the financial condition of the insurance enterprise. Operating performance is another indicator of an enterprise’s ability to maintain itself as a going concern. Accordingly, the income statement is a secondary focus of statutory accounting and should not be diminished in importance to the extent contemplated by a liquidation basis of accounting.
33. The ability to meet policyholder obligations is predicated on the existence of readily marketable assets available when both current and future obligations are due. Assets having economic value other than those which can be used to fulfill policyholder obligations, or those assets which are unavailable due to encumbrances or other third party interests should not be recognized on the balance sheet but rather should be charged against surplus when acquired or when availability otherwise becomes questionable.

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

35. Revenue should be recognized only as the earnings process of the underlying underwriting or investment business is completed. Accounting treatments which tend to defer expense recognition do not generally represent acceptable SAP treatment.

36. SAP income reflects the extent that changes have occurred in SAP assets and liabilities for current period transactions, except changes in capital resulting from receipts or distributions to owners. SAP income also excludes certain other direct charges to surplus which are not directly attributable to the earnings process (e.g., changes in nonadmitted assets).

Conclusion

37. This document states the fundamental concepts for financial statements presented on the basis of SAP. These concepts summarize the conceptual framework that the NAIC uses in developing and maintaining statutory accounting principles for insurance companies. These concepts will also assure that guidance will be provided consistently with the underlying objectives of statutory accounting and will aid in the review of emerging accounting issues.

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

The following Hierarchy is not intended to preempt state legislative and regulatory authority.

Level 1:

- SSAPs including GAAP reference material Categories a, b and c from the GAAP Hierarchy, as defined in *Statement of Auditing Standards No. 69, The Meaning of Present Fairly In Conformity with GAAP* (SAS 69), to the extent it has been adopted by the NAIC and in the order of hierarchy specified by the AICPA.
  - Category a includes: FASB Statements and Interpretations, APB Opinions, and AICPA Accounting Research Bulletins.
  - Category b includes: FASB Technical Bulletins, AICPA Industry Audit and Accounting Guides, and AICPA Statements of Position.
  - Category c includes: Consensus positions of the FASB Emerging Issues Task Force and AICPA Practice Bulletins.

Level 2:

- Consensus positions of the Emerging Accounting Issues Working Group as adopted by the NAIC

Level 3:

- NAIC Annual Statement Instructions
- NAIC *Purposes and Procedures of the Securities Valuation Office* manual

Level 4:

- Statutory Accounting Principles Statement of Concepts

Level 5:

- GAAP reference material below category c in the GAAP Hierarchy

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3 The Statutory Accounting Principles Statement of Concepts incorporates by reference FASB Concepts Statements One, Two, Five and Six to the extent they do not conflict with the concepts outlined in the statement. However, for purposes of applying this hierarchy the FASB Concepts Statements shall be included in Level 5 and only those concepts unique to statutory accounting as stated in the statement are included in Level 4.
39. If the accounting treatment of a transaction or event is not specified by the SSAPs, preparers, regulators and auditors of statutory financial statements should consider whether the accounting treatment is specified by another source of established statutory accounting principles. If an established statutory accounting principle from one or more sources in Level 2 or 3 is relevant to the circumstances, the preparer, regulator or auditor should apply such principle. If there is a conflict between statutory accounting principles from one or more sources in Level 2 or 3, the preparer, regulator or auditor should follow the treatment specified by the source in the higher level—that is, follow Level 2 treatment over Level 3.

40. Because of developments such as new legislation or the evolution of a new type of business transaction, there sometimes are no established statutory accounting principles for reporting a specific transaction or event. In those instances, it might be possible to report the event or transaction on the basis of its substance by selecting a statutory accounting principle that appears appropriate when applied in a manner similar to the application of an established statutory principle to an analogous transaction or event. In the absence of a SSAP or another source of established statutory accounting principles, the preparer, regulator or auditor of statutory financial statements may consider other accounting literature, depending on its relevance in the circumstances. Other accounting literature includes the Statutory Accounting Principles Statement of Concepts and GAAP reference material and accounting literature below category c in the GAAP hierarchy as defined in SAS 69. The appropriateness of other accounting literature depends on its relevance to the particular circumstances, the specificity of the guidance, and the general recognition of the issuer or author as an authority. For example, the Statutory Accounting Principles Statement of Concepts would be more authoritative than any other sources of accounting literature. Similarly, FASB Concepts Statements would normally be more influential than other sources below category d in the GAAP hierarchy.

V. Statements of Statutory Accounting Principles

41. This Manual consists primarily of Statements of Statutory Accounting Principles (SSAPs). SSAPs are the primary Accounting Practices and Procedures promulgated by the NAIC. These statements are the result of issue papers that have been exposed for public comment and finalized. Finalized issue papers are in Appendix E. While it is not intended that there be any significant differences between an underlying issue paper and the resultant SSAP, if differences exist, the SSAP prevails and shall be considered definitive.

42. SSAPs designated as Common Area apply to all insurers. Although the nomenclature or terms provided in the prescribed annual statement forms may vary among different types of insurers, only one set of nomenclature or terms may have been used in the SSAP. For example, the Statement of Income found in the Property and Casualty Annual Statement shall be considered as synonymous with the Summary of Operations found in the Life and Health Annual Statement.

43. Once promulgated, statements will only be amended or superseded through the issuance of new SSAP pronouncements. If it is necessary to modify or augment the guidance in a SSAP, a new statement will be promulgated. A useful tool for tracking of the relationships between statements is contained in the “Status” section of each statement which includes sections labeled “Affects” and “Affected By.” As SSAPs are issued in the future that modify or augment the guidance previously provided, these sections will identify the relationships between statements.

VI. Materiality

44. Those who make accounting decisions and those who make judgments as regulators and auditors continually confront the need to make judgments about materiality. Materiality judgments are primarily

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4 As specified by AU Section 411, paragraph 11.
quantitative in nature. They pose the question: Is this item large enough for users of the information to be
influenced by it? However, the answer to that question will usually be affected by the nature of the item;
items too small to be thought material if they result from routine transactions may be considered material
if they arise in abnormal circumstances.

45. Materiality judgments are concerned with screens or thresholds. Is an item, an error, or an
omission large enough, considering its nature and the attendant circumstances, to pass over the threshold
that separates material from immaterial items? The more important a judgment item is, the finer the screen
should be that will be used to determine whether it is material. For example:

- Circumstances where an accounting adjustment puts an insurer in danger of being in
  breach of a covenant or regulatory requirement may justify a lower materiality threshold
  than if its position were stronger. For example, an error resulting from an insurer
  incorrectly reporting certain nonadmitted assets as admitted assets might be considered
  material if the classification of those assets as nonadmitted would cause the insurer to
  trigger an event under the Risk-Based Capital requirements.

- A failure to disclose separately a nonrecurrent item of revenue may be material at a lower
  threshold than would otherwise be the case if the revenue turns a loss into a profit or
  reverses the trend of earnings from a downward to an upward trend.

- A miscategorization of assets or liabilities that would not be material in amount to the
  basic financial statements, but would cause the insurer to trigger an event under the Risk-
  Based Capital requirements, might be material.

- Amounts too small to warrant disclosure or correction in normal circumstances may be
  considered material if they arise from abnormal or unusual transactions or events.

46. Almost always, the relative rather than the absolute size of a judgment item determines whether it
should be considered material in a given situation. Losses from bad debts that could be shrugged off as
routine by a large insurer may threaten the continued existence of a small one. An error in reserve
valuation may be material in a small insurer for which it cut earnings in half but immaterial in an insurer
for which it might make a barely perceptible ripple in the earnings.

47. Another factor in materiality judgments is the degree of precision that is attainable in estimating
the judgment item. The amount of deviation that is considered immaterial may increase as the attainable
degree of precision decreases. For example, accounts payable usually can be estimated more accurately
than can contingent liabilities arising from litigation or threats of it, and a deviation considered to be
material in the first case may be quite trivial in the second.

48. Individual judgments are required to assess materiality. The essence of the materiality concept is
clear. The omission or misstatement of an item in a statutory financial statement is material if, in the light
of surrounding circumstances, the magnitude of the item is such that it is probable that the judgment of a
reasonable person relying upon the statutory financial statement would have been changed or influenced
by the inclusion or correction of the item.

49. The provisions of this Manual need not be applied to immaterial items.

VII. Relationship to GAAP

50. As expressed in the Statement of Concepts, SAP utilizes the framework established by GAAP.
This Manual integrates that framework with objectives exclusive to statutory accounting. The NAIC’s
guidance on SAP is comprehensive for those principles that differ from GAAP based on the concepts of
statutory accounting outlined herein. Those GAAP pronouncements that are not applicable to insurance
companies will not be adopted by the NAIC. For those principles that do not differ from GAAP, the NAIC may specifically adopt those GAAP Pronouncements to be included in statutory accounting. GAAP Pronouncements do not become part of SAP until and unless adopted by the NAIC. GAAP pronouncements that have been considered in the development of SAP include all issued pronouncements in categories a, b and c of the GAAP Hierarchy. Future SAP pronouncements will specifically identify any GAAP pronouncements that are to be included in SAP whether in whole, in part, or with modification as well as any GAAP pronouncements that are rejected. Future GAAP pronouncements which SAP has not yet addressed shall not be considered as providing authoritative statutory guidance.

VIII. Relationship to Developments within NAIC

51. Various NAIC committees and their working groups will be involved in issues, at any point in time, that could impact accounting guidance. Recommendations that affect accounting guidance must be referred to the Accounting Practices and Procedures (EX4) Task Force which has the responsibility for the maintenance of this Manual for determination of appropriate inclusion in SAP.

52. There are instances where the Codification of Statutory Accounting Principles Working Group (Statutory Accounting Principles Working Group as of January 1, 2000) has established an accounting principle in a SSAP but deferred maintenance and update of the detailed guidance to other NAIC task forces and their working groups. Those instances are specifically set forth in the individual SSAPs and include specific guidance for calculation of the Interest Maintenance Reserve (IMR), the Asset Valuation Reserve (AVR), the provision for overdue reinsurance, and periodic update to the NAIC Purposes and Procedures of the Securities Valuation Office manual.

53. Changes to statutory accounting principles are not authoritative until approved by the general membership of the NAIC.

IX. Financial Statements

A. Annual Financial Statement

54. Each state requires all insurance companies doing business in that state to file an annual financial statement. All states use the annual statement blank promulgated by the NAIC, but each state retains the authority to make changes in those statements. Changes made by states generally require only supplemental information and do not change the basic financial information.

55. To the extent that disclosures required by a SSAP are made within specific notes, schedules, or exhibits to the annual statement, those disclosures are not required to be duplicated in a separate note. Annual statutory financial statements which are not accompanied by annual statement exhibits and schedules (e.g., annual audit report) shall include all disclosures required by the SSAPs based on the applicability, materiality and significance of the item to the insurer. Certain disclosures, as noted in individual SSAPs, are required in the annual audited statutory financial statements only.
B. Interim Financial Statements

56. Interim financial statements, including quarterly statements, shall follow the form and content of presentation prescribed by the domiciliary state for the quarterly financial statements. The NAIC quarterly statement form has been adopted by each state with minor variations as required by certain states.

57. The interim financial information shall include disclosures sufficient to make the information presented not misleading. It may be presumed that the users of the interim financial information have read or have access to the annual statement for the preceding period and that the adequacy of additional disclosure needed for a fair presentation, except in regard to material contingencies may be determined in that context. Accordingly, footnote disclosure which would substantially duplicate the disclosure contained in the most recent annual statement or audited financial statements, such as a statement of significant accounting policies and practices, details of accounts which have not changed significantly in amount or composition since the end of the most recently completed fiscal year, may be omitted. However, disclosure shall be provided where events subsequent to the end of the most recent fiscal year have occurred which have a material impact on the insurer. Disclosures shall encompass, for example, significant changes since the end of the period reported on the last annual statement in such items as: statutory accounting principles and practices, estimates inherent in the preparation of financial statements, status of long term contracts, capitalization including significant new borrowings or modifications of existing financial arrangements, and the reporting entity resulting from business combinations or dispositions. Notwithstanding the above, where material noninsurance contingencies exist, disclosure of such matters shall be provided even though a significant change since year end may not have occurred.
Statement of Statutory Accounting Principles No. 1

Disclosure of Accounting Policies, Risks & Uncertainties, and Other Disclosures

STATUS

Type of Issue: Common Area
Issued: Initial Draft
Effective Date: January 1, 2001
Affects: No other pronouncements
Affected by: No other pronouncements
Interpreted by: INT 01-32

SCOPE OF STATEMENT

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Accounting Policies and Practices
Risks and Uncertainties
Other Disclosures
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Relevant Literature
Effective Date and Transition

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

RELEVANT ISSUE PAPERS
Disclosure of Accounting Policies, Risks & Uncertainties, and Other Disclosures

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for the disclosure of accounting policies, risks and uncertainties, the use of accounting practices which depart from NAIC statutory accounting practices and procedures, and other disclosures.

2. Separate statements of statutory accounting principles have disclosure requirements specific to the topics addressed in those statements. Additional disclosure requirements not addressed in other statements are included herein.

SUMMARY CONCLUSION

3. Refer to the preamble for further discussion of disclosure requirements. The disclosures required under paragraph 6 concerning changes in accounting policies shall be made for each financial statement presented. The disclosures required under paragraphs 9, 10, 12, 13, 14, 15 and 16 shall be included in the annual audited statutory financial reports only.

Accounting Policies and Practices

4. Accounting policies are defined as the specific accounting principles and the methods of applying those principles that are utilized in preparing the statutory financial statements.

5. Disclosure shall be made of all accounting policies that affect the assets, liabilities, capital and surplus or results of operations of the reporting entity. The disclosure shall encompass important judgments as to the appropriateness of principles relating to recognition of revenue particularly when selecting between acceptable alternatives, or methods particular to the business.

6. Disclosure of accounting policies shall be made in a separate Summary of Significant Accounting Policies as the initial note in the notes to the financial statements. If the reporting entity has changed the accounting policies since the end of its preceding year, the changes shall be disclosed in the quarterly financial statements.

7. NAIC statutory accounting practices and procedures are those that are set forth in the Accounting Practices and Procedures Manual. If a reporting entity employs accounting practices that depart from the NAIC accounting practices and procedures, disclosure of the following information about those accounting practices that affect statutory surplus or risk-based capital shall be made:
   a. A description of the accounting practice;
   b. A statement that the accounting practice differs from NAIC statutory accounting practices and procedures; and
   c. The monetary effect on net income and statutory surplus of using an accounting practice which differs from NAIC statutory accounting practices and procedures.

Appendix A-205 provides an illustration of the disclosure requirements described in paragraph 7.
b. A statement that NAIC statutory accounting practices and procedures do not address the accounting for the transaction.

Risks and Uncertainties

9. Companies shall make disclosures in their financial statements about risks and uncertainties existing as of the date of those statements in the following areas:
   a. Nature of operations;
   b. Use of estimates in the preparation of financial statements;
   c. Certain significant estimates; and
   d. Current vulnerability due to certain concentrations.

Nature of Operations

10. Financial statements shall include a summary of the ownership and relationships of the reporting entity and all affiliated companies, and a description of the major products or services the reporting entity sells or provides and its principal markets, including the locations of those markets. If the entity operates in more than one business, the disclosure should also indicate the relative importance of its operations in each business and the basis for the determination (e.g., assets, revenues, or earnings). Disclosures about the nature of operations need not be quantified; relative importance could be conveyed by use of terms such as predominately, about equally, or major.

Use of Estimates in the Preparation of Financial Statements

11. Financial statements shall include an explanation that the preparation of financial statements in conformity with the Annual Statement Instructions and Accounting Practices and Procedures Manuals requires the use of management’s estimates.

Certain Significant Estimates

12. Disclosure regarding an estimate shall be made when known information available prior to issuance of the financial statements indicates that both of the following criteria are met:
   a. It is at least reasonably possible that the estimate of the effect on the financial statements of a condition, situation, or set of circumstances that existed at the date of the financial statements will change in the near term due to one or more future confirming events; and
   b. The effect of the change would be material to the financial statements.

13. The disclosure shall indicate the nature of the uncertainty and include an indication that it is at least reasonably possible that a change in the estimate will occur in the near term (generally a period of time not to exceed one year from the date of the financial statements). If the estimate involves a loss contingency as defined in SSAP No. 5—Liabilities, Contingencies and Impairments of Assets, the disclosure shall include an estimate of the possible loss or range of loss, or state that such an estimate cannot be made. Reporting entities shall disclose the factors that cause the estimate to be sensitive to change.
Current Vulnerability Due to Certain Concentrations

14. Vulnerability from concentrations arises because an entity is exposed to risk of loss greater than it would have had it mitigated its risk through diversification. Such risks manifest themselves differently, depending on the nature of the concentration, and vary in significance.

15. Financial statements shall disclose the concentrations described in paragraph 16 of this statement if, based on information known to management prior to issuance of the financial statements, all of the following criteria are met:

   a. The concentration exists at the date of the financial statements;

   b. The concentration makes the enterprise vulnerable to the risk of a near-term severe (more than material but less than catastrophic) impact; and

   c. It is at least reasonably possible that the events that could cause the severe impact will occur in the near term.

16. Concentrations, including known group concentrations, described below require disclosure if they meet the criteria of paragraph 15 of this statement. (Group concentrations exist if a number of counterparties or items that have similar economic characteristics collectively expose the reporting entity to a particular kind of risk.) Some concentrations may fall into more than one category:

   a. Concentrations in the volume of business transacted with a particular customer, supplier, or lender. The potential for the severe impact can result, for example, from total or partial loss of the business relationship. For the purposes of this statement, it is always considered at least reasonably possible that any customer will be lost in the near term;

   b. Concentrations in revenue from particular products or services. The potential for severe impact can result, for example, from volume or price changes for a particular source of revenue;

   c. Concentrations in the available sources of labor, services, licenses, or other rights used in the entity’s operations;

   d. Concentrations in the market or geographic area in which an entity conducts its operations. The potential for severe impact can result, for example, from negative effects of the economic and political forces within the market or geographic area. For the purposes of this statement, it is always considered at least reasonably possible that operations located outside an entity’s home country will be disrupted in the near term.

Other Disclosures

17. For each year that a balance sheet is presented, reporting entities shall disclose the following information in the financial statements:

   a. Amounts not recorded in the financial statements that represent segregated funds held for others, the nature of the assets and the related fiduciary responsibilities associated with such assets. One example of such an item is escrow accounts held by title insurance companies; and

   b. The amount and nature of any assets pledged to others as collateral.
18. The financial statements shall disclose forward commitments which are not derivative instruments (e.g., the commitment to purchase a GNMA security two months after the commitment date, or a private placement six months after the commitment date).

**Supplemental Investment Disclosure**

19. For the current year, reporting entities shall disclose the information required by Appendix A-001 - Investments of Insurers. A Summary Investment Schedule and Investment Risk Interrogatories shall be filed with the audited statutory financial statements. The Summary Investment Schedule shall be filed with the Annual Statement whereas the interrogatories shall be filed as a supplement to the Annual Statement by April 1 for the applicable reporting period.

**Relevant Literature**


**Effective Date and Transition**

21. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors.

**AUTHORITATIVE LITERATURE**

**Generally Accepted Accounting Principles**

- *Accounting Principles Board Opinion No. 22, Disclosure of Accounting Policies*
- *Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins, Chapter 2A*
- *AICPA Statement of Position No. 94-5, Disclosures of Certain Matters in the Financial Statements of Insurance Enterprises*
- *AICPA Statement of Position No. 94-6, Disclosures of Certain Significant Risks and Uncertainties*

**RELEVANT ISSUE PAPERS**

- Issue Paper No. 77—Disclosure of Accounting Policies, Risks & Uncertainties, and Other Disclosures
Statement of Statutory Accounting Principles No. 2

Cash, Drafts, and Short-term Investments

STATUS

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Affects: No other pronouncements
Affected by: No other pronouncements
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SCOPE OF STATEMENT

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AUTHORITATIVE LITERATURE

Statutory Accounting

RELEVANT ISSUE PAPERS
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Cash, Drafts, and Short-term Investments

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles and related reporting for cash, drafts, and short-term investments.

SUMMARY CONCLUSION

Cash

2. Cash constitutes a medium of exchange that a bank or other similar financial institution will accept for deposit and allow an immediate credit to the depositor’s account.

3. Also classified as cash for financial statement purposes, although not falling within the above definition of cash, are savings accounts and certificates of deposit in banks or other similar financial institutions with maturity dates within one year or less from the acquisition date, and cash equivalents. Cash equivalents are short-term, highly liquid investments that are both (a) readily convertible to known amounts of cash, and (b) so near their maturity that they present insignificant risk of changes in value because of changes in interest rates. Only investments with original maturities \(^1\) of three months or less qualify under this definition.

4. Cash meets the definition of an asset as defined in SSAP No. 4—Assets and Nonadmitted Assets (SSAP No. 4), and is an admitted asset to the extent it conforms to the requirements of this statement.

Treatment of Negative Cash Balances

5. If a reporting entity has multiple cash accounts, the net amount of all accounts shall be reported jointly. Cash accounts with positive balances shall not be reported separately from cash accounts with negative balances. If in the aggregate, the reporting entity has a net negative cash balance, it shall be reported as a negative asset and shall not be recorded as a liability.

Drafts

6. A draft is defined as an order to pay a sum certain in money. It is signed by the drawer (e.g., the insurance company or its agent), and payable to order or bearer (e.g., the policyholder). When the draft is presented to the drawee (i.e., the bank), it is paid only upon approval by the reporting entity.

7. Drafts and checks have different legal characteristics. A check is payable on demand, whereas a draft must be approved for payment by the reporting entity before it is honored by the bank. Because of these different characteristics, a draft meets the definition of a liability as defined by SSAP No. 5—Liabilities, Contingencies and Impairments of Assets. Outstanding checks are accounted for as a reduction of cash.

8. A reporting entity that utilizes instruments meeting the definition of drafts shall elect one of the following accounting methods:

   a. Draft Issued Method—When a draft is issued, an increase in paid losses and a related decrease in loss reserves is recorded. Drafts that have not been presented for payment and remain outstanding at the balance sheet date are reflected as a liability.

\(^1\) Original maturity means original maturity to the entity holding the investment. For example, both a three-month U.S. Treasury bill and a three-year Treasury note purchased three months from maturity qualify as cash equivalents. However, a Treasury note purchased three years ago does not become a cash equivalent when its remaining maturity is three months.
b. Draft Honored Method—An increase in paid losses and a related decrease in loss reserves is recorded when the draft is presented by the bank to the reporting entity for approval and reimbursement. Consequently, under a draft honored method there is no liability for outstanding drafts.

9. The method elected by a reporting entity to account for drafts issued and outstanding shall remain consistent from year to year. Procedures for changes in the accounting method shall be governed by SSAP No. 3—Accounting Changes and Corrections of Errors (SSAP No. 3).

Short-term Investments

10. All investments with remaining maturities (or repurchase dates under repurchase agreements) of one year or less at the time of acquisition (excluding those investments classified as cash equivalents as defined in paragraph 3) shall be considered short-term investments. Short-term investments include, but are not limited to, bonds, commercial paper, money market instruments, repurchase agreements, and collateral and mortgage loans which meet the above criteria. Short-term investments shall not include certificates of deposit.

11. All short-term investments shall be accounted for in the same manner as similar long-term investments. Investments in money market funds shall be reported in accordance with the guidance in the NAIC Purposes and Procedures of the Securities Valuation Office.

12. Short-term investments meet the definition of assets as defined in SSAP No. 4 and are admitted assets to the extent they conform to the requirements of this statement.

Disclosures

13. The following disclosures shall be made for short-term investments in the financial statements:
   a. Fair values in accordance with SSAP No. 27—Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk, Financial Instruments with Concentrations of Credit Risk and Disclosures about Fair Value of Financial Instruments (SSAP No. 27);
   b. Concentrations of credit risk in accordance with SSAP No. 27;
   c. Basis at which the short-term investments are stated.

14. Refer to the preamble for further discussion regarding disclosure requirements. The disclosures in paragraphs 13 a. and 13 b. above shall be included in the annual audited statutory financial reports only.

Effective Date and Transition

15. This statement is effective for years beginning January 1, 2001. 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.
AUTHORITATIVE LITERATURE

Statutory Accounting

- NAIC Purposes and Procedures of the Securities Valuation Office

RELEVANT ISSUE PAPERS

- Issue Paper No. 2—Definition of Cash
- Issue Paper No. 12—Accounting for Drafts Issued and Outstanding
- Issue Paper No. 28—Short-term Investments
Statement of Statutory Accounting Principles No. 3

Accounting Changes and Corrections of Errors

STATUS

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Accounting Changes and Corrections of Errors

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for changes in accounting, which include changes in accounting principles, estimates, and reporting entities, and for corrections of errors in previously issued financial statements.

SUMMARY CONCLUSION

2. An accounting change is defined as a change in an accounting principle, an accounting estimate, or the reporting entity. The correction of an error in previously issued financial statements is not deemed to be an accounting change. The treatment of a change resulting from an insurance department examination will depend on whether the change resulted from a correction of an error, a change in accounting principle, or a change in estimate.

Change in Accounting Principle

3. A change in accounting principle results from the adoption of an accepted accounting principle, or method of applying the principle, which differs from the principles or methods previously used for reporting purposes. A change in the method of applying an accounting principle shall be considered a change in accounting principle.

4. A characteristic of a change in accounting principle is that it concerns a choice from among two or more statutory accounting principles. However, a change in accounting principle is neither (a) the initial adoption of an accounting principle in recognition of events or transactions occurring for the first time or previously immaterial in their effect, nor (b) the adoption or modification of an accounting principle necessitated by transactions or events that are clearly different in substance from those previously occurring.

5. The cumulative effect of changes in accounting principles shall be reported as adjustments to unassigned funds (surplus) in the period of the change in accounting principle. The cumulative effect is the difference between the amount of capital and surplus at the beginning of the year and the amount of capital and surplus that would have been reported at that date if the new accounting principle had been applied retroactively for all prior periods.

Change in Accounting Estimate

6. Changes in estimates used in accounting are necessary consequences of periodic presentations of financial statements which require estimating the effects of future events. Examples of items for which estimates are necessary include service lives of depreciable assets and changes in loss reserve estimates for property and casualty companies. Accounting estimates change as new events occur, as more experience is acquired, or as additional information is obtained.

7. A change in accounting estimate shall be included in the statement of income in the period when the change becomes known.

8. If the effect of a change in accounting principle is inseparable from the effect of a change in accounting estimate, then the change shall be considered as a change in accounting estimate for purposes of applying the accounting principles set forth in this statement.
Correction of an Error

9. Errors in financial statements result from mathematical mistakes, mistakes in the application of accounting principles, or oversight or misuse of facts that existed at the time the financial statements were prepared. In contrast, a change in accounting estimate results from new information, or subsequent developments and, accordingly, from better insight or improved judgment. Thus, an error is distinguished from a change in estimate.

10. Corrections of errors in previously issued financial statements shall be reported as adjustments to unassigned funds (surplus) in the period an error is detected. If a reporting entity becomes aware of a material error in a previously filed financial statement after it has been submitted to the appropriate regulatory agency, the entity shall file or be directed to file an amended financial statement if approved by its domiciliary regulator.

Impact on Historical Schedules

11. Changes which do not affect assets, liabilities, revenues, expenses, or surplus but which materially affect historical information in the financial statement supplemental schedules (e.g., Schedule P for property and casualty insurers or Schedule O for life and accident and health insurers) shall be reflected in the current year’s schedules with appropriate notations made directly to the affected schedules and in the notes to the financial statements.

Mergers

12. For mergers, prior years’ amounts in the Annual Statement shall be restated as if the merger had occurred as of January 1 of the prior year. Additionally, restatement shall be required for the two most recent years included in the Five Year Historical Summary. The Five Year Historical Summary shall include a footnote indicating that the other three years have not been restated. A reporting entity that merges with an entity which effectively is a shell company (i.e., the reporting entity has no outstanding underwriting liabilities) shall be exempt from the above requirements.

Disclosures

13. Disclosure of material changes in accounting and correction of errors shall include:

   a. A brief description of the change, encompassing a general disclosure of the reason and justification for change or correction;

   b. The impact of the change or correction on net income, surplus, total assets, and total liabilities for the two years presented in the financial statements (i.e., the balance sheet and statement of income and operations); and

   c. The effect on net income of the current period for a change in estimate that affects several future periods, such as a change in the service lives of depreciable assets or actuarial assumptions affecting pension costs. Disclosure of the effect on those income statement amounts is not necessary for estimates made each period in the ordinary course of accounting for items such as uncollectible accounts; however, disclosure is recommended if the effect of a change in the estimate is material; and

   d. When subsequent financial statements are issued containing comparative restated results as a result of the filing of an amended financial statement, the reporting entity shall disclose that the prior period has been restated and the nature and amount of such restatement.
14. Refer to the preamble for further discussion regarding disclosure requirements.

Relevant Literature

15. This statement rejects Accounting Research Bulletin No. 51 and the related AICPA Accounting Interpretation FASB Interpretation No. 46: Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51 (FIN 46), Consolidated Financial Statements and FASB Statement No. 94, Consolidation of All Majority-Owned Subsidiaries, an amendment of ARB 51, with related amendments of APB Opinion No. 18 and ARB No. 43, Chapter 12.

16. This statement rejects paragraphs 1—19 and 26—27 of Accounting Principles Board Opinion No. 9, Reporting the Results of Operations, which address the treatment of extraordinary items and prior period adjustments and the related AICPA Accounting Interpretations, Reporting the Results of Operations: Unofficial Accounting Interpretations of APB Opinion No. 9. This statement also rejects Accounting Principles Board Opinion No. 20, Accounting Changes, AICPA Accounting Interpretations, Accounting Changes: Accounting Interpretations of APB Opinion No. 20, and FASB Interpretation No. 20, Reporting Accounting Changes under AICPA Statements of Position, an interpretation of APB Opinion No. 20. FASB Statement No. 16, Prior Period Adjustments, is rejected as corrections of errors in previously issued financial statements are reported as adjustments to unassigned funds (surplus).

Effective Date and Transition

17. This statement is effective for years beginning January 1, 2001.

RELEVANT ISSUE PAPERS

- Issue Paper No. 1—Consolidation of Majority-owned Subsidiaries
- Issue Paper No. 3—Accounting Changes
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Statement of Statutory Accounting Principles No. 4

Assets and Nonadmitted Assets

STATUS

Type of Issue: Common Area

Issued: Initial Draft

Effective Date: January 1, 2001

Affects: No other pronouncements

Affected by: Paragraph 3 superseded by SSAP No. 87

Interpreted by: INT 01-03, INT 01-31, INT 02-02
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Assets and Nonadmitted Assets

SCOPE OF STATEMENT

1. This statement establishes the definition of an “asset” for use in statutory accounting and establishes the criteria for consistent treatment of nonadmitted assets.

SUMMARY CONCLUSION

2. For purposes of statutory accounting, an asset shall be defined as: probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events. An asset has three essential characteristics: (a) it embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows, (b) a particular entity can obtain the benefit and control others’ access to it, and (c) the transaction or other event giving rise to the entity’s right to or control of the benefit has already occurred. These assets shall then be evaluated to determine whether they are admitted. The criteria used is outlined in paragraph number 3 below.

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

a. Specifically identified within the Accounting Practices and Procedures Manual as a nonadmitted asset; or


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

4. Transactions which do not give rise to assets as defined in paragraph 2 shall be charged to operations in the period the transactions occur. Those transactions which result in amounts which may meet the definition of assets, but are specifically identified within the Accounting Practices and Procedures Manual as not giving rise to assets (e.g., policy acquisition costs), shall also be charged to operations in the period the transactions occur.

FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements, states:

Probable is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in FASB Statement No. 5, Accounting for Contingencies, paragraph. 3), and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved.
Relevant Literature


Effective Date and Transition

6. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors*.

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles


RELEVANT ISSUE PAPERS

- Issue Paper No. 4—Definition of Assets and Nonadmitted Assets
Statement of Statutory Accounting Principles No. 5

Liabilities, Contingencies and Impairments of Assets

STATUS

Type of Issue: Common Area

Issued: Initial Draft

Effective Date: January 1, 2001

Affects: No other pronouncements

Affected by: No other pronouncements

Interpreted by: INT 01-31, INT 01-32

SCOPE OF STATEMENT

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Effective Date and Transition

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

RELEVANT ISSUE PAPERS
Liabilities, Contingencies and Impairments of Assets

SCOPE OF STATEMENT

1. This statement defines and establishes statutory accounting principles for liabilities, contingencies and impairments of assets.

SUMMARY CONCLUSION

Liabilities

2. A liability is defined as certain or probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or to provide services to other entities in the future as a result of a past transaction(s) or event(s).

3. A liability has three essential characteristics: (a) it embodies a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, (b) the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and (c) the transaction or other event obligating the entity has already happened. This includes, but is not limited to, liabilities arising from policyholder obligations (e.g., policyholder benefits, reported claims and reserves for incurred but not reported claims). Liabilities shall be recorded on a reporting entity’s financial statements when incurred.

4. Estimates (e.g., loss reserves) are required in financial statements for many ongoing and recurring activities of a reporting entity. The mere fact that an estimate is involved does not of itself constitute a loss contingency. For example, estimates of losses utilizing appropriate actuarial methodologies meet the definition of liabilities as outlined above and are not loss contingencies.

Loss Contingencies or Impairments of Assets

5. For purposes of implementing the statutory accounting principles of loss contingency or impairment of an asset described below, the following additional definitions shall apply:

   a. Probable—The future event or events are likely to occur;

   b. Reasonably Possible—The chance of the future event or events occurring is more than remote but less than probable;

   c. Remote—The chance of the future event or events occurring is slight.

6. A loss contingency or impairment of an asset is defined as an existing condition, situation, or set of circumstances involving uncertainty as to possible loss to an enterprise that will ultimately be resolved when one or more future event(s) occur or fail to occur (e.g., collection of receivables).

7. An estimated loss from a loss contingency or the impairment of an asset shall be recorded by a charge to operations if both of the following conditions are met:

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1 FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements, states:

Probable is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in FASB Statement 5, Accounting for Contingencies, paragraph 3), and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved.
a. Information available prior to issuance of the statutory financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the statutory financial statements. It is implicit in this condition that it is probable that one or more future events will occur confirming the fact of the loss or incurrence of a liability; and

b. The amount of loss can be reasonably estimated.

8. This accounting shall be followed even though the application of other prescribed statutory accounting principles or valuation criteria may not require, or does not address, the recording of a particular liability or impairment of an asset (e.g., a known impairment of a bond even though the VOS manual has not recognized the impairment).

9. Additionally, in instances where a judgment, assessment or fine has been rendered against a reporting entity, there is a presumption that the criteria in paragraph 7 a. and 7 b. have been met. The amount of the liability shall include the anticipated settlement amount, legal costs, insurance recoveries and other related amounts and shall take into account factors such as the nature of the litigation, progress of the case, opinions of legal counsel, and management’s intended response to the litigation, claim, or assessment.

10. When condition 7 a. above is met with respect to a particular loss contingency, and the reasonable estimate of the loss is a range, which meets condition 7 b. above, an amount shall be accrued for the loss. When an amount within management’s estimate of the range of a loss appears to be a better estimate than any other amount within the range, that amount shall be accrued. When, in management’s opinion, no amount within management’s estimate of the range is a better estimate than any other amount, however, the midpoint (mean) of management’s estimate in the range shall be accrued. For purposes of this paragraph, it is assumed that management can quantify the high end of the range. If management determines that the high end of the range cannot be quantified, then a range does not exist, and management’s best estimate shall be used.

11. The use of the midpoint in a range will be applicable only in the rare instance where there is a continuous range of possible values, and no amount within that range is any more probable than any other. This guidance is not applicable when there are several point estimates which have been determined as equally possible values, but those point estimates do not constitute a range. If there are several point estimates with equal probabilities, management should determine their best estimate of the liability.

**Gain Contingencies**

12. A gain is defined as an increase in surplus which results from peripheral or incidental transactions of a reporting entity and from all other transactions and other events and circumstances affecting the reporting entity except those that result from revenues or investments by owners. If, on or before the balance sheet date, (a) the transaction or event has been fully completed, and (b) the amount of the gain is determinable, then the transaction or event is considered a gain, and is recognized in the financial statements. The definition of a gain excludes increases in surplus that result from activities that constitute a reporting entity’s ongoing major or central operations or activities. Because investment activities are central to an insurer’s operations, increases in surplus that result from such investment activities are excluded from the definition of gains. Revenues are inflows or other enhancements of assets of a reporting entity or settlements of its liabilities (or a combination of both) from providing products, rendering services, or other activities that constitute the reporting entity’s ongoing major or central operations. Investments by owners include any type of capital infused into the surplus of the reporting entity.

13. A gain contingency is defined as an existing condition, situation, or set of circumstances involving uncertainty as to possible gain (as defined in the preceding paragraph) to an enterprise that will
ultimately be resolved when one or more future events occur or fail to occur (e.g., a plaintiff has filed suit for damages associated with an event occurring prior to the balance sheet, but the outcome of the suit is not known as of the balance sheet date). Gain contingencies shall not be recognized in a reporting entity’s financial statements. However, if subsequent to the balance sheet date but prior to the issuance of the financial statements, the gain contingency is realized, the gain shall be disclosed in the notes to financial statements and the unissued financial statements should not be adjusted to record the gain. A gain is generally considered realizable when noncash resources or rights are readily convertible to known amounts of cash or claims to cash.

**Disclosures**

14. If a loss contingency or impairment of an asset is not recorded because only one of the conditions 7 a. or 7 b. is met, or if exposure to a loss exists in excess of the amount accrued pursuant to the provisions described above, disclosure of the loss contingency or impairment of the asset shall be made in the financial statements when there is at least a reasonable possibility that a loss or an additional loss may have been incurred. The disclosure shall indicate the nature of the contingency and shall give an estimate of the possible loss or range of loss or state that such an estimate cannot be made.

15. Disclosure is not required of a loss contingency involving an unasserted claim or assessment when there has been no manifestation by a potential claimant of an awareness of a possible claim or assessment unless it is considered probable that a claim will be asserted and there is a reasonable possibility that the outcome will be unfavorable.

16. Certain loss contingencies, the common characteristic of each being a guarantee, shall be disclosed in financial statements even though the possibility of loss may be remote. Examples include (a) guarantees of indebtedness of others, and (b) guarantees to repurchase receivables (or, in some cases, to repurchase related properties) that have been sold or otherwise assigned. The disclosure of those loss contingencies, and others that in substance have the same characteristics, shall be applied to statutory financial statements. The disclosure shall include the nature and amount of the guarantee. Consideration shall be given to disclosing, if estimable, the value of any recovery that could be expected to result, such as from the guarantor’s right to proceed against an outside party.

17. The financial statements shall contain adequate disclosure about the nature of any gain contingency. However, care should be exercised to avoid misleading implications as to the likelihood of realization.

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

**Relevant Literature**

19. This statement adopts *FASB Statement No. 5, Accounting for Contingencies* (FAS 5), *FASB Statement 114, Accounting by Creditors for Impairment of a Loan* only as it amends in part FAS 5 and paragraphs 35 and 36 of *FASB Statement of Financial Accounting Concepts No. 6—Elements of Financial Statements*. *FASB Interpretation No. 14, Reasonable Estimation of the Amount of a Loss, An Interpretation of FASB Statement No. 5* (FIN No. 14) is adopted with the modification to accrue the loss amount as the midpoint of the range rather than the minimum as discussed in paragraph 3 of FIN No. 14. This statement also adopts *FASB Interpretation No. 34, Disclosure of Indirect Guarantees of Indebtedness of Others, An interpretation of FASB Statement No. 5 and Accounting Principles Board Opinion No. 12, Omnibus Opinion—1967*, paragraphs 2 and 3 with the modification that AVR, IMR and Schedule F Penalty shall be shown gross. Appropriation of retained earnings discussed in paragraph 15 of FAS 5 is addressed in *SSAP No. 72—Surplus and Quasi-reorganizations*. 

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Effective Date and Transition

20. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors.

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

- FASB Statement No. 5, Accounting for Contingencies
- FASB Statement No. 114, Accounting by Creditors for Impairment of a Loan
- FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements
- FASB Interpretation No. 14, Reasonable Estimation of the Amount of a Loss, An Interpretation of FASB Statement No. 5
- FASB Interpretation No. 34, Disclosure of Indirect Guarantees of Indebtedness of Others, An interpretation of FASB Statement No. 5
- Accounting Principles Board Opinions No. 12, Omnibus Opinion—1967, paragraphs 2 and 3

RELEVANT ISSUE PAPERS

- Issue Paper No. 5—Definition of Liabilities, Loss Contingencies and Impairments of Assets
- Issue Paper No. 20—Gain Contingencies
Statement of Statutory Accounting Principles No. 6

Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers

STATUS

Type of Issue: Common Area
Issued: Initial Draft
Effective Date: January 1, 2001
Affects: No other pronouncements
Affected by: No other pronouncements
Interpreted by: INT 99-27, INT 01-01, INT 02-02

SCOPE OF STATEMENT

SUMMARY CONCLUSION

Determination of Due Date
Impairment
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Effective Date and Transition

RELEVANT ISSUE PAPERS
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Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for direct and group billed uncollected premiums, bills receivable for premiums, and amounts due from agents and brokers (collectively referred to as agents).

2. This statement does not address uncollected and deferred premiums for life considerations.

SUMMARY CONCLUSION

3. Premium transactions conducted directly with the insured result in uncollected premium balances.

4. Bills receivable, which are generally interest bearing, are used by reporting entities as a method of financing premiums.

5. Amounts due from agents result from various transactions ranging from premiums collected by the agents on behalf of the reporting entity to amounts advanced to the agent by the reporting entity to finance agency operations.

6. Uncollected premium balances, bills receivable for premiums, and amounts due from agents 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. Premiums owed by agents shall be reflected net of commissions, if permitted by the contract. Balances resulting from advances to agents, which are primarily encountered in the life insurance industry, are nonadmitted if (a) the amounts are in the form of unsecured loans or advances, (b) the contractual terms for repayment are through application of future renewal commissions and/or other credits, or (c) the terms of repayment do not provide readily available cash for the satisfaction of policyholder liabilities.

Determination of Due Date

7. The due date for all premium balances addressed by this statement is determined as follows:

   a. Original and deposit premiums—governed by the effective date of the underlying insurance contract and not the agent/reporting entity contractual relationship;

   b. Endorsement premiums—governed by the effective date of the insurance policy endorsement;

   c. Installment premiums—governed by the contractual due date of the installment from the insured;

   d. Audit premiums and retrospective premiums—governed by insurance policy or insurance contract provisions. If the due date for receivables relating to these policies is not addressed by insurance policy provisions or insurance contract provisions, any uncollected audit premium (either accrued or billed) is nonadmitted.

8. The provisions of paragraph 7 shall be applied to all balances due except those arising from force placed insurance obtained by a lender for collateral protection, certain policies, known as Trustee Sales Guarantees (TSGs), issued by title insurance companies to lenders on defaulted real estate loans and crop/hail policies. For forced placed insurance policies, the due date for purposes of applying paragraph 9
shall be the date of billing. For TSGs, the due date for purposes of applying paragraph 9 shall be the expiration of the grace period given to the defaulted debtor, which is provided by statute. Crop/hail premiums are considered installment premiums in accordance with paragraph 7 and accordingly, the due date for purposes of applying paragraph 9 shall be governed by the contractual due date of the installment.

**Impairment**

9. Nonadmitted amounts are determined as follows:

   a. Uncollected Premium—To the extent that there is no related unearned premium, any uncollected premium balances which are over ninety days due shall be nonadmitted. If an installment premium is over ninety days due, the amount over ninety days due plus all future installments that have been recorded on that policy shall be nonadmitted;

   b. Bills Receivable—Bills receivable shall be nonadmitted if either of the following conditions are present:

      i. If any installment is past due, the entire bills receivable balance from that policy is nonadmitted; or

      ii. If the bills receivable balance due exceeds the unearned premium on the policy for which the note was accepted, the amount in excess of the unearned premium is nonadmitted.

   c. Agents’ Balances—The uncollected agent’s receivable on a policy by policy basis which is over ninety days due shall be nonadmitted regardless of any unearned premium;

      i. If amounts are both payable to and receivable from an agent on the same underlying policy, and the contractual agreements between the agent and the reporting entity permit offsetting, the nonadmitted portion of amounts due from that agent shall not be greater than the net balance due, by agent;

      ii. If reconciling items between a reporting entity’s account and an agent’s account are over ninety days due, the amounts shall be nonadmitted.

10. After calculation of nonadmitted amounts, an evaluation shall be made of the remaining admitted assets in accordance with SSAP No. 5—Liabilities, Contingencies and Impairments of Assets (SSAP No. 5), to determine if there is impairment. If, in accordance with SSAP No. 5, it is probable the balance is uncollectible, any uncollectible receivable shall be written off and charged to income in the period the determination is made. If it is reasonably possible a portion of the balance is uncollectible and is therefore not written off, disclosure requirements outlined in SSAP No. 5 shall be followed.

11. Amounts classified as nonadmitted assets collected subsequent to the date of the statutory financial statements shall not be used to adjust the nonadmitted asset otherwise calculated.

**Wash Transactions**

12. Amounts due from agents (affiliated or nonaffiliated) that are collected prior to the date of the financial statements and then repaid to the agent by the reporting entity or one of the reporting entity’s affiliates subsequent to the date of the financial statements shall be accounted for in accordance with the substance of the transaction (a wash transaction) and not its form. Accordingly, the payments received shall be accounted for as deposits and a liability shall be established for the same amount. The amounts
due shall be reestablished as an asset and subjected to asset collectibility and nonadmitted asset calculations using the original due date of the receivable.

13. Short-term financing by third parties shall also be considered a wash transaction if the substance of the transaction is to avoid the nonadmitted asset principle set forth in this statement.

Disclosures

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

Effective Date and Transition

15. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors.

RELEVANT ISSUE PAPERS

- Issue Paper No. 6—Amounts Due From Agents and Brokers
- Issue Paper No. 10—Uncollected Premium Balances
- Issue Paper No. 21—Bills Receivable For Premiums
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Statement of Statutory Accounting Principles No. 7

Asset Valuation Reserve and Interest Maintenance Reserve

STATUS

Type of Issue: Life and Accident and Health
Issued: Initial Draft
Effective Date: January 1, 2001
Affects: No other pronouncements
Affected by: No other pronouncements
Interpretated by: No other pronouncements

SCOPE OF STATEMENT

SUMMARY CONCLUSION

Effective Date and Transition

AUTHORITATIVE LITERATURE

Statutory Accounting

RELEVANT ISSUE PAPERS
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Asset Valuation Reserve and Interest Maintenance Reserve

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for an asset valuation reserve (AVR) and an interest maintenance reserve (IMR) for life and accident and health insurance companies, excluding separate accounts. Separate account AVR/IMR reporting is addressed in SSAP No. 56—Separate Accounts.

SUMMARY CONCLUSION

2. Life and accident and health insurance companies shall recognize liabilities for an AVR and an IMR. The AVR is intended to establish a reserve to offset potential credit-related investment losses on all invested asset categories excluding cash, policy loans, premium notes, collateral notes and income receivable. The IMR defers recognition of the realized capital gains and losses resulting from changes in the general level of interest rates. These gains and losses shall be amortized into investment income over the expected remaining life of the investments sold. The IMR also applies to certain liability gains/losses related to changes in interest rates. These gains and losses shall be amortized into investment income over the expected remaining life of the liability released.

3. The IMR and AVR shall be calculated and reported in accordance with the NAIC Annual Statement Instructions for Life and Accident and Health Insurance Companies.

Effective Date and Transition

4. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors.

AUTHORITATIVE LITERATURE

Statutory Accounting

- NAIC Annual Statement Instructions for Life and Accident and Health Insurance Companies

RELEVANT ISSUE PAPERS

- Issue Paper No. 7—Asset Valuation Reserve and Interest Maintenance Reserve
Statement of Statutory Accounting Principles No. 8

Pensions

STATUS

Type of Issue: Common Area

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Effective Date: January 1, 2001

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Interpreted by: INT 99-24, INT 99-26, INT 01-16, INT 01-17, INT 02-18, INT 03-18

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Pensions

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for employers’ pension obligations.

SUMMARY CONCLUSION

Defined Benefit Plans

2. A defined benefit plan defines the amount of the pension benefit that will be provided to the plan participant at retirement or termination. For such benefit plans, reporting entities shall adopt FASB Statement No. 87, Employers’ Accounting for Pensions (FAS 87) with a modification to exclude non-vested employees. Therefore, the cost related to services rendered prior to becoming eligible and vested in the plan are recognized as a component of the net periodic pension cost in the period the employee becomes vested. Any intangible asset or prepaid expense resulting from adoption of the provisions of this statement shall be considered a nonadmitted asset, as such an asset cannot be readily converted to cash to satisfy policyholder obligations.

3. If a reporting entity settles or curtails a defined benefit plan, the reporting entity shall immediately recognize all previously unrecognized amounts as discussed below.

4. A settlement is a transaction which is irrevocable and releases the employer from responsibility for the pension obligation by eliminating the risks relative to the obligation and the assets associated with the plan (e.g., making lump-sum cash payments to plan participants in exchange for their rights to receive specified pension benefits or purchasing nonparticipating annuity contracts to cover vested benefits). If a settlement occurs and the net result is a loss, such loss is recognized at the time of the settlement. If the net result is a gain, such gain is not recognized until the proceeds are received by the reporting entity. When such gains are recognized, any excise tax surcharges shall also be recognized.

5. A curtailment is an event which significantly alters the make up of the pension plan (e.g., a reduction in the years of service required or the employees covered). If a curtailment occurs, there are generally two components to any gain or loss. Any unrecognized prior service cost shall be recognized as a loss. An increase or decrease in pension benefit obligations due to the curtailment will also result in a gain or loss and is combined with the prior service cost loss. If the net result of the curtailment is a loss, such loss shall be recognized when it is probable that the curtailment will occur and that the effects can be reasonably estimated. If the net result is a gain, such gain shall not be recognized in earnings until the employees terminate or the plan suspension or amendment is adopted and the proceeds are received by the reporting entity. When such gains are recognized, any excise tax surcharges shall also be recognized.

Defined Contribution Plans

6. A defined contribution plan defines the amount of the employer’s contributions to the plan and its allocation to plan participants. The pension benefit provided to the plan participant at retirement or termination depends on the amount of employer and employee contributions, earnings on plan investments and, in some plans, other participant forfeitures.

7. For defined contribution plans, the reporting entity shall expense contributions required by the plan over the period in which the employee vests in those contributions. Contributions to plan participants’ accounts made prior to vesting shall be treated as prepaid expenses and shall be nonadmitted. Contributions required after participants terminate or retire shall be accrued and an expense shall be recorded over the working lives of the participants beginning at the date the participant initially vests in plan contributions.
8. Certain defined contribution plans may define the employer’s contribution as a percentage of the plan participants’ individual compensation rather than as a specific dollar amount which is allocated among the plan participants. If an employer’s contributions to a defined contribution plan are in excess of those required under the plan and required to be allocated to individual participants, such amounts are recorded as a prepaid expense and nonadmitted under statutory accounting principles.

Disclosures

9. The following disclosures shall be made for defined benefit pension plans for which the reporting entity is directly liable:

   a. A reconciliation of beginning and ending balances of the benefit obligation showing separately, if applicable, the effects during the period attributable to service cost, interest cost, contributions by plan participants, actuarial gains and losses, foreign currency exchange rate changes, benefits paid, plan amendments, business combinations, divestitures, curtailments, settlements, and special termination benefits;

   b. The amount of the pension obligation for non-vested employees as of the most recent actuarial valuation date;

   c. A reconciliation of beginning and ending balances of the fair value of plan assets showing separately, if applicable, the effects during the period attributable to actual return on plan assets, foreign currency exchange rate changes, contributions by the reporting entity, contributions by plan participants, benefits paid, business combinations, divestitures, and settlements;

   d. The funded status of the plans, the amounts not recognized in the statement of financial position, and the amounts recognized in the statement of financial position, including:

      i. The amount of any unamortized prior service cost;
      
      ii. The amount of any unrecognized net gain or loss (including asset gains and losses not yet reflected in market-related value);
      
      iii. The amount of any remaining unamortized, unrecognized net obligation or net asset existing at the initial date of application of this statement;
      
      iv. The net pension or other postretirement benefit prepaid assets or accrued liabilities; and

      v. Any intangible asset;

   e. The amount of net periodic benefit cost recognized, showing separately the service cost component, the interest cost component, the expected return on plan assets for the period, the amortization of the unrecognized incremental liability or incremental asset (see paragraph 18), the amount of recognized gains and losses, the amount of prior service cost recognized, and the amount of gain or loss recognized due to a settlement or curtailment;

   f. The amount included in income for the period arising from a change in the additional minimum pension liability recognized pursuant to paragraph 37 of FAS 87;
g. On a weighted-average basis, the following assumptions used in the accounting for the plans: assumed discount rate, rate of compensation increase (for pay-related plans), and expected long-term rate of return on plan assets;

h. If applicable, the amounts and types of securities of the reporting entity and related parties included in plan assets, the approximate amount of future annual benefits of plan participants covered by insurance contracts issued by the reporting entity or related parties, and any significant transactions between the reporting entity or related parties and the plan during the period;

i. If applicable, any alternative amortization method used to amortize prior service amounts or unrecognized net gains and losses pursuant to paragraphs 26 and 33 of FAS 87;

j. If applicable, any substantive commitment, such as past practice or a history of regular benefit increases, used as the basis for accounting for the benefit obligation;

k. If applicable, the cost of providing special or contractual termination benefits recognized during the period and a description of the nature of the event; and

l. An explanation of any significant change in the benefit obligation or plan assets not otherwise apparent in the other disclosures required by this statement.

Amounts related to the reporting entity’s results of operations shall be disclosed for each period for which an income statement is presented. Amounts related to the reporting entity’s statement of financial position shall be disclosed for each balance sheet presented.

10. The reporting entity shall disclose the amount of cost recognized for defined contribution pension plans during the period separately from the amount of cost recognized for defined benefit plans. The disclosures shall include a description of the nature and effect of any significant changes during the period affecting comparability, such as a change in the rate of employer contributions, a business combination, or a divestiture.

11. The reporting entity shall disclose the amount of contributions to multiemployer plans during the period. The reporting entity may disclose total contributions to multiemployer plans without disaggregating the amounts attributable to pensions and other postretirement benefits. The disclosures shall include a description of the nature and effect of any changes affecting comparability, such as a change in the rate of employer contributions, a business combination, or a divestiture.

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

Consolidated/Holding Company Plans

13. The employees of many reporting entities are members of a plan sponsored by a parent company or holding company. A reporting entity who participates in these plans and is not directly liable for obligations under the plan shall recognize pension expense equal to its allocation from the holding company or parent company of the required contribution to the plan for the period. A liability shall be established for any such contributions due and unpaid.

14. The reporting entity shall disclose in the financial statements that its employees participate in a plan sponsored by the holding company for which the reporting entity has no legal obligation. The amount of expense incurred and the allocation methodology utilized by the provider of such benefits shall also be disclosed. If the reporting entity is directly liable for obligations under the plan, then the requirements outlined in paragraphs 2 to 12 and 15 to 21 of this statement shall be applied.
Relevant Literature

15. The conclusions in paragraphs 2 to 12 and 16 to 21 adopt FAS 87, *FASB Statement No. 88, Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits* and *FASB Statement No. 132, Employers’ Disclosures about Pensions and Other Postretirement Benefits* (FAS 132) with the following modifications:

   a. Calculation of the pension obligation shall exclude non-vested employees. Partially vested employees are included only to the extent of their vested amounts;

   b. Any asset which results from an excess of the fair value of plan assets over the pension obligation shall be recorded as a nonadmitted asset;

   c. At the date of adoption of this accounting principle, the pension obligation or asset not previously recognized related to vested employees may be recorded immediately or may be amortized over future periods;

   d. A net gain (net of excise tax surcharge) resulting from the settlement or curtailment of a pension plan is not recognized until the proceeds are received by the reporting entity;

   e. The reduced disclosure requirements for nonpublic entities described in paragraph 8 of FAS 132 are rejected. All reporting entities shall follow the disclosure requirements of this statement;

   f. The disclosures relating to the initial date of application in paragraph 5 of FAS 132 shall be the initial date of adoption of this statement; and

   g. The disclosures relating to other comprehensive income in paragraph 5 of FAS 132 shall be made for income on a statutory basis.

16. This statement also adopts *FASB Emerging Issues Task Force No. 88-1, Determination of Vested Benefit Obligation for a Defined Benefit Pension Plan*, *FASB Emerging Issues Task Force No. 90-3, Accounting for Employers’ Obligations for Future Contributions to a Multiemployer Pension Plan*, *FASB Emerging Issues Task Force No. 91-7, Accounting for Pension Benefits Paid by Employers after Insurance Companies Fail to Provide Annuity Benefits*, and *FASB Emerging Issues Task Force No. 96-5, Recognition of Liabilities for Contractual Termination Benefits or Changing Benefit Plan Assumptions in Anticipation of a Business Combination*.

Effective Date and Transition

17. This statement is effective for years beginning January 1, 2001.

18. As of January 1, 2001, the transition obligation or asset shall be determined as the difference between the projected benefit obligation for vested employees and the fair value of plan assets. If prior to the effective date of January 1, 2001, the reporting entity has adopted FAS 87 for statutory accounting purposes, the transition obligation or asset calculated above shall be compared to those amounts previously recorded under FAS 87. The difference between these amounts represents an incremental asset or liability. If the reporting entity has not previously adopted FAS 87 for statutory accounting purposes, the entire transition asset or obligation represents the incremental asset or liability.
19. As of January 1, 2001, if the reporting entity calculates an incremental liability, this liability shall be recognized according to one of the two following methods:
   a. The reporting entity may elect to record the entire incremental liability as a direct charge to surplus;
   b. Alternatively, the reporting entity may elect to amortize the incremental liability as a component of net periodic pension cost over a period not to exceed 20 years.

20. As of January 1, 2001, if the reporting entity calculates an incremental asset, this asset shall be recognized according to one of the two following methods:
   a. The reporting entity may elect to record the entire incremental asset as a direct credit to surplus;
   b. Alternatively, the reporting entity may elect to accrue the incremental asset as a component of net periodic pension cost in an amount each period such that total net periodic pension cost may be reduced to an amount not less than zero (i.e., the accrual of the incremental asset may be used to offset current period net periodic pension cost).

21. An incremental asset resulting from a transition obligation that is less than an amount previously recorded under FAS 87 should first reduce the recorded liability. Any remaining incremental asset shall be reported as nonadmitted.

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

- FASB Statement No. 87, Employers’ Accounting for Pensions
- FASB Statement No. 88, Employers’ Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits
- FASB Statement No. 132, Employers’ Disclosure about Pensions and Other Postretirement Benefits
- FASB Emerging Issues Task Force No. 88-1, Determination of Vested Benefit Obligation for a Defined Benefit Pension Plan
- FASB Emerging Issues Task Force No. 90-3, Accounting for Employers’ Obligations for Future Contributions to a Multiemployer Pension Plan
- FASB Emerging Issues Task Force No. 91-7, Accounting for Pension Benefits Paid by Employers after Insurance Companies Fail to Provide Annuity Benefits
- FASB Emerging Issues Task Force No. 96-5, Recognition of Liabilities for Contractual Termination Benefits or Changing Benefit Plan Assumptions in Anticipation of a Business Combination

RELEVANT ISSUE PAPERS

- Issue Paper No. 8—Accounting for Pensions
Statement of Statutory Accounting Principles No. 9

Subsequent Events

STATUS

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SCOPE OF STATEMENT

SUMMARY CONCLUSION

Relevant Literature
Effective Date and Transition
OTHER SOURCES

RELEVANT ISSUE PAPERS
Subsequent Events

SCOPE OF STATEMENT

1. This statement defines subsequent events and establishes the criteria for recording such events in the financial statements and/or disclosing them in the notes to the financial statements. The conclusions in this statement apply to both quarterly and annual statement filings.

SUMMARY CONCLUSION

2. Subsequent events shall be defined as events or transactions that occur subsequent to the balance sheet date, but prior to the issuance of the statutory financial statements. The issuance of the statutory financial statements includes not only the submission of the Quarterly and Annual Statement but also the issuance of the audit opinion by the reporting entity’s certified public accountant.

3. Material subsequent events shall be considered either:
   a. Type I. Events that provide additional evidence with respect to conditions that existed at the date of the balance sheet and affect the estimates inherent in the process of preparing financial statements;
   b. Type II. Events that provide evidence with respect to conditions that did not exist at the balance sheet date but arose subsequent to that date.

4. All information that becomes available prior to the issuance of the financial statements relating to a material Type I subsequent event shall be used by management to determine a related accounting estimate (see SSAP No. 4—Assets and Nonadmitted Assets and SSAP No. 5—Liabilities, Contingencies and Impairments of Assets). Any changes in estimates resulting from the use of such evidence shall be recorded in the financial statements unless specifically prohibited, (e.g., subsequent collection of agents balances over 90 days due when determining nonadmitted agents balances as prohibited by SSAP No. 6—Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers).

5. For material Type I subsequent events, the nature and the amount of the adjustment shall be disclosed in the notes to the financial statements only if necessary to keep the financial statements from being misleading.

6. Information that becomes available prior to the issuance of the financial statements relating to a material Type II subsequent event shall not be recorded in the financial statements, but shall be disclosed in the notes to the financial statements. If an event is of such a nature that pro forma disclosures are necessary to keep the financial statements from being misleading, disclosure of supplemental pro forma financial data shall be made including the impact on net income, surplus, total assets, and total liabilities giving effect to the event as if it had occurred on the date of the balance sheet.

7. Identifying events that require adjustment of the financial statements under the criteria stated in the conclusion calls for the management of the entity to exercise judgment and accumulate knowledge of the facts and circumstances surrounding the event. For example, a loss on an uncollectible agent's balance as a result of an agent's deteriorating financial condition leading to bankruptcy subsequent to the balance sheet date would be indicative of conditions existing at the balance sheet date, thereby requiring the recording of such event to the financial statements before their issuance. On the other hand, a similar loss resulting from an agent’s major casualty loss such as a fire or flood subsequent to the balance sheet date would not be indicative of conditions existing at the balance sheet date and recording of the event to the financial statements would not be appropriate. However, this is a Type II subsequent event which would require disclosure in the notes to the financial statements.
8. Refer to the preamble for further discussion regarding disclosure requirements.

**Relevant Literature**

9. The above guidance is consistent with the AICPA *Statement on Auditing Standards No. 1*, Section 560, *Subsequent Events*, which should be considered when applying the provisions of this SSAP.

**Effective Date and Transition**

10. This statement is effective for years beginning January 1, 2001. 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—*Accounting Changes and Corrections of Errors*.

**OTHER SOURCES**

- AICPA *Statement on Auditing Standards No. 1*, Section 560, *Subsequent Events*

**RELEVANT ISSUE PAPERS**

- Issue Paper No. 9—*Subsequent Events*
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Income Taxes

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for current and deferred federal and foreign income taxes and current state income taxes.

SUMMARY CONCLUSION

2. For purposes of accounting for federal and foreign income taxes, reporting entities shall adopt FASB Statement No. 109, Accounting for Income Taxes (FAS 109) with modifications for state income taxes, the realization criteria for deferred tax assets, and the recording of the impact of changes in its deferred tax balances. As a result, financial statements will recognize current and deferred income tax assets and liabilities in accordance with the provisions of this statement.

Current Income Taxes

3. “Income taxes incurred” shall include current income taxes, the amount of federal and foreign income taxes paid (recovered) or payable (recoverable) for the current year. Current income taxes are defined as:

   a. Current year estimates of federal and foreign income taxes (including the equity tax of a mutual life insurer and the “true-up” of such tax), based on tax returns for the current year, and tax contingencies for current and all prior years, to the extent not previously provided, computed in accordance with SSAP No. 5—Liabilities, Contingencies and Impairments of Assets (SSAP No. 5);

   b. Amounts incurred or received during the current year relating to prior periods, to the extent not previously provided, as such amounts are deemed to be changes in accounting estimates as defined in SSAP No. 3—Accounting Changes and Corrections of Errors (SSAP No. 3).

4. State taxes (including premium, income and franchise taxes) shall be computed in accordance with SSAP No. 5 and shall be limited to (a) taxes due as a result of the current year’s taxable basis calculated in accordance with state laws and regulations and (b) amounts incurred or received during the current year relating to prior periods, to the extent not previously provided as such amounts are deemed to be changes in accounting estimates. Property and casualty insurance companies shall report state taxes as other underwriting expenses under the caption “Taxes, licenses, and fees.” Life and accident and health insurance companies shall report such amounts as general expenses under the caption “Insurance taxes, licenses, and fees, excluding federal income taxes.” Other health entities shall report such amounts as general administration expenses under the caption “Taxes, licenses, and fees.” State tax recoverables that are reasonably expected to be recovered in a subsequent accounting period are admitted assets. State taxes are reasonably expected to be recovered if the refund is attributable to overpayment of estimated tax payments, errors, carrybacks, or items for which the reporting entity has authority to recover under a state regulation or statute.

Deferred Income Taxes

5. A reporting entity’s balance sheet shall include deferred income tax assets (DTAs) and liabilities (DTLs), the expected future tax consequences of temporary differences generated by statutory accounting, as defined in paragraph 11 of FAS 109.

6. A reporting entity’s deferred tax assets and liabilities are computed as follows:
a. Temporary differences are identified and measured using a “balance sheet” approach whereby statutory and tax basis balance sheets are compared;

b. Temporary differences include unrealized gains and losses and nonadmitted assets but do not include asset valuation reserve (AVR), interest maintenance reserve (IMR), Schedule F penalties and, in the case of a mortgage guaranty insurer, amounts attributable to its statutory contingency reserve to the extent that “tax and loss” bonds have been purchased;

c. Total DTAs and DTLs are computed using enacted tax rates; and

d. A DTL is not recognized for amounts described in paragraph 31 of FAS 109.

7. Changes in DTAs and DTLs, including changes attributable to changes in tax rates and changes in tax status, if any, shall be recognized as a separate component of gains and losses in unassigned funds (surplus). DTAs and DTLs shall be offset and presented as a single amount on the statement of financial position.

Admissibility of Income Tax Assets

8. Current income tax recoverables shall include all current income taxes, including interest, reasonably expected to be recovered in a subsequent accounting period, whether or not a return or claim has been filed with the taxing authorities. Current income tax recoverables are reasonably expected to be recovered if the refund is attributable to overpayment of estimated tax payments, errors, carrybacks, as defined in paragraph 289 of FAS 109, or items for which the reporting entity has substantial authority, as that term is defined in Federal Income Tax Regulations.

9. Current income tax recoverables meet the definition of assets as specified in SSAP No. 4—Assets and Nonadmitted Assets and are admitted assets to the extent they conform to the requirements of this statement.

10. Gross DTAs shall be admitted in an amount equal to the sum of:

   a. Federal income taxes paid in prior years that can be recovered through loss carrybacks for existing temporary differences that reverse by the end of the subsequent calendar year;

   b. The lesser of:

      i. The amount of gross DTAs, after the application of paragraph 10 a., expected to be realized within one year of the balance sheet date; or

      ii. Ten percent of statutory capital and surplus as required to be shown on the statutory balance sheet of the reporting entity for its most recently filed statement with the domiciliary state commissioner adjusted to exclude any net DTAs, EDP equipment and operating system software and any net positive goodwill; and

   c. The amount of gross DTAs, after application of paragraphs 10 a. and 10 b., that can be offset against existing gross DTLs.

11. In computing a reporting entity’s gross DTA pursuant to paragraph 10;

   a. Existing temporary differences that reverse by the end of the subsequent calendar year shall be determined in accordance with paragraphs 228 and 229 of FAS 109;
b. In determining the amount of federal income taxes that can be recovered through loss carrybacks, the amount and character (i.e., ordinary versus capital) of the loss carrybacks and the impact, if any, of the Alternative Minimum Tax shall be determined in accordance with the provisions of the Internal Revenue Code, and regulations thereunder;

c. The amount of carryback potential that may be considered in calculating the gross DTAs of a reporting entity in subparagraph 10 a. above, that files a consolidated income tax return with one or more affiliates, may not exceed the amount that the reporting entity could reasonably expect to have refunded by its parent; and

d. The phrases “reverse by the end of the subsequent calendar year” and “realized within one year of the balance sheet date” are intended to accommodate interim reporting dates and reporting entities that file on an other than calendar year basis for federal income tax purposes.

**Intercompany Income Tax Transactions**

12. In the case of a reporting entity that files a consolidated income tax return with one or more affiliates, income tax transactions (including payment of tax contingencies to its parent) between the affiliated parties shall be recognized if:

   a. Such transactions are economic transactions as defined in SSAP No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties (SSAP No. 25);

   b. Are pursuant to a written income tax allocation agreement; and

   c. Income taxes incurred are accounted for in a manner consistent with the principles of FAS 109, as modified by this statement.

13. Amounts owed to a reporting entity pursuant to a recognized transaction shall be treated as a loan or advance, and nonadmitted, pursuant to SSAP No. 25, to the extent that the recoverable is not settled within 90 days of the filing of a consolidated income tax return, or where a refund is due the reporting entity’s parent, within 90 days of the receipt of such refund.

**Intraperiod Tax Allocation**

14. In accordance with paragraph 35 of FAS 109, a reporting entity’s unrealized gains and losses shall be recorded net of any allocated DTA or DTL. The amount allocated shall be computed in a manner consistent with paragraph 38 of FAS 109.

15. Income taxes incurred shall be allocated to net income and realized capital gains or losses in a manner consistent with paragraph 38 of FAS 109. Furthermore, income taxes incurred or received during the current year attributable to prior years shall be allocated, to the extent not previously provided, to net income in accordance with SSAP No. 3 unless attributable, in whole or in part, to realized capital gains or losses, in which case, such amounts shall be apportioned between net income and realized capital gains and losses, as appropriate.

**Interim Periods**

16. Income taxes incurred in interim periods shall be computed using an estimated annual effective current tax rate for the annual period in accordance with the methodology described in paragraphs 19 and 20 of Accounting Principles Board Opinion No. 28, Interim Financial Reporting. Estimates of the annual effective tax rate at the end of interim periods are, of necessity, based on estimates and are subject
to subsequent refinement or revision. If a reliable estimate cannot be made, the actual effective tax rate for the year-to-date may be the best estimate of the annual effective tax rate. If a reporting entity is unable to estimate a part of its “ordinary” income (or loss) or the related tax (or benefit) but is otherwise able to make a reliable estimate, the tax (or benefit) applicable to the item that cannot be estimated shall be reported in the interim period in which the item is reported.

**Disclosures**

17. Statutory financial statement disclosure shall be made in a manner consistent with the provisions of paragraphs 43—45 and 48 of FAS 109. However, required disclosures with regard to a reporting entity’s valuation allowance shall be replaced with disclosures relating to the nonadmittance of some portion or all of a reporting entity’s DTAs. The financial statements shall include the disclosures required by paragraph 47 of FAS 109 for non-public companies. Paragraphs 18 to 23 describe the disclosure requirements as modified for the difference between the requirements of FAS 109 and those prescribed by this statement.

18. The components of the net DTA or DTL recognized in a reporting entity’s balance sheet shall be disclosed as follows:

   a. The total of all DTAs (admitted and nonadmitted);
   b. The total of all DTLs;
   c. The total DTAs nonadmitted as the result of the application of paragraph 10; and
   d. The net change during the year in the total DTAs nonadmitted.

19. To the extent that DTLs are not recognized for amounts described in paragraph 31 of FAS 109, the following shall be disclosed:

   a. A description of the types of temporary differences for which a DTL has not been recognized and the types of events that would cause those temporary differences to become taxable;
   b. The cumulative amount of each type of temporary difference;
   c. The amount of the unrecognized DTL for temporary differences related to investments in foreign subsidiaries and foreign corporate joint ventures that are essentially permanent in duration if determination of that liability is practicable or a statement that determination is not practicable; and
   d. The amount of the DTL for temporary differences other than those in item c. above that is not recognized in accordance with the provisions of paragraphs 31 of FAS 109.

20. The significant components of income taxes incurred (i.e., current income tax expense) and the changes in DTAs and DTLs shall be disclosed. Those components would include, for example:

   a. Current tax expense or benefit;
   b. The change in DTAs and DTLs (exclusive of the effects of other components listed below);
   c. Investment tax credits;
   d. The benefits of operating loss carryforwards; and
e. Adjustments of a DTA or DTL for enacted changes in tax laws or rates or a change in the tax status of the reporting entity.

21. Additionally, to the extent that the sum of a reporting entity’s income taxes incurred and the change in its DTAs and DTLs is different from the result obtained by applying the federal statutory rate to its pretax net income, a reporting entity shall disclose the nature of the significant reconciling items.

22. A reporting entity shall also disclose the following:
   a. The amounts, origination dates and expiration dates of operating loss and tax credit carryforwards available for tax purposes; and
   b. The amount of federal income taxes incurred in the current year and each preceding year, which are available for recoupment in the event of future net losses.

23. If a reporting entity’s federal income tax return is consolidated with those of any other entity or entities, the following shall be disclosed:
   a. A list of names of the entities with whom the reporting entity’s federal income tax return is consolidated for the current year; and
   b. The substance of the written agreement, approved by the reporting entity’s Board of Directors, which sets forth the manner in which the total combined federal income tax for all entities is allocated to each entity which is a party to the consolidation. (If no written agreement has been executed, give an explanation of why such an agreement has not been executed.) Additionally, the disclosure shall include the manner in which the entity has an enforceable right to recoup federal income taxes in the event of future net losses which it may incur or to recoup its net losses carried forward as an offset to future net income subject to federal income taxes.

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

**Relevant Literature**

25. This statement adopts the provisions of FAS 109 except as modified in paragraph 2 of this statement which results in paragraphs 29—30, 36—37, 39, 41—42, 46, and 49—59 of FAS 109 being rejected, inasmuch as they are not applicable to reporting entities subject to this statement or are inconsistent with other statutory accounting principles. Paragraph 47 of FAS 109 is adopted with modification to provide for the disclosures required for non public reporting entities.

26. This statement rejects FASB Interpretation No. 18, Accounting for Income Taxes in Interim Periods...an interpretation of APB Opinion No. 28.

27. The following lists Accounting Principles Board Opinions that are adopted or rejected by this statement:
   a. *Accounting Principles Board Opinion No. 2, Accounting for the “Investment Credit,”* paragraphs 9—15 are adopted with modification to utilize the cost reduction method only and rejects all other paragraphs;
   b. *Accounting Principles Board Opinion No. 4 (Amending No. 2), Accounting for the “Investment Credit,”* is rejected in its entirety;
   c. *Accounting Principles Board Opinion No. 10, Omnibus Opinion—1966,* paragraph 6 is adopted;
d. Accounting Principles Board Opinion No. 23, Accounting for Income Taxes—Special Areas, paragraphs 1–3, 5–9, 12–13, and 15–18 are adopted, and paragraphs 19–25, and 31–33 are rejected;

e. Accounting Principles Board Opinion No. 28, Interim Financial Reporting, paragraphs 19 and 20 are adopted and all other paragraphs rejected.

28. The following lists FASB Technical Bulletins that are adopted or rejected by this statement:

a. FASB Technical Bulletin No. 79-9, Accounting in Interim Periods for Changes in Income Tax Rates is rejected in its entirety;

b. FASB Technical Bulletin No. 82-1, Disclosure of the Sale or Purchase of Tax Benefits through Tax Leases is adopted in its entirety.

29. The following lists FASB Emerging Issues Task Force Issues that are adopted or rejected by this statement:

a. FASB Emerging Issues Task Force No. 91-8, Application of FASB Statement No. 96 to a State Tax Based on the Greater of a Franchise Tax or an Income Tax, is rejected in its entirety;

b. FASB Emerging Issues Task Force No. 92-8, Accounting for the Income Tax Effects under FASB Statement No. 109 of a Change in Functional Currency When an Economy Ceases to Be Considered Highly Inflationary, is adopted in its entirety;

c. FASB Emerging Issues Task Force No. 93-13, Effect of a Retroactive Change in Enacted Tax Rates That Is Included in Income from Continuing Operations, is rejected in its entirety;

d. FASB Emerging Issues Task Force No. 93-16, Application of FASB Statement No. 109 to Basis Differences within Foreign Subsidiaries That Meet the Indefinite Reversal Criterion of APB Opinion No. 23, is rejected in its entirety;

e. FASB Emerging Issues Task Force No. 93-17, Recognition of Deferred Tax Assets for a Parent Company's Excess Tax Basis in the Stock of a Subsidiary That Is Accounted for as a Discontinued Operation, is adopted in its entirety;

f. FASB Emerging Issues Task Force No. 94-10, Accounting by a Company for the Income Tax Effects of Transactions among or with Its Shareholders under FASB Statement No. 109, is rejected in its entirety;

g. FASB Emerging Issues Task Force No. 95-9, Accounting for Tax Effects of Dividends in France in Accordance with FASB Statement No. 109, is rejected in its entirety;

h. FASB Emerging Issues Task Force No. 95-10, Accounting for Tax Credits Related to Dividend Payments in Accordance with FASB Statement No. 109, is rejected in its entirety;

i. FASB Emerging Issues Task Force No. 95-20, Measurement in the Consolidated Financial Statements of a Parent of the Tax Effects Related to the Operations of a Foreign Subsidiary That Receives Tax Credits Related to Dividend Payments, is rejected in its entirety.
30. This statement rejects AICPA Accounting Interpretations, Accounting for the Investment Credit: Accounting Interpretations of APB Opinion No. 4 in its entirety.

Effective Date and Transition

31. This statement is effective for years beginning January 1, 2001. 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.

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

- FASB Statement No. 109, Accounting for Income Taxes
- Accounting Principles Board Opinion No. 2, Accounting for the “Investment Credit”
- Accounting Principles Board Opinion No. 10, Omnibus Opinion—1966, paragraph 6
- Accounting Principles Board Opinion No. 23, Accounting for Income Taxes—Special Areas, paragraphs 1—3, 5—9, 12—13, and 15—18
- Accounting Principles Board Opinion No. 28, Interim Financial Reporting, paragraphs 19 and 20
- FASB Technical Bulletin No. 82-1, Disclosure of the Sale or Purchase of Tax Benefits through Tax Leases
- FASB Emerging Issues Task Force No. 92-8, Accounting for the Income Tax Effects under FASB Statement No. 109 of a Change in Functional Currency When an Economy Ceases to Be Considered Highly Inflationary
- FASB Emerging Issues Task Force No. 93-17, Recognition of Deferred Tax Assets for a Parent Company’s Excess Tax Basis in the Stock of a Subsidiary That Is Accounted for as a Discontinued Operation

RELEVANT ISSUE PAPERS

- Issue Paper No. 83—Accounting for Income Taxes
SSAP NO. 10 – EXHIBIT A

Implementation Questions and Answers


Questions regarding implementation of this new standard were raised with the NAIC staff by reporting entities, regulators and auditors. The staff determined that this Question & Answer report should be issued as an aid in understanding and implementing SSAP 10 because of the relatively high number of inquiries received on that SSAP.

This Q&A is effective for reporting periods ending on or after December 31, 2001 with the exception of Question 8, which is effective for reporting periods beginning on or after January 1, 2002. In accordance with paragraph 12 of SSAP No. 1 - *Disclosure of Accounting Policies, Risks & Uncertainties, and Other Disclosures* it is expected that the audit report would include a disclosure of the effect on the financial statements if:

a. It is at least reasonably possible that the estimate used to determine the admission of deferred tax assets at December 31, 2001 will change on January 1, 2002 due to the implementation of Question 8; and
b. The effect of the change would be material to the financial statements.

This Q&A nullifies the following Interpretations of the Emerging Accounting Issues Working Group:

INT 00-21 – Disclosure Requirement of SSAP 10 paragraphs 17 and 18
INT 00-22 – Application of SSAP 10 to Admissibility of DTA
INT 01-19 – Measurement of DTA Associated with Nonadmitted Assets
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1. Q – What are the primary differences between the accounting for income taxes pursuant to FAS 109 and SSAP 10? [No specific paragraph reference]

1.1 A – SSAP 10 establishes statutory accounting principles for current and deferred federal and foreign income taxes and current state income taxes. In general, SSAP 10 adopts the concepts of FAS 109, with modifications. The primary differences and modifications are summarized below:

1.2 State Income Tax
- FAS 109 – State income taxes should be included as “income taxes incurred.” Deferred state income taxes are provided.
- SSAP 10 – State income taxes should be included as “Taxes, Licenses, and Fees” by property and casualty insurers and as “Insurance taxes, licenses, and fees, excluding federal income taxes” by life and accident and health insurers. No deferred state income taxes are provided.

1.3 Valuation Allowance
- FAS 109 – Gross deferred tax assets (DTAs) are reduced by a valuation allowance if it is more likely than not that some portion or all of the DTAs will not be realized. The valuation allowance should be sufficient to reduce the DTA to the amount that is more likely than not to be realized.
- SSAP 10 – DTAs are not reduced by a valuation allowance. Instead, that portion of a reporting entity’s DTAs not meeting the criteria of paragraph 10 of SSAP 10 is nonadmitted. SSAP 10 paragraph 2 states that FAS 109 is adopted with modifications for “the realization criteria for deferred tax assets”. Therefore, the admission standards outlined in paragraphs 8 to 11 is a replacement of the valuation allowance criteria of FAS 109. See Question 4 for a further discussion of the admissibility test.

1.4 Unique Statutory Accounting Items
- FAS 109 – In general, the effects of all temporary differences must be reflected with limited exceptions provided in FAS 109 paragraphs 31 through 34 (relating to items specified in Accounting Principles Board Opinion No. 23) and for temporary differences related to goodwill for which amortization is not deductible for tax purposes.
- SSAP 10 – In addition to the exceptions provided in FAS 109, temporary differences do not include asset valuation reserve (AVR), interest maintenance reserve (IMR), Schedule F penalties and, in the case of a mortgage guaranty insurer, amounts attributable to its statutory contingency reserve to the extent that “tax and loss” bonds have been purchased.

1.5 Changes in Deferred Tax Assets and Liabilities
- FAS 109 – Changes in DTAs and deferred tax liabilities (DTLs) are included in income tax expense or benefit and are allocated to continuing operations, discontinued operations, extraordinary items and items charged directly to shareholders’ equity.
- SSAP 10 – Changes in DTAs and DTLs are recognized as a separate component of gains and losses in surplus, except to the extent allocated to changes in unrealized gains and losses.

1.6 Regulated Enterprises
- FAS 109 – Regulated enterprises that meet the criteria for application of FAS 71, Accounting for the Effects of Certain Types of Regulation, are not exempt from the requirements of FAS 109. However, assets are reported on a net-of-tax basis (see paragraphs 29, 57, 58 and 59 of FAS 109).
- SSAP 10 – These special paragraphs do not apply pursuant to paragraph 25 of SSAP 10.

1.7 Business Combinations
- FAS 109 – Paragraphs 30 and 53 through 56 of FAS 109 provide certain guidance regarding the treatment of business combinations. In general, a deferred tax asset or liability is...
recognized for the differences between the assigned values and the tax bases of the assets and liabilities recognized in a purchased business combination. If financial statements for prior years are restated, all purchase business combinations that were consummated in those prior years shall be remeasured in accordance with FAS 109.

- SSAP 10 – These special paragraphs do not apply pursuant to paragraph 25 of SSAP 10.

1.8 Intraperiod Tax Allocation
- FAS 109 – Income tax expense or benefit is allocated among continuing operations, discontinued operations, extraordinary items, and items charged or credited directly to shareholders’ equity pursuant to paragraphs 36 and 37 of FAS 109.
- SSAP 10 – These paragraphs of SFAS 109 do not apply pursuant to paragraph 25 of SSAP 10. Instead, paragraphs 14 and 15 of SSAP 10 provide special rules for statutory accounting. See Question 10 for a further discussion of these rules.

1.9 Certain Quasi Reorganizations
- FAS 109 – Paragraph 39 provides special rules relating to the treatment of deductible temporary differences and carryforwards as of the date of a quasi reorganization.
- SSAP 10 – Paragraph 39 of FAS 109 does not apply pursuant to paragraph 25 of SSAP 10.

1.10 Financial Statement Classification of DTAs and DTLs
- FAS 109 – Pursuant to paragraphs 41 and 42 of FAS 109, DTAs and DTLs are to be classified separately as either current or noncurrent, depending on the classification of the related asset or liability. Furthermore, current DTAs and DTLs and noncurrent DTAs and DTLs are netted within the classification and with the net amount reported.
- SSAP 10 – These paragraphs do not apply to statutory accounting pursuant to paragraph 25 of SSAP 10. The net admitted DTA, or the net DTL, should be reported in the statutory financial statements.

1.11 Financial Statement Disclosures
- FAS 109 – Paragraphs 43 through 45, and 47 through 48 of FAS 109 provide various requirements for providing information in the financial statements regarding the income taxes of the reporting entity. In general, the reporting entity is to provide certain information regarding the components of its DTAs and DTLs, the amount of and changes in its valuation allowance, significant components of income tax expense, differences between the expected amount of income tax expense using current tax rates and the amount of reported income tax expense, and tax attributes being carried over.
- SSAP 10 – In general, paragraphs 17 through 23 of SSAP 10 follow the disclosure requirements provided by FAS 109, but with various modifications. The disclosures regarding valuation allowance are replaced with disclosures relating to the nonadmitted portion of the DTA, if any. Also, the disclosures relating to deferred income tax expense or benefit are replaced with certain disclosures relating to the reporting entity’s “change in DTAs and DTLs”. Furthermore, only the nature of significant reconciling items between the reported amount and “expected” amount of income tax expense and change in DTAs and DTLs are to be disclosed. This generally follows the disclosure requirements of FAS 109 for nonpublic entities. See Question 12 for a more detailed discussion of the disclosure requirements of SSAP 10.

2. Q – How should an entity measure its gross deferred tax assets and liabilities? [Paragraph 6]

2.1 A – An enterprise shall record a gross deferred tax liability or asset for all temporary differences and operating loss, capital loss and tax credit carryforwards. Temporary differences include unrealized gains and losses and nonadmitted assets but do not include AVR, IMR, Schedule F penalties and, in the
case of a mortgage guaranty insurer, amounts attributable to its statutory contingency reserve to the extent that "tax and loss" bonds have been purchased. In general, temporary differences produce taxable income or result in tax deductions when the related asset is recovered or the related liability is settled. A deferred tax asset or liability represents the increase or decrease in taxes payable or refundable in future years as a result of temporary differences and carryforwards at the end of the current year. This answer only addresses the recognition of gross DTAs and DTLs and does not address the admissibility of such amounts. See Question 4 for a discussion of the admissibility criteria of SSAP 10.

2.2 Paragraph 6 of SSAP 10 states that temporary differences are identified and measured using a “balance sheet” approach whereby the statutory balance sheet and the tax basis balance sheet are compared. Operating loss, capital loss and tax credit carryforwards are computed in accordance with the applicable Internal Revenue Code.

2.3 The following illustrates the recognition and measurement of a typical book to tax difference for an insurance company:

Illustration

Assumptions:
1/1/01 Purchase 100 shares of Darby/Allyn Corp. stock for $25 a share
3/31/01 Fair Value of Darby/Allyn Corp. stock has increased to $35 a share
3/31/01 Tax basis reserves are computed and determined to be 80% of the statutory basis reserves

Balance Sheet at 3/31/01:

<table>
<thead>
<tr>
<th></th>
<th>Statutory Basis</th>
<th>Tax Basis</th>
<th>Basis Difference</th>
<th>Tax Effect DTA (DTL) (35%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Common Stock</td>
<td>$3,500</td>
<td>$2,500</td>
<td>($1,000)</td>
<td>($350)</td>
</tr>
<tr>
<td>Reserves</td>
<td>$100,000</td>
<td>$80,000</td>
<td>$20,000</td>
<td>$7,000</td>
</tr>
</tbody>
</table>

Journal Entries:

<table>
<thead>
<tr>
<th>Date</th>
<th>DR</th>
<th>Credit</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1/1/01</td>
<td>Common stock</td>
<td>Cash</td>
<td>$2,500</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>($2,500)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Acquisition of common stock at $25 per share</td>
<td></td>
</tr>
<tr>
<td>3/31/01</td>
<td>Common stock</td>
<td></td>
<td>$1,000</td>
</tr>
</tbody>
</table>

1 See question 3 for a discussion of “enacted rates”.
2 The carrying value of the stock on the statutory balance sheet reflects the fair value of the common stock per SSAP 30—Investments in Common Stock (excluding investments in common stock of subsidiary, controlled, or affiliated entities) whereas the carrying value of the stock for tax purposes is its original cost. This difference is defined as temporary in that the $1,000 appreciation in value will be recognized in the tax return when the stock is disposed of. The difference is a deferred tax liability in that the reversal of this temporary difference will increase future taxable income.
3 The reserve difference is due to the fact that statutory reserves are computed on a more conservative set of assumptions than for tax (life and health entities) or the tax reserves are discounted (property and casualty and other health entities). This amount is a temporary difference in that the entity will recognize the difference between statutory and tax carrying values over the life of the reserve or upon settlement of the claim or payment of the reserve. The difference is a deferred tax asset in that the reversal of this temporary difference will decrease future taxable income.
2.4 As depicted in the Illustration, the deferred tax assets and liabilities are tracked gross in the entity’s ledger and not netted until after consideration of the admissibility of deferred tax assets.

Grouping of assets and liabilities for measurement

2.5 The manner in which an entity groups its assets and liabilities for measurement shall be conducted in a reasonable and consistent manner. For instance, an entity may group its invested assets into Annual Statement classifications (stocks, bonds, preferred stocks, etc.) or other reasonable groupings (lines of business for grouping its reserves). Entities have the option of recognizing the DTA and DTL within each grouping on a net or gross basis. For instance, a portfolio of common stocks will have both unrealized gain and unrealized losses associated with them. The reporting entity may elect to combine the unrealized gains and losses and compute a single DTA or DTL or it may elect to segregate the unrealized gains from the unrealized losses and compute separate DTAs and DTLs. This option might also arise with respect to depreciable assets. Regardless of which method an entity elects, it is crucial that consistency is maintained and within each grouping from period to period. An entity shall retain internal documentation to support its grouping in addition to the methodologies employed to arrive at such. An entity is permitted to modify its groupings should events or circumstances change from a previous period. Examples include a change in materiality of underlying assets and liabilities, administrative costs associated with detailing groupings increases or changes in the computer systems that allow more specificity. Entities who modify their groupings should be prepared to rationalize these changes. These entities should also disclose that a modification was made and general reason for such in the notes to the financial statements.

Measurement of Nonadmitted Assets

2.6 As noted in paragraph 6 b. of SSAP 10, temporary differences include nonadmitted assets. The measurement of these types of assets is not addressed in FAS 109 in that the concept of nonadmission is unique to statutory accounting. For assets that are nonadmitted for statutory accounting purposes, DTAs and DTLs should be measured after nonadmission.

Illustration:

<table>
<thead>
<tr>
<th>Statutory Before Nonadmit (Info)</th>
<th>Statutory After Nonadmit</th>
<th>Tax</th>
<th>Basis Difference</th>
<th>Tax Effect DTA (DTL) (35%)</th>
</tr>
</thead>
</table>

4 Difference is computed from the “Statutory After Nonadmit” balance.
2.7 The effect of this illustration is a reduction of surplus by $590 ($800 decrease for nonadmitted asset and $210 increase for DTA), provided the resulting DTA meets the admissibility test in paragraph 10 of SSAP 10.

3. **Q – A reporting entity’s deferred tax assets and liabilities are computed using “enacted tax rates.” What is the meaning of the term “enacted tax rates”?** [Paragraph 6 c.]

3.1 A – SSAP 10 provides the following:

6. A reporting entity’s deferred tax assets and liabilities are computed as follows:

   a. Temporary differences are identified and measured using a “balance sheet” approach whereby statutory and tax basis balance sheets are compared;
   b. Temporary differences include unrealized gains and losses and nonadmitted assets but do not include asset valuation reserve (AVR), interest maintenance reserve (IMR), Schedule F penalties and, in the case of a mortgage guaranty insurer, amounts attributable to its statutory contingency reserve to the extent that “tax and loss” bonds have been purchased;
   c. Total DTAs and DTLs are computed using enacted tax rates; and
   d. A DTL is not recognized for amounts described in paragraph 31 of FAS 109.

3.2 SSAP 10 further requires that deferred tax assets and liabilities be measured using the enacted tax rate that is expected to apply to taxable income in the periods in which the deferred tax asset or liability is expected to be settled or realized. The effects of future changes in tax rates are not anticipated in the measurement of deferred tax assets and liabilities. Deferred tax assets and liabilities are adjusted for changes in tax rates and other changes in the tax law, and the effects of those changes are recognized at the time the change is enacted.

3.3 Tax laws may apply different tax rates to ordinary income and capital gains. In instances where the enacted tax law provides for different rates on income of different character, deferred tax assets and liabilities should be measured by applying the appropriate enacted tax rate based on the type of taxable or deductible amounts expected to be realized from the reversal of existing temporary differences.

3.4 Currently, under U.S. federal tax law, if taxable income (both ordinary and capital gain) exceeds a specified amount, all taxable income is taxed at a single flat tax rate, 35%. Unless graduated tax rates are a significant factor, (i.e., unless the company’s taxable income frequently falls below the specified amount), the enacted tax rate is 35% for both ordinary income and capital gain. Alternative minimum tax and the effect of special deductions, such as the small life deduction, are ignored, except to the extent necessary to estimate future taxable income and therefore the enacted rate applicable to that level of taxable income is used.

3.5 If graduated tax rates are expected to be a significant factor in the determination of taxes payable or refundable in future years, deferred tax assets and liabilities should be measured using the average tax rate (based on currently enacted graduated rates) that is expected to apply to estimated average annual taxable income in the period in which the deferred tax asset or liability is expected to be settled or realized. For example, assume a property and casualty insurance company consistently has taxable
income less than $10 million, but in excess of $1 million. The enacted graduated rate applicable to that level of taxable income is 34%. Therefore, the reporting entity should use 34% for the determination of its taxes payable or refundable.

3.6 As a reference, FAS 109 paragraphs 18 and 236 provide the following:

18. The objective is to measure a deferred tax liability or asset using the enacted tax rate(s) expected to apply to taxable income in the periods in which the deferred tax liability or asset is expected to be settled or realized. Under current U.S. federal tax law, if taxable income exceeds a specified amount, all taxable income is taxed, in substance, at a single flat tax rate. That tax rate shall be used for measurement of a deferred tax liability or asset by enterprises for which graduated tax rates are not a significant factor. Enterprises for which graduated tax rates are a significant factor shall measure a deferred tax liability or asset using the average graduated tax rate applicable to the amount of estimated annual taxable income in the periods in which the deferred tax liability or asset is estimated to be settled or realized (paragraph 236). Other provisions of enacted tax laws should be considered when determining the tax rate to apply to certain types of temporary differences and carryforwards (for example, the tax law may provide for different tax rates on ordinary income and capital gains). If there is a phased-in change in tax rates, determination of the applicable tax rate requires knowledge about when deferred tax liabilities and assets will be settled and realized.

236. The following example illustrates determination of the average graduated tax rate for measurement of deferred tax liabilities and assets by an enterprise for which graduated tax rates ordinarily are a significant factor. At the end of year 3 (the current year), an enterprise has $1,500 of taxable temporary differences and $900 of deductible temporary differences, which are expected to result in net taxable amounts of approximately $200 on the future tax returns for each of years 4-6. Enacted tax rates are 15 percent for the first $500 of taxable income, 25 percent for the next $500, and 40 percent for taxable income over $1,000. This example assumes that there is no income (for example, capital gains) subject to special tax rates.

The deferred tax liability and asset for those reversing taxable and deductible temporary differences in years 4-6 are measured using the average graduated tax rate for the estimated amount of annual taxable income in future years. Thus, the average graduated tax rate will differ depending on the expected level of annual taxable income (including reversing temporary differences) in years 4-6. The average tax rate will be:

a. 15 percent if the estimated annual level of taxable income in years 4-6 is $500 or less
b. 20 percent if the estimated annual level of taxable income in years 4-6 is $1,000
c. 30 percent if the estimated annual level of taxable income in years 4-6 is $2,000.

Temporary differences usually do not reverse in equal annual amounts as in the example above, and a different average graduated tax rate might apply to reversals in different future years. However, a detailed analysis to determine the net reversals of temporary differences in each future year usually is not warranted. It is not warranted because the other variable (that is, taxable income or losses exclusive of reversing temporary differences in each of those future years) for determination of the average graduated tax rate in each future year is no more than an estimate. For that reason, an aggregate calculation using a single estimated average graduated tax rate based on estimated average annual taxable income in future years is sufficient. Judgment is permitted, however, to deal with unusual situations, for example, an unusually large temporary difference that will reverse in a single future year, or an abnormal level of taxable income that is expected for a single future year. The lowest graduated tax rate should be used whenever the estimated average graduated tax rate otherwise would be zero.

4. Q – How should a reporting entity calculate the amount of its admitted gross DTAs?
[Paragraph 10]

4.1 A – SSAP 10 paragraph 10 states that:
10. Gross DTAs shall be admitted in an amount equal to the sum of:

   a. Federal income taxes paid in prior years that can be recovered through loss carrybacks for existing temporary differences that reverse by the end of the subsequent calendar year;

   b. The lesser of:
      i. The amount of gross DTAs, after the application of paragraph 10 a., expected to be realized within one year of the balance sheet date; or
      ii. Ten percent of statutory capital and surplus as required to be shown on the statutory balance sheet of the reporting entity for its most recently filed statement with the domiciliary state commissioner adjusted to exclude any net DTAs, EDP equipment and operating system software and any net positive goodwill; and

   c. The amount of gross DTAs, after application of paragraphs 10 a. and 10 b., that can be offset against existing gross DTLs.

4.2 After a reporting entity has calculated the amount of its gross DTAs and DTLs pursuant to paragraph 6, it must determine the amount of its gross DTAs that can be admitted under paragraph 10. The amount of gross DTAs is not recalculated under paragraph 10; rather, some or all of the gross DTA may not be currently admitted.

4.3 Paragraphs 10 a., 10 b. and 10 c. require three interdependent calculations that when added together equals the amount of the reporting entity’s admitted gross DTAs. Each of the calculations starts with the total of the reporting entity’s gross DTAs, and determines the amount of such gross DTAs that can be admitted under that part. For example, the consideration of existing temporary differences in the calculation of admitted gross DTAs under paragraph 10 a., does not prevent the reconsideration of the same temporary differences in the paragraph 10 b.i. calculation. However, to avoid duplication of admitted gross DTAs when adding the three parts together, the amount of admitted gross DTAs under paragraph 10 a. must be subtracted from the amount of gross DTAs in the paragraph 10 b.i. calculation. Similarly, the amount of admitted gross DTAs under paragraphs 10 a. and 10 b. must be subtracted from the total gross DTAs in the paragraph 10 c. calculation.

4.4 Under paragraphs 10 a. and 11 b., a reporting entity can admit gross DTAs to the extent that it would be able to recover federal income taxes paid in the carryback period, by treating existing temporary differences that reverse by the end of the subsequent calendar year as ordinary or capital losses that originated in such subsequent calendar year. Reversing temporary differences for unrealized losses and nonadmitted assets are treated as capital or ordinary losses depending on their character for tax purposes. The entity is not required to project an actual net operating loss in future periods.

4.5 Paragraph 11 b. limits the amount of federal income taxes recoverable under paragraph 10 a. to the amount that would be refunded to the reporting entity if a carryback claim was filed with the IRS. If some amount of taxes paid in the carryback period is not recovered because of limitations imposed by the Alternative Minimum Tax system, the resulting AMT credit is not treated as a newly created DTA. Paragraph 11 c. further limits the amount of federal income taxes recoverable under paragraph 10 a. for a reporting entity that files a consolidated income tax return with one or more affiliates, to the amount that the reporting entity could reasonably expect to have refunded by its parent. See Question 8 for a further discussion of the impact of filing a consolidated federal income tax return.

4.6 The amount of admitted gross DTAs under paragraph 10 b. i., is limited to the amount that the reporting entity expects to realize within one year of the balance sheet date. See Question 6 for a further discussion of the meaning of “expected to be realized”. The amount of admitted gross DTAs under the
paragraph 10 a. calculation is subtracted from the amount of gross DTAs under paragraph 10 b.i., to prevent the counting of the same gross DTAs more than once. If the reporting entity expects to realize an amount of gross DTAs under paragraph 10 b. i. that is equal to or less than the admitted gross DTAs calculated under paragraph 10 a., then the resulting admitted gross DTAs under paragraph 10 b. i. will be zero. The amount of admitted gross DTAs under paragraph 10 b. i. may also be limited by the ten percent of statutory capital and surplus test under paragraph 10 b. ii.

4.7 Under paragraph 10 c., a reporting entity can admit gross DTAs in an amount equal to the lesser of: (1) its gross DTAs, after subtracting the amount of admitted gross DTAs under paragraphs 10 a. and 10 b., or (2) its gross DTLs, regardless of the expected time of reversal. In determining the amount of gross DTAs that can be offset against existing gross DTLs in the paragraph 10 c. calculation, the character (i.e., ordinary versus capital) of the DTAs and DTLs must be taken into consideration such that offsetting would be permitted in the tax return under existing enacted federal income tax laws and regulations. For example, a gross DTA related to unrealized capital losses could not be offset against an ordinary income DTL. This analysis becomes more critical in situations where a reporting entity does not have sufficient ordinary deduction DTAs to offset existing DTLs.

4.8 In certain situations, a reporting entity’s expected federal income tax rate on its reversing temporary differences will be less than the enacted tax rate used in the determination of its gross DTAs and DTLs. Examples of such entities include: property/casualty insurance companies with large municipal bond portfolios that are AMT taxpayers, Blue Cross-Blue Shield Organizations with section 833(b) deductions, small life insurance companies, reporting entities projecting a tax loss for the year, and entities that file in a consolidated federal income tax return that cannot realize the full amount of their gross DTAs under the existing intercompany tax sharing or tax allocation agreement. Pursuant to paragraphs 231, 232 and 238 of FAS 109, such entities are required to report their gross DTLs at the enacted tax rate, and cannot take into consideration the impact of the AMT, section 833(b) deduction, or the small life insurance company deduction to reduce their gross DTLs.

4.9 For those entities, the amount of admitted gross DTAs calculated under paragraphs 10 a. and 10 b. will reflect the actual tax rate in the carryback period under paragraph 10 a. and the expected tax rate in the subsequent year under paragraph 10 b., which takes into consideration the impact of the AMT, special deductions, and the provisions of the intercompany tax sharing or allocation agreement. See Question 6 for further discussion of this issue. As such, the entity’s admitted gross DTAs under paragraphs 10 a. and 10 b. may be less than its gross DTAs on temporary differences at the enacted rate. Any unused amount of DTAs resulting from a rate differential under paragraphs 10 a. and 10 b. can be used under paragraph 10 c. to offset existing DTLs.

4.10 As a reporting entity performs its paragraph 10 a., 10 b. and 10 c. calculations it must evaluate whether a particular gross DTA has the potential to generate an actual income tax benefit equal to its gross DTA value. For example, a gross DTA related to an NOL or tax credit that is expiring would not generate an income tax benefit in the paragraph 10 c. calculation that could be offset against existing gross DTLs. Similarly, a gross DTA related to an AMT credit carryover would not generate a tax benefit if the reporting entity always expected to be an AMT taxpayer. Another example might include, gross DTAs related to temporary differences for tax basis intangible assets may not generate an income tax benefit based on the assets’ full appraised value. In such cases, the gross DTAs related to these temporary differences may have to be reduced if management concludes that based on the weight of available evidence, it is more likely than not that the full income tax benefit will not be realized. However, if a prudent and feasible tax planning strategy were available so that the reporting entity was able to realize the full amount of its gross DTA, then such strategy would be taken into consideration.

4.11 The above principles can be illustrated by the following example:

4.12 Facts:
1. Insurance Company ABC has $10,000,000 of deductible temporary differences at 12-31-01 that generate $3,500,000 of gross DTAs, at the enacted federal income tax rate of 35%. Management has concluded that it has the potential to realize gross DTAs of $3,500,000 related to its $10 million of deductible temporary differences. ABC also has $4,000,000 of taxable temporary differences resulting in $1,400,000 of gross DTLs.

2. ABC has determined that $5,000,000 of its existing deductible temporary differences will reverse by 12-31-02.

3. ABC reported $1,000,000 of taxable income and $350,000 of tax expense on its 2000 federal income tax return. It has also projected taxable income of $1,200,000, and $420,000 of federal income taxes for 2001 that have been reflected in its current statutory income tax provision calculation. There are no differences between its regular and alternative minimum taxable income in 2000 or 2001.

4. ABC is projecting an effective income tax rate of 20% in 2002 based on its estimated taxable income and federal income tax liability. As such, ABC expects to realize a federal income tax benefit of 20% in 2002 related to reversing temporary differences.

5. Ten percent of statutory capital and surplus under paragraph 10 b.ii is $6,000,000. The surplus limitation at 12/31 was computed by subtracting the admitted balances of net DTA’s, goodwill and EDP from statutory surplus (as reported in the 9/30 quarterly statement filed with the domiciliary state commissioner). Statutory surplus is defined in paragraph 2 of SSAP 72.

4.13 Calculation of ABC’s Admitted Gross DTAs:

1. ABC can admit $726,000 of gross DTAs under paragraph 10 a. The difference between the total taxes paid in the 2000 and 2001 carryback period of $770,000 ($350,000 + $420,000), and the amount recoverable ($726,000) through carryback of the $2,200,000 net operating loss, represents a $44,000 AMT credit generated as a result of the 90% AMT NOL limitation. This AMT credit is not treated as a new DTA at 12-31-01. Also, the fact that the full $5,000,000 of reversing deductible temporary differences available for carryback were not used in the paragraph 10 a. calculation, does not prevent their inclusion in the paragraph 10 b. and 10 c. calculations.

2. ABC can admit $274,000 of gross DTAs under paragraph 10 b. The company expects to realize a federal income tax benefit of $1,000,000 ($5,000,000 X 20%) in 2002 related to its reversing deductible temporary differences. The $1,000,000 amount must be reduced by the $726,000 of admitted gross DTAs under paragraph 10 a. to prevent double counting of the same income tax benefit. Ten percent of capital and surplus is not a limiting factor in this example.

3. ABC can admit $1,400,000 of gross DTAs under paragraph 10 c. This amount is equal to its gross DTLs at 12-31-01. If ABC’s gross DTAs, after reduction for the amount of gross DTAs admitted under paragraphs 10 a. and 10 b., were less than $1,400,000 in this example, ABC would be limited to the balance of its gross DTAs in the paragraph 10 c. calculation.

4.14 Summary of ABC’s Admitted Gross DTA Calculation:

<table>
<thead>
<tr>
<th>Gross DTAs at Enacted Tax Rate</th>
<th>$3,500,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Admitted Gross DTAs (paragraph 10 a.)</td>
<td>$726,000</td>
</tr>
<tr>
<td>Admitted Gross DTAs (paragraph 10 b.)</td>
<td>274,000</td>
</tr>
<tr>
<td>Admitted Gross DTAs (paragraph 10 c.)</td>
<td>1,400,000</td>
</tr>
<tr>
<td>Total Admitted Gross DTAs</td>
<td>2,400,000 (2,400,000)</td>
</tr>
</tbody>
</table>
5a. Q – How is the timing of reversals of temporary differences and carryforwards determined for SSAP 10 purposes? [Paragraphs 10 a., 10 b.i. and 11 a]

5.1 A – The timing of temporary difference reversals is critical in determining the amount of gross admitted DTAs. Determining the one-year reversal of temporary differences impacts the DTA admitted pursuant to paragraphs 10 a. and 10 b.i. of SSAP 10.

5.2 Paragraph 11 a. of SSAP 10 states that “[c]existing temporary differences that reverse by the end of the subsequent calendar year shall be determined in accordance with paragraphs 228 and 229 of FAS 109.”

5.3 Paragraph 228 of FAS 109 states, in pertinent part, that “[t]he particular years in which temporary differences result in taxable or deductible amounts generally are determined by the timing of the recovery of the related asset or settlement of the related liability.” Question 1 of the FASB’s Special Report on Statement 109 provides additional guidance on scheduling. It defines “scheduling” as the analysis performed to determine the pattern and timing of the reversal of temporary differences. It also provides certain guidelines to be followed, including the need for the method employed to be systematic and logical, that a consistent method be used for each category of temporary differences, and that a change in the method used be considered a change in accounting principle.

5.4 Assume Company A purchases its only asset for $1,000, an asset that is admissible for statutory accounting purposes and depreciated over five years on a straight-line basis. Assume also that the asset is depreciated over seven years for tax purposes using the Modified Accelerated Cost Recovery System (MACRS). The following table summarizes the statutory and tax basis of the asset at the end of each year.

<table>
<thead>
<tr>
<th>Year</th>
<th>Cost</th>
<th>Statutory Depreciation</th>
<th>Statutory Basis</th>
<th>Tax Depreciation</th>
<th>Tax Basis</th>
<th>Deductible/ (Taxable) Temporary Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$1,000</td>
<td>$200</td>
<td>$800</td>
<td>$143</td>
<td>$857</td>
<td>$57</td>
</tr>
<tr>
<td>2</td>
<td>-</td>
<td>200</td>
<td>600</td>
<td>245</td>
<td>612</td>
<td>12</td>
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<td>3</td>
<td>-</td>
<td>200</td>
<td>400</td>
<td>175</td>
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<td>37</td>
</tr>
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<td>4</td>
<td>-</td>
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<td>312</td>
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<tr>
<td>6</td>
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<td>89</td>
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<tr>
<td>7</td>
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<td>-</td>
<td>89</td>
<td>45</td>
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</tr>
<tr>
<td>8</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>45&lt;sup&gt;5&lt;/sup&gt;</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>

5.5 At the end of year one, the Company would examine reversals by the end of year two and conclude that $45 of the $57 outstanding deductible temporary difference would reverse within one year, leaving a temporary difference of $12 at the end of year two. However, at the end of year two, the Company would not project a reversal of the temporary difference by the end of year three as the deductible temporary difference is scheduled to increase (from $12 to $37). If the Company had decided

<sup>5</sup> Due to the mid-year convention applicable to most asset acquisitions for tax purposes, the asset is treated as acquired in mid-year, meaning that a seven (7) year asset is depreciated over eight (8) tax years.
(at the end of year two) to sell the asset in year three, it may be appropriate to conclude that the outstanding deductible temporary difference of $12 would reverse within one year.

5.6 A similar rationale would apply in the instance of a nonadmitted asset. Assume the same facts as aforementioned, except that the asset is nonadmitted for statutory accounting purposes. The results are summarized in tabular form below.

<table>
<thead>
<tr>
<th>Year</th>
<th>Cost</th>
<th>Statutory Charge to Surplus</th>
<th>Statutory Basis</th>
<th>Tax Depreciation</th>
<th>Tax Basis</th>
<th>Deductible/ (Taxable) Temporary Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$1,000</td>
<td>$1,000</td>
<td>-</td>
<td>$143</td>
<td>$857</td>
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<tr>
<td>2</td>
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<td>-</td>
<td>89</td>
<td>223</td>
<td>223</td>
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<tr>
<td>6</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>89</td>
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</tbody>
</table>

5.7 In this example, the Company has a steady decline in the deductible temporary difference that is not complicated by competing depreciation regimes. This is due to the fact that the Company took the large surplus charge when the asset was nonadmitted, thereby created a significant deductible temporary difference. At the end of year one, the Company would project a $245 temporary difference reversal by the end of year two. Although the Company will take income statement charges for depreciation on the nonadmitted asset, the statutory basis is nonetheless zero from the moment the asset was nonadmitted. Future statutory depreciation deductions will not impact the statutory basis and have no impact on the analysis.

5.8 The above examples assume a single asset. However, the analysis becomes more complicated when the Company has hundreds or thousands of assets within its fixed asset pool. In this instance, it is expected that management will make its best estimate of the expected reversal pattern determined in a manner consistent with the grouping for measurement (see question 2.5 for more discussion about grouping).

5.9 As indicated above, the timing of the reversal of a particular balance sheet item will depend on the expected recovery of the related asset and liability. For example, the temporary difference associated with property & casualty loss reserves would be expected to reverse in a manner consistent with the payout pattern (“development”) of the underlying loss reserves. Historical loss development triangles may be useful in substantiating a reversal pattern. For instance, assume Company A writes two types of property and casualty policies: auto liability and workers’ compensation. The following table details the components of the statutory and tax reserves for Company A as of December 31, 2001.

<table>
<thead>
<tr>
<th>Private Passenger Auto Liability</th>
<th>Statutory Reserves</th>
<th>Tax Reserves</th>
<th>Temporary Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>AY + 0</td>
<td>$1,000</td>
<td>$900</td>
<td>$100</td>
</tr>
<tr>
<td>AY + 1</td>
<td>850</td>
<td>690</td>
<td>160</td>
</tr>
<tr>
<td>AY + 2</td>
<td>700</td>
<td>580</td>
<td>120</td>
</tr>
<tr>
<td>AY + 3</td>
<td>550</td>
<td>490</td>
<td>60</td>
</tr>
<tr>
<td>AY + 4</td>
<td>400</td>
<td>385</td>
<td>15</td>
</tr>
<tr>
<td>AY + 5</td>
<td>300</td>
<td>275</td>
<td>25</td>
</tr>
<tr>
<td>AY + 6</td>
<td>200</td>
<td>175</td>
<td>25</td>
</tr>
</tbody>
</table>

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5.10 One option in analyzing the reversal of the temporary difference would be to calculate the historical one-year loss development patterns for the two lines of business by accident year. By applying these development patterns to the individual temporary differences, the Company could estimate the expected one-year reversal of the temporary difference as a whole.

5.11 Another option would be to apply the average one-year development factor by line of business to each reserve. If the average one-year development factor for all accident years for auto liability and workers’ compensation were 70% and 35%, respectively, the one-year temporary difference reversal would be $371 ($530 x 70%) for auto liability and $343 ($980 x 35%) for workers’ compensation.

5.12 The temporary difference related to property and casualty unearned premiums is typically twenty percent (20%) of the outstanding statutory unearned premium reserve. If a company issues only one-year policies, it is reasonable to assume that the entire temporary difference will reverse in one year. If a company writes multi-year contracts, management will be required to estimate the percentage of the unearned premium that will be earned within one year and apply this percentage to the outstanding temporary difference.

5.13 The reversal of the temporary difference related to life insurance reserves may require actuarial assistance, normally involving anticipated development of the statutory and tax reserves for policies issued prior to the end of the current reporting year. In computing the anticipated development, it would be expected that reasonable assumptions be used, which may include cash-flow modeling of the entity’s reserves. Deferred acquisition costs on life insurance policies are amortized over prescribed periods pursuant to federal tax law. The amortization schedules should provide management with the ability to estimate the one-year reversal with reasonable accuracy.

5.14 For those temporary differences that do not have a defined reversal period, such as unrealized losses on common stock or deferred compensation liabilities, management will need to determine when the temporary difference is “expected” to reverse. For instance, assume a company has an unrealized loss of $200 in its equity portfolio and that, on average, the portfolio turns over twenty-percent (20%) per year. It would be appropriate for the company to conclude that $40 of the temporary difference will reverse in one year. When determining when the temporary difference would be “expected” to reverse,
management should normally take into account events that are likely to occur using information, facts and circumstances in existence as of the reporting date. The estimates used in this circumstance should not be extended to other tests of impairment. For instance, when the entity assumed a 20% turnover in its equity portfolio, it is not involuntarily required to record an impairment in accordance with paragraph 9 of SSAP No. 30 - Investments in Common Stock (excluding investments in common stock of subsidiary, controlled, or affiliated entities).

5.15 In summary, the methodology used to develop the reversal pattern should be consistent, systematic, and rational. Although consistency is encouraged, business conditions may dictate that certain factors be given more or less weight than in previous periods. Factors to be considered include historical patterns, recent trends, and the likely impact of future initiatives (without regard to future originating temporary differences). For instance, if a company has migrated to a more efficient claims management system, outstanding reserves may be settled more quickly than historical payment patterns may indicate. A company that expects to enter into a loss portfolio transfer reinsurance transaction should consider the implications of that treaty in determining the reversal of the loss reserve temporary difference.

5b. Q – How should future originating differences impact the one-year scheduling of temporary difference reversals? [Paragraphs 10 a., 10 b.i. and 11 a]

5.16 A – Future originating differences, and their subsequent reversals, are considered in assessing the existence of future taxable income. However, they should not impact the one-year scheduling of existing temporary difference reversals. Paragraph 229 of FAS 109 provides the following:

229. For some assets or liabilities, temporary differences may accumulate over several years and then reverse over several years. That pattern is common for depreciable assets. Future originating differences for existing depreciable assets and their subsequent reversals are a factor to be considered when assessing the likelihood of future taxable income (paragraph 21(b)) for realization of a tax benefit for existing deductible temporary differences and carryforwards.

6. Q – What is meant by the phrase “expected to be realized”? [Paragraph 10 b. i.]

6.1 A – Paragraph 10 states that:

10. Gross DTAs shall be admitted in an amount equal to the sum of:

a. Federal income taxes paid in prior years that can be recovered through loss carrybacks for existing temporary differences that reverse by the end of the subsequent calendar year;

b. The lesser of:

i. The amount of gross DTAs, after application of paragraph 10 a., expected to be realized within one year of the balance sheet date; or

ii. Ten percent of statutory capital and surplus as required to be shown on the statutory balance sheet of the reporting entity for its most recently filed statement with the domiciliary state commissioner adjusted to exclude any net DTAs, EDP equipment and operating system software and any net positive goodwill; and

c. The amount of gross DTAs, after application of paragraphs 10 a. and 10 b., that can be offset against existing gross DTLs.
6.2 A reporting entity calculates the amount of its gross DTAs and DTLs under paragraph 6 using the enacted tax rate. The amount of gross DTAs and DTLs is not recalculated under paragraph 10. The purpose of paragraph 10 is to determine the amount of gross DTAs that can be admitted in the reporting period.

6.3 An excerpt of SSAP No. 4 – *Assets and Nonadmitted Assets* indicates:

2. For purposes of statutory accounting, an asset shall be defined as: probable\(^6\) future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.

6.4 The phrase “expected to be realized” encompasses a reasonable expectation as to the value of the DTA consistent with SSAP 4. This means that if a reporting entity’s management expects that deductible temporary differences that reverse in the subsequent year will produce a federal income tax benefit at a rate that is lower than the enacted rate, the expected rate should be taken into consideration in the determination of the amount of admitted gross DTAs under paragraph 10 b. i. In other words, available evidence causes the reporting entity to expect the asset to be realized at less than the enacted rate. In such cases, it would not be appropriate to calculate the amount of admitted gross DTAs under paragraph 10 b. i. on the basis of reversing deductible temporary differences at the enacted tax rate.

6.5 The following examples illustrate situations where the amount of admitted gross DTAs under paragraph 10 b. i. would be less than the gross DTAs calculated using deductible temporary differences reversing in the subsequent year at the enacted income tax rate. The approach in these examples is to determine the tax savings that the company would expect to realize from its reversing deductible temporary differences. This is accomplished through a calculation of the company’s income tax liability “with and without” these temporary differences. It is assumed that in these examples there are no prudent and feasible tax-planning strategies that would cause the entity to expect the asset to be realized at a rate different than that presented in the examples.

*Example 1:*

6.6 P&C has a significant portion of its investment portfolio in municipal bonds. It is estimating regular taxable income for 2002 to be $6,000,000. Included in this amount is $10,000,000 of excluded tax-exempt interest and $2,000,000 of reversing deductible temporary differences that were included in P&C’s deferred inventory at 12/31/01.

\[
\begin{array}{c|c|c|c|c|c}
\text{Without Reversing Temporary Differences} & \text{With Reversing Temporary Differences} \\
\hline
\text{Regular Taxable Income} & 8,000,000 & 8,000,000 & 8,000,000 & 8,000,000 \\
\text{AMT/ACE Adjustment} & 6,375,000 \quad 7 & 6,375,000 \quad 7 & 6,375,000 \quad 7 & 6,375,000 \quad 7 \\
\text{Reversing Temporary Differences} & (2,000,000) & (2,000,000) & & \\
\text{Taxable Income} & 8,000,000 & 14,375,000 & 6,000,000 & 12,375,000 \\
\text{Tax (35% regular/20% AMT)} & 2,800,000 & 2,875,000 & 2,100,000 & 2,475,000 \\
\text{Tax Liability} & 2,800,000 & 75,000 & 2,100,000 & 375,000 \\
\text{Total Tax} & \$2,875,000 & & \$2,475,000 & \\
\end{array}
\]

---

\(^7\) $10,000,000 \times 85\% \times 75\%$

\(^6\) *FASB Statement of Financial Accounting Concepts No. 6, Elements of Financial Statements* (CON 6), states: Probable is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in *FASB Statement No. 5, Accounting for Contingencies*, par. 3), and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved.
6.7 In 2002, the reversing deductible temporary differences of $2,000,000 are expected to save P&C income taxes at a rate of 20% or $400,000 ($2,875,000 – $2,475,000). The remaining 15% tax benefit represents an additional AMT credit carryover of $300,000 ($375,000 – $75,000). Therefore, P&C’s admitted gross DTAs under paragraph 10 b.i., before reduction for any admitted gross DTAs under paragraph 10 a. would be 400,000, which is less than the amount of its gross DTAs of $700,000 ($2,000,000 x 35%) on reversing deductible temporary differences at the enacted rate. However, the $300,000 difference generated by the 15% (35% - 20%) rate differential under paragraph 10 b.i. would be taken into account in the paragraph 10 c. calculation to offset existing gross DTLs.

Example 2:

6.8 SL is a small life insurance company with projected assets of less than $500 million at the end of 2002. SL also estimates that its taxable income before the small life insurance company deduction (SLICD) will be $1,300,000. Included in this amount is $400,000 of reversing deductible temporary items that were part of SL’s deferred inventory at 12/31/01.

<table>
<thead>
<tr>
<th>Without Reversing Temporary Differences</th>
<th>With Reversing Temporary Differences</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regular Taxable Income before SLICD</td>
<td>Regular Tax</td>
</tr>
<tr>
<td>Reversing Temporary Differences</td>
<td>$1,700,000</td>
</tr>
<tr>
<td>Net</td>
<td>1,700,000</td>
</tr>
<tr>
<td>Small Life Insurance Company Deduction (60%)</td>
<td>(1,020,000)</td>
</tr>
<tr>
<td>AMT/ACE Adjustment (75% of SLICD)</td>
<td>765,000</td>
</tr>
<tr>
<td>Taxable Income</td>
<td>680,000</td>
</tr>
<tr>
<td>Tax (35% regular/20% AMT)</td>
<td>238,000</td>
</tr>
<tr>
<td>Tax Liability</td>
<td>$238,000</td>
</tr>
<tr>
<td>Total Tax</td>
<td>$289,000</td>
</tr>
</tbody>
</table>

6.9 Since SL is a small life insurance company with less than $3 million of taxable income before the small life insurance company deduction, it is taxed at an effective federal income tax rate of 17%. The $400,000 of reversing deductible temporary differences in 2002 is expected to save SL $68,000 ($289,000 - $221,000) in federal income taxes at the 17% rate. The tax savings represents a reduction in regular taxes of $56,000 and AMT taxes of $12,000. Under paragraph 10 b.i., SL would admit gross DTAs of $68,000, before reduction for any gross DTAs admitted under paragraph 10a. Any unused amount of gross DTAs related to the 18% (35% - 17%) rate differential under paragraph 10 b.i. would be taken into account under paragraph 10 c. to offset existing gross DTLs.

Example 3:

6.10 BCBS is a Blue Cross/Blue Shield Organization that expects to fully offset its regular taxable income with available section 833 (b) deductions in 2002. Prior to considering the section 833 (b) deduction, BCBS projects $8,000,000 of taxable income in 2002 which includes $3,000,000 of reversing deductible temporary differences that were part of its deferred inventory at 12/31/01.
### Income Taxes

<table>
<thead>
<tr>
<th>Regular Taxable Income Before 833(b)</th>
<th>Regular Tax</th>
<th>AMT</th>
<th>Regular Tax</th>
<th>AMT</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reversing Temporary Differences</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net</td>
<td>11,000,000</td>
<td>11,000,000</td>
<td>8,000,000</td>
<td>8,000,000</td>
</tr>
<tr>
<td>Section 833 (b) Deduction</td>
<td>(11,000,000)</td>
<td>(8,000,000)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Taxable Income</td>
<td>0</td>
<td>11,000,000</td>
<td>0</td>
<td>8,000,000</td>
</tr>
<tr>
<td>Tax (35% regular/20% AMT)</td>
<td>0</td>
<td>2,200,000</td>
<td>0</td>
<td>1,600,000</td>
</tr>
<tr>
<td>Tax Liability</td>
<td>$0</td>
<td>2,200,000</td>
<td>$0</td>
<td>1,600,000</td>
</tr>
</tbody>
</table>

- **Tax Liability**: $2,200,000 $1,600,000

### Example 4:

- **6.12** ABC insurance company is projecting an income tax loss in 2002 of $20,000,000, which includes $5,000,000 of reversing deductible temporary differences that were part of its deferred inventory at 12/31/01. ABC expects to pay $0 federal income taxes in 2002 for both regular and AMT tax purposes as a result of its tax loss.

### 7. Q – SSAP 10 provides that a reporting entity may admit deferred tax assets in an amount equal to federal income taxes paid in prior years that can be recovered through loss carrybacks for existing temporary differences that reverse by the end of the subsequent calendar year. What is the meaning of the term “taxes paid”? [Paragraph 10 a.]

- **7.1** A – SSAP 10 Paragraph 10 states that:

  - **10.** Gross DTAs shall be admitted in an amount equal to the sum of:
a. Federal income taxes paid in prior years that can be recovered through loss carrybacks for existing temporary differences that reverse by the end of the subsequent calendar year;

7.2 The term “taxes paid” means the total tax (both regular and AMT), that was or will be reported on the reporting entity’s federal income tax returns for the periods included in the carryback period including any amounts established in accordance with the provision of SSAP 5 as described in paragraph 3 a. of SSAP 10 related to those periods. If a federal income tax return in the carryback period has been amended, or adjusted by the IRS, “taxes paid” would reflect the impact of the amended tax return, or settlement with the IRS.

7.3 In applying the term “taxes paid” to a reporting entity that is party to a consolidated federal income tax return, the term “taxes paid” means the total federal income tax (both regular and AMT) that was paid, or is expected to be paid to the common parent of the reporting entity’s affiliated group, in accordance with the intercompany tax sharing agreement, with respect to the income tax years included in the carryback period. “Taxes paid” includes amounts established in accordance with the provision of SSAP 5 as described in paragraph 3 a. of SSAP 10 related to those periods, including current federal income taxes payable (i.e., accrued in the entity’s financial statements) related to the carryback period. The ability of the reporting entity to recover (through loss carrybacks) taxes that were paid to its common parent is generally governed by the terms and provisions of the affiliated group’s intercompany tax sharing or tax allocation agreement.

8. Q – How is a company’s computation of gross and admitted deferred taxes impacted if it joins in the filing of a consolidated federal income tax return? [paragraphs 6, 10, and 11 c.]

8.1 A – For purposes of determining the amount of DTAs and the amount admitted under paragraph 10, the calculation should be made on a separate company, reporting entity basis. Under paragraph 6, a reporting entity’s gross deferred tax assets and liabilities are determined by identifying its temporary differences. These temporary differences are measured using a “balance sheet” approach by comparing statutory and tax basis balance sheets for that entity. Once a reporting entity determines its gross DTAs, the amount that is admitted is determined in accordance with paragraph 10.

8.2 Under paragraph 10a., an entity shall determine the amount of “federal income taxes paid in prior years that can be recovered through loss carrybacks for existing temporary differences that reverse by the end of the subsequent calendar year.” Consistent with guidance promulgated in other EAIWG interpretations, a reporting entity that files a consolidated federal income tax return with its parent should look to the amount of taxes it paid (or were allocable to it) as a separate legal entity in determining the admitted DTA under paragraph 10a. Furthermore, the DTA under paragraph 10a. may not exceed the amount that the entity could reasonably expect to have refunded by its parent (paragraph 11 c.). The taxes paid by the reporting entity represent the maximum DTA that may be admitted under paragraph 10a., although the amount could be reduced pursuant to the group’s tax allocation agreement.

8.3 The amount of admitted gross DTAs under paragraph 10 b.i. is limited to the amount that the reporting entity expects to realize within one year of the balance sheet date on a separate company basis. The entity must estimate its separate company taxable income and the tax benefit that it expects to receive from reversing deductible temporary differences in the form of lower tax payments to its parent. A reporting entity that projects a tax loss in the following year cannot admit a DTA related to the loss under paragraph 10 b., even if the loss could offset taxable income of other members in the consolidated group and the reporting entity could expect to be paid for the tax benefit pursuant to its tax allocation agreement.

8.4 The following examples reflect this analysis and assume that the surplus limitation of paragraph 10 b.ii. is not applicable:
Example 1:

8.5 Assume Company A joins in the filing of a consolidated federal income tax return. Consolidated taxes paid in prior carryback years total $150, of which Company A paid $100. Company A has existing temporary differences that reverse by the end of the subsequent calendar year on a separate company, reporting entity basis that, at 35%, would give rise to a tax benefit of $125.

8.6 Under paragraph 10 a., Company A could record an admitted DTA under 10 a. of $100, equal to the taxes it paid. Additionally, under paragraph 10 b.i., Company A could admit an additional $25, assuming it expects to realize such tax benefit based on its separate company analysis. Due to the consolidated return filing, the $100 admitted under paragraph 10 a. could only be admitted provided this amount could reasonably be expected to be refunded by the parent [paragraph 11 c.] and would be available pursuant to a written income tax allocation agreement [paragraph 12 b.].

Example 2:

8.7 Assume the same facts as in Example 1, except consolidated taxes paid in prior carryback years that could be recovered are $70 and, pursuant to a written income tax allocation agreement, taxes recoverable through loss carrybacks may not exceed consolidated taxes paid in prior carryback years.

8.8 In this situation, Company A would admit a DTA of $70 under paragraph 10a. (recoverable taxes limited to consolidated taxes paid which could be refunded by the parent). In addition, $55 ($125-$70) of DTA may be admitted under paragraph 10 b.i., if Company A expected to realize this tax benefit on the basis of its separate company estimated taxable income and temporary differences that are expected to be realized within one year of the balance sheet date.

Example 3:

8.9 Parent Company P files a consolidated federal income tax return with its insurance subsidiaries, R, S and T. Assume consolidated taxes that could be recovered through loss carryback total $450. However, in the prior carryback years $200 was paid by each of the subsidiaries, R, S and T. The difference between the amount paid by the subsidiaries ($600) and the amount available through loss carryback ($150) is attributable to interest expense incurred by Company P. Pursuant to the group’s written income tax allocation agreement, in the case of loss carrybacks, taxes recoverable are limited to the consolidated taxes paid in the carryback years.

8.10 Because the DTA admitted under paragraph 10 a. for each reporting entity cannot exceed what each entity paid and could reasonably be expected to be refunded by P, no more than $450 in total may be admitted by the subsidiaries (under paragraph 10 a.). If the DTA associated with the subsidiaries’ temporary differences that reverse in the 10 a. period exceed the $450 of taxes recoverable through loss carryback on a consolidated basis the DTA admitted by the insurance subsidiaries under paragraph 10 a. should be allocated among the subsidiaries, consistent with the principles of its written income tax allocation agreement. This allocation would, in most instances, be based on each subsidiary’s share of reversing temporary differences.

8.11 Under paragraph 10 c., an entity may admit its gross DTAs, after application of paragraphs 10 a. and 10 b., based upon offset against its own existing gross DTLs and not against DTLs of other members of the affiliated or consolidated group.

9. Q – Current income taxes are defined by paragraph 3 a. to include estimates of tax contingencies for the current and all prior years, to the extent not previously provided, computed in accordance with SSAP 5. What impact, if any, does the inclusion of tax contingencies as a
component of current income taxes have on the determination of deferred income taxes? [Paragraph 3 a.]

9.1 A – It is not the intention of this interpretation to modify existing FAS 109 guidance with respect to the general reporting of tax contingencies and/or the net interest on such contingencies. The purpose of this interpretation is to address when such contingencies should be “grossed-up” and reflected in the calculation of both statutory current and deferred federal income taxes.

9.2 Gross deferred tax assets and liabilities are determined in accordance with paragraph 6 of SSAP 10, and reflect the changes in temporary differences taken into account in estimating taxes currently payable and are manifested in the enterprise’s tax basis balance sheet. If gross tax contingencies associated with temporary differences have been included in taxes currently payable, a corresponding adjustment must be made to the tax basis balance sheet used in the determination of gross deferred tax assets and liabilities. Deferred tax assets and liabilities are not adjusted for tax contingencies not associated with temporary differences (i.e. permanent differences).

9.3 For example, assume that a company determines, in accordance with SSAP 5, a tax contingency is required to be established for a $100 deduction claimed in a prior year federal income tax return. Assuming a 35% tax rate, the company would establish a current tax liability in the amount of $35, increasing its current income tax expense by $35.

\[
\begin{align*}
\text{DR} & \quad \text{Current income tax expense} & $35 \\
\text{CR} & \quad \text{Liability for current income tax} & $35
\end{align*}
\]

9.4 If the $100 deduction was associated with a temporary difference such as reserves, the company would make a corresponding adjustment to deferred taxes. The company would increase its gross deferred tax asset for reserves by $35 to reflect the future tax benefit associated with that reserve deduction.

\[
\begin{align*}
\text{DR} & \quad \text{Gross deferred tax asset} & $35 \\
\text{CR} & \quad \text{Change in net deferred tax (surplus)} & $35
\end{align*}
\]

9.5 If the $100 deduction was associated with a permanent item such as meals and entertainment expenses, the company would make no corresponding adjustment to the deferred tax assets.

9.6 In determining when tax contingencies associated with temporary differences should be included in current income taxes under Paragraph 3 a., and, thus, deferred taxes, a reporting entity is not required to “gross-up” its current and deferred taxes until such time as an event has occurred that would cause a re-evaluation of the contingency and its probability of assessment, e.g., the IRS has identified the item as one which may be adjusted upon audit. Such an event could be the company’s receipt of a Form 5701, Proposed Audit Adjustment, or could occur earlier upon receipt of an Information Document Request. At such time, the company must reassess the probability of an adjustment, reasonably re-estimate the amount of loss (see SSAP 5), make any necessary adjustment to deferred taxes, and redetermine the admissibility of any gross deferred tax asset as provided in Paragraph 10 in SSAP 10.

10a. Q – If the reporting entity adjusts the amount of regular taxable income and capital gains reported on a prior year income tax return from the amount originally determined for financial reporting purposes, how is the effect of the change reported in the current year? [Paragraph 15]

10.1 A – Paragraph 15 of SSAP 10 indicates that “income taxes incurred or received during the current year attributable to prior years shall be allocated, to the extent not previously provided, to net income in accordance with SSAP No. 3 unless attributable, in whole or in part, to realized capital gains or losses, in which case, such amounts shall be apportioned between net income and realized capital gains and losses,
as appropriate”. Paragraph 15 also indicates that income taxes incurred are to be allocated to ordinary income and realized capital gains consistent with paragraph 38 of FAS 109. Paragraph 38 of FAS 109 provides, in general, that the portion of the total income tax expense remaining after allocation to ordinary income would be allocated to realized capital gains or losses.

10.2 In accordance with paragraph 15, the amount of additional federal income taxes incurred in the current year with respect to the prior year would be allocated between ordinary income and realized capital gain items. The amount of additional federal income tax expense allocated to ordinary income should be determined by comparing the amount of additional tax expense actually incurred to the amount of tax expense that would have been incurred had the adjustment to ordinary income been zero (a “with and without” computation). The remaining amount of additional federal income tax expense would then be allocated to realized capital gains. The amounts of additional federal income tax expense allocated to ordinary income and realized capital gains would be included in the current period’s federal income tax expense and not as a direct adjustment to surplus.

10.3 As an example, assume Company X files its 2000 Federal income tax return and reports $1,000,000 of taxable income comprised of $800,000 of ordinary income and $200,000 of capital gain income. Since the company is subject to taxation at a 34 percent tax rate on all its income, it incurred federal income tax expense of $340,000. In preparing its 2000 statutory income tax provision, the company estimated that its liability for 2000 federal income tax would be $238,000 based on $600,000 of ordinary income and $100,000 realized capital gains.

10.4 In determining the amount of “income taxes incurred” for its 2001 financial statement, Company X must include the additional $102,000 of income tax expense incurred on its 2000 federal income tax return ($340,000 actual tax incurred less $238,000 originally reported) in net income for 2001 pursuant to paragraph 15 of SSAP 10 and not as a surplus adjustment. The $102,000 additional expense would be allocated to federal income taxes on net income and realized capital gains and losses as follows:

<table>
<thead>
<tr>
<th>Total additional income tax expense</th>
<th>$102,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax expense allocated to operations ($200,000 additional income x 34%)</td>
<td>68,000</td>
</tr>
<tr>
<td>Tax expense allocated to realized gains</td>
<td>$ 34,000</td>
</tr>
</tbody>
</table>

The tax expense allocated to operations was determined as follows:

| Total recomputed tax expense | $340,000 |
| Tax expense with only capital gain changes | 272,000 8 |
| Tax expense allocated to operations | $ 68,000 |

10.5 For all purposes of computing and allocating federal income taxes between operations and capital gains and losses, the character of the income or loss item as determined for statutory accounting purposes should be followed. Thus, if an income item is treated as a capital gain for statutory accounting purposes but as ordinary income for tax purposes, the federal income tax allocable to such income would be considered tax expense attributable to capital gains.

10b. Q – What is meant by the phrase in paragraph 14 “a reporting entity’s unrealized gains and losses shall be recorded net of any allocated DTA or DTL”? [Paragraph 14]

10.6 A – Pursuant to Paragraph 14 of SSAP 10, a reporting entity’s unrealized gains and losses shall be recorded net of any allocated DTA or DTL in accordance with paragraph 35 of FAS 109. Paragraph

8 This is a company with less than $10 million of taxable income therefore $600,000 of original ordinary income plus $200,000 recomputed capital gains equals $800,000 taxable income times 34 percent applicable tax rate equals $272,000.
35 of FAS 109 indicates that income taxes incurred are to be allocated between various items, including gains from operations and items charged or credited directly to shareholders’ equity, such as the change in unrealized gains and losses.

10.7 To the extent a reporting entity’s admitted DTA or its DTL changes during the year, the portion of such change allocable to changes in unrealized gains and losses during the year should be determined. The portion so allocable would be reported with, and netted against, the related change in unrealized gains and losses reported as a component of changes in surplus. The remaining portion of the change in DTA or DTL allocable to other temporary differences should be reported as a separate component of changes in surplus and/or change in nonadmitted assets.

10.8 For example, assume the reporting entity has DTAs of $1,000 relating to temporary differences other than unrealized losses, and a $100 DTL relating to unrealized gains as of the beginning of the year. Since the entity is subject to tax at 35 percent and all of its DTAs are expected to reverse within one year, the entity recorded a $900 net admitted DTA as of the beginning of the year.

10.9 During the current year, the DTAs relating to temporary differences other than unrealized losses did not change, but the DTL relating to the entity’s unrealized gains increased by $100 (unrealized gains increased by $285 during the year). As a result, the amount of the entity’s net admitted DTAs decreased by $100.

10.10 Pursuant to paragraph 14 of SSAP 10, the $100 decrease in the DTA during the year is to be allocated between changes attributable to temporary differences other than unrealized gains and losses and those attributable to unrealized gains and losses. Since the DTA relating to temporary differences other than unrealized gains and losses did not change during the year, the entire decrease is allocable to the change in unrealized gains. Therefore, the $100 decrease is to be allocated and netted against the $285 change in unrealized gains reported in change in surplus, resulting in a $185 net increase in surplus relating to its unrealized gains. If a portion of the unrealized loss DTA is determined to be nonadmitted, that amount is not recorded separately from the operating differences DTA. The change in the total nonadmitted DTA from period to period is recorded in surplus as a Change in Nonadmitted Assets.

11. Q – How are current and deferred income taxes to be accounted for in interim periods? [Paragraphs 11 d. and 16]

11.1 A – In setting forth the methodology for the computation of current income taxes (income taxes incurred) in interim periods, paragraph 16 states:

16. Income taxes incurred in interim periods shall be computed using an estimated annual effective current tax rate for the annual period in accordance with the methodology described in paragraphs 19 and 20 of Accounting Principles Board Opinion No. 28, Interim Financial Reporting. Estimates of the annual effective tax rate at the end of interim periods are, of necessity, based on estimates and are subject to subsequent refinement or revision. If a reliable estimate cannot be made, the actual effective tax rate for the year-to-date may be the best estimate of the annual effective tax rate. If an insurer is unable to estimate a part of its “ordinary” income (or loss) or the related tax (or benefit) but is otherwise able to make a reliable estimate, the tax (or benefit) applicable to the item that cannot be estimated shall be reported in the interim period in which the item is reported.

11.2 As a result, to the extent a reliable estimate can be made of an expected annual effective tax rate, reporting entities should apply this rate to net income before federal and foreign income taxes, in the case of property and casualty insurers and health insurers, and net income and realized capital gains before federal and foreign income taxes in the case of life insurers. If a reliable estimate of the expected annual effective tax rate cannot be made, reporting entities should compute current and deferred taxes at interim reporting dates using the most reliable information that is available.
11.3 The following examples illustrate the estimation process for income taxes incurred using the estimated annual effective rate:

<table>
<thead>
<tr>
<th>Estimated annual permanent differences:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax exempt income</td>
<td>$(2,000,000)</td>
</tr>
<tr>
<td>Officers’ life insurance premiums</td>
<td>(50,000)</td>
</tr>
<tr>
<td></td>
<td>(2,050,000)</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Estimated annual temporary differences:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Loss reserve discounting</td>
<td>1,000,000</td>
</tr>
<tr>
<td>Unearned premium reserve offset</td>
<td>250,000</td>
</tr>
<tr>
<td></td>
<td>1,250,000</td>
</tr>
</tbody>
</table>

| Projected taxable income for current year | $9,200,000 |
| Projected federal tax for current year (at 35%) | $3,220,000 |

| Estimated annual effective tax rate | 32.2% |

11.4 As a result, assuming that during the calendar year the insurer’s expectations as to its statutory and taxable income do not change, income tax incurred will be recorded on a quarterly basis as follows:

<table>
<thead>
<tr>
<th>Quarter</th>
<th>Statutory Income (Loss)</th>
<th>Income Taxes Incurred</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$(2,000,000)</td>
<td>$(644,000)</td>
</tr>
<tr>
<td>2</td>
<td>4,000,000</td>
<td>1,288,000</td>
</tr>
<tr>
<td>3</td>
<td>6,000,000</td>
<td>1,932,000</td>
</tr>
<tr>
<td>4</td>
<td>2,000,000</td>
<td>644,000</td>
</tr>
<tr>
<td>Total</td>
<td>$10,000,000</td>
<td>$3,220,000</td>
</tr>
</tbody>
</table>

11.5 If the insurer’s expectations as to its statutory and taxable income change in the second quarter so that it expects that its annual effective rate will increase from 32.2% to 34%, it will record income taxes incurred in the second quarter of $1,324,000 (cumulative statutory income at end of the second quarter of $2,000,000 at 34% or $680,000 less $644,000 tax benefit recorded in first quarter).

11.6 As noted above, life insurers must estimate their annual effective tax rate and record income taxes incurred based on net income and realized capital gains before federal and foreign income taxes. With regard to intraperiod tax allocation, paragraph 15 states in relevant part:

15. Income taxes incurred shall be allocated to net income and realized capital gains or losses in a manner consistent with paragraph 38 of FAS 109.

11.7 As a result of the above and where the insurer expects realized capital gains or losses for the annual period, income taxes incurred must be allocated using a “with and without” methodology to net income before taxes and realized capital gains (see question 10.4 for further discussion).
11.8 An example of this “with and without” methodology is as follows:

| Projected statutory net income for current year | $10,000,000 |
| Realized gains included above | (1,000,000) |
| Estimated annual permanent differences: | |
| Tax exempt income | $(2,000,000) |
| Officers’ life insurance premiums | (50,000) |
| Estimated annual temporary differences: | |
| Loss reserve discounting | 1,000,000 |
| Unearned premium reserve offset | 250,000 |
| Projected ordinary taxable income for current year | $8,200,000 |
| Projected ordinary federal tax for current year (at 35%) | $2,870,000 |
| Projected capital gain federal tax for current year (at 35%) | 350,000 |
| Projected total federal tax for current year | $3,220,000 |
| Estimated ordinary annual effective tax rate | 31.9% |
| Estimated capital gain annual effective tax rate | 35.0% |
| Estimated total annual effective tax rate | 32.2% |

11.9 As a result, assuming that during the calendar year the insurer’s expectations as to its statutory and taxable income (including the amounts of ordinary and capital income) do not change, income tax incurred will be recorded on a quarterly basis as follows:

<table>
<thead>
<tr>
<th>Quarter</th>
<th>Ordinary Income (Loss)</th>
<th>Capital Income (Loss)</th>
<th>Ordinary Taxes Incurred</th>
<th>Capital Taxes Incurred</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$(1,000,000)</td>
<td>$(1,000,000)</td>
<td>$(319,000)</td>
<td>$(350,000)</td>
</tr>
<tr>
<td>2</td>
<td>3,000,000</td>
<td>1,000,000</td>
<td>956,000</td>
<td>350,000</td>
</tr>
<tr>
<td>3</td>
<td>5,000,000</td>
<td>1,000,000</td>
<td>1,595,000</td>
<td>350,000</td>
</tr>
<tr>
<td>4</td>
<td>2,000,000</td>
<td>0</td>
<td>638,000</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>$9,000,000</td>
<td>$1,000,000</td>
<td>$2,870,000</td>
<td>$350,000</td>
</tr>
</tbody>
</table>

11.10 With respect to the recording of deferred taxes on an interim basis paragraph 11(d) states:

11(d) The phrases “reverse by the end of the subsequent calendar year” and “realized within one year of the balance sheet date” are intended to accommodate interim reporting dates and insurers that file on an other than a calendar year basis for federal income tax purposes.

11.11 When considered in the context of paragraph 16, this paragraph requires the use of the annual effective rate when determining deferred taxes at an interim reporting date. As such, an insurer’s admissible deferred tax assets are determined in accordance with paragraph 10 by reference to the deferred tax assets that will reverse in the subsequent calendar year (tax year when the insurer’s tax year is not the calendar year). Note however, that due to the inherent unpredictability, and general inability to project changes in capital gains and losses on a quarter by quarter basis, the deferred tax implications of the changes in unrealized gains and losses should be recorded on a discrete period basis (i.e., based on the change in the amounts on a quarter by quarter basis). For example in determining its admissible deferred tax assets at March 31, 2002, the reversal period referred to above is calendar year 2003 (i.e., expected deferred tax assets at December 31, 2002 that are expected to reverse in 2003).

11.12 This methodology is illustrated by the following example:
Projected statutory net income for 2002 | $10,000,000
---|---
Estimated annual permanent differences:
- Tax exempt income | $(2,000,000)
- Officers’ life insurance premiums | $(50,000)
| (2,050,000)
Estimated annual temporary differences:
- Loss reserve discounting | 1,000,000
- Unearned premium reserve offset | 250,000
| 1,250,000
Projected ordinary taxable income for current year | $9,200,000
Temporary differences at December 31, 2001:
- Loss reserve discounting | 5,000,000
- Unearned premium reserve offset | 750,000
Estimated temporary differences at December 31, 2002:
- Loss reserve discounting | 6,000,000
- Unearned premium reserve offset | 1,000,000
Taxable income in carryback period (taxes paid at 35%):
| Year ended December 31, 2000 | $1,000,000 | ($350,000)
| Year ended December 31, 2001 | 2,000,000 | (700,000)
| Year ended December 31, 2002 | 9,200,000 | (3,220,000)

*Note: Year ended December 31, 2002 taxable income and taxes paid considered in the calculation of its interim tax accruals are based on the insurer’s estimate of its annual taxable income and taxes to be paid. This amount may differ from the quarterly federal income tax estimates it expects to make during the year.*

Temporary differences anticipated to reverse in 2002:
- Loss reserve discounting | $1,250,000
- Unearned premium reserve offset | 750,000
Temporary differences anticipated to reverse in 2003:
- Loss reserve discounting | $3,000,000
- Unearned premium reserve offset | 1,000,000
Estimated surplus, as adjusted at September 30, 2002 | $10,000,000

Admitted deferred tax assets at December 31, 2001:

| Paragraph 10(a) | 2000 | $1,000,000
| | 2001 | 1,000,000
| | 2002 | 2,000,000
| Taxes paid at 35% | $700,000

| Paragraph 10(b) | 0
| Paragraph 10(c) | 0
| Total admitted | $700,000

Admitted deferred tax assets at December 31, 2002:

| Paragraph 10(a) | 2001 | $1,000,000
| | 2002 | 3,000,000
| | 2003 | 4,000,000
| Taxes paid at 35% | $1,400,000

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Total estimated federal taxes for 2002:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income taxes incurred (current tax)</td>
<td>$3,220,000</td>
</tr>
<tr>
<td>Change in deferred tax</td>
<td>($700,000)</td>
</tr>
<tr>
<td></td>
<td>$2,520,000</td>
</tr>
</tbody>
</table>

11.13 As a result of the above, the annual effective tax rate for current and deferred income taxes is as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current ($3,220,000/$10,000,000)</td>
<td>32.2%</td>
</tr>
<tr>
<td>Deferred (($700,000)/$10,000,000)</td>
<td>(7.0)%</td>
</tr>
<tr>
<td>Total annual effective rate</td>
<td>25.2%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Quarter</th>
<th>Statutory Income (Loss)</th>
<th>Income Taxes Incurred</th>
<th>Deferred Taxes</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$(2,000,000)</td>
<td>$(644,000)</td>
<td>$140,000</td>
</tr>
<tr>
<td>2</td>
<td>4,000,000</td>
<td>1,288,000</td>
<td>(280,000)</td>
</tr>
<tr>
<td>3</td>
<td>6,000,000</td>
<td>1,932,000</td>
<td>(420,000)</td>
</tr>
<tr>
<td>4</td>
<td>2,000,000</td>
<td>644,000</td>
<td>(140,000)</td>
</tr>
<tr>
<td>Total</td>
<td>$10,000,000</td>
<td>$3,220,000</td>
<td>$(700,000)</td>
</tr>
</tbody>
</table>

11.14 To the extent that an insurer’s estimated December 31, 2002 admitted deferred tax assets are limited by its surplus pursuant to paragraph 10(b) ii., the annual effective deferred tax rate must be adjusted to consider the impact of this limitation on a quarterly basis.

12. Q – How do you present deferred taxes in the Annual Statement? [Paragraphs 7, 14 and 17-23]

12.1 A – This answer is divided into four different parts.

Change in Accounting Principle

12.2 The initial recognition of balances computed under SSAP 10 on January 1, 2001 shall be presented in the Annual Statement as a Cumulative Effect of Changes in Accounting Principles. SSAP 3 provides the following:

3. A change in accounting principle results from the adoption of an accepted accounting principle, or method of applying the principle, which differs from the principles or methods previously used for reporting purposes. A change in the method of applying an accounting principle shall be considered a change in accounting principle.

4. A characteristic of a change in accounting principle is that it concerns a choice from among two or more statutory accounting principles. However, a change in accounting principle is neither (a) the initial adoption of an accounting principle in recognition of events or transactions occurring for the first time or previously immaterial in their effect, nor (b) the adoption or modification of an accounting principle necessitated by transactions or events that are clearly different in substance from those previously occurring.

5. The cumulative effect of changes in accounting principles shall be reported as adjustments to unassigned funds (surplus) in the period of the change in accounting principle. The cumulative effect is the difference between the amount of capital and surplus at the
beginning of the year and the amount of capital and surplus that would have been reported at that date if the new accounting principle had been applied retroactively for all prior periods.

12.3 In accordance with an interpretation from the Emerging Accounting Issues Working Group, INT 01-27: Accounting Change versus Correction of Error, adjustments to amounts recorded as of January 1, 2001 would be recorded as a modification to the changes in accounting principle account rather than corrections of an error through the period of 2001.

Illustration A Assumptions:

12.4 On January 1, 2001 the AlphaBeta P/C Company computed the following balances related to deferred taxes:

<table>
<thead>
<tr>
<th></th>
<th>1/1/01</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross DTA</td>
<td>$200,000</td>
</tr>
<tr>
<td>Gross DTL</td>
<td>100,000</td>
</tr>
<tr>
<td>Net DTA</td>
<td>100,000</td>
</tr>
<tr>
<td>Nonadmitted DTA</td>
<td>25,000</td>
</tr>
<tr>
<td>Net Admitted DTA</td>
<td>$75,000</td>
</tr>
</tbody>
</table>

12.5 The Cumulative Effect of Changes in Accounting Principles line shown in the surplus section of the Annual Statement would show an increase of $75,000 ($200,000 DTA – $100,000 DTL – $25,000 Nonadmitted DTA) on 1/1/01. During the second quarter of 2001, the Company modified its opening balance as follows (note that modifications were not a result of changes in circumstances or events which occurred during 2001):

<table>
<thead>
<tr>
<th></th>
<th>Revised 1/1/01</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross DTA</td>
<td>$220,000</td>
</tr>
<tr>
<td>Gross DTL</td>
<td>100,000</td>
</tr>
<tr>
<td>Net DTA</td>
<td>120,000</td>
</tr>
<tr>
<td>Nonadmitted DTA</td>
<td>55,000</td>
</tr>
<tr>
<td>Net Admitted DTA</td>
<td>$65,000</td>
</tr>
</tbody>
</table>

12.6 The Company would record the following balances in its 3/31/01 financial statements:

<table>
<thead>
<tr>
<th></th>
<th>1/1/01</th>
<th>Revised 1/1/01</th>
<th>Increase (Decrease)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross DTA</td>
<td>$200,000</td>
<td>$220,000</td>
<td>$20,000</td>
</tr>
<tr>
<td>Gross DTL</td>
<td>100,000</td>
<td>100,000</td>
<td>0</td>
</tr>
<tr>
<td>Net DTA</td>
<td>100,000</td>
<td>120,000</td>
<td>20,000</td>
</tr>
<tr>
<td>Nonadmitted DTA</td>
<td>25,000</td>
<td>55,000</td>
<td>30,000</td>
</tr>
<tr>
<td>Net Admitted DTA</td>
<td>$75,000</td>
<td>$65,000</td>
<td>($10,000)</td>
</tr>
</tbody>
</table>

12.7 The $10,000 decrease in net admitted DTA would be recorded through the Cumulative Effect of Changes in Accounting Principles line shown in the surplus section of the Annual Statement.

Unrealized Capital Gains and Losses

12.8 SSAP 10 paragraph 14 states:
14. In accordance with paragraph 35 of FAS 109, a reporting entity's unrealized gains and losses shall be recorded net of any allocated DTA or DTL. The amount allocated shall be computed in a manner consistent with paragraph 38 of FAS 109.

12.9 The following illustrates the presentation of such requirement in the Annual Statement:

**Illustration B Assumptions:**

12.10 Entity grouped its investments in a reasonable and consistent manner and calculated the following gross amounts attributable to appreciation and depreciation in the fair value of its common stocks during 2001 (see question 2 regarding grouping of assets and liabilities for measurement):

<table>
<thead>
<tr>
<th>Gross</th>
<th>Carrying Value</th>
<th>Rate</th>
<th>Tax effected DTA (DTL)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Common stock carrying value 1/1/01</td>
<td>$800,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unrealized (loss)</td>
<td>($428,571)</td>
<td>35%</td>
<td>$150,000</td>
</tr>
<tr>
<td>Unrealized gain</td>
<td>342,857</td>
<td>35%</td>
<td>(120,000)</td>
</tr>
<tr>
<td>Net (loss) gain</td>
<td>(85,714)</td>
<td></td>
<td>$30,000</td>
</tr>
<tr>
<td>Common stock carrying value 12/31/01</td>
<td>$714,286</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

12.11 The journal entries need to present unrealized losses and gains net of tax are:

<table>
<thead>
<tr>
<th>Date</th>
<th>Dr</th>
<th>Cr</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>12/31/01</td>
<td>Dr Change in unrealized capital gains and losses</td>
<td>Cr Common stock</td>
<td>$85,714</td>
</tr>
<tr>
<td></td>
<td>Cr Common stock</td>
<td>Dr Change in unrealized capital gains and losses</td>
<td>($85,714)</td>
</tr>
</tbody>
</table>

*Recognition of net depreciation in FV of common stock*

<table>
<thead>
<tr>
<th>Date</th>
<th>Dr</th>
<th>Cr</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>12/31/01</td>
<td>Dr Deferred tax asset</td>
<td>Cr Deferred tax liability</td>
<td>$150,000</td>
</tr>
<tr>
<td></td>
<td>Cr Deferred tax liability</td>
<td>Dr Deferred tax asset</td>
<td>($120,000)</td>
</tr>
<tr>
<td></td>
<td>Cr Change in deferred income taxes</td>
<td>Dr Change in deferred income taxes</td>
<td>($30,000)</td>
</tr>
</tbody>
</table>

*Recognition of gross deferred tax amounts*

<table>
<thead>
<tr>
<th>Date</th>
<th>Dr</th>
<th>Cr</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>12/31/01</td>
<td>Dr Change in deferred income taxes</td>
<td>Cr Change in unrealized capital gains and losses</td>
<td>$30,000</td>
</tr>
<tr>
<td></td>
<td>Cr Change in unrealized capital gains and losses</td>
<td>Dr Change in deferred income taxes</td>
<td>($30,000)</td>
</tr>
</tbody>
</table>

*Reclass tax effect of net unrealized loss per paragraph 14 of SSAP No. 10*

12.12 Condensed 12/31/01 Balance Sheet:

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Common Stock</td>
<td>$714,286</td>
<td>$800,000</td>
<td></td>
<td>$800,000</td>
<td></td>
</tr>
<tr>
<td>Net deferred tax asset</td>
<td>30,000</td>
<td></td>
<td>Beginning of year</td>
<td></td>
<td>$800,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Change in UNL</td>
<td>(55,714)</td>
<td></td>
</tr>
<tr>
<td>Total Assets</td>
<td>$744,286</td>
<td>$800,000</td>
<td>Liabilities &amp; Surplus</td>
<td>$744,286</td>
<td>$800,000</td>
</tr>
</tbody>
</table>

**Annual Statement Presentation**

12.13 In accordance with SSAP 10, DTAs and DTLs shall be offset and presented as a single amount on the statement of financial position. The following illustrates this requirement:

**Illustration C Assumptions:**

12.14 The entity had the following balances (1/1/01 balances carried forward from Illustration A):

* Computed at $85,714 (total change in UNG/UNL) - $30,000 tax effect
### Illustrative 12/31/01 Balance Sheet for Illustration C:

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>Current Year</th>
<th>Prior Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Assets</td>
<td>2 Nonadmitted Assets</td>
<td>3 Net Admitted Assets (Cols. 1 - 2)</td>
</tr>
<tr>
<td>Federal and foreign income tax recoverable and interest thereon (including $150,000(^1) net admitted deferred tax asset)</td>
<td>$320,000</td>
<td>$150,000</td>
</tr>
</tbody>
</table>

### Illustrative 12/31/01 Income Statement for Illustration C:

**STATEMENT OF INCOME (P/C)**

**SUMMARY OF OPERATIONS (Life & Health)**

**STATEMENT OF REVENUES AND EXPENSES (Health)**

<table>
<thead>
<tr>
<th>GAINS AND (LOSSES) IN SURPLUS</th>
<th>1 Current Year</th>
<th>2 Prior Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net unrealized capital gains (losses)</td>
<td>($55,714)</td>
<td>0</td>
</tr>
<tr>
<td>Change in net deferred income tax</td>
<td>$170,000</td>
<td>0</td>
</tr>
<tr>
<td>Change in nonadmitted assets (Exhibit 1, Line 6, Col. 3)</td>
<td>($125,000)</td>
<td>0</td>
</tr>
</tbody>
</table>

### Illustrative 12/31/01 Analysis of Nonadmitted Assets and Related Items for Illustration C:

<table>
<thead>
<tr>
<th></th>
<th>1 End of Current Year</th>
<th>2 End of Prior Year</th>
<th>3 Changes for Year (Increase) Decrease</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aggregate write-ins for other than invested assets</td>
<td>$150,000</td>
<td>$25,000(^1)</td>
<td>($125,000)</td>
</tr>
<tr>
<td>Total</td>
<td>$150,000</td>
<td>$25,000</td>
<td>($125,000)</td>
</tr>
</tbody>
</table>

**Illustration D Assumptions:**

### The entity had the following balances (1/1/01 balances carried forward from Illustration A):

<table>
<thead>
<tr>
<th></th>
<th>1/1/01</th>
<th>12/31/01</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross DTA</td>
<td>$200,000</td>
<td>$500,000</td>
<td>$300,000</td>
</tr>
<tr>
<td>Gross DTL</td>
<td>100,000</td>
<td>200,000</td>
<td>100,000</td>
</tr>
<tr>
<td>Net DTA</td>
<td>100,000</td>
<td>300,000</td>
<td>200,000(^1)</td>
</tr>
</tbody>
</table>

\(^{10}\) Includes $30,000 resulting from net unrealized losses as shown in Illustration B. As such the change in net deferred income taxes at 12/31/01 is $170,000 ($200,000 (gross change in DTA) - $30,000 reclass to net unrealized capital gains (losses)).

\(^{11}\) The parenthetical disclosure of net DTA should be after application of admission test. The RBC formula will utilize the net admitted DTA in 2002 and as such the amount should be shown on the face of the balance sheet for ease of data capture.

\(^{12}\) Prior year balance adjusted to include 1/1/01 Change in Accounting Principle
Nonadmitted DTA 25,000 150,000 125,000
Net Admitted DTA $75,000 $150,000 $75,000
Current FIT Liability $7,000 $12,000 $5,000

12.19 Illustrative 12/31/01 Balance Sheet for Illustration D:

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>Current Year</th>
<th>Prior Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Nonadmitted Assets</td>
<td>Net Admitted Assets (Cols. 1 - 2)</td>
</tr>
<tr>
<td>Federal and foreign income tax recoverable and interest thereon (including $150,000 net admitted deferred tax asset)</td>
<td>$300,000</td>
<td>$150,000</td>
</tr>
</tbody>
</table>

LIABILITIES, SURPLUS AND OTHER FUNDS

<table>
<thead>
<tr>
<th>Current Year</th>
<th>Prior Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Federal and foreign income taxes (including $0 net deferred tax liability)</td>
<td>$12,000</td>
</tr>
</tbody>
</table>

12.20 Illustrative 12/31/01 Income Statement for Illustration D:

STATEMENT OF INCOME (P/C)
SUMMARY OF OPERATIONS (Life & Health)
STATEMENT OF REVENUES AND EXPENSES (Health)

<table>
<thead>
<tr>
<th>GAINS AND (LOSSES) IN SURPLUS</th>
<th>Current Year</th>
<th>Prior Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net unrealized capital gains (losses)</td>
<td>($55,714)</td>
<td>0</td>
</tr>
<tr>
<td>Change in net deferred income tax</td>
<td>$170,000</td>
<td>0</td>
</tr>
<tr>
<td>Change in nonadmitted assets (Exhibit 1, Line 6, Col. 3)</td>
<td>($125,000)</td>
<td>0</td>
</tr>
</tbody>
</table>

12.21 Illustrative 12/31/01 Analysis of Nonadmitted Assets and Related Items for Illustration D:

<table>
<thead>
<tr>
<th>Aggregate write-ins for other than invested assets</th>
<th>End of Current Year</th>
<th>End of Prior Year</th>
<th>Changes for Year (Increase) Decrease</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>$150,000</td>
<td>$25,000</td>
<td>($125,000)</td>
</tr>
</tbody>
</table>

Notes to the Financial Statements Disclosures:

12.22 SSAP 10 paragraphs 17-23 include extensive disclosure requirements. Although some of these amounts are presented on the face of the financial statements or in schedules or exhibits to the Annual Statement, they will be included in the Notes to the Financial Statements both in the Annual Statement and in the Annual Audited Financial Statements.

12.23 This section provides specific examples that illustrate the disclosures required in SSAP 10. The formats in the illustrations are not requirements. Some of the disclosure paragraphs of SSAP 10 are not specific as to whether the entity should disclose the nature of certain items or whether the entity should disclose specific amounts. The illustrations included herein use a combination of each method. The NAIC encourages a format that provides the information in the most understandable manner in the

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13 Includes $30,000 resulting from net unrealized losses as shown in Illustration B. As such the change in net deferred income taxes at 12/31/01 is $170,000 ($200,000 (gross change in DTA) - $30,000 reclass to net unrealized capital gains (losses)).

14 The parenthetical disclosure of net DTA should be after application of admission test. The RBC formula will utilize the net admitted DTA in 2002 and as such the amount should be shown on the face of the balance sheet for ease of data capture.

15 Prior year balance adjusted to include 1/1/01 Change in Accounting Principle
specific circumstances. The following illustrations are for a single hypothetical insurance enterprise, referred to as AlphaBeta Property & Casualty Insurance Company. Note that in certain disclosures, the prior year balances are as of January 1, 2001 (date of cumulative change in accounting principle).

12.24 All of the disclosures would be completed in the year-end Annual Statement and audited statutory financial statements. The disclosures of paragraphs 18, 20 b., 21 (on a prospective basis) and 23 must be presented in the first Quarterly Statement. In accordance with paragraph 57 of the Preamble, these notes would only be presented in the second and third Quarterly Statements if the underlying data changed significantly.

12.25 Selected AlphaBeta P/C Company Financial Data at December 31, 2001 (Balance Sheet information carried forward from Illustration C):

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>Current Year</th>
<th>Prior Year</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1 Assets</td>
<td>2 Nonadmitted Assets</td>
</tr>
<tr>
<td>Federal and foreign income tax recoverable and interest thereon (including $150,000 net deferred tax asset)</td>
<td>$320,000</td>
<td>$150,000</td>
</tr>
</tbody>
</table>
GAINS AND (LOSSES) IN SURPLUS

<table>
<thead>
<tr>
<th></th>
<th>1 Current Year</th>
<th>2 Prior Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net unrealized capital gains (losses)</td>
<td>($55,714)</td>
<td>0</td>
</tr>
<tr>
<td>Change in net deferred income tax</td>
<td>$170,000</td>
<td>0</td>
</tr>
<tr>
<td>Change in nonadmitted assets</td>
<td>($125,000)</td>
<td>0</td>
</tr>
</tbody>
</table>

ANALYSIS OF NONADMITTED ASSETS AND RELATED ITEMS

<table>
<thead>
<tr>
<th></th>
<th>1 End of Current Year</th>
<th>2 End of Prior Year</th>
<th>3 Changes for Year (Increase) Decrease</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aggregate write-ins for other than invested assets</td>
<td>$150,000</td>
<td>$25,000&lt;sup&gt;16&lt;/sup&gt;</td>
<td>($125,000)</td>
</tr>
</tbody>
</table>

STATEMENT OF INCOME 2001

<table>
<thead>
<tr>
<th></th>
<th>2001</th>
</tr>
</thead>
<tbody>
<tr>
<td>Premiums earned</td>
<td>$5,250,000</td>
</tr>
<tr>
<td>Losses incurred</td>
<td>3,550,000</td>
</tr>
<tr>
<td>Loss expenses incurred</td>
<td>1,750,000</td>
</tr>
<tr>
<td>Other underwriting expenses incurred</td>
<td>525,000</td>
</tr>
<tr>
<td>Net underwriting gain (loss)</td>
<td>($575,000)</td>
</tr>
<tr>
<td>Net investment gain (loss)</td>
<td>1,350,000</td>
</tr>
<tr>
<td>Total other income</td>
<td>125,000</td>
</tr>
<tr>
<td>Net income before dividends to policyholders and before federal and foreign income taxes</td>
<td>900,000</td>
</tr>
<tr>
<td>Dividends to policyholders</td>
<td>200,000</td>
</tr>
<tr>
<td>Net income, after dividends to policyholders but before federal and foreign income taxes</td>
<td>700,000</td>
</tr>
<tr>
<td>Federal and foreign income taxes incurred</td>
<td>210,000</td>
</tr>
<tr>
<td>Net income</td>
<td>$490,000</td>
</tr>
</tbody>
</table>

Paragraph 18 Illustration:

12.26 The components of the net DTA recognized in the Company’s Assets, Liabilities, Surplus and Other Funds are as follows:

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Total of gross deferred tax assets</td>
<td>$500,000</td>
<td>$200,000</td>
</tr>
<tr>
<td>Total of deferred tax liabilities</td>
<td>(200,000)</td>
<td>(100,000)</td>
</tr>
<tr>
<td>Net deferred tax asset</td>
<td>300,000</td>
<td>100,000</td>
</tr>
<tr>
<td>Deferred tax asset nonadmitted</td>
<td>(150,000)</td>
<td>(25,000)</td>
</tr>
<tr>
<td>Net admitted deferred tax asset</td>
<td>$150,000</td>
<td>$75,000</td>
</tr>
<tr>
<td>(Increase) decrease in nonadmitted asset</td>
<td>($125,000)</td>
<td>-</td>
</tr>
</tbody>
</table>

Paragraph 19 Illustration:

12.27 The Company has not recognized a deferred tax liability of approximately $30,000 for the undistributed earnings of its 100 percent owned foreign subsidiaries that arose in 2001 and prior years because the Company does not expect those unremitting earnings to reverse and become taxable to the Company in the foreseeable future. A deferred tax liability will be recognized when the Company expects that it will recover those undistributed earnings in a taxable manner, such as through receipt of dividends or sale of the investments. As of December 31, 2001, the undistributed earnings of these subsidiaries were approximately $88,000.

Paragraph 20 Illustration:

12.28 The provisions for incurred taxes on earnings for the years ended December 31 are:

<sup>16</sup> Prior year balance adjusted to include 1/1/01 Change in Accounting Principle
12.29 The tax effects of temporary differences that give rise to significant\(^\text{17}\) portions of the deferred tax assets and deferred tax liabilities are as follows:

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Discounting of unpaid losses</td>
<td>$30,000</td>
<td>$10,000</td>
</tr>
<tr>
<td>Change in unearned premium reserve</td>
<td>235,000</td>
<td>50,000</td>
</tr>
<tr>
<td>Deferred compensation</td>
<td>55,000</td>
<td>15,000</td>
</tr>
<tr>
<td>Unrealized capital losses</td>
<td>150,000</td>
<td>60,000</td>
</tr>
<tr>
<td>Net capital loss carryforward</td>
<td>10,000</td>
<td>62,000</td>
</tr>
<tr>
<td>Other</td>
<td>20,000</td>
<td>3,000</td>
</tr>
<tr>
<td><strong>Total deferred tax assets</strong></td>
<td>500,000</td>
<td>200,000</td>
</tr>
<tr>
<td>Nonadmitted deferred tax assets</td>
<td>(150,000)</td>
<td>(25,000)</td>
</tr>
<tr>
<td>Admitted deferred tax assets</td>
<td>350,000</td>
<td>175,000</td>
</tr>
<tr>
<td>Deferred tax liabilities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation</td>
<td>70,000</td>
<td>30,000</td>
</tr>
<tr>
<td>Unrealized capital gains</td>
<td>120,000</td>
<td>60,000</td>
</tr>
<tr>
<td>Other</td>
<td>10,000</td>
<td>10,000</td>
</tr>
<tr>
<td><strong>Total deferred tax liabilities</strong></td>
<td>200,000</td>
<td>100,000</td>
</tr>
<tr>
<td><strong>Net admitted deferred tax asset</strong></td>
<td>$150,000</td>
<td>$75,000</td>
</tr>
</tbody>
</table>

12.30 The change in net deferred income taxes is comprised of the following (this analysis is exclusive of nonadmitted assets as the Change in Nonadmitted Assets is reported separately from the Change in Net Deferred Income Taxes in the surplus section of the Annual Statement):

<table>
<thead>
<tr>
<th></th>
<th>Dec. 31, 2001</th>
<th>Jan. 1, 2001</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total deferred tax assets</td>
<td>$500,000</td>
<td>$200,000</td>
<td>$300,000</td>
</tr>
<tr>
<td>Total deferred tax liabilities</td>
<td>200,000</td>
<td>100,000</td>
<td>100,000</td>
</tr>
<tr>
<td>Net deferred tax asset (liability)</td>
<td>$300,000</td>
<td>$100,000</td>
<td>200,000</td>
</tr>
<tr>
<td>Tax effect of unrealized gains (losses)</td>
<td>(30,000)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Change in net deferred income tax</td>
<td></td>
<td></td>
<td>$170,000</td>
</tr>
</tbody>
</table>

Paragraph 21 Illustration\(^\text{18}\):

12.31 The provision for federal and foreign income taxes incurred is different from that which would be obtained by applying the statutory Federal income tax rate to income before income taxes. The significant items causing this difference are as follows:

\(^{17}\) Significant defined as any amount in excess of 5% of the total applicable DTA or DTL

\(^{18}\) This illustration includes both the rate reconciliation and the tax effected amounts although only one of these is required to be disclosed under SSAP 10.
12.32 The Company has net capital loss carryforwards which expire as follows: 2001 through 2005; $9,000; 2005 through 2010; $1,000.

Paragrapgh 23 Illustration:

12.33 The Company is included in a consolidated federal income tax return with its parent company, Alpha Corporation. The Company has a written agreement, approved by the Company’s Board of Directors, which sets forth the manner in which the total combined federal income tax is allocated to each entity which is a party to the consolidation. Pursuant to this agreement, the Company has the enforceable right to recoup federal income taxes paid in prior years in the event of future net losses, which it may incur, or to recoup its net losses carried forward as an offset to future net income subject to federal income taxes.

13. Q – Are tax-planning strategies to be considered in determining admitted DTAs? [Paragraphs 10 a. and 10 b.i.]

13.1 A – An entity needs to demonstrate that it has a prudent and feasible tax-planning strategy available that, if implemented, would result in realization of DTAs within one year of the balance sheet date. While the entity is not required to implement the strategy within the 12 month period, it must have the ability to implement such strategy within such time period. Additionally, the entity must demonstrate that while it ordinarily might not take such actions, elections, etc., it would do so to prevent an operating loss, tax credit carryforward or other similar item from expiring unused. In such circumstances an entity may recognize, as admitted assets, the related DTAs that are realizable as a result of the available tax-planning strategy in accordance with paragraphs 10 a. and 10 b. i. of SSAP 10. Using tax-planning strategies in determining the admissible DTA is analogous to the use of tax-planning strategies in determining the amount of valuation allowance required under FAS 109, as outlined in Paragraph 22 of FAS 109, which states:

22. In some circumstances, there are actions (including elections for tax purposes) that (a) are prudent and feasible, (b) an enterprise ordinarily might not take, but would take to prevent an operating loss or tax credit carryforward from expiring unused, and (c) would result in realization

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19 As reported in the surplus section of the Annual Statement. The change in net deferred income taxes is before nonadmission of any DTA. The change in nondadmitted DTA is reported as together with the total change in nonadmits and presented as a separate component of surplus.
of deferred tax assets. This Statement refers to those actions as tax-planning strategies. An enterprise shall consider tax-planning strategies in determining the amount of valuation allowance required. Significant expenses to implement a tax-planning strategy or any significant losses that would be recognized if that strategy were implemented (net of any recognizable tax benefits associated with those expenses or losses) shall be included in the valuation allowance.

13.2 Paragraph 248 of FAS 109 additionally states that:

248. Tax-planning strategies also may shift the estimated pattern and timing of future reversals of temporary differences…. A tax-planning strategy to accelerate the reversal of deductible temporary differences in time to offset taxable income that is expected in an early future year might be the only means to realize a tax benefit for those deductible temporary differences if they otherwise would reverse and provide no tax benefit in some later future year(s).

13.3 The requirement in Paragraph 10 a. and 10 b. i. of SSAP 10 to consider only those DTAs that reverse or are realized within one year of the balance sheet date causes those DTAs which would otherwise reverse beyond one year of the balance sheet date to potentially provide no tax benefit (unless admitted under Paragraph 10 e.). The potential reversal beyond one year of the balance sheet date is comparable to an expiring net operating loss, in that the deduction would not provide a tax benefit under SSAP 10. Thus, to the extent prudent and feasible tax-planning strategies exist to accelerate the reversal or realization of these DTAs, these strategies are comparable to those contemplated in Paragraph 248 of FAS 109 above.

13.4 It should be noted that if a tax planning strategy is used to accelerate the reversal or realization of an item, any potential costs associated with the implementation of the strategy should reduce the admitted DTA.

13.5 An example of a prudent and feasible tax-planning strategy is as follows:

13.6 Company A, a property/casualty insurance company for federal income tax purposes, has paid federal income taxes of $500,000 in each of calendar years 2000 and 2001. It has capital and surplus for purposes of Paragraph 10 b ii. of SSAP 10 of $20,000,000. Company A has an obligation to provide post-retirement health benefits to its employees. At December 31, 2001, Company A has included a liability for $1,000,000 on its statutory-basis financial statements for post-retirement health benefits. This liability is not deductible for federal income tax purposes, and only $50,000 reverses within the next calendar year. This is Company A’s only DTA under SSAP 10, and there are no DTLs. Company A, absent any tax-planning strategies, would compute a DTA of $350,000 ($1,000,000 times 35%), and would admit $17,500 ($50,000 times 35%) under Paragraph 10 a., and has no additional admitted DTA under Paragraph 10 b.

13.7 Company A could implement a welfare benefit fund for tax purposes, and contribute assets to the fund to cover qualifying welfare benefits. The contribution, subject to limitations, would be deductible for federal income tax purposes, and would have the effect of accelerating the deduction for Company A’s post-retirement health benefits. Company A has computed that $300,000 could be contributed to the welfare benefit fund, and to implement this strategy, it would cost $15,000 on an after-tax basis. Company A management believe that this strategy is prudent and feasible, and the Company would be able to implement this strategy if necessary. Company A would be able to admit an additional $90,000 of DTAs ($300,000 times 35%, or $105,000, less $15,000 in costs) under Paragraph 10 a., with no additional admitted DTA under Paragraph 10 b.

13.8 A tax-planning strategy would not be considered prudent or feasible if use of the strategy would be inconsistent with assumptions inherent in statutory or other accounting basis financial statements. For instance, a tax-planning strategy to sell securities identified as “held to maturity” for GAAP-basis
financial statements at a loss would not be prudent or feasible. Additionally, if a potential tax planning strategy were to involve selling debt securities at a loss, it would not be prudent or feasible if the securities had not been identified as impaired and the loss recognized for statutory-basis financial statements. Additionally, a tax-planning strategy that could not be implemented within twelve months of the balance sheet date or is inconsistent with management’s business plan objectives, would not be prudent and/or feasible.
Statement of Statutory Accounting Principles No. 11

Postemployment Benefits and Compensated Absences

STATUS

Type of Issue: Common Area
Issued: Initial Draft
Effective Date: January 1, 2001
Affects: No other pronouncements
Affected by: No other pronouncements
Interpreted by: No other pronouncements

SCOPE OF STATEMENT

SUMMARY CONCLUSION

Consolidated/Holding Company Plans
Disclosures
Relevant Literature
Effective Date and Transition
AUTHORITATIVE LITERATURE
Generally Accepted Accounting Principles
RELEVANT ISSUE PAPERS
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Postemployment Benefits and Compensated Absences

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for postemployment benefits and for compensated absences.

SUMMARY CONCLUSION

2. Postemployment benefits are all types of benefits provided by an employer to former or inactive employees or agents, their beneficiaries, and covered dependents, after employment but before retirement. Those benefits include, but are not limited to, salary continuation, supplemental unemployment benefits, severance benefits, disability-related benefits (including workers’ compensation), job training and counseling, and continuation of benefits such as health care benefits and life insurance coverage. Compensated absences include, but are not limited to, benefits such as vacation, sick pay, and holidays.

3. A reporting entity shall accrue a liability for postemployment benefits and for employees’ compensation for future absences if all of the following conditions are met:
   a. The reporting entity’s obligation relating to compensated absences and postemployment benefits is attributable to employees’ services already rendered;
   b. The obligation relates to rights that vest\(^1\) or accumulate\(^2\);
   c. Payment is probable; and
   d. The amount can be reasonably estimated.

4. In the unlikely situation in which a reporting entity does not accrue a liability in accordance with paragraph 3 only because the amount cannot be reasonably estimated (i.e., condition d. is not met), that fact and the reasons therefore shall be disclosed in the financial statements.

5. A reporting entity shall accrue a liability for employees’ compensated absences and postemployment benefits reimbursable under service agreements with an affiliate, if all of the conditions of paragraph 3 are met.

6. Postemployment benefits provided to employees or agents in connection with their termination can include special termination benefits and contractual termination benefits. Special termination benefits are defined as those that are offered only for a short period of time; contractual termination benefits are defined as those required by the terms of a plan only if a specified event, such as a facility closing, occurs. An employer that offers special termination benefits to employees or agents shall recognize a liability and an expense when the employees or agents accept the offer and the amount can be reasonably estimated. An employer that provides contractual termination benefits shall recognize a liability and an expense when it is probable that employees or agents will be entitled to benefits and the amount can be reasonably estimated. The cost of such termination benefits shall include the amount of any lump-sum payments and the present value of any expected future payments.

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\(^1\) In this statement, vested rights are those for which the reporting entity has an obligation to make payment even if an employee terminates; thus, they are not contingent on an employee’s future service.

\(^2\) For purposes of this statement, accumulate means that earned but unused rights to compensated absences may be carried forward to one or more periods subsequent to that in which they are earned, even though there may be a limit to the amount that can be carried forward.
7. An employer is not required to accrue a liability for nonvesting accumulating rights for compensated absences if the right to receive those benefits is contingent upon future events and continued employment.

**Consolidated/Holding Company Plans**

8. The employees of many reporting entities are eligible for certain compensated absence and postemployment benefits granted by a parent company or holding company. An entity with employees who are eligible for those benefits and is not directly liable for those related obligations shall recognize an expense equal to its allocation from the parent company or holding company of the benefits earned during the period. A liability shall be established for any such amounts due but not yet paid.

9. The reporting entity shall disclose in the financial statements that its employees participate in a plan sponsored by the holding company for which the reporting entity has no legal obligation. The amount of expense incurred and the allocation methodology utilized by the provider of such benefits shall also be disclosed. If the reporting entity is directly liable for the benefits, then the requirements outlined above in paragraphs 2 - 7 shall be applied.

**Disclosures**

10. The following disclosures shall be made for defined benefit postemployment plans for which the reporting entity is directly liable:

   a. A reconciliation of beginning and ending balances of the benefit obligation showing separately, if applicable, the effects during the period attributable to service cost, interest cost, contributions by plan participants, actuarial gains and losses, foreign currency exchange rate changes, benefits paid, plan amendments, business combinations, divestitures, curtailments, settlements, and special termination benefits;

   b. A reconciliation of beginning and ending balances of the fair value of plan assets showing separately, if applicable, the effects during the period attributable to actual return on plan assets, foreign currency exchange rate changes, contributions by the reporting entity, contributions by plan participants, benefits paid, business combinations, divestitures, and settlements;

   c. The amount of net periodic benefit cost recognized, showing separately the service cost component, the interest cost component, the expected return on plan assets for the period, the amount of recognized gains and losses, the amount of prior service cost recognized, and the amount of gain or loss recognized due to a settlement or curtailment; and

   d. If applicable, the cost of providing special or contractual termination benefits recognized during the period and a description of the nature of the event.

Refer to the preamble for further discussion regarding disclosure requirements.
Relevant Literature

11. This statement adopts *FASB Statement No. 43, Accounting for Compensated Absences* (FAS 43). This statement also adopts *FASB Statement No. 112, Employers’ Accounting for Postemployment Benefits: an amendment of FASB Statements No. 5 and 43*, and the provisions of *FASB Statement No. 88, Employers’ Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*, and *FASB Statement No. 132, Employers’ Disclosures about Pensions and Other Postretirement Benefits*, that address termination benefits.

Effective Date and Transition

12. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors*.

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

- *FASB Statement No. 43, Accounting for Compensated Absences*
- *FASB Statement No. 88, Employers’ Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*
- *FASB Statement No. 112, Employers’ Accounting for Postemployment Benefits: an amendment of FASB Statements No. 5 and 43*
- *FASB Statement No. 132, Employers’ Disclosures about Pensions and Other Postretirement Benefits*

RELEVANT ISSUE PAPERS

- Issue Paper No. 11—Compensated Absences
- Issue Paper No. 13—Employers’ Accounting for Postemployment Benefits
Statement of Statutory Accounting Principles No. 12

Employee Stock Ownership Plans

STATUS

Type of Issue: Common Area
Issued: Initial Draft
Effective Date: January 1, 2001
Affects: No other pronouncements
Affected by: No other pronouncements
Interpreted by: No other pronouncements

SCOPE OF STATEMENT

SUMMARY CONCLUSION

Leveraged ESOPs
Nonleveraged ESOPs
Pension Reversion ESOPs
Issues Related to Accounting for Income Taxes
Leveraged ESOPs
Nonleveraged ESOPs
Other
Disclosures
Relevant Literature
Effective Date and Transition

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

RELEVANT ISSUE PAPERS
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Employee Stock Ownership Plans

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for the plan sponsors’ accounting for Employee Stock Ownership Plans (ESOPs).

SUMMARY CONCLUSION

2. An ESOP is an employee benefit plan that is described by the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code of 1986 as a stock bonus plan, or a combination stock bonus and money purchase pension plan, designed to invest primarily in employer stock. For such plans, reporting entities shall adopt AICPA Statement of Position 93-6, Employers’ Accounting for Employee Stock Ownership Plans (SOP 93-6) except that debt obligations of ESOPs shall be reported consistent with SSAP No. 15—Debt and Holding Company Obligations, and the related income tax effects shall be accounted for consistent with SSAP No. 10—Income Taxes (SSAP No. 10), as further clarified in this statement. There are two basic forms of ESOPs: nonleveraged and leveraged. A summary of the financial reporting for each is provided below.

Leveraged ESOPs

3. A leveraged ESOP borrows money to acquire shares of the employer company (sponsor). The money may be borrowed from the plan sponsor or from an outside lender, with or without a guarantee from the plan sponsor. The debt usually is collateralized by the employer’s shares. Debt obligations of an ESOP shall be reported as borrowed money by company sponsors, except when the ESOP has both the ability and intent to satisfy the debt from sources other than dividends on the company stock, contributions from the company or the sale or exchange of the company’s securities.

4. The sponsor shall record the issuance of shares or the sale of treasury shares to an ESOP when it occurs. The consideration recorded for the stock issued is unearned compensation and the unearned ESOP shares shall be recorded as a separate reduction of unassigned funds (surplus).

5. The unearned shares initially held by the ESOP in a suspense account are called suspense or unallocated shares. As the debt is repaid (generally from employer contributions and dividends on the employer’s stock), suspense shares are released and must be allocated to individual accounts as of the end of the ESOP’s fiscal year. As ESOP shares are committed to be released, unearned ESOP shares shall be credited and, depending on the purpose for which the shares are released, either (a) compensation cost, (b) dividends payable, or (c) compensation liabilities shall be charged consistent with SOP 93-6.

6. Because employers control the use of dividends on unallocated shares, dividends on unallocated shares are not considered dividends for financial reporting purposes (although such dividends are generally subject to normal dividend requirements under state statutes or regulations). Dividends on unallocated shares used to pay debt service shall be reported as a reduction of debt or of accrued interest payable. Dividends on unallocated shares paid to participants or added to participant accounts shall be reported as compensation cost. Dividends on allocated shares shall be charged to unassigned funds (surplus).

7. If the ESOP sells the suspense shares and uses the proceeds to repay the debt, the employer shall report the release of the suspense shares as a credit to unearned ESOP shares based on the cost of the shares to the ESOP, charge debt and accrued interest payable, and recognize the difference in paid-in capital. However, if there is a difference between the amount paid to an outside lender and the net carrying amount of the debt, such difference shall be reported as a capital gain or loss on extinguishment of debt and, accordingly, shall be charged to operations and disclosed in the financial statements with other disclosures required by paragraph 17.
8. If an employer reacquires the suspense shares from the ESOP, the purchase of the shares shall be accounted for as a treasury stock transaction consistent with SOP 93-6.

**Nonleveraged ESOPs**

9. Employers with nonleveraged ESOPs shall report compensation cost equal to the contribution called for in the period under the plan.

10. Employers with nonleveraged ESOPs shall charge dividends on shares held by the ESOPs to unassigned funds (surplus), except that dividends on suspense account shares of pension reversion ESOPs shall be accounted for the same way as dividends on suspense account shares of leveraged ESOPs.

**Pension Reversion ESOPs**

11. Pension reversion ESOPs are created by transferring the assets of a defined benefit pension plan to existing or newly created ESOPs and may be leveraged or nonleveraged. Pension reversion ESOPs shall be accounted for consistent with SOP 93-6.

**Issues Related to Accounting for Income Taxes**

**Leveraged ESOPs**

12. The amount of ESOP-related expense for a leveraged ESOP for a period may differ from the amount of the ESOP-related income tax deduction (prescribed by income tax rules and regulations) for that period. Such differences shall be reported in accordance with SSAP No. 10.

13. If the cost of shares committed to be released is greater than their fair value, the employer shall credit the tax effect of the amount by which the deductible expense exceeds the book expense to unassigned funds. Conversely, if the cost of shares committed to be released is less than their fair value, the employer shall charge the tax effect of the amount by which the book expense exceeds the deductible expense to unassigned funds. Such amounts shall be limited to the amount of previous credits to unassigned funds related to cost exceeding fair value of ESOP shares committed to be released in previous periods.

14. The tax benefit of tax-deductible dividends on allocated ESOP shares shall be recorded as a reduction of income tax expense.

**Nonleveraged ESOPs**

15. Reporting entities with nonleveraged ESOPs may accrue compensation cost for financial reporting purposes earlier than the cost is deductible for income tax purposes. Accruing the compensation cost earlier for financial reporting purposes creates a temporary difference that shall be accounted for in accordance with SSAP No. 10.

**Other**

16. Under federal income tax regulations, employer securities (such as convertible preferred stock) that are held by participants in an ESOP and are not readily tradable on an established market must include a put option. Securities subject to such repurchase obligations shall be reported as outstanding and as a component of capital stock and/or gross paid-in and contributed surplus in accordance with SSAP No. 72—Surplus and Quasi-reorganizations.
Disclosures

17. An employer sponsoring an ESOP shall disclose the following information about the plan, if applicable:

   a. A description of the plan, the basis for determining contributions, including the employee groups covered, and the nature and effect of significant matters affecting comparability of information for all periods presented. For leveraged ESOPs and pension reversion ESOPs, the description shall include the basis for releasing shares and how dividends on allocated and unallocated shares are used;

   b. A description of the accounting policies followed for ESOP transactions, including the method of measuring compensation and the classification of dividends on ESOP shares;

   c. The amount of compensation cost recognized during the period;

   d. The number of allocated shares, committed-to-be-released shares, and suspense shares held by the ESOP at the balance sheet date;

   e. The fair value of unearned ESOP shares at the balance sheet date; and

   f. The existence and nature of any repurchase obligation, including disclosure of the fair value of the shares allocated as of the balance sheet date, which are subject to a repurchase obligation.

18. Refer to the preamble for further discussions regarding disclosure requirements. The disclosures in paragraph 17 above shall be included in the annual audited statutory financial reports only.

Relevant Literature

19. This statement adopts SOP 93-6 with a modification to reject paragraphs 13 and 25 to the extent they require reporting all debt obligations of an ESOP as liabilities, paragraphs 28 through 34, 44, and 53 b. as they relate to earnings per share, and paragraph 37 as it relates to reporting gains and losses on extinguishment of debt.

20. This statement rejects FASB Emerging Issues Task Force No. 89-11, Sponsor’s Balance Sheet Classification of Capital Stock with a Put Option Held by an Employee Stock Ownership Plan.

Effective Date and Transition

21. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors.

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

- AICPA Statement of Position 93-6, Employers’ Accounting for Employee Stock Ownership Plans

RELEVANT ISSUE PAPERS

- Issue Paper No. 78—Employee Stock Ownership Plans
Statement of Statutory Accounting Principles No. 13

Stock Options and Stock Purchase Plans

STATUS

Type of Issue: Common Area

Issued: Initial Draft

Effective Date: January 1, 2001

Affects: No other pronouncements

Affected by: No other pronouncements

Interpreted by: INT 99-06, INT 99-13, INT 99-17, INT 00-06, INT 00-32, INT 01-14
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Stock Options and Stock Purchase Plans

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for employee stock options and stock purchase plans.

SUMMARY CONCLUSION

2. A stock purchase or stock option plan is any arrangement to issue stock to officers and employees, as a group or individually. A plan shall be classified as either noncompensatory or compensatory.

Noncompensatory Plans

3. A reporting entity recognizes no compensation expense for services received in return for stock issued through noncompensatory plans. The following four characteristics are essential in a noncompensatory plan:

   a. Substantially all full-time employees meeting limited employment qualifications may participate (employees owning a specified percent of the outstanding stock and executives may be excluded);

   b. Stock is offered to eligible employees equally or based on a uniform percentage of salary or wages (the plan may limit the number of shares of stock an employee may purchase through the plan);

   c. The time permitted for exercise of an option or purchase right is limited to a reasonable period; and

   d. The discount from the market price of the stock is no greater than would be reasonable in an offer of stock to stockholders or others.

Compensatory Plans

4. Stock purchase and stock option plans which do not meet the criteria of a noncompensatory plan shall be classified as compensatory.

5. Consideration that a reporting entity receives for stock issued through employee stock option, purchase, and award plans in the form of services shall be measured by the fair value of the stock at the measurement date less the amount, if any, that the employee is required to pay.

6. The measurement date for determining compensation cost in stock option, purchase, and award plans is the first date on which are known both (a) the number of shares that an individual employee is entitled to receive and (b) the option or purchase price, if any. That date for many or most plans is the date an option or purchase right is granted or stock is awarded to an individual employee. However, the measurement date may be later than the date of grant or award in plans with variable terms that depend on events after the date of grant or award. Thus, a reporting entity recognizes compensation cost for stock issued through compensatory plans unless the employee pays an amount that is at least equal to the quoted market price of the stock at the measurement date.
7. Compensation cost in stock option, purchase, and award plans shall be recognized as an expense of one or more periods in which an employee performs services and also as part or all of the consideration received for stock issued to the employee through a plan. The grant or award may specify the period or periods during which the employee performs services, or the period or periods may be inferred from the terms or from the past pattern of grants or awards. An employee may perform services in several periods before a reporting entity issues stock for those services. The reporting entity shall accrue compensation expense in each period in which the services are performed. If the measurement date is later than the date of grant or award, a reporting entity shall record the compensation expense each period from date of grant or award to date of measurement based on the fair value of the stock at the end of each period.

8. Quoted market prices in active markets are the best evidence of fair value and shall be used as fair value, if available. If quoted market prices are not available, the estimate of fair value shall be based on the best information available in the circumstances.

9. If stock is issued in a plan before some or all of the services are performed, part of the consideration recorded for the stock issued is unearned compensation and shall be reported as a component of unassigned funds (surplus). The unearned compensation shall be accounted for as expense of the period or periods in which the employee performs service.

Accounting for Income Tax Benefits

10. A reporting entity may obtain an income tax benefit related to stock issued to an employee through a stock option, purchase, or award plan. Generally, the reporting entity is entitled to a deduction for income tax purposes of the amount that an employee reports as ordinary income, and the deduction is allowable to the corporation in the year in which the amount is includable in the gross income of the employee. Thus, the amount and timing of the deduction for income tax purposes, if any, may differ from the related compensation expense recognized in the financial statements. For example, the reporting entity may be entitled to a deduction for income tax purposes even though no compensation expense is recognized in measuring net income.

11. The income tax reduction, if any, related to a stock option, purchase, or award plan shall be accounted for within one or more of the following three components:

   a. Income tax expense for a period shall be reduced by no more than the income tax reduction related to the stock option, purchase, or award plan that is proportionate to compensation expense recognized during the period, for such plan;

   b. Compensation expense that is deductible in the income tax return for a period different from the one in which such expense is reported in measuring net income results in a temporary difference. Deferred income taxes shall be recognized for such differences and included with all deferred income taxes as a separate component of gains and losses in surplus consistent with SSAP No. 10—Income Taxes;

   c. The remainder of the income tax reduction, if any, is related to an amount that is deductible for income tax purposes but does not affect net income. The remainder of the income tax reduction shall not be included in income, but shall be added to capital stock or gross paid-in and contributed surplus in the period of the income tax reduction. Conversely, a tax reduction may be less than if recorded compensation expenses were deductible for income tax purposes. If so, the reporting entity may deduct the difference from capital stock or gross paid-in and contributed surplus in the period of the income tax reduction, to the extent that income tax reductions under the same or similar
compensatory stock option, purchase, or award plans have been included in capital stock or gross paid-in and contributed surplus.

12. In certain situations, it may be advantageous to the reporting entity to compensate an employee to make an option that is detrimental to him but advantageous to the company. A reporting entity may, either by cash payment or otherwise, reimburse an employee for his action related to a stock option, purchase, or award plan that results in a reduction of income taxes of the reporting entity; for example, for incentive stock purchase plans, a reduction in the purchase price of stock is allowed. The reporting entity shall include this reimbursement as an expense.

13. Stock option, purchase, and award plans of the principal stockholder (i.e., a holding company) or equity instruments granted or otherwise transferred directly to an employee by a principal stockholder shall be treated as contributed surplus by the principal stockholder with the offsetting charge accounted for in accordance with this statement, unless such transfers are clearly for a purpose other than compensation for services rendered the reporting entity.

14. Compensation expense related to stock appreciation rights and other variable stock option or award plans shall be measured at the end of each period as the amount by which the quoted market price or value of the shares of the enterprise’s stock covered by a grant exceeds the option price or value specified under the plan and should be accrued as a charge to expense over the periods the employee performs the related services. Changes in the quoted market price or value should be reflected as an adjustment of accrued compensation and compensation expense in the periods in which the changes occur until the date the number of shares and purchase price, if any, are both known.

Disclosures

15. The financial statements shall disclose deferred stock compensation plans for employees such as profit sharing, stock option, or incentive plans. If warranted by materiality, the following information with regard to stock options shall be furnished and analogous information shall be supplied for warrants or rights:

a. A brief description of the terms of each option arrangement including the title and amount of securities to option; the year or years during which the options were granted; and the year or years during which the optionees became, or will become, entitled to exercise the options; and

b. The number of shares under option, the option price and the number of shares as to which options were exercisable; as to options exercised during the period, the number of shares involved and the option price thereof.

The required information may be summarized by category as appropriate and shall be disclosed separately for agents and brokers, employees and officers, and others. The disclosures shall be supplied whether the stock involved relates to the reporting entity, the parent of the reporting entity, a subsidiary of the reporting entity, or an affiliated corporation.

16. Refer to the preamble for further discussion regarding disclosure requirements. The disclosures in paragraph 15 above shall be included in the annual audited statutory financial reports only.
Relevant Literature

17. This statement rejects FASB Statement No. 123, Accounting for Stock-Based Compensation (FAS 123) and FASB Statement No. 148: Accounting for Stock-Based Compensation – Transition and Disclosure – an amendment of FASB Statement No. 123 (FAS 148).

18. This statement adopts APB Opinion No. 25, Accounting for Stock Issued to Employees, except for paragraph 19 regarding disclosure. The disclosure required by this statement is consistent with the disclosure requirements of Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins (ARB 43), “Chapter 13, Compensation, Section B—Compensation Involved in Stock Option and Stock Purchase Plans,” prior to its amendment by FAS 123.

19. This statement adopts ARB 43, Chapter 13, Section B, with modification to exclude the additions to paragraph 2 and the deletion of paragraph 15 pursuant to FAS 123. This statement also adopts AICPA Accounting Interpretations, Accounting for Stock Issued to Employees: Accounting Interpretations of APB Opinion No. 25, FASB Interpretation No. 28, Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans, and FASB Interpretation No. 38, Determining the Measurement Date for Stock Option, Purchase, and Award Plans Involving Junior Stock.

20. This statement adopts the following pronouncements which clarify and/or provide guidance in certain circumstances:

   a. FASB Emerging Issues Task Force No. 84-13, Purchase of Stock Options and Stock Appreciation Rights in a Leveraged Buyout;
   b. FASB Emerging Issues Task Force No. 84-18, Stock Option Pyramiding;
   c. FASB Emerging Issues Task Force No. 85-45, Business Combinations: Settlement of Stock Options and Awards;
   d. FASB Emerging Issues Task Force No. 87-6, Adjustments Relating to Stock Compensation Plans;
   e. FASB Emerging Issues Task Force No. 87-23, Book Value Stock Purchase Plans;
   f. FASB Emerging Issues Task Force No. 87-33, Stock Compensation Issues Related to Market Decline;
   g. FASB Emerging Issues Task Force No. 88-6, Book Value Plans in an Initial Public Offering;
   h. FASB Emerging Issues Task Force No. 90-7, Accounting for a Reload Stock Option;
   i. FASB Emerging Issues Task Force No. 90-9, Changes to Fixed Employee Stock Option Plans as a Result of Equity Restructuring;
   j. FASB Emerging Issues Task Force No. 94-6, Accounting for the Buyout of Compensatory Stock Options;
   k. FASB Emerging Issues Task Force No. 95-16, Accounting for Stock Compensation Arrangements with Employer Loan Features under APB Opinion No. 25.
21. This statement rejects FASB Emerging Issues Task Force No 96-3, Accounting for Equity Instruments That Are Issued for Consideration Other Than Employee Services under FASB Statement No. 123 and FASB Emerging Issues Task Force No 96-18, Accounting for Equity Instruments with Variable Terms That Are Issued for Consideration Other Than Employee Services under FASB Statement No. 123.

Effective Date and Transition

22. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors.

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

- APB Opinion No. 25, Accounting for Stock Issued to Employees
- Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins, Chapter 13B before modification by FAS 123
- Accounting Interpretation of APB Opinion No. 25, Accounting for Stock Issued to Employees
- FASB Interpretation No. 28, Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans
- FASB Interpretation No. 38, Determining the Measurement Date for Stock Option, Purchase, and Award Plans Involving Junior Stock
- FASB Emerging Issues Task Force No. 84-13, Purchase of Stock Options and Stock Appreciation Rights in a Leveraged Buyout
- FASB Emerging Issues Task Force No. 84-18, Stock Option Pyramiding
- FASB Emerging Issues Task Force No. 85-45, Business Combinations: Settlement of Stock Options and Awards
- FASB Emerging Issues Task Force No. 87-6, Adjustments Relating to Stock Compensation Plans
- FASB Emerging Issues Task Force No. 87-23, Book Value Stock Purchase Plans
- FASB Emerging Issues Task Force No. 87-33, Stock Compensation Issues Related to Market Decline
- FASB Emerging Issues Task Force No. 88-6, Book Value Plans in an Initial Public Offering
- FASB Emerging Issues Task Force No. 90-7, Accounting for a Reload Stock Option
- FASB Emerging Issues Task Force No. 90-9, Changes to Fixed Employee Stock Option Plans as a Result of Equity Restructuring
• FASB Emerging Issues Task Force No. 94-6, Accounting for the Buyout of Compensatory Stock Options

• FASB Emerging Issues Task Force No. 95-16, Accounting for Stock Compensation Arrangements with Employer Loan Features under APB Opinion No. 25

RELEVANT ISSUE PAPERS

• Issue Paper No. 82—Stock Options and Stock Purchase Plans
Statement of Statutory Accounting Principles No. 14

Postretirement Benefits Other Than Pensions

STATUS
Type of Issue: Common Area
Issued: Finalized March 13, 2000
Effective Date: January 1, 2001
Affects: No other pronouncements
Affected by: No other pronouncements
Interpreted by: INT 99-26, INT 01-16
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Postretirement Benefits Other Than Pensions

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for employers’ accounting for postretirement benefits other than pensions.

SUMMARY CONCLUSION

2. Postretirement benefits are all forms of benefits, other than retirement income, provided by an employer to retirees. Those benefits may be defined in terms of specified benefits that are provided to retirees as the need for those benefits arises, such as certain health care benefits, or they may be defined in terms of monetary amounts that become payable on the occurrence of a specified event, such as life insurance benefits or deferred compensation arrangements.

3. The principles contained herein shall apply to postretirement benefits other than pensions for all eligible and vested employees and vested former employees including their beneficiaries and covered dependents, pursuant to the terms of an employer’s undertaking to provide those benefits. Any asset resulting from an overfunding of the plan shall be recorded as a nonadmitted asset.

4. An employer shall account for its postretirement benefits on an accrual basis. The postretirement benefit obligation for current retirees and fully eligible or vested employees at transition (initial adoption date) is measured by estimating the actuarial present value of benefits expected to be received at retirement using explicit assumptions. A health care cost trend rate assumption is used in the estimation. A health care cost trend rate is an assumption about the annual rate(s) of change in the cost of health care benefits currently provided by the postretirement benefit plan, due to factors other than changes in the composition of the plan population by age and dependency status, for each year from the measurement date until the end of the period in which benefits are expected to be paid. The health care cost trend rates implicitly consider estimates of health care inflation, changes in health care utilization or status of the plan participants.

5. Plan assets, if any, shall be segregated and restricted, and measured at fair value.

6. In each period, estimated postretirement benefits for newly eligible or vested employees shall be accrued at eligibility date (“estimated eligibility cost”). Interest cost on the postretirement benefit obligation at the beginning of the period shall be recognized during the period. Actuarial gains and losses (other than plan asset gains and losses) arising from differences between assumptions and actual experience upon subsequent remeasurement of the obligation may be recognized as a component of the net periodic postretirement benefit cost in the current period or amortized. The net actuarial gain or loss shall be included as a component of the net periodic postretirement benefit cost for a year, if, as of the beginning of the year, that unrecognized net gain or loss exceeds 10 percent of the greater of the postretirement benefit obligation or the fair value of plan assets. That gain or loss, if not recognized immediately, shall be amortized over the average life expectancy of the employer’s fully vested and retiree group. The method elected must be consistently applied.

Gains or Losses On Plan Assets

7. Plan asset gains and losses are differences between the actual return on plan assets (including changes in the fair values of plan assets) during a period and the expected return on plan assets for that period. Amortization of an unrecognized net asset gain or loss shall be included as a component of net postretirement benefit cost for a year if, as of the beginning of the year, that unrecognized net gain or loss exceeds 10 percent of the greater of the postretirement benefit obligation or the fair value of plan assets.
That excess shall be amortized over the average life expectancy of the employer’s fully vested and retiree group.

**Plan Amendments**

8. Plan amendments may include provisions that increase or reduce benefits to retirees and fully eligible employees. The cost of benefit improvements is the increase in the postretirement benefit obligation as a result of the plan amendment, measured at the date of the amendment. That increase shall be amortized over the average life expectancy of the employer’s fully vested and retiree group.

9. A plan amendment can reduce, rather than increase, the postretirement benefit obligation. A reduction in that obligation shall first reduce any existing unrecognized plan amendment cost, and then, reduce any remaining unrecognized transition obligation. The excess, if any, shall be amortized on the same basis as plan amendments that increase benefits.

**Financial Statement Presentation**

10. The net periodic postretirement benefit cost (i.e., the estimated eligibility cost, interest cost, actuarial gains or losses, and any amortization costs) shall be reflected in the income statement. If an employer elects immediate recognition of the initial transition obligation, it shall be accounted for as a change of accounting method (i.e., the initial transition obligation is recorded as an adjustment to statutory surplus).

**Transition Asset**

11. If the fair value of plan assets exceeds the postretirement obligation and a transition asset results, the asset shall be considered a nonadmitted asset.

**Defined Contribution Plans**

12. A defined contribution postretirement benefit plan is a plan that provides postretirement benefits by establishing an individual account for each participant and has terms that specify how contributions to the individual’s account are to be determined rather than the amount of postretirement benefits the individual is to receive. Under a defined contribution plan, postretirement benefits a plan participant will receive are limited to the amount contributed to the plan participant’s account, the returns earned on investments of these contributions, and forfeitures of other plan participants’ benefits that may be allocated to the plan participant’s account.

13. To the extent that an employer’s defined contributions to an individual’s account are vested or irrevocable, the net postretirement benefit cost for a period shall be the contribution called for in that period. If a plan calls for contributions for periods after an individual retires, the estimated costs shall be accrued at retirement date.

**Consolidated/Holding Company Plans**

14. The employees of many reporting entities are eligible for certain postretirement benefits other than pensions provided by a parent company or holding company. A reporting entity with employees who are eligible for those benefits and is not directly liable for those related obligations shall recognize an expense equal to its allocation of the benefits earned during the period. A liability shall be established for any such amounts due but not yet paid.

15. The reporting entity shall disclose in the financial statements that its employees participate in a plan sponsored by the holding company for which the reporting entity has no legal obligation. The
amount of the postretirement benefit expense incurred and the allocation methodology utilized by the provider of such benefits shall also be disclosed. If the reporting entity is directly liable for postretirement benefits other than pensions, then the requirements outlined in paragraphs 2 through 13 and paragraphs 16 through 19 of this statement shall be applied.

**Disclosures**

16. The following disclosures shall be made for postretirement defined benefit plans for which the reporting entity is directly liable:

a. A reconciliation of beginning and ending balances of the benefit obligation showing separately, if applicable, the effects during the period attributable to service cost, interest cost, contributions by plan participants, actuarial gains and losses, foreign currency exchange rate changes, benefits paid, plan amendments, business combinations, divestitures, curtailments, settlements, and special termination benefits;

b. The amount of the postretirement obligation for nonvested employees as of the most recent actuarial valuation date;

c. A reconciliation of beginning and ending balances of the fair value of plan assets showing separately, if applicable, the effects during the period attributable to actual return on plan assets, foreign currency exchange rate changes, contributions by the reporting entity, contributions by plan participants, benefits paid, business combinations, divestitures, and settlements;

d. The funded status of the plans, the amounts not recognized in the statement of financial position, and the amounts recognized in the statement of financial position, including:

i. The amount of any unamortized prior service cost;

ii. The amount of any unrecognized net gain or loss (including asset gains and losses not yet reflected in market-related value);

iii. The amount of any remaining unamortized, unrecognized net obligation or net asset existing at the initial date of application, which is described in paragraph 22 of this statement;

iv. The net pension or other postretirement benefit prepaid assets or accrued liabilities; and

v. Any intangible asset;

e. The amount of net periodic benefit cost recognized, showing separately the service cost component, the interest cost component, the expected return on plan assets for the period, the amortization of the unrecognized transition obligation or transition asset, the amount of recognized gains and losses, the amount of prior service cost recognized, and the amount of gain or loss recognized due to a settlement or curtailment;

f. On a weighted-average basis, the following assumptions used in the accounting for the plans: assumed discount rate, rate of compensation increase (for pay-related plans), and expected long-term rate of return on plan assets;
g. The assumed health care cost trend rate(s) for the next year used to measure the expected cost of benefits covered by the plan (gross eligible charges) and a general description of the direction and pattern of change in the assumed trend rates thereafter, together with the ultimate trend rate(s) and when that rate is expected to be achieved;

h. The effect of a one-percentage-point increase and the effect of a one-percentage-point decrease in the assumed health care cost trend rates on (1) the aggregate of the service and interest cost components of net periodic postretirement health care benefit cost and (2) the accumulated postretirement benefit obligation for health care benefits (For purposes of this disclosure, all other assumptions shall be held constant, and the effects shall be measured based on the substantive plan that is the basis for the accounting.);

i. If applicable, the amounts and types of securities of the reporting entity and related parties included in plan assets, the approximate amount of future annual benefits of plan participants covered by insurance contracts issued by the reporting entity or related parties, and any significant transactions between the reporting entity or related parties and the plan during the period;

j. If applicable, any alternative amortization method used to amortize prior service amounts or unrecognized net gains and losses pursuant paragraphs 53 and 60 of FASB Statement No. 106, Employers’ Accounting for Postretirement Benefits Other Than Pensions (FAS 106);

k. If applicable, any substantive commitment, such as past practice or a history of regular benefit increases, used as the basis for accounting for the benefit obligation;

l. If applicable, the cost of providing special or contractual termination benefits recognized during the period and a description of the nature of the event; and

m. An explanation of any significant change in the benefit obligation or plan assets not otherwise apparent in the other disclosures required by this statement.

Amounts related to the reporting entity’s results of operations shall be disclosed for each period for which an income statement is presented. Amounts related to the reporting entity’s statement of financial position shall be disclosed for each balance sheet presented.

17. The reporting entity shall disclose the amount of cost recognized for defined contribution other postretirement benefit plans during the period separately from the amount of cost recognized for defined benefit plans. The disclosures shall include a description of the nature and effect of any significant changes during the period affecting comparability, such as a change in the rate of employer contributions, a business combination, or a divestiture.

18. The reporting entity shall disclose the amount of contributions to multiemployer plans during the period. The reporting entity may disclose total contributions to multiemployer plans without disaggregating the amounts attributable to pensions and other postretirement benefits. The disclosures shall include a description of the nature and effect of any changes affecting comparability, such as a change in the rate of employer contributions, a business combination, or a divestiture.

19. Refer to the preamble for further discussion regarding disclosure requirements.
Relevant Literature

20. This statement adopts FAS 106, FASB Statement No. 132, Disclosures about Pensions and Other Postretirement Benefits (FAS 132) and Accounting Principles Board Opinion No. 12, Omnibus Opinion—1967, paragraphs 6 through 8 with the following modifications:

   a. Any asset which results from an excess of the fair value of plan assets over the postretirement benefit obligation shall be recorded as a nonadmitted asset;

   b. Calculation of the postretirement benefit obligation shall exclude non-vested employees. Partially vested employees are included only to the extent of their vested amounts; and

   c. The disclosures required by this statement are modified from those required by FAS 132 in consideration of the modification in this statement to include only vested employees.

   d. The reduced disclosure requirements for nonpublic entities described in paragraph 8 of FAS 132 are rejected. All reporting entities shall follow the disclosure requirements of this statement.

   e. The disclosures relating to the initial date of application in paragraph 5 of FAS 132 shall be the date of adoption for statutory purposes. The initial adoption date is described in paragraph 22 of this statement.

   f. The disclosures relating to other comprehensive income in paragraph 5 of FAS 132 shall be made for income on a statutory basis.

21. This statement adopts FASB Emerging Issues Task Force No. 93-3, Plan Assets under FASB Statement No. 106.

Effective Date and Transition

22. For most reporting entities, the transition or initial adoption date was January 1, 1993. For reporting entities whose plans are outside the United States and for defined benefits of employers with no more than 500 plan participants in the aggregate, the transition or initial adoption was January 1, 1995. At transition, an employer elects to recognize the unfunded postretirement benefit obligation immediately in statutory surplus or amortize it as a component of net periodic postretirement benefit cost over a period of up to twenty years.

23. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors.

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

- FASB Statement No. 106, Employers’ Accounting for Postretirement Benefits Other Than Pensions
- FASB Statement No. 132, Employers’ Disclosure about Pensions and Other Postretirement Benefits
- FASB Emerging Issues Task Force No. 93-3, Plan Assets under FASB Statement No. 106
• *Accounting Principles Board Opinion No. 12, Omnibus Opinion—1967*, paragraphs 6 through 8

**RELEVANT ISSUE PAPERS**

• Issue Paper No. 14—Employers’ Accounting for Postretirement Benefits Other Than Pensions
Statement of Statutory Accounting Principles No. 15

Debt and Holding Company Obligations

STATUS

Type of Issue: Common Area

Issued: Initial Draft

Effective Date: January 1, 2001

Affects: No other pronouncements

Affected by: No other pronouncements

Interpreted by: INT 00-08, INT 00-10

SCOPE OF STATEMENT

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Generally Accepted Accounting Principles

RELEVANT ISSUE PAPERS
Debt and Holding Company Obligations

SCOPE OF STATEMENT

1. The purpose of this statement is to establish statutory accounting principles for recording debt and related disclosure requirements, including holding company obligations and any related guarantees in the financial statements of an insurance company subsidiary, and debt obligations of Employee Stock Ownership Plans (ESOPs).

SUMMARY CONCLUSION

Debt

2. Debt shall be reported as a liability unless (a) it is debt on real estate in accordance with SSAP No. 40—Real Estate Investments (i.e., reported as a reduction in the carrying value of real estate), (b) it is offset against another asset in accordance with SSAP No. 64—Offsetting and Netting of Assets and Liabilities, or (c) other treatment is specified elsewhere within the Accounting Practices and Procedures Manual. Instruments that meet the requirements to be recorded as surplus as specified in SSAP No. 72—Surplus and Quasi-reorganizations are not considered debt.

3. Debt discount or premium, if any, shall be reported in the balance sheet as a direct deduction from or addition to the face amount of the note. Discount or premium shall be amortized over the life of the note using the interest method.

4. Interest on debt shall be accrued and charged to operations over the life of the debt, except when capitalized in accordance with SSAP No. 44—Capitalization of Interest. Interest payable shall include interest payable on all debt reported as a liability, approved interest on surplus notes, and interest payable on debt reported as a reduction in the carrying value of real estate.

5. Debt issuance costs (e.g., loan fees and legal fees) do not meet the definition of an asset as defined in SSAP No. 4—Assets and Nonadmitted Assets. Accordingly, these costs shall be charged to operations in the period incurred.

6. Debt obligations of ESOPs shall be reported as debt by company sponsors, except when the ESOP has both the ability and intent to satisfy the debt from sources other than dividends on the company stock, contributions from the company, or the sale or exchange of the company’s securities. ESOPs are addressed in SSAP No. 12—Employee Stock Ownership Plans.

7. Debt which is subject to a troubled debt restructuring shall be accounted for in accordance with SSAP No. 36—Troubled Debt Restructuring.

8. Convertible debt securities that are convertible into common stock of the issuer or an affiliated company at a specified price at the option of the holder and which are sold at a price not significantly in excess of the face amount shall be accounted for solely as debt at the time of issuance. An expense shall be recognized, equal to the fair value of additional securities granted or other consideration issued to induce conversion subsequent to the issuance of convertible debt securities.

9. Proceeds from debt issued with detachable stock purchase warrants shall be allocated based on the relative fair value of the two securities at the time of issuance. The value attributable to the warrants shall be accounted for as paid-in capital.

10. Other types of debt securities, e.g., capital notes, shall be accounted for in accordance with the substance of the transaction.
11. A reporting entity shall derecognize a liability if, and only if, it has been extinguished. A liability has been extinguished if either of the following conditions is met:

   a. The reporting entity pays the creditor and is relieved of its obligation for the liability. Paying the creditor includes delivery of cash, other financial assets, goods or services, or reacquisition by the debtor of its outstanding debt securities; or

   b. The reporting entity is legally released from being the primary obligor under the liability, either judicially or by the creditor.

**Holding Company Obligations**

12. In situations where the reporting entity does not guarantee the obligation of the holding company, there is no legal obligation on the part of the reporting entity. Therefore, the reporting entity shall not record the obligation of its parent holding company unless the obligation relates to services or benefits incurred by a non-insurance parent company or holding company on its behalf. In these situations, the reporting entity shall recognize an expense for its share of the services or benefits provided to it during the period by the parent company or holding company based on an allocation from the parent or holding company. A liability shall be established for any such amounts due, but not yet paid. The amount of expense incurred and the allocation methodology utilized by the provider of such benefits shall also be disclosed. **SSAP No. 8—Pensions** (SSAP No. 8), **SSAP No. 11—Postemployment Benefits and Compensated Absences** (SSAP No. 11), and **SSAP No. 14—Postretirement Benefits Other Than Pensions** (SSAP No. 14) address specific examples where the obligation relates to benefits provided to the subsidiary by a non-insurance parent company or holding company.

13. If the reporting entity guarantees an obligation of the holding company, the guidance in **SSAP No. 5—Liabilities, Contingencies and Impairments of Assets** shall be followed for determining the recording and disclosure of the guarantee. SSAP Nos. 8, 11, and 14 provide specific accounting and disclosure guidelines for employee benefit plans when the reporting entity is directly liable for obligations under the plan.

**Disclosures**

14. The financial statements shall disclose the following items related to debt:

   a. Date issued;

   b. Pertinent information concerning the kind of borrowing (e.g., debentures, commercial paper outstanding, bank loans, and lines of credit);

   c. Face amount of the debt;

   d. Carrying value of debt;

   e. The rate at which interest accrues;

   f. The effective interest rate;

   g. Collateral requirements;

   h. Interest paid in the current year;

   i. A summary of significant debt terms and covenants and any violations;
j. The combined aggregate amount of maturities and sinking fund requirements for each of the five years following the latest balance sheet presented;

k. If debt was considered to be extinguished by in-substance defeasance prior to the effective date of this statement and any of the debt remains outstanding, a general description of the transaction and the amount of debt that is considered extinguished at the end of the period; and

l. If assets are set aside after the effective date of this statement solely for satisfying scheduled payments of a specific obligation, a description of the nature of restrictions placed on those assets.

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

**Relevant Literature**

16. This statement adopts *Accounting Principles Board Opinion No. 14, Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants* and *FASB Statement No. 84, Induced Conversions of Convertible Debt*.

17. This statement adopts *Accounting Principles Board Opinion No. 21, Interest on Receivables and Payables*, with a modification to require that debt issuance costs be charged to operations.

18. This statement adopts *Accounting Principles Board Opinion No. 26, Early Extinguishment of Debt* with modification to require that gains and losses from extinguishment of debt be reported as capital gains or losses, and charged to operations.

19. This statement adopts paragraphs 13 and 25 of AICPA *Statement of Position 93-6, Employers’ Accounting for Employee Stock Ownership Plans* (SOP 93-6) with a modification to exclude debt obligations when the ESOP has both the ability and intent to satisfy the debt from sources other than dividends on the company’s stock, contributions from the company, or the sale or exchange of the company’s securities. This statement rejects paragraph 37 of SOP 93-6 as it relates to reporting gains and losses on extinguishment of debt which shall be accounted for consistent with *SSAP No. 24—Discontinued Operations and Extraordinary Items*.

20. This statement adopts *FASB Emerging Issues Task Force No. 90-19, Convertible Bonds with Issuer Option to Settle for Cash upon Conversion* with a modification to reject guidance related to earnings per share.

21. This statement adopts *FASB Technical Bulletin No. 80-1, Early Extinguishment of Debt through Exchange for Common or Preferred Stock*, with a modification to reject guidance related to classification of the loss as an extraordinary item.

22. This statement adopts the following pronouncements:

   a. *Accounting Principles Board Opinion No. 12, paragraphs 16 and 17, Omnibus Opinion—1967*;

   b. AICPA *Accounting Interpretations of APB 21, Interest on Receivables and Payables*;

   c. AICPA *Accounting Interpretations of APB 26, Early Extinguishment of Debt*;

   d. *FASB Emerging Issues Task Force No. 85-9, Revenue Recognition on Options to Purchase Stock of Another Entity*;
e. FASB Emerging Issues Task Force No. 85-17, Accrued Interest upon Conversion of Convertible Debt;
f. FASB Emerging Issues Task Force No. 85-29, Convertible Bonds with a “Premium Put”;
g. FASB Emerging Issues Task Force No. 86-8, Sale of Bad-Debt Recovery Rights;
h. FASB Emerging Issues Task Force No. 86-15, Increasing-Rate Debt;
i. FASB Emerging Issues Task Force No. 86-18, Debtor’s Accounting for a Modification of Debt Terms;
j. FASB Emerging Issues Task Force No. 86-28, Accounting Implications of Indexed Debt Instruments;
k. FASB Emerging Issues Task Force No. 86-36, Invasion of a Defeasance Trust;
l. FASB Emerging Issues Task Force No. 95-15, Recognition of Gain or Loss When a Binding Contract Requires a Debt Extinguishment to Occur at a Future Date for a Specified Amount.

23. This statement rejects FASB Statement No. 4, Reporting Gains and Losses from Extinguishment of Debt and FASB Statement No. 64, Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements—an Amendment of FASB Statement No. 4. This statement also rejects FASB Emerging Issues Task Force No. 84-40, Long-Term Debt Repayable by a Capital Stock.

Effective Date and Transition

24. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors.

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

- Accounting Principles Board Opinion No. 12, Omnibus Opinion -- 1967, paragraphs 16 and 17
- Accounting Principles Board Opinion No. 14, Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants
- Accounting Principles Board Opinion No. 21, Interest on Receivables and Payables
- Accounting Principles Board Opinion No. 26, Early Extinguishment of Debt
- FASB Statement No. 84, Induced Conversions of Convertible Debt
- AICPA Statement of Position 93-6, Employers’ Accounting for Employee Stock Ownership Plans, paragraphs 13 and 25
- AICPA Accounting Interpretations of APB 21, Interest on Receivables and Payables
- AICPA Accounting Interpretations of APB 26, Early Extinguishment of Debt
Debt and Holding Company Obligations

• **FASB Emerging Issues Task Force No. 85-9, Revenue Recognition on Options to Purchase Stock of Another Entity**

• **FASB Emerging Issues Task Force No. 85-17, Accrued Interest upon Conversion of Convertible Debt**

• **FASB Emerging Issues Task Force No. 85-29, Convertible Bonds with a “Premium Put”**

• **FASB Emerging Issues Task Force No. 86-8, Sale of Bad-Debt Recovery Rights**

• **FASB Emerging Issues Task Force No. 86-15, Increasing-Rate Debt**

• **FASB Emerging Issues Task Force No. 86-18, Debtor’s Accounting for a Modification of Debt Terms**

• **FASB Emerging Issues Task Force No. 86-28, Accounting Implications of Indexed Debt Instruments**

• **FASB Emerging Issues Task Force No. 86-36, Invasion of a Defeasance Trust**

• **FASB Emerging Issues Task Force No. 90-19, Convertible Bonds with Issuer Option to Settle for Cash upon Conversion**

• **FASB Emerging Issues Task Force No. 95-15, Recognition of Gain or Loss When a Binding Contract Requires a Debt Extinguishment to Occur at a Future Date for a Specified Amount**

• **FASB Technical Bulletin No. 80-1, Early Extinguishment of Debt through Exchange for Common or Preferred Stock**

**RELEVANT ISSUE PAPERS**

• Issue Paper No. 80—Debt

• Issue Paper No. 95—Holding Company Obligations
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Statement of Statutory Accounting Principles No. 16

Electronic Data Processing Equipment and Software

STATUS

Type of Issue: Common Area

Issued: Initial Draft

Effective Date: January 1, 2001

Affects: No other pronouncements

Affected by: Paragraphs 3 and 8 superseded by SSAP No. 79

Interpreted by: INT 01-18, INT 01-21

SCOPE OF STATEMENT

SUMMARY CONCLUSION

Disclosures

Effective Date and Transition

RELEVANT ISSUE PAPERS
Electronic Data Processing Equipment and Software

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for electronic data processing (EDP) equipment and software.

SUMMARY CONCLUSION

2. EDP equipment and software generally meet the definition of assets established in SSAP No. 4—Assets and Nonadmitted Assets. EDP equipment and operating system software are admitted assets to the extent they conform to the requirements of this statement. Nonoperating system software are nonadmitted assets.

3. EDP equipment and software shall be depreciated for a period not to exceed three years using methods detailed in SSAP No. 19—Furniture, Fixtures and Equipment; Leasehold Improvements Paid by the Reporting Entity as Lessee; Depreciation of Property and Amortization of Leasehold Improvements.

4. The aggregate amount of admitted EDP equipment and operating system software (net of accumulated depreciation) shall be limited to three percent of the reporting entity’s capital and surplus as required to be shown on the statutory balance sheet of the reporting entity for its most recently filed statement with the domiciliary state commissioner adjusted to exclude any EDP equipment and operating system software, net deferred tax assets and net positive goodwill.

Disclosures

5. The following disclosures shall be made in the financial statements:
   a. Depreciation and amortization expense for the period;
   b. For EDP equipment and operating system software, balances of major classes of depreciable assets, by nature or function, at the balance sheet date;
   c. For EDP equipment and operating system software, accumulated depreciation and amortization, either by major classes of depreciable assets or in total, at the balance sheet date; and
   d. A general description of the method or methods used in computing depreciation with respect to major classes of depreciable assets.

6. Refer to the preamble for further discussion regarding disclosure requirements. The disclosures in paragraph 5 above shall be included in the annual audited statutory financial reports only.

Effective Date and Transition

7. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors.

8. EDP equipment and software capitalized prior to January 1, 2001 shall be depreciated over the shorter of its remaining useful life or three years.

RELEVANT ISSUE PAPERS

- Issue Paper No. 16—Electronic Data Processing Equipment and Software
Statement of Statutory Accounting Principles No. 17

Preoperating and Research and Development Costs

STATUS

Type of Issue: Common Area
Issued: Initial Draft
Effective Date: January 1, 2001
Affects: No other pronouncements
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SCOPE OF STATEMENT

SUMMARY CONCLUSION

Disclosures
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Effective Date and Transition

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

RELEVANT ISSUE PAPERS

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Preoperating and Research and Development Costs

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for organizational costs, research and development costs, and start-up costs for new and existing entities.

SUMMARY CONCLUSION

2. Preoperating, including organization and start-up costs, and research and development costs shall be expensed as incurred. Preoperating and research and development costs are incurred for such new projects as: (a) arranging operations for a new entity (e.g., legal, actuarial and accounting costs associated with regulatory approval and licensing and issuance of stock), (b) establishing production, sales or service facilities at a new site, (c) changing operations or production significantly, or (d) developing and producing a new product, adopting a new process or offering a new service.

3. Preoperating, including organization and start-up costs, and research and development costs specifically exclude tangible assets acquired in connection with such activities.

Disclosures

4. Disclosure shall be made in the financial statements of the total research and development costs charged to expense in each period for which an income statement is presented. The disclosure shall be included in the annual audited statutory financial report only.

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

Relevant Literature

6. This statement adopts FASB Statement No. 2, Accounting for Research and Development Costs and FASB Interpretation No. 6, Applicability of FASB Statement No. 2 to Computer Software. This statement also adopts FASB Statement No. 86, Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed, with the exception of paragraphs 5 and 6 and paragraphs 8 through 11. These paragraphs have been rejected to preclude the capitalization of software development costs. FASB Emerging Issues Task Force No. 96-14, Accounting for the Costs Associated with Modifying Computer Software for the Year 2000 is also adopted.

7. This statement rejects FASB Statement No. 7, Accounting and Reporting by Development Stage Enterprises and FASB Interpretation No. 7, Applying FASB Statement No. 7 in Financial Statements of Established Operating Enterprises, an interpretation of FASB Statement No. 7.

Effective Date and Transition

8. This statement is effective for years beginning January 1, 2001. 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–Accounting Changes and Corrections of Errors.

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

- FASB Statement No. 2, Accounting for Research and Development Costs
- FASB Statement No. 86, Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed
• FASB Interpretation No. 6, Applicability of FASB Statement No. 2 to Computer Software

• FASB Emerging Issues Task Force No. 96-14, Accounting for the Costs Associated with Modifying Computer Software for the Year 2000

RELEVANT ISSUE PAPERS

• Issue Paper No. 17—Preoperating and Research and Development Costs
Statement of Statutory Accounting Principles No. 18

Transfers and Servicing of Financial Assets and Extinguishments of Liabilities

STATUS

Type of Issue: Common Area

Issued: Initial Draft

Effective Date: January 1, 2001

Affects: No other pronouncements

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SCOPE OF STATEMENT

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Transfers and Servicing of Financial Assets and Extinguishments of Liabilities

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for accounting for transfers and servicing of financial assets and extinguishments of liabilities. This statement discusses generalized situations. Facts and circumstances and specific contracts need to be considered carefully in applying this statement.

2. Except as addressed in this statement and in other statements (including, but not limited to, SSAP No. 15—Debt and Holding Company Obligations (SSAP No. 15), SSAP No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties, SSAP No. 26—Bonds, excluding Loan-backed and Structured Securities, SSAP No. 30—Investments in Common Stock (excluding investments in common stock of subsidiary, controlled, or affiliated entities), SSAP No. 32—Investments in Preferred Stock (excluding investments in preferred stock of subsidiary, controlled, or affiliated entities), SSAP No. 42—Sale of Premium Receivables (SSAP No. 42), SSAP No. 43—Loan-backed and Structured Securities, SSAP No. 45—Repurchase Agreements, Reverse Repurchase Agreements and Dollar Repurchase Agreements (SSAP No. 45), and SSAP No. 33—Securitization (SSAP No. 33)), transfers and servicing of financial assets and extinguishments of liabilities shall be accounted for in accordance with FASB Statement No. 125, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (FAS 125).

SUMMARY CONCLUSION

3. Except as discussed in paragraph 35, a transfer of a group of financial assets, or a portion of a financial asset in which the transferor surrenders control over those financial assets shall be accounted for as a sale to the extent that consideration other than beneficial interests in the transferred assets is received in exchange. The transferor has surrendered control over transferred assets if, and only if, all of the following conditions are met:

   a. The transferred assets have been isolated from the transferor—put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership (see paragraphs 12 and 13);

   b. Either (i) each transferee obtains the right, free of conditions that constrain it from taking advantage of that right (see paragraph 14), to pledge or exchange the transferred assets or (ii) the transferee is a qualifying special-purpose entity as defined in paragraph 9 of SSAP No. 33 and the holders of beneficial interests in that entity have the right, free of conditions that constrain them from taking advantage of that right (see paragraph 14), to pledge or exchange those interests; and

   c. The transferor does not maintain effective control over the transferred assets through (i) an agreement that both entitles and obligates the transferor to repurchase or redeem them before their maturity (see paragraphs 15-17) or (ii) an agreement that entitles the transferor to repurchase or redeem transferred assets that are not readily obtainable (see paragraph 18).

4. Upon completion of any transfer of financial assets, the transferor shall:

   a. Continue to carry in its balance sheet any retained interest in the transferred assets, including, if applicable, beneficial interests in assets transferred to a qualifying special-
purpose entity in a securitization (see SSAP No. 33), and retained undivided interests (see paragraph 20); and

b. Allocate the previous carrying amount between the assets sold, if any, and the retained interests, if any, based on their relative fair values at the date of transfer (see paragraphs 19 and 20).

5. Upon completion of a transfer of assets that satisfies the conditions to be accounted for as a sale (see paragraph 3), the transferor (seller) shall:

   a. Eliminate the transferred assets from the balance sheet;

   b. Allocate the previous carrying amount of the transferred assets to the securities representing beneficial interests retained by the reporting entity, if any, and the securities representing beneficial interests not retained, if any, based on the relative fair values of the transferred assets at the date of transfer;

   c. Record in its balance sheet, the allocated carrying value of the securities representing retained beneficial interests in the assets (e.g., loan-backed securities);

   d. Recognize all additional assets obtained (i.e., other than the securities representing retained beneficial interests which are recorded in accordance with 5 c.) and liabilities incurred in consideration as proceeds of the sale;

   e. Initially measure such additional assets obtained and liabilities incurred in the sale at fair value; and

   f. For reporting entities required to maintain an Interest Maintenance Reserve (IMR), the accounting for realized capital gains and losses shall be in accordance with SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve. For reporting entities not required to maintain an IMR, realized gains and losses shall be reported as net realized capital gains or losses in the statement of income.

6. The transferee shall recognize all assets obtained and any liabilities incurred, and initially measure them at fair value (in aggregate, presumptively the price paid).

7. Repurchase agreements, reverse repurchase agreements, and dollar repurchase agreements shall meet the definition of SSAP No. 45. When an asset is sold and the proceeds are reinvested within 30 days in the same or substantially the same security, such transfers shall be considered to be wash sales and shall be accounted for as sales and disclosed as required by paragraph 37. Unless there is a concurrent contract to repurchase or redeem the transferred financial assets from the transferee, the transferor does not maintain effective control over the transferred assets.

8. If a transfer of financial assets in exchange for cash or other consideration (other than beneficial interests in the transferred assets) (a) does not meet the criteria for a sale in paragraph 3, or (b) is a sale of receivables with recourse (see paragraph 35); the transferor and transferee shall account for the transfer as a secured borrowing with pledge of collateral (see paragraph 10).
Recognition and Measurement of Servicing Assets and Liabilities

9. Servicing rights become a distinct asset or liability only when contractually separated from the underlying assets by sale or securitization of the assets with servicing retained, or separate purchase or assumption of the servicing. If distinct servicing rights to transferred assets exist and are retained by the reporting entity, the reporting entity shall recognize a servicing asset or liability. When the servicing fees to be received exceed the cost of servicing the transferred assets, a servicing asset is recognized and nonadmitted. When the cost of servicing the transferred assets is greater than the servicing fees to be received, a liability shall be recorded for the excess to recognize this obligation. A corresponding loss shall be recorded through the Summary of Operations. The servicing asset or liability shall be amortized into income in proportion to, and over the period of estimated servicing income (if an asset) or estimated servicing loss (if a liability). A servicing asset or liability shall be assessed for impairment or increased obligation based on its fair value.

Secured Borrowings and Collateral

10. A debtor may grant a security interest in certain assets to a lender (the secured party) to serve as collateral for its obligation under a borrowing, with or without recourse to other assets of the debtor. An obligor under other kinds of current or potential obligations, for example, interest rate swaps, also may grant a security interest in certain assets to a secured party. If collateral is transferred to the secured party, the custodial arrangement is commonly referred to as a pledge. Secured parties sometimes are permitted to sell or repledge (or otherwise transfer) collateral held under a pledge. The same relationships occur, under different names, in transfers documented as sales that are accounted for as secured borrowings (see paragraph 8). The accounting for collateral by the debtor (or obligor) and the secured party depends on whether the secured party has taken control over the collateral, and on the rights and obligations that result from the collateral arrangement:

   a. If the secured party is permitted to sell or repledge the collateral, and the debtor does not have the right and ability to redeem the collateral on short notice, (e.g., by substituting other collateral or terminating the contract), then:

      i. The debtor shall disclose the amount of such assets and the secured party’s right to sell or repledge such collateral;

      ii. The secured party shall recognize that collateral as its asset, initially measure it at fair value, and also recognize its obligation to return it.

   b. If the secured party sells or repledges collateral on terms that do not give it the right and ability to repurchase or redeem the collateral from the transferee on short notice, the secured party shall recognize the proceeds from the sale or the asset repledged and its obligation to return the asset to the extent that it has not already recognized them. The sale or repledging of the asset is a transfer subject to the provisions of this statement;

   c. If the debtor defaults under the terms of the secured contract and is no longer entitled to redeem the collateral, it shall derecognize the collateral. The secured party shall recognize the collateral as an asset (to the extent it has not already recognized it) and initially measure it at fair value;

   d. Otherwise, the debtor shall continue to carry the collateral as an asset, and the secured party shall not recognize the pledged asset.
Extinguishments of Liabilities

11. A debtor shall derecognize a liability if, and only if, it has been extinguished (see SSAP No. 15). A liability has been extinguished if either of the following conditions is met:

   a. The debtor pays the creditor and is relieved of its obligation for the liability. Paying the creditor includes delivery of cash, other financial assets, goods, or services or reacquisition by the debtor of its outstanding debt securities; or

   b. The debtor is legally released from being the primary obligor under the liability, either judicially or by the creditor.

Isolation Beyond the Reach of the Transferor and Its Creditors

12. The nature and extent of supporting evidence required for an assertion in financial statements that transferred financial assets have been isolated—put presumptively beyond the reach of the transferor and its creditors, either by a single transaction or a series of transactions taken as a whole—depend on the facts and circumstances. All available evidence that either supports or questions an assertion shall be considered. That consideration includes making judgments about whether the contract or circumstances permit the transferor to revoke the transfer. It also may include making judgments about the kind of bankruptcy or other receivership into which a transferor or special-purpose entity might be placed, whether a transfer of financial assets would likely be deemed a true sale at law, whether the transferor is affiliated with the transferee, and other factors pertinent under applicable law. Derecognition of transferred assets is appropriate only if the available evidence provides reasonable assurance that the transferred assets would be beyond the reach of the powers of a bankruptcy trustee or other receiver for the transferor or any of its affiliates, except for an affiliate that is a qualifying special-purpose entity designed to make remote the possibility that it would enter bankruptcy or other receivership (see SSAP No. 33).

13. Many common financial transactions, for example, typical repurchase agreements (see SSAP No. 45) and securities lending transactions, isolate transferred assets from the transferor, although they may not meet the other criteria for surrender of control.

Conditions That Constrain a Transferee

14. Many transferor-imposed or other conditions on a transferee’s contractual right to pledge or exchange a transferred asset constrain a transferee from taking advantage of that right. However, a transferor’s right of first refusal on a bona fide offer from a third party, a requirement to obtain the transferor’s permission to sell or pledge that shall not be unreasonably withheld, or a prohibition on sale to the transferor’s competitor generally does not constrain a transferee from pledging or exchanging the asset and, therefore, presumptively does not preclude a transfer containing such a condition from being accounted for as a sale. For example, a prohibition on sale to the transferor’s competitor would not constrain the transferee if it were able to sell the transferred assets to a number of other parties; however, it would be a constraint if that competitor were the only potential willing buyer.

Agreements That Maintain Effective Control Over Transferred Assets

15. An agreement that both entitles and obligates the transferor to repurchase or redeem transferred assets from the transferee maintains the transferor’s effective control over those assets, and the transfer is therefore to be accounted for as a secured borrowing, if and only if all of the following conditions are met:
Transfers and Servicing of Financial Assets and Extinguishments of Liabilities

18–7

Transfers and Servicing of Financial Assets
and Extinguishments of Liabilities

SSAP No. 18

a. The assets to be repurchased or redeemed are the same or substantially the same as those transferred (see paragraph 16);

b. The transferor is able to repurchase or redeem them on substantially the agreed terms, even in the event of default by the transferee (see paragraph 17);

c. The agreement is to repurchase or redeem them before maturity, at a fixed or determinable price; and

d. The agreement is entered into concurrently with the transfer.

16. To be substantially the same, the asset that was transferred and the asset that is to be repurchased or redeemed need to have all of the following characteristics:

a. The same primary obligor (except for debt guaranteed by a sovereign government, central bank, government-sponsored enterprise or agency thereof, in which case the guarantor and the terms of the guarantee must be the same);

b. Identical form and type so as to provide the same risks and rights;

c. The same maturity (or in the case of mortgage-backed pass-through and pay-through securities have similar remaining weighted-average maturities that result in approximately the same market yield);

d. Identical contractual interest rates;

e. Similar assets as collateral; and

f. The same aggregate unpaid principal amount or principal amounts within accepted good delivery standards for the type of security involved.

17. To be able to repurchase or redeem assets on substantially all of the agreed terms, even in the event of default by the transferee, a transferor must at all times during the contract term have obtained cash or other collateral sufficient to fund substantially all of the cost of purchasing replacement assets from others.

18. A call option or forward contract that entitles the transferor to repurchase, prior to maturity, transferred assets not readily obtainable elsewhere maintains the transferor’s effective control, because it would constrain the transferee from exchanging those assets, unless it is only a cleanup call.

Assets Obtained and Liabilities Incurred as Proceeds

19. The proceeds from a sale of financial assets consist of the cash and any other assets obtained in the transfer less any liabilities incurred. Any asset obtained that is not an interest in the transferred asset is part of the proceeds from the sale. Any liability incurred, even if it is related to the transferred assets, is a reduction of the proceeds. Any derivative financial instrument entered into concurrently with a transfer of financial assets is either an asset obtained or a liability incurred and part of the proceeds received in the transfer. All proceeds and reductions of proceeds from a sale shall be initially measured at fair value.
Retained Interests

20. Other interests in transferred assets—those that are not part of the proceeds of the transfer—are retained interests over which the transferor has not relinquished control. They shall be measured at the date of the transfer by allocating the previous carrying amount between the assets sold, if any, and the retained interests, based on their relative fair values. That procedure shall be applied to all transfers in which interests are retained, even those that do not qualify as sales. Examples of retained interests include securities backed by the transferred assets, undivided interests, servicing assets, and cash reserve accounts and residual interests in securitization trusts. If a transferor cannot determine whether an asset is a retained interest or proceeds from the sale, the asset shall be treated as proceeds from the sale and accounted for in accordance with paragraph 19.

Fair Value

21. The fair value of an asset (or liability) is the amount at which that asset (or liability) could be bought (or incurred) or sold (or settled) in a current transaction between willing parties, that is, other than in a forced or liquidation sale. Quoted market prices in active markets are the best evidence of fair value and shall be used as the basis for the measurement, if available. If a quoted market price is available, the fair value is the product of the number of trading units times market price.

22. If quoted market prices are not available, the estimate of fair value shall be based on the best information available. The estimate of fair value shall consider prices for similar assets and liabilities and the results of valuation techniques to the extent available in the circumstances. Examples of valuation techniques include the present value of estimated expected future cash flows using a discount rate commensurate with the risks involved, option-pricing models, matrix pricing, option-adjusted spread models, and fundamental analysis. Valuation techniques for measuring financial assets and liabilities and servicing assets and liabilities shall be consistent with the objective of measuring fair value. Those techniques shall incorporate assumptions that market participants would use in their estimates of values, future revenues, and future expenses, including assumptions about interest rates, default, prepayment, and volatility. In measuring financial liabilities and servicing liabilities at fair value by discounting estimated future cash flows, an objective is to use discount rates at which those liabilities could be settled in an arm’s-length transaction.

23. Estimates of expected future cash flows, if used to estimate fair value, shall be the best estimate based on reasonable and supportable assumptions and projections. All available evidence shall be considered in developing estimates of expected future cash flows. The weight given to the evidence shall be commensurate with the extent to which the evidence can be verified objectively. If a range is estimated for either the amount or timing of possible cash flows, the likelihood of possible outcomes shall be considered in determining the best estimate of future cash flows.

If It Is Not Practicable to Estimate Fair Values

24. If it is not practicable to estimate the fair values of assets, the transferor shall record those assets at zero. If it is not practicable to estimate the fair values of liabilities, the transferor shall recognize no gain on the transaction and shall record those liabilities at the greater of:

   a. The excess, if any, of (i) the fair values of assets obtained less the fair values of other liabilities incurred, over (ii) the sum of the carrying values of the assets transferred;

   b. The amount that would be recognized in accordance with SSAP No. 5—Liabilities, Contingencies and Impairments of Assets.
Securities Lending Transactions

25. When securities are loaned, they remain assets of the reporting entity and are not removed from the accounting records. Any fees received by the transferor for loaning the securities, net of direct expenses, should be recorded as miscellaneous in investment income in the subcategory of investment income known as aggregate write-ins for miscellaneous income. Interest income on loaned securities that is unrelated to securities lending shall be reported in the annual statement categories and exhibits that are consistent with the income earned on similar investment categories, e.g., bonds. During a securities lending transaction, collateral is pledged by the transferee to the transferor that has loaned the securities. If the collateral pledged by the transferee is not available for the general use of the transferor (restricted), then the transferor shall not reflect the collateral in the transferor’s balance sheet as an asset, and the transferor shall not establish a liability for the return of the collateral. However, if the collateral pledged is available for the general use of the transferor (unrestricted), then the collateral shall be recorded as an asset on the transferor’s balance sheet and a separate liability shall be established on the transferor’s balance sheet to record the obligation to return the collateral. The failure by the transferor to maintain sufficient collateral for the loaned securities would result in nonadmission of the undercollateralized portion. The specific collateral requirements are as follows:

   a. The reporting entity shall receive collateral having a fair value as of the transaction date at least equal to 102 percent of the fair value of the loaned securities at that date. If at any time the fair value collateral is less than 100 percent of the fair value of the loaned securities, the counterparty shall be obligated to deliver additional collateral, the fair value of which, together with the fair value of all collateral then held in connection with the transaction at least equals 102 percent of the fair value of the loaned securities.

   b. In the event that foreign securities are loaned and the denomination of the currency of the collateral is other than the denomination of the currency of the loaned foreign securities, the amount of collateral shall be at least equal to 105 percent of the fair value of the loaned securities at that date. If at any time the fair value is less than 102 percent of the fair value of the loaned securities, the reporting entity must obtain additional collateral, the fair value of which together with the fair value of all collateral then held in connection with the transaction at least equals 105 percent of the fair value of the loaned securities.

26. Securities lending transactions are generally initiated by broker-dealers and other financial institutions that need specific securities to cover a short sale or a customer’s failure to deliver securities sold. Transferees (borrowers) of securities generally are required to provide collateral to the transferor (lender) of securities, commonly cash but sometimes other securities or standby letters of credit, with a value slightly higher than that of the securities borrowed. If the collateral is cash, the transferor typically earns a return by investing that cash at rates higher than the rate paid or rebated to the transferee. If the collateral is other than cash, the transferor typically receives a fee. Securities custodians or other agents commonly carry out securities lending activities on behalf of clients. Because of the protection of collateral (typically valued daily and adjusted frequently for changes in the market price of the securities transferred) and the short terms of the transactions, most securities lending transactions in themselves do not impose significant credit risks on either party. Other risks arise from what the parties to the transaction do with the assets they receive. For example, investments made with cash collateral impose market and credit risks on the transferor.

27. Securities lending transactions are accompanied by an agreement that entitles and obligates the transferor to repurchase or redeem the transferred assets before their maturity under which the transferor maintains effective control over those assets (see paragraphs 15-18). Those transactions shall be
accounted for as secured borrowings, in which cash (or securities that the holder is permitted by contract or custom to sell or repledge) received as collateral is considered the amount borrowed, the securities loaned are considered pledged as collateral against the cash borrowed, and any rebate paid to the transferee of securities is interest on the cash the transferor is considered to have borrowed. Collateral provided in securities lending transactions that are accounted for as secured borrowings shall be reported and disclosed like other collateral, as set forth in paragraphs 10 and 25.

28. In some transactions, characterized as securities lending, all of the criteria in paragraph 3 are met. During the term of such agreements, the transferor has surrendered control over the securities transferred and the transferee has obtained control over those securities, with the ability to sell or transfer them at will. In that case, creditors of the transferor have a claim only to the collateral and the forward repurchase commitment. Those transactions shall be accounted for:

a. By the transferor as a sale of the loaned securities, for proceeds consisting of the collateral and a forward repurchase commitment. (If the collateral is a financial asset that the holder is permitted to sell or repledge and the debtor does not have the right and ability to redeem the collateral on short notice, e.g., by substituting other collateral or terminating the contract, that financial asset is proceeds of the sale of the loaned securities. To the extent that the collateral consists of letters of credit or other financial instruments that the holder is not permitted to sell or pledge, a securities lending transaction does not satisfy the sale criteria and is accounted for as a loan of securities by the transferor to the transferee); and

b. By the transferee as a purchase of the borrowed securities in exchange for the collateral and a forward resale commitment.

Loan Syndications

29. Borrowers often borrow amounts greater than any one lender is willing to lend. Therefore, it is common for groups of lenders to jointly fund those loans. That may be accomplished by a syndication under which several lenders share in lending to a single borrower, but each lender loans a specific amount to the borrower and has the right to repayment from the borrower.

30. Each lender in the syndication shall account for the amounts it is owed by the borrower. Repayments by the borrower may be made to a lead lender who then distributes the collections to the other lenders of the syndicate. In those circumstances, the lead lender is also functioning as a servicer and, therefore, shall only recognize its portion of the loan as an asset.

Loan Participations

31. Groups of banks or other entities also may jointly fund large borrowings through loan participations in which a single lender makes a large loan to a borrower and subsequently transfers undivided interests in the loan to other entities.

32. Transfers by the originating lender may take the legal form of either assignments or participations. The transfers are usually on a nonrecourse basis, and the transferor (originating lender) continues to service the loan. The transferee (participating entity) may or may not have the right to sell or transfer its participation during the term of the loan, depending upon the terms of the participation agreement.

33. If the loan participation agreement gives the transferee the right to pledge or exchange those participations and the other criteria in paragraph 3 are met, the transfers to the transferee shall be accounted for by the transferor as sales of financial assets. A transferor’s right of first refusal on a bona
fide offer from a third party, a requirement to obtain the transferor’s permission that shall not be unreasonably withheld, or a prohibition on sale to the transferor’s competitor is a limitation on the transferee’s rights but presumptively does not constrain a transferee from exercising its right to pledge or exchange. However, if the loan participation agreement constrains the transferees from pledging or exchanging their participations, the transferor has not relinquished control over the loan and shall account for the transfers as secured borrowings.

**Factoring Arrangements**

34. Factoring arrangements are a means of discounting accounts receivable on a nonrecourse, notification basis. Accounts receivable are sold outright, usually to a transferee (the factor) that assumes the full risk of collection, without recourse to the transferor in the event of a loss. Debtors are directed to send payments to the transferee. Factoring arrangements that meet the criteria in paragraph 3 shall be accounted for as sales of financial assets because the transferor surrenders control over the receivables to the factor.

**Transfers of Receivables with Recourse**

35. In a transfer of receivables with recourse, the transferor is obligated under the terms of the recourse provision to make payments to the transferee or to repurchase receivables sold under certain circumstances, typically for defaults up to a specified percentage. A transfer of receivables with recourse shall not be recognized as a sale but rather, as a financing. A transfer of receivables without recourse shall only be recognized if the transferor receives cash for the receivables. The sale shall be recognized when cash is received. Sales of premium receivables are addressed in SSAP No. 42.

**Disclosures**

36. A reporting entity shall disclose the following:

   a. If it is not practicable to estimate the fair value of certain assets obtained or liabilities incurred in transfers of financial assets during the period, a description of those items and the reasons why it is not practicable to estimate their fair value;

   b. Description of any loaned securities, including the amount, a description of, and the policy for, requiring collateral, and whether or not the collateral is restricted; and

   c. For all servicing assets and servicing liabilities:

      i. The amounts of servicing assets nonadmitted or liabilities recognized and amortized during the period; and

      ii. The fair value of servicing liabilities for which it is practicable to estimate that value and the method and significant assumptions used to estimate the fair value.

37. A reporting entity shall disclose the following information for wash sales, as defined in paragraph 7, involving transactions for securities with a NAIC designation of 3 or below, or unrated:

   a. A description of the reporting entity’s objectives regarding these transactions;

   b. An aggregation of transactions by NAIC Designation 3 or below, or unrated;

   c. The number of transactions involved during the reporting period;
d. The book value of securities sold;
e. The cost of securities repurchased; and
f. The realized gains/losses associated with the securities involved.

38. Refer to the preamble for further discussion regarding disclosure requirements. The disclosures required by paragraph 37 shall be made for the current quarter in the quarterly statement and for the year in the annual statement.

**Relevant Literature**

39. This statement adopts FAS 125 with modification to paragraphs 9, 10 a., 11 d., 13, 15—17, 35—41, and 68. Additionally, paragraphs 14, 59—60, 77—81, and 83 are rejected. The modifications to FAS 125 primarily relate to (a) the nonadmission of servicing rights assets, (b) the accounting for repurchase agreements, reverse repurchase agreements, and dollar repurchase agreements, (c) the accounting for realized gains and losses for reporting entities required to maintain an IMR, (d) the accounting for financial assets subject to prepayment, (e) the accounting for assets pledged as collateral, (f) the accounting for leases in accordance with SSAP No. 22—Leases, and (g) the accounting for sales of receivables with recourse. Paragraphs 77-81 are rejected because they are not applicable to the insurance industry.

40. This statement adopts AICPA Statement of Position 90-3, Definition of the Term Substantially the Same for Holders of Debt Instruments, as used In Certain Audit Guides and a Statement of Position. This statement adopts FASB Emerging Issues Task Force No. 87-34, Sale of Mortgage Servicing Rights with a Subservicing Agreement, FASB Emerging Issues Task Force No. 88-11, Allocation of Recorded Investment When a Loan as Part of a Loan is Sold, FASB Emerging Issues Task Force No. 88-18, Sales of Future Revenues, FASB Emerging Issues Task Force No. 88-22, Securitization of Credit Card and Other Receivable Portfolios, FASB Emerging Issues Task Force No. 90-21, Balance Sheet Treatment of a Sale of Mortgage Servicing Rights with a Subservicing Agreement, FASB Emerging Issues Task Force No. 95-5, Determination of What Risks and Rewards, If Any, Can Be Retained and Whether Any Unresolved Contingencies May Exist in a Sale of Mortgage Loan Servicing Rights and FASB Emerging Issues Task Force No. 96-19, Debtor’s Accounting for a Modification or Exchange of Debt Instruments.

41. This statement rejects FASB Statement No. 127, Deferral of the Effective Date of Certain Provisions of FASB Statement No. 125, an amendment of FASB Statement No. 125, FASB Emerging Issues Task Force No. 84-5, Sale of Marketable Securities with a Put Option, FASB Emerging Issues Task Force No. 92-2, Measuring Loss Accruals by Transferors of Receivables with Recourse, and FASB Emerging Issues Task Force No. 96-20, Impact of FASB Statement No. 125 on Consolidation of Special-Purpose Entities.

**Effective Date and Transition**

42. This statement shall be effective for transfers and servicing of financial assets and extinguishments of liabilities occurring after January 1, 2001, and shall be applied prospectively.

43. For each servicing contract in existence before January 1, 2001, previously recognized or nonadmitted servicing rights and excess servicing receivables shall be combined, net of any previously recognized servicing obligations under that contract, as a servicing asset (nonadmitted) or liability. Thereafter, the subsequent measurement provisions of this statement shall be applied to the servicing assets (nonadmitted) or liabilities for those servicing contracts.
AUTHORITATIVE LITERATURE

Statutory Accounting

- NAIC Purposes and Procedures of the Securities Valuation Office

Generally Accepted Accounting Principles

- FASB Statement No. 125, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities
- AICPA Statement of Position 90-3, Definition of the Term Substantially the Same for Holders of Debt Instruments, as used In Certain Audit Guides and a Statement of Position
- FASB Emerging Issues Task Force No. 87-34, Sale of Mortgage Servicing Rights with a Subservicing Agreement
- FASB Emerging Issues Task Force No. 88-11, Allocation of Recorded Investment When a Loan as Part of a Loan is Sold
- FASB Emerging Issues Task Force No. 88-18, Sales of Future Revenues
- FASB Emerging Issues Task Force No. 88-22, Securitization of Credit Card and Other Receivable Portfolios
- FASB Emerging Issues Task Force No. 90-21, Balance Sheet Treatment of a Sale of Mortgage Servicing Rights with a Subservicing Agreement
- FASB Emerging Issues Task Force No. 95-5, Determination of What Risks and Rewards, If Any, Can Be Retained and Whether Any Unresolved Contingencies May Exist in a Sale of Mortgage Loan Servicing Rights
- FASB Emerging Issues Task Force No. 96-19, Debtor’s Accounting for a Modification or Exchange of Debt Instruments
SSAP NO. 18—GLOSSARY

Beneficial interests

Rights to receive all or portions of specified cash inflows to a trust or other entity, including senior and subordinated shares of interest, principal, or other cash inflows to be passed-through or paid-through, premiums due to guarantors, and residual interests.

Cleanup call

An option held by the servicer, which may be the transferor, to purchase transferred financial assets when the amount of outstanding assets falls to a level at which the cost of servicing those assets becomes burdensome.

Collateral

Personal or real property in which a security interest has been given.

Derecognize

Remove previously recognized assets or liabilities from the balance sheet.

Derivative financial instrument

A futures, forward, swap, or option contract, or other financial instrument with similar characteristics.

Financial asset

Cash, evidence of an ownership interest in an entity, or a contract that conveys to a second entity a contractual right (a) to receive cash or another financial instrument from a first entity or (b) to exchange other financial instruments on potentially favorable terms with the first entity.

Financial liability

A contract that imposes on one entity a contractual obligation (a) to deliver cash or another financial instrument to a second entity or (b) to exchange other financial instruments on potentially unfavorable terms with the second entity.

Proceeds

Cash, derivatives, or other assets that are obtained in a transfer of financial assets, less any liabilities incurred.

Recourse

The right of a transferee of receivables to receive payment from the transferor of those receivables for (a) failure of debtors to pay when due, (b) the effects of prepayments, or (c) adjustments resulting from defects in the eligibility of the transferred receivables.

Securitization

The process by which financial assets are transformed into securities.
Security interest

A form of interest in property that provides that upon default of the obligation for which the security interest is given, the property may be sold in order to satisfy that obligation.

Seller

A transferor that relinquishes control over financial assets by transferring them to a transferee in exchange for consideration.

Servicing asset

A contract to service financial assets under which the estimated future revenues from contractually specified servicing fees, late charges, and other ancillary revenues are expected to more than adequately compensate the servicer for performing the servicing. A servicing contract is either (a) undertaken in conjunction with selling or securitizing the financial assets being serviced or (b) purchased or assumed separately.

Servicing liability

A contract to service financial assets under which the estimated future revenues from stated servicing fees, late charges, and other ancillary revenues are not expected to adequately compensate the servicer for performing the servicing.

Transfer

The conveyance of a noncash financial asset by and to someone other than the issuer of that financial asset. Thus, a transfer includes selling a receivable, putting it into a securitization trust, or posting it as collateral but excludes the origination of that receivable, the settlement of that receivable, or the restructuring of that receivable into a security in a troubled debt restructuring.

Transferee

An entity that receives a financial asset, a portion of a financial asset, or a group of financial assets from a transferor.

Transferor

An entity that transfers a financial asset, a portion of a financial asset, or a group of financial assets that it controls to another entity.

Undivided interest

Partial legal or beneficial ownership of an asset as a tenant in common with others. The proportion owned may be pro rata, for example, the right to receive 50 percent of all cash flows from a security, or non–pro rata, for example, the right to receive the interest from a security while another has the right to the principal.

Unrestricted collateral

Securities received that may be sold or repledged and which were obtained under agreements that are not subject to repurchase or redemption on short notice, for example, by substitution of other collateral or termination of the contract.
Statement of Statutory Accounting Principles No. 19

Furniture, Fixtures and Equipment; Leasehold Improvements Paid by the Reporting Entity as Lessee; Depreciation of Property and Amortization of Leasehold Improvements

STATUS

Type of Issue: Common Area

Issued: Initial Draft

Effective Date: January 1, 2001

Affects: No other pronouncements

Affected by: Paragraphs 3 and 6 superseded by SSAP No. 87

Interpreted by: INT 99-05, INT 01-18, INT 01-21

SCOPE OF STATEMENT

SUMMARY CONCLUSION

Furniture, Fixtures and Equipment

Leasehold Improvements Paid by the Reporting Entity as Lessee

Depreciation and Amortization

Disclosures

Relevant Literature

Effective Date and Transition

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

RELEVANT ISSUE PAPERS
Furniture, Fixtures and Equipment; Leasehold Improvements Paid by the Reporting Entity as Lessee; Depreciation of Property and Amortization of Leasehold Improvements

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for furniture, fixtures, and equipment (excluding electronic data processing equipment and software that is addressed in SSAP No. 16—Electronic Data Processing Equipment and Software (SSAP No. 16)), leasehold improvements paid by the reporting entity as lessee, and depreciation of property and amortization of leasehold improvements.

SUMMARY CONCLUSION

Furniture, Fixtures and Equipment

2. Furniture, fixtures and equipment generally meet the definition of assets established in SSAP No. 4—Assets and Nonadmitted Assets (SSAP No. 4). Within that definition, such items also meet the criteria defining nonadmitted assets. Accordingly, these assets shall be depreciated against net income as the estimated economic benefit expires and the undepreciated portion of these assets shall be reported as nonadmitted assets and charged against surplus.

3. In accordance with the reporting entity’s capitalization policy, immaterial amounts of such assets can be expensed when purchased.

Leasehold Improvements Paid by the Reporting Entity as Lessee

4. Leasehold improvements shall be defined as lessee expenditures that are permanently attached to an asset that a reporting entity is leasing under an operating lease.

5. Leasehold improvements that increase the value and enhance the usefulness of the leased asset meet the definition of assets established in SSAP No. 4. Within that definition, such items also meet the criteria defining nonadmitted assets. Accordingly, such assets shall be reported as nonadmitted assets and charged against surplus. These nonadmitted assets shall be amortized against net income over the shorter of their estimated useful life or the remaining life of the original lease excluding renewal or option periods. Leasehold improvements that do not meet the definition of assets shall be charged to expense when acquired.

6. In accordance with the reporting entity’s capitalization policy, immaterial amounts of such assets can be expensed when acquired.

Depreciation and Amortization

7. Depreciable assets include all tangible capital assets classified as either admitted or nonadmitted in accordance with SSAP No. 4. Land shall not be considered a depreciable asset.

8. The acquisition cost of depreciable assets, net of salvage, shall be depreciated against net income over the estimated useful lives of the assets in a systematic and rational manner. The acquisition cost of a leasehold improvement shall be amortized against net income over the shorter of its estimated useful life or the original lease term excluding options or renewal periods. For leasehold improvements capitalized subsequent to inception of the lease, the cost shall be amortized over the shorter of its estimated useful life or the remaining original lease term excluding options or renewal periods. Amounts capitalized for leasehold improvements in periods subsequent to the original lease term (i.e., during renewal periods), are amortized utilizing the shorter of the estimated useful life of the asset or the remaining term of the renewal period.
9. A variety of systematic depreciation and amortization methods is available such as the straight-line method, sum-of-the-years’ digits method, and various declining balance methods. The depreciation or amortization method selected shall be that which most appropriately allocates the cost of the depreciable asset or leasehold improvement over its estimated useful life. The use of the sinking fund or constant yield methods of depreciation does not constitute acceptable statutory accounting practice.

10. Useful lives of depreciable assets and leasehold improvements can be obtained from contractors, appraisers, engineers, and manufacturers, or they may be based on prior experience. Estimates published by the Internal Revenue Service can be helpful in the selection of useful lives for specific assets.

11. Changes in the estimated useful lives of depreciable assets or leasehold improvements from one period to another shall be considered a change in accounting estimate and shall be accounted for in accordance with SSAP No. 3—Accounting Changes and Corrections of Errors (SSAP No. 3).

12. Changes in depreciation or amortization methods from one period to another shall be considered a change in accounting principle and shall be accounted for in accordance with SSAP No. 3.

13. Depreciation and amortization expense shall be recorded in the statement of income in accordance with SSAP No. 70—Allocation of Expenses.

Disclosures

14. The following disclosures shall be made in the financial statements:

   a. Depreciation and amortization expense for the period;

   b. A general description of the method or methods used in computing depreciation and amortization with respect to major classes of depreciable assets and leasehold improvements.

15. Refer to the preamble for further discussion regarding disclosure requirements. The disclosures in paragraph 14 above shall be included in the annual audited statutory financial reports only.

Relevant Literature

16. This statement adopts paragraphs 4 and 5 of Accounting Principles Board Opinion No. 12, Omnibus Opinion—1967. This statement also adopts AICPA Practice Bulletin No. 1, Purpose and Scope of AcSEC Practice Bulletins and Procedures for Their Issuance, Exhibit A.

17. This statement rejects Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins, “Chapters 9A and 9C;” however, it is considered appropriate to use the concepts of depreciating assets discussed in the GAAP guidance, which requires that the acquisition cost less salvage value be recorded as an expense over the estimated useful life of the asset, as the basis for the statutory guidance in this statement.

Effective Date and Transition

18. This statement is effective for years beginning January 1, 2001. 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.

19. The use of the sinking fund or constant yield method does not constitute acceptable statutory accounting practice and these methods shall not be applied to new properties acquired since December 3, 1990 (the date the Emerging Accounting Issues Working Group reached its conclusion...
regarding this method) nor if the reporting entity changes its existing properties’ method of depreciation. This conclusion would not impact those properties currently being depreciated using the constant yield method.

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

- *Accounting Principles Board Opinion No. 12, Omnibus Opinion—1967*, paragraphs 4 and 5
- *AICPA Practice Bulletin No. 1, Purpose and Scope of AcSEC Practice Bulletins and Procedures for Their Issuance, Exhibit A*

RELEVANT ISSUE PAPERS

- Issue Paper No. 19—Furniture, Fixtures, and Equipment
- Issue Paper No. 31—Leasehold Improvements Paid by the Reporting Entity as Lessee
- Issue Paper No. 67—Depreciation of Property and Amortization of Leasehold Improvements
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Statement of Statutory Accounting Principles No. 20

Nonadmitted Assets

STATUS

Type of Issue: Common Area
Issued: Initial Draft
Effective Date: January 1, 2001
Affects: No other pronouncements
Affected by: No other pronouncements
Interpreted by: No other pronouncements

SCOPE OF STATEMENT

SUMMARY CONCLUSION

Relevant Literature
Effective Date and Transition
RELEVANT ISSUE PAPERS
Nonadmitted Assets

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for nonadmitted assets which are not specifically addressed in other statements.

SUMMARY CONCLUSION

2. The definition and accounting treatment for nonadmitted assets is outlined in *SSAP No. 4—Assets and Nonadmitted Assets* (SSAP No. 4) as follows:

As stated in the Statement of Concepts, “The ability to meet policyholder obligations is predicated on the existence of readily marketable assets available when both current and future obligations are due. Assets having economic value other than those which can be used to fulfill policyholder obligations, or those assets which are unavailable due to encumbrances or other third party interests should not be recognized on the balance sheet,” and are, therefore, considered nonadmitted.

SSAP No. 4 defines nonadmitted assets as follows:

A nonadmitted asset shall be defined as an asset meeting the criteria in paragraph 2 above, which is accorded limited or no value in statutory reporting, and is one which is:

a. Specifically identified within the Accounting Practices and Procedures Manual as a nonadmitted asset; or


If an asset meets one of these criteria, the asset shall be reported as a nonadmitted asset and charged against surplus unless otherwise specifically addressed within the Accounting Practices and Procedures Manual. The asset shall be depreciated or amortized against net income as the estimated economic benefit expires.

3. This statement shall not be considered an all-inclusive list of nonadmitted assets. Certain admitted assets and nonadmitted assets are addressed in other SSAPs.

4. Consistent with paragraph 2, the following assets shall be nonadmitted:

a. Deposits in Suspended Depositories—Amounts on deposit with suspended depositories may not be fully recoverable. Any amounts not reasonably expected to be recovered shall be written off in accordance with *SSAP No. 5—Liabilities, Contingencies and Impairments of Assets* (SSAP No. 5). Amounts in excess of that written off shall be nonadmitted as they are not available to satisfy obligations to policyholders;

b. Bills Receivable Not for Premium and Loans Unsecured or Secured by Assets That Do Not Qualify As Investments—In accordance with SSAP No. 5, amounts determined to be uncollectible or otherwise impaired shall be written off. Amounts in excess of that written off are not considered to be properly collateralized as there are no underlying assets which would otherwise be admitted assets. Such amounts shall be nonadmitted as they may be of questionable economic value if needed to fulfill policyholder obligations;
c. Loans on Personal Security, Cash Advances To, Or In The Hands Of, Officers Or Agents And Travel Advances—In accordance with SSAP No. 5, amounts determined to be uncollectible or otherwise impaired shall be written off. Amounts in excess of that written off typically are unsecured and as such have no underlying assets which would otherwise be admitted assets. Such amounts shall be nonadmitted as they may be of questionable economic value if needed to fulfill policyholder obligations. Some of these items may also be considered prepaid expenses which, per SSAP No. 29—Prepaid Expenses, are nonadmitted;

d. All “Non-Bankable” Checks—Examples of “non-bankable” checks are NSF (non-sufficient funds) checks, post dated checks, or checks for which payment has been stopped. Although these checks may still maintain probable future benefits (and thus meet the definition of assets), at the date on which they are non-bankable they are not available for policyholder obligations and shall be nonadmitted until the uncertainty related to the probable future benefit is resolved and the checks are converted to available funds;

e. Trade Names And Other Intangible Assets—These assets, by their nature, are not readily marketable and available to satisfy policyholder obligations and shall be nonadmitted;

f. Automobiles, Airplanes and Other Vehicles—Automobiles, airplanes and other vehicles meet the definition of assets established in SSAP No. 4. However, they are not readily available to satisfy policyholder obligations and as a result the undepreciated portion shall be nonadmitted. The accounting for these assets shall be consistent with the accounting for equipment provided in SSAP No. 19—Furniture, Fixtures and Equipment; Leasehold Improvements Paid by the Reporting Entity as Lessee; Depreciation of Property and Amortization of Leasehold Improvements;

g. Company’s Stock as Collateral for Loan—When a reporting entity lends money and accepts its own stock as collateral for the loan, it shall report the amount of the loan receivable and any related accrued interest on the loan as a nonadmitted asset. The asset is nonadmitted as the collateral could not be used to satisfy the obligation in the event of default.

Relevant Literature

5. This statement rejects Chapters 3A and 11 of Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins.

Effective Date and Transition

6. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors.

RELEVANT ISSUE PAPERS

• Issue Paper No. 90—Nonadmitted Assets
Statement of Statutory Accounting Principles No. 21

Other Admitted Assets

STATUS

Type of Issue: Common Area

Issued: Initial Draft

Effective Date: January 1, 2001

Affects: No other pronouncements

Affected by: No other pronouncements

Interpreted by: INT 00-12

SCOPE OF STATEMENT

SUMMARY CONCLUSION

Collateral Loans
Cash Value of Life Insurance Where the Reporting Entity is Owner and Beneficiary
Receivables for Securities
Other Amounts Receivable Under Reinsurance Contracts
Guaranteed Investment Contracts
State Guaranty Association Loan Agreements
Relevant Literature
Effective Date and Transition

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

RELEVANT ISSUE PAPERS

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Other Admitted Assets

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for admitted assets which are not specifically addressed in other statements.

SUMMARY CONCLUSION

2. The definition and accounting treatment for admitted assets is outlined in paragraphs 2 and 3 of SSAP No. 4—Assets and Nonadmitted Assets (SSAP No. 4) as amended by SSAP No. 87—Capitalization Policy, an Amendment to SSAP Nos. 4, 19, 29, 73, 79 and 82 as follows:

   For purposes of statutory accounting, an asset shall be defined as: probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events. An asset has three essential characteristics: (a) it embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows, (b) a particular entity can obtain the benefit and control others’ access to it, and (c) the transaction or other event giving rise to the entity’s right to or control of the benefit has already occurred. These assets shall then be evaluated to determine whether they are admitted. The criteria used is outlined in paragraph number 3 below.

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

   a. Specifically identified within the Accounting Practices and Procedures Manual as a nonadmitted asset; or


   If an asset meets one of these criteria, the asset shall be reported as a nonadmitted asset and charged against surplus unless otherwise specifically addressed within the Accounting Practices and Procedures Manual. The asset shall be depreciated or amortized against net income as the estimated economic benefit expires. In accordance with the reporting entity’s written capitalization policy, amounts less than a predefined threshold of furniture, fixtures, equipment, or supplies, shall be expensed when purchased.

3. Consistent with paragraph 2, the following assets shall be considered admitted and shall be reported in accordance with SSAP No. 4. These admitted assets are not addressed in other statements.
Collateral Loans

4. Collateral loans are unconditional obligations for the payment of money secured by the pledge of an investment ¹ and meet the definition of assets as defined in SSAP No. 4, and are admitted assets to the extent they conform to the requirements of this statement. The outstanding principal balance on the loan and any related accrued interest shall be recorded as an admitted asset subject to the following limitations:

   a. Loan Impairment—Determination as to the impairment of a collateral loan shall be based on current information and events. When it is considered probable that any portion of amounts due under the contractual terms of the loan will not be collected the loan is considered impaired. The impairment shall be measured based on the fair value of the collateral less estimated costs to obtain and sell the collateral. The difference between the net value of the collateral and the recorded asset shall be written off in accordance with SSAP No. 5—Liabilities, Contingencies and Impairments of Assets (SSAP No. 5);

   b. Nonadmitted Asset—In accordance with SSAP No. 20—Nonadmitted Assets, collateral loans secured by assets that do not qualify as investments shall be nonadmitted. Further, any amount of the loan outstanding which is in excess of the permitted relationship of fair value of the pledged investment to the collateral loan shall be treated as a nonadmitted asset.

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

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

Receivables for Securities

6. Sales of securities are recorded as of the trade date. A receivable due from the broker is established in instances when a security has been sold, but the proceeds from the sale have not yet been received. Unless the receivable for securities, other than a receivable arising from the sale of a security which was acquired on a “To Be Announced” ("TBA") basis, or from the sale of securities that are received as stock distributions that may be restricted (unregistered) or in physical form, and which has yet to be actually received (see paragraph 9), meets the criteria set forth in paragraph 8, the receivable for securities is an admitted asset to the extent it conforms to the requirements of this statement.

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

8. Receivables for securities not received within 15 days from the settlement date shall be nonadmitted and shall be classified as “Other than invested assets”.

9. Receivables arising from the secondary sale of securities acquired on a TBA basis, or from stock distributions that may be restricted (unregistered) or in physical form, which have not yet been received by the seller in the secondary sale transaction, may be admitted until the security is exchanged for payment. TBA securities are originally purchased well in advance of the actual date of security issuance.

¹ Investment defined as those assets listed in Section 3 of Appendix A-001: Investments of Reporting Entities.
(frequently 90 days or more). Accordingly, secondary sales of securities so acquired may occur before the date of issuance. Sales of securities so acquired always include a provision that requires simultaneous delivery of the security and receipt of consideration. Upon the secondary sale, and prior to the actual receipt, of a security acquired on a TBA basis, the seller in the secondary sale transaction records a liability for the book value of the security thus sold and a receivable for the consideration reflected in the secondary sale transaction. Profits or losses emanating from the secondary sale transaction are recorded in the same manner as profits and losses emanating from any other sale transaction involving an investment.

**Other Amounts Receivable Under Reinsurance Contracts**

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

**Guaranteed Investment Contracts**

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

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

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

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

**State Guarantee-Guaranty Association Promissory Notes Loan Agreements**

15. State guaranty associations have the statutory authority to reinsure any or all of the policies of an impaired or insolvent insurer and borrow funds. When this is done in the case of reinsurance, the assuming carrier receives assets supporting the liabilities from the insolvent company’s estate and/or the responsible state guaranty association. If available, the state guaranty association transfers cash at the closing of the transaction. Loan agreements, promissory notes may be utilized in the event a guaranty association does not have the funds on hand or is unable to raise the funds by the closing date. In the case of adverse cash flow situations, guaranty associations may enter into loan agreements with insurers to provide funds that will allow the association to perform its duties as required by statute. These promissory notes, loan agreements are essentially credit risk free because the notes are backed by all member insurers of an association.

16. Promissory notes, loan agreements issued by state guaranty associations taken by an insurance company in connection with funding an assumption reinsurance agreement or as interim financing meet the definition of assets as defined in SSAP No. 4, are admitted assets to the extent they conform to the requirements of this statement, and shall be reported as a note receivable—other than invested assets.
Relevant Literature

17. This statement is consistent with *FASB Statement No. 114, Accounting by Creditors for the Impairment of a Loan* which was adopted with modification in SSAP No. 37—Mortgage Loans. This statement is consistent with *Accounting Principles Board Opinion No. 21, Interest on Receivables and Payables* which was adopted in SSAP No. 15—Debt and Holding Company Obligations.

18. This statement adopts *FASB Emerging Issues Task Force No. 88-5, Recognition of Insurance Death Benefits* and *FASB Technical Bulletin 85-4, Accounting for Purchases of Life Insurance* with the modification that the entity must be the owner and the beneficiary.

Effective Date and Transition

19. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors*.

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

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

RELEVANT ISSUE PAPERS

- Issue Paper No. 87—Other Admitted Assets
Statement of Statutory Accounting Principles No. 22

Leases

STATUS

Type of Issue: Common Area

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SCOPE OF STATEMENT

SUMMARY CONCLUSION

Accounting and Reporting by Lessees

Accounting and Reporting by Lessors

Sale-Leaseback Transactions

Sale-Leaseback Transactions Involving Real Estate

Continuing Involvement

Leveraged Leases for Lessors

Related-Party Leases

Disclosures

Relevant Literature

Effective Date and Transition

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

RELEVANT ISSUE PAPERS
Leases

SCOPE OF STATEMENT

1. The purpose of this statement is to establish statutory accounting principles for leases by lessors and lessees. It addresses:

   a. Accounting and reporting by lessees;

   b. Accounting and reporting by lessors;

   c. Sale-leaseback transactions;

   d. Leveraged leases for lessors;

   e. Related party leases; and

   f. Disclosures.

SUMMARY CONCLUSION

2. A lease is defined as an agreement conveying the right to use property, plant, or equipment (land and/or depreciable assets) usually for a stated period of time. This definition does not include agreements that are contracts for services that do not transfer the right to use property, plant, or equipment from one contracting party to the other (i.e., employee lease contracts). On the other hand, agreements that do transfer the right to use property, plant, or equipment meet the definition of a lease even though substantial services by the contractor (lesser) may be called for in connection with the operation or maintenance of the assets.

Accounting and Reporting by Lessees

3. All leases shall be considered operating leases. Rent on an operating lease shall be charged to expense over the lease term as it becomes payable, except as provided in paragraphs 4 and 5.

4. As discussed in FASB Technical Bulletin 85-3, Accounting for Operating Leases with Scheduled Rent Increases, the effects of scheduled rent increases normally shall be recognized on a straight-line basis over the lease term.

5. Lease agreements may also include incentives for the lessee to sign the lease, such as an up-front cash payment to the lessee, payment of costs for the lessee (such as moving expenses), or the assumption by the lessor of the lessee’s preexisting lease. As discussed in FASB Technical Bulletin 88-1, Issues Relating to Accounting for Leases: Time Pattern of the Physical Use of the Property in an Operating Lease; Lease Incentives in an Operating Lease; Applicability of Leveraged Lease Accounting to Existing Assets of the Lessor; Money-Over-Money Lease Transactions; Wrap Lease Transactions, incentives paid to or payments made on behalf of the lessee shall be considered reductions of minimum lease payments (i.e., the payments that the lessee is obligated to make or can be required to make in connection with the leased properties.) These incentives shall be recognized over the lease term on a straight-line basis unless the use of another systematic and rational allocation basis is more representative of the time pattern in which the leased property is physically employed. The lessee’s immediate recognition of expenses or losses (e.g., moving costs, losses on subleases, write-offs of leasehold improvements) shall not be changed by this guidance.
Accounting and Reporting by Lessors

6. All leases, except leveraged leases as defined in paragraph 21, shall be considered operating leases and accounted for by the lessor as follows:
   
a. The leased property shall be included in the same balance sheet category it would be had the property not been leased. The property shall be depreciated following the lessor’s normal depreciation policies for such assets;
   
b. Rental income shall be reported as investment income as it becomes receivable according to the provisions of the lease. However, as discussed in paragraphs 4 and 5 of this statement, rentals may be recognized before they become due, if rentals vary from the straight-line basis. The guidance in SSAP No. 34—Investment Income Due and Accrued shall be applied to the receivable balance; and
   
c. Initial direct costs shall be charged to expense when incurred and shall not be deferred and allocated over the lease term. Initial direct costs are those incremental costs that the lessor has incurred in directly evaluating, negotiating, administering, and closing a lease transaction.

7. The sale of property subject to an operating lease, or of property that is leased by or intended to be leased by the third-party purchaser to another party, shall not be treated as a sale if the seller or any party related to the seller (related party is defined in SSAP No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties (SSAP No. 25)) retains substantial risks of ownership in the leased property.

Sale-Leaseback Transactions

8. Sale-leaseback transactions involve the sale of property by the owner and a lease of the property back to the seller. Sale-leaseback accounting is a method of accounting in which the seller-lessee records the sale, removes all property and related liabilities from its balance sheet.

9. A sale of property that is accompanied by a leaseback of all or any part of the property for all or part of its remaining economic life shall be accounted for by the buyer-lessee and seller-lessee as a purchase and operating lease and a sale and an operating lease, respectively, unless the sale-leaseback involves real estate or a sale of nonadmitted assets to a related party.

10. If the transaction involves a sale of nonadmitted assets to a related party, the transaction shall be accounted for by the deposit method (refer to paragraphs 30-33 of FASB Statement No. 98, Accounting for Leases (FAS 98) for illustration).

11. When applying sale-leaseback accounting for non-real estate transactions, the sale and income statement gains and losses thereon, shall be recognized in accordance with paragraphs 2 and 3 of FASB Statement No. 28, Accounting for Sales with Leasebacks.

Sale-Leaseback Transactions Involving Real Estate

12. Paragraphs 12 through 20 present the additional standards of statutory accounting by a seller-lessee for sale-leaseback transactions involving real estate, including real estate with equipment, such as office buildings with furniture and fixtures. A sale-leaseback transaction involving real estate with equipment includes any sale-leaseback transaction in which the equipment and the real estate are sold and leased back as a package, irrespective of the relative value of the equipment and the real estate. Those
paragraphs also address sale-leaseback transactions in which the seller-lessee sells property improvements or integral equipment\(^1\) to a buyer-lessor and leases them back while retaining the underlying land.\(^2\)

13. Sale-leaseback accounting shall be used by a seller-lessee only if a sale-leaseback transaction includes all of the following:

a. A normal leaseback as described in paragraph 14.

b. Payment terms and provisions that adequately demonstrate the buyer-lessor's initial and continuing investment in the property (refer to paragraphs 8-16 of FASB Statement No. 66, Accounting for Sales of Real Estate (FAS 66)).

c. Payment terms and provisions that transfer all of the other risks and rewards of ownership as demonstrated by the absence of any other continuing involvement by the seller-lessee described in paragraphs 17 through 19 of this section and paragraphs 25-39 and 41-43 of FAS 66.

d. Admitted assets, if the buyer-lessor is a related party, or either admitted or nonadmitted assets if the buyer-lessor is not a related party. For purposes of this paragraph, related parties include those identified in SSAP No. 25 and entities created for the purpose of buying and leasing nonadmitted assets for the reporting entity and/or its affiliates.

14. A normal leaseback is a lessee-lessor relationship that involves the active use of the property by the seller-lessee in consideration for payment of rent, including contingent rentals that are based on the future operations of the seller-lessee,\(^3\) and excludes other continuing involvement provisions or conditions described in paragraphs 17 through 19 of this section. The phrase active use of the property by the seller-lessee refers to the use of the property during the lease term in the seller-lessee's trade or business, provided that subleasing of the leased back property is minor.\(^4\) If the present value of a reasonable amount of rental for that portion of the leaseback that is subleased is not more than 10 percent of the fair value of the asset sold, the leased back property under sublease is considered minor. Active use of the property may involve the providing of services where the occupancy of the property is generally transient or short-term and is integral to the ancillary services being provided. Those ancillary services include, but are not limited to, housekeeping, inventory control, entertainment, bookkeeping, and food services. Thus, the use of property by a seller-lessee engaged in the hotel or bonded warehouse business or the operation of a golf course or a parking lot, for example, is considered active use.

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\(^1\) The terms *property improvements* or *integral equipment* as used in paragraphs 12 through 19 of this section refer to any physical structure or equipment attached to the real estate, or other parts thereof, that cannot be removed and used separately without incurring significant cost.

\(^2\) Paragraphs 38 and 39 of FAS 66 address transactions in which the seller sells property improvements to a buyer and leases the underlying land to the buyer of the improvements. Under certain circumstances, paragraph 38 of FAS 66 precludes sales recognition for such transactions and requires that they be accounted for as leases of both the land and improvements. Paragraphs 11-18 of this section are not intended to modify paragraph 38 of FAS 66; thus, they do not address a sale-leaseback transaction that does not qualify for sales recognition under the provisions of paragraph 38 of FAS 66. However, those paragraphs do address a sale-leaseback transaction that qualifies for sales recognition under the provisions of paragraph 39 of FAS 66.

\(^3\) Paragraphs 12-19 distinguish between contingent rentals that are based on the future operations of the seller-lessee and those that are based on some predetermined or determinable level of future operations of the buyer-lessor. The latter type of contingent rental is addressed in paragraph 18e of this section.

\(^4\) The term *minor* is used here in the context of the underlying the classification criteria of this section. In that context, a test based on a 90 percent recovery test could be used as a guideline; that is, if the present value of a reasonable amount of rental for the leaseback represents 10 percent or less of the fair value of the asset sold, the seller-lessee could be presumed to have transferred to the [buyer-lessor] the right to substantially all of the remaining use of the property sold, and the seller-lessee could be presumed to have retained only a minor portion of such use.
15. Terms of the sale-leaseback transaction that are substantially different from terms that an independent third-party lessor or lessee would accept represent an exchange of some stated or unstated rights or privileges. Those rights or privileges shall be considered in evaluating the continuing involvement provisions in paragraphs 17-19 of this section. Those terms or conditions include, but are not limited to, the sales price, the interest rate, and other terms of any loan from the seller-lessee to the buyer-lessee. The fair value of the property used in making that evaluation shall be based on objective evidence, for example, an independent third-party appraisal or recent sales of comparable property.

**Continuing Involvement**

16. A sale-leaseback transaction that does not qualify for sale-leaseback accounting because of any form of continuing involvement by the seller-lessee other than a normal leaseback shall be accounted for by the deposit method or as a financing (refer to paragraphs 34-39 of FAS 98 for illustration), whichever is appropriate under FAS 66. If the criteria of paragraph 13d is not met, the sale-leaseback shall be accounted for by the deposit method under FAS 66. The provisions or conditions described in paragraphs 17-19 of this section are examples of continuing involvement for the purpose of applying paragraphs 12-20.

17. Paragraphs 25-39 and 41-43 of FAS 66 describe forms of continuing involvement by the seller-lessee with the leased property that result in the seller-lessee not transferring the risks or rewards of ownership to the buyer-lessee. Two examples of continuing involvement specified in those paragraphs that are frequently found in sale-leaseback transactions are provisions or conditions in which:

   a. The seller-lessee has an obligation or an option\(^6\) to repurchase the property or the buyer-lessee can compel the seller-lessee to repurchase the property.

   b. The seller-lessee guarantees the buyer-lessee's investment or a return on that investment for a limited or extended period of time.

18. Other provisions or conditions that are guarantees and that do not transfer all of the risks of ownership shall constitute continuing involvement for the purpose of applying paragraphs 12-19 to sale-leaseback transactions and include, but are not limited to, the following:

   a. The seller-lessee is required to pay the buyer-lessee at the end of the lease term for a decline in the fair value of the property below the estimated residual value on some basis other than excess wear and tear of the property levied on inspection of the property at the termination of the lease.

   b. The seller-lessee provides nonrecourse financing to the buyer-lessee for any portion of the sales proceeds or provides recourse financing in which the only recourse is to the leased asset.

   c. The seller-lessee is not relieved of the obligation under any existing debt related to the property.

   d. The seller-lessee provides collateral on behalf of the buyer-lessee other than the property directly involved in the sale-leaseback transaction, the seller-lessee or a related party to the seller-lessee guarantees the buyer-lessee's debt, or a related party to the seller-lessee guarantees a return of or on the buyer-lessee's investment.

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\(^6\) A right of first refusal based on a bona fide offer by a third party ordinarily is not an obligation or an option to repurchase. An agreement that allows the seller-lessee to repurchase the asset in the event no third-party offer is made is an option to repurchase.
e. The seller-lessee's rental payment is contingent on some predetermined or determinable level of future operations of the buyer-lessor.  

19. The following provisions or conditions also shall be considered examples of continuing involvement for the purpose of applying paragraphs 12-19 to sale-leaseback transactions:

   a. The seller-lessee enters into a sale-leaseback transaction involving property improvements or integral equipment 7 without leasing the underlying land to the buyer-lessor.  

   b. The buyer-lessor is obligated to share with the seller-lessee any portion of the appreciation of the property.

   c. Any other provision or circumstance that allows the seller-lessee to participate in any future profits of the buyer-lessor or the appreciation of the leased property, for example, a situation in which the seller-lessee owns or has an option to acquire any interest in the buyer-lessor.

20. When applying sales-leaseback accounting, the sale and gains and losses, thereon, shall be recognized in accordance with SSAP No. 40—Real Estate Investments, which adopts FAS 66.  

**Leveraged Leases for Lessors**

21. Generally, leveraged leases are those in which the lessor acquires, through the incurrence of debt (such that the lessor is substantially “leveraged” in the transaction), property, plant or equipment with the intentions to lease the asset(s) to the lessee. Leveraged leases are defined as those leases that meet the criteria set forth in paragraph 42 a-d (and the related paragraphs to which 42 refers) of FASB Statement No. 13, Accounting for Leases (FAS 13). Leases which meet the preceding definition shall be accounted for in accordance with paragraphs 43-47 (and the related paragraphs to which 43-47 refer) of FAS 13. The lessor shall record its investment net of the nonrecourse debt. In cases where the asset being leased is a nonadmitted asset, any net leveraged lease asset shall be nonadmitted.

**Related-Party Leases**

22. This statement applies to arms-length transactions. To the extent that leases between related parties are, in substance, arms-length transactions the guidance in this statement shall be applied. The determination of whether related party leases qualify as arms-length transactions is addressed in SSAP No. 25.

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6 Paragraphs 12-19 distinguish between contingent rentals that are based on the future operations of the seller-lessee and those that are based on some predetermined or determinable level of future operations of the buyer-lessor.

7 The terms property improvements or integral equipment as used in paragraphs 12 through 19 of this section refer to any physical structure or equipment attached to the real estate, or other parts thereof, that cannot be removed and used separately without incurring significant cost.

8 Paragraphs 38 and 39 of FAS 66 address transactions in which the seller sells property improvements to a buyer and leases the underlying land to the buyer of the improvements. Under certain circumstances, paragraph 38 of FAS 66 precludes sales recognition for such transactions and requires that they be accounted for as leases of both the land and improvements. Paragraphs 12-19 of this section are not intended to modify paragraph 38 of FAS 66; thus, they do not address a sale-leaseback transaction that does not qualify for sales recognition under the provisions of paragraph 38 of FAS 66. However, those paragraphs do address a sale-leaseback transaction that qualifies for sales recognition under the provisions of paragraph 39 of FAS 66.
Disclosures

23. The following disclosures shall be made in the financial statements of lessees:
   a. A general description of the lessee’s leasing arrangements including, but not limited to, the following:
      i. Rental expense for each period for which an income statement is presented, with separate amounts for minimum rentals, contingent rentals, and sublease rentals. Rental payments under leases with terms of a month or less that were not renewed need not be included;
      ii. The basis on which contingent rental payments are determined;
      iii. The existence and terms of renewal or purchase options and escalation clauses; and
      iv. Restrictions imposed by lease agreements, such as those concerning dividends, additional debt, and further leasing.
   b. For leases having initial or remaining noncancelable lease terms in excess of one year:
      i. Future minimum rental payments required as of the date of the latest balance sheet presented, in the aggregate and for each of the five succeeding years; and
      ii. The total of minimum rentals to be received in the future under noncancelable subleases as of the date of the latest balance sheet presented.
   c. For sale-leaseback transactions:
      i. A description of the terms of the sale-leaseback transaction, including future commitments, obligations, provisions, or circumstances that require or result in the seller-lessee’s continuing involvement; and
      ii. For those accounted for as deposits, (a) the obligation for future minimum lease payments as of the date of the latest balance sheet presented in the aggregate and for each of the five succeeding years and (b) the total of minimum sublease rentals, if any, to be received in the future under noncancelable subleases in the aggregate and for each of the five succeeding years.

24. When leasing is a significant part of the lessor’s business activities in terms of revenue, net income, or assets, the following information with respect to leases shall be disclosed in the financial statements:
   a. For operating leases:
      i. The cost and carrying amount, if different, of property on lease or held for leasing by major classes of property according to nature or function, and the amount of accumulated depreciation in total as of the date of the latest balance sheet presented;
      ii. Minimum future rentals on noncancelable leases as of the date of the latest balance sheet presented, in the aggregate and for each of the five succeeding years;
iii. Total contingent rentals included in income for each period for which an income statement is presented; and

iv. A general description of the lessor’s leasing arrangements.

b. For leveraged leases:

i. A description of the terms including the pretax income from the leveraged leases. For purposes of presenting the investment in a leveraged lease in the lessor’s balance sheet, the amount of related deferred taxes shall be presented separately (from the remainder of the net investment);

ii. Separate presentation (from each other) shall be made of pretax income from the leveraged lease, the tax effect of pretax income, and the amount of investment tax credit recognized as income during the period; and

iii. When leveraged leasing is a significant part of the lessor’s business activities in terms of revenue, net income, or assets, the components of the net investment balance in leveraged leases shall be disclosed.

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

Relevant Literature

26. This statement rejects FAS 13, as amended and interpreted, except for certain of the guidance on operating leases, sale-leaseback transactions and leveraged leases (i.e., paragraphs 15, 16(b, c, d), 19(a, b), 23(b, c), 36, 37, 38(b), 39(c) and, 42-47). A complete list of all FASB Statements, Interpretations and Technical Bulletins adopted and rejected in this statement is as follows:

a. FASB Statement No. 13, Accounting for Leases, [paragraphs 15, 16(b, c, d), 19(a, b), 23(b, c), 36, 37, 38(b), 39(c), 42-47 adopted; all other paragraphs rejected];

b. FASB Statement No. 22, Changes in the Provisions of Lease Agreements Resulting from Refundings of Tax-Exempt Debt (an amendment of FASB Statement No. 13) [rejected in its entirety];

c. FASB Statement No. 23, Inception of the Lease (an amendment of FASB Statement No. 13) [paragraph 10 adopted; all other paragraphs rejected];

d. FASB Statement No. 27, Classification of Renewals or Extensions of Existing Sales-Type or Direct Financing Leases (an amendment of FASB Statement No. 13) [rejected in its entirety];

e. FASB Statement No. 28, Accounting for Sales with Leasebacks (an amendment of FASB Statement No. 13) [adopted in its entirety, except guidance on capital leases is not applicable other than those leases that qualify as leveraged leases];

f. FASB Statement No. 29, Determining Contingent Rentals (an amendment of FASB Statement No. 13) [paragraphs 8 and 11 adopted; all other paragraphs rejected];

g. FASB Statement No. 98, Accounting for Leases:
   • Sale-Leaseback Transactions Involving Real Estate
   • Sales-Type Leases of Real Estate
• Definition of the Lease Term

• Initial Direct Costs of Direct Financing Leases

(an amendment of FASB Statements No. 13, 66 and 91 and a rescission of FASB Statement No. 26 and Technical Bulletin No. 79-11) [paragraphs 1-13, 17-22(a-e, j-n) adopted; all other paragraphs rejected];

h. FASB Statement No. 109, Accounting for Income Taxes [paragraphs 256-258 adopted; all other paragraphs addressed in SSAP No. 10—Income Taxes (SSAP No. 10)];

i. FASB Statement No. 145, Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13 and Technical Corrections [paragraph 9 c.c. adopted; all other paragraphs rejected];

j. FASB Interpretation No. 19, Lessee Guarantee of the Residual Value of Leased Property (an interpretation of FASB Statement No. 13) [rejected in its entirety];

k. FASB Interpretation No. 21, Accounting for Leases in a Business Combination (an interpretation of FASB Statement No. 13) [rejected in its entirety];

l. FASB Interpretation No. 23, Leases of Certain Property Owned by a Governmental Unit or Authority (an interpretation of FASB Statement No. 13) [rejected in its entirety];

m. FASB Interpretation No. 24, Leases Involving Only Part of a Building (an interpretation of FASB Statement No. 13) [rejected in its entirety];

n. FASB Interpretation No. 26, Accounting for Purchase of a Leased Asset by the Lessee during the Term of the Lease (an interpretation of FASB Statement No. 13) [rejected in its entirety];

o. FASB Interpretation 27, Accounting for a Loss on a Sublease (an interpretation of FASB Statement No. 13 and APB Opinion No. 30) [adopted in its entirety];

p. FASB Technical Bulletin 79-10, Fiscal Funding Clauses in Lease Agreements [rejected in its entirety];

q. FASB Technical Bulletin 79-12, Interest Rate Used in Calculating the Present Value of Minimum Lease Payments [rejected in its entirety];

r. FASB Technical Bulletin 79-13, Applicability of FASB Statement No. 13 to Current Value Financial Statements [rejected in its entirety];

s. FASB Technical Bulletin 79-14, Upward Adjustment of Guaranteed Residual Values [rejected in its entirety];

t. FASB Technical Bulletin 79-15, Accounting for Loss on a Sublease Not Involving the Disposal of a Segment [adopted in its entirety];

u. FASB Technical Bulletin 79-16(R), Effect of a Change in Income Tax Rate on the Accounting for Leveraged Leases [adopted in its entirety];

v. FASB Technical Bulletin 79-17, Reporting Cumulative Effect Adjustment from Retroactive Application of FASB Statement No. 13 [rejected in its entirety];
w. *FASB Technical Bulletin 79-18, Transition Requirement of Certain FASB Amendments and Interpretations of FASB Statement No. 13* [rejected in its entirety];

x. *FASB Technical Bulletin 85-3, Accounting for Operating Leases with Scheduled Rent Increases* [adopted in its entirety];

   - Acquired by a Third Party or
   - Retained by a Lessor That Sells the Related Minimum Rental Payments
[adopted in its entirety];

z. *FASB Technical Bulletin 88-1, Issues Related to Accounting for Leases:*
   - Time Pattern of the Physical Use of the Property in an Operating Lease
   - Lease Incentives in an Operating Lease
   - Applicability of Leveraged Lease Accounting to Existing Assets of the Lessor
   - Money-Over-Money Lease Transactions
   - Wrap Lease Transactions
[paragraphs 1-12 adopted; all other paragraphs rejected];

aa. *FASB Emerging Issues Task Force No. 85-16, Leveraged Leases* [adopted in its entirety]

bb. *FASB Emerging Issues Task Force No. 86-17, Deferred Profit on Sale-Leaseback Transaction with Lessee Guarantee of Residual Value* [rejected in its entirety];

c. *FASB Emerging Issues Task Force No. 86-33, Tax Indemnifications in Lease Agreements* [adopted in its entirety];

dd. *FASB Emerging Issues Task Force No. 86-43, Effect of a Change in Tax Law or Rates on Leveraged Leases* [adopted in its entirety];

ee. *FASB Emerging Issues Task Force No. 87-7, Sale of an Asset Subject to a Lease and Nonrecourse Financing: “Wrap Lease Transactions”* [rejected in its entirety];


gg. *FASB Emerging Issues Task Force No. 88-10, Costs Associated with Lease Modification or Termination* [adopted in its entirety];

hh. *FASB Emerging Issues Task Force No. 88-21, Accounting for the Sale of Property Subject to the Seller's Preexisting Lease* [rejected in its entirety];

ii. *FASB Emerging Issues Task Force No. 89-16, Consideration of Executory Costs in Sale-Leaseback Transactions* [adopted in its entirety];
jj. FASB Emerging Issues Task Force No. 90-14, Unsecured Guarantee by Parent of Subsidiary's Lease Payments in a Sale-Leaseback Transaction [adopted in its entirety];

kk. FASB Emerging Issues Task Force No. 90-15, Impact of Nonsubstantive Lessors, Residual Value Guarantees, and Other Provisions in Leasing Transactions [rejected in its entirety];

ll. FASB Emerging Issues Task Force No. 90-20, Impact of an Uncollateralized Irrevocable Letter of Credit on a Real Estate Sale-Leaseback Transaction [adopted in its entirety];

mm. FASB Emerging Issues Task Force No. 92-1, Allocation of Residual Value or First-Loss Guarantee to Minimum Lease Payments in Leases Involving Land and Building(s) [rejected in its entirety];

nn. FASB Emerging Issues Task Force No. 93-8, Accounting for the Sale and Leaseback of an Asset That Is Leased to Another Party [adopted in its entirety];

oo. FASB Emerging Issues Task Force No. 95-17, Accounting for Modifications to an Operating Lease That Do Not Change the Lease Classification [adopted in its entirety];

pp. FASB Emerging Issues Task Force No. 96-21, Implementation Issues in Accounting for Leasing Transactions involving Special-Purpose Entities [rejected in its entirety].

Effective Date and Transition

27. This statement is effective for years beginning January 1, 2001. The provisions of this statement shall be applied to all new leases entered into, or for existing leases which are renewed, on or after January 1, 2001.

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

- FASB Statement No. 13, Accounting for Leases, [paragraphs 15, 16(b, c, d), 19(a, b), 23(b, c), 36, 37, 38(b), 39(c), 42-47 adopted; all other paragraphs rejected]

- FASB Statement No. 23, Inception of the Lease (an amendment of FASB Statement No. 13) [paragraph 10 adopted; all other paragraphs rejected]

- FASB Statement No. 28, Accounting for Sales with Leasebacks (an amendment of FASB Statement No. 13) [adopted in its entirety, except guidance on capital leases is not applicable other than those leases that qualify as leveraged leases]

- FASB Statement No. 29, Determining Contingent Rentals (an amendment of FASB Statement No. 13) [paragraphs 8, 11 adopted; all other paragraphs rejected]

- FASB Statement No. 98, Accounting for Leases:
  - Sale-Leaseback Transactions Involving Real Estate
  - Sales-Type Leases of Real Estate
  - Definition of the Lease Term
  - Initial Direct Costs of Direct Financing Leases
(an amendment of FASB Statements No. 13, 66 and 91 and a recession of FASB Statement No. 26 and Technical Bulletin No. 79-11) [paragraphs 1-13, 17-22(a-e, j-n) adopted; all other paragraphs rejected]

- FASB Statement No. 109, Accounting for Income Taxes [paragraphs 256-258 adopted; all other paragraphs addressed in SSAP No. 10]

- FASB Statement No. 145, Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13 and Technical Corrections [paragraph 9 c.c. adopted; all other paragraphs rejected]

- FASB Interpretation 27, Accounting for a Loss on a Sublease (an interpretation of FASB Statement No. 13 and APB Opinion No. 30) [adopted in its entirety]


- FASB Technical Bulletin 79-16(R), Effect of a Change in Income Tax Rate on the Accounting for Leveraged Leases [adopted in its entirety]

- FASB Technical Bulletin 85-3, Accounting for Operating Leases with Scheduled Rent Increases [adopted in its entirety]

- FASB Technical Bulletin 86-2, Accounting for an Interest in the Residual Value of a Leased Asset:
  - Acquired by a Third Party or
  - Retained by a Lessor That Sells the Related Minimum Rental Payments

[adopted in its entirety]

- FASB Technical Bulletin 88-1, Issues Related to Accounting for Leases:
  - Time Pattern of the Physical Use of the Property in an Operating Lease
  - Lease Incentives in an Operating Lease
  - Applicability of Leveraged Lease Accounting to Existing Assets of the Lessor
  - Money-Over-Money Lease Transactions
  - Wrap Lease Transactions

[paragraphs 1-12 adopted; all other paragraphs rejected]

- FASB Emerging Issues Task Force No. 85-16, Leveraged Leases [adopted in its entirety]

- FASB Emerging Issues Task Force No. 86-33, Tax Indemnifications in Lease Agreements [adopted in its entirety]

- FASB Emerging Issues Task Force No. 86-43, Effect of a Change in Tax Law or Rates on Leveraged Leases [adopted in its entirety]
• **FASB Emerging Issues Task Force No. 87-8, Tax Reform Act of 1986: Issues Related to the Alternative Minimum Tax [Issue No. 10 adopted]**

• **FASB Emerging Issues Task Force No. 88-10, Costs Associated with Lease Modification or Termination [adopted in its entirety]**

• **FASB Emerging Issues Task Force No. 89-16, Consideration of Executory Costs in Sale-Leaseback Transactions [adopted in its entirety]**

• **FASB Emerging Issues Task Force No. 90-14, Unsecured Guarantee by Parent of Subsidiary’s Lease Payments in a Sale-Leaseback Transaction [adopted in its entirety]**

• **FASB Emerging Issues Task Force No. 90-20, Impact of an Uncollateralized Irrevocable Letter of Credit on a Real Estate Sale-Leaseback Transaction [adopted in its entirety]**

• **FASB Emerging Issues Task Force No. 93-8, Accounting for the Sale and Leaseback of an Asset That Is Leased to Another Party [adopted in its entirety]**

• **FASB Emerging Issues Task Force No. 95-17, Accounting for Modifications to an Operating Lease That Do Not Change the Lease Classification [adopted in its entirety]**

**RELEVANT ISSUE PAPERS**

• Issue Paper No. 22—Leases
**Statement of Statutory Accounting Principles No. 23**

**Foreign Currency Transactions and Translations**

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Foreign Currency Transactions and Translations

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for accounting for foreign currency transactions and translations.

SUMMARY CONCLUSION

2. A foreign currency transaction is a transaction denominated in a currency other than the reporting entity’s functional currency. The reporting entity’s functional currency is defined as the currency of the primary economic environment in which the reporting entity operates. Foreign currency translation is the translation of financial statements, denominated in the reporting entity’s functional currency, into U.S. dollars prior to their incorporation into financial statements through consolidation or the equity method of accounting.

3. For the purposes of this statement, a U.S. domiciled reporting entity’s reporting currency shall be defined as the U.S. dollar, regardless of the primary economic environment in which the reporting entity operates. In order to ensure consistency, all elements of statutory financial statements shall be reported in U.S. dollars.

4. Each foreign currency transaction shall be examined and a determination made if the foreign currency transaction was made in support of insurance operations denominated in the same foreign currency. For example, some reporting entities engage in insurance operations in foreign countries with the premiums collected and claims paid in local currency. As in any insurance operation there will at times be uncollected premiums, policy reserves, unpaid claims, and other incomplete transactions that must be recorded in the reporting entity’s balance sheet. Premiums, reserves, and claims normally are recorded in U.S. dollars at the rate of exchange that is in effect at the time the policy is written, or when the claim is incurred. Changes in exchange rates, while not affecting the foreign policyholder, do affect the value of the foreign business as it is recorded in U.S. dollars.

5. Foreign currency transactions made in support of insurance operations denominated in the same foreign currency, such as foreign branches, shall be accounted for as follows:

   a. Canadian Insurance Operations—Canadian insurance operations, resulting in less than 10% of the reporting entity’s admitted assets, less than 10% of the reporting entity’s liabilities and less than 10% of the reporting entity’s net premium, can be translated to U.S. dollars by making an adjustment to the net assets of the foreign operation. The adjustment is calculated by summarizing the assets and liabilities in the foreign currency and in U.S. dollars. The net value is converted to U.S. dollars at the current rate of exchange and compared with the net value in U.S. dollars recorded by the reporting entity. Any difference in the net value to current exchange rates is recorded as a separate asset or liability and the change in the foreign exchange adjustment is recorded as an unrealized capital gain or loss;

   b. All Other Foreign Insurance Operations—All other foreign insurance operations must be translated to U.S. dollars as follows: each financial statement line shall be translated to U.S. dollars by applying the following exchange rates: (i) for assets and liabilities, the exchange rate at the balance sheet date shall be used and (ii) for revenues, expenses, gains, losses and surplus adjustments, the exchange rate at the dates on which those elements are recognized shall be used. Because translation at the exchange rates at the dates the numerous revenues, expenses, gains, losses and surplus adjustments are recognized is generally impractical, an appropriately weighted average exchange rate for
the period may be used to translate those elements. Gains or losses due to translating foreign operations to U.S. dollars shall be recorded as unrealized capital gains or losses.

6. All other foreign currency transactions shall be accounted for as follows:

   a. Assets and liabilities denominated in foreign currencies shall be accounted for at their U.S. dollar equivalent values using exchange rates at the balance sheet date. Income and expenses recognized during an accounting period shall be recorded at an appropriately weighted average exchange rate;

   b. Changes in balance sheet asset and liability values due to fluctuations in foreign currency exchange rates shall be recorded as unrealized capital gains and losses until the asset is sold or exchanged or the liability is settled. Upon settlement, previously recorded unrealized capital gains and losses shall be reversed and the foreign exchange profit or loss for the entire holding period shall be recorded as a realized capital gain or loss;

   c. Transactions involving settlement in cash, such as purchases, payment of expenses, sales, and receipt of income, shall be recorded at their U.S. dollar equivalent value based on the foreign currency exchange rate as of the transaction date. Any foreign currency exchange gains or losses on purchases, payment of expenses, sales, maturities or changes in income or expense accruals shall be recorded as a capital gain or loss realized on the purchase, sale or maturity.

7. Nominal information such as par value of investments may be expressed in the foreign currency or U.S. dollar equivalent (description of issue), but where the information is displayed comparatively (column of par values), U.S. dollar equivalent amount shall be used. The U.S. dollar equivalent amount is translated utilizing the exchange rate at the balance sheet date. Ratios and factors shall be based on data that is entirely consistent with respect to currency.

8. A currency in a highly inflationary environment (one that has cumulative inflation of approximately 100% or more over a three year period) is not considered stable enough to serve as a functional currency and the more stable currency of the reporting parent is to be used instead. If a reporting entity’s books of record are not maintained in its functional currency, remeasurement into the functional currency is required. That remeasurement is required before translation into the reporting currency. The remeasurement process is intended to produce the same result as if the reporting entity’s books of record had been maintained in the functional currency. The remeasurement of and subsequent accounting for transactions denominated in a currency other than the functional currency shall be recognized as a realized gain or loss in the statement of operations.

Relevant Literature

Effective Date and Transition

10. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors.

RELEVANT ISSUE PAPERS

- Issue Paper No. 81—Foreign Currency Transactions and Translations
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Statement of Statutory Accounting Principles No. 24

Discontinued Operations and Extraordinary Items

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Discontinued Operations and Extraordinary Items

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles related to the accounting and reporting for the effects of the disposal of a segment of a business and extraordinary items.

SUMMARY CONCLUSION

Definitions

2. The following definitions shall apply:
   a. “Discontinued operations” shall be defined as the operations of a segment of a business that has been sold, abandoned, spun off, or otherwise disposed of or, although still operating, is the subject of a formal plan for disposal;
   b. A “segment” of a business shall be defined as a component of an entity, likely in the form of a subsidiary, whose activities represent a separate major type of business or class of customer. The assets, results of operations, and activities of a segment must be clearly distinguished, physically and operationally and for financial reporting purposes, from the other assets, results of operations, and activities of the entity. The fact that the results of operations of the segment being sold or abandoned cannot be separately identified strongly suggests that the transaction should not be classified as the disposal of a segment of the business. The disposal of a segment of a business shall be distinguished from other disposals of assets incident to the evolution of the entity’s business, such as the disposal of a line of business or the shifting of marketing activities from one location to another;
   c. “Measurement date” shall be defined as the date on which management having authority to approve the action commits itself to a formal plan to dispose of a segment of the business, whether by sale or abandonment. The plan, at a minimum, should include identification of the major assets to be disposed of, the expected method of disposal, the period expected to be required for completion of the disposal, an active program to find a buyer if disposal is to be by sale, the estimated results of operations of the segment from the measurement date to the disposal date (defined below), and the estimated proceeds or salvage to be realized by disposal;
   d. “Disposal date” shall be defined as the date of closing the sale if the disposal is by sale or the date that operations cease if the disposal is by abandonment;
   e. “Extraordinary items” shall be defined as those events or transactions which meet both of the following criteria:
      i. Unusual nature—the underlying event or transaction possesses a high degree of abnormality and is clearly unrelated to, or only incidentally related to, the ordinary and typical activities of the reporting entity, taking into account the environment in which the reporting entity operates; and
      ii. Infrequency of occurrence—the underlying event or transaction would not reasonably be expected to recur in the foreseeable future, taking into account the environment in which the reporting entity operates.
Discontinued Operations

3. If a loss is expected from the proposed sale or abandonment of a segment of business, the estimated loss shall be accrued at the measurement date, as defined in paragraph 2 above. If a gain is expected, it shall be recognized when realized, which ordinarily is the disposal date. This accounting is consistent with the accounting provided for in SSAP No. 5—Liabilities, Contingencies and Impairments of Assets.

4. The determination of whether a gain or loss results from the disposal shall be made at the measurement date based on estimates at that date of the net realizable value of the segment after giving consideration to any estimated costs and expenses directly associated with the disposal and, if a plan of disposal is to be carried out over a period of time and contemplates continuing operations during that period, to any estimated income or losses from operations. If it is expected that net losses from operations will be incurred between the measurement date and the expected disposal date, the computation of the gain or loss on disposal shall also include an estimate of such amounts. If it is expected that net income will be generated from operations during that period the computation shall include the estimated net income, limited however to the amount of any loss otherwise recognizable for the disposal, with any remainder accounted for when realized. Any changes in the original estimate shall be accounted for in accordance with SSAP No. 3—Accounting Changes and Corrections of Errors.

5. The results of a reporting entity’s discontinued operations shall be reported consistently with the entity’s reporting of continuing operations (i.e., no separate line item presentation in the balance sheet or statement of operations aggregating current and future losses from the measurement date).

6. Additionally, the financial statements for the period encompassing the measurement date and the year subsequent shall contain the following:
   a. The identity of the segment of business that has been or will be discontinued;
   b. The expected disposal date, if known (see definition in paragraph 2 above);
   c. The expected manner of disposal;
   d. A description of the remaining assets and liabilities of the segment at the balance sheet date; and
   e. The amounts related to the discontinued operations and the effect on the financial statements, including the balance sheet and income statement line items which have been affected.

7. If material revisions are made to the estimates of the cost to dispose of a segment in years subsequent to the disclosure required in paragraph 6 above, the nature and the effect of the revisions to the estimates shall be disclosed for the period in which the revision was made including the effect on income or loss from operations and the effect on the carrying amount of the remaining assets and liabilities of the segment at the balance sheet date.
Extraordinary Items

8. Extraordinary items, as defined in paragraph 2 above, shall be reported consistently with the reporting entity’s reporting of continuing operations (i.e., no separate line item presentation in the balance sheet or statement of operations). Such items shall not be charged directly to surplus unless specifically addressed elsewhere within the Accounting Practices and Procedures Manual.

9. The nature of an extraordinary event or transaction and the principal items entering into the determination of an extraordinary gain or loss shall be disclosed in the financial statements. This disclosure shall include the line items which have been affected by the estimate of the extraordinary item.

10. Material events or transactions that are either unusual or occur infrequently, but not both, are not considered extraordinary items. However, such material events or transactions shall be disclosed in the financial statements.

Disclosures

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

Relevant Literature

12. This statement adopts the accounting principles relating to the accounting for the disposal of a segment of a business included in Accounting Principles Board Opinion No. 30, Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions, (APB No. 30), paragraphs 13 through 18 and adopts the definition of an extraordinary item included in paragraph 20 of APB 30. This statement also adopts AICPA Accounting Interpretations, Reporting the Results of Operations: Accounting Interpretations of APB Opinion No. 30, relating to the definition of extraordinary items and terminology relevant to the disposal of a segment and the criteria for recording a related loss. This statement also adopts FASB Emerging Issues Task Force No. 85-36, Discontinued Operations with Expected Gain and Interim Operating Losses.

13. This statement rejects all other paragraphs of APB 30 and all other interpretations of APB 30 relating to the accounting and reporting of discontinued operations, extraordinary items and unusual or infrequently occurring events and transactions. This statement rejects FASB Statement No. 146, Accounting for Costs Associated with Exit or Disposal Activities, FASB Emerging Issues Task Force No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring), and FASB Emerging Issues Task Force No. 95-18, Accounting and Reporting for a Discontinued Business Segment When the Measurement Date Occurs after the Balance Sheet Date but before the Issuance of Financial Statements.

Effective Date and Transition

14. This statement is effective for years beginning January 1, 2001. 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.
AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

- Accounting Principles Board Opinion No. 30, Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions

- AICPA Accounting Interpretations, Reporting the Results of Operations: Accounting Interpretations of APB Opinion No. 30

- FASB Emerging Issues Task Force No. 85-36, Discontinued Operations with Expected Gain and Interim Operating Losses

RELEVANT ISSUE PAPERS

- Issue Paper No. 24—Discontinued Operations and Extraordinary Items
Statement of Statutory Accounting Principles No. 25

Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties

STATUS

Type of Issue: Common Area

Issued: Initial Draft

Effective Date: January 1, 2001

Affects: No other pronouncements

Affected by: No other pronouncements

Interpreted by: No other pronouncements

SCOPE OF STATEMENT

SUMMARY CONCLUSION

Related Party Loans

Transactions Involving the Exchange of Assets or Liabilities

Transactions Involving Services

Disclosures

Relevant Literature

Effective Date and Transition

AUTHORITATIVE LITERATURE

Statutory Accounting

Generally Accepted Accounting Principles

RELEVANT ISSUE PAPERS
Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties

SCOPE OF STATEMENT

1. Related party transactions are subject to abuse because reporting entities may be induced to enter transactions that may not reflect economic realities or may not be fair and reasonable to the reporting entity or its policyholders. As such, related party transactions require specialized accounting rules and increased regulatory scrutiny. This statement establishes statutory accounting principles and disclosure requirements for related party transactions.

SUMMARY CONCLUSION

2. Related parties are defined as entities that have common interests as a result of ownership, control, affiliation or by contract. Related parties shall include but are not limited to the following:
   a. Affiliates of the reporting entity, as defined in paragraph 3;
   b. Trusts for the benefit of employees, such as pension and profit-sharing trusts and Employee Stock Ownership Plans that are managed by or under the trusteeship of management of the reporting entity, its parent or affiliates;
   c. The principal owners of the reporting entity;
   d. The management of the reporting entity, its parent or affiliates (including directors);
   e. Members of the immediate families of principal owners and management of the reporting entity, its parent or affiliates and their management;
   f. Parties with which the reporting entity may deal if either party directly or indirectly controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interest;
   g. A party which can, directly or indirectly, significantly influence the management or operating policies of the reporting entity, which may include a provider who is contracting with the reporting entity. This is not intended to suggest that all provider contracts create related party relationships;
   h. A party which has an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests;
   i. Attorney-in-fact of a reciprocal reporting entity or any affiliate of the attorney-in-fact; and

3. An affiliate is defined as an entity that is within the holding company system or a party that, directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with the reporting entity. An affiliate includes a parent or subsidiary and partnerships, joint ventures, and limited liability companies. An affiliate is any person that is directly or indirectly, owned or controlled by the same person or by the same group of persons, that, directly or indirectly, own or control the reporting entity.
4. Control is defined as the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of a person or entity, whether through the (a) ownership of voting securities, (b) by contract other than a commercial contract for goods or nonmanagement services, (c) by contract for goods or nonmanagement services where the volume of activity results in a reliance relationship (d) by common management, or (e) otherwise. Control shall be presumed to exist if a reporting entity and its affiliates directly or indirectly, own, control, hold with the power to vote, or hold proxies representing 10% or more of the voting interests of the entity.

5. The 10% ownership threshold shall be measured at the holding company level. For example, if one member of an affiliated group has a 5% interest in a company and a second member of the group has an 8% interest in the same company, the total interest is 13%, and therefore, each member of the affiliated group shall be presumed to have control. These presumptions can be overcome by predominant evidence to the contrary. However, they shall stand until overcome by such predominant contradictory evidence. A reporting entity with 10% or more of the voting interest shall evaluate all facts and circumstances relating to the investment and reach a judgment about whether the presumption of control is overcome. The corollary is required to demonstrate control when a reporting entity owns less than 10% of the voting interest of an investee.

Related Party Loans

6. Loans or advances (including debt, public or private) made by a reporting entity to its parent or principal owner shall be admitted if approval for the transaction has been obtained from the domiciliary commissioner and the loan or advance is determined to be collectible based on the parent or principal owner’s independent payment ability. An affiliate’s ability to pay shall be determined after consideration of the liquid assets or revenues available from external sources (i.e., determination shall not include dividend paying ability of the subsidiary making the loan or advance) which are available to repay the balance and/or maintain its account on a current basis. Evaluation of the collectibility of loans or advances shall be made periodically. If, in accordance with SSAP No. 5—Definition of Liabilities, Loss Contingencies and Impairments of Assets (SSAP No. 5), it is probable the balance is uncollectible, any uncollectible receivable shall be written off and charged to income in the period the determination is made.

7. Loans or advances by a reporting entity to all other related parties shall be evaluated by management and nonadmitted if they do not constitute arm’s-length transactions as defined in paragraph 10. Loans or advances made by a reporting entity to related parties (other than its parent or principal owner) that are economic transactions as defined in paragraph 10 shall be admitted. This includes financing arrangements with providers of health care services with whom the reporting entity contracts with from time to time. Such arrangements can include both loans and advances to these providers. Evaluation of the collectibility of loans or advances shall be made periodically. If, in accordance with SSAP No. 5, it is probable the balance is uncollectible, any uncollectible receivable shall be written off and charged to income in the period the determination is made.

8. Any advances under capitation arrangements made directly to providers, or to intermediaries that represent providers, that exceed one month’s payment shall be nonadmitted assets.

9. Indirect loans are loans or extensions of credit to any person who is not an affiliate, where the reporting entity makes loans or extensions of credit with the agreement or understanding that the proceeds of the transactions, in whole or in substantial part, are to be used to make loans or extensions of credit to, to purchase assets of, or to make investments in, any affiliate of the reporting entity making the loans or extensions of credit. The admissibility of indirect loans made by a reporting entity for the benefit of its parent or principal owner shall be determined in accordance with the guidelines in paragraph 6. Indirect loans or advances made for the benefit of all other related parties shall be evaluated and accounted for consistent with loans or advances to related parties as described in paragraphs 7 and 8.
Transactions Involving the Exchange of Assets or Liabilities

10. An arm’s-length transaction is defined as a transaction in which willing parties, each being reasonably aware of all relevant facts and neither under compulsion to buy, sell, or loan, would be willing to participate. A transaction between related parties involving the exchange of assets or liabilities shall be designated as either an economic transaction or non-economic transaction. An economic transaction is defined as an arm’s-length transaction which results in the transfer of the risks and rewards of ownership and represents a consummated act thereof, i.e., “permanence.” The appearance of permanence is also an important criterion in assessing the economic substance of a transaction. In order for a transaction to have economic substance and thus warrant revenue (loss) recognition, it must appear unlikely to be reversed. If subsequent events or transactions reverse the effect of an earlier transaction prior to the issuance of the financial statements, the reversal shall be considered in determining whether economic substance existed in the case of the original transaction. Subsequent events are addressed in SSAP No. 9—Subsequent Events. An economic transaction must represent a bonafide business purpose demonstrable in measurable terms. A transaction which results in the mere inflation of surplus without any other demonstrable and measurable betterment is not an economic transaction. The statutory accounting shall follow the substance, not the form of the transaction.

11. In determining whether there has been a transfer of the risks and rewards of ownership in the transfer of assets or liabilities between related parties, the following—and any other relevant facts and circumstances related to the transaction—shall be considered:

   a. Whether the seller has a continuing involvement in the transaction or in the financial interest transferred, such as through the exercise of managerial authority to a degree usually associated with ownership;

   b. Whether there is an absence of significant financial investment by the buyer in the financial interest transferred, as evidenced, for example, by a token down payment or by a concurrent loan to the buyer;

   c. Whether repayment of debt that constitutes the principal consideration in the transaction is dependent on the generation of sufficient funds from the asset transferred;

   d. Whether limitations or restrictions exist on the buyer’s use of the financial interest transferred or on the profits arising from it;

   e. Whether there is retention of effective control of the financial interest by the seller.

12. A transaction between related parties may meet the criteria for treatment as an economic transaction at one level of financial reporting, but may not meet such criteria at another level of financial reporting. An example of such a transaction is a reporting entity purchasing securities at fair value from an affiliated reporting entity that carried the securities at amortized cost. This transaction meets the criteria of an economic transaction at this level of financial reporting, and therefore, the selling reporting entity would record a gain and the acquiring reporting entity would record the securities at their cost (fair value on the transaction date). At the common parent level of reporting, this transaction has resulted in the mere inflation of surplus, and therefore, is a non-economic transaction. The parent reporting entity shall defer the net effects of any gain or increase in surplus resulting from such transactions by recording a deferred gain and an unrealized loss. The deferred gain shall not be recognized by the parent reporting entity unless and until arms-length transaction(s) with independent third parties give rise to appropriate recognition of the gain.

13. A non-economic transaction is defined as any transaction that does not meet the criteria of an economic transaction. Similar to the situation described in paragraph 12, transfers of assets from a parent reporting entity to a subsidiary, controlled or affiliated entity shall be treated as non-economic.
transactions at the parent reporting level because the parent has continuing indirect involvement in the assets.

14. When accounting for a specific transaction, reporting entities shall use the following valuation methods:

   a. Economic transactions between related parties shall be recorded at fair value at the date of the transaction. To the extent that the related parties are affiliates under common control, the controlling reporting entity shall defer the effects of such transactions that result in gains or increases in surplus (see paragraph 12);

   b. Non-economic transactions between reporting entities, which meet the definition of related parties above, shall be recorded at the lower of existing book values or fair values at the date of the transaction;

   c. Non-economic transactions between a reporting entity and an entity that has no significant ongoing operations other than to hold assets that are primarily for the direct or indirect benefit or use of the reporting entity or its affiliates, shall be recorded at the fair value at the date of the transaction; however, to the extent that the transaction results in a gain, that gain shall be deferred until such time as permanence can be verified;

   d. Transactions which are designed to avoid statutory accounting practices shall be reported as if the reporting entity continued to own the assets or to be obligated for a liability directly instead of through a subsidiary.

Examples of transactions deemed to be non-economic include security swaps of similar issues between or among affiliated companies, and swaps of dissimilar issues accompanied by exchanges of liabilities between or among affiliates.

Transactions Involving Services

15. Transactions involving services between related parties can take a variety of different forms. One of the significant factors as to whether these transactions will be deemed to be arm’s length is the amount charged for such services. In general, amounts charged for services are based either on current market rates or on allocations of costs. Determining market rates for services is difficult because the circumstances surrounding each transaction are unique. Unlike transactions involving the exchange of assets and liabilities between related parties, transactions for services create income on one party’s books and expense on the second party’s books, and therefore, do not lend themselves to the mere inflation of surplus. These arrangements are generally subject to regulatory approval.

16. Transactions involving services provided between related parties shall be recorded at the amount charged. Regulatory scrutiny of related party transactions where amounts charged for services do not meet the fair and reasonable standard established by Appendix A-440, may result in (a) amounts charged being recharacterized as dividends or capital contributions, (b) transactions being reversed, (c) receivable balances being nonadmitted, or (d) other regulatory action. Expenses that result from cost allocations shall be allocated subject to the same fair and reasonable standards, and the books and records of each party shall disclose clearly and accurately the precise nature and details of the transaction. See SSAP No 70—Allocation of Expenses for additional discussion regarding the allocation of expenses.
Disclosures

17. The financial statements shall include disclosures of all material related party transactions. In some cases, aggregation of similar transactions may be appropriate. Sometimes, the effect of the relationship between the parties may be so pervasive that disclosure of the relationship alone will be sufficient. If necessary to the understanding of the relationship, the name of the related party should be disclosed. Transactions shall not be purported to be arm’s-length transactions unless there is demonstrable evidence to support such statement. The disclosures shall include:

a. The nature of the relationships involved;

b. A description of the transactions for each of the periods for which financial statements are presented, and such other information considered necessary to obtain an understanding of the effects of the transactions on the financial statements. Exclude reinsurance transactions, any non-insurance transactions which involve less than 1/2 of 1% of the total admitted assets of the reporting entity, and cost allocation transactions. The following information shall be provided if applicable:

   i. Date of transaction;

   ii. Explanation of transaction;

   iii. Name of reporting entity;

   iv. Name of affiliate;

   v. Description of assets received by reporting entity;

   vi. Statement value of assets received by reporting entity;

   vii. Description of assets transferred by reporting entity; and

   viii. Statement value of assets transferred by reporting entity.

c. The dollar amounts of transactions for each of the periods for which financial statements are presented and the effects of any change in the method of establishing the terms from that used in the preceding period;

d. Amounts due from or to related parties as of the date of each balance sheet presented and, if not otherwise apparent, the terms and manner of settlement;

e. Any guarantees or undertakings, written or otherwise, for the benefit of an affiliate or related party which result in a material contingent exposure of the reporting entity’s or any related party’s assets or liabilities;

f. A description of material management or service contracts and cost-sharing arrangements involving the reporting entity and any related party. This shall include, but is not limited to, sale lease-back arrangements, computer or fixed asset leasing arrangements, and agency contracts, which remove assets otherwise recordable (and potentially nonadmitted) on the reporting entity’s financial statements;

g. The nature of the control relationship whereby the reporting entity and one or more other enterprises are under common ownership or control and the existence of that control could result in operating results or financial position of the reporting entity significantly different from those that would have been obtained if the enterprises were autonomous.
The relationship shall be disclosed even though there are no transactions between the enterprises; and

h. The amount deducted from the value of an upstream intermediate entity or ultimate parent owned, either directly or indirectly, via a downstream subsidiary, controlled, or affiliated entity, in accordance with the NAIC Purposes and Procedures of the Securities Valuation Office, “Procedures for Valuing Common Stocks and Stock Warrants.”

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

Relevant Literature

19. This statement adopts FASB Statement No. 57, Related Party Disclosures with a modification to paragraph 2 to require disclosure of compensation arrangements, expense allowances, and other similar items in the ordinary course of business.

20. This statement rejects AICPA Accounting Interpretations, Business Combinations: Accounting Interpretations of APB Opinion No. 16, #39, “Transfers and Exchanges Between Companies Under Common Control”.

Effective Date and Transition

21. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors.

AUTHORITATIVE LITERATURE

Statutory Accounting

• NAIC Purposes and Procedures of the Securities Valuation Office

Generally Accepted Accounting Principles

• FASB Statement No. 57, Related Party Disclosures

RELEVANT ISSUE PAPERS

• Issue Paper No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties
Statement of Statutory Accounting Principles No. 26

Bonds, excluding Loan-backed and Structured Securities

STATUS

Type of Issue: Common Area

Issued: Initial Draft

Effective Date: January 1, 2001

Affects: No other pronouncements

Affected by: No other pronouncements

Interpreted by: INT 01-25, INT 02-05, INT 02-07
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Bonds, excluding Loan-backed and Structured Securities

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for bonds, excluding loan-backed and structured securities.

SUMMARY CONCLUSION

2. Bonds shall be defined as any securities representing a creditor relationship, whereby there is a fixed schedule for one or more future payments. This definition includes U.S. Treasury securities, U.S. government agency securities, municipal securities, corporate bonds, bank participations, convertible debt, certificates of deposit and commercial paper that have a fixed schedule of payments and a maturity date in excess of one year from the date of acquisition. Loan-backed and structured securities meet this definition, but are excluded from the scope of this statement, and are addressed in SSAP No. 43—Loan-backed and Structured Securities. Securities which meet the definition above, but have a maturity date of one year or less from the date of acquisition are addressed in SSAP No. 2—Cash, Drafts, and Short-term Investments. Mortgage loans and other real estate lending activities made in the ordinary course of business meet the definition above, but are not addressed in this statement. These types of transactions are addressed in SSAP No. 37—Mortgage Loans and SSAP No. 39—Reverse Mortgages.

3. Bonds meet the definition of assets 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.

Acquisitions and Sales

4. A bond acquisition or disposal shall be recorded on the trade date, not the settlement date, except for the acquisition of private placement bonds which shall be recorded on the funding date. At acquisition, bonds shall be reported at their cost, including brokerage and other related fees, which cannot exceed the fair value at the date of acquisition.

5. For reporting entities required to maintain an Interest Maintenance Reserve (IMR), the accounting for realized capital gains and losses on sales of bonds shall be in accordance with SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve. For reporting entities not required to maintain an IMR, realized gains and losses on sales of bonds shall be reported as net realized capital gains or losses in the statement of income.

Amortized Cost

6. Amortization of bond premium or discount shall be calculated using the scientific (constant yield) interest method taking into consideration specified interest and principal provisions over the life of the bond. Bonds containing call provisions (where the issue can be called away from the reporting entity at the issuer’s discretion) shall be amortized to the call or maturity value/date which produces the lowest asset value (yield to worst).
Balance Sheet Amount

7. Bonds shall be valued and reported in accordance with the NAIC Valuations of Securities manual prepared by the Securities Valuation Office (Valuations of Securities manual). For reporting entities that maintain an Asset Valuation Reserve (AVR), the bonds shall be reported at amortized cost, except for those with an NAIC designation of 6, which shall be reported at the lower of amortized cost or fair value. For reporting entities that do not maintain an AVR, bonds that are designated highest-quality and high-quality (NAIC designations 1 and 2, respectively) shall be reported at amortized cost; with all other bonds (NAIC designations 3 to 6) reported at the lower of amortized cost or fair value.

Impairment

8. If it is determined that a decline in the fair value of a bond is other than temporary, the cost basis of the bond shall be written down to fair value as a new cost basis and the amount of the write down shall be accounted for as a realized loss. The new cost basis shall not be changed for subsequent recoveries in fair value. Future declines in fair value which are determined to be other than temporary, shall be recorded as realized losses. An impairment shall be considered to have occurred if it is probable that the reporting entity will be unable to collect all amounts due according to the contractual terms of a debt security in effect at the date of acquisition. A decline in fair value which is other than temporary includes situations where a reporting entity has made a decision to sell a security prior to its maturity at an amount below its carrying value.

Income

9. Interest income for any period consists of interest collected during the period, the change in the due and accrued interest between the beginning and end of the period as well as reductions for premium amortization and interest paid on acquisition of bonds, and the addition of discount accrual. In accordance with SSAP No. 34—Investment Income Due and Accrued, investment income shall be reduced for amounts which have been determined to be uncollectible. Contingent interest may be accrued if the applicable provisions of the underlying contract and the prerequisite conditions have been met.

10. A bond may provide for a prepayment penalty or acceleration fee in the event the bond is liquidated prior to its scheduled termination date. Such fees shall be reported as investment income when received.

Origination Fees

11. Origination fees represent fees charged to the borrower in connection with the process of originating or restructuring a transaction such as the private placement of bonds. The fees include, but are not limited to, points, management, arrangement, placement, application, underwriting, and other fees pursuant to such a transaction. Origination fees shall not be recorded until received in cash. Origination fees intended to compensate the reporting entity for interest rate risks (e.g., points), shall be amortized into income over the term of the bond consistent with paragraph 6 of this statement. Other origination fees shall be recorded as income upon receipt.

Origination, Acquisition, and Commitment Costs

12. Costs related to origination when paid in the form of brokerage and other related fees shall be capitalized as part of the cost of the bond, consistent with paragraph 4 of this statement. All other costs, including internal costs or costs paid to an affiliated entity related to origination, purchase or commitment to purchase bonds shall be charged to expense when incurred.
Commitment Fees

13. Commitment fees are fees paid to the reporting entity that obligate the reporting entity to make available funds for future borrowing under a specified condition. A fee paid to the reporting entity to obtain a commitment to make funds available at some time in the future, generally, is refundable only if the bond is issued. If the bond is not issued, then the fees shall be recorded as investment income by the reporting entity when the commitment expires.

14. A fee paid to the reporting entity to obtain a commitment to be able to borrow funds at a specified rate and with specified terms quoted in the commitment agreement, generally, is not refundable unless the commitment is refused by the reporting entity. This type of fee shall be deferred, and amortization shall depend on whether or not the commitment is exercised. If the commitment is exercised, then the fee shall be amortized in accordance with paragraph 6 of this statement over the life of the bond as an adjustment to the investment income on the bond. If the commitment expires unexercised, the commitment fee shall be recognized in income on the commitment expiration date.

Exchanges and Conversions

15. If a bond is exchanged or converted into other securities, the fair value of the bond surrendered at the date of the exchange or conversion shall become the cost basis for the new securities with any gain or loss realized at the time of the exchange or conversion. However, if the fair value of the securities received in an exchange or conversion is more clearly evident than the fair value of the bond surrendered, then it shall become the cost basis for the new securities.

Disclosures

16. The financial statements shall include the following disclosures:

a. Fair values in accordance with SSAP No. 27—Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk, Financial Instruments with Concentrations of Credit Risk and Disclosures about Fair Value of Financial Instruments (SSAP No. 27);

b. Concentrations of credit risk in accordance with SSAP No. 27;

c. The basis at which the bonds are stated;

d. Amortization method;

e. For each balance sheet presented, the book/adjusted carrying values, fair values, excess of book/carrying value over fair value or fair value over book/adjusted carrying values for each pertinent bond category issued by:

i. U.S. Governments;

ii. All Other Governments;

iii. States, Territories and Possessions (Direct and Guaranteed);

iv. Political Subdivisions of States, Territories and Possessions (Direct and Guaranteed);

v. Special Revenue & Special Assessment Obligations and all Non-Guaranteed Obligations of Agencies and Authorities of Governments and Their Political Subdivisions;

vi. Public Utilities (Unaffiliated);

vii. Industrial & Miscellaneous (Unaffiliated);

viii. Credit Tenant Loans (Unaffiliated);

ix. Parent, Subsidiaries and Affiliates;
f. For the most recent balance sheet, the book/adjusted carrying values and the fair values of bonds due:
   i. In one year or less;
   ii. After one year through five years;
   iii. After five years through ten years;
   iv. After ten years; and

g. For each period for which results of operations are presented, the proceeds from sales of such bonds and gross realized gains and gross realized losses on such sales.

17. Refer to the preamble for further discussion regarding disclosure requirements. The disclosures in paragraphs 16 a., 16 b., 16 e., 16 f. and 16 g. above shall be included in the annual audited statutory financial reports only.

Relevant Literature

18. This statement adopts AICPA Statement of Position 90-11, Disclosure of Certain Information by Financial Institutions About Debt Securities Held as Assets, and AICPA Practice Bulletin No. 4, Accounting for Foreign Debt/Equity Swaps.

19. This statement rejects the GAAP guidance for debt securities, which is contained in FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities, FASB Statement No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases, FASB Emerging Issues Task Force No. 89-18, Divestitures of Certain Investment Securities to an Unregulated Commonly Controlled Entity under FIRREA, and FASB Emerging Issues Task Force No. 96-10, Impact of Certain Transactions on Held-to-Maturity Classifications Under FASB Statement No. 115.

Effective Date and Transition

20. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors.

AUTHORITATIVE LITERATURE

Statutory Accounting

• NAIC Purposes and Procedures of the Securities Valuation Office
• NAIC Valuations of Securities manual prepared by the Securities Valuation Office

Generally Accepted Accounting Principles

• AICPA Statement of Position 90-11, Disclosure of Certain Information by Financial Institutions About Debt Securities Held as Assets
• AICPA Practice Bulletin No. 4, Accounting for Foreign Debt/Equity Swaps

RELEVANT ISSUE PAPERS

• Issue Paper No. 26—Bonds, excluding Loan-backed and Structured Securities
Statement of Statutory Accounting Principles No. 27

Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk, Financial Instruments with Concentrations of Credit Risk and Disclosures about Fair Value of Financial Instruments

STATUS

Type of Issue: Common Area

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Effective Date: January 1, 2001

Affects: No other pronouncements

Affected by: No other pronouncements

Interpreted by: No other pronouncements

SCOPE OF STATEMENT

SUMMARY CONCLUSION


Disclosure of Credit Risk of Financial Instruments with Off-Balance-Sheet Credit Risk

Disclosure of Concentrations of Credit Risk of All Financial Instruments

Disclosures about Fair Value of Financial Instruments

Annual and Quarterly Disclosure Requirements

Relevant Literature

Effective Date and Transition

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

RELEVANT ISSUE PAPERS
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Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk, Financial Instruments with Concentrations of Credit Risk and Disclosures about Fair Value of Financial Instruments

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for disclosure of information about financial instruments with off-balance-sheet risk, financial instruments with concentration of credit risk and for disclosures about the fair value of financial instruments.

SUMMARY CONCLUSION

2. A financial instrument shall be defined as cash, evidence of an ownership interest in an entity, or a contract that both:

   a. Imposes on one entity a contractual obligation (i) to deliver cash or another financial instrument to a second entity or (ii) to exchange other financial instruments on potentially unfavorable terms with the second entity; and

   b. Conveys to that second entity a contractual right (i) to receive cash or another financial instrument from the first entity or (ii) to exchange other financial instruments on potentially favorable terms with the first entity.

3. Examples of the financial instruments, which encompass both assets and liabilities recognized and not recognized in the financial statement, to which this statement applies include, but are not limited to, short-term investments, bonds, common stocks, preferred stocks, mortgage loans, derivatives, financial guarantees written, standby letters of credit, notes payable and deposit-type contracts.


4. For financial instruments with off-balance-sheet risk, except as noted in paragraphs 14 and 15 of FASB Statement No. 105, Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk and Financial Instruments with Concentrations of Credit Risk (FAS 105), a reporting entity shall disclose in the financial statements the following information by class of financial instrument:

   a. The face or contract amount (or notional principal amount if there is no face or contract amount); and

   b. The nature and terms including, at a minimum, a discussion of (i) the credit and market risk of those instruments, (ii) the cash requirements of those instruments, and (iii) the related accounting policy pursuant to the requirements of APB Opinion No. 22, Disclosure of Accounting Policies.

5. Additional disclosures related to derivatives are addressed in SSAP No. 31—Derivative Instruments (SSAP No. 31).

Disclosure of Credit Risk of Financial Instruments with Off-Balance-Sheet Credit Risk

6. For financial instruments with off-balance-sheet credit risk, except as noted in paragraphs 14 and 15 of FAS 105, an entity shall disclose in the financial statements the following information by class of financial instrument:
a. The amount of accounting loss the entity would incur if any party to the financial instrument failed completely to perform according to the terms of the contract and the collateral or other security, if any, for the amount due proved to be of no value to the entity; and

b. The entity’s policy of requiring collateral or other security to support financial instruments subject to credit risk, information about the entity’s access to that collateral or other security, and the nature and a brief description of the collateral or other security supporting those financial instruments.

Disclosure of Concentrations of Credit Risk of All Financial Instruments

7. Except as noted in paragraph 14 of FAS 105, a reporting entity shall disclose all significant concentrations of credit risk arising from all financial instruments whether from an individual or group. Group concentrations of credit risk exist if a number of individuals or groups are engaged in similar activities and have similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions. The following shall be disclosed in the financial statements about each significant concentration:

a. Information about the (shared) activity, region, or economic characteristic that identifies the concentration;

b. The amount of the accounting loss due to credit risk the entity would incur if parties to the financial instruments that make up the concentration failed completely to perform according to the terms of the contracts and the collateral or other security, if any, for the amount due proved to be of no value to the entity; and

c. The entity’s policy of requiring collateral or other security to support financial instruments subject to credit risk, information about the entity’s access to that collateral or other security, and the nature and a brief description of the collateral or other security supporting those financial instruments.

Disclosures about Fair Value of Financial Instruments

8. A reporting entity shall disclose in the notes to the financial statements the aggregate fair value of all financial instruments, summarized by type of financial instrument, for which it is practicable to estimate fair value, except for certain financial instruments named in paragraph 8 of FASB Statement No. 107, Disclosures about Fair Value of Financial Instruments (FAS 107). Fair value disclosed in the notes shall be presented together with the related admitted values in a form that makes it clear whether the fair values and admitted values represent assets or liabilities and to which line items in the Statement of Assets, Liabilities, Surplus and Other Funds they relate. Separate disclosure of this information in the notes is required even if such information is presented elsewhere in the financial statements. Unless specified otherwise in another SSAP, the disclosures may be made net of encumbrances, if the asset or liability is so reported. A reporting entity shall also disclose the method(s) and significant assumptions used to estimate the fair value of financial instruments. For example, the notes should specify the reported value of investments using market prices published by the NAIC Securities Valuation Office (SVO).
9. For purposes of this statement, the fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. Unit prices published by the SVO, if available, shall always be used to calculate the fair value amount disclosed. In the absence of SVO published unit prices, or when amortized cost is used by the SVO as unit price, quoted market prices by other third party organizations, if available, shall be used to calculate the fair value of financial instruments. If neither SVO published unit prices nor quoted market prices are available, management’s best estimate of fair value shall be based on the quoted market price of a financial instrument with similar characteristics, or on industry recognized valuation techniques (for example, the present value of estimated future cash flows using a discount rate commensurate with the risks involved).

10. If it is not practicable for an entity to estimate the fair value of a financial instrument or a class of financial instruments, the following shall be disclosed:

   a. Information pertinent to estimating the fair value of that financial instrument or class of financial instruments, such as the carrying amount, effective interest rate, and maturity; and

   b. The reasons why it is not practicable to estimate fair value.

Annual and Quarterly Disclosure Requirements

11. Refer to the preamble for further information regarding disclosure requirements. The disclosures in paragraphs 7, 8, and 10 above shall be included in the annual audited statutory financial reports only.

Relevant Literature

12. This statement adopts the provisions of FAS 105 with the following modifications:

   a. The disclosures required in paragraph 17 of FAS 105 shall distinguish between derivatives entered into for hedging purposes and for other than hedging purposes.

   b. Paragraph 19 of FAS 105 is rejected. It addresses voluntary disclosures not required by this statement.

13. This statement adopts FAS 107 as amended by FASB Statement No. 119, Disclosure about Derivative Financial Instruments and Fair Value of Financial Instruments (FAS 119), except that paragraph 15(c) of FAS 119 relating to disclosure of financial instruments held or issued for trading is rejected and FASB Emerging Issues Task Force No. 85-20, Recognition of Fees for Guaranteeing a Loan. In addition, this statement rejects FASB Statement No. 126, Exemptions from Certain Required Disclosures about Financial Instruments for Certain Nonpublic Entities, an amendment of FAS 107. Furthermore, this statement requires that if the SVO publishes a unit price, that amount shall be used to calculate the fair value disclosures required by this statement. FAS 119 is addressed in SSAP No. 31.

14. Paragraph 8 of FAS 107 discusses financial instruments which are exempt from fair value disclosure. Included as exempt instruments are insurance contracts, except for financial guaranty contracts.
Effective Date and Transition

15. This statement is effective for years beginning January 1, 2001.

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

- FASB Statement No. 105, Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk and Financial Instruments with Concentrations of Credit Risk
- FASB Statement No. 107, Disclosures about Fair Value of Financial Instruments
- FASB Statement No. 119, Disclosure about Derivative Financial Instruments and Fair Value of Financial Instruments
- FASB Emerging Issues Task Force No. 85-20, Recognition of Fees for Guaranteeing a Loan

RELEVANT ISSUE PAPERS

- Issue Paper No. 27—Disclosure of Information about Financial Instruments with Concentration of Credit Risk
- Issue Paper No. 33—Disclosures about Fair Value of Financial Instruments
- Issue Paper No. 85—Derivative Instruments (as it relates to disclosure about financial instruments with off-balance-sheet risk)
Statement of Statutory Accounting Principles No. 28

Nonmonetary Transactions

STATUS

Type of Issue: Common Area
Issued: Initial Draft
Effective Date: January 1, 2001
Affects: No other pronouncements
Affected by: No other pronouncements
Interpreted by: INT 99-21, INT 00-12, INT 00-26, INT 02-19, INT 03-16
Nonmonetary Transactions

SCOPE OF STATEMENT

1. This statement establishes general statutory accounting principles for nonmonetary transactions. Specific statutory requirements for certain types of nonmonetary transactions are addressed in other statements.

SUMMARY CONCLUSION

2. The definitions of certain terms used in this statement are:
   a. Monetary assets and liabilities are assets and liabilities whose amounts are fixed in terms of units of currency by contract or otherwise. Examples are cash; amounts due from agents, brokers, and intermediaries; policy loans; accounts payable; and other amounts receivable or payable in cash;
   b. Nonmonetary assets and liabilities are assets and liabilities other than monetary ones. Examples are common stocks; furniture, fixtures, and equipment; real estate and liabilities for rent collected in advance;
   c. Exchange (or exchange transaction) is a reciprocal transfer between a reporting entity and another entity that results in the reporting entity acquiring assets or services or satisfying liabilities by surrendering other assets or services or incurring other obligations;
   d. Nonreciprocal transfer is a transfer of assets or services in one direction, either from a reporting entity to its owners (whether or not in exchange for their ownership interests) or another entity, or from owners or another entity, to the reporting entity. An insurance company’s reacquisition of its outstanding stock is an example of a nonreciprocal transfer.

3. Except as addressed in other statements (including, but not limited to, SSAP No. 12—Employee Stock Ownership Plans, SSAP No. 13—Stock Option and Stock Purchase Plans, SSAP No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties (SSAP No. 25), SSAP No. 68—Business Combinations and Goodwill, and SSAP No. 72—Surplus and Quasi-reorganizations), nonmonetary transactions shall be accounted for in accordance with Accounting Principles Board Opinion No. 29, Accounting for Nonmonetary Transactions (APB 29). The accounting for such transactions shall be based on the fair values of the assets (or services) involved, as defined in paragraph 25 of APB 29.

4. In a reciprocal transfer, the fair value of the asset surrendered shall be used to measure the cost of the assets received unless the fair value of the asset received is more clearly evident.

5. A nonmonetary asset received in a nonreciprocal transfer shall be recorded at the fair value of the asset received. A nonmonetary asset transferred to a stockholder or other entity in a nonreciprocal transfer shall be accounted for at the fair value of the asset transferred and a gain or loss on disposition of the asset recognized for the difference, if any, between fair value and carrying value of the asset transferred.

6. Fair value of assets received or transferred in a nonreciprocal transfer shall be measured based on statutory accounting principles for the type of asset transferred. Accordingly, the value shall be determined in accordance with SSAP No. 26—Bonds, excluding Loan-backed and Structured Securities, SSAP No. 30—Investments in Common Stock (excluding investments in common stock of subsidiary, controlled, or affiliated entities), SSAP No. 32—Investments in Preferred Stock (excluding investments in preferred stock of subsidiary, controlled, or affiliated entities), SSAP No. 37—Mortgage Loans, SSAP No.
39—Reverse Mortgages, SSAP No. 40—Real Estate Investments, SSAP No. 43—Loan-backed and Structured Securities or other applicable statement. The guidance provided in SSAP No. 25 shall be followed in accounting for nonreciprocal transactions.

7. Stock received in the form of a stock dividend or stock split shall not result in the recognition of income. The cost basis of stock held shall be reallocated ratably to the total shares held after receipt of the stock dividend or stock split.

8. Involuntary conversions of nonmonetary assets to monetary assets (for example, as a result of total or partial destruction, theft, seizure, or condemnation) are monetary transactions for which gain or loss shall be recognized even though a reporting entity reinvests or is obligated to reinvest the monetary assets in replacement nonmonetary assets. In some cases, a nonmonetary asset may be destroyed or damaged in one accounting period, and the amount of monetary assets to be received is not determinable until a subsequent accounting period. In those cases, gain or loss shall be recognized in accordance with the conclusions in SSAP No. 5—Liabilities, Contingencies and Impairments of Assets (SSAP No. 5). Gain or loss resulting from an involuntary conversion of a nonmonetary asset to monetary assets shall be reported consistently with the reporting entity’s reporting of continuing operations and disclosed in the notes to financial statements in accordance with SSAP No. 24—Discontinued Operations and Extraordinary Items (SSAP No. 24).

Disclosures

9. A reporting entity that engages in a nonmonetary transaction during a period shall disclose the following in the financial statements:
   a. The nature of the transaction;
   b. The basis of accounting for the assets transferred; and
   c. Gains or losses recognized on transfers.

10. Refer to the preamble for further discussion regarding disclosure requirements. The disclosure in paragraph 9 above shall be included in the annual audited statutory financial reports only.

Relevant Literature

11. This statement adopts APB 29, FASB Emerging Issues Task Force No. 86-29, Nonmonetary Transactions: Magnitude of Boot and the Exceptions to the Use of Fair Value, and FASB Emerging Issues Task Force No. 93-11, Accounting for Barter Transactions Involving Barter Credits.

12. This statement adopts Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins, “Chapter 7, Capital Accounts, Section B—Stock Dividends and Stock Split-ups,” paragraphs 1 through 9, as it relates to the receipt of stock in the form of a stock dividend or stock split.

13. This statement adopts FASB Interpretation No. 30, Accounting for Involuntary Conversions of Nonmonetary Assets to Monetary Assets with modification to provide that gain or loss contingencies be recognized in accordance with SSAP No. 5, and that gain or loss resulting from an involuntary conversion of nonmonetary assets to monetary assets be accounted for in continuing operations and disclosed in accordance with SSAP No. 24.

14. This statement rejects paragraph 16 of Accounting Principles Board Opinion No. 6, Status of Accounting Research Bulletins and Emerging Issues Task Force No. 96-4, Accounting for Reorganizations Involving a Non-Pro Rata Split-off of Certain Nonmonetary Assets to Owners.
Effective Date and Transition

15. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors.

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

- Accounting Principles Board Opinion No. 29, Accounting for Nonmonetary Transactions
- Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins, “Chapter 7, Capital Stock, Section B—Stock Dividends and Stock Split-ups,” paragraphs 1 through 9
- FASB Interpretation No. 30, Accounting for Involuntary Conversions of Nonmonetary Assets to Monetary Assets
- FASB Emerging Issues Task Force No. 86-29, Nonmonetary Transactions: Magnitude of Boot and the Exceptions to the Use of Fair Value
- FASB Emerging Issues Task Force No. 93-11, Accounting for Barter Transactions Involving Barter Credits

RELEVANT ISSUE PAPERS

- Issue Paper No. 73—Nonmonetary Transactions
# Statement of Statutory Accounting Principles No. 29

## Prepaid Expenses

### STATUS

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<th>Type of Issue</th>
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<tbody>
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<td>Issued</td>
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1. STATUS

2. SCOPE OF STATEMENT

3. SUMMARY CONCLUSION

3. Relevant Literature

3. Effective Date and Transition

3. RELEVANT ISSUE PAPERS

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Prepaid Expenses

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for the accounting for prepaid expenses. This statement does not address accounting for deferred policy acquisition costs and other underwriting expenses, income taxes, and guaranty fund assessments.

SUMMARY CONCLUSION

2. A prepaid expense is an amount which has been paid in advance of receiving future economic benefits anticipated by the payment. Prepaid expenses generally meet the definition of assets in SSAP No. 4—Assets and Nonadmitted Assets (SSAP No. 4). Such expenditures also meet the criteria defining nonadmitted assets as specified in SSAP No. 4 (i.e., the assets are not readily available to satisfy policyholder obligations). Prepaid expenses shall be reported as nonadmitted assets and charged against unassigned funds (surplus). They shall be amortized against net income as the estimated economic benefit expires.

3. In accordance with the reporting entity’s capitalization policy, immaterial prepaid expenses may be expensed when purchased.

Relevant Literature


Effective Date and Transition

5. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors.

RELEVANT ISSUE PAPERS

- Issue Paper No. 29—Prepaid Expenses (excluding Deferred Policy Acquisition Costs and other underwriting expenses, income taxes and Guaranty Fund Assessments)
Statement of Statutory Accounting Principles No. 30

Investments in Common Stock (excluding investments in common stock of subsidiary, controlled, or affiliated entities)

STATUS

Type of Issue: Common Area
Issued: Initial Draft
Effective Date: January 1, 2001
Affects: No other pronouncements
Affected by: No other pronouncements
Interpreted by: INT 99-09, INT 02-07

SCOPE OF STATEMENT

SUMMARY CONCLUSION

Acquisitions and Sales
Balance Sheet Amount
Impairment
Income
Stock Splits, Stock Dividends, Payment in Kind Dividends, and Stock Exchanges
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Relevant Literature
Effective Date and Transition

AUTHORITATIVE LITERATURE

Statutory Accounting

RELEVANT ISSUE PAPERS
Investments in Common Stock (excluding investments in common stock of subsidiary, controlled, or affiliated entities)

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for common stocks.

2. Investments in common stock of subsidiaries, controlled or affiliated entities (investments in affiliates) are not within the scope of this statement. They are addressed in SSAP No. 46—Investments in Subsidiary, Controlled, and Affiliated Entities.

SUMMARY CONCLUSION

3. Common stocks (excluding investments in affiliates) are securities which represent a residual ownership in a corporation and shall include:
   a. Publicly traded common stocks;
   b. Master limited partnerships trading as common stock and American deposit receipts only if the security is traded on the New York, American, or NASDAQ exchanges;
   c. Publicly traded common stock warrants;
   d. Shares of mutual funds, except for certain money market funds and Class 1 Bond Funds as designated in the NAIC Purposes and Procedures of the Securities Valuation Office (Purposes and Procedures of the SVO), regardless of the types or mix of securities owned by the fund, e.g., bonds, stocks, money market instruments, or other type of investments;
   e. Common stocks that are not publicly traded; and
   f. Common stocks that are restricted as to transfer of ownership. Restricted stock shall be defined as a security for which sale is restricted by governmental or contractual requirement (other than in connection with being pledged as collateral), except where that requirement terminates within one year or if the holder has the power by contract or otherwise to cause the requirement to be met within one year. Any portion of the security that can be reasonably expected to qualify for sale within one year is not considered restricted.

4. Common stocks meet the definition of assets 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.

Acquisitions and Sales

5. At acquisition, common stocks shall be reported at their cost, including brokerage and other related fees. Cost shall not exceed fair value. Common stock acquisitions and dispositions shall be recorded on the trade date. Private placement stock transactions shall be recorded on the funding date.

6. A reporting entity can subscribe for the purchase of stock, but not be required to make payment until a later time. Transactions of this nature are common in the formation of corporations. Common stock acquired under a subscription represents a conditional transaction in a security authorized for issuance but not yet actually issued. Such transactions are settled if and when the actual security is issued and the exchange or National Association of Securities Dealers (NASD) rules that the transactions are to be settled. Common stock acquired under a subscription shall be recorded as an admitted asset when the reporting entity or its designated custodian or transfer agent takes delivery of the security and the security
is recorded in the name of the reporting entity or its nominee (i.e., the accounting for such common stock acquisitions shall be on the settlement date).

**Balance Sheet Amount**

7. Investments in common stocks shall be valued and reported in accordance with the NAIC *Purposes and Procedures of the Securities Valuation Office*, “Procedures for Valuing Common Stocks and Stock Warrants.” In those instances where unit price is not available from the SVO, it is the responsibility of management to determine fair value based on analytical or pricing mechanisms.

8. For reporting entities required to maintain an Asset Valuation Reserve (AVR), the accounting for unrealized capital gains and losses shall be in accordance with SSAP No. 7—*Asset Valuation Reserve and Interest Maintenance Reserve* (SSAP No. 7). For reporting entities not required to maintain an AVR, unrealized capital gains and losses shall be recorded as a direct credit or charge to surplus.

**Impairment**

9. For any decline in the fair value of a common stock which is determined to be other than temporary the common stock shall be written down to fair value as the new cost basis and the amount of the write down shall be accounted for as a realized loss. For those reporting entities required to maintain an AVR, realized losses shall be accounted for in accordance with SSAP No. 7. Subsequent fluctuations in fair value shall be recorded as unrealized gains or losses. Future declines in fair value which are determined to be other than temporary shall be recorded as realized losses. A decline in fair value which is other than temporary includes situations where a reporting entity has made a decision to sell a security at an amount below its carrying value.

**Income**

10. Dividends on common stock shall be recorded as investment income on the ex-dividend date with a corresponding receivable to be extinguished upon receipt of cash (i.e., dividend income shall be recorded on stocks declared to be ex-dividends on or prior to the statement date).

11. For reporting entities required to maintain an AVR, the accounting for realized capital gains and losses on sales of common stock shall be in accordance with SSAP No. 7. For reporting entities not required to maintain an AVR, realized gains and losses on sales of common stock shall be reported as realized gains/losses in the statement of operations.

**Stock Splits, Stock Dividends, Payment in Kind Dividends, and Stock Exchanges**

12. Stock splits, stock dividends, payment in kind dividends, and stock exchanges shall be accounted for in accordance with SSAP No. 28—*Nonmonetary Transactions*.

**Disclosures**

13. The following disclosures regarding common stocks shall be made in the financial statements:

   a. Basis at which the common stocks are stated; and

   b. A description, as well as the amount, of common stock that is restricted and the nature of the restriction.

14. Refer to the preamble for further discussion regarding disclosure requirements.
Relevant Literature

15. This statement rejects *FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities*.

Effective Date and Transition

16. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors*.

AUTHORITATIVE LITERATURE

Statutory Accounting

- NAIC *Purposes and Procedures of the Securities Valuation Office*
- NAIC *Valuations of Securities* manual prepared by the Securities Valuation Office

RELEVANT ISSUE PAPERS

- Issue Paper No. 30—Investments in Common Stock (excluding investments in common stock of subsidiary, controlled, or affiliated entities)
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## Statement of Statutory Accounting Principles No. 31

### Derivative Instruments

#### STATUS

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#### SCOPE OF STATEMENT

- Hedge Accounting
- Mark to Market Accounting
- Consistent Application of Alternatives
- Specific Accounting Procedures for Derivatives
- Income Generation Transactions
- Insurance Futures and Insurance Futures Options
- Documentation Guidance
- Disclosures
- Relevant Literature
- Effective Date and Transition

#### SUMMARY CONCLUSION

- Hedge Accounting
- Mark to Market Accounting
- Consistent Application of Alternatives
- Specific Accounting Procedures for Derivatives
- Income Generation Transactions
- Insurance Futures and Insurance Futures Options
- Documentation Guidance
- Disclosures
- Relevant Literature
- Effective Date and Transition

#### AUTHORITATIVE LITERATURE

- Generally Accepted Accounting Principles

#### RELEVANT ISSUE PAPERS

- Generally Accepted Accounting Principles
Derivative Instruments

SCOPE OF STATEMENT

1. The purpose of this statement is to establish statutory accounting principles for derivative instruments (hereinafter referred to as derivatives).

SUMMARY CONCLUSION

2. Derivatives are defined as swaps, options, forwards, futures, caps, floors, and collars. The following are general definitions for these derivative instruments.

Swaps

3. Swaps are contracts to exchange, for a period of time, the investment performance of one underlying instrument for the investment performance of another underlying instrument, typically without exchanging the instruments themselves. Swaps can be viewed as a series of forward contracts that settle in cash rather than by physical delivery. Swaps generally are negotiated over-the-counter directly between the dealer and the end user. Interest rate swaps are the most common form of swap contract. However, foreign currency and commodity swaps also are common.

4. An interest rate swap is a contractual agreement between two parties to exchange interest rate payments (usually fixed for variable) based on a specified amount of underlying assets or liabilities (known as the notional amount) for a specified period. The swap does not involve an exchange of principal. The result of these transactions is to transform payments from a variable rate to a fixed rate, from a fixed rate to a variable rate or from one variable rate index to another variable rate index.

5. Interest rate swaps have historically been entered into for the purpose of lowering borrowing costs, obtaining otherwise unavailable financing terms, and/or improving asset and liability management through a reduction of an entity’s exposure to interest rate risk. Banks and brokers will enter into an interest rate swap with an interested party before a swap partner is found, creating a swap portfolio. This activity allows the entity that desires a swap transaction immediate access to the market. This secondary market also allows a swap participant a vehicle to unwind or reverse swap positions it no longer wants or to receive cash if the position to be disposed of is favorable in relation to the current market.

6. While swaps may involve the trading of interest on liabilities or assets, the insurance industry has used swaps to match return on assets to contract obligations. Insurers also have acted as an intermediary or broker in the process of arranging a swap. Swaps may involve long periods of time and significant amounts of interest on substantial notional amounts. Unmatched or naked swaps are sometimes written where no underlying asset or liability exists.

7. The risk to the parties of a swap agreement is reduced by the fact that no transfer of principal is involved. The cash exchanged between the parties is usually the net interest differential only.

Options

8. Options are contracts that give the option holder (purchaser of the option rights) the right, but not the obligation, to enter into a transaction with the option writer (seller of the option rights) on terms specified in the contract. A call option allows the holder to buy the underlying instrument, while a put option allows the holder to sell the underlying instrument. Options are traded on exchanges and over the counter.
9. Forward contracts are agreements (other than futures) between two parties that commit one party to purchase and the other to sell the instrument or commodity underlying the contract at a specified future date. Forward contracts fix the price, quantity, quality, and date of the purchase and sale. Some forward contracts involve the initial payment of cash and may be settled in cash instead of by physical delivery of the underlying instrument.

Futures

10. Futures are standardized forward contracts traded on organized exchanges. Each exchange specifies the standard terms of futures contracts it sponsors. Futures contracts are available for a wide variety of underlying instruments, including insurance, agricultural commodities, minerals, debt instruments (such as U.S. Treasury bonds and bills), composite stock indices, and foreign currencies.

Caps

11. Caps are option contracts in which the cap writer (seller), in return for a premium, agrees to limit, or cap, the cap holder’s (purchaser) risk associated with an increase in a reference rate or index. For example, in an interest rate cap, if rates go above a specified interest rate level (the strike price or the cap rate), the cap holder is entitled to receive cash payments equal to the excess of the market rate over the strike price multiplied by the notional principal amount. Because a cap is an option-based contract, the cap holder has the right but not the obligation to exercise the option. If rates move down, the cap holder has lost only the premium paid. A cap writer has virtually unlimited risk resulting from increases in interest rates above the cap rate.

Floors

12. Floors are option contracts in which the floor writer (seller), in return for a premium, agrees to limit the risk associated with a decline in a reference rate or index. For example, in an interest rate floor, if rates fall below an agreed rate, the floor holder (purchaser) will receive cash payments from the floor writer equal to the difference between the market rate and an agreed rate multiplied by the notional principal amount.

Collars

13. A collar is a combination of a cap and a floor (one purchased and one written). A collar fixes the rate between two levels (the strike prices of the cap and the floor).

14. To the extent a derivative is in an asset position, the instrument meets the definition of an asset as defined in SSAP No. 4—Assets and Nonadmitted Assets and is an admitted asset to the extent it conforms to the requirements of this statement. To the extent a derivative is in a liability position, the instrument meets the definition of a liability as defined in SSAP No. 5—Liabilities, Contingencies and Impairments of Assets (SSAP No. 5).
Hedge Accounting

General

15. A hedging transaction is defined as a derivative transaction which is entered into and maintained to reduce:

   a. The risk of a change in the value, yield, price, cash flow, or quantity of assets or liabilities which the reporting entity has acquired or incurred or anticipates acquiring or incurring, or;

   b. The currency exchange rate risk or the degree of exposure as to assets or liabilities which a reporting entity has acquired or incurred or anticipates acquiring or incurring.

16. Derivatives used by reporting entities in hedging activities shall be accounted for in a manner consistent with the item hedged. For example, if the item being hedged is accounted for at amortized cost, the hedging derivative also is accounted for at amortized cost. If the item being hedged is accounted for at market value, the hedging derivative also is accounted for at market value.

Criteria to Qualify for Hedge Accounting

17. To qualify for hedge accounting, the derivative shall be designated as a hedge of a specific asset, liability, or anticipated transaction. The specific asset, liability, or anticipated transaction to be hedged must expose the reporting entity to a risk and the designated derivative transaction must reduce that exposure. Examples of items that expose the reporting entity to risk include change in the value, yield, price, cash flow, or quantity of, or degree of exposure with respect to assets, liabilities, or future cash flows which a reporting entity has acquired or incurred, or anticipates acquiring or incurring.

18. To satisfy the condition of risk reduction, the reporting entity shall demonstrate how the derivative reduces risk by using an appropriate method. There are a variety of methods available that can be used to demonstrate risk reduction, including methods which analyze the correlation of gains and losses on the derivative in relation to the losses and gains on the hedged asset, liability, or future cash flow.

19. Reporting entities shall set specific criteria at the inception of the hedge as to what will be considered effective in measuring the hedge and apply those criteria in the ongoing assessment of actual hedge results. For example, if correlation is used to measure the effectiveness of a hedge, high correlation of changes in the fair value of the derivative and the fair value of the item being hedged shall be probable so that such changes will substantially offset each other throughout the hedge period. Other methods used shall demonstrate a similar result to be considered effective. Also, at the inception of the hedge, formal documentation of the hedging instrument and the related hedged item, as provided in the documentation guidance section of this statement, shall be drafted and retained for future reference.

Gain or Loss Upon Termination

20. Upon termination of a derivative that qualifies for hedge accounting, the gain or loss shall adjust the basis of the hedged item. Alternatively, if the item being hedged is subject to IMR, the gain or loss on the hedging derivative may be realized and shall be subject to IMR upon termination. Reporting entities shall account for a derivative at estimated fair value if it ceases to be effective as a hedge (that is, the gains and losses on the derivative no longer offset the losses and gains on the hedged instrument) and recognize the gain or loss currently in earnings.
Settlement Accounting for Swaps

21. Included in the concept of hedge accounting is the notion of settlement accounting for interest rate swaps that are matched through designation with an asset or a liability on the balance sheet. Under settlement accounting, periodic net cash settlements under the swap agreement are recognized in income when they accrue.

Mark to Market Accounting

22. Under the immediate recognition method of accounting, (i.e. mark to market) changes in fair value from one reporting period to another reporting period shall be recognized currently in earnings. The immediate recognition method of accounting (mark to market) shall be applied in situations where:

   a. A reporting entity enters into a derivative for other than hedging purposes;
   
   b. A portfolio has been hedged and the reporting entity is unable to assign the hedging instrument to specific assets and liabilities;
   
   c. There are derivatives that are not specifically addressed elsewhere in this guidance.

23. Other than hedging is defined as any transaction which does not qualify for hedge accounting, including active derivatives trading by a reporting entity who enters into derivatives for purposes of generating profits on short-term differences in market movements and not for risk reduction purposes. Unrealized gains and losses cannot be deferred when categorized as other than hedging.

24. Generally, mark to market accounting is used where it is impractical to allocate gains and losses to specific hedged assets, liabilities, or future cash flows. However, mark to market accounting is not precluded from being utilized in situations where the derivative qualifies for hedge accounting.

Consistent Application of Alternatives

25. The determination of hedge accounting or immediate recognition accounting shall be made for each individual instrument. A reporting entity may utilize immediate recognition accounting for certain derivatives within a category and hedge accounting for other derivatives within that same category. The reporting entity’s choice between hedge accounting and mark to market accounting shall be applied consistently for each individual instrument over the life of the derivative. A change in method shall be justified by a significant change in circumstance.

Specific Accounting Procedures for Derivatives

26. Call and Put Options, Caps, and Floors shall be accounted for as follows:

   a. Accounting at Date of Acquisition (purchase) or Issuance (written): The premium paid or received for purchasing or writing a call option, put option, cap or floor shall be recorded as an asset (purchase) or liability (written) as an Aggregate Write-in for Invested Asset (or) Liability;
b. Statement Value:

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<th>i. Open derivatives hedging items recorded at amortized cost:</th>
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<tbody>
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<td>(a) Options, caps, and floors purchased or written shall be valued at amortized cost in a manner consistent with the hedged item;</td>
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<tr>
<td>(b) The amortization period and methods used shall result in a constant effective yield over the life of the hedged item or program. (For floating rate securities, the estimated effective yield shall be based on the current rate so the changes in yields attributable to changes in interest rates will be recognized in the period of change). Specific treatment includes:</td>
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<tr>
<td>(1) Holdings in derivatives purchased or written within a year of maturity or expiry need not be amortized;</td>
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<tr>
<td>(2) For anticipatory hedges, the derivative may be recorded at cost until the anticipated hedged transaction occurs or it is determined that the hedge was not effective;</td>
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<tr>
<td>(3) For other derivatives, the amortization period is usually from date of acquisition (issuance) of the derivative to maturity of the hedged item or program.</td>
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<tr>
<td>(c) For hedges where the cost of the derivative is combined with the hedged item, the statement value is zero. The market value of the hedging and hedged items shall be determined and reported separately;</td>
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<tr>
<td>(d) If during the life of the derivative it is no longer effective as a hedge, valuation at amortized cost ceases and the derivative shall be valued at its current market value (marked to market) with gains and losses recognized in earnings to the extent they ceased to be effective hedges.</td>
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<td>ii. Open derivatives hedging items recorded at market value, (where gains and losses on the hedging item are recognized as adjustments to unassigned funds (surplus)):</td>
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<tr>
<td>(b) This will result in unrealized gain/loss treatment with adjustment to unassigned funds (surplus);</td>
</tr>
<tr>
<td>(c) For hedges where the cost of the derivative is combined with the hedged item, the market value of the hedging and hedged items will be determined and reported separately. The cost (book value) basis used to figure gain/loss on the derivative is zero.</td>
</tr>
<tr>
<td>iii. Open derivatives hedging items recorded at market value, where gains and losses on the hedging item are recognized currently in earnings and for open derivatives accounted for under the immediate recognition method, options, caps, or floors</td>
</tr>
</tbody>
</table>
purchased or written shall be valued at current market value (marked to market) with changes in market value recognized currently in earnings.

c. Cash Flows and Income

i. Where the cost of the derivative is not combined with the hedged item:

(a) Amortization of premium or discount on derivatives is an adjustment to net investment (operating) income;

(b) Periodic cash flows and accruals of income/expense shall be reported in a manner consistent with the hedged item, usually as other investment income (operating income).

ii. Where the cost of the derivative is combined with the hedged item, the cash flows and income of the derivative on Schedule DB will be zero. All related amortization and cash flow accounting shall be reported with the hedged item instead of with the derivative.

d. Gain/Loss on Termination of an option, cap or floor accounted for under hedge accounting (includes closing, exercise, maturity, and expiry):

i. Exercise of an Option: The remaining book value of the derivative shall become an adjustment to the cost or proceeds of the hedged item(s) received or disposed of individually or in aggregate;

ii. Sale, maturity, expiry, or other closing transaction of a derivative which is an effective hedge—Any gain or loss on the transaction will adjust the basis (or proceeds) of the hedged item(s) individually or in aggregate;

iii. Gain/loss on termination of derivatives will be recognized currently in net income (realized gain/loss) to the extent they ceased to be effective hedges.

27. Swaps, Collars, and Forwards shall be accounted for as follows:

a. Accounting at Date of Opening Position:

i. Any premium paid or received at date of opening shall be recorded as an asset (paid) or liability (received) as an Aggregate Write-in for Invested Asset (or) Liability;

b. Statement Value:

i. Open derivatives hedging items recorded at amortized cost:

(a) Swaps, collars, and forwards shall be valued at amortized cost in a manner consistent with hedged item;

(b) The amortization period and methods used shall result in a constant effective yield over the life of the hedged item or program. (For floating rate securities the estimated effective yield shall be based on the current rate so the changes in yields attributable to changes in interest rates will be recognized in the period of change.) Specific treatment includes:
(1) Holdings in derivatives purchased or written within a year of maturity or expiry need not be amortized;

(2) For anticipatory hedges, the derivative may be recorded at cost until the anticipated hedged transaction occurs or it is determined that the hedge was not effective;

(3) For other derivatives the amortization period is usually from date of acquisition (issuance) of the derivative to maturity of the hedged item or program;

(4) For hedges where the cost of the derivative is combined with the hedged item, the statement value is zero. The market value of the hedging and hedged items shall be determined and reported separately;

(5) If during the life of the derivative it is no longer effective as a hedge, valuation at amortized cost ceases and the derivative shall be valued at its current market value (marked to market) with gains and losses recognized in earnings to the extent that it ceased to be an effective hedge.

ii. Open derivatives hedging items recorded at market value (where gains and losses on the hedging item are recognized as adjustments to unassigned funds (surplus)):

(a) Swaps, collars, or forwards shall be valued at current market value (marked to market) with changes in market value recognized currently consistent with the hedged item;

(b) This will result in unrealized gain/loss treatment with adjustment to unassigned funds (surplus);

(c) For hedges where the derivative is combined with the hedged item, the market value of the hedging and hedged items shall be determined and reported separately. The cost (book value) basis used to figure gain/loss on the derivative is zero.

iii. Open foreign currency swap and forward contracts hedging foreign currency exposure on items denominated in a foreign currency and translated into U.S. dollars where the immediate recognition method of accounting is not being used:

(a) The foreign exchange premium (discount) on the currency contract shall be amortized into income over the life of the contract. The foreign exchange premium (discount) is defined as the foreign currency (notional) amount to be received (paid) times the net of the forward rate minus the spot rate at the time the contract was opened.

Amortization is not required if the contract was entered into within a year of maturity;
(b) A foreign currency translation adjustment shall be reflected as an unrealized gain/loss (unassigned funds (surplus) adjustment) using the same procedures as done to translate the hedged item;

(c) The unrealized gain/loss for the period equals the foreign currency (notional) amount to be received (paid) times the net of the current spot rate minus the prior period end spot rate;

(d) The statement value of the currency contract equals the amortized (premium) discount plus the cumulative unrealized gain/(loss) on the contract. The cumulative unrealized gain/(loss) equals the foreign currency (notional) amount to be received (paid) times the net of the current spot rate minus the spot rate at the time the contract was opened;

(e) Recognition of unrealized gains/losses and amortization of foreign exchange premium/discount on anticipated firm commitments may be deferred until the hedged transaction occurs. These deferred gains/losses will adjust the basis or proceeds of the hedged transaction when it occurs;

(f) For hedges where the cost of the foreign currency contract is combined with the hedged item, the statement value is zero. The market value of the hedging and hedged items is determined and reported separately;

(g) If during the life of the currency contract it is not effective as a hedge, valuation at amortized cost shall cease. To the extent it ceased to be an effective hedge, a cumulative unrealized gain/loss will be recognized in earnings equal to the notional amount times the difference between the forward rate available for the remaining maturity of the contract (i.e., the forward rate as of the balance sheet date) and the forward rate at the time it ceased to be an effective hedge.

iv. Open derivatives hedging items recorded at market value, where gains and losses on the hedging item are recognized currently in earnings and for open derivatives accounted for under the immediate recognition method, swaps, collars and forwards shall be valued at current market value (marked to market) with changes in market value recognized currently in earnings.

c. Cash Flows and Income:

i. Where the cost of the derivative is not combined with the hedged item:

(a) Amortization of premium or discount on derivatives is an adjustment to net investment (operating) income;

(b) Periodic cash flows and accruals of income/expense are to be reported in a manner consistent with the hedged item, usually as other investment income (operating income).

ii. Where the cost of the derivative is combined with the hedged item, the cash flows and income of the derivative on Schedule DB is zero. All related amortization and cash flow accounting shall be reported with the hedged item instead of with the derivative.
d. Gain/Loss on Termination of a swap, collar or forward accounted for under hedge accounting (includes closing, exercise, maturity, and expiry):

i. Exercise—The remaining book value of the derivative shall become an adjustment to the cost or proceeds of the hedged item(s) received or disposed of individually or in aggregate;

ii. Sale, maturity, expiry, or other closing transaction of a derivative which is an effective hedge—Any gain or loss on the transaction will adjust the basis (or proceeds) of the hedged item(s) individually or in aggregate;

iii. Gain/loss on termination of derivatives will be recognized currently in net income (realized gain/loss) to the extent they ceased to be effective hedges;

28. Futures shall be accounted for as follows:

a. Accounting at Date of Acquisition:

i. Positions in futures contracts shall be initially valued at the amount of cash deposits (i.e., basis or book value of the contract), if any, placed with a broker. Subsequent additions (reductions) in cash deposits plus changes in contract value from date of contract opening (i.e., variation margin) paid (received) will increase (decrease) the book value of the futures contract.

b. Statement Value:

i. Hedges of Items Recorded at Amortized Cost:

(a) Futures shall be valued at book value;

(b) Book value of open futures contracts need not be amortized;

(c) For hedges where the cost of the futures contract is combined with the hedged item, the statement value would be equal to cash deposits outstanding. The market value of the hedging and hedged items will be determined and reported separately. Market value on futures contracts is limited to the value of the cash deposits outstanding;

(d) If during the life of the futures contract it is no longer effective as a hedge, valuation at book value (deferral accounting) ceases. A gain/(loss) equal to the variation margin received (paid) shall be recognized in earnings to the extent it ceased to be an effective hedge. Statement value will be limited to the cash deposits outstanding.

ii. Hedges of Items Recorded at Market Value (where gains and losses on the hedging item are recognized as adjustments to unassigned funds (surplus)):

(a) Changes in contract value from date of contract opening (i.e., variation margin) shall be recognized currently consistent with the hedged item. Statement value will be limited to the cash deposits outstanding;

(b) This will result in unrealized gain/loss treatment with adjustment to unassigned funds (surplus);
iii. Open foreign currency futures contracts hedging foreign currency exposure on item(s) denominated in a foreign currency and translated into U.S. dollars (where the immediate recognition method of accounting is not being used):

(a) The foreign exchange premium (discount) on the currency contract will be amortized into investment income over the life of the contract. The foreign exchange premium (discount) is defined as the foreign currency (notional) amount to be received (paid) times the net of the forward rate minus the spot rate at the time the contract was opened. The cumulative income recognized since the contract was opened shall be reported as recognized variation margin received or (paid).

Amortization is not required if the contract was entered into within a year of maturity;

(b) A foreign currency translation adjustment shall be reflected as an unrealized gain/loss (unassigned funds (surplus) adjustment) using the same procedures as is done to translate the hedged item. The cumulative unrealized gain/(loss) which equals the foreign currency (notional) amount to be received (paid) times the net of the current spot rate minus the spot rate at the time the contract was opened shall be reported as recognized variation margin received or (paid);

(c) The statement value of the currency futures contract is book value, including any increase (decrease) for amortization of foreign exchange (premium) discount plus the foreign exchange translation gain/(loss), which is reported as deferred variation margin;

(d) Recognition of unrealized gains/losses and amortization of foreign exchange premium/discount on anticipated firm commitments may be deferred until the hedged transaction occurs. These deferred gains/losses will adjust the basis or proceeds of the hedged transaction when it occurs;

(e) For hedges where the variation margin of the foreign currency contract is combined with the hedged item, the statement value would equal the cash deposits outstanding. The market value of the hedging and hedged items will be determined and reported separately. Market value on futures contracts is limited to the value of the cash deposits outstanding;

(f) If during the life of the currency contract it is not effective as a hedge, valuation at amortized cost ceases. To the extent it ceased to be an effective hedge, a cumulative unrealized gain/loss will be recognized in earnings equal to the notional amount times the difference between the forward rate available for the remaining maturity of the contract (i.e., the forward rate as of the balance sheet date) and the forward rate at the time it ceased to be an effective hedge.
iv. Open derivatives hedging items recorded at market value, where gains and losses on the hedging item are recognized currently in earnings and for open derivatives accounted for under the immediate recognition method, futures shall be valued at current market value (marked to market) with changes in market value recognized currently in earnings.

c. Gain/Loss on Termination of a futures contract accounted for under hedge accounting:

i. Settlement at maturity of a futures contract—The remaining variation margin of the futures contract shall become an adjustment to the cost or proceeds of the hedged item(s) received, disposed of or held, individually or in aggregate;

ii. Sale or other closing transaction of a futures contract which is an effective hedge—Any gain or loss on the transaction will adjust the basis (or proceeds) of the hedged item(s) individually or in aggregate;

iii. Gain/loss on termination of futures contracts will be recognized currently in net income (realized gain/loss) to the extent they ceased to be effective hedges;

Income Generation Transactions

General

29. Income generation transactions are defined as derivatives written or sold to generate additional income or return to the reporting entity. They include covered options, caps, and floors (e.g., a reporting entity writes an equity call option on stock which it already owns).

30. Because these transactions require writing derivatives, they expose the reporting entity to potential future liabilities for which the reporting entity receives a premium up front. Because of this risk, dollar limitations and additional constraints are imposed requiring that the transactions be “covered” (i.e., offsetting assets can be used to fulfill potential obligations). To this extent, the combination of the derivative and the covering asset works like a reverse hedge where an asset owned by the reporting entity in essence hedges the derivative risk.

31. As with derivatives in general, these instruments include a wide variety of terms regarding maturities, range of exercise periods and prices, counterparties, underlying instruments, etc.

32. The principal features of income generation transactions are:

a. Premium received is initially recorded as a deferred liability;

b. The accounting of the covering asset or underlying interest controls the accounting of the derivative. The covering asset/underlying interest is accounted at either mark-to-market (e.g., common stocks) or (amortized) cost (e.g., bonds);

c. The gain/loss on termination of the derivative is a capital item. For life insurance companies, it shall be subject to IMR treatment if interest rate related;

d. For options which are exercised, the remaining premium shall adjust the proceeds (cost) associated with the exercise resulting in no explicit gain or loss reported for the derivative itself.
### Written Fixed Income Covered Call Options

**33.** The principal features of written fixed income covered call options are:

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>a.</td>
<td>The general approach is to value at cost (i.e., consideration received) without amortization over the life of the contract;</td>
</tr>
<tr>
<td>b.</td>
<td>An alternative to the general approach combines the accounting of the written option with the covering asset and then uses standard accounting for callable bonds (yield to worst amortization) on the adjusted asset. This method prevents the possibility of future loss recognition upon exercise while at the same time providing recognition of the income feature of the option over time. This approach would appear most relevant for longer-lived covered European call options, which are in substance like callable bonds;</td>
</tr>
<tr>
<td>c.</td>
<td>For life insurance companies, the gain or loss flows through the IMR if the covering asset or underlying interest is subject to the IMR using callable bond rules to determine the remaining life;</td>
</tr>
<tr>
<td>d.</td>
<td>Reporting entities are responsible for timely recognition of any probable losses that may occur as a result of the strategy. If the exercise price is below the covering asset’s book value, the asset shall be evaluated for write down or disclosure treatment in accordance with SSAP No. 5. All relevant factors such as whether the option is currently exercisable, the fair value of the bond relative to its exercise price, to what extent the statement value of the option premium offsets any loss on the asset, or how any IMR transaction on exercise would affect unassigned funds (surplus) and income shall be considered.</td>
</tr>
</tbody>
</table>
34. Written fixed income covered call options shall be accounted for as follows:

<table>
<thead>
<tr>
<th>STATUS OF OPTION</th>
<th>COVERING ASSET VALUED AT AMORTIZED COST</th>
<th>COVERING ASSET VALUED AT MARKET VALUE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Open</td>
<td>Record premium as deferred liability.</td>
<td>Record premium as deferred liability.</td>
</tr>
<tr>
<td></td>
<td>Carry at consideration received. (1)</td>
<td>Mark to market with changes in market value recorded as unrealized adjustments to unassigned funds (surplus) – gain/loss.</td>
</tr>
<tr>
<td></td>
<td>Alternatively, attach premium to covering asset and amortize (under yield to worse scenario) using standard callable bond accounting. (2)</td>
<td></td>
</tr>
<tr>
<td>Closed – Expired</td>
<td>Premium received recognized as realized capital gain.</td>
<td>Premium received recognized as realized capital gain.</td>
</tr>
<tr>
<td></td>
<td>Gain from expiration to flow through IMR, if applicable. (3)</td>
<td></td>
</tr>
<tr>
<td>Closed – Exercised</td>
<td>Adjust disposition proceeds. (Include in capital gain/loss of disposed asset.)</td>
<td>Adjust disposition proceeds. (Include in capital gain/loss of disposed asset.)</td>
</tr>
<tr>
<td></td>
<td>Gain or loss from disposition to flow through IMR, if applicable. (3)</td>
<td></td>
</tr>
<tr>
<td>Closed – Terminated</td>
<td>Recognize net amount as realized capital gain/loss.</td>
<td>Recognize net amount as realized capital gain/loss.</td>
</tr>
<tr>
<td></td>
<td>Gain or loss from disposition to flow through IMR, if applicable. (3)</td>
<td></td>
</tr>
</tbody>
</table>

Notes

1. Reporting entities writing options for income generation purposes are responsible for the timely recognition of any probable losses that may occur as a result of the strategy due to holding and accounting for options on Schedule DB—Part B.
3. If premium is attached to covering asset, the accounting treatment for the covering asset applies.
Written Covered Put Options

35. The principal features of written covered put options are:

a. The accounting for the underlying interest instead of the covering asset governs the accounting of the written put while it is open. For example, if a reporting entity wrote a put requiring it to purchase a certain common stock (underlying interest) at a specific price, the reporting entity might cover that option by holding cash or cash equivalents (covering asset). The accounting for the common stock would govern the accounting of the option in this case;

b. As with covered call writing for life insurance companies, gain/loss on termination may be subject to IMR over the remaining life of the underlying interest;

c. As with covered call writing, entities writing put options for income generation purposes are responsible for timely recognition of any probable losses that may occur as a result of the strategy.

36. Written covered put options shall be accounted for as follows:

<table>
<thead>
<tr>
<th>STATUS OF OPTION</th>
<th>UNDERLYING INTEREST VALUED AT AMORTIZED COST</th>
<th>UNDERLYING INTEREST VALUED AT MARKET VALUE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Open</td>
<td>Record premium as deferred liability.</td>
<td>Record premium as deferred liability.</td>
</tr>
<tr>
<td></td>
<td>Carry at consideration received. (1)</td>
<td>Mark to market with changes in market value recorded as unrealized adjustments to unassigned funds (surplus) – gain/loss.</td>
</tr>
<tr>
<td>Closed – Expired</td>
<td>Premium received recognized as realized capital gain.</td>
<td>Premium received recognized as realized capital gain.</td>
</tr>
<tr>
<td></td>
<td>Gain from expiration to flow through IMR, if applicable.</td>
<td></td>
</tr>
<tr>
<td>Closed – Exercised</td>
<td>Adjust acquisition cost by premium received.</td>
<td>Adjust acquisition cost by premium received.</td>
</tr>
<tr>
<td>Closed – Terminated</td>
<td>Recognize net amount as realized capital gain/loss.</td>
<td>Recognize net amount as realized capital gain/loss.</td>
</tr>
<tr>
<td></td>
<td>Gain or loss from disposition to flow through IMR, if applicable.</td>
<td></td>
</tr>
</tbody>
</table>

Notes

1. Reporting entities writing options for income generation purposes are responsible for the timely recognition of any probable losses that may occur as a result of the strategy due to holding and accounting for options on Schedule DB—Part B.
Written Fixed Income Caps And Floors

37. The principal features of written fixed income caps and floors are:

a. The value of the premium received shall be amortized into income over the life of the contract. For caps and floors, where the entity is selling off possible excess interest/income, the value of the covering asset is not relevant;

b. Gain/loss may be subject to IMR. The expected maturity would be the derivative contract’s maturity.

38. Written fixed income caps and floors shall be accounted for as follows:

<table>
<thead>
<tr>
<th>STATUS OF OPTION</th>
<th>COVERING ASSET VALUED AT AMORTIZED COST</th>
<th>COVERING ASSET VALUED AT MARKET VALUE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Open</td>
<td>Record premium as deferred liability.</td>
<td>Record premium as deferred liability.</td>
</tr>
<tr>
<td></td>
<td>Carry at amortized value. (Alternatively carry at consideration received if within 1 year of maturity.)</td>
<td>Mark to market with changes in market value recorded as unrealized adjustments to unassigned funds (surplus) – gain/loss.</td>
</tr>
<tr>
<td></td>
<td>Amortize over life of contract to produce constant yield.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Record any interest expense as “Other Investment Income” – negative value.</td>
<td></td>
</tr>
<tr>
<td>Closed – Matured</td>
<td>Would usually mature at zero amortized value.</td>
<td>Premium received recognized as realized capital gain.</td>
</tr>
<tr>
<td></td>
<td>Any remaining unamortized value recognized as ordinary income through a final amortization adjustment.</td>
<td></td>
</tr>
<tr>
<td>Closed – Exercised</td>
<td>Not applicable.</td>
<td>Not applicable.</td>
</tr>
<tr>
<td>Closed – Terminated</td>
<td>Recognize net amount as realized capital gain/loss.</td>
<td>Recognize net amount as realized capital gain/loss.</td>
</tr>
<tr>
<td></td>
<td>Gain/loss on termination to flow through IMR, if applicable.</td>
<td></td>
</tr>
</tbody>
</table>

39. Examples of accounting and presentation based on varying assumptions can be found in the October 1, 1996 minutes of the Accounting Practices and Procedures (EX4) Task Force.
Insurance Futures and Insurance Futures Options

General

40. Accounting for futures or options is similar to that of insurance futures or insurance futures options accounting. However, for purposes of this statement, insurance futures are viewed as insurance-related transactions and not as investment-related transactions. This distinction results in different reporting for the results of insurance futures and insurance futures options. As a result separate guidance is provided for insurance futures and insurance futures options.

41. Insurers generally use insurance futures or insurance futures options, to hedge against adverse development in incurred losses. This strategy typically would involve any or a combination of:

a. The purchase of insurance futures contracts;
b. The purchase of a call option on insurance futures contracts;
c. The sale (writing) of a put option on insurance futures contracts.

Insurance Futures Contracts

42. An insurance futures contract is a futures contract based on an underlying index of performance of insurance contracts (policies) or factors relating thereto. In connection with a given insurance futures position, a reporting entity is required by the listing exchange to maintain a margin deposit with respect to the underlying insurance futures contracts purchased.

43. A reporting entity shall report the amount of any margin deposit as an asset. The specific accounting treatment of increases or decreases in the value of the subject contracts will depend on whether the insurance futures position constitutes a hedge of the reporting entity’s incurred losses. The determination of whether an insurance futures position constitutes a hedge shall be made consistent with the criteria identified in paragraphs 17 through 19.

Insurance Futures Contracts—Hedge Accounting

44. Increases (decreases) in the value of insurance futures contracts that effectively hedge incurred losses shall be reported as an increase (decrease) in other income when the insurance futures position corresponds to incurred losses for the current reporting period. With respect to any insurance futures position which corresponds to a period beyond the current reporting period, any increases (decreases) in the value of the underlying insurance futures contracts shall be reported as a direct increase (decrease) in unassigned funds (surplus). When the insurance futures position thereafter corresponds to a current reporting period, the initial increase (decrease) in direct unassigned funds (surplus) shall be reversed and the amount shall be reported as an increase (decrease) to other income for the current period, along with any current changes in value of the insurance futures contracts.

45. In either of the foregoing instances, the increase (decrease) in the market value of the insurance futures contracts shall either (a) increase (decrease) other than invested assets, to the extent that such increase (decrease) affects the corresponding margin deposit, or (b) increase (decrease) cash or other assets, to the extent of mark-to-market payments that are not maintained as a margin deposit. When the insurance futures position is closed, any corresponding margin balance shall be transferred to cash or other assets, as appropriate.
Insurance Futures Contracts—Other than Hedge Accounting

46. If the insurance futures position is no longer effective as a hedge, any increases (decreases) in the value of the insurance futures contract shall be reported as miscellaneous income. When the insurance futures positions close, any corresponding margin balance shall be transferred to cash or other assets, as appropriate.

Options on Insurance Futures Contracts

47. An insurance futures option is either a put or call option on an insurance futures contract. An insurance futures call option is a contract under which the holder has the right to purchase the underlying insurance futures contract covered by the option at a stated price (strike price) on or before a fixed expiration date. An insurance futures put option gives the holder the right to sell the underlying insurance futures contract. The consideration paid (received) for the purchase (sale) of an insurance futures option is referred to as a premium. Because all insurance futures options relate to an underlying insurance futures contract, the accounting treatment of insurance futures options generally follows the treatment afforded insurance futures contracts.

48. The amount of any premium paid for an insurance futures option shall be reported as other than invested assets. Similarly, the amount of any premium received for the sale (writing) of an insurance futures option shall be reported as a liability. The specific statutory accounting treatment of increases or decreases in the market value of the subject insurance futures option shall depend on whether such position constitutes a hedge of incurred losses. The determination of whether an insurance futures position constitutes a hedge shall be made consistent with the criteria identified in paragraphs 17 through 19.

Options on Insurance Futures Contracts—Hedge Accounting

49. Increases (decreases) in the market value of call options purchased, which effectively hedge incurred losses, shall be reported as an increase (decrease) in other income, when the call options correspond to incurred losses for the current reporting period. With respect to any call option which corresponds to a period beyond the current reporting period, any increases (decreases) in the market value of the underlying option shall be reported as a direct increase (decrease) in unassigned funds (surplus). When the option thereafter corresponds to a current reporting period, the initial increase (decrease) in direct unassigned funds (surplus) shall be reversed and the amount shall be reported as an increase (decrease) to other income along with any current changes in the market value of the option.

50. If the option position is terminated through a closing transaction, the corresponding balance of the asset (i.e., aggregate write-in for other than invested assets) shall be eliminated, with a corresponding charge to cash or other assets, as appropriate. If the option is exercised, the corresponding balance of the asset (i.e., aggregate write-in for other than invested assets) shall be eliminated, with a corresponding charge to either (a) insurance futures margin, to the extent of margin deposit requirements, or (b) cash or other assets, as appropriate. If the option expires, the corresponding balance of the asset shall be eliminated, with an appropriate decrease to the reporting entity’s other income.

51. The accounting treatment for the sale (writing) of insurance futures put options is essentially the mirror image of the foregoing treatment presented with respect to purchased call options. Upon termination (through a closing transaction), exercise, or expiration of the put option, the corresponding balance of the liability shall be eliminated, in the mirror image of the foregoing treatment.
Options on Insurance Futures Contracts—Other than Hedge Accounting

52. If the insurance futures option position is no longer effective as a hedge, any increases (decreases) in the value option shall be reported as miscellaneous income. Other than hedge accounting shall be used in the event that an original hedge position loses its character as such, until such time as the position is terminated.

Documentation Guidance

53. A reporting entity shall maintain documentation and records relating to derivatives opened during the year, instruments outstanding at year end, and instruments terminated during the year. Minimum required documentation is described in the following paragraphs.

54. For derivatives opened during the year:

   a. A description, for each instrument, of the purpose of the transaction, including:

      i. A brief description of the assets and/or liabilities hedged by the instrument;
      ii. A brief description of the manner in which the instrument reduces risk;
      iii. A reference to the reporting entity’s hedge program under which such transaction is internally authorized.

   b. Signature of approval, for each instrument, by person(s) authorized, either by the entity’s board of directors or a committee authorized by the board, to approve such transactions;

   c. A description, for each instrument, of the nature of the transaction, including:

      i. The date of the transaction;
      ii. A complete and accurate description of the specific derivative, including description of the underlying securities, currencies, rates, indices, commodities, derivatives, or other financial market instruments;
      iii. Number of contracts or notional amount;
      iv. Date of maturity, expiry or settlement;
      v. Strike price, rate or index, (opening price for futures contracts);
      vi. Counterparty, or exchange on which the transaction was traded;
      vii. Cost or consideration received, if any, for opening transaction.

   d. A description of the reporting entity’s methodology used to verify that opening transactions do not exceed limitations promulgated by the state of domicile.
55. For derivatives terminated during the year:
   a. Signature of approval, for each instrument, by person(s) authorized, either by the entity’s board of directors or a committee authorized by the board, to approve such transactions;
   b. A description, for each instrument, of the nature of the transaction, including:
      i. The date of the transaction;
      ii. A complete and accurate description of the specific derivative, including description of the underlying securities, currencies, rates, indices, commodities, derivatives, or other financial market instruments;
      iii. Number of contracts or notional amount;
      iv. Date of maturity, expiry or settlement;
      v. Strike price, rate or index, (termination price for futures contracts);
      vi. Counterparty, or exchange on which the transaction was traded;
      vii. Consideration paid or received, if any, on termination.
   c. Description of the reporting entity’s methodology to verify that derivatives were effective hedges;
   d. Identification of any derivatives that ceased to be effective as hedges.

56. For derivatives open at year end:
   a. A description of the methodology used to verify the continued effectiveness of hedges;
   b. An identification of any derivatives which have ceased to be effective as hedges;
   c. A description of the reporting entity’s methodology to determine market values of derivatives;
   d. Copy of Master Agreements, if any, where indicated on Schedule DB Part E Section 1.

Disclosures

57. Reporting entities shall disclose the following for all derivative contracts outstanding:
   a. Disclosures by category of instrument:
      i. Notional or contract amounts;
      ii. Carrying and fair values;
      iii. A description of the accounting policies for derivatives;
      iv. A discussion of the market risk, credit risk, and cash requirements of the derivatives.
b. General Disclosures:

i. A description of the reporting entity’s objectives for holding or issuing the derivatives, the context needed to understand those objectives, and its strategies for achieving those objectives, including the classes of derivatives used;

ii. A description of how each category of derivative is reported in the financial statements including the policies for recognizing (or reasons for not recognizing) and measuring the derivatives held or issued, and when recognized, where those instruments and related gains and losses are reported.

58. Reporting entities shall disclose the following for derivatives held for other than hedging purposes:

a. Average fair value of the derivatives during the reporting period together with the related end-of-period fair value distinguishing between assets and liabilities;

b. Net gains or losses disaggregated by class, business activity or other category that is consistent with the management of those activities and where the net gains or losses are reported.

59. The financial statements shall disclose details of covered items and/or written transactions to allow evaluation of cash flow implications for all written covered options used for income generation.

60. Refer to the preamble for further discussion regarding disclosure requirements. The disclosure requirements of paragraphs 58 and 59 shall be included in the annual audited statutory financial reports only.

Relevant Literature

61. This statement adopts FASB Statement No. 105, Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk and Financial Instruments with Concentrations of Credit Risk (FAS 105) for all financial instruments with off-balance sheet risk with modification to the disclosure required in paragraph 17 to require that the disclosure distinguish between derivatives entered into for hedging purposes from those entered into for other than hedging purposes. Paragraph 19 is rejected as it addresses voluntary disclosures not required by this statement.

62. This statement adopts FASB Statement No. 119, Disclosure about Derivative Financial Instruments and Fair Value of Financial Instruments (FAS 119) with the modification to the disclosure required in paragraph 8 to distinguish between derivatives entered into for hedging purposes from those entered into for other than hedging purposes. The disclosures required for trading derivatives by paragraph 10 of FAS 119 shall be required for derivatives entered into for other than hedging purposes. Paragraphs 12 and 13 are rejected. This statement also adopts FASB Emerging Issues Task Force No. 84-7, Termination of Interest Rate Swaps and FASB Emerging Issues Task Force No. 84-36, Interest Rate Swap Transactions.

63. This statement rejects FASB Statement No. 52, Foreign Currency Translation, FASB Statement No. 80, Accounting for Futures Contracts and the following FASB Emerging Issues Task Force pronouncements:

a. FASB Emerging Issues Task Force No. 84-14, Deferred Interest Rate Setting;
b. FASB Emerging Issues Task Force No. 86-34, Futures Contracts Used as Hedges of Anticipated Reverse Repurchase Transactions;

c. FASB Emerging Issues Task Force No. 87-2, Net Present Value Method of Valuing Speculative Foreign Exchange Contracts;

d. FASB Emerging Issues Task Force No. 88-8, Mortgage Swaps;

e. FASB Emerging Issues Task Force No. 90-17, Hedging Foreign Currency Risk with Purchased Options;

f. FASB Emerging Issues Task Force No. 91-1, Hedging Intercompany Foreign Currency Risks;

g. FASB Emerging Issues Task Force No. 91-4, Hedging Foreign Currency Risks with Complex Options and Similar Transactions;

h. FASB Emerging Issues Task Force No. 96-11, Accounting for Forward Contracts and Purchase Options to Acquire Securities Covered Under FASB Statement No. 115.

Effective Date and Transition

64. This statement is effective for years beginning January 1, 2001. Changes resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with SSAP No. 3—Accounting Changes and Corrections of Errors.

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

- FASB Statement No. 105, Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk and Financial Instruments with Concentrations of Credit Risk

- FASB Statement No. 119, Disclosure about Derivative Financial Instruments and Fair Value of Financial Instruments

- FASB Emerging Issues Task Force No. 84-7, Termination of Interest Rate Swaps

- FASB Emerging Issues Task Force No. 84-36, Interest Rate Swap Transactions

RELEVANT ISSUE PAPERS

- Issue Paper No. 85—Derivative Instruments
Statement of Statutory Accounting Principles No. 32

Investments in Preferred Stock (excluding investments in preferred stock of subsidiary, controlled, or affiliated entities)

STATUS

Type of Issue: Common Area

Issued: Initial Draft

Effective Date: January 1, 2001

Affects: No other pronouncements

Affected by: No other pronouncements

Interpreted by: INT 99-09, INT 99-29, INT 02-07

SCOPE OF STATEMENT

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AUTHORITATIVE LITERATURE

Statutory Accounting

RELEVANT ISSUE PAPERS
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Investments in Preferred Stock (excluding investments in preferred stock of subsidiary, controlled, or affiliated entities)

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for preferred stock.

2. Investments in preferred stock of subsidiaries, controlled or affiliated entities (investments in affiliates) are not within the scope of this statement. They are addressed in SSAP No. 46—Investments in Subsidiary, Controlled, and Affiliated Entities.

SUMMARY CONCLUSION

3. Preferred stock (excluding investments in affiliates), which may or may not be publicly traded and may include shares against which exchange traded call options are outstanding, shall include:

   a. Redeemable preferred stock, including mandatory sinking fund preferred stock and preferred stock redeemable at the option of the holder; and

   b. Perpetual preferred stock, including nonre redeemable preferred stock and preferred stock redeemable at the option of the issuer.

4. Redeemable preferred stock is defined as preferred stock that must be redeemed by the issuing enterprise or is redeemable at the option of the reporting entity. It includes mandatory sinking fund preferred stock and payment-in-kind (PIK) preferred stock.

5. Mandatory sinking fund preferred stock is defined as redeemable preferred stock subject to a 100% mandatory sinking fund, annual installments of which will (a) commence not more than 10 years from the date of issue or December 31, 1978, if outstanding on that date; (b) be not less than 2% of the number of shares issued (or outstanding on December 31, 1978, if issued prior to that date); (c) provide for the redemption of the entire issue over a period not longer than 40 years from the date of issue, or December 31, 1978, if outstanding on that date. Redeemable preferred stock which is subject to a 100% mandatory sinking fund, but which does not, at date of issue or December 31, 1978, if outstanding at that time, meet one or more of the other requirements above, shall be considered as mandatory sinking fund preferred stock at the time the deficiency is cured through the passage of time or otherwise.

6. PIK preferred stock is defined as redeemable preferred stock on which, at the option of the issuer, dividends can be paid in additional securities rather than cash.

7. Perpetual preferred stock is defined as preferred stock with no redemption or sinking fund features or preferred stock redeemable at the option of the issuer.

8. Restricted preferred stock is defined as a security for which sale is restricted by governmental or contractual requirement (other than in connection with being pledged as collateral) except where that requirement terminates within one year or if the holder has the power by contract or otherwise to cause the requirement to be met within one year. Any portion of the security that can be reasonably expected to qualify for sale within one year is not considered restricted.

9. Preferred stocks meet the definition of assets 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.
Acquisitions and Sales

10. At acquisition, preferred stock shall be reported at cost, including brokerage and other related fees. Cost shall not exceed fair value. PIK stock received as dividends shall be recorded at fair value. Acquisitions and dispositions shall be recorded on the trade date. Private placement stock transactions shall be recorded on the funding date.

11. A reporting entity can subscribe for the purchase of stock, but not be required to make payment until a later time. Transactions of this nature are common in the formation of corporations. Preferred stock acquired under a subscription represents a conditional transaction in a security authorized for issuance but not yet actually issued. Such transactions are settled if and when the actual security is issued and the exchange or National Association of Securities Dealers (NASD) rules that the transactions are to be settled. Preferred stock acquired under a subscription shall be recorded as an admitted asset when the reporting entity or its designated custodian or transfer agent takes delivery of the security and the security is recorded in the name of the reporting entity or its nominee, (i.e., the accounting for such preferred stock acquisitions shall be on the settlement date).

Amortization

12. Redeemable preferred stock purchased at a premium shall be amortized to reduce the carrying value to the call or redemption value over the period to the call or earliest redemption date, whichever produces the lowest asset value (yield to worst). Redeemable preferred stock purchased at a discount shall be amortized to increase the carrying value to par value over the period to maturity or the latest redemption date.

13. PIK preferred stock shall be amortized to the lower of the call price or par value, measured in either case at the end of the stock dividend period and based on all of the shares expected to be held at the end of that period, including those received as dividends.

14. Amortization shall be calculated using the interest method and shall be reported as increases or decreases in dividends collected during the year.

Balance Sheet Amount

15. The Securities Valuation Office classifies preferred stocks into six redeemable preferred stock quality categories and six perpetual preferred stock quality categories. Preferred stocks shall be classified in accordance with the Valuations of Securities manual published by the NAIC Valuation of Securities (EX4) Task Force.

16. Preferred stock shall be valued based on (a) the underlying characteristics of the security, (b) the quality rating of the security as defined in the NAIC Purposes and Procedures of the Securities Valuation Office (Purposes and Procedures of the SVO) and reported in the NAIC Valuations of Securities manual, and (c) whether an Asset Valuation Reserve (AVR) is maintained by the reporting entity. Unrealized gains and losses on perpetual preferred stock shall be included as a direct credit or charge to unassigned funds (surplus).

Reporting Entities That Do Not Maintain An AVR

17. Highest-quality or high-quality redeemable preferred stocks (NAIC designations 1 and 2), which have characteristics of debt securities, shall be valued at cost or amortized cost. All other redeemable preferred stocks (NAIC designations 3 to 6) shall be reported at the lower of cost, amortized cost, or fair value.
18. Highest-quality or high-quality perpetual preferred stocks (NAIC designations 1 and 2), which have characteristics of equity securities, shall be valued using unit prices as reported in NAIC Valuations of Securities manual. All other perpetual preferred stocks (NAIC designations 3 to 6) shall be reported at the lower of cost or fair value.

**Reporting Entities That Do Maintain An AVR**

19. Highest-quality, high-quality or medium quality redeemable preferred stocks (NAIC designations 1 to 3), which have characteristics of debt securities, shall be valued at cost or amortized cost. All other redeemable preferred stocks (NAIC designations 4 to 6) shall be reported at the lower of cost, amortized cost, or fair value.

20. Highest-quality, high-quality or medium quality perpetual preferred stocks (NAIC designations 1 to 3), which have characteristics of equity securities, shall be valued at cost. All other perpetual preferred stocks (NAIC designations 4 to 6) shall be reported at the lower of cost or fair value.

**Impairment**

21. If it is determined that a decline in the fair value of a preferred stock is other than temporary, the preferred stock shall be written down to fair value as a new cost basis and the amount of the write down shall be accounted for as a realized loss. For those reporting entities required to maintain an AVR, realized losses shall be accounted for in accordance with SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve.

22. Perpetual preferred stock shall be accounted for in accordance with paragraph 18 or paragraph 20, as applicable, subsequent to the recognition of an other than temporary impairment. Future declines in fair value which are determined to be other than temporary, shall be recorded as realized losses. A decline in fair value which is other than temporary includes situations where the reporting entity has made a decision to sell a security at an amount below its carrying value.

23. Redeemable preferred stock shall be accounted for in accordance with paragraph 17 or paragraph 19, as applicable, subsequent to the recognition of an other than temporary impairment. Future declines in fair value which are determined to be other than temporary, shall be recorded as realized losses. An impairment shall be considered to have occurred if it is probable that the reporting entity will be unable to collect all amounts due according to the contractual terms of the security in effect at the date of acquisition. A decline in fair value which is other than temporary includes situations where the reporting entity has made a decision to sell a security prior to its maturity at an amount below its carrying value (i.e., amortized cost).

**Income**

24. Dividends on preferred stock (whether cumulative or noncumulative), other than mandatorily redeemable preferred stock, shall be recorded as investment income on the ex-dividend date with a corresponding receivable to be extinguished upon receipt of cash (i.e., dividend income shall be recorded on preferred stock declared to be ex-dividend on or prior to the statement date).

25. Dividends on mandatorily redeemable preferred stock shall be accrued to the redemption price, even if not declared, using the interest method over the period ending on the redemption date.

26. Cash dividends paid on PIK stock during the stock dividend period shall be accounted for as a reduction in the investment.
Exchanges and Conversions

27. If preferred stock is exchanged or converted into other securities, the fair value of the preferred stock surrendered at the date of the exchange or conversion shall become the cost basis for the new securities with any gain or loss realized at the time of the exchange or conversion. However, if the fair value of the securities received in an exchange or conversion is more clearly evident than the fair value of the preferred stock surrendered, then it shall become the cost basis for the new securities.

Disclosures

28. The following disclosures regarding preferred stocks shall be made in the financial statements:
   a. Fair values in accordance with SSAP No. 27—Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk, Financial Instruments with Concentrations of Credit Risk and Disclosures about Fair Value of Financial Instruments (SSAP No. 27);
   b. Concentrations of credit risk in accordance with SSAP No. 27;
   c. Basis at which the preferred stocks are stated; and
   d. A description, as well as the amount, of preferred stock that is restricted and the nature of the restriction.

29. Refer to the preamble for further discussion regarding disclosure requirements. The disclosure requirements of paragraphs 28 a. and 28 b. shall be included in the annual audited statutory financial reports only.

Relevant Literature

30. This statement rejects FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities and FASB Emerging Issues Task Force No. 86-32, Early Extinguishment of a Subsidiary’s Mandatorily Redeemable Preferred Stock.

Effective Date and Transition

31. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors.

AUTHORITATIVE LITERATURE

Statutory Accounting
  • NAIC Purposes and Procedures of the Securities Valuation Office
  • NAIC Valuations of Securities manual prepared by the Securities Valuation Office

RELEVANT ISSUE PAPERS
  • Issue Paper No. 32—Investments in Preferred Stock (excluding investments in preferred stock of subsidiary, controlled, or affiliated companies)
Statement of Statutory Accounting Principles No. 33

Securitization

STATUS

Type of Issue: Common Area
Issued: Initial Draft
Effective Date: January 1, 2001
Affects: No other pronouncements
Affected by: No other pronouncements
Interpreted by: INT 01-04, INT 01-31

SCOPE OF STATEMENT

SUMMARY CONCLUSION

Accounting for Securitizations of Financial Assets
Investments in Special-Purpose Entities
Secured Obligations and Collateral
Recognition of Servicing Rights
Sales of Future Revenues
Relevant Literature
Effective Date and Transition

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

RELEVANT ISSUE PAPERS
Securitization

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for asset securitizations and securitizations of policy acquisition costs. This statement is not intended to address transfers accomplished by means other than securitization.

SUMMARY CONCLUSION

2. An asset securitization is the process of converting assets which would normally serve as collateral for a loan into securities.

Accounting for Securitizations of Financial Assets

3. A financial asset shall be defined as cash, evidence of an ownership interest in an entity, or a contract that both
   a. Imposes on one entity a contractual obligation (i) to deliver cash or another financial instrument to a second entity or (ii) to exchange other financial instruments on potentially unfavorable terms with the second entity; and
   b. Conveys to that second entity a contractual right (i) to receive cash or another financial instrument from the first entity or (ii) to exchange other financial instruments on potentially favorable terms with the first entity.

4. A securitization in which the transferor surrenders control over the financial asset transferred shall be accounted for as a sale, with recognition of proceeds and measurement of a gain or loss only to the extent that consideration other than beneficial interests in the transferred assets is received in exchange. The portion of the securitization for which beneficial interests in the transferred assets are received shall not be accounted for as a sale, but shall be treated as an exchange of assets with no measurement of a gain or loss. All other securitizations shall be accounted for as secured borrowings in accordance with paragraph 11.

5. The transferor has surrendered control if, and only if, all of the following conditions are met:
   a. The transferred assets have been isolated from the transferor—put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership;
   b. The transferee is a qualifying special-purpose entity and the holders of beneficial interests in that entity have the right—free of transferor-imposed conditions that constrain them from taking advantage of that right—to pledge or exchange those interests; and
   c. The transferor does not maintain effective control over the transferred assets through (i) an agreement that entitles and obligates the transferor to repurchase or redeem them before their maturity, or (ii) an agreement that entitles the transferor to repurchase or redeem transferred assets that are not readily obtainable.

6. A beneficial interest shall be defined as the right to receive all or portions of specified cash inflows to a trust or other entity, including senior and subordinated shares of interest or principal inflows to be “passed through” or “paid through,” premiums due guarantors, and residual interests. Residual interests are interests in the cash flows of the trust or other entity, after the cash flows of structured securities issued by the trust are met.
7. Upon completion of the securitization of financial assets meeting the criteria for sales treatment required by paragraph 5, the transferor shall:
   a. Eliminate the transferred assets from the statement of financial position;
   b. Allocate the previous carrying amount of the transferred assets to the securities representing beneficial interests retained by the reporting entity, if any, and the securities representing beneficial interests not retained, if any, based on the relative fair values of the transferred assets at the date of transfer;
   c. Record in its statement of financial position, the allocated carrying value of the securities representing retained beneficial interests in the assets (e.g., loan-backed securities);
   d. Recognize all additional assets obtained (i.e., other than the securities representing retained beneficial interests which are recorded in accordance with 7 c.) and liabilities incurred in consideration as proceeds of the sale;
   e. Initially measure such additional assets obtained and liabilities incurred in the sale at fair value; and
   f. For reporting entities required to maintain an Interest Maintenance Reserve (IMR), the accounting for realized capital gains and losses shall be in accordance with SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve. For reporting entities not required to maintain an IMR, realized gains and losses shall be reported as net realized capital gains or losses line in the Investment Income section of the Underwriting and Investment Exhibit.

8. The successor (transferee) shall recognize all assets obtained and any liabilities incurred and initially measure them at fair value.

9. A qualifying special-purpose entity (including a CMO special-purpose entity) as used in this statement must meet all of the following conditions:
   a. It is a trust, corporation, or other legal vehicle whose activities are permanently limited by the legal documents establishing the special-purpose entity to:
      i. Holding title to transferred financial assets;
      ii. Issuing beneficial interests (If some of the beneficial interests are in the form of debt securities or equity securities, the transfer of assets is a securitization.);
      iii. Collecting cash proceeds from assets held, reinvesting proceeds in financial instruments pending distribution to holders of beneficial interests, and otherwise servicing the assets held; and
      iv. Distributing proceeds to the holders of its beneficial interests.
   b. It has a standing at law distinct from the transferor. Having standing at law depends in part on the nature of the special-purpose entity. For example, generally, under U.S. law, if a transferor of assets to a special-purpose trust holds all of the beneficial interests, it can unilaterally dissolve the trust, and thereby resume control over the individual assets held in the trust, and the transferor can effectively assign its interest and its creditors can reach it. In that circumstance, the trust has no standing at law, is not distinct, and thus is
not a qualified special-purpose entity. A special-purpose entity that has distinct standing at law may still be an affiliate of the transferor.

Investments in Special-Purpose Entities

10. Reporting entities that have qualifying special-purpose entities as affiliates shall carry their investment in such entity at its underlying statutory book value in accordance with SSAP No. 46—Investments in Subsidiary, Controlled, and Affiliated Entities. Additionally, transactions entered involving affiliated qualifying special-purpose entities are subject to the provisions of SSAP No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties.

Secured Obligations and Collateral

11. Securitizations of financial assets that do not meet the criteria for sale treatment set forth in paragraph 5 shall be presumed to be secured borrowings and shall be recorded as follows. Financial assets shall remain on the reporting entity’s books and a liability shall be recorded to reflect the proceeds from the issuance of any type of certificate. Non-cash proceeds shall be recorded as a contra liability and netted against the liability. The liability shall be reduced as the obligation to holders of beneficial interests is repaid. Financial assets pledged as collateral shall not be offset against the liability reflecting the proceeds of the transaction.

Recognition of Servicing Rights

12. Servicing rights become a distinct asset or liability only when contractually separated from the underlying assets by sale or securitization of the assets with servicing retained or separate purchase or assumption of the servicing. If distinct servicing rights to transferred assets exist and are retained by the reporting entity, the reporting entity shall recognize a servicing asset or liability. When the servicing fees to be received exceed the cost of servicing the transferred assets, a servicing asset is recognized and nonadmitted. When the cost of servicing the transferred assets is greater than the servicing fees to be received, a liability shall be recorded for the excess to recognize this obligation. A corresponding loss shall be recorded through the Summary of Operations. The servicing asset or liability shall be amortized into income in proportion to, and over the period of estimated servicing income (if an asset) or estimated servicing loss (if a liability). The servicing asset or liability shall be measured in a manner consistent with paragraphs 13 and 35 through 38 of FASB Statement No. 125, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (FAS 125).

Sales of Future Revenues

13. In addition to securitization of assets, some reporting entities have entered into transactions characterized as a sale of future revenues. These transactions are sometimes referred to as securitizations and are sometimes characterized as selling deferred acquisition costs. A sale of future revenues by a reporting entity shall not result in the immediate recognition of income or surplus. The proceeds of any such sale shall be established as a liability and shall be reduced as the proceeds are repaid.
Relevant Literature

14. This statement adopts portions of FAS 125, with the following modifications (FAS 125 is addressed in its entirety in SSAP No. 18—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities):
   a. This statement requires servicing rights assets to be nonadmitted;
   b. This statement does not permit sales treatment for transactions where recourse provisions exist or where “call” or “put” options exist on the transferred assets whereas GAAP would permit the recognition of the transfer as a sale under some circumstances;
   c. This statement requires debtors to provide disclosure when a secured party is permitted to sell or pledge financial assets transferred as collateral whereas FAS 125 requires the encumbered assets to be reported separately from unencumbered assets;
   d. This statement does not address transfers of financial assets accomplished in a manner other than through securitizations whereas FAS 125 does address such transfers; and
   e. Paragraph 14 is rejected as it is not applicable.

Effective Date and Transition

15. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors.

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

• FASB Statement No. 125, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities

RELEVANT ISSUE PAPERS

• Issue Paper No. 86—Securitization
Statement of Statutory Accounting Principles No. 34

Investment Income Due and Accrued

STATUS

Type of Issue: Common Area
Issued: Initial Draft
Effective Date: January 1, 2001
Affects: No other pronouncements
Affected by: No other pronouncements
Interpreted by: No other pronouncements

SCOPE OF STATEMENT

SUMMARY CONCLUSION

Disclosures
Effective Date and Transition

RELEVANT ISSUE PAPERS
Investment Income Due and Accrued

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for investment income due and accrued.

SUMMARY CONCLUSION

2. Investment income due shall be defined as investment income earned and legally due to be paid to the reporting entity (i.e., receivable) as of the reporting date. Investment income accrued shall be defined as investment income earned as of the reporting date but not legally due to be paid to the reporting entity until subsequent to the reporting date.

3. In general, gross investment income shall be recorded as earned and shall include investment income collected during the period, the change in investment income due and accrued, the change in unearned investment income plus any amortization (e.g., discounts or premiums on bonds, origination fees on mortgage loans, etc.).

4. Investment income due and accrued shall be recorded as an asset in accordance with SSAP No. 4—Assets and Nonadmitted Assets (SSAP No. 4). An evaluation shall be made of such assets in accordance with SSAP No. 5—Liabilities, Contingencies and Impairments of Assets (SSAP No. 5), to determine whether an impairment exists. Amounts determined to be uncollectible shall be written off through the statement of operations. Then an evaluation shall be made to determine nonadmitted amounts.

5. This two step process is set forth below.

   a. Investment income due and accrued shall be assessed for collectibility. If, in accordance with SSAP No. 5, it is probable the investment income due and accrued balance is uncollectible, the amount shall be written off and shall be charged against investment income in the period such determination is made;

   b. Any remaining investment income due and accrued (i.e., amounts considered probable of collection) representing either (1) amounts that are over 90 days past due (generated by any invested asset except mortgage loans in default), or (2) amounts designated elsewhere in the Accounting Practices and Procedures Manual as nonadmitted shall be considered nonadmitted assets and recognized through a direct charge to surplus in accordance with SSAP No. 4. These nonadmitted amounts shall be subject to continuing assessments of collectibility and, if determined to be uncollectible, a write-off shall be recorded in the period such determination is made in accordance with subparagraph a. above.

6. Accrued interest on mortgage loans that are in default (as defined in SSAP No. 37—Mortgage Loans) shall be recorded as Investment Income Due and Accrued when such interest is deemed collectible. Interest can be accrued on mortgage loans in default if deemed collectible; if interest is deemed uncollectible, it shall not be accrued and any previously accrued amounts are to be written off in accordance with the guidelines in paragraph 5 a. above. If a mortgage loan in default has interest 180 days past due which has been assessed as collectible, all interest shall be considered a nonadmitted asset and recognized through a direct charge to surplus as outlined in paragraph 5 b. above.
Disclosures

7. The following disclosures shall be made for investment income due and accrued in the financial statements.
   a. The bases by category of investment income for excluding (nonadmitting) any investment income due and accrued;
   b. Disclose total amount excluded.

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

Effective Date and Transition

9. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors.

RELEVANT ISSUE PAPERS

• Issue Paper No. 34—Investment Income Due and Accrued
Statement of Statutory Accounting Principles No. 35

Guaranty Fund and Other Assessments

STATUS

Type of Issue: Common Area
Issued: Finalized March 13, 2000
Effective Date: January 1, 2001
Affects: No other pronouncements
Affected by: No other pronouncements
Interpreted by: INT 03-01

SCOPE OF STATEMENT

SUMMARY CONCLUSION

Disclosures
Relevant Literature
Effective Date and Transition

RELEVANT ISSUE PAPERS
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Guaranty Fund and Other Assessments

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for guaranty fund and other assessments.

2. Guaranty fund assessments represent a funding mechanism employed by states to provide funds to cover policyholder obligations of insolvent reporting entities. Most states have enacted legislation establishing guaranty funds for both life and health insurance and for property and casualty insurance to provide for covered claims or to meet other insurance obligations of insolvent reporting entities in the state. Guaranty funds generally make assessments after an insolvency based upon retrospective premium writings.

3. This statement addresses other assessments including but not limited to workers’ compensation second injury funds and for funds that pay operating costs of an insurance department, a state guaranty fund, and/or the workers’ compensation board. This statement also addresses health related assessments including but not limited to state health insurance high-risk pools, health insurance small group and individual reinsurance pools, state health demographic or risk adjustment assessments.

SUMMARY CONCLUSION

4. This statement applies SSAP No. 5—Liabilities, Contingencies and Impairments of Assets (SSAP No. 5) to guaranty fund and other assessments. SSAP No. 5 requires accrual of a liability when both of the following conditions are met:

   a. Information available prior to issuance of the statutory financial statements indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the statutory financial statements. It is implicit in this condition that it is probable that one or more future events will occur confirming the fact of the loss or incurrence of a liability; and

   b. The amount of loss can be reasonably estimated.

   For the purposes of subparagraph 4 b., loss generally means assessment or assessment rate. Guaranty fund and other assessments shall be charged to expense (Taxes, Licenses and Fees) and a liability shall be accrued when the above criteria are met except for certain health related assessments which shall be reported as a part of claims. Health related assessments that are reported as a part of claims instead of taxes, licenses and fees are those assessments that are designed for the purpose of spreading the risk of severe claims or adverse enrollment selection among all participating entities, and where the funds collected via the assessment are re-distributed back to the participating entities based upon the cost of specific claims, enrollment demographics, or other criteria affecting health care expenses.

5. For refunded guaranty or other fund assessments and assessments used to fund state operating expenses, reporting entities shall credit the refund or charge the assessment to expense when notification of the refund or assessment is made.

6. For guaranty fund assessments, subparagraph 4 a. is met when the insolvency has occurred, regardless of whether the assessments are based on premiums written before or after the insolvency. For purposes of applying this guidance, the insolvency shall be considered to have occurred when a reporting entity meets a state’s (ordinarily the state of domicile of the insolvent reporting entity) statutory definition of an insolvent reporting entity. In most states, the reporting entity must be declared to be financially insolvent by a court of competent jurisdiction. In some states, there must also be a final order of...
liquidation. Loss-based administrative-type and second injury fund assessments are presumed probable when the losses on which the assessments are expected to be based are incurred.

7. Subparagraph 4 b. requires that the amounts can be reasonably estimated. For guaranty fund assessments, a reporting entity’s estimate of the liability shall reflect an estimate of its share of the ultimate loss expected from the insolvency. The reporting entity shall also estimate any applicable premium tax credits and policy surcharges. An entity need not be able to compute the exact amounts of the assessments or be formally notified of such assessments by a guaranty fund to make a reasonable estimate of its liability. Entities subject to assessments may have to make assumptions about future events, such as when the fund making the assessment will incur costs and pay claims to determine the amounts and the timing of assessments. The best available information about market share or premiums by state and premiums by line of business generally should be used to estimate the amount of future assessments. Estimates of loss-based assessments should be consistent with estimates of the underlying incurred losses and should be developed based upon enacted laws or regulations and expected assessment rates. Premium tax credits or policy surcharges may only be considered in the estimate if it is probable they will be realized. Changes in the amount of the liability (or asset) as a result of the passage of time and revisions to estimates in the amount or timing of the payments shall be recorded in taxes, licenses and fees.

8. In accordance with SSAP No. 5, when the reasonable estimate of the loss is a range, the amount in the range that is considered the best estimate shall be accrued. When, in management’s opinion, no amount within management’s estimate of the range is a better estimate than any other amount, however, the midpoint (mean) of management’s estimate in the range shall be accrued. For purposes of this statement, it is assumed that management can quantify the high end of the range. If management determines that the high end of the range cannot be quantified, then a range does not exist, and management’s best estimate shall be accrued.

9. The liability for assessments shall be established gross of any probable and estimable recoveries from premium tax credits and premium surcharges. Because assessments are generally paid before premium tax credits are realized or policy surcharges are collected, an asset may result, which represents a receivable for premium tax credits that will be taken and policy surcharges which will be collected in the future. These amounts, to the extent it is probable they will be realized, meet the definition of assets, as specified in SSAP No. 4—Assets and Nonadmitted Assets and are admitted assets to the extent they conform to the requirements of this statement. The asset shall be established and reported independent from the liability (not reported net).

10. In certain circumstances, a reporting entity acts as an agent for certain state or federal agencies in the collection and remittance of fees or assessments. In these circumstances, the liability for the fees and assessments rests with the policyholder rather than with the reporting entity. The reporting entity’s obligation is to collect and subsequently remit the fee or assessment. When both the following conditions are met, an assessment shall not be reported in the statement of operations of a reporting entity:

a. The assessment is reflected as a separately identifiable item on the billing to the policyholder; and

b. Remittance of the assessment by the reporting entity to the state or federal agency is contingent upon collection from the insured.
Disclosures

11. Describe the nature of any assessments that could have a material financial effect and state the estimate of the liability or that an estimate cannot be made. To the extent assessments have been accrued disclose the amounts of the liabilities, any related asset for premium tax credits or policy surcharges, the periods over which the assessments are expected to be paid, and the period over which the recorded premium tax offsets or policy surcharges are expected to be realized.

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

Relevant Literature

13. This statement rejects GAAP guidance for recording guaranty fund and other assessments, which is contained in AICPA Statement of Position 97-3, Accounting by Insurance and Other Enterprises for Insurance-Related Assessments.

Effective Date and Transition

14. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors.

RELEVANT ISSUE PAPERS

- Issue Paper No. 35—Accounting for Guaranty Fund and Other Assessments
Statement of Statutory Accounting Principles No. 36

Troubled Debt Restructuring

STATUS

Type of Issue: Common Area

Issued: Initial Draft

Effective Date: January 1, 2001

Affects: No other pronouncements

Affected by: No other pronouncements

Interpreted by: INT 02-03, INT 03-12

SCOPE OF STATEMENT

SUMMARY CONCLUSION

Accounting by Debtors

Accounting by Creditors

Disclosure by Debtors

Disclosure by Creditors

Relevant Literature

Effective Date and Transition

AUTHORITATIVE LITERATURE

Statutory Accounting

Generally Accepted Accounting Principles

RELEVANT ISSUE PAPERS
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Troubled Debt Restructuring

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for troubled debt restructuring.

SUMMARY CONCLUSION

2. A troubled debt restructuring is defined as a debt restructuring whereby the creditor, for economic or legal reasons related to the debtor’s financial difficulties, grants a concession to the debtor that it would not otherwise grant. That concession either stems from an agreement between the creditor and the debtor or is imposed by law or a court. Many troubled debt restructurings involve modifying terms to reduce or defer cash payments required of the debtor in the near future to help the debtor attempt to improve its financial condition and eventually be able to pay the creditor. The creditor, for example, may accept cash, other assets, or an equity interest in the debtor in satisfaction of the debt though the value received is less than the amount of the debt, because the creditor concludes the concession will maximize recovery of its investment. A debtor in a troubled debt restructuring can obtain funds from sources other than the existing creditor, if at all, only at effective interest rates (based on market prices) so high that it cannot afford to pay them. A troubled debt restructuring shall include debt that is fully satisfied by foreclosure, repossession, or other transfer of assets or by grant of equity securities by the debtor that is, in a technical sense, not restructured.

3. The determination of whether a debt restructuring is considered a troubled debt restructuring, as defined above, shall be made independently for the debtor and the creditor.

4. A debt restructuring shall not necessarily be considered a troubled debt restructuring for purposes of this statement even if the debtor is experiencing some financial difficulties. In general, a debtor that can obtain funds from sources other than the existing creditor at market interest rates at or near those for nontroubled debt is not involved in a troubled debt restructuring. For example, a troubled debt restructuring is not involved if:

   a. The fair value of cash, other assets, or an equity interest accepted by a creditor from a debtor in full satisfaction of its receivable at least equals the creditor’s recorded investment in the receivable;

   b. The fair value of cash, other assets, or an equity interest transferred by a debtor to a creditor in full settlement of its payable at least equals the debtor’s carrying amount of the payable;

   c. The creditor reduces the effective interest rate on the debt primarily to reflect a decrease in market interest rates in general or a decrease in the risk so as to maintain a relationship with a debtor that can readily obtain funds from other sources at the current market interest rate;

   d. The debtor issues, in exchange for its debt, new marketable debt having an effective interest rate based on its market price that is at or near the current market interest rates of debt with similar maturity dates and stated interest rates issued by nontroubled debtors; or

   e. The debtor, in connection with bankruptcy proceedings, enters into debt restructuring that results in a general restatement of most of the debtor’s liabilities.
5. A debtor shall account for a troubled debt restructuring according to the type of the restructuring (transfer of assets in full settlement, grant of equity interest in full settlement, modification of terms or combination of types). Generally, troubled debt restructuring involving the transfer of assets or the grant of an equity interest shall be accounted for at the fair value of the assets transferred or the equity interest granted.

6. A debtor in a troubled debt restructuring involving only modification of terms of a payable—that is, not involving a transfer of assets or grant of an equity interest—shall account for the effects of the restructuring prospectively from the time of restructuring, and shall not change the carrying amount of the payable at the time of the restructuring unless the carrying amount exceeds the total future cash payments specified by the new terms. That is, the effects of changes in the amounts or timing (or both) of future cash payments designated as either interest or face amount shall be reflected in future periods. Interest expense shall be computed in a way that a constant effective interest rate is applied to the carrying amount of the payable at the beginning of each period between restructuring and maturity. The new effective interest rate shall be the discount rate that equates the present value of the future cash payments specified by the new terms (excluding amounts contingently payable) with the carrying amount of the payable.

7. If the total future cash payments specified by the new terms of a payable, including both payments designated as interest and those designated as face amount, are less than the carrying amount of the payable, the debtor shall reduce the carrying amount to an amount equal to the total future cash payments specified by the new terms and shall recognize a gain on restructuring of payables equal to the amount of the reduction. Thereafter, all cash payments under the terms of the payable shall be accounted for as reductions of the carrying amount of the payable, and no interest expense shall be recognized on the payable for any period between the restructuring and maturity of the payable.

8. A debtor shall not recognize a gain on a restructured payable involving indeterminate future cash payments as long as the maximum total future cash payments may exceed the carrying amount of the payable. Amounts designated either as interest or as face amount by the new terms may be payable contingent on a specified event or circumstance (e.g., the debtor may be required to pay specified amounts if its financial condition improves to a specified degree within a specified period). To determine whether the debtor shall recognize a gain according to the provisions of paragraphs 6 and 7, those contingent amounts shall be included in the “total future cash payments specified by the new terms” to the extent necessary to prevent recognizing a gain at the time of restructuring that may be offset by future interest expense. Thus, the debtor shall apply SSAP No. 5—Liabilities, Contingencies and Impairments of Assets (SSAP No. 5) in which probability of occurrence of a gain contingency is not a factor and shall assume that contingent future payments will have to be paid. The same principle applies to amounts of future cash payments that must sometimes be estimated to apply the provisions of paragraphs 6 and 7. For example, if the number of future interest payments is flexible because the face amount and accrued interest is payable on demand or becomes payable on demand, estimates of total future cash payments shall be based on the maximum number of periods possible under the restructured terms.

9. If a troubled debt restructuring involves amounts contingently payable, those contingent amounts shall be recognized as a payable and as interest expense in future periods in accordance SSAP No. 5. Thus, in general, interest expense for contingent payments shall be recognized in each period in which (a) it is probable that a liability has been incurred and (b) the amount of that liability can be reasonably estimated. Before recognizing a payable and interest expense for amounts contingently payable, however, accrual or payment of those amounts shall be deducted from the carrying amount of the restructured payable to the extent that contingent payments included in “total future cash payments specified by the new terms” prevented recognition of a gain at the time of restructuring (paragraph 8).
Accounting by Creditors

10. 10. A creditor shall account for a troubled debt restructuring according to the type of the restructuring (receipt of assets in full satisfaction, modification of terms, combination of types). Generally, troubled debt restructuring involving the transfer of assets shall be accounted for at the fair value of the assets received. Troubled debt restructuring involving modification of terms shall be accounted for at fair value (as determined by acceptable appraisal methodologies or, if applicable, the value determined in accordance with the NAIC Purposes and Procedures of the Securities Valuation Office (SVO Purposes and Procedures)). If the restructured loan is collateral dependent, fair value shall be the fair value of the collateral. If the restructured loan is not collateral dependent, fair value shall be determined in accordance with the SVO Purposes and Procedures, if applicable, or at the present value of expected future cash flows. If the determined fair value of the loan is less than the recorded investment in the loan (including accrued interest, net deferred loan fees or costs, and unamortized premium or discount), a new cost basis shall be established at the fair value with the difference being recorded as a realized loss in the statement of operations. After the troubled debt restructuring, a creditor shall account for the assets consistent with the statutory guidance for such assets.

11. 11. A creditor shall account for assets, including foreclosed property and equity interests in corporations, joint ventures, or partnerships, received in satisfaction of the loan at their fair value (as determined by acceptable appraisal methodologies or, if applicable, the value determined in accordance with the SVO Purposes and Procedures) at the time of restructuring or at the book value of the loan if lower. If the fair value is less than the book value, the required writedown shall be recognized as a realized capital loss. The creditor shall reclassify the asset from loans to the appropriate asset account, such as real estate or other invested assets, at the time that the creditor obtains clear title to the asset except for mortgage loans which shall be reclassified at the beginning of the redemption period unless it is probable that the mortgage loan will be redeemed. After the troubled debt restructuring, a creditor shall account for the assets received in satisfaction of the loan consistent with the statutory guidance for similar assets.

12. 12. Any fees received in connection with a modification of terms of a troubled debt restructuring shall be applied as a reduction of the recorded investment in the loan. All costs associated with the restructuring, including direct loan origination costs, shall be charged to expense as incurred.

Disclosure by Debtors

13. 13. A debtor in a troubled debt restructuring shall disclose in the financial statements the following information about troubled debt restructurings that have occurred during a period for which financial statements are presented:

   a. For each restructuring or separate restructuring within a fiscal period for the same category of payables, (e.g., accounts payable or subordinated debentures), a description of the principal changes in terms, the major features of settlement, or both;

   b. Aggregate gain on restructuring of payables and the related income tax effect; and

   c. Aggregate net gain or loss on transfers of assets recognized during the period.

14. 14. A debtor shall disclose in financial statements for periods after a troubled debt restructuring the extent to which amounts contingently payable are included in the carrying amount of restructured payables. A debtor shall also disclose total amounts that are contingently payable on restructured payables and the conditions under which those amounts would become payable or would be forgiven.

15. 15. Refer to the preamble for further discussion regarding disclosure requirements.
Disclosure by Creditors

16. A creditor shall disclose in the financial statements the following information about troubled debt restructuring as of the date of each balance sheet presented:
   a. As of the date of each statement of financial position presented, the recorded investment in the loans for which impairment has been recognized in accordance with this statement and the related realized capital loss;
   b. The amount of commitments, if any, to lend additional funds to debtors owing receivables whose terms have been modified in troubled debt restructuring; and
   c. The creditor’s income recognition policy for interest income on an impaired loan.

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

18. This statement is not intended to modify the requirement for life and health insurers to complete the Annual Statement exhibit disclosing long-term mortgage loans in good standing with restructured terms.

Relevant Literature

19. This statement adopts FASB Statement No. 15, Accounting by Debtors and Creditors for Troubled Debt Restructurings (FAS 15) with modification to specify that creditors shall reclassify assets obtained in a troubled debt restructuring from loans to the appropriate asset account at the time the creditor obtains clear title to the asset, except for mortgage loans which shall be reclassified at the beginning of the redemption period unless it is probable that the mortgage loan will be redeemed and with modification to require that gains and losses from extinguishment of debt be reported as capital gains or losses, and charged to operations.

20. This statement adopts paragraphs 9, 22, and 25 of FASB Statement No. 114, Accounting by Creditors for Impairment of a Loan (FAS 114). Paragraphs 6 d., 13 and 21 of FAS 114 are rejected. FASB Statement No. 118, Accounting by Creditors for Impairment of a Loan—Income Recognition and Disclosures is adopted as it relates to troubled debt restructuring.


22. Although FASB Statement No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases (FAS 91) was rejected in SSAP No. 26—Bonds, excluding Loan-backed and Structured Securities, this statement is consistent with paragraph 14 of FAS No. 91.

Effective Date and Transition

24. This statement is effective for years beginning January 1, 2001. The provisions of this statement shall be applied to all troubled debt restructurings entered into on or after January 1, 2001.

AUTHORITATIVE LITERATURE

Statutory Accounting

- NAIC Purposes and Procedures of the Securities Valuation Office

Generally Accepted Accounting Principles

- FASB Statement No. 15, Accounting by Debtors and Creditors for Troubled Debt Restructurings
- FASB Statement No. 114, Accounting by Creditors for Impairment of a Loan, Paragraphs 9, 22 and 25
- FASB Statement No. 118, Accounting by Creditors for Impairment of a Loan—Income Recognition and Disclosures, as it relates to troubled debt restructurings
- FASB Technical Bulletin 80-2, Classification of Debt Restructuring by Debtors and Creditors
- FASB Technical Bulletin 81-6, Applicability of Statement 15 to Debtors in Bankruptcy Situations
- FASB Emerging Issues Task Force No. 87-18, Use of Zero Coupon Bonds in a Troubled Debt Restructuring
- FASB Emerging Issues Task Force No. 87-19, Substituted Debtors in a Troubled Debt Restructuring
- FASB Emerging Issues Task Force No. 89-15, Accounting for a Modification of Debt Terms When the Debtor is Experiencing Financial Difficulties
- FASB Emerging Issues Task Force No. 96-22, Applicability of the Disclosures Required by FASB Statement No. 114 When a Loan Is Restructured in a Troubled Debt Restructuring into Two (or More) Loans

RELEVANT ISSUE PAPERS

- Issue Paper No. 36—Troubled Debt Restructurings
Statement of Statutory Accounting Principles No. 37

Mortgage Loans

STATUS

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Issued: Initial Draft
Effective Date: January 1, 2001
Affects: No other pronouncements
Affected by: No other pronouncements
Interpreted by: INT 99-04, INT 02-03, INT 02-07

SCOPE OF STATEMENT

SUMMARY CONCLUSION

Commitment Fees
Loan Origination Fees
Loan Origination, Acquisition, and Commitment Costs
Initial Investment
Amortization
Prepayments
Interest Income
Accrued Interest
Impairments
Escrow Payments
Construction Loans
Disclosures
Relevant Literature
Effective Date and Transition

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

RELEVANT ISSUE PAPERS
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Mortgage Loans

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for the accounting and reporting of mortgage loans and related fees.

SUMMARY CONCLUSION

2. A mortgage loan is defined as a debt obligation that is not a security, which is secured by a mortgage on real estate. (A security is a share, participation, or other interest in property or in an enterprise of the issuer or an obligation of the issuer that (a) either is represented by an instrument issued in bearer or registered form, or if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer, (b) is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment, and (c) either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations).

3. Mortgage loans meet the definition of assets as specified in SSAP No. 4—Assets and Nonadmitted Assets and are admitted assets to the extent they conform to the requirements of this statement.

Commitment Fees

4. Commitment (or commitment standby) fees are fees paid to the reporting entity that obligate the reporting entity to make or acquire a loan or to satisfy an obligation of another party under a specified condition. A fee paid to the reporting entity to obtain a commitment to make funds available at some time in the future, generally, is refundable only if the loan is granted. If the loan is not granted, then the fees shall be recorded as investment income by the reporting entity when the commitment is no longer available.

5. A fee paid to the reporting entity to obtain a commitment to be able to borrow funds at a specified rate and with specified terms quoted in the commitment agreement, generally, is not refundable unless the commitment is refused by the reporting entity. This type of fee shall be deferred, and amortization shall depend on whether or not the commitment is exercised. If the commitment is exercised, then the fee shall be amortized in accordance with paragraph 9 over the life of the loan as an adjustment to the investment income on the loan. If the commitment expires unexercised, the commitment fee shall be recognized in income on the commitment expiration date.

Loan Origination Fees

6. Loan origination fees are defined as fees charged to the borrower in connection with the process of originating, refinancing, or restructuring a loan. The term includes, but is not limited to, points, management, arrangement, placement, application, underwriting, and other fees pursuant to a lending transaction. Nonrefundable loan origination fees shall not be recorded until received in cash. Nonrefundable fees representing points shall be deferred as part of the loan balance and amortized over the life of the loan in accordance with paragraph 9 below. Nonrefundable fees other than points shall be recorded in income upon receipt.

Loan Origination, Acquisition, and Commitment Costs

7. All costs incurred in connection with originating a loan, acquiring purchased loans or committing to purchase loans shall be charged to expense as incurred.
Initial Investment

8. For mortgage loans originated by the reporting entity, the initial investment in mortgage loans shall be recorded at the principal amount of the loan net of any amounts deferred under the provisions of paragraphs 5 and 6. For mortgage loans purchased by an reporting entity, the initial investment shall be recorded as the amount paid to the seller. Accordingly, there may be a premium or discount on such loans resulting from a difference between the amount paid and the principal amount.

Amortization

9. Premiums and discounts on acquired loans, and mortgage interest points and commitment fees (if such qualify for amortization as described in paragraphs 5 and 6) shall be recognized as an adjustment of yield over the life of the loan (i.e., the period of time until total principal proceeds of the loan are received in cash) to produce a constant effective yield each year to maturity. If the reporting entity holds a large number of similar loans for which the prepayments of principal are probable, (probable is used in the same context as in paragraph 5 in SSAP No. 5—Liabilities, Contingencies and Impairments of Assets, which defines probable as the future event or events are likely to occur), and the timing and amount can be reasonably estimated, the reporting entity shall include estimates of future principal prepayments in the calculation of the constant effective yield necessary to apply the interest method. The amount recognized as an adjustment of yield shall be credited or charged to interest income in the calculation of net investment income.

Prepayments

10. Payments received in advance of due dates may produce prepaid interest which shall be recorded as a liability, Unearned Investment Income, on the reporting entity’s balance sheet. The portion of the payments received in advance of due dates that represents prepayments of principal shall be recorded as a reduction in the mortgage loan balance.

11. A mortgage loan may provide for a prepayment penalty or acceleration fee in the event the loan is liquidated prior to its scheduled termination date. Such fees shall be reported as investment income when received.

Interest Income

12. Interest income shall be recorded as earned and shall be included in investment income in the Summary of Operations. Interest income shall include interest collected, the change in interest income due and accrued, and the change in unearned interest income as well as amortization of premiums, discounts, and deferred fees as specified in paragraph 9.

Accrued Interest

13. Reporting entities that use servicing agents for their mortgage loans shall report the Interest Due and Accrued asset on the balance sheet consistently with the income statement treatment of the charge for servicing costs. If interest income is reported net of servicing costs, which is usual when the servicing agent fee is based on a percentage retention of each interest payment, then the interest receivable in the balance sheet shall be net of the related servicing costs. If interest is reported gross, with the servicing costs reported as an expense item, then interest due and accrued shall be reflected as an asset at the gross amount, with an appropriate liability to reflect the related servicing cost accrual.

14. When a loan is determined to be in default (per the contractual terms of the loan), the accrued interest on the loan shall be recorded as investment income due and accrued if deemed collectible. If a loan in default has any investment income due and accrued which is 180 days past due and collectible, the investment income shall continue to accrue, but all interest related to the loan is to be reported as a
nonadmitted asset. If accrued interest on a mortgage loan in default is not collectible, the accrued interest shall be written off immediately and no further interest accrued.

15. Contingent interest represents income generated through the occurrence of specific economic events in relation to the borrower. For example, contingent interest may become payable upon the attainment of a given level of cash flow or income. Contingent interest may be reported as income when received or accrued. The proper accrual of such income does, however, require an analysis of the applicable provisions in the underlying agreement and the verification that the prerequisite conditions have been met.

Impairments

16. A mortgage loan shall be considered to be impaired when, based on current information and events, it is probable that an reporting entity will be unable to collect all amounts due according to the contractual terms of the mortgage agreement. According to the contractual terms means that both the contractual principal payments and contractual interest payments of the mortgage loan will be collected as scheduled in the mortgage agreement. A reporting entity shall measure impairment based on the fair value (as determined by acceptable appraisal methodologies) of the collateral less estimated costs to obtain and sell. The difference between the net value of the collateral and the recorded investment in the mortgage loan shall be recognized as an impairment by creating a valuation allowance with a corresponding charge to unrealized loss or by adjusting an existing valuation allowance for the impaired loan with a corresponding charge or credit to unrealized gain or loss. Subsequent to the initial measurement of impairment, if there is a significant change (increase or decrease) in the net value of the collateral, the reporting entity shall adjust the valuation allowance; however, the net carrying amount of the loan shall at no time exceed the recorded investment in the loan. For reporting entities required to maintain an asset valuation reserve (AVR), the unrealized gain or loss on impairments shall be included in the calculation of the AVR. If the impairment is other than temporary, a direct write down shall be recognized as a realized loss, and a new cost basis is established. This new cost basis shall not be changed for subsequent recoveries in value. Mortgage loans for which foreclosure is probable shall be considered permanently impaired.

17. For loans that are in default, being voluntarily conveyed, or being foreclosed, the carrying value shall be adjusted for additional expenses, such as insurance, taxes, and legal fees that have been incurred to protect the investment or to obtain clear title to the property to the extent that these amounts are deemed to be recoverable from the ultimate disposition of the property. However, if these costs cannot reasonably be expected to be recovered, they shall not be added to the carrying value, and the costs shall be expensed.

Escrow Payments

18. Amounts paid to the reporting entity by the mortgagor to cover future tax payments, insurance premiums, and other costs related to the property requires the creation of escrow accounts in the general ledger to record these liabilities. If these amounts are held by the servicing agents, they shall be reported on the reporting entity’s balance sheet both as an asset and as a liability when they produce income for the reporting entity. This may occur if the servicing agent invests the escrow funds and is required to remit the income (or portion thereof) to the reporting entity.
Construction Loans

19. A construction loan is defined as a mortgage loan of less than three years in term, made for financing the cost of construction of a building or other improvement to real estate, which is secured by the real estate. The principal amount of a construction loan shall be the amount of funds disbursed to the borrower. If, in accordance with the terms of the contract, interest is deferred until the maturity of the loan, the accrued interest shall be included in the balance of the loan outstanding. The impairment test in paragraph 16 shall be applied to all construction loans, regardless of whether there are any defaults. Accordingly, construction loans shall not be reported at an amount greater than the fair value of the property. The percentage of completion of the property shall be considered in determining fair values of property securing construction loans.

Disclosures

20. The following disclosures shall be made in the financial statements:

a. Fair values in accordance with SSAP No. 27—Disclosure of Information About Financial Instruments with Off-Balance-Sheet Risk, Financial Instruments with Concentrations of Credit Risk and Disclosures about Fair Value of Financial Instruments (SSAP No. 27);

b. Concentrations of credit risk in accordance with SSAP No. 27;

c. Description of the valuation basis of the mortgage loans;

d. Information on the minimum and maximum rates of interest received for new loans made by category;

e. Maximum percentage of any one loan to the value of security at the time of the loan;

f. Total carrying amount of mortgages with interest 180 days past due and the amount of interest past due thereon. The carrying amount and number of mortgage loans where interest has been reduced, by percent reduced; and

g. Taxes, assessments, and amounts advanced not included in the mortgage loan total.

21. The following additional disclosures shall be made for impaired loans:

a. The total recorded investment in impaired loans at the end of each period and (i) the amount of that recorded investment for which there is a related allowance for credit losses determined in accordance with this statement and the amount of that allowance and (ii) the amount of that recorded investment for which there is no related allowance for credit losses determined in accordance with this statement;

b. The policy for recognizing interest income on impaired loans, including how cash receipts are recorded;

c. For each period for which results of operations are presented, the average recorded investment in the impaired loans during each period, the related amount of interest income recognized during the time within that period that the loans were impaired, and, unless not practicable, the amount of interest income recognized using a cash-basis method of accounting during the time within that period that the loans were impaired; and

d. For each period for which results of operations are presented, the activity in the allowance for credit losses account, including the balance in the allowance for credit losses account at the beginning and end of each period, additions charged to operations,
direct write-downs charged against the allowance, and recoveries of amounts previously charged off.

22. Refer to the preamble for further discussion regarding disclosure requirements. The disclosure requirements of paragraphs 20 a. and 20 b. shall be included in the annual audited statutory financial reports only.

Relevant Literature

23. This statement adopts FASB Statement No. 114, Accounting by Creditors for Impairment of a Loan (FAS 114), and FASB Statement No. 118, Accounting by Creditors for Impairment of a Loan—Income Recognition and Disclosures, an amendment of FASB Statement No. 114, for collateral dependent loans with the following modifications:

   a. Impairment shall be measured based on the fair value of the collateral less costs to obtain and sell, whereas that is just one option under FAS 114; and

   b. The reporting entity is required to record any other than temporary impairment as a realized loss and shall not record subsequent recoveries in fair value.

24. This statement also adopts FASB Emerging Issues Task Force Issue No. 84-19, Mortgage Loan Payment Modifications.

25. This statement rejects FASB Statement No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases, FASB Emerging Issues Task Force No. 88-17, Accounting for Fees and Costs Associated with Loan Syndications and Loan Participations, and AICPA Practice Bulletin 6, Amortization of Discounts on Certain Acquired Loans.

Effective Date and Transition

26. This statement is effective for years beginning January 1, 2001. Initial recognition of the impairment losses resulting from the application of this statement shall apply to mortgage loans held at January 1, 2001, and be based on management’s best estimates as of that date. 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—Accounting Changes and Corrections or Errors.

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

- FASB Statement No. 114, Accounting by Creditors for Impairment of a Loan
- FASB Statement No. 118, Accounting by Creditors for Impairment of a Loan—Income Recognition and Disclosures, an amendment of FASB Statement No. 114
- FASB Emerging Issues Task Force No. 84-19, Mortgage Loan Payment Modifications

RELEVANT ISSUE PAPERS

- Issue Paper No. 37—Mortgage Loans
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Statement of Statutory Accounting Principles No. 38

Acquisition, Development and Construction Arrangements

STATUS

Type of Issue: Common Area

Issued: Initial Draft

Effective Date: January 1, 2001

Affects: No other pronouncements

Affected by: No other pronouncements

Interpreted by: INT 99-15

SCOPE OF STATEMENT

SUMMARY CONCLUSION

Relevant Literature

Effective Date and Transition

AUTHORITATIVE LITERATURE

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Acquisition, Development and Construction Arrangements

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for real estate acquisition, development and construction (ADC) arrangements and provides guidance on when to account for ADC arrangements as mortgage loans and when to account for ADC arrangements as investments in real estate or real estate joint ventures.

SUMMARY CONCLUSION

2. ADC arrangements shall be defined as lending agreements that are made to the owner of property to finance the acquisition, development and construction of real estate projects on the property in which the lender participates in the expected residual profits. Expected residual profit is the amount of profit, whether called interest or another name (e.g., equity kicker) above a reasonable amount of interest and fees expected to be earned by the lender. ADC arrangements shall include participations in loans and purchased loans that meet that definition of ADC arrangements.

3. If the lender is expected to receive over 50% of the expected residual profits of the project, the ADC arrangement shall be classified and accounted for as an investment in real estate in accordance with SSAP No. 40—Real Estate Investments. If the lender is expected to receive 50% or less of the expected residual profits, the ADC arrangement shall be classified and accounted for as a loan or as a real estate joint venture, depending on the circumstances.

4. If any of the characteristics in paragraph 9 b. through 9 e. of AcSEC Practice Bulletin 1, “Exhibit I, ADC Arrangements” (PB1), or if a qualifying personal guarantee (as defined in PB1) is present, the ADC arrangement shall be classified and accounted for as a construction loan in accordance with SSAP No. 37—Mortgage Loans. Otherwise, the ADC arrangement shall be classified and accounted for as a real estate joint venture in accordance with SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies.

5. The factors that are evaluated in determining the accounting treatment at inception may subsequently change for some ADC arrangements, for example, as a result of a renegotiation of the terms. Consequently, the accounting treatment for an ADC arrangement shall be periodically reassessed, as described in paragraph 20 of PB1. Any changes in classification shall result in a reclassification of the asset at the amount the asset should be reported at under its new classification with the net effect, if any, charged to income in the period that the change in classification is made.

6. Regardless of whether an ADC arrangement is accounted for as an investment in real estate, a joint venture, or a mortgage loan, the ADC arrangement meets the definition of an asset as defined in SSAP No. 4—Assets and Nonadmitted Assets and is an admitted asset to the extent it conforms to the requirements of this statement.

7. ADC arrangements may involve related parties, in which case, SSAP No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties shall also be followed.

Relevant Literature

8. This statement adopts PB1, “Exhibit I, ADC Arrangements” and FASB Emerging Issues Task Force No. 86-21, Application of the AICPA Notice to Practitioners regarding Acquisition, Development, and Construction Arrangements to Acquisition of an Operating Property.
Effective Date and Transition

9. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors.

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

- AcSEC Practice Bulletin 1, “Exhibit I, ADC Arrangements”

- FASB Emerging Issues Task Force No. 86-21, Application of the AICPA Notice to Practitioners regarding Acquisition, Development, and Construction Arrangements to Acquisition of an Operating Property

RELEVANT ISSUE PAPERS

- Issue Paper No. 38—Acquisition, Development and Construction Arrangements
# Statement of Statutory Accounting Principles No. 39

## Reverse Mortgages

### STATUS

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Reverse Mortgages

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for reverse mortgages.

SUMMARY CONCLUSION

2. A reverse mortgage loan is defined as a non-recourse loan with the following characteristics:
   a. It is secured by a mortgage against the primary residence of the borrower;
   b. It guarantees a stream of cash disbursements to the borrower, either for the life of the borrower with no limit or up to a set percentage of the value of the residence or as a line of credit which the borrower can draw upon as needed; and
   c. It has no maturity date and requires no repayment until one of the following events occur:
      i. The borrower dies;
      ii. The borrower sells the residence;
      iii. The residence ceases to be the borrower’s primary residence; or
      iv. The borrower terminates the loan by paying back the outstanding balance.

3. A reverse mortgage meets the definition of an asset as defined in SSAP No. 4—Assets and Nonadmitted Assets and is an admitted asset to the extent it conforms to the requirements of this statement. Reverse mortgages shall be recorded as an other invested asset on the reporting entity’s statement of financial position and Schedule BA, Other Long-Term Invested Assets, of the Annual Statement.

4. To be considered admitted assets, investments in reverse mortgages are limited to first lien mortgages only.

5. All expenses associated with acquiring reverse mortgages shall be recognized immediately as investment expense.

6. Revenue associated with originating or otherwise acquiring reverse mortgages, including non-refundable fees, shall be amortized to investment income on a straight line basis over the period from inception to the expected maturity date.

7. Generally, fees are not paid by the borrower at the time of closing but become payable when the outstanding balance of the reverse mortgage becomes due. In these situations, no accounting entries are recorded at the time of closing. Investment income shall be recognized and the outstanding balance of the loan shall increase as the fees are amortized.

8. If fees are paid by the borrower at the time of closing, a liability shall be established. Investment income shall be recognized and the liability shall decrease as the fees are amortized.

9. Interest is payable by the borrower when the outstanding balance of the reverse mortgage becomes due. Accrued interest shall be calculated on the outstanding balance of the loan on a monthly basis. As it is earned, accrued interest shall be recorded to investment income and added to the outstanding balance of the loan.
10. The outstanding balance of the reverse mortgage shall include the accumulation of amounts disbursed, accrued interest, and amortized origination fees (i.e., origination fees not paid by the borrower at the time of closing). Neither the fair value of the underlying collateral nor the obligation for future cash payments guaranteed by the lender are recorded.

11. The lender’s equity in the appreciation of the property, if any, is not recorded until realized upon the sale of the home.

Valuation and Impairment

12. The major categories of risk affecting reverse mortgages are:

a. Mortality risk—risk of loan payments extending beyond the borrower’s original projected life expectancy. Since most reverse mortgages guarantee a continuing monthly payment to the borrower, there is the possibility that the borrower will collect cash payments and accrue interest exceeding the ultimate disposal value of the collateral. In situations where loan payments extend beyond the borrower’s original projected life expectancy, the reporting entity will experience a diminished yield, and may experience a loss. Reverse mortgage contracts shall be combined into groups which are of sufficient size to provide an actuarially and statistically credible basis for estimating life expectancy to project future cash flows;

b. Collateral risk—risk of deterioration in the value of the collateral such that it is insufficient to cover the loan balance. This risk shall be evaluated loan-by-loan and is based on information obtained from periodic real estate appraisals and other pertinent information;

c. Interest rate risk—risk of interest rates rising on adjustable rate reverse mortgages to the extent that accrued interest creates a collateral risk.

13. Reverse mortgages subject to the risks addressed in paragraph 12 shall be reported net of an appropriate actuarially calculated valuation reserve. Assumptions shall be applied consistently to similar loans. The assumptions, cash flow projections, and evaluation of risk shall be reviewed and updated at least annually. The fair value of the underlying collateral and the obligation for future cash payments guaranteed by the lender shall be considered in cash flow projections. Future appreciation in property value beyond the valuation date shall not be included in the projection of cash receipts.

14. If the impairment is temporary, any resulting adjustment shall be made to the valuation reserve (contra-asset) and unrealized gains and losses. Subsequent to the initial measurement of impairment, if there is a significant change (increase or decrease) in the risk factors affecting the value of the mortgage, the reporting entity shall adjust the valuation allowance in accordance with paragraph 13; however, the net carrying amount of the loan shall at no time exceed the recorded investment in the loan. The term recorded investment in the loan is distinguished from net carrying amount of the loan because the latter term is net of the valuation allowance, while the former term is not. The recorded investment (including accrued interest, net deferred loan fees, and unamortized premium or discount) in the loan does, however, reflect any direct write down of the investment. If the impairment is other than temporary, the investment shall be written down to fair value as the new cost basis and the amount of the write down shall be accounted for as a realized loss. The new basis shall not be changed for subsequent recoveries in fair value. A reverse mortgage shall be considered to be impaired when, based on current information and events, it is probable that the reporting entity will be unable to collect all amounts due according to the contractual terms of the reverse mortgage. “According to the contractual terms” means that both the contractual principal payments and contractual interest payments of the loan will be collected as specified in the reverse mortgage agreement.
Disclosures

15. The following disclosures shall be made for reverse mortgages in the financial statements:

   a. A description of the reporting entity’s accounting policies and methods, including the statistical methods and assumptions used in calculating the reserve;
   b. General information regarding the reporting entity’s commitment under the agreement;
   c. The reserve amount which is netted against the asset value;
   d. Investment income or loss recognized in the period as a result of the re-estimated cash flows.

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

Effective Date and Transition

17. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors.

RELEVANT ISSUE PAPERS

• Issue Paper No. 39—Reverse Mortgages
Statement of Statutory Accounting Principles No. 40

Real Estate Investments

STATUS
Type of Issue: Common Area
Issued: Initial Draft
Effective Date: January 1, 2001
Affects: No other pronouncements
Affected by: Paragraphs 16 and 17 superseded by SSAP No. 77

SCOPE OF STATEMENT

SUMMARY CONCLUSION

Income, Expenses, and Capital Improvements
Sale of Real Estate
Real Estate Projects Under Development
Disclosures
Relevant Literature
Effective Date and Transition

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

RELEVANT ISSUE PAPERS
Real Estate Investments

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for real estate investments.

SUMMARY CONCLUSION

2. Real estate investments are defined as directly-owned real estate properties. These may be acquired in exchange for consideration (including but not limited to cash, a contract for deed or mortgage, or other non-cash consideration), obtained through foreclosure or voluntary conveyance in satisfaction of a mortgage loan, or received as contributed surplus. Real estate investments meet the definition of assets 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.

3. Real estate investments include certain acquisition, development and construction arrangements (ADC) as defined in SSAP No. 38—Acquisition, Development and Construction Arrangements (SSAP No. 38).

4. Real estate investments shall be reported net of encumbrances in the following balance sheet categories, with parenthetical disclosure of the amount of related encumbrances:

   a. Properties occupied by the company;
   b. Properties held for the production of income; and
   c. Properties held for sale.

5. Any real estate which is owned by and is more than 50% occupied by the reporting entity and its affiliates shall be considered property occupied by the company. “More than 50% occupied” shall mean that the square footage occupied by the reporting entity and its affiliates totals more than 50% of the rentable square footage of the property, including common areas. This shall include property occupied by the company which is not necessarily home office (e.g., claims processing, data processing and branch centers). Property which does not meet this 50% requirement shall be classified as property held for the production of income or property held for sale, consistent with paragraphs 9 and 10.

6. Encumbrances represent outstanding mortgages or other debt related to the real estate investment and any unpaid accrued acquisition or construction costs. Interest expense shall be included in investment expenses.

7. The cost of real estate represents the fair value of the consideration exchanged plus any costs incurred to place the real estate asset in usable condition, including but not limited to, brokerage fees, legal fees, demolition, clearing and grading, fees of architects and engineers, any additional expenditures made for equipment and fixtures that are made a permanent part of the structure and certain interest costs as provided for in SSAP No. 44—Capitalization of Interest. Where cost includes both land and building, the cost shall be allocated among the assets purchased based on the relative values determined using appraisals, as described in paragraph 11 below. The cost shall be reduced by any amounts received for sales of rights or privileges in connection with the property or by any cash recoveries received after acquiring title to the property. The cost of real estate which has been foreclosed upon shall be initially established in accordance with SSAP No. 36—Troubled Debt Restructuring. The cost of contributed real estate shall be initially established in accordance with SSAP No. 28—Nonmonetary Transactions as a nonreciprocal transfer.
8. The cost of property included in real estate investments, other than land, shall be depreciated over the estimated useful life, not to exceed fifty years. Depreciation expense shall be included in investment expenses.

9. Properties occupied by the company and properties held for the production of income shall be carried at depreciated cost less encumbrances unless events or circumstances indicate the carrying amount of the asset (amount prior to reduction for encumbrances) may not be recoverable. Paragraph 5 of FASB Statement No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of (FAS 121), provides examples of events or changes in circumstances which indicate that the recoverability of the carrying amount of properties occupied by the company or properties held for the production of income should be assessed. If the events or changes in circumstances set forth in paragraph 5 of FAS 121 are present or if other events or changes in circumstances indicate that the carrying amount of properties occupied by the company or properties held for the production of income may not be recoverable, the entity shall determine whether an impairment loss must be recognized in accordance with paragraph 6 of FAS 121. Property occupied by the company shall be evaluated using the asset grouping approach of paragraph 8 of FAS 121. An impairment loss is measured as the amount by which the individual carrying amounts exceed the fair value of properties occupied by the company or properties held for the production of income. Fair value is determined in accordance with paragraph 11 of this statement. If the fair value of the asset is less than the carrying value, the asset shall be written down to the fair value thereby establishing a new cost basis. The new cost basis shall not be changed for subsequent recoveries in fair value. The adjustment shall be recorded in the statement of operations as a realized loss.

10. Properties that the reporting entity has the intent to sell or is required to sell shall be classified as properties held for sale and carried at the lower of depreciated cost or fair value less encumbrances and estimated costs to sell the property consistent with paragraph 16 of FAS 121. The intent to sell a property exists when management, having the authority to approve the action, has committed to a plan to dispose of the asset, either by sale or abandonment. Fair value of the asset shall be determined in accordance with paragraph 11 of this statement. Subsequent revisions to the fair value of the asset shall be accounted for in accordance with paragraph 17 of FAS 121.

11. The current fair value of real estate shall be determined on a property by property basis (i.e., increases in the fair value of one property shall not be used to offset declines in fair value of another) and shall be defined as the price that a property would bring in a competitive and open market under all conditions requisite to a fair sale (i.e., the buyer and seller acting prudently and knowledgeably with the price not affected by any undue stimulus). If market quotes are unavailable, estimates of fair value shall be determined by an appraisal (internal or third party), which is based upon an evaluation of all relevant data about the market, considering the following:

a. A physical inspection of the premises;
b. The present value of future cash flows generated by the property (Discounted Cash Flows), or capitalization of stabilized net operating income (Direct Capitalization);
c. Current sales prices of similar properties with adjustments for differences in the properties (Sales Comparison Approach);
d. Costs to sell the property if the reporting entity does not have the intent or ability to hold the real estate as an investment; and
e. Replacement costs of the improvements, less depreciation, plus the value of the land (Cost Approach).
12. For all properties held for the production of income, the reporting entity must maintain an appraisal that is no more than five years old as of the reporting date. For all properties held for sale, an appraisal shall be obtained at the time such property is classified as held for sale, and subsequently an appraisal shall be maintained that is no more than five years old as of the reporting date. However, if conditions indicate there has been a significant decrease in the fair value of a property, a current appraisal shall be obtained. Additionally, appraisals shall be obtained for real estate investments at the time of foreclosure or contribution. Contributed real estate shall be supported by an independent third party appraisal at the date of contribution. If any of the previous conditions exist but an appraisal has not been obtained, the related property shall be considered a nonadmitted asset until the required appraisals are obtained.

Income, Expenses, and Capital Improvements

13. Rental income on real estate leased is addressed in *SSAP No. 22—Leases*, which requires that rental income be included in investment income. Expenses incurred in operating the real estate investment, including but not limited to, real estate taxes, utilities, and ordinary repair and maintenance, shall be charged to expense as incurred and included in investment expenses.

14. Expenditures that are necessary to put the asset back into good operating condition or to keep it in good operating condition, shall be charged to expense as incurred. Expenditures that add to or prolong the life of the property shall be added to the cost of the real estate (capitalized) and depreciated over the remaining estimated useful life of the property.

15. A reporting entity shall include in both its income and expenses an amount for rent relating to its occupancy of its own buildings. The amount recorded shall be at a rate comparable to rent received from others and/or rental rates of like property in the same area. If this is unavailable, it shall be derived from consideration of the repairs, expenses, taxes, and depreciation incurred, plus interest added at an average fair rate on the carrying value of the reporting entity’s investment in its home office building.

Sale of Real Estate

16. Recognition of profit on sales of real estate investments shall be accounted for in accordance with *FASB Statement No. 66, Accounting for Sales of Real Estate* (FAS 66), except as modified in paragraph 17 of this statement, *FASB Emerging Issues Task Force No. 87-9, Profit Recognition on Sales of Real Estate with Insured Mortgages or Surety Bonds* (EITF 87-9), and *FASB Emerging Issues Task Force No. 87-29, Exchange of Real Estate Involving Boot* (EITF 87-29). Profit shall be recognized in full when real estate is sold, provided (a) the profit is determinable, that is, the collectibility of the sales price is reasonably assured or the amount that will not be collectible can be estimated, and (b) the earnings process is virtually complete, that is, the seller is not obliged to perform significant activities after the sale to earn the profit. Unless both conditions exist, recognition of all or part of the profit shall be postponed. Profit shall not be recognized by the full accrual method until all of the following criteria are met:

- A sale is consummated;
- The buyer’s initial and continuing investments are adequate to demonstrate a commitment to pay for the property;
- The seller’s receivable is not subject to future subordination; and
- The seller has transferred to the buyer the usual risks and rewards of ownership in a transaction that is in substance a sale and does not have a substantial continuing involvement with the property after the sale.
17. The calculation of the buyer’s initial investment specified in paragraph 9 of FAS 66 shall be modified to reflect that buyer’s notes must be supported by letters of credit from institutions that are listed by the Securities Valuation Office of the National Association of Insurance Commissioners as meeting credit standards to be included in determining the buyer’s initial investment. Any profit or loss is considered a realized gain or loss in the year of the sale in accordance with FAS 66.

Real Estate Projects Under Development

18. Costs and initial rental operations of real estate projects under development, which include ADC arrangements accounted for as real estate under the provisions of SSAP No. 38, shall be accounted for in accordance with FASB Statement No. 67, Accounting for Costs and Initial Rental Operations of Real Estate Projects (FAS 67). Costs incurred in connection with real estate projects shall be expensed as incurred unless the criteria established in FAS 67 are met. The statement value of a real estate project, or parts thereof, held for sale or development and sale shall not exceed the estimated selling price in the ordinary course of business less estimated costs of completion (to stage of completion assumed in determining the selling price), holding, and disposal (net realizable value). If costs exceed net realizable value, capitalization of eligible costs shall continue, however, an allowance shall be provided to reduce the admitted value to estimated net realizable value.

Disclosures

19. An entity that recognizes an impairment loss shall disclose all of the following in financial statements that include the period of the impairment write-down:
   a. A description of the impaired assets and the facts and circumstances leading to the impairment;
   b. The amount of the impairment loss and how fair value was determined; and
   c. The caption in the statement of operations in which the impairment loss is aggregated.

20. An entity that engages in retail land sales operations shall disclose:
   a. Maturities of accounts receivable for each of the five years following the date of the financial statements;
   b. Delinquent accounts receivable and the method(s) for determining delinquency;
   c. The weighted average and range of stated interest rates of receivables;
   d. Estimated total costs and estimated dates of expenditures for improvements for major areas from which sales are being made over each of the five years following the date of the financial statements; and
   e. Recorded obligations for improvements.

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

Relevant Literature

22. This statement adopts FAS 66, with modification to paragraph 9 to indicate that only letters of credit from institutions listed by the Securities Valuation Office shall be included in determining the buyer’s initial investment. Additionally, as they relate to FAS 66, the following are adopted: FASB
Emerging Issues Task Force Issue No. 86-6, Antispeculation Clauses in Real Estate Sales Contracts, FASB Emerging Issues Task Force No 87-9, Profit Recognition on Sales of Real Estate with Insured Mortgages or Surety Bonds, FASB Emerging Issues Task Force No 87-29, Exchange of Real Estate Involving Boot, FASB Emerging Issues Task Force No. 88-12, Transfer of Ownership Interest as Part of Down Payment under FASB Statement No. 66, and FASB Emerging Issues Task Force No. 88-24, Effect of Various Forms of Financing under FASB Statement No. 66.

23. This statement adopts FASB Emerging Issues Task Force No. 84-17, Profit Recognition on Sales of Real Estate with Graduated Payment Mortgages or Insured Mortgages, FASB Emerging Issues Task Force No. 89-13, Accounting for the Cost of Asbestos Removal, FASB Emerging Issues Task Force No. 89-14, Valuation of Repossessed Real Estate, FASB Emerging Issues Task Force No. 90-8, Capitalization of Costs to Treat Environmental Contamination, and FASB Emerging Issues Task Force No. 95-23, The Treatment of Certain Site Restoration/Environmental Exit Costs When Testing a Long-Lived Asset for Impairment.

24. This statement adopts FAS 121 for real estate investments except for paragraphs 13, 14 c. and 14 d. which are rejected in SSAP No. 68—Business Combinations and Goodwill. This statement also adopts FAS 67, AICPA Statement of Position 92-1, Accounting for Real Estate Syndication Income, and AICPA Statement of Position 92-3, Accounting for Foreclosed Assets.

25. This statement rejects paragraph 52 of FASB Statement No. 60, Accounting and Reporting by Insurance Enterprises and Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins, “Chapter 10, Taxes, Section A—Real Estate and Personal Property Taxes.”

Effective Date and Transition

26. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Correction of Errors.

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

- FASB Statement No. 66, Accounting for Sales of Real Estate
- FASB Statement No. 67, Accounting for Costs and Initial Rental Operations of Real Estate Projects
- FASB Statement No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of
- AICPA Statement of Position 92-1, Accounting for Real Estate Syndication Income,
- AICPA Statement of Position 92-3, Accounting for Foreclosed Assets
- FASB Emerging Issues Task Force No. 84-17, Profit Recognition on Sales of Real Estate with Graduated Payment Mortgages or Insured Mortgages
- FASB Emerging Issues Task Force No. 86-6, Antispeculation Clauses in Real Estate Sales Contracts
- FASB Emerging Issues Task Force No. 87-9, Profit Recognition on Sales of Real Estate with Insured Mortgages or Surety Bonds
• FASB Emerging Issues Task Force No. 87-29, Exchange of Real Estate Involving Boot

• FASB Emerging Issues Task Force No. 88-12, Transfer of Ownership Interest as Part of Down Payment under FASB Statement No. 66

• FASB Emerging Issues Task Force No. 88-24, Effects of Various Forms of Financing under FASB Statement No. 66

• FASB Emerging Issues Task Force No. 89-13, Accounting for the Cost of Asbestos Removal

• FASB Emerging Issues Task Force No. 89-14, Valuation of Repossessed Real Estate

• FASB Emerging Issues Task Force No. 90-8, Capitalization of Costs to Treat Environmental Contamination


RELEVANT ISSUE PAPERS

• Issue Paper No. 23—Property Occupied by the Company

• Issue Paper No. 40—Real Estate Investments
Statement of Statutory Accounting Principles No. 41

Surplus Notes

STATUS

Type of Issue: Common Area

Issued: Initial Draft

Effective Date: January 1, 2001

Affects: No other pronouncements

Affected by: No other pronouncements

Interpreted by: No other pronouncements

SCOPE OF STATEMENT

SUMMARY CONCLUSION

Issuers of Surplus Notes

Holders of Surplus Notes

Disclosures

Relevant Literature

Effective Date and Transition

AUTHORITATIVE LITERATURE

Statutory Accounting

RELEVANT ISSUE PAPERS
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Surplus Notes

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for issuers and holders of surplus notes.

SUMMARY CONCLUSION

Issuers of Surplus Notes

2. Reporting entities sometimes issue instruments that have the characteristics of both debt and equity. These instruments are commonly referred to as surplus notes, the term used herein, but are also referred to as surplus debentures or contribution certificates. These instruments are used for various reasons, including but not limited to:
   a. Providing regulators with flexibility in dealing with problem situations to attract capital to reporting entities whose surplus levels are deemed inadequate to support their operations;
   b. Providing a source of capital to mutual and other types of non-stock reporting entities who do not have access to traditional equity markets for capital needs;
   c. Providing an alternative source of capital to stock reporting entities, although not for the purpose of initially capitalizing the reporting entity.

3. Surplus notes issued by a reporting entity that are subject to strict control by the commissioner of the reporting entity’s state of domicile and have been approved as to form and content shall be reported as surplus and not as debt only if the surplus note contains the following provisions:
   a. Subordination to policyholders;
   b. Subordination to claimant and beneficiary claims;
   c. Subordination to all other classes of creditors other than surplus note holders; and
   d. Interest payments and principal repayments require prior approval of the commissioner of the state of domicile.

4. Proceeds received by the issuer must be in the form of cash or other admitted assets having readily determinable values and liquidity satisfactory to the commissioner of the state of domicile.

5. Interest shall not be recorded as a liability nor an expense until approval for payment of such interest has been granted by the commissioner of the state of domicile. All interest, including interest in arrears, shall be expensed in the statement of operations when approved for payment. Unapproved interest shall not be reported through operations, shall not be represented as an addition to the principal or notional amount of the instrument, and shall not accrue further interest, i.e., interest on interest.

6. As of the date of approval of principal repayment by the commissioner of the state of domicile, the issuer shall reclassify such approved payments from surplus to liabilities.

7. Costs of issuing surplus notes (e.g., loan fees and legal fees) shall be charged to operations when incurred.

8. Discount or premium, if any, shall be reported in the balance sheet as a direct deduction from or addition to the face amount of the note. Such discount or premium shall be charged or credited to the
statement of operations concurrent with approved interest payments on the surplus note and in the same proportion or percentage as the approved interest payment is to the total estimated interest to be paid on the surplus note.

**Holders of Surplus Notes**

9. Investments in surplus notes meet the definition of assets 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.

10. Surplus notes shall be accounted for in accordance with SSAP No. 26—Bonds, excluding Loan-backed and Structured Securities (SSAP No. 26). Holders of surplus notes shall value their investment in surplus notes as follows:

   a. Rated Notes
      
      i. If the notes have been rated by a Nationally Recognized Statistical Rating Organization (NRSRO) and have a designation equivalent of NAIC 1, then amortized cost shall be used. If there is more than one NRSRO rating, the lowest rating equivalent shall be used for purposes of this valuation procedure;

      ii. The *Purposes and Procedures Manual of the NAIC Securities Valuation Office* contains a listing of NAIC equivalent NRSRO designations as well as a listing of insurers that meet the requirements of i above.

   b. Non-Rated Notes
      
      i. If the notes are not NRSRO rated or have an NAIC designation equivalent of NAIC 2 through 6, then value as follows:

      (a) At its outstanding face value, notwithstanding the payment of interest and/or principal, when the notes were issued by a reporting entity whose capital and surplus (excluding surplus notes included therein) is greater than or equal to the greater of 5% of its admitted assets (excluding separate accounts) or $6,000,000. The valuation shall be calculated using the most recently filed statutory financial statements of the entity that issued the notes;

      (b) By applying a “statement factor” to the outstanding face amount of the capital or surplus notes, notwithstanding the payment of interest and/or principal when the notes were issued by a reporting entity whose capital and surplus (excluding surplus notes included therein) is less than or equal to the greater of 5% of its admitted assets (excluding separate accounts) or $6,000,000. The “statement factor” is equal to the total capital and surplus, including surplus notes, less the greater of 5% of admitted assets (excluding separate accounts) or $6,000,000 divided by the capital or surplus notes. The valuation should be calculated using the most recently filed statutory financial statements of the entity that issued the notes. Should the result of the “statement factor” yield a product less than zero, the surplus notes shall be carried at zero and not a negative amount.

If the notes are issued by an entity which is subject to any order of liquidation, conservation, rehabilitation or a company action level event based on its risk-based capital, then the valuation is at zero,
notwithstanding any previous payments of interest and/or principal. The admitted asset value of a surplus note shall not exceed the amount that would be admitted if the instrument was considered an equity instrument and added to any other equity investments in the issuer held directly or indirectly by the holder of the surplus note. If the calculated value (after application of paragraph 10.b.i.(b)) is less than the outstanding face value, then that amount shall be accounted for as a nonadmitted asset.

11. Only interest that has been approved by the issuer’s domiciliary commissioner shall be accrued as income by a holder of surplus notes in a manner consistent with SSAP No. 26.

Disclosures

12. The notes to the financial statements of a reporting entity that issues surplus notes shall disclose the following as long as the surplus notes are outstanding:

   a. Date issued;
   b. Description of the assets received;
   c. Holder of the note or if public the names of the underwriter and trustee;
   d. Amount of note;
   e. Carrying value of note;
   f. The rate at which interest accrues;
   g. Maturity dates or repayment schedules, if stated;
   h. Unapproved interest and/or principal;
   i. Interest and/or principal paid in the current year;
   j. Total interest and/or principal paid on surplus notes;
   k. Subordination terms;
   l. Liquidation preference to the reporting entity’s common and preferred shareholders;
   m. The repayment conditions and restrictions.

13. In addition to the above, a reporting entity shall identify all affiliates that hold any portion of a surplus debenture or similar obligation (including an offering registered under the Securities Act of 1933 or distributed pursuant to rule 144A under the Securities Act of 1933), and any holder of 10% or more of the outstanding amount of any surplus note registered under the Securities Act of 1933 or distributed pursuant to Rule 144A under the Securities Act of 1933.

Relevant Literature

14. This statement adopts the NAIC Purposes and Procedures of the Securities Valuation Office, “Procedures for Valuing Surplus Debentures.” This statement rejects AICPA Practice Bulletin No. 15, Accounting by the Issuer of Surplus Notes, which requires surplus notes to be accounted for as debt and that interest be accrued over the life of the surplus note, irrespective of the approval of interest and principal payments by the insurance commissioner.
Effective Date and Transition

15. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors. The provisions of paragraph 3, which are required for an instrument to qualify as a surplus note, apply to all surplus notes issued or amended after December 12, 1991. Surplus notes issued on or before December 12, 1991, shall not be required to meet the provisions of paragraph 3 in order to be accounted for as a surplus note.

AUTHORITATIVE LITERATURE

Statutory Accounting


RELEVANT ISSUE PAPERS

- Issue Paper No. 41—Surplus Notes
Statement of Statutory Accounting Principles No. 42

Sale of Premium Receivables

STATUS

Type of Issue: Common Area
Issued: Initial Draft
Effective Date: January 1, 2001
Affects: No other pronouncements
Affected by: No other pronouncements
Interpreted by: No other pronouncements

SCOPE OF STATEMENT

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RELEVANT ISSUE PAPERS
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Sale of Premium Receivables

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for the sale or factoring of premium receivables.

SUMMARY CONCLUSION

2. For purposes of this statement, receivables shall only include amounts due to the reporting entity for premium receivables (i.e., uncollected premium, agent’s balances, and bills receivable).

3. A transfer of receivables can take the form of a transfer with recourse or a transfer without recourse:
   a. Recourse means that the transferee has the right to receive payment from the transferor of those receivables for (i) failure of the debtors to pay when due, (ii) the effects of prepayments, or (iii) adjustments resulting from defects in the eligibility of the transferred receivables, for example defects in the legal title of the transferred receivables. When the transferor has the right to repurchase (a call) or the transferee has the right to require the transferor to repurchase (a put) the transferred receivables, the transfer shall be considered to have recourse;
   b. Without recourse means that the transferor has surrendered all of the future economic implications of the risks and rewards embodied in the transferred receivables.

4. A transfer of receivables with recourse shall not be recognized as a sale. A transfer of receivables without recourse shall only be recognized if the transferor receives cash for the receivables. The sale shall be recognized when cash is received.

5. If a transfer qualifies to be recognized as a sale, the difference between (a) the sales price and (b) the receivables transferred shall be recognized as a gain or loss. If receivables are sold with servicing retained and the stated servicing fee is less than a current (normal) servicing fee rate (a servicing fee rate that is representative of servicing fee rates most commonly used in comparable servicing agreements covering similar types of receivables) or no servicing fee is specified, the gain or loss recognized by the sale of receivables shall be adjusted to recognize the deviation of the stated servicing fee rate from the commonly used servicing fee rate and a liability shall be established to provide for a normal servicing fee in each subsequent servicing period, which shall not be less than the estimated servicing costs. When the stated servicing fee is greater than a normal servicing fee the gain or loss shall not be adjusted and the excess servicing fee revenues shall not be recorded currently but shall be recorded when realized.

6. If the conditions of subparagraph 3b. are not met, or the transfer is for other than cash, the receivables shall remain on the transferor’s financial statements. A liability shall be established in an amount equal to the greater of the carrying amount of the receivables transferred or the amount of the proceeds received. To the extent that the proceeds received are less than the carrying amount of receivables transferred, a loss shall be recorded. The carrying amount of the receivable balance shall be evaluated at each reporting period and adjusted for any uncollectible amounts. The liability shall be derecognized as the transferee receives cash. When the proceeds received are greater than the receivables transferred, the liability shall be derecognized on a pro rata basis as the receivables are collected.
Disclosures

7. For transfers of receivables reported as sales, the transferor’s financial statements shall disclose:
   a. The proceeds to the transferor; and
   b. The gain or loss recorded on the sale.

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

Relevant Literature

9. This statement rejects paragraph 83 of *FASB Statement No. 125, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (FAS 125) to the extent that it permits sales recognition for sales of receivables with recourse provisions. FAS 125 is addressed in its entirety in *SSAP No. 18—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*.

Effective Date and Transition

10. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors*.

RELEVANT ISSUE PAPERS

- Issue Paper No. 42—Sale of Premium Receivables
Statement of Statutory Accounting Principles No. 43

Loan-backed and Structured Securities

STATUS

Type of Issue: Common Area
Issued: Initial Draft
Effective Date: January 1, 2001
Affects: No other pronouncements
Affected by: No other pronouncements
Interpreted by: INT 00-11, INT 02-07

SCOPE OF STATEMENT

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AUTHORITATIVE LITERATURE

Statutory Accounting

RELEVANT ISSUE PAPERS
Loan-backed and Structured Securities

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for investments in loan-backed securities and structured securities. In this statement loan-backed securities and structured securities are collectively referred to as loan-backed securities.

SUMMARY CONCLUSION

2. Loan-backed securities are defined as pass-through certificates, collateralized mortgage obligations (CMOs), and other securitized loans not included in structured securities, as defined below, for which the payment of interest and/or principal is directly proportional to the interest and/or principal received by the issuer from the mortgage pool or other underlying securities.

3. Structured securities are defined as loan-backed securities which have been divided into two or more classes for which the payment of interest and/or principal of any class of securities has been allocated in a manner which is not proportional to interest and/or principal received by the issuer from the mortgage pool or other underlying securities.

4. Loan-backed securities are issued by special-purpose corporations or trusts (issuer) established by a sponsoring parent organization. Mortgage loans or other securities securing the loan-backed obligation are acquired by the issuer and pledged to an independent trustee until the issuer’s obligation has been fully satisfied. The investor can look only to the issuer’s assets (primarily the trusteed assets or third parties such as insurers or guarantors) for repayment of the obligation. As a result, the sponsor and its other affiliates may have no financial obligation under the instrument, although one of those entities may retain the responsibility for servicing the underlying mortgage loans. Some sponsors do guarantee the performance of the underlying loans.

5. Loan-backed securities meet the definition of assets 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.

Acquisitions and Sales

6. At acquisition, loan-backed securities shall be reported at cost, including brokerage and related fees. Cost shall not exceed fair value. Acquisitions and dispositions shall be recorded on the trade date, not the settlement date, except for the acquisition of private placement loan-backed securities which shall be recorded on the funding date. For securities where all information is not known as of the trade date (e.g., actual payment factors and specific pools), a reporting entity shall make its best estimate based on known facts.

Amortization

7. Amortization of premium or discount shall be calculated using the scientific (constant yield) interest method and shall be recorded as an adjustment to investment income. The interest method results in a constant effective yield equal to the prevailing rate at the time of purchase or at the time of subsequent adjustments to book value. The amortization period shall reflect estimates of the period over which repayment of principal of the loan-backed securities is expected to occur, not the stated maturity period.
Balance Sheet Amount

8. Loan-backed securities shall be valued and reported in accordance with the NAIC *Purposes and Procedures of the Securities Valuation Office* and the NAIC *Valuations of Securities* manual prepared by the Securities Valuation Office. For reporting entities that maintain an Asset Valuation Reserve (AVR), loan-backed securities shall be reported at amortized cost, except for those with an NAIC designation of 6, which shall be reported at the lower of amortized cost or fair value. For reporting entities that do not maintain an AVR, loan-backed securities designated highest-quality and high-quality (NAIC designations 1 and 2, respectively) shall be reported at amortized cost; loan-backed securities that are designated medium quality, low quality and lower quality (NAIC designations 3 to 6) shall be reported at the lower of amortized cost or fair value.

Changes in Valuation

9. Prepayments are a significant variable element in the cash flow of loan-backed securities because they affect the yield and determine the expected maturity against which the yield is evaluated. Falling interest rates generate faster prepayment of the mortgages underlying the security, shortening its duration. This causes the reporting entity to reinvest assets sooner than expected at potentially less advantageous rates. This is called prepayment risk. Extension risk is created by rising interest rates which slow repayment and can significantly lengthen the duration of the security.

10. Changes in prepayment assumptions and the resulting cash flows shall be reviewed periodically. For securities that have the potential for loss of a portion of the original investment due to changes in interest rates or prepayments, the review shall be performed at least quarterly. For other securities, the review shall be performed at least annually. Examples of securities that have the potential for loss of a portion of the original investment include CMO residuals and mortgage-backed interest-only certificates. For these securities, an effective yield or internal rate of return is calculated at acquisition based on the purchase price and anticipated future cash flows.

11. The prepayment rates of the underlying loans shall be used to determine prepayment assumptions. Prepayment assumptions shall be applied consistently across portfolios to all securities backed by similar collateral (similar with respect to coupon, issuer, and age of collateral). Reporting entities shall use consistent assumptions across portfolios for similar collateral within controlled affiliated groups. Since each reporting entity may have a unique method for determining the prepayment assumptions, it is impractical to set standard assumptions for the industry. Relevant sources and rationale used to determine each prepayment assumption shall be documented by the reporting entity.

12. Loan-backed securities shall be revalued using the new prepayment assumptions using either the prospective or retrospective adjustment methodologies, consistently applied by type of securities.

13. The prospective approach recognizes, through the recalculation of the effective yield to be applied to future periods, the effects of all cash flows whose amounts differ from those estimated earlier and the effects and changes in projected cash flows. Under the prospective method, the recalculated effective yield will equate the carrying amount of the investment to the present value of the anticipated future cash flows. The recalculated yield is then used to accrue income on the investment balance for subsequent accounting periods. There are no accounting changes in the current period unless the undiscounted anticipated cash flow is less than the carrying amount of the investment.
14. The retrospective methodology changes both the yield and the asset balance so that expected future cash flows produce a return on the investment equal to the return now expected over the life of the investment as measured from the date of acquisition. Under the retrospective method, the recalculated effective yield will equate the present value of the actual and anticipated cash flows with the original cost of the investment. The current balance is then increased or decreased to the amount that would have resulted had the revised yield been applied since inception, and investment income is correspondingly decreased or increased.

Impairment

15. Regardless of whether a reporting entity is using a prospective or retrospective method, if the revaluation based on new prepayment assumptions results in a negative yield (i.e., undiscounted estimated future cash flows are less than the current book value), an other than temporary impairment shall be considered to have occurred. If it is determined that a decline in the fair value of a loan-backed security is other than temporary, the cost basis of the security shall be written down to the undiscounted estimated future cash flows and the amount of the write down shall be accounted for as a realized loss (which shall be included in Interest Maintenance Reserve (IMR), if applicable). The new cost basis shall not be changed for subsequent recoveries in fair value. Therefore, the prospective adjustment method must be utilized for periods subsequent to the loss recognition.

Income

16. Interest shall be accrued using the interest method using the redemption prices and redemption dates used for amortizing premiums and discounts. Interest income consists of interest collected during the period, the change in the due and accrued interest between the beginning and end of the period as well as reductions for premium amortization and interest paid on acquisition of loan-backed securities, and the addition of discount accrual. Contingent interest may be accrued if the applicable provisions of the underlying contract and the prerequisite conditions have been met.

17. For reporting entities required to maintain an IMR, the accounting for realized capital gains and losses on sales of loan-backed securities shall be in accordance with SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve. For reporting entities not required to maintain an IMR, realized gains and losses on sales of loan-backed securities shall be recorded on the trade date and shall be reported as net realized capital gains or losses in the Statement of Income.

18. A loan-backed security may provide for a prepayment penalty or acceleration fee in the event the investment is liquidated prior to its scheduled termination date. These fees shall be reported as investment income when received.

Origination Fees

19. Origination fees represent fees charged to the borrower in connection with the process of originating or restructuring a transaction. The fees include, but are not limited to, points, management, arrangement, placement, application, underwriting, and other fees pursuant to such a transaction. Origination fees shall not be recorded until received in cash. Origination fees intended to compensate the reporting entity for interest rate risks (e.g., points), shall be amortized into income over the term of the loan-backed security consistent with paragraph 7 of this statement. Other origination fees shall be recorded as income upon receipt.

Origination, Acquisition, and Commitment Costs

20. Costs related to origination when paid in the form of brokerage and other related fees shall be capitalized as part of the cost of the loan-backed security, consistent with paragraph 6 of this statement.
All other costs, including internal costs or costs paid to an affiliated entity related to origination, purchase, or commitment to purchase loan-backed securities, shall be charged to expense when incurred.

**Commitment Fees**

21. Commitment fees are fees paid to the reporting entity that obligate the reporting entity to make available funds for future borrowing under a specified condition. A fee paid to the reporting entity to obtain a commitment to make funds available at some time in the future, generally, is refundable only if the loan-backed security is issued. If the loan-backed security is not issued, then the fees shall be recorded as investment income by the reporting entity when the commitment expires.

22. A fee paid to the reporting entity to obtain a commitment to borrow funds at a specified rate and with specified terms quoted in the commitment agreement, generally, is not refundable unless the commitment is refused by the reporting entity. This type of fee shall be deferred, and amortization shall depend on whether or not the commitment is exercised. If the commitment is exercised, then the fee shall be amortized in accordance with paragraph 7 of this statement over the life of the loan-backed security as an adjustment to the investment income on the loan-backed security. If the commitment expires unexercised, the commitment fee shall be recognized in income on the commitment expiration date.

**Giantization/Megatization of FHLMC or FNMA Mortgage Backed Securities**

23. Giantization/megatization of mortgage backed securities is defined as existing pools of FHLMC or FNMA mortgage-backed securities (MBS) with like coupon and prefix which are repooled together by the issuing agency creating a new larger security. The new Fannie Mae “Mega” or Freddie Mac “Giant” is a guaranteed MBS pass-through representing an undivided interest in the underlying pools of loans.

24. The benefits derived from giantization/megatization include:

   a. Increased liquidity: Smaller MBS pools (particularly those with current face of less than $1 million) are less liquid than mortgage pools with current faces exceeding $5 million. Repooling smaller MBS pools into one larger pool improves the marketability for the aggregate package;

   b. Geographic diversity: Regrouping of multiple pools generally will create greater geographic pool loan diversity resulting in less prepayment variation due to regional economic factors;

   c. Reduced administrative expenses: The reduced number of pools lowers bank custodial fees, pricing/factor service fees, and increases efficiency for the accounting and investment departments.

25. Repooled FHLMC and FNMA securities meet the definition of substantially the same as defined in SSAP No. 45—Repurchase Agreements, Reverse Repurchase Agreements and Dollar Repurchase Agreements. The transaction shall not be considered a sale/purchase and no gain or loss shall be recognized. To properly document the repooling, the transaction shall be reported through Schedule D of the Annual Statement as a disposition and an acquisition.

26. Transaction fees charged by the issuing agencies shall be capitalized and amortized over the life of the repooled security.
Disclosures

27. In addition to the disclosures required for invested assets in general, the following disclosures regarding loan-backed securities shall be made in the financial statements:

a. Fair values in accordance with SSAP No. 27—Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk, Financial Instruments with Concentrations of Credit Risk and Disclosures about Fair Value of Financial Instruments (SSAP No. 27);

b. Concentrations of credit risk in accordance with SSAP No. 27;

c. Basis at which the loan-backed securities are stated;

d. The adjustment methodology used for each type of security (prospective or retrospective);

e. Changes from the retrospective to the prospective adjustment methodology due to negative yield on specific securities;

f. If, for applying the retrospective method, the reporting entity has elected to use book value as of January 1, 1994 as the cost for securities purchased prior to January 1, 1994 where historical cash flows are not readily available; and

g. Descriptions of sources used to determine prepayment assumptions.

28. Refer to the preamble for further discussion regarding disclosure requirements. The disclosures in paragraphs 27 a. and 27 b. above shall be included in the annual audited statutory financial reports only.

Relevant Literature

29. This statement rejects FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities and FASB Statement No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases.


Effective Date and Transition

31. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors.

32. For securities purchased prior to January 1, 1994, where historical cash flows are not readily available for applying the retrospective method, the reporting entity may use January 1, 1994 as the acquisition date and the then book value as the cost for purposes of determining yield adjustments in future periods.
AUTHORITATIVE LITERATURE

Statutory Accounting

- NAIC Purposes and Procedures of the Securities Valuation Office
- NAIC Valuations of Securities manual prepared by the Securities Valuation Office

RELEVANT ISSUE PAPERS

- Issue Paper No. 43—Loan-backed and Structured Securities
Statement of Statutory Accounting Principles No. 44

Capitalization of Interest

STATUS
Type of Issue: Common Area
Issued: Initial Draft
Effective Date: January 1, 2001
Affects: No other pronouncements
Affected by: No other pronouncements
Interpreted by: No other pronouncements

SCOPE OF STATEMENT

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AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

RELEVANT ISSUE PAPERS

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Capitalization of Interest

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for capitalization of interest.

SUMMARY CONCLUSION

2. The historical cost of acquiring an asset generally includes the necessary costs incurred to bring it to the condition and location necessary for its intended use. If an asset requires a period of time in which to carry out the activities necessary to bring it to that condition and location, the interest cost incurred during that period as a result of expenditures for the asset shall be included as a part of the historical cost of acquiring the asset.

3. Interest cost shall be capitalized for the following types of assets:
   a. Assets constructed or otherwise produced for an enterprise’s own use (including assets constructed or produced for the enterprise by others for which deposits or progress payments have been made);
   b. Assets intended for sale or lease that are constructed or otherwise produced as discrete projects (e.g., real estate developments);
   c. Investments (equity, loans, and advances) accounted for by the equity method while the investee has activities in progress necessary to commence its planned principal operations provided that the investee’s activities include the use of funds to acquire qualifying assets for its operations. The equity method is defined in SSAP No. 46—Investments in Subsidiaries, Controlled, and Affiliated Entities.

4. Interest cost shall not be capitalized for the following types of assets:
   a. Assets that are in use or ready for their intended use in the earning activities of the enterprise;
   b. Assets that are not being used in the earning activities of the enterprise and that are not undergoing the activities necessary to get them ready for use;
   c. Investments accounted for by the equity method after the planned principal operations of the investee begin;
   d. Investments in regulated investees that are capitalizing both the cost of debt and equity capital;
   e. Assets acquired with gifts and grants that are restricted by the donor or grantor to acquisition of those assets to the extent that funds are available from such gifts and grants. Interest earned from temporary investment of those funds that is similarly restricted shall be considered an addition to the gift or grant for this purpose;
   f. Nonadmitted assets.

5. Capitalized interest meets the definition of an asset as defined in SSAP No. 4—Assets and Nonadmitted Assets and is an admitted asset to the extent it conforms to the requirements of this statement.
Capitalization

6. The amount of interest cost to be capitalized for qualifying assets shall be determined in accordance with paragraphs 12 through 16 of FASB Statement No. 34, Capitalization of Interest Cost (FAS 34) and paragraph 6 of FASB Statement No. 62, Capitalization of Interest Cost in Situations Involving Certain Tax-Exempt Borrowings and Certain Gifts and Grants (FAS 62).

7. The capitalization period shall be in accordance with paragraphs 17 through 19 of FAS 34 and paragraph 7 of FAS 62.

Disclosures

8. Disclosures shall be made in the financial statements in accordance with paragraph 21 of FAS 34.

9. Refer to the preamble for further discussion regarding disclosure requirements. The disclosure in paragraph 8 above shall be included in the annual audited statutory financial reports only.

Impairment

10. Capitalized interest shall be assessed for impairment in conjunction with the assessment of the related asset. Interest capitalization shall not cease when such an assessment requires recognition of a lower value for the asset than acquisition cost; rather the provision required to reduce acquisition cost to such lower value shall be increased appropriately.

Relevant Literature

11. The statutory principles established in this statement adopt the GAAP accounting principles for capitalization of interest cost set forth in FAS 34, FASB Statement No. 42, Determining Materiality for Capitalization of Interest Cost, FASB Statement No. 58, Capitalization of Interest Cost in Financial Statements That Include Investments Accounted for by the Equity Method, and FAS 62, except that nonadmitted assets are ineligible for capitalization of interest.

Effective Date and Transition

12. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors.

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

- FASB Statement No. 34, Capitalization of Interest Cost
- FASB Statement No. 42, Determining Materiality for Capitalization of Interest Cost
- FASB Statement No. 58, Capitalization of Interest Cost in Financial Statements That Include Investments Accounted for by the Equity Method
- FASB Statement No. 62, Capitalization of Interest Cost in Situations Involving Certain Tax-Exempt Borrowings and Certain Gifts and Grants

RELEVANT ISSUE PAPERS

- Issue Paper No. 44—Capitalization of Interest
Statement of Statutory Accounting Principles No. 45

Repurchase Agreements, Reverse Repurchase Agreements and Dollar Repurchase Agreements

STATUS

Type of Issue: Common Area

Issued: Initial Draft

Effective Date: January 1, 2001

Affects: No other pronouncements

Affected by: No other pronouncements

Interpreted by: INT 00-11, INT 01-31

SCOPE OF STATEMENT

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AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

RELEVANT ISSUE PAPERS
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Repurchase Agreements, Reverse Repurchase Agreements and Dollar Repurchase Agreements

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for repurchase and reverse repurchase agreements, including dollar repurchase and dollar reverse repurchase agreements.

SUMMARY CONCLUSION

2. Repurchase agreements, reverse repurchase agreements and dollar repurchase agreements meet the definition of assets 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.

Repurchase Agreements

3. Repurchase agreements are defined as agreements under which a reporting entity purchases securities and simultaneously agrees to resell the same or substantially the same securities at a stated price on a specified date within 12 months of the purchase. For securities to be substantially the same, the criteria defined in paragraph 14 must be met, and for mortgage-backed securities excluding mortgage pass-through securities, the projected cash flows of the securities must be substantially the same under multiple scenario prepayment assumptions.

4. Repurchase agreements shall be accounted for as collateralized lendings. The underlying securities shall not be accounted for as investments owned by the reporting entity. The amount paid for the securities shall be reported as a short-term investment, and the difference between the amount paid and the amount at which the securities will be subsequently resold shall be reported as interest income, calculated on the straight-line method or the scientific interest (constant yield) method, over the term of the agreement.

5. Reporting entities generally take possession of the underlying collateral under repurchase agreements and in many cases may obtain additional collateral when the estimated fair value of such securities falls below their current contract value. However, to the extent that the current fair value of the collateral is less than the recorded amount, the shortfall shall reduce the admitted asset value of the repurchase agreement.

Reverse Repurchase Agreements

6. Reverse repurchase agreements are defined as agreements under which a reporting entity sells securities and simultaneously agrees to purchase the same or substantially the same securities at a stated price on a specified date within 12 months of the sale date. For securities to be substantially the same, the criteria defined in paragraph 13 must be met, and for mortgage-backed securities excluding mortgage pass-through securities, the projected cash flows of the securities must be substantially the same under multiple scenario prepayment assumptions.

7. Reverse repurchase agreements shall be accounted for as collateralized borrowings (financing transactions). The underlying securities shall continue to be accounted for as an investment by the reporting entity. The proceeds from the sale of the securities shall be recorded as a liability, and the difference between the proceeds and the amount at which the securities will be subsequently reacquired shall be reported as interest expense, calculated on the straight-line method or the scientific interest (constant yield) method, over the term of the agreement. Although recording these transactions grossly tends to inflate assets and liabilities, it more closely reflects the financing nature of the transactions and their associated leverage impact to the financial statements.
Collateral Requirements

8. The collateral requirements for repurchase and reverse repurchase agreements are as follows:

Repurchase Transaction

a. The reporting entity shall receive as collateral transferred securities having a fair value at least equal to 102 percent of the purchase price paid by the reporting entity for the securities. If at anytime the fair value of the collateral is less than 100 percent of the purchase price paid by the reporting entity, the counterparty shall be obligated to provide additional collateral, the fair value of which, together with fair value of all collateral then held in connection with the transaction, at least equals 102 percent of the purchase price.

Reverse Repurchase Transaction

b. The reporting entity shall receive collateral having a fair value as of the transaction date at least equal to 95 percent of the fair value of the securities transferred by the reporting entity in the transaction as of that date. If at anytime the fair value of the collateral is less than 95 percent of the fair value of the securities so transferred, the counterparty shall be obligated to deliver additional collateral, the fair value of which, together with the fair value of all collateral then held in connection with the transaction, at least equals 95 percent of the fair value of the transferred securities.

Dollar Repurchase Agreements

9. Dollar repurchase and dollar reverse repurchase agreements are defined as repurchase and reverse repurchase agreements involving debt instruments that are pay-through securities collateralized with Government National Mortgage Association (GNMA), Federal Home Loan Mortgage Corporation (FHLMC) and Federal National Mortgage Association (FNMA) collateral, and pass-through certificates sponsored by GNMA, mortgage participation certificates issued by the FHLMC or similar securities issued by the FNMA. Dollar repurchase agreements are also commonly referred to as dollar roll transactions. To meet the definition of dollar repurchase and dollar reverse repurchase agreements, the securities underlying the agreements must meet the criteria defined in paragraph 13, and for mortgage-backed securities excluding mortgage pass-through securities, the projected cash flows of the securities must be substantially the same under multiple scenario prepayment assumptions.

10. For the seller in a dollar reverse repurchase agreement, a liability is recorded for the amount of proceeds of the sale and the sold mortgage-backed securities are not removed from the accounting records. During the period of the agreement, interest income is recorded as if the mortgage-backed security had been held during the term of the agreement. This is offset by an equal amount of interest expense related to the proceeds received from the sale. Additional interest expense is recorded representing the difference between the sales price and the repurchase price of the mortgage-backed securities sold.

11. When the mortgage-backed securities are repurchased under the agreement, the original mortgage-backed securities sold are removed from the accounting records and the purchased mortgage-backed securities are recorded. The principal amount of the mortgage-backed securities repurchased must be in good delivery form consistent with paragraph 13.

12. If the principal amount repurchased is greater than the amount sold, the cash paid is recorded as an additional investment in the newly acquired certificates. If the principal amount repurchased is less than the amount sold, a gain or loss relating to the original certificates held is recorded.
13. For the purchaser in a dollar repurchase agreement, an asset is recorded for the amount of the purchase. Since the term of the agreement is limited to twelve months, it is accounted for as a short-term investment. Upon completion of the reverse repurchase agreement, cash is received in exchange for a “substantially the same” security. The difference between the purchase and reselling price represents interest income for the lending of short-term funds.

Criteria to Meet Substantially the Same

14. For debt instruments, including mortgage-backed securities, to be substantially the same, all the following criteria must be met:

   a. The debt instruments must have the same primary obligor, except for debt instruments guaranteed by a sovereign government, central bank, government-sponsored enterprise or agency thereof, in which case the guarantor and terms of the guarantee must be the same;

   b. The debt instruments must be identical in form and type so as to give the same risks and rights to the holder;

   c. The debt instruments must bear the identical contractual interest rate;

   d. The debt instruments must have the same maturity except for mortgage-backed pass-through and pay-through securities for which the mortgages collateralizing the securities must have similar remaining weighted average maturities (WAMs) that result in approximately the same market yield;

   e. Mortgage-backed pass-through and pay through securities must be collateralized by a similar pool of mortgages, such as single-family residential mortgages; and

   f. The debt instruments must have the same aggregate unpaid principal amounts, except for mortgage-backed pass-through and pay-through securities, where the aggregate principal amounts of the mortgage-backed securities given up and the mortgage-backed securities reacquired must be within the accepted “good delivery” standard for the type of mortgage-backed security involved.

Separate Transactions

15. Agreements to repurchase and resell securities that do not meet the definitions in paragraph 3, 6, or 8 of this statement shall be accounted for as two separate transactions, that is, as a sale and purchase or as a purchase and sale, in accordance with the relevant statutory accounting guidance. For example, sales of bonds would result in recognition of realized gains or losses.

Offsetting

16. Reporting entities may operate on both sides of the repurchase agreement market resulting in recording of liabilities and assets representing repurchase and reverse repurchase agreements, respectively.

17. Reporting entities shall offset such liabilities and assets only to the extent that one of the following occurs:

   a. A legal right of offset exists as defined in SSAP No. 64—Offsetting and Netting of Assets and Liabilities (SSAP No. 64), or
b. The securities have the same settlement date, are executed with the same counterparty in accordance with a master netting arrangement, involve securities that exist in “book entry” form, and settle on securities transfer systems that have the same key elements and operating characteristics as the Fedwire Securities Transfer System.

Otherwise, separate assets and liabilities shall be recognized.

Disclosures

18. The following disclosures shall be made in the financial statements:

a. If the reporting entity has entered into repurchase agreements, its policy for requiring collateral or other security;

b. A description of the securities underlying the agreements, including book values and fair values, maturities, and weighted average interest rates for the following categories: (i) securities subject to reverse repurchase agreements; (ii) securities subject to repurchase agreements; (iii) securities subject to dollar repurchase agreements; and (iv) securities subject to dollar reverse repurchase agreements; and

c. A description of the terms of reverse repurchase agreements whose amounts are included in borrowed money.

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

Relevant Literature

20. This statement adopts AICPA Statement of Position 90-3, Definition of the Term Substantially the Same for Holders of Debt Instruments, as Used In Certain Audit Guides and a Statement of Position.

21. This statement adopts paragraphs 9 through 13, 15 through 17, 23 through 25, 27 through 30 and 66 through 71 of FASB Statement No. 125, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (FAS 125), as they relate to repurchase agreements, reverse repurchase agreements and dollar repurchase agreements.

22. This statement adopts FASB Emerging Issues Task Force No. 84-20, GNMA Dollar Rolls. This statement is consistent with FASB Interpretation No. 39, Offsetting of Amounts Related to Certain Contracts—an interpretation of APB Opinion No. 10 and FASB Statement No. 105 (FIN 39) (as it relates to reverse repurchase and repurchase agreements) and FASB Interpretation No. 41, Offsetting of Amounts Related to Certain Repurchase and Reverse Repurchase Agreements—an interpretation of APB Opinion No. 10 and a modification of FASB Interpretation No. 39 (FIN 41). FIN 39 and FIN 41 are adopted in SSAP No. 64.

23. This statement rejects paragraph 14 of FAS 125 as it relates to the classifications of securities under FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities (FAS 115). FAS 115 is rejected in SSAP No. 26—Bonds, excluding Loan-backed and Structured Securities.

Effective Date and Transition

24. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors.
AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

- AICPA Statement of Position 90-3, Definition of the Term Substantially the Same for Holders of Debt Instruments, as Used In Certain Audit Guides and a Statement of Position

- FASB Statement No. 125, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities

- FASB Interpretation No. 39, Offsetting of Amounts Related to Certain Contracts—an interpretation of APB Opinion No. 10 and FASB Statement No. 105

- FASB Interpretation No. 41, Offsetting of Amounts Related to Certain Repurchase and Reverse Repurchase Agreements—an interpretation of APB Opinion No. 10 and a modification of FASB Interpretation No. 39

- FASB Emerging Issues Task Force No. 84-20, GNMA Dollar Rolls

RELEVANT ISSUE PAPERS

- Issue Paper No. 45—Repurchase Agreements, Reverse Repurchase Agreements and Dollar Repurchase Agreements
Statement of Statutory Accounting Principles No. 46

Investments in Subsidiary, Controlled, and Affiliated Entities

STATUS

Type of Issue: Common Area

Issued: Initial Draft

Effective Date: January 1, 2001

Affects: No other pronouncements

Affected by: No other pronouncements

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RELEVANT ISSUE PAPERS
Investments in Subsidiary, Controlled, and Affiliated Entities

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for investments in subsidiaries, controlled, and affiliated entities (hereafter referred to as SCA entities).

SUMMARY CONCLUSION

Definitions

2. Parent and subsidiary are defined as follows:
   a. Parent—An entity that directly or indirectly owns and controls the reporting entity;
   b. Subsidiary—An entity that is, directly or indirectly, owned and controlled by the reporting entity.

3. An affiliate is defined as an entity that is within the holding company system or a party that, directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with the reporting entity. An affiliate includes a parent or subsidiary and may also include partnerships, joint ventures, and limited liability companies as defined in SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies (SSAP No. 48). Those entities are accounted for under the guidance provided in SSAP No. 48, which requires an equity method for all such investments.

4. Control is defined as the possession, directly or indirectly, of the power to direct or cause the direction of the management and policies of the investee, whether through the (a) ownership of voting securities, (b) by contract other than a commercial contract for goods or nonmanagement services, (c) by common management, or (d) otherwise. Control shall be presumed to exist if a reporting entity and its affiliates directly or indirectly, own, control, hold with the power to vote, or hold proxies representing 10% or more of the voting interests of the entity.

5. The 10% ownership threshold shall be measured at the holding company level. For example, if one member of an affiliated group has a 5% interest in an entity and a second member of the group has an 8% interest in the same entity, the total interest is 13% and therefore each member of the affiliated group shall be presumed to have control. These presumptions can be overcome by predominant evidence to the contrary, however, they shall stand until overcome by such predominant contradictory evidence. FASB Interpretation No. 35, Criteria for Applying the Equity Method of Accounting for Investments in Common Stock, an Interpretation of APB Opinion No. 18, provides guidance on determining when such evidence exists. A reporting entity with 10% or more of the voting interest shall evaluate all facts and circumstances relating to the investment and reach a judgment about whether the presumption of control is overcome. The corollary is required to demonstrate control when a reporting entity owns less than 10% of the voting interest of an investee.

6. Investments in SCA entities meet the definition of assets 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.
Applying the Market Valuation, Statutory Equity and GAAP Equity Methods

7. The admitted investments in SCA entities shall be recorded using a market valuation approach (as described in paragraph 7 a.), or equity methods (as described in paragraph 7 b.). Once the reporting entity elects to use a valuation approach for a particular subsidiary, the reporting entity cannot change the valuation method to another method without the approval of the domiciliary commissioner.

a. In order to use the market valuation approach for SCA entities, the following requirements apply:

i. The subsidiary must be traded on one of the following three major exchanges: (1) the New York Stock Exchange, (2) the American Stock Exchange, or (3) the NASDAQ National exchange;

ii. The reporting entity must submit subsidiary information to the Securities Valuation Office (SVO) for their calculation of the subsidiary’s market value. Such calculation could result in further discounts in market value above the established base discounts based on ownership percentages detailed below;

iii. Ownership percentages for determining the discount rate shall be measured at the holding company level;

iv. If an investment in a SCA results in an ownership percentage between 10% and 50%, a base discount percentage between 0% and 20% on a sliding scale basis is required;

v. If an investment in a SCA results in an ownership percentage greater than 50% up to and including 80%, a base discount percentage between 20% and 30% on a sliding scale basis is required;

vi. If an investment in a SCA results in an ownership percentage greater than 80% up to and including 85%, a minimum base discount percentage of 30% is required. Further, the SCA must have at least two million shares outstanding, with a total market value of at least $50 million in the public’s control; and

vii. Any ownership percentages exceeding 85% will result in the SCA being recorded on an equity method.

b. If a SCA investment does not meet the requirements for the market valuation approach in paragraph 7 a. or, if the requirements are met, but a reporting entity elects not to use that approach, investments in SCAs shall be recorded as follows:

i. Investments in insurance SCA entities shall be recorded based on the underlying statutory equity of the respective entity’s financial statements, adjusted for unamortized goodwill as provided for in SSAP No. 68—Business Combinations and Goodwill (SSAP No. 68).

ii. Investments in noninsurance SCA entities that have no significant ongoing operations other than to hold assets that are primarily for the direct or indirect benefit or use of the reporting entity or its affiliates, shall be recorded based on the underlying equity of the respective entity’s financial statements adjusted to a statutory basis of accounting and the resultant proportionate share of the subsidiary’s adjusted surplus, adjusted for unamortized goodwill as provided for in SSAP No. 68. Examples include but are not limited to: (i) an insurer and a
SCA entity that leases autos, furniture, office equipment, or computer equipment to the insurer; (ii) an insurer and a SCA entity that owns real estate property that is leased to the insurer for office space; and (iii) an insurer and an SCA entity that holds investments that an insurer could acquire directly (i.e., “look through” investment subsidiary);

iii. Investments in noninsurance SCA entities that have significant ongoing operations beyond the holding of assets that are primarily for the direct or indirect benefit or use of the reporting entity or its affiliates shall be recorded based on the audited GAAP equity of the investee. Examples include but are not limited to: (i) a property-casualty or life insurer and a SCA entity that is an oil and gas venture; and (ii) a property-casualty insurer or life insurer and a SCA manufacturer.

8. This statement requires that investments for noninsurance SCA entities that have no significant ongoing operations other than to hold assets that are primarily for the direct or indirect benefit or use of the reporting entity or its affiliates, and that do not qualify for the market valuation approach outlined in paragraph 7 a. or for which the reporting entity does not elect that approach, shall be recorded based on their underlying equity adjusted to a statutory basis of accounting. In applying the provisions of this statement to noninsurance SCA entities, the focus is on the primary operations of the SCA for purposes of determining if it is required to be accounted for under subparagraph 7 b. ii. Entities whose primary operations do not provide services to the insurance industry fall under provisions of subparagraph 7 b. iii. It is not the intent of subparagraph 7 b. ii. to apply to an affiliate which has insignificant transactions within the insurance industry. This rule requires judgment by the reporting entity in making the determination and provides flexibility to the regulator in analyzing the determination.

9. For investments in entities recorded based on the underlying audited GAAP equity of the investee, the amount to be recorded shall be defined as the initial investment in an investee at cost (as defined in SSAP No. 68). The carrying amount of the investment shall be adjusted to recognize the reporting entity’s share of the audited GAAP basis earnings or losses of the investee after the date of acquisition, adjusted for any dividends received. A reporting entity’s share of adjustments that are recorded directly to the investee’s stockholder’s equity under GAAP shall also be recorded as adjustments to the carrying value of the investment with an offsetting amount recorded directly to unrealized capital gains and losses on investments.

10. The statutory equity method as described in subparagraph 7 b. i. shall be applied by recording an initial and subsequent investment in an investee at cost, which is defined in SSAP No. 68 as the sum of (a) any cash payment, (b) the fair value of other assets distributed, (c) the fair value of any liabilities assumed, and (d) any direct costs of the acquisition. After the date of acquisition, the investment amount shall be adjusted for the amortization of goodwill and the reporting entity’s share of the change in special surplus funds, other than special surplus funds and unassigned funds (surplus), as defined in SSAP No. 72—Surplus and Quasi-Reorganizations. This represents the carrying amount of the investment.

11. To apply the equity method of accounting to investees as described in subparagraph 7 b. ii., certain adjustments shall be made to GAAP (or other basis) income to determine the reporting entity’s share of the investee’s statutory earnings and losses and other changes in surplus. Further guidance on recording the initial investment (including goodwill and negative goodwill) and other aspects of applying the equity method are discussed in paragraph 13.

12. If the reporting entity is using an equity method, the reporting entity’s share of undistributed earnings and losses of the investee shall be included in unrealized gains and losses of the reporting entity. The reporting entity’s share of other changes in the investee’s surplus (e.g., the change in the investee’s nonadmitted assets) shall be recorded by the investor as a component of unrealized capital gains and
losses on investments. If the reporting entity uses the market valuation approach outlined in paragraph 7 a., changes in that valuation shall be included in unrealized gains and losses. Dividends or distributions received from an investee shall be recognized in investment income when declared to the extent that they are not in excess of the undistributed accumulated earnings attributable to the investee. Dividends or distributions declared in excess of the undistributed accumulated earnings attributable to the investee shall reduce the carrying amount of the investment.

13. The procedures set forth below shall be followed by a reporting entity in applying an equity method of accounting (as described in paragraphs 7 b. i. through 7 b. iii.), as applicable, to investments in SCA entities:

a. A difference between the cost of an investment and the underlying equity in the statutory book value (GAAP book value if a noninsurance SCA entity that has significant ongoing operations beyond the holding of assets that are primarily for the direct or indirect benefit or use of the reporting entity or its affiliates) of the acquired company at the date of acquisition shall be accounted for in accordance with SSAP No. 68;

b. A transaction of an investee of a capital nature that affects the reporting entity’s share of stockholders’ equity of the investee shall be reflected as an unrealized gain or loss (e.g., where the investee issues additional stock or a new class of stock that impacts the reporting entity’s equity ownership in the investee, the reporting entity’s recorded investment shall be adjusted to reflect the transaction);

c. Realized gains or losses on the sale of an investment in a SCA entity shall be recorded in an amount equal to the difference at the time of sale between the selling price and carrying amount of the investment plus any previously recorded unrealized gain or loss;

d. If financial statements of an investee are not sufficiently timely for the reporting entity to apply an equity method to the investee’s current results of operations, the reporting entity shall record its share of the earnings or losses of an investee from the most recent available financial statements. A lag in reporting shall be consistent from period to period;

e. A reporting entity’s share of losses of an investee may equal or exceed the carrying amount of an investment accounted for by an equity method plus advances made by the investor. The reporting entity shall discontinue applying an equity method when the investment (including advances) is reduced to zero and shall not provide for additional losses unless the reporting entity has guaranteed obligations of the investee or is otherwise committed to provide further financial support for the investee (guaranteed obligations meeting the definition of liabilities in SSAP No. 5—Liabilities, Contingencies and Impairments of Assets shall be recorded as liabilities). If the investee subsequently reports net income, the reporting entity shall resume applying an equity method only after its share of that net income equals the share of net losses not recognized during the period that an equity method was suspended;

f. When an investee has outstanding cumulative preferred stock, the reporting entity shall compute its share of earnings (losses) after deducting the investee’s preferred dividends, whether or not such dividends are declared;

g. An investment in a SCA entity may fall below the level of ownership described in paragraph 4 from the sale of a portion of an investment by the reporting entity, the sale of additional interests by an investee, or other transactions. The reporting entity shall discontinue accruing its share of the earnings or losses of the investee for an investment that no longer qualifies for an equity method. The earnings or losses that relate to the
investment interests retained by the reporting entity and that were previously accrued shall remain as a part of the carrying amount of the investment. The investment account shall not be adjusted retroactively under the conditions described in this subparagraph. However, dividends received by the investor in subsequent periods which exceed the reporting entity’s share of earnings for such periods shall be applied as a reduction of the carrying amount of the investment;

h. An investment in a SCA entity that was previously accounted for under one method may become qualified for use of another method (as prescribed in paragraph 7) because of a change in the level of ownership (i.e., acquisition of additional interests by the reporting entity, acquisition or retirement of interests by the investee, or other transactions, or a change in facts or circumstances (e.g., paragraphs 7 a. i., 7 a. viii.)). When an investment qualifies for use of another method of accounting, the reporting entity shall adopt the new method of accounting and the investment shall be adjusted to reflect the reporting entity’s equity interest in the SCA entity under the new method. A corresponding amount shall be recorded as an unrealized gain or loss.

14. A reporting entity that owns an interest in itself via direct ownership of shares of an upstream intermediate or ultimate parent shall reduce the value of such shares for the reciprocal ownership. If the shares of the parent are owned indirectly by a reporting entity, via a downstream SCA entity, the directly held entity, which owns the parent’s shares, shall have its value reduced for the reciprocal ownership.

15. Any parent reporting entity that owns an interest in itself via either direct or indirect ownership of a downstream affiliate, which in turn owns shares of the parent reporting entity, shall eliminate its proportionate interest in these shares from the valuation of such affiliate.

Impairment

16. When there is a decline in the fair value of an asset owned by a SCA entity that is other than temporary, the SCA entity shall write the asset down to fair value.

17. For any decline in the fair value of an investment in a SCA entity that is other than temporary, the investment shall be written down to fair value as the new cost basis and the amount of the write down shall be accounted for as a realized loss. The write down shall first be considered as an adjustment to any portion of the investment that is nonadmitted (e.g., goodwill). The new cost basis shall not be changed for subsequent recoveries in fair value. Future declines in fair value, which are determined to be other than temporary shall be recorded as realized losses. An impairment shall be considered to have occurred if it is probable that the reporting entity will be unable to recover the carrying amount of the investment or there is evidence indicating inability of the investee to sustain earnings which would justify the carrying amount of the investment. A fair value of an investment that is below the carrying amount based on the statutory equity method or the existence of investee operating losses may indicate a loss in value, however, they are not necessarily indicative of a loss in value that is other than temporary.

Consolidation

18. Majority-owned subsidiaries shall not be consolidated for individual entity statutory reporting. This does not exempt certain reporting entities that are members of an affiliated group from the requirement to issue consolidated or combined annual statements as supplemental information in accordance with NAIC guidelines.

Disclosures

19. The significance of an investment to the reporting entity’s financial position and results of operations shall be considered in evaluating the extent of disclosures of the financial position and results
of operations of an investee. The following disclosures shall be made for all investments in SCA entities that exceed 10% of the total admitted assets of the reporting entity:

a. Financial statements of a reporting entity shall disclose (i) the name of each SCA entity and percentage of ownership of common stock, (ii) the accounting policies of the reporting entity with respect to investments in SCA entities, and (iii) the difference, if any, between the amount at which the investment is carried and the amount of underlying equity in net assets (i.e., goodwill, other nonadmitted assets, market value or discounted market value adjustments) and the accounting treatment of the difference;
b. For those SCA entities for which a quoted market price is available, the aggregate value of each SCA investment based on the quoted market price and the difference, if any, between the amount at which the investment is carried and the quoted market price shall be disclosed;
c. Summarized information as to assets, liabilities, and results of operations shall be presented for SCA entities, either individually or in groups; and
d. Conversion of outstanding convertible securities, exercise of outstanding options and warrants and other contingent issuances of an investee may have a significant effect on an investor’s share of reported earnings or losses. Accordingly, material effects of possible conversions, exercises or contingent issuances shall be disclosed in notes to the financial statements of the reporting entity.

20. Any commitment or contingent commitment to a SCA entity shall be disclosed (e.g., guarantees or commitments to provide additional capital contributions).

21. A reporting entity that recognizes an impairment loss shall disclose the following in the financial statements that include the period of the impairment writedown:
a. A description of the impaired assets and the facts and circumstances leading to the impairment; and
b. The amount of the impairment and how fair value was determined.

22. Refer to the preamble for further discussion regarding disclosure requirements. The disclosures in paragraph 19 d. above shall be included in the annual audited statutory financial reports only.

**Relevant Literature**

23. This statement adopts the NAIC *Purposes and Procedures of the Securities Valuation Office*.

24. This statement adopts *FASB Interpretation No. 35, Criteria for Applying the Equity Method of Accounting for Investments in Common Stock, an Interpretation of APB Opinion No. 18* as guidance to be considered in determining the existence of control.

25. This statement rejects *APB Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock, AICPA Accounting Interpretations, The Equity Method of Accounting for Investments in Common Stock: Accounting Interpretations of APB Opinion No. 18, FASB Technical Bulletin No. 79-19, Investor’s Accounting for Unrealized Losses on Marketable Securities Owned by an Equity Method Investee, FASB Emerging Issues Task Force No. 87-21, Change of Accounting Basis in Master Limited Partnership Transactions, and FASB Emerging Issues Task Force No. 96-16, Investor’s Accounting for an Investee When the Investor Owns a Majority of the Voting Stock but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights*. 

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Effective Date and Transition

26. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Correction of Errors.

AUTHORITATIVE LITERATURE

Statutory Accounting

- NAIC Purposes and Procedures of the Securities Valuation Office

Generally Accepted Accounting Principles

- FASB Interpretation No. 35, Criteria for Applying the Equity Method of Accounting for Investments in Common Stock, an Interpretation of APB Opinion No. 18

RELEVANT ISSUE PAPERS

- Issue Paper No. 1—Consolidation of Majority-owned Subsidiaries
- Issue Paper No. 46—Accounting for Investments in Subsidiary, Controlled and Affiliated Entities
Statement of Statutory Accounting Principles No. 47

Uninsured Plans

STATUS
Type of Issue: Common Area
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Affected by: No other pronouncements
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SCOPE OF STATEMENT

SUMMARY CONCLUSION

Revenue/Expense Recognition
Amounts Receivable
Liabilities
Disclosures
Effective Date and Transition

RELEVANT ISSUE PAPERS
Uninsured Plans

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for all uninsured plans.

SUMMARY CONCLUSION

2. For purposes of this statement, uninsured accident and health plans, including HMO administered plans, and uninsured property and casualty plans (collectively referred to as uninsured plans) are defined as plans for which a reporting entity, as an administrator, performs administrative services such as claims processing for a third party that is at risk, and accordingly, the administrator has not issued an insurance policy, regardless of whether an identification card is issued. In the case of uninsured accident and health plans, the administrator may arrange for the provision of medical services through a contracted or employed provider network. The plan (whether insured by another reporting entity or self insured) bears all of the insurance risk, and there is no possibility of loss or liability to the administrator caused by claims incurred related to the plan. The administrator, however, may be subject to credit risk with regard to the risk bearing entity. An uninsured accident and health plan may be either an Administrative Services Only (ASO) plan or an Administrative Services Contract (ASC) plan. Under an ASO plan, claims are paid from a bank account owned and funded directly by the uninsured plan sponsor; or, claims are paid from a bank account owned by the reporting entity, but only after the reporting entity has received funds from the uninsured plan sponsor that are adequate to fully cover the claim payments. Under an ASC plan, the reporting entity pays claims from its own bank accounts, and only subsequently receives reimbursement from the uninsured plan sponsor. No arrangement where the reporting entity receives a capitated payment for providing medical services to a third party shall qualify as an uninsured plan.

3. Uninsured accident and health plans also include Federal, state or other government department funded programs such as Medicare cost contracts where there is no underwriting risk to the reporting entity. Under Medicare cost contracts, service provided to recipients includes the direct delivery of health care for which the reporting entity is reimbursed based on costs incurred as provided for in regulations governing the administration of such contracts. Other such programs may include some Medicaid contracts for which administration or other non-underwriting services are provided.

4. Partially insured or combination plans exist, under which the reporting entity issues an insurance policy for some of the risks related to the claims (e.g. minimum premium and stop loss coverage), but acts as an administrator for some, or all, of the claims paid by the plan. Such plans shall be treated as two plans: an insured plan (the part for which the reporting entity has issued a policy) and an uninsured plan (the part that meets the definition in paragraph 2 of this statement). The components related to uninsured plans shall be accounted for using the accounting principles established in this statement; the components related to insured plans shall be accounted for as insurance.

Revenue/Expense Recognition

5. The administrator’s statement of operations shall exclude all income and expenses related to claims, losses, premiums, and other amounts received or paid on behalf of uninsured ASO or uninsured ASC plans. An administrator acting as a provider of services, that provides such services through a salaried network, where the cost allocation of the service provided to insured vs. uninsured plans cannot be reasonably determined, shall report medical and hospital expenses on a gross basis by type of expense and report revenue from uninsured plans on a gross basis as fee for service income.

6. Commissions, expenses, and taxes paid by the administrator to administer such plans shall be reported on a gross basis by type of expense. Where the only functions provided are administrative, administrative fees and related reimbursements from the plan shall be deducted from general expenses. Reporting entities filing the health blank should deduct administrative fees and related reimbursements
from general administrative expenses or claim adjustment expenses if the administrative services
provided include services for claim adjustment expenses as defined in SSAP No. 55—Unpaid Claims,
Losses and Loss Adjustment Expenses. Where the reporting entity provides both administration and health
care services directly, income from Medicare or similarly structured cost based reimbursement contracts
is not recorded as premium but is recorded as revenue in the appropriate category. Health care services
rendered as “medical and hospital” categorized by type and administrative expenses by type of expense
shall be reported on an incurred basis.

7. Income from cost based reimbursement contracts is recorded as revenue because the service
provided is for the direct delivery of care to recipients. There are risks associated with these plans in that
all costs incurred under the contract may not be reimbursable and revenues may be adjusted based on
subsequent challenges of costs included in filed cost reports. In addition, revenue may also be adjusted
based on the performance under the terms of the contract or other external factors.

Amounts Receivable

8. Amounts receivable from uninsured plans for (a) claims and other costs paid by the administrator
on behalf of the third party at risk and (b) fees related to services provided by the administrator to the plan
meet the definition of assets as set forth in SSAP No. 4—Assets and Nonadmitted Assets. A receivable
shall not be recorded for unpaid claims. A receivable related to Medicare or a similarly structured cost
based reimbursement contract shall only be recorded when services have been rendered.

9. An evaluation shall be made of the amounts receivable to determine any nonadmitted amounts.
Next, an evaluation shall be made in accordance with SSAP No. 5—Liabilities, Contingencies and
Impairments of Assets (SSAP No. 5), to determine whether there is an impairment. This two step process
is set forth below:

a. Uncollected uninsured plan receivables (excluding Medicare and similar government
plans) over ninety days due shall be accounted for as a nonadmitted asset;

b. Remaining amounts determined to be uncollectible shall be written off. If in accordance
with SSAP No. 5, it is “probable” the amount receivable is uncollectible, any
uncollectible amount receivable shall be written off against operations in the period such
determination is made. If it is “reasonably possible” the amount receivable is
uncollectible, the disclosure requirements outlined in SSAP No. 5 paragraph 14 shall be
made. This evaluation may consider irrevocable letters of credit to which the
administrator is beneficiary, amounts on deposit with the administrator or other
unrestricted funds available to the administrator.

10. The following shall provide additional guidance in determining the nonadmitted portion of
amounts receivable from uninsured plans:

a. Amounts classified as nonadmitted assets collected subsequent to the date of the statutory
financial statements shall not be used to decrease the nonadmitted asset otherwise
calculated;

b. The due date is governed by the contractual billing date of the uninsured plan;

c. Medicare and similar government funded plans—Amounts due related to Medicare and
similar government plans shall not be nonadmitted when they become over ninety days
due. Appropriate reserves shall be established to cover costs incurred which may not be
reimbursed upon final determination by the governing agencies under the cost contract or
for adjustments to revenues based on performance under the terms of the contract or other external factors.

Liabilities

11. A liability shall be established for funds held by an administrator in its general assets for the benefit of an uninsured plan or for funds which may be owed by the administrator in connection with the administration of an uninsured plan. A liability relating to one plan shall not be offset by an asset relating to a different plan. Administrators shall not record aggregate reserves, claim/loss reserves, or liabilities (except for Medicare or similarly structured cost based reimbursement contracts) for any other claim costs paid by the administrator on behalf of uninsured plans.

Disclosures

12. The statutory financial statements shall provide the following:

a. Information with regard to the profitability to the administrator of all ASO plans and the uninsured portions of partially insured plans for which the reporting entity serves as an ASO administrator;

For the total and each category separately provided: (i) net reimbursement for administrative expenses (including administrative fees) in excess of actual expenses, (ii) total net other income or expense (including interest paid to or received from plans), and (iii) total net gain or loss from operations and (iv) the claim payment volume;

b. Information with regard to the profitability to the administrator of all ASC plans and the uninsured portions of partially insured plans for which the reporting entity serves as an ASC administrator;

For the total and each category separately provided: (i) gross reimbursement for medical cost incurred, (ii) gross administrative fees accrued, (iii) other income or expense (including interest paid to or received from plans), (iv) gross expenses incurred (claims and administrative), and (v) total net gain or loss from operations.

c. Information with regards to Medicare or similarly structured cost based reimbursement contracts shall include: (i) major components of revenue by payor, (ii) receivables from payors with account balances the greater of 10% of gross amounts receivable relating to uninsured accident and health plans or $10,000, (iii) recorded allowances and reserves for adjustment of recorded revenues, (iv) adjustments to revenue resulting from audit of receivables related to revenues recorded in the prior period.

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

Effective Date and Transition

14. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors.

RELEVANT ISSUE PAPERS

- Issue Paper No. 47—Uninsured Plans
Statement of Statutory Accounting Principles No. 48

Joint Ventures, Partnerships and Limited Liability Companies

STATUS

Type of Issue: Common Area
Issued: Initial Draft
Effective Date: January 1, 2001
Affects: No other pronouncements
Affected by: No other pronouncements
Interpreted by: INT 99-15, INT 01-10, INT 01-24, INT 02-07, INT 03-03

SCOPE OF STATEMENT

SUMMARY CONCLUSION

Impairment
Disclosures
Relevant Literature
Effective Date and Transition

RELEVANT ISSUE PAPERS
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Joint Ventures, Partnerships and Limited Liability Companies

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for investments in joint ventures, partnerships, and limited liability companies.

SUMMARY CONCLUSION

2. This statement addresses accounting for investments in any joint venture, partnership, or limited liability company whether or not it is considered to be controlled by or affiliated with the reporting entity.

3. Investments in joint ventures shall include investments in corporate joint ventures and unincorporated joint ventures (also referred to as undivided interests in ventures). A corporate joint venture is defined as a corporation owned and operated by a small group (the joint venturers) as a separate and specific business or project for the mutual benefit of the members of the group. A corporate joint venture usually provides an arrangement under which each joint venturer may participate, directly or indirectly, in the overall management of the joint venture. Joint venturers thus have an interest or relationship other than as passive investors. An unincorporated joint venture is similar in its purpose but is not incorporated.

4. Investments in partnerships shall include investments in general partnership interests and limited partnership interests. A general partnership is defined as an association in which each partner has unlimited liability. Each partner assumes joint and several liability for all partnership debts. A limited partnership shall be defined as a partnership having two classes of partners: (a) general partners who manage the partnership, subject to the partnership agreement, and have personal liability for the general obligations of the partnership and (b) limited partners who are passive investors and have no personal liability beyond their investment.

5. A limited liability company is defined as a business organization which is a hybrid of a corporation and partnership whereby the owners have limited liability like a corporation and profits may pass through to the owners for tax purposes like a partnership if certain criteria are met. The owner’s personal liability is limited to his own acts and the owners can fully participate in the management of the business with no adverse impact on their limited liability.

6. Investments in the ventures defined in paragraphs 3 through 5 meet the definition of assets 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. Investments in joint ventures, partnerships, and limited liability companies shall be reported in Other Invested Assets in the financial statements.

7. Investments in these ventures, except for joint ventures, partnerships and limited liability companies with a minor ownership interest, shall be reported using an equity method as defined in SSAP No. 46—Investments in Subsidiary, Controlled, and Affiliated Entities (SSAP No. 46), paragraphs 7 b. i. through 7 b. iii.

8. Joint ventures, partnerships, and limited liability companies in which the entity has a minor ownership interest (i.e., less than 10%) shall be recorded based on the underlying audited GAAP equity of the investee. The amount to be recorded shall be defined as the initial investment in an investee at cost (as defined in paragraph 3 of SSAP No. 68—Business Combinations and Goodwill). The carrying amount of the investment shall be adjusted to recognize the reporting entity’s share of the audited GAAP basis earnings or losses of the investee after the date of acquisition, adjusted for any distributions received. A reporting entity’s share of adjustments that are recorded directly to the investee’s stockholder’s equity under GAAP shall also be recorded as adjustments to the carrying value of the investment with an offsetting amount recorded to unrealized capital gains and losses on investments.
9. The reporting entity’s share of undistributed earnings and losses of the investee shall be included in unrealized gains and losses of the reporting entity. The reporting entity’s share of other changes in the investee’s surplus (e.g., the change in the investee’s nonadmitted assets) shall be recorded by the investor as a component of unrealized capital gains and losses on investments. Distributions received from an investee shall be recognized in investment income when declared to the extent that they are not in excess of the undistributed accumulated earnings attributable to the investee. Distributions declared in excess of the undistributed accumulated earnings attributable to the investee shall reduce the carrying amount of the investment.

Impairment

10. For any decline in the fair value of an investment in a joint venture, partnership, or limited liability company which is determined to be other than temporary, the investment shall be written down to fair value as the new cost basis and the amount of the write down shall be accounted for as a realized loss. The write down shall first be considered as an adjustment to any portion of the investment that is nonadmitted (e.g., goodwill). The new cost basis shall not be changed for subsequent recoveries in fair value. Future declines in fair value, which are determined to be other than temporary, shall be recorded as realized losses.

11. An impairment shall be considered to have occurred if it is probable that the reporting entity will be unable to recover the carrying amount of the investment or there is evidence indicating inability of the investee to sustain earnings which would justify the carrying amount of the investment. Even if the fair value of an investment is below the carrying amount it is not necessarily indicative of a loss in value that is other than temporary. Similarly, the existence of investee operating losses may indicate a loss in value; however, it is not necessarily indicative of a loss in value that is other than temporary.

Disclosures

12. The significance of an investment to the reporting entity’s financial position and results of operations shall be considered in evaluating the extent of disclosures of the financial position and results of operations of an investee. Disclosures as follows shall be made for all investments in joint ventures, partnerships, or limited liability companies that exceed 10% of the total admitted assets of the reporting entity:

a. (1) the name of each joint venture, partnership or limited liability company and percentage of ownership, (2) the accounting policies of the reporting entity with respect to investments in joint ventures, partnerships and limited liability companies and (3) the difference, if any, between the amount at which the investment is carried and the amount of underlying equity in net assets (i.e., nonadmitted goodwill or other nonadmitted assets) and the accounting treatment of the difference;

b. For joint ventures, partnerships, and limited liability companies for which a quoted market price is available, the aggregate value of each joint venture, partnership, or limited liability company investment based on the quoted market price; and

c. Summarized information as to assets, liabilities, and results of operations for joint ventures, partnerships, and limited liability companies either individually or in groups.

13. Any commitment or contingent commitment (e.g., guarantees or commitments to provide additional capital contributions) to a joint venture, partnership, or limited liability company shall be disclosed.

14. A reporting entity that recognizes an impairment loss shall disclose the following in the financial statements that include the period of the impairment write-down:
a. A description of the impaired assets and the facts and circumstances leading to the impairment; and

b. The amount of the impairment and how fair value was determined.

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

Relevant Literature

16. This statement is inconsistent with the guidance in paragraph 17 of APB Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock (APB 18), which addresses when control exists. APB 18 is addressed in its entirety and rejected in SSAP No. 46. This statement also rejects AICPA Statement of Position 78-9, Accounting for Investments in Real Estate Ventures.

Effective Date and Transition

17. This statement is effective for years beginning January 1, 2001. For investments made in joint ventures, partnerships and limited liability companies prior to January 1, 2001, if the joint venture, partnership or limited liability company does not prepare audited GAAP financial statements, and the reporting entity together with all other investors subject to this statement does not have sufficient voting power (pursuant to the joint venture, partnership or limited liability agreement) to force the preparation of audited GAAP financial statements, the reporting entity may then value its investment based on unaudited GAAP or audited tax-basis financial statements. 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—Accounting Changes and Corrections of Errors.

RELEVANT ISSUE PAPERS

- Issue Paper No. 48—Investments in Joint Ventures, Partnerships and Limited Liability Companies
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Statement of Statutory Accounting Principles No. 49

Policy Loans

STATUS

Type of Issue: Life and Accident and Health

Issued: Initial Draft

Effective Date: January 1, 2001

Affects: No other pronouncements

Affected by: No other pronouncements

Interpreted by: INT 01-05

SCOPE OF STATEMENT

SUMMARY CONCLUSION

Effective Date and Transition

RELEVANT ISSUE PAPERS
Policy Loans

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for policy loans.

SUMMARY CONCLUSION

2. A policy (or contract) loan shall be defined as a loan to a policyholder, under the provisions of an insurance contract that is secured by the cash surrender value or collateral assignment of the related policy or contract. Policy loans shall include:

   a. Cash loans, including loans resulting from early payment benefits or accelerated payment benefits, on contracts when the terms of the contract specify that such payments are policy loans secured by the policy;

   b. Automatic premium loans, which are loans made in accordance with policy provisions whereby delinquent premium payments are automatically paid from the cash value at the end of the established grace period for premium payments.

3. Policy loans meet the definition of assets, as defined in SSAP No. 4—Assets and Nonadmitted Assets and are admitted assets, except as specified in paragraphs 5 and 6 of this statement. Policy loans are readily available to satisfy policyholder obligations as the terms of the policy loan allow the reporting entity to offset an outstanding policy loan balance against the cash surrender value of the policy.

4. Policy loans shall be carried at the unpaid balance of the loan. The unpaid balance of the loan shall include any unpaid principal plus any accrued interest which is 90 days or more past due.

5. If the unpaid balance of the loan exceeds the cash surrender value or policy reserves established for the policy, the policy generally lapses. Cash surrender value shall be defined as the cash value of the basic policy plus cash value of any policy accumulations such as paid-up additions. The excess of the unpaid balance of the loan over the cash surrender value shall be evaluated for collectibility. If the amount is considered uncollectible, it shall be written off as a reduction of investment income in the statement of operations during the period it is determined to be uncollectible. Except for collateral assignment loans, all other amounts in excess of the cash surrender value shall be considered nonadmitted assets. The change in this nonadmitted asset shall be recorded as an unrealized capital gain or loss as applicable.

6. A loan resulting from early payment benefits or accelerated payment benefits and secured by an assignment of the policy to the reporting entity as collateral for the loan shall be an admitted asset, except that the amount of any loan (including accrued interest) in excess of the policy reserve for that policy shall be nonadmitted. Upon death, the entire death benefit is recorded as a death benefit expense. The policy proceeds shall be used to repay the loan. Any proceeds in excess of that needed to repay the loan are payable to the named beneficiary.

7. Interest income on policy loans shall be recorded as earned and included in investment income consistent with SSAP No. 34—Investment Income Due and Accrued. For interest received before it is earned, unearned interest income shall be recorded as a liability in accordance with SSAP No. 5—Liabilities, Contingencies and Impairments of Assets.

8. Accrued interest income on policy loans that is past due 90 days or more shall be reclassified from Investment Income Due and Accrued and included in the unpaid balance of the policy loan as defined in paragraph 4.
Effective Date and Transition

9. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors.

RELEVANT ISSUE PAPERS

• Issue Paper No. 49—Policy Loans
Statement of Statutory Accounting Principles No. 50

Classifications and Definitions of Insurance or Managed Care Contracts In Force

STATUS

Type of Issue: Common Area

Issued: Initial Draft

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SCOPE OF STATEMENT

SUMMARY CONCLUSION

Overview
Life Contracts
Life Contracts—Definitions
Accident and Health Contracts
Accident and Health Contracts—Definitions
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Property and Casualty Contracts—Definitions
Deposit-Type Contracts
Relevant Literature
Effective Date and Transition

RELEVANT ISSUE PAPERS
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Classifications and Definitions of Insurance or Managed Care Contracts In Force

SCOPE OF STATEMENT

1. This statement provides a general framework for classifying insurance or managed care contracts into categories where the recognition of contract and policy reserves and related revenue, benefits, and claims is fundamentally different. Separate statements will establish the accounting principles for premium and income recognition and policy benefit and claim reserves for all contracts defined herein.

SUMMARY CONCLUSION

Overview

2. The primary purpose of insurance, including managed care coverage, is to provide economic protection from identified risks occurring or discovered within a specified period. These risks include death, disability, health benefits, outliving one’s financial assets, and damage to property by an insured peril or damage or injury to the insured or third parties. The accounting for the contract is significantly influenced by the terms of the insurance or managed care contract.

3. In order to provide for a conservative, consistent, and comparable method of accounting for insurance or managed care contracts, premiums and related benefits shall be recognized considering the policy term, premium payment requirements, risks assumed and benefits provided under the contract using conservative assumptions as to interest, mortality, morbidity, and incurred costs for health benefits as applicable. The reserve and income recognition methods reflect the premium payment pattern and the insurance protection and/or benefits provided for in the insurance or managed care contract.

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

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

Life Contracts

6. The primary purpose of life insurance is to provide financial assistance to a beneficiary at the insured’s death. The long period of coverage involving the risk of death, a risk which usually increases with age, is the distinguishing characteristic by which life insurance is set apart from other forms of insurance. Life insurance is often sold on a level premium basis under which the annual premium remains constant even though the expected policy benefits and services do not occur evenly over the duration of the contract. Premium revenue generally exceeds expected policy benefits in the early years of the contract and it is necessary to accrue, as premium revenue is recognized, a liability for costs that are expected to be paid in the later years of the contract.
7. The liability for expected costs relating to most types of life contracts is accrued over the current and expected renewal periods of the contracts. The net valuation premium is based upon an assumed interest rate and upon the frequency of death derived from mortality tables. The net premiums collected, after deducting benefits and other costs each year, are accumulated at interest. This accumulation, when combined with future net premiums and future investment income theoretically generate a sum sufficient to pay the claims resulting from the death or disabilities of the insured.

8. The liability which corresponds to this fund is referred to as the policy reserve. These contracts are generally expected to be in force for an extended period of time and require the performance of various functions and services for an undefined period of time and are generally not subject to unilateral changes in their provisions. The policy reserve is generally calculated as the excess of the present value of future benefits to be paid to or on behalf of policyholders less the present value of future net premiums, discounted at valuation interest and mortality.

9. Life insurance contracts shall include contracts with life contingencies, including, but not limited to:
   - Whole life contracts
   - Endowment contracts
   - Term life contracts
   - Supplementary contracts
   - Group life contracts
   - Franchise life contracts
   - Universal life type contracts
   - Variable life contracts
   - Limited payment contracts
   - Credit life contracts
   - Annuity contracts

**Life Contracts—Definitions**

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

11. Whole life contracts provide a fixed amount of insurance coverage over the life of the insured and the related benefits are normally payable only upon the insured’s death. Premiums are paid over various periods as allowed by the terms of the policy contract. Whole life insurance contracts provide for nonforfeiture values, some common types being reduced paid up insurance, extended term insurance, and
12. **Endowment contracts** are principally savings contracts which incorporate an element of life insurance protection. Endowment insurance contracts provide a benefit if the insured survives the endowment period or the amount is paid to a beneficiary if the insured does not survive. A pure endowment contract only provides a benefit to the insured if he/she survives the endowment period. Endowment policies mature at a specified attained age of the insured or at the end of a specified period. Premium payments for endowment contracts are made over a specified period, but may also be made under a single premium or limited-payment plan. Both whole life and endowment policies contain nonforfeiture or similar clauses which provide for a value in cash or some other form of insurance to be available in the event of failure to continue the required premiums.

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

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

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

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

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

18. **Limited-payment contracts** are contracts with terms that are fixed and guaranteed and for which premiums are paid over a specified number of years or to a specified age. The insurance coverage continues for the remainder of the insured’s life. A single-premium policy requires a lump-sum payment at the inception of the policy.
19. Credit life contracts are sold in connection with loans or other credit transactions not exceeding a stated duration and provide insurance protection against death. This form of insurance is generally issued in connection with the issuance of credit to an individual by a bank, retailer, finance company, or other similar organizations. This type of insurance most often protects the creditor to the extent of the unpaid balance of the loan in the form of decreasing term insurance; however, some credit life insurance is sold on a level-term basis.

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

a. A deferred annuity provides for the accumulation of funds to be applied at some future period designated by the policyholder. Premium payments can be made in a lump sum amount (single premium deferred annuity), or periodically (flexible or fixed premium deferred annuity) as allowed by the policy contract. At the end of the accumulation period, the policyholder may elect to receive a lump sum distribution or may elect to receive periodic payments for life, or over a specific period, or some combination thereof;

b. A variable annuity is an annuity which includes a provision for benefit payments which vary in accordance with the rate of return of the underlying investment portfolio selected by the policyholder. The considerations for a variable annuity are usually invested in a separate account in which the value of the contract share varies according to the performance of the separate account before the commencement of annuity payments as well as after. Premium payments can be made in lump sum amounts or periodically as allowed by the policy contract. A minimum death benefit is often guaranteed during the annuity consideration accumulation period and these contracts are, therefore, classified as life contracts;

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

d. A life annuity with a period certain works essentially the same way as the straight-life annuity as the annuitant receives periodic payments for as long as the annuitant lives. However, if the annuitant dies before the end of the specified “certain” period, payments are continued to a beneficiary until the specified number of “certain” payments (i.e., the specified period in the contract) is completed;

e. A refund annuity is similar to the life annuity with a period certain in which the annuitant receives periodic payments for as long as the annuitant lives. There are two variants of this type of annuity. Under the cash refund annuity, a lump-sum payment is made at the death of the annuitant equal to the excess, if any, of the purchase price of the annuity over the sum of the annuity payments made to date of death. The installment refund annuity provides that annuity payments are to continue to a beneficiary after the death of the annuitant until the sum of all payments made equals the purchase price;

f. A joint and survivorship annuity provides for the continuation of payments after the death of one of the annuitants during the lifetime of the surviving annuitant.
Accident and Health Contracts

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

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

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

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

25. The liability for expected costs relating to accident and health contracts sold on a level premium basis is accrued over the current and expected renewal periods of the contracts. The net valuation premium is based upon an assumed interest rate, persistency, and the frequency of expected death and disability claims, generally derived from mortality and morbidity tables. The net premiums collected, after deducting benefits and other costs each year, are accumulated with interest. Similar to life insurance, this accumulation or policy reserve, when combined with future net premiums and future investment income theoretically generate a sum sufficient to pay the claims resulting from the death or disabilities of the insured or subscriber. The reserve is generally calculated as the excess of the present value of future benefits to be paid to or on behalf of insureds or subscribers less the present value of future net premiums, discounted at valuation interest, mortality, and morbidity.
26. Accident and health contracts shall include contracts with health benefits or disability contingencies, including, but not limited to:

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

**Accident and Health Contracts—Definitions**

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

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

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

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

31. Long-term care contracts represent any contract or policy rider providing coverage for not less than 12 consecutive months for each covered person for one or more necessary diagnostic, preventive, therapeutic, rehabilitative, maintenance or personal care services, provided in a setting other than an acute care unit of a hospital. Under long-term care contracts, the insured event is generally the inability of the contractholder to perform certain activities of daily living as compared to medical contracts which generally provide insurance protection against accident or sickness or disabilities contracts which generally provide income replacement protection.
Property and Casualty Contracts

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

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

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

Property and Casualty Contracts—Definitions

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

36. Types of insurance represent the perils that are insured by property and liability insurance companies and classified as property and casualty contracts. Some of the more important types of insurance are as follows:
   a. Fire and allied lines, which include coverage for fire, windstorm, hail, and water damage (but not floods);
   b. Ocean marine, which includes coverage for ships and their equipment, cargos, freight or money to be paid for use of the ships, and liability to third parties for damages. This type of insurance includes inland as well as ocean water transportation;
   c. Inland marine, which covers property in transit. (It also includes floaters, which are policies that cover movable property, such as a tourist’s personal property);
   d. Workers’ compensation, which compensates employees for injuries or illness sustained in the course of their employment;
   e. Automobile, which covers personal injury or automobile damage sustained by the insured and the related liability to third parties for losses caused by the insured;
   f. Multiple peril, which is a package coverage including most property and liability coverage except workers’ compensation, automobile insurance, and surety bonds;
   g. Professional liability, which covers physicians, surgeons, dentists, hospitals, engineers, architects, accountants, attorneys, and other professionals from liability arising from error or misconduct in providing or failing to provide professional service;
   h. Miscellaneous liability, which covers most other physical and property damages not included under workers’ compensation, automobile liability, and multiple peril policies.
(Damages include death, cost of care, and loss of services resulting from bodily injury, as well as loss of use of property);

i. Fidelity bonds, which cover employers against dishonest acts by employees. Blanket fidelity bonds cover groups of employees; and

j. Surety bonds, which provide for monetary compensation to third parties for failure by the insured to perform specifically covered acts within a stated period. (Most surety bonds are issued for persons doing contract construction, persons connected with court actions, and persons seeking licenses and permits. Surety bonds also include financial guarantees.)

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

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

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

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

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

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

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

44. Deposit-type contracts shall include contracts without any life or disability contingencies, including, but not limited to, certain types of the following policy categories:

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

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

Relevant Literature

46. This statement rejects the GAAP classifications (i.e., short-duration and long-duration) found in 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, and FASB Statement No. 120, Accounting and Reporting by Mutual Life Insurance Enterprises and by Insurance Enterprises for Certain Long Duration Participating Contracts.

Effective Date and Transition

47. This statement is effective for years beginning January 1, 2001.

RELEVANT ISSUE PAPERS

- Issue Paper No. 50—Classifications and Definitions of Insurance or Managed Care Contracts In Force
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Statement of Statutory Accounting Principles No. 51

Life Contracts

STATUS

Type of Issue: Life and Accident and Health
Issued: Initial Draft
Effective Date: January 1, 2001
Affects: No other pronouncements
Affected by: Paragraph 43 superseded by SSAP No. 80
Interpreted by: INT 00-03, INT 00-30, INT 01-26

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AUTHORITATIVE LITERATURE

Statutory Accounting

RELEVANT ISSUE PAPERS
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 25).

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. 61—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 21 through 23. 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.

Policy Reserves

14. 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. 5—Liabilities, Contingencies and Impairments of Assets (SSAP No. 5). The actuarial methodologies referred to in the following paragraph meet the criteria required for reasonable estimates in SSAP No. 5.

15. 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.

16. 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.

17. 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.

18. 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.

Valuation (Reserve) Method and Deferred Premiums

19. 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.

20. 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

21. 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.

22. 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.

23. 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

24. 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

25. 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

26. 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.

27. 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.

28. 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.

29. 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

30. 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

31. 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

32. 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

33. 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

34. 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

35. 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

36. 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

37. 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.

38. Disclose the amount of annuity actuarial reserves and deposit liabilities by withdrawal
    characteristics as follows:
    a. Subject to discretionary withdrawal:
       i. With market value adjustment, where withdrawal of funds is payable at all times,
          or prior to specified maturity dates where such dates are more than one year after
          the statement date and;
          (a) In a lump sum with adjustments to reflect general changes in interest
              rates, or asset values since receipt of funds by the 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 (v.(d)) below;

iii. At market value, where the withdrawal of funds is payable at current market value of the assets supporting the liabilities, the assets are stated at current market value, and the liabilities are stated at the current market value or per unit value of the assets supporting the liabilities. These liabilities are for contracts where the customer bears the entire investment risk;

iv. Total with adjustment or at market value;

v. At book value without adjustment (minimal or no charge or adjustment), where the withdrawal of funds is either payable at all times, or at any time (including a withdrawal on a scheduled payment date) within one year from the statement date and:

(a) In a lump sum without adjustment;

(b) In installments over less than five years, with or without a reduction in interest rate during the installment period;

(c) In a lump sum subject to a fixed surrender charge of less than 5%;

(d) In a lump sum subject to surrender charge, but such charge is waived if the credited rate falls below a specified “bail out” rate and the “bail out” rate is more than the maximum statutory valuation rate for life insurance policies for more than 20 years for new issues;

b. Not subject to discretionary withdrawal;

c. Total gross;

d. Reinsurance ceded;

e. Total net.

39. 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.

40. 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.

41. 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.

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

Relevant Literature


44. 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.

Effective Date and Transition

45. 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.
AUTHORITATIVE LITERATURE

Statutory Accounting

- NAIC Financial 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
Statement of Statutory Accounting Principles No. 52

Deposit-Type Contracts

STATUS

Type of Issue: Life and Accident and Health

Issued: Initial Draft

Effective Date: January 1, 2001

Affects: No other pronouncements

Affected by: Paragraph 19 superseded by SSAP No. 80

Interpreted by: INT 00-03, INT 00-23

SCOPE OF STATEMENT

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RELEVANT ISSUE PAPERS
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Deposit-Type Contracts

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for income recognition and policy reserves for all contracts classified as deposit-type contracts defined in SSAP No. 50—Classifications and Definitions of Insurance or Managed Care Contracts In Force (SSAP No. 50).

SUMMARY CONCLUSION

Introduction

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

3. Deposit-type contracts frequently grant policyholders significant discretion over the amount and timing of deposits and withdrawals. Reporting entities are frequently granted significant discretion over amounts that accrue to or that are assessed against policyholders.

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

5. Categories of contracts that may not subject the reporting entity to risks arising from policyholder mortality or morbidity include, but are not limited to, certain types of the following policy categories:

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

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

Policy Reserves

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

8. 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.

9. The policy reserve for contracts without life contingencies where the future benefits are fixed and guaranteed (e.g., certain supplemental contracts, lottery payouts, structured settlements, guaranteed interest contracts, income settlement options, annuities certain, and unmatured coupon accumulations) shall be based on the present value of the future guaranteed benefits discounted at the valuation interest rate. The policy reserve for all other contracts (e.g., certain premium and other deposit funds, and dividend and matured coupon accumulations) shall be based on the accumulated amounts paid plus an income accumulation based on the contract provisions, less any withdrawals and applicable surrender charges.

10. Policy reserves shall be increased for reinsurance assumed and decreased for reinsurance ceded as further described in SSAP No. 61—Life, Deposit-Type and Accident and Health Reinsurance.

Structured Settlements

11. Reporting entities that have accepted an assignment of obligations under structured settlements shall record those obligations consistent with the accounting and reporting provided for structured settlements in SSAP No. 65—Property and Casualty Contracts.

Cost Recognition

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

Change In Valuation Basis

13. A change in valuation basis shall be defined as a change in the interest rate assumption or other factor affecting the reserve computation of policies in force and meets the definition of an accounting change as defined in 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 specific transition that allows for grading.

**Unearned Income**

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

**Additional Reserves Not Included Elsewhere**

15. Additional actuarial liabilities are commonly held for such items as:
   
   a. Surrender values in excess of reserves otherwise required or carried; and
   
   b. Additional reserves required based on asset adequacy analysis as discussed in Appendix A-822.

**Disclosures**

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

   a. A description of reserve practices including the amount of any surrender value promised in excess of the reserve as legally computed;

   b. The method of determination of tabular interest on funds not involving life contingencies; and

   c. The nature of significant other reserve changes.

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

   a. Subject to discretionary withdrawal:

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

         (a) In a lump sum with adjustments to reflect general changes in interest rates, or asset values since receipt of funds by the reporting entity; and

         (b) In installments over five years or more, with or without a reduction in the interest rate during the installment period.

      ii. At book value less current surrender charge, where the withdrawal of funds is payable at all times, or at any time within one year from the statement date in a lump sum subject to a current fixed surrender charge of 5% or more and it does not contain a meaningful bail out rate as described in subparagraph v.(d) below;

      iii. At market value, where the withdrawal of funds is payable at current market value of the assets supporting the liabilities, the assets are stated at current market value, and the liabilities are stated at the current market value or per unit value of
the assets supporting the liabilities. These liabilities are for contracts where the customer bears the entire investment risk;

iv. Total with adjustment or at market value;

v. At book value without adjustment (minimal or no charge or adjustment), where the withdrawal of funds is either payable at all times, or at any time (including a withdrawal on a scheduled payment date) within one year from the statement date and:

(a) In a lump sum without adjustment;

(b) In installments over less than five years, with or without a reduction in interest rate during the installment period;

(c) In a lump sum subject to a fixed surrender charge of less than 5%;

(d) In a lump sum subject to surrender charge, but such charge is waived if the credited rate falls below a specified “bail out” rate and the “bail out” rate is more than the maximum statutory valuation rate for life insurance policies for more than 20 years for new issues;

b. Not subject to discretionary withdrawal;

c. Total gross;

d. Reinsurance ceded;

e. Total net.

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

Relevant Literature


20. 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.
Effective Date and Transition

21. 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.

AUTHORITATIVE LITERATURE

Statutory Accounting

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

RELEVANT ISSUE PAPERS

- Issue Paper No. 52—Deposit-Type Contracts
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Statement of Statutory Accounting Principles No. 53

Property Casualty Contracts—Premiums

STATUS

Type of Issue: Common Area

Issued: Initial Draft

Effective Date: January 1, 2001

Affects: No other pronouncements

Affected by: No other pronouncements

Interpreted by: INT 99-23, INT 01-23, INT 02-11

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RELEVANT ISSUE PAPERS.................................................................6
Property Casualty Contracts—Premiums

SCOPE OF STATEMENT

1. This statement establishes general statutory accounting principles for the recording and recognition of premium revenue for property and casualty contracts as defined in SSAP No. 50 - Classifications and Definitions of Insurance or Managed Care Contracts In Force.

2. Specific statutory requirements for certain property and casualty premiums are addressed in the following statements: (a) SSAP No. 57—Title Insurance, (b) SSAP No. 58—Mortgage Guaranty Insurance, (c) SSAP No. 60—Financial Guaranty Insurance, (d) SSAP No. 62—Property and Casualty Reinsurance, (e) SSAP No. 65—Property and Casualty Contracts, and (f) SSAP No. 66—Retrospectively Rated Contracts and Contracts.

SUMMARY CONCLUSION

3. Except as provided for in paragraph 4, written premium is defined as the contractually determined amount charged by the reporting entity to the policyholder for the effective period of the contract based on the expectation of risk, policy benefits, and expenses associated with the coverage provided by the terms of the insurance contract. Frequently, insurance contracts are subject to audit by the reporting entity and the amount of premium charged is subject to adjustment based on the actual exposure. Premium adjustments are discussed in paragraphs 8 through 11 of this statement.

4. For workers’ compensation contracts, which have a premium that may periodically vary based upon changes in the activities of the insured, written premiums may be recorded on an installment basis to match the billing to the policyholder. Under this type of arrangement, the premium is determined and billed according to the frequency stated in the contract, and written premium is recorded on the basis of that frequency.

5. Written premiums for all other contracts shall be recorded as of the effective date of the contract. Upon recording written premium, a liability, the unearned premium reserve, shall be established to reflect the amount of premium for the portion of the insurance coverage that has not yet expired. Flat fee service charges on installment premiums1 (fees charged to policyholders who pay premiums on an installment basis rather than in full at inception of contract) are reported in the Other Income section of the Underwriting and Investment Exhibit as Finance and Service Charges. Flat fee service charges on installment premiums, which do not meet the requirements outlined in footnote 1 (e.g., policy may be cancelled for non-payment of fee or fee is refundable), shall be recorded as written premium on the effective date of the contract and subject to the unearned premium guidelines included in paragraph 7.

6. The exposure to insurance risk for most property and casualty insurance contracts does not vary significantly during the contract period. Therefore, premiums from those types of contracts shall be recognized in the statement of income, as earned premium, using either the daily pro-rata or monthly pro-rata methods as described in paragraph 7. Certain statements provide for different methods of recognizing premium in the statement of operations for specific types of contracts. For contracts not separately

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1 If the policyholder elects to pay an installment rather than the full amount or the full remaining balance, the policyholder is traditionally charged a flat fee service charge on the subsequent billing cycle(s). The amount charged is primarily intended to compensate the insurer for the additional administrative costs associated with processing more frequent billings and has no relationship to the amount of insurance coverage provided, the period of coverage, or the lost investment income associated with receiving the premium over a period of time rather than in a lump sum. As described, there is no underwriting risk associated with this service charge. If a policyholder does not pay the service charge, the policy is not cancelled (unlike non-payment of premium), but instead the policy is converted back to an annual pay plan. If a policyholder cancels coverage, the premium is returned but the service charge is not, as the service charge is not a part of premium. Clarification of finance and service charges as other income should not be construed as having any bearing on whether such charges are subject to premium taxation, which remains an issue of state law and regulation.
identified in specific statements where the reporting entity can demonstrate the period of risk differs significantly from the contract period, premiums shall be recognized as revenue over the period of risk in proportion to the amount of insurance protection provided.

7. One of the following methods shall be used for computation of the unearned premium reserve:
   a. Daily pro rata method—Calculate the unearned premium on each policy—At the end of each period, the calculation is made on each item of premium to ascertain the unexpired portion and to arrive at the aggregate unearned premium reserve;
   b. Monthly pro rata method—This method assumes that, on average, the same amount of business is written each day of any month so that the mean will be the middle of the month. For example, one-year premiums written during the first three months of the year have, at the end of the year, the following unearned fractions: January-1/24; February-3/24; March-5/24.

8. Additional premiums charged to policyholders for endorsements and changes in coverage under the contract shall be recorded on the effective date of the endorsement and accounted for in a manner consistent with the methods discussed in paragraphs 4 through 7. This is done so that, at any point in time, a liability is accrued for unearned premium related to the unexpired portion of the policy endorsement.

Earned but Unbilled Premium

9. Adjustments to the premium charged for changes in the level of exposure to insurance risk (e.g., audit premiums on workers’ compensation policies) are generally determined based upon audits conducted after the policy has expired. Reporting entities shall estimate audit premiums, the amount generally referred to as earned but unbilled (EBUB) premium, and shall record the amounts as an adjustment to premium, either through written premium or as an adjustment to earned premium. The estimate for EBUB may be determined using actuarially or statistically supported aggregate calculations using historical company unearned premium data, or per policy calculations.

10. EBUB shall be adjusted upon completion of the audit and the adjustment shall be recognized as revenue immediately. Upon completion of an audit that results in a return of premiums to the policyholder, earned premiums shall be reduced.

11. Reporting entities shall establish all of the requisite liabilities associated with the asset such as commissions and premium taxes.

12. Ten percent of EBUB in excess of collateral specifically held and identifiable on a per policy basis shall be reported as a nonadmitted asset. To the extent that amounts in excess of the 10% are not anticipated to be collected, they shall be written off against operations in the period the determination is made.

Advance Premiums

13. Advance premiums result when the policies have been processed, and the premium has been paid prior to the effective date. These advance premiums are reported as a liability in the statutory financial statement and not considered income until due. Such amounts are not included in written premium or the unearned premium reserve.
Premium Deposits on Perpetual Fire Deposits

14. Premium deposits on perpetual fire insurance risks should be charged as a liability to the extent of at least 90% of the gross amount of such deposit.

Premium Deficiency Reserve

15. When the anticipated losses, loss adjustment expenses, commissions and other acquisition costs, and maintenance costs exceed the recorded unearned premium reserve, and any future installment premiums on existing policies, a premium deficiency reserve shall be recognized by recording an additional liability for the deficiency, with a corresponding charge to operations. Commission and other acquisition costs need not be considered in the premium deficiency analysis to the extent they have previously been expensed. For purposes of determining if a premium deficiency exists, insurance 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.

16. If a premium deficiency reserve is established in accordance with paragraph 15, 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.

Disclosures

17. 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.

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

Relevant Literature

19. This statement rejects FASB Statement No. 60, Accounting and Reporting by Insurance Enterprises.

Effective Date and Transition

20. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors.
RELEVANT ISSUE PAPERS

• Issue Paper No. 53—Property Casualty Contracts—Premiums
Statement of Statutory Accounting Principles No. 54

Individual and Group Accident and Health Contracts

STATUS

Type of Issue: Common Area

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SCOPE OF STATEMENT

SUMMARY CONCLUSION

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AUTHORITATIVE LITERATURE

Statutory Accounting

RELEVANT ISSUE PAPERS
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 and Definitions of Insurance or Managed Care Contracts In Force, 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 healthcare 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. 61—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, 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.

Reserve Requirements

8. 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 23. 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.

9. 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.

10. 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. 5—Liabilities, Contingencies and Impairments of Assets (SSAP No. 5). The actuarial methodologies referred to in the following paragraph meet the criteria required for reasonable estimates in SSAP No. 5.

11. The reserving methodologies and assumptions used in calculating individual and group accident and health reserves shall meet the provisions of Appendices A-010, A-641, A-820 and A-822 (as applicable) 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. The Health Reserves Guidance Manual (HRGM) provides further guidance related to reserving methodologies and assumptions used in determining individual and group accident and health reserves. The guidelines included in the HRGM are intended to be a general statement of reserving principles and not specific, detailed instructions. The HRGM is designed to encompass all health coverages including medical, dental, disability and long-term care. The HRGM outlines the minimum guidance for reserving for health coverages, and additional reserves may be appropriate based on actuarial principles and standards of practice.

Policy Reserves

12. 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.

13. 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 12.

14. 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).

15. 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.

16. 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 21 through 24 of SSAP No. 51—Life Contracts. Other appropriate methods, including an exact reserve valuation, may also be used.

17. 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)**

18. 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, 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**

19. 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

20. 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

21. 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). 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

22. 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.

Reserve Adequacy

23. 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 or additional reserves, claim reserves (including claim liabilities), and miscellaneous reserves combined; however, each component shall be computed separately.

Additional Reserves Not Included Elsewhere

24. Reserves for experience-rating refunds or the dividend liability in group policies are discussed in SSAP No. 66—Retrospectively Rated Contracts.

25. 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

26. 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.

27. 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. 5, respectively.

28. 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.

29. 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 as a write-in for other than invested assets, with a corresponding entry to premiums; accrued return premium adjustments shall be recorded as a liability with a corresponding entry to premiums.

30. If, in accordance with SSAP No. 5, 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. 5 shall be made.

31. 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

32. 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.
33. 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.

34. If a premium deficiency reserve is established in accordance with paragraph 18, 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.

35. 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.

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

**Relevant Literature**

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

38. 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**

39. 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.

**AUTHORITATIVE LITERATURE**

Statutory Accounting

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

**RELEVANT ISSUE PAPERS**

- Issue Paper No. 54—Individual and Group Accident and Health Contracts
Statement of Statutory Accounting Principles No. 55

Unpaid Claims, Losses and Loss Adjustment Expenses

STATUS

Type of Issue: Common Area

Issued: Initial Draft

Effective Date: January 1, 2001

Affects: No other pronouncements

Affected by: Paragraphs 6 c. and 7 b. superseded by SSAP No. 85

Interpreted by: INT 00-31, INT 01-28, INT 02-21

SCOPE OF STATEMENT

SUMMARY CONCLUSION

Disclosures

Relevant Literature

Effective Date and Transition

RELEVANT ISSUE PAPERS
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Unpaid Claims, Losses and Loss Adjustment Expenses

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for recording liabilities for unpaid claims and claim adjustment expenses for life insurance contracts and accident and health contracts and unpaid losses and loss adjustment expenses for property and casualty insurance contracts. This statement applies to all insurance contracts as defined in SSAP No. 50—Classifications and Definitions of Insurance or Managed Care Contracts In Force (SSAP No. 50).

2. This statement does not address policy reserves for life and accident and health policies. These reserves are addressed in SSAP No. 51—Life Contracts, SSAP No. 52—Deposit-Type Contracts, SSAP No. 54—Individual and Group Accident and Health Contracts (SSAP No. 54), and SSAP No. 59—Credit Life and Accident and Health Insurance Contracts.

3. This statement does not address liabilities for punitive damages. These liabilities shall be recorded in accordance with SSAP No. 5—Liabilities, Contingencies and Impairments of Assets (SSAP No. 5).

SUMMARY CONCLUSION

4. Claims, losses, and loss/claim adjustment expenses shall be recognized as expense when a covered or insured event occurs. In most instances, the covered or insured event is the occurrence of an incident which gives rise to a claim or the incurring of costs. For claims made type policies, the covered or insured event is the reporting to the entity of the incident that gives rise to a claim. Claim payments and related expense payments are made subsequent to the occurrence of a covered or insured event and, in order to recognize the expense of a covered or insured event that has occurred, it is necessary to establish a liability. Liabilities shall be established for any unpaid claims and unpaid losses (loss reserves), unpaid loss/claim adjustment expenses (loss/claim adjustment expense reserves) and incurred costs, with a corresponding charge to income.

5. The following are types of future costs relating to property and casualty contracts, as defined in SSAP No. 50, which shall be considered in determining the liabilities for unpaid losses and loss adjustment expenses:

   a. Reported Losses: Expected payments for losses relating to insured events that have occurred and have been reported to, but not paid by, the reporting entity as of the statement date;

   b. Incurred But Not Reported Losses (IBNR): Expected payments for losses relating to insured events that have occurred but have not been reported to the reporting entity as of the statement date. As a practical matter, IBNR may include losses that have been reported to the reporting entity but have not yet been entered to the claims system or bulk provisions. Bulk provisions are reserves included with other IBNR reserves to reflect deficiencies in known case reserves;

   c. Loss Adjustment Expenses: Expected payments for costs to be incurred in connection with the adjustment and recording of losses defined in subparagraphs 5 a. and 5 b. Examples of expenses incurred in these activities are estimating the amounts of losses, disbursing loss payments, maintaining records, general clerical, secretarial, office maintenance, occupancy costs, utilities, computer maintenance, supervisory and executive duties, supplies, and postage. Loss adjustment expenses can be classified into two broad categories: Defense and Cost Containment (DCC) and Adjusting and Other (AO):

      i. DCC include defense, litigation, and medical cost containment expenses, whether internal or external. DCC include, but are not limited to, the following items:

         (a) Surveillance expenses;
(b) Fixed amounts for medical cost containment expenses;
(c) Litigation management expenses;
(d) Loss adjustment expenses for participation in voluntary and involuntary market pools if reported by accident year;
(e) Fees or salaries for appraisers, private investigators, hearing representatives, reinspectors and fraud investigators, if working in defense of a claim, and fees or salaries for rehabilitation nurses, if such cost is not included in losses;
(f) Attorney fees incurred owing to a duty to defend, even when other coverage does not exist; and
(g) The cost of engaging experts;

ii. AO are those expenses other than DCC as defined in (i) above assigned to the expense group “Loss Adjustment Expense”. AO include, but are not limited to, the following items:

(a) Fees and expenses of adjusters and settling agents;
(b) Loss adjustment expenses for participation in voluntary and involuntary market pools if reported by calendar year;
(c) Attorney fees incurred in the determination of coverage, including litigation between the reporting entity and the policyholder; and
(d) Fees and salaries for appraisers, private investigators, hearing representatives, reinspectors and fraud investigators, if working in the capacity of an adjuster.

6. The following future costs relating to life and accident and health indemnity contracts, as defined in SSAP No. 50, shall be considered in determining the liability for unpaid claims and claim adjustment expenses:

a. Accident and Health Claim Reserves: Reserves for claims that involve a continuing loss. This reserve is a measure of the future benefits or amounts not yet due as of the statement date which are expected to arise under claims which have been incurred as of the statement date. This shall include the amount of claim payments that are not yet due such as those amounts commonly referred to as disabled life reserves for accident and health claims. The methodology used to establish claim reserves is discussed in SSAP No. 54.

b. Claim Liabilities for Life/Accident and Health Contracts:
   i. Due and Unpaid Claims: Claims for which payments are due as of the statement date;
   ii. Resisted Claims in Course of Settlement: Liability for claims that are in dispute and are unresolved on the statement date. The liability either may be the full amount of the submitted claim or a percentage of the claim based on the reporting entity’s past experience with similar resisted claims;
   iii. Other Claims in the Course of Settlement: Liability for claims that have been reported but the reporting entity has not received all of the required information or processing has not otherwise been completed as of the statement date;
iv. Incurred But Not Reported Claims: Liability for which a covered event has occurred (such as death, accident, or illness) but has not been reported to the reporting entity as of the statement date.

c. Claim Adjustment Expenses for Accident and Health Reporting Entities: Costs expected to be incurred in connection with the adjustment and recording of accident and health claims defined in subparagraphs 6 a. and 6 b. Examples of expenses incurred in these activities are estimating the amounts of losses, disbursing loss payments, maintaining records, general clerical, secretarial, office maintenance, occupancy costs, utilities, computer maintenance, supervisory and executive duties, supplies, and postage;

d. Claim Adjustment Expenses for Life Reporting Entities: Costs expected to be incurred (including legal and investigation) in connection with the adjustment and recording of life claims defined in subparagraph 6 b.

The Health Reserves Guidance Manual (HRGM) provides further guidance related to reserving methodologies and assumptions used in determining individual and group accident and health reserves. The guidelines included in the HRGM are intended to be a general statement of reserving principles and not specific, detailed instructions. The HRGM is designed to encompass all health coverages including medical, dental, disability and long-term care. The HRGM outlines the minimum guidance for reserving for health coverages, and additional reserves may be appropriate based on actuarial principles and standards of practice.

7. The following costs relating to managed care contracts as defined in SSAP No. 50 shall be considered in determining the claims unpaid and claims adjustment expenses:

a. Claims unpaid for Managed Care Reporting Entities:

i. Unpaid amounts for costs incurred in providing care to a subscriber, member or policyholder including inpatient claims, physician claims, referral claims, other medical claims, resisted claims in the course of settlement and other claims in the course of settlement;

ii. Incurred But Not Reported Claims: Liability for which a covered event has occurred (such as an accident, illness or other service) but has not been reported to the reporting entity as of the statement date;

iii. Additional unpaid medical costs resulting from failed contractors under capitation contracts and provision for losses incurred by contractors deemed to be related parties for which it is probable that the reporting entity will be required to provide funding;

b. Claim Adjustment Expenses for Managed Care Reporting Entities: Costs expected to be incurred in connection with the adjustment and recording of accident and health claims defined in subparagraph 7 a. of this statement. Examples of expenses incurred in these activities are estimating the amounts of losses, disbursing loss payments, maintaining records, general clerical, secretarial, office maintenance, occupancy costs, utilities, computer maintenance, supervisory and executive duties, supplies, and postage;

c. Liabilities for percentage withholds (“withholds”) from payments made to contracted providers;

d. Liabilities for accrued medical incentives under contractual arrangements with providers and other risk sharing arrangements whereby the health entity agrees to share savings with contracted providers.
The HRGM provides further guidance related to reserving methodologies and assumptions used in determining individual and group accident and health reserves. The guidelines included in the HRGM are intended to be a general statement of reserving principles and not specific, detailed instructions. The HRGM is designed to encompass all health coverages including medical, dental, disability and long-term care. The HRGM outlines the minimum guidance for reserving for health coverages, and additional reserves may be appropriate based on actuarial principles and standards of practice.

8. The liability for claim reserves and claim liabilities, unpaid losses, and loss/claim adjustment expenses shall be based upon the estimated ultimate cost of settling the claims (including the effects of inflation and other societal and economic factors), using past experience adjusted for current trends, and any other factors that would modify past experience. These liabilities shall not be discounted unless authorized for specific types of claims by specific SSAPs, including SSAP No. 54 and SSAP No. 65—Property and Casualty Contracts.

9. Various analytical techniques can be used to estimate the liability for IBNR claims, future development on reported losses/claims, and loss/claim adjustment expenses. These techniques generally consist of statistical analysis of historical experience and are commonly referred to as loss reserve projections. The estimation process is generally performed by line of business, grouping contracts with like characteristics and policy provisions. The decision to use a particular projection method and the results obtained from that method shall be evaluated by considering the inherent assumptions underlying the method and the appropriateness of those assumptions to the circumstances. No single projection method is inherently better than any other in all circumstances. The results of more than one method should be considered.

10. For each line of business and for all lines of business in the aggregate, management shall record its best estimate of its liabilities for unpaid claims, unpaid losses, and loss/claim adjustment expenses. Because the ultimate settlement of claims (including IBNR for death claims and accident and health claims) is subject to future events, no single claim or loss and loss/claim adjustment expense reserve can be considered accurate with certainty. Management’s analysis of the reasonableness of claim or loss and loss/claim adjustment expense reserve estimates shall include an analysis of the amount of variability in the estimate. If, for a particular line of business, management develops its estimate considering a range of claim or loss and loss/claim adjustment expense reserve estimates bounded by a high and a low estimate, management’s best estimate of the liability within that range shall be recorded. The high and low ends of the range shall not correspond to an absolute best-and-worst case scenario of ultimate settlements because such estimates may be the result of unlikely assumptions. Management’s range shall be realistic and, therefore, shall not include the set of all possible outcomes but only those outcomes that are considered reasonable.

11. In the rare instances when, for a particular line of business, after considering the relative probability of the points within management’s estimated range, it is determined that no point within management’s estimate of the range is a better estimate than any other point, the midpoint within management’s estimate of the range shall be accrued. It is anticipated that using the midpoint in a range will be applicable only when there is a continuous range of possible values, and no amount within that range is any more probable than any other. For purposes of this statement, it is assumed that management can quantify the high end of the range. If management determines that the high end of the range cannot be quantified, then a range does not exist, and management’s best estimate shall be accrued. This guidance is not applicable when there are several point estimates which have been determined as equally possible values, but those point estimates do not constitute a range. If there are several point estimates with equal probabilities, management should determine its best estimate of the liability.

12. If a reporting entity chooses to anticipate salvage and subrogation recoverables (including amounts recoverable from second injury funds, other governmental agencies, or quasi-governmental agencies, where applicable), the recoverables shall be estimated in a manner consistent with paragraphs 8 through 10 of this statement and shall be deducted from the liability for unpaid claims or losses.

13. Changes in estimates of the liabilities for unpaid claims or losses and loss/claim adjustment expenses resulting from the continuous review process, including the consideration of differences between estimated and
actual payments, shall be considered a change in estimate and shall be recorded in accordance with SSAP No. 3—
Accounting Changes and Corrections of Errors (SSAP No. 3). SSAP No. 3 requires changes in estimates to be
included in the statement of operations in the period the change becomes known.

Disclosures

14. The financial statements shall include the following disclosures for each year full financial statements are
presented. Life and annuity contracts are not subject to this disclosure requirement.

a. The balance in the liabilities for unpaid claims and unpaid losses and loss/claim adjustment
expense reserves at the beginning and end of each year presented;

b. Incurred claims, losses, and loss/claim adjustment expenses with separate disclosures of the
provision for insured or covered events of the current year and increases or decreases in the
provision for insured or covered events of prior years;

c. Payments of claims, losses, and loss/claim adjustment expenses with separate disclosures of
payments of losses and loss/claim adjustment expenses attributable to insured or covered events
of the current year and insured or covered events of prior years;

d. The reasons for the change in the provision for incurred claims, losses, and loss/claim adjustment
expenses attributable to insured or covered events of prior years. The disclosure should indicate
whether additional premiums or return premiums have been accrued as a result of the prior-year
effects;

e. A summary of management’s policies and methodologies for estimating the liabilities for losses
and loss/claim adjustment expenses, including discussion of claims for toxic waste cleanup,
asbestos-related illnesses, or other environmental remediation exposures;

f. Disclosure of the amount paid and reserved for losses and loss/claim adjustment expenses for
asbestos and/or environmental claims, on a gross and net of reinsurance basis (the reserves
required to be disclosed in this section shall exclude amounts relating to policies specifically
written to cover asbestos and environmental exposures); and

g. Estimates of anticipated salvage and subrogation (including amounts recoverable from second
injury funds, other governmental agencies, or quasi-governmental agencies, where applicable),
deducted from the liability for unpaid claims or losses.

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

Relevant Literature

16. Although FASB Statement No. 60, Accounting and Reporting by Insurance Enterprises (FAS 60), is
rejected in SSAP No. 50, this statement is consistent with the guidance provided for the recognition of claim costs
in FAS 60 with the exception of the statutory requirement to accrue the midpoint of a range of loss or loss
adjustment expense reserve estimates when no point within management’s continuous range of reasonably
possible estimates is determined to be a better estimate than any other point.

17. This statement also rejects AICPA Statement of Position 92-4, Auditing Insurance Entities’ Loss Reserves.

Effective Date and Transition

18. This statement is effective for years beginning January 1, 2001. 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.
RELEVANT ISSUE PAPERS

- Issue Paper No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses
Statement of Statutory Accounting Principles No. 56

Separate Accounts

STATUS

Type of Issue: Life and Accident and Health
Issued: Finalized March 13, 2000
Effective Date: January 1, 2001
Affects: No other pronouncements
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Interpreted by: INT 00-03

SCOPE OF STATEMENT

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AUTHORITATIVE LITERATURE

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Separate Accounts

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for accounting and reporting for separate accounts in both the general account and separate account statements.

SUMMARY CONCLUSION

Introduction

2. Separate accounts are used to fund variable life insurance, variable annuities, modified guaranteed annuities and modified guaranteed life insurance, or various group contracts under pension or other employee benefit plans where funds are held in a separate account to support a liability. When separate accounts are established and filed accordingly, they may be used to fund guaranteed benefits. Separate account contracts may also be used to accumulate funds which are intended to be applied at some later time to provide life insurance or to accumulate proceeds applied under settlement or dividend options.

3. Assets held in separate accounts are owned by the insurer. All investment income and realized and unrealized capital gains and losses from assets allocated to a separate account, net of related investment expenses, are generally reflected in the separate account and, except for modified guaranteed annuities, modified guaranteed life insurance, and separate accounts established and filed to provide guaranteed benefits, investment performance is generally not guaranteed by the insurer. Charges relating to contract guarantees, administration, and investment management are deducted from separate accounts.

General Account Reporting

4. Insurance activities such as sales, underwriting and contract administration, premium collection and payment of premium taxes, claims, and benefits are functions of the insurance company distinct from the separate account and shall be accounted for as transactions of the general account.

5. For those separate account contracts classified as life contracts under SSAP No. 50—Classification and Definitions of Insurance or Managed Care Contracts In Force, premiums and annuity considerations shall be recorded as income in the Summary of Operations of the general account, and as transfers to premiums and considerations in the separate account statement. Deposit-type contracts shall be recorded in the general account in accordance with SSAP No. 52—Deposit-Type Contracts. Charges (e.g., fees associated with investment management, administration, and contract guarantees) assessed on the separate accounts, as well as the net gain from operations of the separate account, shall be recorded as income in the Summary of Operations of the general account. Expenses relating to investment management, administration, and contract guarantees pertaining to separate account operations, as well as benefits and surrenders incurred on behalf of separate account contracts classified as life contracts, net transfers between separate accounts, commissions, and premium taxes (if any) shall be recorded as expenses in the Summary of Operations of the general account.

6. The general account shall include the total assets and liabilities, including transfers due or accrued, of any separate accounts business which it maintains and, therefore, the surplus, if any, of its separate accounts business. Transfers to the general account due or accrued shall be reported on a net basis so that the asset and the liability totals of the general account are not overstated. Changes in the surplus of the separate accounts business of an insurer, except for changes resulting from the net gain from operations of the separate account, shall be charged or credited directly to the unassigned funds (surplus) of the general account.
7. Where a variable annuity contract or variable life insurance contract contains a guaranteed minimum death benefit, any reserve liability for such death benefit provision shall be recorded and held in the general account based on the reserving guidance in paragraphs 25 and 26. Any differences between the benefit paid and the separate account asset value of the contract shall be charged against or credited to the general account in its net gain from operations.

8. Separate account surplus may not become negative. For example, for separate account contracts which have annuitized (i.e., contracts in the payout stage), lower than expected mortality on variable annuity contracts containing mortality guarantees may cause a deficiency in the investment funds underlying the contract reserves. Thus the general account incurs an expense and the separate account realizes revenue to cover the deficiency, if necessary. Conversely, excess funds from higher than expected mortality will result in mortality gains, which are included in the Summary of Operations of the separate account and are ultimately recorded as equity in net income from separate account operations as discussed in paragraph 5.

9. Separate account surplus created through the use of the commissioners’ reserve valuation method (CRVM), commissioners’ annuity reserve valuation method (CARVM), or other reserving methods, shall be reported by the general account as an unsettled transfer from the separate account. The net change on such transfers shall be included as a part of the net gain from operations in the general account.

10. Surplus funds transferred from the general account to the separate account, commonly referred to as seed money, and earnings accumulated thereon shall be reported as surplus in the separate accounts until transferred or repatriated to the general account. The transfer of such funds between the separate account and the general account shall be reported as surplus contributed or withdrawn during the year.

11. If an Asset Valuation Reserve (AVR) is required for investments held by separate accounts, it is combined with the general account AVR and accounted for in the general account financial statements (see SSAP No. 7—Asset Valuation Reserve and Interest Maintenance Reserve). The criteria for determining when an AVR is required for separate accounts are described in paragraph 18 of this statement.

12. Reporting entities collect fees for managing Separate Account Guaranteed Investment Contracts (GICs), Synthetic GICs, as well as participating separate account group annuities. These are in the form of administrative fees, risk fees and some investment management fees. For defined contribution business, these are in the form of fees related to mutual fund management. These fees are meant to offset expenses and generate some profit.

13. Amounts receivable from contractholders for separate account management fees meet the definition of assets as set forth in SSAP No. 4—Assets and Nonadmitted Assets.

14. An evaluation shall be made of the amounts receivable to determine any nonadmitted amounts. Next, an evaluation shall be made in accordance with SSAP No. 5—Liabilities, Contingencies and Impairments of Assets (SSAP No. 5), to determine whether there is an impairment. This two step process is set forth below:

a. Uncollected separate account management fees receivable over ninety days due shall be accounted for as a nonadmitted asset. Reporting entities shall begin aging the receivable when it is contractually required to be billed, or in the absence of contract specifications, when the reporting entity actually sends the bill to the contractholder;

b. Remaining amounts determined to be uncollectible shall be written off. If in accordance with SSAP No. 5, it is “probable” the amount receivable is uncollectible, any uncollectible amount receivable shall be written off against operations in the period such determination is made. If it is “reasonably possible” the amount receivable is
uncollectible, the disclosure requirements outlined in SSAP No. 5 paragraph 14 shall be made.

Separate Account Reporting

15. The separate accounts annual statement is concerned with the flow of funds related to investment activities and obligations of the separate accounts and with the transfer of funds between the separate account and the general account. As a result, the separate account statement shall report only the assets, liabilities, and operations of the separate account and shall not include general account expenses related to investment management, administration, or contract guarantees pertaining to separate account operations which are recorded in the general account.

16. The separate account records premiums, considerations (net of loading for sales charges such as commissions and premium taxes) and receipts (other than for net investment income and realized capital gains and losses) as income transfers from the general account. Net investment income and realized and unrealized capital gains and losses relating to the investment operations of the separate account are recorded as income in the Summary of Operations. When the contract provides for such, expenses and taxes associated with the separate account investment operations shall be deducted in the determination of net investment income. Deposits and withdrawals on deposit-type contracts shall be recorded in the Summary of Operations. Benefits and surrenders, reserve transfers, policy loans, policyholder charges (e.g., fees associated with investment management, administration, and contract guarantees), and federal income taxes relating to the separate account are recorded as expense transfers to the general account in the Summary of Operations. The net change in aggregate reserves relating to separate account contracts is reported as an expense in the Summary of Operations.

17. Assets supporting fund accumulation contracts (GICs), which do not participate in underlying portfolio experience, with a fixed interest rate guarantee, purchased under a retirement plan or plan of deferred compensation, established or maintained by an employer, will be recorded as if the assets were held in the general account. Assets supporting all other contractual benefits shall be recorded at market value on the date of valuation, or if there is no readily available market, then in accordance with the valuation procedures in the applicable contract.

Separate Account AVR and IMR Reporting

18. An AVR is generally required for separate accounts when the insurer, rather than the policyholder/contractholder, suffers the loss in the event of asset default or market value loss. An AVR is required unless:

   a. The asset default or market value risk is borne directly by the policyholders; or

   b. The regulatory authority for such separate accounts already explicitly provides for a reserve for asset default risk, where such reserves are essentially equivalent to the AVR.

19. Assets supporting traditional variable annuities and variable life insurance generally do not require an AVR because the policyholders/contractholders bear the risk of change in the value of the assets. However, an AVR is required for that portion of the assets representing the insurer’s equity interest in the investments of the separate account (e.g., seed money).

20. Assets supporting typical modified guaranteed contracts, market value adjusted contracts, and contracts with book value guarantees similar to contracts generally found in the general account do require an AVR because the insurer is responsible for credit related asset loss.

21. Certain separate accounts are also required to maintain an Interest Maintenance Reserve (IMR). The IMR requirements for investments held in separate accounts are applied on an account by account.
basis. If an IMR is required for a separate account, all of the investments in that separate account are subject to the requirement. If an IMR is not required for a separate account, none of the investments in that separate account are subject to the requirement.

22. An IMR is required for separate accounts with assets recorded at book value, but is not required for separate accounts with assets recorded at market value. For example, separate accounts for traditional variable annuities or variable life insurance do not require an IMR because assets and liabilities are valued at market value.

23. If an IMR is required for investments held by separate accounts, it is kept separate from the general account IMR and accounted for in the separate accounts statement.

24. The AVR and IMR shall be calculated and reported in accordance with the NAIC Annual Statement Instructions for Life, Accident and Health Insurance Companies.

Policy Reserves

25. Statutory policy reserves shall be established for all contractual obligations of the insurer 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. 5—Liabilities, Contingencies and Impairments of Assets (SSAP No. 5). The actuarial methodologies referred to in the following paragraph meet the criteria required for reasonable estimates in SSAP No. 5.

26. The reserving methodologies and assumptions used in computation of policy reserves shall also meet the provisions of Appendices A-250, A-270, A-255, A-585, A-588, A-620, A-820, A-822, and the actuarial guidelines found in Appendix C of this Manual. Where separate account contracts have guaranteed elements, the basis for determining the value of the liability shall be consistent with the basis used for asset values (i.e., valuation interest rates as defined in Appendix A-820 shall be used when assets are recorded as if held in the general account and current interest rates based on market rates shall be used when assets are recorded at market). Further, policy reserves shall be in compliance with those Actuarial Standards of Practice promulgated by the Actuarial Standards Board.

Other Liabilities

27. The separate account shall accrue as a liability, subject to contractual provisions, amounts payable, including, but not limited to:

   a. Fees associated with investment management, administration, and contract guarantees;

   b. Investment expenses;

   c. Investment taxes, licenses, and fees (Investment taxes such as real estate taxes, licenses and fees (excluding federal income taxes) are usually paid directly by the separate account but may be transferred to the general account for payment);

   d. Federal income taxes;

   e. Unearned investment income;

   f. Net transfer due to (from) the general account;

   g. Remittances and items not allocated;
h. Payable for investments purchased;
i. Net adjustments in assets and liabilities due to foreign exchange rates.

**Seed Money**

28. When a new separate account is initiated, the insurer may make a temporary transfer of surplus funds commonly referred to as seed money to the separate account. Such funds and earnings accumulated thereon shall be reported as surplus in the separate accounts statement until transferred or repatriated to the general account. The transfer of such funds to and from the separate account shall be reported as surplus contributed or withdrawn during the year.

**Disclosures**

29. The general account financial statement shall include a description of the general nature and characteristics of the various kinds of separate accounts business conducted by the company and included in the company’s Separate Accounts Statement. For each grouping (as detailed in paragraph 30), the following shall be disclosed:

a. Premiums, considerations or deposits received during the year;
b. Reserves by the valuation basis of the investments supporting the reserves at the financial statement date. List reserves for separate accounts whose assets are carried at market value separately from those whose assets are carried at amortized cost/book value;
c. Reserves by withdrawal characteristics, i.e., whether or not the separate account is subject to discretionary withdrawal or market value adjustment, or to withdrawal at book value with or without surrender charge;
d. Reserves for asset default risk, as described in paragraph 18 b., that are recorded in lieu of AVR.

30. Separate accounts shall be addressed in the following groupings (which are the same as those used for risk-based capital):

a. Separate Accounts with Guarantees:
   i. Indexed separate accounts, which are invested to mirror an established index which is the basis of the guarantee;
   ii. Nonindexed separate accounts, with reserve interest rate at no greater than 4% and/or fund long-term interest guarantee in excess of a year that does not exceed 4%;
   iii. Nonindexed separate accounts, with reserve interest rate at greater than 4% and/or fund long-term interest guarantee in excess of a year that exceeds 4%.

b. Nonguaranteed Separate Accounts—Variable separate accounts, where the benefit is determined by the performance and/or market value of the investments held in the separate account. Include variable accounts with incidental risks, nominal expense, and minimum death benefit guarantees.

31. Provide a reconciliation of the amount reported as transfers to and from separate accounts in the Summary of Operations of the separate accounts statement and the amount reported as net transfers to or from separate accounts in the Summary of Operations of the general accounts statement.
32. Refer to the preamble for further discussion regarding disclosure requirements.

Relevant Literature


Effective Date and Transition

34. This statement is effective for years beginning January 1, 2001. Contracts with assets held in a Separate Account that were issued in accordance with applicable state laws and regulations and issued prior to that effective date, for which assets and liabilities have been recorded using a consistent basis since issue, i.e., both assets and liabilities are recorded either as if in the general account (“book value”) or as at market value (current interest rates based on market rates shall be used for liabilities when assets are recorded at market value), shall continue to be recorded using such basis until such time as the applicable contract terms or provisions are substantially changed, such as by a contract amendment modifying interest rate or withdrawal provisions. 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. Changes that do not require change in the basis of recording would include: address changes, continued deposits, and other non-substantive changes such as these. For example, additional funds received after January 1, 2001 under contracts issued prior to January 1, 2001 may continue to be recorded using the basis in effect prior to January 1, 2001 until such time as a triggering change is made. 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—*Accounting Changes and Corrections of Errors*.

AUTHORITATIVE LITERATURE

Statutory Accounting

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

RELEVANT ISSUE PAPERS

- Issue Paper No. 89—Separate Accounts
Statement of Statutory Accounting Principles No. 57

Title Insurance

STATUS

Type of Issue: Property and Casualty

Issued: Initial Draft

Effective Date: January 1, 2001

Affects: No other pronouncements

Affected by: No other pronouncements

Interpreted by: No other pronouncements

SCOPE OF STATEMENT

SUMMARY CONCLUSION

AUTHORITATIVE LITERATURE

RELEVANT ISSUE PAPERS
Title Insurance

SCOPE OF STATEMENT

1. Title insurance insures that the policyholder has title to the property on the subject real estate as of the date of policy issuance, subject to exceptions and exclusions in the policy. When issued, a title policy has a one time premium and reserves are established by the title insurance company. Title insurance differs from other lines of property and casualty insurance because its basic goal is risk elimination.

2. This statement establishes statutory accounting principles for title insurance and addresses areas where title insurance accounting differs from other lines of insurance. To the extent a topic is not covered by this statement, title insurance accounting shall comply with statutory accounting guidance for other lines of property and casualty insurance.

SUMMARY CONCLUSION

General

3. Title insurers perform many services in connection with the transfer of real estate; however, their principal function involves insuring, guaranteeing, or indemnifying owners of real property or the holders of liens or encumbrances thereon against loss or damage due to defective titles, liens, or encumbrances or, in most states, the unmarketability of the title.

4. In addition to insuring against defective records or examination of those records, an insurer insures against “non-record defects” such as:
   a. Forgeries;
   b. Fraud;
   c. Confusion of name in change of title;
   d. Incompetence (minors or persons of unsound mind);
   e. Mistakes in public records;
   f. Undisclosed or missing heirs;
   g. Instruments executed under a fabricated or expired power of attorney;
   h. Deeds delivered after death of grantor or grantee or without the consent of the grantor;
   i. Deeds by persons supposedly single but actually married;
   j. Wills not probated;
   k. Liens against property (e.g., mechanics liens and tax liens);
   l. Falsified records.

5. Before a title insurance policy is issued, the title insurer, or its agent, must search and examine public records concerning the ownership, liens, and encumbrances on the subject real estate together with...
information relating to persons having an interest in the real property as well as maps and other records to determine that title to the property is insurable, or defects can be overcome.

**Premium Revenue and Loss Reserve Recognition**

6. A variety of services are generally provided (either by the title insurance underwriter, its agent, or others) in connection with the transfer of title to real estate. Title insurance premiums frequently are determined in the rate making process based on the bundle of services provided, including some or all of title search and examination and closing or escrow fees, referred to as “Gross All-Inclusive” premiums. By statute or custom, certain states exclude title search and examination and closing or escrow fees from the rate-making process for title insurance premiums, referred to as “Gross Risk Rate” premiums. Premiums shall be recorded at the date of policy issuance, on either the Gross All-Inclusive or Gross Risk Rate premium basis, consistent with the rate-making method used. The premium related to a title insurance policy is due upon the effective date of the insurance and is not refundable. The term of a title insurance policy is indefinite because the policyholder is insured for as long as he or his heirs or devisees have an interest in the property.

7. Amounts paid to or retained by agents shall be reported as an expense.

8. A liability shall be established for all known unpaid claims and loss adjustment expenses (known claims reserve), consistent with the reserve section of Appendix A-628 with a corresponding charge to income.

9. Premium revenue shall be deferred to the extent necessary to maintain a Statutory or Unearned Premium Reserve (SPR or UPR) determined in accordance with the reserve section of Appendix A-628.

10. A supplemental reserve shall be established consisting of any other reserves necessary which, when taken in combination with the reserves required by paragraphs 8 and 9 of this statement, will be sufficient to cover the company’s liabilities with respect to all known claims, IBNR claims, and loss adjustment expenses. The total of the known claims reserve, SPR/UPR, and the supplemental reserve shall not be less than the actuarially determined liability for the sum of known claims, IBNR claims, and loss adjustment expenses or the amount determined in accordance with the reserve section of Appendix A-628.

11. The actuarially determined liability for the sum of known claims reserve required in paragraph 8 and the IBNR claims and loss adjustment expenses required in paragraph 10 of this statement shall be determined consistently with the guidance detailed in SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses and consistent with paragraph 13 of this statement.

12. Assets acquired in settlement of claims (e.g., mortgages and real estate) shall be accounted for consistent with the guidance related to the asset acquired. For example, an impaired loan shall be accounted for in accordance with SSAP No. 37—Mortgage Loans, and real estate acquired in foreclosure shall be accounted for in accordance with SSAP No. 40—Real Estate Investments.

**Salvage and Subrogation**

13. Salvage and subrogation shall be reflected as follows:

   a. Paid losses shall be reported net of realized, but not anticipated, salvage and subrogation. Case basis loss and loss adjustment expense reserves shall not be reduced for anticipated salvage and subrogation, nor shall an asset be established;
b. Paid salvage and subrogation is not realized until a salvage asset or an actual payment pursuant to a subrogation right is in the direct control of the insurer and admissible as an asset for statutory reporting purposes in its own right;

c. Salvage assets and payments pursuant to a subrogation right shall be recorded at current fair value. Current fair value of real estate shall be established through an appraisal conducted by a qualified independent appraiser;

d. If a salvage asset is sold or revalued by the insurer within twelve months of realization for an amount less than the value at which it was originally placed on the books of the insurer, then the loss on disposition shall be treated as a decrease in paid salvage (same effect as an addition to the paid loss) on the corresponding claim. After twelve months, such salvage revaluation will be treated as a loss on disposition or change in value of an asset, and shall not be deducted from the salvage on the corresponding claim;

e. If a salvage asset is sold or revalued by the insurer within twelve months of realization for an amount greater than the value at which it was originally placed on the books of the insurer, then the gain on disposition shall be treated as an increase in paid salvage (same effect as a deduction to the paid loss) on the corresponding claim. After twelve months, such salvage revaluation shall be treated as a gain on disposition or change in value of an asset and shall not be added to the salvage on the corresponding claim;

f. In completing Schedule P and Part 3B, IBNR reserves may make an actuarially determined provision for the expected value of future salvage and subrogation on open claims and IBNR claims.

### Reinsurance

14. Although by their nature, title claims relate to errors or omissions that occurred prior to the inception of the reinsurance agreement, title reinsurance contracts shall be accounted for as prospective reinsurance agreements if they meet all of the other criteria established in SSAP No. 62—Property and Casualty Reinsurance.

### Allocation of Expenses

15. This statement establishes uniform allocation rules to classify title insurance expenses within prescribed principal groupings. It is necessary to allocate those expenses which may contain characteristics of more than one classification, which this statement will refer to as allocable expenses.

16. Allocable expenses for title insurance companies shall be classified into the following categories on the expense section of the Operations and Investment Exhibit of the annual statement.

a. Title and Escrow Operating Expenses—Title and escrow operating expenses consist of all expenses incurred in relation to engaging in the business of title insurance, including costs associated with the following: (i) issuing or offering to issue a title insurance policy; (ii) soliciting or negotiating the issuance of a title insurance policy; (iii) guaranteeing, warranting or otherwise insuring the correctness of title searches affecting title to real property; (iv) handling of escrows, settlements or closings; (v) executing title insurance policies, effecting contracts of reinsurance, and abstracting, searching or examining titles. Also included are specifically identifiable and allocated expenses relating to the following activities; (i) supervision and training of employees and agents; (ii) operating costs for branch offices or agencies; (iii) underwriting activities; (iv) receiving and paying of premiums and commissions; (v) maintaining general and detailed
records; (vi) data processing, advertising, and publicity, clerical, secretarial, office maintenance, supervisory, and executive duties; (vii) postage and delivery; and (viii) all other functions reasonably associated with the business of title insurance. Title and escrow operating expenses do not include losses, loss adjustment expenses (allocated or unallocated), expense of other operations, or investment expenses. The expenses include only amounts incurred directly by the insurer and do not include expenses incurred by any agents (regardless of ownership interest).

b. Title and Escrow Operating Expenses are further broken down in the annual statement by the distribution network that gives rise to the expense incurrence. Accordingly, expenses are specifically identified or allocated (in accordance with reasonable allocation procedures consistently applied) to either Direct Operations, Non-affiliated Agency Operations, or Affiliated Agency Operations.

c. Unallocated Loss Adjustment Expenses (ULAE)—ULAE are those indirect costs incurred by a title insurer, typically internal to the company, which are necessary to process claims or manage the claims settlement function and which are not incurred on a claim-specific basis. ULAE shall include all costs of outside parties involved in claims adjusting services, but shall not include any costs incurred by agents in settlement of title or other claims.

d. Investment Expenses—Investment expenses are those expenses incurred in the investing of funds and the pursuit of investment income, including specifically identifiable and allocated expenses related to such activities as: (i) initiating or handling orders and recommendations for investments; (ii) research, pricing, appraising, and valuing; (iii) disbursing funds and collecting income; (iv) safekeeping of securities and valuable papers; (v) maintaining general and detailed records; (vi) data processing; (vii) general clerical, secretarial, office maintenance, supervisory, and executive duties; (viii) supplies, postage, and the like; and (ix) all other functions reasonably attributable to the investment of funds. Real estate expenses and real estate taxes are attributable to the Investment Expenses group.

e. Other Operations—The amounts shown for this category represent the allocable expenses incurred by the company in operations other than title and escrow, unallocated loss adjustment, or investment activities.

17. Allocation to the above categories should be based on a method that yields the most accurate results. Specific identification of an expense with an activity that is represented by one of the categories above will generally be the most accurate method. Where specific identification is not feasible, allocation of expenses should be based upon pertinent factors or ratios such as studies of employee activities, salary ratios, or similar analyses.

18. Many companies operate within a group where personnel and facilities are shared. Shared expenses, including expenses under the terms of a management contract, shall be apportioned to the companies incurring the expense as if the expense had been paid solely by the incurring company. The apportionment shall be completed based upon specific identification to the company incurring the expense. Where specific identification is not feasible, apportionment shall be based upon pertinent factors or ratios. Any basis adopted to apportion expenses shall be that which yields the most accurate results and may result from special studies of employee activities, salary ratios, premium ratios or similar analyses. Expenses that relate solely to the operations of an insurance company, such as personnel costs associated with the adjusting and paying of claims, must be borne solely by the insurance company and are not to be apportioned to other companies within a group. Pertinent factors in making this determination shall
include which entity has the ultimate obligation to pay the expense. Apportioned expenses are subject to presentation and allocation as provided in paragraphs 16 and 17.

Title Plant

19. Title plants are an integrated and indexed collection of title records consisting of documents, maps, surveys, or entries affecting title to real property or any interest in or encumbrance on the property, which have been filed or recorded in the jurisdiction for which the title plant is established or maintained. They are tangible assets unique to the title insurance industry and are the principal productive asset used to generate title insurance revenue and to mitigate the risk of claims. Title plant shall be reported as an admitted asset, subject to the following valuation restrictions:

a. Costs incurred to construct a title plant, including the costs incurred to obtain, organize, and summarize historical information in an efficient and useful manner, shall be capitalized until the title plant can be used by the company to conduct title searches and issue title insurance policies. The capitalized costs shall be directly related to, and properly identified with, the activities necessary to construct the title plant;

b. Purchased title plants, including a purchased undivided interest in a title plant, shall be recorded at cost at the date of acquisition. For a title plant acquired separately, cost shall be measured by the fair value of the consideration given. For title plant acquired as part of a group of assets, cost shall be measured by the fair value of the consideration given and then cost shall be allocated to the title plant based on its fair value in relation to the total fair value of the group of assets acquired. For title plants acquired as part of a purchase of assets or in a business combination, cost shall be determined in accordance with SSAP No. 68—Business Combinations and Goodwill;

c. A backplant, i.e., a title plant that antedates the period of time covered by the existing title plant may be purchased or constructed. Costs to construct a backplant must be properly identifiable to qualify for capitalization;

d. Costs incurred after a title plant is operational to (i) convert the information from one storage and retrieval system to another, or (ii) modify or modernize the storage and retrieval system shall not be capitalized;

e. Costs incurred to maintain a title plant shall be expensed as incurred;

f. Costs incurred to perform title searches shall be expensed as incurred;

g. The aggregate carrying value of an investment in a title plant or plants which exceeds the lesser of 20% of admitted assets or forty percent (40%) of surplus to policyholders, as shown on the most recent statement on file with the domiciliary commissioner, at the date of investment shall be nonadmitted.

20. Certain circumstances may indicate that the value of the title plant may be impaired and, thus, the carrying value of the asset may not be recoverable. If there is an indication of possible impairment of value, the title plant shall be evaluated for impairment and recorded in accordance with SSAP No. 5—Liabilities, Contingencies and Impairments of Assets. The following are examples of circumstances that may indicate impairment:

a. Effects of obsolescence, demand, and other economic factors;

b. A significant change in legal requirements or statutory practices in the jurisdiction for which the title plant is established and maintained;
c. A current period operating or cash flow loss combined with a history of such losses or projections that indicate continued losses associated with the revenue produced by the title plant;

d. Failure to maintain the title plant on a current basis and/or lack of appropriate maintenance to keep the title plant up to date; or,

e. Abandonment of a title plant.

21. A properly maintained title plant has an indeterminate life and does not diminish in value with the passage of time, and accordingly, shall not be depreciated.

22. A title insurer may (a) sell its title plant and relinquish all rights to its future use, (b) sell an undivided ownership interest in its title plant, or (c) sell a copy of its title plant or the right to use it. Accounting and presentation for each type of sale noted shall be as follows:

a. When a title insurer sells its title plant and relinquishes all rights to its future use, consideration received shall be presented as a separate component of revenue net of the carrying value of the title plant sold;

b. When a title insurer sells an undivided ownership interest in its title plant, consideration received shall be presented as a separate component of revenue net of the pro rata portion of the carrying value of the title plant;

c. When a title insurer sells a copy of its title plant or the right to use it, consideration received shall be presented as a separate component of revenue and the carrying value of the title plant shall not be reduced.

Disclosures

23. The financial statements shall disclose the following for each period presented:

a. The amount of premium revenue reported on the Gross All-Inclusive and on the Gross Risk Rate premium basis;

b. The amount of the known claims reserve, SPR/UPR, and the supplemental reserve;

c. Whether the insurer uses discounting in the calculation of its supplemental reserve, the method and rate used to determine the discount, and the amount of such discount.

24. Any material individual component of the reported expense categories shall be presented either on the face of the Summary of Operations or within the footnotes or related exhibits to the financial statements.

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

Relevant Literature

26. This statement rejects FASB Statement No. 60, Accounting and Reporting by Insurance Enterprises (FAS 60); however, it is considered appropriate to use the factors to be considered in the determination of the ultimate cost of settling claims included in FAS 60 when establishing the reserves in accordance with paragraphs 8 and 10 of this statement.
This statement adopts *FASB Statement No. 61, Accounting for Title Plant*, with modification for carrying value restrictions. Restrictions on the total carrying value of an investment in a title plant or plants are determined by paragraph 19 g.

**Effective Date and Transition**

This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors*.

Additions to the SPR or UPR as a result of the provisions of paragraph 17 v. of Appendix A-628 shall be phased in pursuant to the provisions of paragraph 17 vi. of Appendix A-628.

**AUTHORITATIVE LITERATURE**

**Generally Accepted Accounting Principles**

- *FASB Statement No. 61, Accounting for Title Plant*

**RELEVANT ISSUE PAPERS**

- Issue Paper No. 57—Title Insurance
Statement of Statutory Accounting Principles No. 58

Mortgage Guaranty Insurance

STATUS

Type of Issue: Property and Casualty

Issued: Initial Draft

Effective Date: January 1, 2001

Affects: No other pronouncements

Affected by: No other pronouncements

Interpreted by: No other pronouncements

SCOPE OF STATEMENT

SUMMARY CONCLUSION

General

Insured Risk

Pool Insurance

Premium Revenue Recognition

Unpaid Losses and Loss Adjustment Expense Recognition

Contingency Reserve

Premium Deficiency Reserve

U.S. Mortgage Guaranty Tax and Loss Bonds

Contingency Reserve (for Tax Purposes, the Mortgage Guaranty Account)

Disclosures

Effective Date and Transition

RELEVANT ISSUE PAPERS
Mortgage Guaranty Insurance

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for mortgage guaranty insurance and addresses areas where mortgage guaranty insurance accounting differs from other lines of insurance. To the extent a topic is not covered by this statement and Appendix A-630, mortgage guaranty insurance accounting shall comply with statutory accounting guidance for other lines of property and casualty insurance.

2. Mortgage guaranty insurance protects a lender against loss of all or a portion of the principal amount of a mortgage loan upon default of the mortgagor. Mortgage guaranty insurance differs from other types of property and casualty insurance in that coverage is long-term, and in most cases premiums are level and paid monthly. Most states require issuers of mortgage guaranty contracts to be monoline insurers and impose limitations on the aggregate amount of risk insured based on geographic territories. Additionally, states may require mortgage guaranty insurers to reinsure with only selected reinsurers.

SUMMARY CONCLUSION

General

3. Mortgage guaranty insurance is provided on residential loans (one to four family residences, including condominiums and townhouses). Coverage can range from as little as 5% on pool insurance to as much as 100% of the outstanding loan amount on individual policies. Most policies cover 10% to 30% of the loan amount and are written on first mortgage loans where the loan amount is a high percentage (generally 80% to 95%) of the value of the mortgaged property.

4. Lenders obtain mortgage guaranty insurance to facilitate sales of mortgage loans in secondary markets. It also enables lenders to make a greater number of high ratio (above 80%) loans and allows them to diversify their portfolio of loans.

5. Mortgage guaranty insurers market directly to mortgage lenders. Individual mortgage loans or pools of mortgage loans are insured under individual insurance certificates or policies; each loan, however, is separately underwritten.

6. Mortgage guaranty insurance companies generally offer the following premium payment plans: (a) monthly premiums, (b) a single premium which provides coverage for periods ranging from three to 15 years, (c) nonlevel annual premiums, and (d) level annual premiums. All policies are renewable at the discretion of the lender. The mortgage guaranty insurer does not have an option to cancel or nonrenew the policy, except for fraud or nonpayment of the premium.

7. Premiums are based upon: (a) the percentage of insurance coverage provided, (b) the ratio of the insured mortgage loan to the property value or sales price, and (c) the term and/or premium payment method selected by the lender. Premiums are quoted as a percentage of the total mortgage loan insured and increase as insurance coverage and loan-to-value ratio increases.

8. If a default occurs, the mortgage guaranty insurer generally requires the lender to foreclose and tender merchantable title to the mortgaged property in order to make a claim. The insurer may then, at its option: (a) purchase the property for the lender’s cost (generally the entire remaining principal loan balance plus accumulated interest and allowable expenses), (b) pay the percentage of the lender’s cost specified by the policy, or (c) arrange for the lender to sell the property and reimburse the lender for any loss up to an agreed amount. Under settlement option (a), the insurer intends to resell the property with the expectation of reducing the amount of loss which would have resulted if option (b) had been elected.
Insured Risk

9. The nature of the insured risk is influenced by certain factors which set mortgage guaranty insurance apart from other types of insurance. These factors are addressed in paragraphs 10 through 12.

Exposure Period

10. The exposure period is significantly longer for mortgage insurance than for most other property and casualty insurance products. The exposure period can run for the term of the mortgage; however, the average policy life is seven years. The policy is terminated when the mortgage obligation is satisfied or the lender elects to cancel or not renew the policy. In contrast to mortgage guaranty insurance, most property and casualty products need not be renewed by the insurer at the expiration of the policy. Mortgage insurance is renewable at the option of the insured at the renewal rate quoted when the policy commitment was issued.

Losses

11. Losses are affected by the following factors specific to mortgage guaranty insurance:

a. The insured peril—the default of a borrower arises from the credit risk associated with mortgage loans. The frequency of loss is strongly influenced by economic conditions. The likelihood of individual default is further increased if the property has deteriorated since a borrower in financial difficulty will be less able to sell the property at a price sufficient to discharge the mortgage;

b. Mortgage insurance losses can be divided into three categories:

   i. Normal losses associated with regular business cycles, interruptions in the borrower's earning power, and errors made in evaluating the borrower’s willingness or ability to meet mortgage obligations;

   ii. Defaults caused by adverse local economic conditions;

   iii. Widespread defaults caused by a severe depression in the U.S. economy.

Loss Incidence

12. Losses are incurred over the exposure period which runs for the term of the mortgage. However, loss incidence peaks in the earlier years. When a loan has been delinquent two to four months, the policy requires the lender to notify the insurer. The lender generally agrees to institute foreclosure proceedings six to nine months from the date of delinquency. Foreclosure can require an additional 18 months which means a considerable delay between the delinquency and the presentation of the claim. Without adverse economic conditions, most delinquencies do not result in a loss payment. Once a claim is presented, payment normally is made within one or two months and ultimate loss costs can be known relatively quickly.

Pool Insurance

13. Mortgage guaranty insurance may be provided on pools of mortgage loans. Typically, pool insurance supports mortgage-backed securities or group sales. Unlike other pool or group products, each loan is individually underwritten.

14. Pool insurance may be provided on loans that are already insured by primary insurance, in which case the pool insurance provides an additional level of coverage, or it may be provided on loans without primary insurance (usually loans with loan-to-value ratios below 80%). Generally, pool insurance
provides 100% coverage and includes a stop-loss limit of liability which may range from 5% to 20% of the initial aggregate principal balance. Because of regulatory requirements in some states, pool insurance usually uses participating reinsurance arrangements to limit the exposure of any one mortgage insurer of a pool of loans to 25% of each mortgage insured.

15. Pool insurance policies are not cancelable by the insurer except for nonpayment of premium. These policies may be written on mortgage pools having terms of up to 30 years. However, the average policy life is 8 to 12 years.

16. Upon default, the insurer has the same options as with individual insured mortgage loans. However, pool insurance loss payments are reduced by settlements under primary insurance and subject to the stop-loss limit.

17. Three kinds of mortgage-backed securities which use pool insurance are:
   a. Mortgage-backed bonds—Issued by banks, savings and loan associations and other mortgage lenders as a general obligation of the issuing institution. These bonds are collateralized by a pool of mortgages and have a stated rate of return and maturity date;
   b. Mortgage revenue bonds—Issued by state and local housing authorities to support housing affordability for targeted income groups;
   c. Mortgage pass-through certificates—Issued by banks, savings and loan associations, mortgage bankers, and others providing an undivided interest in a pool of mortgages with principal and interest payment passed to the certificate holder as received.

Premium Revenue Recognition

18. Written premium shall be recorded in accordance with SSAP No. 53—Property Casualty Contracts—Premiums. Premium revenue shall be earned as follows:
   a. For monthly premium plans, revenues shall be earned in the month to which they relate;
   b. For annual premium plans, revenues shall be earned on a pro rata basis over the applicable year;
   c. For single premium plans, revenues shall be earned over the policy life in relation to the expiration of risk;
   d. Additional first year premiums or initial renewal premiums on nonlevel policies shall be deferred and amortized to income over the anticipated premium paying period of the policy in relation to the expiration of risk.

Unpaid Losses and Loss Adjustment Expense Recognition

19. Unpaid losses and loss adjustment expenses shall be recognized in accordance with SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses (SSAP No. 55). For mortgage guaranty insurance contracts, the default shall be considered the incident that gives rise to a claim as discussed in SSAP No. 55. If a claim is ultimately presented, the date of default shall be considered the loss incurred date.

20. The process for estimating the liability shall include projections for losses that have been reported as well as those that have been incurred but not reported. The estimates shall be made based on historical data, trends, economic factors, and other statistical information including paid claims, reported losses, insurance in force statistics, and risk statistics.
21. Real estate and mortgages are acquired by mortgage guaranty insurers to mitigate losses. These assets shall be shown on the balance sheet at the lower of cost or net realizable value, net of encumbrances. Gains or losses from the holding or disposition of these assets shall be recorded as a component of losses incurred. Rental income or holding expenses shall be included in loss adjustment expenses.

Contingency Reserve

22. In addition to the unearned premium reserve, mortgage guaranty insurers shall maintain a liability referred to as a statutory contingency reserve. The purpose of this reserve is to protect policyholders against loss during periods of extreme economic contraction. The annual addition to the liability shall equal 50% of the earned premium from mortgage guaranty insurance contracts and shall be maintained for ten years regardless of the coverage period for which premiums were paid. With commissioner approval, when required by statute, the contingency reserve may be released in any year in which actual incurred losses exceed 35% of the corresponding earned premiums. Any such reductions shall be made on a first-in, first-out basis. Changes in the reserve shall be recorded directly to unassigned funds (surplus).

Premium Deficiency Reserve

23. When the anticipated losses, loss adjustment expenses, commissions and other acquisition costs, and maintenance costs exceed the recorded unearned premium reserve, contingency reserve, and the estimated future renewal premium on existing policies, a premium deficiency reserve shall be recognized by recording an additional liability for the deficiency with a corresponding charge to operations. Commissions and other acquisition costs need not be considered in the premium deficiency analysis to the extent they have been expensed. If an insurer utilizes anticipated investment income as a factor in the premium deficiency calculation, disclosure of such shall be made in the financial statements.

U.S. Mortgage Guaranty Tax and Loss Bonds

24. To obtain a current federal income tax benefit derived from annual additions to the statutory contingency reserve (for tax purposes, the mortgage guaranty account), mortgage guaranty insurers must purchase tax and loss bonds to the extent of the tax benefits. These bonds are noninterest bearing obligations of the U.S. Treasury and mature 10 years after issue. The usual purpose of tax and loss bonds is to satisfy taxes that will be due in 10 years when the tax benefit is reversed; however, the bonds may be redeemed earlier in the event of excess underwriting losses. These bonds are reported as admitted assets allowing mortgage insurers to conserve capital. In accordance with SSAP No. 10—Income Taxes, temporary differences (as defined in that statement) do not include amounts attributable to the statutory contingency reserve to the extent that “tax and loss” bonds have been purchased.

Contingency Reserve (for Tax Purposes, the Mortgage Guaranty Account)

25. Under IRS Code Section 832(e), mortgage guaranty insurers are permitted to deduct the annual addition to the contingency reserve from gross income. The tax deduction is generally an amount equal to (a) 50% of earned premium, or (b) taxable income as computed prior to this special deduction if less than 50% of earned premium. Annual deductions not utilized for tax purposes during the current period may be carried forward for eight years on a basis similar to net operating losses. The amount deducted must be restored to gross income after ten years; however, it may be restored to gross income at an earlier date in the event of a taxable net operating loss.

26. The tax deduction is permitted only if special U.S. Mortgage Guaranty Tax and Loss Bonds are purchased in an amount equal to the tax benefit derived from the deduction. Upon redemption the tax and loss bonds can be used to satisfy the additional tax liability that arises when the deduction is restored to income.
Disclosures

27. Mortgage guaranty insurers shall make all disclosures required by other statements within the Accounting Practices and Procedures Manual, including but not limited to the requirements of SSAP No. 55, and SSAP No. I—Disclosure of Accounting Policies, Risks & Uncertainties, and Other Disclosures.

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

Effective Date and Transition

29. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors.

RELEVANT ISSUE PAPERS

- Issue Paper No. 88—Mortgage Guaranty Insurance
Statement of Statutory Accounting Principles No. 59

Credit Life and Accident and Health Insurance Contracts

STATUS

Type of Issue: Common Area

Issued: Initial Draft

Effective Date: January 1, 2001

Affects: No other pronouncements

Affected by: No other pronouncements

Interpreted by: INT 01-29

SCOPE OF STATEMENT

SUMMARY CONCLUSION

Definitions

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AUTHORITATIVE LITERATURE

Statutory Accounting

RELEVANT ISSUE PAPERS
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Credit Life and Accident and Health Insurance Contracts

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for income recognition and policy reserves for all contracts classified as credit life and credit accident and health contracts defined in SSAP No. 50—Classifications and Definitions of Insurance or Managed Care Contracts In Force.

SUMMARY CONCLUSION

Definitions

2. Credit life and accident and health insurance contracts will be referred to collectively as “credit insurance” for purposes of this statement. Credit insurance is generally issued in connection with the issuance of credit to an individual by a bank, retailer, finance company, or other similar organization. This type of insurance most often protects the creditor to the extent of the unpaid balance of the loan. Contracts sold in connection with loans or other credit transactions not exceeding a stated duration shall be reported as credit insurance. Mortgage guaranty insurance is addressed in SSAP No. 58—Mortgage Guaranty Insurance. Credit policies are generally limited to issues of 120 months or less in most states. Credit insurance is sold as either an individual or group policy and may provide for single or joint life coverage.

3. Credit life insurance, generally in the form of decreasing term insurance, is issued on the lives of debtors to cover payment of loan balances in case of death. Credit accident and health insurance is insurance on a debtor to either provide indemnity for payments becoming due on a specific loan or other credit transaction while the debtor is disabled.

4. Premiums for credit insurance contracts shall be defined as the contractually determined amount charged by the reporting entity to the policyholder for the effective period of the contract.

Income Recognition

5. Consistent with SSAP No. 51—Life Contracts, premiums shall be recognized in the summary of operations as income on the gross basis (amount charged to the policyholder) when due from policyholders under the terms of the insurance contract.

Policy Reserves

6. 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. The statutory policy reserves for credit life contracts 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. The statutory policy reserves for credit accident and health contracts generally consist of an unearned premium reserve, and other reserves, as required, as further discussed in paragraphs 12 and 13. Statutory policy reserves meet the definition of liabilities as defined in SSAP No. 5—Liabilities, Contingencies and Impairments of Assets (SSAP No. 5). The actuarial methodologies referred to in the following paragraph meet the criteria required for reasonable estimates in SSAP No. 5.

7. 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.
8. Policy reserves are established through either a gross unearned premium reserve or a mortality/morbidity reserve. The gross unearned premium reserve represents the estimated amount of premium for insurance coverage that has not yet expired. The mortality/morbidity reserve represents the estimated amount of future anticipated benefits, discounted at valuation interest and mortality/morbidity, to be incurred on policies in force.

9. When the level of insurance risk is constant during the contract period, policy reserves shall be recognized over the period of risk using either the daily pro-rata or monthly pro-rata methods as described in SSAP No. 53—Property Casualty Contracts—Premiums. Policy reserves for contracts where the level of insurance risk is not constant throughout the contract period shall be recognized over the period of risk in proportion to the amount of insurance protection provided. Various methods may be used to accomplish this as described below. The reporting entity shall select the method that most closely reflects the pattern of insurance protection provided. To the extent that these methods do not reflect the pattern of insurance protection provided, the reporting entity shall modify or develop, if necessary, a method that recognizes net income from the policy over the exposure period of the contract in proportion to the amount of insurance protection provided.

10. Single premium credit life policy reserves shall be based on either a gross unearned premium reserve based on a refund formula, or a reserve based on assumed risks using mortality factors. In practice, various methods exist and are currently used to estimate the amount of gross unearned premiums applicable to the unexpired portion of the policies in force. For decreasing gross coverage, the gross unearned premium may be estimated using a Rule of 78’s method; for decreasing net payoff coverage, either the Rule of 78’s or the single premium method is used; and for level coverage, the pro rata method is generally used. The reporting entity shall select a method that reflects the pattern of insurance protection provided.

11. Policy reserves for credit A&H policies shall be based on either a gross unearned premium reserve using either the pro rata, Rule of 78’s, mean of pro rata and Rule of 78’s, or actuarial methods; or a reserve based on assumed risks using morbidity factors. The actuarial gross unearned premium reserve is a measure of the single premium for the debt’s remaining term and amount. Prior to the establishment of a standardized morbidity table for single premium credit disability policies, most states required reporting entities to record a gross unearned premium reserve using the Rule of 78’s method. In practice, such a mean gross unearned premium reserve has been the (average of the Rule of 78’s and the pro rata methods) is often recorded. In the future, greater use of the standardized morbidity table may occur. The reporting entity shall select a method that reflects the pattern of insurance protection provided. Also, the method should be consistent with the refund method actually used or required in the state.

12. For credit accident and health contracts, the policy reserve recorded shall not be less than the gross unearned premium reserve. In addition, for all credit contracts in the aggregate, if the premium refund liability exceeds the aggregate recorded reserve, an additional liability shall be established. This premium refund (excess) liability may include consideration of commission, premium tax, and other expenses recoverable.

13. When the anticipated benefits, expected dividends to policyholders and maintenance cost exceed the recorded policy reserve, a premium deficiency reserve shall be recognized by recording an additional liability for the excess deficiency with a corresponding charge to operations. Commission and other acquisition costs need not be considered in the premium deficiency analysis since they have previously been expensed.

14. The difference between the policy reserves at the beginning and end of the reporting period shall be reflected as the change in reserves or change in unearned premium, as appropriate, in the summary of operations, except for any difference due to a change in valuation basis as discussed in paragraph 15.
Change In Valuation Basis

15. 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.

Disclosures

16. For life 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;
   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);
   e. The nature of significant other reserve changes.

17. If the company has reported life insurance premiums deferred and uncollected on policies in force as of the financial statement date, disclose separately the amounts and the loading excluded for credit life business.

18. 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.

19. Refer to the preamble for further discussion regarding disclosure requirements.
Relevant Literature

20. This statement incorporates the requirements of Appendices A-225, A-812, A-820 and A-822, and the Actuarial Standards Board *Actuarial Standards of Practice* and the actuarial guidelines found in Appendix C of this Manual.

21. This statement rejects *FASB Statement No. 60, Accounting and Reporting by Insurance Enterprises* relating to accounting and reporting for credit life and accident and health insurance contracts.

Effective Date and Transition

22. 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.

AUTHORITATIVE LITERATURE

Statutory Accounting

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

RELEVANT ISSUE PAPERS

- Issue Paper No. 59—Credit Life and Accident and Health Insurance Contracts
Statement of Statutory Accounting Principles No. 60

Financial Guaranty Insurance

STATUS

Type of Issue: Common Area
Issued: Initial Draft
Effective Date: January 1, 2001
Affects: No other pronouncements
Affected by: No other pronouncements
Interpreted by: INT 00-04

SCOPE OF STATEMENT

SUMMARY CONCLUSION

Premium Revenue Recognition
Unpaid Losses and Loss Adjustment Expense Recognition
Contingency Reserve
Disclosures
Effective Date and Transition

RELEVANT ISSUE PAPERS

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Financial Guaranty Insurance

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for financial guaranty insurance and addresses areas where financial guaranty insurance accounting differs from other lines of insurance. To the extent a topic is not covered by this statement, financial guaranty insurance accounting shall comply with statutory accounting guidance for other lines of property and casualty insurance.

SUMMARY CONCLUSION

2. Financial guaranty insurance provides protection against financial loss as a result of default, changes in interest rate levels, differentials in interest rate levels between markets or products, fluctuations in exchange rates between currencies, inconvertibility of one currency into another, inability to withdraw funds held in a foreign country resulting from restrictions imposed by a governmental body, changes in the value of specific assets or commodities, financial or commodity indices, or price levels in general. Financial guaranty insurance does not provide protection from losses which occur due to fortuitous physical events, failure or deficiency in the operation of equipment, or the inability to extract natural resources. Additionally, it does not provide coverage from losses related to various types of bonds (e.g., individual or schedule public official bond; a contract bond; a court bond), credit insurance, guaranteed investment contracts, and residual value insurance.

Premium Revenue Recognition

3. Written premium shall be recorded in accordance with SSAP No. 53—Property Casualty Contracts—Premiums except that installment premiums, which may vary substantially over the term of the contract since the total amount insured and the premium rate are contingent upon the performance of the insured obligations, shall be recorded when received.

4. When premiums are paid on the installment basis, premium revenue shall be recognized in the statement of operations using the monthly pro-rata method. Premiums not paid on the installment basis shall be recognized in the statement of operations in proportion with the amount and expected coverage period of the insured risk.

5. When the anticipated losses, loss adjustment expenses, and maintenance cost exceed the recorded unearned premium reserve and contingency reserve, a premium deficiency reserve shall be recognized by recording an additional liability for the deficiency with a corresponding charge to operations. Commission and other acquisition costs need not be considered in the premium deficiency analysis since they have previously been expensed. 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.

Unpaid Losses and Loss Adjustment Expense Recognition

6. Unpaid losses and loss adjustment expenses shall be recognized in accordance with SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses (SSAP No. 55). Each financial guaranty insurer shall establish and maintain reserves for unpaid losses and loss adjustment expenses. The initial date of default shall be considered the incident which gives rise to a claim. Loss reserves shall include a reserve for claims reported and unpaid net of collateral.

7. A deduction from loss reserves shall be allowed for the time value of money by application of a discount rate equal to the average rate of return on the admitted assets of the financial guaranty insurer as of the date of the computation of the reserve. The discount rate shall be adjusted at the end of each calendar year. In addition, a reserve component for incurred but not reported claims shall be reasonably
Contingency Reserve

8. In addition to the unearned premium reserve and the liability established for unpaid losses and loss adjustment expenses, financial guaranty insurers shall maintain a liability referred to as a statutory contingency reserve. The purpose of this reserve is to protect policyholders against loss during periods of extreme economic contraction.

9. The contingency reserve shall be the greater of fifty percent of premiums written for each category or the amount provided by applying the following percentages to the principal guaranteed in each calendar year. The premiums written shall be net of reinsurance if the reinsurer has established a contingency reserve.

a. Municipal obligation bonds 0.55 percent
b. Special revenue bonds 0.85 percent
c. Investment grade Industrial Development Bonds (IDBs)
   secured by collateral or having a term of seven years or less,
   and utility first mortgage obligations 1.00 percent
d. Other investment grade IDBs 1.50 percent
e. Other IDBs 2.50 percent
f. Investment grade obligations, secured by collateral or having a
term of seven years or less 1.00 percent
g. Other investment grade obligations not secured 1.50 percent
h. Non-investment grade consumer debt obligations 2.00 percent
i. Non-investment grade asset backed securities 2.00 percent
j. All other non-investment grade obligations 2.50 percent

10. Additions to the reserve for items a. through e. in paragraph 9, equal to one-eightieth of the amounts derived by applying the appropriate contribution specified above, shall be made each quarter for a period of twenty (20) years. Additions to the reserve for items f. through j. in paragraph 9 above, equal to one-sixtieth of the amounts derived by applying the appropriate contribution specified above, shall be made each quarter for a period of fifteen (15) years.

11. For contingency reserves required to be maintained for 20 years, contributions may be discontinued if the total reserve established for all categories in subparagraphs 9 a. through 9 e. exceeds the sum of the percentages contained therein multiplied by the unpaid principal guaranteed. For contingency reserves required to be maintained for 15 years, contributions may be discontinued if the total reserve established for all categories in subparagraphs 9 f. through 9 j. exceeds the sum of the percentages contained therein multiplied by the unpaid principal guaranteed.

12. The contingency reserve may also be released in the following circumstances:

a. For contingency reserves required to be maintained for 20 years:
   i. In any year in which actual incurred losses exceed 35% of the corresponding
      earned premiums, with commissioner approval;
   ii. If the reserve has been in existence less than 40 quarters, upon demonstration that
      the amount is excessive in relation to the outstanding obligations under the
      insurer’s financial guarantees, with commissioner approval;
iii. If the reserve has been in existence more than 40 quarters, upon demonstration that the amount is excessive in relation to the outstanding obligations under the insurer’s financial guarantees, upon 30 days prior written notice to the commissioner.

b. For contingency reserves required to be maintained for 15 years:

i. In any year in which actual incurred losses exceed 65% of the corresponding earned premiums, with commissioner approval;

ii. If the reserve has been in existence less than 30 quarters, upon demonstration that the amount is excessive in relation to the outstanding obligations under the insurer’s financial guarantees, with commissioner approval;

iii. If the reserve has been in existence more than 30 quarters, upon demonstration that the amount is excessive in relation to the outstanding obligations under the insurer’s financial guarantees, upon 30 days prior written notice to the commissioner.

Any reductions shall be made on a first-in first-out basis. Changes in the reserve shall be recorded through unassigned funds (surplus).

Disclosures

13. Financial guaranty insurers shall make all disclosures required by other statements within the Accounting Practices and Procedures Manual, including but not limited to the requirements of SSAP No. 55 and SSAP No. 1—Disclosure of Accounting Policies, Risks & Uncertainties, and Other Disclosures.

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

Effective Date and Transition

15. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors.

RELEVANT ISSUE PAPERS

- Issue Paper No. 69—Financial Guaranty Insurance
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Statement of Statutory Accounting Principles No. 61

Life, Deposit-Type and Accident and Health Reinsurance

STATUS

Type of Issue: Life and Accident and Health

Issued: Initial Draft

Effective Date: January 1, 2001

Affects: No other pronouncements

Affected by: No other pronouncements

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SCOPE OF STATEMENT

SUMMARY CONCLUSION

Indemnity Reinsurance

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Accounting for Assumption Reinsurance Transactions

Accounting for Non-economic Assumption Reinsurance Transactions

Disclosures

Relevant Literature

Effective Date and Transition
Life, Deposit-Type and Accident and Health Reinsurance

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for life, deposit-type and accident and health reinsurance. This statement applies to life, deposit-type and accident and health contracts as defined in SSAP No. 50—Classifications and Definitions of Insurance or Managed Care Contracts In Force (SSAP No. 50).

SUMMARY CONCLUSION

Indemnity Reinsurance

2. Reinsurance is an agreement by which a reporting entity transfers all or part of its risk under a contract to another reporting entity. The entity that issued the policy is called the primary insurer, direct writer, or ceding entity and the entity to which the risk is transferred is called the reinsurer or assuming entity. The process of transferring the risk from the ceding entity to the reinsurer is known as a cession. If an assuming entity, in turn, transfers a portion of this risk, the process is called a retrocession. A retrocession is customarily made when the amount assumed is beyond the reinsurer’s limits of retention.

3. There is no direct relationship between the reinsurer or the retrocessionaire and the ceding entity’s policyholder unless there is a “cut-through endorsement.” In the event of the ceding entity’s insolvency, except in the case of a “cut-through endorsement,” the policyholder or beneficiary under a contract that is reinsured has the same status as a policyholder or beneficiary of a policy that was not reinsured. An entity may not need to be licensed, have accredited reinsurer status or other means of authorization in a state in order to act as a reinsurer of a domestic entity. However, the domestic entity is not permitted to take reserve credits on the business ceded to any unauthorized reinsurers to the extent that they are not properly securitized by means of a trust, letter of credit or funds withheld or other acceptable forms of collateral.

4. Fronting arrangements, pools and association business are often accomplished using reinsurance contracts. The guidance included in this statement also applies to these types of contracts except as specifically exempted.

Retention

5. In formulating its rules for accepting applications for insurance, an entity must decide upon three areas of action—retaining, reinsuring, or declining the risks presented. Entities of various sizes have different desired capacities to write insurance on a single life and/or entire blocks of business or portfolios. An entity determines the amount of risk exposure it is able to accept and retain as its own insurance business. Having made this determination, the entity then decides what to do with any risks presented that exceed the maximum amount it is willing to retain. It has two choices—accept the additional risk and reinsure it, or decline the extra risk.

6. Business to be written is expected to be profitable, so the direct writing entity will generally want to retain as much of the risk as possible, consistent with its overall objectives. The entity also will want to avoid exposure to large losses that could jeopardize its financial condition and the policy values of its policyholders. Consequently, a common practice in the life insurance industry is for a reporting entity to establish a schedule for maximum amounts of insurance, called retention limits, which it will retain at its own risk on individual lives in various categories of insurance. By adopting a suitably chosen schedule of retention, the reporting entity eliminates exposure to large losses and reduces fluctuations in the cost of death claims from year to year, which could adversely affect the reporting entity’s surplus position. In addition, the reporting entity can utilize aggregate stop loss reinsurance to protect it from aggregate claims exceeding a specific threshold.
7. There are also reasons why a reporting entity might retain less than its defined maximum. One is to transfer from the ceding entity to the reinsurer the part of the surplus strain that results from writing new life insurance. The ceding entity may wish to limit the risk of loss on substandard business. Testing new coverages or new classes of lives may lead to reinsurance.

Reinsurance Arrangements

8. Reinsurance can be on a facultative or an automatic basis. For facultative, each risk is handled separately at the time it is written. When the direct writing entity receives an application for a policy and it wishes to reinsure some or all of the risk, it negotiates with another entity for a transfer of all or a portion of that risk. For purely facultative cessions, the assuming entity is not obligated to assume any of the risk until its offer to reinsure is accepted. For facultative obligatory reinsurance, the assuming entity is obligated to reinsure the risk subject to its having sufficient available capacity.

9. For automatic reinsurance, the ceding entity agrees to reinsure with the reinsurer entity all cases which meet certain defined conditions for amounts as defined in the reinsurance agreement. The reinsurer entity is bound to accept all such amounts, up to a predetermined maximum. Amounts in excess of automatic limits set out in the reinsurance agreement may be handled as facultative cessions. When the amount lies within the automatic maximum limit, called the binding authority, the ceding entity issues its policy upon completion of its underwriting procedures and without securing the prior approval of the reinsurer entity. Notification of automatic reinsurance is sent to the reinsurer entity within a specified period after the ceding entity issues its policy.

10. By agreeing to accept all business automatically ceded to it, the reinsurer is relying on the underwriting judgment of the ceding entity and is bound to accept the case even when it, the reinsurer, may not agree with the underwriting action. The reinsurer is protected by the requirement that the ceding entity retains at its own risk its defined retention limit for the class of business that is involved and by the maximum which may be ceded automatically.

Types of Reinsurance Arrangements

11. Once an entity has decided to reinsure amounts in excess of its desired retention, it may proceed in one of several basic arrangements—coinsurance, modified coinsurance, yearly renewable term or non-proportional. Such contracts may have funds withheld.

Coinsurance

12. In this arrangement, the risks are reinsured on the same plan as that of the original policy. The direct writer and the reinsurer share in the risk in the same manner. The ceding entity pays the reinsurer a proportional part of the premiums collected from the insured. In return, the reinsurer reimburses the ceding entity for the proportional part of the death or accident and health claim payments and other benefits provided by the policy, including nonforfeiture values, policy dividends, experience rating refunds, commissions, premium taxes, and other direct expenses agreed to in the contract. The reinsurer must also establish the required reserves for the portion of the policy it has assumed. A single policy can be coinsured with more than one entity or under more than one reinsurance contract with the same entity as long as the combined total of reinsurance and the retention of the ceding entity is not more than 100% of the risk.

13. In coinsurance of participating policies, the reinsurer may reimburse the ceding entity for its portion of the dividends paid to the policyholder. In determining its schedule of dividends, the ceding entity takes into account the experience on the business as written. If the reinsurer reimburses dividends it will typically accept the ceding entity’s schedule but may require input into the schedule. Changes to the schedule may have to be agreed to by the reinsurer. Coinsurance of all or a portion of a block of business also is used in situations where a severe strain is placed on the direct writing entity’s surplus in the first
policy year. For example, the premium received by the direct writer during the first policy year usually is insufficient to pay the high first-year commissions and other costs of issue and to establish the initial reserve. In such an example, coinsurance relieves some of the surplus strain of adding large amounts of new insurance.

Modified coinsurance

14. The “modified coinsurance” or “modco” arrangement is a variation of coinsurance. The ceding entity has transferred all or a portion of the net policy liabilities on the reinsured policies to the reinsurer, and the reinsurer is required to indemnify the ceding entity for the same amount. The assets necessary to support the reserves for the original policies are maintained by the ceding entity instead of the reinsurer. This is accomplished by designating in the contract the transfer of the net policy liabilities to the assuming entity and an immediate transfer back to the extent of the modco deposit. Under modified coinsurance, the assuming entity shall transfer to the ceding entity the increase in the reserve on the reinsured portion. This transaction reflects the reinsurer’s risk with respect to the reinsured business and its obligation to maintain the reserves supporting such obligation. In some cases, a policy may be reinsured partially on a coinsurance arrangement and partially on a modified coinsurance arrangement. This may be accomplished through the use of two contracts or in a single contract.

Yearly renewable term (YRT)

15. Under this arrangement of reinsurance, the ceding entity transfers the net amount at risk on the portion reinsured to the reinsurer and pays a one-year term premium. The “net amount at risk”—as defined in the contract—is usually the amount of insurance provided by the policy in excess of the ceding entity’s reserve on it.

Non-proportional

16. Other forms of reinsurance are also available, such as catastrophe and stop loss coverage. These arrangements provide for financial protection to the ceding entity for aggregate losses rather than providing indemnification for an individual policy basis as described in the preceding three reinsurance arrangements. Catastrophic and stop loss reinsurance are written on an annual basis to protect the ceding entity from excessive aggregate losses. Usually, the coverage does not extend over the life of the underlying policy nor is there any requirement on the ceding entity to renew the arrangement.

Transfer of Risk

17. Reinsurance agreements must transfer risk from the ceding entity to the reinsurer in order to receive the reinsurance accounting treatment discussed in this statement. If the terms of the agreement violate the risk transfer criteria contained herein, (i.e., limits or diminishes the transfer of risk by the ceding entity to the reinsurer), the agreement shall follow the guidance for Deposit Accounting. In addition, any contractual feature that delays timely reimbursement violates the conditions of reinsurance accounting.

18. This paragraph applies to all life, deposit-type and accident and health reinsurance agreements except for yearly renewable term reinsurance agreements and non-proportional reinsurance agreements such as stop loss and catastrophe reinsurance. All reinsurance agreements covering products that transfer significant risk shall follow the guidance for reinsurance accounting contained in this statement. All reinsurance contracts covering products that do not provide for sufficient transfer of risk shall follow the guidance for Deposit Accounting.

19. Yearly renewable term reinsurance agreements that transfer a proportionate share of mortality or morbidity risk inherent in the business being reinsured and do not contain any of the conditions described in Appendix A-791, paragraphs 2 b., 2 c., 2 d., 2 h., 2 i., 2 j., or 2 k., shall follow the guidance for
reinsurance accounting. Contracts that fail to meet the requirements for reinsurance accounting shall follow the guidance for Deposit Accounting.

20. For non-proportional reinsurance agreements such as stop loss and catastrophe reinsurance agreements, contract terms shall be evaluated to assess whether they transfer significant risk to the reinsurer. For example, prepayment schedules and accumulating retentions from multiple years are contractual features inherently designed to delay the timing of reimbursement to the ceding entity limits the risk to the reinsurer. Regardless of what a particular feature might be called, any feature that can delay timely reimbursement violates the conditions for reinsurance accounting. Transfer of insurance risk requires that the reinsurer’s payment to the ceding entity depend on and directly vary with the amount and timing of claims settled under the reinsured contracts. Contractual features that can delay timely reimbursement prevent this condition from being met. Reinsurance accounting shall apply to all non-proportional agreements that transfer significant risk and do not contain any provisions that protect the reinsurer from incurring a loss. Contracts that fail to meet the requirements for reinsurance accounting shall follow the guidance for Deposit Accounting.

Accounting and Reporting of Reinsurance

21. The obligation of reporting reinsurance in force and of determining unpaid premiums and incurred claims and other balances is generally on the ceding entity because it knows the current status of the policies it has written directly and reinsured. A lag will develop between the time of the entry of the underlying policy transaction on the books of the ceding entity and the transmittal of information and its entry on the books of the assuming entity. The assuming entity shall estimate any material unreported premiums and related costs.

22. The ceding entity must report these items in its balance sheet:
   a. Credits (deductions) to its policy and claim reserves and unpaid claims;
   b. Premiums or other amounts payable on reinsured risks;
   c. Amounts recoverable on claims, surrender values, dividends, experience rating refunds, taxes, commissions, and other expenses;
   d. Modified coinsurance reserves; and,
   e. Amounts receivable or payable for funds withheld.

23. Similarly, in its balance sheet, the assuming entity must report:
   a. Reserves for reinsurance assumed reduced by any modified coinsurance reserves;
   b. Reinsurance premiums receivable or other amounts receivable;
   c. Amounts payable for claims, surrender values, dividends, experience rating refunds, taxes, commissions, and other expenses; and,
   d. Amounts receivable or payable for funds withheld by the ceding entity.

24. While the premiums, commissions, expense allowances, reserves, claims, etc. will result in a net amount, the proper way to report them is in their separate classifications on the balance sheet. Each reinsurance agreement must be accounted for separately. Certain assets and liabilities are created by entities when they engage in reinsurance contracts. Reinsurance assets meet the definition of assets as defined by *SSAP No. 4—Assets and Nonadmitted Assets* and are admitted to the extent they conform to the requirements of this statement.
Reinsurance Premiums

25. For all reinsurance arrangements, the assuming entity must report premiums under the terms of the reinsurance contract as income and establish any asset or liability consistent with the methods and assumptions used to establish its policy reserves and guidance contained in SSAP No. 51—Life Contracts, SSAP No. 54—Individual and Group Accident and Health Contracts, and SSAP No. 59—Credit Life and Accident and Health Insurance Contracts. The ceding entity shall reduce premium income by the amounts paid or payable to the reinsurers. The ceding entity shall reduce its deferred and uncollected premiums reported as an asset by the corresponding proportionate amount of any deferred and uncollected premium attributable to those insurance policies reinsured. When the ceding entity has collected the premium but has not remitted the proportionate share to the reinsurer, the ceding entity shall establish a liability for the amount due the reinsurer. The assuming entity shall record an asset for premiums receivable from the ceding entity.

Reinsurance Benefit Payments

26. Policy benefit payments paid or payable by the reinsurer shall be reported in the summary of operations and reduces the ceding entity’s reported benefit payments. The reinsurer shall establish a liability for its share of any unpaid claim payments and the ceding entity shall reduce any policy and contract claim liability with respect to the reinsured policies or establish a receivable for the amount due from the reinsurer for claims paid.

Reinsurance of Deposit-Type Contracts

27. At the outset of a reinsurance contract covering deposit-type contracts as defined in SSAP No. 52—Deposit-Type Contracts, the net consideration exchanged between the parties shall be recorded as a contra-liability (reduction of reserve) by the payer of the net considerations and as a liability (reserve) by the receiver. Throughout the life of the contract, receipts and disbursements shall be recorded through the asset/liability accounts.

Expenses

28. It is common for the assuming entity to provide an expense allowance to cover expenses of the ceding entity. The allowance is frequently nonspecific with respect to premium taxes and other general expenses of the ceding entity and it is usually combined with and accounted for as part of the commissions on reinsurance assumed or ceded.

29. Commissions on direct business, commissions and expense allowances on reinsurance assumed, and commissions and expense allowances on reinsurance ceded are each accounted for separately in the summary of operations and on the balance sheet. Accordingly, commissions and expense allowances on reinsurance ceded are reported as income in the summary of operations and the balance sheet provision for due and accrued amounts is reported as an asset.

30. The taxes, commissions, and other expenses that will be paid by the assuming entity to the ceding entity are agreed upon when the reinsurance agreement is negotiated. These items are calculated in accordance with the reinsurance agreement and usually relate to premiums or claims or both. At the statement date, the amount of unpaid expenses is generally based upon the amount of premiums and claims unpaid at that date.

31. Some coinsurance contracts provide that the assuming entity pay to the ceding entity a commission that exceeds the first-year premium. In the absence of any guarantees for payment of future premiums, or other similar persistency guarantees, these commissions are accounted for on the cash basis. If, however, the contract contains a persistency guarantee which provides for return of the excess commission, the ceding entity must record the excess commission as a liability. This liability is then released as future
premiums are paid to the assuming entity or the persistency guarantee otherwise expires. The rate of release is determined in accordance with the anticipated experience and reasonable commission rate for first-year and renewal premiums. Excess commissions such as these are a means of financing for the ceding entity.

32. If renewal expense allowances in any accounting period are not sufficient to cover anticipated allocable renewal expenses of the ceding entity on the portion of the business reinsured, a liability is to be established by the ceding entity for the present value of the shortfall. In establishing this liability, assumptions are to be used equal to the applicable statutory reserve basis on the business reinsured. Anticipated allocable expenses include commissions, premium taxes and direct expenses including, but not limited to, billing, valuation, claims and maintenance expected by the entity at the time the business is reinsured.

Experience Refunds

33. Some reinsurance contracts, generally proportional reinsurance, provide that the reinsurer will refund an agreed upon portion of its profit to the ceding entity. The reinsurance contract will provide the calculation and the factors to be included.

34. If the contract provides for experience refunds, the ceding entity must record, as an asset, the amount of the refund receivable as of the statement date, but reduced by any amount that is contingent upon future experience. The assuming entity is also required to record, as a liability, the amount of the refund calculated at the statement date, but without regard to any effects that future experience might have.

Credits for Ceded Reinsurance

35. The credit taken by the ceding entity under the coinsurance arrangement is calculated using the same methodology and assumptions used in determining its policy and claim reserves. It is, of course, only for the percentage of the risk that was reinsured. Under modified coinsurance, the reserve credit is reduced by the modco deposit retained by the ceding entity. If the entity reinsures on a yearly renewable term basis, it is itself buying insurance for the portion of the ceded amount at risk. The amount of yearly renewable term reinsurance that is required on a given policy generally decreases each year as the entity’s reserve increases. The net amount at risk may increase, however, on interest sensitive products such as universal life. The amount at risk on accident and health yearly renewal term reinsurance will remain level and the reinsurance premium will increase each year.

36. The reserve credit taken by the ceding entity is reported as a reduction to the reserves and not as an asset of the entity. The ceding entity’s reserve credit and assuming entity’s reserve for yearly renewable term reinsurance shall be computed as the one year term mean reserve on the amount of insurance ceded. The ceding entity must use the same mortality and interest bases which were used for valuing the original policy before reinsurance. The credit may also be computed on a pro rata basis if the result is not materially different from the credit computed on the mean reserve basis. For all types of reinsurance, the ceding entity also takes credit for other amounts due from the reinsurer such as unpaid claims and claims incurred but not reported. If contemplated by the reinsurance contract, recognition of related assets and liabilities must occur (policy loans, due and deferred premiums, etc.).

37. Non-proportional reinsurance is entered into on an annual basis to limit the claims experience of the ceding entity and thereby protect its financial integrity. When the period of the arrangement exceeds one year, the contract must be carefully reviewed to determine if the end result more closely follows proportional reinsurance. No reserve credit is taken for non-proportional reinsurance unless the aggregate attachment point has in fact been penetrated. In order for an entity to reflect reserve credits on a prospective basis, the entity will need to demonstrate that the present value of expected recoveries using realistic assumptions, to be realized from the reinsurer are in excess of the present value of the reinsurance premiums guaranteed to be paid by the ceding entity under the terms of the contract. Because
non-proportional reinsurance aggregates experience, and does not indemnify the ceding entity for each policy loss, the use of statutory assumptions underlying the insured policies is inappropriate for determining any reserve credit to be taken by the ceding entity. Historical experience, pricing assumptions and asset shares shall be considered in determining if the reinsurer may be reasonably expected to pay any claims. The reserve credit taken shall only reflect these reasonable expectations. This treatment of non-proportional reinsurance is similar to the way property and casualty (P&C) reinsurance is considered. This is because these modes of reinsurance more closely follow P&C indemnification principles than life insurance formula basis, and because these coverages are very similar to excess insurance on P&C products. In determining the appropriate reserve credit, the probability of a loss penetrating to the reinsurer’s level of coverage (using reasonable assumptions) must be multiplied by the expected amount of recovery. This is the same as reserve credits on coinsurance where the probability of a claim (i.e., mortality) is multiplied by the expected return (i.e., death benefit). In that the coverage is for aggregate experience, the mortality assumptions underlying any one policy risk are inappropriate to analyze the appropriate credits for non-proportional coverage.

Reserves for Reinsurance Assumed

38. In assuming any insurance risks, the assuming entity is required to establish policy reserves that are consistent with its obligations. The reserves it must establish, therefore, are also dependent upon the arrangement of reinsurance that is used. For risks transferred under the reinsurance arrangement, policy and claim reserves must be at least equal to the required reserves calculated using the same methodology and assumptions that would be used if the reinsurer had written the risk directly.

Accounting for Modified Coinsurance Arrangements

39. The following accounting applies to modified coinsurance arrangements:

a. **Ceding Entity**—In a modified coinsurance arrangement, the ceding entity retains the assets equal to the modified coinsurance reserve. This reserve represents a prepayment of the reinsurer’s future obligation. Premiums paid or payable to the reinsurer net of any experience refunds shall result in the reduction of premium income. Policy benefit payments paid by the reinsurer shall reduce the ceding entity’s reported policy benefits. Expense allowances paid by the reinsurer shall be reported separately in the summary of operations as they are earned. The modified coinsurance reserve is included in the category of policy reserves. The modified coinsurance reserve adjustment from period-to-period shall be reported separately in the summary of operations;

b. **Assuming Entity (Reinsurer)**—Premiums received or receivable by the reinsurer shall increase premium income net of any experience refunds and policy benefit payments paid by the reinsurer shall increase the reported policy benefits. Expense allowances paid by the reinsurer shall be reported separately in the summary of operations when payable. The statutory policy reserves exclude the modified coinsurance reserve. The modified coinsurance reserve adjustment from period-to-period shall be reported separately in the summary of operations. The reinsurer’s accounting of its obligations shall be consistent with the ceding entity’s accounting for the transfer of the obligations.

Accounting for Coinsurance With Funds Withheld Arrangements

40. The following accounting applies to coinsurance arrangements with funds withheld:

a. **Ceding Entity**—Premiums paid or payable to the reinsurer net of any experience refunds shall reduce premium income. Policy benefit payments paid by the reinsurer shall reduce the ceding entity’s reported policy benefits. Expense allowances paid by the reinsurer shall be reported separately in the summary of operations as they are earned. A net
reduction to policy reserves shall be taken for the portion of the obligation assumed by
the reinsurer. Any amounts withheld by the ceding entity shall be recorded as a separate
liability. Reporting entities filing the annual statement for life and accident and health
insurers shall record any interest due or payable on the amounts withheld as a component of aggregate write-ins for miscellaneous deductions. Reporting entities filing the health annual statement shall record any interest due or payable on the amounts withheld as a component of aggregate write-ins for other income or expense.

b. **Assuming Entity (Reinsurer)—**Premiums received or receivable by the reinsurer net of any experience refunds shall increase premium income and policy benefit payments paid by the reinsurer shall increase the reported policy benefits. Expense allowances paid by the reinsurer shall be reported separately in the summary of operations when payable. The reinsurer shall record its share of the statutory policy reserves attributable to the business identified in the contract. Any funds withheld by the ceding entity shall be recorded as an accounts receivable. For reporting entities filing the annual statement for life and accident and health insurers shall record any interest earned or receivable on the funds withheld as a component of aggregate write-ins for miscellaneous income. Reporting entities filing the health annual statement shall record any interest earned or receivable on the funds withheld as a component of aggregate write-ins for other income or expense.

**Uncollectible Reinsurance**

41. The ceding and assuming companies must determine if reinsurance recoverables are collectible. If it is probable that reinsurance recoverables on paid or unpaid claim or benefit payments will be uncollectible, consistent with **SSAP No. 5—Liabilities, Contingencies and Impairments of Assets**, these amounts shall be written off through a charge to the Statement of Operations utilizing the same accounts which established the reinsurance recoverables.

**Unauthorized Reinsurance**

42. If the reinsurer is not authorized to do business, or is not otherwise approved, the reinsurance is considered to be unauthorized. A liability is established to offset credit taken in various balance sheet accounts for reinsurance ceded to unauthorized reinsurers. Credit for reinsurance with unauthorized companies shall be permitted if the ceding entity holds securities or cash of the assuming entity equal to the reserve credit taken. Such deposits are to be held under the control of the ceding entity. Additionally, any securities held under such an arrangement must be investments that the ceding entity is allowed to make under the provisions of the investment sections of the insurance statutes. Other permissible arrangements include irrevocable trusts or “clean” letters of credit. If the assuming entity is not licensed or is not an authorized reinsurer in the domiciliary state of the ceding entity or if the reinsurance does not meet required standards, the ceding entity must set up a net liability equal to the following:

a. Reserve credits taken including any Interest Maintenance Reserve (IMR) liability adjustment; plus

b. Claim liability credits taken on paid and unpaid (in course of settlement) claims recoverable; plus

c. Other asset increases or liability reductions resulting from amounts recoverable from the assuming entity including commissions, expense allowances, modified coinsurance reserve adjustments, experience rating refunds, and estimated incurred but not reported claim liabilities; less
d. Deposits by or funds withheld from the reinsurer, as provided for in the reinsurance treaty and in compliance with the security requirements of Appendix A-785, pledged as security for the payment of reinsurance obligations. Such deposits or funds are typically held by the ceding entity or are placed in a trust or custodial account. Amounts placed in trust or custodial accounts are held subject to withdrawal by, and under the control of, the ceding entity; less

e. Amounts of reinsurance recoverables covered by a clean, irrevocable letter of credit issued by a qualified U.S. financial institution as defined in Appendix A-785; less

f. Amounts contractually due the assuming entity.

43. The net liability defined above shall never be less than zero for any particular reinsurer. The change in liability for unauthorized reinsurance is a direct charge or credit to surplus.

Funds Held Under Reinsurance Treaties with Unauthorized Reinsurers

44. This liability is established for funds deposited by or contractually withheld from unauthorized reinsurers.

Accounting for Interest Maintenance Reserve (IMR)

45. The interest-related gain or loss (net of taxes) associated with the sale, transfer or reinsurance of a block of liabilities must be credited or charged to the IMR in accordance with the IMR instructions contained in the NAIC Annual Statement Instructions for Life and Accident and Health Insurance Companies.

Gains and Losses on Indemnity Reinsurance

46. Under an indemnity reinsurance arrangement the ceding entity continues to be liable to the policyholders and the reinsurer has no obligations to them except in the case of cut-through agreements. Typically the ceding entity will continue to perform all functions in connection with claims and other policyholder services. Gains and losses on indemnity reinsurance are defined as the net experience under the reinsurance contract within a calendar year. Net experience (underwriting gains or loss) includes ceded premiums, claims, expense allowances, reserve adjustments, any IMR liability adjustment, and experience refunds and dividends.

47. Losses that occur in any year of an indemnity reinsurance contract are immediately recognized. For reinsurance of in-force blocks of business, gains that occur in the initial calendar year are accounted for in accordance with Appendix A-791, paragraph 3. If a retrocession of all or a portion of an in-force block of assumed business occurs contemporaneously with assuming the in-force block of business, any resulting net gain from assuming the in-force block of business and the retrocession shall be accounted for in accordance with Appendix A-791. Any resulting net loss shall be recognized immediately in earnings.

48. For indemnity reinsurance agreements entered into for other than in-force blocks of business, the gains and losses are immediately recognized by the ceding and assuming entity.

Recaptures and Commutations

49. A recapture or a commutation of a reinsurance agreement is a transaction which results in the complete and final settlement and discharge of all present and future obligations between the parties arising out of the agreement or a portion of the agreement. Commuted and recaptured balances shall be accounted for by writing them off through the accounts, exhibits and schedules in which they were originally recorded. The assumed reserves and reserve credits taken are eliminated by the reinsurer and
ceding entity, respectively. The reinsurer and ceding entity must also make any required IMR liability adjustment changes. Any net gain or loss is reported in the summary of operations.

Deposit Accounting

50. To the extent that a reinsurance contract does not, despite its form, provide for sufficient transfer of risk amounts exchanged between the parties are to be accounted for and reported as follows:

a. At the outset of the reinsurance contract, the net consideration exchanged between the parties shall be recorded as an asset by the payer of the net considerations and as a liability by the receiver. The amount to be admitted as an asset is subject to the limitations for transactions with unauthorized reinsurers described in Appendix A-785. Throughout the life of the contract, receipts and disbursements shall be recorded through the asset/liability accounts. Income and losses shall be recognized by a party when, according to the terms of the contract, it has earned the amount and the other party has no recourse to repayment of such amount in future periods. When the contract is completed, or when there is a loss payment in excess of the deposit, any difference between consideration and recoveries shall be recorded as other miscellaneous insurance income or miscellaneous insurance loss;

b. No deduction shall be made from the policy or claim reserves on the balance sheet, schedules and exhibits.

Assumption Reinsurance

51. An entity may sell all or part of a block of insurance business through an assumption reinsurance agreement. Typically, under an assumption reinsurance arrangement, the reinsurance contract is intended to effect a novation, thereby to extinguish the ceding entity’s liability to the policyholder. Assumption reinsurance requires that the reinsurer issue assumption certificates to the existing policyholders and take over responsibility for policyholder services. On occasion, the reinsurer will contract with the original entity to continue to provide such services on a fee basis or may contract with a third party. Regulatory approval of assumption reinsurance arrangements is usually required. Approval is also usually required from the policyholders, who have a predetermined time period in which to accept or reject the reinsurance transfer. After the deadline has passed, approval is considered implied for all outstanding responses. For those policyholders that reject the transfer, the reinsurance agreement typically converts to an indemnity arrangement. Under this circumstance, reinsurance accounting, as defined earlier in this statement, is to be followed.

Accounting for Assumption Reinsurance Transactions

52. Accounting for assumption reinsurance transactions involves all existing assets and liabilities with respect to the assumed policies. This involves policy reserves, policy loans, net due and deferred premiums, dividend accumulations, dividend liability, policy claims, advance premiums, unearned interest on policy loans, etc. The total effect of all of these assets and liabilities is collectively referred to as net policy liabilities.

53. Typically, because a block of in-force business has value, the sale transaction will result in a gain to the ceding entity. If the policies are somewhat mature and have reasonably large net policy liabilities, the transaction probably will result in a transfer of cash or other assets by the ceding entity. In this case, the net policy liabilities released by the ceding entity will be greater than the value of the assets transferred. If the policies are young and have very small net policy liabilities, the assuming entity may pay some amount in the purchase. The ceding entity is to follow accounting for indemnity reinsurance for the policies sold until it has been formally relieved of the legal liability by either consent from the policyholders or when the expiration period for objecting to the transfer has expired. Upon release of the
liability or risk, the ceding entity shall recognize any gain or loss immediately. The gain or loss shall be the difference between the book value of the assets and liabilities including any unamortized IMR allocated or related to the block of business transferred. Direct and ceded balances are to be eliminated and gains are to be taken into income proportionally as the policyholders approve the transfer or at the end of the response period.

54. The assuming entity is to value the assets acquired at the date of acquisition at their market values, and the reserves are to be established according to statutory requirements based on the benefits in the individual policies reinsured. If the liabilities exceed the assets, the difference represents goodwill that must be amortized into operations using the interest method over the life of the policies, but for a period not to exceed 10 years. Goodwill resulting from assumption reinsurance transactions shall be included in the total goodwill of an entity when calculating the amount of goodwill that is a nonadmitted asset pursuant to SSAP No. 68—Business Combinations and Goodwill. If the assets exceed the liabilities, the assuming entity shall record a deferred liability and amortize the amount into operations using the interest method over the expected life of the business but not to exceed ten years.

55. Upon initiation of the assumption reinsurance contract, the ceding and assuming companies are to report all balances reinsured as direct adjustments to the balance sheet. Any net gain or loss is reported as miscellaneous income when recognized.

**Accounting for Non-economic Assumption Reinsurance Transactions**

56. When the sale, transfer, or reinsurance of an in-force block of business occurs between affiliated companies that is not an economic transaction, the ceding and assuming entity shall not recognize any gain or loss. The statutory liabilities and any unamortized IMR shall be transferred from the ceding entity to the assuming entity without adjustment. The assuming entity shall amortize any transferred IMR at the same rate or amount that would have occurred for the ceding entity. To the extent that the value of the assets transferred by the ceding entity or the net asset value recorded by the assuming entity differs from the liabilities including any unamortized IMR, the ceding and assuming entity shall defer and amortize their respective differences consistent with the interest method described for non-affiliated transactions.

**Disclosures**

57. 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;
      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);
   e. The method of determination of tabular interest on funds not involving life contingencies; and
f. The nature of significant other reserve changes.

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

a. Subject to discretionary withdrawal:

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

(a) In a lump sum with adjustments to reflect general changes in interest rates, or asset values since receipt of funds by the entity;

(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 v.(d) below;

iii. At market value, where the withdrawal of funds is payable at current market value of the assets supporting the liabilities, the assets are stated at current market value, and the liabilities are stated at the current market value or per unit value of the assets supporting the liabilities. These liabilities are for contracts where the customer bears the entire investment risk;

iv. Total with adjustment or at market value;

v. At book value without adjustment (minimal or no charge or adjustment), where the withdrawal of funds is either payable at all times, or at any time (including a withdrawal on a scheduled payment date) within one year from the statement date and:

(a) In a lump sum without adjustment;

(b) In installments over less than five years, with or without a reduction in interest rate during the installment period;

(c) In a lump sum subject to a fixed surrender charge of less than 5%;

(d) In a lump sum subject to surrender charge, but such charge is waived if the credited rate falls below a specified “bail out” rate and the “bail out” rate is more than the maximum statutory valuation rate for life insurance policies for more than 20 years for new issues.

b. Not subject to discretionary withdrawal;

c. Total gross;

d. Reinsurance ceded; and

e. Total net.
59. Reconcile the total annuity reserves and deposit fund liabilities amount disclosed to the appropriate sections of the Aggregate Reserve for Life Policies and Contracts Exhibit and the Deposit Funds and Other Liabilities without Life or Disability Contingencies Exhibit, of the Life, Accident & Health Annual Statement and the corresponding lines in the Separate Accounts Statement.

60. Disclosures shall be made consistent with the interrogatories made under the “Ceded Reinsurance Report” detailed in the NAIC Annual Statement Instructions For Life, Accident and Health Insurance Companies in the Notes to the Financial Statements section.

61. Describe uncollectible reinsurance written off during the year reported in the following annual statement classifications, including the name or names of the reinsurer(s):

   a. Claims incurred;
   b. Claim adjustment expenses incurred;
   c. Premiums earned; and
   d. Other.

62. Describe commutation of ceded reinsurance during the year reported in the following annual statement classifications, including the name or names of the reinsurer(s):

   a. Claims incurred;
   b. Claim adjustment expenses incurred;
   c. Premiums earned; and
   d. Other.

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

Relevant Literature

64. This statement adopts FASB Statement No. 113, Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts with modification. The statutory accounting principles established by this statement differ substantially from GAAP, reflecting much more detailed guidance, as follows:

   a. Reserve credits taken by ceding companies as a result of reinsurance contracts are netted against the ceding entity’s policy and claim reserves and unpaid claims;
   b. First year and renewal ceding commissions on indemnity reinsurance of new business are recognized as income. Ceding commissions on ceded in-force business are included in the calculation of initial gain or loss;
   c. As discussed in SSAP No. 50, statutory accounting defines deposit-type contracts as those contracts which do not include any mortality or morbidity risk. GAAP defines investment contracts as those that do not subject the insurance enterprise to significant policyholder mortality or morbidity risk. (The distinction is any mortality or morbidity risk for statutory purposes vs. significant mortality or morbidity risk for GAAP purposes.) Therefore, a contract may be considered an investment contract for GAAP purposes, and that same contract may be considered other than deposit-type for statutory purposes. A reinsurance treaty covering contracts that have insignificant mortality or
morbidity risk (i.e., contracts classified as other than deposit-type contracts for statutory purposes, but investment contracts for GAAP purposes) that does not transfer that mortality or morbidity risk, but does transfer all of the significant risk inherent in the business being reinsured (e.g., lapse, credit quality, reinvestment or disintermediation risk) qualifies for reinsurance accounting for statutory reporting purposes, but would not qualify for reinsurance accounting treatment for GAAP purposes;

d. Initial gains on indemnity reinsurance of in-force blocks of business have unique accounting treatment. A portion of the initial gain (equal to the tax effect of the initial gain in surplus) is reported as commissions and expense allowances on reinsurance ceded in the statement of operations. The remainder of the initial gain is reported on a net-of-tax basis as a write-in for gain or loss in surplus in the Capital and Surplus Account. In subsequent years, the ceding entity recognizes income on the reinsurance ceded line for the net-of-tax profits that emerged on the reinsured block of business with a corresponding decrease in the write-in for gain or loss in surplus;

e. This statement prohibits recognition of a gain or loss in connection with the sale, transfer or reinsurance of an in-force block of business between affiliated entities in a non-economic transaction. Any difference between the assets transferred by the ceding entity and the liabilities, including unamortized IMR, shall be deferred and amortized under the interest method;

f. This statement requires that a liability be established through a provision reducing surplus for unsecured reinsurance recoverables from unauthorized reinsurers;

g. This statement prescribes offsetting certain reinsurance premiums.

65. This statement incorporates Appendices A-785 and A-791.

Effective Date and Transition

66. This statement is effective for years beginning January 1, 2001, and, except as noted in paragraph 66, applies to all reinsurance contracts entered into or amended subsequent to January 1, 1996. Changes resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with SSAP No. 3—Accounting Changes and Corrections of Errors (SSAP No. 3).

67. The accounting and reporting practices revised by this statement shall not apply to reinsurance agreements in force on January 1, 1996.

68. The requirements of paragraph 18 relating to reinsurance of deposit-type contracts shall be effective for all accounting periods beginning on or after January 1, 2001.

69. Agreements which were: a) entered into on or after January 1, 1996, and which do not transfer risk shall be accounted for as deposits; b) amended on or after January 1, 1996, and which do not transfer risk shall be accounted for prospectively as deposits with the appropriate reclassification of outstanding reinsurance balances as deposits with no surplus impact. For arrangements which were amended on or after January 1, 1996, a change in accounting principle associated with the revised accounting in this statement shall be applied prospectively with no adjustment to surplus as required by SSAP No. 3.
AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

- *FASB Statement No. 113, Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts*

RELEVANT ISSUE PAPERS

- Issue Paper No. 74—Life, Deposit-Type and Accident and Health Reinsurance
SSAP NO. 61—GLOSSARY

Assume

To accept or take over an insurance risk; the reverse of cede.

Assumption Reinsurance

The form of reinsurance that extinguishes the ceding entity’s liability to the policyholder. The reinsurer directly assumes all the service and financial obligations of the original entity on the block of business being assumed. Unlike indemnity reinsurance, assumption reinsurance makes the assuming entity (reinsurer) directly liable to the policyholders. In some instances, the original entity may continue to administer and service the business but, if it does so, it does it as the agent of the reinsurer.

Automatic Maximum Limit

The amount of risk which can be automatically ceded if all other conditions are met. Also called the binding authority.

Authorized Reinsurer

An assuming entity is considered an authorized reinsurer if either: 1) it is licensed in the domiciliary state of the ceding entity; 2) it is an accredited reinsurer in the domiciliary state of the ceding entity; 3) it is domiciled and licensed in a state which employs standards regarding credit for reinsurance substantially similar to those of the domiciliary state of the ceding entity and maintains surplus of at least $20 million; 4) it maintains a trust for the benefit of all its U.S. policyholders and ceding entities equal to its U.S. liabilities plus a level of surplus prescribed in the NAIC model law on credit for reinsurance; or 5) it is a reinsurer accepting risks located in jurisdictions where the laws require reinsurance to be ceded to such entity.

Automatic Reinsurance

A reinsurance agreement under which the reinsurer is obligated to accept or assume risks which meet certain specific criteria based on the ceding entity’s underwriting. The reinsurance is ceded on the underwriting judgment of the ceding entity without a case by case concurrence of the reinsurer, up to a specified amount, the automatic maximum limit. The ceding entity normally is required to keep its full stipulated retention for the class of business involved on any case ceded automatically. Often certain defined types of cases are not eligible for automatic treatment. Cases in excess of the automatic maximum limits or otherwise ineligible for automatic cover can usually be submitted for facultative consideration.

Binding Authority

The amount of risk over the ceding entity’s retention which can be automatically ceded if all other conditions are met. Also called the automatic maximum limit.

1Definitions in this glossary are adapted from the Society of Actuaries’ Reinsurance Section Treaty Committee paper, “Discussion of Reinsurance Provisions in a Life Reinsurance Agreements,” dated August 1, 1994, and the glossary contained in Life, Health, and Annuity Reinsurance, by John E. Tiller, Jr., FSA, and Denise Fagerbert, FSA (ACTEX Publications, Inc.).
Catastrophe Reinsurance

A form of non-proportional reinsurance offering the ceding entity protection against excess losses from multiple claims arising out of a single event or a single large loss. Typically, reinsurance benefits will be paid if at least a specified minimum number of claims exceeding a minimum threshold amount of benefits arises out of a single event. When these conditions are met, the ceding entity is reimbursed for a percentage (often 100%) of the claims over the threshold attachment point up to the maximum reinsurance benefit specified in the treaty.

Cede

To transfer an insurance risk from the entity originally issuing the policy to another insurance entity known as the reinsurer; the reverse of assume.

Cession

The process of transferring risk from the ceding entity to the reinsurer.

Coinsurance

Indemnity life reinsurance in which the reinsurer participates in the risks and rewards of the policy provisions; the ceding entity retains its liability to the contractual relationship with the insured. The reinsurer is liable not only for its portion of the death benefit, but also all the nonforfeiture values. The reinsurer receives its proportionate share of the ceding entity’s gross premium less a coinsurance allowance for commissions and other expenses. The reinsurer holds the reserve on its portion of the policy and usually retains any excess investment earnings.

Commutation

The termination of all obligations between the parties to a reinsurance agreement, normally accompanied by a final cash settlement. Commutation may be required by the reinsurance agreement or may be effected by mutual agreement.

Credit for Reinsurance

Negative entries (i.e., reductions) to the ceding entity’s policy reserves and positive entries (i.e., increases) to the ceding entity’s assets (amounts recoverable from reinsurers). In the context of reinsurance, the term “credit” is the opposite of its meaning in pure accounting terminology. In balance sheet accounting, a credit is a positive entry to a liability (reserve).

Cut Through Endorsement

An endorsement to a policy and referred to in a reinsurance agreement which requires that, in the event of the ceding entity’s insolvency, any loss covered under the reinsurance agreement will be paid by the reinsurer directly to the insured (or a third party beneficiary).

Experience Rating Refund

A part of the profits under a reinsurance agreement which is returned to the ceding entity, allowing the ceding entity to share in a portion of profits realized on the reinsurance.

Facultative Reinsurance

Reinsurance under which the ceding entity has the option (faculty) of submitting and the reinsurer has the option of accepting or declining individual risks. Thus it is reinsurance that the ceding
entity chooses to submit to a reinsurer for its consideration and which may be ceded to the reinsurer only if the reinsurer makes an offer to reinsure. The underwriting classification assigned to the risk for purposes of the reinsurance is determined by the reinsurer. Facultative reinsurance may be ceded under the facultative terms of an automatic treaty for risks that the ceding entity cannot or does not wish to cede automatically, or it may be ceded under a purely facultative treaty.

Facultative Obligatory Reinsurance

A form of reinsurance that shares aspects of both facultative and automatic reinsurance. As with facultative reinsurance, the ceding entity has no obligation to offer specific cases to the reinsurer. However, once a case is offered to the facultative obligatory reinsurer, the case is treated largely as if it were automatic. The reinsurer receives no underwriting information and is offered the case at the ceding entity’s rating with the option to accept or reject the case. While not always stated in the treaty, it is usually understood that the case will be rejected by the reinsurer only if the reinsurer does not have available capacity (i.e., its own retention and automatic retrocession facilities).

Fronting Arrangement

A situation where one insurance entity issues policies to specified applicants and reinsures all or substantially all of the risks on the insurance to another insurance entity for a fee or portion of the profits. Fronting typically is used in jurisdictions where the reinsuring entity is not licensed to do business.

Funds Withheld

Assets that would normally be paid over to a reinsurer but are withheld by the ceding entity to permit statutory credit for nonadmitted reinsurance, to reduce a potential credit risk, or to retain control over investments. Under certain conditions, the reinsurer may withhold funds from the ceding entity.

Indemnity Reinsurance

The form of reinsurance under which the ceding entity secures reinsurance as a partial or total reimbursement on the risks assumed on policies it has issued or reinsured. Under indemnity reinsurance, the reinsurer has no relationship with the original policyholders; the ceding entity continues to administer and service the insurance on which it has secured reinsurance and remains fully responsible for all the interests of the policyholders. If the reinsurer cannot or does not honor its obligations to the ceding entity, the ceding entity would still be fully liable to its policyholders.

Indemnity reinsurance may be employed, not only between a direct writing entity and a reinsurer, but also between two reinsurers when retrocession of risks is being implemented.

Mod-co Reserve Adjustment

The net of two modified coinsurance items: the interest on reserves (payable by the ceding entity to the reinsurer) and the increase in the reserve (payable by the reinsurer to the ceding entity) or decrease in the reserve (payable by the ceding entity to the reinsurer).
Modified Coinsurance

Indemnity life insurance that differs from coinsurance only in that the reserves are retained by the ceding entity, which represents a prepayment of all or a portion of the reinsurer’s future obligation. Periodically an adjustment is made to the mean reserve on deposit with the ceding entity. This is usually done quarterly but may be done more frequently. If the reserve increases, the increase in mean reserve less interest on the mean reserve held at the end of the previous accounting period is paid by the reinsurer to the ceding entity. If the mean reserve decreases, the decrease and interest are paid by the ceding entity to the reinsurer. The appropriate interest rate is defined in the treaty.

Net Amount at Risk

The excess of the death benefit of a policy over the policy reserve. It is the amount which must come from surplus in the event of a death claim.

Non-proportional Reinsurance

Reinsurance that is not secured on individual lives for specific individual amounts of reinsurance, but rather reinsurance that protects the ceding entity’s overall experience on its entire portfolio of business, or at least a broad segment of it. The most common forms of non-proportional reinsurance are stop loss reinsurance and catastrophe reinsurance.

Non-proportional reinsurance is a form of casualty insurance. Usually neither the premium nor continuance of coverage is guaranteed beyond a specified term.

Pool

A method of allocating reinsurance among several reinsurers. Using this method, each reinsurer receives a specified percentage of risk ceded into the pool. Percentages may vary by reinsurer.

Proportional Reinsurance

Reinsurance on a particular life for a specified amount or share generally, though not necessarily, secured at the time the policy is issued to the insured. The continuation of coverage guarantees for the reinsurance generally parallel those in the life insurance coverage reinsured. Most life reinsurance conducted in the United States is done so on a proportional basis.

Recapture

The process by which the ceding entity recovers the liabilities transferred to a reinsurer. Reinsurance treaties often provide that if a ceding entity increases its retention, the ceding entity can, under previously agreed upon terms, take back (recapture) amounts of insurance previously ceded to fill up its new retention.

Reinsurer

An insurance entity to which another insurance entity can transfer, through the mechanism of reinsurance, part or all of its risk under a policy or policies it has issued or reinsured. If the transfer of risk is secured through indemnity reinsurance, the reinsurer becomes liable to the ceding entity for the reinsured benefits while the original entity, the ceding entity, remains fully liable to its insured policyholders. If the transfer of risk is secured through assumption reinsurance, the original entity steps out of the picture and transfers all of its liabilities and
responsibilities to the reinsurer, who then is henceforth directly responsible to the original policyholders.

**Retention**

The portion of a policy which the ceding entity retains for its own liability on life insurance. It is normally expressed in terms of face amount of insurance, especially if more than the mortality risk is reinsured. It is sometimes expressed in terms of risk amount, particularly with single premium products.

An entity’s retention is often graded by age and/or underwriting classification. Less frequently, special reduced retentions apply to specified risks, such as those engaging in aviation activities or with histories of coronary artery disease.

**Retrocession**

A form of reinsurance under which a reinsurer cedes to another insurer (the retrocessionaire) part or all of the reinsurance it has assumed from another entity. The original ceding entity has no relationship or recourse to the retrocessionaire and the original reinsurer remains fully liable to its client, the original ceding entity.

Retrocession provides a reinsurer with a method of accommodating its clients with respect to larger risks while still managing its own risk exposure.

**Stop Loss Reinsurance**

A form of non-proportional reinsurance under which the reinsurer pays some or all of a ceding entity’s aggregate retained losses in excess of a predetermined dollar amount or in excess of a percentage of premium. Stop loss coverage provides protection against an excessive number or amount of claims in any given contract period.

**Unauthorized Reinsurer**

A reinsurer that is neither authorized nor accredited (see “Authorized Reinsurer”). The ceding entity still may be able to take credit in its financial statements for reinsurance ceded to an unauthorized reinsurer if the reinsurer provides sufficient security for amounts due under the reinsurance treaty. This can usually be accomplished by permitting the ceding entity to withhold funds due the reinsurer (funds withheld approach) or by the reinsurer providing the ceding entity with a letter of credit, in a form acceptable to the state in question, or by the reinsurer establishing a trust agreement for the benefit of the ceding entity.

**Yearly Renewable Term (YRT)**

A form of life reinsurance under which the mortality or morbidity risks, but not the permanent plan reserves, are transferred to the reinsurer for a premium that varies each year with the amount at risk and the ages of the insureds. The amount of reinsurance, which may change annually, is generally the amount of insurance provided by the policy in excess of the primary insurer’s reserve.
Statement of Statutory Accounting Principles No. 62

Property and Casualty Reinsurance

STATUS

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Property and Casualty Reinsurance

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for property and casualty reinsurance. A wide range of methods for structuring reinsurance arrangements can be employed depending on the requirements of individual companies. This statement deals with the more commonly employed methods.

SUMMARY CONCLUSION

General

2. Reinsurance is the assumption by an insurer of all or part of a risk undertaken originally by another insurer. The transaction whereby a reinsurer cedes all or part of the reinsurance it has assumed to another reinsurer is known as a retrocession.

3. Reinsurance has many beneficial purposes. Among them are that it enables an insurance entity to (a) expand its capacity, (b) share large risks with other insurers, (c) spread the risk of potential catastrophes and stabilize its underwriting results, (d) finance expanding volume by sharing the financial burden of reserves, (e) withdraw from a line or class of business, and (f) reduce its net liability to amounts appropriate to its financial resources.

4. Reinsurance agreements are generally classified as treaty or facultative. Treaty reinsurance refers to an arrangement involving a class or type of business written, while facultative reinsurance involves individual risks offered and accepted.

5. Reinsurance coverage can be pro rata (i.e., proportional reinsurance) where the reinsurer shares a pro rata portion of the losses and premium of the ceding entity or excess of loss (i.e., non-proportional) where the reinsurer, subject to a specified limit, indemnifies the ceding entity against the amount of loss in excess of a specified retention. Most reinsurance agreements fall into one of the following categories:

I. Treaty Reinsurance Contracts—Pro Rata:
   A. Quota Share Reinsurance—The ceding entity is indemnified against a fixed percentage of loss on each risk covered in the agreement;
   B. Surplus Share Reinsurance—The ceding entity establishes a retention or “line” on the risks to be covered and cedes a fraction or a multiple of that line on each policy subject to a specified maximum cession;

II. Treaty Reinsurance Contracts—Excess of Loss:
   A. Excess Per Risk Reinsurance—The ceding entity is indemnified, subject to a specified limit, against the amount of loss in excess of a specified retention with respect to each risk covered by a treaty;
   B. Aggregate Excess of Loss Reinsurance—The ceding entity is indemnified against the amount by which the ceding entity’s net retained losses incurred during a specific period exceed either a predetermined dollar amount or a percentage of the entity’s subject premiums for the specific period subject to a specified limit;

III. Treaty Reinsurance Contracts—Catastrophe: The ceding entity is indemnified, subject to a specified limit, against the amount of loss in excess of a specified retention with respect to an accumulation of losses resulting from a catastrophic event or series of events;
IV. Facultative Reinsurance Contracts—Pro Rata: The ceding entity is indemnified for a specified percentage of losses and loss expenses arising under a specific insurance policy in exchange for that percentage of the policy’s premium;

V. Facultative Reinsurance Contracts—Excess of Loss: The ceding entity is indemnified, subject to a specified limit, for losses in excess of its retention with respect to a particular risk.

Characteristics of Reinsurance Agreements

6. Common contract provisions that may affect accounting practices include:
   a. Reporting responsibility of the ceding entity—Details required and time schedules shall be established;
   b. Payment terms—Time schedules, currencies intended, and the rights of the parties to withhold funds shall be established;
   c. Payment of premium taxes—Customarily the responsibility of the ceding entity, a recital of nonliability of the reinsurer may be found;
   d. Termination—May be on a cut-off or run-off basis. A cut-off provision stipulates that the reinsurer shall not be liable for loss as a result of occurrences taking place after the date of termination. A run-off provision stipulates that the reinsurer shall remain liable for loss under reinsured policies in force at the date of termination as a result of occurrences taking place after the date of termination until such time as the policies expire or are canceled; and
   e. Insolvency clause—Provides for the survival of the reinsurer’s obligations in the event of insolvency of the ceding entity, without diminution because of the insolvency.

7. Reinsurance contracts shall not permit entry of an order of rehabilitation or liquidation to constitute an anticipatory breach by the reporting entity, nor grounds for retroactive revocation or retroactive cancellation of any contracts of the reporting entity.

Required Terms for Reinsurance Agreements

8. In addition to credit for reinsurance requirements applicable to reinsurance transactions generally, no credit or deduction from liabilities shall be allowed by the ceding entity for reinsurance recoverable where the agreement was entered into after the effective date of these requirements (see paragraphs 76 and 77) unless each of the following conditions is satisfied:
   a. The agreement must contain an acceptable insolvency clause;
   b. Recoveries due the ceding entity must be available without delay for payment of losses and claim obligations incurred under the agreement, in a manner consistent with orderly payment of incurred policy obligations by the ceding entity;
   c. The agreement shall constitute the entire contract between the parties and must provide no guarantee of profit, directly or indirectly, from the reinsurer to the ceding entity or from the ceding entity to the reinsurer;
   d. The agreement must provide for reports of premiums and losses, and payment of losses, no less frequently than on a quarterly basis, unless there is no activity during the period. The report of premiums and losses shall set forth the ceding entity’s total loss and loss
expense reserves on the policy obligations subject to the agreement, so that the respective obligations of the ceding entity and reinsurer will be recorded and reported on a basis consistent with this statement; and

e. With respect to retroactive reinsurance agreements, the following additional conditions apply:

i. The consideration to be paid by the ceding entity for the retroactive reinsurance must be a sum certain stated in the agreement;

ii. Direct or indirect compensation to the ceding entity or reinsurer is prohibited;

iii. Any provision for subsequent adjustment on the basis of actual experience in regard to policy obligations transferred, or on the basis of any other formula, is prohibited in connection with a retroactive reinsurance transaction, except that provision may be made for the ceding entity’s participation in the reinsurer’s ultimate profit, if any, under the agreement;

iv. A retroactive reinsurance agreement shall not be canceled or rescinded without the approval of the commissioner of the domiciliary state of the ceding entity.

Reinsurance Contracts Must Include Transfer of Risk

9. The essential ingredient of a reinsurance contract is the transfer of risk. The essential element of every true reinsurance agreement is the undertaking by the reinsurer to indemnify the ceding entity, i.e., reinsured entity, not only in form but in fact, against loss or liability by reason of the original insurance. Unless the agreement contains this essential element of risk transfer, no credit shall be recorded.

10. Insurance risk involves uncertainties about both (a) the ultimate amount of net cash flows from premiums, commissions, claims, and claims settlement expenses (underwriting risk) and (b) the timing of the receipt and payment of those cash flows (timing risk). Actual or imputed investment returns are not an element of insurance risk. Insurance risk is fortuitous—the possibility of adverse events occurring is outside the control of the insured.

11. Determining whether an agreement with a reinsurer provides indemnification against loss or liability (transfer of risk) relating to insurance risk requires a complete understanding of that contract and other contracts or agreements between the ceding entity and related reinsurers. A complete understanding includes an evaluation of all contractual features that (a) limit the amount of insurance risk to which the reinsurer is subject (e.g., experience refunds, cancellation provisions, adjustable features, or additions of profitable lines of business to the reinsurance contract) or (b) delay the timely reimbursement of claims by the reinsurer (e.g., payment schedules or accumulating retentions from multiple years).

12. Indemnification of the ceding entity against loss or liability relating to insurance risk in reinsurance requires both of the following:

a. The reinsurer assumes significant insurance risk under the reinsured portions of the underlying insurance agreements; and

b. It is reasonably possible that the reinsurer may realize a significant loss from the transaction.

13. A reinsurer shall not have assumed significant insurance risk under the reinsured contracts if the probability of a significant variation in either the amount or timing of payments by the reinsurer is remote. Implicit in this condition is the requirement that both the amount and timing of the reinsurer’s payments depend on and directly vary with the amount and timing of claims settled by the ceding entity.
Contractual provisions that delay timely reimbursement to the ceding entity prevent this condition from being met.

14. The ceding entity’s evaluation of whether it is reasonably possible for a reinsurer to realize a significant loss from the transaction shall be based on the present value of all cash flows between the ceding and assuming companies under reasonably possible outcomes, without regard to how the individual cash flows are described or characterized. An outcome is reasonably possible if its probability is more than remote. The same interest rate shall be used to compute the present value of cash flows for each reasonably possible outcome tested. A constant interest rate shall be used in determining those present values because the possibility of investment income varying from expectations is not an element of insurance risk. Judgment is required to identify a reasonable and appropriate interest rate.

15. Significance of loss shall be evaluated by comparing the present value of all cash flows, determined as described in paragraph 14, with the present value of the amounts paid or deemed to have been paid to the reinsurer. If, based on this comparison, the reinsurer is not exposed to the reasonable possibility of significant loss, the ceding entity shall be considered indemnified against loss or liability relating to insurance risk only if substantially all of the insurance risk relating to the reinsured portions of the underlying insurance agreements has been assumed by the reinsurer. In this narrow circumstance, the reinsurer’s economic position is virtually equivalent to having written the insurance contract directly. This condition is met only if insignificant insurance risk is retained by the ceding entity on the retained portions of the underlying insurance contracts, so that the reinsurer’s exposure to loss is essentially the same as the reporting entity’s.

16. Payment schedules and accumulating retentions from multiple years are contractual features inherently designed to delay the timing of reimbursement to the ceding entity. Regardless of what a particular feature might be called, any feature that can delay timely reimbursement violates the conditions for reinsurance accounting. Transfer of insurance risk requires that the reinsurer’s payment to the ceding entity depend on and directly vary with the amount and timing of claims settled under the reinsured contracts. Contractual features that can delay timely reimbursement prevent this condition from being met. Therefore, any feature that may affect the timing of the reinsurer’s reimbursement to the ceding entity shall be closely scrutinized.

**Accounting for Reinsurance**

17. Reinsurance recoverables shall be recognized in a manner consistent with the liabilities (including estimated amounts for claims incurred but not reported) relating to the underlying reinsured contracts. Assumptions used in estimating reinsurance recoverables shall be consistent with those used in estimating the related liabilities. Certain assets and liabilities are created by entities when they engage in reinsurance contracts. Reinsurance assets meet the definition of assets as defined by SSAP No. 4—Assets and Nonadmitted Assets and are admitted to the extent they conform to the requirements of this statement.

18. Accounting for members of a reinsurance pool shall follow the accounting for the pool member which issued the underlying policy. Specific accounting rules for underwriting pools and associations are addressed in SSAP No. 63—Underwriting Pools and Associations Including Intercompany Pools.

19. Reinsurance recoverable on loss payments is an admitted asset. Notwithstanding the fact that reinsurance recoverables on paid losses may meet the criteria for offsetting under the provisions of SSAP No. 64—Offsetting and Netting of Assets and Liabilities (SSAP No. 64), reinsurance recoverables on paid losses shall be reported as an asset without any available offset. Unauthorized reinsurance is included in this asset and reflected separately as a liability to the extent required. Penalty for overdue authorized reinsurance shall be reflected as a liability.

20. Funds held or deposited with reinsured companies, whether premiums withheld as security for unearned premium and outstanding loss reserves or advances for loss payments, are admitted assets
provided they do not exceed the liabilities they secure and provided the reinsured is solvent. Those funds which are in excess of the liabilities, and any funds held by an insolvent reinsured shall be nonadmitted.

21. Prospective reinsurance is defined as reinsurance in which a reinsurer agrees to reimburse a ceding entity for losses that may be incurred as a result of future insurable events covered under contracts subject to the reinsurance. Retroactive reinsurance is defined as reinsurance in which a reinsurer agrees to reimburse a ceding entity for liabilities incurred as a result of past insurable events covered under contracts subject to the reinsurance. A reinsurance agreement may include both prospective and retroactive reinsurance provisions.

22. The distinction between prospective and retroactive reinsurance agreements is based on whether the agreement reinsures future or past insured events covered by the underlying insurance policies. For example, in occurrence-based insurance, the insured event is the occurrence of a loss covered by the insurance contract. In claims-made insurance, the insured event is the reporting to the insurer, within the period specified by the policy, of a claim for a loss covered by the insurance agreement. A claims-made reinsurance contract that reinsures claims asserted to the reinsurer in a future period as a result of insured events that occurred prior to entering into the reinsurance agreement is a retroactive agreement. (However, a reinsurance agreement that reinsures claims reported to an insurer that are covered under currently effective claims-made insurance policies is a prospective reinsurance agreement.)

23. It is not uncommon for a reinsurance arrangement to be initiated before the beginning of a policy period but not finalized until after the policy period begins. Whether there was agreement in principle at the beginning of the policy period and, therefore, the agreement is substantively prospective shall be determined based on the facts and circumstances. However, except as respects business assumed by a U.S. reinsurer from ceding companies domiciled outside the U.S. and not affiliated with such reinsurer, or business assumed by a U.S. reinsurer where either the lead reinsurer or a majority of the capacity on the agreement is domiciled outside the U.S. and is not affiliated with such reinsurer, if an agreement entered into, renewed or amended on or after January 1, 1994 has not been finalized, reduced to a written form and signed by the parties within nine months after the commencement of the policy period covered by the reinsurance arrangement, then the arrangement is presumed to be retroactive and shall be accounted for as a retroactive reinsurance agreement. This presumption shall not apply to: (a) facultative reinsurance contracts, nor to (b) reinsurance agreements with more than one reinsurer which are signed by the lead reinsurer (i.e., the reinsurer setting the terms of the agreement for the reinsurers) within nine months after the commencement of the policy period covered by the reinsurance agreement, nor to (c) reinsurance agreements with more than one reinsurer (whether signed by the lead reinsurer or not) which were entered into, renewed or amended on or before December 31, 1996, (and which were not renewed or amended after that date) if reinsurers representing more than 50% of the capacity on the agreement have signed cover notes, placement slips or similar documents describing the essential terms of coverage and exclusions within nine months after the commencement of the policy period covered by the reinsurance arrangement. Also exempt from this presumption are reinsurance agreements where one of the parties is in conservation, rehabilitation, receivership or liquidation proceedings.

24. Prospective and retroactive provisions included within a single agreement shall be accounted for separately. If separate accounting for prospective and retroactive provisions included within a single agreement is impracticable, the agreement shall be accounted for as a retroactive agreement provided the conditions for reinsurance accounting are met.

Accounting for Prospective Reinsurance Agreements

25. Amounts paid for prospective reinsurance that meet the conditions for reinsurance accounting shall be reported as a reduction of written and earned premiums by the ceding entity and shall be earned over the remaining contract period in proportion to the amount of reinsurance protection provided or, if applicable, until the reinsurer’s maximum liability under the agreement has been exhausted. If the amounts paid are subject to adjustment and can be reasonably estimated, the basis for amortization shall
be the estimated ultimate amount to be paid. Reinstatement premium, if any, shall be earned over the period from the reinstatement of the limit to the expiration of the agreement.

26. Changes in amounts of estimated reinsurance recoverables shall be recognized as a reduction of gross losses and loss expenses incurred in the current period statement of income. Reinsurance recoverables on paid losses shall be reported as an asset, reinsurance recoverables on loss and loss adjustment expense payments, in the balance sheet. Reinsurance recoverables on unpaid case-basis and incurred but not reported losses and loss adjustment expenses shall be netted against the liability for gross losses and loss adjustment expenses.

Accounting for Retroactive Reinsurance Agreements

27. Certain reinsurance agreements which transfer both components of insurance risk cover liabilities which occurred prior to the effective date of the agreement. Due to potential abuses involving the creation of surplus to policyholders and the distortion of underwriting results, special accounting treatment for these agreements is warranted.

28. All retroactive reinsurance agreements entered into, renewed or amended on or after January 1, 1994 (including subsequent development of such transactions) shall be accounted for and reported in the following manner:

a. The ceding entity shall record, without recognition of the retroactive reinsurance, loss and loss expense reserves on a gross basis on the balance sheet and in all schedules and exhibits;

b. The assuming entity shall exclude the retroactive reinsurance from loss and loss expense reserves and from all schedules and exhibits;

c. The ceding entity and the assuming entity shall report by write-in item on the balance sheet, the total amount of all retroactive reinsurance, identified as retroactive reinsurance reserve ceded or assumed, recorded as a contra-liability by the ceding entity and as a liability by the assuming entity;

d. The ceding entity shall, by write-in item on the balance sheet, restrict surplus resulting from any retroactive reinsurance as a special surplus fund, designated as special surplus from retroactive reinsurance account;

e. The surplus gain from any retroactive reinsurance shall not be classified as unassigned funds (surplus) until the actual retroactive reinsurance recovered exceeds the consideration paid;

f. The special surplus from retroactive reinsurance account for each respective retroactive reinsurance agreement shall be reduced at the time the ceding entity begins to recover funds from the assuming entity in amounts exceeding the consideration paid by the ceding entity under such agreement, or adjusted as provided in subparagraph 28 j.;

g. For each agreement, the reduction in the special surplus from retroactive reinsurance account shall be limited to the lesser of (i) the actual amount recovered in excess of consideration paid or (ii) the initial surplus gain resulting from the respective retroactive reinsurance agreement. Any remaining balance in the special surplus from retroactive reinsurance account derived from any such agreement shall be returned to unassigned funds (surplus) upon elimination of all policy obligations subject to the retroactive reinsurance agreement;
h. The ceding entity shall report the initial gain arising from a retroactive reinsurance transaction (i.e., the difference between the consideration paid to the reinsurer and the total reserves ceded to the reinsurer) as a write-in item on the statement of income, to be identified as Retroactive Reinsurance Gain and included under Other Income;

i. The assuming entity shall report the initial loss arising from a retroactive reinsurance transaction, as defined in the preceding subparagraph 28 g., as a write-in item on the statement of income, to be identified as Retroactive Reinsurance Loss and included under Other Income;

j. Any subsequent increase or reduction in the total reserves ceded under a retroactive reinsurance agreement shall be reported in the manner described in the preceding subparagraphs 28 h. and 28 i., in order to recognize the gain or loss arising from such increase or reduction in reserves ceded. The Special Surplus from Retroactive Reinsurance Account write-in entry on the balance sheet shall be adjusted, upward or downward, to reflect such increase or reduction in reserves ceded. The Special Surplus from Retroactive Reinsurance Account write-in entry shall be equal to or less than the total ceded reserves under all retroactive reinsurance agreements in-force as of the date of the financial statement. Special surplus arising from a retroactive reinsurance transaction shall be considered to be earned surplus (i.e., transferred to unassigned funds (surplus)) only when cash recoveries from the assuming entity exceed the consideration paid by the ceding entity as respects such retroactive reinsurance transaction; and

k. The consideration paid for a retroactive reinsurance agreement shall be reported as a decrease in ledger assets by the ceding entity and as an increase in ledger assets by the assuming entity.

(For an illustration of ceding entity accounting entries see Question 33 in Exhibit A.)

29. Portfolio reinsurance is the transfer of an insurer’s entire liability for in force policies or outstanding losses, or both, of a segment of the insurer’s business. Loss portfolio transactions are to be accounted for as retroactive reinsurance.

30. The accounting principles for retroactive reinsurance agreements in paragraph 28 shall not apply to the following types of agreements (which shall be accounted for as prospective reinsurance agreements):

a. Structured settlement annuities for individual claims purchased to implement settlements of policy obligations;

b. Novations, (i.e., (i) transactions in which the original direct insurer’s obligations are completely extinguished, resulting in no further exposure to loss arising on the business novated or (ii) transactions in which the original assuming entity’s obligations are completely extinguished) resulting in no further exposure to loss arising on the business novated, provided that (1) the parties to the transaction are not affiliates (or if affiliates, that the transaction has the prior approval of the domiciliary regulators of the parties) and (2) the accounting for the original reinsurance agreement will not be altered from retroactive to prospective;

c. The termination of, or reduction in participation in, reinsurance treaties entered into in the ordinary course of business; or
d. Intercompany reinsurance agreements, and any amendments thereto, among companies 100% owned by a common parent or ultimate controlling person provided there is no gain in surplus as a result of the transaction.

31. Retroactive reinsurance agreements resulting in surplus gain to the ceding entity (with or without risk transfer) entered into between affiliates or between insurers under common control (as those terms are defined in Appendix A-440) shall be reported as follows:

   a. The consideration paid by the ceding entity shall be recorded as a deposit and reported as a nonadmitted asset; and

   b. No deduction shall be made from loss and loss adjustment expense reserves on the ceding entity’s balance sheet, schedules, and exhibits.

32. The accounting and reporting provisions applicable to retroactive reinsurance apply to all transactions transferring liabilities in connection with a court-ordered rehabilitation, liquidation, or receivership. The requirement to include stipulated contract provisions in the reinsurance agreements shall not apply to these transactions, with written approval of the ceding entity’s domiciliary commissioner.

33. Novations meeting the requirements of subparagraph 30 b. shall be accounted for as prospective reinsurance agreements. The original direct insurer, or the original assuming insurer, shall report amounts paid as a reduction of written and earned premiums, and unearned premiums to the extent that premiums have not been earned. Novated balances (e.g., loss and loss adjustment expense reserves) shall be written off through the accounts, exhibits, and schedules in which they were originally recorded. The assuming insurer shall report amounts received as written and earned premiums, and obligations assumed as incurred losses in the statement of income.

Deposit Accounting

34. To the extent that a reinsurance agreement does not, despite its form, transfer both components of insurance risk, all or part of the agreement shall be accounted for and reported as deposits in the following manner:

   a. At the outset of the reinsurance agreement the net consideration paid by the ceding entity (premiums less commissions or other allowances) shall be recorded as a deposit by the ceding entity and as a liability by the assuming entity. The deposit shall be reported as an admitted asset by the ceding entity if (i) the assuming entity is licensed, accredited or otherwise qualified in the ceding entity’s state of domicile as described in Appendix A-785 or (ii) there are funds held by or on behalf of the ceding entity as described in Appendix A-785;

   b. Throughout the life of the agreement, receipts and disbursements shall be recorded through the deposit/liability accounts;

   c. When individual case reserves are the basis for the deposit and the assuming entity pays in excess of the amount transferred by the ceding entity, the amount paid in excess of the deposit received shall be recognized as a loss by the assuming entity and as a gain by the ceding entity as Other Income in the statement of income;

   d. When the agreement is completed, or when there is a loss payment in excess of the deposit, any difference between consideration and recoveries shall be recorded in the Other Income or Loss account as a loss to the reinsurer and as a gain in the Other Income or Loss account by the reinsured;
e. With regard to bulk reserves, (i.e., IBNR) it shall be assumed that any cash transactions for the settlement of losses will reduce the asset/liability accounts by the amount of the cash transferred. When the remaining losses are revalued upward, an increase in the liability shall be recorded as a loss recognized by the assuming entity. Conversely, the ceding entity shall increase its deposit (asset) and outstanding loss liability;

f. No deduction shall be made from the loss and loss adjustment expense reserves on the ceding entity’s balance sheet, schedules, and exhibits; and

g. The assuming entity shall record net consideration to be returned to the ceding entity as liabilities.

**Assumed Reinsurance**

35. Reinsurance premiums receivable at the end of the accounting period are combined with direct business receivables and reported as agents’ balances or uncollected premiums. Where the ceding entity withholds premium funds pursuant to the terms of the reinsurance agreement, such assets shall be shown by the assuming entity as funds held by or deposited with reinsured companies. Reporting entities shall record any interest earned or receivable on the funds withheld as a component of aggregate write-ins for miscellaneous income.

36. Reinsurance premiums more than 90 days overdue shall be nonadmitted except (a) to the extent the assuming entity maintains unearned premium and loss reserves as to the ceding entity, under principles of offset accounting as discussed in SSAP No. 64, or (b) where the ceding entity is licensed and in good standing in assuming entity’s state of domicile. Reinsurance premiums are due pursuant to the original contract terms (as the agreement stood on the date of execution). In the absence of a specific contract date, reinsurance premiums will be deemed due thirty (30) days after the date on which (i) notice or demand of premium due is provided to the ceding entity or (ii) the assuming entity books the premium (see SSAP No. 6—Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers).

37. A lag will develop between the time of the entry of the underlying policy transaction on the books of the ceding entity and the transmittal of information and entry on the books of the assuming entity. Assuming companies shall estimate unreported premiums and related costs to the extent necessary to prevent material distortions in the loss development contained in the assuming entity’s annual statement schedules where calendar year premiums are compared to accident year losses.

38. Proportional reinsurance (i.e., first dollar pro rata reinsurance) premiums shall be allocated to the appropriate annual statement lines of business in the Underwriting and Investment exhibits. Non-proportional assumed reinsurance premiums shall be classified as reinsurance under the appropriate subcategories.

39. Assumed retroactive reinsurance premiums shall be excluded from all schedules and exhibits as addressed in subparagraph 28 k.

40. Amounts payable by reinsurers on losses shall be classified as unpaid losses. Assumed reinsurance payable on paid losses shall be classified as a separate liability item on the balance sheet. IBNR losses on assumed reinsurance business shall be netted with ceded losses on the balance sheet and listed separately by annual statement line of business in the Underwriting and Investment exhibits.
Ceded Reinsurance

41. Ceded reinsurance premiums payable (net of ceding commission) shall be classified as a liability. Consistent with SSAP No. 64, ceded reinsurance premiums payable may be deducted from amounts due from the reinsurer, such as amounts due on assumed reinsurance, when a legal right of offset exists.

42. Amounts withheld by the ceding entity that would otherwise be payable under the reinsurance agreement shall be reported as funds held by entity under reinsurance treaties. Reporting entities shall record any interest due or payable on the amounts withheld as a component of aggregate write-ins for miscellaneous income.

43. Ceded reinsurance transactions shall be classified in the annual statement line of business which relates to the direct or assumed transactions creating the cession or retrocession.

44. Ceded retroactive reinsurance premiums shall be excluded from all schedules and exhibits as addressed in subparagraph 28 k.

Adjustable Features/Retrospective Rating

45. Reinsurance treaties may provide for adjustment of commission, premium, or amount of coverage, based on loss experience. The accounting for common examples is outlined in the following paragraphs:

Commission Adjustments

46. An accrual shall be maintained for the following adjustable features based upon the experience recorded for the accounting period:

   a. Contingent or Straight Profit—The reinsurer returns to the ceding entity a stipulated percentage of the profit produced by the business assumed from the ceding entity. Profit may be calculated for any specified period of time, but the calculation is often based on an average over a period of years; and

   b. Sliding Scale—A provisional rate of commission is paid over the course of the agreement, with a final adjustment based on the experience of the business ceded under the agreement.

Premium Adjustments

47. If the reinsurance agreement incorporates an obligation on the part of the ceding entity to pay additional premium to the assuming entity based upon loss experience under the agreement, a liability in the amount of such additional premium shall be recognized by the ceding entity during the accounting period in which the loss event(s) giving rise to the obligation to pay such additional premium occur(s). The assuming entity shall recognize an asset in a consistent manner. If the reinsurance agreement incorporates an obligation on the part of the assuming entity to refund to the ceding entity any portion of the consideration received by the assuming entity based upon loss experience under the agreement, an asset in the amount of any such refund shall be recognized by the ceding entity during the accounting period in which the loss event(s) giving rise to the obligation to make such refund occur(s). The initial provisional or deposit premium is recalculated retrospectively, based on loss experience under the agreement during a specified period of time; the calculation is often based on an average over a period of years. The assuming entity shall recognize a liability in a consistent manner.
Adjustments in the Amount of Coverage

48. The amount of coverage available for future periods is adjusted, upward or downward, based on loss experience under the agreement during a specified period of time. If the reinsurance agreement incorporates a provision under which the reinsurance coverage afforded to the ceding entity may be increased or reduced based upon loss experience under the agreement, an asset or a liability shall be recognized by the ceding entity in an amount equal to that percentage of the consideration received by the assuming entity which the increase or reduction in coverage represents of the amount of coverage originally afforded. The asset or liability shall be recognized during the accounting period in which the loss event(s) (or absence thereof) giving rise to the increase or decrease in reinsurance coverage occur(s), and shall be amortized over all accounting periods for which the increased or reduced coverage is applicable. The term “consideration” shall mean, for this purpose, the annualized deposit premium for the period used as the basis for calculating the adjustment in the amount of coverage to be afforded thereafter under the agreement.

Impairment

49. Include as a nonadmitted asset, amounts accrued for premium adjustments on retrospectively rated reinsurance agreements with respect to which all uncollected balances due from the ceding company have been classified as nonadmitted.

Commissions

50. Commissions payable on reinsurance assumed business shall be included as an offset to Agents’ Balances or Uncollected Premiums. Commissions receivable on reinsurance ceded business shall be included as an offset to Ceded Reinsurance Balances Payable.

51. If the ceding commission paid under a reinsurance agreement exceeds the anticipated acquisition cost of the business ceded, the ceding entity shall establish a liability, equal to the difference between the anticipated acquisition cost and the reinsurance commissions received, to be amortized pro rata over the life of the reinsurance agreement.

Provision for Reinsurance

52. The NAIC Annual Statement Instructions for Property and Casualty Companies for Schedule F—Provision for Overdue Reinsurance, provide for a minimum reserve for uncollectible reinsurance with an additional reserve required if an entity’s experience indicates that a higher amount should be provided. The minimum reserve Provision for Reinsurance is recorded as a liability and the change between years is recorded as a gain or loss directly to unassigned funds (surplus). Any reserve over the minimum amount shall be recorded on the statement of income by reversing the accounts previously utilized to establish the reinsurance recoverable.

53. The provision for reinsurance is calculated separately for unauthorized and authorized companies. An authorized reinsurer is licensed, accredited or approved by the ceding entity’s state of domicile; an unauthorized reinsurer is not so licensed, accredited or approved.

Disputed Items

54. Occasionally a reinsurer will question whether an individual claim is covered under a reinsurance agreement or may even attempt to nullify an entire agreement. A ceding entity, depending upon the individual facts, may or may not choose to continue to take credit for such disputed balances. A ceding entity shall take no credit whatsoever for reinsurance recoverables in dispute with an affiliate.
55. Items in dispute are those claims with respect to which the ceding entity has received formal written communication from the reinsurer denying the validity of coverage.

Uncollectible Reinsurance

56. Uncollectible reinsurance balances shall be written off through the accounts, exhibits, and schedules in which they were originally recorded.

Commutations

57. A commutation of a reinsurance agreement, or any portion thereof, is a transaction which results in the complete and final settlement and discharge of all, or the commuted portion thereof, present and future obligations between the parties arising out of the reinsurance agreement.

58. In commutation agreements, an agreed upon amount determined by the parties is paid by the reinsurer to the ceding entity. The ceding entity immediately eliminates the reinsurance recoverable recorded against the ultimate loss reserve and records the cash received as a negative paid loss. Any net gain or loss shall be reported in underwriting income in the statement of income.

59. The reinsurer eliminates a loss reserve carried at ultimate cost for a cash payout calculated at present value. Any net gain or loss shall be reported in underwriting income in the statement of income.

60. Commuted balances shall be written off through the accounts, exhibits, and schedules in which they were originally recorded.

National Flood Insurance Program

61. The National Flood Insurance Program was created by the Federal Emergency Management Agency (FEMA) and is designed to involve private insurers in a write-your-own (WYO) flood insurance program financially backed by FEMA at no risk to the insurer. To become a participating WYO entity, the entity signs a document with the Federal Insurance Administration (FIA) of the Federal Emergency Management Agency known as the Financial Assistance/Subsidy Arrangement.

62. Premium rates are set by FEMA. The WYO participating companies write the flood insurance coverage qualifying for the program on their own policies, perform their own underwriting, premium collections, claim payments, administration, and premium tax payments for policies written under the program.

63. Monthly accountings are made to FIA and participants draw upon FEMA letters of credit for deficiencies of losses, loss expenses, and administrative expenses in excess of premiums, subject to certain percentage limitations on expenses.

64. Balances due from or to FEMA shall be reported as ceded reinsurance balances receivable or payable.

Disclosures

65. Unsecured Reinsurance Recoverables:

   a. If the entity has with any individual reinsurers, authorized or unauthorized, an unsecured aggregate recoverable for losses, paid and unpaid including IBNR, loss adjustment expenses, and unearned premium, that exceeds 3% of the entity’s policyholder surplus, list each individual reinsurer and the unsecured aggregate recoverable pertaining to that reinsurer; and
b. If the individual reinsurer is part of a group, list the individual reinsurers, each of its related group members having reinsurance with the reporting entity, and the total unsecured aggregate recoverables for the entire group.

66. Reinsurance Recoverables in Dispute—Reinsurance recoverable on paid and unpaid (including IBNR) losses in dispute by reason of notification, arbitration or litigation shall be identified if the amounts in dispute from any entity (and/or affiliate) exceed 5% of the ceding entity’s policyholders surplus or if the aggregate of all disputed items exceeds 10% of the ceding entity’s policyholders surplus. Notification means a formal written communication from a reinsurer denying the validity of coverage.

67. Uncollectible Reinsurance—Describe uncollectible reinsurance written off during the year reported in the following annual statement classifications, including the name(s) of the reinsurer(s):
   a. Losses incurred;
   b. Loss adjustment expenses incurred;
   c. Premiums earned; and
   d. Other.

68. Commutation of Ceded Reinsurance—Describe commutation of ceded reinsurance during the year reported in the following annual statement classifications, including the name(s) of the reinsurer(s):
   a. Losses incurred;
   b. Loss adjustment expenses incurred;
   c. Premiums earned; and
   d. Other.

69. Retroactive Reinsurance—The table illustrated in the NAIC Annual Statement Instructions for Property and Casualty Companies under Retroactive Reinsurance in the Notes to Financial Statements section shall be completed for all retroactive reinsurance agreements that transfer liabilities for losses that have already occurred and that will generate special surplus transactions. The insurer (assuming or ceding) shall assign a unique number to each retroactive reinsurance agreement and shall utilize this number for as long as the agreement exists. Transactions utilizing deposit accounting shall not be reported in this note.

70. Reinsurance Assumed and Ceded—The tables illustrated in the NAIC Annual Statement Instructions for Property and Casualty Companies under “Reinsurance Assumed and Ceded in the Notes to Financial Statements” section shall be completed as follows:
   a. The financial statements shall disclose the maximum amount of return commission which would have been due reinsurers if all reinsurance were canceled with the return of the unearned premium reserve; and
   b. The financial statements shall disclose the accrual of additional or return commission, predicated on loss experience or on any other form of profit sharing arrangements as a result of existing contractual arrangements.

71. A specific interrogatory requires information on reinsurance of risk accompanied by an agreement to release the reinsurer from liability, in whole or in part, from any loss that may occur on the risk or portion thereof.
72. Refer to the preamble for further discussion regarding disclosure requirements.

Relevant Literature

73. This statement adopts FASB Statement No. 113, Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts (FAS 113) with modification and FASB Emerging Issues Task Force No. 93-6, Accounting for Multiple-Year Retrospectively Rated Contracts by Ceding and Assuming Enterprises with modification for the following:

a. Reinsurance recoverables on unpaid case-basis and incurred but not reported losses and loss adjustment expenses shall be reported as a contra-liability netted against the liability for gross losses and loss adjustment expenses;

b. Amounts paid for prospective reinsurance that meet the conditions for reinsurance accounting shall be reported as a reduction of unearned premiums;

c. The gain created by a retroactive reinsurance agreement because the amount paid to the reinsurer is less than the gross liabilities for losses and loss adjustment expenses ceded to the reinsurer is reported in the statement of income as a write-in gain in other income by the ceding entity and a write-in loss by the assuming entity. The gain created by a retroactive reinsurance agreement is restricted as a special surplus account until the actual retroactive reinsurance recovered is in excess of the consideration paid;

d. This statement requires that a liability be established through a provision reducing unassigned funds (surplus) for unsecured reinsurance recoverables from unauthorized reinsurers and for certain overdue balances due from authorized reinsurers;

e. Some reinsurance agreements contain adjustable features that provide for adjustment of commission, premium or amount of coverage, based on loss experience. This statement requires that the asset or liability arising from the adjustable feature be computed based on experience to date under the agreement, and the impact of early termination may only be considered at the time the agreement has actually been terminated;

f. Structured settlements are addressed in SSAP No. 65—Property and Casualty Contracts. Statutory accounting and FAS 113 are consistent in accounting for structured settlement annuities where the reporting entity is the owner and payee and where the claimant is the payee and the reporting entity has been released from its obligation. FAS 113 distinguishes structured settlement annuities where the claimant is the payee and a legally enforceable release from the reporting entity’s liability is obtained from those where the claimant is the payee but the reporting entity has not been released from its obligation. GAAP requires the deferral of any gain resulting from the purchase of a structured settlement annuity where the reporting entity has not been released from its obligation; and

g. This statement requires that reinsurance recoverables on unpaid losses and loss adjustment expenses be presented as a contra-liability. Requirements for offsetting and netting are addressed in SSAP No. 64.

74. This statement rejects AICPA Statement of Position No. 92-5, Accounting for Foreign Property and Liability Reinsurance. This statement incorporates Appendix A-785 as applicable.
Effective Date and Transition

75. This statement shall apply to:

   a. Reinsurance agreements entered into, renewed, or amended on or after January 1, 1994. An amendment is any revision or adjustment of contractual terms. The payment of premiums or reimbursement of losses recoverable under the agreement shall not constitute an amendment; and

   b. Reinsurance agreements in force on January 1, 1995, which cover losses occurring or claims made on or after that date on policies reinsured under such agreements.

76. The guidance shall not apply to:

   a. Reinsurance agreements which cover only losses occurring or claims made before January 1, 1994, and which were entered into before January 1, 1994, and were not subsequently renewed or amended; and

   b. Reinsurance agreements that expired before and were not renewed or amended after January 1, 1995.

77. The guidance in paragraphs 45 through 49 shall be effective for all accounting periods beginning on or after January 1, 1996, and shall apply to reinsurance agreements entered into, renewed or amended on or after January 1, 1994.

78. This statement is effective for years beginning January 1, 2001. Changes resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with SSAP No. 3—Accounting Changes and Corrections of Errors.

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

- FASB Statement No. 113, Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts

- FASB Emerging Issues Task Force Issue No. 93-6, Accounting for Multiple-Year Retrospectively Rated Contracts by Ceding and Assuming Enterprises

RELEVANT ISSUE PAPERS

- Issue Paper No. 75—Property and Casualty Reinsurance
Was the contract entered into, renewed, amended, or does the contract have an anniversary date (i.e., multi-year contract) during or after 1994?

Yes

The contract would be “grandfathered” and accounted for in accordance with Chapter 22 of the NAIC Accounting Practices and Procedures Manual for Property/Casualty Insurance Companies dated January 1992

No

Has the reinsurer assumed significant insurance risk, both as to timing of risk (including timely reimbursement) and amount of insurance loss under the reinsured portions of the underlying contracts?

Yes

Has the reinsurer assumed substantially all of the risk relating to the reinsured portion of the underlying contract (i.e., the reinsurer is in the same economic position as the reinsured)?

No

No

The contract has not transferred risk and should be accounted for as a deposit. Any previously recognized gains and losses should not be restated, and existing balances should be reclassified as deposits.

Yes

The contract has transferred risk and should be accounted for as reinsurance in accordance with SSAP No. 62

Is it reasonably possible that the reinsurer may realize a significant loss from the transaction?

Yes

No

Does the contract only reinsure losses from insured events that may occur after the date the contract is entered into?

Yes

Account for the contract as a prospective reinsurance.

No

Does the contract only reinsure losses from insured events that occurred prior to the date the contract is entered into?

Yes

Account for the contract as a retroactive reinsurance.

No

Is it practicable to identify and account separately for the prospective and retroactive portions of a blended contract?

No

Yes

Account for the prospective and retroactive components separately.
SSAP NO. 62—EXHIBIT A

Implementation Questions and Answers

Applicability

1. Q: The accounting practices in SSAP No. 62 specify the accounting and reporting for reinsurance contracts. What contracts are considered reinsurance contracts for purposes of applying these accounting practices?

   A: Any transaction that indemnifies an insurer against loss or liability relating to insurance risk shall be accounted for in accordance with the accounting practices included in SSAP No. 62. Therefore, all contracts, including contracts that may not be structured or described as reinsurance, shall be accounted for as reinsurance when those conditions are met.

2. Q: The provisions of this statement will apply to (a) reinsurance contracts entered into, renewed or amended on or after January 1, 1994, and (b) any other reinsurance contracts that are in force on January 1, 1995 and cover insurable events on the underlying insurance policies that occur on or after that date. What contracts would be exempt from the new accounting rules included in SSAP No. 62?

   A: The only exempt contracts are:
   1) Purely retroactive reinsurance contracts that cover only insured events occurring before January 1, 1994, provided those contracts were entered into before that date and are not subsequently amended and
   2) Contracts that expired before January 1, 1995 and are not amended after that date.

3. Q: This statement is to be applied to contracts which are amended on or after January 1, 1994. What if the change in terms is not significant, or the terms changed have no financial effect on the contract?

   A: In general, the term amendment should be viewed broadly to include all but the most trivial changes. Examples of amendments include, but are not limited to, replacing one assuming entity with another (including an affiliated entity), or modifying the contract’s limit, coverage, premiums, commissions, or experience-related adjustable features. No distinction is made between financial and non-financial terms.

4. Q: Must the accounting provisions of SSAP No. 62 be applied to an otherwise exempt contract if the ceding entity pays additional premiums under the contract on or after January 1, 1994?

   A: The answer depends on why the additional premiums are paid. If the additional premiums are the result of a renegotiation, adjustment, or extension of terms, the contract is subject to the accounting provisions of SSAP No. 62. However, additional premiums paid without renegotiation, adjustment, or extension of terms would not make an otherwise exempt contract subject to those provisions.

5. Q: Prospective and retroactive portions of a reinsurance contract are allowed to be accounted for separately, if practicable. Can the retroactive portion of an existing contract be segregated and, therefore, exempted with other retroactive contracts covering insured events occurring prior to January 1, 1994?

   A: No. The transition provisions apply to an entire contract, which is either subject to or exempt from the revised provisions of SSAP No. 62. A ceding entity may bifurcate a contract already
subject to the new accounting rules in SSAP No. 62 and then account for both the prospective and retroactive portions in accordance with the new accounting standard.

Risk Transfer

6. Q: Do the new risk transfer provisions apply to existing contracts?

A: Yes, the new risk transfer provisions apply to some existing contracts. SSAP No. 62 applies in its entirety only to existing contracts which were renewed or amended on or after January 1, 1994, or which cover losses occurring or claims made after that date. Therefore, those contracts must be evaluated to determine whether they transfer risk and qualify for reinsurance accounting. For accounting periods commencing on or after January 1, 1995, balances relating to such contracts which do not transfer insurance risk shall be reclassified as deposits and shall be accounted for and reported in the manner described under the caption Reinsurance Contracts Must Include Transfer of Risk.

SSAP No. 62 does not apply to existing contracts which were entered into before, and were not renewed or amended on or after, January 1, 1994, and which cover only losses occurring or claims made before that date, nor to contracts which expired before, and were not renewed or amended on or after, January 1, 1995. Those contracts will continue to be accounted for in the manner provided by SSAP No. 62 before these revisions.

7. Q: How does the effective date affect the assessment of whether a significant loss to the reinsurer was reasonably possible?

A: The risk transfer assessment is made at contract inception, based on facts and circumstances known at the time. Because that point in time has passed for existing contracts, some have suggested that the risk transfer provisions be applied as of the effective date. However, that approach to the risk transfer assessment would violate the requirement to consider all cash flows from the contract. Therefore, the test must be applied from contract inception, considering the effect of any subsequent contract amendments. Careful evaluation and considered judgment will be required to determine whether a significant loss to the reinsurer was reasonably possible at inception.

8. Q: Should risk transfer be reassessed if contractual terms are subsequently amended?

A: Yes. When contractual terms are amended, risk transfer should be reassessed. For example, a contract that upon inception met the conditions for reinsurance accounting could later be amended so that it no longer meets those conditions. The contract should then be reclassified and accounted for as a deposit.

9. Q: How should the risk transfer assessment be made when a contract has been amended?

A: No particular method is prescribed for assessing risk transfer in light of a contract amendment. Whether an amended contract in substance transfers risk must be determined considering all of the facts and circumstances in light of the risk transfer requirements. Judgment also will be required to determine whether an amendment in effect creates a new contract.

10. Q: For purposes of evaluating whether a contract with a reinsurer transfers risk, what constitutes a contract?

A: A contract is not defined, but is essentially a question of substance. It may be difficult in some circumstances to determine the boundaries of a contract. For example, the profit-sharing
provisions of one contract may refer to experience on other contracts and, therefore, raise the question of whether, in substance, one contract rather than several contracts exist.

The inconsistency that could result from varying interpretations of the term *contract* is limited by requiring that features of the contract or other contracts or agreements that directly or indirectly compensate the reinsurer or related reinsurers for losses be considered in evaluating whether a particular contract transfers risk. Therefore, if agreements with the reinsurer or related reinsurers, in the aggregate, do not transfer risk, the individual contracts that make up those agreements also would not be considered to transfer risk, regardless of how they are structured.

11. Q: If the assessment of risk transfer changes after the initial assessment at contract inception, how should the ceding entity account for the change?

A: The status of a contract should be determinable at inception and, absent amendment, subsequent changes should be very rare. If the risk of significant loss was not deemed reasonably possible at inception, and a significant loss subsequently occurred, the initial assessment was not necessarily wrong, because remote events do occur. Likewise, once a reasonable possibility of significant loss has been established, such loss need not occur in order to maintain the contract’s status as reinsurance.

12. Q: SSAP No. 62 requires that reasonably possible outcomes be evaluated to determine the reinsurer’s exposure to significant loss. What factors should be considered in determining whether a scenario being evaluated is reasonably possible?

A: The term *reasonably possible* means that the probability is more than remote. The test is applied to a particular scenario, not to the individual assumptions used in the scenario. Therefore, a scenario is not reasonably possible unless the likelihood of the entire set of assumptions used in the scenario occurring together is reasonably possible.

13. Q: In determining the amount of the reinsurer’s loss under reasonably possible outcomes, may cash flows directly related to the contract other than those between the ceding and assuming companies, such as taxes and operating expenses of the reinsurer, be considered in the calculation?

A: No. The evaluation is based on the present value of all cash flows between the ceding and assuming enterprises under reasonably possible outcomes and, therefore, precludes considering other expenses of the reinsurer in the calculation.

14. Q: In evaluating the significance of a reasonably possible loss, should the reasonably possible loss be compared to gross or net premiums?

A: Gross premiums should be used.

15. Q: How does a commutation clause affect the period of time over which cash flows are evaluated for reasonable possibility of significant loss to the reinsurer?

A: All cash flows are to be assessed under reasonably possible outcomes. Therefore, unless commutation is expected in the scenario being evaluated, it should not be assumed in the calculation. Further, the assumptions used in a scenario must be internally consistent and economically rational in order for that scenario’s outcome to be considered reasonably possible.

16. Q: What interest rate should be used in each evaluated scenario to make the present value calculation?
A: A reasonable and appropriate rate is required, which generally would reflect the expected timing of payments to the reinsurer and the duration over which those cash flows are expected to be invested by the reinsurer.

17. Q: SSAP No. 62 refers to payment schedules and accumulating retentions from multiple years as features that delay timely reimbursement of claims. Does the presence of those features generally prevent a contract from meeting the conditions for reinsurance accounting?

A: Yes. Payment schedules and accumulating retentions from multiple years are contractual features inherently designed to delay the timing of reimbursement to the ceding entity. Regardless of what a particular feature might be called, any feature that can delay timely reimbursement violates the conditions for reinsurance accounting. Transfer of insurance risk requires that the reinsurer’s payments to the ceding entity depend on and directly vary with the amount and timing of claims settled under the reinsured contracts. Contractual features that can delay timely reimbursement prevent this condition from being met. Therefore, any feature that may affect the timing of the reinsurer’s reimbursement to the ceding entity should be closely scrutinized.

18. Q: What if a contract contains a feature such as a payment schedule or accumulating retention but could still result in the reasonable possibility of significant loss to the reinsurer?

A: Both of the following conditions are required for reinsurance accounting:

a. Transfer of significant risk arising from uncertainties about both (i) the ultimate amount of net cash flows from premiums, commission, claims, and claim settlement expenses paid under a contract (underwriting risk) and (ii) the timing of the receipt and payment of those cash flows (timing risk); and

b. Reasonable possibility of significant loss to the reinsurer.

Because both condition (a) and condition (b) must be met, failure to transfer significant timing and underwriting risk is not overcome by the possibility of significant loss to the reinsurer.

19. Q: Is it permissible to evaluate timely reimbursement on a present value basis?

A: No. The word timely is used in the ordinary temporal sense to refer to the length of time between payment of the underlying reinsured claims and reimbursement by the reinsurer.

While the test for reasonable possibility of significant loss to the reinsurer provides for a present value-based assessment of the economic characteristics of the reinsurance contract, the concept of timely reimbursement relates to the transfer of insurance risk (condition a above), not the reasonable possibility of significant loss (condition b above). Accordingly, timely reimbursement should be evaluated based solely on the length of time between payment of the underlying reinsured losses and reimbursement by the reinsurer.

20. Q: Are there any circumstances under which the conditions for risk transfer need not be met?

A: Yes. An extremely narrow and limited exemption is provided for contracts that reinsure either an individual risk or an underlying book of business that is inherently profitable. When substantially all of the insurance risk relating to the reinsured portions of the underlying insurance contracts has been assumed by the reinsurer, the contract meets the conditions for reinsurance accounting. To qualify under this exception, no more than trivial insurance risk on the reinsured portions of the underlying insurance contracts may be retained by the ceding entity. The reinsurer’s economic position must be virtually equivalent to having written the relevant portions of the reinsured contracts directly.

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21. Q: In determining whether a reinsurance contract qualifies under the exception referred to in the preceding question, how should the economic position of the reinsurer be assessed in relation to that of the ceding entity?

A: The assessment should be made by comparing the net cash flows of the reinsurer under the reinsurance contract with the net cash flows of ceding entity on the reinsured portions of the underlying insurance contracts. This may be relatively easy for reinsurance of individual risks or for unlimited-risk quota-share reinsurance, because the premiums and losses on these types of reinsurance generally are the same as the premiums and losses on the reinsured portions of the underlying insurance policies.

In other types of reinsurance, determining the reinsurer’s net cash flows relative to the insurer is likely to be substantially more difficult. For example, it generally would be difficult to demonstrate that the ceding entity’s premiums and losses for a particular layer of insurance are the same as the reinsurer’s premiums and losses related to that layer. If the economic position of the reinsurer relative to the insurer cannot be determined, the contract would not qualify under the exception.

Accounting Provisions

22. Q: An existing contract that was accounted for as reinsurance no longer qualifies for reinsurance accounting under the new accounting rules included in SSAP No. 62. How should the ceding and assuming companies account for the contract in future periods?

A: Because the statement of income cannot be restated, previously recognized gains and losses are not revised. If the contract was entered into before, and not renewed or amended on or after, January 1, 1994 and covers only losses occurring or claims made before that date, or the contract expired before January 1, 1995 and was not renewed or amended on or after that date, it would continue to be accounted for in the manner provided before these revisions.

For accounting periods commencing on or after January 1, 1995, existing balances relating to contracts which do not transfer insurance risk and which were entered into on or after January 1, 1994 (covering losses occurring or claims made after that date) would be reclassified as deposits.

Premium payments to a reinsurer would be recorded as deposits. Likewise, losses recoverable from a reinsurer would not be recognized as receivables. Rather, any reimbursement for losses would be accounted for upon receipt as a refund of a deposit.

23. Q: What is the definition of past insurable events that governs whether reinsurance coverage is prospective or retroactive? For example, could a reinsurance contract that covers losses from asbestos and pollution claims on occurrence-based insurance policies effective during previous periods be considered prospective if the reinsurance coverage is triggered by a court interpretation that a loss is covered within the terms of the underlying insurance policies?

A: The distinction between prospective and retroactive reinsurance is based on whether a contract reinsures future or past insured events covered by the underlying reinsurance contracts. In the example above, the insured event is the occurrence of loss within the coverage of the underlying insurance contracts, not the finding of a court. Therefore, the fact that the asbestos exposure or pollution is covered under insurance policies effective during prior periods makes the reinsurance coverage in this example retroactive.

24. Q: Would the answer to the above question change if the reinsurance were written on a claims-made basis?
A: No. The form of the reinsurance—whether claims-made or occurrence-based—does not determine whether the reinsurance is prospective or retroactive. A claims-made reinsurance contract that reinsures claims asserted to the reinsurer in a future period as a result of insured events that occurred prior to entering into the reinsurance contract is a retroactive contract.

25. Q: What is the effect of adjustments to future premiums or coverage in determining whether reinsurance is prospective or retroactive?

A: Adjustments to future premiums or coverage may affect the accounting for a reinsurance contract. Whenever an adjustment results in a reinsurer providing new or additional coverage for past insurable events, that coverage is retroactive. For example, if subsequent years’ premiums under a multiple accident year contract create additional coverage for previous accident years, the additional coverage is retroactive, even if the original coverage provided in the contract for those accident years was prospective. Likewise, if current losses under a multiple-year contract eliminate coverage in future periods, some or all of the premiums to be paid in those future periods should be charged to the current period.

26. Q: A reinsurance contract is entered into after the contract’s effective date. Is the coverage between the contract’s effective date and the date the contract was entered into prospective or retroactive?

A: The portion of the contract related to the period of time between the effective date of the contract and the date the contract was entered into is retroactive because it covers insured events that occurred prior to entering into the reinsurance contract.

27. Q: How is the date the reinsurance contract was entered into determined?

A: It is not uncommon for a reinsurance arrangement to be initiated before the beginning of a policy period but not finalized until after the policy period begins. Whether there was agreement in principle at the beginning of the policy period and, therefore, the contract is substantively prospective must be determined based on the facts and circumstances. For example, a contract may be considered to have been substantively entered into even though regulatory approval of that contract has not taken place.

The absence of agreement on significant terms, or the intention to establish or amend those terms at a later date based on experience or other factors, generally indicates that the parties to the contract have not entered into a reinsurance contract, but rather have agreed to enter into a reinsurance contract at a future date. If contractual provisions under a contract substantively entered into at a future date covered insurable events prior to that date, that coverage is retroactive.

In any event, SSAP No. 62 provides that if a contract (except facultative contracts and contracts signed by the lead reinsurer and certain cover notes or similar documents signed by reinsurers representing more than 50% of the capacity on the contract) has not been finalized, reduced to written form and signed by the parties within 9 months after its effective date, it is presumed to be retroactive.

28. Q: Are contracts to reinsure calendar-year incurred losses considered blended contracts that have both prospective and retroactive elements?

A: Yes. Most reinsurance contracts covering calendar-year incurred losses combine coverage for insured events that occurred prior to entering into the reinsurance contract with coverage for future insured events and, therefore, include both prospective and retroactive elements.
In any event, SSAP No. 62 provides that if a contract (except facultative contracts, contracts signed by the lead reinsurer and certain cover notes or similar documents signed by reinsurers representing more than 50% of the capacity on the contract) has not been finalized, reduced to written form and signed by the parties within 9 months after its effective date it is presumed retroactive.

29. Q: When the prospective and retroactive portions of a contract are being accounted for separately, how should premiums be allocated to each portion of the contract?

A: No specific method for allocating the reinsurance premiums to the risks covered by the prospective and retroactive portions of a contract is required. However, separate accounting for the prospective and retroactive portions of a contract may take place only when an allocation is practicable.

Practicability requires a reasonable basis for allocating the reinsurance premiums to the risks covered by the prospective and retroactive portions of the contract, considering all amounts paid or deemed to have been paid regardless of the timing of payment. If a reasonable basis for allocating the premiums between the prospective and retroactive coverage does not exist, the entire contract must be accounted for as a retroactive contract.

30. Q: A retroactive reinsurance contract contains a cut-through provision that provides the ceding entity’s policyholders and claimants with the right to recover their claims directly from the reinsurer. May the ceding entity immediately recognize earned surplus associated with this type of contract?

A: No. SSAP No. 62 states that earned surplus may not be recognized “until the actual retroactive reinsurance recovered exceeds the consideration paid”.

31. Q: A ceding entity enters into a retroactive reinsurance agreement that gives rise to segregated surplus. If the reinsurer prepays its obligation under the contract, may the ceding entity recognize earned surplus at the time the prepayment is received?

A: Segregated surplus arising from retroactive reinsurance transactions is earned as actual liabilities that have been transferred are recovered or terminated. Therefore, earned surplus is based on when the reinsurer settles its obligations to the ceding entity, and it may be appropriate to recognize earned surplus at the time the prepayment is received.

However, all of the facts and circumstances must be considered to determine whether the ceding entity has substantively recovered the liabilities transferred to the reinsurer. For example, if the ceding entity agrees to compensate the reinsurer for the prepayment, such as by crediting the reinsurer with investment income on prepaid amounts or balances held, the ceding entity has not, in substance, recovered its transferred liabilities but rather has received a deposit from the reinsurer that should be accounted for accordingly.

32. Q: If the ceding entity does not expect to receive any recoveries because the reinsurer has agreed to reimburse claimants under the reinsured contracts directly, would the ceding entity be considered to have recovered or terminated its transferred liabilities?

A: No. In the example given, the reinsurer is substantively acting as disbursing agent for the ceding entity. Therefore, the ceding entity cannot be said to have recovered amounts due from the reinsurer before payment is made to the claimant.

33. Q: What accounting entries would a ceding entity make to report a retroactive reinsurance contract?
A: Accounting Entries for a Ceding Entity to Report a Retroactive Reinsurance Contract:

**Entry 1**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retroactive Reinsurance Reserves</td>
<td>10,000</td>
</tr>
<tr>
<td>Ceded or Assumed (B/S)</td>
<td></td>
</tr>
<tr>
<td>Retroactive Reinsurance Gain (I/S)</td>
<td>2,000</td>
</tr>
<tr>
<td>Cash</td>
<td>8,000</td>
</tr>
</tbody>
</table>

To record initial portfolio transfer see items #3 and #8. The ceding entity must establish the segregated surplus per item #4.

**Entry 1A**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retro. Reins. Gain</td>
<td>2,000</td>
</tr>
<tr>
<td>Profit/Loss Account</td>
<td>2,000</td>
</tr>
</tbody>
</table>

To close gain from retroactive transaction.

**Entry 1B**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit/Loss Account</td>
<td>2,000</td>
</tr>
<tr>
<td>Special Surplus from Retro. Reins.</td>
<td>2,000</td>
</tr>
</tbody>
</table>

To close profit from retroactive reinsurance to special surplus.

**Entry 2**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>2,000</td>
</tr>
<tr>
<td>Retroactive Reinsurance Reserves</td>
<td></td>
</tr>
<tr>
<td>Ceded or Assumed (B/S)</td>
<td>2,000</td>
</tr>
</tbody>
</table>

To record recovery of paid losses from the reinsurer. Outstanding ceded reserves after this recovery equals $8,000, and special surplus from retroactive reinsurance account equals $2,000; therefore, segregated surplus account is not changed per item #10.

**Entry 3**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retroactive Reinsurance Reserves</td>
<td>3,000</td>
</tr>
<tr>
<td>Ceded or Assumed (B/S)</td>
<td></td>
</tr>
<tr>
<td>Retroactive Reinsurance Gain (I/S)</td>
<td>3,000</td>
</tr>
</tbody>
</table>

To record subsequent revision of the initial reserves ceded per item #10. The segregated surplus account is increased to $5,000 as a result of this upward development.

**Entry 3A**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retro. Reinsurance Gain</td>
<td>3,000</td>
</tr>
<tr>
<td>Profit/Loss Account</td>
<td>3,000</td>
</tr>
</tbody>
</table>

To close profit from retroactive reinsurance.
Entry 3B

Profit/Loss (I/S) 3,000
Special Surplus from Retro. Reins. 3,000

To close profit and loss account to special surplus. (Retroactive reinsurance reserves ceded or assumed account balance equals $11,000. Special Surplus from retroactive reinsurance balance equals $5,000.)

Entry 4

Cash 4,000
Retroactive Reinsurance Reserves
Ceded or Assumed (B/S) 4,000

To record recovery of paid losses from the reinsurer. Outstanding ceded reserves after this recovery equals $7,000, therefore segregated surplus account is not changed per item #10.

Entry 5

Cash 3,000
Retroactive Reinsurance Reserves
Ceded or Assumed (B/S) 3,000

To record recovery of paid losses from reinsurer. Outstanding ceded reserves after recovery equals $4,000, therefore the following entry is needed per items #6 and #10.

Entry 5A

Special Surplus—Retro. Reins. 1,000
Unassigned Funds 1,000

Retroactive Reinsurance reserves ceded or assumed after this entry equals $4,000.

Entry 6

Retroactive Reinsurance Loss (I/S) 1,000
Retroactive Reinsurance Reserves
Ceded or Assumed (B/S) 1,000

To record subsequent revision of the initial reserves ceded per item #10. The segregated surplus account is decreased as a result of this downward development to $3,000. The following entry is needed per items #6 and #10.

Entry 6A

Profit/Loss Account 1,000
Retro. Reins. Loss 1,000

To close loss to profit and loss account.
Entry 6B

Special Surplus from Retro. Reins.  
Profit/Loss Account  
\[1,000\]  
\[1,000\]

To close profit and loss account to special surplus. (Remaining balance of retroactive reinsurance reserve ceded or assumed account equals $3,000.) (Special surplus from retro. reins. account balance equals $3,000.)

Entry 7

Cash 2,500
Retroactive Reinsurance Gain (I/S) 500
Retroactive Reinsurance Reserves Ceded or Assumed (B/S) 3,000

Entry 7A

Profit and Loss Account 500
Retro. Reins. Gain 500

To close other income to profit and loss account.

Entry 7B

Special Surplus from Retro. Reins. 500
Profit/Loss Account 500

To close profit and loss account to special surplus. (Remaining balance of special surplus from retro. reins. account equals $2,500.) (Remaining balance of retroactive reinsurance reserve ceded or assumed account -0-.)

Entry 7C

Special Surplus from Retro. Reins. 2,500
Unassigned Funds 2,500

To close remaining special surplus account to unassigned surplus.

34. Q: How should the parties account for an adverse loss development reinsurance contract where, as of the statement date, the attachment level of the contract exceeds the ceding company’s current case and IBNR reserves for the covered accident years (i.e. no surplus gain and no reinsurance recoverable as of the statement date), and the ceding company transferred cash to the reinsurer at the inception of the contract?

A: An adverse loss development reinsurance contract covering prior accident years meets the definition of “retroactive reinsurance” set forth in paragraph 21 of SSAP No. 62:

….reinsurance in which a reinsurer agrees to reimburse a ceding entity for liabilities incurred as a result of past insurable events covered under contracts subject to the reinsurance….

Subparagraph 28 k of SSAP No. 62 specifically provides that the consideration paid for a retroactive reinsurance contract is to be recorded as a decrease in ledger assets by the ceding entity and an increase in ledger assets by the assuming entity.

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Question 33 illustrates the accounting entries for retroactive reinsurance contracts.

If the retroactive reinsurance contract transfers both components of insurance risk then, pursuant to paragraph 28 of SSAP No. 62, the ceding company would record the consideration paid as a decrease in ledger assets, recognize an expense for the reinsurance ceded through Other Income or Loss accounts as a write-in item identified as “Retroactive Reinsurance Ceded”, and record the recoverable from the reinsurer as a contra liability.

No contra liability is established until and unless (and then only to the extent that) the ceding company establishes reserves which exceed the attachment point.

For the contract described, at inception no contra liability is recorded to offset current liability for the business ceded, since the ceded retroactive reinsurance premium relates to coverage in excess of the current liabilities recorded by the ceding company.

Once the ceding company’s recorded liabilities exceed the attachment point of the adverse loss development reinsurance contract and triggers reinsurance recoverable from the reinsurer, a contra liability is established by the ceding company for the amount of the reinsurance recoverable. Any surplus resulting from the retroactive reinsurance is carried as a write-in item on the balance sheet designated as “Special Surplus from Retroactive Reinsurance Account”. The surplus gain may not be classified as unassigned funds (surplus) until the actual retroactive reinsurance recovered exceeds the consideration paid.

If any portion of a retroactive reinsurance contract does not transfer insurance risk, then the portion which does not transfer risk is accounted for as a deposit pursuant to paragraph 34 of SSAP No. 62. The deposit is reported as an admitted asset of the ceding company if the reinsurer is licensed, accredited or otherwise qualified in the ceding company’s state of domicile as described in Appendix A-785, or if there are funds held by or on behalf of the ceding company as described in that appendix. Receipts and disbursements under the contract are recorded through the deposit/liability accounts. Amounts received in excess of the deposit made are recognized as a gain in the Other Income or Loss account.

Accounting entries for a ceding entity to report a retroactive reinsurance contract at the inception of which the cedent’s reserves are lower than the attachment point of the reinsurance coverage:

Assume the company pays $16m to purchase adverse development coverage of $50m, above an attachment point.

Entry 1: Payment of Retrospective Reinsurance Premium

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retrospective Reinsurance Expense*</td>
<td>$16m</td>
</tr>
<tr>
<td>Cash</td>
<td>$16m</td>
</tr>
</tbody>
</table>

The company pays $16m premium for the retrospective reinsurance contract
*This is an Other Expense item, it does not flow through Sch F or Sch P
Entry 2: Adverse Development reaches the Attachment Point

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Losses Incurred</td>
<td>$25m</td>
</tr>
<tr>
<td>Gross Loss Reserve</td>
<td>$25m</td>
</tr>
<tr>
<td>Recoverable on Retro Reinsurance Contract**</td>
<td>$25m</td>
</tr>
<tr>
<td>Other Income*</td>
<td>$9m</td>
</tr>
<tr>
<td>Contra – Retro Reinsurance Expense*</td>
<td>$16m</td>
</tr>
<tr>
<td>Surplus***</td>
<td>$9m</td>
</tr>
<tr>
<td>Segregated Surplus***</td>
<td>$9m</td>
</tr>
</tbody>
</table>

The company incurs $25m development on reserves related to the contract.

*These are Other Income/Expense items, do not flow through Sch F or Sch P

**A contra-liability write-in item, not netted against loss reserves

***Surplus is segregated in the amount of [$25m - $16m = $9m] recoverables less consideration paid

Entry 3: Cash is Recovered on Paid Losses

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$20m</td>
</tr>
<tr>
<td>Recoverable on Retrospective Reinsurance Contract</td>
<td>$20m</td>
</tr>
<tr>
<td>Segregated Surplus</td>
<td>$4m</td>
</tr>
<tr>
<td>Surplus</td>
<td>$4m</td>
</tr>
</tbody>
</table>

The company recovers $20m cash from reinsurer on this retro contract. Segregated Surplus decreases in the amount of [$20m - $16m = $4m] (decreases for amount recovered in excess of consideration paid)

35. Q: How should a ceding company account for payment of the premium for a retroactive reinsurance contract by the ceding company’s parent company or some other person not a party to the reinsurance contract (for example, adverse loss development reinsurance contracts purchased by the parent company in the context of the purchase or sale of the ceding company)?

A: If the reinsurance premium is not paid directly by the ceding company but is instead paid on behalf of the ceding company by the ceding company’s parent company or some other entity not a party to the reinsurance contract, then the ceding company should (1) record an increase in gross paid in and contributed surplus in the amount of the reinsurance premium to reflect the contribution to surplus by the parent or third party payor, and (2) record an expense in the amount of the reinsurance premium and account for the contract as provided in Questions 33 and 34.
Statement of Statutory Accounting Principles No. 63

Underwriting Pools and Associations Including Intercompany Pools

STATUS

Type of Issue: Common Area

Issued: Initial Draft

Effective Date: January 1, 2001

Affects: No other pronouncements

Affected by: No other pronouncements

Interpreted by: INT 03-02

SCOPE OF STATEMENT

SUMMARY CONCLUSION

Disclosures

Effective Date and Transition

RELEVANT ISSUE PAPERS
Underwriting Pools and Associations Including Intercompany Pools

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for underwriting pools and associations.

SUMMARY CONCLUSION

2. Underwriting pools and associations can be categorized as follows: (a) involuntary, (b) voluntary, and (c) intercompany.

3. Involuntary pools represent a mechanism employed by states to provide insurance coverage to those with higher than average probability of loss who otherwise would be excluded from obtaining coverage. Reporting entities are generally required to participate in the underwriting results, including premiums, losses, expenses, and other operations of involuntary pools, based on their proportionate share of similar business written in the state. Involuntary plans are also referred to as residual market plans, involuntary risk pools, and mandatory pools.

4. Voluntary pools are similar to involuntary pools except they are not state mandated and a reporting entity participates in the pool voluntarily. In addition, voluntary pools are not limited to the provision of insurance coverage to those with higher than average probability of loss, but often are used to provide greater capacity for risks with exceptionally high levels of insurable values (e.g., aircraft, nuclear power plants, refineries, and offshore drilling platforms).

5. Intercompany pooling relates to business which is pooled among affiliated entities who are party to a pooling arrangement.

6. Participation in a pool may be on a joint and several basis, i.e., in addition to a proportional share of losses and expenses incurred by the pool, participants will be responsible for their share of any otherwise unrecoverable obligations of other pool participants. In certain instances, one or more entities may be designated as servicing carriers for purposes of policy issuance, claims handling, and general administration of the pooled business, while in other cases a pool manager or administrator performs all of these functions and simply bills pool participants for their respective shares of all losses and expenses incurred by the pool. In either case, liabilities arising from pooled business are generally incurred on a basis similar to those associated with non-pooled business, and should therefore be treated in a manner consistent with the guidelines set forth in SSAP No. 5—Liabilities, Contingencies and Impairments of Assets (SSAP No. 5).

7. Intercompany pooling arrangements involve establishment of a conventional quota share reinsurance agreement under which all of the pooled business is ceded to the lead entity and then retroceded back to the pool participants in accordance with their stipulated shares. In these arrangements, only the policy issuing entity has direct liability to its policyholders or claimants; other pool participants are liable as reinsurers for their share of the issuing entity’s obligations. Although participants may use different assumptions (e.g., discount rates) in recording transactions, the timing of recording transactions shall be consistently applied by all participants.

8. Underwriting results shall be accounted for on a gross basis whereby the participant’s portion of premiums, losses, expenses, and other operations of the pools are recorded separately in the financial statements rather than netted against each other. Premiums and losses shall be recorded as direct, assumed, and/or ceded as applicable. If the reporting entity is a direct writer of the business, premiums shall be recorded as directly written and accounted for in the same manner as other business which is directly written by the entity. To the extent that premium is ceded to a pool, premiums and losses shall be recorded in the same manner as any other reinsurance arrangement. A reporting entity who is a member...
of a pool shall record its participation in the pool as assumed business as in any other reinsurance arrangement.

9. Equity interests in, or deposits receivable from, a pool represent cash advances to provide funding for operations of the pool. These are admitted assets and shall be recorded separately from receivables and payables related to a pool’s underwriting results. Receivables and payables related to underwriting results shall be accounted for in accordance with the guidance in paragraphs 6 to 8, above. If it is probable that these receivables are uncollectible, any uncollectible amounts shall be written off against operations in the period such determination is made. If it is reasonably possible a portion of the balance is uncollectible but is not written off, disclosure requirements outlined in SSAP No. 5 shall be followed.

Disclosures

10. If a reporting entity is part of a group of affiliated entities which utilizes a pooling arrangement under which the pool participants cede substantially all of their direct and assumed business to the pool, the financial statements shall include:

a. A description of the basic terms of the arrangement and the related accounting;

b. Identification of the lead entity and of all affiliated entities participating in the intercompany pool (include NAIC Company Codes) and indication of their respective percentage shares of the pooled business;

c. Description of the lines and types of business subject to the pooling agreement;

d. Description of cessions to non-affiliated reinsurers of business subject to the pooling agreement, and indication of whether such cessions were prior to or subsequent to the cession of pooled business from the affiliated pool members to the lead entity;

e. Identification of all pool members which are parties to reinsurance agreements with non-affiliated reinsurers covering business subject to the pooling agreement and which have a contractual right of direct recovery from the non-affiliated reinsurer per the terms of such reinsurance agreements;

f. Explanation of any discrepancies between entries regarding pooled business on the assumed and ceded reinsurance schedules of the lead entity and corresponding entries on the assumed and ceded reinsurance schedules of other pool participants;

g. Description of intercompany sharing, if other than in accordance with the pool participation percentage, of the Provision for Reinsurance (Schedule F, Part 7) and the write–off of uncollectible reinsurance.

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

Effective Date and Transition

12. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors.

RELEVANT ISSUE PAPERS

• Issue Paper No. 97—Underwriting Pools and Associations Including Intercompany Pools
Statement of Statutory Accounting Principles No. 64

Offsetting and Netting of Assets and Liabilities

STATUS

Type of Issue: Common Area
Issued: Initial Draft
Effective Date: January 1, 2001
Affects: No other pronouncements
Affected by: No other pronouncements
Interpreted by: No other pronouncements

SCOPE OF STATEMENT

SUMMARY CONCLUSION

Relevant Literature
Effective Date and Transition
AUTHORITATIVE LITERATURE
Generally Accepted Accounting Principles
RELEVANT ISSUE PAPERS
Offsetting and Netting of Assets and Liabilities

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for offsetting and netting of assets and liabilities.

SUMMARY CONCLUSION

2. Assets and liabilities shall be offset and reported net only when a valid right of setoff exists except as provided for in paragraphs 3 and 4. A right of setoff is a reporting entity’s legal right, by contract or otherwise, to discharge all or a portion of the debt owed to another party by applying an amount that the other party owes to the reporting entity against the debt. A valid right of setoff exists only when all the following conditions are met:

   a. Each of the two parties owes the other determinable amounts. An amount shall be considered determinable for purposes of this provision when it is reliably estimable by both parties to the agreement;

   b. The reporting party has the right to setoff the amount owed with the amount owed by the other party;

   c. The reporting party intends to setoff; and

   d. The right of setoff is enforceable at law.

3. Assets and liabilities that meet the criteria for offset shall not be netted when prohibited by specific statements of statutory accounting principles. An example of such is in the case of reinsurance recoverables on paid losses and ceded premiums payable as provided for in SSAP No. 62—Property and Casualty Reinsurance.

4. Netting of assets and liabilities for reporting purposes when no valid right of setoff exists shall be allowed only when provided for by specific statements of statutory accounting principles. An example of such is in the case of real estate investments required to be shown net of encumbrances as provided for in SSAP No. 40—Real Estate Investments.

5. Amounts due to or from affiliates shall be offset and reported net only when the provisions of paragraph 2 above are met.

Relevant Literature

6. This statement adopts paragraphs 1, 7 and 13 of APB Opinion No. 10, Omnibus Opinion—1966 and FASB Interpretation No. 39, Offsetting of Amounts Related to Certain Contracts with a modification to prohibit offsetting as provided in specific statements and require netting when provided in specific statements. This statement adopts FASB Interpretation No. 41, Offsetting of Amounts Related to Certain Repurchase and Reverse Repurchase Agreements.

7. This statement adopts FASB Emerging Issues Task Force No. 86-25, Offsetting Foreign Currency Swaps.
Effective Date and Transition

8. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors.

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

- APB Opinion No. 10, Omnibus Opinion—1966, paragraphs 1, 7 and 13
- FASB Interpretation No. 39, Offsetting of Amounts Related to Certain Contracts
- FASB Interpretation No. 41, Offsetting of Amounts Related to Certain Repurchase and Reverse Repurchase Agreements
- FASB Emerging Issues Task Force No. 86-25, Offsetting Foreign Currency Swaps

RELEVANT ISSUE PAPERS

- Issue Paper No. 76—Offsetting and Netting of Assets and Liabilities
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Property and Casualty Contracts

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for property and casualty insurance contracts. Topics not covered by this statement shall comply with the more general statutory accounting guidance.

2. Topics specific to title insurance, mortgage guaranty insurance, and financial guaranty insurance are not within the scope of this statement. These topics are addressed in SSAP No. 57—Title Insurance, SSAP No. 58—Mortgage Guaranty Insurance, and SSAP No. 60—Financial Guaranty Insurance.

SUMMARY CONCLUSION

3. Property and casualty insurance contracts can be written to cover insured events on the following reporting bases:
   a. Occurrence—These policies cover insured events that occur within the effective dates of the policy regardless of when they are reported to the reporting entity. Liabilities for losses on these policies shall be recorded when the insured event occurs;
   b. Claims made—These policies cover insured events that are reported (as defined in the policy) within the effective dates of the policy, subject to retroactive dates when applicable. Liabilities for losses on these policies shall be recorded when the event is reported to the reporting entity; and
   c. Extended reporting—Endorsements to claims made policies covering insured events reported after the termination of a claims made contract but subject to the same retroactive dates where applicable. See paragraphs 7 and 8 for guidance for when premium shall be earned and losses shall be recorded.

Claims Made Policies

4. Normally, when claims made coverage is obtained, existing coverage is being replaced. The existing coverage may have been a claims made policy or an occurrence policy. In either case, in an effort to reduce premium costs, the insured may request that the claims made coverage cover only claims reported within the effective dates of the policy that occur after a specified date. This specified date is referred to as the retroactive date of the claims made policy and eliminates duplicate coverage when converting from occurrence coverage to claims made coverage.

5. The liability for an insured event shall be determined in accordance with SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses (SSAP No. 55).

6. Extended reporting endorsements, commonly referred to as tail coverage, allow extended reporting of insured events after the termination of a claims made contract. Extended reporting endorsements modify the exposure period of the underlying contract and can be for a defined period (e.g., six months, one year, five years) or can be for an indefinite period.

7. When a reporting entity issues an extended reporting endorsement or contract and the preceding claims made policy terminates, the reporting entity assumes liability for unreported claims and expense. This extended reporting coverage can be issued for an indefinite period or a fixed period. For indefinite reporting periods, premium shall be fully earned and loss and expense liability associated with unreported claims shall be recognized immediately. For coverage for a fixed period, premium shall be earned over
the term of the fixed period, the reporting entity shall establish an unearned premium reserve for the unexpired portion of the premium and shall record losses as reported.

8. Some claims made policies provide extended reporting coverage at no additional charge in the event of death, disability, or retirement of a natural person insured. In such instance, a policy reserve is required to assure that premiums are not earned prematurely. The amount of the reserve should be adequate to pay for all future claims arising from these coverage features, after recognition of future premiums to be paid by current insureds for these benefits. The reserve, entitled “extended reporting endorsement policy reserve” shall be classified as a component part of the unearned premium reserve considered to run more than one year from the date of the policy.

9. When the anticipated losses, loss adjustment expenses, and maintenance costs anticipated to be reported during the extended reporting period exceed the recorded unearned premium reserve for a claims made policy, a premium deficiency reserve shall be recognized in accordance with SSAP No. 53—Property Casualty Contracts—Premiums.

Discounting

10. With the exception of fixed and reasonably determinable payments such as those emanating from workers’ compensation tabular indemnity reserves and long-term disability claims, property and casualty loss reserves shall not be discounted.

11. Tabular reserves are indemnity reserves that are calculated using discounts determined with reference to actuarial tables which incorporate interest and contingencies such as mortality, remarriage, inflation, or recovery from disability applied to a reasonably determinable payment stream. Tabular reserves shall not include medical loss reserves or loss adjustment expense reserves.

12. Exhibit A provides guidelines for states who prescribe or permit discounting on a non-tabular basis.

13. In accordance with SSAP No. 3—Accounting Changes and Corrections of Errors (SSAP No. 3), a change in the discount rate used in discounting loss reserves shall be accounted for as a change in estimate. SSAP No. 3 requires changes in estimates to be included in the statement of income in the period the change becomes known.

14. The financial statements shall disclose whether or not any of the liabilities for unpaid losses or unpaid loss adjustment expenses are discounted, including liabilities for workers’ compensation. The following disclosures, for each line of business, shall be made separately:

   a. Table(s) used;
   b. Rate(s) used;
   c. The amount of discounted liability reported in the financial statement; and
   d. The amount of tabular discount, by the line of business and reserve category (i.e., case and Incurred But Not Reported (IBNR)).

15. If the rate(s) used to discount prior accident years’ liabilities have changed from the previous financial statement or if there have been changes in other key discount assumptions such as payout patterns, the financial statements shall disclose:

   a. Amount of discounted current liabilities at current rate(s) and assumption(s) (exclude the current accident year);
   b. Amount of discounted current liabilities at previous rate(s) and assumption(s) (exclude the current accident year);
c. Change in discounted liability due to change in interest rate(s) and assumption(s); and

d. Amount of non-tabular discount, by line of business and reserve category (i.e., case, allocated loss adjustment expense, and unallocated loss adjustment expense).

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

Structured Settlements

17. Structured settlements are periodic fixed payments to a claimant for a determinable period, or for life, for the settlement of a claim. Frequently a reporting entity will purchase an annuity to fund the future payments. Reporting entities may purchase an annuity in which the entity is the owner and payee, or an annuity in which the claimant is the payee. When annuities are purchased to fund periodic fixed payments, they shall be accounted for as follows:

a. When the reporting entity is the owner and payee, no reduction shall be made to loss reserves. The annuity shall be recorded at its present value and reported as an other than invested asset. Income from the annuities shall be recorded as miscellaneous income. The present value of the annuity and the related amortization schedule shall be obtained from the issuing life insurance company at the time the annuity is purchased; and

b. When the claimant is the payee, loss reserves shall be reduced to the extent that the annuity provides for funding of future payments. The cost of the annuities shall be recorded as paid losses.

18. Statutory accounting and Generally Accepted Accounting Principles (GAAP) are consistent for the accounting of structured settlement annuities where the reporting entity is the owner and payee, and where the claimant is the owner and payee and the reporting entity has been released from its obligation. GAAP distinguishes structured settlement annuities where the owner is the claimant and a legally enforceable release from the reporting entity’s liability is obtained from those where the claimant is the owner and payee but the reporting entity has not been released from its obligation. GAAP requires the deferral of any gain resulting from the purchase of a structured settlement annuity where the claimant is the owner and payee yet the reporting entity has not been released from its obligation. Statutory accounting treats these settlements as completed transactions and considers the earnings process complete, thereby allowing for immediate gain recognition.

19. The following information regarding structured settlements shall be disclosed in the financial statements:

a. The amount of reserves no longer carried by the reporting entity because it has purchased annuities with the claimant as payee, and the extent to which the reporting entity is contingently liable for such amounts should the issuers of the annuities fail to perform under the terms of the annuities; and

b. The name, location, and aggregate statement value of annuities due from any life insurer to the extent that the aggregate value of those annuities equal or exceed 1% of policyholders’ surplus. This disclosure shall only include those annuities for which the reporting entity has not obtained a release of liability from the claimant as a result of the purchase of an annuity. The reporting entity shall also disclose whether the life insurers are licensed in the reporting entity’s state of domicile.

20. Refer to the preamble for further discussion regarding disclosure requirements.
Policies with Coverage Periods Equal to or in Excess of Thirteen Months

21. Some property and casualty insurance contracts are written for coverage periods that equal or exceed thirteen months. These contracts may be single premium or fixed premium policies, and generally are not subject to cancellation or premium modification by the reporting entity. The most common policies with such coverage periods are home warranty and mechanical breakdown policies. Accordingly, this guidance is primarily focused on home warranty and mechanical breakdown policies and does not apply to multiple year contracts comprised of single year policies each of which have separate premiums and annual aggregate deductibles.

22. Revenues are generally not received in proportion to the level of exposure or period of exposure. In order to recognize the economic results of the contract over the contract period, a liability shall be established for the estimated future policy benefits while taking into account estimated future premiums to be received. Unearned premiums shall be recorded in accordance with paragraphs 23 to 33 of this statement.

23. Paragraphs 24 to 33 shall apply to all direct and assumed contracts or policies (“contracts”), excluding financial guaranty contracts, mortgage guaranty contracts, and surety contracts, that fulfill both of the following conditions:
   a. The policy or contract term is greater than or equal to 13 months; and
   b. The reporting entity can neither cancel the contract, nor increase the premium during the policy or contract term.

24. At any reporting date prior to the expiration of the contracts, the reporting entity is required to establish an adequate unearned premium reserve, to be reported as the unearned premium reserve. For each of the three most recent policy years, the gross (i.e., direct plus assumed) unearned premium reserve shall be no less than the largest result of the three tests described in paragraphs 27 to 29. For years prior to the three most recent policy years, the gross unearned premium reserve shall be no less than the larger of the aggregate result of Test 1 or the aggregate result of Test 2 or the aggregate result of Test 3 taken over all of those policy years.

25. Any reserve credit applicable for reinsurance ceded shall be appropriately reflected in the financial statements with the resulting net unearned premium reserve being established by the reporting entity.

26. The projected losses and expenses may be reduced for expected salvage and subrogation recoveries, but may not be reduced for anticipated deductible recoveries, unless the deductibles are secured by a letter of credit (LOC) or like security. Projected salvage and subrogation recoveries (net of associated expenses) shall be established based on reporting entity experience, if credible; otherwise, based on industry experience.

27. Test 1 is management’s best estimate of the amounts refundable to the contractholders at the reporting date.

28. Test 2 is the gross premium multiplied by the ratio of subparagraph 28 a. to subparagraph 28 b.:
   a. Projected future gross losses and expenses to be incurred during the unexpired term of the contracts; and
   b. Projected total gross losses and expenses under the contracts.
29. Test 3 is the projected future gross losses and expenses to be incurred during the unexpired term of the contracts as adjusted below, reduced by the present value of the future guaranteed gross premiums, if any.

   a. A provision for investment income is permitted in the unearned premium reserve only with respect to the projected future losses and expenses used to determine the unearned premium reserve, and not with respect to incurred but unpaid losses and expenses;

   b. A provision for investment income on projected future losses and expenses may be calculated to the expected date the loss or expense is incurred, not from the expected date of payment;

   c. The rate of interest used to calculate the provision for investment income shall be reviewed and changed as necessary at each reporting date and shall not exceed the lesser of the following two standards:

      i. The reporting entity’s future net yield to maturity on statutory invested assets as shown in Schedule D, less a 1.5% actuarial provision for adverse deviations; or

      ii. The current yield to maturity on a United States Treasury debt instrument maturing in five (5) years as of the reporting date.

   d. The reporting entity’s statutory invested assets shall be reduced by the loss and loss adjustment expense reserves on unpaid losses and expenses to calculate “available invested assets.” If the available invested assets are less than the result of Test 3, as calculated above, an “invested asset shortfall” exists. In this event, the Test 3 reserve shall be recalculated with the provision for investment income based on the restricted amount of available invested assets.

30. For the purposes of Tests 2 and 3 above, “expenses” shall include all incurred and anticipated expenses related to the issuance and maintenance of the policy, including loss adjustment expenses, policy issuance and maintenance expenses, commissions, and premium taxes.

31. The projected future losses and expenses are to be re-estimated for each reporting date, and the most recent estimate of these projected losses and expenses is to be used in these Tests. If a range is selected and no single point in the range is identified as being the most likely, then the midpoint of management’s estimate of the range shall be used. For purposes of this statement, it is assumed that management can quantify the high end of the range. If management determines that the high end of the range cannot be quantified, then a range does not exist, and management’s best estimate shall be accrued.

32. The reporting entity shall provide an Actuarial Opinion and Report in conformity with the NAIC Annual Statement Instructions for Property and Casualty Insurers. The scope paragraph of the actuarial opinion shall include the following three items: the Reserve for Ceded Unearned Premiums (as reported on Page 3 of the Annual Statement), the Reserve for Direct Unearned Premiums (as reported on the State Page) and the Reserve for Net Unearned Premiums (as reported on Page 3). These three items must also be covered in the opinion and relevant comments paragraphs of the actuarial opinion. The actuarial opinion shall also disclose the following with regard to both direct insurance and reinsurance assumed subject to this rule:

   a. The provision for investment income in the projected future losses and expenses under unexpired policies; and
b. The amount of reduction in unearned premium and loss reserves for each of the following: (i) salvage and subrogation; (ii) reinsurance; (iii) credits for deductibles and self-insured retentions; and (iv) other statutory approved credits.

33. The actuarial report shall include a description of the manner in which the adequacy of the amount of security for deductibles and self-insured retentions is determined. The actuarial report need not assess the credit-worthiness of the specific securities (e.g. LOC’s), but the actuarial opinion must report collectibility problems if known to the actuary.

**High Deductible Policies**

34. Certain policies, particularly workers’ compensation coverage, are available under high deductible plans. High deductible plans differ from self insurance coupled with an excess of loss policy because state laws generally require the reporting entity to fund the deductible and to periodically review the financial viability of the insured and make an assessment of the suitability of the deductible plan to the insured.

35. The liability for loss reserves shall be determined in accordance with SSAP No. 55. Because the risk of loss is present from the inception date, the reporting entity shall reserve losses throughout the policy period, not over the period after the deductible has been reached. Reserves for claims arising under high deductible plans shall be established net of the deductible, however, no reserve credit shall be permitted for any claim where any amount due from the insured has been determined to be uncollectible.

36. If the policy form requires the reporting entity to fund all claims including those under the deductible limit, the reporting entity is subject to credit risk, not underwriting risk. Reimbursement of the deductible shall be accrued and recorded as a reduction of paid losses simultaneously with the recording of the paid loss by the reporting entity.

37. Amounts accrued for reimbursement of the deductible shall be billed in accordance with the provisions of the policy or the contractual agreement and shall be aged according to the contractual due date. Ten percent of deductible recoverable in excess of collateral specifically held and identifiable on a per policy basis, shall be reported as a nonadmitted asset; however, to the extent that amounts in excess of the 10% are not anticipated to be collected they shall also be nonadmitted.

38. The financial statements shall disclose the amount of reserve credit that has been recorded for high deductibles on unpaid claims and the amounts that have been billed and are recoverable on paid claims.

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

**Asbestos and Environmental Exposures**

40. Asbestos exposures are defined as any loss or potential loss (including both first party and third party claims) related directly or indirectly to the manufacture, distribution, installation, use, and abatement of asbestos-containing material, excluding policies specifically written to cover these exposures. Environmental exposures are defined as any loss or potential loss, including third party claims, related directly or indirectly to the remediation of a site arising from past operations or waste disposal. Examples of environmental exposures include but are not limited to chemical waste, hazardous waste treatment, storage and disposal facilities, industrial waste disposal facilities, landfills, superfund sites, toxic waste pits, and underground storage tanks.

41. Reporting entities that are potentially exposed to asbestos and/or environmental claims shall record reserves consistently with SSAP No. 55.
42. The financial statements shall disclose the following if the reporting entity is potentially exposed to asbestos and/or environmental claims:

   a. The reserving methodology for both case and IBNR reserves;

   b. The amount paid and reserved for losses and loss adjustment expenses for asbestos and/or environmental claims, on a gross and net of reinsurance basis;

   c. Description of the lines of business written for which there is potential exposure of a liability due to asbestos and/or environmental claims, and the nature of the exposure(s);

   d. The following for each of the five most current calendar years on both a gross and net of reinsurance basis, separately for asbestos and environmental losses (including coverage dispute costs):

       Beginning reserves $_____

       Incurred losses and loss adjustment expenses ______

       Calendar year payments for losses and loss adjustment expenses ______

       Ending reserves $_____

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

**Excess Statutory Reserve**

44. This statement eliminates the requirement to record excess statutory reserves. Excess statutory reserves do not meet the definition of a liability established in *SSAP No. 5—Liabilities, Contingencies and Impairments of Assets*.

**Policyholder Dividends**

45. Dividends to policyholders immediately become liabilities of the reporting entity when they are declared by the board of directors and shall be recorded as a liability. Incurred policyholder dividends are reported in the statement of income.

46. The financial statements shall disclose the terms of dividend restrictions, if any. Refer to the preamble for further discussion regarding disclosure requirements.

**Relevant Literature**

47. Structured settlements are addressed in *FASB Statement No. 113, Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts* (FAS 113). FAS 113 is addressed in *SSAP No. 62—Property and Casualty Reinsurance*. This statement rejects the AICPA *Audit and Accounting Guide—Audits of Property and Liability Insurance Companies*.

**Effective Date and Transition**

48. This statement is effective for years beginning January 1, 2001. To the extent that the requirements of paragraphs 23 to 33 produce a higher reserve than the reporting entity would have established through the use of their previous methodology, the reporting entity may phase in the additional reserve over a period not to exceed three years. Such a phase in period shall only be permitted if the reporting entity is able to demonstrate that it would not be operating in a hazardous financial condition and that there is not adverse risk to its insureds. The phase in shall be at least 60% of the
difference between the reserve required by this statement and the reserve determined by the previous methodology during the first year, 80% in the second year, and 100% in the third year. 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.

AUTHORITATIVE LITERATURE

Statutory Accounting

- Actuarial Standard of Practice No. 20, Discounting of Property and Casualty Loss and Loss Adjustment Expense
- NAIC Annual Statement Instructions for Property and Casualty Insurers

RELEVANT ISSUE PAPERS

- Issue Paper No. 65—Property and Casualty Contracts
EXHIBIT A

Guidelines for States Who Prescribe or Permit Discounting on a Non-Tabular Basis

As discussed in paragraph 10 of this statement, with the exception of fixed and reasonably determinable payments such as those emanating from workers’ compensation tabular indemnity reserves and long-term disability claims, property and casualty loss reserves shall not be discounted. However, one of the most common prescribed or permitted state practices is to allow discounting of unpaid losses and unpaid loss adjustment expenses on a non-tabular basis. The recommendations in this exhibit are not requirements and therefore should only be viewed as a recommendation to those states that prescribe or permit non-tabular discounting.

Recommended Prescribed or Permitted Practice Guidelines

The state of XYZ office will permit [insert domestic companies if prescribed or insert insurance company name if prescribed] to discount its December 20XX unpaid loss (i.e., reported losses and incurred but not reported losses) and unpaid loss adjustment expense (LAE) reserves on an non-tabular basis subject to the following conditions:

1. The unpaid loss and LAE reserves shall be determined in accordance with Actuarial Standard of Practice No. 20, Discounting of Property and Casualty Loss and Loss Adjustment Expense (and as agreed to by an actuary) but in no event shall the rate used exceed the lesser of the following two standards:
   a. If the reporting entity’s statutory invested assets are at least equal to the total of all policyholder reserves, the reporting entity’s net rate of return on statutory invested assets, less 1.5%, otherwise, the reporting entity’s average net portfolio yield rate less 1.5% as indicated by dividing the net investment income earned by the average of the reporting entity’s current and prior year total assets; or
   b. The current yield to maturity on a United States Treasury debt instrument with maturities consistent with the expected payout of the liabilities.

2. Disclosure of the [insert either prescribed or permitted practice] in compliance with the requirements of the NAIC Accounting Practices and Procedures Manual and the NAIC Annual Statement Instructions – Property and Casualty, including but not limited to:

   Note 1 – Summary of Significant Accounting Policies
   A. Disclosure of permitted practice
      a. Disclose that the reporting entity employs a prescribed or permitted accounting practice that departs from the NAIC Accounting Practices and Procedures; and
      b. Disclose the monetary effect on net income and statutory surplus of using the practice of discounting on a non-tabular basis rather than the NAIC statutory accounting practice of discounting fixed and reasonably determinable payments such as those emanating from workers’ compensation tabular indemnity reserves and long-term disability claims.

   Note 20 – Other Items
   XX. Non-tabular discounting
      a. Disclosure of whether the reporting entity is applying non-tabular discounting based upon a state prescribed or permitted practice. If permitted, provide further disclosure as to the date domiciliary state issued permitted practice and the
expiration date of such practice;

b. Rate(s) used and the basis for the rate(s) used;

c. Amount of non-tabular discount disclosed by line of business and reserve category (i.e., unpaid loss, incurred but not reported, defense and cost containment expense, and adjusting and other expense); and

d. The amount of non-tabular discount reported in the statement.

Non-tabular discounting illustration:

<table>
<thead>
<tr>
<th>Case</th>
<th>IBNR</th>
<th>Defense &amp; Cost Containment Expense</th>
<th>Adjusting &amp; Other Expense</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Homeowners/Farmowners</td>
<td></td>
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<tr>
<td>2. Private Passenger Auto Liability/Medical</td>
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<tr>
<td>3. Commercial Auto/Truck Liability/Medical</td>
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<tr>
<td>4. Workers’ Compensation</td>
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<td>5. Commercial Multiple Peril</td>
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<td>6. Medical Malpractice – occurrence</td>
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<td>7. Medical Malpractice – claims-made</td>
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<td>8. Special Liability</td>
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<td>9. Other Liability – occurrence</td>
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<td>10. Other Liability – claims-made</td>
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<tr>
<td>11. Special Property</td>
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<tr>
<td>12. Auto Physical Damage</td>
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<td>13. Fidelity, Surety</td>
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<td>14. Other (including Credit, Accident &amp; Health)</td>
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<td>15. International</td>
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<tr>
<td>16. Reinsurance Nonproportional Assumed Property</td>
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<tr>
<td>17. Reinsurance Nonproportional Assumed Liability</td>
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<tr>
<td>18. Reinsurance Nonproportional Assumed Financial Lines</td>
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<tr>
<td>19. Products Liability – occurrence</td>
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<tr>
<td>20. Products Liability – claims-made</td>
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<tr>
<td>21. Financial Guaranty/Mortgage Guaranty</td>
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<tr>
<td>22. Total</td>
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</tbody>
</table>

The rates used to discount Medical Malpractice unpaid losses at December 31, 20X2 have changed from the rates used at December 31, 20X1. At December 31, 20X2, the amount of discounted Medical Malpractice unpaid losses, excluding the current accident year, is $_____________. Had these unpaid losses been discounted at the rates used at December 31, 20X1 the amount of discounted liabilities would be $_____________. The reduction in the discounted liability due to the change in rates is $_____________.

This illustration neither regulates, permits, nor prohibits the practice of discounting liabilities for unpaid losses or unpaid loss adjustment expenses.
Statement of Statutory Accounting Principles No. 66

Retrospectively Rated Contracts

STATUS
Type of Issue: Common Area
Issued: Initial Draft
Effective Date: January 1, 2001
Affects: No other pronouncements
Affected by: No other pronouncements
Interpreted by: No other pronouncements

STATUS ................................................................. ................................................................. 1
SCOPE OF STATEMENT ................................................................. .............................................. 3
SUMMARY CONCLUSION ................................................................. .............................................. 3
Disclosures ........................................................................................................ 6
Relevant Literature .............................................................................................. 6
Effective Date and Transition ................................................................. .............................................. 6
AUTHORITATIVE LITERATURE ................................................................. .............................................. 7
Statutory Accounting ........................................................................................................ 7
RELEVANT ISSUE PAPERS ................................................................. .............................................. 7
Retrospectively Rated Contracts

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for retrospectively rated contracts. This statement applies to property and casualty contracts, life insurance contracts, and accident and health contracts.

2. Retrospective reinsurance contracts are not within the scope of this statement. They are addressed in SSAP No. 62—Property and Casualty Reinsurance (SSAP No. 62).

SUMMARY CONCLUSION

3. A retrospectively rated contract is one which has the final policy premium calculated based on the loss experience of the insured during the term of the policy (including loss development after the term of the policy) and the stipulated formula set forth in the policy. The periodic adjustments may involve either the payment of return premium to the insured or payment of an additional premium by the insured, or both, depending on experience. Retrospective rating features are common in certain property and casualty contracts, group life, and group accident and health contracts. Contracts with retrospective rating features are referred to as loss sensitive contracts.

4. Amounts due from insureds and amounts due to insureds under retrospectively rated contracts meet the definitions of assets and liabilities as set forth in SSAP No. 4—Assets and Nonadmitted Assets and SSAP No. 5—Liabilities, Contingencies and Impairment of Assets (SSAP No. 5), respectively. Amounts due from insureds and amounts due to insureds under retrospectively rated contracts are admitted assets to the extent they conform to the requirements of this statement.

5. Initial premiums shall be recognized in accordance with SSAP No. 51—Life Contracts, SSAP No. 53—Property Casualty Contracts—Premiums, and SSAP No. 54 —Individual and Group Accident and Health Contracts.

6. Because policy periods do not always correspond to reporting periods and because an insured’s loss experience may not be known with certainty until some time after the policy period expires, retrospective premium adjustments shall be estimated based on the experience to date using one of the following methods:

   a. Property and Casualty Contracts:

      i. Use of actuarially accepted methods in accordance with filed and approved retrospective rating plans. This includes but is not limited to the application of historical ratios of retrospective rated developments to earned standard premium to develop a ratio which is then applied to those policies for which no retrospective calculation has been recorded or for which no modification to the recorded calculation is needed. This method results in the calculation of one amount which is either a net asset or a net liability;

      ii. Reviewing each individual retrospectively rated risk, comparing known loss development (including IBNR) with that anticipated in the policy contract to arrive at the best estimate of return or additional premium earned at that point in time. This method results in the calculation of an asset or a liability for each risk. The total of all receivables shall be recorded as an asset and the total of all return premiums shall be recorded as a liability.
b. Life and Accident & Health Contracts: Reporting entities offering group coverage have extensive underwriting procedures and complex individually negotiated benefits and contracts. Due to cost and reporting deadlines, these factors make it difficult to establish an exact valuation of retrospective premium adjustments. The method used to estimate the liability shall be reasonable based on the reporting entity’s procedures and consistent among reporting periods. Common methods include a mathematical approach using a complex algorithm of the reporting entity’s underwriting rules and experience rating practices, and an aggregate or group approach.

7. Assumptions used in estimating retrospective premium adjustments shall be consistent with the assumptions made in recording other assets and liabilities necessary to reflect the underwriting results of the reporting entity such as claim and loss reserves (including IBNR) and contingent commissions. Contingent commissions and other related expenses shall be adjusted in the same period the additional or return retrospective premiums are recorded.

8. Retrospective premium adjustments are estimated for the portion of the policy period that has expired and shall be considered an immediate adjustment to premium. Additional retrospective premiums and return retrospective premiums shall be recorded as follows:

a. Property and Casualty Reporting Entities:
   i. Accrued additional retrospective premiums shall be recorded as a receivable with a corresponding entry made either to written premiums or as an adjustment to earned premiums. Premiums not recorded through written premium when accrued shall be recorded through written premium when billed;
   ii. Accrued return retrospective premiums shall be recorded as a write-in liability with a corresponding entry made either to written premiums or as an adjustment to earned premiums. Premiums not recorded through written premium when accrued shall be recorded through written premium when billed;
   iii. Ceded retrospective premium balances payable shall be recorded as liabilities, consistent with SSAP No. 62. Ceded retrospective premiums recoverable shall be recorded as an asset. Consistent with SSAP No. 64—Offsetting and Netting of Assets and Liabilities (SSAP No. 64), ceded retrospective premium balances payable may be deducted from ceded retrospective premiums recoverable when a legal right of setoff exists.

b. Life and Accident and Health Reporting Entities:
   i. Accrued additional retrospective premiums shall be recorded as a write-in for other than invested assets, with a corresponding entry to premiums;
   ii. Accrued return retrospective premiums shall be recorded as a liability, provision for experience rating refunds, with a corresponding entry to premiums.

9. The amount of accrued estimated retrospective premiums to be recorded as a nonadmitted asset for property and casualty insurers shall be determined as follows:

a. 100% of the amount recoverable from any person for whom any agents’ balances or uncollected premiums are classified as nonadmitted, and item (b), plus item (c) or (d) below. Once an insurer has elected either (c) or (d) below, a change from one to the other requires approval from the insurer’s domiciliary state and such change must be disclosed in the financial statements.
b. Retrospective premium adjustments shall be determined and billed or refunded in accordance with the policy provisions or contract provisions. If accrued additional retrospective premiums are not billed in accordance with the policy provisions or contract provisions, the accrual shall be nonadmitted.

c. 10% of any accrued retrospective premiums not offset by retrospective return premiums, other liabilities to the same party (other than loss and loss adjustment expense reserves), or collateral, not otherwise used. Collateral shall be of the same types and quality permitted for use in connection with reinsurance (types of acceptable collateral vary from state to state) or by financial guaranty coverage issued by an insurer having an “A” or better rating from a nationally recognized rating agency. The financial guaranty coverage must allow the insured under the financial guaranty policy the same degree of access to payments under that policy as a beneficiary has under a qualified letter of credit as described in Appendix A-785. Accrued retrospectively rated premiums relating to bulk IBNR must be allocated to individual policyholder accounts prior to applying collateral by account. If the insurer is unable to allocate amounts by account, no credit may be taken for collateral.

d. An amount calculated using the factors below for accrued retrospective premiums not offset by retrospective return premiums, other liabilities to the same party (other than loss and loss expense reserves), or collateral, not otherwise used. Collateral shall be of the same types and quality permitted for use in connection with reinsurance (types of acceptable collateral vary from state to state) or by financial guaranty coverage issued by an insurer having an “A” or better rating from a nationally recognized rating agency. The financial guaranty coverage must allow the insured under the financial guaranty policy the same degree of access to payments under that policy as a beneficiary has under a qualified letter of credit as described in Appendix A-785.

Accrued retrospectively rated premiums relating to bulk IBNR must be allocated to individual policyholder accounts prior to categorizing by Quality Rating.

<table>
<thead>
<tr>
<th>Insured’s Current Quality Rating*</th>
<th>Insured’s Corporate Debt Equivalent to (S&amp;P/Moody’s)**</th>
<th>Percentage of Retro Premium to be Nonadmitted***</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 AAA, AA, A/Aaa, Aa, A</td>
<td>1%</td>
<td>1%</td>
</tr>
<tr>
<td>2 BBB/Baa</td>
<td>2%</td>
<td>2%</td>
</tr>
<tr>
<td>3 BB/Ba</td>
<td>5%</td>
<td>5%</td>
</tr>
<tr>
<td>4 B/B</td>
<td>10%</td>
<td>10%</td>
</tr>
<tr>
<td>5 CCC, CC, C/Caa, Ca</td>
<td>20%</td>
<td>20%</td>
</tr>
<tr>
<td>6 CI, D/C, or insured in default on debt service payments, or insured’s debt service payments are jeopardized upon filing of a bankruptcy petition</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>

* The Percentage of Retro Premium to be Nonadmitted is based upon the Insured’s Current Quality Rating (i.e., if an insured’s quality rating drops, the percentage relating to the lower quality rating is used in calculating the amount to be nonadmitted and vice versa).

** Insureds that do not have a debt rating issued by a publicly
recognized rating agency are required to be rated by the NAIC’s Securities Valuation Office (SVO).

***

In the event the insured has no debt rating (either from a publicly recognized rating agency or from the SVO) the insured’s quality rating will be considered category 5 for purposes of this calculation (i.e., a factor of 20% shall be applied), unless the insurer is aware of conditions of the insured that would warrant a category 6 classification (i.e., a factor of 100%).

10. Once accrued retrospective premium is billed, the due date is governed by SSAP No. 6—Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers. Life and accident and health reporting entities shall nonadmit any accrued retrospective premium that is more than 90 days due. If a reporting entity has issued more than one policy to the same insured, retrospective balances shall be netted in accordance with SSAP No. 64.

11. If, in accordance with SSAP No. 5, it is probable that the additional retrospective premium is uncollectible, any uncollectible additional retrospective premium shall be written off against operations in the period the determination is made. If it is reasonably possible a portion of the balance in excess of the nonadmitted portion determined in accordance with paragraph 9 is not anticipated to be collected, the disclosure requirements outlined in SSAP No. 5 shall be made.

Disclosures

12. The financial statements shall disclose the method used by the reporting entity to estimate retrospective premium adjustments. The amount of net premiums written that are subject to retrospective rating features, as well as the corresponding percentage to total net premiums written, shall be disclosed.

13. The financial statements shall disclose the calculation of nonadmitted retrospective premium. If a reporting entity chooses treatment described in paragraph 9 (c) or (d), the appropriate exhibit must be included in the notes to financial statements in the Annual Statement. Once a reporting entity has elected either 9 (c) or (d), a change from one to the other requires approval from the reporting entity’s domiciliary state and such change must be disclosed in the financial statements.

14. Refer to the preamble for further discussion of the disclosure requirements.

Relevant Literature

15. This statement rejects FASB Emerging Issues Task Force No. 93-14, Accounting for Multiple Year Retrospectively Rated Insurance Contracts (EITF 93-14) since it applies only to multiple-year retrospectively rated contracts. The statutory principles outlined in the conclusion above are consistent with the guidance provided for accounting and retrospectively rated contracts in FASB Statement No. 60, Accounting and Reporting by Insurance Companies (FAS 60) and EITF 93-14, with the exception of the requirement to record certain amounts as nonadmitted. Although FAS 60 is rejected in SSAP No. 50—Classifications and Definitions of Insurance or Managed Care Contracts In Force and EITF 93-14 is rejected in this statement, it is considered appropriate that the accounting for retrospectively rated contracts be consistent with those provisions of both FAS 60 and EITF 93-14 as they are consistent with the Statement of Concepts.

Effective Date and Transition

16. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors.
AUTHORITATIVE LITERATURE

Statutory Accounting

• NAIC Annual Statement Instructions for Property and Casualty Insurance Companies

RELEVANT ISSUE PAPERS

• Issue Paper No. 66—Accounting for Retrospectively Rated Contracts
Statement of Statutory Accounting Principles No. 67

Other Liabilities

STATUS

Type of Issue: Common Area

Issued: Initial Draft

Effective Date: January 1, 2001

Affects: No other pronouncements

Affected by: No other pronouncements

Interpreted by: INT 03-13

SCOPE OF STATEMENT

SUMMARY CONCLUSION

Self-Insurance

Amounts Withheld or Retained by Company as Agent or Trustee

Remittances and Items Not Allocated

Interest Payable

Payable to Parent, Subsidiaries and Affiliates

Relevant Literature

Effective Date and Transition

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

RELEVANT ISSUE PAPERS
Other Liabilities

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for other liabilities.

SUMMARY CONCLUSION

2. For purposes of identifying other liabilities, the guidance outlined in SSAP No. 5—Liabilities, Contingencies and Impairments of Assets (SSAP No. 5) must be considered. This statement is not an all inclusive list of other liabilities. Certain other liabilities are covered in other statements. All other liabilities, whether or not specifically identified in this statement, shall be recorded and disclosed in accordance with SSAP No. 5, which states that “Liabilities shall be recorded on a reporting entity’s financial statements when incurred.”

Self-Insurance

3. Self-insurance occurs when an entity retains insurance risks associated with the entity’s day-to-day operations that are commonly transferred to an insurer through an insurance contract.

4. The fact that a decision is made not to insure against losses that can reasonably be expected some time in the future does not necessitate accrual by the entity if it is not probable that an asset has been impaired or a liability incurred at the date of the financial statements.

5. If an uninsured (self-insured) event occurs, which either creates a liability or impairs an asset, the entity shall either establish a liability or write-down the impaired asset. The liability shall be established using the same estimation methodology an insurance company uses when an insurance contract is issued for the type of insurance risk which is self-insured. SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses describes the specific reserving guidance which shall be followed.

6. The related costs shall be recorded based on the nature of the underlying expenses, and allocated in accordance with SSAP No. 70—Allocation of Expenses. Related costs shall be recorded based on the nature of the underlying expenses.

Amounts Withheld or Retained by Company as Agent or Trustee

7. A reporting entity may, in the normal course of its business, withhold funds as an agent or trustee which will ultimately be paid to others.

8. Amounts withheld or retained by an entity as trustee or agent shall be recorded as a liability when the salaries or other compensation are expensed (subparagraphs 8 a. and 8 b.) or the funds are received (subparagraphs 8 c. through 8 e.). Examples of such occurrences are:

   a. As an employer, the reporting entity deducts and withholds federal and state income taxes, social security taxes, charitable contributions, savings plan deductions, garnishments, employee contributions to pension plans, employee share of group life and health insurance premiums, and other employee salary withholdings or deductions;

   b. Amounts due under deferred compensation arrangements shall be accrued in accordance with the provisions of SSAP No. 14—Postretirement Benefits Other Than Pensions. Segregated funds (i.e., Rabbi trusts and similar arrangements) shall not be netted against the accrued liability unless the requirements of SSAP No. 64—Offsetting and Netting of Assets and Liabilities (SSAP No. 64) are met.
c. For a reporting entity that invests in commercial and residential mortgages, the entity may require the mortgagor to prepay real estate taxes and property insurance premiums which the entity will hold in escrow and pay when due;

d. The reporting entity holds deposits in connection with leases of investment property; and

e. The reporting entity may receive and hold other funds in a fiduciary capacity.

**Remittances and Items Not Allocated**

9. Cash receipts cannot always be identified for a specific purpose or, for other reasons, applied to a specific account when received. The reporting entity shall record a liability for these cash receipts when the funds are received. These liability accounts are generally referred to as suspense accounts. Examples include:

   a. Premium payments received with the application for policies which have not yet been issued;

   b. Premium payments in an amount different than the amount billed by the reporting entity; and

   c. Unidentified cash receipts.

**Interest Payable**

10. Interest payable includes interest on debt, interest on real estate obligations, and approved interest on surplus notes. It also includes interest on funds held as a deposit or security, such as those held by a ceding company against a reinsurer. The amount to be reported is the amount which has accrued and is unpaid at the balance sheet date.

**Payable to Parent, Subsidiaries and Affiliates**

11. A liability shall be recognized and identified as due to affiliates for expenditures incurred on behalf of the reporting entity by a parent, affiliates, or subsidiaries or for amounts owed through other intercompany transactions. Amounts due to or from affiliates shall be offset and reported net only when the provisions of SSAP No. 64 are met. Examples of these expenses are executive salaries, workers’ compensation insurance premiums, and pension contributions.

12. Reinsurance transactions are not considered liabilities of this nature and are covered in SSAP No. 61—Life, Deposit-Type and Accident and Health Reinsurance and SSAP No. 62—Property and Casualty Reinsurance.

**Relevant Literature**

13. This statement adopts FASB Statement No. 116, Accounting for Contributions Received and Contributions Made and AICPA Statement of Position 96-1, Environmental Remediation Liabilities. This statement is consistent with FASB Statement No. 5, Accounting for Contingencies as discussed in SSAP No. 5.
Effective Date and Transition

14. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors.

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

- FASB Statement No 116, Accounting for Contributions Received and Contributions Made
- AICPA Statement of Position 96-1, Environmental Remediation Liabilities

RELEVANT ISSUE PAPERS

- Issue Paper No. 96—Other Liabilities
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Statement of Statutory Accounting Principles No. 68

Business Combinations and Goodwill

STATUS

Type of Issue: Common Area
Issued: Initial Draft
Effective Date: January 1, 2001
Affects: No other pronouncements
Affected by: No other pronouncements
Interpreted by: INT 99-10, INT 99-19, INT 99-20, INT 00-14, INT 00-15, INT 00-19, INT 00-26, INT 00-28, INT 01-18, INT 01-21, INT 02-07, INT 03-04, INT 03-14, INT 03-16

SCOPE OF STATEMENT

SUMMARY CONCLUSION

Business Combinations
Statutory Purchases of SCA Investments
Impairment
Statutory Mergers
Disclosures
Relevant Literature
Effective Date and Transition

AUTHORITATIVE LITERATURE

Statutory Accounting
Generally Accepted Accounting Principles

RELEVANT ISSUE PAPERS
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Business Combinations and Goodwill

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for business combinations. It addresses: (a) accounting for purchases of subsidiary, controlled and affiliated (SCA) investments (defined in SSAP No. 46—Accounting for Investments in Subsidiary, Controlled, and Affiliated Entities (SSAP No. 46)); (b) accounting for purchases of partnerships, joint ventures, and limited liability companies (defined in SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies); (c) accounting for goodwill; and (d) accounting for mergers.

SUMMARY CONCLUSION

Business Combinations

2. A business combination shall be accounted for as either a statutory purchase or a statutory merger. Business combinations that create a parent-subsidiary relationship shall be accounted for as a statutory purchase. Business combinations where equity of one entity is issued in exchange for the equity of another entity, which is then canceled, and prospectively only one entity exists, shall be accounted for as a statutory merger.

Statutory Purchases of SCA Investments

3. The statutory purchase method of accounting is defined as accounting for a business combination as the acquisition of one entity by another. It shall be used for all purchases of SCA entities including partnerships, joint ventures, and limited liability companies. The acquiring reporting entity shall record its investment at cost. Cost is defined as the sum of: (a) any cash payment, (b) the fair value of other assets distributed, (c) the fair value of any liabilities assumed, and (d) any direct costs of the acquisition.

4. For those acquired SCA entities accounted for in accordance with paragraphs 7 b. i., 7 b. ii., or 7 b. iii. of SSAP No. 46, goodwill is defined as the difference between the cost of acquiring the entity and the reporting entity’s share of the book value of the acquired entity. When the cost of the acquired entity is greater than the reporting entity’s share of the book value, positive goodwill exists. When the cost of the acquired entity is less than the reporting entity’s share of the book value, negative goodwill exists. Goodwill resulting from assumption reinsurance shall be recorded as a separate write-in for other than invested assets. All other goodwill shall be reported in the carrying value of the investment.

5. A business combination accounted for under the statutory purchase method and in which the acquired entity is valued in accordance with paragraph 7 b. iii. of SSAP No. 46 shall determine the amount of positive goodwill or negative goodwill created by the combination using the reporting entity’s share of the Generally Accepted Accounting Principles (GAAP) net book value of the acquired entity. Business combinations accounted for under the statutory purchase method and in which the acquired entity is valued in accordance with paragraph 7 b. i. or 7 b. ii. of SSAP No. 46 shall determine the amount of positive or negative goodwill created by the business combination using the reporting entity’s share of the statutory book value of the acquired entity.

6. Under the statutory purchase method the historical bases of the acquired entity shall continue to be used in preparing its statutory financial statements except in those instances provided for in subparagraph 7 b. iii. of SSAP No. 46. Therefore, pushdown accounting is not permitted.

7. Positive goodwill recorded under the statutory purchase method of accounting shall be admitted subject to the following limitation: Positive goodwill from all sources, including life, accident and health, and deposit-type assumption reinsurance, is limited in the aggregate to 10% of the acquiring entity’s capital and surplus as required to be shown on the statutory balance sheet of the reporting entity for its
most recently filed statement with the domiciliary state commissioner adjusted to exclude any net positive goodwill, EDP equipment and operating system software, and net deferred tax assets. When negative goodwill exists, it shall be recorded as a contra-asset. Positive or negative goodwill resulting from the purchase of a SCA shall be amortized to unrealized capital gains and losses on investments over the period in which the acquiring entity benefits economically, not to exceed 10 years. Positive or negative goodwill resulting from life, accident and health, and deposit-type assumption reinsurance shall be amortized to operations as a component of general insurance expenses over the period in which the assuming entity benefits economically, not to exceed 10 years. Goodwill shall be evaluated separately for each transaction.

Impairment

8. For any decline in the fair value of an entity, acquired through a purchase, that is other than temporary, the investment shall be written down to fair value as the new cost basis and the amount of the write down shall be accounted for as a realized loss. The write down shall first be considered as an adjustment to any portion of the investment that is nonadmitted (e.g., nonadmitted goodwill). The new cost basis shall not be changed for subsequent recoveries in fair value. Future declines in fair value, which are determined to be other than temporary, shall be recorded as realized losses.

9. An impairment shall be considered to have occurred if it is probable that the reporting entity will be unable to recover the carrying amount of the investment or there is evidence indicating inability of the investee to sustain earnings which would justify the carrying amount of the investment. A fair value of an investment that is below the carrying amount based on the statutory equity method or the existence of investee operating losses may indicate a loss in value; however, they are not necessarily indicative of a loss in value that is other than temporary.

Statutory Mergers

10. The statutory merger method of accounting is defined as accounting for a business combination in which the original investors in the investee receive equity of the reporting entity for their interest in the investee and only one entity survives. It shall be used for all business combinations accomplished by (a) issuing equity of a newly formed entity for the equity of the merging entities, (b) one entity issuing equity in exchange for the equity of another entity and immediately canceling the equity of that entity, or (c) the exchange of membership interest.

11. Under the statutory merger method, no acquisition shall be recognized because the combination is accomplished without disbursing resources of the constituents. Ownership interest continues and the former statutory bases of accounting shall be retained. However, if one of the merged entities did not employ the statutory basis of accounting, the accounts shall be adjusted to the statutory bases with an offsetting adjustment to beginning surplus of the earliest period presented. The recorded assets, liabilities, and related surplus accounts of the constituents shall be carried forward to the combined corporation at their recorded statutory amounts. The capital accounts of the entities shall be adjusted as necessary to reflect the appropriate par values of the capital stock of the new entity. Adjustments to the capital stock account shall be made to gross paid-in and contributed surplus, to the extent there is a balance in the account.

12. Income of the combined reporting entity shall include income of the constituents for the entire fiscal period in which the combination occurs and the balance sheet and the statement of operations for the two years presented shall be restated, as required by SSAP No. 3—Accounting Changes and Corrections of Errors.

13. Goodwill on the historical books of any merged entity that arose from a previous business combination involving the merged entities shall be charged or credited to surplus immediately.
Disclosures

14. For business combinations accounted for under the statutory purchase method, the financial statements shall disclose the following for as long as unamortized goodwill is reported as a component of the investment:

   a. The name and brief description of the acquired entity;
   b. Method of accounting, that is the statutory purchase method;
   c. Cost of the acquired entity and the amount of goodwill; and
   d. The amount of amortization of goodwill recorded for the period.

15. For business combinations taking the form of a statutory merger, the financial statements shall disclose:

   a. The names and brief description of the combined entities;
   b. Method of accounting, that is the statutory merger method;
   c. Description of the shares of stock issued in the transaction;
   d. Details of the results of operations of the previously separate entities for the period before the combination is consummated that are included in the current combined net income, including revenue, net income, and other changes in surplus; and
   e. A description of any adjustments recorded directly to surplus for any entity that previously did not prepare statutory statements.

16. The financial statements shall disclose the following information regarding goodwill resulting from assumption reinsurance:

   a. The name of the ceding entity;
   b. The type of business assumed;
   c. The cost of the acquired business and the amount of goodwill; and
   d. The amount of amortization of goodwill recorded for the period.

17. A reporting entity that recognizes an impairment loss shall disclose the following in the financial statements that include the period of the impairment write-down:

   a. A description of the impaired assets and the facts and circumstances leading to the impairment; and
   b. The amount of the impairment charged to realized capital gains and losses and how fair value was determined.
Relevant Literature

18. This statement adopts paragraph 12 of FASB Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of* (FAS 121) to the extent that it addresses impairment of goodwill. Subparagraphs 14 a. and 14 b. of FAS 121 are also adopted. Paragraphs 13, 14 c. and 14 d. of FAS 121 are rejected.

19. This statement adopts FASB Emerging Issues Task Force No. 95-19, *Determination of the Measurement Date for the Market Price of Securities Issued in a Purchase Business Combination*.


a. AICPA Accounting Interpretations, *Business Combinations: Accounting Interpretations of APB Opinion No. 16*;

b. FASB Statement No. 10, *Extension of "Grandfather" Provisions for Business Combinations*;

c. AICPA Accounting Interpretations, *Intangible Assets: Unofficial Accounting Interpretations of APB Opinion No. 17*;

d. FASB Emerging Issues Task Force No. 85-14, *Securities That Can Be Acquired for Cash in a Pooling of Interests*;

e. FASB Emerging Issues Task Force No. 86-9, IRC Section 338 and *Push-Down Accounting*;

f. FASB Emerging Issues Task Force No. 86-10, *Pooling with 10 Percent Cash Payout Determined by Lottery*;

g. FASB Emerging Issues Task Force No. 87-11, *Allocation of Purchase Price to Assets to Be Sold*;

h. FASB Emerging Issues Task Force No. 87-15, *Effect of a Standstill Agreement on Pooling-of-Interests Accounting*;

i. FASB Emerging Issues Task Force No. 87-16, *Whether the 90 Percent Test for a Pooling of Interests Is Applied Separately to Each Company or on a Combined Basis*;

j. FASB Emerging Issues Task Force No. 87-27, *Poolings of Companies that Do Not Have a Controlling Class of Common Stock*;

k. FASB Emerging Issues Task Force No. 88-26, *Controlling Preferred Stock in a Pooling of Interests*;

l. FASB Emerging Issues Task Force No. 88-27, *Effect of Unallocated Shares in an Employee Stock Ownership Plan on Accounting for Business Combinations*;

m. FASB Emerging Issues Task Force No. 89-7, *Exchange of Assets or Interest in a Subsidiary for a Noncontrolling Equity Interest in a New Entity*;
n. FASB Emerging Issues Task Force No. 90-5, Exchanges of Ownership Interest between Entities under Common Control;

o. FASB Emerging Issues Task Force No. 90-6, Accounting for Certain Events Not Addressed in Issue No. 87-11 Relating to an Acquired Operating Unit to Be Sold;

p. FASB Emerging Issues Task Force No. 90-12, Allocating Basis to Individual Assets and Liabilities for Transactions within the Scope of Issue No. 88-16;

q. FASB Emerging Issues Task Force No. 90-13, Accounting for Simultaneous Common Control Mergers;

r. FASB Emerging Issues Task Force No. 91-5, Nonmonetary Exchange of Cost-Method Investments;

s. FASB Emerging Issues Task Force No. 92-9, Accounting for the Present Value of Future Profits Resulting from the Acquisition of a Life Insurance Company;

t. FASB Emerging Issues Task Force No. 93-7, Uncertainties Related to Income Taxes in a Purchase Business Combination;

u. FASB Emerging Issues Task Force No. 95-3, Recognition of Liabilities in Connection with a Purchase Business Combination;

v. FASB Emerging Issues Task Force No. 95-8, Accounting for Contingent Consideration Paid to the Shareholders of an Acquired Enterprise in a Purchase Business Combination;

w. FASB Emerging Issues Task Force No. 95-12, Pooling of Interests with a Common Interest in a Joint Venture;

x. FASB Emerging Issues Task Force No. 95-14, Recognition of Liabilities in Anticipation of a Business Combination;

y. FASB Emerging Issues Task Force No. 96-8, Accounting for a Business Combination When the Issuing Company Has Targeted Stock;

z. FASB Technical Bulletin 85-5, Issues Related to Accounting for Business Combinations;

aa. FASB Interpretations No. 4, Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method, an interpretation of FASB Statement No. 2.

Effective Date and Transition

21. This statement is effective for years beginning January 1, 2001. The provisions of this statement shall be applied to all business combinations entered into on or after January 1, 2001. Goodwill that had been written off prior to the effective date of this statement is prohibited from being restored for purposes of applying the provisions of this statement.
AUTHORITATIVE LITERATURE

Statutory Accounting

- NAIC Purposes and Procedures of the Securities Valuation Office

Generally Accepted Accounting Principles

- FASB Statement No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of, paragraphs 12, 14 a. and 14 b.

- FASB Emerging Issues Task Force No. 95-19, Determination of the Measurement Date for the Market Price of Securities Issued in a Purchase Business Combination

RELEVANT ISSUE PAPERS

- Issue Paper No. 68—Business Combinations and Goodwill
Statement of Statutory Accounting Principles No. 69

Statement of Cash Flow

STATUS

Type of Issue: Common Area
Issued: Initial Draft
Effective Date: January 1, 2001
Affects: No other pronouncements
Affected by: No other pronouncements
Interpreted by: INT 01-13, INT 03-13

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RELEVANT ISSUE PAPERS ...

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Statement of Cash Flow

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for the Statement of Cash Flow.

SUMMARY CONCLUSION

2. The Statement of Cash Flow shall be prepared using the direct method. Cash from operations shall be reported consistent with the Statement of Income, excluding the effect of current and prior year accruals. For purposes of the Statement of Cash Flow, cash shall include short-term investments. Specific instructions for the classification of items are provided in the Annual Statement Instructions.

Disclosures

3. The financial statements shall disclose the following:
   a. Transactions considered to be investing and financing activities (consistent with the classifications in the Annual Statement) that affect recognized assets or liabilities but do not result in cash receipts or cash payments in the period (in narrative or schedule form); and
   b. The cash and noncash aspects of the above transactions identified as investing or financing consistent with the classifications provided by the Annual Statement Instructions. Examples of noncash investing and financing transactions include:
      i. Converting debt to equity;
      ii. Acquiring assets by assuming directly related liabilities, such as purchasing a building by incurring a mortgage to the seller; and
      iii. Exchanging noncash assets or liabilities for other noncash assets or liabilities.

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

Relevant Literature

5. This statement adopts FASB Emerging Issues Task Force Issue No. 95-13, Classification of Debt Issue Costs in the Statement of Cash Flows which requires that cash payments for debt issue costs shall be classified as a financing activity in the Statement of Cash Flow.


Effective Date and Transition

7. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors.
AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles


RELEVANT ISSUE PAPERS

- Issue Paper No. 92—Statement of Cash Flow
# Statement of Statutory Accounting Principles No. 70

## Allocation of Expenses

### STATUS

**Type of Issue:** Common Area  
**Issued:** Initial Draft  
**Effective Date:** January 1, 2001  
**Affects:** No other pronouncements  
**Affected by:** No other pronouncements  
**Interpreted by:** No other pronouncements

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Allocation of Expenses

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for presentation and allocation of certain expenses of reporting entities into general categories and the apportionment of shared expenses between members of a group of entities.

SUMMARY CONCLUSION

2. This statement establishes uniform expense allocation rules to classify expenses within prescribed principal groupings. It is necessary to allocate those expenses which may contain characteristics of more than one classification, which this statement will refer to as allocable expenses.

3. Allocable expenses for property and casualty insurance companies shall be classified into one of three categories on the Underwriting and Investment Exhibit as follows:

   a. Loss adjustment expenses—Expenses incurred in the adjusting, recording and paying of claims (including expenses associated with commutations);

   b. Investment expenses—Expenses incurred in the investing of funds and pursuit of investment income. Such expenses include those specifically identifiable and allocated costs related to activities such as initiating and handling orders, researching and recommending investments (i.e., investment strategy), appraising, valuing, disbursing funds and collecting income, securities safekeeping, real estate taxes, records maintenance, data processing, support personnel, postage and supplies, office overhead, management and executive duties and all other functions reasonably associated with the investment of funds; or

   c. Other underwriting expenses—Allocable expenses other than loss adjustment expenses and investment related expenses.

4. Similarly for life and accident and health insurers allocable expenses shall be categorized as general insurance expenses; insurance taxes, licenses and fees; or investment expenses which are netted against investment income on the Summary of Operations.

5. Allocable expenses for health insurers shall be classified as claim adjustment expenses; general administrative expenses; or investment expenses which are netted against investment income on the Statement of Revenue and Expenses.

6. Allocation to the above categories should be based on a method that yields the most accurate results. Specific identification of an expense with an activity that is represented by one of the categories above will generally be the most accurate method. Where specific identification is not feasible allocation of expenses should be based upon pertinent factors or ratios such as studies of employee activities, salary ratios or similar analyses.

7. Allocation may be entirely to one expense category based upon the type of expense incurred, for example, premium taxes would be 100% allocated to Other Underwriting Expenses for property and casualty companies. Other expenses may be allocated across several categories, such as salaries, which may be allocated to both general insurance expenses and net investment income of a life and accident and health company.

8. Many entities operate within a group where personnel and facilities are shared. Shared expenses, including expenses under the terms of a management contract, shall be apportioned to the entities
incurring the expense as if the expense had been paid solely by the incurring entity. The apportionment shall be completed based upon specific identification to the entity incurring the expense. Where specific identification is not feasible apportionment shall be based upon pertinent factors or ratios.

98. Any basis adopted to apportion expenses shall be that which yields the most accurate results and may result from special studies of employee activities, salary ratios, premium ratios or similar analyses. Expenses that relate solely to the operations of a reporting entity, such as personnel costs associated with the adjusting and paying of claims, must be borne solely by the reporting entity and are not to be apportioned to other entities within a group.

109. Apportioned expenses are subject to presentation and allocation as provided in paragraphs 3 through 6.

1140. Any material individual component of the reported expense categories shall be presented either on the face of the Summary of Operations or within the footnotes or related Exhibits to the financial statements (e.g., Exhibits 5 and 6 of the Life and Accident and Health annual statement, and Underwriting and Investment Exhibit, Part 4—Expenses of the Property and Casualty annual statement) and/or the Health annual statement to the financial statements.

1244. Refer to the preamble for further discussion regarding disclosure requirements.

Effective Date and Transition

1342. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors.

AUTHORITATIVE LITERATURE

Statutory Accounting

- NAIC Annual Statement Instructions for Property and Casualty Insurance Companies, “Underwriting and Investment Exhibit”
- NAIC Annual Statement Instructions for Life and Accident and Health Insurance Companies, “Exhibit 5—General Expenses”

RELEVANT ISSUE PAPERS

- Issue Paper No. 94—Allocation of Expenses
Statement of Statutory Accounting Principles No. 71

Policy Acquisition Costs and Commissions

STATUS

Type of Issue: Common Area

Issued: Initial Draft

Effective Date: January 1, 2001

Affects: No other pronouncements

Affected by: No other pronouncements

Interpreted by: No other pronouncements
Policy Acquisition Costs and Commissions

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for policy acquisition costs and commissions.

SUMMARY CONCLUSION

2. Acquisition costs are those costs that are incurred in the acquisition of new and renewal insurance contracts and include those costs that vary with and are primarily related to the acquisition of insurance contracts (e.g., agent and broker commissions, certain underwriting and policy issue costs, and medical and inspection fees). Acquisition costs and commissions shall be expensed as incurred. Determination of when acquisition costs and commissions have been incurred shall be made in accordance with SSAP No. 5—Liabilities, Contingencies and Impairments of Assets.

3. Contingent commission liabilities shall be determined in accordance with the terms of each individual commission agreement. Commission liabilities determined on the basis of a formula that relates to loss experience shall be established for the earned portion. Assumptions used to calculate the contingent commission liability shall be consistent with the terms of the policy contract and with the assumptions made in recording other assets and liabilities necessary to reflect underwriting results of the reporting entity such as retrospective premium adjustments and loss reserves, including incurred but not reported.

4. Levelized commissions occur in situations where agents receive normal (non-level) commissions with payments made by a third party. It is intended, but not necessarily guaranteed, that the amounts paid to the agents by the third party would ultimately be repaid (with interest explicit or implied) to the third party by levelized payments (which are less than the normal first year commissions but exceed the normal renewal commissions) from the reporting entity. These transactions are, in fact, funding agreements between a reporting entity and a third party. The continuance of the stream of payments specified in the levelized commission contract is a mechanism to bypass recognition of those expenses which are ordinarily charged to expense in the first year of the contract. Consequently, the normal link between the persistency of the policy, the continuance of the premium payment or the maintenance of the agent’s license with the reporting entity is not maintained with respect to the payment stream.

5. The use of an arrangement where commission payments are not linked to traditional elements such as premium payments and policy persistency, but rather are linked to the repayment of an advance amount requires the establishment of a liability for the full amount of the unpaid principal and accrued interest which is payable to a third party related to levelized commissions.

Relevant Literature

6. This statement rejects FASB Statement No. 60, Accounting and Reporting by Insurance Enterprises and 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.

Effective Date and Transition

7. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors.
RELEVANT ISSUE PAPERS

• Issue Paper No. 71—Policy Acquisition Costs and Commissions
Statement of Statutory Accounting Principles No. 72

Surplus and Quasi-reorganizations

STATUS

Type of Issue: Common Area
Issued: Initial Draft
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Affected by: No other pronouncements
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SCOPE OF STATEMENT

SUMMARY CONCLUSION

Capital Stock
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AUTHORITATIVE LITERATURE

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RELEVANT ISSUE PAPERS
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Surplus and Quasi-reorganizations

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for statutory surplus and quasi-reorganizations.

SUMMARY CONCLUSION

2. Statutory surplus of a reporting entity consists of the following:
   a. Capital stock;
   b. Treasury stock;
   c. Gross paid-in and contributed surplus;
   d. Surplus notes;
   e. Unassigned funds (surplus);
   f. Special surplus funds; and
   g. Other than special surplus funds.

Capital Stock

3. The articles of incorporation set forth the number of authorized shares of capital stock and the par value of each share. The capital stock account represents the number of shares issued times the par value of each share. When no par value is set forth, the reporting entity shall declare a “stated value” and record such amount in the capital stock account. Changes in the par value of a reporting entity’s capital stock shall be reflected as a reclassification between the capital stock account and gross paid-in and contributed surplus.

4. Notes or other receivables received for the issuance of capital stock which have been approved by the domiciliary commissioner and have been satisfied by receipt of cash or readily marketable securities prior to the filing of the statutory financial statement shall be treated as a Type I subsequent event in accordance with SSAP No. 9—Subsequent Events (SSAP No. 9) and as such shall be considered an admitted asset. To the extent that the notes or other receivables are not satisfied, they shall be nonadmitted.

5. Stock splits, similar to stock dividends, have no impact on the overall surplus of a reporting entity. The distinction between a stock split and a stock dividend shall be made in accordance with Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins, “Chapter 7, Capital Accounts, Section B-Stock Dividends and Split-ups” (ARB 43). Stock splits shall be recorded by adjusting the capital stock account to reflect the par value of the outstanding number of shares after the split. An offsetting entry shall be made to paid-in or contributed surplus. Stock dividends shall be recorded in a manner consistent with subparagraph 12 i.

Treasury Stock

6. Treasury stock is capital stock that has been issued and subsequently reacquired by the reporting entity. It is held for either reissuance or cancellation in the future. When a reporting entity’s stock is acquired for purposes other than retirement, or when ultimate disposition has not yet been decided, the cost of acquired stock shall be reported as treasury stock which reduces statutory surplus. The acquisition
of treasury stock has no effect on either the number of shares issued or the amount of paid up capital shown in the capital stock account. Cancellation of treasury stock shall reduce the capital stock account by the par value and reduce paid-in or contributed surplus by the excess of cost over par value or stated value.

**Gross Paid-in and Contributed Surplus**

7. Gross paid-in and contributed surplus is the amount of capital received in excess of the par value of the stock issued. Changes in the par value of a reporting entity’s capital stock shall be reflected as a reclassification between the capital stock account and gross paid-in and contributed surplus. Forgiveness of a reporting entity’s obligations to its parent or other stockholders shall be accounted for as contributed surplus.

8. Notes or other receivables received as additional capital contributions satisfied by receipt of cash or readily marketable securities prior to the filing of the statutory financial statement shall be treated as a Type I subsequent event in accordance with SSAP No. 9 and as such shall be considered an admitted asset based on the evidence of collection and approval of the domiciliary commissioner. To the extent that the notes or other receivables are not satisfied, they shall be nonadmitted.

9. Real estate or other assets received as additional capital contributions are nonreciprocal transfers as defined in SSAP No. 28—Nonmonetary Transactions.

10. Stock purchase warrants issued in return for cash shall be credited to gross paid-in and contributed surplus. When debt instruments are issued with conversion features, no value shall be assigned to the conversion features unless the conversion feature is clearly separable from the debt obligation in the form of a detachable stock purchase warrant. In such instances the relative fair value of the detachable stock purchase warrant at time of issue shall be credited to gross paid-in and contributed surplus.

**Surplus Notes**

11. Surplus notes are financial instruments that are subject to strict control by the commissioner of the reporting entity’s state of domicile and have been approved by the commissioner as to form and content. These instruments are commonly referred to as surplus notes but are also referred to as surplus debentures or contribution certificates. SSAP No. 41—Surplus Notes (SSAP No. 41) provides the specific characteristics of surplus notes and provides accounting guidance for surplus notes. Only notes meeting the requirements of SSAP No. 41 shall be accounted for as surplus notes.

**Unassigned Funds (Surplus)**

12. Unassigned funds (surplus) represents the undistributed and unappropriated amount of surplus at the balance sheet date. Certain components of unassigned funds (surplus) are addressed in more detail in other issue papers. Unassigned funds (surplus) is comprised of the cumulative effect of:

   a. Net Income

      Net income resulting from insurance and other operating activities of the reporting entity since its inception is a component of unassigned funds (surplus);

   b. Unrealized Capital Gains and Losses on Investments

      The cumulative unrealized capital gain or loss that results from differences between the prescribed statement value of investments carried at fair value and the cost of those investments is a component of unassigned funds (surplus). This component changes as
periodic unrealized gains and losses are credited or charged directly to unassigned funds (surplus);

c. Effect of Exchange Rate Fluctuations

The cumulative gain or loss due to translating foreign operations to U.S. dollars and changes in balance sheet asset and liability values due to foreign currency translation is recorded as an unrealized capital gain or and loss and therefore is a component of unassigned funds (surplus). This component changes as the exchange rates fluctuate;

d. Nonadmitted Assets

The nonadmitted values of assets owned by a reporting entity are a reduction of unassigned funds (surplus). This component of unassigned funds (surplus) changes as nonadmitted asset values change. Changes in nonadmitted asset values are charged or credited directly to unassigned funds (surplus);

e. Provision for Reinsurance

A reporting entity must establish a statutory liability, provision for reinsurance, for unsecured reinsurance recoverables from unauthorized reinsurers and certain overdue balances from authorized reinsurers. The liability is charged directly to unassigned funds (surplus). Therefore, at any point in time there is a reduction of unassigned funds (surplus) equal to a reporting entity’s liability for unauthorized reinsurance;

f. Asset Valuation Reserves

Where an Asset Valuation Reserve is required to be recorded as a statutory liability, there is a reduction of unassigned funds (surplus) in an amount equal to the liability. Changes to the Asset Valuation Reserve are charged or credited directly to unassigned funds (surplus);

g. Separate Accounts

A life insurer’s balance sheet includes the total assets and liabilities of any separate accounts business which it maintains and, therefore, the surplus, if any, of its separate accounts business. Changes in the surplus of the separate accounts business of an insurer are charged or credited directly to unassigned funds (surplus);

h. Subscribers Savings Accounts

Subscribers Savings Accounts (SSAs) are unique to reciprocals. SSAs represent a portion of a reciprocal insurance company’s surplus that has been identified as subscribers (policyholders) accounts. When the source of amounts credited to the subscriber accounts is from the reciprocal’s operations, the amounts are reported as unassigned funds (surplus);

i. Dividends to Stockholders

Dividends declared are charged directly to unassigned funds (surplus) on the declaration date and are carried as a liability until paid. The amount of the dividend is the cash paid if it is a cash dividend, the fair value of the assets distributed if it is property dividend, or the par value of the company’s stock if it is a stock dividend. A stock dividend is recorded as a transfer from unassigned funds (surplus) to capital stock. Stock dividends have no effect on total capital and surplus while other forms of dividends reduce surplus.
Forgiveness by a reporting entity of any debt, surplus note or other obligation of its parent or other stockholders shall be accounted for as a dividend. Dividends paid to related parties are subject to the requirements of SSAP No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties;

j. Change in Accounting Principles

The effects of a change in accounting principle or the application of an accounting principle, such as a change in reserve account because of a change in valuation basis, are reported as a charge or credit to unassigned funds (surplus). The effect of these changes shall not be included in the determination of net income or loss;

k. Correction of an Error

Corrections of errors in previously issued financial statements are charged or credited directly to unassigned funds (surplus). The effect of corrections of errors shall not be included in the determination of net income or loss;

l. Stock Issuance Expenses

Expenses relating to the issuance of capital stock, for example underwriting commissions and filing fees are charged to unassigned funds (surplus);

m. Change in Surplus as a Result of Reinsurance

Life and accident and health insurers report increases in surplus that result from certain types of reinsurance transactions on a net of tax basis. As profits emerge from the ceded business the increase in surplus is amortized to income as provided for in Appendix A-791;

n. Changes in Deferred Tax Assets and Deferred Tax Liabilities

Consistent with the conclusions reached in SSAP No. 10—Income Taxes, changes in deferred tax assets and deferred tax liabilities, including changes attributable to changes in tax rates and changes in tax status, if any, shall be recognized as a separate component of unassigned funds (surplus);

o. Other

This category includes other gains and losses in surplus not specifically identified elsewhere in this statement including but not limited to net proceeds from life insurance on employees, changes in the additional minimum pension liability as discussed in SSAP No. 89—Accounting for Pension, A Replacement of SSAP No. 8 and unearned compensation relating to stock issuances made under compensatory Employee Stock Ownership Plans, Stock Option Plans and Stock Purchase Plans.

Special Surplus Funds

13. A company may establish a segregated surplus account to provide for contingencies. Surplus thus appropriated is called appropriated surplus or special surplus funds. Surplus resulting from any retroactive reinsurance transaction entered by a property and casualty insurer must be recorded as an appropriation of surplus by the ceding company (special surplus from retroactive reinsurance account). Voluntary and general contingency reserves which are not actual liabilities of the company are shown as appropriated surplus or special surplus funds.
Other Than Special Surplus Funds

14. Amounts provided to reporting entities, other than stock companies, in the organization stage to defray the expenses and meet initial minimum surplus requirements required to obtain a license to do the business of insurance shall be reported as Other than Special Surplus Funds. Examples of these types of deposits include but are not limited to: guaranty fund notes and subscriber accounts that represent individual subscriber contributions.

Quasi-reorganizations

15. Restatement of gross paid-in and contributed surplus and unassigned funds (surplus) under a quasi-reorganization shall be permitted only if the criteria in both subparagraphs 15 a. and 15 b. and either subparagraph 15 c. or 15 d. are met:
   a. The restatement is approved in writing by the domiciliary commissioner;
   b. An 80% or greater change in the ultimate ownership of the reporting entity has occurred within six months prior to approval of the restatement;
   c. A new business plan has been adopted that results in a substantive change in the operations and business mix of the reporting entity and the situation or circumstances that gave rise to the negative unassigned funds (surplus) will not be part of the ongoing operations;
   d. The reporting entity is a shell company with no existing operations, in force policies or outstanding claims.

16. Restatement shall not result in the unassigned funds (surplus) account being greater than zero or the gross paid-in and contributed surplus account being less than zero immediately following the restatement. Total surplus as regards policyholders shall remain unchanged following restatement. The following components of unassigned funds (surplus) shall be considered in determining the amount available for restatement:
   a. Net Income;
   b. Effect of Exchange Rate Fluctuations;
   c. Dividends to Stockholders;
   d. Change in Accounting Principles;
   e. Correction of an Error and
   f. Stock Issuance Expenses.

17. The assets and liabilities of the reporting entity shall continue to be carried at historical cost or other value required by statutory accounting principles. No adjustments to assets or liabilities shall be made to reflect the effect of a quasi-reorganization.

Changes in Statutory Surplus

18. The components of the change in the capital and surplus accounts shall be presented for each year for which an income statement is presented.
Disclosures

19. The financial statements shall disclose the following:

   a. The number of shares of each class of capital stock authorized, issued and outstanding as of the balance sheet date and the par value or stated value of each class;

   b. The dividend rate, liquidation value and redemption schedule (including prices and dates) of any preferred stock issues;

   c. Dividend restrictions, if any, and an indication if the dividends are cumulative;

   d. The portion of the reporting entity profits that may be paid as ordinary dividends to stockholders;

   e. A description of any restrictions placed on the unassigned funds (surplus) including for whom the surplus is being held;

   f. For mutual reciprocals and similarly organized entities, the total amount of advances to surplus not repaid, if any;

   g. The total amount of stock held by the reporting entity, including stock of affiliated entities, for special purposes such as conversion of preferred stock, employee stock options, and stock purchase warrants;

   h. A description of the reasons for changes in the balances of any special surplus funds from the prior period;

   i. The portion of unassigned funds (surplus) represented or reduced by each of the following items:

      i. unrealized gains and losses;

      ii. nonadmitted asset values;

      iii. separate account business;

      iv. asset valuation reserves;

      v. provision for reinsurance.

   j. For reciprocal insurance companies only:

      i. the amount of surplus identified as subscriber savings accounts;

      ii. the source of the funds (either from the reciprocal’s operations or contributed by the individual subscriber) and, the reporting location in surplus;

      iii. the conditions upon which the balances are paid to the subscribers.

   k. Disclosures required by SSAP No. 41;

   l. Disclosures required by SSAP No. 9;

   m. The impact of the restatement in a quasi-reorganization as long as financial statements for the period of the reorganization are presented; and
n. The effective date of a quasi-reorganization for a period of ten years following the reorganization.

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

**Relevant Literature**

21. Paragraphs 9 and 10 of *Accounting Principles Board Opinion No. 12, Omnibus Opinion—1967*, are adopted with modification to eliminate the option of disclosing changes in the notes to the financial statements rather than in the Statement of Capital and Surplus. This statement adopts paragraphs 10 and 11 of *Accounting Principles Board Opinion No. 10, Omnibus Opinion—1966* (APB 10). This statement also adopts paragraph 12 of *Accounting Principles Board Opinion No. 6* (APB 6), *Status of Accounting Research Bulletins*, with modification to eliminate the option of recording treasury stock as an asset.

22. Paragraph 15 of *FASB Statement No. 5, Accounting For Contingencies*, is adopted by this statement. Paragraphs 1 through 4 and 10 through 16 of *Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins*, “Chapter 7, Capital Accounts, Section B—Stock Dividends and Stock Split-ups” are adopted by this statement.

23. This statement adopts *Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins*, “Chapter 7, Capital Accounts, Section A—Quasi-Reorganization or Corporate Readjustment,” with a modification to permit restatement of gross paid-in and contributed surplus and unassigned funds (surplus) only in certain limited circumstances.

24. This statement adopts *Accounting Research Bulletin No. 46, Discontinuance of Dating Earned Surplus*, with modification to require disclosure of the impact of the restatement in the financial statements as long as financial statements for the period of reorganization are presented and paragraph 28 of *Accounting Principles Board Opinion No. 9, Reporting the Results of Operations*. This statement also adopts *FASB Emerging Issues Task Force No. 88-9, Put Warrants*, with a modification to reject guidance related to earnings per share.

25. This statement rejects paragraphs 1 through 11 and 13 through 24 of APB 6, *FASB Emerging Issue Task Force No. 85-1, Classifying Notes Received for Capital Stock*, and *FASB Emerging Issue Task Force No. 85-2, Classification of Costs Incurred in a Takeover Defense*.

26. This statement also rejects *Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins*, “Chapter 1, Prior Opinions,” paragraph 12 of APB 10, and *FASB Technical Bulletin No. 85-6, Accounting for a Purchase of Treasury Shares at a Price Significantly in Excess of the Current Market Price of the Shares* and the *Income Statement Classification of Costs Incurred in Defending against a Takeover Attempt*.

**Effective Date and Transition**

27. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors*.

**AUTHORITATIVE LITERATURE**

**Generally Accepted Accounting Principles**

- *Accounting Principles Board Opinion No. 6, Status of Accounting Research Bulletins*, paragraph 12
Accounting Principles Board Opinion No. 9, Reporting the Results of Operations, paragraph 28

Accounting Principles Board Opinion No. 10, Omnibus Opinion—1966, paragraphs 10 and 11

Accounting Principles Board Opinion No. 12, Omnibus Opinion—1967, paragraphs 9 and 10

FASB Statement No. 5, Accounting for Contingencies, paragraph 15

Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins, “Chapter 7, Capital Accounts, Section A—Quasi-Reorganization or Corporate Readjustment”

Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins, “Chapter 7, Capital Accounts, Section B—Stock Dividends and Stock Split-ups,” paragraphs 1 through 4 and 10 through 16

Accounting Research Bulletin No. 46, Discontinuance of Dating Earned Surplus

FASB Emerging Issues Task Force No. 88-9, Put Warrants

RELEVANT ISSUE PAPERS

Issue Paper No. 72—Statutory Surplus

Issue Paper No. 84—Quasi-reorganizations
Statement of Statutory Accounting Principles No. 73

Health Care Delivery Assets - Supplies, Pharmaceuticals and Surgical Supplies, Durable Medical Equipment, Furniture, Medical Equipment and Fixtures, and Leasehold Improvements in Health Care Facilities

STATUS

Type of Issue: Health Entities

Issued: Initial Draft

Effective Date: January 1, 2001

Affects: No other pronouncements

Affected by: Paragraph 10 superseded by SSAP No. 87

Interpreted by: No other pronouncements

SCOPE OF STATEMENT

SUMMARY CONCLUSION

Relevant Literature

Effective Date and Transition

RELEVANT ISSUE PAPERS
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Health Care Delivery Assets - Supplies, Pharmaceuticals and Surgical Supplies, Durable Medical Equipment, Furniture, Medical Equipment and Fixtures, and Leasehold Improvements in Health Care Facilities

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for health care delivery assets - supplies, pharmaceuticals and surgical supplies, durable medical equipment, furniture, medical equipment and fixtures and leasehold improvements.

SUMMARY CONCLUSION

2. This statement applies only to reporting entities which directly provide health care services to subscribers, members or policyholders. Such providers acquire and retain assets commonly referred to as “health care delivery assets” used in connection with the direct delivery of health care services in facilities owned or operated by the reporting entity and include supplies, pharmaceuticals and surgical supplies, durable medical equipment, furniture, medical equipment and fixtures and leasehold improvements in health care facilities.

3. Furniture, medical equipment and fixtures used in connection with the direct provision of health care services include diagnostic equipment, laboratory equipment, patient monitoring equipment, hospital beds, examining tables, and operating room equipment.

4. Supplies, pharmaceuticals and surgical supplies, durable medical equipment, furniture, medical equipment and fixtures, and leasehold improvements in health care facilities owned or operated by the reporting entity meet the definition of assets established in SSAP No. 4—Assets and Nonadmitted Assets (SSAP No. 4). Pharmaceuticals and surgical supplies, and durable medical equipment held by reporting entities and used for the direct delivery of health care services are assets which are used to fulfill policyholder obligations within the meaning of SSAP No. 4 and are admitted assets to the extent that they conform to the requirements of this statement. Furniture, medical equipment and fixtures, and leasehold improvements held by health reporting entities and used for the direct delivery of health care services are admitted assets to the extent that they conform to the requirements of this statement. Furniture, fixtures and equipment, and leasehold improvements which are not used in the direct delivery of health care (e.g., for administrative activities including claims processing, billing, and maintenance of medical records) are nonadmitted assets and are addressed in SSAP No. 19—Furniture, Fixtures and Equipment; Leasehold Improvements Paid by the Reporting Entity as Lessee; Depreciation of Property and Amortization of Leasehold Improvements (SSAP No. 19).

5. The reporting entity shall maintain a control system that provides for identification of quantities on hand and appropriate valuation (lower of cost or market) of supplies, pharmaceuticals and surgical supplies, and durable medical equipment.

6. Supplies except for pharmaceuticals and surgical supplies discussed in paragraph 7 (e.g., linens, uniforms and garments, food and other commodities, and housekeeping, maintenance, and office supplies) shall be nonadmitted assets.

7. Pharmaceutical and surgical supplies (e.g. drugs, surgical items (such as implants), and medical dressings) used directly in the treatment of medical conditions shall be admitted assets.

8. Durable medical equipment includes consumable or salable equipment such as wheelchairs, crutches, braces, that is generally classified as inventory, and is of a nature that it may be reused. Subscribers, members or policyholders may utilize durable medical equipment on a temporary
basis and later return the equipment to the provider. The provider shall recognize the diminution in value, if any, as a result of use of such equipment.

9. Furniture, medical equipment and fixtures, and leasehold improvements shall be depreciated over their estimated useful lives but for a period not to exceed three years, except for a leasehold improvement which shall be amortized against net income over the shorter of its estimated useful life or the remaining life of the original lease excluding renewal or option periods, using methods detailed in SSAP No. 19.

10. In accordance with the reporting entity’s capitalization policy, immaterial amounts of medical supplies, pharmaceuticals and surgical supplies, durable medical equipment, furniture, medical equipment and fixtures, and leasehold improvements may be expensed when purchased.

Relevant Literature

11. This statement rejects the AICPA Audit and Accounting Guide: Health Care Organizations.

Effective Date and Transition

12. This statement is effective for years beginning January 1, 2001. 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—Accounting Changes and Corrections of Errors.

13. Medical supplies, pharmaceuticals and surgical supplies, durable medical equipment, furniture, medical equipment and fixtures, and leasehold improvements capitalized prior to January 1, 2001 shall be depreciated over the shorter of its remaining useful life or three years.

RELEVANT ISSUE PAPERS

- Issue Paper No. 100 - Health Care Delivery Assets - Supplies, Pharmaceuticals and Surgical Supplies, and Durable Medical Equipment
- Issue Paper No. 101 - Health Care Delivery Assets - Furniture, Medical Equipment and Fixtures, and Leasehold Improvements in Health Care Facilities
Statement of Statutory Accounting Principles No. 74

Accounting for the Issuance of Insurance-Linked Securities Issued by a Property and Casualty Insurer through a Protected Cell

STATUS

Type of Issue: Property and Casualty
Issued: Finalized September 12, 2000
Effective Date: January 1, 2001
Affects: No other pronouncements
Affected by: No other pronouncements
Interpreted by: No other pronouncements
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Accounting for the Issuance of Insurance-Linked Securities Issued by a Property and Casualty Insurer through a Protected Cell

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for the issuance of insurance-linked securities issued by a property and casualty insurer through a protected cell. This statement applies to property and casualty contracts as defined in SSAP No. 50—Classifications and Definitions of Insurance or Managed Care Contracts In Force (SSAP No. 50).

SUMMARY CONCLUSION

2. An insurance-linked security can be issued by the insurer through a protected cell for purchase by investors. A protected cell is retained within the insurance or reinsurance company and is used to insulate the proceeds of the securities offering from the general business risks of the insurer, granting an additional comfort level for investors of the securitized instrument. The insurance exposures that have been securitized by the insurance-linked securities are attributed to the protected cell.

3. Under the terms of the security, the principal may be paid to the investor on a specified maturity date, with interest, unless a trigger event occurs. The proceeds of the security offering will collateralize (i) the issuer’s obligation under an insurance or reinsurance agreement if a trigger event occurs and (ii) the issuer’s obligation to repay the security if a trigger event does not occur.

4. If the trigger event takes place before a specified date, the issuer is relieved of some or its entire obligation to repay the securityholders, and the investor incurs a loss of some or all of its investment. The security must be issued with an indemnity trigger.

5. In an insurance-linked security, the insurer that originated the transaction has hedged its portfolio of insurance risks by transferring certain of those risks to the securityholders. Should the triggering event occur, the issuer would incur a loss that would be partly offset by the amount of liability to securityholders from which it is relieved. This statement provides statutory accounting guidance solely for indemnity triggered insurance securitization transactions conducted through a protected cell.

Accounting for Prefunded Insurance-Linked Securities for Business Attributed to the Protected Cell from the General Account

General Account Reporting

6. Activities such as sales, underwriting and contract administration, premium collection and payment of premium taxes, and claims processing are activities of the insurance company distinct from the protected cell and shall be accounted for as transactions of the general account.

7. Amounts paid to the protected cell for underwriting risks, which ultimately will be securitized by the protected cell, shall be reported separately as a reduction of written and earned premiums in the current period general account’s statement of income. This premium is earned by the general account in accordance with SSAP No. 53—Property Casualty Contracts—Premiums (SSAP No. 53).

8. At the maturity of the protected cell all assets and liabilities of the protected cell are distributed based on the contractual agreement with the securityholders. If after this distribution assets still reside in the protected cell, these assets shall be attributed to the general account and recognized as an adjustment to surplus.
9. Insurance claim liabilities arising from past insurable events attributed to the protected cell account from the general account shall be accounted for as retroactive reinsurance as prescribed in SSAP No. 62—Property and Casualty Reinsurance (SSAP No. 62).

10. General account recoverables from the protected cell as a result of an indemnity based securitized event, shall be recognized separately as a reduction of gross losses and loss expenses incurred in the current period general account’s statement of income. General account recoverables from the protected cell on unpaid reported and incurred but not reported losses and loss adjustment expenses shall be netted against the liability for gross losses and loss adjustment expenses in the general account’s balance sheet. Recoverables from the protected cell shall not exceed the assets carried at fair value in the protected cell.

11. The general account shall include an aggregate write-in for the total assets and an aggregate write-in for liabilities of any protected cell which it maintains. Transfers to the general account due or accrued shall be reported on a net basis so that the asset and the liability totals of the general account are not overstated.

Protected Cell Reporting

12. The protected cell annual statement is concerned with the investment activities and obligations relating to insurance-linked securities attributed to that protected cell. As a result, the protected cell statement shall report only the financial activities of the protected cell and shall not include general account expenses related to insurance activities which are recorded for in the general account.

13. The protected cell shall record premium income for transactions attributed to it by the general account as income reported in the protected cell's statement of income. This premium attribution is earned by the protected cell in accordance with SSAP No. 53.

14. The obligation from the issuance of the insurance-linked security is recorded as Funds Held Under Securitization Agreement, a liability on the protected cell balance sheet which is reported at its contractual value which will be the lower of the scheduled amount to be repaid to investors or the fair value of the investments in the protected cell. All protected cell assets shall be reported at fair value. Interest expenses payable to securityholders associated with the protected cell investment operations shall be deducted in the determination of net operating income of the cell. Net investment income and realized capital gains and losses relating to the investment operations of the protected cell are recorded as net investment income. Payables to the general account shall not exceed the assets carried at fair value in the protected cell.

15. Changes in both (i) the fair value of the protected cell invested assets and (ii) the protected cell contractual value of liabilities to investors shall be reported as an unrealized gain/loss in the equity section of the protected cell balance sheet.

16. If the trigger event occurs with respect to the underlying exposures attributed to the protected cell, the protected cell shall record the appropriate incurred losses in its current period statement of income. Correspondingly, the Funds Held Under Securitization Agreement shall be reduced and offset by gross losses incurred in the current period Statement of Income. The applicable funds to cover the subject exposure are then attributed to the general account via a balance sheet account, “Due to/from the General Account.”

17. If the trigger event does not take place on or before the contractual maturity date, the protected cell repays the security as prescribed in the debt contract by reducing Funds Held Under Securitization Agreement.
Disclosures

General Account

18. The general account shall reflect all activities with its protected cells as an aggregate write-in in its statutory balance sheet and income statement. The general account shall also disclose in its notes to the financial statements the types and amounts of exposures /risks attributed to each of its protected cells.

Protected Cells

19. Each protected cell of a protected cell company shall prepare and submit to all states where the protected cell company is licensed and the NAIC the following supplemental financial information:

   a. Balance Sheet
   b. Income Statement
   c. Statement of Cash Flows
   d. Investment Schedules as typically required for a property/casualty insurer
   e. Schedule P

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

Relevant Literature

21. This statement only contemplates transactions with an indemnity-based trigger, as such they would be excluded from FAS No. 133, Accounting for Derivative Instruments and Hedging Activities.

Effective Date and Transition

22. This statement is effective for years beginning January 1, 2001. Changes resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with SSAP No. 3—Accounting Changes and Corrections of Errors (SSAP No. 3).

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

None

RELEVANT ISSUE PAPER

- Issue Paper No. 103 - Accounting for the Issuance of Insurance-Linked Securities Issued by a Property and Casualty Insurer through a Protected Cell
Fully funded

With respect to any exposure attributed to a protected cell, the fair value of the protected cell assets, on the date on which the insurance securitization is effected, equals or exceeds the maximum possible exposure attributable to the protected cell with respect to such exposures.

General account

The assets and liabilities of a protected cell company other than protected cell assets and protected cell liabilities.

Indemnity trigger

A transaction term by which relief of the issuer’s obligation to repay investors is triggered by its incurring a specified level of losses under its insurance or reinsurance contracts.

Fair value

See GLOSSARY to the Statements of Statutory Accounting Principles

Protected cell

An identified pool of assets and liabilities of a protected cell company segregated and insulated by means of this Act from the remainder of the protected cell company’s assets and liabilities.

Protected cell account

A specifically identified bank or custodial account established by a protected cell company for the purpose of segregating the protected cell assets of one protected cell from the protected cell assets of other protected cells and from the assets of the protected cell company’s general account.

Protected cell assets

All assets, contract rights and general intangibles, identified with and attributable to a specific protected cell of a protected cell company.

Protected cell company

A domestic insurer that has one or more protected cells.

Protected cell company insurance securitization

The issuance of debt instruments, the proceeds from which support the exposures attributed to the protected cell, by a protected cell company where repayment of principal or interest, or both, to investors pursuant to the transaction terms is contingent upon the occurrence or nonoccurrence of

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1Definitions in this glossary were adapted from the Protected Cell Company Model Act as adopted by the Insurance Securitization Working Group of the Financial Condition (E) Committee in 1999. These definitions are not intended to change the meaning of any terms used elsewhere in the Accounting Practices and Procedures Manual, and should only be used in the context of SSAP No. 74.
an event with respect to which the protected cell company is exposed to loss under insurance or reinsurance contracts it has issued.

**Protected cell liabilities**

All liabilities and other obligations identified with and attributable to a specific protected cell of a protected cell company.
Statement of Statutory Accounting Principles No. 75

Reinsurance Deposit Accounting - An Amendment to SSAP No. 62, Property and Casualty Reinsurance

STATUS

Type of Issue: Property and Casualty
Issued: Finalized December 4, 2000
Effective Date: January 1, 2001
Affects: Supersedes paragraph 34 of SSAP No. 62
Affected by: No other pronouncements
Interpreted by: No other pronouncements
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Reinsurance Deposit Accounting - An Amendment to SSAP No. 62, Property and Casualty Reinsurance

SCOPE OF STATEMENT

1. This statement provides statutory accounting principles for reinsurance contracts that do not transfer both components of insurance risk (underwriting risk and timing risk).

SUMMARY CONCLUSION

2. This statement supersedes paragraph 34 of SSAP No. 62—Property and Casualty Reinsurance (SSAP No. 62). The following guidance shall be followed when reinsurance contracts do not transfer both components of insurance risk.

3. To the extent that a reinsurance agreement does not, despite its form, transfer both components of insurance risk, all or part of the agreement shall be accounted for and reported as deposits in the following manner:

   a. At the outset of the reinsurance agreement, the net consideration paid by the ceding entity (premiums less commissions or other allowances) shall be recorded as a deposit by the ceding company and as a liability by the assuming entity. The deposit shall be reported as an admitted asset by the ceding company if (i) the assuming company is licensed, accredited or otherwise qualified in the ceding company’s state of domicile as described in Appendix A-785 or (ii) there are funds held by or on behalf of the ceding company which meet the requirements of paragraph 16 of Appendix A-785;

   b. At subsequent reporting dates, the amount of the deposit/liability shall be adjusted by calculating the effective yield on the deposit agreement to reflect actual payments to date (receipts and disbursements shall be recorded through the deposit/liability accounts) and expected future payments (as discussed below), with a corresponding credit or charge to interest income or interest expense;

   c. The calculation of the effective yield shall use the estimated amount and timing of cash flows. If a change in the actual or estimated timing or amount of cash flows occurs, the effective yield shall be recalculated to reflect the revised actual or estimated cash flows. The deposit shall be adjusted to the amount that would have existed at the reporting date had the new effective yield been applied since the inception of the reinsurance agreement. Changes in the carrying amount of the deposit asset/liability resulting from changes in the effective yield shall be recorded as interest income or interest expense;

   d. It shall be assumed that any cash transactions for the settlement of losses will reduce the asset/liability accounts by the amount of the cash transferred. When the remaining losses are revalued upward, an increase in the deposit liability shall be recorded as interest expense – by the assuming company. Conversely, the ceding company shall increase its deposit (asset) with an offsetting credit to interest income; and increase its outstanding loss liability with an offsetting charge to incurred losses;

   e. No deduction shall be made from the loss and loss adjustment expense reserves on the ceding company’s Statement of Financial Position, schedules, and exhibits;

   f. The assuming company shall record net consideration to be returned to the ceding company as a liability.
Disclosures

4. The financial statements shall disclose the following with respect to reinsurance agreements that have been accounted for as deposits:
   a. A description of the reinsurance agreements.
   b. Any adjustment of the amounts initially recognized for expected recoveries. The individual components of the adjustment (e.g., interest accrual, change due to a change in estimated or actual cash flow) shall be disclosed separately.

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

Relevant Literature

6. This statement adopts American Institute of Certified Public Accountants (AICPA) Statement of Position 98-7, Deposit Accounting: Accounting for Insurance and Reinsurance Contracts That Do Not Transfer Insurance Risk (SOP 98-7) paragraphs 10 to 12 and 19 (subsection b only). This statement rejects AICPA SOP 98-7 paragraphs 13 to 17 and 19 (subsections a and c).

Effective Date and Transition

7. This statement is effective for years beginning January 1, 2001. Changes resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with SSAP No. 3—Accounting Changes and Corrections of Errors.

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

- AICPA Statement of Position 98-7, Deposit Accounting: Accounting for Insurance and Reinsurance Contracts That Do Not Transfer Insurance Risk

RELEVANT ISSUE PAPER

- Issue Paper No. 104 - Reinsurance Deposit Accounting – An Amendment to SSAP No. 62—Property and Casualty Reinsurance
SSAP NO. 75 – EXHIBIT A

Illustration of a Reinsurance Contract That Is Accounted for as a Deposit using the Interest Method

Assumptions:

- Premium = $1,000 (assumes no commissions or allowances)
- Coverage Period = 1 year
- Initial expected recoveries = $225 per year (at end of year) for five years
- Initial Implicit rate = 4 percent*

*present value of $225 per year for five years at 4 percent = $1,000

At the end of Year 2, the timing of anticipated recoveries under the reinsurance contract changes. A reevaluation of the implicit interest rate produces a rate of 3.63 percent and an asset of $640 at the end of the year.

<table>
<thead>
<tr>
<th>Description</th>
<th>Interest Income</th>
<th>Cash Recoveries</th>
<th>Deposit Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initial payment</td>
<td></td>
<td></td>
<td>$1,000</td>
</tr>
<tr>
<td>Year 1 (4%)</td>
<td>$ 40</td>
<td>$ (225)</td>
<td>$1,040</td>
</tr>
<tr>
<td>End of Year 1</td>
<td></td>
<td></td>
<td>$ 815</td>
</tr>
<tr>
<td>Year 2 (4 %)</td>
<td>$ 33</td>
<td></td>
<td>$ 848</td>
</tr>
<tr>
<td>End of Year 2</td>
<td></td>
<td>$ (200)</td>
<td>$ 648</td>
</tr>
<tr>
<td>Yield adjustment</td>
<td>$ (8)</td>
<td></td>
<td>$ 640</td>
</tr>
<tr>
<td>Year 3 (3.63 %)</td>
<td>$ 23</td>
<td></td>
<td>$ 663</td>
</tr>
<tr>
<td>End of Year 3</td>
<td></td>
<td>$ (175)</td>
<td>$ 488</td>
</tr>
<tr>
<td>Year 4 (3.63 %)</td>
<td>$ 18</td>
<td></td>
<td>$ 506</td>
</tr>
<tr>
<td>End of Year 4</td>
<td></td>
<td>$ (175)</td>
<td>$ 331</td>
</tr>
<tr>
<td>Year 5 (3.63 %)</td>
<td>$ 12</td>
<td></td>
<td>$ 343</td>
</tr>
<tr>
<td>End of Year 5</td>
<td></td>
<td>$ (175)</td>
<td>$ 168</td>
</tr>
<tr>
<td>Year 6 (3.63 %)</td>
<td>$ 7</td>
<td></td>
<td>$ 175</td>
</tr>
<tr>
<td>End of Year 6</td>
<td></td>
<td>$ (175)</td>
<td>$ 0</td>
</tr>
</tbody>
</table>

At the inception of the contract, the ceding insurer records a deposit asset of $1,000 and the assuming company, a $1,000 deposit liability. The asset is admitted providing the conditions for credit for reinsurance are met.

At subsequent reporting dates, the deposit asset is adjusted by calculating the effective yield on the reinsurance agreement to reflect actual payments to date and expected future payments with a corresponding credit to interest income by the ceding company and interest expense by the assuming company.

At the end of year two, it is determined that the expected cash flows will differ from previous estimates, resulting in a lower effective yield on the deposit asset. The deposit asset is adjusted to the amount that would have existed at the reporting date had the new effective yield been applied from the inception of the reinsurance agreement. The adjustment is charged to interest income, i.e., as a reduction of interest income. Interest income during the remaining term of the agreement is reduced accordingly (i.e., the yield is reduced from 4.0% to 3.63%).
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Statement of Statutory Accounting Principles No. 76

Reporting on the Costs of Start-Up Activities

STATUS

Type of Issue: Common

Issued: Finalized December 4, 2000

Effective Date: January 1, 2002

Affects: No other pronouncements

Affected by: No other pronouncements

Interpreted by: No other pronouncements

SCOPE OF STATEMENT

SUMMARY CONCLUSION

Disclosures

Relevant Literature

Effective Date and Transition

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

RELEVANT ISSUE PAPER
Reporting on the Costs of Start-Up Activities

SCOPE OF STATEMENT

1. This statement addresses start-up costs. In practice, various terms are used to refer to start-up costs, such as pre-opening, pre-operating, and organization costs. For purpose of this statement, these costs are referred to as start-up costs.

SUMMARY CONCLUSION

2. Costs of start-up activities, including activities related to organizing a new entity (commonly referred to as organization costs), shall be expensed as incurred. Start-up activities are defined broadly as those one-time activities related to: (1) opening a new facility; (2) introducing a new product or service; (3) conducting business in a new territory; (4) conducting business with a new class of customer or beneficiary; (5) initiating a new process in an existing facility; or (6) commencing some new operation.

Disclosures

3. Cost of start-up activities incurred in an accounting period shall be disclosed in the annual audited statutory financial report only.

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

Relevant Literature

5. This statement adopts American Institute of Certified Public Accountants (AICPA) Statement of Position SOP 98-5, Reporting on the Costs of Start-Up Activities (SOP 98-5), which requires costs of start-up activities and organization costs to be expensed as incurred. This statement is consistent with SSAP No. 17—Preoperating and Research and Development Costs (SSAP No. 17).

Effective Date and Transition

6. This statement is effective for years beginning January 1, 2002. Adoption as of January 1, 2001 is encouraged but not required. Changes resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with SSAP No. 3—Accounting Changes and Corrections of Errors (SSAP No. 3).

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

- AICPA Statement of Position 98-5, Reporting on the Costs of Start-Up Activities

RELEVANT ISSUE PAPER

- Issue Paper No. 105—Reporting on the Costs of Start-Up Activities
Statement of Statutory Accounting Principles No. 77

Real Estate Sales – An Amendment to SSAP No. 40, Real Estate Investments

STATUS

Type of Issue: Common

Issued: Finalized December 4, 2000

Effective Date: January 1, 2002

Affects: Supersedes paragraphs 16 and 17 of SSAP No. 40

Affected by: No other pronouncements

Interpreted by: No other pronouncements

SCOPE OF STATEMENT

SUMMARY CONCLUSION

Relevant Literature

Effective Date and Transition

AUTHORIZED LITERATURE

Generally Accepted Accounting Principles

RELEVANT ISSUE PAPER
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Real Estate Sales – An Amendment to SSAP No. 40, Real Estate Investments

SCOPE OF STATEMENT

1. This statement addresses the accounting for real estate sales.

SUMMARY CONCLUSION

2. This statement supersedes paragraphs 16 and 17 of SSAP No. 40—Real Estate Investments (SSAP No. 40). The guidance outlined in paragraphs 3 through 5 of this statement shall be followed when accounting for the sales of real estate.

3. Recognition of profit on sales of real estate investments shall be accounted for in accordance with FASB Statement No. 66, Accounting for Sales of Real Estate (FAS 66), except as modified in paragraph 5 of this statement, FASB Emerging Issues Task Force No. 87-9, Profit Recognition on Sales of Real Estate with Insured Mortgages or Surety Bonds, FASB Emerging Issues Task Force No. 87-29, Exchange of Real Estate Involving Boot, FASB Interpretation No. 43, Real Estate Sales an interpretation of FASB Statement No. 66 (FIN 43) and FASB Emerging Issues Task Force 00-13, Determining Whether Equipment is “Integral Equipment” Subject to FASB Statements No. 66 and No. 98. This statement applies to all sales of real estate including real estate with property improvements or integral equipment. The terms “property improvements” and “integral equipment” refer to any physical structure or equipment attached to the real estate that cannot be removed and used separately without incurring significant costs, such as an office building.

4. Profit shall be recognized in full when real estate is sold, provided (a) the profit is determinable, that is, the collectibility of the sales price is reasonably assured or the amount that will not be collectible can be estimated, and (b) the earnings process is virtually complete, that is, the seller is not obliged to perform significant activities after the sale to earn the profit. Unless both conditions exist, recognition of all or part of the profit shall be postponed. Profit shall not be recognized by the full accrual method until all of the following criteria are met:

   a. A sale is consummated;
   b. The buyer’s initial and continuing investments are adequate to demonstrate a commitment to pay for the property;
   c. The seller’s receivable is not subject to future subordination; and
   d. The seller has transferred to the buyer the usual risks and rewards of ownership in a transaction that is in substance a sale and does not have a substantial continuing involvement with the property after the sale.

5. The calculation of the buyer’s initial investment specified in paragraph 9 of FAS 66 shall be modified to reflect that buyer’s notes must be supported by letters of credit from institutions that are listed by the Securities Valuation Office of the National Association of Insurance Commissioners as meeting credit standards to be included in determining the buyer’s initial investment. Any profit or loss is considered a realized gain or loss in the year of the sale in accordance with FAS 66.

Relevant Literature

6. This statement adopts FIN 43, which clarifies that the phrase “all real estate sales” includes sales of real estate with property improvements or integral equipment that cannot be removed and used separately from the real estate without incurring significant costs. This is consistent with SSAP No. 40. This statement also adopts and FASB Emerging Issues Task Force 00-13, Determining Whether
Equipment is “Integral Equipment” Subject to FASB Statements No. 66 and No. 98 which clarifies the term “integral equipment” as used in this statement.

Effective Date and Transition

7. This statement is effective for years beginning January 1, 2002. Adoption as of January 1, 2001 is encouraged but not required. Changes resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with SSAP No. 3—Accounting Changes and Corrections of Errors (SSAP No. 3).

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

- FASB Interpretation No. 43, Real Estate Sales an interpretation of FASB Statement No. 66
- FASB Emerging Issues Task Force 00-13, Determining Whether Equipment is “Integral Equipment” Subject to FASB Statements No. 66 and No. 98

RELEVANT ISSUE PAPER

- Issue Paper No. 106 - Real Estate Sales – An Amendment to SSAP No. 40, Real Estate Investments
Statement of Statutory Accounting Principles No. 78

Multiple Peril Crop Insurance

STATUS

Type of Issue: Property and Casualty

Issued: Finalized December 4, 2000

Effective Date: January 1, 2001

Affects: No other pronouncements

Affected by: No other pronouncements

Interpreted by: No other pronouncements

SCOPE OF STATEMENT

SUMMARY CONCLUSION

Introduction

Premium Recognition

Amounts Receivable or Payable

Unpaid Losses and Loss Adjustment Expenses

Administrative Expense Payment

Escrow Account

Effective Date

RELEVANT ISSUE PAPER

SSAP NO. 78 – EXHIBIT A - ILLUSTRATION OF CEDED PREMIUMS AND LOSSES
Multiple Peril Crop Insurance

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for Multiple Peril Crop Insurance (MPCI). This statement also establishes statutory accounting principles for the Aquatic Crop Reinsurance Agreement (hereinafter included in the term MPCI).

SUMMARY CONCLUSION

Introduction

2. Farming has always been an inherently risky enterprise because farmers operate at the mercy of nature and frequently are subjected to weather-related perils such as droughts, floods, hurricanes, and other natural disasters. Since the 1930s, many farmers have been able to transfer part of the risk of loss in production to the federal government through the subsidized MPCI program administered by the Federal Crop Insurance Corporation (FCIC), an agency of the United States Department of Agriculture. Major legislation enacted in 1980 and 1994 restructured the MPCI program. The 1980 legislation enlisted, for the first time, private insurance companies to sell, service, and share the risk of MPCI insurance policies. Subsequently, in 1994, the Federal Crop Insurance Reform and Department of Agriculture Reorganization Act revised the program to offer farmers two primary levels of insurance coverage, catastrophic and buy-up.

3. Catastrophic insurance is designed to provide farmers with protection against extreme crop losses for a small processing fee. Buy-up insurance provides protection against more typical and smaller crop losses in exchange for a policyholder-paid premium. The government subsidizes the total premium for catastrophic insurance and a portion of the premium for buy-up insurance. Farmers who purchase buy-up crop insurance must choose both the coverage level (the proportion of the crop to be insured) and the unit price (such as, per bushel) at which any loss is calculated. With respect to the coverage level of production, farmers can choose to insure as much as 85 percent of normal production or as little as 50 percent of normal production at different price levels. With respect to the unit price, farmers choose whether to value their insured production at FCICs full estimated market price or at a percentage of the full price.

4. In recent years, FCIC has introduced a new risk management tool called revenue insurance. Unlike traditional crop insurance, which insures against losses in the level of crop production, revenue insurance plans insure against losses in revenue. The plans protect the farmer from the effects of declines in crop prices or declines in crop yields, or both. Like traditional buy-up insurance, the government subsidizes a portion of the premiums. One of the plans, called Crop Revenue Coverage, is available in many states for major crops. Two other plans, called Income Protection and Revenue Assurance, are available to farmers in only limited areas.

5. Companies participate in the MPCI program with FCIC through the Standard Reinsurance Agreement (SRA) per the terms of which the insurance companies share in the underwriting results of each policy. The SRA reinsurance terms provide a company the flexibility to limit its exposure on a state by state basis. MPCI premium is not expense loaded, therefore FCIC pays the insurance companies, on behalf of the policyholder, a percent of premium for administrative expenses associated with selling and servicing crop insurance policies, including the expenses associated with adjusting claims.

6. The FCIC utilizes an escrow account to distribute or collect additional funds. Premium (collected from the policyholders and the federal government subsidy) is deposited in the escrow account and is available to pay the claims arising under the program.
Premium Recognition

7. MPCI gross premium is defined as the contractually determined amount specified by FCIC to the policyholder for the effective period of the contract based on the actuarially determined expectation of risk and policy benefits associated with the coverage provided by the terms of the insurance contract. In addition, gross premium shall also include the government premium subsidy paid on behalf of the policyholder.

8. MPCI ceded premium and losses are defined as the amount calculated by applying the proportional and non-proportional factors as stated in the SRA. An example of this application is shown in Exhibit A to this statement.

9. MPCI written premium shall be recorded as soon as an estimate can be made, but no later than the processing date. Upon recording written premium, a liability for the unearned premium reserve shall be established to reflect the amount of premium for the portion of the insurance coverage that has not yet expired. Premiums shall be recognized as revenue over the period of risk in proportion to the amount of insurance protection provided.

10. The company shall disclose the method used to compute the unearned premium reserve in the financial statements.

Amounts Receivable or Payable

11. The company shares underwriting risk with FCIC and can earn or lose money according to the claims it must pay farmers for crop losses. The company earns underwriting profits when the net retained premiums exceed the net crop loss claims paid. The company incurs underwriting losses when the net claims paid for crop losses exceed the net retained premiums. These definitions do not consider underwriting expenses, which would be included for traditional statutory accounting underwriting gains and losses. The use of the terms underwriting gains and losses in this issue paper are unique to the MPCI program. As the premiums of the program are held by FCIC in escrow, the company shall recognize as a write-in asset a receivable from FCIC for the amount of the underwriting gain (as defined in this paragraph). Whereas, when the company is in an underwriting loss position, the company shall recognize a write-in liability to the FCIC for the amount of the underwriting loss (as defined in this paragraph), as the monies held in the escrow account are not sufficient to cover the company’s claims. In accordance with the SRA, funds that remain in escrow will be distributed to the company at the conclusion of the contract period if the contract results in a gain to the company. If the company owes additional funds to the escrow (i.e., it is in a loss position), those funds are remitted on a periodic basis until the contract expires. These amounts shall be recorded net as the program meets the requirements of offsetting as defined in SSAP No. 64—Offsetting and Netting of Assets and Liabilities (SSAP No. 64). In accordance with SSAP No. 21—Other Admitted Assets (SSAP No. 21), the amount receivable under the Federal Crop Insurance program shall be reported as an admitted asset.

12. Amounts receivable from policyholders meet the definition of an admitted asset as set forth in SSAP No. 4—Assets and Nonadmitted Assets (SSAP No. 4) and should be accounted for in accordance with SSAP No. 6—Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers (SSAP No. 6). The due date shall be governed by contractual due date of the premium billing, and not the effective date of the contract.

Unpaid Losses and Loss Adjustment Expenses

13. In accordance with SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses (SSAP No. 55), losses and loss adjustment expenses shall be recognized as expense when a covered or insured event occurs.
14. The covered or insured event is the occurrence of an incident which gives rise to a claim or the incurring of costs. Claim payments and related expense payments are made subsequent to the occurrence of a covered or insured event and, in order to recognize the expense of a covered or insured event, it is necessary to establish a liability. The following are the types of future costs relating to the MPCI program:

   a. Reported Losses: Expected payments for losses relating to insured events that have occurred and have been reported to, but not paid by, the insurer as of the statement date;

   b. Incurred But Not Reported Losses, (IBNR): Expected payments for losses relating to insured events that have occurred but have not been reported to the insurer as of the statement date;

   c. Loss Adjustment Expenses: Costs expected to be incurred in connection with the adjustment and recording of losses defined in subparagraphs 14a. and 14b. of this statement.

Administrative Expense Payment

15. FCIC pays the insurance companies a percent of premium for administrative expenses associated with selling and servicing crop insurance policies, including the expenses associated with adjusting claims. The expense payment associated with the catastrophic coverage shall be recorded as a reduction of loss expenses whereas the expense payment for the buy-up coverage shall be recorded as a reduction of other underwriting expenses. The company shall disclose the total amounts received for each type of coverage.

Escrow Account

16. The escrow account shall not be recorded on the financial statements of the insurance company. This account is considered an FCIC account and as such is not owned by the insurance company, however, the company’s underwriting gain is reflected as a receivable in accordance with paragraph 13.

Effective Date

17. This statement is effective for SRA contracts entered into on or after January 1, 2001. 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—Accounting Changes and Correction of Errors (SSAP No. 3).

RELEVANT ISSUE PAPER

- Issue Paper No. 108 - Multiple Peril Crop Insurance
### SSAP NO. 78 – EXHIBIT A - ILLUSTRATION OF CEDED PREMIUMS AND LOSSES

#### NOTES TO THE ILLUSTRATION

<table>
<thead>
<tr>
<th>Column</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fund</td>
<td>The reinsurance fund specified in the Standard Reinsurance Agreement (SRA).</td>
</tr>
<tr>
<td>Column 1</td>
<td>Reinsured Company proportional reinsurance retention percentage.</td>
</tr>
<tr>
<td>Column 2</td>
<td>Gross Written Premium equals the insured paid premium amount plus premium subsidy provided by FCIC.</td>
</tr>
<tr>
<td>Column 3</td>
<td>Net Retained Premium is the Reinsured Company retained premium after proportional reinsurance. Gross Written Premium (Column 2) times the Reinsured Company retention percentage (Column 1).</td>
</tr>
<tr>
<td>Column 4</td>
<td>Proportional Ceded Premium is the premium retained by FCIC after proportional reinsurance. Gross Written Premium (Column 2) minus the Reinsured Company Net Retained Premium (Column 3).</td>
</tr>
<tr>
<td>Column 5</td>
<td>Reinsured Company proportional reinsurance retention percentage (Column 1).</td>
</tr>
<tr>
<td>Column 6</td>
<td>Gross Losses equals total claim payments to insured.</td>
</tr>
<tr>
<td>Column 7</td>
<td>Net Retained Losses are the Reinsured Company retained losses after proportional reinsurance. Gross Losses (Column 6) times the Reinsured Company retention percentage (Column 5).</td>
</tr>
<tr>
<td>Column 8</td>
<td>Proportional Ceded Losses are the losses retained by FCIC after proportional reinsurance. Gross Losses (Column 6) minus the Reinsured Company Net Retained Losses (Column 7).</td>
</tr>
<tr>
<td>Column 9</td>
<td>Retained Loss Ratio is the Reinsured Company's Net Retained Losses (Column 7) divided by the Reinsured Company's Net Retained Premium (Column 3).</td>
</tr>
<tr>
<td>Column 10</td>
<td>Underwriting (Gain)/Loss is the Reinsured Company share of the MPCI program gain or loss after calculating the non-proportional reinsurance provided in the SRA.</td>
</tr>
<tr>
<td>Column 11</td>
<td>Non-Proportional Ceded Premium is equal to the Reinsured Company Net Retained Premium (Column 3) minus Net Retained Losses (Column 7) minus an Underwriting (Gain) (Column 10) if one exists. This is FCIC's share of the underwriting gain after proportional reinsurance, based on the non-proportional reinsurance gain sharing factors specified in the SRA.</td>
</tr>
<tr>
<td>Column 12</td>
<td>Non-Proportional Ceded Losses is equal to the Reinsured Company Net Retained Premium (Column 3) minus Net Retained Losses (Column 7) minus an Underwriting Loss (Column 10) if one exists. This is FCIC's share of the underwriting loss after proportional reinsurance, based on the non-proportional reinsurance loss sharing factors specified in the SRA.</td>
</tr>
<tr>
<td>Column 13</td>
<td>Final Retained Premium is equal to the Reinsured Company Net Retained Premium (Column 3) minus the Non-Proportional Ceded Premium (Column 11). The Reinsured Company Net Retained Premium after proportional reinsurance is reduced by the amount of FCIC’s underwriting gain share after non-proportional reinsurance.</td>
</tr>
</tbody>
</table>
Column 14  Final Retained Losses is equal to the Reinsured Company Net Retained Premium (Column 3) minus the Non-Proportional Ceded Losses (Column 12). The Reinsured Company Net Retained Losses after proportional reinsurance are reduced by the amount of FCIC's underwriting loss share after non-proportional reinsurance.

Column 15  Final Retained Loss Ratio is equal to Final Retained Losses divided by Final Retained Premium.

(a) Calculated based on the loss ratios for each fund by state. Net Retained Premium (Col 3) is applied to the percentages of Section II. C. and D. of the Standard Reinsurance Agreement.

(b) If the fund is in a GAIN position then there would be Non-proportional ceded premium. If the fund is in a LOSS position then there would be Non-proportional ceded losses.

Since each fund and state stands alone in the calculations, there is a possibility of Non-proportional ceded premium AND ceded losses within the same reinsurance year. There is also the possibility of this within the same fund (some states with a Gain and some states with a Loss).
### SSAP NO. 78 – EXHIBIT A - ILLUSTRATION OF CEDED PREMIUMS AND LOSSES

<table>
<thead>
<tr>
<th>FUND</th>
<th>Retention %</th>
<th>Gross Written Premium</th>
<th>Net Retained Premium (Col 2 x Col 1)</th>
<th>Proportional Ceded Premium (Col 2 - Col 3)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assigned Risk</td>
<td>20%</td>
<td>20,000,000</td>
<td>4,000,000</td>
<td>16,000,000</td>
</tr>
<tr>
<td>Developmental</td>
<td>35%</td>
<td>10,000,000</td>
<td>3,500,000</td>
<td>6,500,000</td>
</tr>
<tr>
<td>Dev - CRC</td>
<td>35%</td>
<td>5,000,000</td>
<td>1,750,000</td>
<td>3,250,000</td>
</tr>
<tr>
<td>Dev - CAT</td>
<td>35%</td>
<td>5,000,000</td>
<td>1,750,000</td>
<td>3,250,000</td>
</tr>
<tr>
<td>Commercial</td>
<td>100%</td>
<td>100,000,000</td>
<td>100,000,000</td>
<td>0</td>
</tr>
<tr>
<td>Comm - CRC</td>
<td>100%</td>
<td>20,000,000</td>
<td>20,000,000</td>
<td>0</td>
</tr>
<tr>
<td>Comm - CAT</td>
<td>100%</td>
<td>40,000,000</td>
<td>40,000,000</td>
<td>0</td>
</tr>
<tr>
<td>Total Premium</td>
<td></td>
<td>200,000,000</td>
<td>171,000,000</td>
<td>29,000,000</td>
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<th>Fund</th>
<th>Retention %</th>
<th>Gross Losses</th>
<th>Net Retained Losses (Col 6 x Col 5)</th>
<th>Proportional Ceded Losses (Col 6 - Col 7)</th>
<th>Retained Loss Ratio (Col 7/Col 3)</th>
<th>Underwriting (Gain)Loss (a)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assigned Risk</td>
<td>20%</td>
<td>40,000,000</td>
<td>8,000,000</td>
<td>32,000,000</td>
<td>200.0%</td>
<td>184,000</td>
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<tr>
<td>Developmental</td>
<td>35%</td>
<td>16,000,000</td>
<td>5,600,000</td>
<td>10,400,000</td>
<td>160.0%</td>
<td>525,000</td>
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<td>Dev - CRC</td>
<td>35%</td>
<td>7,000,000</td>
<td>2,450,000</td>
<td>4,550,000</td>
<td>140.0%</td>
<td>210,000</td>
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<tr>
<td>Dev - CAT</td>
<td>35%</td>
<td>4,000,000</td>
<td>1,400,000</td>
<td>2,600,000</td>
<td>80.0%</td>
<td>(157,500)</td>
</tr>
<tr>
<td>Commercial</td>
<td>100%</td>
<td>80,000,000</td>
<td>80,000,000</td>
<td>0</td>
<td>80.0%</td>
<td>(18,800,000)</td>
</tr>
<tr>
<td>Comm - CRC</td>
<td>100%</td>
<td>18,000,000</td>
<td>18,000,000</td>
<td>0</td>
<td>90.0%</td>
<td>(1,880,000)</td>
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<tr>
<td>Comm - CAT</td>
<td>100%</td>
<td>22,000,000</td>
<td>22,000,000</td>
<td>0</td>
<td>55.0%</td>
<td>(12,500,000)</td>
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<tr>
<td>Total Losses</td>
<td></td>
<td>187,000,000</td>
<td>137,450,000</td>
<td>49,550,000</td>
<td>80.4%</td>
<td>(32,418,500)</td>
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<table>
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<th>Fund</th>
<th>Non-Proportional Ceded Premium (Col 3 - Col 7 - Col 10 &quot;Gain&quot;)</th>
<th>Non-Proportional Ceded Losses (Col 3 - Col 7 + Col 10 &quot;Loss&quot;)</th>
<th>Final Retained Premium (Col 3 - Col 11)</th>
<th>Final Retained Losses (Col 7 - Col 12)</th>
<th>Final Retained Loss Ratio (Col 14/Col 13)</th>
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<tbody>
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<td>Dev - CAT</td>
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<td>Commercial</td>
<td>1,200,000</td>
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<td>98,800,000</td>
<td>80,000,000</td>
<td>81.0%</td>
</tr>
<tr>
<td>Comm - CRC</td>
<td>120,000</td>
<td>0</td>
<td>19,880,000</td>
<td>18,000,000</td>
<td>90.5%</td>
</tr>
<tr>
<td>Comm - CAT</td>
<td>5,500,000</td>
<td>0</td>
<td>34,500,000</td>
<td>22,000,000</td>
<td>63.8%</td>
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<tr>
<td>Total</td>
<td>7,012,500</td>
<td>5,881,000</td>
<td>163,987,500</td>
<td>131,569,000</td>
<td>80.2%</td>
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Statement of Statutory Accounting Principles No. 79

Depreciation of Nonoperating System Software – An Amendment to SSAP No. 16—Electronic Data Processing Equipment and Software

STATUS

Type of Issue: Common Area

Issued: Finalized December 4, 2000

Effective Date: January 1, 2001

Affects: Supersedes paragraphs 3 and 8 of SSAP No. 16

Affected by: Paragraph 4 superseded by SSAP No. 87

Interpreted by: INT 01-18, INT 01-21

STATUS .............................................................................................................................

SCOPE OF STATEMENT ........................................................................................................3

SUMMARY CONCLUSION ......................................................................................................3

Effective Date and Transition .............................................................................................3

RELEVANT ISSUE PAPER ..................................................................................................3
Depreciation of Nonoperating System Software – An Amendment to SSAP No. 16—Electronic Data Processing Equipment and Software

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for the depreciation of EDP equipment, operating system software and nonoperating system software.

SUMMARY CONCLUSION

2. This statement supersedes paragraphs 3 and 8 of SSAP No. 16. The guidelines outlined in paragraphs 3 through 5 of this statement shall be followed for depreciation of EDP equipment, operating system software and nonoperating system software.

3. EDP equipment and operating system software shall be depreciated over the lesser of its useful life or three years. Nonoperating system software shall be depreciated over the lesser of its useful life or five years. In either case, the methods detailed in SSAP No. 19—Furniture, Fixtures and Equipment; Leasehold Improvements Paid by the Reporting Entity as Lessee; Depreciation of Property and Amortization of Leasehold Improvements (SSAP No. 19) shall be used.

4. In accordance with the reporting entity’s capitalization policy, immaterial amounts may be expensed when purchased, otherwise the assets shall be capitalized and depreciated in accordance with this statement.

Effective Date and Transition

5. This statement is effective for years beginning January 1, 2001. EDP equipment and operating system software capitalized prior to January 1, 2001 shall be depreciated over the lesser of its remaining useful life or three years. Nonoperating system software capitalized prior to January 1, 2001 shall be depreciated over the lesser of its remaining useful life or five years.

RELEVANT ISSUE PAPER

- Issue Paper No. 109 - Depreciation of Nonoperating System Software – An Amendment to SSAP No. 16—Electronic Data Processing Equipment and Software
Statement of Statutory Accounting Principles No. 80

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

STATUS

Type of Issue: Life and Accident and Health

Issued: Finalized December 4, 2000

Effective Date: January 1, 2001

Affects: Supersedes paragraph 43 of SSAP No. 51
          Supersedes paragraph 19 of SSAP No. 52
          Supersedes paragraphs 26 and 33 of SSAP No. 56

Affected by: No other pronouncements

Interpreted by: No other pronouncements

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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

SCOPE OF STATEMENT

1. This statement amends SSAP No. 51, SSAP No. 52 and SSAP No. 56 to incorporate the guidance included in appendices A-200, A-695 and A-830.

SUMMARY CONCLUSION

2. 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.

3. 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.

4. 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.

5. This statement amends paragraph 43 of SSAP No. 51 to the following:

6. This statement amends paragraph 19 of SSAP No. 52 to the following:

7. This statement amends the first sentence of paragraph 26 of SSAP No. 56 to the following:

8. This statement amends paragraph 33 of SSAP No. 56 to the following:

Effective Date

9. 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.
RELEVANT ISSUE PAPER

- 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
Statement of Statutory Accounting Principles No. 81

Software Revenue Recognition

STATUS

Type of Issue: Common Area
Issued: Finalized March 26, 2001
Effective Date: January 1, 2002
Affects: No other pronouncements
Affected by: No other pronouncements
Interpreted by: No other pronouncements

SCOPE OF STATEMENT

SUMMARY CONCLUSION

Effective Date and Transition

AUTHORITATIVE LITERATURE

RELEVANT ISSUE PAPER

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Software Revenue Recognition

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for recognition of revenue from software.

SUMMARY CONCLUSION

2. This statement adopts AICPA Statement of Position 97-2, Software Revenue Recognition paragraphs 6 through 91 with certain modifications; AICPA Statement of Position 98-9, Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions paragraphs 6 through 8; and FASB Emerging Issues Task Force 00-3, Application of AICPA Statement of Position 97-2 to Arrangements That Include the Right to Use Software Stored on Another Entity's Hardware in its entirety. This statement rejects AICPA Statement of Position 98-4, Deferral of the Effective Date of a Provision of SOP 97-2, Software Revenue Recognition as not applicable because the effective date is inconsistent with this statement.

3. The modifications to SOP 97-2 are as follows:
   a. Paragraph 10 is amended to require that entities follow the guidance outlined in SSAP No. 5—Liabilities, Contingencies and Impairments of Assets rather than Statement of Financial Accounting Standard (FAS) No. 5, Accounting for Contingencies;
   b. Paragraph 33 is amended to remove the reference to Technical Bulletin No. 79-10, Fiscal Funding Clauses in Lease Agreements;
   c. Paragraph 57 is amended to remove the reference to FAS No. 86, Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed;
   d. Paragraph 73 is rejected as not applicable to statutory accounting.

Effective Date and Transition

4. This statement is effective for years beginning January 1, 2002. Early adoption is encouraged but not required. Any change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with SSAP No. 3—Accounting Changes and Corrections of Errors.

AUTHORITATIVE LITERATURE

• AICPA Statement of Position 97-2, Software Revenue Recognition
• AICPA Statement of Position 98-4, Deferral of the Effective Date of a Provision of SOP 97-2, Software Revenue Recognition
• AICPA Statement of Position 98-9, Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions
• FASB Emerging Issues Task Force 00-3, Application of AICPA Statement of Position 97-2 to Arrangements That Include the Right to Use Software Stored on Another Entity's Hardware

RELEVANT ISSUE PAPER

• Issue Paper No. 111—Software Revenue Recognition
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Statement of Statutory Accounting Principles No. 82

Accounting for the Costs of Computer Software Developed or Obtained for Internal Use and Web Site Development Costs

STATUS
Type of Issue: Common Area
Issued: Finalized March 26, 2001
Effective Date: January 1, 2002
Affects: No other pronouncements
Affected by: Paragraph 4 superseded by SSAP No. 87
Interpreted by: No other pronouncements

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Accounting for the Costs of Computer Software Developed or Obtained for Internal Use and Web Site Development Costs

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for the costs of computer software developed or obtained for internal use and web site development costs.

SUMMARY CONCLUSION

2. This statement adopts AICPA Statement of Position 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use (SOP 98-1) paragraphs 11 through 42 and paragraph 93 with certain modifications. This statement adopts FASB Emerging Issue Task Force 00-2, Accounting for Web Site Development Costs in its entirety.

3. The modifications to SOP 98-1 are as follows:

   a. Paragraph 11 states that the accounting for costs of reengineering activities, which often are associated with new or upgraded software applications, is not included within the scope of this SOP. This statement expands upon that paragraph to require that such costs shall be expensed as incurred;

   b. Paragraph 32 is amended to require that entities who license internal-use computer software follow the operating lease provisions outlined in SSAP No. 22—Leases;

   c. Paragraph 36 is amended to require that entities follow the amortization guidelines as established in paragraph 9 of SSAP No. 19—Furniture, Fixtures and Equipment; Leasehold Improvements Paid by the Reporting Entity as Lessee; Depreciation of Property and Amortization of Leasehold Improvements;

   d. Paragraph 37 is amended to require that capitalized operating system software shall be depreciated for a period not to exceed three years. Capitalized nonoperating system software shall be depreciated for a period not to exceed five years. This treatment is consistent with the guidelines of SSAP No. 16—Electronic Data Processing Equipment and Software (SSAP No. 16) and SSAP No. 79—Depreciation of Nonoperating System Software – An Amendment to SSAP No. 16, Electronic Data Processing Equipment and Software;

   e. Paragraph 40 is amended to require that if during the development of internal-use software, an entity decides to market the software to others, the entity shall immediately expense any amounts previously capitalized;

   f. Paragraph 41 is amended to require entities to follow the disclosure provisions outlined in paragraph 5 of SSAP No. 16 and paragraph 4 of SSAP No. 17—Preoperating and Research and Development Costs;

   g. Paragraph 42 is amended to require an effective date of January 1, 2002; and

   h. Any software costs capitalized in accordance with this SSAP shall be deemed either operating or nonoperating system software costs. Entities shall make this determination in accordance with the definitions of operating and nonoperating system software contained...
in the Glossary. Nonoperating system software is a nonadmitted asset in accordance with SSAP No. 16.

4. In accordance with the reporting entity’s capitalization policy, immaterial amounts of such costs can be expensed when incurred.

Effective Date and Transition

5. This statement is effective for years beginning January 1, 2002. Early adoption is encouraged but not required. Any change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with SSAP No. 3—Accounting Changes and Corrections of Errors.

AUTHORITATIVE LITERATURE

- AICPA Statement of Position 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use
- FASB Emerging Issue Task Force 00-2, Accounting for Web Site Development Costs

RELEVANT ISSUE PAPER

- Issue Paper No. 112—Accounting for the Costs of Computer Software Developed or Obtained for Internal Use and Web Site Development Costs
Statement of Statutory Accounting Principles No. 83

Mezzanine Real Estate Loans

STATUS

Type of Issue: Common Area
Issued: Finalized October 16, 2001
Effective Date: December 31, 2001
Affects: No other pronouncements
Affected by: No other pronouncements
Interpreted by: No other pronouncements

SCOPE OF STATEMENT

SUMMARY CONCLUSION

Disclosures
Effective Date and Transition
AUTHORITATIVE LITERATURE
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Mezzanine Real Estate Loans

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for Mezzanine Real Estate Loans (MREL). An MREL is a loan secured by a pledge of direct or indirect equity interests in an entity that owns real estate (the “real estate owner”). The real estate owner is typically the borrower under a mortgage loan secured by the same real estate. The MREL borrower (“mezz borrower”) may be the real estate owner or one or more of the holder(s) of the direct or indirect equity interest(s) in the real estate owner. As used herein, “direct equity interests” means the then issued and outstanding shares or units of partnership, membership or other beneficial interests in the real estate owner, and “indirect equity interests” means the then issued and outstanding shares or units of partnership, membership or other beneficial interests in a member, partner, shareholder or other holder of direct equity interests in the real estate owner.

SUMMARY CONCLUSION

2. For statutory accounting purposes, a MREL shall be defined as a debt obligation, that is not a security, which is secured by a pledge of equity interest in an entity that owns real estate. (A security is a share, participation, or other interest in property or in an enterprise of the issuer or an obligation of the issuer that:
   a. Either is represented by an instrument issued in bearer or registered form, or if not represented by an instrument, is registered in books maintained to record transfers by or on behalf of the issuer;
   b. Is of a type commonly dealt in on securities exchanges or markets or, when represented by an instrument, is commonly recognized in any area in which it is issued or dealt in as a medium for investment; and
   c. Either is one of a class or series or by its terms is divisible into a class or series of shares, participations, interests, or obligations).

3. MREL’s meet the definition of assets as specified in SSAP No. 4—Assets and Nonadmitted Assets and are admitted assets to the extent they conform to the requirements of this statement.

4. Reporting entities holding MREL’s shall follow the accounting, reporting and disclosure requirements defined within SSAP No. 37—Mortgage Loans (SSAP No. 37).

5. In order for a MREL to qualify as an admitted asset, the MREL agreement (the agreement) shall:
   a. Require that each pledgor abstain from granting additional security interests in the equity interest pledged; and
   b. In addition to satisfaction of the requirements set forth in paragraphs c and d below, the MREL lender shall employ techniques to minimize the likelihood or impact of a bankruptcy filing on the part of the real estate owner and, if different, on the part of the mezz borrower. These techniques may include (by way of example and not limitation) one or more of the following: (i) separateness covenants, (ii) cash management techniques, (iii) exceptions to the non-recourse provisions for damages arising out of the mezz borrower’s failure to comply with covenants prohibiting additional debt, transfers of the real estate, transfers of pledged interests, and violation of the single asset/single purpose covenants, (iv) full recourse liability in the event of a bankruptcy filing on the...
part of the real estate owner and, if different, on the part of the mezz borrower, and (v) loan guaranties; and

The selection of techniques that are applied in the instance of any particular MREL to achieve said purposes requires an exercise of judgement by the MREL lender. The reasonableness of the techniques utilized in any particular MREL will be assessed in light of the credit characteristics of the MREL borrower, any guarantors and the underlying real estate at the time of origination. Utilizing this standard provides flexibility to the MREL lender and provides a basis for the regulator and auditor in analyzing the reasonableness of the judgement of the MREL lender; and

c. The real estate owner and, if different, the mezz borrower shall:

i. Hold no assets other than, in the case of the real estate owner, the real property, and in the case of the mezz borrower (if different), the equity interest in the real estate owner;

ii. Not engage in any business other than, in the case of the real estate owner, the ownership and operation of the real estate, and in the case of the mezz borrower (if different), holding an ownership interest in the real estate owner; and

iii. Not incur additional debt, other than limited trade payables, a first mortgage loan (in the case of the real estate owner), and the MREL (in the case of the mezz borrower, if different).

d. At the time of the initial investment, the MREL lender shall corroborate that the sum of the first mortgage and the MREL does not exceed 100% of the value of the real estate as evidenced by a current appraisal. Acceptable appraisal methods are described in paragraph 11 of SSAP No. 40—Real Estate Investments.

Disclosures

6. The financial statements shall disclose, as applicable, the requirements of SSAP No. 37 paragraphs 20, 21 and 22. The MREL lender shall report in Appendix A-001 to its annual statement the amount and percentages of its total admitted assets held in MREL and the largest three investments held in MREL except that such detail shall not be required for assets held in MREL totaling less than 2.5% of its total admitted assets.

Effective Date and Transition

7. This statement is effective for years ending on and after December 31, 2001. Any change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with SSAP No. 3—Accounting Changes and Corrections of Errors.

AUTHORITATIVE LITERATURE

- FASB Statement No. 60, Accounting and Reporting by Insurance Enterprises
- FASB Statement No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases
- FASB Statement No. 114, Accounting by Creditors for Impairment of a Loan
Mezzanine Real Estate Loans
SSAP No. 83

- FASB Statement No. 118, Accounting by Creditors for Impairment of a Loan - Income Recognition and Disclosures, an amendment of FASB Statement No. 114

- FASB Emerging Issues Task Force Issue No. 84-19, Mortgage Loan Payment Modifications

- FASB Emerging Issues Task Force Issue 88-17, Accounting for Fees and Costs Associated with Loan Syndications and Loan Participations

- AICPA Practice Bulletin 6, Amortization of Discounts on Certain Acquired Loans

RELEVANT ISSUE PAPER

- Issue Paper No. 113—Mezzanine Real Estate Loans
Certain Health Care Receivables and Receivables Under Government Insured Plans

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for pharmaceutical rebate receivables, claim overpayment receivables, loans and advances to providers who do not meet the definition of related parties, capitation arrangement receivables, risk sharing receivables, and amounts receivable under government insured plans.

SUMMARY CONCLUSION

Overview

2. Pharmaceutical rebates are arrangements between pharmaceutical companies and reporting entities in which the reporting entities receive rebates based upon the drug utilization of its subscribers at participating pharmacies. These rebates are sometimes recorded as receivables by reporting entities using estimates based upon historical trends which should be adjusted to reflect significant variables involved in the calculation, such as number of prescriptions written/filled, type of drugs prescribed, use of generic vs. brand-name drugs, etc. In other cases, the reporting entity determines the amount of the rebate due based on the actual use of various prescription drugs during the accumulation period and then bills the pharmaceutical company. Oftentimes, a pharmacy benefits management company may determine the amount of the rebate based on a listing (of prescription drugs filled) prepared for the reporting entity’s review. The reporting entity will confirm the listing and the pharmaceutical rebate receivable.

3. Claim overpayments may occur as a result of several events, including but not limited to claim payments made in error to a provider. Reporting entities often establish receivables for claim overpayments.

4. A health entity may make loans or advances to large hospitals or other providers. Such loans or advances are supported by legally enforceable contracts and are generally entered into at the request of the provider. In many cases, loans or advances are paid monthly and are intended to represent one month of fee-for-service claims activity with the respective provider.

5. A capitation arrangement is a compensation plan used in connection with some managed care contracts in which a physician or other medical provider is paid a flat amount, usually on a monthly basis, for each subscriber who has elected to use that physician or medical provider. In some instances, advances are made to a provider under a capitation arrangement in anticipation of future services.

6. Risk sharing agreements are contracts between reporting entities and providers with a risk sharing element based upon utilization. The compensation payments for risk sharing agreements are typically estimated monthly and settled annually. These agreements can result in receivables due from the providers if annual utilization is different than that used in estimating the monthly compensation.

7. The definition and accounting treatment for nonadmitted assets is outlined in paragraph 3 of SSAP No. 4—Assets and Nonadmitted Assets (SSAP No. 4) as amended by SSAP No. 87—Capitalization Policy, an Amendment to SSAP Nos. 4, 19, 29, 73, 79 and 82 as follows:

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

a. Specifically identified within the Accounting Practices and Procedures Manual as a nonadmitted asset; or


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

8. Pharmaceutical rebate receivables, claim overpayment receivables, loans and advances to providers, capitation arrangement receivables, risk sharing receivables, and amounts receivable under government insured plans meet the definition of assets as set forth in SSAP No. 4, and are admitted assets to the extent that the requirements for admission defined in this statement are met.

9. This statement shall not be considered an all-inclusive list of health care receivables. Certain health care receivables are addressed in other statements. Health care receivable assets not addressed in other statements or this statement are nonadmitted assets.

Pharmaceutical Rebate Receivables

10. Pharmaceutical rebate receivables consist of reasonably estimated amounts and billed amounts. Both the billed amount and the estimated amount shall be admitted assets subject to the conditions specified below:

a. Estimated amounts shall be related solely to actual prescriptions filled during the 3 months immediately preceding the reporting date;

b. Billed amounts represent pharmaceutical rebate receivables that have been invoiced or confirmed in writing but not collected as of the reporting date. Billed amounts for an estimated amount under paragraph 10 a. above shall be admitted only if the determination of the rebate, based on actual prescriptions filled, occurs and is invoiced or confirmed in writing within the 2 months following the reporting date of the estimated amount. Adjustments to previously billed amounts related to prior periods shall be nonadmitted until invoiced or confirmed in writing. Pharmaceutical rebates that have not been collected within 90 days of the invoice date or confirmation date shall be nonadmitted. Furthermore, if accrued pharmaceutical rebate receivables are not invoiced or confirmed in writing in accordance with the contract provisions, the accrual shall be nonadmitted; and

c. Evaluation of the collectibility of pharmaceutical rebate receivables shall be made periodically. If in accordance with SSAP No. 5—Liabilities, Contingencies and Impairments of Assets (SSAP No. 5), it is probable the balance is uncollectible, any uncollectible receivable shall be written off and charged to income in the period the determination is made.

11. The method used to reasonably estimate the receivable shall be consistent from period to period and shall be adjusted periodically for any changes in the underlying pharmaceutical rebate contract
provisions. The financial statements shall disclose information regarding the reporting entity’s pharmaceutical rebates in accordance with paragraph 24 of this statement.

12. Income from pharmaceutical rebates of insured plans shall be reported as a reduction to claims expense on the summary of operations.

13. Receivable and payable balances related to uncollected pharmaceutical rebates of uninsured plans shall be recorded on the financial statements of the reporting entity. Any pharmaceutical rebates earned by the reporting entity that are in excess of the amounts to be remitted to the uninsured plan pursuant to an administrative services agreement shall be determined consistent with the requirements of paragraphs 10 and 11 and shall be reported on the balance sheet as an amount receivable relating to uninsured accident and health plans, and as a reduction to general expenses on the statement of operations.

Claim Overpayment Receivables

14. A claim overpayment shall not be recorded as a receivable until invoiced. To the extent that the claim overpayment meets the setoff conditions in SSAP No. 64—Offsetting and Netting of Assets and Liabilities (SSAP No. 64) and the overpayment is a specific identifiable payment and not an estimate, the receivable may be admitted up to the amount of the payable to the provider for reported claims (i.e., excluding incurred but not reported claims). The receivable and payable shall be reported gross rather than netted on the balance sheet. Evaluation of the collectibility of claim overpayment receivables shall be made periodically. If in accordance with SSAP No. 5, it is probable the balance is uncollectible, any uncollectible receivable shall be written off and charged to income in the period the determination is made. Amounts in excess of that written off that do not meet the right of offset conditions shall be nonadmitted as they are not available to satisfy policyholder obligations.

Loans and Advances to Providers

15. Loans or advances to providers who meet the definition of related parties in SSAP No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties shall follow the guidance in that statement. To the extent a loan or advance to a non-related party provider meets the setoff conditions in SSAP No. 64, the loan or advance may be admitted up to the amount of the payable to the provider for reported claims (i.e., excluding incurred but not reported claims).

16. In addition, a loan or advance to a non-related party hospital shall be admitted up to the amount of claims incurred and payable to the hospital if all of the following conditions are met:
   a. The loan or advance meets the setoff conditions in SSAP No. 64;
   b. The loan or advance is supported by a legally enforceable contract;
   c. The loan or advance is administered pursuant to contractual terms;
   d. The contractual terms of the agreement provide for separate quarterly reconciliations;
   e. Each quarterly reconciliation shall be completed within nine months of the end of such quarter; and
   f. A quarterly reconciled difference shall be settled within 90 days of the date the reconciliation is completed.

17. If a quarterly reconciliation is not performed or settled in accordance with paragraphs 16 e. and 16 f. above, all assets for loans or advances to that hospital shall be nonadmitted.
18. The receivable and payable shall be reported gross rather than netted on the balance sheet. Evaluation of the collectibility of loans and advances to providers shall be made periodically. If in accordance with SSAP No. 5, it is probable the balance is uncollectible, any uncollectible receivable shall be written off and charged to income in the period the determination is made. Amounts in excess of that written off that do not meet the right of offset conditions shall be nonadmitted as they are not available to satisfy policyholder obligations.

**Capitation Arrangement Receivables**

19. Advances to providers under capitation arrangements that are made under the terms of an approved provider services contract in anticipation of future services shall be admitted to the extent that the advanced amount does not exceed one month of average capitation payments for the subject provider during the preceding twelve months, and provided that the contract can not be terminated before the end of the month for which the advanced amount was paid. Evaluation of the collectibility of capitation arrangement receivables shall be made periodically. If in accordance with SSAP No. 5, it is probable the balance is uncollectible, any uncollectible receivable shall be written off and charged to income in the period the determination is made.

**Risk Sharing Receivables**

20. Risk sharing receivables may consist of reasonably estimated amounts and billed amounts. Both the billed amount and the estimated amount shall be admitted assets subject to the conditions specified below:

a. Risk sharing receivables and payables shall only be recorded when reasonably estimated. Estimates of risk sharing receivables may be admitted if based on at least six months of actual claims experience for each risk sharing contract. The contractual terms of any risk sharing agreement shall provide for evaluation of the experience under the contract at least annually. The determination of the risk sharing balance shall commence no later than 6 months following the close of such annual period, and the balance shall be invoiced no later than 8 months following close of the annual period;

b. Billed amounts represent risk sharing receivables that have been invoiced but not collected as of the reporting date. Risk sharing receivables and payables shall be invoiced or refunded in accordance with the contractual provisions of the risk sharing agreement. Adjustments resulting in increases to previously billed amounts related to prior periods shall be nonadmitted until invoiced. Adjustments resulting in decreases to previously billed amounts shall be recognized immediately. Risk sharing receivables that have not been collected within 90 days of the date of billing shall be nonadmitted;

c. Risk sharing receivables and payables shall be reported gross rather than netted on the balance sheet. However, if a reporting entity has both a receivable and payable balance with the same provider and the balances meet the setoff conditions in SSAP No. 64, those balances shall be netted in accordance with SSAP No. 64; and

d. Evaluation of the collectibility of risk sharing receivables shall be made quarterly. If in accordance with SSAP No. 5, it is probable the balance is uncollectible, any uncollectible receivable shall be written off and charged to income in the period the determination is made.

21. The method used to reasonably estimate the receivable shall be consistent from period to period and shall be adjusted periodically for any changes in the underlying risk sharing contract. The financial statements shall disclose information regarding the reporting entity’s risk sharing receivables in accordance with paragraph 25 of this statement.
22. Income/expense from risk sharing contracts shall be reported as a component of claims expense on the summary of operations.

**Amounts Receivable Under Government Insured Plans**

23. Amounts receivable under government insured plans, including amounts over 90 days due, that qualify as accident and health contracts in accordance with *SSAP No. 50—Classifications and Definitions of Insurance or Managed Care Contracts in Force* shall be admitted assets. Amounts receivable under government insured plans include but are not limited to receivables under Medicare, Medicaid and similarly funded government insured plans. Evaluation of the collectibility of amounts receivable under government insured plans shall be made periodically. If in accordance with SSAP No. 5, it is probable the balance is uncollectible, any uncollectible receivable shall be written off and charged to income in the period the determination is made.

**Disclosures**

24. The financial statements shall disclose the method used by the reporting entity to estimate pharmaceutical rebate receivables. Furthermore, for the most recent three years and for each quarter therein, the reporting entity shall also disclose the following:

   a. Estimated balance of pharmacy rebate receivable as reported on the financial statements;
   b. Pharmacy rebates as invoiced or confirmed in writing; and
   c. Pharmacy rebates collected.

   An example of this disclosure is shown in Exhibit A to this statement.

25. The financial statements shall disclose the method used by the reporting entity to estimate its risk sharing receivables. If any receivable and payable balances with the same provider are netted, the reporting entity shall disclose the gross receivable and payable balances in the notes to the financial statements. Furthermore, for the most recent three years, the reporting entity shall also disclose the following:

   a. Risk sharing receivables as estimated and reported on the prior year financial statements for annual periods ending in the current year;
   b. Risk sharing receivables as estimated and reported on the financial statements for annual periods ending in the current year and the following year;
   c. Risk sharing receivables invoiced as determined after the annual period;
   d. Risk sharing receivables not yet invoiced; and
   e. Amounts collected from providers as payments under risk sharing contracts.

   An example of this disclosure is shown in Exhibit B to this statement.

**Effective Date and Transition**

26. This statement is effective for years ending on and after December 31, 2001. 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—Accounting Changes and Corrections of Errors.*
27. Prior to January 1, 2003, reporting entities may transition the invoicing provision outlined in paragraph 10 and shall invoice pharmaceutical rebates on no less than a semi-annual basis. Furthermore, prior to January 1, 2003, reporting entities may transition the 90 day admissibility provision outlined in paragraph 10 and shall nonadmit pharmaceutical rebates if such rebates have not been collected within 180 days of the billing date.

28. Prior to January 1, 2003, reporting entities may transition the invoicing provision outlined in paragraph 20 and shall invoice the risk sharing balance no later than 11 months following the close of the annual period.

RELEVANT ISSUE PAPERS

- Issue Paper No. 107—Certain Health Care Receivables and Receivables Under Government Insured Plans
EXHIBIT A – ILLUSTRATION OF PHARMACEUTICAL REBATE RECEIVABLES

(000 omitted)

<table>
<thead>
<tr>
<th>Quarter</th>
<th>Estimated Pharmacy Rebates as Reported on Financial Statements</th>
<th>Pharmacy Rebates as Invoiced/Confirmed</th>
<th>Actual Rebates Collected Within 90 Days of Invoicing/Confirmation</th>
<th>Actual Rebates Collected Within 91 to 180 Days of Invoicing/Confirmation</th>
<th>Actual Rebates Collected More Than 180 Days After Invoicing/Confirmation</th>
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<td>70</td>
<td>$55</td>
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<td>15</td>
<td>10</td>
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<td>3/31/2001</td>
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**EXHIBIT B – ILLUSTRATION OF RISK SHARING RECEIVABLES**

(000 omitted)

<table>
<thead>
<tr>
<th>Calendar Year</th>
<th>Evaluation Period Year Ending</th>
<th>Risk Sharing Receivable as Estimated and Reported in the Prior Year</th>
<th>Risk Sharing Receivable as Estimated and Reported in the Current Year</th>
<th>Risk Sharing Receivable Invoiced</th>
<th>Risk Sharing Receivable Not Invoiced</th>
<th>Actual Risk Sharing Amounts Collected in Year Invoiced</th>
<th>Actual Risk Sharing Amounts Collected First Year Subsequent</th>
<th>Actual Risk Sharing Amounts Collected Second Year Subsequent</th>
<th>Actual Risk Sharing Amounts Collected – All Other</th>
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<td>$XXX</td>
<td>XXX</td>
<td>XXX</td>
<td>XXX</td>
<td>XXX</td>
</tr>
</tbody>
</table>

If there were only one contract or if all contracts have the same experience period, then there would only be an entry in either the “Invoiced” or “Not Invoiced” column for the current year. This example assumes varying dates on experience periods for multiple contracts. Assumptions: Two risk sharing contracts are in place, one with an experience period that ends 3/31/03 and one with an experience period that ends 10/31/03.

The $155,000 receivable for the contract period that ends 3/31/03 would be invoiced no later than 11/30/03 (or 8 months following close of the contract period) and could be collected no later than 2/28/04. Therefore, the $155,000 would appear in the “Invoiced” column in 2003 but not shown as collected in 2003. Further, the $189,000 estimate for the experience period that ends 3/31/04 could be recorded on the December 31, 2003 financial statement, since there is more than six months of experience under the contract.

The contract with the experience period that ends 10/31/03 with an estimated $77,000 receivable would be invoiced by 6/30/04 and collected by 09/30/04. Therefore, it would appear in the “Not Invoiced” column and not shown as collected in 2003. However, no estimate could be reported on the December 31, 2003 financial statement for the experience period that ends 10/31/04, because there is less than six months of experience under the contract.
EXHIBIT C – IMPLEMENTATION GUIDE

The purpose of this guide is to assist regulators as well as reporting entities in the practical application of SSAP No. 84.

Pharmaceutical Rebate Receivables

1. Q: What is a reasonable method of determining receivables for estimated amounts?

   A: At any one reporting date, a reporting entity’s receivable for pharmaceutical rebates can consist of two distinct amounts: 1) an estimated amount, and 2) a billed amount (that can include adjustments to previously billed amounts). The estimated amount represents the reporting entity’s best estimate of the rebates it expects to receive for those prescriptions drugs filled during the most recent quarter, i.e. at 12/31/20X1, the estimate would relate to those prescriptions filled during the fourth quarter of 20X1. Estimated rebate amounts for prescription drugs filled in any other quarter must be nonadmitted.

   When determining its estimate, the reporting entity should use the most accurate methods possible that utilize historical information relative to pharmaceutical rebates received. The reporting entity should use methods that consider contractual changes in rebate amounts, seasonality differences, changes in membership or premium revenue, changes in utilization of drugs with varying rebate levels, etc.

2. Q: Paragraph 10 b. states “Billed amounts for an estimated amount under paragraph 10 a. above shall be admitted only if the determination of the rebate, based on actual prescriptions filled, occurs and is invoiced or confirmed in writing within the 2 months following the reporting date of the estimated amount.” What is meant by the phrase “within 2 months following the reporting date of the estimated amount?” Why does the SSAP make a distinction between those rebates that are invoiced and those that are confirmed in writing?

   A: This sentence is worded in this fashion in order to show the relationship between an estimated amount and the related billed amount. At any reporting date, a billed amount will qualify as an admitted asset only if it was invoiced or confirmed in writing within the two months following the most previously filed financial statement, or the financial statement in which the related estimate was reported. E.g., using the example in Q&A #1 above, the reporting entity could admit billed amounts for rebates attributable to prescriptions drugs filled in third quarter of 20X1, only if the rebates were invoiced or confirmed in writing no later than 11/30/20X1. Further, the billed amount must be collected by 2/28/20X2 or it will become a nonadmitted asset.

   Secondly, reporting entities typically administer their pharmaceutical benefit programs in one of two fashions, either directly or though a pharmaceutical benefit manager (PBM). The SSAP makes a distinction for these two instances. Entities that contract directly with the pharmaceutical company will invoice the pharmaceutical company for its rebates. However, for those entities that use a PBM, the SSAP requires that to admit billed amounts the reporting entity must receive reports from the PBM on a quarterly basis; the reports should provide fairly detailed information as to the number of each prescription drug filled, the rebate for each individual drug, the total amount of rebates to be received, any rebates to be received that relate to prior periods, etc. The reporting entity must then accept or “confirm” the report, and then communicate formal acceptance of the report to the PBM. Only after this occurs is the amount considered confirmed as required by the SSAP.
3. Q: What is a reasonable method of confirming a report received from our PBM?

A: The reporting entity should perform whatever verification procedures it deems necessary to provide adequate assurance that the report is accurate. These procedures might include, but are not limited to, reviewing the information required from the PBM as discussed in Q&A 2 above, verification of payments for prescription drug charges, trend testing, etc.

4. Q: Rebates relating to uninsured plans have been included in the gross receivable for pharmaceutical rebates. However, much of the amount was nonadmitted because of the requirement to bill within two months was not met. Is it still necessary to record the payable to the uninsured plan, even though the liability is essentially a pass-through?

A: Yes, the liability must still be recorded, regardless of the fact that the related asset may be nonadmitted.

5. Q: Should the disclosure in Exhibit A include rebates for both insured and uninsured business?

A: Yes, the disclosure to be included in the Notes to Financial Statements for pharmaceutical rebate receivables should include pharmaceutical rebates of insured and uninsured business. However, ultimately the reporting entity must have the ability to separately identify rebates for insured and uninsured business, given the distinct difference in treatment on the Statement of Revenue and Expenses.

6. Q: Please explain the transition period related to the invoicing of pharmaceutical rebate receivables.

A: The transition applies to all reporting periods preceding January 1, 2003, and allows transition for the invoicing and collection provisions found in paragraph 10 b. Throughout the transition period, the reporting entity may invoice (or confirm in writing) its pharmaceutical rebates semi-annually, i.e. the receivable for the estimated or billed amount may include two quarters, depending upon the invoice dates elected. However, reporting entities must still invoice or confirm in writing their rebates within 2 months of the end of each semi-annual period for the billed amount to be admitted.

For example, during the transition period B&P HMO elected to invoice its pharmaceutical rebates with semi-annual periods ending 12/31/2001 and 6/30/2002. B&Ps admitted asset for pharmaceutical rebate receivables for reporting periods ending 12/31/2001 through 3/31/2003 would be comprised of the following:

<table>
<thead>
<tr>
<th>Date</th>
<th>Estimated amounts</th>
<th>Billed amounts</th>
</tr>
</thead>
<tbody>
<tr>
<td>12/31/2001</td>
<td>third and fourth quarters of 2001</td>
<td>none</td>
</tr>
<tr>
<td>6/30/2002</td>
<td>first and second quarters of 2002</td>
<td>third and fourth quarters of 2001 if billed by 2/28/2002 (note that these billed amounts must be collected by 8/31/2002)</td>
</tr>
</tbody>
</table>
9/30/2002  Estimated amounts: third quarter of 2002
Billed amounts: first and second quarters of 2002 if billed by 8/31/2002 (these
billed amounts must be collected by 1/1/2003, the date of full implementation of
SSAP No. 84)

12/31/2002  Estimated amounts: third and fourth quarters of 2002
Billed amounts: first and second quarters of 2002 if billed by 8/31/2002 (take
note that these billed amounts must be collected by 1/1/2003, the date of full
implementation of SSAP No. 84)

Full implementation of SSAP No. 84

Billed amounts: fourth quarter of 2002 if billed by 2/28/2003

Note that this situation will result in no admitted asset allowed for the billed amount related to the
third quarter of 2002, given that the requirements of the SSAP are fully effective on 1/1/2003.
B&P should consider invoicing its rebates as required by the SSAP prior to the close of the
transition period to avoid this situation.

7. Q:  How much historical data is required in the pharmaceutical rebates disclosure in 2001 and 2002?

A:  Reporting entities should include as much information as possible when completing this
disclosure in 2001 and 2002. Be aware that in 2001 and 2002, this disclosure will be included under
Note 20, Other Items. In 2003, this disclosure will be a separate note.

8. Q:  Should the disclosure include rebates invoiced or confirmed in writing that relate to prior periods?

A:  Yes. The disclosure should include all rebates invoiced or confirmed in writing during the
respective quarter, whether such rebates relate to the most recently invoiced quarter or any quarter
preceding that.

Illustrative timeline of SSAP No. 84 requirements relative to pharmaceutical rebate receivables, assuming
a financial statement date of 12/31/20X1:

<table>
<thead>
<tr>
<th>6/30/20X1</th>
<th>7/31/20X1</th>
<th>8/31/20X1</th>
<th>9/30/20X1</th>
<th>10/31/20X1</th>
<th>11/30/20X1*</th>
<th>12/31/20X1</th>
<th>1/31/20X2</th>
<th>2/28/20X2</th>
</tr>
</thead>
</table>

- Billed amounts may be admitted
- Billing Period
- Collection period for Billed amounts
- Estimated amounts may be admitted

* Billed amounts are an admitted asset on the 12/31/20X1 financial statement if invoiced or confirmed in writing by 11/30/20X1.
Illustrative timeline of SSAP No. 84 transition guidance as related to pharmaceutical rebate receivables, assuming a financial statement date of 6/30/2002 and that the reporting entity has elected to invoice/confirm in writing its rebates at 12/31/2001 and 6/30/2002:

Loans and Advances to Providers

9. Q: Why was a distinction made between loans and advances to providers and loans and advances to hospitals?

A: This distinction was made to recognize the unique nature of certain arrangements between reporting entities and hospitals, whereby the participating hospitals are loaned and advanced amounts monthly or quarterly. Such arrangements oftentimes result in lower charges to the reporting entity and work to the benefit of the reporting entity.

10. Q: With regard to the phrase “a loan or advance to a non-related party hospital shall be admitted up to the amount of claims incurred and payable to the hospital,” what does this mean? Does this require that the IBNR valuation be performed for each hospital in which funds are loaned or advanced?

A: In a situation in which amounts are loaned/advanced to a hospital, as the hospital provides services and reports such to the reporting entity, the costs of such services are applied against the outstanding loan. Also applied against the loan is the reporting entity’s estimate of the amount of services provided but not yet reported, i.e. IBNR. The remaining portion of the loan represents the receivable subject to the requirements of the SSAP.

In determining the amount of claims incurred and payable to a particular hospital, the reporting entity should use the most accurate method available. In most instances an IBNR calculation would be the most accurate method of determining this amount.

11. Q: Please explain the reconciliation requirements in paragraph 16 d. and 16 e. related to loans and advances to hospitals.

A: While loans and advances to hospitals are typically paid monthly, the SSAP requires that such balances be reconciled at least quarterly on a per-hospital basis. The SSAP further requires that each quarter’s account be reconciled within nine months of the end of that quarter, i.e. the reconciliation for the quarter ending 3/31/20X1 must be completed by 12/31/20X1.
Therefore, at 12/31/20X1, a reporting entity can have four quarters of loans and advances in its receivable: three quarters worth of unreconciled amounts and one quarter that has been reconciled but not settled.

12. Q: If amounts are loaned or advanced to a hospital but the reconciliation requirements of paragraph 16 are not met, must these amounts be nonadmitted?

A: Not necessarily. In this event, the guidance in paragraph 15 can be followed to determine admissibility, in that the loan or advance may be admitted up to the amount of the payable to the provider for reported claims.

Risk Sharing Receivables

13. Q: The SSAP allows for the classification of certain estimates of risk sharing receivables as admitted assets. In what instances may estimates be admitted, and what is a reasonable method of determining receivables for estimated amounts?

A: At any reporting date, a reporting entity’s receivable for any one risk sharing arrangement can consist of two amounts: 1) an estimated amount, and 2) a billed amount (that can include adjustments to previously billed amounts). An estimate can be admitted only if at least six months have passed since the commencement of the annual experience period. The estimated amount represents the reporting entity’s best estimate of the receivable related to the contract period from inception to the reporting date.

When determining its estimate, the reporting entity should use the most accurate methods possible that utilize inception-to-date encounter data relative to outpatient surgery encounters, hospital days, etc. If the reporting entity cannot reasonably estimate its risk sharing receivables, then such amounts must be nonadmitted.

14. Q: The SSAP requires that the determination of the risk share balance begin within six months from the end of the annual experience period, and further requires that the final amount must be invoiced no later than eight months following the close of such period. Must data accumulation stop with month six? Can the reporting entity utilize experience data from months seven and eight in its calculation?

A: The reporting entity should use as much experience data as possible within the 8-month invoicing requirement of paragraph 20 a. This requirement was included to ensure that reporting entities are being proactive when determining risk share balances but was in no way intended to limit the amount of experience data considered.

15. Q: Describe a situation when a receivable and payable would exist with the same provider under a risk sharing arrangement?

A: This could happen 1) if the risk share arrangement requires separate risk sharing for each line of business, for certain large groups, etc. or 2) where two contract/evaluation periods under a risk-sharing arrangement are involved.

16. Q: Please explain the transition period related to the invoicing of risk sharing receivables.

A: The transition applies to all reporting periods preceding January 1, 2003, and allows transition for the invoicing provision found in paragraph 20. Throughout the transition period, the reporting entity may invoice its risk sharing receivables within 11 months of the end of the contract period, i.e.
11/30/20X2 for a risk sharing contract with an annual period ending 12/31/20X1. Therefore, during the transition period estimated amounts may be admitted for an additional three-month time period, i.e. from 7/1/20X1 through 11/30/20X2.

17. Q: The disclosure for risk sharing receivables seems confusing. Please explain what should be included in columns three through six that address estimated and billed/invoiced balances.

A: The third column from the left contains the heading “Risk Sharing Receivable as Estimated and Reported in the Prior Year.” This column should reflect the amount of risk sharing receivables as determined in the prior year and reported as admitted assets on the prior year’s financial statement. Therefore, there will never be information reported for the year subsequent to the year in question, as contracts with evaluation periods ending in the following year cannot have risk sharing receivables recorded in the previous year.

The fourth column, “Risk Sharing Receivable as Estimated and Reported in the Current Year,” should contain the admitted amounts of risk sharing receivables on the current year’s financial statement. These amounts should be segregated between those agreements with contract periods ending in the current year and those ending in the following year.

The fifth column from the left contains the heading “Risk Sharing Receivable Invoiced” and will contain the amount of risk sharing receivables invoiced during the designated year, regardless of whether such are outstanding as of the financial statement date.

The sixth column, reflecting the heading “Risk Sharing Receivable Not Invoiced,” should contain the current year-end receivable balance for agreements which qualify for estimation under paragraph 20 b., i.e. the contract has been in effect for at least six months but no amounts have been invoiced. Note that a particular reporting entity might not have any estimated receivables, if that entity’s risk sharing contracts have not been in effect for at least six months.

Be aware that in 2001 and 2002, this disclosure will be included under Note 20, Other Items. In 2003, this disclosure will be a separate note.

Illustrative timeline of SSAP No. 84 requirements relative to risk sharing receivables, assuming the reporting entity has one risk sharing agreement in place with an effective date of 1/1/20X1:

Illustrative timeline of SSAP No. 84 transition guidance as related to risk sharing receivables, assuming the reporting entity has one risk sharing agreement in place with an effective date of 1/1/2001:
Statement of Statutory Accounting Principles No. 85

Claim Adjustment Expenses, Amendments to SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses

STATUS

Type of Issue: Life and Accident and Health
Issued: Finalized June 10, 2002
Effective Date: January 1, 2003
Affects: Supersedes paragraphs 6 c. and 7 b. of SSAP No. 55
Affected by: No other pronouncements
Interpreted by: No other pronouncements

SCOPE OF STATEMENT

SUMMARY CONCLUSION

Effective Date and Transition

RELEVANT ISSUE PAPERS
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Claim Adjustment Expenses, Amendments to SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses

SCOPE OF STATEMENT

1. This statement addresses the accounting for claim adjustment expenses on accident and health contracts.

SUMMARY CONCLUSION

2. This statement supersedes paragraphs 6 c. and 7 b. of SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses (SSAP No. 55). The guidance outlined in paragraphs 3 through 6 of this statement shall be followed when accounting for claim adjustment expenses of accident and health contracts and managed care contracts.

3. Claim Adjustment Expenses for Accident and Health Reporting Entities are those costs expected to be incurred in connection with the adjustment and recording of accident and health claims defined in subparagraphs 6 a. and 6 b. of SSAP No. 55. Further, Claim Adjustment Expenses for Managed Care Reporting Entities are those costs expected to be incurred in connection with the adjustment and recording of managed care claims defined in subparagraph 7 a. of SSAP No. 55. Certain claim adjustment expenses reduce the number or cost of health services thereby resulting in lower premiums or lower premium increases. These claim adjustment expenses shall be classified as cost containment expenses.

4. Claim adjustment expenses, including legal expenses, can be subdivided into cost containment expenses and other claim adjustment expenses:

   a. Cost containment expenses: Expenses that actually serve to reduce the number of health services provided or the cost of such services. The following are examples of items that shall be considered “cost containment expenses” only if they result in reduced levels of costs or services:

      i. Case management activities;

      ii. Utilization review;

      iii. Detection and prevention of payment for fraudulent requests for reimbursement;

      iv. Network access fees to Preferred Provider Organizations and other network-based health plans (including prescription drug networks), and allocated internal salaries and related costs associated with network development and/or provider contracting;

      v. Consumer education solely relating to health improvement and relying on the direct involvement of health personnel (this would include smoking cessation and disease management programs, and other programs that involve hands on medical education); and

      vi. Expenses for internal and external appeals processes.

   b. Other claim adjustment expenses: Claim adjustment expenses as defined in paragraph 3 that are not cost containment expenses. Examples of other claim adjustment expenses are:
i. Estimating the amounts of losses and disbursing loss payments;
ii. Maintaining records, general clerical, and secretarial;
iii. Office maintenance, occupancy costs, utilities, and computer maintenance;
iv. Supervisory and executive duties; and
v. Supplies and postage.

Effective Date and Transition

5. This statement is effective for years ending on and after December 31, 2003.

RELEVANT ISSUE PAPERS

• Issue Paper No. 116—Claim Adjustment Expenses, Amendments to SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses
Statement of Statutory Accounting Principles No. 86

Accounting for Derivative Instruments and Hedging, Income Generation, and Replication (Synthetic Asset) Transactions

STATUS

Type of Issue: Common Area

Issued: Finalized May 14, 2002

Effective Date: January 1, 2003

Affects: Supersedes SSAP No. 31

Affected by: No other pronouncements

Interpreted by: INT 03-06, INT 03-07, INT 03-08, INT 03-11

SCOPE OF STATEMENT

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GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

STATUTORY ACCOUNTING PRINCIPLES

RELEVANT ISSUE PAPERS

SSAP NO. 86 – EXHIBIT A
Accounting for Derivative Instruments and Hedging Activities

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles for derivative instruments and hedging, income generation, and replication (synthetic asset) transactions using selected concepts outlined in FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities (FAS 133).

2. This statement supersedes the provisions of SSAP No. 31—Derivative Instruments.

SUMMARY CONCLUSION

3. This statement addresses the recognition of derivatives and measurement of derivatives used in:

   a. Hedging transactions;
   b. Income generation transactions; and
   c. Replication (synthetic asset) transactions

Definitions (for purposes of this statement)

4. “Derivative instrument” means an agreement, option, instrument or a series or combination thereof:

   a. To make or take delivery of, or assume or relinquish, a specified amount of one or more underlying interests, or to make a cash settlement in lieu thereof; or

   b. That has a price, performance, value or cash flow based primarily upon the actual or expected price, level, performance, value or cash flow of one or more underlying interests.

5. Derivative instruments include, but are not limited to; options, warrants used in a hedging transaction and not attached to another financial instrument, caps, floors, collars, swaps, forwards, futures and any other agreements or instruments substantially similar thereto or any series or combination thereof.

   a. “Caps” are option contracts in which the cap writer (seller), in return for a premium, agrees to limit, or cap, the cap holder’s (purchaser) risk associated with an increase in a reference rate or index. For example, in an interest rate cap, if rates go above a specified interest rate level (the strike price or the cap rate), the cap holder is entitled to receive cash payments equal to the excess of the market rate over the strike price multiplied by the notional principal amount. Because a cap is an option-based contract, the cap holder has the right but not the obligation to exercise the option. If rates move down, the cap holder has lost only the premium paid. A cap writer has virtually unlimited risk resulting from increases in interest rates above the cap rate;

   b. “Collar” means an agreement to receive payments as the buyer of an option, cap or floor and to make payments as the seller of a different option, cap or floor;

   c. “Floors” are option contracts in which the floor writer (seller), in return for a premium, agrees to limit the risk associated with a decline in a reference rate or index. For example, in an interest rate floor, if rates fall below an agreed rate, the floor holder (purchaser) will receive cash payments from the floor writer equal to the difference between the market rate and an agreed rate multiplied by the notional principal amount;
d. “Forwards” are agreements (other than futures) between two parties that commit one party to purchase and the other to sell the instrument or commodity underlying the contract at a specified future date. Forward contracts fix the price, quantity, quality, and date of the purchase and sale. Some forward contracts involve the initial payment of cash and may be settled in cash instead of by physical delivery of the underlying instrument;

e. “Futures” are standardized forward contracts traded on organized exchanges. Each exchange specifies the standard terms of futures contracts it sponsors. Futures contracts are available for a wide variety of underlying instruments, including insurance, agricultural commodities, minerals, debt instruments (such as U.S. Treasury bonds and bills), composite stock indices, and foreign currencies;

f. “Options” are contracts that give the option holder (purchaser of the option rights) the right, but not the obligation, to enter into a transaction with the option writer (seller of the option rights) on terms specified in the contract. A call option allows the holder to buy the underlying instrument, while a put option allows the holder to sell the underlying instrument. Options are traded on exchanges and over the counter;

g. “Swaps” are contracts to exchange, for a period of time, the investment performance of one underlying instrument for the investment performance of another underlying instrument, typically, but not always, without exchanging the instruments themselves. Swaps can be viewed as a series of forward contracts that settle in cash and, in some instances, physical delivery. Swaps generally are negotiated over-the-counter directly between the dealer and the end user. Interest rate swaps are the most common form of swap contract. However, foreign currency, commodity, and credit default swaps also are common;

h. “Warrants” are instruments that give the holder the right to purchase an underlying financial instrument at a given price and time or at a series of prices and times outlined in the warrant agreement. Warrants may be issued alone or in connection with the sale of other securities, for example, as part of a merger or recapitalization agreement, or to facilitate divestiture of the securities of another business entity.

6. “Firm commitment” is an agreement with an unrelated party, binding on both parties and expected to be legally enforceable, with the following characteristics:

a. The agreement specifies all significant terms, including the quantity to be exchanged, the fixed price, and the timing of the transaction. The fixed price may be expressed as a specified amount of an entity’s functional currency or of a foreign currency. It may also be expressed as a specified interest rate or specified effective yield;

b. The agreement includes a disincentive for nonperformance that is sufficiently large to make performance probable; and

c. For investments in subsidiary, controlled, and affiliated entities (as defined by SSAP No. 46—Investments in Subsidiary, Controlled, and Affiliated Entities) and investments in limited liability companies (as defined by SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies) it must be probable that acquisition will occur within a reasonable period of time.
A hedging transaction is defined as a derivative(s) transaction which is entered into and maintained to reduce:

a. The risk of a change in the fair value or cash flow of assets and liabilities which the reporting entity has acquired or incurred or has a firm commitment to acquire or incur or for which the entity has forecasted acquisition or incurrence; or

b. The currency exchange rate risk or the degree of foreign currency exposure in assets and liabilities which a reporting entity has acquired or incurred or has a firm commitment to acquire or incur or for which the entity has forecasted acquisition or incurrence.

“Income generation transaction” is defined as derivatives written or sold to generate additional income or return to the reporting entity. They include covered options, caps, and floors (e.g., a reporting entity writes an equity call option on stock that it already owns).

“Replication (Synthetic Asset) transaction” is a derivative transaction entered into in conjunction with other investments in order to reproduce the investment characteristics of otherwise permissible investments. A derivative transaction entered into by an insurer as a hedging or income generation transaction shall not be considered a replication (synthetic asset) transaction.

“Forecasted transaction” is a transaction that is expected to occur for which there is no firm commitment. Because no transaction or event has yet occurred and the transaction or event when it occurs will be at the prevailing market price, a forecasted transaction does not give an entity any present rights to future benefits or a present obligation for future sacrifices.

An “underlying” is a specified interest rate, security price, commodity price, foreign exchange rate, index of prices or rates, or other variable. An underlying may be a price or rate of an asset or liability but is not the asset or liability itself.

Embedded Derivative Instruments

Contracts that do not in their entirety meet the definition of a derivative instrument, such as bonds, insurance policies, and leases, may contain “embedded” derivative instruments—implicit or explicit terms that affect some or all of the cash flows or the value of other exchanges required by the contract in a manner similar to a derivative instrument. The effect of embedding a derivative instrument in another type of contract (“the host contract”) is that some or all of the cash flows or other exchanges that otherwise would be required by the contract, whether unconditional or contingent upon the occurrence of a specified event, will be modified based on one or more underlyings. An embedded derivative instrument shall not be separated from the host contract and accounted for separately as a derivative instrument.

Impairment

This statement adopts the impairment guidelines established by SSAP No. 5—Liabilities, Contingencies and Impairments of Assets (SSAP No. 5) for the underlying financial assets or liabilities.

Recognition and Measurement of Derivatives Used in Hedging Transactions

Derivative instruments represent rights or obligations that meet the definitions of assets (SSAP No. 4—Assets and Nonadmitted Assets) or liabilities (SSAP No. 5) and shall be reported in financial statements. In addition, derivative instruments also meet the definition of financial instruments as defined in SSAP No. 27—Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk,
15. Derivative instruments used in hedging transactions that meet the criteria of a highly effective hedge shall be considered an effective hedge and valued and reported in a manner that is consistent with the hedged asset or liability (referred to as hedge accounting). For instance, assume an entity has a financial instrument on which it is currently receiving income at a variable rate but wishes to receive income at a fixed rate and thus enters into a swap agreement to exchange the cash flows. If the transaction qualifies as an effective hedge and a financial instrument on a statutory basis is valued and reported at amortized cost, then the swap would also be valued and reported at amortized cost. Derivative instruments used in hedging transactions that do not meet or no longer meet the criteria of an effective hedge shall be accounted for at fair value and the changes in the fair value shall be recorded as unrealized gains or unrealized losses (referred to as fair value accounting).

16. Entities shall not bifurcate the effectiveness of derivatives. A derivative instrument is either classified as an effective hedge or an ineffective hedge. Entities must account for the derivative using fair value accounting if it is deemed to be ineffective or becomes ineffective. Entities may redesignate a derivative in a hedging relationship even though the derivative was used in a previous hedging relationship that proved to be ineffective. An entity shall prospectively discontinue hedge accounting for an existing hedge if any one of the following occurs:

   a. Any criterion in paragraphs 19 through 31 is no longer met;
   b. The derivative expires or is sold, terminated, or exercised (the effect is recorded as realized gains or losses or, for effective hedges of firm commitments or forecasted transactions, in a manner that is consistent with the hedged transaction – see paragraph 18);
   c. The entity removes the designation of the hedge; or
   d. The derivative is deemed to be impaired in accordance with paragraph 13. A permanent decline in a counterparty’s credit quality/rating is one example of impairment required by paragraph 13, for derivatives used in hedging transactions.

17. For those derivatives which qualify for hedge accounting, the change in the carrying value or cash flow of the derivative shall be recorded consistently with how the changes in the carrying value or cash flow of the hedged asset, liability, firm commitment or forecasted transaction are recorded. Upon termination of a derivative that qualified for hedge accounting, the gain or loss shall adjust the basis of the hedged item and be recognized in income in a manner that is consistent with the hedged item (alternatively, if the item being hedged is subject to IMR, the gain or loss on the hedging derivative may be realized and shall be subject to IMR upon termination.) Entities who choose the alternative method shall apply it consistently thereafter.

Hedge Designations

18. An entity may designate a derivative instrument as hedging the exposure to:
a. Changes in the fair value of an asset or a liability or an identified portion thereof that is attributable to a particular risk. This type of hedge can be utilized regardless of whether the hedged asset or liability is recorded in the financial statements at fair value;

b. Variability in expected future cash flows that are attributable to a particular risk. That exposure may be associated with an existing recognized asset or liability (such as all or certain future interest payments on variable-rate debt) or a forecasted transaction; or

c. Foreign currency exposure. Specific examples include a fair value or cash flow hedge of a foreign-currency-denominated firm commitment or financial instrument.

Fair Value Hedges

19. Fair value hedges qualify for hedge accounting if all of the following criteria are met:

a. At inception of the hedge, the formal documentation requirements of paragraph 34 are met;

b. Both at inception of the hedge and on an ongoing basis, the hedging relationship must be highly effective in achieving offsetting changes in fair value attributable to the hedged risk during the period that the hedge is designated. An assessment of effectiveness is required whenever financial statements or earnings are reported, and at least every three months. All assessments of effectiveness shall be consistent with the risk management strategy documented for that particular hedging relationship;

c. The term highly effective describes a cash flow hedging relationship where the change in fair value of the derivative hedging instrument is within 80 to 125 percent of the opposite change in the fair value of the hedged item attributable to the hedged risk. It shall also apply when an R-squared of .80 or higher is achieved when using a regression analysis technique. Further guidance on determining effectiveness can be found within Exhibits A and B;

d. The hedged item is specifically identified as either all or a specific portion of a recognized asset or liability or of an unrecognized firm commitment. The hedged item is a single asset or liability (or a specific portion thereof) or is a portfolio of similar assets or a portfolio of similar liabilities (or a specific portion thereof); and

e. If similar assets or similar liabilities are aggregated and hedged as a portfolio, the individual assets or individual liabilities must share the risk exposure for which they are designated as being hedged. The change in fair value attributable to the hedged risk for each individual item in a hedged portfolio must be expected to respond in a generally proportionate manner to the overall change in fair value of the aggregate portfolio attributable to the hedged risk.

Cash Flow Hedges

20. Cash flow hedges qualify for hedge accounting if all of the following criteria are met:

a. At inception of the hedge, the formal documentation requirements of paragraph 34 are met;
b. Both at inception of the hedge and on an ongoing basis, the hedging relationship shall be highly effective in achieving offsetting cash flows attributable to the hedged risk during the term of the hedge. An assessment of effectiveness is required whenever financial statements or earnings are reported, and at least every three months. All assessments of effectiveness shall be consistent with the originally documented risk management strategy for that particular hedging relationship; and

c. The term highly effective describes a cash flow hedging relationship where the change in cash flows or present value of cash flows of the derivative hedging instrument is within 80 to 125 percent of the opposite change in the cash flows or present value of the cash flows of the hedged item attributable to the hedged risk. It shall also apply when an R-squared of .80 or higher is achieved when using a regression analysis technique. Further guidance on determining effectiveness can be found within Exhibits A and B.

Hedging Forecasted Transactions

21. A forecasted transaction is eligible for designation as a hedged transaction in a cash flow hedge if all of the following additional criteria are met:

a. The forecasted transaction is specifically identified as a single transaction or a group of individual transactions. If the hedged transaction is a group of individual transactions, those individual transactions must share the same risk exposure for which they are designated as being hedged. Thus, a forecasted purchase and a forecasted sale cannot both be included in the same group of individual transactions that constitute the hedged transaction.

b. The occurrence of the forecasted transaction is probable. An assessment of the likelihood that a forecasted transaction will take place should not be based solely on management's intent because intent is not verifiable. The transaction's probability should be supported by observable facts and the attendant circumstances. Consideration should be given to the following circumstances in assessing the likelihood that a transaction will occur:

i. The frequency of similar past transactions;

ii. The financial and operational ability of the entity to carry out the transaction;

iii. Substantial commitments of resources to a particular activity (for example, a manufacturing facility that can be used in the short run only to process a particular type of commodity);

iv. The extent of loss or disruption of operations that could result if the transaction does not occur; and

v. The likelihood that transactions with substantially different characteristics might be used to achieve the same business purpose (for example, an entity that intends to raise cash may have several ways of doing so, ranging from a short-term bank loan to a common stock offering).

The term probable requires a significantly greater likelihood of occurrence than the phrase more likely than not. In addition, both the length of time until a forecasted transaction is projected to occur and the quantity of the forecasted transaction are considerations in determining probability. Other factors being equal, the more distant a
forecasted transaction is, the less likely it is that the transaction would be considered probable and the stronger the evidence that would be needed to support an assertion that it is probable. For example, a transaction forecasted to occur in five years may be less likely than a transaction forecasted to occur in one year. However, forecasted interest payments for the next 20 years on variable-rate debt typically would be probable if supported by an existing contract. Additionally, other factors being equal, the greater the physical quantity or future value of a forecasted transaction, the less likely it is that the transaction would be considered probable and the stronger the evidence that would be required to support an assertion that it is probable. For example, less evidence generally would be needed to support forecasted investments of $100,000 in a particular month than would be needed to support forecasted investments of $950,000 in that month by an entity, even if its investments have averaged $950,000 per month for the past 3 months.

A forecasted transaction that is expected to occur within 2 months of the original forecasted date (or time frame) may still be considered probable. If the transaction will not occur until greater than 2 months after the original forecasted date, it is no longer probable and will be accounted for as per the following paragraph.

If a forecasted transaction is determined to no longer be probable per the standards above, hedge accounting shall cease immediately and any deferred gains or losses on the derivative must be recognized in unrealized gains or losses. If an entity demonstrates a pattern of determining that hedged forecasted transactions probably will not occur, such action would call into question both the entity's ability to accurately predict forecasted transactions and the propriety of using hedge accounting in the future for similar forecasted transactions. Accordingly, hedge accounting for transactions forecasted by that entity will no longer be permitted.

c. If the hedged transaction is the forecasted purchase or sale of a nonfinancial asset, the designated risk being hedged is (1) the risk of changes in the functional-currency-equivalent cash flows attributable to changes in the related foreign currency exchange rates or (2) the risk of changes in the cash flows relating to all changes in the purchase price or sales price of the asset (reflecting its actual location if a physical asset), not the risk of changes in the cash flows relating to the purchase or sale of a similar asset in a different location or of a major ingredient.

d. If the hedged transaction is the forecasted purchase or sale of a financial asset or liability or the variable cash inflow or outflow of an existing financial asset or liability, the designated risk being hedged is (1) the risk of changes in the cash flows of the entire asset or liability, such as those relating to all changes in the purchase price or sales price (regardless of whether that price and the related cash flows are stated in the entity’s functional currency or a foreign currency), (2) the risk of changes in its cash flows attributable to changes in the designated benchmark interest rate, (3) the risk of changes in the functional-currency-equivalent cash flows attributable to changes in the related foreign currency exchange rates, or (4) the risk of changes in its cash flows attributable to default or changes in the obligor’s creditworthiness, and changes in the spread over the benchmark interest rate with respect to the hedged item’s credit sector at inception of the hedge. Two or more of the above risks may be designated simultaneously as being hedged. The benchmark interest rate being hedged in a hedge of interest rate risk must specifically be identified as part of the designation and documentation at the inception of the hedging relationship. An entity may not designate prepayment risk as the risk being hedged.
e. If the hedged item is a financial asset or liability, a recognized loan servicing right, or a
nonfinancial firm commitment with financial components, the designated risk being
hedged is (1) the risk of changes in the overall fair value of the entire hedged item, (2) the
risk of changes in its fair value attributable to changes in benchmark interest rate (3) the
risk of changes in its fair value attributable to changes in the related foreign currency
exchange rates, or (4) the risk of changes in its fair value attributable to both changes in
the obligor’s creditworthiness and changes in the spread over the benchmark interest rate
with respect to the hedged item’s credit sector at inception of the hedged (referred to as
credit risk). If the risk designated as being hedged is not the risk in paragraph 21(e)(1)
above, two or more of the other risks (benchmark interest rate risk, foreign currency
exchange risk, and credit risk) may simultaneously be designated as being hedged.

The benchmark interest rate being hedged in a hedge of interest rate risk must be
specifically identified as part of the designation and documentation at the inception of the
hedging relationship. Ordinarily, an entity should designate the same benchmark interest
rate as the risk being hedged for similar hedges; the use of different benchmark interest
rates for similar hedges should be rare and must be justified. In calculating the change in
the hedged item's fair value attributable to changes in the benchmark interest rate, the
estimated cash flows used in calculating fair value must be based on all of the contractual
cash flows of the entire hedged item. Excluding some of the hedged item's contractual
cash flows (for example, the portion of the interest coupon in excess of the benchmark
interest rate) from the calculation is not permitted. An entity may not simply designate
prepayment risk as the risk being hedged for a financial asset. However, it can designate
the option component of a prepayable instrument as the hedged item in a fair value hedge
of the entity's exposure to changes in the fair value of that "prepayment" option, perhaps
thereby achieving the objective of its desire to hedge prepayment risk. The effect of an
embedded derivative of the same risk class must be considered in designating a hedge of
an individual risk. For example, the effect of an embedded prepayment option must be
considered in designating a hedge of benchmark interest rate risk.

Foreign Currency Hedges

22. If the hedged item is denominated in a foreign currency, an entity may designate the following
types of hedges of foreign currency exposure, as specified in paragraphs 19 through 21:

a. A fair value hedge of an unrecognized firm commitment or a recognized asset or liability;

b. A cash flow hedge of a forecasted transaction, an unrecognized firm commitment, the
forecasted functional-currency-equivalent cash flows associated with a recognized asset
or liability, or a forecasted intercompany transaction; or

c. A hedge of a net investment in a foreign operation.

23. The recognition in earnings of the foreign currency transaction gain or loss on a foreign-currency-
denominated asset or liability based on changes in the foreign currency spot rate is not considered to be
the remeasurement of that asset or liability with changes in fair value attributable to foreign exchange risk
recognized in earnings. Thus, those criteria are not impediments to either a foreign currency fair value or
cash flow hedge of such a foreign-currency-denominated asset or liability or a foreign currency cash flow
hedge of the forecasted acquisition or incurrence of a foreign-currency-denominated asset or liability
whose carrying amount will be remeasured at spot exchange rates. A foreign currency derivative
instrument that has been entered into with another member of a holding company can be a hedging

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1 The first sentence of paragraph 21(a) that specifically permits the hedged item to be identified as either all or a specific portion
of a recognized asset or liability or of an unrecognized firm commitment is not affected by the provisions in this subparagraph.
instrument in a fair value hedge or in a cash flow hedge of a recognized foreign-currency-denominated asset or liability or in a net investment hedge only if that other member has entered into an offsetting contract with an unrelated third party to hedge the exposure it acquired from issuing the derivative instrument to the affiliate that initiated the hedge.

24. The provisions in paragraph 23 that permit a recognized foreign-currency-denominated asset or liability to be the hedged item in a fair value or cash flow hedge of foreign currency exposure also pertain to a recognized foreign-currency-denominated receivable or payable that results from a hedged forecasted foreign-currency-denominated sale or purchase on credit. An entity may choose to designate a single cash flow hedge that encompasses the variability of functional currency cash flows attributable to foreign exchange risk related to the settlement of a foreign-currency-denominated receivable or payable resulting from a forecasted sale or purchase on credit. Alternatively, an entity may choose to designate a cash flow hedge of the variability of functional currency cash flows attributable to foreign exchange risk related to a forecasted foreign-currency-denominated sale or purchase on credit and then separately designate a foreign currency fair value hedge of the resulting recognized foreign-currency-denominated receivable or payable. In that case, the cash flow hedge would terminate (be desiginated) when the hedged sale or purchase occurs and the foreign-currency-denominated receivable or payable is recognized. Although the use of the same foreign currency derivative instrument for both the cash flow hedge and the fair value hedge is not prohibited, some ineffectiveness may result.

**Foreign Currency Fair Value Hedges**

25. *Unrecognized firm commitment*. A derivative instrument or a nonderivative financial instrument that may give rise to a foreign currency transaction gain or loss can be designated as hedging changes in the fair value of an unrecognized firm commitment, or a specific portion thereof, attributable to foreign currency exchange rates. The designated hedging relationship qualifies for hedge accounting if all the fair value hedge criteria in paragraph 19 are met.

26. *Recognized asset or liability*. A nonderivative financial instrument shall not be designated as the hedging instrument in a fair value hedge of the foreign currency exposure of a recognized asset or liability. A derivative instrument can be designated as hedging the changes in the fair value of a recognized foreign-currency-denominated asset or liability (or a specific portion thereof) for which a foreign currency transaction gain or loss is recognized in earnings. All recognized foreign-currency-denominated assets or liabilities for which a foreign currency transaction gain or loss is recorded in earnings may qualify for hedge accounting if all the fair value hedge criteria in paragraph 19 are met.

27. *Securities carried at fair value*. A nonderivative financial instrument shall not be designated as the hedging instrument in a fair value hedge of the foreign currency exposure of security carried at fair value. A derivative instrument can be designated as hedging the changes in the fair values of an debt security carried at fair value (or a specific portion thereof) attributable to changes in foreign currency exchange rates. The designated hedging relationship qualifies for hedge accounting if all the fair value hedge criteria in paragraph 19 are met. An equity security carried at fair value can be hedged for changes in the fair value attributable to changes in foreign currency exchange rates and qualify for hedge accounting if all the fair value hedge criteria in paragraph 19 are met and the following two conditions are satisfied.

   a. The security is not traded on an exchange (or other established marketplace) on which trades are denominated in the investor’s functional currency; and

   b. Dividends or other cash flows to holders of the security are all denominated in the same foreign currency as the currency expected to be received upon sale of the security.
28. Gain and losses on a qualifying foreign currency fair value hedge shall be accounted for as specified in paragraphs 15-17 and Exhibit C. The gain or loss on a nonderivative hedging instrument attributable to foreign currency risk is the foreign currency transaction gain or loss as determined under SSAP No. 23—Foreign Currency Transactions and Translations (SSAP No. 23).

**Foreign Currency Cash Flow Hedges**

29. A nonderivative financial instrument shall not be designated as a hedging instrument in a foreign currency cash flow hedge. A derivative instrument designated as hedging the foreign currency exposure to variability in the functional-currency-equivalent cash flows associated with a forecasted transaction (for example, a forecasted sale to an unaffiliated entity with the price to be denominated in a foreign currency), a recognized asset or liability, an unrecognized firm commitment, or a forecasted intercompany transaction (for example, a forecasted sale to a foreign subsidiary or a forecasted royalty from a foreign subsidiary) qualifies for hedge accounting if all the following criteria are met:

a. The hedged transaction is denominated in a currency other than the hedging unit’s functional currency.

b. All of the criteria in paragraph 20 are met.

c. If the hedged transaction is a group of individual forecasted foreign-currency-denominated transactions, a forecasted inflow of a foreign currency and a forecasted outflow of the foreign currency cannot both be included in the same group.

d. If the hedged item is a recognized foreign-currency-denominated asset or liability, all the variability in the hedged item’s functional-currency-equivalent cash flows must be eliminated by the effect of the hedge. (For example, with a variable-rate foreign-currency-denominated asset or liability a cash flow hedge cannot be used to hedge changes in exchange rates alone because the derivative would not eliminate all the variability in the functional currency cash flows.)

e. If the hedged transaction is the forecasted purchase or sale of a financial asset or liability or the interest payments on that financial asset or liability or the variable cash inflow or outflow of an existing financial asset or liability, the designated risk being hedged is (1) the risk of overall change in the hedged cash flows related to the asset or liability, such as those relating to all changes in the purchase price or sales price (regardless of whether that price and the related cash flows are stated in the entity's functional currency or a foreign currency), (2) the risk of changes in its cash flows attributable to changes in the designated benchmark interest rate (referred to as interest rate risk), (3) the risk of changes in the functional-currency-equivalent cash flows attributable to changes in the related foreign currency exchange rates, or (4) the risk of changes in its cash flows attributable to default, changes in the obligor’s creditworthiness, and changes in the spread over the benchmark interest rate with respect to the hedged item’s credit sector at inception of the hedge (referred to as credit risk). Two or more of the above risks may be designated simultaneously as being hedged. An entity may not designate prepayment risk as the risk being hedged.

The benchmark interest rate being hedged in a hedge of interest rate risk must be specifically identified as part of the designation and documentation at the inception of the hedging relationship. Ordinarily, an entity should designate the same benchmark interest rate as the risk being hedged for similar hedges, consistent with FAS 133 paragraph 62; the use of different benchmark interest rates for similar hedges should be rare and must be justified. In a cash flow hedge of a variable-rate financial asset or liability, either
existing or forecasted, the designated risk being hedged cannot be the risk of changes in its cash flows attributable to changes in the specifically identified benchmark interest rate if the cash flows of the hedged transaction are explicitly based on a different index, for example, based on a specific bank's prime rate, which cannot qualify as the benchmark rate. However, the risk designated as being hedged could potentially be the risk of overall changes in the hedged cash flows related to the asset or liability, provided that the other criteria for a cash flow hedge have been met.

30. A qualifying foreign currency cash flow hedge shall be accounted for in accordance with paragraphs 15-17 and Exhibit C.

Hedges of the Foreign Currency Exposure of a Net Investment in a Foreign Operation

31. A derivative instrument or a nonderivative financial instrument that may give rise to a foreign currency transaction gain or loss under SSAP No. 23 can be designated as hedging the foreign currency exposure of a net investment in a foreign operation. The gain or loss on a hedging derivative instrument (or the foreign currency transaction gain or loss on the nonderivative instrument) that is designated as, and is effective as, an economic hedge of the net investment in a foreign operation shall be reported in the same manner as a translation adjustment to the extent it is effective as a hedge. The hedged net investment shall be accounted for consistent with SSAP No. 23; the provisions of this statement for recognizing the gain or loss on assets designated as being hedged in a fair value hedge do not apply to the hedge of a net investment in a foreign operation.

Hedge Effectiveness

32. The measurement of hedge effectiveness for a particular hedging relationship shall be consistent with the entity’s risk management strategy and the method of assessing hedge effectiveness that was documented at the inception of the hedging relationship, as discussed in paragraph 34.

33. The gain or loss on a derivative designated as a hedge and assessed to be effective is reported consistently with the hedged item. If an entity’s defined risk management strategy for a particular hedging relationship excludes a specific component of the gain or loss, or related cash flows, on the hedging derivative from the assessment of hedge effectiveness (as discussed in Exhibit B), that excluded component of the gain or loss shall be recognized as an unrealized gain or loss. For example, if the effectiveness of a hedge with an option contract is assessed based on changes in the option’s intrinsic value, the changes in the option’s time value would be recognized in unrealized gains or losses. Time value is equal to the fair value of the option less its intrinsic value.

Documentation Guidance

34. At inception of the hedge, documentation must include:

a. A formal documentation of the hedging relationship and the entity’s risk management objective and strategy for undertaking the hedge, including identification of the hedging instrument, the hedged item, the nature of the risk being hedged, and how the hedging instrument’s effectiveness in offsetting the exposure to changes in the hedged item’s fair value or variability in cash flows attributable to the hedged risk will be assessed. There must be a reasonable basis for how the entity plans to assess the hedging instrument’s effectiveness;

b. An entity’s defined risk management strategy for a particular hedging relationship may exclude certain components of a specific hedging derivative’s change in fair value, such
as time value, from the assessment of hedge effectiveness, as discussed in paragraph 33 and Exhibit B;

c. Signature of approval, for each instrument, by person(s) authorized, either by the entity's board of directors or a committee authorized by the board, to approve such transactions; and

d. A description of the reporting entity's methodology used to verify that opening transactions do not exceed limitations promulgated by the state of domicile.

35. For all derivatives terminated, expired, or exercised during the year:

   a. Signature of approval, for each instrument, by person(s) authorized, either by the entity's board of directors or a committee authorized by the board, to approve such transactions;

   b. A description, for each instrument, of the nature of the transaction, including:

      i. The date of the transaction;

      ii. A complete and accurate description of the specific derivative, including description of the underlying securities, currencies, rates, indices, commodities, derivatives, or other financial market instruments;

      iii. Number of contracts or notional amount;

      iv. Date of maturity, expiry or settlement;

      v. Strike price, rate or index (termination price for futures contracts);

      vi. Counterparty, or exchange on which the transaction was traded; and

      vii. Consideration paid or received, if any, on termination.

   c. Description of the reporting entity's methodology to verify that derivatives were effective hedges; and

   d. Identification of any derivatives that ceased to be effective as hedges.

36. For derivatives open at quarter-end:

   a. A description of the methodology used to verify the continued effectiveness of hedges;

   b. An identification of any derivatives that have ceased to be effective as hedges;

   c. A description of the reporting entity's methodology to determine fair values of derivatives;

   d. Copy of Master Agreements, if any, where indicated on Schedule DB Part E Section 1.

Recognition and Measurement of Derivatives Used in Income Generation Transactions

General
37. Income generation transactions are defined as derivatives written or sold to generate additional income or return to the reporting entity. They include covered options, caps, and floors (e.g., a reporting entity writes an equity call option on stock that it already owns).

38. Because these transactions require writing derivatives, they expose the reporting entity to potential future liabilities for which the reporting entity receives a premium up front. Because of this risk, dollar limitations and additional constraints are imposed requiring that the transactions be "covered" (i.e., offsetting assets can be used to fulfill potential obligations). To this extent, the combination of the derivative and the covering asset works like a reverse hedge where an asset owned by the reporting entity in essence hedges the derivative risk.

39. As with derivatives in general, these instruments include a wide variety of terms regarding maturities, range of exercise periods and prices, counterparties, underlying instruments, etc.

40. The principal features of income generation transactions are:
   a. Premium received is initially recorded as a deferred liability;
   b. The accounting of the covering asset or underlying interest controls the accounting of the derivative. The covering asset/underlying interest is accounted at either fair value (e.g., common stocks) or (amortized) cost (e.g., bonds);
   c. The gain/loss on termination of the derivative is a capital item. For life insurance companies, it shall be subject to IMR treatment if interest rate related;
   d. For options that are exercised, the remaining premium shall adjust the proceeds (cost) associated with the exercise resulting in no explicit gain or loss reported for the derivative itself.

Written Fixed Income Covered Call Options

41. The principal features of written fixed income covered call options are:
   a. The general approach is to value at cost (i.e., consideration received) without amortization over the life of the contract if the original duration is less than one year, otherwise carry at amortized cost;
   b. An alternative to the general approach combines the accounting of the written option with the covering asset and then uses standard accounting for callable bonds (yield to worst amortization) on the adjusted asset. This method prevents the possibility of future loss recognition upon exercise while at the same time providing recognition of the income feature of the option over time. This approach would appear most relevant for longer-lived covered European call options, which are in substance like callable bonds;
   c. For life insurance companies, the gain or loss flows through the IMR if the covering asset or underlying interest is subject to the IMR using callable bond rules to determine the remaining life;
   d. Reporting entities are responsible for timely recognition of any probable losses that may occur as a result of the strategy. If the exercise price is below the covering asset's book value, the asset shall be evaluated for write down or disclosure treatment in accordance with SSAP No. 5. All relevant factors such as whether the option is currently exercisable, the fair value of the bond relative to its exercise price, to what extent the statement value...
of the option premium offsets any loss on the asset, or how any IMR transaction on exercise would affect unassigned funds (surplus) and income shall be considered.

42. Written fixed income covered call options shall be accounted for as follows:

<table>
<thead>
<tr>
<th>STATUS OF OPTION</th>
<th>COVERING ASSET VALUED AT AMORTIZED COST</th>
<th>COVERING ASSET VALUED AT FAIR VALUE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Open</td>
<td>Record premium as deferred liability.</td>
<td>Record premium as deferred liability.</td>
</tr>
<tr>
<td></td>
<td>Carry at amortized value.</td>
<td>Changes in fair value recorded as unrealized adjustments to unassigned funds (surplus) – gain/loss.</td>
</tr>
<tr>
<td></td>
<td>(Alternatively carry at consideration received if original duration is less than 1 year to maturity.)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Alternatively, attach premium to covering asset and amortize (under yield to worse scenario) using standard callable bond accounting.</td>
<td></td>
</tr>
<tr>
<td>Closed – Expired</td>
<td>Premium received recognized as realized capital gain. Gain from expiration to flow through IMR, if applicable. (1)</td>
<td>Premium received recognized as realized capital gain.</td>
</tr>
<tr>
<td>Closed – Exercised</td>
<td>Adjust disposition proceeds. (Include in capital gain/loss of disposed asset.) Gain or loss from disposition to flow through IMR, if applicable. (1)</td>
<td>Adjust disposition proceeds. (Include in capital gain/loss of disposed asset.)</td>
</tr>
<tr>
<td>Closed – Terminated</td>
<td>Recognize net amount as realized capital gain/loss. Gain or loss from disposition to flow through IMR, if applicable. (1)</td>
<td>Recognize net amount as realized capital gain/loss.</td>
</tr>
</tbody>
</table>

NOTE (1) If premium is attached to covering asset, the accounting treatment for the covering asset applies.

Written Covered Put Options

43. The principal features of written covered put options are:

a. The accounting for the underlying interest instead of the covering asset governs the accounting of the written put while it is open. For example, if a reporting entity wrote a put requiring it to purchase a certain common stock (underlying interest) at a specific price, the reporting entity might cover that option by holding cash or cash equivalents (covering asset). The accounting for the common stock would govern the accounting of the option in this case;
b. As with covered call writing for life insurance companies, gain/loss on termination may be subject to IMR over the remaining life of the underlying interest;

c. As with covered call writing, entities writing put options for income generation purposes are responsible for timely recognition of any probable losses that may occur as a result of the strategy.

44. Written covered put options shall be accounted for as follows:

<table>
<thead>
<tr>
<th>STATUS OF OPTION</th>
<th>UNDERLYING INTEREST VALUED AT AMORTIZED COST</th>
<th>UNDERLYING INTEREST VALUED AT FAIR VALUE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Open</td>
<td>Record premium as deferred liability.</td>
<td>Record premium as deferred liability.</td>
</tr>
<tr>
<td></td>
<td>Carry at amortized value.</td>
<td>Changes in fair value recorded as unrealized adjustments to unassigned funds (surplus) – gain/loss.</td>
</tr>
<tr>
<td></td>
<td>(Alternatively carry at consideration received if original duration is less than 1 year to maturity.)</td>
<td></td>
</tr>
<tr>
<td>Closed – Expired</td>
<td>Premium received recognized as realized capital gain. Gain from expiration to flow through IMR, if applicable.</td>
<td>Premium received recognized as realized capital gain.</td>
</tr>
<tr>
<td>Closed – Exercised</td>
<td>Adjust acquisition cost by premium received.</td>
<td>Adjust acquisition cost by premium received.</td>
</tr>
<tr>
<td>Closed – Terminated</td>
<td>Recognize net amount as realized capital gain/loss. Gain or loss from disposition to flow through IMR, if applicable.</td>
<td>Recognize net amount as realized capital gain/loss.</td>
</tr>
</tbody>
</table>

Written Fixed Income Caps and Floors

45. The principal features of written fixed income caps and floors are:

a. The value of the premium received shall be amortized into income over the life of the contract. For caps and floors, where the entity is selling off possible excess interest/income, the value of the covering asset is not relevant;

b. Gain/loss may be subject to IMR. The expected maturity would be the derivative contract's maturity.

46. Written fixed income caps and floors shall be accounted for as follows:

<table>
<thead>
<tr>
<th>STATUS OF OPTION</th>
<th>COVERING ASSET VALUED AT AMORTIZED COST</th>
<th>COVERING ASSET VALUED AT FAIR VALUE</th>
</tr>
</thead>
</table>

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<table>
<thead>
<tr>
<th>Status</th>
<th>Description</th>
<th>Changes in Fair Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Open</td>
<td>Record premium as deferred liability. Carry at amortized value. (Alternatively carry at consideration received if original duration is less than 1 year to maturity.) Amortize over life of contract to produce constant yield. Record any interest expense as “Other Investment Income” – negative value.</td>
<td>Changes in fair value recorded as unrealized adjustments to unassigned funds (surplus) – gain/loss.</td>
</tr>
<tr>
<td>Closed – Matured</td>
<td>Would usually mature at zero amortized value. Any remaining unamortized value recognized as ordinary income through a final amortization adjustment.</td>
<td>Premium received recognized as realized capital gain.</td>
</tr>
<tr>
<td>Closed – Exercised</td>
<td>Not applicable.</td>
<td>Not applicable.</td>
</tr>
<tr>
<td>Closed – Terminated</td>
<td>Recognize net amount as realized capital gain/loss. Gain/loss on termination to flow through IMR, if applicable.</td>
<td>Recognize net amount as realized capital gain/loss.</td>
</tr>
</tbody>
</table>

**Recognition and Measurement of Derivatives Used in Replication (Synthetic Asset) Transactions**

47. Replication (Synthetic Asset) transaction means a derivative transaction entered into in conjunction with other investments in order to reproduce the investment characteristics of otherwise permissible investments. A derivative transaction entered into by an insurer as a hedging or income generation transaction shall not be considered a replication (synthetic asset) transaction.

48. Any premium paid or received shall be carried as an asset or liability on the balance sheet (Aggregate Write-in for Invested Asset (or) Liability). Premiums paid or received on the replication (synthetic asset) derivative should be amortized into investment income or expense until the exercise, termination or maturity date of the derivative.

49. If the replication (synthetic asset) transaction would be carried at amortized cost and the cash instrument used is carried at amortized cost, then the derivative used should be carried at amortized cost. The derivative may be valued at fair value when both the replication (synthetic asset) and the cash instrument are valued at amortized cost. This is consistent with the alternative valuation methods available for hedges. If the replication (synthetic asset) transaction would be carried at fair value and/or the cash instrument used is carried at fair value, then the derivative used should be carried at fair value.
50. In the case of No. 3 in the chart above, the fair values for the cash instrument and derivative, when added together, shall not exceed the replication (synthetic asset) statement value. If this does occur, the excess shall reduce the fair value of the derivative and shall be recorded as an unrealized gain separate from the AVR.

51. If the replication (synthetic asset) transaction involves the exchange of interest related cash flows (default free assets), then the cash flows should be accrued as investment income. If the replication (synthetic asset) transaction involves the exchange of total return or change in index cash flows, then the cash flows should be segregated between interest income and fair value (equity) changes. The interest income portion should be accrued as investment income.

52. If the derivative is carried at fair value, the periodic change in the fair value should be recorded as an unrealized gain or loss adjustment to surplus until the transaction is terminated. If the replication (synthetic asset) transaction involves the exchange of total return or change in index cash flows, then the cash flows should be segregated between interest income and fair value (equity) changes. The fair value (equity) change should be recognized as a deferred asset/liability until the termination of the contract. Gains or losses on the derivative at termination or sale should be recognized as realized.

Disclosure Requirements

53. Reporting entities shall disclose the following for all derivative contracts used:

a. General disclosures:
   i. A description of the reporting entity’s objectives for using derivatives, i.e., hedging, income generation or replication;
   ii. A description of the context needed to understand those objectives and its strategies for achieving those objectives;
   iii. The description for hedging objectives shall identify the category, e.g., fair value hedges, cash flow hedges, or foreign currency hedges, and for all objectives, the type of instrument(s) used;
   iv. A description of the accounting policies for derivatives including the policies for recognizing (or reasons for not recognizing) and measuring the derivatives used, and when recognized, where those instruments and related gains and losses are reported;
   v. The net gain or loss recognized in unrealized gains or losses during the reporting period representing the component of the derivative instruments’ gain or loss, if any, excluded from the assessment of hedge effectiveness; and

<table>
<thead>
<tr>
<th>(a)</th>
<th>(b)</th>
<th>(c)</th>
<th>(d)</th>
</tr>
</thead>
<tbody>
<tr>
<td>If the Replication (Synthetic Asset) is Valued at:</td>
<td>And Cash Instrument(s) Used is (are) Valued at:</td>
<td>The Derivative is Valued at:</td>
<td>Alternative Derivative Value Basis:</td>
</tr>
<tr>
<td>1. Amortized Cost</td>
<td>Amortized Cost</td>
<td>Amortized Cost</td>
<td>Fair value</td>
</tr>
<tr>
<td>2. Fair value</td>
<td>Fair value</td>
<td>Fair value</td>
<td>N/A</td>
</tr>
<tr>
<td>3. Amortized Cost</td>
<td>Fair value</td>
<td>Fair value</td>
<td>N/A</td>
</tr>
<tr>
<td>4. Fair value</td>
<td>Amortized Cost</td>
<td>Fair value</td>
<td>N/A</td>
</tr>
</tbody>
</table>
vi. The net gain or loss recognized in unrealized gains or losses during the reporting period resulting from derivatives that no longer qualify for hedge accounting.

b. Disclosures by type of instrument outstanding, e.g., call options, floors, etc.:

i. Notional or contract amounts;

ii. Carrying and fair values; and

iii. A discussion of the market risk, credit risk, and cash requirements of the derivatives.

c. For derivatives held for other than hedging purposes in addition to a and b above:

i. Average fair value of the derivatives during the reporting period together with the related end-of-period fair value distinguishing between assets and liabilities;

ii. Net gains or losses detailed by class, business activity or other category that is consistent with the management of those activities and where the net gains or losses are reported.

d. The financial statements shall disclose details of covered items and/or written transactions to allow evaluation of cash flow implications for all written covered options used for income generation.

e. For derivatives accounted for as cash flow hedges of a forecasted transaction, disclose:

i. The maximum length of time over which the entity is hedging its exposure to the variability in future cash flows for forecasted transactions excluding those forecasted transactions related to the payment of variable interest on existing financial instruments; and

ii. The amount of gains and losses classified in unrealized gains/losses related to cash flow hedges that have been discontinued because it was no longer probable that the original forecasted transactions would occur by the end of the originally specified time period or within 2 months of that date.

f. The disclosure requirements of 53 a., 53 b., and 53 e. shall be included in the Annual Statement. Refer to the preamble for further discussion regarding interim disclosure requirements. The disclosure requirements of paragraphs 53 a. through 53 e. shall be included in the annual audited statutory financial reports. Paragraph 55 of the Preamble states that disclosures made within specific schedules or exhibits to the Annual Statement need not be duplicated in a separate note.

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

Relevant Literature

55. This statement adopts the framework established by FAS 133, *FASB Statement No. 137, Accounting for Derivative Instruments and Hedging Activities—Deferral of the Effective Date of FASB Statement No. 133, An amendment of FASB Statement No. 133* (FAS 137) and *FASB Statement No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities, An amendment of FASB Statement No. 133* (FAS 138), for fair value and cash flow hedges, including its technical guidance to the
extent such guidance is consistent with the statutory accounting approach to derivatives utilized in this statement. This statement adopts the provisions of FAS 133 and 138 related to foreign currency hedges. With the exception of guidance specific to foreign currency hedges and amendments specific to refining the hedging of interest rate risk (under FAS 138, the risk of changes in the benchmark interest rate would be a hedged risk), this statement rejects FAS No. 137 and 138 as well as the various related Emerging Issues Task Force interpretations. It should be noted that the conclusions reached in this statement are not intended to usurp the rules and regulations put forth by states in their respective investment laws. The contents of this statement are intended to provide accounting guidance on the use of derivatives as allowed by an insurer’s state of domicile. It is not intended to imply that insurers may use derivatives or cash instruments that the insurer’s state of domicile does not allow under the state’s insurance regulatory requirements, e.g., in replication transactions.

Effective Date and Transition

56. This statement is effective for derivative transaction entered into or modified on or after January 1, 2003. A modification is any revision or change in contractual terms of the derivative. SSAP No. 31 applies to derivative transaction prior to January 1, 2003. Alternatively, an insurer may choose to apply this statement to all derivatives to which the insurer is a party as of January 1, 2003. In either case, the insurer is to disclose the transition approach that is being used.

AUTHORITATIVE LITERATURE

Generally Accepted Accounting Principles

- FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities
- FASB Statement No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities, An amendment of FASB Statement No. 133
- FASB Emerging Issues Task Force No. 98-10, Accounting for Contracts Involved in Energy Trading and Risk Management Activities
- FASB Emerging Issues Task Force No. 98-12, Application of Issue No. 96-13 to Forward Equity Sales Transactions
- FASB Emerging Issues Task Force No. 99-01, Accounting for Debt Convertible into the Stock of a Consolidated Sub
- FASB Emerging Issues Task Force No. 99-02, Accounting for Weather Derivatives
- FASB Emerging Issues Task Force No. 99-03, Application of Issue No. 96-13 to Derivative Instruments with Multiple Settlement Alternatives
- FASB Emerging Issues Task Force No. 99-08, Accounting for Transfers of Assets That Are Derivative Instruments but That Are Not Financial Assets
- FASB Emerging Issues Task Force No. 99-09, Effect of Derivative Gains and Losses on the Capitalization of Interest
- FASB Emerging Issues Task Force No. 00-07, Application of Issue No. 96-13 to Equity Derivative Instruments That Contain Certain Provisions That Require Net Cash Settlement If Certain Events outside the Control of the Issuer Occur
- FASB Emerging Issues Task Force No. 00-09, Classification of a Gain or Loss from a Hedge of Debt That Is Extinguished
- FASB Derivatives Implementation Group (DIG) Issue E7: Hedging—General: Methodologies to Assess Effectiveness of Fair Value and Cash Flow Hedges
- DIG Issue E8: Hedging—General: Assessing Hedge Effectiveness of Fair Value and Cash

Statutory Accounting Principles

- SSAP No. 31—Derivative Instruments
SSAP No. 86 Statement of Statutory Accounting Principle

- Emerging Accounting Issues Working Group June 7, 1999
- Flow Hedges Period-by-Period or Cumulatively under a Dollar-Offset Approach
- Purposes and Procedures Manual of the NAIC Securities Valuation Office–Part 13

RELEVANT ISSUE PAPERS

- Issue Paper No. 114—Accounting for Derivative Instruments and Hedging Activities
SSAP No. 86 – EXHIBIT A

Discussion of Hedging Effectiveness

The Financial Accounting Standards Board established the Derivatives Implementation Group in 1999 to address execution of FAS 133. The Derivatives Implementation Group addressed two issues related to effectiveness that are applicable to this statement. The issues have been authored by the FASB staff and represents the staff’s views, although FASB has discussed the responses at a public meeting and chosen not to object to dissemination of those responses. Official positions of the FASB are determined only after extensive due process and deliberation.

E7: Hedging—General: Methodologies to Assess Effectiveness of Fair Value and Cash Flow Hedges

Paragraph references: 20(b), 22, 28(b), 62, 86, 87
Date cleared by FASB Board: May 17, 2000

QUESTION

1. Since Statement 133 provides an entity with flexibility in choosing the method it will use in assessing hedge effectiveness, must an entity use a dollar-offset approach in assessing effectiveness?

BACKGROUND

2. Paragraph 20(b) of Statement 133 states, in part:

   Both at inception of the [fair value] hedge and on an ongoing basis, the hedging relationship is expected to be highly effective in achieving offsetting changes in fair value attributable to the hedged risk during the period that the hedge is designated. An assessment of effectiveness is required whenever financial statements or earnings are reported, and at least every three months.

3. Paragraph 28(b) indicates a similar requirement that the hedging relationship be expected to be highly effective in achieving offsetting changes in cash flows attributable to the hedged risk during the period that the hedge is designated.

4. Paragraph 22 of Statement 133 states, in part:

   The measurement of hedge ineffectiveness for a particular hedging relationship shall be consistent with the entity’s risk management strategy and the method of assessing hedge effectiveness that was documented at the inception of the hedging relationship, as discussed in paragraph 20(a).

5. Paragraph 62 emphasizes that each entity must “define at the time it designates a hedging relationship the method it will use to assess the hedge’s effectiveness in achieving offsetting changes in fair value or offsetting cash flows attributable to the risk being hedged.” It also states, “This Statement does not specify a single method for either assessing whether a hedge is expected to be highly effective or measuring hedge ineffectiveness.”

RESPONSE

6. No. Statement 133 requires an entity to consider hedge effectiveness in two different ways—in prospective considerations and in retrospective evaluations.

   a. Prospective considerations.
Upon designation of a hedging relationship (as well as on an ongoing basis), the entity must be able to justify an expectation that the relationship will be highly effective over future periods in achieving offsetting changes in fair value or cash flows. That expectation, which is forward-looking, can be based upon regression or other statistical analysis of past changes in fair values or cash flows as well as on other relevant information.

b. Retrospective evaluations.

At least quarterly, the hedging entity must determine whether the hedging relationship has been highly effective in having achieved offsetting changes in fair value or cash flows through the date of the periodic assessment. That assessment can be based upon regression or other statistical analysis of past changes in fair values or cash flows as well as on other relevant information. If an entity elects at the inception of a hedging relationship to utilize the same regression analysis approach for both prospective considerations and retrospective evaluations of assessing effectiveness, then during the term of that hedging relationship those regression analysis calculations should generally incorporate the same number of data points. Electing to utilize a regression or other statistical analysis approach instead of a dollar-offset approach to perform retrospective evaluations of assessing hedge effectiveness may affect whether an entity can apply hedge accounting for the current assessment period as discussed below.

7. Paragraph 62 requires that at the time an entity designates a hedging relationship, it must define and document the method it will use to assess the hedge’s effectiveness. That paragraph also states that ordinarily “an entity should assess effectiveness for similar hedges in a similar manner; use of different methods for similar hedges should be justified.” Furthermore, it requires that an entity use that defined and documented methodology consistently throughout the period of the hedge. If an entity elects at the inception of a hedging relationship to utilize a regression analysis approach for prospective considerations of assessing effectiveness and the dollar-offset method to perform retrospective evaluations of assessing effectiveness, then that entity must abide by the results of that methodology as long as that hedging relationship remains designated. Thus, in its retrospective evaluation, an entity might conclude that, under a dollar-offset approach, a designated hedging relationship does not qualify for hedge accounting for the period just ended, but that the hedging relationship may continue and hedge accounting may be applied without interruption because, under a regression analysis approach, there is an expectation that the relationship will be highly effective in achieving offsetting changes in fair value or cash flows in future periods. In its next period’s retrospective evaluation, covering the entire period for which the hedge has been designated, if that entity concludes that, under a dollar-offset approach, the hedging relationship has not been highly effective in having achieved offsetting changes in fair value or cash flows, hedge accounting may not be applied.

8. If an entity elects at the inception of a hedging relationship to utilize a regression analysis (or other statistical analysis) approach for either prospective considerations or retrospective evaluations of assessing effectiveness, then that entity must periodically update its regression analysis (or other statistical analysis). For example, if there is significant ineffectiveness measured and recognized in earnings for a hedging relationship, which is calculated each assessment period, the regression analysis should be rerun to determine whether the expectation of high effectiveness is still valid. As long as an entity reruns its regression analysis and determines that the hedging relationship is still expected to be highly effective, then it can continue to apply hedge accounting without interruption.
9. The application of a regression or other statistical analysis approach to assessing effectiveness is complex. Those methodologies require appropriate interpretation and understanding of the statistical inferences.

**E8: Hedging–General: Assessing Hedge Effectiveness of Fair Value and Cash Flow Hedges Period-by-Period or Cumulatively under a Dollar-Offset Approach**

Paragraph references: 20(b), 28(b), 30, 62, 64, 67

Date cleared by FASB Board: June 28, 2000

**QUESTION**

1. In periodically assessing retrospectively the effectiveness of a fair value hedge (or a cash flow hedge) in having achieved offsetting changes in fair values (or cash flows), an entity compares the change in the hedging instrument’s fair value (or cash flows) to the change in the hedged item’s fair value (or hedged transaction’s cash flows) attributable to the hedged risk. If an entity elects at inception of a hedging relationship to utilize the dollar-offset approach for retrospective evaluations of assessing effectiveness, then should that entity base that comparison on (a) the fair value (or cash flow) changes that have occurred during the period being assessed (that is, on a period-by-period basis) or (b) the cumulative fair value (or cash flow) changes to date from the inception of the hedge? Is that entity permitted to use either a period-by-period approach or a cumulative approach on individual fair value hedges (or cash flow hedges) under a dollar-offset approach?

**BACKGROUND**

2. Paragraph 20(b) of Statement 133 states, in part:

   Both at inception of the [fair value] hedge and on an ongoing basis, the hedging relationship is expected to be highly effective in achieving offsetting changes in fair value attributable to the hedged risk during the period that the hedge is designated. An assessment of effectiveness is required whenever financial statements or earnings are reported, and at least every three months….All assessments of effectiveness shall be consistent with the risk management strategy documented for that particular hedging relationship.

3. Paragraph 28(b) states, in part:

   Both at inception of the [cash flow] hedge and on an ongoing basis, the hedging relationship is expected to be highly effective in achieving offsetting cash flows attributable to the hedged risk during the term of the hedge, except as indicated in paragraph 28(d) below. An assessment of effectiveness is required whenever financial statements or earnings are reported, and at least every three months….All assessments of effectiveness shall be consistent with the originally documented risk management strategy for that particular hedging relationship.

4. Paragraph 30(b) specifies how effectiveness (on a derivative designated as a cash flow hedge) should be calculated. The calculation of effectiveness is, in part, based on “cumulative gain or loss on the derivative from inception of the hedge.”

5. Paragraph 67 of the Statement states, in part:

   If the hedge initially qualifies for hedge accounting, the entity would continue to assess whether the hedge meets the effectiveness test and also would measure any ineffectiveness during the hedge period. If the hedge fails the effectiveness test at any time (that is, if the entity does not
expect the hedge to be highly effective at achieving offsetting changes in fair values or cash flows), the hedge ceases to qualify for hedge accounting.

RESPONSE

6. In periodically (that is, at least quarterly) assessing retrospectively the effectiveness of a fair value hedge (or a cash flow hedge) in having achieved offsetting changes in fair values (or cash flows) under a dollar-offset approach, Statement 133 permits an entity to use either a period-by-period approach or a cumulative approach on individual fair value hedges (or cash flow hedges). The period-by-period approach involves comparing the changes in the hedging instrument’s fair values (or cash flows) that have occurred during the period being assessed to the changes in the hedged item’s fair value (or hedged transaction’s cash flows) attributable to the risk hedged that have occurred during the same period. The cumulative approach involves comparing the cumulative changes (to date from inception of the hedge) in the hedging instrument’s fair values (or cash flows) to the cumulative changes in the hedged item’s fair value (or hedged transaction’s cash flows) attributable to the risk hedged. At inception of the hedge, an entity may choose either approach in designating how effectiveness will be assessed, depending on the nature of the hedge documented in accordance with paragraphs 20(a) and 28(a). For example, an entity may decide that the cumulative approach is generally preferred, yet may wish to use the period-by-period approach in certain circumstances.

7. Paragraph 62 requires that at the time an entity designates a hedging relationship, it must define and document the method it will use to assess the hedge’s effectiveness. That paragraph also states that ordinarily “an entity should assess effectiveness for similar hedges in a similar manner; use of different methods for similar hedges should be justified.” Furthermore, it requires that an entity use that defined and documented methodology consistently throughout the period of the hedge. If an entity elects at inception of a hedging relationship to base its comparison of changes in fair value (or cash flows) on a cumulative approach, then that entity must abide by the results of that methodology as long as that hedging relationship remains designated. Electing to utilize a period-by-period approach instead of a cumulative approach (or vice versa) to perform retrospective evaluations of assessing hedge effectiveness under the dollar-offset method may affect whether an entity can apply hedge accounting for the current assessment period.

8. If an entity elects to base its comparison of changes in fair value (or cash flows) on a period-by-period approach, the period cannot exceed three months. Fair value (or cash flow) patterns of the hedging instrument or the hedged item (or hedged transaction) in periods prior to the period being assessed are not relevant.

9. The foregoing guidance relates to an entity’s periodic retrospective assessment and determining whether a hedging relationship continues to qualify for hedge accounting.

10. The above response has been authored by the FASB staff and represents the staff’s views, although the Board has discussed the above response at a public meeting and chosen not to object to dissemination of that response. Official positions of the FASB are determined only after extensive due process and deliberation.
Assessment of Hedging Effectiveness

The following is based on paragraphs 62-70 of FAS 133 to offer additional guidance on assessing hedging effectiveness. The intent of such is to remain consistent with FAS 133 with respect to assessing hedge effectiveness.

1. This statement requires that an entity define at the time it designates a hedging relationship the method it will use to assess the hedge’s effectiveness in achieving offsetting changes in fair value or offsetting cash flows attributable to the risk being hedged. It also requires that an entity use that defined method consistently throughout the hedge period to assess at inception of the hedge and on an ongoing basis whether it expects the hedging relationship to be highly effective in achieving offset. If the entity identifies an improved method and wants to apply that method prospectively, it must discontinue the existing hedging relationship and designate the relationship anew using the improved method. Although this statement suggests a method for assessing whether a hedge is expected to be highly effective or measuring hedge ineffectiveness, the appropriateness of a given method of assessing hedge effectiveness can depend on the nature of the risk being hedged and the type of hedging instrument used. Ordinarily, however, an entity should assess effectiveness for similar hedges in a similar manner; use of different methods for similar hedges should be justified.

2. In defining how hedge effectiveness will be assessed, an entity must specify whether it will include in that assessment all of the gain or loss on a hedging instrument. As discussed in paragraph 33, this statement permits (but does not require) an entity to exclude all or a part of the hedging instrument’s time value from the assessment of hedge effectiveness, as follows:

   a. If the effectiveness of a hedge with an option contract is assessed based on changes in the option’s intrinsic value, the change in the time value of the contract would be excluded from the assessment of hedge effectiveness.

   b. If the effectiveness of a hedge with an option contract is assessed based on changes in the option’s minimum value, that is, its intrinsic value plus the effect of discounting, the change in the volatility value of the contract would be excluded from the assessment of hedge effectiveness.

   c. If the effectiveness of a hedge with a forward or futures contract is assessed based on changes in fair value attributable to changes in spot prices, the change in the fair value of the contract related to the changes in the difference between the spot price and the forward or futures price would be excluded from the assessment of hedge effectiveness.

In each circumstance above, changes in the excluded component would be included in unrealized gains or losses. As noted in paragraph 1 of this Exhibit, the effectiveness of similar hedges generally should be assessed similarly; that includes whether a component of the gain or loss on a derivative is excluded in assessing effectiveness. No other components of a gain or loss on the designated hedging instrument may be excluded from the assessment of hedge effectiveness.

3. In assessing the effectiveness of a cash flow hedge, an entity generally will need to consider the time value of money if significant in the circumstances. Considering the effect of the time value of money is especially important if the hedging instrument involves periodic cash settlements. An example of a situation in which an entity likely would reflect the time value of money is a tailing strategy with futures contracts. When using a tailing strategy, an entity adjusts the size or contract amount of futures contracts used in a hedge so that earnings (or expense) from reinvestment (or funding) of daily settlement
gains (or losses) on the futures do not distort the results of the hedge. To assess offset of expected cash flows when a tailing strategy has been used, an entity could reflect the time value of money, perhaps by comparing the present value of the hedged forecasted cash flow with the results of the hedging instrument.

4. Whether a hedging relationship qualifies as highly effective sometimes will be easy to assess. If the critical terms of the hedging instrument and of the entire hedged asset or liability (as opposed to selected cash flows) or hedged forecasted transaction are the same, the entity could conclude that changes in fair value or cash flows attributable to the risk being hedged are expected to completely offset at inception and on an ongoing basis. For example, an entity may assume that a hedge of a forecasted purchase of a commodity with a forward contract will be highly effective if:

a. The forward contract is for purchase of the same quantity of the same commodity at the same time and location as the hedged forecasted purchase.

b. The fair value of the forward contract at inception is zero.

c. Either the change in the discount or premium on the forward contract is excluded from the assessment of effectiveness and included directly in unrealized gains and losses pursuant to paragraph 22B or the change in expected cash flows on the forecasted transaction is based on the forward price for the commodity.

5. However, assessing hedge effectiveness can be more complex. For example, hedge effectiveness would be reduced by the following circumstances, among others:

a. A difference between the basis of the hedging instrument and the hedged item or hedged transaction (such as a Deutsche mark-based hedging instrument and Dutch guilder-based hedged item), to the extent that those bases do not move in tandem

b. Differences in critical terms of the hedging instrument and hedged item or hedged transaction, such as differences in notional amounts, maturities, quantity, location, or delivery dates.

Hedge effectiveness also would be reduced if part of the change in the fair value of a derivative is attributable to a change in the counterparty’s creditworthiness.

6. A hedge that meets the effectiveness test specified in paragraphs 19 b. and 20 b. (that is, both at inception and on an ongoing basis, the entity expects the hedge to be highly effective at achieving offsetting changes in fair values or cash flows) also must meet the other hedge accounting criteria to qualify for hedge accounting. If the hedge initially qualifies for hedge accounting, the entity would continue to assess whether the hedge meets the effectiveness test. If the hedge fails the effectiveness test at any time (that is, if the entity does not expect the hedge to be highly effective at achieving offsetting changes in fair values or cash flows), the hedge ceases to qualify for hedge accounting. The discussions of measuring hedge effectiveness in the examples in the remainder of this Exhibit assume that the hedge satisfied all of the criteria for hedge accounting at inception.

Assuming Effectiveness in a Hedge with an Interest Rate Swap

7. An entity may assume effectiveness in a hedging relationship of interest rate risk involving an interest-bearing asset or liability and an interest rate swap if all of the applicable conditions in the following list are met:
Accounting for Derivative Instruments and Hedging Activities

SSAP No. 86

Conditions applicable to both fair value hedges and cash flow hedges

a. The notional amount of the swap matches the principal amount of the interest-bearing asset or liability.

b. The fair value of the swap at its inception is zero.

c. The formula for computing net settlements under the interest rate swap is the same for each net settlement. (That is, the fixed rate is the same throughout the term, and the variable rate is based on the same index and includes the same constant adjustment or no adjustment.)

d. The interest-bearing asset or liability is not prepayable (that is, able to be settled by either party prior to its scheduled maturity), except as indicated in the following sentences. This criterion does not apply to an interest-bearing asset or liability that is prepayable solely due to a call option provided that the hedging interest rate swap contains a mirror-image call option. The call option contained in the swap is considered a mirror-image of the call option contained in the hedged item if (1) the terms of the two call options exactly match (see Statement 133 Implementation Issue No. E6: Hedging–General: The Shortcut Method and the Provisions That Permit the Debtor or Creditor to Require Prepayment) and (2) the entity is the writer of one call option and the holder (or purchaser) of the other call option. Similarly, this criterion does not apply to the interest-bearing asset or liability that is prepayable solely due to a put option provided that the hedging interest rate swap contains an a mirror-image put option.

e. Any other terms in the interest-bearing financial instruments or interest rate swaps are typical of those instruments and do not invalidate the assumption of no ineffectiveness.

Conditions applicable to fair value hedges only

f. The expiration date of the swap matches the maturity date of the interest-bearing asset or liability.

g. There is no floor or ceiling on the variable interest rate of the swap.

h. The interval between repricings of the variable interest rate in the swap is frequent enough to justify an assumption that the variable payment or receipt is at a market rate (generally three to six months or less).

Conditions applicable to cash flow hedges only

i. All interest receipts or payments on the variable-rate asset or liability during the term of the swap are designated as hedged, and no interest payments beyond the term of the swap are designated as hedged.

j. There is no floor or cap on the variable interest rate of the swap unless the variable-rate asset or liability has a floor or cap. In that case, the swap must have a floor or cap on the variable interest rate that is comparable to the floor or cap on the variable-rate asset or liability. (For this purpose, comparable does not necessarily mean equal. For example, if a swap's variable rate is LIBOR and an asset's variable rate is LIBOR plus 2 percent, a 10 percent cap on the swap would be comparable to a 12 percent cap on the asset.)

k. The repricing dates match those of the variable-rate asset or liability.
1. The index on which the variable rate is based matches the index on which the asset or liability’s variable rate is based.

8. The fixed rate on a hedged item need not exactly match the fixed rate on a swap designated as a fair value hedge. Nor does the variable rate on an interest-bearing asset or liability need to be the same as the variable rate on a swap designated as a cash flow hedge. A swap’s fair value comes from its net settlements. The fixed and variable rates on a swap can be changed without affecting the net settlement if both are changed by the same amount. That is, a swap with a payment based on LIBOR and a receipt based on a fixed rate of 5 percent has the same net settlements and fair value as a swap with a payment based on LIBOR plus 1 percent and a receipt based on a fixed rate of 6 percent.

9. Comparable credit risk at inception is not a condition for assuming effectiveness even though actually achieving perfect offset would require that the same discount rate be used to determine the fair value of the swap and of the hedged item or hedged transaction. To justify using the same discount rate, the credit risk related to both parties to the swap as well as to the debtor on the hedged interest-bearing asset (in a fair value hedge) or the variable-rate asset on which the interest payments are hedged (in a cash flow hedge) would have to be the same. However, because that complication is caused by the interaction of interest rate risk and credit risk, which are not easily separable, comparable creditworthiness is not considered a necessary condition to assume effectiveness in a hedge of interest rate risk.
Specific Hedge Accounting Procedures for Derivatives

Synopsis: Derivatives may be designated as hedges of changes in the fair value or variability in expected cash flows of assets, liabilities, forecasted transactions or firm commitments due to one or more of the following risks: interest rate, security price, commodity price, foreign exchange rate, index of prices or rates or other variables (excluding risks of identifiable insurable events such as death, disability, accident, illness, damage to property or damage or injury to an insured or third party). Derivatives used in hedging transactions that meet the criteria of a highly effective hedge shall be considered an effective hedge and valued and reported in a manner that is consistent with the hedged asset or liability (referred to as hedge accounting). Under hedge accounting the valuation method used for the derivative shall be consistent with the valuation method used for the hedged item: e.g., amortized cost or fair value. Changes in the carrying value (i.e., amortization or fair value changes) or cash flow of the derivative shall be recognized in the same period and in the same category of income or surplus as the amortization or fair value changes of the hedged item: e.g. net gain from operations, realized capital gains and losses on investments, unrealized capital gains and losses on investments, or unrealized foreign exchange capital gain or loss.

The effects of hedge accounting are reflected in a manner that does not change the reporting of the item being hedged, consistent with the financial statement category that would normally be required under statutory accounting principles. Generally, if the change in the item being hedged is reported as a component of net gain from operations, the change in the derivative shall be reported in its appropriate component of net gain from operations. For example, a change in the aggregate reserve liabilities is reflected in its appropriate annual statement line change in aggregate reserves. A change in the related derivatives that are hedging that item is reflected through other income.

In the case where a portion of the item being hedged is reported as a component of net gain from operations, with the remainder reported as an other change to surplus, then the change in the hedging derivative is bifurcated; a portion is reported as a component of net gain from operations, in the appropriate category and included in the net gain from operations with the remainder reported as an other change to surplus.

For example, in the hedge of a foreign currency denominated asset the change in the value of the asset due to fluctuations in foreign exchange rates is recorded as unrealized capital gains or losses until the asset is sold. A derivative instrument that is in an effective hedging relationship of that item, shall have its change in value associated with fluctuations in foreign currency exchange rates bifurcated and recorded in unrealized capital gains and losses with the remaining change in value recorded consistent with the item being hedged (amortized cost or fair value).

A common purpose of entering into derivatives such as interest rate swaps and forwards as hedges is to change the interest rate characteristics of hedged items. Consistent with this purpose and the hedge accounting concept of matched accounting between the hedging and hedged item, hedged items may be viewed as bearing the changed interest rate characteristics and the cost of the derivatives may therefore be combined with the hedged items. All derivatives shall be reported on Schedule DB. When one or more derivatives hedge more than one asset, liability, forecasted transaction or firm commitment (or a portfolio of hedged items), a company may allocate the total derivative(s) to hedged items individually or in the aggregate. If derivatives are allocated to hedged items, indicate on Schedule DB the nature of the items hedged and the schedule or exhibit where they are presented.

An open derivative hedging a forecasted transaction or firm commitment shall be recorded at cost until the hedged transaction occurs. When the hedged forecasted transaction or firm commitment occurs, an
open derivative shall be accounted for in a manner consistent with the hedged item (i.e., amortized cost or fair value).

Upon termination of a derivative that qualified for hedge accounting of an existing asset or liability or a forecasted transaction or firm commitment, the resulting gain or loss shall be recognized in income in a manner that is consistent with the hedged item. If the hedged item is recorded at amortized cost, the gain or loss shall adjust, individually or in the aggregate, the basis of the hedged item subject to amortization. Alternatively, if the item being hedged is subject to IMR, the gain or loss on the terminated hedging derivative may be realized and shall be subject to IMR upon termination. For terminated derivatives, indicate on Section 3 of Schedule DB the nature of the assets or liabilities so adjusted and the schedule or exhibit where they are presented.

Derivative instruments used in hedging transactions that (i) do not meet or no longer meet the criteria of an effective hedge or (ii) meet the required hedge criteria but the entity has chosen not to apply hedge accounting shall be accounted for at fair value and the changes in the fair value shall be recorded in surplus as unrealized gains or unrealized losses (referred to as fair value accounting). Hedge accounting may not be applied upon inception, redesignation or termination of a derivative designated in a hedging relationship if documentation is not maintained in accordance with SSAP No. 86 paragraphs 34-36.

Specific hedge accounting procedures for derivative instruments are outlined below.

1. Call and Put Options, Warrants, Caps, and Floors:

   a. Accounting at Date of Acquisition (purchase) or Issuance (written): The premium paid or received for purchasing or writing a call option, put option, warrant, cap or floor shall either be (i) recorded as an asset (purchase) or liability (written) as an Aggregate Write-in for Invested Asset (or Liability) or (ii) combined with the hedged item(s) individually or in the aggregate;

   b. Statement Value:

   i. Open derivatives hedging items recorded at amortized cost:

   (a) Options, warrants, caps, and floors purchased or written shall be valued at amortized cost in a manner consistent with the hedged item;

   (b) The amortization period and methods used shall result in a constant effective yield over the life of the hedged item or program. (For floating rate hedged items, the estimated effective yield shall be based on the current rate so the changes in yields attributable to changes in interest rates will be recognized in the period of change). Specific treatment includes:

   (1) Holdings in derivatives purchased or written within a year of maturity or expiry need not be amortized;

   (2) For hedges of forecasted transactions or firm commitments, the derivative may be recorded at cost until the hedged transaction occurs or it is determined that the hedge was not effective (see (d) below in this section 1.b. i);
(3) For other derivatives, the amortization period is usually from date of acquisition (issuance) of the derivative to maturity of the hedged item or program.

(c) For hedges where the cost of the derivative is combined with the hedged item, the statement value is zero. The fair value of the derivative and hedged item shall be determined and reported separately, either individually or in the aggregate;

(d) For hedges of forecasted transactions or firm commitments, the derivative shall be recorded at cost until (1) the hedged transaction occurs or (2) it is determined that the hedge was not effective (when the derivative is valued in accordance with (e) in this section below);

(e) If during the life of the derivative it or a designated portion of the derivative is no longer effective as a hedge, valuation at amortized cost ceases and the derivative or the designated portion of the derivative shall be valued at its current fair value (marked to market) with gains and losses recognized in unrealized gains or unrealized losses to the extent it ceased to be an effective hedge.

ii. Open derivatives hedging items recorded at fair value (where gains and losses on the hedged item are recognized as adjustments to unassigned funds (surplus)):

(a) Options, warrants, caps, or floors purchased or written shall be valued at current fair value (marked to market) with changes in fair value recognized currently consistent with the hedged item; this will result in unrealized gain/loss treatment with adjustment to unassigned funds (surplus).

(b) For hedges where the cost of the derivative is combined with the hedged item, the fair value of the derivative and hedged item will be determined and reported separately, either individually or in the aggregate. The cost (book value) basis used to figure unrealized gain/loss on the derivative on Schedule DB is zero.

(c) For hedges of forecasted transactions or firm commitments, the derivative shall be recorded at cost until the hedged transaction occurs or it is determined that the hedge was not effective (when fair value accounting is applied as described in the Introduction above).

iii. Open derivatives hedging items recorded at fair value, where gains and losses on the hedged item are recognized currently in earnings: options, warrants, caps, or floors purchased or written shall be valued at current fair value (marked to market) with changes in fair value recognized currently in earnings together with the gains and losses on the hedged item.

(a) For hedges of forecasted transactions or firm commitments, the derivative shall be recorded at cost until (1) the hedged transaction occurs or (2) it is determined that the hedge was not effective (when fair value accounting is applied as described in (b) of this section below).
(b) If during the life of the derivative it or a designated portion of the derivative is no longer effective as a hedge, recognition of changes in fair value through earnings ceases. The derivative or the designated portion of the derivative shall continue to be valued at its current fair value (marked to market), but thereafter gains or losses shall be recognized in unrealized gains or unrealized losses to the extent it ceased to be an effective hedge.

c. Cash Flows and Income

i. Where the cost of the derivative is not combined with the hedged item:

   (a) Amortization of premium or discount on derivatives is an adjustment to net investment income or another appropriate caption within operating income consistent with the reporting of the hedged item;

   (b) Periodic cash flows and accruals of income/expense shall be reported in a manner consistent with the hedged item, such as net investment income or interest and adjustments on policy or deposit-type contract funds (operating income) or net realized capital gains.

ii. Where the cost of the derivative is combined with the hedged item, the cash flows and income of the derivative on Schedule DB will be zero. All related amortization and cash flow accounting shall be reported with the hedged item instead of with the derivative.

d. Gain/Loss on Termination of an option, warrant, cap or floor accounted for under hedge accounting (includes closing, exercise, maturity, and expiry):

i. Exercise of an Option: The remaining book value of the derivative shall become an adjustment to the cost or proceeds of the hedged item(s) received or disposed of individually or in aggregate;

ii. Sale, maturity, expiry, redesignation, or other closing transaction of a derivative which is an effective hedge—Any gain or loss on the transaction will adjust the basis (or proceeds) of the hedged item(s) individually or in aggregate. Alternatively, if the item being hedged is subject to IMR, the gain or loss on the terminated hedging derivative may be realized and shall be subject to IMR upon termination;

iii. Gain/loss on termination of derivatives will be recognized currently in net income (realized gain/loss) to the extent they ceased to be effective hedges.

(iv) Upon the redesignation of a derivative from a currently effective hedging relationship:

   (a) with an item(s) carried at amortized cost to another effective hedging relationship with an item(s) carried at amortized cost, the derivative shall continue to be recorded at amortized cost and no gain or loss on the derivative shall be recognized.

   (b) with an item(s) carried at amortized cost or fair value to an effective relationship with an item(s) carried at fair value, the accounting for the derivative shall be consistent with (ii) above.
2. Swaps, Collars, and Forwards (see also discussion in Introduction above):

a. Accounting at Date of Opening Position:

   i. Any premium paid or received at date of opening shall either be (a) recorded as an asset (paid) or liability (received) as an Aggregate Write-in for Invested Asset (or Liability) or (b) combined with the hedged item(s), individually or in the aggregate;

b. Statement Value:

   i. Open derivatives hedging items recorded at amortized cost:

      (a) Swaps, collars, and forwards shall be valued at amortized cost in a manner consistent with hedged item;

      (b) The amortization period and methods used shall result in a constant effective yield over the life of the hedged item or program. (For floating rate hedged items the estimated effective yield shall be based on the current rate so the changes in yields attributable to changes in interest rates will be recognized in the period of change.) Specific treatment includes:

         (1) Holdings in derivatives purchased or written within a year of maturity or expiry need not be amortized;

         (2) For hedges of forecasted transactions or firm commitments, the derivative shall be recorded at cost until (a) the hedged transaction occurs or (b) it is determined that the hedge was not effective (see (5) in this section 2. (b)(i) below);

         (3) For other derivatives the amortization period is usually from date of acquisition (issuance) of the derivative to maturity of the hedged item or program;

         (4) For hedges where the cost of the derivative is combined with the hedged item, the statement value is zero. The fair value of the derivative and hedged item shall be determined and reported separately, either individually or in the aggregate;

         (5) If during the life of the derivative it or a designated portion of the derivative is no longer effective as a hedge, valuation at amortized cost ceases and the derivative or a designated portion of the derivative shall be valued at its current fair value (marked to market) with gains and losses recorded in unrealized gains or unrealized losses to the extent that it ceased to be an effective hedge. Upon redesignation into an effective
hedging relationship, the derivative’s mark to fair value through unrealized gain or loss shall be reversed.

ii. Open derivatives hedging items recorded at fair value (where gains and losses on the hedged item are recognized as adjustments to unassigned funds (surplus)):

(a) Swaps, collars, or forwards shall be valued at current fair value (marked to market) with changes in fair value recognized currently consistent with the hedged item; this will result in unrealized gain/loss treatment with adjustment to unassigned funds (surplus);

(b) For hedges where the derivative is combined with the hedged item, the fair value of the derivative and hedge item shall be determined and reported separately, either individually or in the aggregate. The cost (book value) basis used to figure gain/loss on the derivative is zero.

iii. Open foreign currency swap and forward contracts hedging foreign currency exposure on items denominated in a foreign currency and translated into U.S. dollars where fair value accounting is not being used:

(a) The foreign exchange premium (discount) on the currency contract shall be amortized into income over the life of the contract or hedge program. The foreign exchange premium (discount) is defined as the foreign currency (notional) amount to be received (paid) times the net of the forward rate minus the spot rate at the time the contract was opened.

Amortization is not required if the contract was entered into within a year of maturity;

(b) A foreign currency translation adjustment shall be reflected as an unrealized gain/loss (unassigned funds (surplus) adjustment) using the same procedures as done to translate the hedged item;

(c) The unrealized gain/loss for the period equals the foreign currency (notional) amount to be received (paid) times the net of the current spot rate minus the prior period end spot rate;

(d) The statement value of the derivative equals the amortized (premium) discount plus the cumulative unrealized gain/(loss) on the contract. The cumulative unrealized gain/(loss) equals the foreign currency (notional) amount to be received (paid) times the net of the current spot rate minus the spot rate at the time the contract was opened;

(e) Recognition of unrealized gains/losses and amortization of foreign exchange premium/discount on derivatives hedging forecasted transactions or firm commitments shall be deferred until the hedged transaction occurs. These deferred gains/losses will adjust the basis or proceeds of the hedged transaction when it occurs;

(f) For hedges where the cost of the foreign currency contract is combined with the hedged item, the statement value on Schedule DB is zero. The fair value of the derivative and hedged item shall be determined and reported separately, either individually or in the aggregate;
(g) If during the life of the currency contract it or a designated portion of the currency contract is not effective as a hedge, valuation at amortized cost shall cease. To the extent it ceased to be an effective hedge, a cumulative unrealized gain/loss (surplus adjustment) will be recognized equal to the notional amount or designated notional amount times the difference between the forward rate available for the remaining maturity of the contract (i.e., the forward rate as of the balance sheet date) and the forward rate at the time it ceased to be an effective hedge.

iv. Open derivatives hedging items recorded at fair value, where gains and losses on the hedged item are recognized currently in earnings: swaps, collars and forwards shall be valued at current fair value (marked to market) with changes in fair value recognized currently in earnings together with the gains and losses on the hedged item.

(a) If during the life of the derivative it or a designated portion of the derivative is no longer effective as a hedge, recognition of changes in fair value through earnings ceases. The derivative shall continue to be valued at its current fair value (marked to market), but thereafter gains or losses shall be recognized in unrealized gains or unrealized losses to the extent it ceased to be an effective hedge.

c. Cash Flows and Income:

i. Where the cost of the derivative is not combined with the hedged item:

(a) Amortization of premium paid or received on derivatives is an adjustment to net investment income or another appropriate caption within operating income consistent with the reporting of the hedged item;

(b) Periodic cash flows and accruals of income/expense are to be reported in a manner consistent with the hedged item, usually as net investment income or another appropriate caption within operating income.

ii. Where the cost of the derivative is combined with the hedged item, the cash flows and income of the derivative on Schedule DB is zero. All related amortization and cash flow accounting shall be reported with the hedged item instead of with the derivative.

d. Gain/Loss on Termination of a swap, collar or forward accounted for under hedge accounting (includes closing, exercise, maturity, and expiry):

i. Exercise—The remaining book value of the derivative shall become an adjustment to the cost or proceeds of the hedged item(s) received or disposed of individually or in aggregate;

ii. Sale, maturity, expiry, redesignation, or other closing transaction of a derivative which is an effective hedge—Any gain or loss on the transaction will adjust the basis (or proceeds) of the hedged item(s) individually or in aggregate. Alternatively, if the item being hedged is subject to IMR, the gain or loss on the terminated hedging derivative may be realized and shall be subject to IMR upon termination;
iii. Gain/loss on termination of derivatives will be recognized currently in net income (realized gain/loss) to the extent they ceased to be effective hedges.

(iv) Upon the redesignation of a derivative from a currently effective hedging relationship-

(a) with an item(s) carried at amortized cost to another effective hedging relationship with an item(s) carried at amortized cost, the derivative shall continue to be recorded at amortized cost and no gain or loss on the derivative shall be recognized.

(b) with an item(s) carried at amortized cost or fair value to an effective relationship with an item(s) carried at fair value, the accounting for the derivative shall be consistent with (ii) above.

(c) with an item(s) carried at fair value to an effective relationship with an item(s) carried at amortized cost, the accounting for the derivative shall be consistent with (ii) above.

3. Futures (see also discussion in Introduction above):

a. Accounting at Date of Acquisition:

i. Positions in futures contracts shall be initially valued at the amount of cash deposits (i.e., basis or book value of the contract), if any, placed with a broker and either be (a) recorded as an asset (paid) or liability (received) as an Aggregate Write-in for Invested Asset (or Liability) or (b) combined with the hedged item. Subsequent additions (reductions) in cash deposits plus changes in contract value from date of contract opening (i.e., variation margin) paid (received) will increase (decrease) the book value of the futures contract (hedge accounting).

b. Statement Value:

i. Hedges of Items Recorded at Amortized Cost:

(a) Futures shall be valued at book value;

(b) Book value of open futures contracts need not be amortized;

(c) For hedges where the variation margin portion of the cost of the futures contract is combined with the hedged item, the statement value of the futures contract would be equal to cash deposits outstanding, if any. The fair value of the futures contract and the hedged item will be determined and reported separately, either individually or in the aggregate. Fair value on futures contracts is limited to the value of the cash deposits outstanding;

(d) For hedges of forecasted transactions or firm commitments, the derivative shall be recorded at cost (with the variation margin deferred) until (1) the hedged transaction occurs or (2) it is determined that the hedge was not effective (see (e) in this section below);
(e) If during the life of the futures contract it or a designated portion of the futures contract is no longer effective as a hedge, hedge accounting for the variation margin ceases. A gain/(loss) equal to the variation margin received (paid) shall be recognized in unrealized gains or unrealized losses (surplus adjustment) to the extent it or a designated portion of the variation margin ceased to be an effective hedge. Statement value will be limited to the cash deposits outstanding, if any, and subsequent changes in the variation margin will be recognized in unrealized gains or unrealized losses (surplus adjustment).

ii. Hedges of Items Recorded at Fair Value (where gains and losses on the hedged item are recognized as adjustments to unassigned funds (surplus)):

(a) Changes in futures contract value from date of contract opening (i.e., variation margin) shall be recognized currently consistent with the hedged item. Statement value will be limited to the cash deposits outstanding, if any;

(b) This will result in unrealized gain/loss treatment with adjustment to unassigned funds (surplus);

(c) For hedges where the variation margin of the futures contract is combined with the hedged item, the fair value of the futures contract and the hedged item will be determined and reported separately, either individually or in the aggregate.

iii. Open foreign currency futures contracts hedging foreign currency exposure on item(s) denominated in a foreign currency and translated into U.S. dollars (where fair value accounting is not being used):

(a) The foreign exchange premium (discount) on the currency contract will be amortized into net investment income over the life of the contract or hedge program. The foreign exchange premium (discount) is defined as the foreign currency (notional) amount to be received (paid) times the net of the forward rate minus the spot rate at the time the contract was opened.

Amortization is not required if the contract was entered into within a year of maturity;

(b) A foreign currency translation adjustment shall be reflected as an unrealized gain/loss (unassigned funds (surplus) adjustment) using the same procedures as is done to translate the hedged item. The cumulative unrealized gain/(loss) which equals the foreign currency (notional) amount to be received (paid) times the net of the current spot rate minus the spot rate at the time the contract was opened shall be reported as recognized variation margin;

(c) The statement value of the currency futures contract is book value, including any cash deposits outstanding and increase (decrease) for amortization of foreign exchange (premium) discount plus the foreign
exchange translation gain/(loss), which is reported as deferred variation margin;

(d) Recognition of unrealized gains/losses and amortization of foreign exchange premium/discount on derivatives hedging forecasted transactions or firm commitments shall be deferred until the hedged transaction occurs. These deferred gains/losses will adjust the basis or proceeds of the hedged transaction when it occurs;

(e) For hedges where the variation margin of the foreign currency contract is combined with the hedged item, the statement value of the foreign currency contract would equal the cash deposits outstanding, if any. The fair value of the derivative and the hedged item will be determined and reported separately, either individually or in the aggregate. Fair value on futures contracts is limited to the value of the cash deposits outstanding;

(f) If during the life of the currency contract it or a designated portion of the currency contract is not effective as a hedge, valuation at amortized cost ceases. To the extent it ceases to be an effective hedge, an unrealized gain/loss will be recognized equal to the notional amount or a designated portion of the notional amount times the difference between the forward rate available for the remaining maturity of the contract (i.e., the forward rate as of the balance sheet date) and the forward rate at the time it ceased to be an effective hedge.

iv. Open futures hedging items recorded at fair value, where gains and losses on the hedging item are recognized currently in earnings shall be valued at current fair value (marked to market) with changes in fair value recognized currently in earnings.

(a) If during the life of the futures contract it or a designated portion of the futures contract is not longer effective as a hedge, current recognition in earnings of changes in fair value ceases. Prospective changes in the variation margin shall be recognized in unrealized gains or unrealized losses (surplus adjustment) to the extent it or a designated portion of the variation margin ceased to be an effective hedge. Statement value of the derivative will thereafter be limited to the cash deposits outstanding, if any.

c. Gain/Loss on Termination of a futures contract accounted for under hedge accounting:

i. Settlement at maturity of a futures contract—The remaining variation margin of the futures contract shall become an adjustment to the cost or proceeds of the hedged item(s) received, disposed of or held, individually or in aggregate;

ii. Sale, redesignation, or other closing transaction of a futures contract which is an effective hedge—Any gain or loss on the transaction will adjust the basis (or proceeds) of the hedged item(s) individually or in aggregate. Alternatively, if the item being hedged is subject to IMR, the gain or loss on the terminated hedging derivative may be realized and shall be subject to IMR upon termination;

iii. Gain/loss on termination of futures contracts will be recognized currently in net income (realized gain/loss) to the extent they ceased to be effective hedges.
(iv) Upon the redesignation of a derivative from a currently effective hedging relationship-

(a) with an item(s) carried at amortized cost to another effective hedging relationship with an item(s) carried at amortized cost, the derivative shall continue to be recorded at amortized cost and no gain or loss on the derivative shall be recognized.

(b) with an item(s) carried at amortized cost or fair value to an effective relationship with an item(s) carried at fair value, the accounting for the derivative shall be consistent with (ii) above.

(c) with an item(s) carried at fair value to an effective relationship with an item(s) carried at amortized cost, the accounting for the derivative shall be consistent with (ii) above.
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Statement of Statutory Accounting Principles No. 87

Capitalization Policy, An Amendment to SSAP Nos. 4, 19, 29, 73, 79 and 82

STATUS

Type of Issue: Common
Issued: Finalized September 11, 2002
Effective Date: January 1, 2004
Affects: Supersedes paragraph 3 of SSAP No. 4
Supersedes paragraphs 3 and 6 of SSAP No. 19
Supersedes paragraph 3 of SSAP No. 29
Supersedes paragraph 10 of SSAP No. 73
Supersedes paragraph 4 of SSAP No. 79
Supersedes paragraph 4 of SSAP No. 82

Affected by: No other pronouncements
Interpreted by: No other pronouncements

SCOPE OF STATEMENT

SUMMARY CONCLUSION

Disclosures
Effective Date and Transition

RELEVANT ISSUE PAPERS
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SCOPE OF STATEMENT

1. This statement establishes a statutory capitalization policy that is consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts).

SUMMARY CONCLUSION

2. In general, this statement amends the phrase “in accordance with the reporting entity's capitalization policy, immaterial amounts ... can be expensed ...” to “in accordance with the reporting entity’s written capitalization policy, amounts less than a predefined threshold ... shall be expensed ...”. A predefined threshold shall be established, for each asset class identified by SSAP Nos. 19, 29, 73, 79 and 82, by management based upon an analysis of circumstances unique to the entity and shall not be adjusted from period to period except under extenuating circumstances. If an entity demonstrates a pattern of varying its capitalization policy from period to period without sufficient evidence as determined by the reporting entity’s domestic regulator, such action would call into question both the entity’s ability to accurately establish a predefined threshold and the propriety of expensing or capitalizing certain assets. Accordingly, entities shall expense all immaterial amounts (i.e., entity is no longer allowed to establish its own capitalization policy).

3. This statement amends paragraph 3 of SSAP No. 4 to the following:

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

   a. Specifically identified within the Accounting Practices and Procedures Manual as a nonadmitted asset; or


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

4. This statement amends paragraphs 3 and 6 of SSAP No. 19 to the following:

   In accordance with the reporting entity's written capitalization policy, amounts less than a predefined threshold of such assets shall be expensed when purchased.
5. This statement amends paragraph 3 of SSAP No. 29 to the following:

   In accordance with the reporting entity's written capitalization policy, prepaid expenses less than a predefined threshold shall be expensed when purchased.

6. This statement amends paragraph 10 of SSAP No. 73 to the following:

   In accordance with the reporting entity's written capitalization policy, amounts less than a predefined threshold of medical supplies, pharmaceuticals and surgical supplies, durable medical equipment, furniture, medical equipment and fixtures, and leasehold improvements shall be expensed when purchased.

7. This statement amends paragraph 4 of SSAP No. 79 to the following:

   In accordance with the reporting entity’s written capitalization policy, amounts less than a predefined threshold shall be expensed when purchased, otherwise the assets shall be capitalized and depreciated in accordance with this statement.

8. This statement amends paragraph 4 of SSAP No. 82 to the following:

   In accordance with the reporting entity’s written capitalization policy, amounts less than a predefined threshold of such costs shall be expensed when incurred.

9. The reporting entity shall maintain a capitalization policy containing the predefined thresholds for each asset class to be made available for the department(s) of insurance.

Disclosures

10. The financial statements shall disclose if the written capitalization policy and the resultant predefined thresholds changed from the prior period and the reason(s) for such change.

Effective Date and Transition

11. This statement is effective for years beginning on and after January 1, 2004. Early adoption is encouraged but not required.

RELEVANT ISSUE PAPERS

• Issue Paper No. 119–Capitalization Policy, An Amendment to SSAP Nos. 4, 19, 29, 73, 79 and 82
Statement of Statutory Accounting Principles No. 89

Accounting for Pensions, A Replacement of SSAP No. 8

STATUS

Type of Issue: Common Area

Issued: December 8, 2003

Effective Date: December 31, 2003

Affects: Supersedes SSAP No. 8
Nullifies INT 99-24, INT 01-17, INT 02-18

Affected by: No other pronouncements

Interpreted by: No other pronouncements

SCOPE OF STATEMENT

SUMMARY CONCLUSION

Defined Benefit Plans

Defined Contribution Plans

Disclosures

Consolidated/Holding Company Plans

Relevant Literature

Effective Date and Transition

AUTHORITATIVE LITERATURE

RELEVANT ISSUE PAPERS
Accounting for Pensions, A Replacement of SSAP No. 8

SCOPE OF STATEMENT

1. This statement establishes statutory accounting principles and related reporting for employers’ pension obligations.

2. This statement supersedes the conclusions reached in Statement of Statutory Accounting Principles (SSAP) No. 8—Pensions (SSAP No. 8) and incorporates the guidance in Interpretation (INT) 99-24 – Accounting for Restructuring Charges, INT 99-26 – Offsetting Pension Assets and Liabilities, INT 01-16 – Measurement Date for SSAP No. 8 Actuarial Valuations, INT 01-17 – Accounting for Nonqualified Retirement Plans, Nonvested Ancillary Benefits Within Retirement Plans, and Protected Benefits Such as Early Retirement Subsidies in Retirement Plans, as well as some of the guidance in INT 02-18 – Accounting for the Intangible Asset as Described in SSAP No. 8 Paragraph 9 d.v. and 9f.

SUMMARY CONCLUSION

Defined Benefit Plans

3. A defined benefit plan defines the amount of the pension benefit that will be provided to the plan participant at retirement or termination. For such benefit plans, reporting entities shall adopt Financial Accounting Standards Board (FASB) Statement No. 87 (FAS 87), Employers’ Accounting for Pensions with modifications to exclude non-vested employees and to account for the additional minimum pension liability. Therefore, the cost related to services rendered prior to becoming eligible and vested in the plan are recognized as a component of the net periodic pension cost in the period the employee becomes vested. Any intangible asset or prepaid expense, other than the intangible asset associated with the transition obligation recorded as of January 1, 2001, resulting from adoption of the provisions of this statement shall be considered a nonadmitted asset, as such an asset cannot be readily converted to cash to satisfy policyholder obligations. This is consistent with the definition of assets and nonadmitted assets set forth in SSAP No. 4—Assets and Nonadmitted Assets.

4. If the accumulated benefit obligation exceeds the fair value of plan assets, the reporting entity shall recognize a liability (including unfunded accrued pension cost) that is at least equal to the unfunded accumulated benefit obligation. Recognition of an additional minimum liability is required if an unfunded accumulated benefit obligation exists and (a) a prepaid pension cost asset has been recognized as a nonadmitted asset, (b) the liability already recognized as unfunded accrued pension cost is less than the unfunded accumulated benefit obligation, or (c) no accrued or prepaid pension cost has been recognized.

5. If an additional minimum liability is recognized an equal amount shall be recognized as an intangible asset, provided that the asset recognized shall not exceed the amount of unrecognized prior service cost (unrecognized prior service cost shall include unamortized incremental liability). If an intangible asset generated by the additional minimum liability is recognized, only that portion in excess of the unamortized incremental liability associated with the transition shall be nonadmitted. If an additional liability required to be recognized exceeds unrecognized prior service cost, the excess (which would represent a net loss not yet recognized as net periodic pension cost) shall be reported as a component of unassigned funds (surplus), net of any tax benefits that result from considering such losses as temporary differences for purposes of applying the provisions of SSAP No. 10—Income Taxes.

6. When a new determination of the amount of additional liability is made, the related intangible asset and the balance accumulated in unassigned funds (surplus) shall be eliminated or adjusted as necessary.
7. If a reporting entity settles or curtails a defined benefit plan, the reporting entity shall immediately recognize all previously unrecognized amounts as discussed below. A settlement is a transaction which is irrevocable and releases the employer from responsibility for the pension obligation by eliminating the risks relative to the obligation and the assets associated with the plan (e.g., making lump-sum cash payments to plan participants in exchange for their rights to receive specified pension benefits or purchasing nonparticipating annuity contracts to cover vested benefits). If a settlement occurs and the net result is a loss, such loss is recognized at the time of the settlement. If the net result is a gain, such gain is not recognized until the proceeds are received by the reporting entity. A curtailment is an event which significantly alters the makeup of the pension plan. If a curtailment occurs, there are generally two components to any gain or loss (e.g., a reduction in the years of service required or the employees covered). Any unrecognized prior service cost shall be recognized as a loss. An increase or decrease in pension benefit obligations due to the curtailment will also result in a gain or loss, and is combined with the prior service cost loss. If the net result of the curtailment is a loss, such loss shall be recognized when it is probable that the curtailment will occur and that the effects can be reasonably estimated. If the net result is a gain, such gain shall not be recognized in earnings until the employees terminate or the plan suspension or amendment is adopted and the proceeds are received by the reporting entity. When settlement gains or curtailment gains are recognized, any excise tax surcharges shall also be recognized.

**Defined Contribution Plans**

8. A defined contribution plan defines the amount of the employer's contributions to the plan and its allocation to plan participants. The pension benefit provided to the plan participant at retirement or termination depends on the amount of employer and employee contributions, earnings on plan investments and, in some plans, other participant forfeitures.

9. For defined contribution plans, the reporting entity shall expense contributions required by the plan over the period in which the employee vests in those contributions. Contributions to plan participants' accounts made prior to vesting shall be treated as prepaid expenses, and shall be nonadmitted. Contributions required after participants terminate or retire shall be accrued and an expense shall be recorded over the working lives of the participants beginning at the date the participant initially vests in plan contributions.

10. Certain defined contribution plans may define the employer's contribution as a percentage of the plan participants' individual compensation rather than as a specific dollar amount which is allocated among the plan participants. If an employer's contributions to a defined contribution plan are in excess of those required under the plan and required to be allocated to individual participants, such amounts are recorded as a prepaid expense and nonadmitted under statutory accounting principles.

**Disclosures**

11. The following disclosures shall be made for defined benefit pension plans for which the reporting entity is directly liable:

   a. A reconciliation of beginning and ending balances of the benefit obligation showing separately, if applicable, the effects during the period attributable to service cost, interest cost, contributions by plan participants, actuarial gains and losses, foreign currency exchange rate changes, benefits paid, plan amendments, business combinations, divestitures, curtailments, settlements, and special termination benefits;

   b. The amount of the pension obligation for non-vested employees as of the most recent actuarial valuation date;

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c. A reconciliation of beginning and ending balances of the fair value of plan assets showing separately, if applicable, the effects during the period attributable to actual return on plan assets, foreign currency exchange rate changes, contributions by the reporting entity, contributions by plan participants, benefits paid, business combinations, divestitures, and settlements;

d. The funded status of the plan, the amounts not recognized in the statement of financial position, and the amounts recognized in the statement of financial position, including:

   i. The amount of any unamortized prior service cost;

   ii. The amount of any unrecognized net gain or loss (including asset gains and losses not yet reflected in market-related value);

   iii. The amount of any remaining unamortized, unrecognized net obligation or net asset existing at the initial date of application of this statement;

   iv. The net pension or other postretirement benefit prepaid assets or accrued liabilities; and

   v. Any intangible asset;

e. The amount of net periodic benefit cost recognized, showing separately the service cost component, the interest cost component, the expected return on plan assets for the period, the amortization of the unrecognized incremental liability or incremental asset (see paragraph 18), the amount of recognized gains and losses, the amount of prior service cost recognized, and the amount of gain or loss recognized due to a settlement or curtailment;

f. The amount included in unassigned funds (surplus) for the period arising from a change in the additional minimum pension liability recognized pursuant to paragraph 5;

g. On a weighted-average basis, the following assumptions used in the accounting for the plan: assumed discount rate, rate of compensation increase (for pay-related plans), and expected long-term rate of return on plan assets;

h. If applicable, the amounts and types of securities of the reporting entity and related parties included in plan assets, the approximate amount of future annual benefits of plan participants covered by insurance contracts issued by the reporting entity or related parties, and any significant transactions between the reporting entity or related parties and the plan during the period;

i. If applicable, any alternative amortization method used to amortize prior service amounts or unrecognized net gains and losses pursuant to paragraphs 26 and 33 of FAS 87;

j. If applicable, any substantive commitment, such as past practice or a history of regular benefit increases, used as the basis for accounting for the benefit obligation;

k. If applicable, the cost of providing special or contractual termination benefits recognized during the period and a description of the nature of the event; and

l. An explanation of any significant change in the benefit obligation or plan assets not otherwise apparent in the other disclosures required by this statement.
Amounts related to the reporting entity’s results of operations shall be disclosed for each period for which an income statement is presented. Amounts related to the reporting entity’s statement of financial position shall be disclosed for each balance sheet presented.

12. The reporting entity shall disclose the amount of cost recognized for defined contribution pension plans during the period separately from the amount of cost recognized for defined benefit plans. The disclosures shall include a description of the nature and effect of any significant changes during the period affecting comparability, such as a change in the rate of employer contributions, a business combination, or a divestiture.

13. The reporting entity shall disclose the amount of contributions to multiemployer plans during the period. The reporting entity may disclose total contributions to multiemployer plans without disaggregating the amounts attributable to pensions and other postretirement benefits. The disclosures shall include a description of the nature and effect of any changes affecting comparability, such as a change in the rate of employer contributions, a business combination, or a divestiture.

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

**Consolidated/Holding Company Plans**

15. The employees of many reporting entities are members of a plan sponsored by a parent company or holding company. A reporting entity who participates in these plans and is not directly liable for obligations under the plan shall recognize pension expense equal to its allocation from the holding company or parent company of the required contribution to the plan for the period. A liability shall be established for any such contributions due and unpaid. Furthermore, the reporting entity shall disclose in the notes to the financial statements that its employees participate in a plan sponsored by the holding company for which the reporting entity has no legal obligation. The amount of expense incurred and the allocation methodology utilized by the provider of such benefits shall also be disclosed. If the reporting entity is directly liable for obligations under the plan, then the requirements outlined above in paragraphs 3 to 11 and 18 to 22 of this statement shall be applied.

**Relevant Literature**

16. The conclusions in paragraphs 3 to 11 and 18 to 22 adopt FAS 87, *FASB Statement No. 88, Employers’ Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits* (FAS 88), and FASB Statement No. 132, *Employers’ Disclosures about Pensions and Other Postretirement Benefits* an amendment of *FASB Statements No. 87, 88, and 106* (FAS 132) with certain modifications. Those modifications and additional information from nullified interpretations are listed below:

   a. Calculation of the pension obligation shall exclude non-vested employees. Partially vested employees are included only to the extent of their vested amounts;

   b. A liability for ancillary benefits (primarily death and disability benefits) shall be accrued prior to the triggering event of these benefits for purposes of Projected Benefit Obligation (PBO) and Service Cost (SC) in accordance with the guidance in FAS 87 (use of a general vesting standard rather than an Internal Revenue Service income tax vesting standard);

   c. A liability for protected, nonvested benefits shall be accrued for purposes of PBO and SC in accordance with the guidance in FAS 87 (use of a general vesting standard rather than an Internal Revenue Service income tax vesting standard);
d. A liability for nonvested, nonqualified benefits prior to retirement or when there is no longer a substantial risk of forfeiture, shall be accrued for purposes of PBO and SC in accordance with the guidance in FAS 87 (use of a general vesting standard rather than an Internal Revenue Service income tax vesting standard);

e. Entities shall perform actuarial analysis consistent with the three month guideline contained within FAS 87;

f. A reporting entity that utilizes an actuarial valuation as of a date prior to the financial statement date to measure plan assets and obligations, and determines that an additional minimum liability is required to be established in accordance with paragraph 37 of FAS 87, and if the reporting entity contributes amounts to the plan to fund that additional minimum liability prior to the financial statement date, such amount funded may be used to reduce the additional minimum liability recognized in the reporting entity’s financial statements;

g. It is not acceptable statutory accounting practice to offset pension or postretirement benefits other than pensions (OPEB) liability generated by one plan against the prepaid asset of another plan;

h. Reporting entities may downsize their operations and in doing so, often offer severance pay and other benefits to displaced workers. Costs associated with downsizing shall be recorded as an expense in the financial statements;

i. The prepaid asset which results from an excess of the fair value of plan assets over the pension obligation shall be recorded as a nonadmitted asset;

j. Any intangible asset offsetting the minimum pension liability (excluding the unamortized incremental liability associated with transition) shall be nonadmitted and charged to surplus;

k. Any additional minimum liability in excess of unrecognized prior service cost that is reported as a component of unassigned funds (surplus), shall be classified as an aggregate write-in for gains and losses in surplus;

l. As of January 1, 2001 the pension obligation or asset not previously recognized related to vested employees may be recorded immediately or may be amortized over future periods;

m. Paragraphs 36 through 38 of FAS 87 are adopted with the modifications described in paragraph 5 of this statement;

n. A net gain (net of excise tax surcharge) resulting from the settlement or curtailment of a pension plan is not recognized until the proceeds are received by the reporting entity;

o. The reduced disclosure requirements for nonpublic entities described in paragraph 8 of FAS 132 are rejected. All reporting entities shall follow the disclosure requirements included in paragraph 5 of FAS 132;

p. For the disclosures relating to the initial date of application in paragraph 5 of FAS 132, January 1, 2001 shall be considered the initial date of application; and

q. Pension disclosures relating to other comprehensive income in paragraph 5 of FAS 132 shall be made for unassigned funds (surplus) on a statutory basis.
17. This statement also adopts FASB Emerging Issues Task Force No. 88-1, Determination of Vested Benefit Obligation for a Defined Benefit Pension Plan, FASB Emerging Issues Task Force No. 90-3, Accounting for Employers' Obligations for Future Contributions to a Multiemployer Pension Plan, FASB Emerging Issues Task Force No. 91-7, Accounting for Pension Benefits Paid by Employers after Insurance Companies Fail to Provide Annuity Benefits, and FASB Emerging Issues Task Force No 96-5, Recognition of Liabilities for Contractual Termination Benefits or Changing Benefit Plan Assumptions in Anticipation of a Business Combination.

Effective Date and Transition

18. As of January 1, 2001, the transition obligation or asset shall be determined as the difference between the vested projected benefit obligation and the fair value of plan assets. If prior to the effective date of January 1, 2001, the reporting entity has adopted FAS 87 for statutory accounting purposes, the transition obligation or asset calculated above shall be compared to those amounts previously recorded under FAS 87. The difference between these amounts represents an incremental asset or liability. If the reporting entity has not previously adopted FAS 87 for statutory accounting purposes, the entire transition asset or obligation represents the incremental asset or liability.

19. As of January 1, 2001, if the reporting entity calculates an incremental liability, this liability shall be recognized according to one of the two following methods:

   a. The reporting entity may elect to record the entire incremental liability as a direct charge to surplus;

   b. Alternatively, the reporting entity may elect to amortize the incremental liability as a component of net periodic pension cost over a period not to exceed 20 years.

20. As of January 1, 2001, if the reporting entity calculates an incremental asset, this asset shall be recognized according to one of the two following methods:

   a. The reporting entity may elect to record the entire incremental asset as a direct credit to surplus;

   b. Alternatively, the reporting entity may elect to accrue the incremental asset as a component of net periodic pension cost in an amount each period such that total net periodic pension cost may be reduced to an amount not less than zero (i.e., the accrual of the incremental asset may be used to offset current period net periodic pension cost).

21. An incremental asset resulting from a transition obligation that is less than an amount previously recorded under FAS 87 shall first reduce the recorded liability. Any remaining incremental asset shall be recorded as nonadmitted.

22. This statement is effective for years ending on or after, December 31, 2003. SSAP No. 8 applies to the calculation of the transition obligation in accordance with the adoption of FAS 87 for periods prior to the adoption of this statement. 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—Accounting Changes and Corrections of Errors. For reporting entities that expensed the additional minimum pension liability through income prior to January 1, 2004 under SSAP No. 8, if the additional minimum pension liability subsequently decreases because of factors such as asset value recovery, the reversal of the expense shall be through unassigned funds (surplus). Restatement of previously expensed additional minimum liability amounts through the income statement is not permitted.
AUTHORITATIVE LITERATURE

Statutory Accounting

- Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy
- SSAP No. 8—Pensions
- Minutes from the June 23, 1987 meeting of the Accounting Practices and Procedures (EX4) Task Force
- Minutes from the September 15, 1987 meeting of the Accounting Practices and Procedures (EX4) Task Force
- Minutes from the June 12, 1986 meeting of the Emerging Accounting Issues Working Group of the Accounting Practices and Procedures (EX4) Task Force
- Minutes from the September 8, 1986 meeting of the Emerging Accounting Issues Working Group of the Accounting Practices and Procedures (EX4) Task Force
- Accounting Practices and Procedures Manual for Life and Accident and Health Insurance Companies, Chapter 17, Other Liabilities
- Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies
- NAIC Annual Statement Instructions for Life and Accident and Health Insurance Companies
- NAIC Annual Statement Instructions for Property and Casualty Insurance Companies
- Employers’ Accounting for Postretirement Benefits Other Than Pensions - Field Test of the Statutory Proposal - prepared by the Codification Advisory Group, September 20, 1992
- INT 02-18: Accounting for the Intangible Asset as Described in SSAP No. 8 Paragraph 9 d.v. and 9 f.
- INT 01-16 – Measurement Date for SSAP No. 8 Actuarial Valuations
- INT 01-17 – Accounting for Nonqualified Retirement Plans, Nonvested Ancillary Benefits Within Retirement Plans, and Protected Benefits Such as Early Retirement Subsidies in Retirement Plans
- INT 99-24 – Accounting for Restructuring Charges
- INT 99-26 – Offsetting Pension Assets and Liabilities

Generally Accepted Accounting Principles

- FASB Statement No. 87, Employers’ Accounting for Pensions
- FASB Statement No. 88, Employers’ Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits
• FASB Statement No. 132, Employers’ Disclosures about Pensions and Other Postretirement Benefits an amendment of FASB Statements No. 87, 88, and 106

• FASB Emerging Issues Task Force No. 88-1, Determination of Vested Benefits Obligation for a Defined Benefit Pension Plan

• FASB Emerging Issues Task Force No. 90-3, Accounting for Employers’ Obligations for Future Contributions to a Multiemployer Pension Plan

• FASB Emerging Issues Task Force No. 91-7, Accounting for Pension Benefits Paid by Employers after Insurance Companies Fail to Provide Annuity Benefits

• FASB Emerging Issues Task Force No. 96-5, Recognition of Liabilities for Contractual Termination Benefits or Changing Benefit Plan Assumptions in Anticipation of a Business Combination

RELEVANT ISSUE PAPERS

• Issue Paper No. 3—Accounting Changes

• Issue Paper No. 4—Definition of Assets and Nonadmitted Assets

• Issue Paper No. 5—Definition of Liabilities, Loss Contingencies and Impairments of Assets

• Issue Paper No. 8—Accounting for Pensions

• Issue Paper No. 123—Accounting for Pensions, A Replacement of SSAP No. 8
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**Book Value** Original cost, including capitalized acquisition costs and accumulated depreciation, unamortized premium and discount, deferred origination and commitment fees, direct write-downs, and increase/decrease by adjustment.

**Call Provision** Option to buy an asset at a specified price within a specified period.

**Capitation Arrangement** A compensation plan used in connection with some managed care contracts in which a physician or other medical provider is paid a flat amount, usually on a monthly basis, for each subscriber who has elected to use that physician or medical provider.

**Carrying Value (Amount)** The SAP book value plus accrued interest and reduced by any valuation allowance and any nonadmitted adjustment applied to the individual investment. Carrying value is used in the determination of impairment.

**Deferred Tax Asset** The deferred tax consequences attributable to deductible temporary differences and carryforwards. A deferred tax asset is measured using the applicable enacted tax rate and provisions of the enacted tax law. Deferred tax assets are subject to the admissibility criteria as outlined in SSAP No. 10, paragraph 10.

**Deferred Tax Liability** The deferred tax consequences attributable to taxable temporary differences. A deferred tax liability is measured using the applicable enacted tax rate and provisions of the enacted tax law.

**Fair Value** The fair value of an asset (or liability) is the amount at which that asset (or liability) could be bought (or incurred) or sold (or settled) in a current transaction between willing parties, that is, other than in a forced or liquidation sale. Quoted market prices in active markets are the best evidence of fair value and shall be used as the basis for the measurement, if available. If a quoted market price is available, the fair value is the product of the number of trading units times market price.

If quoted market prices are not available, the estimate of fair value shall be based on the best information available. The estimate of fair value shall consider prices for similar assets and liabilities and the results of valuation techniques to the extent available in the circumstances. Examples of valuation techniques include the present value of estimated expected future cash flows using a discount rate commensurate with the risks involved, option-pricing models, matrix pricing, option-adjusted spread models, and fundamental analysis. Valuation techniques for measuring financial assets and liabilities and servicing assets and liabilities shall be consistent with the objective of measuring fair value. Those techniques shall incorporate assumptions that market participants would use in their estimates of values, future revenues, and future expenses, including assumptions about interest rates, default, prepayment, and volatility. In measuring financial liabilities and servicing liabilities at fair value by discounting estimated future cash flows, an objective is to use discount rates at which those liabilities could be settled in an arm’s-length transaction.

Estimates of expected future cash flows, if used to estimate fair value, shall be the best estimate based on reasonable and supportable assumptions and projections. All available evidence shall be considered in developing estimates of expected future cash flows. The weight given to the evidence shall be commensurate with the extent to which the evidence can be verified objectively. If a range is estimated for either the amount or timing of possible cash flows, the likelihood of possible outcomes shall be considered in determining the best estimate of future cash flows.
Guaranteed Investment Contract or Guaranteed Interest Contract (GIC) An insurer-issued funding vehicle, typically issued to retirement plans, under which the insurer accepts a deposit (or, less frequently, a series of deposits) from the purchaser and guarantees to pay a specified interest rate of return on the funds deposited during a specified period of time.

Market Value Market value is equivalent to fair value.

Morbidity Risk The potential for a person to experience illness, injury, or other physical or psychological impairment, whether temporary or permanent. Morbidity risk excludes the potential for an individual’s death, but includes the potential for an illness or injury that results in death.

Mortality Risk The potential for loss of life, with respect to a specified person or group of people.

Nonforfeiture The principle that some types of insurance contract have an economic value to which the contract owner is entitled even upon lapsation or surrender of the contract. A nonforfeiture value is the economic value that must be provided to the contract owner upon lapsation or surrender; it can take various forms, such as a lump-sum cash payment, an amount of paid-up insurance, an amount of term insurance, etc.

Nonoperating System Software Application systems software such as language processors, library routines and debugging aides and other computer software are not considered operating system software.

Operating System Software The operating system is a program or a series of programs controlling the data job and task management operations of a computer or a computer network through executive scheduling and monitoring. It increases the productivity of a computer installation by managing the allocation of all available computer resources including the control processing unit, main storage and input/output devices.

Par Value The nominal (or face value) of a stock or bond.

Statement Value The SAP book value reduced by any valuation allowance and nonadmitted adjustment applied to an individual investment or a similar group of investments, e.g., bonds, mortgage loans, common stock.
Appendix A

Introduction

The following appendices are an integral part of the Accounting Practices and Procedures Manual. The guidance herein is referred to by specific SSAPs.

Some Appendices define certain terms. Such definitions are not intended to change the meaning of any terms used elsewhere in the Accounting Practices and Procedures Manual and should only be used in the context of the Appendix in which it appears and the SSAP that refers to that Appendix.

Certain Appendices contain requirements regarding reserves, which are effective with new business written after the effective date of the related SSAP. Transition guidance is provided in the related SSAPs.

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<tr>
<td>A-585</td>
<td>Universal Life Insurance</td>
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<td>A-588</td>
<td>Modified Guaranteed Life Insurance</td>
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<td>A-620</td>
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<td>A-630</td>
<td>Mortgage Guaranty Insurance</td>
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<td>A-641</td>
<td>Long-Term Care Insurance</td>
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<td>Credit for Reinsurance</td>
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<td>A-791</td>
<td>Life and Health Reinsurance Agreements</td>
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Appendix A-001

Investments of Reporting Entities

Introduction

Section 1. Reporting Requirements
Section 2. Investment Risk Interrogatories
Section 3. Summary Investment Schedule

Introduction

A reporting entity may acquire, hold or invest in investments or engage in investment practices as set forth in the laws and regulations of its domiciliary state. The disclosure required by this appendix is not intended to preempt such state authority and the financial information disclosed herein is intended solely for the use of state regulators for solvency analysis and should not be used for any other purpose.

Section 1. Reporting Requirements

The following reporting requirements apply to the provisions of this appendix:

1. Annual Statement – Section 3
2. Supplement to Annual Statement filed by April 1 – Section 2
3. Audited Statutory Financial Statements – Sections 2 and 3
Section 2. Investment Risks Interrogatories

Answer the following interrogatories by stating the applicable U.S. dollar amounts and percentages of the reporting entity’s total admitted assets held in that category of investments as shown on the Summary Investment Schedule. All reporting entities must answer interrogatories 1 through 4, 11, 13 through 17, 19 and, if applicable, 20 through 24. Answer each of interrogatories 5 through 10 only if the reporting entity’s aggregate holding in the gross investment category addressed in interrogatory 4 equals or exceeds 2.5% of the reporting entity’s total admitted assets. Answer interrogatory 12 only if the reporting entity’s aggregate holding in the gross investment category addressed in interrogatory 11 equals or exceeds 2.5% of the reporting entity’s total admitted assets. Answer interrogatory 18 only if the reporting entity’s aggregate holding in the gross investment category addressed in interrogatory 17 equals or exceeds 2.5% of the reporting entity’s total admitted assets. For Life, Health and Fraternal blanks, responses are to exclude Separate Accounts. For Property Casualty blank, responses are to exclude Protected Cell Accounts.

1. State the reporting entity’s total admitted assets as reported on page two of this annual statement.
   $____________

2. State by investment category the 10 largest exposures to a single issuer/borrower/investment, excluding (i) U.S. government, U.S. government agency securities and those U.S. government money market funds listed in the Appendix to the SVO Purposes and Procedures Manual as exempt, (ii) property occupied by the company and (iii) policy loans.

<table>
<thead>
<tr>
<th>Investment Category</th>
<th>Amount</th>
<th>Percentage of Total Admitted Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>a.</td>
<td>$</td>
<td>%</td>
</tr>
<tr>
<td>b.</td>
<td>$</td>
<td>%</td>
</tr>
<tr>
<td>c.</td>
<td>$</td>
<td>%</td>
</tr>
<tr>
<td>d.</td>
<td>$</td>
<td>%</td>
</tr>
<tr>
<td>e.</td>
<td>$</td>
<td>%</td>
</tr>
<tr>
<td>f.</td>
<td>$</td>
<td>%</td>
</tr>
<tr>
<td>g.</td>
<td>$</td>
<td>%</td>
</tr>
<tr>
<td>h.</td>
<td>$</td>
<td>%</td>
</tr>
<tr>
<td>i.</td>
<td>$</td>
<td>%</td>
</tr>
<tr>
<td>j.</td>
<td>$</td>
<td>%</td>
</tr>
</tbody>
</table>

3. State the amounts and percentages of the reporting entity’s total admitted assets held in bonds and preferred stocks by NAIC rating.

<table>
<thead>
<tr>
<th>Bonds</th>
<th>Preferred Stocks</th>
</tr>
</thead>
<tbody>
<tr>
<td>NAIC – 1</td>
<td>%</td>
</tr>
<tr>
<td>NAIC – 2</td>
<td>%</td>
</tr>
<tr>
<td>NAIC – 3</td>
<td>%</td>
</tr>
<tr>
<td>NAIC – 4</td>
<td>%</td>
</tr>
<tr>
<td>NAIC – 5</td>
<td>%</td>
</tr>
<tr>
<td>NAIC – 6</td>
<td>%</td>
</tr>
</tbody>
</table>

4. State the amounts and percentages of the reporting entity’s total admitted assets held in foreign investments (regardless of whether there is any foreign currency exposure) and unhedged foreign currency exposure (defined as the statement value of investments denominated in foreign currencies which are not hedged by financial instruments qualifying for hedge accounting as specified in SSAP No. 31—Derivative Instruments and SSAP No. 86—Accounting for Derivative Instruments and Hedging, Income Generation, and Replication (Synthetic Asset) Transactions),
including (i) foreign-currency-denominated investments of $______ supporting insurance liabilities denominated in that same foreign currency of $______ and excluding (ii) Canadian investments and currency exposure of $______:

Assets held in foreign investments less than 2.5% of the reporting entity’s total admitted assets, detail not required ___

5. Aggregate foreign investment exposure categorized by NAIC sovereign rating:
   i. Countries rated NAIC – 1 $ ______________ ___ ___ %
   ii. Countries rated NAIC – 2 $ ______________ ___ ___ %
   iii. Countries rated NAIC – 3 or below $ ______________ ___ ___ %

6. Two largest foreign investment exposures to a single country, categorized by the country’s NAIC sovereign rating:
   i. Countries rated NAIC – 1:
      Country: ______________________ $ ______________ ___ ___ %
      Country: ______________________ $ ______________ ___ ___ %
   ii. Countries rated NAIC – 2:
      Country: ______________________ $ ______________ ___ ___ %
      Country: ______________________ $ ______________ ___ ___ %
   iii. Countries rated NAIC – 3 or below:
      Country: ______________________ $ ______________ ___ ___ %
      Country: ______________________ $ ______________ ___ ___ %

7. Aggregate unhedged foreign currency exposure $ ______________ ___ ___ %

8. Aggregate unhedged foreign currency exposure categorized by NAIC sovereign rating:
   i. Countries rated NAIC – 1 $ ______________ ___ ___ %
   ii. Countries rated NAIC – 2 $ ______________ ___ ___ %
   iii. Countries rated NAIC – 3 or below $ ______________ ___ ___ %

9. Two largest unhedged foreign currency exposures to a single country, categorized by the country’s NAIC sovereign rating:
   i. Countries rated NAIC – 1:
      Country: ______________________ $ ______________ ___ ___ %
      Country: ______________________ $ ______________ ___ ___ %
   ii. Countries rated NAIC – 2:
      Country: ______________________ $ ______________ ___ ___ %
      Country: ______________________ $ ______________ ___ ___ %
   iii. Countries rated NAIC – 3 or below:
      Country: ______________________ $ ______________ ___ ___ %
      Country: ______________________ $ ______________ ___ ___ %

10. List the 10 largest non-sovereign (i.e. non-governmental) foreign issues:
    i. NAIC rating ______ $ ______________ ___ ___ %
    ii. NAIC rating ______ $ ______________ ___ ___ %
    iii. NAIC rating ______ $ ______________ ___ ___ %
    iv. NAIC rating ______ $ ______________ ___ ___ %
    v. NAIC rating ______ $ ______________ ___ ___ %
    vi. NAIC rating ______ $ ______________ ___ ___ %
    vii. NAIC rating ______ $ ______________ ___ ___ %

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viii. NAIC rating ______ $ ______________ _________%

xi. NAIC rating ______ $ ______________ _________%

x. NAIC rating ______ $ ______________ _________%

11. State the amounts and percentages of the reporting entity’s total admitted assets held in Canadian investments and unhedged Canadian currency exposure, including Canadian-currency-denominated investments of $______ supporting Canadian-denominated insurance liabilities of $______

Assets held in Canadian investments less than 2.5% of the reporting entity’s total admitted assets, detail not required ___

12. Aggregate Canadian investment exposure
   a. Canadian investments $ ______________ _________%
   b. Unhedged Canadian currency exposure ______ $ ______________ _________%

13. State the aggregate amounts and percentages of the reporting entity’s total admitted assets held in investments with contractual sales restrictions (defined as investments having restrictions that prevent investments from being sold within 90 days).

Assets held in investments with contractual sales restrictions less than 2.5% of the reporting entities total admitted assets, detail not required ___

   a. Aggregate statement value of investments with contractual sales restrictions $ ______________ _________%
   b. Largest 3 investments with contractual sales restrictions:
      i. $ ______________ _________%
      ii. $ ______________ _________%
      iii. $ ______________ _________%

14. State the amounts and percentages of admitted assets held in the largest 10 equity interests (including investments in the shares of mutual funds, preferred stocks, publicly traded equity securities, and other equity securities, and excluding money market and bond mutual funds listed in the Appendix to the SVO Practices and Procedures Manual as exempt or Class 1).

Assets held in equity interests less than 2.5% of the reporting entity’s total admitted assets, detail not required ___

   Investment Category
   a. $ ______________ _________ %
   b. $ ______________ _________ %
   c. $ ______________ _________ %
   d. $ ______________ _________ %
   e. $ ______________ _________ %
   f. $ ______________ _________ %
   g. $ ______________ _________ %
   h. $ ______________ _________ %
   i. $ ______________ _________ %
   j. $ ______________ _________ %
15. State the amounts and percentages of the reporting entity’s total admitted assets held in nonaffiliated, privately placed equities (included in other equity securities) and excluding securities eligible for sale under (i) Securities and Exchange Commission (SEC) Rule 144a or (ii) SEC Rule 144 without volume restrictions.

Assets held in nonaffiliated, privately placed equities less than 2.5% of the reporting entity’s total admitted assets, detail not required ___

a. Aggregate statement value of investments held in nonaffiliated, privately placed equities $ ______________% 
   b. Largest 3 investments held in nonaffiliated, privately placed equities:
      i. $ ______________% 
      ii. $ ______________% 
      iii. $ ______________%

16. State the amounts and percentages of the reporting entity’s total admitted assets held in general partnership interests (included in other equity securities).

Assets held in general partnership interests less than 2.5% of the reporting entity’s total admitted assets, detail not required ____

a. Aggregate statement value of investments held in general partnership interests $ ______________% 
   b. Largest 3 investments held in general partnership interests:
      i. $ ______________% 
      ii. $ ______________% 
      iii. $ ______________%

17. With respect to mortgage loans reported in Schedule B, state the amounts and percentages of the reporting entity’s total admitted assets held:

Mortgage loans reported in Schedule B less than 2.5% of the reporting entity’s total admitted assets, detail not required____

Each of the 10 largest aggregate mortgage interests. The aggregate mortgage interest represents the combined value of all mortgages secured by the same property or same group of properties:

<table>
<thead>
<tr>
<th>Type (Residential, Commercial, Agricultural)</th>
<th>$ ______________%</th>
</tr>
</thead>
<tbody>
<tr>
<td>i.</td>
<td>$ ______________%</td>
</tr>
<tr>
<td>ii.</td>
<td>$ ______________%</td>
</tr>
<tr>
<td>iii.</td>
<td>$ ______________%</td>
</tr>
<tr>
<td>iv.</td>
<td>$ ______________%</td>
</tr>
<tr>
<td>v.</td>
<td>$ ______________%</td>
</tr>
<tr>
<td>vi.</td>
<td>$ ______________%</td>
</tr>
<tr>
<td>vii.</td>
<td>$ ______________%</td>
</tr>
<tr>
<td>viii.</td>
<td>$ ______________%</td>
</tr>
<tr>
<td>ix.</td>
<td>$ ______________%</td>
</tr>
<tr>
<td>x.</td>
<td>$ ______________%</td>
</tr>
</tbody>
</table>

18. Aggregate mortgage loans having the following loan-to-value ratios as determined from the most current appraisal as of the annual statement date:
## Loan-to-Value

<table>
<thead>
<tr>
<th>Loan-to-Value</th>
<th>Residential</th>
<th>Commercial</th>
<th>Agricultural</th>
</tr>
</thead>
<tbody>
<tr>
<td>i. above 95%</td>
<td>$ ________</td>
<td>$ ________</td>
<td>$ ________</td>
</tr>
<tr>
<td>ii. 91% to 95%</td>
<td>$ ________</td>
<td>$ ________</td>
<td>$ ________</td>
</tr>
<tr>
<td>iii. 81% to 90%</td>
<td>$ ________</td>
<td>$ ________</td>
<td>$ ________</td>
</tr>
<tr>
<td>iv. 71% to 80%</td>
<td>$ ________</td>
<td>$ ________</td>
<td>$ ________</td>
</tr>
<tr>
<td>v. below 70%</td>
<td>$ ________</td>
<td>$ ________</td>
<td>$ ________</td>
</tr>
</tbody>
</table>

### a. Construction loans
$ ______________

### b. Mortgage loans over 90 days past due
$ ______________

### c. Mortgage loans in the process of foreclosure
$ ______________

### d. Mortgage loans foreclosed
$ ______________

### e. Restructured mortgage loans
$ ______________

## 19. State the amounts and percentages of the reporting entity’s total admitted assets held in each of the five largest investments in one parcel or group of contiguous parcels of real estate reported in Schedule A, excluding property occupied by the company.

Assets held in each of the five largest investments in one parcel or group of contiguous parcels of real estate reported in Schedule A less than 2.5% of the reporting entity’s total admitted assets, detail not required.

<table>
<thead>
<tr>
<th>Investments</th>
<th>Amount</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>a.</td>
<td>$ ________</td>
<td>______%</td>
</tr>
<tr>
<td>b.</td>
<td>$ ________</td>
<td>______%</td>
</tr>
<tr>
<td>c.</td>
<td>$ ________</td>
<td>______%</td>
</tr>
<tr>
<td>d.</td>
<td>$ ________</td>
<td>______%</td>
</tr>
<tr>
<td>e.</td>
<td>$ ________</td>
<td>______%</td>
</tr>
</tbody>
</table>

## 20. State the amounts and percentages of the reporting entity’s total admitted assets subject to the following types of agreements:

<table>
<thead>
<tr>
<th>Agreement Type</th>
<th>At End of Each Quarter</th>
<th>At Year-end</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Securities lending (do not include assets held as collateral for such transactions)</td>
<td>$ ________ $ ________ $ ________ $ ________</td>
<td>$ ________</td>
</tr>
<tr>
<td>b. Repurchase agreements</td>
<td>$ ________ $ ________ $ ________ $ ________</td>
<td>$ ________</td>
</tr>
<tr>
<td>c. Reverse repurchase agreements</td>
<td>$ ________ $ ________ $ ________ $ ________</td>
<td>$ ________</td>
</tr>
<tr>
<td>d. Dollar repurchase agreements</td>
<td>$ ________ $ ________ $ ________ $ ________</td>
<td>$ ________</td>
</tr>
<tr>
<td>e. Dollar reverse repurchase agreements</td>
<td>$ ________ $ ________ $ ________ $ ________</td>
<td>$ ________</td>
</tr>
</tbody>
</table>

## 21. State the amounts and percentages indicated below for warrants not attached to other financial instruments, options, caps, and floors:

<table>
<thead>
<tr>
<th>Category</th>
<th>Owned</th>
<th>Written</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Hedging</td>
<td>$ ________</td>
<td>______%</td>
</tr>
<tr>
<td>b. Income generation</td>
<td>$ ________</td>
<td>______%</td>
</tr>
<tr>
<td>c. Other</td>
<td>$ ________</td>
<td>______%</td>
</tr>
</tbody>
</table>

## 22. State the amounts and percentages indicated below of potential exposure (defined as the amount determined in accordance with the NAIC Annual Statement Instructions) for collars, swaps, and forwards:
23. State the amounts and percentages indicated below of potential exposure (defined as the amount determined in accordance with the NAIC Annual Statement Instructions) for futures contracts:

<table>
<thead>
<tr>
<th></th>
<th>At Year-end</th>
<th>1st Qtr</th>
<th>2nd Qtr</th>
<th>3rd Qtr</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Hedging</td>
<td>$ ______</td>
<td>______%</td>
<td>$ ______</td>
<td>______%</td>
</tr>
<tr>
<td>b. Income generation</td>
<td>$ ______</td>
<td>______%</td>
<td>$ ______</td>
<td>______%</td>
</tr>
<tr>
<td>c. Replications</td>
<td>$ ______</td>
<td>______%</td>
<td>$ ______</td>
<td>______%</td>
</tr>
<tr>
<td>d. Other</td>
<td>$ ______</td>
<td>______%</td>
<td>$ ______</td>
<td>______%</td>
</tr>
</tbody>
</table>

24. State the amounts and percentages of 10 largest investments included in the Write-ins for Invested Assets category included on the Summary Investment Schedule

a. ____________________________ $ _______________  ________ %
b. ____________________________ $ _______________  ________ %
c. ____________________________ $ _______________  ________ %
d. ____________________________ $ _______________  ________ %
e. ____________________________ $ _______________  ________ %
f. ____________________________ $ _______________  ________ %
g. ____________________________ $ _______________  ________ %
h. ____________________________ $ _______________  ________ %
i. ____________________________ $ _______________  ________ %
j. ____________________________ $ _______________  ________ %
## Section 3. Summary Investment Schedule

<table>
<thead>
<tr>
<th>Investment Categories</th>
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<td>Revenue and assessment obligations</td>
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<td>Other mortgage-backed securities</td>
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Investment Categories

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  Unaffiliated
Other equity securities
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  Unaffiliated
Tangible personal property under leases
  Affiliated
  Unaffiliated
Mortgage loans
  Construction and land development
  Agricultural
  Single family residential properties
  Multifamily residential properties
  Commercial loans
Real Estate Investments
  Property occupied by company
  Property held for production of income (includes $ ............ of property acquired in satisfaction of debt)
  Property held for sale ($.............including property acquired in satisfaction of debt)
Policy Loans
Receivables for securities
Cash and Short term Investments
Other Invested Assets

Total Invested Assets

* Gross Investment Holdings as valued in compliance with NAIC Accounting Practices & Procedures Manual
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Appendix A-010

Minimum Reserve Standards For Individual And Group Health Insurance Contracts

Definitions

1. “Annual claim cost” is the net annual cost per unit of benefit before the addition of expenses, including claim settlement expenses, and a margin for profit or contingencies. For example, the annual claim cost for a $100 monthly disability benefit, for a maximum disability benefit period of one year, with an elimination period of one week, with respect to a male at age 35, in a certain occupation might be $12, while the gross premium for this benefit might be $18. The additional $6 would cover expenses and profit or contingencies.

2. “Claims accrued” is that portion of claims incurred on or prior to the valuation date that result in liability of the insurer for the payment of benefits for medical services that have been rendered on or prior to the valuation date, and for the payment of benefits for days of hospitalization and days of disability that have occurred on or prior to the valuation date, that the insurer has not paid as of the valuation date, but for which it is liable and will have to pay after the valuation date. This liability is sometimes referred to as a liability for “accrued” benefits. A claim reserve, which represents an estimate of this accrued claim liability, must be established. SSAP #55 defines this as a Claim Liability and not a Claim Reserve.

3. “Claims reported” are considered as a reported claim for annual statement purposes when an insurer has been informed that a claim has been incurred, if the date reported is on or prior to the valuation date.

4. “Claims unaccrued” represent that portion of claims incurred on or prior to the valuation date which result in liability of the insurer for the payment of benefits for medical services expected to be rendered after the valuation date, and for benefits expected to be payable for days of hospitalization and days of disability occurring after the valuation date. This liability is sometimes referred to as a liability for unaccrued benefits. A claim reserve, which represents an estimate of the unaccrued claim payments expected to be made (which may or may not be discounted with interest), must be established. SSAP #54 defines this as a Claim Reserve differentiated from the Claim Liability in paragraph 2 above.

5. “Date of disablement” is the earliest date the insured is considered as being disabled under the definition of disability in the contract, based on a doctor’s evaluation or other evidence. Normally this date will coincide with the start of any elimination period.

6. “Elimination period” is a specified number of days, weeks, or months starting at the beginning of each period of loss, during which no benefits are payable.

7. “Gross premium” is the amount of premium charged by the insurer. It includes the net premium (based on claim-cost) for the risk, together with any loading for expenses, profit or contingencies.

8. The term “group insurance” includes blanket insurance and franchise insurance and any other forms of group insurance.
9. “Level premium” is a premium calculated to remain unchanged throughout either the lifetime of the policy or for some shorter projected period of years. The premium need not be guaranteed; in which case, although it is calculated to remain level, it may be changed if any of the assumptions on which it was based are revised at a later time. Generally, the annual claim costs are expected to increase each year and the insurer, instead of charging premiums that correspondingly increase each year, charges a premium calculated to remain level for a period of years or for the lifetime of the contract. In this case the benefit portion of the premium is more than needed to provide for the cost of benefits during the earlier years of the policy and less than the actual cost in the later years. The building of a prospective contract reserve is a natural result of level premiums.

10. “Long-term care insurance” is any insurance policy or rider advertised, marketed, offered or designed to provide coverage for not less than twelve (12) consecutive months for each covered person on an expense incurred, indemnity, prepaid or other basis; for one or more necessary or medically necessary diagnostic, preventive, therapeutic, rehabilitative, maintenance or personal care services, provided in a setting other than an acute care unit of a hospital. Such term also includes a policy or rider which provides for payment of benefits based upon cognitive impairment or the loss of functional capacity. Long-term care insurance may be issued by insurers; fraternal benefit societies; nonprofit health, hospital, and medical service corporations; prepaid health plans; health maintenance organizations or any similar organization to the extent they are otherwise authorized to issue life or health insurance. Long-term care insurance shall not include any insurance policy which is offered primarily to provide basic Medicare supplement coverage, basic hospital expense coverage, basic medical-surgical expense coverage, hospital confinement indemnity coverage, major medical expense coverage, disability income or related asset-protection coverage, accident only coverage, specified disease or specified accident coverage, or limited benefit health coverage.

11. “Modal Premium” refers to the premium paid on a contract based on a premium term which could be annual, semi-annual, quarterly, monthly, or weekly. Thus if the annual premium is $100 and if, instead, monthly premiums of $9 are paid then the modal premium is $9.

12. Normally the terminal reserve is a positive value. However, if the values of the benefits are decreasing with advancing age or duration it could be a negative value, called a “negative reserve.”

13. “Preliminary Term Reserve Method” is a method of valuation whereby the valuation net premium for each year falling within the preliminary term period is exactly sufficient to cover the expected incurred claims of that year, so that the terminal reserves will be zero at the end of the year. As of the end of the preliminary term period, a new constant valuation net premium (or stream of changing valuation premiums) becomes applicable such that the present value of all such premiums is equal to the present value of all claims expected to be incurred following the end of the preliminary term period.

14. “Present value of amounts not yet due on claims” represents the reserve for “claims unaccrued” (see definition), which may be discounted at interest.

15. “Rating block” means a grouping of contracts determined by the valuation actuary based on common characteristics, such as a policy form or forms having similar benefit designs.

16. The term “reserve” is used to include all items of benefit liability, whether in the nature of incurred claim liability or in the nature of contract liability relating to future periods of
coverage, and whether the liability is accrued or unaccrued. An insurer under its contracts promises benefits which result in:

a. Claims which have been incurred, that is, for which the insurer has become obligated to make payment, on or prior to the valuation date. On these claims, payments expected to be made after the valuation date for accrued and unaccrued benefits are liabilities of the insurer which shall be provided for by establishing claim reserves; or

b. Claims which are expected to be incurred after the valuation date. Any present liability of the insurer for these future claims shall be provided for by the establishment of contract reserves and unearned premium reserves.

17. “Terminal reserve” is the reserve at the end of a contract year and is defined as the present value of benefits expected to be incurred after that contract year minus the present value of future valuation net premiums.

18. “Unearned premium reserve” values that portion of the premium paid or due to the insurer which is applicable to the period of coverage extending beyond the valuation date. Thus if an annual premium of $120 was paid on November 1, $20 would be earned as of December 31 and the remaining $100 would be unearned. The unearned premium reserve could be on a gross basis as in this example or on a valuation net premium basis.

19. “Valuation net modal premium” is the modal fraction of the valuation net annual premium that corresponds to the gross modal premium in effect on any contract to which contract reserves apply. Thus if the mode of payment in effect is quarterly, the valuation net modal premium is the quarterly equivalent of the valuation net annual premium.

Scope

20. These standards apply to all individual and group health and accident and sickness insurance coverages, including single premium credit disability insurance. All other credit insurance is not subject to Appendix A-010.

21. When an insurer determines that adequacy of its health insurance reserves requires reserves in excess of the minimum standards specified herein, such increased reserves shall be held and shall be considered the minimum reserves for that insurer.

22. With respect to any block of contracts, or with respect to an insurer’s health business as a whole, a prospective gross premium valuation is the ultimate test of reserve adequacy as of a given valuation date. Such a gross premium valuation will take into account, for contracts in force, in a claims status, or in a continuation of benefits status on the valuation date, the present value as of the valuation date of: all expected benefits unpaid, all expected expenses unpaid, and all unearned or expected premiums, adjusted for future premium increases reasonably expected to be put into effect.

23. Such a gross premium valuation is to be performed whenever a significant doubt exists as to reserve adequacy with respect to any major block of contracts, or with respect to the insurer’s health business as a whole. In the event inadequacy is found to exist, immediate loss recognition shall be made and the reserves restored to adequacy. Adequate reserves (inclusive of claim, premium and contract reserves, if any) shall be held with respect to all contracts, regardless of whether contract reserves are required for such contracts under these standards.
24. Whenever minimum reserves, as defined in this Appendix, exceed reserve requirements as determined by a prospective gross premium valuation, such minimum reserves remain the minimum requirement under these standards.

25. The following paragraphs set forth minimum standards for three categories of health insurance reserves:
   a. Claim Reserves;
   b. Premium Reserves;
   c. Contract Reserves.

26. Adequacy of an insurer’s health insurance reserves is to be determined on the basis of all three categories combined. However, these standards emphasize the importance of determining appropriate reserves for each of the three categories separately.

**Claim Reserves**

27. General:
   a. Claim reserves are required for all incurred but unpaid claims on all health insurance policies.
   b. Appropriate claim expense reserves are required with respect to the estimated expense of settlement of all incurred but unpaid claims.
   c. All such reserves for prior valuation years are to be tested for adequacy and reasonableness along the lines of claim run-off schedules in accordance with the statutory financial statement including consideration of any residual unpaid liability.

28. Minimum Standards for Claim Reserves:
   a. Disability Income
      i. Interest. The maximum interest rate for claim reserves is specified in Exhibit 1.
      ii. Morbidity. Minimum standards with respect to morbidity are those specified in Exhibit 1, except that;
         (a) For claims with a duration from date of disablement of less than two years, reserves may be based on the insurer’s experience, if such experience is considered credible, or upon other assumptions designed to place a sound value on the liabilities.
         (b) For group disability income claims with a duration from date of disablement of more than two (2) years but less than five (5) years, reserves may be based on the insurer’s experience if such experience is considered credible and for which the insurer maintains underwriting and claim administration control. For experience to be considered credible for purposes of this appendix, the company should be able to provide claim
termination patterns over no more than six (6) years reflecting at least 5,000 claims terminations during the third through fifth claims durations on reasonably similar applicable policy forms.

(c) For claim reserves to reflect “sound values” and/or reasonable margins, reserve tables based on credible experience should be adjusted regularly to maintain reasonable margins.

iii. Duration of Disablement. For contracts with an elimination period, the duration of disablement shall be measured as dating from the time that benefits would have begun to accrue had there been no elimination period.

b. All Other Benefits
   i. Interest. The maximum interest rate for claim reserves is specified in Exhibit 1.
   ii. Morbidity or other Contingency. The reserve shall be based on the insurer’s experience, if such experience is considered credible, or upon other assumptions designed to place a sound value on the liabilities.

29. Claim Reserve Methods Generally - A generally accepted actuarial reserving method or other reasonable method or a combination of methods may be used to estimate all claim liabilities. The methods used for estimating liabilities generally may be aggregate methods, or various reserve items may be separately valued. Approximations based on groupings and averages may also be employed. Adequacy of the claim reserves, however, shall be determined in the aggregate.

Premium Reserves

30. General
   a. Unearned premium reserves are required for all contracts with respect to the period of coverage for which premiums, other than premiums paid in advance, have been paid beyond the date of valuation.
   b. 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.
   c. The gross premiums paid in advance for a period of coverage commencing after the next premium due date which follows the date of valuation may be appropriately discounted to the valuation date and shall be held either as a separate liability or as an addition to the unearned premium reserve which would otherwise be required as a minimum.

31. Minimum Standards for Unearned Premium Reserves
a. The minimum unearned premium reserve with respect to any contract is the pro rata unearned modal premium that applies to the premium period beyond the valuation date, with such premium determined on the basis of:

i. The valuation net modal premium on the contract reserve basis applying to the contract; or;

ii. The gross modal premium for the contract if no contract reserve applies.

b. However, in no event may the sum of the unearned premium and contract reserves for all contracts of the insurer subject to contract reserve requirements be less than the gross modal unearned premium reserve on all such contracts, as of the date of valuation. Such reserve shall never be less than the expected claims for the period beyond the valuation date represented by such unearned premium reserve, to the extent not provided for elsewhere.

32. Premium Reserve Methods Generally - The insurer may employ suitable approximations and estimates; including, but not limited to groupings, averages and aggregate estimation; in computing premium reserves. Such approximations or estimates shall be tested periodically to determine their continuing adequacy and reliability.

**Contract Reserves**

33. General:

a. Contract reserves are required, unless otherwise specified in 33 b. below for:

i. All individual and group contracts with which level premiums are used; or

ii. All individual and group contracts with respect to which, due to the gross premium pricing structure at issue, the value of the future benefits at any time exceeds the value of any appropriate future valuation net premiums at that time. 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. The actuary should state in the certification that premiums for the rating block were developed such that each year’s premium was intended to cover that year’s costs without any prefunding. If the premium is also intended to recover costs for any prior years, the actuary should also disclose the reasons for and magnitude of such recovery. The values specified in this paragraph shall be determined on the basis specified in paragraph 34 below.

iii. If rates are determined such that each year’s premium is intended to cover that year’s cost, the rating block approach results in no contract reserves unless required by paragraph 36. If rates are designed to prefund future years’ costs, contract reserves will be required.

b. Contracts not requiring a contract reserve are contracts which cannot be continued after one year from issue.
c. The contract reserve is in addition to claim reserves and premium reserves.

d. The methods and procedures for contract reserves shall be consistent with those for claim reserves for any contract, or else appropriate adjustment must be made when necessary to assure provision for the aggregate liability. The definition of the date of incurrence must be the same in both determinations.

34. Minimum Standards for Contract Reserves:

a. Basis:

i. Morbidity or other Contingency. Minimum standards with respect to morbidity are those set forth in Exhibit 1.

(a) Valuation net premiums used under each contract must have a structure consistent with the gross premium structure at issue of the contract as this relates to advancing age of insured, contract duration and period for which gross premiums have been calculated.

(b) Except as provided in paragraph 33.a.ii, if for a policy form there is no gross premium variation by age, the valuation net premiums will nonetheless vary based on age at issue for each contract since at issue the present value of valuation net premiums for a contract must equal the present value of tabular claim costs.

(c) Contracts for which tabular morbidity standards are not specified in Exhibit 1 shall be valued using tables established for reserve purposes by a qualified actuary. The morbidity tables shall contain a pattern of incurred claims cost that reflects the underlying morbidity and shall not be constructed for the primary purpose of minimizing reserves.

ii. Interest. The maximum interest rate is specified in Exhibit 1.

iii. Termination rates. Termination rates used in the computation of reserves shall be on the basis of a mortality table as specified in Exhibit 1 except as noted in the following paragraphs.

(a) Under contracts for which premium rates are not guaranteed, and where the effects of insurer underwriting are specifically used by policy duration in the valuation morbidity standard or for return of premium or other deferred cash benefits, total termination rates may be used at ages and durations where these exceed specified mortality table rates, but not in excess of the lesser of:

(1) Eighty percent of the total termination rate used in the calculation of the gross premiums, or

(2) Eight percent;
(b) For long-term care individual policies or group certificates, the contract reserve may be established on a basis of separate:

(1) Mortality (as specified in Exhibit 1) and

(2) Terminations other than mortality, where the terminations are not to exceed:

a. For policy years one through four (4), the lesser of eighty percent (80%) of the voluntary lapse rate used in the calculation of gross premiums and eight percent (8%);

b. For policy years five (5) and later, the lesser of one hundred percent (100%) of the voluntary lapse rate used in the calculation of gross premiums and four percent (4%).

(c) Where a morbidity standard specified in Exhibit 1 is on an aggregate basis, such morbidity standard may be adjusted to reflect the effect of insurer underwriting by policy duration. The adjustments must be appropriate to the underwriting.

b. Reserve Method:

i. For insurance except long-term care and return of premium or other deferred cash benefits, the minimum reserve is the reserve calculated on the two-year full preliminary term method; that is, under which the terminal reserve is zero at the first and also the second contract anniversary.

ii. For long-term care insurance, the minimum reserve is the reserve calculated on the one-year full preliminary term method.

iii. (a) For return of premium or other deferred cash benefits, the minimum reserve is the reserve calculated as follows:

(1) On the one year preliminary term method if the benefits are provided at any time before the twentieth anniversary;

(2) On the two year preliminary term method if the benefits are only provided on or after the twentieth anniversary.

(b) The preliminary term method may be applied only in relation to the date of issue of a contract. Reserve adjustments introduced later, as a result of rate increases, revisions in assumptions (e.g., projected inflation rates) or for other reasons, are to be applied immediately as of the effective date of adoption of the adjusted basis.
c. Negative Reserves. Negative reserves on any benefit may be offset against positive reserves for other benefits in the same contract, but the total contract reserve with respect to all benefits combined may not be less than zero.

d. Nonforfeiture Benefits for Long-Term Care Insurance. The contract reserve on a policy basis shall not be less than the net single premium for the nonforfeiture benefits at the appropriate policy duration, where the net single premium is computed according to the above specifications.

35. Alternative Valuation Methods and Assumptions Generally - Provided the contract reserve on all contracts to which an alternative method or basis is applied is not less in the aggregate than the amount determined according to the applicable standards specified above; an insurer may use any reasonable assumptions as to interest rates, termination and/or mortality rates, and rates of morbidity or other contingency. Also, subject to the preceding condition, the insurer may employ methods other than the methods stated above in determining a sound value of its liabilities under such contracts, including but not limited to the following: the net level premium method; the one-year full preliminary term method; prospective valuation on the basis of actual gross premiums with reasonable allowance for future expenses; the use of approximations such as those involving age groupings, groupings of several years of issue, average amounts of indemnity, grouping of similar contract forms; the computation of the reserve for one contract benefit as a percentage of, or by other relation to, the aggregate contract reserves exclusive of the benefit or benefits so valued; and the use of a composite annual claim cost for all or any combination of the benefits included in the contracts valued.

36. Tests For Adequacy and Reasonableness of Contract Reserves:

a. Annually, an appropriate review shall be made of the insurer’s prospective contract liabilities on contracts valued by tabular reserves, to determine the continuing adequacy and reasonableness of the tabular reserves giving consideration to future gross premiums. The insurer shall make appropriate increments to such tabular reserves if such tests indicate that the basis of such reserves is no longer adequate subject, however, to the minimum standards in paragraph 33 above.

b. In the event a company has a contract or a group of related similar contracts, for which future gross premiums will be restricted by contract, insurance department regulations, or for other reasons, such that the future gross premiums reduced by expenses for administration, commissions, and taxes will be insufficient to cover future claims, the company shall establish contract reserves for such shortfall in the aggregate.

Reinsurance

37. Increases to, or credits against reserves carried, arising because of reinsurance assumed or reinsurance ceded, must be determined in a manner consistent with these minimum reserve standards and with all applicable provisions of the reinsurance contracts which affect the insurer’s liabilities.
Exhibit 1. Specific Standards For Morbidity, Interest And Mortality

Morbidity

1. Minimum morbidity standards for valuation of specified individual contract health insurance benefits are as follows:

   a. Disability Income Benefits Due to Accident or Sickness.

      i. Contract Reserves:

         (a) The 1985 Commissioners Individual Disability Tables A (85CIDA); or

         (b) The 1985 Commissioners Individual Disability Tables B (85CIDB).

         (c) Each insurer shall elect, with respect to all individual contracts issued in any one statement year, whether it will use Tables A or Tables B as the minimum standard.

   ii. Claim Reserves:

      (a) For claims incurred on or after January 1, 2002:

         The 1985 Commissioners Individual Disability Table A (85CIDA) with claim termination rates multiplied by the following adjustment factors:

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<td>0.01792</td>
</tr>
<tr>
<td>Year 3</td>
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<td>0.16839</td>
</tr>
<tr>
<td>4</td>
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<tr>
<td>5</td>
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<td>0.07434</td>
</tr>
<tr>
<td>6 and later</td>
<td>1.000</td>
<td>**</td>
</tr>
</tbody>
</table>

* The adjusted termination rates derived from the application of the adjustment factors to the DTS Valuation Table termination rates shown in exhibits 3a, 3b, 3c, 4, and 5 (Transactions of the Society of Actuaries (TSA) XXXVII, pp. 457-463) is displayed. The adjustment factors for age, elimination period, class, sex, and cause displayed in exhibits 3a, 3b, 3c, and 4 should be applied to the adjusted termination rates shown in this table.

** Applicable DTS Valuation Table duration rate from exhibits 3c and 4 (TSA XXXVII, pp. 462-463).

The 85CIDA table so adjusted for the computation of claim reserves shall be known as 85CIDC (The 1985 Commissioners Individual Disability Table C).

(b) For claims incurred prior to January 1, 2002:

Each insurer may elect which of the following to use as the minimum standard for claims incurred prior to January 1, 2002:
(i) The minimum morbidity standard in effect for contract reserves on currently issued contracts, as of the date the claim is incurred, or
(ii) The standard as defined in Item (i), applied to all open claims.
(iii) Once an insurer elects to calculate reserves for all open claims on the standard defined in Item (i), all future valuations.

b. Hospital Benefits, Surgical Benefits and Maternity Benefits (Scheduled benefits or fixed time period benefits only).
   i. Contract Reserves:

      The 1974 Medical Expense Tables, Table A, Transactions of the Society of Actuaries, Volume XXX, pg. 63. Refer to the paper (in the same volume, pg. 9) to which this table is appended, including its discussions, for methods of adjustment for benefits not directly valued in Table A: “Development of the 1974 Medical Expense Benefits,” Houghton and Wolf.

   ii. Claim Reserves:

      No specific standard. See 1f.

c. Cancer Expense Benefits (Scheduled benefits or fixed time period benefits only).
   i. Contract Reserves:

      The 1985 NAIC Cancer Claim Cost Tables.

   ii. Claim Reserves:

      No specific standard. See 1f.

d. Accidental Death Benefits.
   i. Contract Reserves:

      The 1959 Accidental Death Benefits Table.

   ii. Claim Reserves:

      Actual amount incurred.

e. Single Premium Credit Disability.
   i. Contract Reserves:

      (a) For contracts issued on or after January 1, 2002:

          (i) For plans having less than a thirty-day elimination period, the 1985 Commissioners Individual Disability
Table A (85CIDA) with claim incidence rates increased by twelve percent (12%).

(ii) For plans having a thirty-day and greater elimination period, the 85CIDA for a fourteen-day elimination period with the adjustment in Item (i).

(b) For contracts issued prior to January 1, 2002, each insurer may elect either Item (i) or (ii) to use as the minimum standard. Once an insurer elects to calculate reserves for all contracts on the standard defined in Item (a), all future valuations must be on that basis.

(i) The minimum morbidity standard in effect for contract reserves on currently issued contracts, as of the date the contract was issued, or

(ii) The standard as defined in Item (a), applied to all contracts.

ii. Claim Reserves:

Claim reserves are to be determined as provided in paragraph 29.

f. Other Individual Contract Benefits.

i. Contract Reserves:

For all other individual contract benefits, morbidity assumptions are to be determined as provided in the reserve standards.

ii. Claim Reserves:

For all benefits other than disability, claim reserves are to be determined as provided in the standards.

2. Minimum morbidity standards for valuation of specified group contract health insurance benefits are as follows:

a. Disability Income Benefits Due to Accident or Sickness.

i. Contract Reserves:

The 1987 Commissioners Group Disability Income Table (87CGDT).

ii. Claim Reserves:

The 1987 Commissioners Group Disability Income Table (87CGDT);

b. Single Premium Credit Disability

i. Contract Reserves:
(a) For contracts issued on or after January 1, 2002:

(i) For plans having less than a thirty-day elimination period, the 1985 Commissioners Individual Disability Table A (85CID) with claim incidence rates increased by twelve percent (12%).

(ii) For plans having a thirty-day and greater elimination period, the 85CID for a fourteen-day elimination period with the adjustment in item (i).

ii. For contracts issued prior to January 1, 2002, each insurer may elect either Item (a) or (b) to use as the minimum standard. Once an insurer elects to calculate reserves for all contracts on the standard defined in Item (a), all future valuations must be on that basis.

(a) The minimum morbidity standard in effect for contract reserves on currently issued contracts, as of the date the contract was issued, or

(b) The standard as defined in Item (a), applied to all contracts.

iii. Claim Reserves:

Claim reserves are to be determined as provided in paragraph 29.

c. Other Group Contract Benefits.

i. Contract Reserves:

For all other group contract benefits, morbidity assumptions are to be determined as provided in the reserve standards.

ii. Claim Reserves:

For all benefits other than disability, claim reserves are to be determined as provided in the standards.

Interest

3. For contract reserves the maximum interest rate is the maximum rate allowed by Appendix A-820 in the valuation of whole life insurance issued on the same date as the health insurance contract.

4. For claim reserves on policies that require contract reserves, the maximum interest rate is the maximum rate allowed by Appendix A-820 in the valuation of whole life insurance issued on the same date as the claim incurral date.

5. For claim reserves on policies not requiring contract reserves, the maximum interest rate is the maximum rate allowed by Appendix A-820 in the valuation of single premium immediate annuities issued on the same date as the claim incurral date, reduced by 100 basis points.
Mortality

6. The mortality basis used for all policies except long-term care individual policies and group certificates shall be according to a table (but without use of selection factors) allowed by Appendix A-820 for the valuation of whole life insurance issued on the same date as the health insurance contract. For long-term care insurance individual policies or group certificates the mortality basis used shall be the 1983 Group Annuity Mortality Table without projection.

7. For single premium credit insurance using the 85 CIDA table, no separate mortality shall be assumed.
Exhibit 2. Reserves for Waiver of Premium (Supplementary explanatory material)

1. Waiver of premium reserves involve several special considerations. First, the disability valuation tables promulgated by the NAIC are based on exposures that include contracts on premium waiver as in-force contracts. Hence, contract reserves based on these tables are NOT reserves on “active lives” but rather reserves on contracts “in force.” This is true for the 1964 CDT and for both the 1985 CIDA and CIDB tables.

2. Accordingly, tabular reserves using any of these tables should value reserves on the following basis:

   a. Claim reserves should include reserves for premiums expected to be waived, valuing as a minimum the valuation net premium being waived.
   
   b. Premium reserves should include contracts on premium waiver as in-force contracts, valuing as a minimum the unearned modal valuation net premium being waived.
   
   c. Contract reserves should include recognition of the waiver of premium benefit in addition to other contract benefits provided for, valuing as a minimum the valuation net premium to be waived.

If an insurer is, instead, valuing reserves on what is truly an active life table, or if a specific valuation table is not being used but the insurer’s gross premiums are calculated on a basis that includes in the projected exposure only those contracts for which premiums are being paid, then it may not be necessary to provide specifically for waiver of premium reserves. Any insurer using such a true “active life” basis should carefully consider, however, whether or not additional liability should be recognized on account of premiums waived during periods of disability or during claim continuation.
Appendix A-200

Separate Accounts Funding Guaranteed Minimum Benefits Under Group Contracts

Scope

1. This appendix applies to a group life insurance contract providing survivor income benefits, a group annuity contract, or a funding agreement if the contract is a group contract that utilizes a separate account and provides guaranteed minimum benefits. This appendix shall not apply to modified guaranteed annuities or modified guaranteed life insurance or variable annuity or variable life insurance subject to appendices A-255, A-588, A-250, and A-270 or equity index products but this appendix shall apply to index contracts as defined in paragraph 18.

Definitions

2. “Account assets” means separate account assets plus any assets held in the general account or a supplemental account to meet the asset maintenance requirements.

3. “Account contracts” means the contracts providing guaranteed minimum benefits or other benefits and funded by a separate account and, if applicable, funded in part by the general account or a supplemental account to meet the asset maintenance requirements.

4. “Actuarial opinion” means the valuation actuary’s opinion covering reserves for contract liabilities under account contracts that is required to be submitted to the commissioner.

5. “Actuarial memorandum” means the memorandum of the valuation actuary that supports the actuarial opinion covering reserves for contract liabilities under account contracts.

6. “Appointed actuary” means the qualified actuary appointed or retained either directly by or by the authority of the board of directors through an executive officer of the company to prepare the annual statement of actuarial opinion for the company as a whole.

7. “Asset maintenance requirements” means the requirement to maintain assets to fund contract benefits in accordance with paragraphs 29 through 39.

8. “Book value contract” means a fixed accumulation contract (GIC), purchased under a retirement plan or plan of deferred compensation, established or maintained by an employer, that does not participate in the investment experience of a separate account, with a fixed interest rate guarantee, including a guarantee based on an external index, and that is supported by a separate account, the plan of operations of which provides that the separate account’s assets are valued as if the assets were held in the insurance company’s general account.

9. “Class of contracts” means the set of all contracts to which a given plan of operations pertains.

10. “Contract” means a group life insurance policy, group annuity contract, or funding agreement that is within the scope of this appendix as set forth in paragraph 1.

11. “Contract benefits” means the amounts obligated to be paid by the insurance company under an account contract.
12. “Contract liabilities” means the liabilities of the insurance company under account contracts, including liabilities with respect to which guarantees as to amount are provided by the insurance company and liabilities with respect to which guarantees as to amount are not provided by the insurance company.

13. a. “Derivative instrument” means an agreement, option, instrument or a series or combination of them:
   i. To make or take delivery of, or assume or relinquish, a specified amount of one or more underlying interests, or to make a cash settlement in lieu thereof; or
   ii. That has a price, performance, value or cash flow based primarily upon the actual or expected price, level, performance, value or cash flow of one or more underlying interests.

b. Derivative instruments include options, warrants used in a hedging transaction and not attached to another financial instrument, caps, floors, collars, swaps, forwards, futures and any other agreements, options or substantially similar instruments or any series or combination of them.

14. “Duration” means, with respect to separate account or supplemental account assets or guaranteed contract liabilities, a measure of the price sensitivity of a stream of cash flows to interest rate movements, including, but not limited to, modified duration or option adjusted duration.

15. “General account” means the assets of the insurance company other than separate account and supplemental account assets, and associated reserves.

16. “Guaranteed minimum benefits” means benefits payable under the terms of the contract that are based on either (1) the greater of Subparagraph a. or b., or (2) Subparagraph c. of this paragraph where:
   a. Is that part of the market value of account assets that determines the contractholder’s benefits, i.e., to the extent the assets are beneficially “client” assets; provided, that if asset performance does not determine the contractholder’s benefit, this subparagraph equals zero;
   b. Is a fixed minimum guarantee related to all or part of the considerations received under the contract; and
   c. Is an amount based upon a publicly available interest rates series or an index of the aggregate market value of a group of publicly traded financial instruments, either of which is specified in the contract.

17. “Hedging transaction” means a derivative transaction, involving use of one or more derivative instruments, that is entered into and maintained to reduce:
   a. The risk of a change in the value, yield, price, cash flow or quantity of assets or liabilities that the insurer has acquired or incurred or anticipates acquiring or incurring; or
   b. The currency exchange risk or the degree of exposure as to assets or liabilities that an insurer has acquired or incurred or anticipates acquiring or incurring.

18. “Index contract” means a contract under which contract benefits shall be based upon a publicly available interest rate series or an index of the aggregate market value of a group of publicly traded financial instruments, either of which is specified in the contract, and that does not provide a guarantee of
some or all of the consideration received plus earnings at a fixed rate specified in advance and that does not provide any secondary guarantees on elective benefits or maturity values.

19. “Market value separate account” means a separate account in which the separate account assets are valued at their market value.

20. “Nationally Recognized Statistical Rating Organization (NRSRO)” means a rating organization so designated by the Securities and Exchange Commission of the United States of America (SEC) which has applied to, and whose NRSRO status has been confirmed by, the NAIC Securities Valuation Office.

21. “Plan of operations” means a written plan meeting the requirements of paragraph 27.

22. “Qualified actuary” means an individual who is qualified to sign statements of actuarial opinion in accordance with the qualification standards set forth in Appendix A-820.

23. “Spot rate” corresponding to a given time of benefit payment means the yield on a zero-coupon non-callable and non-prepayable United States government obligation maturing at that time, or the zero-coupon yield implied by the price of a representative sampling of coupon-bearing non-callable and non-prepayable United States government obligations in accordance with a formula set forth in the plan of operations. To the extent that guaranteed contract liabilities are denominated in the currency of a foreign country rated in one of the two highest rating categories by an NRSRO and are supported by investments denominated in the currency of the foreign country, the spot rate may be determined by reference to substantially similar obligations of the government of the foreign country.

24. “Supplemental account” means a separate account to which assets may be contributed by the insurance company for the purpose of complying, in whole or in part, with the asset maintenance requirement and with respect to which neither the account contracts nor applicable law shall provide that the assets of the supplemental account are not chargeable with liabilities arising out of any other business of the insurance company.

25. “United States government obligation” means a direct obligation issued, assumed, guaranteed or insured by the United States of America or by an agency or instrumentality of the United States.

26. “Valuation actuary” means the appointed actuary or, alternatively, a qualified actuary designated by the appointed actuary to render the actuarial opinion. Written documentation of any such designation shall be on file at the company and available for review upon request.

**Plan of Operations**

27. The plan of operations for a class of contracts shall describe the financial implications for the insurer of the issuance of contracts in the class, and shall include at least the following:

   a. A description of the class of contracts to which the plan of operations pertains. This should include a description of the products, the markets to which the products will be sold, the benefits that are being offered (including whether those benefits will be paid on a market or book value basis);

   b. A statement of the investment policy for the separate account and any supplemental account, including requirements for diversification, maturity, type and quality of assets, and as applicable, target duration for matching guaranteed contract liabilities or the degree to which the investment policy is likely to match the performance of an interest rate series or index on which contract benefits are based;
A description of how the value of the separate account assets and any supplemental account is to be determined, including but not limited to, a statement of procedures and rules for valuing securities and other assets that are not publicly traded;

d. A description of how the guaranteed contract liabilities are to be valued, including, if applicable, with respect to guaranteed minimum benefits or other benefits, a description of the methodology for calculating spot rates and the rates proposed to be used to discount guaranteed contract liabilities if higher than the applicable spot rates, but the rate or rates used shall not exceed 105 percent of the spot rate, except that if the expected time of payment of a contract benefit is more than thirty (30) years, it shall be discounted from the expected time of payment to year thirty (30) at a rate of no more than eighty percent (80%) of the thirty-year spot rate and from year thirty (30) to the date of valuation at a rate not greater than 105 percent of the thirty-year spot rate, and shall conservatively reflect expected investment returns (taking into account foreign exchange risks);

e. A statement of how the separate account’s operations are designed to provide for payment of contract benefits as they become due, including but not limited to:

i. A description of the method for estimating the amount and timing of benefit payments;

ii. The arrangements necessary to provide liquidity to cover contingencies;

iii. The method to be used to comply with the asset maintenance requirement;

iv. The manner in which account assets will be allocated between the separate account, any supplemental account, and the general account;

v. If applicable, the deductions to be used in determining the market value of an asset when determining the asset maintenance requirement when the investment policy of the separate account and any supplemental accounts is not likely to match the performance of an interest rate series or index on which contract benefits are based; and

vi. For index contracts, the deductions to be used for replicated (synthetic) asset transactions in determining the market value of the separate account.

f. If hedging transactions are to be utilized in managing separate account or any supplemental account assets, a description of the instruments and techniques and an explanation of how they are intended to reduce risk of loss;

g. If the amount of the asset maintenance requirement depends on the separate account, any supplemental account or a subportfolio of either being duration matched, a description of the method used to determine the durations of separate account and any supplemental account assets and guaranteed contract liabilities;

h. If a part of the asset maintenance requirement is to be met by maintaining a reserve liability in the general account, a description of:

i. The circumstances under which increases and decreases in the general account portion of the reserve liability will be made;

ii. The circumstances under which transfers will be made between the separate account and the general account; and
iii. Any arrangements needed to provide sufficient liquidity in the general account to enable the insurance company to make transfers to the separate account when due.

i. A statement as to the extent to which the contracts in the class will provide or applicable law does provide that the separate account assets shall not be chargeable with liabilities arising out of any other business of the insurance company; and

j. If any person other than the insurance company may authorize, approve or review the acquisition and disposition of investments for the separate account or any supplemental account, a statement of the safeguards adopted by the insurance company to assure that the actions to be taken by these persons are appropriate, including a description of the criteria used by the insurance company in selecting the person.

28. Notwithstanding the descriptions in the plan of operations, the insurance company may change the rate used pursuant to paragraph 34 to discount guaranteed contract liabilities and other items applicable to the separate account or any supplemental accounts, such as if the investment portfolio is different from that anticipated by the plan of operations, provided that the rates used shall not exceed the maximum multiples of the spot rates as prescribed in paragraph 27d.

Asset Maintenance Requirements for Market Value Separate Accounts Supporting Contracts other than Index Contracts

29. At all times an insurer shall hold sufficient assets as a reserve in the general account, the separate account or supplemental accounts, as appropriate, such that the:

a. Market value of the assets held in the separate account, plus

b. The market value of any supplemental account, plus

c. Any assets held in the general account as a reserve for guaranteed contract liabilities, less

d. The deductions provided for in paragraph 30, equals or exceeds the value of guaranteed contract liabilities determined in accordance with paragraph 34.

30. In determining compliance with the asset maintenance requirement and the reserve for guaranteed contract liabilities in accordance with paragraph 29, the insurance company shall deduct a percentage of the market value of the separate account or supplemental account asset or an amount attributable to a replicated (synthetic) asset transaction as follows:

a. For debt instruments, the percentage shall be the NAIC asset valuation reserve “reserve objective factor,” but the factor shall be increased fifty percent (50%) for the purpose of this calculation if the difference in durations of the assets and liabilities is more than one-half year;

b. For assets that are not debt instruments, the percentage shall be the NAIC asset valuation reserve “maximum reserve factor”; and

c. For replicated (synthetic) asset transactions, the market value of the separate account or supplemental account assets shall be decreased by an amount equal to the asset valuation reserve for the transaction as if the transaction were occurring in the general account, determined in accordance with SSAP No. 7; but to the extent that the NAIC asset valuation reserve maximum reserve factor was not used in determining the amount of the...
deduction, the amount of the deduction shall be increased fifty percent (50%) for purposes of this calculation.

31. To the extent that guaranteed contract liabilities are denominated in the currency of a foreign country and are supported by separate account or supplemental account assets denominated in the currency of the foreign country, the percentage deduction for these assets under paragraph 30 shall be that for a substantially similar investment denominated in the currency of the United States.

32. To the extent that guaranteed contract liabilities are denominated in the currency of the United States and are supported by separate account or supplemental account assets denominated in the currency of a foreign country, and to the extent that guaranteed contract liabilities are denominated in the currency of a foreign country and are supported by separate account or supplemental account assets denominated in the currency of the United States, the deduction for debt instruments and replicated (synthetic) assets transactions under paragraph 30 shall be increased by fifteen percent (15%) of its market value unless the currency exchange risk has been adequately hedged, in which case the percentage deduction under paragraph 30 shall be increased by one-half percent (0.5%). No guaranteed contract liabilities denominated in the currency of a foreign country shall be supported by separate account or supplemental account assets denominated in the currency of another foreign country. For purposes of this paragraph, the currency exchange rate on an asset is deemed to be adequately hedged if:

   a. It is an obligation of a jurisdiction that is rated in one of two (2) highest rating categories by an NRSRO or a political subdivision or other governmental unit of the jurisdiction, or is organized under the laws of the jurisdiction; and

   b. At all times the principal amount and scheduled interest payments on the principal are hedged against the United States dollar pursuant to contracts or agreements that are:

      i. Issued by or traded on a securities exchange or board of trade regulated under the laws of the United States or Canada or a province of Canada;

      ii. Entered into with a United States banking institution that has assets in excess of $5 billion and that has obligations outstanding, or has a parent corporation that has obligations, that are rated in one of the two (2) highest rating categories by an NRSRO, or with a broker-dealer registered with the Securities and Exchange Commission that has net capital in excess of $250 million; or

      iii. Entered into with any other banking institution that has assets in excess of $5 billion and that has obligations outstanding, or has a parent corporation that has obligations outstanding, that are rated in one of the two (2) highest rating categories by an NRSRO and that is organized under the laws of a jurisdiction that is rated in one of the two (2) highest rating categories by an NRSRO.

33. All or a portion of the amount needed to comply with the asset maintenance requirement may be allocated to one or more supplemental accounts. If the account contract or applicable law provides that the assets in the separate account shall not be chargeable with liabilities arising out of any other business of the insurance company, the insurance company shall maintain in a supplemental account or the general account the amount of any account assets in excess of the sum of (i) the amounts contributed (net of withdrawals) by the contractholder, and (ii) the earnings attributable to the amounts contributed (net of withdrawals) by the contractholder.

34. For purposes of paragraphs 29 through 34, the minimum value of guaranteed contract liabilities is defined to be the sum of the expected guaranteed contract benefits, each discounted at a rate corresponding to the expected time of payment of the contract benefit that is not greater than the maximum multiple of the spot rate supportable by the expected return from the separate account and any
supplemental account assets provided that the rate used shall not exceed the maximum multiples of the spot rates as prescribed in paragraph 27d. or as described in the actuarial opinion. In calculating the minimum value of contract benefits, all guaranteed contract benefits potentially available to the contractholder shall be considered in the valuation process and analysis, and the reserve held shall be sufficient to fund the greatest present value of each independent guaranteed benefit stream, including guaranteed annuitization options available. To the extent that future cash flows are dependent upon the benefit responsiveness features of an employer-sponsored plan, a best estimate or an estimate based on the insurance company’s experience shall be used in the projections of the future cash flows. In addition, the valuation actuary shall periodically review the actual experience under the contract to validate the assumptions used. In projecting cash flows for contingent benefits involving mortality, the mortality tables for these benefits prescribed in Appendix A-820 shall be used.

**Asset Maintenance Requirements for Market Value Separate Accounts Supporting Index Contracts**

35. At all times an insurance company shall hold sufficient assets as a reserve in the general account, the separate account or supplemental accounts, as appropriate, such that the:

   a. Market value of the assets held in the separate account, plus
   b. The market value of any supplemental account, plus
   c. Any assets held in the general account as a reserve for guaranteed contract liabilities, less
   d. Any deduction provided for in paragraph 36, equals or exceeds the value of guaranteed contract liabilities determined in the manner set forth in the plan of operations.

36. In determining compliance with the asset maintenance requirement and the reserves for guaranteed contract liabilities in accordance with paragraph 35, the insurance company shall deduct a percentage of the market value of a separate account or supplemental account asset as set forth in the plan of operations, and for replication (synthetic asset) transactions, the value of the separate account or supplemental account assets shall be decreased in the manner set forth in the plan of operations.

37. All or a portion of the amount needed to comply with the asset maintenance requirement may be allocated to one or more supplemental accounts. If the account contract or applicable law provides that the assets in the separate account shall not be chargeable with liabilities arising out of any other business of the insurance company, the insurance company shall maintain in a supplemental account or the general account the amount of any account assets in excess of the sum of (i) the amounts contributed (net of withdrawals) by the contractholder, and (ii) the earnings attributable to the amounts contributed (net of withdrawals) by the contractholder.

**Asset Maintenance Requirements for Separate Accounts Supporting Book Value Contracts**

38. At all times an insurance company shall hold sufficient assets in the general account, the separate account or supplemental accounts, as appropriate, such that the value of the account assets, valued as if the assets were held in the insurance company’s general account, equals or exceeds the reserve required for contracts supported by the separate account, determined as if the contracts were held in the general account.

39. All or any portion of the amount needed to comply with the asset maintenance requirement may be allocated to one or more supplemental accounts. If the account contract or applicable law provides that the assets in the separate account shall not be chargeable with liabilities arising out of any other business of the insurance company, the insurance company shall maintain in a supplemental account or the general account the amount of any account assets in excess of the sum of (i) the amounts contributed (net of withdrawals) by the contractholder, and (ii) the earnings attributable to the amounts contributed (net of withdrawals) by the contractholder.
withdrawals) by the contractholder, and (ii) the earnings attributable to the amounts contributed (net of withdrawals) by the contractholder.

Asset Valuation Reserve

40. When the insurance company values separate account or supplemental account assets at market and complies with the asset maintenance requirements of the section entitled Asset Maintenance Requirements for Market Value Separate Accounts Supporting Contracts other than Index Contracts or the section entitled Asset Maintenance Requirements for Market Value Separate Accounts Supporting Index Contracts, it need not maintain an asset valuation reserve with respect to these assets.

Reserve Valuation and Documentation

41. Reserves for contracts funded by a market value separate account supporting contracts other than index contracts shall be an amount equal to the following:
   a. The total reserve required to be maintained on the valuation date under paragraphs 29 through 34;
   b. Plus the excess, if any, of the market value of separate account assets (to the extent that the market value of the assets determines the contractholder’s benefits, i.e., to the extent the assets are beneficially “client” assets) over the amount determined in accordance with subparagraph a. above;
   c. Plus any additional amount determined by the valuation actuary as necessary to make adequate provision for all of the contract liabilities.

42. Reserves for index contracts funded by a market value separate account shall be an amount equal to the following:
   a. The total reserve required to be maintained on the valuation date under paragraphs 35 through 37;
   b. Plus the excess, if any, of the market value of separate account assets (to the extent that the market value of the assets determines the contractholder’s benefits, i.e., to the extent the assets are beneficially “client” assets) over the amount determined in accordance with subparagraph a. above;
   c. Plus any additional amounts determined by the valuation actuary as necessary to make adequate provision for all of the contract liabilities.

43. Reserves for book value contracts shall be determined as if the contracts were held in the general account.

44. The amount of any reserves required by paragraph 41c. or paragraph 42c. may be established by either:
   a. Allocating sufficient assets to the separate account or a supplemental account to satisfy the requirement; or
   b. Setting up the additional reserves in the general account.

45. Account assets shall make adequate provision for contract liabilities, taking into account any risk charge payable from the separate account assets and the amount of any reserve liability of the general account and amounts held in any supplemental account with respect to the asset maintenance requirement.
46. The level of risk charges, if any, payable to the general account shall be appropriate in view of such factors as the nature of the guaranteed contract liabilities and losses experienced in connection with account contracts and other pricing factors.

47. The fixed-income asset portfolio shall conform to and justify the rates used to discount contract liabilities for valuation pursuant to paragraph 34 if applicable.

48. The company shall document whether any rates used pursuant to paragraph 34 to discount guaranteed contract liabilities and other items applicable to the separate account or any supplemental account were modified from the rate or rates described in the plan of operations.

49. The company shall substantially conform with Appendix A-822 and maintain internal documentation to either:

   a. Demonstrate the adequacy of account assets based upon cash flow analysis; or
   b. Explain why cash flow analysis is not appropriate, describe the alternative methodology of asset adequacy testing used, and demonstrate the adequacy of account assets under such methodology.

50. The company’s internal documentation pertaining to reserves for contract liabilities under account contracts shall also:

   a. Clearly describe the assumptions used in projecting cash flows under each class of assets, and any dynamic portfolio hedging techniques utilized and the tests performed on the utilization of the techniques;
   b. Clearly describe how the company reflected the risk of default on obligations and mortgage loans, including obligations and mortgage loans that are not investment grade;
   c. Clearly describe how the company has reflected withdrawal risks, if applicable, including a discussion of the positioning of the contracts within the benefit withdrawal priority order pertaining to the contracts;
   d. If the plan of operations provides for investments in separate account or supplemental account assets other than United States government obligations, demonstrate that the rates used to discount contract liabilities pursuant to paragraph 34 conservatively reflect expected investment returns (taking into account any foreign exchange risks);
   e. If the contracts provide that in certain circumstances they would cease to be funded by a separate account and, instead, would become contracts funded by the general account, clearly describe how any increased reserves would be provided for if and to the extent these circumstances occurred;
   f. Document the amount of separate account assets that are not chargeable with liabilities arising out of any other business of the insurance company;
   g. Document the amount of reserves and supporting assets as of December 31 and where the reserves and assets are shown in the annual statement;
   h. Document the amount of any contingency reserve carried as part of surplus;
   i. For book value contracts, document the market value of supporting assets; and
j. Where separate account assets are not chargeable with liabilities arising out of any other business of the insurance company, describe how the level of risk charges payable to the general account provider are appropriate compensation for the risk taken by the general account.
Appendix A-205

Illustrative Disclosure Of Differences Between NAIC Statutory Accounting Practices And Procedures And Accounting Practices Prescribed Or Permitted By The State Of Domicile

XYZ Insurance Company
Footnotes to Financial Statements
December 31, 2002 and 2001

Note 1–Organization

The XYZ Company is a mutual life insurance company domiciled in the state of ABC and licensed to do business in all 50 states. The company markets traditional whole life, term and disability income insurance policies to individuals through its career agency force.

Notes 2–Basis of Presentation

The financial statements of XYZ Company are presented on the basis of accounting practices prescribed or permitted by the ABC Insurance Department.

The ABC Insurance Department recognizes only statutory accounting practices prescribed or permitted by the state of ABC for determining and reporting the financial condition and results of operations of an insurance company, for determining its solvency under the ABC Insurance Law. The National Association of Insurance Commissioners’ (the “NAIC”) Accounting Practices and Procedures Manual version effective January 1, 2001 (“NAIC SAP”) has been adopted as a component of prescribed or permitted practices by the state of ABC. The state has adopted certain prescribed accounting practices which differ from those found in NAIC SAP. Specifically, 1) goodwill arising from the purchase of a subsidiary, controlled or affiliated entity is written off directly to surplus in the year it originates by ABC domiciled companies; in NAIC SAP, goodwill in amounts not to exceed 10% of an insurer’s capital and surplus may be capitalized and all amounts of goodwill are amortized to unrealized gains and losses on investments over periods not to exceed 10 years, and 2) 100% of all fixed assets may be admitted by ABC domiciled companies; in NAIC SAP, fixed assets are not admitted. The Commissioner of Insurance has the right to permit other specific practices which deviate from prescribed practices.

The Company, with the explicit permission of the Commissioner of Insurance of the state of ABC, records the value of its home office building at fair market value instead of at the depreciated cost method required by NAIC SAP. If the home office building were carried at depreciated cost, home office property and statutory surplus would be decreased by $2,500,000 and $2,300,000 as of December 31, 2002 and 2001, respectively. Additionally, net income would be increased by $120,000 and $103,000 respectively, for the years then ended.
A reconciliation of the Company’s net income and capital and surplus between NAIC SAP and practices prescribed and permitted by the state of ABC is shown below.

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<thead>
<tr>
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<tr>
<td><strong>Net Income, ABC state basis</strong></td>
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<td><strong>State Prescribed Practices:</strong></td>
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<tr>
<td>Depreciation of fixed assets</td>
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<td>110,000</td>
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<td><strong>State Permitted Practices:</strong></td>
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<td></td>
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<tr>
<td>Depreciation, home office property</td>
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<td><strong>103,000</strong></td>
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<td><strong>Net Income, NAIC SAP</strong></td>
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<td><strong>$3,113,000</strong></td>
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<td><strong>Statutory Surplus, ABC state basis</strong></td>
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<td><strong>State Prescribed Practices:</strong></td>
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<td>(950,000)</td>
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<tr>
<td><strong>State Permitted Practices:</strong></td>
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<td></td>
</tr>
<tr>
<td>Home Office Property</td>
<td>(2,500,000)</td>
<td>(2,300,000)</td>
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<tr>
<td><strong>Statutory Surplus, NAIC SAP</strong></td>
<td><strong>$29,650,000</strong></td>
<td><strong>$27,350,000</strong></td>
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</table>
Appendix A-225

Managing General Agents

Definitions

1. “Managing General Agent” (MGA) means any person, firm, association or corporation who:
   a. Manages all or part of the insurance business of an insurer (including the management of a separate division, department or underwriting office); and
   b. Acts as an agent for such insurer whether known as a Managing General Agent, manager or other similar term, who, with or without the authority, either separately or together with affiliates, produces, directly or indirectly, and underwrites an amount of gross direct written premium equal to or more than five percent (5%) of the policyholder surplus as reported in the last annual statement of the insurer in any one quarter or year together with one or more of the following activities related to the business produced:
      i. Adjusts or pays claims in a material amount;
      ii. Negotiates reinsurance on behalf of the insurer.
   c. Notwithstanding the above, the following persons shall not be considered MGA’s for the purposes of this Appendix:
      i. An employee of the insurer;
      ii. A U.S. Manager of the United States branch of an alien insurer;
      iii. An underwriting manager which, pursuant to contract, manages all or part of the insurance operations of the insurer, is under common control with the insurer, subject to a regulatory holding company act, if any, and whose compensation is not based on the volume of premiums written;
      iv. The attorney-in-fact authorized by and acting for the subscribers of a reciprocal insurer or inter-insurance exchange under powers of attorney.

2. “Underwrite” means the authority to accept or reject risk on behalf of the insurer.
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Appendix A-235

Interest-Indexed Annuity Contracts

Definition

1. “Interest-indexed annuity contract” means any annuity contract where the interest credits are linked to an external reference.

Valuation Requirements

2. In developing life insurance reserves for interest-indexed annuity contracts, the insurer must be in compliance with the minimum requirements of Appendix A-820.

3. In the calculation of reserves for interest-indexed annuity contracts, future guarantees will be determined by assuming that future interest crediting rates will be equal to the statutory valuation interest rate for such contracts as defined in Appendix A-820.
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Appendix A-250

Variable Annuities

Definitions

1. “Variable annuity” means a policy or contract, individual or group, that provides for annuity benefits that vary according to the investment experience of a separate account or accounts maintained by the insurer as to the policy or contract.

2. The company shall maintain in each such separate account assets with a value at least equal to the reserves and other contract liabilities with respect to the account.

3. The reserve liability for variable annuities shall be established pursuant to the requirements of Appendix A-820 in accordance with actuarial procedures that recognize the variable nature of the benefits provided and any mortality guarantees.
Appendix A-255

Modified Guaranteed Annuities

Definitions

1. A “Modified Guaranteed Annuity” is a deferred annuity contract, individual or group, the underlying assets of which are held in a separate account, and the values of which are guaranteed if held for specified periods. The contract contains nonforfeiture values that are based upon a market-value adjustment formula if held for shorter periods. This formula may or may not reflect the value of assets held in the separate account. The assets underlying the contract must be in a separate account during the period or periods when the contract holder can surrender the contract.

2. “Interest credits” means all interest that is credited to the contract.

3. “Separate account” means a separate account established pursuant to the insurance laws pertaining to the insurer.

Valuation Requirements

4. Reserve liabilities for modified guaranteed annuities shall be established as provided in Appendix A-820 in accordance with actuarial procedures that recognize:
   a. That assets of the separate account are based on market values;
   b. The variable nature of benefits provided; and
   c. Any mortality guarantees.

5. As a minimum, the separate account liability will equal the surrender value based upon the market-value adjustment formula contained in the contract. If that liability is greater than the market value of the assets, a transfer of assets will be made into the separate account so that the market value of the assets at least equals that of the liabilities. Any additional reserve that is needed to cover future guaranteed benefits shall be established.

6. The market-value adjustment formula, the interest guarantees, and the degree to which projected cash flow of assets and liabilities are matched must also be considered. The company shall determine whether the assets in the separate account are adequate to provide all future benefits that are guaranteed.

Separate Accounts

7. The insurer shall maintain in each separate account assets with a value at least equal to the valuation reserves and other contract liabilities respecting such account.
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Appendix A-270

Variable Life Insurance

Definitions

1. “Variable life insurance policy” means an individual or group policy that provides for life insurance the amount or duration of which varies according to the investment experience of any separate account or accounts established and maintained by the insurer as to the policy.

2. “Affiliate” of an insurer means a person, directly or indirectly, controlling, controlled by, or under common control with the insurer; a person who regularly furnishes investment advice to the insurer with respect to its separate accounts for which a specific fee or commission is charged; or any director, officer, partner or employee of the insurer, controlling or controlled person, or person providing investment advice or any member of the immediate family of such person.

3. “Assumed investment rate” means the rate of investment return that would be required to be credited to a variable life insurance policy, after deduction of charges for taxes, investment expenses and mortality and expense guarantees to maintain the variable death benefit equal at all times to the amount of death benefit, other than incidental insurance benefits, which would be payable under the plan of insurance if the death benefit did not vary according to the investment experience of the separate account.

4. “Benefit base” means the amount to which the net investment return is applied.

5. “Control” (including the terms “controlling,” “controlled by” and “under common control with”) means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract other than a commercial contract for goods or non-management services, or otherwise, unless the power is the result of an official position with or corporate office held by the person. Control shall be presumed to exist if a person, directly or indirectly, owns, controls, holds with the power to vote, or holds proxies representing more than ten percent (10%) of the voting securities of any other person. This presumption can be overcome by predominant evidence to the contrary, however, it shall stand until overcome by such predominant contradictory evidence.

6. “Flexible premium policy” means any variable life insurance policy other than a “scheduled premium policy” as defined in paragraph 13.

7. “General account” means all assets of the insurer other than assets in separate accounts.

8. “Incidental insurance benefit” means all insurance benefits in a variable life insurance policy, other than the variable death benefit and the minimum death benefit, including but not limited to, accidental death and dismemberment benefits, disability benefits, guaranteed insurability options, family income or term riders.

9. “Minimum death benefit” means the amount of the guaranteed death benefit, other than incidental insurance benefits, payable under a variable life insurance policy regardless of the investment performance of the separate account.

10. “Net investment return” means the rate of investment return in a separate account to be applied to the benefit base.

11. “Person” means an individual, corporation, partnership, association, trust or fund.
12. “Policy processing day” means the day on which charges authorized in the policy are deducted from the policy’s cash value.

13. “Scheduled premium policy” means a variable life insurance policy under which both the amount and timing of premium payments are fixed by the insurer.

14. “Variable death benefit” means the amount of the death benefit, other than incidental insurance benefits, payable under a variable life insurance policy dependent on the investment performance of the separate account, which the insurer would have to pay in the absence of any minimum death benefit.

Valuation Requirements

15. Reserve liabilities for variable life insurance policies shall be established as provided in Appendix A-820 in accordance with actuarial procedures that recognize the variable nature of the benefits provided and any mortality guarantees.

16. Reserve liabilities for the guaranteed minimum death benefit shall be the reserve needed to provide for the contingency of death occurring when the guaranteed minimum death benefit exceeds the death benefit that would be paid in the absence of the guarantee, and shall be maintained in the general account of the insurer and shall not be less than the greater of the following minimum reserves:

   a. The aggregate total of the term costs, if any, covering a period of one full year from the valuation date or, if less, covering the period provided for in the guarantee not otherwise provided for by the reserves held in the separate account, on each variable life insurance contract, assuming an immediate one-third depreciation in the current value of the assets in the separate account followed by a net investment return equal to the assumed investment rate; or

   b. The aggregate total of the “attained age level” reserves on each variable life insurance contract. The “attained age level” reserve on each variable life insurance contract shall not be less than zero and shall equal the “residue,” as described in paragraph 16 b. i. below, of the prior year’s “attained age level” reserve on the contract, with any such “residue,” increased or decreased by a payment computed on an attained age basis as described in paragraph 16 b. ii. below.

   i. The “residue” of the prior year’s “attained age level” reserve on each variable life insurance contract shall not be less than zero and shall be determined by adding interest at the valuation interest rate to the prior year’s reserve, deducting the tabular claims based on the “excess,” if any, of the guaranteed minimum death benefit over the death benefit that would be payable in the absence of a guarantee, and dividing the net result by the tabular probability of survival. The “excess” referred to in the preceding sentence shall be based on the actual level of death benefits that would have been in effect during the preceding year in the absence of the guarantee, taking appropriate account of the reserve assumptions regarding the distribution of death claim payments over the year.

   ii. The payment referred to in this paragraph shall be computed so that the present value of a level payment of that amount each year over the future period for which charges for this risk will be collected under the contract, is equal to (A) minus (B) minus (C), where (A) is the present value of the future guaranteed minimum death benefits, (B) is the present value of the future death benefits that would be payable in the absence of such guarantee, and (C) is any “residue,” as described in paragraph 16 b. i. of the prior year’s “attained age level” reserve on such variable life insurance contract. This result shall be divided by the present
value, at the valuation date, of a temporary life annuity of one per annum at the current attained age payable over the period in which future charges for this risk will be collected under the contract. If no future charges for this risk will be collected under the contract, the payment shall equal (A) minus (B) minus (C). The amounts of the future death benefits referred to in (B) shall be computed assuming a net investment return of the separate account which may differ from the assumed investment rate or the valuation interest but in no event may exceed the maximum interest rate permitted for the valuation of life contracts.

c. The valuation interest rate and mortality table used in computing the two minimum reserves described in 16 a. and 16 b. above shall conform to acceptable standards for the valuation of life insurance contracts. In determining the minimum reserves, the company may employ suitable approximations and estimates, including but not limited to groupings and averages.

17. Incidental Insurance Benefit. Reserve liabilities for all fixed incidental insurance benefits and any guarantees associated with variable accidental insurance benefits shall be maintained in the general account and reserve liabilities for all variable aspects of the variable incidental insurance benefits shall be maintained in a separate account, in amounts determined in accordance with the actuarial procedures appropriate to the benefit.

Separate Accounts

18. The assets of separate accounts shall be valued at least as often as variable benefits are determined but in any event at least monthly.

19. The insurer shall maintain in each separate account assets with a value at least equal to the valuation reserves and other contract liabilities respecting such account.
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Appendix A-440

Insurance Holding Companies

Definitions

1. “Affiliate.” An “affiliate” of, or person “affiliated” with, a specific person, is a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified.

2. “Control.” The term “control” (including the terms “controlling,” “controlled by” and “under common control with”) means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract other than a commercial contract for goods or nonmanagement services, or otherwise, unless the power is the result of an official position with or corporate office held by the person. Control shall be presumed to exist if any person, directly or indirectly, owns, controls, holds with the power to vote, or holds proxies representing, ten percent (10%) or more of the voting securities of any other person. This presumption can be overcome by predominant evidence to the contrary, however, it shall stand until overcome by such predominant contradictory evidence.

3. “Insurance Holding Company System.” An “insurance holding company system” consists of two (2) or more affiliated persons, one or more of which is an insurer.

4. “Person.” A “person” is an individual, a corporation, a limited liability company, a partnership, an association, a joint stock company, a trust, an unincorporated organization, any similar entity or any combination of the foregoing acting in concert, but shall not include any joint venture partnership exclusively engaged in owning, managing, leasing or developing real or tangible personal property.

5. “Securityholder.” A “securityholder” of a specified person is one who owns any security of such person, including common stock, preferred stock, debt obligations and any other security convertible into or evidencing the right to acquire any of the foregoing.

6. “Subsidiary.” A “subsidiary” of a specified person is an affiliate controlled by such person directly or indirectly through one or more intermediaries.

7. “Voting Security.” The term “voting security” shall include any security convertible into or evidencing a right to acquire a voting security.

Subsidiaries of Insurers

8. A domestic insurer, either by itself or in cooperation with one or more persons, may organize or acquire one or more subsidiaries. The subsidiaries may conduct any kind of business or businesses and their authority to do so shall not be limited by reason of the fact that they are subsidiaries of a domestic insurer.

9. In addition to investments in common stock, preferred stock, debt obligations and other securities detailed under all other areas of the Codification, a domestic insurer may also invest in, and report as an admitted asset, common stock, preferred stock, debt obligations, and other securities of one or more subsidiaries, amounts which do not exceed the lesser of ten percent (10%) of the insurer’s assets or fifty percent (50%) of the insurer’s surplus as regards policyholders, both as required to be shown on the statutory balance sheet of the insurer for its most recently filed statement with the domiciliary state commissioner, provided that after such investments, the insurer’s surplus as regards policyholders will be reasonable in relation to the insurer’s outstanding liabilities and adequate to meet its financial needs.
calculating the amount of such investments, investments in domestic or foreign insurance subsidiaries and health maintenance organizations shall be excluded.

10. Qualification of Investment; When Determined. Whether any investment meets the requirements outlined herein is to be determined before the investment is made, by calculating the applicable investment limitations as though the investment had already been made, taking into account the then carrying value of all previous investments in debt obligations, and the carrying value of all previous investments in equity securities as required to be shown on the statutory balance sheet of the insurer for its most recently filed statement with the domiciliary state commissioner.

Standards and Management of an Insurer Within a Holding Company System

Transactions Within a Holding Company System

11. Transactions within a holding company system to which an insurer subject to registration is a party shall be subject to the following standards:

a. The terms shall be fair and reasonable;

b. Charges or fees for services performed shall be reasonable;

c. Expenses incurred and payment received shall be allocated to the insurer in conformity with statutory accounting practices consistently applied;

d. The books, accounts and records of each party to all such transactions shall be so maintained as to clearly and accurately disclose the nature and details of the transactions including such accounting information as is necessary to support the reasonableness of the charges or fees to the respective parties; and

e. The insurer’s surplus as regards policyholders following any dividends or distributions to shareholder affiliates shall be reasonable in relation to the insurer’s outstanding liabilities and adequate to meet its financial needs. In determining whether an insurer’s surplus as regards policyholders is reasonable in relation to the insurer’s outstanding liabilities and adequate to meet its financial needs, the following factors, among others, shall be considered:

i. The size of the insurer as measured by its assets, capital and surplus, reserves, premium writings, insurance in force and other appropriate criteria;

ii. The extent to which the insurer’s business is diversified among several lines of insurance;

iii. The number and size of risks insured in each line of business;

iv. The extent of the geographical dispersion of the insurer’s insured risks;

v. The nature and extent of the insurer’s reinsurance program;

vi. The quality, diversification and liquidity of the insurer’s investment portfolio;

vii. The recent past and projected future trend in the size of the insurer’s investment portfolio;

viii. The surplus as regards policyholders maintained by other comparable insurers;
ix.  The adequacy of the insurer’s reserves; and

x.  The quality and liquidity of investments in affiliates.

[Drafting Note: The methodology for determining proper admission of subsidiary investments, based on the limits discussed in paragraphs 9 and 10 of this Appendix, has been adapted to conform to the methodologies used elsewhere in this Codification regarding limits for admission of assets.]
Appendix A-585

Universal Life Insurance

Definitions

1. “Cash surrender value” means the net cash surrender value plus any amounts outstanding as policy loans.

2. “Fixed premium universal life insurance policy” means a universal life insurance policy other than a flexible premium universal life insurance policy.

3. “Flexible premium universal life insurance policy” means a universal life insurance policy which permits the policyowner to vary, independently of each other, the amount or timing of one or more premium payments or the amount of insurance.

4. “Interest-indexed universal life insurance policy” means any universal life insurance policy where the interest credits are linked to an external referent.

5. “Net cash surrender value” means the maximum amount payable to the policyowner upon surrender.

6. “Policy value” means the amount to which separately identified interest credits and mortality, expense, or other charges are made under a universal life insurance policy.

7. “Universal life insurance policy” means a life insurance policy where separately identified interest credits (other than in connection with dividend accumulations, premium deposit funds, or other supplementary accounts) and mortality and expense charges are made to the policy. A universal life insurance policy may provide for other credits and charges, such as charges for the cost of benefits provided by rider.

Valuation Requirements

8. The minimum valuation standard for universal life insurance policies shall be the Commissioners Reserve Valuation Method, as described below for such policies, and the tables and interest rates specified below. The terminal reserve for the basic policy and any benefits and/or riders for which premiums are not paid separately as of any policy anniversary shall be equal to the net level premium reserves less (C) and less (D), where:

   a. Reserves by the net level premium method shall be equal to \((A)-(B) \times r\) where \((A)\), \((B)\) and “\(r\)” are as defined below:

      i. \((A)\) is the present value of all future guaranteed benefits at the date of valuation.

      ii. \((B)\) is the quantity \(\text{PVFB} \, \bar{a}_x + t\) where \(\text{PVFB}\) is the present value of all benefits guaranteed at issue assuming future guaranteed maturity premiums are paid by the policyowner and taking into account all guarantees contained in the policy or declared by the insurer.

   b. \(\bar{a}_x\) and \(\bar{a}_x + t\) are present values of an annuity of one per year payable on policy anniversaries beginning at ages \(x\) and \(x+t\), respectively, and continuing until the highest
attained age at which a premium may be paid under the policy. The letter “x” is defined as the issue age and the letter “t” is defined as the duration of the policy.

c. The guaranteed maturity premium for flexible premium universal life insurance policies shall be that level gross premium, paid at issue and periodically thereafter over the period during which premiums are allowed to be paid, which will mature the policy on the latest maturity date, if any, permitted under the policy (otherwise at the highest age in the valuation mortality table), for an amount which is in accordance with the policy structure. The guaranteed maturity premium is calculated at issue based on all policy guarantees at issue (excluding guarantees linked to an external referent). The guaranteed maturity premium for fixed premium universal life insurance policies shall be the premium defined in the policy which at issue provides the minimum policy guarantees.

d. The letter “r” is equal to one, unless the policy is a flexible premium policy and the policy value is less than the guaranteed maturity fund, in which case “r” is the ratio of the policy value to the guaranteed maturity fund.

e. The guaranteed maturity fund at any duration is that amount which, together with future guaranteed maturity premiums, will mature the policy based on all policy guarantees at issue.

f. (C) is the quantity \((a)-(b) \frac{\text{ax}}{\text{ax}+t} \times r\) where \((a)-(b)\) is as described in paragraph 9 of Appendix A-820 for the plan of insurance defined at issue by the guaranteed maturity premiums and all guarantees contained in the policy or declared by the insurer.

g. (D) is the sum of any additional quantities analogous to (C) which arise because of structural changes in the policy, with each such quantity being determined on a basis consistent with that of (C) using the maturity date in effect at the time of the change.

h. The guaranteed maturity premium, the guaranteed maturity fund and (B) above shall be recalculated to reflect any structural changes in the policy. This recalculation shall be done in a manner consistent with the descriptions above.

i. Future guaranteed benefits are determined by (1) projecting the greater of the guaranteed maturity fund and the policy value, taking into account future guaranteed maturity premiums, if any, and using all guarantees of interest, mortality, expense deductions, etc., contained in the policy or declared by the insurer; and (2) taking into account any benefits guaranteed in the policy or by declaration which do not depend on the policy value.

j. All present values shall be determined using (i) an interest rate (or rates) specified by Appendix A-820 for policies issued in the same year; (ii) the mortality rates specified by Appendix A-820 for policies issued in the same year; and (iii) any other tables needed to value supplementary benefits provided by a rider which is being valued together with the policy.

9. To the extent that the insurer declares guarantees more favorable than those in the policy (contractual guarantees), such declared guarantees shall be applicable to the determination of future guaranteed benefits.

10. The mortality and interest bases for calculating present values are the minimum standards in Appendix A-820.
11. In effecting structural changes, consistent methods are prescribed when calculating reserves. Several such methods are possible, but perhaps the simplest such method would be that of maintaining proportionality between the Guaranteed Maturity Fund and Guaranteed Maturity Premium values and the current face amount. In applying this method, Guaranteed Maturity Fund and Guaranteed Maturity Premium values could be calculated per dollar of face amount and simply multiplied by the new face amount. This would eliminate much of the complexity involved in other methods.

**Alternative Minimum Reserves**

12. If, in any policy year, the guaranteed maturity premium on any universal life insurance policy is less than the valuation net premium for such policy, calculated by the valuation method actually used in calculating the reserve thereon but using the minimum valuation standards of mortality and rate of interest, the minimum reserve required for such contract shall be the greater of a. or b.

   a. The reserve calculated according to the method, the mortality table, and the rate of interest actually used.

   b. The reserve calculated according to the method actually used but using the minimum valuation standards of mortality and rate of interest and replacing the valuation net premium by the Guaranteed Maturity Premium in each policy year for which the valuation net premium exceeds the Guaranteed Maturity Premium.

13. For universal life insurance reserves on a net level premium basis, the valuation net premium is:

   \[
   \frac{PVFB}{\bar{a}x}
   \]

   and for reserves on a Commissioners Reserve Valuation Method, the valuation net premium is:

   \[
   \frac{PVFB + (a)-(b)}{\bar{a}x + \bar{a}x}
   \]

**Footnotes:**

1. The maturity amount shall be the initial death benefit where the death benefit is level over the lifetime of the policy except for the existence of a minimum-death-benefit corridor, or shall be the specified amount where the death benefit equals a specified amount plus the policy value or cash surrender value except for the existence of a minimum-death-benefit corridor.

2. The Guaranteed Maturity Premium for both flexible and fixed premium policies shall be adjusted for death benefit corridors provided by the policy. The Guaranteed Maturity Premium may be less than the premium necessary to pay all charges. This can especially happen in the first year for policies with large first year expense charges.

3. Structural changes are those changes which are separate from the automatic workings of the policy. Such changes usually would be initiated by the policyholder and include changes in the guaranteed benefits, changes in latest maturity date, or changes in allowable premium payment period. For fixed premium universal life policies with redetermination of all credits and charges no more frequently than annually, on policy anniversaries, structural changes also include changes in guaranteed benefits, or in fixed premiums, unanticipated by the guaranteed maturity premium for such policies at the date of issue, even if such changes arise from automatic workings of the policy. The recomputation of (B) in paragraph 8 a. ii. above, for fixed premium universal life structural changes, shall exclude from PVFB, the present value of future guaranteed benefits, those guaranteed benefits which are funded by the excess of the insurer’s declared guarantees of interest, mortality and expenses, over the guarantees contained in the policy at the date of issue.
Appendix A-588

Modified Guaranteed Life Insurance

Definitions

1. “Interest Credits” means all interest that is credited to the policy.

2. “Modified Guaranteed Life Insurance Policy” means an individual or group policy of life insurance, the underlying assets which are held in a separate account, and the values of which are guaranteed if held for specified periods. It contains cash-surrender values that are based upon a market value adjustment formula if held for shorter periods. The formula may, or may not, reflect the value of assets held in the separate account. The assets underlying the policy must be in a separate account during the period or periods when the policyholder can surrender the policy.

3. “Policy processing day” means the day on which charges authorized in the policy are deducted from the policy’s cash value.

4. “Separate account” means a separate account established pursuant to the insurance laws pertaining to the insurer.

Valuation Requirements

5. Reserve liabilities for modified guaranteed life insurance policies shall be established pursuant to the requirements of Appendix A-820 in accordance with actuarial procedures that recognize:
   a. That assets of the separate account are based on market value;
   b. The variable nature of the benefits provided; and
   c. Any mortality guarantees.

6. As a minimum, the separate account liability will equal the surrender value based upon the market value adjustment formula contained in the policy. If that liability is greater than the market value of the assets, a transfer of assets will be made into the separate account so that the market value of the assets at least equals that of the liabilities. Any additional reserve that is needed to cover future guaranteed benefits shall be established.

7. The market value adjustment formula, the interest guarantees and the degree to which projected cash flow of assets and liabilities are matched must also be considered. The company shall determine whether the assets in the separate account are adequate to provide all future guaranteed benefits.

8. Reserve liabilities for all fixed incidental insurance benefits and any guarantees associated with variable incidental insurance benefits shall be maintained in the general account.

Separate Accounts

9. The insurer shall maintain in each separate account assets with a value at least equal to the valuation reserves and other contract liabilities respecting such account.
Appendix A-620

Accelerated Benefits

Purpose

The purpose of this Appendix is to provide guidance with respect to accelerated benefit related to individual and group life insurance policies. This Appendix shall apply to all accelerated benefits provisions of individual and group life insurance policies except those subject to Appendix A-641.

Definitions

1. “Accelerated benefits” covered under this Appendix are benefits payable under a life insurance contract:
   a. To a policyowner 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; and
   b. Which reduce the death benefit otherwise payable under the life insurance contract; and
   c. Which 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.

2. “Qualifying event” shall mean one or more of the following:
   a. A medical condition which would result in a drastically limited life span as specified in the contract, for example, twenty-four (24) months or less; or
   b. A medical condition which has required or requires extraordinary medical intervention, such as, but not limited to, major organ transplant or continuous artificial life support, without which the insured would die; or
   c. Any condition which usually requires continuous confinement in an eligible institution as defined in the contract if the insured is expected to remain there for the rest of his or her life; or
   d. A medical condition which would, in the absence of extensive or extraordinary medical treatment, result in a drastically limited life span. Such conditions may include, but are not limited to, one or more of the following:
     e. Coronary artery disease resulting in an acute infarction or requiring surgery;
     f. Permanent neurological deficit resulting from cerebral vascular accident;
     g. End stage renal failure; or
     h. Acquired Immune Deficiency Syndrome.

Valuation Requirements

3. 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 Appendix A-820. Mortality tables and interest for life insurance reserves as specified in Appendix A-820.
shall be used as well as appropriate assumptions for the other provisions incorporated in the policy form. Reserves in the aggregate should be sufficient to cover:

a. Policies upon which no claim has yet arisen.

b. Policies upon which an accelerated claim has arisen.

4. For policies and certificates which provide actuarially equivalent benefits, no additional reserves need to be established.

5. Policy liens and policy loans, including accrued interest, represent assets of the company for statutory reporting purposes. For any policy on which the policy lien exceeds the policy's statutory reserve liability such excess must be held as a nonadmitted asset.
Appendix A-628

Title Insurance

Definitions

1. "Abstract of title" or "abstract" means a written history, synopsis or summary of the recorded instruments affecting the title to real property.

2. "Affiliate" means a specific person that directly, or indirectly through one or more intermediaries, controls, or is controlled by or is under common control with the person specified.

3. "Bona fide employee" of the title insurer or title insurance agent means an individual who devotes substantially all of his or her time to performing services on behalf of a title insurer or title insurance agent and whose compensation for those services is in the form of salary or its equivalent paid by the title insurer or title insurance agent.

4. "Control" (including the terms "controlling," "controlled by" and "under common control with") means the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract other than a commercial contract for goods or nonmanagement services, or otherwise, unless the power is the result of an official position or corporate office held by the person. Control shall be presumed to exist if a person, directly or indirectly, owns, controls, holds with the power to vote, or holds proxies representing, ten percent (10%) or more of the voting securities of another person. This presumption can be overcome by predominant evidence to the contrary; however, it shall stand until overcome by such predominant contradictory evidence.

5. "Escrow" means written instruments, money or other items deposited by one party with a depository, escrow agent or escrowee for delivery to another party upon the performance of a specified condition or the happening of a certain event.

6. "Escrow, settlement or closing fee" means the consideration for supervising or handling the actual execution, delivery or recording of transfer and lien documents and for disbursing funds.

7. "Net retained liability" means the total liability retained by a title insurer for a single risk, after taking into account any ceded liability and collateral, acceptable to the commissioner, maintained by the insurer.

8. "Person" means any natural person, partnership, association, cooperative, corporation, trust or other legal entity.

9. "Security" or "security deposit" means funds or other property received by the title insurer as collateral to secure an indemnitor’s obligation under an indemnity agreement pursuant to which the insurer is granted a perfected security interest in the collateral in exchange for agreeing to provide coverage in a title insurance policy for a specific title exception to coverage.

10. "Title insurance agent" or "agent" means an authorized person, other than a bona fide employee of the title insurer who, on behalf of the title insurer, performs the following acts, in conjunction with the issuance of a title insurance report or policy:

a. Determines insurability and issues title insurance reports or policies, or both, based upon the performance or review of a search or abstract of title; and
b. Performs one or more of the following functions:
   i. Collects or disburses premiums, escrow or security deposits or other funds;
   ii. Handles escrows, settlements or closings;
   iii. Solicits or negotiates title insurance business; or
   iv. Records closing documents.

11. “Title insurance business” or “business of title insurance” means:

   a. Issuing as insurer or offering to issue as insurer a title insurance policy;
   b. Transacting or proposing to transact by a title insurer any of the following activities when conducted or performed in contemplation of or in conjunction with the issuance of a title insurance policy:
      i. Soliciting or negotiating the issuance of a title insurance policy;
      ii. Guaranteeing, warranting or otherwise insuring the correctness of title searches for all instruments affecting titles to real property, any interest in real property, cooperative units and proprietary leases and for all liens or charges affecting the same;
      iii. Handling of escrows, settlements or closings;
      iv. Executing title insurance policies;
      v. Effecting contracts of reinsurance; or
      vi. Abstracting, searching or examining titles;
   c. Guaranteeing, warranting or insuring searches or examinations of title to real property or any interest in real property; or
   d. Guaranteeing or warranting the status of title as to ownership of or liens on real property and personal property by any person other than the principals to the transaction; or
   e. Doing or proposing to do any business substantially equivalent to any of the activities listed in this paragraph in a manner designed to evade the provisions of this Appendix.

12. “Title insurance policy” or “policy” means a contract insuring or indemnifying owners of, or other persons lawfully interested in, real or personal property or any interest in real property, against loss or damage arising from any or all of the following conditions existing on or before the policy date and not excepted or excluded:

   a. Defects in or liens or encumbrances on the insured title;
   b. Unmarketability of the insured title;
   c. Invalidity, lack of priority or unenforceability of liens or encumbrances on the stated property;
   d. Lack of legal right of access to the land; or
e. Unenforceability of rights in title to the land.

13. “Title insurance report” or “report” means a preliminary report, commitment or binder issued prior to the issuance of a title insurance policy containing the terms, conditions, exceptions and any other matters incorporated by reference under which the title insurer is willing to issue its title insurance policy.

14. “Title insurer” or “insurer” means a company organized for the purpose of transacting the business of title insurance.

15. “Title plant” means a set of records consisting of documents, maps, surveys or entries affecting title to real property or any interest in or encumbrance on the property, which have been filed or recorded in the jurisdiction for which the title plant is established or maintained.

Admitted Asset Standards

16. An investment in a title plant or plants in an amount equal to the actual cost shall be allowed as an admitted asset for title insurers. The aggregate amount of the investment shall not exceed the lesser of twenty percent (20%) of admitted assets or forty percent (40%) of surplus to policyholders, both as required to be shown on the statutory balance sheet of the insurer for its most recently filed statement with the domiciliary state commissioner; if the amount of the investment exceeds the above limits, the excess amount shall be recorded as a nonadmitted asset.

Reserves

17. A title insurer shall establish and maintain:

   a. A known claim reserve in an amount estimated to be sufficient to cover all unpaid losses, claims and allocated loss adjustment expenses arising under title insurance policies, guaranteed certificates of title, guaranteed searches and guaranteed abstracts of title, and all unpaid losses, claims and allocated loss adjustment expenses for which the title insurer may be liable, and for which the insurer has received notice by or on behalf of the insured, holder of a guarantee or escrow or security depositor.

   b. A Statutory or Unearned Premium Reserve consisting of:

      i. The amount of the statutory or unearned premium or reinsurance reserve legally held at December 31, 2000. The balance of this reserve shall be released in accordance with the state laws in effect prior to January 1, 2001; and

      ii. For those title insurance policies and guarantees written after January 1, 2001, reserves shall be established that are equal to the sum of the following items, as set forth in the title insurer’s most recent annual statement:

         (a) For each title insurance policy on a single risk written or assumed, an amount, as determined by the insurer’s state of domicile, per $1,000 of net retained liability for policies under $500,000 and for policies of $500,000 or greater, or any other reasonable method as required by the insurer’s state of domicile; and

         (b) An amount as determined by the insurer’s state of domicile for the escrow, settlement and closing fees collected in contemplation of the issuance of title insurance policies or guarantees.
iii. The aggregate of the amounts set aside in this reserve in any calendar year pursuant to subparagraphs b. ii. shall be released from the reserve and restored to net profits over a period of twenty (20) years pursuant to the following formula: thirty-five percent (35%) of the aggregate sum on July 1 of the year next succeeding the year of addition; fifteen percent (15%) of the aggregate sum on July 1 of each of the succeeding two (2) years; ten percent (10%) of the aggregate sum on July 1 of the next succeeding year; three percent (3%) of the aggregate sum on July 1 of each of the next three (3) succeeding years; two percent (2%) of the aggregate sum on July 1 of each of the next three (3) succeeding years; and one percent (1%) of the aggregate sum on July 1 of each of the next succeeding ten (10) years.

iv. The insurer shall calculate a retroactive adjusted statutory or unearned premium reserve on an aggregate basis at January 1, 2001. The adjusted aggregate reserve shall be calculated as if Subsection b. ii. had been in effect for all years beginning twenty (20) years prior to January 1, 2001. If the adjusted aggregate reserve exceeds the aggregate amount set aside for statutory or unearned premiums in the insurer’s December 31, 2000 annual statement, the insurer shall–increase its statutory or unearned premium reserve by an amount equal to one-sixth of that excess in each of the succeeding six years, commencing with the 2001 calendar year.

v. The aggregate of the amounts set aside in this reserve in any calendar year as adjustments to the insurer’s statutory or unearned premium reserve pursuant to Subsection b. iv. shall be released from the reserve and restored to net profits, or equity if the additions required by subparagraph b. iv. of this section reduced equity directly, over a period not exceeding ten (10) years pursuant to the following table:

<table>
<thead>
<tr>
<th>Year of Addition</th>
<th>Release</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>Equally over 10 years</td>
</tr>
<tr>
<td>2002</td>
<td>Equally over 9 years</td>
</tr>
<tr>
<td>2003</td>
<td>Equally over 8 years</td>
</tr>
<tr>
<td>2004</td>
<td>Equally over 7 years</td>
</tr>
<tr>
<td>2005</td>
<td>Equally over 6 years</td>
</tr>
<tr>
<td>2006</td>
<td>Equally over 5 years</td>
</tr>
</tbody>
</table>

c. A supplemental reserve shall be established consisting of any other reserves necessary, when taken in combination with the reserves required by Subsections a. and b. of this paragraph, to cover the company’s liabilities with respect to all losses, claims and loss adjustment expenses.
Appendix A-630

Mortgage Guaranty Insurance

Definitions

1. “Mortgage guaranty insurance” is:

   a. Insurance against financial loss by reason of nonpayment of principal, interest or other sums agreed to be paid under the terms of any note or bond or other evidence of indebtedness secured by a mortgage, deed of trust, or other instrument constituting a lien or charge on real estate, provided the improvement on such real estate is a residential building or a condominium unit or buildings designed for occupancy by not more than four families.

   b. Insurance against financial loss by reason of nonpayment of principal, interest or other sums agreed to be paid under the terms of any note or bond or other evidence of indebtedness secured by a mortgage, deed of trust, or other instrument constituting a lien or charge on real estate, providing the improvement on such real estate is a building or buildings designed for occupancy by five (5) or more families or designed to be occupied for industrial or commercial purposes.

   c. Insurance against financial loss by reason of nonpayment of rent or other sums agreed to be paid under the terms of a written lease for the possession, use or occupancy of real estate, provided the improvement on such real estate is a building or buildings designed to be occupied for industrial or commercial purposes.

2. “Authorized real estate security” for the purpose of this Appendix means an amortized note, bond or other evidence of indebtedness, not exceeding ninety-five percent (95%) of the fair market value of the real estate, secured by a mortgage, deed of trust, or other instrument which constitutes, or is equivalent to, a first lien or charge on real estate; provided:

   a. The real estate loan secured in such manner is one of a type which a bank, savings and loan association, or an insurance company, which is supervised and regulated by a state department or the federal government, is authorized to make, or would be authorized to make, disregarding any requirement applicable to such an institution that the amount of the loan not exceed a certain percentage of the value of the real estate.

   b. The improvement on such real estate is a building or buildings designed for occupancy as specified by paragraphs 1.a. and 1.b. of this Appendix.

   c. The lien on such real estate may be subject to and subordinate to the following:

      i. The lien of any public bond, assessment or tax, when no installment, call or payment of or under such bond, assessment or tax is delinquent.

      ii. Outstanding mineral, oil, water or timber rights, rights-of-way, easements or rights-of-way of support, sewer rights, building restrictions or other restrictions or covenants, conditions or regulations of use, or outstanding leases upon such real property under which rents or profits are reserved to the owner thereof.

3. “Contingency reserve” means an additional premium reserve established to protect policyholders against the effect of adverse economic cycles.
Investment Limitation

4. A mortgage guaranty insurance company shall not report as an admitted asset notes or other evidences of indebtedness secured by mortgage or other lien upon real property. This provision shall not apply to obligations secured by real property, or contracts for the sale of real property, which obligations or contracts of sale are acquired in the course of the good faith settlement of claims under policies of insurance issued by the mortgage guaranty insurance company, or in the good faith disposition of real property so acquired.

Reserves

5. Unearned Premium Reserves - A mortgage guaranty insurance company shall compute and maintain an unearned premium reserve.

6. Loss Reserve - A mortgage guaranty insurance company shall compute and maintain adequate case basis and other loss reserves which accurately reflect loss frequency and loss severity and shall include components for claims reported and for claims incurred but not reported, including estimated losses on:
   a. Insured loans which have resulted in the conveyance of property which remains unsold;
   b. Insured loans in the process of foreclosure;
   c. Insured loans in default for four (4) months or for any lesser period which is defined as default for such purposes in the policy provisions; and
   d. Insured leases in default for four (4) months or for any lesser period which is defined as default for such purposes in policy provisions.

7. Contingency Reserve

Each mortgage guaranty insurance company shall compute and maintain a contingency reserve.

8. Reinsurance

Whenever a mortgage guaranty insurance company obtains reinsurance from an insurance company which is properly licensed to provide such reinsurance or from an appropriate governmental agency, the mortgage guaranty insurer and the reinsurer shall establish and maintain the reserves required in this Appendix in appropriate proportions in relation to the risk retained by the original insurer and ceded to the assuming reinsurer so that the total reserves established shall not be less than the reserves required by this Appendix.
Appendix A-641

Long-Term Care Insurance

Definitions

1. “Long-term care insurance” means any insurance policy or rider advertised, marketed, offered or designed to provide coverage for not less than twelve (12) consecutive months for each covered person on an expense incurred, indemnity, prepaid or other basis; for one or more necessary or medically necessary diagnostic, preventive, therapeutic, rehabilitative, maintenance or personal care services, provided in a setting other than an acute care unit of a hospital. Such term includes group and individual annuities and life insurance policies or riders which provide directly or which supplement long-term care insurance. Such term also includes a policy or rider which provides for payment of benefits based upon cognitive impairment or the loss of functional capacity. The term shall also include qualified long-term care insurance contracts. Long-term care insurance may be issued by insurers; fraternal benefit societies; nonprofit health, hospital, and medical service corporations; prepaid health plans; health maintenance organizations or any similar organization to the extent they are otherwise authorized to issue life or health insurance. Long-term care insurance shall not include any insurance policy which is offered primarily to provide basic Medicare supplement coverage, basic hospital expense coverage, basic medical-surgical expense coverage, hospital confinement indemnity coverage, major medical expense coverage, disability income or related asset-protection coverage, accident only coverage, specified disease or specified accident coverage, or limited benefit health coverage. With regard to life insurance, this term does not include life insurance policies which accelerate the death benefit specifically for one or more of the qualifying events of terminal illness, medical conditions requiring extraordinary medical intervention, or permanent institutional confinement, and which provide the option of a lump-sum payment for those benefits and in which neither the benefits nor the eligibility for the benefits is conditioned upon the receipt of long-term care. Notwithstanding any other provision contained herein, any product advertised, marketed or offered as long-term care insurance shall be subject to the provisions of this Appendix.

2. “Applicant” means:
   a. In the case of an individual long-term care insurance policy, the person who seeks to contract for benefits, and
   b. In the case of a group long-term care insurance policy, the proposed certificate holder.

3. “Certificate” means, for the purposes of this Appendix, any certificate issued under a group long-term care insurance policy, which policy has been delivered or issued for delivery.

4. “Group long-term care insurance” means a long-term care insurance policy which is delivered or issued for delivery to:
   a. One or more employers or labor organizations, or to a trust or to the trustees of a fund established by one or more employers or labor organizations, or a combination thereof, for employees or former employees or a combination thereof or for members or former members or a combination thereof, of the labor organizations; or
   b. Any professional, trade or occupational association for its members or former or retired members, or combination thereof, if such association:
      i. Is composed of individuals all of whom are or were actively engaged in the same profession, trade or occupation; and
ii. Has been maintained in good faith for purposes other than obtaining insurance; or

c. An association or a trust or the trustee(s) of a fund established, created or maintained for the benefit of members of one or more associations. Prior to advertising, marketing or offering such policy, the association or associations, or the insurer of the association or associations, shall evidence that the association or associations have at the outset a minimum of 100 persons and have been organized and maintained in good faith for purposes other than that of obtaining insurance; have been in active existence for at least one year; and have a constitution and bylaws which provide that:

i. The association or associations hold regular meetings not less than annually to further purposes of the members;

ii. Except for credit unions, the association or associations collect dues or solicit contributions from members; and

iii. The members have voting privileges and representation on the governing board and committees.

5. “Policy” means, for the purposes of this Appendix, any policy, contract, subscriber agreement, rider or endorsement delivered or issued for delivery by an insurer; fraternal benefit society; nonprofit health, hospital, or medical service corporation; prepaid health plan; health maintenance organization or any similar organization.

6. a. “Qualified long-term care insurance contract” or “federally tax-qualified long-term care insurance contract” means an individual or group insurance contract that meets the requirements of Section 7702B(b) of the Internal Revenue Code of 1986, as amended, as follows:

i. The only insurance protection provided under the contract is coverage of qualified long-term care services. A contract shall not fail to satisfy the requirements of this subparagraph by reason of payments being made on a per diem or other periodic basis without regard to the expenses incurred during the period to which the payments relate;

ii. The contract does not pay or reimburse expenses incurred for services or items to the extent that the expenses are reimbursable under Title XVIII of the Social Security Act, as amended, or would be so reimbursable but for the application of a deductible or coinsurance amount. The requirements of this subparagraph do not apply to expenses that are reimbursable under Title XVIII of the Social Security Act only as a secondary payor. A contract shall not fail to satisfy the requirements of this subparagraph by reason of payments being made on a per diem or other periodic basis without regard to the expenses incurred during the period to which the payments relate;

iii. The contract is guaranteed renewable, within the meaning of section 7702B(b)(1)(C) of the Internal Revenue Code of 1986, as amended;

iv. The contract does not provide for a cash surrender value or other money that can be paid, assigned, pledged as collateral for a loan, or borrowed except as provided in subparagraph 6av. below;
v. All refunds of premiums, and all policyholder dividends or similar amounts, under the contract are to be applied as a reduction in future premiums or to increase future benefits, except that a refund on the event of death of the insured or a complete surrender or cancellation of the contract cannot exceed the aggregate premiums paid under the contract; and

vi. The contract meets the consumer protection provisions set forth in Section 7702B(g) of the Internal Revenue Code of 1986, as amended.

b. “Qualified long-term care insurance contract” or “federally tax-qualified long term care insurance contract” also means the portion of a life insurance contract that provides long-term care insurance coverage by rider or as part of the contract and that satisfies the requirements of Sections 7702B(b) and (e) of the Internal Revenue Code of 1986, as amended.

Valuation Requirements

7. When long-term care benefits are provided through the acceleration of benefits under group or individual life policies or riders to such policies, policy reserves for the benefits shall be determined in accordance with Appendix A-820. Claim reserves shall also be established in the case when the policy or rider is in claim status.

8. Reserves for policies and riders subject to this Appendix should be based on the multiple decrement model utilizing all relevant decrements except for voluntary termination rates. Single decrement approximations are acceptable if the calculation produces essentially similar reserves, if the reserve is clearly more conservative, or if the reserve is immaterial. The calculations may take into account the reduction in life insurance benefits due to the payment of long-term care benefits. However, in no event shall the reserves for the long-term care benefit and the life insurance benefit be less than the reserves for the life insurance benefit assuming no long-term care benefit.

9. In the development and calculation of reserves for policies and riders subject to this Appendix, due regard shall be given to the applicable policy provisions, marketing methods, administrative procedures and all other considerations which have an impact on projected claim costs, including, but not limited to, the following:

   a. Definition of insured events;
   b. Covered long-term care facilities;
   c. Existence of home convalescence care coverage;
   d. Definition of facilities;
   e. Existence or absence of barriers to eligibility;
   f. Premium waiver provision;
   g. Renewability;
   h. Ability to raise premiums;
   i. Marketing method;
   j. Underwriting procedures;
k. Claims adjustment procedures;
l. Waiting period;
m. Maximum benefit;
n. Availability of eligible facilities;
o. Margins in claim costs;
p. Optional nature of benefit;
q. Delay in eligibility for benefit;
r. Inflation protection provisions; and
s. Guaranteed insurability option.

10. When long-term care benefits are provided other than as in the above, reserves shall be determined in accordance with Appendix A-010.
Appendix A-695

Synthetic Guaranteed Investment Contracts

Scope and Application

1. This appendix applies to that portion of a group annuity contract or other agreement defined in paragraph 23 and issued by a life insurer that functions as an accounting record for an accumulation fund and has benefit guarantees relating to a principal amount and levels of interest at a fixed rate of return specified in advance. The fixed rates of return will be constant over the applicable rate periods, and may reflect prior and current market conditions with respect to the segregated portfolio but may not reference future changes in market conditions.

Definitions

2. “Account assets” means the assets in the segregated portfolio plus any assets held in the general account or a separate account to meet the asset maintenance requirements.

3. “Actuarial opinion and memorandum” means the valuation actuary’s opinion and memorandum covering synthetic guaranteed investment contract liabilities that is required to be submitted to the commissioner.

4. “Appointed actuary” means the qualified actuary appointed or retained either directly by or by the authority of the board of directors through an executive officer of the company to prepare the annual statement of actuarial opinion for the company as a whole.

5. “Asset maintenance requirement” means the requirement to maintain assets to fund contract benefits in accordance with paragraph 27 of this appendix.

6. “Class of contracts” means the set of all contracts to which a given plan of operation pertains.

7. “Contract value record” means an accounting record, provided by the contract in relation to a segregated portfolio of assets, that is credited with a fixed rate of return over regular periods, and that is used to measure the extent of the insurer’s obligation to the contractholder. The fixed rate of return credited to the contract value record is determined by means of a crediting rate formula or declared at the inception of the contract and valid for the entire term of the contract.

8. “Crediting rate formula” means a mathematical formula used to calculate the fixed rate of return credited to the contract value record during any rate period and based in part upon the difference between the contract value record and the market value record amortized over an appropriate period. The fixed rate of return calculated by means of this formula may reflect prior and current market conditions with respect to the segregated portfolio, but may not reference future changes in market conditions.

9. “Duration” means, with respect to the segregated portfolio assets or guaranteed contract liabilities, a measure of price sensitivity to changes in interest rates, such as the Macaulay duration or option-adjusted duration.

10. “Fair market value” means a reasonable estimate of the amount that a knowledgeable buyer of an asset would be willing to pay, and a knowledgeable seller of an asset would be willing to accept, for the asset without duress in an arm's length transaction. In the case of a publicly traded security, the fair market value is the price at which the security is traded or, if no price is available, a price that appropriately reflects the latest bid and asked prices for the security. In the case of a debt instrument that is not publicly traded, the fair market value is the discounted present value of the asset calculated at a
reasonable discount rate. For all other non-publicly traded assets, fair market value will be determined in accordance with valuation practices customarily used within the financial industry.

11. “Guaranteed minimum benefits” means contract benefits on a specified date that may be either:

   a. A principal guarantee, with or without a fixed minimum interest rate guarantee, related to the segregated portfolio;

   b. An assurance as to the future investment return or performance of the segregated portfolio; or

   c. The fair market value of the segregated portfolio, to the extent that the fair market value of the assets determines the contractholder’s benefits.

12. a. “Hedging instrument” means:

   i. An interest rate futures agreement or foreign currency futures agreement, an option to purchase or sell an interest rate futures agreement or foreign currency futures agreement, or any option to purchase or sell a security or foreign currency, used in a bona fide hedging transaction; or

   ii. A financial agreement or arrangement entered into with a broker, dealer or bank, qualified under applicable federal and state securities or banking law and regulation, in connection with investment in one or more securities in order to reduce the risk of changes in market valuation or to create a synthetic investment that, when added to the portfolio, reduces the risk of changes in market valuation.

   b. An instrument shall not be considered a hedging instrument or a part of a bona fide hedging transaction if it is purchased in conjunction with another instrument where the effect of the combined transaction is an increase in the portfolio's exposure to market risk.

13. “Investment guidelines” means a set of written guidelines, established in advance by the person with investment authority over the segregated portfolio, to be followed by the investment manager. The guidelines shall include a description of:

   a. The segregated portfolio's investment objectives and limitations;

   b. The investment manager’s degree of discretion;

   c. The duration, asset class, quality, diversification, and other requirements of the segregated portfolio; and

   d. The manner in which derivative instruments may be used, if at all, in the segregated portfolio.

14. “Investment manager” means the person (including the contractholder) responsible for managing the assets in the segregated portfolio in accordance with the investment guidelines in a fiduciary capacity to the owner of the assets.

15. “Market value record” means an accounting record provided by the contract to reflect the fair market value of the segregated portfolio.
16. “Nationally Recognized Statistical Rating Organization (NRSRO)” means a rating organization so designated by the Securities and Exchange Commission of the United States of America (SEC) which has applied to, and whose NRSRO status has been confirmed by, the NAIC Securities Valuation Office.

17. “Permitted custodial institution” means a bank, trust company or other licensed fiduciary services provider.

18. “Plan of operation” means a written plan meeting the requirements of paragraph 26 of this appendix.

19. “Qualified actuary” means an individual who meets the qualification standards set forth in Appendix A-820.

20. “Rate period” means the period of time during which the fixed rate of return credited to the contract value record is applicable between crediting rate formula adjustments.

21. “Segregated portfolio” means:
   a. A portfolio or sub-portfolio of assets to which the contract pertains that is held in a custody or trust account by the permitted custodial institution and identified on the records of the permitted custodial institution as special custody assets held for the exclusive benefit of the retirement plans or other entities on whose behalf the contractholder holds the contract; and
   b. Any related cash or currency received by the permitted custodial institution for the account of the contractholder and held in a deposit account for the exclusive benefit of the retirement plans or other entities on whose behalf the contractholder holds the contract.

22. “Spot rate” corresponding to a given time of benefit payment means the yield on a zero-coupon non-callable and non-prepayable United States government obligation maturing at that time, or the zero-coupon yield implied by the price of a representative sampling of coupon-bearing, non-callable and non-prepayable United States government obligations in accordance with a formula set forth in the plan of operation. To the extent that guaranteed contract liabilities are denominated in the currency of a foreign country rated in one of the two (2) highest rating categories by an NRSRO and are supported by investments denominated in the currency of the foreign country, the spot rate may be determined by reference to substantially similar obligations of the government of the foreign country.

23. “Synthetic guaranteed investment contract” or “contract” means a group annuity contract or other agreement that in whole or in part establishes the insurer’s obligations by reference to a segregated portfolio of assets that is not owned by the insurer.

24. “United States government obligation” means a direct obligation issued, assumed, guaranteed or insured by the United States of America or by an agency or instrumentality of the United States government.

25. “Valuation actuary” means the appointed actuary or, alternatively, a qualified actuary designated by the appointed actuary to render the actuarial opinion. Written documentation of any such designation shall be on file at the company and available for review upon request.

**Plan of Operation**

26. The plan of operation for a class of contracts shall describe the financial implications for the insurer of the issuance of contracts in the class, and shall include at least the following:
Appendix A

Reserves and Documentation

27. Asset maintenance requirements for segregated portfolios covered by this appendix.

a. At all times an insurer shall hold minimum reserves in the general account or one or more separate accounts, as appropriate, equal to the excess, if any, of the value of the guaranteed contract liabilities, determined in accordance with paragraphs 27f. and 27g., over the market value of the assets in the segregated portfolio less the deductions provided for in paragraph 27b. These reserve requirements shall be applied on a contract-by-contract basis.

b. In determining compliance with the asset maintenance requirement and the reserve for guaranteed contract liabilities specified in paragraph 27a., the insurer shall deduct a percentage of the market value of an asset as follows:

i. For debt instruments, the percentage shall be the NAIC asset valuation reserve "reserve objective factor," but the factor shall be increased by fifty percent (50%) for the purpose of this calculation if the difference in durations of the assets and liabilities is more than one-half year.

ii. For assets that are not debt instruments, the percentage shall be the NAIC asset valuation reserve “maximum reserve factor.”

c. To the extent that guaranteed contract liabilities are denominated in the currency of a foreign country and are supported by segregated portfolio assets denominated in the currency of the foreign country, the percentage deduction for these assets under paragraph 27b. shall be that for a substantially similar investment denominated in the currency of the United States.

d. To the extent that guaranteed contract liabilities are denominated in the currency of the United States and are supported by segregated portfolio assets denominated in the currency of a foreign country, and to the extent that guaranteed contract liabilities are denominated in the currency of a foreign country and are supported by segregated portfolio assets denominated in the currency of the United States, the deduction for debt instruments under paragraph 27b. shall be increased by fifteen percent (15%) of the market value of the assets unless the currency exchange risk on the assets has been adequately hedged, in which case the percentage deduction under paragraph 27b. shall be increased by one-half percent (.5%). No guaranteed contract liabilities denominated in the currency of a foreign country shall be supported by segregated portfolio assets denominated in the currency of another foreign country. For purposes of this paragraph, the currency exchange risk on an asset is deemed to be adequately hedged if:

i. It is an obligation of
(a) A jurisdiction that is rated in one of the two (2) highest rating categories by an NRSRO;

(b) Any political subdivision or other governmental unit of such a jurisdiction, or any agency or instrumentality of jurisdiction, political subdivision or other governmental unit; or

(c) An institution that is organized under the laws of any such jurisdiction; and

ii. At all times the principal amount of the obligation and scheduled interest payments on the obligation are hedged against the United States dollar pursuant to contracts or agreements that are:

(a) Issued by or traded on a securities exchange or board of trade regulated under the laws of the United States or Canada or a province of Canada;

(b) Entered into with a United States banking institution that has assets in excess of $5 billion and that has obligations outstanding, or has a parent corporation that has obligations outstanding, that are rated in one of the two (2) highest rating categories by an NRSRO, or with a broker-dealer registered with the Securities and Exchange Commission that has net capital in excess of $250 million; or

(c) Entered into with any other banking institution that has assets in excess of $5 billion and that has obligations outstanding, or has a parent corporation that has obligations outstanding, that are rated in one of the two (2) highest rating categories by an NRSRO.

e. These contracts may provide for the allocation to one or more separate accounts of all or any portion of the amount needed to meet the asset maintenance requirement. If the contract provides that the assets in the separate account shall not be chargeable with liabilities arising out of any other business of the insurer, the insurer shall maintain in a distinct separate account that is so chargeable:

i. That portion of the amount needed to meet the asset maintenance requirement that has been allocated to separate accounts; less

ii. The amounts contributed to separate accounts by the contractholder in accordance with the contract and the earnings on the contract.

f. For purposes of this paragraph, the minimum value of guaranteed contract liabilities is defined to be the sum of the expected guaranteed contract benefits, each discounted at a rate corresponding to the expected time of payment of the contract benefit that is not greater than the maximum multiple of the spot rate supportable by the expected return from the segregated portfolio assets, and in no event greater than 105 percent of the spot rate as described in the plan of operation or the actuary’s opinion and memorandum, except that if the expected time of payment of a contract benefit is more than thirty (30) years, it shall be discounted from the expected date of payment to year thirty (30) at a rate of no more than eighty percent (80%) of the thirty-year spot rate and from year thirty (30) to the date of valuation at a rate not greater than 105 percent of the thirty-year spot rate.
g. In calculating the minimum value of guaranteed contract benefits:

i. All guaranteed benefits potentially available to the contractholder on an ongoing basis shall be considered in the valuation process and analysis, and the reserve held must be sufficient to fund the greatest present value of each independent guaranteed contract benefit. For purposes of this subparagraph, the right granted to the contractholder to exit the contract by discharging the insurer of its guarantee obligation under the contract and taking control of the assets in the segregated portfolio shall not be considered a guaranteed benefit.

ii. To the extent that future guaranteed cash flows are dependent upon the benefit responsiveness of an employer-sponsored plan, a best estimate based on company experience, or other reasonable criteria if company experience is not available, shall be used in the projections of future cash flows.

28. Account assets shall make adequate provision for contract liabilities, taking into account any risk charge payable, the segregated portfolio assets, and the amount of any reserve liability with respect to the asset maintenance requirement.

29. The fixed-income segregated portfolio shall conform to and justify the rates used to discount contract liabilities for valuation pursuant to paragraph 27f.

30. The company shall document whether any rates used pursuant to paragraph 27f. to discount guaranteed contract liabilities and other items applicable to the segregated portfolio were modified from the rate or rates described in the plan of operation.

31. The level of risk charges, if any, retained in the general account shall be appropriate in view of such factors as the nature of the guaranteed contract liabilities and losses experienced in connection with account contracts and other pricing factors.

32. The company shall substantially conform with Appendix A-822 and maintain internal documentation to either:

a. Demonstrate the adequacy of account assets based upon cash flow analysis, or

b. Explain why cash flow testing analysis is not appropriate, describe the alternative methodology of asset adequacy testing used, and demonstrate the adequacy of account assets under that methodology;

33. The company’s internal documentation pertaining to reserves for synthetic guaranteed investment contract liabilities shall also:

a. Clearly describe the assumptions used in projecting cash flows under each class of assets, and any dynamic portfolio hedging techniques utilized and the tests performed on the utilization of the techniques;

b. Clearly describe how the company has reflected the cost of capital;

c. Clearly describe how the company has reflected the risk of default on obligations and mortgage loans, including obligations and mortgage loans that are not investment grade;

d. Clearly describe how the company has reflected withdrawal risks, if applicable, including a discussion of the positioning of the contracts within the benefit withdrawal priority order pertaining to the contracts;

e. If the plan of operation provides for investments in segregated portfolio assets other than United States government obligations, demonstrate that the rates used to discount contract liabilities pursuant to paragraph 27f. conservatively reflect expected investment returns, taking into account any foreign exchange risks;

f. If the contracts provide that in certain circumstances they would cease to be funded by a segregated portfolio and, instead would become contracts funded by the general account, clearly describe how any increased reserves would be provided for if and to the extent these circumstances occurred;

g. Document the amount of account assets maintained in a separate account that are not chargeable with liabilities arising out of any other business of the insurance company;

h. Document the amount of reserves and supporting assets as of December 31 and where the reserves are shown in the annual statement;

i. Document the amount of any contingency reserve carried as part of surplus;

j. Document the market value of the segregated asset portfolio; and

k. Where separate account assets are not chargeable with liabilities arising out of any other business of the insurance company, describe how the level of risk charges payable to the general account provides an appropriate compensation for the risk taken by the general account.

34. When the insurer issues a synthetic guaranteed investment contract and complies with the asset maintenance requirements of paragraph 27, it need not maintain an asset valuation reserve with respect to those account assets.

35. This paragraph describes the reserve valuation requirements for contracts subject to this appendix.

a. Reserves for synthetic investment contracts subject to this appendix shall be an amount equal to the sum of the following:

i. The amounts determined as the minimum reserve as required under paragraph 27; and

ii. Any additional amount determined by the insurer's valuation actuary as necessary to make adequate provision for all contract liabilities.

b. The amount of any reserves required by paragraph 35a. may be established by either:

i. Allocating sufficient assets to one or more separate accounts; or

ii. Setting up the additional reserves in the general account.
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Appendix A-785

Credit For Reinsurance

Definitions

1. “Commissioner” refers to the commissioner of insurance in the state where credit or a reduction from liability is taken.

2. “Jurisdiction” refers to any state, district or territory of the United States and also to territories, provinces or jurisdictions other than the United States.

3. “Liabilities” shall mean the assuming insurer’s gross liabilities attributable to reinsurance ceded by U. S. domiciled insurers that are not otherwise secured by acceptable means.

4. “Beneficiary” means the entity for whose sole benefit the trust has been established and any successor of the beneficiary by operation of law. If a court of law appoints a successor in interest to the named beneficiary, then the named beneficiary includes and is limited to the court appointed domiciliary receiver (including conservator, rehabilitator or liquidator).

5. “Grantor” means the entity that has established a trust for the sole benefit of the beneficiary. When established in conjunction with a reinsurance agreement, the grantor is the unlicensed, unaccredited assuming insurer.

6. “Obligations,” as used in paragraph 27 of this Appendix means:
   a. Reinsured losses and allocated loss expenses paid by the ceding company, but not recovered from the assuming insurer;
   b. Reserves for reinsured losses reported and outstanding;
   c. Reserves for reinsured losses incurred but not reported; and
   d. Reserves for allocated reinsured loss expenses and unearned premiums.

Credit Allowed a Domestic Ceding Insurer

7. Credit for reinsurance shall be allowed a domestic ceding insurer as either an asset or a reduction from liability on account of reinsurance ceded only when the reinsurer meets the requirements of paragraphs 8, 9, 10, 11 or 12 of this Appendix. Credit shall be allowed under paragraphs 8, 9, or 10 of this Appendix only as respects cessions of those kinds or classes of business which the assuming insurer is licensed or otherwise allowed to write or assume in its state of domicile or, in the case of a U.S. branch of an alien assuming insurer, in the state through which it is entered and licensed to transact insurance or reinsurance. Credit shall be allowed under paragraphs 10 or 11 of this Appendix only if the applicable requirements of paragraph 13 have been satisfied.

8. Credit shall be allowed when the reinsurance is ceded to an assuming insurer that is licensed to transact insurance or reinsurance in the domiciliary state of the ceding insurer.

9. Credit shall be allowed when the reinsurance is ceded to an assuming insurer that is accredited as a reinsurer in the domiciliary state of the ceding insurer. An accredited reinsurer is one that:
   a. Files with the commissioner evidence of its submission to the domiciliary state’s jurisdiction;
b. Submits to the domiciliary state’s authority to examine its books and records;

c. Is licensed to transact insurance or reinsurance in at least one state, or in the case of a U.S. branch of an alien assuming insurer, is entered through and licensed to transact insurance or reinsurance in at least one state;

d. Files annually with the commissioner a copy of its annual statement filed with the insurance department of its state of domicile and a copy of its most recent audited financial statement; and

i. Maintains a surplus as regards policyholders in an amount not less than $20,000,000 and whose accreditation has not been denied by the commissioner within ninety (90) days of its submission; or

ii. Maintains a surplus as regards policyholders in an amount less than $20,000,000 and whose accreditation has been approved by the commissioner.

e. Credit shall not be allowed a domestic ceding insurer if the assuming insurer’s accreditation has been revoked by the commissioner.

10. a. Credit shall be allowed when the reinsurance is ceded to an assuming insurer that is domiciled in, or in the case of a U.S. branch of an alien assuming insurer is entered through, a state that employs standards regarding credit for reinsurance substantially similar to those of the domiciliary state of the ceding insurer and the assuming insurer or U.S. branch of an alien assuming insurer:

i. Maintains a surplus as regards policyholders in an amount not less than $20,000,000; and

ii. Submits to the authority of the domiciliary state to examine its books and records.

b. The requirement of paragraph 10 a. i. does not apply to reinsurance ceded and assumed pursuant to pooling arrangements among insurers in the same holding company system.

11. a. Credit shall be allowed when the reinsurance is ceded to an assuming insurer that maintains a trust fund in a qualified U.S. financial institution, as defined in paragraph 51, for the payment of the valid claims of its U.S. ceding insurers, their assigns and successors in interest. The assuming insurer shall report annually information substantially the same as that required to be reported on the NAIC Annual Statement form by licensed insurers. The assuming insurer shall submit to examination of its books and records by the commissioner and bear the expense of examination.

b. i. Credit for reinsurance shall not be granted under this paragraph 11 unless the form of the trust and any amendments to the trust have been approved by:

(a) The commissioner of the state where the trust is domiciled; or

(b) The commissioner of another state who, pursuant to the terms of the trust instrument, has accepted principal regulatory oversight of the trust.

ii. The trust instrument shall provide that:
(a) Contested claims shall be valid and enforceable out of funds in trust to the extent remaining unsatisfied thirty (30) days after entry of the final order of any court of competent jurisdiction in the United States;

(b) Legal title to the assets of the trust shall be vested in the trustee for the benefit of the grantor’s U.S. ceding insurers, their assigns and successors in interest;

(c) The trust shall be subject to examination as determined by the commissioner;

(d) The trust shall remain in effect for as long as the assuming insurer, or any member or former member of a group of insurers, shall have outstanding obligations under reinsurance agreements subject to the trust; and

(e) No later than February 28 of each year the trustee of the trust shall report to the commissioner in writing setting forth the balance in the trust and listing the trust’s investments at the preceding year-end, and shall certify the date of termination of the trust, if so planned, or certify that the trust shall not expire prior to the following December 31.

c. The following requirements apply to the following categories of assuming insurer:

i. The trust fund for a single assuming insurer shall consist of funds in trust in an amount not less than the assuming insurer’s liabilities attributable to reinsurance ceded by U.S. ceding insurers, and, in addition, the assuming insurer shall maintain a trusteed surplus of not less than $20,000,000.

ii. (a) In the case of a group including incorporated and individual unincorporated underwriters:

(1) For reinsurance ceded under reinsurance agreements with an inception, amendment or renewal date on or after August 1, 1995, the trust shall consist of a trusteed account in an amount not less than the group’s several liabilities attributable to business ceded by U.S. domiciled ceding insurers to any member of the group;

(2) For reinsurance ceded under reinsurance agreements with an inception date on or before July 31, 1995, and not amended or renewed after that date, notwithstanding the other provisions contained herein, the trust shall consist of a trusteed account in an amount not less than the group’s several insurance and reinsurance liabilities attributable to business written in the United States; and

(3) In addition to these trusts, the group shall maintain in trust a trusteed surplus of which $100,000,000 shall be held jointly for the benefit of the U.S. domiciled ceding insurers of any member of the group for all years of account; and

(b) The incorporated members of the group shall not be engaged in any business other than underwriting as a member of the group and shall be
subject to the same level of regulation and solvency control by the group’s domiciliary regulator as are the unincorporated members.

(c) Within ninety (90) days after its financial statements are due to be filed with the group’s domiciliary regulator, the group shall provide to the commissioner an annual certification by the group’s domiciliary regulator of the solvency of each underwriter member; or if a certification is unavailable, financial statements, prepared by independent public accountants, of each underwriter member of the group.

iii. In the case of a group of incorporated underwriters under common administration, the group shall:

(a) Have continuously transacted an insurance business outside the United States for at least three (3) years immediately prior to making application for accreditation;

(b) Maintain aggregate policyholders’ surplus of at least $10,000,000,000;

(c) Maintain a trust fund in an amount not less than the group’s several liabilities attributable to business ceded by U.S. domiciled ceding insurers to any member of the group pursuant to reinsurance contracts issued in the name of the group;

(d) In addition, maintain a joint trusteed surplus of which $100,000,000 shall be held jointly for the benefit of U.S. domiciled ceding insurers of any member of the group as additional security for these liabilities; and

(e) Within ninety (90) days after its financial statements are due to be filed with the group’s domiciliary regulator, make available to the commissioner an annual certification of each underwriter member’s solvency by the member’s domiciliary regulator and financial statements of each underwriter member of the group prepared by its independent public accountant.

d. Liabilities shall include:

i. For business ceded by domestic insurers authorized to write accident and health, and property and casualty insurance:

(a) Losses and allocated loss expenses paid by the ceding insurer, recoverable from the assuming insurer;

(b) Reserves for losses reported and outstanding;

(c) Reserves for losses incurred but not reported;

(d) Reserves for allocated loss expenses; and

(e) Unearned premiums.

ii. For business ceded by domestic insurers authorized to write life, health and annuity insurance:
Credit for Reinsurance

(a) Aggregate reserves for life policies and contracts net of policy loans and net due and deferred premiums;

(b) Aggregate reserves for accident and health policies;

(c) Deposit funds and other liabilities without life or disability contingencies; and

(d) Liabilities for policy and contract claims.

12. Credit shall be allowed when the reinsurance is ceded to an assuming insurer not meeting the requirements of paragraphs 8, 9, 10, or 11 of this Appendix, but only as to the insurance of risks located in jurisdictions where the reinsurance is required by applicable law or regulation of that jurisdiction.

13. If the assuming insurer is not licensed or accredited to transact insurance or reinsurance in the domiciliary state of the ceding insurer, the credit allowed by paragraphs 10 and 11 of this Appendix shall not be allowed unless the assuming insurer agrees in the reinsurance agreements:

a. i. That in the event of the failure of the assuming insurer to perform its obligations under the terms of the reinsurance agreement, the assuming insurer, at the request of the ceding insurer, shall submit to the jurisdiction of any court of competent jurisdiction in any state of the United States, will comply with all requirements necessary to give the court jurisdiction, and will abide by the final decision of the court or of any appellate court in the event of an appeal.

ii. To designate the commissioner or a designated attorney as its true and lawful attorney upon whom may be served any lawful process in any action, suit or proceeding instituted by or on behalf of the ceding company.

b. This paragraph 13 is not intended to conflict with or override the obligation of the parties to a reinsurance agreement to arbitrate their disputes, if this obligation is created in the agreement.

14. If the assuming insurer does not meet the requirements of paragraphs 8, 9, or 10, the credit allowed by paragraph 11 of this Appendix shall not be allowed unless the assuming insurer agrees in the trust agreements to the following conditions:

a. Notwithstanding any other provisions in the trust instrument, if the trust fund is inadequate because it contains an amount less than the amount required by paragraph 11 c. of this Appendix, or if the grantor of the trust has been declared insolvent or placed into receivership, rehabilitation, liquidation or similar proceedings under the laws of its state or country of domicile, the trustee shall comply with an order of the commissioner with regulatory oversight over the trust or with an order of a court of competent jurisdiction directing the trustee to transfer to the commissioner with regulatory oversight all of the assets of the trust fund.

b. The assets shall be distributed by and claims shall be filed with and valued by the commissioner with regulatory oversight in accordance with the laws of the state in which the trust is domiciled that are applicable to the liquidation of domestic insurance companies.

c. If the commissioner with regulatory oversight determines that the assets of the trust fund or any part thereof are not necessary to satisfy the claims of the U.S. ceding insurers of the grantor of the trust, the assets or part thereof shall be returned by the commissioner.
with regulatory oversight to the trustee for distribution in accordance with the trust agreement.

d. The grantor shall waive any right otherwise available to it under U.S. law that is inconsistent with this provision.

Valuation of and Requirements for Trust Assets

15. Assets deposited in the trust shall be valued according to their fair market value and shall consist only of cash in U.S. dollars, certificates of deposit issued by a U.S. financial institution as defined in paragraph 50, clean, irrevocable, unconditional and “evergreen” letters of credit issued or confirmed by a qualified U.S. financial institution, as defined in paragraph 50, and investments of the type specified in this paragraph, but investments in or issued by an entity controlling, controlled by or under common control with either the grantor or beneficiary of the trust shall not exceed five percent (5%) of total investments. No more than twenty percent (20%) of the total of the investments in the trust may be foreign investments authorized under paragraphs 15a.v., c, f. ii. or g. of this paragraph, and no more than ten percent (10%) of the total of the investments in the trust may be securities denominated in foreign currencies. For purposes of applying the preceding sentence, a depository receipt denominated in U.S. dollars and representing rights conferred by a foreign security shall be classified as a foreign investment denominated in a foreign currency. The assets of a trust shall be invested only as follows:

a. Government obligations that are not in default as to principal or interest, that are valid and legally authorized and that are issued, assumed or guaranteed by:
   i. The United States or by any agency or instrumentality of the United States;
   ii. A state of the United States;
   iii. A territory, possession or other governmental unit of the United States;
   iv. An agency or instrumentality of a governmental unit referred to in paragraphs 15a.i. and 15a.ii. if the obligations shall be by law (statutory of otherwise) payable, as to both principal and interest, from taxes levied or by law required to be levied or from adequate special revenues pledged or otherwise appropriated or by law required to be provided for making these payments, but shall not be obligations eligible for investment under this paragraph if payable solely out of special assessments on properties benefited by local improvements; or
   v. The government of any other country that is a member of the Organization for Economic Cooperation and Development and whose government obligations are rated A or higher, or the equivalent, by a rating agency recognized by the Securities Valuation Office of the NAIC;

b. Obligations that are issued in the United States, or that are dollar denominated and issued in a non-U.S. market, by a solvent U.S. institution (other than an insurance company) or that are assumed or guaranteed by a solvent U.S. institution (other than an insurance company) and that are not in default as to principal or interest if the obligations:
   i. Are rated A or higher (or the equivalent) by a securities rating agency recognized by the Securities Valuation Office of the NAIC, or if not so rated, are similar in structure and other material respects to other obligations of the same institution that are so rated;

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ii. Are insured by at least one authorized insurer (other than the investing insurer or a parent, subsidiary or affiliate of the investing insurer) licensed to insure obligations in this state and, after considering the insurance, are rated AAA (or the equivalent) by a securities rating agency recognized by the Securities Valuation Office of the NAIC; or

iii. Have been designated as Class One or Class Two by the Securities Valuation Office of the NAIC;

c. Obligations issued, assumed or guaranteed by a solvent non U.S. institution chartered in a country that is a member of the Organization for Economic Cooperation and Development or obligations of U.S. corporations issued in a non-U.S. currency, provided that in either case the obligations are rated A or higher, or the equivalent, by a rating agency recognized by the Securities Valuation Office of the NAIC;

d. An investment made pursuant to the provisions of paragraph 15a., b. or c. shall be subject to the following additional limitations:

i. An investment in or loan upon the obligations of an institution other than an institution that issues mortgage-related securities shall not exceed five percent (5%) of the assets of the trust;

ii. An investment in any one mortgage-related security shall not exceed five percent (5%) of the assets of the trust;

iii. The aggregate total investment in mortgage-related securities shall not exceed twenty-five percent (25%) of the assets of the trust; and

iv. Preferred or guaranteed shares issued or guaranteed by a solvent U.S. institution are permissible investments if all of the institution’s obligations are eligible as investments under paragraphs 15b.i. and b.iii. of this paragraph, but shall not exceed two percent (2%) of the assets of the trust.

e. As used in this appendix:

i. “Mortgage-related security” means an obligation that is rated AA or higher (or the equivalent) by a securities rating agency recognized by the Securities Valuation Office of the NAIC and that either:

(a) Represents ownership of one or more promissory notes or certificates of interest or participation in the notes (including any rights designed to assure servicing of, or the receipt or timeliness of receipt by the holders of the notes, certificates, or participation of amounts payable under, the notes, certificates or participation), that:

(1) Are directly secured by a first lien on a single parcel of real estate, including stock allocated to a dwelling unit in a residential cooperative housing corporation, upon which is located a dwelling or mixed residential and commercial structure, or on a residential manufactured home as defined in 42 U.S.C.A. Section 5402(6), whether the manufactured home is considered real or personal property under the laws of the state in which it is located; and
(2) Were originated by a savings and loan association, savings bank, commercial bank, credit union, insurance company, or similar institution that is supervised and examined by a federal or state housing authority, or by a mortgagee approved by the Secretary of Housing and Urban Development pursuant to 12 U.S.C.A. Sections 1709 and 1715-b, or, where the notes involve a lien on the manufactured home, by an institution or by a financial institution approved for insurance by the Secretary of Housing and Urban Development pursuant to 12 U.S.C.A. Section 1703; or

(b) Is secured by one or more promissory notes or certificates of deposit or participations in the notes (with or without recourse to the insurer of the notes) and, by its terms, provides for payments of principal in relation to payments, or reasonable projections of payments, or notes meeting the requirements of paragraphs 15 e. i. (a) (1) and 15 e. i. (a) (2);

ii. “Promissory note,” when used in connection with a manufactured home, shall also include a loan, advance or credit sale as evidenced by a retail installment sales contract or other instrument.

f. Equity interests

i. Investments in common shares or partnership interests of a solvent U.S. institution are permissible if:

(a) Its obligations and preferred shares, if any, are eligible as investments under this paragraph; and

(b) The equity interests of the institution (except an insurance company) are registered on a national securities exchange as provided in the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a to 78kk or otherwise registered pursuant to that Act, and if otherwise registered, price quotations for them are furnished through a nationwide automated quotations system approved by the National Association of Securities Dealers, Inc. A trust shall not invest in equity interests under this paragraph an amount exceeding one percent (1%) of the assets of the trust even though the equity interests are not so registered and are not issued by an insurance company.

ii. Investments in common shares of a solvent institution organized under the laws of a country that is a member of the Organization for Economic Cooperation and Development, if:

(a) All its obligations are rated A or higher, or the equivalent, by a rating agency recognized by the Securities Valuation Office of the NAIC; and

(b) The equity interests of the institution are registered on a securities exchange regulated by the government of a country that is a member of the Organization for Economic Cooperation and Development.

iii. An investment in or loan upon any one institution’s outstanding equity interests shall not exceed one percent (1%) of the assets of the trust. The cost of an investment in equity interests made pursuant to this paragraph, when added to the
aggregate cost of other investments in equity interests then held pursuant to this paragraph, shall not exceed ten percent (10%) of the assets in the trust;

g. Obligations issued, assumed or guaranteed by a multinational development bank, provided the obligations are rated A or higher, or the equivalent, by a rating agency recognized by the Securities Valuation Office of the NAIC.

h. Investment companies:

i. Securities of an investment company registered pursuant to the Investment Company Act of 1940, 15 U.S.C. § 802, are allowable investments if the investment company:

(a) Invests at least ninety percent (90%) of its assets in the types of securities that qualify as an investment under paragraphs 15 a., 15 b., or 15 c., or invests in securities that are determined to be substantively similar to the types of securities set forth in paragraphs 15 a., 15 b., or 15 c.; or

(b) Invests at least ninety percent (90%) of its assets in the types of equity interests that qualify as an investment under paragraph 15 f. i.;

ii. Investments made by a trust in investment companies under this paragraph shall not exceed the following limitations:

(a) An investment in an investment company qualifying under paragraph 15 h. i. (a) shall not exceed ten percent (10%) of the assets in the trust and the aggregate amount of investment in qualifying investment companies shall not exceed twenty-five percent (25%) of the assets in the trust; and

(b) Investments in an investment company qualifying under paragraph 15 h. i. (b) of this paragraph shall not exceed five percent (5%) of the assets in the trust and the aggregate amount of investment in qualifying investment companies shall be included when calculating the permissible aggregate value of equity interests pursuant to paragraph 15 f. i.

i. Letters of Credit

i. In order for a letter of credit to qualify as an asset of the trust, the trustee shall have the right and the obligation pursuant to the deed of trust or some other binding agreement (as duly approved by the commissioner), to immediately draw down the full amount of the letter of credit and hold the proceeds in trust for the beneficiaries of the trust if the letter of credit will otherwise expire without being renewed or replaced.

ii. The trust agreement shall provide that the trustee shall be liable for its negligence, willful misconduct or lack of good faith. The failure of the trustee to draw against the letter of credit in circumstances where such draw would be required shall be deemed to be negligence and/or willful misconduct.

Asset or Reduction from Liability for Reinsurance Ceded by a Domestic Insurer to an Assuming Insurer not Meeting the Requirements detailed above under “Credit Allowed a Domestic Ceding Insurer” (paragraphs 7 through 15)
16. An asset or a reduction from liability for the reinsurance ceded by a domestic insurer to an assuming insurer not meeting the requirements under “Credit Allowed a Domestic Ceding Insurer” (paragraphs 7 through 15) shall be allowed in an amount not exceeding the liabilities carried by the ceding insurer. The reduction shall be in the amount of funds held by or on behalf of the ceding insurer, including funds held in trust for the ceding insurer, under a reinsurance contract with the assuming insurer as security for the payment of obligations thereunder, if the security is held in the United States subject to withdrawal solely by, and under the exclusive control of, the ceding insurer; or, in the case of a trust, held in a qualified U.S. financial institution, as defined under “Qualified U.S. Financial Institutions” at paragraph 51. This security may be in the form of:

a. Cash;

b. Securities listed by the Securities Valuation Office of the National Association of Insurance Commissioners and qualifying as admitted assets;

c. i. Clean, irrevocable, unconditional and evergreen letters of credit, issued or confirmed by a qualified U.S. financial institution, as defined in paragraph 50, effective no later than December 31 of the year for which the filing is being made, and in the possession of, or in trust for, the ceding company on or before the filing date of its annual statement;

ii. Letters of credit meeting applicable standards of issuer acceptability as of the dates of their issuance (or confirmation) shall, notwithstanding the issuing (or confirming) institution’s subsequent failure to meet applicable standards of issuer acceptability, continue to be acceptable as security until their expiration, extension, renewal, modification or amendment, whichever first occurs.

d. An admitted asset or a reduction from liability for reinsurance ceded to an unauthorized assuming insurer pursuant to this Appendix shall be allowed only when the requirements of paragraph 13 and the applicable portions under the sections below titled “Trust Agreements Qualified under Paragraph 16”, “Letters of Credit Qualified under Paragraph 16”, and “Other Security” at paragraph 49.

Trust Agreements Qualified under Paragraph 16

17. The trust agreement shall be entered into between the beneficiary, the grantor and a trustee, which shall be a qualified U.S. financial institution as defined in paragraph 51.

18. The trust agreement shall create a trust account into which assets shall be deposited.

19. All assets in the trust account shall be held by the trustee at the trustee’s office in the United States.

20. The trust agreement shall provide that:

a. The beneficiary shall have the right to withdraw assets from the trust account at any time, without notice to the grantor, subject only to written notice from the beneficiary to the trustee;

b. No other statement or document is required to be presented to withdraw assets, except that the beneficiary may be required to acknowledge receipt of withdrawn assets;

c. It is not subject to any conditions or qualifications outside of the trust agreement; and
d. It shall not contain references to any other agreements or documents except as provided for in paragraph 27.

21. The trust agreement shall be established for the sole benefit of the beneficiary.

22. The trust agreement shall require the trustee to:
   a. Receive assets and hold all assets in a safe place;
   b. Determine that all assets are in such form that the beneficiary, or the trustee upon direction by the beneficiary, may whenever necessary negotiate any such assets, without consent or signature from the grantor or any other person or entity;
   c. Furnish to the grantor and the beneficiary a statement of all assets in the trust account upon its inception and at intervals no less frequent than the end of each calendar quarter;
   d. Notify the grantor and the beneficiary within ten (10) days, of any deposits to or withdrawals from the trust account;
   e. Upon written demand of the beneficiary, immediately take any and all steps necessary to transfer absolutely and unequivocally all right, title and interest in the assets held in the trust account to the beneficiary and deliver physical custody of the assets to the beneficiary; and
   f. Allow no substitutions or withdrawals of assets from the trust account, except on written instructions from the beneficiary, except that the trustee may, without the consent of but with notice to the beneficiary, upon call or maturity of any trust asset, withdraw such asset upon condition that the proceeds are paid into the trust account.

23. The trust agreement shall provide that at least thirty (30) days, but not more than forty-five (45) days, prior to termination of the trust account, written notification of termination shall be delivered by the trustee to the beneficiary.

24. The trust agreement shall be made subject to and governed by the laws of the state in which the trust is domiciled.

25. The trust agreement shall prohibit invasion of the trust corpus for the purpose of paying compensation to, or reimbursing the expenses of, the trustee. In order for a letter of credit to qualify as an asset of the trust, the trustee shall have the right and the obligation pursuant to the deed of trust or some other binding agreement, as duly approved by the commissioner, to immediately draw down the full amount of the letter of credit and hold the proceeds in trust for the beneficiaries of the trust if the letter of credit will otherwise expire without being renewed or replaced.

26. The trust agreement shall provide that the trustee shall be liable for its negligence, willful misconduct or lack of good faith. The failure of the trustee to draw against the letter of credit in circumstances where such draw would be required shall be deemed to be negligence and/or willful misconduct.

27. Notwithstanding other provisions of this Appendix, when a trust agreement is established in conjunction with a reinsurance agreement covering risks other than life, annuities and accident and health, where it is customary practice to provide a trust agreement for a specific purpose, the trust agreement may provide that the ceding insurer shall undertake to use and apply amounts drawn upon the trust account, without diminution because of the insolvency of the ceding insurer or the assuming insurer, only for the following purposes:
a. To pay or reimburse the ceding insurer for the assuming insurer’s share under the specific reinsurance agreement regarding any losses and allocated loss expenses paid by the ceding insurer, but not recovered from the assuming insurer, or for unearned premiums due to the ceding insurer if not otherwise paid by the assuming insurer;

b. To make payment to the assuming insurer of any amounts held in the trust account that exceed 102 percent of the actual amount required to fund the assuming insurer’s obligations under the specific reinsurance agreement; or

c. Where the ceding insurer has received notification of termination of the trust account and where the assuming insurer’s entire obligations under the specific reinsurance agreement remain unliquidated and undischarged ten (10) days prior to the termination date, to withdraw amounts equal to the obligations and deposit those amounts in a separate account, in the name of the ceding insurer in any qualified U.S. financial institution as defined in paragraph 51 apart from its general assets, in trust for such uses and purposes specified in paragraphs 27 a. and b. above as may remain executory after such withdrawal and for any period after the termination date.

28. Notwithstanding other provisions of this appendix, when a trust agreement is established to meet the requirements of paragraph 16 in conjunction with a reinsurance agreement covering life, annuities or accident and health risks, where it is customary to provide a trust agreement for a specific purpose, the trust agreement may provide that the ceding insurer shall undertake to use and apply amounts drawn upon the trust account, without diminution because of the insolvency of the ceding insurer or the assuming insurer, only for the following purposes:

a. To pay or reimburse the ceding insurer for:

i. The assuming insurer’s share under the specific reinsurance agreement of premiums returned, but not yet recovered from the assuming insurer, to the owners of policies reinsured under the reinsurance agreement on account of cancellations of the policies; and

ii. The assuming insurer’s share under the specific reinsurance agreement of surrenders and benefits or losses paid by the ceding insurer, but not yet recovered from the assuming insurer, under the terms and provisions of the policies reinsured under the reinsurance agreement;

b. To pay to the assuming insurer amounts held in the trust account in excess of the amount necessary to secure the credit or reduction from liability for reinsurance taken by the ceding insurer; or

c. Where the ceding insurer has received notification of termination of the trust and where the assuming insurer’s entire obligations under the specific reinsurance agreement remain unliquidated and undischarged ten (10) days prior to the termination date, to withdraw amounts equal to the assuming insurer’s share of liabilities, to the extent that the liabilities have not yet been funded by the assuming insurer, and deposit those amounts in a separate account, in the name of the ceding insurer in any qualified U.S. financial institution apart from its general assets, in trust for the uses and purposes specified in paragraphs 28 a. and b. as may remain executory after withdrawal and for any period after the termination date.

29. The reinsurance agreement may, but need not, contain the provisions required in paragraph 36 b., so long as these required conditions are included in the trust agreement.
30. Notwithstanding any other provisions in the trust instrument, if the grantor of the trust has been declared insolvent or placed into receivership, rehabilitation, liquidation or similar proceedings under the laws of its state or country of domicile, the trustee shall comply with an order of the commissioner with regulatory oversight over the trust or court of competent jurisdiction directing the trustee to transfer to the commissioner with regulatory oversight or other designated receiver all of the assets of the trust fund. The assets shall be applied in accordance with the priority statutes and laws of the state in which the trust is domiciled applicable to the assets of insurance companies in liquidation. If the commissioner with regulatory oversight determines that the assets of the trust fund or any part thereof are not necessary to satisfy claims of the U.S. beneficiaries of the trust, the assets or any part of them shall be returned to the trustee for distribution in accordance with the trust agreement.

31. The trust agreement may provide that the trustee may resign upon delivery of a written notice of resignation, effective not less than ninety (90) days after the beneficiary and grantor receive the notice and that the trustee may be removed by the grantor by delivery to the trustee and the beneficiary of a written notice of removal, effective not less than ninety (90) days after the trustee and the beneficiary receive the notice, provided that no such resignation or removal shall be effective until a successor trustee has been duly appointed and approved by the beneficiary and the grantor and all assets in the trust have been duly transferred to the new trustee.

32. The grantor may have the full and unqualified right to vote any shares of stock in the trust account and to receive from time to time payments of any dividends or interest upon any shares of stock or obligations included in the trust account. Any interest or dividends shall be either forwarded promptly upon receipt to the grantor or deposited in a separate account established in the grantor’s name.

33. The trustee may be given authority to invest, and accept substitutions of, any funds in the account, provided that no investment or substitution shall be made without prior approval of the beneficiary, unless the trust agreement specifies categories of investments acceptable to the beneficiary and authorizes the trustee to invest funds and to accept substitutions that the trustee determines are at least equal in market value to the assets withdrawn and that are consistent with the restrictions in paragraph 36 b.

34. The trust agreement may provide that the beneficiary may at any time designate a party to which all or part of the trust assets are to be transferred. Transfer may be conditioned upon the trustee receiving, prior to or simultaneously, other specified assets.

35. The trust agreement may provide that, upon termination of the trust account, all assets not previously withdrawn by the beneficiary shall, with written approval by the beneficiary, be delivered over to the grantor.

36. A reinsurance agreement may contain provisions that:

   a. Require the assuming insurer to enter into a trust agreement and to establish a trust account for the benefit of the ceding insurer, and specifying what the agreement is to cover;

   b. Stipulate that assets deposited in the trust account shall be valued according to their current fair market value and shall consist only of cash in United States dollars, certificates of deposit issued by a United States bank and payable in United States dollars, and investments permitted by the Insurance Code or any combination of the above, provided investments in or issued by an entity controlling, controlled by or under common control with either the grantor or the beneficiary of the trust shall not exceed five percent (5%) of total investments. The reinsurance agreement may further specify the types of investments to be deposited. Where a trust agreement is entered into in conjunction with a reinsurance agreement covering risks other than life, annuities and
accident and health, then the trust agreement may contain the provisions required by this paragraph in lieu of including such provisions in the reinsurance agreement;

c. Require the assuming insurer, prior to depositing assets with the trustee, to execute assignments or endorsements in blank, or to transfer legal title to the trustee of all shares, obligations or any other assets requiring assignments, in order that the ceding insurer, or the trustee upon the direction of the ceding insurer, may whenever necessary negotiate these assets without consent or signature from the assuming insurer or any other entity;

d. Require that all settlements of account between the ceding insurer and the assuming insurer be made in cash or its equivalent; and

e. Stipulate that the assuming insurer and the ceding insurer agree that the assets in the trust account, established pursuant to the provisions of the reinsurance agreement, may be withdrawn by the ceding insurer at any time, notwithstanding any other provisions in the reinsurance agreement, and shall be utilized and applied by the ceding insurer or its successors in interest by operation of law, including without limitation any liquidator, rehabilitator, receiver or conservator of such company, without diminution because of insolvency on the part of the ceding insurer or the assuming insurer, only for the following purposes:

i. To pay or reimburse the ceding insurer for:

   (a) The assuming insurer’s share under the specific reinsurance agreement of premiums returned, but not yet recovered from the assuming insurer, to the owners of policies reinsured under the reinsurance agreement because of cancellations of such policies;

   (b) The assuming insurer’s share of surrenders and benefits or losses paid by the ceding insurer pursuant to the provisions of the policies reinsured under the reinsurance agreement; and

   (c) Any other amounts necessary to secure the credit or reduction from liability for reinsurance taken by the ceding insurer;

ii. To make payment to the assuming insurer of amounts held in the trust account in excess of the amount necessary to secure the credit or reduction from liability for reinsurance taken by the ceding insurer.

37. The reinsurance agreement also may contain provisions that:

a. Give the assuming insurer the right to seek approval from the ceding insurer, which shall not be unreasonably or arbitrarily withheld, to withdraw from the trust account all or any part of the trust assets and transfer those assets to the assuming insurer, provided:

i. The assuming insurer shall, at the time of withdrawal, replace the withdrawn assets with other qualified assets having a market value equal to the market value of the assets withdrawn so as to maintain at all times the deposit in the required amount; or

ii. After withdrawal and transfer, the market value of the trust account is no less than 102 percent of the required amount.
Credit for Reinsurance

b. Provide for the return of any amount withdrawn in excess of the actual amounts required for paragraph 36 e., and for interest payments at a rate not in excess of the prime rate of interest on the amounts held pursuant to paragraph 36 e.;

c. Allow the award by any arbitration panel or court of competent jurisdiction of:
   i. Interest at a rate different from that provided in paragraph 37 b.;
   ii. Court or arbitration costs;
   iii. Attorney’s fees; and
   iv. Any other reasonable expenses.

38. Financial Reporting - A trust agreement may be used to reduce any liability for reinsurance ceded to an unauthorized assuming insurer in statutory financial statements when established on or before the date of filing of the statutory financial statement of the ceding insurer. Further, the reduction for the existence of an acceptable trust account may be up to the current fair market value of acceptable assets available to be withdrawn from the trust account at that time, but such reduction shall be no greater than the specific obligations under the reinsurance agreement that the trust account was established to secure.

39. The failure of any trust agreement to specifically identify the beneficiary as defined in paragraph 4 shall not be construed to affect any actions or rights that the commissioner may take or possess pursuant to the provisions of the laws of the domiciliary state.

Letters of Credit Qualified under Paragraph 16

40. The letter of credit must be clean, irrevocable, unconditional and issued or confirmed by a qualified U.S. financial institution as defined in paragraph 50. The letter of credit shall contain an issue date and expiration date and shall stipulate that the beneficiary need only draw a sight draft under the letter of credit and present it to obtain funds and that no other document need be presented. The letter of credit also shall indicate that it is not subject to any condition or qualifications outside of the letter of credit. In addition, the letter of credit itself shall not contain reference to any other agreements, documents or entities, except as provided in paragraph 48. a. If a court of law appoints a successor in interest to the named beneficiary, then the named beneficiary includes and is limited to the court appointed domiciliary receiver (including conservator, rehabilitator or liquidator).

41. The heading of the letter of credit may include a boxed section containing the name of the applicant and other appropriate notations to provide a reference for the letter of credit. The boxed section shall be clearly marked to indicate that such information is for internal identification purposes only.

42. The letter of credit shall contain a statement to the effect that the obligation of the qualified U.S. financial institution under the letter of credit is in no way contingent upon reimbursement with respect thereto.

43. The term of the letter of credit shall be for at least one year and shall contain an “evergreen clause” that prevents the expiration of the letter of credit without due notice from the issuer. The “evergreen clause” shall provide for a period of no less than thirty (30) days notice prior to expiration date or nonrenewal.

44. The letter of credit shall state whether it is subject to and governed by the laws of the ceding insurers state or the Uniform Customs and Practice for Documentary Credits of the International Chamber of Commerce (Publication 500), or any successor publication, and all drafts drawn thereunder shall be presentable at an office in the United States of a qualified U.S. financial institution.
45. If the letter of credit is made subject to the Uniform Customs and Practice for Documentary
Credits of the International Chamber of Commerce (Publication 500), or any successor publication, then
the letter of credit shall specifically address and provide for an extension of time to draw against the letter
of credit in the event that one or more of the occurrences specified in Article 17 of Publication 500 or any
other successor publication, occur.

46. The letter of credit shall be issued or confirmed by a qualified U.S. financial institution
authorized to issue letters of credit, pursuant to paragraph 50.

47. If the letter of credit is issued by a qualified U.S. financial institution authorized to issue letters of
credit, other than a qualified U.S. financial institution as described in paragraph 46, then the following
additional requirements shall be met:

a. The issuing qualified U.S. financial institution shall formally designate the confirming
qualified U.S. financial institution as its agent for the receipt and payment of the drafts; and

b. The “evergreen clause” shall provide for thirty (30) days notice prior to expiration date
for nonrenewal.

48. Reinsurance agreement provisions:

a. The reinsurance agreement in conjunction with which the letter of credit is obtained may
contain provisions that:

i. Require the assuming insurer to provide letters of credit to the ceding insurer and
specify what they are to cover;

ii. Stipulate that the assuming insurer and ceding insurer agree that the letter of
credit provided by the assuming insurer pursuant to the provisions of the
reinsurance agreement may be drawn upon at any time, notwithstanding any
other provisions in the agreement, and shall be utilized by the ceding insurer or
its successors in interest only for one or more of the following reasons:

(a) To pay or reimburse the ceding insurer for:

(1) The assuming insurer’s share under the specific reinsurance
agreement of premiums returned, but not yet recovered from the
assuming insurers, to the owners of policies reinsured under the
reinsurance agreement on account of cancellations of such
policies;

(2) The assuming insurer’s share, under the specific reinsurance
agreement, of surrenders and benefits or losses paid by the
ceding insurer, but not yet recovered from the assuming insurers,
under the terms and provisions of the policies reinsured under
the reinsurance agreement; and

(3) Any other amounts necessary to secure the credit or reduction
from liability for reinsurance taken by the ceding insurer;

(b) Where the letter of credit will expire without renewal or be reduced or
replaced by a letter of credit for a reduced amount and where the
assuming insurer’s entire obligations under the specific reinsurance
remain unliquidated and undischarged ten (10) days prior to the termination date, to withdraw amounts equal to the assuming insurer’s share of the liabilities, to the extent that the liabilities have not yet been funded by the assuming insurer and exceed the amount of any reduced or replacement letter of credit, and deposit those amounts in a separate account in the name of the ceding insurer in a qualified U.S. financial institution apart from its general assets, in trust for such uses and purposes specified in paragraph 48. a. ii. (a) as may remain after withdrawal and for any period after the termination date.

iii. All of the provisions of paragraph 48. a. shall be applied without diminution because of insolvency on the part of the ceding insurer or assuming insurer.

b. Nothing contained in paragraph 48. a. shall preclude the ceding insurer and assuming insurer from providing for:

i. An interest payment, at a rate not in excess of the prime rate of interest, on the amounts held pursuant to paragraph 48. a. ii.; or

ii. The return of any amounts drawn down on the letters of credit in excess of the actual amounts required for the above or any amounts that are subsequently determined not to be due.

Other Security

49. A ceding insurer may take credit for unencumbered funds withheld by the ceding insurer in the United States subject to withdrawal solely by the ceding insurer and under its exclusive control.

Qualified U.S. Financial Institutions

50. For purposes of paragraphs 15, 16 c., 40 and 46 a “qualified U.S. financial institution” means an institution that:

a. Is organized or (in the case of a U.S. office of a foreign banking organization) licensed, under the laws of the United States or any state thereof;

b. Is regulated, supervised and examined by U.S. federal or state authorities having regulatory authority over banks and trust companies; and

c. Has been determined by either the commissioner or the Securities Valuation Office of the National Association of Insurance Commissioners to meet such standards of financial condition and standing as are considered necessary and appropriate to regulate the quality of financial institutions whose letters of credit will be acceptable to the commissioner.

51. A “qualified U.S. financial institution” means, for purposes of those provisions of this appendix specifying those institutions that are eligible to act as a fiduciary of a trust, an institution that:

a. Is organized, or in the case of a U.S. branch or agency office of a foreign banking organization, licensed, under the laws of the United States or any state thereof and has been granted authority to operate with fiduciary powers; and

b. Is regulated, supervised and examined by federal or state authorities having regulatory authority over banks and trust companies.
Appendix A-791

Life And Health Reinsurance Agreements

Accounting Requirements

1. This Appendix shall not apply to assumption reinsurance, yearly renewable term reinsurance or certain nonproportional reinsurance such as stop loss or catastrophe reinsurance.

Q – Aside from assumption reinsurance, what other types of reinsurance are exempt from the accounting requirements?

A – Yearly renewable term (YRT) and certain nonproportional reinsurance arrangements, such as stop loss and catastrophe reinsurance are exempt because these do not normally provide significant surplus relief and therefore are outside the scope of this Appendix. If a catastrophe arrangement takes a reserve credit for actual losses beyond the attachment point or the unearned premium reserve (UPR) of the current year's premium, there will most likely be no regulatory concern.

Similarly, if a YRT treaty provides incidental reserve credits for the ceding insurer’s net amount at risk for the year with no other allowance to enhance surplus, there will most likely be no regulatory concern. For purposes of this exemption, a treaty labeled as YRT does not meet the intended definition of YRT if the surplus relief in the first year is greater than that provided by a YRT treaty with zero first year reinsurance premium and no additional allowance from the reinsurer.

Additional pertinent information applicable to all YRT treaties and to non-proportional reinsurance arrangements is contained in paragraphs 19 and 20 of SSAP 61.

2. No insurer shall, for reinsurance ceded, reduce any liability or establish any asset in any statutory financial statement if, by the terms of the reinsurance agreement, in substance or effect, any of the following conditions exist:

a. Renewal expense allowances provided or to be provided to the ceding insurer by the reinsurer in any accounting period are not sufficient to cover anticipated allocable renewal expenses of the ceding insurer on the portion of the business reinsured, unless a liability is established for the present value of the shortfall (using assumptions equal to the applicable statutory reserve basis on the business reinsured). Those expenses include commissions, premium taxes and direct expenses including, but not limited to, billing, valuation, claims and maintenance expected by the company at the time the business is reinsured.

Q – What should be included in the renewal expense allowances with regard to direct expenses? An allocation of salaries? Computer usage? Or just marginal expenses directly related to the business reinsured such as claim payment expenses, postage, etc.?

A – The primary purpose of the accounting requirements is to prohibit credit for reinsurance under financial arrangements where the ceding company enters into an agreement for the principal purpose of producing significant surplus aid for the ceding insurer on a temporary basis, while not transferring all of the significant risks inherent in the business being reinsured.

Paragraph 2. a. implements that purpose by prohibiting credit for reinsurance in certain instances where the ceding insurer is afforded a large ceding commission at the inception of the agreement resulting in a significant increase in surplus only to have such surplus increase be drained away in subsequent periods because renewal expense allowances provided under the agreement are insufficient to cover the direct expenses.
allocable costs estimated at the time the business is reinsured, which are anticipated to be incurred by the ceding insurer in maintaining the business reinsured.

An exception to complete disallowance of credit for reinsurance is allowed in situations where the ceding insurer reflects a liability for the present value of the shortage between renewal expense allowances provided under the agreement and the direct allocable costs expected in the future by the insurer in maintaining the business reinsured. This liability must be calculated using actuarial assumptions that are consistent with those utilized in the statutory reserve calculation. The expenses to be accounted for in establishing this liability should represent all costs of the ceding insurer in servicing the business that is subject to the agreement.

In determining what the ceding insurer should include in the renewal expenses with regard to direct expenses, there should be an allocation of all renewal expenses anticipated at the time the business is reinsured including salaries, computer usage, postage, etc. This comprehensive calculation should recognize that the anticipated expense levels may be estimated; a comparison with pricing assumptions may be considered in determining the reasonableness of such assumptions.

When an agreement does not comply with paragraph 2. a., this area of non-compliance should be addressed by the posting of a reserve for the present value of the deficiency rather than denial for credit for reinsurance, assuming that no other area of non-compliance is encountered with the agreement and that the assets received corresponding to the ceding commission are in compliance with the Codification, including Appendix A-785. For example, the assets received corresponding to the ceding commission must be admissible and not subject to repayment to the reinsurer.

b. The ceding insurer can be deprived of surplus or assets at the reinsurer’s option or automatically upon the occurrence of some event, such as the insolvency of the ceding insurer, except that termination of the reinsurance agreement by the reinsurer for nonpayment of reinsurance premiums or other amounts due, such as modified coinsurance reserve adjustments, interest and adjustments on funds withheld, and tax reimbursements, shall not be considered to be such a deprivation of surplus or assets;

Q – With regard to existing business, should the coinsurance reserve percentage or the coinsurance reserve amount not be allowed to increase in a combination coinsurance/modified coinsurance treaty? How would the rule be applicable to the difference between the total reserve and the amount of funds withheld in a coinsurance with funds withheld treaty?

A – Under a combination coinsurance/modified coinsurance (co/modco) arrangement the ceding company and the reinsurer both establish reserves for future claim payments. Treaty provisions which adjust the reserves each party holds in lieu of transferring funds owed to the reinsurer are acceptable. However, adjustment of reserves in lieu of payment when funds are due to the ceding company is a violation of the accounting requirements since it is a depletion of the ceding company’s assets. In other words, statutory gains can be used to increase the modified coinsurance reserve but statutory losses cannot be used to reduce the modified coinsurance reserve. This is the case even if the agreement provides for this adjustment at inception and never requires a payment to be owed by the reinsurer.

Under a coinsurance with funds withheld treaty the reinsurer establishes the entire amount of reserve liability on its share of reinsured policies, but the ceding company withholds a portion of the reinsurer’s assets typically in an amount less than the reserves, to offset future obligations. Provided the withheld assets are not withheld for any purpose other than the payment of future claims, it is not a violation of the accounting requirements for the reinsurer to require full use of such withheld assets for the payment of claims prior to using any other assets owned by the reinsurer.
Paragraph 2. b. disallows reinsurance credit if the ceding company can be deprived of assets at the reinsurer's option or automatically upon the occurrence of some event. Thus, a provision in a coinsurance with funds withheld or modified coinsurance treaty which unilaterally or automatically allows the reinsurer to convert the treaty to coinsurance at some later date would be of concern. Although the parties could have entered a coinsurance agreement at inception, regulators are concerned that the reinsurer would take invested assets from the ceding company at a time which would be to the detriment of the ceding company's policyholders. Therefore, a conversion provision will not violate paragraph 2. b. only if all of the following are met:

i) the triggers for conversion are limited to ceding company violations of treaty provisions, including complying representations and warranties; the occurrence of a violation has been determined; and the ceding company has been given an opportunity and refuses to promptly remedy the violation;

ii) the conversion is structured so that the surplus of the ceding company will remain unchanged immediately following the conversion;

iii) the invested assets to be transferred upon conversion are less than or equal to the modco reserve, in the case of modco or co/modco, or to the Funds Withheld, in the case of coinsurance funds withheld, and have been maintained in a Trust or Escrow Account since inception of the agreement; and

iv) the reinsurance complies with Credit for Reinsurance requirements (see Appendix A-785) immediately upon conversion.

c. The ceding insurer is required to reimburse the reinsurer for negative experience under the reinsurance agreement, except that neither offsetting experience refunds against current and prior years’ losses under the agreement nor payment by the ceding insurer of an amount equal to the current and prior years’ losses under the agreement upon voluntary termination of in force reinsurance by the ceding insurer shall be considered such a reimbursement to the reinsurer for negative experience. Voluntary termination does not include situations where termination occurs because of unreasonable provisions which allow the reinsurer to reduce its risk under the agreement. An example of such a provision is the right of the reinsurer to increase reinsurance premiums or risk and expense charges to excessive levels forcing the ceding company to prematurely terminate the reinsurance treaty;

d. The ceding insurer must, at specific points in time scheduled in the agreement, terminate or automatically recapture all or part of the reinsurance ceded;

e. The reinsurance agreement involves the possible payment by the ceding insurer to the reinsurer of amounts other than from income realized from the reinsured policies. For example, it is improper for a ceding company to pay reinsurance premiums, or other fees or charges to a reinsurer which are greater than the direct premiums collected by the ceding company;

Q – Should a reinsurer have a unilateral right to establish underlying cost of insurance rates or credited interest rates for policies which are wholly or partially reinsured?

A – No, only the ceding company has the right to set the cost of insurance rates charged policyholders and to set the rates of interest credited to them. However, a representation (but not a warranty) that the ceding company shall vary nonguaranteed elements reinsured in a manner consistent with the ceding
company’s documented procedures, in effect at the time the agreement was entered into, does not violate the accounting requirements.

Q – May a reinsurance contract allow the reinsurer to change the cost of insurance that the ceding company must pay under the treaty?

A – So long as the aggregate amounts payable by the ceding company in any settlement period do not exceed the income of the reinsured policies during that period, the treaty's structure would not be in violation of paragraph 2. e. There is not compliance if any changes could cause payments made by the ceding company to exceed income from the reinsured business, unless the change is necessary to conform to the documented procedures represented to the reinsurer at the time the treaty was entered into and as long as the ceding company has the ability to change the insurance rates it charges policyholders by at least as much as was included in the original representation.

Q – If a reinsured policy allows the ceding company to guarantee rates of interest to be credited to the policyholder which are greater than those guaranteed by the policy, may a reinsurance contract allow the reinsurer to limit its participation in such credited rate as long as it at least provides for the amount based on the rate guaranteed in the contract?

A – So long as the aggregate amounts payable by the ceding company in any settlement period do not exceed the income of the reinsured policies during that period, the treaty's structure would not be in violation of paragraph 2. e. There is not compliance if any changes could cause payments made by the ceding company to exceed income from the reinsured business, unless the limited participation reflects a change in declared interest rates which is necessary to conform to the documented procedures represented to the reinsurer at the time the treaty was entered into and as long as the ceding company has the ability to change the declared interest rates to be credited to policyholders by at least as much as was included in the original representation.

f. The treaty does not transfer all of the significant risk inherent in the business being reinsured. The following table identifies for a representative sampling of products or type of business, the risks which are considered to be significant. For products not specifically included, the risks determined to be significant shall be consistent with this table.

Risk categories:

i. Morbidity

ii. Mortality

iii. Lapse

This is the risk that a policy will voluntarily terminate prior to the recoupment of a statutory surplus strain experienced at issue of the policy.

iv. Credit Quality

This is the risk that invested assets supporting the reinsured business will decrease in value. The main hazards are that assets will default or that there will be a decrease in earning power. It excludes market value declines due to changes in interest rate.

v. Reinvestment
This is the risk that interest rates will fall and funds reinvested (coupon payments or monies received upon asset maturity or call) will therefore earn less than expected. If asset durations are less than liability durations, the mismatch will increase.

**vi. Disintermediation**

This is the risk that interest rates rise and policy loans and surrenders increase or maturing contracts do not renew at anticipated rates of renewal. If asset durations are greater than the liability durations, the mismatch will increase. Policyholders will move their funds into new products offering higher rates. The company may have to sell assets at a loss to provide for these withdrawals.

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<td>Traditional Non-Par Term</td>
<td>0</td>
<td>+</td>
<td>+</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Traditional Par Permanent</td>
<td>0</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>+</td>
</tr>
<tr>
<td>Traditional Par Term</td>
<td>0</td>
<td>+</td>
<td>+</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Adjustable Premium Permanent</td>
<td>0</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>+</td>
</tr>
<tr>
<td>Indeterminate Premium Permanent</td>
<td>0</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>+</td>
</tr>
<tr>
<td>Universal Life Flexible Premium</td>
<td>0</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>+</td>
</tr>
<tr>
<td>Universal Life Fixed Premium</td>
<td>0</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>+</td>
</tr>
<tr>
<td>Universal Life Fixed Premium dump-in premiums allowed</td>
<td>0</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>+</td>
</tr>
</tbody>
</table>

* LTC = Long Term Care Insurance

LTD = Long Term Disability Insurance

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g. i. The credit quality, reinvestment, or disintermediation risk is significant for the business reinsured and the ceding company does not (other than for the classes of business excepted in paragraph g. ii.) either transfer the underlying assets to the reinsurer or legally segregate such assets in a trust or escrow account or otherwise establish a satisfactory mechanism which legally segregates, by contract or contract provision, the underlying assets.

Q – Is asset segmentation an acceptable mechanism for legal segregation of assets?

A – Generally no. Segmentation involves the allocation of a company's general account investment earnings over several lines of business, or various groups of policies within those lines, such that the performance of one corporate bond, for example, may affect the earnings of several segments within a company. The accounting for the segmentation is largely internal, and the detail of the record keeping varies from company to company.

The fundamental purpose of the requirement for a reinsurance treaty to employ the use of a segregated asset portfolio ("SAP") is that all payments (interest, benefits, allowances, etc.) must be made from the SAP, so as to eliminate any problems that could arise in determining what asset or assets should be sold, and to avoid disputes in the event of insolvency. Any sale of assets that could affect policies not subject to reinsurance, or policies subject to reinsurance with other reinsurers is problematic.

In addition, auditing the performance of a treaty using traditional segmentation methods would be extremely difficult and prone to disagreement, which could provide a reinsurer with broad leverage to contest amounts due that reinsurer, especially in the event of insolvency or rehabilitation of the ceding company.

It is important to determine that the arrangement in place does in fact transfer all of the risks of the underlying assets supporting the reinsured business to the reinsurer.

Q – If a percentage of all policies in a block of business is reinsured, must the company segregate that percentage of the assets supporting the business, or can it segregate all the assets?

A – The company may segregate only assets supporting the reinsured portion or the segregated asset portfolio may represent the entire block of business if the reinsured portion is the same for all policies. In the latter case, the reinsurer would take its proportionate share of the SAP performance.

Q – If the ceding company cedes a portion of each policy in a block of business to one reinsurer and a portion to another, while retaining some itself, does it have to segregate assets separately for each reinsurer, or is it acceptable to have all the assets segregated together with each reinsurer responsible for its portion of the investment risk?

A – The ceding company does not need to segregate assets separately for each reinsurer if the treaties are virtually identical.

Q – At the time assets are legally segregated under a coinsurance with funds withheld treaty, should they be valued at market value, statutory value, or some combination?

A – The assets should be valued at their statutory admitted value.

Q – When the assets are legally segregated, how are the funds withheld payables and receivables reported?
A – The payables and receivables are recorded in the same manner as in a funds withheld treaty where the assets are not legally segregated and will usually mirror the value of the funds withheld account. However, the funds withheld account, which reflects the statutory admitted value of the assets in the SAP, will fluctuate, and thus may differ from the reserves on the reinsured business.

ii. Notwithstanding the requirements of paragraph g. i., the assets supporting the reserves for the following classes of business and any classes of business which do not have a significant credit quality, reinvestment or disintermediation risk may be held by the ceding company without segregation of such assets:

(a) Health Insurance - LTC/LTD
(b) Traditional Non-Par Permanent
(c) Traditional Par Permanent
(d) Adjustable Premium Permanent
(e) Indeterminate Premium Permanent
(f) Universal Life Fixed Premium

(no dump-in premiums allowed)

The associated formula for determining the reserve interest rate adjustment must use a formula which reflects the ceding company’s investment earnings and incorporates all realized and unrealized gains and losses reflected in the statutory statement. The following is an acceptable formula:

\[
Rate = \frac{2(I + CG)}{X + Y - I - CG}
\]

Where:
I is the net investment income
CG is capital gains less capital losses
X is the current year cash and invested assets plus investment income due and accrued less borrowed money
Y is the same as X but for the prior year

h. Settlements are made less frequently than quarterly or payments due from the reinsurer are not made in cash within ninety (90) days of the settlement date.

i. The ceding insurer is required to make representations or warranties not reasonably related to the business being reinsured.

j. The ceding insurer is required to make representations or warranties about future performance of the business being reinsured.

k. The reinsurance agreement is entered into for the principal purpose of producing significant surplus aid for the ceding insurer, typically on a temporary basis, while not transferring all of the significant risks inherent in the business reinsured and, in substance or effect, the expected potential liability to the ceding insurer remains basically unchanged.

3. Any increase in surplus net of federal income tax resulting from reinsurance agreements entered into or amended after the effective date of the Codification which involve the reinsurance of business
issued prior to the effective date of the agreements shall be identified separately on the insurer’s statutory financial statement as a surplus item and recognition of the surplus increase as income shall be reflected on a net of tax basis as earnings emerge from the business reinsured.

{For example, on the last day of calendar year N, company XYZ pays a $20 million initial commission and expense allowance to company ABC for reinsuring an existing block of business. Assuming a 34% tax rate, the net increase in surplus at inception is $13.2 million ($20 million - $6.8 million) which is reported on the “Aggregate write-ins for gains and losses in surplus” line in the Capital and Surplus account. $6.8 million (34% of $20 million) is reported as income on the “Commissions and expense allowances on reinsurance ceded” line of the Summary of Operations.

At the end of year N+1 the business has earned $4 million. ABC has paid $.5 million in profit and risk charges in arrears for the year and has received a $1 million experience refund. Company ABC’s annual statement would report $1.65 million (66% of ($4 million - $1 million - $.5 million) up to a maximum of $13.2 million) on the “Commissions and expense allowance on reinsurance ceded” line of the Summary of Operations, and -$1.65 million on the “Aggregate write-ins for gains and losses in surplus” line of the Capital and Surplus account. The experience refund would be reported separately as a miscellaneous income item in the Summary of Operations.}

Written Agreements

4. No reinsurance agreement or amendment to any agreement may be used to reduce any liability or to establish any asset in any financial statement, unless the agreement, amendment or a binding letter of intent has been duly executed by both parties no later than the “as of date” of the financial statement.

5. In the case of a letter of intent, a reinsurance agreement or an amendment to a reinsurance agreement must be executed within a reasonable period of time, not exceeding ninety (90) days from the execution date of the letter of intent, in order for credit to be granted for the reinsurance ceded.
Appendix A-812

Smoker/Nonsmoker Mortality Tables for Use in Determining Minimum Reserve Liabilities

Purpose

1. The purpose of this Appendix is to permit the use of mortality tables that reflect differences in mortality between smokers and nonsmokers in determining minimum reserve liabilities for plans of insurance with separate premium rates for smokers and nonsmokers.

Definitions

2. As used in this Appendix, “1980 CSO Table, with or without Ten-Year Select Mortality Factor” means that mortality table, consisting of separate rates of mortality for male and female lives, developed by the Society of Actuaries Committee to Recommend New Mortality Tables for Valuation of Standard Individual Ordinary Life Insurance, referred to as the Commissioners 1980 Standard Ordinary Mortality Table. The same select factors will be used for both smokers and nonsmokers tables.

3. As used in this Appendix, “1980 CET Table” means that mortality table consisting of separate rates of mortality for male and female lives, developed by the Society of Actuaries Committee to Recommend New Mortality Tables for Valuation of Standard Individual Ordinary Life Insurance, and referred to as the Commissioners 1980 Extended Term Insurance Table.

4. As used in this Appendix, the phrase “smoker and nonsmoker mortality tables” refers to the mortality tables with separate rates of mortality for smokers and nonsmokers derived from the tables defined in paragraphs 2 through 3 which were developed by the Society of Actuaries Task Force on Smoker/Nonsmoker Mortality and the California Insurance Department staff and recommended by the NAIC Technical Staff Actuarial Group.

5. As used in this Appendix, the phrase “composite mortality tables” refers to the mortality tables defined in paragraphs 2 through 3 as they were originally published with rates of mortality that do not distinguish between smokers and nonsmokers.

Alternate Tables

6. For any policy of insurance delivered or issued for delivery after the effective date of Codification, at the option of the company and subject to the conditions stated in paragraph 7 of this Appendix;

   a. The 1980 CSO Smoker and Nonsmoker Mortality Tables, with or without Ten-Year Select Mortality Factors, may be substituted for the 1980 CSO Table, with or without Ten-Year Select Mortality Factors, and

   b. The 1980 CET Smoker and Nonsmoker Mortality Tables may be substituted for the 1980 CET Table for use in determining minimum reserve liabilities.

Conditions

7. For each plan of insurance with separate rates for smokers and nonsmokers an insurer may

   a. Use composite mortality tables to determine minimum reserve liabilities,
b. Use smoker and nonsmoker mortality tables to determine the valuation net premiums and additional minimum reserves, if any, required by Appendix A-820 and use composite mortality tables to determine the basic minimum reserves, or

c. Use smoker and nonsmoker mortality to determine minimum reserve liabilities.
Appendix A-820

Minimum Life And Annuity Reserve Standards

Definitions

1. A “qualified actuary” is an individual who:
   a. Is a member in good standing of the American Academy of Actuaries;
   b. Is qualified to sign statements of actuarial opinion for life and health insurance company annual statements in accordance with the American Academy of Actuaries qualification standards for actuaries signing such statements;
   c. Is familiar with the valuation requirements applicable to life and health insurance companies;
   d. Has not been found by the Commissioner (or if so found has subsequently been reinstated as a qualified actuary), following appropriate notice and hearing to have:
      i. Violated any provision of, or any obligation imposed by, the Insurance Law or other law in the course of his or her dealings as a qualified actuary;
      ii. Been found guilty of fraudulent or dishonest practices;
      iii. Demonstrated his or her incompetence, lack of cooperation, or untrustworthiness to act as a qualified actuary;
      iv. Submitted to the Commissioner during the past five (5) years, pursuant to this regulation, an actuarial opinion or memorandum that the Commissioner rejected because it did not meet the provisions of this regulation including standards set by the Actuarial Standards Board; or
      v. Resigned or been removed as an actuary within the past five (5) years as a result of acts or omissions indicated in any adverse report on examination or as a result of failure to adhere to generally acceptable actuarial standards; and
   e. Has not failed to notify the Commissioner of any action taken by any Commissioner of any other state similar to that under subparagraph d. above.

Valuation Requirements

2. Reserves reported in the financial statements shall:
   a. Be computed in accordance with presently accepted actuarial standards,
   b. Be based on actuarial assumptions that produce reserves at least as great as those called for in any contract provision as to reserve basis and method, and are in accordance with all other contract provisions,
   c. Be computed on the basis of assumptions consistent with those used in computing the corresponding items in the annual statement of the preceding year-end with any exceptions disclosed in the notes to the financial statements, and
d. Include provision for all actuarial reserves and related statement items which ought to be established.

Computation of Minimum Standard for Life Insurance and Endowment Benefits

3. The minimum standard for the valuation of all life insurance and endowment policies and contracts shall be the commissioners reserve valuation methods defined in paragraphs 9 through 11, valuation interest rates provided in paragraphs 5 through 8, and the following tables:

a. For all ordinary policies of life insurance issued on the standard basis, excluding any disability and accidental death benefits in the policies:
   i. The Commissioners 1980 Standard Ordinary Mortality Table;
   ii. At the election of the company for any one or more specified plans of life insurance, the Commissioners 1980 Standard Ordinary Mortality Table with Ten-Year Select Mortality Factors; or
   iii. Any ordinary mortality table, adopted after 1980 by the National Association of Insurance Commissioners, for use in determining the minimum standard of valuation for such policies;

b. For all industrial life insurance policies issued on the standard basis, excluding any disability and accidental death benefits in the policies, the Commissioners 1961 Standard Industrial Mortality Table or any industrial mortality table adopted after 1980 by the National Association of Insurance Commissioners for use in determining the minimum standard of valuation for the policies;

c. For total and permanent disability benefits in or supplementary to ordinary policies or contracts, the tables of Period 2 disablement rates and the 1930 to 1950 termination rates of the 1952 Disability Study of the Society of Actuaries, with due regard to the type of benefit or any tables of disablement rates and termination rates adopted after 1980 by the National Association of Insurance Commissioners, for use in determining the minimum standard of valuation for those policies. Any such table shall, for active lives, be combined with a mortality table permitted for calculating the reserves for life insurance policies;

d. For accidental death benefits in or supplementary to policies, the 1959 Accidental Death Benefits Table or any accidental death benefits table adopted after 1980 by the National Association of Insurance Commissioners for use in determining the minimum standard of valuation for those policies. The table shall be combined with a mortality table for calculating the reserves for life insurance policies; and

e. For group life insurance, life insurance issued on the substandard basis and other special benefits: tables which provide for an adequate reserve.

Computation of Minimum Standard for Annuities

4. The minimum standard for the valuation of all individual annuity and pure endowment contracts and for all annuities and pure endowments purchased under group annuity and pure endowment contracts, shall be the commissioners annuity reserve valuation methods defined in paragraphs 12 and 13, valuation interest rates provided in paragraphs 5 through 8, and the tables defined in Appendix A-821.
Computation of Minimum Standard Valuation Interest Rates by Calendar Year of Issue - All Business

5. The interest rates used in determining the minimum standard for the valuation of policies issued on or after the effective date of the Codification shall be the calendar year statutory valuation interest rates as defined below:

a. Calendar Year Statutory Valuation Interest Rates

i. The calendar year statutory valuation interest rates, I, shall be determined as follows and the results rounded to the nearer one-quarter of one percent:

(a) For life insurance:

\[ I = 0.03 + W(R_1 - 0.03) + \frac{W}{2}(R_2 - 0.09); \]

(b) For single premium immediate annuities and for annuity benefits involving life contingencies arising from other annuities with cash settlement options and from guaranteed interest contracts with cash settlement options:

\[ I = 0.03 + W(R - 0.03) \]

where \( R_1 \) is the lesser of \( R \) and 0.09,

\( R_2 \) is the greater of \( R \) and 0.09,

\( R \) is the reference interest rate defined in paragraph 7,

and \( W \) is the weighting factor defined in paragraph 6;

(c) For other annuities with cash settlement options and guaranteed interest contracts with cash settlement options, valued on an issue year basis, except as stated in Subparagraph (b) above, the formula for life insurance stated in Subparagraph (a) above shall apply to annuities and guaranteed interest contracts with guarantee durations in excess of ten (10) years and the formula for single premium immediate annuities stated in Subparagraph (b) above shall apply to annuities and guaranteed interest contracts with guarantee duration of ten (10) years or less;

(d) For other annuities with no cash settlement options and for guaranteed interest contracts with no cash settlement options, the formula for single premium immediate annuities stated in Subparagraph (b) above shall apply.

(e) For other annuities with cash settlement options and guaranteed interest contracts with cash settlement options, valued on a change in fund basis, the formula for single premium immediate annuities stated in Subparagraph (b) above shall apply.

ii. However, if the calendar year statutory valuation interest rate for a life insurance policy issued in any calendar year determined without reference to this sentence differs from the corresponding actual rate for similar policies issued in the immediately preceding calendar year by less than one-half of one percent (1/2 of...
1%), the calendar year statutory valuation interest rate for the life insurance policies shall be equal to the corresponding actual rate for the immediately preceding calendar year.

6. The weighting factors referred to in the formulas stated above are given in the following tables:

a. Weighting Factors for Life Insurance:

<table>
<thead>
<tr>
<th>Guarantee Duration (Years)</th>
<th>Weighting Factors</th>
</tr>
</thead>
<tbody>
<tr>
<td>10 or less</td>
<td>.50</td>
</tr>
<tr>
<td>More than 10, but not more than 20</td>
<td>.45</td>
</tr>
<tr>
<td>More than 20</td>
<td>.35</td>
</tr>
</tbody>
</table>

For life insurance, the guarantee duration is the maximum number of years the life insurance can remain in force on a basis guaranteed in the policy or under options to convert to plans of life insurance with premium rates or nonforfeiture values or both which are guaranteed in the original policy;

b. Weighting factor for single premium immediate annuities and for annuity benefits involving life contingencies arising from other annuities with cash settlement options and guaranteed interest contracts with cash settlement options:

.80

c. Weighting factors for other annuities and for guaranteed interest contracts, except as stated in Subparagraph (b) above, shall be as specified in Items i., ii. and iii. below, according to the rules and definitions in Items iv., v. and vi. below:

i. For annuities and guaranteed interest contracts valued on an issue year basis:

<table>
<thead>
<tr>
<th>Guarantee Duration (Years)</th>
<th>Weighting Factor for Plan Type A</th>
<th>B</th>
<th>C</th>
</tr>
</thead>
<tbody>
<tr>
<td>5 or less</td>
<td>.80</td>
<td>.60</td>
<td>.50</td>
</tr>
<tr>
<td>More than 5, but not more than 10:</td>
<td>.75</td>
<td>.60</td>
<td>.50</td>
</tr>
<tr>
<td>More than 10, but not more than 20:</td>
<td>.65</td>
<td>.50</td>
<td>.45</td>
</tr>
<tr>
<td>More than 20</td>
<td>.45</td>
<td>.35</td>
<td>.35</td>
</tr>
</tbody>
</table>
### ii. For annuities and guaranteed interest contracts valued on a change in fund basis, the factors shown in Item i. above increased by:

<table>
<thead>
<tr>
<th>Plan Type</th>
<th>A</th>
<th>B</th>
<th>C</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>.15</td>
<td>.25</td>
<td>.05</td>
</tr>
</tbody>
</table>

### iii. For annuities and guaranteed interest contracts valued on an issue year basis (other than those with no cash settlement options) that do not guarantee interest on considerations received more than one year after issue or purchase and for annuities and guaranteed interest contracts valued on a change in fund basis that do not guarantee interest rates on considerations received more than twelve (12) months beyond the valuation date, the factors shown in Item i. or derived in Item ii. increased by:

<table>
<thead>
<tr>
<th>Plan Type</th>
<th>A</th>
<th>B</th>
<th>C</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>.05</td>
<td>.05</td>
<td>.05</td>
</tr>
</tbody>
</table>

### iv. For other annuities with cash settlement options and guaranteed interest contracts with cash settlement options, the guarantee duration is the number of years for which the contract guarantees interest rates in excess of the calendar year statutory valuation interest rate for life insurance policies with guarantee duration in excess of twenty (20) years. For other annuities with no cash settlement options and for guaranteed interest contracts with no cash settlement options, the guaranteed duration is the number of years from the date of issue or date of purchase to the date annuity benefits are scheduled to commence.

### v. Plan type as used in the above tables is defined as follows:

- **(a) Plan Type A:** At any time policyholder may withdraw funds only (1) with an adjustment to reflect changes in interest rates or asset values since receipt of the funds by the insurance company, or (2) without an adjustment but installments over five years or more, or (3) as an immediate life annuity, or (4) no withdrawal permitted.

- **(b) Plan Type B:** Before expiration of the interest rate guarantee, policyholder may withdraw funds only (1) with an adjustment to reflect changes in interest rates or asset values since receipt of the funds by the insurance company, or (2) without an adjustment but in installments over
five years or more, or (3) no withdrawal permitted. At the end of interest rate guarantee, funds may be withdrawn without an adjustment in a single sum or installments over less than five years.

(c) Plan Type C: Policyholder may withdraw funds before expiration of interest rate guarantee in a single sum or installments over less than five years either (1) without adjustment to reflect changes in interest rates or asset values since receipt of the funds by the insurance company, or (2) subject only to a fixed surrender charge stipulated in the contract as a percentage of the fund.

vi. A company may elect to value guaranteed interest contracts with cash settlement options and annuities with cash settlement options on either an issue year basis or on a change in fund basis. Guaranteed interest contracts with no cash settlement options and other annuities with no cash settlement options must be valued on an issue year basis. An issue year basis of valuation refers to a valuation basis under which the interest rate used to determine the minimum valuation standard for the entire duration of the annuity or guaranteed interest contract is the calendar year valuation interest rate for the year of issue or year of purchase of the annuity or guaranteed interest contract, and the change in fund basis of valuation refers to a valuation basis under which the interest rate used to determine the minimum valuation standard applicable to each change in the fund held under the annuity or guaranteed interest contract is the calendar year valuation interest rate for the year of the change in the fund.

7. The reference interest rate referred to in paragraph 5 of this Appendix shall be defined as follows:

a. For all life insurance, the lesser of the average over a period of thirty-six (36) months and the average over a period of twelve (12) months, ending on June 30 of the calendar year preceding the year of issue, of the monthly average of the composite yield on seasoned corporate bonds, as published by Moody’s Investors Service, Inc.;

b. For single premium immediate annuities and for annuity benefits involving life contingencies arising from other annuities with cash settlement options and guaranteed interest contracts with cash settlement options, the average over a period of twelve (12) months, ending on June 30 of the calendar year of issue or year of purchase, of the monthly average of the composite yield on seasoned corporate bonds, as published by Moody’s Investors Service, Inc.;

c. For other annuities with cash settlement options and guaranteed interest contracts with cash settlement options, valued on a year of issue basis, except as stated in Subparagraph (b) above, with guarantee duration in excess of ten (10) years, the lesser of the average over a period of thirty-six (36) months and the average over a period of twelve (12) months, ending on June 30 of the calendar year of issue or purchase, of the monthly average of the composite yield on seasoned corporate bonds, as published by Moody’s Investors Service, Inc.;

d. For other annuities with cash settlement options and guaranteed interest contracts with cash settlement options, valued on a year of issue basis, except as stated in Subparagraph (b) above, with guarantee duration of ten (10) years or less, the average over a period of twelve (12) months, ending on June 30 of the calendar year of issue or purchase, of the monthly average of the composite yield on seasoned corporate bonds, as published by Moody’s Investors Service, Inc.;
e. For other annuities with no cash settlement options and for guaranteed interest contracts with no cash settlement options, the average over a period of twelve (12) months, ending on June 30 of the calendar year of issue or purchase, of the monthly average of the composite yield on seasoned corporate bonds, as published by Moody’s Investors Service, Inc.;

f. For other annuities with cash settlement options and guaranteed interest contracts with cash settlement options, valued on a change in fund basis, except as stated in Subparagraph b. above, the average over a period of twelve (12) months, ending on June 30 of the calendar year of the change in the fund, of the monthly average of the composite yield on seasoned corporate bonds, as published by Moody’s Investors Service, Inc.

8. In the event that the monthly average of the composite yield on seasoned corporate bonds is no longer published by Moody’s Investors Service, Inc. or in the event that the National Association of Insurance Commissioners determines that the monthly average of the composite yield on seasoned corporate bonds as published by Moody’s Investors Service, Inc. is no longer appropriate for the determination of the reference interest rate, then an alternative method for determination of the reference interest rate adopted by the National Association of Insurance Commissioners may be substituted.

Reserve Valuation Method—Life Insurance and Endowment Benefits

9. Except as otherwise provided in this Appendix, reserves according to the commissioners reserve valuation method, for the life insurance and endowment benefits of policies providing for a uniform amount of insurance and requiring the payment of uniform premiums shall be the excess, if any, of the present value, at the date of valuation, of the future guaranteed benefits provided for by those policies, over the then present value of any future modified net premiums therefor. The modified net premiums for a policy shall be the uniform percentage of the respective contract the premiums for the benefits that the present value, at the date of issue of the policy, of all modified net premiums shall be equal to the sum of the then present value of the benefits provided for by the policy and the excess of a. over b., as follows:

a. A net level annual premium equal to the present value, at the date of issue, of the benefits provided for after the first policy year, divided by the present value, at the date of issue, of an annuity of one per annum payable on the first and each subsequent anniversary of the policy on which a premium falls due. However, the net level annual premium shall not exceed the net level annual premium on the nineteen-year premium whole life plan for insurance of the same amount at an age one year higher than the age at issue of the policy.

b. A net one-year term premium for the benefits provided for in the first policy year.

10. For a life insurance policy for which the contract premium in the first policy year exceeds that of the second year and for which no comparable additional benefit is provided in the first year for the excess and which provides an endowment benefit or a cash surrender value or a combination in an amount greater than the excess premium, the reserve according to the commissioners reserve valuation method as of any policy anniversary occurring on or before the assumed ending date defined herein as the first policy anniversary on which the sum of any endowment benefit and any cash surrender value then available is greater than the excess premium shall, except as otherwise provided in paragraphs 17 and 18, be the greater of the reserve as of the policy anniversary calculated as described in the preceding paragraph and the reserve as of the policy anniversary calculated as described in those paragraphs, but with (i) the value defined in that paragraph being reduced by fifteen percent (15%) of the amount of such excess first year premium, (ii) all present values of benefits and premiums being determined without reference to premiums or benefits provided for by the policy after the assumed ending date, (iii) the
policy being assumed to mature on that date as an endowment, and (iv) the cash surrender value provided
on that date being considered as an endowment benefit. In making the above comparison the mortality
stated in paragraph 3 and interest bases stated in paragraphs 5 through 8 shall be used.

11. Reserves according to the commissioners reserve valuation method shall be calculated by a
method consistent with the principles of paragraphs 9 and 10 for:

a. Life insurance policies providing for a varying amount of insurance or requiring the
   payment of varying premiums;

b. Group annuity and pure endowment contracts purchased under a retirement plan or plan
   of deferred compensation, established or maintained by an employer (including a
   partnership or sole proprietorship) or by an employee organization, or by both, other than
   a plan providing individual retirement accounts or individual retirement annuities under
   Section 408 of the Internal Revenue Code, as now or hereafter amended;

c. Disability and accidental death benefits in all policies and contracts; and

d. All other benefits, except life insurance and endowment benefits in life insurance policies
   and benefits provided by all other annuity and pure endowment contracts.

Reserve Valuation Method—Annuity and Pure Endowment Benefits

12. Paragraph 13 shall apply to all annuity and pure endowment contracts other than group annuity
and pure endowment contracts purchased under a retirement plan or plan of deferred compensation,
established or maintained by an employer (including a partnership or sole proprietorship) or by an
employee organization, or by both, other than a plan providing individual retirement accounts or
individual retirement annuities under Section 408 of the Internal Revenue Code, as now or hereafter amended.

13. Reserves according to the commissioners annuity reserve method for benefits under annuity or
pure endowment contracts, excluding any disability and accidental death benefits in the contracts, shall be
the greatest of the respective excesses of the present values, at the date of valuation, of the future
guaranteed benefits, including guaranteed nonforfeiture benefits, provided for by the contracts at the end
of each respective contract year, over the present value, at the date of valuation, of any future valuation
considerations derived from future gross considerations, required by the terms of the contract, that
become payable prior to the end of the respective contract year. The future guaranteed benefits shall be
determined by using the mortality table, if any, and the interest rate, or rates, specified in the contracts for
determining guaranteed benefits. The valuation considerations are the portions of the respective gross
considerations applied under the terms of the contracts to determine nonforfeiture values.

Minimum Reserves

14. In no event shall a company’s aggregate reserves for all life insurance policies, excluding
disability and accidental death benefits be less than the aggregate reserves calculated in accordance with
the methods set forth in paragraphs 9-11, 12-13, 17-18 and 19 and the mortality table or tables and rate or
rates of interest used in calculating nonforfeiture benefits for the policies.

Optional Reserve Calculation

15. Reserves for any category of policies, contracts or benefits, may be calculated, at the option of the
company, according to any standards that produce greater aggregate reserves for the category than those
calculated according to the minimum standard provided here, but the rate or rates of interest used for
policies and contracts, other than annuity and pure endowment contracts, shall not be higher than the corresponding rate or rates of interest used in calculating any nonforfeiture benefits provided there.

16. A company that shall have adopted at any time a standard of valuation producing greater aggregate reserves than those calculated according to the minimum standard provided here may, adopt a lower standard of valuation, but not lower than the minimum provided here; provided that the holding of additional reserves previously determined by a qualified actuary shall not be deemed to be the adoption of a higher standard of valuation.

Reserve Calculation—Valuation Net Premium Exceeding the Gross Premium Charged

17. If in any contract year the gross premium charged by a life insurance company on a policy or contract is less than the valuation net premium for the policy or contract calculated by the method used in calculating the reserve but using the minimum valuation standards of mortality and rate of interest, the minimum reserve required for the policy or contract shall be the greater of either the reserve calculated according to the mortality table, rate of interest, and method actually used for the policy or contract, or the reserve calculated by the method actually used for the policy or contract but using the minimum valuation standards of mortality and rate of interest and replacing the valuation net premium by the actual gross premium in each contract year for which the valuation net premium exceeds the actual gross premium. The minimum valuation standards of mortality and rate of interest to be used are those standards stated in paragraph 3 and paragraphs 5 through 8 of this Appendix.

18. For a life insurance policy for which the gross premium in the first policy year exceeds that of the second year and for which no comparable additional benefit is provided in the first year for the excess and which provides an endowment benefit or a cash surrender value or a combination in an amount greater than the excess premium, the provisions of paragraphs 17 and 18 shall be applied as if the method actually used in calculating the reserve for the policy were the method described in paragraph 9. The minimum reserve at each policy anniversary of such a policy shall be the greater of the minimum reserve calculated in accordance with paragraphs 9 and 10 and the minimum reserve calculated in accordance with paragraphs 17 and 18.

Reserve Calculation—Indeterminate Premium Plans

19. In the case of a plan of life insurance that provides for future premium determination, the amounts of which are to be determined by the insurance company based on then estimates of future experience, or in the case of a plan of life insurance or annuity that is of such a nature that the minimum reserves cannot be determined by the methods described above, the reserves that are held under the plan shall:

a. Be appropriate in relation to the benefits and the pattern of premiums for that plan; and

b. Be computed by a method that is consistent with the principles of this Appendix and which produce a good and sufficient reserve.
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Appendix A-821

Annuity Mortality Table for Use in Determining Reserve Liabilities for Annuities

Purpose

1. The purpose of this Appendix is to recognize the following mortality tables for use in determining the minimum standard of valuation for annuity and pure endowment contracts: the 1983 Table “a,” the Annuity 2000 Mortality Table, and the 1994 Group Annuity Reserving (1994 GAR) Table.

Definitions

2. As used in this Appendix “1983 Table ‘a’” means that mortality table developed by the Society of Actuaries Committee to Recommend a New Mortality Basis for Individual Annuity Valuation and adopted as a recognized mortality table for annuities in June 1982 by the National Association of Insurance Commissioners.

3. As used in this Appendix “1994 GAR Table” means that mortality table developed by the Society of Actuaries Group Annuity Valuation Table Task Force and shown in the Proceedings of the NAIC.

4. As used in this Appendix “Annuity 2000 Mortality Table” means that mortality table developed by the Society of Actuaries Committee on Life Insurance Research and shown in the Proceedings of the NAIC.

Individual Annuity or Pure Endowment Contracts

5. Except as provided in paragraph 6 of this Appendix, the Annuity 2000 Mortality Table shall be used for determining the minimum standard of valuation for any individual annuity or pure endowment contract.

6. The 1983 Table “a” without projection is to be used for determining the minimum standards of valuation for an individual annuity or pure endowment contract solely when the contract is based on life contingencies and is issued to fund periodic benefits arising from:

   a. Settlements of various forms of claims pertaining to court settlements or out of court settlements from tort actions;

   b. Settlements involving similar actions such as worker’s compensation claims; or

   c. Settlements of long term disability claims where a temporary or life annuity has been used in lieu of continuing disability payments.

Group Annuity or Pure Endowment Contracts

7. The 1994 GAR Table shall be used for determining the minimum standard of valuation for any annuity or pure endowment purchased under a group annuity or pure endowment contract.

Application of the 1994 GAR Table

8. In using the 1994 GAR Table, the mortality rate for a person age x in year (1994 + n) is calculated as follows:
$q_x^{1994} = q_x^{1994} (1 - A_{A_x})^n$

where the $q_x^{1994}$ and $A_{A_x}$s are as specified in the 1994 GAR Table.
Appendix A-822

Asset Adequacy Analysis Requirements

Definitions

1. “Asset adequacy analysis” means an analysis of the adequacy of reserves and related actuarial items, in light of the assets supporting such reserves and related items, to meet the obligations of an insurer.

Asset Adequacy Analysis

2. The reserves and related items, when considered in light of the assets held by the company with respect to such reserves and related actuarial items including, but not limited to, the investment earnings on the assets, and the considerations anticipated to be received and retained under the policies and contracts, shall make adequate provision, according to presently accepted actuarial standards of practice, for the anticipated cash flows required by the contractual obligations and related expenses of the company.

3. If the company determines as the result of asset adequacy analysis that a reserve should be held in addition to the aggregate reserve held and calculated in accordance with methods set forth in Appendix A-820, the company shall establish the additional reserve.

4. Additional reserves established above and deemed not necessary in subsequent years may be released. The release of such reserves would not be deemed an adoption of a lower standard of valuation.
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Appendix A-825

Commissioners’ Annuity Reserve Valuation Method (CARVM)

Purpose

1. The purpose of this Appendix is to clarify which surrender charge factors may be taken into account and which are to be disregarded under CARVM.

Valuation Requirements

2. Reserves according to CARVM depend in part upon the present values of “future guaranteed benefits, including guaranteed nonforfeiture benefits.” It has always been recognized that this phrase, as used in Appendix A-820, includes cash surrender values based on contractual guarantees after reduction for any contractual surrender charges available to the insurer.

3. Contingent surrender charges may not be available upon cash surrender at future contract anniversaries, and it is not consistent with the conservative nature of CARVM to reduce the value of future guaranteed benefits on account of such contingent surrender charges. Accordingly, the value of future guaranteed benefits under CARVM may not be reduced by contingent surrender charges which may not be available upon cash surrender.

4. However, there may be some contracts with contingent surrender charges with bail-out rates which are so low that it would not be contrary to the conservative intent of CARVM to treat such surrender charges as available. Contingent surrender charges with bail-out rates less than or equal to the calendar year statutory valuation interest rate for life insurance policies with guarantee duration in excess of twenty years issued in the same year may be treated as available.

5. In addition, there are some contracts with contingent surrender charges with bail-out rates which are a function of an external index whose future values are not known. Judgment is required to determine whether or not such surrender charges may be treated as available. Comparison to the calendar year statutory valuation interest rate for life insurance policies with guarantee duration in excess of twenty years may be useful.

6. For contracts with contingent surrender charges with bail-out rates which are a function of an external index, a judgment as to the availability of the surrender charges may be made by comparing historical values of the function with corresponding values of the calendar year statutory valuation interest rate for life insurance with guarantee duration in excess of twenty years. If the values of the function have generally been less than or equal to the valuation rates, then the surrender charges may be treated as available.

7. For the purpose of this Appendix, in the case of a variable annuity that offers the policyholder a choice of multiple investment options, a surrender charge that may be waived for all of the accounts of the contract by reference to one or more of the accounts will be treated as a contingent surrender charge that may not be available upon cash surrender with respect to the entire contract. If no surrender charge is imposed on transfers among the accounts, and the surrender charge may be waived for one account, provided the formula for the availability of the waiver is set at the date of issuance, then the surrender charge will be treated as a contingent surrender charge that may not be available upon cash surrender with respect to the entire contract.
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Appendix A-830

Valuation of Life Insurance Policies
( Including the Introduction and Use of New Select Mortality Factors)

Purpose

1. The purpose of this appendix is to provide:
   a. Tables of select mortality factors and rules for their use;
   b. Rules concerning a minimum standard for the valuation of plans with nonlevel premiums or benefits; and
   c. Rules concerning a minimum standard for the valuation of plans with secondary guarantees.

2. The method for calculating basic reserves defined in this appendix will constitute the Commissioners’ Reserve Valuation Method for policies to which this appendix is applicable.

Applicability

3. This appendix shall apply to all life insurance policies, with or without nonforfeiture values, issued on or after the effective date of this appendix, subject to the following exceptions and conditions.

   a. Exceptions

   i. This appendix shall not apply to any individual life insurance policy issued on or after the effective date of this appendix if the policy is issued in accordance with and as a result of the exercise of a reentry provision contained in the original life insurance policy of the same or greater face amount, issued before the effective date of this appendix, that guarantees the premium rates of the new policy. This appendix also shall not apply to subsequent policies issued as a result of the exercise of such a provision, or a derivation of the provision, in the new policy.

   ii. This appendix shall not apply to any universal life policy that meets all the following requirements:

       (a) Secondary guarantee period, if any, is five (5) years or less;

       (b) Specified premium for the secondary guarantee period is not less than the net level reserve premium for the secondary guarantee period based on the CSO valuation tables as defined in paragraph 9 and the applicable valuation interest rate; and

       (c) The initial surrender charge is not less than 100 percent of the first year annualized specified premium for the secondary guarantee period.

Drafting Note: Policies with a secondary guarantee are described in paragraph 29.

   iii. This appendix shall not apply to any variable life insurance policy that provides for life insurance, the amount or duration of which varies according to the investment experience of any separate account or accounts.
This appendix shall not apply to any variable universal life insurance policy that provides for life insurance, the amount or duration of which varies according to the investment experience of any separate account or accounts.

This appendix shall not apply to a group life insurance certificate unless the certificate provides for a stated or implied schedule of maximum gross premiums required in order to continue coverage in force for a period in excess of one year.

**Conditions**

i. Calculation of the minimum valuation standard for policies with guaranteed nonlevel gross premiums or guaranteed nonlevel benefits (other than universal life policies), or both, shall be in accordance with the provisions of paragraphs 21 through 28.

ii. Calculation of the minimum valuation standard for flexible premium and fixed premium universal life insurance policies, that contain provisions resulting in the ability of a policyholder to keep a policy in force over a secondary guarantee period shall be in accordance with the provisions of paragraphs 29 through 32.

**Definitions**

4. “Basic reserves” means reserves calculated in accordance with Appendix A-820, paragraphs 9 through 11.

5. “Contract segmentation method” means the method of dividing the period from issue to mandatory expiration of a policy into successive segments, with the length of each segment being defined as the period from the end of the prior segment (from policy inception, for the first segment) to the end of the latest policy year as determined below. All calculations are made using the 1980 CSO valuation tables, as defined in paragraph 9 (or any other valuation mortality table adopted by the National Association of Insurance Commissioners (NAIC) after the effective date of this appendix for this purpose), and, if elected, the optional minimum mortality standard for deficiency reserves stipulated in paragraph 17 of this appendix.

The length of a particular contract segment shall be set equal to the minimum of the value $t$ for which $G_t$ is greater than $R_t$ (if $G_t$ never exceeds $R_t$, the segment length is deemed to be the number of years from the beginning of the segment to the mandatory expiration date of the policy), where $G_t$ and $R_t$ are defined as follows:

$$G_t = \frac{GP_{x+k+t}}{GP_{x+k+t-1}}$$

where:

- $x =$ original issue age;
- $k =$ the number of years from the date of issue to the beginning of the segment;
- $t =$ 1, 2, ...; $t$ is reset to 1 at the beginning of each segment;
- $GP_{x+k+t-1} =$ Guaranteed gross premium per thousand of face amount for year $t$ of the segment, ignoring policy fees only if level for the premium paying period of the policy.
\[ R_t = \frac{q_{x+k+t}}{q_{x+k+t-1}} \]

However, \( R_t \) may be increased or decreased by one percent in any policy year, at the company’s option, but \( R_t \) shall not be less than one;

where: \( x, k \) and \( t \) are as defined above, and

\[ q_{x+k+t-1} = \text{valuation mortality rate for deficiency reserves in policy year } k+t \]

but using the mortality of paragraph 17 b. if paragraph 17 c. is elected for deficiency reserves.

However, if \( GP_{x+k+t} \) is greater than 0 and \( GP_{x+k+t-1} \) is equal to 0, \( G_t \) shall be deemed to be 1000. If \( GP_{x+k+t} \) and \( GP_{x+k+t-1} \) are both equal to 0, \( G_t \) shall be deemed to be 0.

**Drafting Note:** The purpose of the one percent tolerance in the R factor is to prevent irrational segment lengths due to such things as premium rounding. For example, consider a plan in which gross premiums are designed at some point to be a ratio times the underlying ultimate mortality rates, where the ratio varies by issue age. The resulting segments may be greater than one year, because the guaranteed gross premiums are not expressed in fractional cents. The tolerance factor allows the creation of one year segments for a plan in which premiums parallel the underlying valuation mortality table.

6. “Deficiency reserves” means the excess, if greater than zero, of
   a. Minimum reserves calculated in accordance with Appendix A-820, paragraphs 17 and 18, over
   b. Basic reserves.

7. “Guaranteed gross premiums” means the premiums under a policy of life insurance that are guaranteed and determined at issue.

8. “Maximum valuation interest rates” means the interest rates defined in Appendix A-820, paragraphs 5 through 8 (Computation of Minimum Standard by Calendar Year of Issue – All Business) that are to be used in determining the minimum standard for the valuation of life insurance policies.

9. “1980 CSO valuation tables” means the Commissioners’ 1980 Standard Ordinary Mortality Table (1980 CSO Table) without ten-year selection factors, referenced in Appendix A-820, and variations of the 1980 CSO Table approved by the NAIC, such as the smoker and nonsmoker versions approved in December 1983.

**Drafting Note:** This appendix defines the 1980 CSO Tables without the existing ten-year select mortality factors to assure that, if select mortality factors are elected, only one set of factors may be applied to the base valuation mortality table.

10. “Scheduled gross premium” means the smallest illustrated gross premium at issue for other than universal life insurance policies. For universal life insurance policies, scheduled gross premium means the smallest specified premium described in paragraph 29 c., if any, or else the minimum premium described in paragraph 29 d.

11. a. “Segmented reserves” means reserves, calculated using segments produced by the contract segmentation method, equal to the present value of all future guaranteed benefits less the present value of all future net premiums to the mandatory expiration of a policy, where the net premiums within each segment are a uniform percentage of the respective
guaranteed gross premiums within the segment. The uniform percentage for each segment is such that, at the beginning of the segment, the present value of the net premiums within the segment equals:

i. The present value of the death benefits within the segment, plus

ii. The present value of any unusual guaranteed cash value (see paragraph 24) occurring at the end of the segment, less

iii. Any unusual guaranteed cash value occurring at the start of the segment, plus

iv. For the first segment only, the excess of the Item (a) over Item (b), as follows:

(a) A net level annual premium equal to the present value, at the date of issue, of the benefits provided for in the first segment after the first policy year, divided by the present value, at the date of issue, of an annuity of one per year payable on the first and each subsequent anniversary within the first segment on which a premium falls due. However, the net level annual premium shall not exceed the net level annual premium on the nineteen-year premium whole life plan of insurance of the same renewal year equivalent level amount at an age one year higher than the age at issue of the policy.

(b) A net one year term premium for the benefits provided for in the first policy year.

b. The length of each segment is determined by the “contract segmentation method,” as defined in paragraph 5.

c. The interest rates used in the present value calculations for any policy may not exceed the maximum valuation interest rate, determined with a guarantee duration equal to the sum of the lengths of all segments of the policy.

d. For both basic reserves and deficiency reserves computed by the segmented method, present values shall include future benefits and net premiums in the current segment and in all subsequent segments.

Drafting Note: The segmentation requirement should not be limited to plans with no cash surrender values; otherwise companies could avoid segmentation entirely by designing policies with minimal (positive) cash values. Segmentation for plans with cash surrender values should be based solely upon gross premium levels. Basing segmentation upon the level of cash surrender values introduces complications because of the inter-relationship between minimum cash surrender values and gross premium patterns. The requirements of this appendix relating to reserves for plans with unusual cash values and to reserves if cash values exceed calculated reserves serve to link required reserves and cash surrender values. The calculation of segmented reserves shall not be linked to the occurrence of a positive unitary terminal reserve at the end of a segment. The requirement of this appendix to hold the greater of the segmented reserve or the unitary reserve eliminates the need for any linkage.

12. “Tabular cost of insurance” means the net single premium at the beginning of a policy year for one-year term insurance in the amount of the guaranteed death benefit in that policy year.

14. a. “Unitary reserves” means the present value of all future guaranteed benefits less the present value of all future modified net premiums, where:

i. Guaranteed benefits and modified net premiums are considered to the mandatory expiration of the policy; and

ii. Modified net premiums are a uniform percentage of the respective guaranteed gross premiums, where the uniform percentage is such that, at issue, the present value of the net premiums equals the present value of all death benefits and pure endowments, plus the excess of Item (a) over Item (b), as follows:

(a) A net level annual premium equal to the present value, at the date of issue, of the benefits provided for after the first policy year, divided by the present value, at the date of issue, of an annuity of one per year payable on the first and each subsequent anniversary of the policy on which a premium falls due. However, the net level annual premium shall not exceed the net level annual premium on the nineteen-year premium whole life plan of insurance of the same renewal year equivalent level amount at an age one year higher than the age at issue of the policy.

(b) A net one year term premium for the benefits provided for in the first policy year.

b. The interest rates used in the present value calculations for any policy may not exceed the maximum valuation interest rate, determined with a guarantee duration equal to the length from issue to the mandatory expiration of the policy.

Drafting Note: The purpose of this paragraph is to define as specifically as possible what has become commonly called the unitary method. Appendix A-820 does not define the term “unitary” for policies with nonlevel premiums or benefits; its requirement for reserves “computed by a method that is consistent with the principles of Appendix A-820” has not been uniformly interpreted.

15. “Universal life insurance policy” means any individual life insurance policy under the provisions of which separately identified interest credits (other than in connection with dividend accumulations, premium deposit funds, or other supplementary accounts) and mortality or expense charges are made to the policy.

General Calculation Requirements for Basic Reserves and Premium Deficiency Reserves

16. At the election of the company for any one or more specified plans of life insurance, the minimum mortality standard for basic reserves may be calculated using the 1980 CSO valuation tables with select mortality factors (or any other valuation mortality table adopted by the NAIC after the effective date of this appendix for this purpose). If select mortality factors are elected, they may be:

a. The ten-year select mortality factors referenced in Appendix A-820;

b. The select mortality factors in Attachment 1 of this appendix; or

Drafting Note: The select mortality factors for duration 1 through 15 in Attachment 1 of this appendix reflect the Society of Actuaries’ data for the years 1983 through 1986, split by sex and smoking status, with fifteen years of mortality improvement, based on Society of Actuaries’ Projection Scale A applied. A 50% margin was added. The factors were then graded to the 1980 CSO Tables over the next five durations. A 50% margin was deemed appropriate to provide a reasonable margin, with little likelihood that actual experience for significant blocks of business would exceed it.
c. Any other table of select mortality factors adopted by the NAIC after the effective date of this appendix for the purpose of calculating basic reserves.

17. Deficiency reserves, if any, are calculated for each policy as the excess, if greater than zero, of the quantity $A$ over the basic reserve. The quantity $A$ is obtained by recalculating the basic reserve for the policy using guaranteed gross premiums instead of net premiums when the guaranteed gross premiums are less than the corresponding net premiums. At the election of the company for any one or more specified plans of insurance, the quantity $A$ and the corresponding net premiums used in the determination of quantity $A$ may be based upon the 1980 CSO valuation tables with select mortality factors (or any other valuation mortality table adopted by the NAIC after the effective date of this appendix). If select mortality factors are elected, they may be:

a. The ten-year select mortality factors referenced in Appendix A-820;

b. The select mortality factors in Attachment 1 of this appendix;

Drafting Note: The select mortality factors in Attachment 1 of this appendix do not reflect the underwriting risk classes that have evolved since the period of the underlying experience. In light of this consideration and the recent recognition of the regulatory value of actuarial opinions, this appendix allows actuarial judgment to be used for deficiency reserves.

c. For durations in the first segment, $X$ percent of the select mortality factors in Attachment 1 of this appendix, subject to the following:

i. $X$ may vary by policy year, policy form, underwriting classification, issue age, or any other policy factor expected to affect mortality experience;

ii. $X$ shall not be less than twenty percent (20%);

iii. $X$ shall not decrease in any successive policy years;

iv. $X$ is such that, when using the valuation interest rate used for basic reserves, Item (a) is greater than or equal to Item (b);

   (a) The actuarial present value of future death benefits, calculated using the mortality rates resulting from the application of $X$;

   (b) The actuarial present value of future death benefits calculated using anticipated mortality experience without recognition of mortality improvement beyond the valuation date;

v. $X$ is such that the mortality rates resulting from the application of $X$ are at least as great as the anticipated mortality experience, without recognition of mortality improvement beyond the valuation date, in each of the first five (5) years after the valuation date;

vi. The appointed actuary shall increase $X$ at any valuation date where it is necessary to continue to meet all the requirements of paragraph 17 c.;

vii. The appointed actuary may decrease $X$ at any valuation date as long as $X$ does not decrease in any successive policy years and as long as it continues to meet all the requirements of paragraph 17 c.; and
viii. The appointed actuary shall specifically take into account the adverse effect on expected mortality and lapsation of any anticipated or actual increase in gross premiums.

(a) If X is less than 100 percent at any duration for any policy, the following requirements shall be met:

(i) The appointed actuary shall annually prepare an actuarial opinion and memorandum for the company in conformance with the asset adequacy analysis requirements as outlined in Appendix A-822; and

(ii) The appointed actuary shall annually opine for all policies subject to this appendix as to whether the mortality rates resulting from the application of X meet the requirements of paragraph 17 c. This opinion shall be supported by an actuarial report, subject to appropriate Actuarial Standards of Practice promulgated by the Actuarial Standards Board of the American Academy of Actuaries. The X factors shall reflect anticipated future mortality, without recognition of mortality improvement beyond the valuation date, taking into account relevant emerging experience.

d. Any other table of select mortality factors adopted by the NAIC after the effective date of this appendix for the purpose of calculating deficiency reserves.

18. This paragraph applies to both basic reserves and deficiency reserves. Any set of select mortality factors may be used only for the first segment. However, if the first segment is less than ten (10) years, the appropriate ten-year select mortality factors referenced in Appendix A-820 may be used thereafter through the tenth policy year from the date of issue.

Drafting Note: This appendix does not allow the use of select mortality factors beyond the first segment. The rationale is that the result of a premium increase that is sufficient to require a new segment will be increased lapsation, leading to mortality deterioration after the increase. Also, for policies that have reentry provisions, select mortality factors shall not be used in segments beginning after reentry unless a new policy is actually issued. However, this appendix allows the use of the ten-year select mortality factors referenced in Appendix A-820 beyond the first segment (but in no case beyond the tenth policy year) in recognition that the mortality deterioration is unlikely to occur to a significant degree within the first ten (10) years.

19. In determining basic reserves or deficiency reserves, guaranteed gross premiums without policy fees may be used where the calculation involves the guaranteed gross premium but only if the policy fee is a level dollar amount after the first policy year. In determining deficiency reserves, policy fees may be included in guaranteed gross premiums, even if not included in the actual calculation of basic reserves.

20. Reserves for policies that have changes to guaranteed gross premiums, guaranteed benefits, guaranteed charges, or guaranteed credits that are unilaterally made by the insurer after issue and that are effective for more than one year after the date of the change shall be the greatest of the following: (1) reserves calculated ignoring the guarantee, (2) reserves assuming the guarantee was made at issue, and (3) reserves assuming that the policy was issued on the date of the guarantee.
Calculation of Minimum Valuation Standard for Policies with Guaranteed Nonlevel Gross Premiums or Guaranteed Nonlevel Benefits (Other than Universal Life Policies)

21. Basic Reserves
   a. Basic reserves shall be calculated as the greater of the segmented reserves and the unitary reserves. Both the segmented reserves and the unitary reserves for any policy shall use the same valuation mortality table and selection factors. At the option of the insurer, in calculating segmented reserves and net premiums, either of the adjustments described in subparagraph i. or ii. below may be made:
      i. Treat the unitary reserve, if greater than zero, applicable at the end of each segment as a pure endowment and subtract the unitary reserve, if greater than zero, applicable at the beginning of each segment from the present value of guaranteed life insurance and endowment benefits for each segment.
      ii. Treat the guaranteed cash surrender value, if greater than zero, applicable at the end of each segment as a pure endowment; and subtract the guaranteed cash surrender value, if greater than zero, applicable at the beginning of each segment from the present value of guaranteed life insurance and endowment benefits for each segment.

22. Deficiency Reserves
   a. The deficiency reserve at any duration shall be calculated:
      i. On a unitary basis if the corresponding basic reserve determined by paragraph 21 is unitary;
      ii. On a segmented basis if the corresponding basic reserve determined by paragraph 21 is segmented; or
      iii. On the segmented basis if the corresponding basic reserve determined by paragraph 21 is equal to both the segmented reserve and the unitary reserve.
   b. Paragraph 22 shall apply to any policy for which the guaranteed gross premium at any duration is less than the corresponding modified net premium calculated by the method used in determining the basic reserves, but using the minimum valuation standards of mortality (specified in paragraph 17) and rate of interest.
   c. Deficiency reserves, if any, shall be calculated for each policy as the excess if greater than zero, for the current and all remaining periods, of the quantity A over the basic reserve, where A is obtained as indicated in paragraph 17.
   d. For deficiency reserves determined on a segmented basis, the quantity A is determined using segment lengths equal to those determined for segmented basic reserves.

23. Minimum Value
   a. Basic reserves may not be less than the tabular cost of insurance for the balance of the policy year, if mean reserves are used. Basic reserves may not be less than the tabular cost of insurance for the balance of the current modal period or to the paid-to-date, if later, but not beyond the next policy anniversary, if mid-terminal reserves are used. The tabular cost of insurance shall use the same valuation mortality table and interest rates as that used for the calculation of the segmented reserves. However, if select mortality
factors are used, they shall be the ten-year select factors referenced in Appendix A-820. In no case may total reserves (including basic reserves, deficiency reserves and any reserves held for supplemental benefits that would expire upon contract termination) be less than the amount that the policyowner would receive (including the cash surrender value of the supplemental benefits, if any, referred to above), exclusive of any deduction for policy loans, upon termination of the policy.

24. Unusual Pattern of Guaranteed Cash Surrender Values

**Drafting Note:** This requirement is independent of both the segmentation process and the unitary process. After the greater of the segmented or the unitary reserve has been determined, then this paragraph imposes an additional floor on the ultimate reserve. The purpose of this paragraph is to assure adequate funding of significant increases in guaranteed cash surrender values.

a. For any policy with an unusual pattern of guaranteed cash surrender values, the reserves actually held prior to the first unusual guaranteed cash surrender value shall not be less than the reserves calculated by treating the first unusual guaranteed cash surrender value as a pure endowment and treating the policy as an \( n \) year policy providing term insurance plus a pure endowment equal to the unusual cash surrender value, where \( n \) is the number of years from the date of issue to the date the unusual cash surrender value is scheduled.

b. The reserves actually held subsequent to any unusual guaranteed cash surrender value shall not be less than the reserves calculated by treating the policy as an \( n \) year policy providing term insurance plus a pure endowment equal to the next unusual guaranteed cash surrender value, and treating any unusual guaranteed cash surrender value at the end of the prior segment as a net single premium, where

i. \( n \) is the number of years from the date of the last unusual guaranteed cash surrender value prior to the valuation date to the earlier of:

   (a) The date of the next unusual guaranteed cash surrender value, if any, that is scheduled after the valuation date; or

   (b) The mandatory expiration date of the policy; and

ii. The net premium for a given year during the \( n \) year period is equal to the product of the net to gross ratio and the respective gross premium; and

iii. The net to gross ratio is equal to Item (a) divided by Item (b) as follows:

   (a) The present value, at the beginning of the \( n \) year period, of death benefits payable during the \( n \) year period plus the present value, at the beginning of the \( n \) year period, of the next unusual guaranteed cash surrender value, if any, minus the amount of the last unusual guaranteed cash surrender value, if any, scheduled at the beginning of the \( n \) year period.

   (b) The present value, at the beginning of the \( n \) year period, of the scheduled gross premiums payable during the \( n \) year period.

c. For purposes of this paragraph, a policy is considered to have an unusual pattern of guaranteed cash surrender values if any future guaranteed cash surrender value exceeds the prior year’s guaranteed cash surrender value by more than the sum of:

i. One hundred ten percent (110%) of the scheduled gross premium for that year;
ii. One hundred ten percent (110%) of one year’s accrued interest on the sum of the prior year’s guaranteed cash surrender value and the scheduled gross premium using the nonforfeiture interest rate used for calculating policy guaranteed cash surrender values; and

iii. Five percent (5%) of the first policy year surrender charge, if any.

25. Optional Exemption for Yearly Renewable Term Reinsurance. At the option of the company, the following approach for reserves on YRT reinsurance may be used:

Drafting Note: Traditional reserves for yearly renewable term (YRT) reinsurance, the calculations of which this section describes, are already adequate and sufficient. However, without this option in the appendix, YRT reinsurance would be subject to the more complex segmentation calculations.

a. Calculate the valuation net premium for each future policy year as the tabular cost of insurance for that future year.

b. Basic reserves shall never be less than the tabular cost of insurance for the appropriate period, as defined in paragraph 23.

c. Deficiency reserves.

i. For each policy year, calculate the excess, if greater than zero, of the valuation net premium over the respective maximum guaranteed gross premium.

ii. Deficiency reserves shall never be less than the sum of the present values, at the date of valuation, of the excesses determined in accordance with subparagraph i. above.

d. For purposes of this paragraph, the calculations use the maximum valuation interest rate and the 1980 CSO mortality tables with or without ten-year select mortality factors, or any other table adopted after the effective date of this appendix by the NAIC for this purpose.

e. A reinsurance agreement shall be considered YRT reinsurance for purposes of this paragraph if only the mortality risk is reinsured.

f. If the assuming company chooses this optional exemption, the ceding company’s reinsurance reserve credit shall be limited to the amount of reserve held by the assuming company for the affected policies.

26. Optional Exemption for Attained-Age-Based Yearly Renewable Term Life Insurance Policies. At the option of the company, the following approach for reserves for attained-age-based YRT life insurance policies may be used:

Drafting Note: Traditional reserves for attained-age-based YRT policies, the calculations of which this subsection describes, are already adequate and sufficient. However, without this option in the appendix, these policies would be subject to the more complex segmentation calculations.

a. Calculate the valuation net premium for each future policy year as the tabular cost of insurance for that future year.

b. Basic reserves shall never be less than the tabular cost of insurance for the appropriate period, as defined in paragraph 23.
c. Deficiency reserves.
   i. For each policy year, calculate the excess, if greater than zero, of the valuation net premium over the respective maximum guaranteed gross premium.
   ii. Deficiency reserves shall never be less than the sum of the present values, at the date of valuation, of the excesses determined in accordance with subparagraph i. above.

d. For purposes of this paragraph, the calculations use the maximum valuation interest rate and the 1980 CSO valuation tables with or without ten-year select mortality factors, or any other table adopted after the effective date of this appendix by the NAIC for this purpose.

e. A policy shall be considered an attained-age-based YRT life insurance policy for purposes of this subsection if:
   i. The premium rates (on both the initial current premium scale and the guaranteed maximum premium scale) are based upon the attained age of the insured such that the rate for any given policy at a given attained age of the insured is independent of the year the policy was issued; and
   ii. The premium rates (on both the initial current premium scale and the guaranteed maximum premium scale) are the same as the premium rates for policies covering all insureds of the same sex, risk class, plan of insurance and attained age.

f. For policies that become attained-age-based YRT policies after an initial period of coverage, the approach of this subsection may be used after the initial period if:
   i. The initial period is constant for all insureds of the same sex, risk class and plan of insurance; or
   ii. The initial period runs to a common attained age for all insureds of the same sex, risk class and plan of insurance; and
   iii. After the initial period of coverage, the policy meets the conditions of paragraph 26 e. above.

g. If this election is made, this approach shall be applied in determining reserves for all attained-age-based YRT life insurance policies issued on or after the effective date of this appendix.

27. Exemption from Unitary Reserves for Certain n-Year Renewable Term Life Insurance Policies.
Unitary basic reserves and unitary deficiency reserves need not be calculated for a policy if the following conditions are met:

Drafting Note: Without this exemption, companies issuing certain n-year renewable term policies could be forced to hold reserves higher than n-year term reserves, even though in many cases gross premiums are well above valuation mortality rates.

a. The policy consists of a series of n-year periods, including the first period and all renewal periods, where n is the same for each period, except that for the final renewal period, n may be truncated or extended to reach the expiry age, provided that this final renewal period is less than 10 years and less than twice the size of the earlier n-year periods, and
for each period, the premium rates on both the initial current premium scale and the
guaranteed maximum premium scale are level;

b. The guaranteed gross premiums in all \( n \)-year periods are not less than the corresponding
net premiums based upon the 1980 CSO Table with or without the ten-year select
mortality factors; and

c. There are no cash surrender values in any policy year.

28. Exemption from Unitary Reserves for Certain Juvenile Policies. Unitary basic reserves and
unitary deficiency reserves need not be calculated for a policy if the following conditions are met, based
upon the initial current premium scale at issue:

a. At issue, the insured is age twenty-four (24) or younger;

b. Until the insured reaches the end of the juvenile period, which shall occur at or before
age twenty-five (25), the gross premiums and death benefits are level, and there are no
cash surrender values; and

c. After the end of the juvenile period, gross premiums are level for the remainder of the
premium paying period, and death benefits are level for the remainder of the life of the
policy.

Drafting Note: The jumping juvenile policy described has traditionally been valued in two segments.
This exemption will allow that practice to continue without requiring the calculation of reserves on a
unitary basis. However, within each segment, both basic and deficiency reserves shall comply with the
segmented reserve requirements.

Calculation of Minimum Valuation Standard for Flexible Premium and Fixed Premium Universal
Life Insurance Policies That Contain Provisions Resulting in the Ability of a Policyowner to Keep a
Policy in Force Over a Secondary Guarantee Period

29. General

a. Policies with a secondary guarantee include:

i. A policy with a guarantee that the policy will remain in force at the original
schedule of benefits, subject only to the payment of specified premiums;

ii. A policy in which the minimum premium at any duration is less than the
corresponding one year valuation premium, calculated using the maximum
valuation interest rate and the 1980 CSO valuation tables with or without ten-
year select mortality factors, or any other table adopted after the effective date of
this appendix by the NAIC for this purpose; or

iii. A policy with any combination of Subparagraph i. and ii.

Drafting Note: Universal life and variable universal life policies with secondary guarantees that meet the
requirements of paragraph 3a.ii. are not subject to this appendix.

b. A secondary guarantee period is the period for which the policy is guaranteed to remain
in force subject only to a secondary guarantee. When a policy contains more than one
secondary guarantee, the minimum reserve shall be the greatest of the respective
minimum reserves at that valuation date of each unexpired secondary guarantee, ignoring
all other secondary guarantees. Secondary guarantees that are unilaterally changed by the
Valuation of Life Insurance Policies

insurer after issue shall be considered to have been made at issue. Reserves described in paragraphs 30 and 31 below shall be recalculated from issue to reflect these changes.

c. Specified premiums mean the premiums specified in the policy, the payment of which guarantees that the policy will remain in force at the original schedule of benefits, but which otherwise would be insufficient to keep the policy in force in the absence of the guarantee if maximum mortality and expense charges and minimum interest credits were made and any applicable surrender charges were assessed.

d. For purposes of this paragraph, the minimum premium for any policy year is the premium that, when paid into a policy with a zero account value at the beginning of the policy year, produces a zero account value at the end of the policy year. The minimum premium calculation shall use the policy cost factors (including mortality charges, loads and expense charges) and the interest crediting rate, which are all guaranteed at issue.

e. The one-year valuation premium means the net one-year premium based upon the original schedule of benefits for a given policy year. The one-year valuation premiums for all policy years are calculated at issue. The select mortality factors defined in paragraphs 17b., 17c. and 17d. may not be used to calculate the one-year valuation premiums.

f. The one-year valuation premium should reflect the frequency of fund processing, as well as the distribution of deaths assumption employed in the calculation of the monthly mortality charges to the fund.

30. Basic Reserves for the Secondary Guarantees. Basic reserves for the secondary guarantees shall be the segmented reserves for the secondary guarantee period. In calculating the segments and the segmented reserves, the gross premiums shall be set equal to the specified premiums, if any, or otherwise to the minimum premiums, that keep the policy in force and the segments will be determined according to the contract segmentation method as defined in paragraph 5.

31. Deficiency Reserves for the Secondary Guarantees. Deficiency reserves, if any, for the secondary guarantees shall be calculated for the secondary guarantee period in the same manner as described in paragraph 22 with gross premiums set equal to the specified premiums, if any, or otherwise to the minimum premiums that keep the policy in force.

32. Minimum Reserves. The minimum reserves during the secondary guarantee period are the greater of:

a. The basic reserves for the secondary guarantee plus the deficiency reserve, if any, for the secondary guarantees; or

b. The minimum reserves required by other appendices governing universal life plans.
Attachment 1

SELECT MORTALITY FACTORS

This Attachment contains tables of select mortality factors that are the bases to which the respective percentage of paragraphs 16b., 17b. and 17c. are applied.

The six tables of select mortality factors contained herein include: (1) male aggregate, (2) male nonsmoker, (3) male smoker, (4) female aggregate, (5) female nonsmoker, and (6) female smoker.

These tables apply to both age last birthday and age nearest birthday mortality tables.

For sex-blended mortality tables, compute select mortality factors in the same proportion as the underlying mortality. For example, for the 1980 CSO-B Table, the calculated select mortality factors are eighty percent (80%) of the appropriate male table in this Attachment, plus twenty percent (20%) of the appropriate female table in this Attachment.
### SELECT MORTALITY FACTORS

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### Male, Aggregate

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|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|
| 66  | 22  | 30  | 39  | 45  | 60  | 65  | 70  | 70  | 70  | 70  | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 67  | 22  | 30  | 39  | 60  | 60  | 65  | 70  | 70  | 70  | 70  | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 68  | 23  | 32  | 55  | 60  | 60  | 65  | 70  | 70  | 70  | 70  | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 69  | 23  | 52  | 55  | 60  | 60  | 65  | 70  | 70  | 70  | 70  | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 70  | 48  | 52  | 55  | 60  | 60  | 65  | 70  | 70  | 70  | 70  | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 71  | 48  | 52  | 55  | 60  | 60  | 65  | 70  | 70  | 70  | 70  | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 72  | 48  | 52  | 55  | 60  | 60  | 65  | 70  | 70  | 70  | 70  | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 73  | 48  | 52  | 55  | 60  | 60  | 65  | 70  | 70  | 70  | 70  | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 74  | 48  | 52  | 55  | 60  | 60  | 65  | 70  | 70  | 70  | 70  | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 75  | 48  | 52  | 55  | 60  | 60  | 65  | 70  | 70  | 70  | 70  | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 76  | 48  | 52  | 55  | 60  | 60  | 65  | 70  | 70  | 70  | 70  | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 77  | 48  | 52  | 55  | 60  | 60  | 65  | 70  | 70  | 70  | 70  | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 78  | 48  | 52  | 55  | 60  | 60  | 65  | 70  | 70  | 70  | 70  | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 79  | 48  | 52  | 55  | 60  | 60  | 65  | 70  | 70  | 70  | 70  | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 80  | 48  | 52  | 55  | 60  | 60  | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 81  | 48  | 52  | 55  | 60  | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 82  | 48  | 52  | 55  | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 83  | 48  | 52  | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 84  | 48  | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 85+ | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |</p>
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| 41    | 40  | 49  | 63  | 68  | 71  | 72  | 72  | 73  | 75  | 76  | 78  | 81  | 84  | 85  | 88  | 91  | 94  | 97  | 100 |
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| 45    | 37  | 50  | 60  | 66  | 68  | 68  | 68  | 67  | 67  | 69  | 73  | 78  | 81  | 85  | 88  | 91  | 94  | 97  | 100 |
| 46    | 37  | 48  | 58  | 63  | 65  | 67  | 66  | 66  | 66  | 71  | 74  | 78  | 81  | 84  | 87  | 90  | 94  | 97  | 100 |
| 47    | 36  | 47  | 55  | 61  | 63  | 64  | 64  | 64  | 65  | 71  | 75  | 79  | 81  | 84  | 87  | 90  | 94  | 97  | 100 |
| 48    | 35  | 46  | 53  | 58  | 60  | 62  | 63  | 63  | 65  | 72  | 75  | 79  | 81  | 84  | 87  | 90  | 94  | 97  | 100 |
| 49    | 34  | 45  | 51  | 56  | 58  | 59  | 61  | 62  | 63  | 67  | 72  | 77  | 80  | 81  | 83  | 86  | 90  | 93  | 97  |
| 50    | 34  | 43  | 49  | 53  | 55  | 57  | 60  | 61  | 63  | 67  | 73  | 78  | 80  | 81  | 85  | 89  | 94  | 97  | 100 |
| 51    | 32  | 42  | 47  | 52  | 55  | 57  | 60  | 61  | 63  | 67  | 73  | 78  | 80  | 83  | 84  | 87  | 90  | 94  | 97  |
| 52    | 32  | 40  | 46  | 50  | 54  | 56  | 60  | 61  | 63  | 67  | 73  | 78  | 81  | 84  | 85  | 88  | 91  | 94  | 100 |
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| 55    | 29  | 35  | 42  | 47  | 53  | 55  | 59  | 61  | 63  | 67  | 75  | 80  | 84  | 86  | 90  | 100  |
| 56    | 28  | 35  | 42  | 47  | 53  | 55  | 57  | 60  | 63  | 68  | 74  | 79  | 83  | 85  | 100  |
| 57    | 28  | 35  | 42  | 47  | 53  | 54  | 57  | 60  | 64  | 67  | 74  | 78  | 81  | 100  |
| 58    | 26  | 33  | 43  | 48  | 53  | 54  | 56  | 59  | 63  | 67  | 73  | 78  | 100  |
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### Female, Aggregate

| Issue | 1   | 2   | 3   | 4   | 5   | 6   | 7   | 8   | 9   | 10  | 11  | 12  | 13  | 14  | 15  | 16  | 17  | 18  | 19  | 20+ |
|-------|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|
| 71    | 60  | 60  | 64  | 68  | 68  | 72  | 75  | 75  | 80  | 80  | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 72    | 60  | 60  | 64  | 68  | 68  | 72  | 75  | 75  | 80  | 80  | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 73    | 60  | 60  | 64  | 68  | 68  | 72  | 75  | 75  | 80  | 80  | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 74    | 60  | 60  | 64  | 68  | 68  | 72  | 75  | 75  | 80  | 80  | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 75    | 60  | 60  | 64  | 68  | 68  | 72  | 75  | 75  | 80  | 80  | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 76    | 60  | 60  | 64  | 68  | 68  | 72  | 75  | 75  | 80  | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 77    | 60  | 60  | 64  | 68  | 68  | 72  | 75  | 75  | 80  | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 78    | 60  | 60  | 64  | 68  | 68  | 72  | 75  | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 79    | 60  | 60  | 64  | 68  | 68  | 72  | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 80    | 60  | 60  | 64  | 68  | 68  | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 81    | 60  | 60  | 64  | 68  | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 82    | 60  | 60  | 64  | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 83    | 60  | 60  | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 84    | 60  | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 85+   | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
## Female, Non-Smoker

### Issue Duration

| Age | 1   | 2   | 3   | 4   | 5   | 6   | 7   | 8   | 9   | 10  | 11  | 12  | 13  | 14  | 15  | 16  | 17  | 18  | 19  | 20+ |
|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|
|     | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | 100 |
| 16  |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |
| 17  | 96  | 98  | 98  | 98  | 96  | 96  | 96  | 96  | 96  | 96  | 96  | 96  | 96  | 96  | 96  | 96  | 96  | 96  | 96  | 96  |
| 18  |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |     |
| 19  | 60  | 62  | 63  | 63  | 65  | 65  | 65  | 65  | 65  | 65  | 65  | 65  | 65  | 65  | 65  | 65  | 65  | 65  | 65  | 65  |
| 20  | 42  | 44  | 45  | 45  | 42  | 42  | 42  | 42  | 42  | 42  | 42  | 42  | 42  | 42  | 42  | 42  | 42  | 42  | 42  | 42  |
| 21  | 41  | 42  | 44  | 45  | 41  | 42  | 42  | 42  | 42  | 42  | 42  | 42  | 42  | 42  | 42  | 42  | 42  | 42  | 42  | 42  |
| 22  | 39  | 41  | 41  | 41  | 41  | 41  | 41  | 41  | 41  | 41  | 41  | 41  | 41  | 41  | 41  | 41  | 41  | 41  | 41  | 41  |
| 23  | 38  | 41  | 40  | 40  | 41  | 42  | 42  | 42  | 42  | 42  | 42  | 42  | 42  | 42  | 42  | 42  | 42  | 42  | 42  | 42  |
| 24  | 36  | 38  | 40  | 40  | 41  | 42  | 42  | 42  | 42  | 42  | 42  | 42  | 42  | 42  | 42  | 42  | 42  | 42  | 42  | 42  |
| 25  | 32  | 34  | 37  | 37  | 38  | 40  | 40  | 40  | 40  | 40  | 40  | 40  | 40  | 40  | 40  | 40  | 40  | 40  | 40  | 40  |
| 26  | 32  | 34  | 37  | 41  | 43  | 45  | 47  | 50  | 53  | 53  | 60  | 62  | 63  | 64  | 64  | 64  | 64  | 64  | 64  | 64  |
| 27  | 32  | 34  | 38  | 43  | 46  | 47  | 49  | 51  | 53  | 55  | 62  | 63  | 64  | 64  | 64  | 64  | 64  | 64  | 64  | 64  |
| 28  | 30  | 34  | 39  | 43  | 47  | 49  | 51  | 53  | 56  | 58  | 63  | 63  | 64  | 64  | 64  | 64  | 64  | 64  | 64  | 64  |
| 29  | 30  | 35  | 40  | 45  | 50  | 51  | 52  | 55  | 58  | 59  | 64  | 61  | 62  | 63  | 63  | 63  | 63  | 63  | 63  | 63  |
| 30  | 31  | 35  | 40  | 46  | 51  | 52  | 53  | 56  | 59  | 60  | 62  | 62  | 63  | 63  | 63  | 63  | 63  | 63  | 63  | 63  |
| 31  | 31  | 35  | 40  | 46  | 51  | 53  | 55  | 58  | 60  | 60  | 62  | 63  | 63  | 63  | 63  | 63  | 63  | 63  | 63  | 63  |
| 32  | 32  | 35  | 40  | 45  | 51  | 53  | 56  | 59  | 57  | 57  | 62  | 63  | 63  | 63  | 63  | 63  | 63  | 63  | 63  | 63  |
| 33  | 32  | 36  | 41  | 47  | 52  | 55  | 58  | 55  | 58  | 59  | 63  | 63  | 63  | 63  | 63  | 63  | 63  | 63  | 63  | 63  |
| 34  | 33  | 36  | 41  | 47  | 52  | 55  | 55  | 57  | 58  | 59  | 63  | 65  | 64  | 64  | 64  | 64  | 64  | 64  | 64  | 64  |
| 35  | 33  | 36  | 41  | 47  | 52  | 53  | 57  | 58  | 59  | 61  | 63  | 64  | 64  | 64  | 64  | 64  | 64  | 64  | 64  | 64  |
| 36  | 33  | 36  | 41  | 47  | 49  | 53  | 57  | 59  | 59  | 61  | 63  | 64  | 64  | 64  | 64  | 64  | 64  | 64  | 64  | 64  |
| 38  | 32  | 37  | 39  | 45  | 50  | 54  | 57  | 58  | 60  | 60  | 61  | 61  | 61  | 61  | 61  | 61  | 61  | 61  | 61  | 61  |
| 39  | 30  | 35  | 39  | 45  | 50  | 54  | 57  | 58  | 60  | 60  | 60  | 60  | 60  | 60  | 60  | 60  | 60  | 60  | 60  | 60  |
| 40  | 28  | 35  | 39  | 45  | 50  | 54  | 56  | 57  | 59  | 59  | 60  | 60  | 60  | 60  | 60  | 60  | 60  | 60  | 60  | 60  |
| Issue | 1   | 2   | 3   | 4   | 5   | 6   | 7   | 8   | 9   | 10  | 11  | 12  | 13  | 14  | 15  | 16  | 17  | 18  | 19  | 20+ |
|-------|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|-----|
| 41    | 28  | 35  | 39  | 45  | 49  | 52  | 55  | 55  | 58  | 57  | 58  | 59  | 59  | 60  | 68  | 76  | 84  | 92  | 100 |
| 42    | 27  | 35  | 39  | 44  | 49  | 52  | 54  | 55  | 56  | 57  | 57  | 57  | 58  | 60  | 61  | 69  | 77  | 84  | 92  | 100 |
| 43    | 27  | 34  | 39  | 44  | 47  | 50  | 53  | 53  | 55  | 55  | 56  | 57  | 56  | 60  | 61  | 69  | 77  | 84  | 92  | 100 |
| 44    | 26  | 34  | 38  | 42  | 47  | 50  | 52  | 53  | 54  | 55  | 55  | 56  | 56  | 61  | 62  | 70  | 77  | 85  | 92  | 100 |
| 45    | 26  | 33  | 38  | 42  | 45  | 48  | 51  | 51  | 52  | 53  | 54  | 55  | 56  | 61  | 62  | 70  | 77  | 85  | 92  | 100 |
| 46    | 24  | 32  | 37  | 40  | 43  | 47  | 49  | 51  | 52  | 53  | 54  | 55  | 56  | 60  | 61  | 69  | 77  | 84  | 92  | 100 |
| 47    | 24  | 30  | 35  | 39  | 42  | 45  | 47  | 49  | 51  | 53  | 54  | 55  | 56  | 59  | 60  | 68  | 76  | 84  | 92  | 100 |
| 48    | 23  | 30  | 35  | 37  | 40  | 44  | 47  | 49  | 50  | 53  | 54  | 55  | 55  | 59  | 57  | 66  | 74  | 83  | 91  | 100 |
| 49    | 23  | 29  | 33  | 35  | 39  | 42  | 45  | 48  | 50  | 53  | 54  | 55  | 55  | 57  | 56  | 65  | 74  | 82  | 91  | 100 |
| 50    | 21  | 27  | 32  | 34  | 37  | 41  | 44  | 48  | 50  | 53  | 54  | 55  | 56  | 56  | 55  | 64  | 73  | 82  | 91  | 100 |
| 51    | 21  | 26  | 30  | 34  | 37  | 41  | 44  | 48  | 49  | 51  | 53  | 53  | 54  | 55  | 55  | 64  | 73  | 82  | 91  | 100 |
| 52    | 20  | 25  | 30  | 33  | 37  | 41  | 44  | 47  | 48  | 50  | 50  | 51  | 51  | 55  | 53  | 62  | 72  | 81  | 100 |
| 53    | 19  | 24  | 29  | 32  | 37  | 41  | 43  | 47  | 48  | 48  | 49  | 49  | 51  | 52  | 52  | 62  | 71  | 100 |
| 54    | 18  | 24  | 29  | 32  | 37  | 41  | 43  | 45  | 47  | 47  | 47  | 49  | 49  | 51  | 51  | 61  | 100 |
| 55    | 18  | 23  | 28  | 32  | 37  | 41  | 43  | 45  | 45  | 45  | 46  | 46  | 47  | 50  | 50  | 100 |
| 56    | 18  | 23  | 28  | 32  | 36  | 39  | 42  | 44  | 44  | 45  | 46  | 46  | 46  | 49  | 100 |
| 57    | 18  | 23  | 28  | 31  | 37  | 38  | 41  | 42  | 44  | 44  | 45  | 45  | 46  | 100 |
| 58    | 17  | 23  | 26  | 31  | 35  | 36  | 38  | 41  | 41  | 42  | 45  | 45  | 100 |
| 59    | 17  | 23  | 26  | 30  | 33  | 35  | 38  | 39  | 40  | 41  | 44  | 100 |
| 60    | 17  | 23  | 26  | 30  | 32  | 34  | 36  | 38  | 39  | 40  | 100 |
| 61    | 17  | 22  | 25  | 29  | 32  | 33  | 35  | 36  | 38  | 80  | 100 |
| 62    | 16  | 22  | 25  | 28  | 30  | 32  | 34  | 35  | 80  | 80  | 100 |
| 63    | 16  | 20  | 24  | 28  | 30  | 32  | 34  | 80  | 80  | 100 |
| 64    | 14  | 21  | 24  | 27  | 29  | 30  | 80  | 80  | 80  | 100 |
| 65    | 15  | 19  | 23  | 25  | 28  | 72  | 75  | 75  | 80  | 80  | 100 |

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Appendix B
Interpretations of the Emerging Accounting Issues Working Group

Introduction

The NAIC Emerging Accounting Issues Working Group (EAIWG) is responsible for responding to Statutory Accounting Principle (SAP) questions that generally relate to application, interpretation and clarification.

The NAIC Statutory Accounting Principles Working Group (SAPWG) addressed all Generally Accepted Accounting Principle (GAAP) pronouncements included in categories a, b and c of the Statutory Hierarchy issued through 1996 during the initial drafting of the SSAPs. As documented in the Policy Statement on the Maintenance of Statutory Accounting Principles (included in Appendix F), the SAPWG will continue to review new GAAP guidance for applicability to SAP. Beginning January 1, 1999, the NAIC EAIWG has addressed the EITF opinions issued subsequent to 1996.

Appendix B includes the final interpretations of the EAIWG through December 7, 2003.

Reporting entities should note that the interpretations are generally effective when finalized by the NAIC EAIWG. This Manual may not include all of the interpretations currently in effect due to the fact that it is printed annually. A current listing of NAIC EAIWG issues is maintained at and updated quarterly at www.naic.org.

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Interpretation of the Emerging Accounting Issues Working Group

INT 99-01: Accounting for Tax Benefits of Operating Losses and Tax Credits in Quasi-Reorganizations

INT 99-01 Dates Discussed
December 7, 1998; March 8, 1999

INT 99-01 References
SSAP No. 72—Surplus and Quasi-reorganizations (SSAP No. 72)

INT 99-01 Issue
1. SSAP No. 72 provides for quasi-reorganization accounting for insurers under certain limited circumstances. Quasi-reorganization accounting allows an insurer to increase and restate its unassigned funds deficit to $0 with a like decrease to gross paid-in and contributed surplus. Quasi-reorganization accounting essentially allows for a “fresh start” for unassigned funds from the date of restatement. However, the SSAP is silent with regard how the tax benefits of operating losses or other tax credits which existed as of the date of the quasi-reorganization should be accounted for when such benefits or credits are subsequently realized.

2. Should the tax benefits of operating losses or tax credits existing at the date of a quasi-reorganization and subsequently recognized after the quasi-reorganization be recognized as income or an adjustment to gross paid-in and contributed surplus? Existing GAAP and SEC literature would suggest that subsequently recognized benefits not be recognized as income, but rather as an adjustment to contributed surplus.

INT 99-01 Discussion
3. The working group reached a consensus that the tax benefits of operating losses or tax credits existing at the date of a quasi-reorganization and subsequently recognized after the quasi-reorganization be recognized as an adjustment to gross paid-in and contributed surplus.

INT 99-01 Status
4. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 99-02: Accounting for Collateral in Excess of Debt Principal

INT 99-02 Date Discussed

December 7, 1998; March 8, 1999

INT 99-02 References

SSAP No. 18—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (SSAP No. 18)

INT 99-02 Issue

1. Insurers who borrow from Federal Home Loan Banks (“FHLB”) are required to pledge assets in excess of the principal amounts they borrow (while this issue emanates from reviewing a FHLB loan to an insurer, the same issue arises with regard to an over-collateralized loan to any reporting entity). Insurers must deposit assets pledged to secure FHLB loans with the lending FHLB, and do not have the ability to withdraw the requisite excess collateral unless the loan is repaid.

2. If an insurer (reporting entity) is required to secure a borrowing with assets/collateral in excess of the principal amount of the loan received, should that excess collateral be considered a non-admitted asset?

3. There does not appear to be any guidance on this issue in the current Accounting Practice and Procedure Manual. SSAP No. 18, paragraph 10 provides guidance on accounting for collateralized loans, but does not address excess collateralization.

INT 99-02 Discussion

4. The working group was unable to reach a consensus as to either to disclose the excess collateral in the notes to the financial statements or nonadmit the asset.

INT 99-02 Status

5. As the working group was unable to reach a consensus, this issue will be referred to the Accounting Practices and Procedures Task Force for appointment to the Codification of Statutory Accounting Principles Working Group and further discussion.
Interpretation of the Emerging Accounting Issues Working Group

INT 99-03: Accounting for Investment in Subsidiary, Controlled or Affiliated (SCA) Entities with Subsequent Downstream Investment in an Insurance Company

INT 99-03 Dates Discussed

December 7, 1998; March 8, 1999

INT 99-03 References

SSAP No. 46—Investments in Subsidiary, Controlled, and Affiliated Entities (SSAP No. 46)

INT 99-03 Issue

1. SSAP No. 46 defines the accounting for investments in SCAs by classifying them into three broad categories; 1) insurance SCAs, 2) noninsurance SCA entities that have no significant ongoing operations other than to hold assets that are primarily for the direct or indirect benefit or use of the reporting entity or its affiliates, and 3) noninsurance SCA entities that have significant ongoing operations beyond the holding of assets that are primarily for the direct or indirect benefit or use of the reporting entity or its affiliates. If the equity method of accounting is used, category (1) and (2) SCAs receive statutory equity accounting whereas category (3) SCAs receive audited GAAP equity accounting. An investment in an entity that in turn owns one or more insurance companies and noninsurance company’s meets the definition of outlined in both category (1) and (3) SCAs.

2. Is an investment in an entity that in turn owns one or more insurance companies and noninsurance companies meet the definition of an insurance SCA or a noninsurance SCA that has significant ongoing operations beyond the holding of assets that are primarily for the direct or indirect benefit or use of the reporting entity or its affiliates?

INT 99-03 Discussion

3. The working group reached a consensus to clarify that the definition of an insurance SCA would apply to any entity that included an insurance company with its reporting or holding company structure.

INT 99-03 Status

4. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 99-04: Recognition of Prepayment Penalties Upon Adoption of Codification

INT 99-04 Dates Discussed

December 7, 1998; March 8, 1999

INT 99-04 References

SSAP No. 37—Mortgage Loans (SSAP No. 37)

INT 99-04 Issue

1. SSAP No. 37 requires insurers to report a prepayment penalty or acceleration fee as investment income when received. Currently, some insurers record these fees as realized gains and thus amortize them through IMR. SSAP No. 37 also stipulates a change resulting from the adoption of the statement be accounted for as a change in accounting principle. Upon adoption of Codification, it is probable that some insurers might continue to amortize the existing gain included in IMR and recognize subsequent fees as investment income.

2. Should an insurer release all unamortized amounts included in IMR and related to prepayment penalties upon adoption of Codification and recognize such change in accordance with SSAP No. 3 - Accounting Changes and Corrections of Errors (SSAP No. 3)?

INT 99-04 Discussion

3. The working group reached a consensus to instruct insurer’s to release all unamortized amounts included in IMR related to prepayment penalties upon adoption of Codification and recognize such change in accordance with SSAP No. 3.

INT 99-04 Status

4. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 99-05: EITF 97-1 Implementation Issues in Accounting for Lease Transactions, Including Those Involving Special-Purpose Entities

INT 99-05 Dates Discussed
March 8, 1999; June 7, 1999

INT 99-05 References
SSAP No. 22—Leases (SSAP No. 22)
SSAP No. 19—Furniture, Fixtures and Equipment; Leasehold Improvements Paid by the Reporting Entity as Lessee; Depreciation of Property and Amortization of Leasehold Improvements (SSAP No. 19)

INT 99-05 Issue
1. For GAAP purposes, leases shall be classified as either operating or capital. The accounting for both the lessee and the lessor is dependent upon this classification. For statutory purposes, SSAP No. 22 requires insurers to account for all leases, except leveraged leases, as operating leases. The SSAP provides specific guidance for leveraged leases; however, the accounting is not based upon the classification of a lease as either capital or operating. EITF 97-1, Implementation Issues in Accounting for Lease Transactions, Including Those Involving Special-Purpose Entities (EITF 97-1), requires an entity to consider specific situations in determining its classification of a lease as either operating or capital.

2. SSAP No. 19 provides specific depreciation requirements for property.

INT 99-05 Discussion
3. The working group reached a consensus that EITF 97-1 is not applicable to statutory accounting. Therefore, there is no condition to require that a lessee consider environmental risk and non-performance-related default covenants in determining the classification of a lease for SSAP No. 22.

4. There is also no condition to require that depreciation be calculated in a different manner when an SPE as a lessee has retained the expected substantive residual risks and substantially all of the residual rewards of the leased asset and, therefore, condition (2) of EITF 90-15 exists.

INT 99-05 Status
5. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 99-06: EITF 97-2 Application of FASB Statement No. 94 and APB Opinion No. 16 to Physician Practice Management Entities and Certain Other Entities with Contractual Management Arrangements

INT 99-06 Dates Discussed

March 8, 1999; June 7, 1999

INT 99-06 References

SSAP No. 3—Accounting Changes and Corrections of Errors (SSAP No. 3)
SSAP No. 13—Stock Options and Stock Purchase Plans (SSAP No. 13)

INT 99-06 Issue

1. For GAAP purposes, some entities are required to present their financial statements on a consolidated basis. The primary GAAP guidance in this area is located within FASB Statement No. 94, Consolidation of All Majority-Owned Subsidiaries, an amendment of ARB 51, with related amendments of APB No. 18 and ARB No. 43, Chapter 12 (FASB No. 94). For statutory purposes, SSAP No. 3 provides that the statutory financial statements of a reporting entity should not be consolidated and rejects FASB Statement No. 94 in its entirety. EITF 97-2 Application of FASB Statement No. 94 and APB Opinion No. 16 to Physician Practice Management Entities and Certain Other Entities with Contractual Management Arrangements (EITF 97-2) provides specific situations when certain entities should be included in the consolidated financial statements of a company.

2. For GAAP purposes, goodwill is based upon the excess of the purchase price over the total of 1) the net book value of a company and 2) the excess of the fair market value of identifiable assets over their carrying value. The primary GAAP guidance in this area is located in Accounting Principles Board Opinion (APB) No. 16, Business Combinations (APB No. 16). For statutory purposes, SSAP No. 68—Business Combinations and Goodwill rejects this approach of determining goodwill and provides that statutory goodwill does not consider the excess of fair market value of identifiable assets over their carrying value, as provided for in APB No. 16. EITF 97-2 provides specific intangible assets that should be included in the calculation of goodwill for certain entities.

3. For statutory purposes, stock based compensation plans are addressed in SSAP No. 13. The term employee is used throughout the statement but is not defined.

INT 99-06 Discussion

4. The working group reached a consensus that EITF 97-2 is not applicable to statutory accounting. Therefore there is no condition to provide consolidation guidance for physician practice management entities.

5. There is no condition to require that common types of intangibles be considered when performing the purchase price allocation under the purchase method of accounting.
6. There is no condition that an employee of a physician practice that is consolidated by the PPM be considered an employee of the PPM for purposes of determining the appropriate method of accounting for that employee's stock-based compensation.

INT 99-06 Status

7. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 99-07: EITF 97-3 Accounting for Fees and Costs Associated with Loan Syndications and Loan Participations after the Issuance of FASB Statement No. 125

INT 99-07 Dates Discussed
March 8, 1999; June 7, 1999

INT 99-07 References
SSAP No. 18—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (SSAP No. 18)

INT 99-07 Issue
1. SSAP No. 18 provides that if certain conditions are met, loan syndications and loan participations should be accounted for as transfers of financial assets.

2. EITF 97-3 provides that loan syndications be accounted for in accordance with FASB 91 Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases (FAS 91). Additionally, EITF 97-3 provides that loan participations be accounted for as a transfer of financial assets.

INT 99-07 Discussion
3. The working group reached a consensus to reject EITF 97-3. Therefore there is no condition to provide that loan syndications be accounted for in accordance with FASB 91.

4. There is no condition to provide that loan participations be accounted for as a transfer of financial assets.

INT 99-07 Status
5. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 99-08: EITF 97-6 Application of Issue No. 96-20 to Qualifying Special-Purpose Entities Receiving Transferred Financial Assets Prior to the Effective Date of FASB Statement No. 125

INT 99-08 Dates Discussed

March 8, 1999; June 7, 1999

INT 99-08 References

SSAP No. 3—Accounting Changes and Corrections of Errors (SSAP No. 3)
SSAP No. 18—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (SSAP No. 18)

INT 99-08 Issue

1. For statutory purposes, SSAP No. 18 rejects EITF 96-20, Impact of FASB Statement 125 on consolidation of Special-Purpose Entities (EITF 96-20). EITF 96-20 provides guidance on determining when a special purpose entity (SPE) should be consolidated in the financial statements of a company. SSAP No. 3 provides that the statutory financial statements of a reporting entity should not be consolidated. The primary GAAP guidance for consolidations is located within FASB Statement No. 94, Consolidation of All Majority-Owned Subsidiaries, an amendment of ARB 51, with related amendments of APB No. 18 and ARB No. 43, Chapter 12, which is rejected in SSAP 3. EITF 97-6, Application of Issue No. 96-20 to Qualifying Special-Purpose Entities Receiving Transferred Financial Assets Prior to the Effective Date of FASB Statement No. 125 (EITF 97-6), provides for a change in the transition rules for consolidation of an SPE.

INT 99-08 Discussion

2. The working group reached a consensus that EITF 97-6 is not applicable to statutory accounting. Therefore there is no condition to allow the transition rules for consolidation of an SPE in EITF 96-20 to be changed.

INT 99-08 Status

3. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 99-09: EITF 97-7 Accounting for Hedges of the Foreign Currency Risk Inherent in an Available-for-Sale Marketable Equity Security

INT 99-09 Dates Discussed

March 8, 1999; June 7, 1999

INT 99-09 References

SSAP No. 30—Investments in Common Stock (excluding investments in common stock of subsidiary, controlled, or affiliated entities) (SSAP No. 30)
SSAP No. 32—Investments in Preferred Stock (excluding investments in preferred stock of subsidiary, controlled, or affiliated entities) (SSAP No. 32)

INT 99-09 Issue

1. For GAAP purposes, FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities, (FAS 115) requires that all investments in debt and equity securities be classified as either trading, held to maturity or available for sale (AFS). More specifically, FAS 115 specifically requires accounting changes in the fair value of AFS marketable equity securities to be reported in a separate component of stockholders’ equity until realized. The classification of equity securities as trading, held to maturity or available sale, and related accounting treatment, was rejected in full in SSAP No. 30 and SSAP No 32.

2. EITF 97-7, Accounting for Hedges of the Foreign Currency Risk Inherent in an Available-for-Sale Marketable Equity Security (EITF 97-7) provides that an AFS marketable equity securities that includes changes in fair value resulting from changes in the exchange rate between the foreign currency and the investor’s functional currency should be included in the separate FAS 115 component of stockholders’ equity.

3. For statutory purposes, changes in common and preferred stock values due to fluctuations in foreign currency exchange rates are recorded as unrealized capital gains and losses as required by SSAP No 23—Foreign Currency Transactions and Translations (SSAP No. 23).

INT 99-09 Discussion

4. The working group reached a consensus that EITF 97-7 is not applicable to statutory accounting. Therefore, there is no condition to provide that foreign currency transaction gains or losses on a foreign currency forward exchange contract or foreign-currency-denominated liability that are included in the changes in the fair value of an AFS security be reported in the FAS 115 separate component of stockholders’ equity.

INT 99-09 Status

5. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 99-10: EITF 97-8 Accounting for Contingent Consideration Issued in a Purchase Business Combination

INT 99-10 Dates Discussed
March 8, 1999; June 7, 1999

INT 99-10 References
SSAP No. 68—Business Combinations and Goodwill (SSAP No. 68)

INT 99-10 Issue
1. EITF 97-8 provides that a contingent security or separate financial instrument should be recorded by the issuer at fair value at the date of acquisition (as part of the cost of the business acquired).

2. For statutory purposes, SSAP No. 68 requires the acquiring reporting entity to record its investment at cost where cost includes the fair value of all assets distributed. However, the determination of the fair value of the assets is not specifically addressed within this SSAP, but it is presumed that the fair value would be based upon the requirements of the applicable SSAP that addresses the specific asset, including derivatives, as discussed in SSAP No. 31 - Derivative Instruments. Additionally, SSAP No. 68 defines the difference between the cost of acquiring the entity and the reporting entity’s share of the book value as goodwill.

INT 99-10 Discussion
3. The working group reached a consensus that EITF 97-8 should be adopted to provide that contingent consideration issued in a purchase business combination that is embedded in a security or that is in the form of a separate financial instrument be recorded by the issuer at fair value at the acquisition date.

INT 99-10 Status
4. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 99-11: EITF 95-22 Balance Sheet Classification of Borrowings Outstanding under Revolving Credit Agreements That Include both a Subjective Acceleration Clause and a Lock-Box Arrangement

INT 99-11 Date Discussed

June 7, 1999; October 4, 1999

INT 99-11 References

None

INT 99-11 Issue

1. For GAAP purposes, balance sheet items are classified as either short term or long term. For statutory purposes, a classified balance sheet is not required. EITF 95-22, *Balance Sheet Classification of Borrowings Outstanding under Revolving Credit Agreements That Include both a Subjective Acceleration Clause and a Lock-Box Arrangement* (EITF 95-22), provides classification guidance for specific types of revolving credit agreements.

2. EITF 95-22 was determined to be not applicable during the base portion of Codification but the EITF subsequently modified its position regarding this issue on November 19, 1998. Because the guidance was modified, the Emerging Accounting Issues Working Group is forced to readdress the issue.

INT 99-11 Discussion

3. The working group reached a consensus that EITF 95-22 is not applicable to statutory accounting. Therefore, there is no condition to require that certain borrowings outstanding under a revolving credit agreement be considered short-term, rather than long-term, obligations.

INT 99-11 Status

4. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 99-12: EITF 96-16: Investor’s Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights

INT 99-12 Date Discussed

June 7, 1999; October 4, 1999

INT 99-12 References

SSAP No. 3—Accounting Changes and Corrections of Errors (SSAP No. 3)
SSAP No. 46—Investments in Subsidiaries, Controlled, and Affiliated Entities (SSAP No. 46)

INT 99-12 Issue

1. For GAAP purposes, some entities are required to present their financial statements on a consolidated basis. The primary GAAP guidance in this area is located within FASB Statement No. 94, Consolidation of All Majority-Owned Subsidiaries, an amendment of ARB 51, with related amendments of APB No. 18 and ARB No. 43, Chapter 12 (FAS 94). For statutory purposes, SSAP No. 3 provides that the statutory financial statements of a reporting entity should not be consolidated and rejects FAS 94 in its entirety. EITF 96-16, Investor’s Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights, (EITF 96-16) addresses specific situations where shareholders minority rights affect when financial statements should be consolidated.

2. EITF 96-16 was rejected in SSAP No. 46, during the base portion of Codification but the EITF subsequently modified its position regarding this issue on July 23, 1998. Because the guidance was modified, the Emerging Accounting Issues Working Group is forced to readdress the issue.

INT 99-12 Discussion

3. The working group reached a consensus to reject EITF 96-16. Therefore, there is no condition to require that a reporting entity consider the effect that minority shareholders rights have in determining if financial statements should be consolidated.

INT 99-12 Status

4. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 99-13: EITF 96-18: Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services

INT 99-13 Date Discussed

June 7, 1999; October 4, 1999

INT 99-13 References

SSAP No. 13—Stock Options and Stock Purchase Plans (SSAP No. 13)

INT 99-13 Issue

1. For GAAP purposes, SFAS No. 123, Accounting for Stock-Based Compensation, (FAS 123) establishes the measurement principles for transactions in which equity instruments are issued in exchange for the receipt of goods or services. For statutory purposes, FAS 123 was rejected during the base portion of Codification in SSAP No. 13. Also rejected in the base portion of Codification was this EITF 96-18, Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services (EITF 96-18).

2. EITF 96-18 was rejected in SSAP No. 13 during the base portion of Codification but the EITF subsequently modified its conclusion regarding this issue on November 20, 1997. Because the guidance was modified, the Emerging Accounting Issues Working Group is forced to readdress the issue.

INT 99-13 Discussion

3. The working group reached a consensus to reject EITF 96-18. Therefore, there is no condition to require that an issuer should measure the fair value of the equity instruments using the stock price and other measurement assumptions as of the earlier of the commitment for performance date or counterparty’s performance date. Additionally, there is no condition to require that the fair value of the equity instruments be recognized as an asset, expense, or sales discount in the same period(s) and in the same manner (that is, capitalize versus expense) as if the enterprise had paid cash for the goods or services. Nor is there is condition to require that the costs be recognized before the measurement date for equity instruments (using current fair values at the time) where the quantity and terms are known prior to the measurement date. Furthermore, there is no condition to provide how the equity instruments are measured, before and after the measurement date, for transactions where the quantity and terms are based on counterparty performance or market conditions.

INT 99-13 Status

4. No further discussion is planned.
Appendix B

Interpretation of the Emerging Accounting Issues Working Group

INT 99-14: EITF 96-19 Debtor’s Accounting for a Modification or Exchange of Debt Instruments

INT 99-14 Date Discussed

June 7, 1999; October 4, 1999

INT 99-14 References

SSAP No. 18—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (SSAP No. 18)

INT 99-14 Issue

1. For GAAP purposes, prior to the issuance of SFAS No. 125, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (FAS 125), the primary guidance for extinguishment of debt was located within SFAS No. 76, Extinguishment of Debt (FAS 76). However, when FAS 125 was issued, it superseded FAS 76 and caused some confusion in the accounting for some transactions where debt is extinguished through an exchange. EITF 96-19, Debtor’s Accounting for a Modification or Exchange of Debt Instruments (EITF 96-19) provides guidance for the application of FAS 125 as it relates to exchanges of debt instruments.

2. EITF 96-19 was adopted in the base portion of Codification, along with FAS 125, in SSAP No. 18. At the time of its adoption, only one conclusion had been reached (Issue 1) on the below accounting issues, and it was a tentative conclusion. EITF 96-19 should now be considered for the consensus positions that have been adopted by the EITF on this matter.

INT 99-14 Discussion

3. The working group reached a consensus to adopt EITF 96-19. Therefore, an exchange of debt instruments with substantially different terms is a debt extinguishment and should be accounted for in accordance with paragraph 11 of SSAP No. 18.

4. Furthermore, a debtor’s exchange of debt instruments (in a nontroubled debt situation) is accomplished with debt instruments that are substantially different if the present value of the cash flows under the terms of the new debt instrument is at least 10 percent different from the present value of the remaining cash flows under the terms of the original instrument.

INT 99-14 Status

5. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 99-15: EITF 97-10 The Effect of Lessee Involvement in Asset Construction

INT 99-15 Date Discussed

June 7, 1999; October 4, 1999

INT 99-15 References

SSAP No. 22—Leases (SSAP No. 22)
SSAP No. 40—Real Estate Investments (SSAP No. 40)
SSAP No. 38—Acquisition, Development and Construction Arrangements (SSAP No. 38)
SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies (SSAP No. 48)

INT 99-15 Issue

1. In some cases, a lessee may be substantially involved in the construction of an asset prior to its completion. The involvement raises questions concerning the lessees accounting prior to the assets completion. EITF 97-10, The Effect of Lessee Involvement in Asset Construction (EITF 97-10), provides specific guidance in determining if the lessee should be considered the owner during this construction period and later subject to sale leaseback accounting requirements. The involvement may vary from agreement to agreement. For statutory purposes, sale-leaseback transactions are accounted for in accordance with SSAP No. 22, but this issue is not addressed specifically within the statement. SSAP No. 22 provides that when applying sale-leaseback accounting, the sale, and gains or losses thereon, shall be recognized in accordance with the relevant statutory guidance for the asset being sold.

INT 99-15 Discussion

2. The working group reached a consensus to reject EITF 97-10. Therefore, there is no condition to require when a lessee is considered the owner of a real estate project as discussed in EITF 97-10.

3. Furthermore, there is no condition to require that when a lessee is determined to be an owner of a real estate project, the profit is deferred and amortized to income.

INT 99-15 Status

4. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 99-16: EITF 97-11 Accounting for Internal Costs Relating to Real Estate Property Acquisitions

INT 99-16 Date Discussed
June 7, 1999; October 4, 1999

INT 99-16 References
SSAP No. 40—Real Estate Investments (SSAP No. 40)

INT 99-16 Issue
1. For GAAP purposes, capitalization of costs related to real estate projects are addressed in SFAS No. 67, Accounting for Costs and Initial Rental Operations of Real Estate Projects (FAS 67). For statutory purposes, FAS 67 was adopted in SSAP No. 40. EITF 97-11, Accounting for Internal Costs Relating to Real Estate Property Acquisitions (EITF 97-11), provides guidance for determining when internal preacquisition costs should be capitalized.

INT 99-16 Discussion
2. The working group reached a consensus that EITF 97-11 should be adopted to provide that internal preacquisition costs classified as nonoperating at date of acquisition of a property (that otherwise meet the requirements of paragraph 4 of FAS 67) be capitalized and if the entity subsequently determines that the property be classified as operating at the date of acquisition, such costs should be charged to expense and any additional costs be expensed as incurred.

3. Furthermore, internal preacquisition costs classified as operating at the date of acquisition be expensed as incurred but if the entity subsequently determines that the property be classified as nonoperating at the date of acquisition, such costs should not be capitalized and should be charged to expense.

INT 99-16 Status
4. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 99-17: EITF 97-12 Accounting for Increased Share Authorizations in an IRS Section 423 Employee Stock Purchase Plan under APB Opinion No. 25

INT 99-17 Date Discussed

June 7, 1999; October 4, 1999

INT 99-17 References

SSAP No. 13—Stock Options and Stock Purchase Plans (SSAP No. 13)

INT 99-17 Issue

1. For GAAP purposes, stock purchase plans are accounted for in accordance with the provisions of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, (APB No. 25). EITF 97-12, Accounting for Increased Share Authorizations in an IRS Section 423 Employee Stock Purchase Plan under APB Opinion No. 25, (EITF 97-12), provides an interpretation on the classification (compensatory or noncompensatory) of additional shares granted (above the initial authorization) under a Section 423 plan. For statutory purposes, the APB No. 25 classification requirements of a stock purchase plan were adopted in paragraph 3 of SSAP No. 13.

INT 99-17 Discussion

2. The working group reached a consensus that EITF 97-12 should be adopted to require that additional shares granted in a stock purchase plan be classified as compensatory or noncompensatory at the grant date of the additional shares. If the discount at that date does not meet the market discount criterion in paragraph 3(d) of SSAP No. 13, then the new grant would be treated as a compensatory award under SSAP No. 13, which would result in compensation cost.

INT 99-17 Status

3. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 99-18: EITF 97-13 Accounting for Costs Incurred in Connection with a Consulting Contract or an Internal Project That Combines Business Process Reengineering and Information Technology Transformation

INT 99-18 Date Discussed

June 7, 1999; October 4, 1999

INT 99-18 References

SSAP No. 17—Preoperating and Research and Development Costs (SSAP No. 17)

INT 99-18 Issue

1. EITF 97-13, Accounting for Costs Incurred in Connection with a Consulting Contract or an Internal Project That Combines Business Process Reengineering and Information Technology Transformation (EITF 97-13) requires business process reengineering costs to be expensed as incurred. EITF 97-13 also requires allocation of third parties costs, based upon relative fair values, that include both reengineering activities and software costs before capitalizing of the software costs are considered. For statutory purposes, reengineering costs are considered preoperating costs, as they may be seen as having the ability to change operations or production significantly. Preoperating costs are addressed in SSAP No. 17 which requires these costs to be expensed as incurred.

INT 99-18 Discussion

2. The working group reached a consensus that EITF 97-13 should be adopted to require that costs associated with business process reengineering activities, whether done internally or by third parties, be expensed as incurred.

3. The working group also reached a consensus that the total consulting contract price (or the sum of the linked contracts with the same vendor) in a business process reengineering project should be allocated to each activity based on the relative fair values when a third party is used to complete a such a project.

INT 99-18 Status

4. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 99-19: EITF 97-9 Effect on Pooling-of-Interests Accounting of Certain Contingently Exercisable Options or Other Equity Instruments

INT 99-19 Date Discussed
June 7, 1999; October 4, 1999

INT 99-19 References
SSAP No. 68—Business Combinations and Goodwill (SSAP No. 68)

INT 99-19 Issue

1. For GAAP purposes, business combinations shall be accounted for using either the purchase method or the pooling-of-interests method. The primary GAAP guidance in this area is located in Accounting Principles Board Opinion No. 16, Business Combinations. For statutory purposes, the pooling of interest method of accounting was rejected during the base portion of Codification under SSAP No. 68. EITF 97-9, Effect on Pooling-of-Interests Accounting of Certain Contingently Exercisable Options or Other Equity Instruments (EITF 97-9) provides an interpretation of specific guidance related to the use of the pooling of interest method of accounting.

INT 99-19 Discussion

2. The working group reached a consensus that EITF 97-9 is not applicable to statutory accounting. Therefore, there is no condition to require that contingently exercisable instruments and lock up options be considered in determining the accounting for a business combination.

INT 99-19 Status

3. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 99-20: EITF 98-1 Valuation of Debt Assumed in a Purchase Business Combination

INT 99-20 Date Discussed

June 7, 1999; October 4, 1999

INT 99-20 References

SSAP No. 68—Business Combinations and Goodwill (SSAP No. 68)

INT 99-20 Issue

1. For GAAP purposes, business combinations shall be accounted for using the guidance in Accounting Principles Board Opinion No. 16, Business Combinations, (APB 16). APB 16 provides that when a company is involved in a purchase business combination, all identifiable assets and liabilities should be assigned a portion of the cost of the acquired company (marked to market). EITF 98-1, Valuation of Debt Assumed in a Purchase Business Combination (EITF 98-1), provides guidance in determining how the value assigned to debt is determined in a purchase business combination. For statutory purposes, this method of marking the assets and liabilities to market was rejected in SSAP No. 68.

INT 99-20 Discussion

2. The working group reached a consensus that EITF 98-1 is not applicable to statutory accounting. Therefore, there is no condition to require that debt assumed in a purchase business combination be adjusted to its fair value.

INT 99-20 Status

3. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 99-21: EITF 98-7 Accounting for Exchanges of Similar Equity Method Investments

INT 99-21 Date Discussed

June 7, 1999; October 4, 1999

INT 99-21 References

SSAP No. 18—Accounting For Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (SSAP No. 18)
SSAP No. 28—Nonmonetary Transactions (SSAP No. 28)

INT 99-21 Issue

1. For GAAP purposes, accounting for the exchange of nonmonetary assets is addressed in Accounting Principles Board Opinion No. 29, Accounting for Nonmonetary Transactions (APB 29), and allows in some cases, such as an equity method investment, an exchange to be based upon its historical cost. For statutory purposes, APB 29 was adopted without modification in SSAP No. 28. SFAS No. 125, Accounting For Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (FAS 125), provides that transfers of financial assets should be recorded at their fair market values. This concept was also adopted for statutory purposes in SSAP No. 18. EITF 98-7, Accounting for Exchanges of Similar Equity Method Investments (EITF 98-7), clarifies the inconsistency between these two GAAP pronouncements as they relate to the exchange of equity method investments.

INT 99-21 Discussion

2. The working group reached a consensus that EITF 98-7 be adopted to provide that the exchange of equity method investments to be accounted for at historical cost, and not fair market value.

INT 99-21 Status

3. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 99-22: EITF 98-8 Accounting for Transfers of Investments That Are in Substance Real Estate

INT 99-22 Date Discussed
June 7, 1999; October 4, 1999

INT 99-22 References
SSAP No. 18—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (SSAP No. 18)
SSAP No. 40—Real Estate Investments (SSAP No. 40)

INT 99-22 Issue
1. SFAS No. 125, Accounting For Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (FAS 125), provides specific criteria that must be met to account for a transfer of financial assets as a sale. This criteria differs from the criteria outlined for a sale in SFAS No. 66, Accounting for Sales of Real Estate, (FAS 66). EITF 98-8, Accounting for Transfers of Investments That Are in Substance Real Estate (EITF 98-8), provides guidance in determining which criteria should be used when recording a sale of an investment that is in substance real estate. For statutory purposes, the sale criteria referred to above for FAS 125 and FAS 66 was adopted in SSAP No. 18 and SSAP No. 40, respectively.

INT 99-22 Discussion
2. The working group reached a consensus that EITF 98-8 be adopted to provide that transfers of financial assets that are in substance real estate be accounted for based upon the requirements of SSAP No. 40.

INT 99-22 Status
3. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 99-23: Disclosure of Premium Deficiency Reserves

INT 99-23 Dates Discussed
October 4, 1999; December 6, 1999

INT 99-23 References
SSAP No. 53—Property Casualty Contracts—Premiums (SSAP No. 53)

INT 99-23 Issue

1. SSAP No. 53 requires that 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.

2. Is the reporting entity required to disclose the dollar amount of anticipated investment income or is a simple statement that anticipated investment income was used in the calculation of the premium deficiency reserve sufficient disclosure? Additionally, are reporting entities required to disclose (either a dollar amount or by simple disclosure statement) the use of anticipated investment income in the calculation of premium deficiency reserves whether a reserve is recorded or not recorded in the financial statements?

INT 99-23 Discussion

3. The working group reached a consensus that the entity’s disclosure be limited to a statement that anticipated investment income was utilized and the dollar amount need not be included in such statement.

4. The working group reached a consensus that entities need to disclose by statement only that anticipated investment income was utilized in the calculation of premium deficiency reserves whether a reserve is recorded or not (i.e., the use of anticipated investment income mitigated the need for recording a premium deficiency reserve).

INT 99-23 Status

5. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 99-24: Accounting for Restructuring Charges

ISSUE NULLIFIED BY SSAP No. 89

INT 99-24 Dates Discussed
October 4, 1999; December 6, 1999

INT 99-24 References
SSAP No. 8—Pensions (SSAP No. 8)

INT 99-24 Issue

1. Reporting entities may make a strategic decision to downsize their operations. In doing so, these entities often offer severance pay and other benefits to displaced workers, cancel leases early, etc. These costs are estimated at the time of restructuring and on a GAAP basis are booked to the financial statements. It has been noted that companies handle these costs in at least two different ways. In one case, the reporting entity recorded these restructuring costs as an aggregate write-in for gains and losses in surplus. In another case, the company was allocated the cost by its parent, and appropriately accounted for these costs in accordance with SSAP No. 15—Debt and Holding Company Obligations.

2. Should costs associated with downsizing be recorded as an expense in the reporting entity’s financial statements, or should they be recorded as an adjustment of unassigned funds (surplus)?

INT 99-24 Discussion

3. The working group reached a consensus to record costs associated with downsizing as an expense in the financial statements.

INT 99-24 Status

4. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 99-25: Accounting for Capital Improvements

INT 99-25 Dates Discussed
October 4, 1999; December 6, 1999

INT 99-25 References
SSAP No. 40—Real Estate Investments (SSAP No. 40)

INT 99-25 Issue

1. Reporting entities may incur significant costs for capital improvements on property they own. These capital improvements frequently increase the useful life of the property.

2. If the property is already fully depreciated, should capital improvement costs be expensed as incurred or should they be capitalized and depreciated over the property’s extended useful life?

INT 99-25 Discussion

3. The working group reached a consensus that these costs should be capitalized and depreciated over the remaining extended useful life of the asset.

INT 99-25 Status

4. No further discussion is planned.
INT 99-26: Offsetting Pension Assets and Liabilities

INT 99-26 Dates Discussed
October 4, 1999; December 6, 1999

INT 99-26 References

**SSAP No. 8—Pensions (SSAP No. 8)**

*Note: The guidance from this Interpretation applicable to pensions was incorporated into SSAP No. 89—Accounting for Pensions, A Replacement of SSAP No. 8, in paragraph 16.g.*

SSAP No. 14—Postretirement Benefits Other Than Pensions (SSAP No. 14)

INT 99-26 Issue

1. SSAP No. 8 and SSAP No. 14 define the accounting treatment for pensions and postretirement benefits other than pensions (OPEB) obligations.

2. Both SSAP No. 8 and SSAP No. 14 state that a liability is to be recorded if the computed obligation exceeds the plan assets and consequently an asset is booked if the plan assets exceed the computed obligation. Should an entity determine that an asset exists, the amount is recorded as a prepaid assets and nonadmitted under statutory accounting principles.

3. If a reporting entity has multiple pension and OPEB plans, can the entity offset any liabilities generated by one of the plans against the prepaid asset of another plan before computing the nonadmitted amount?

INT 99-26 Discussion

4. The working group reached a consensus that it is not an acceptable statutory accounting practice to offset pension or OPEB liabilities generated by one plan against the prepaid asset of another plan.

INT 99-26 Status

5. No further discussion is planned.

6. During 2003, the Statutory Accounting Principles Working Group developed SSAP No. 89—Accounting for Pensions, A Replacement of SSAP No. 8 (SSAP No. 8). Paragraph 16.g. of SSAP No. 89 incorporated the guidance of this INT 99-26.
Interpretation of the Emerging Accounting Issues Working Group

INT 99-27: Nonadmitting Installment Receivables

INT 99-27 Dates Discussed
October 4, 1999; December 6, 1999

INT 99-27 References
SSAP No. 6—Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers (SSAP No. 6)

INT 99-27 Issue

1. SSAP No. 6 includes the following guidance:

9. Nonadmitted amounts are determined as follows:
   a. Uncollected Premium—To the extent that there is no related unearned premium, any uncollected premium balances, which are over ninety days due, shall be nonadmitted. If an installment premium is over ninety days due, the amount over ninety days due plus all future installments that have been recorded on that policy shall be nonadmitted;

2. The NAIC staff has received several inquires as to the practical application of the above. The staff’s interpretation of the accounting guidance is depicted in the following series of journal entries.

Worker’s compensation policy written on 1/1/X1 for $120,000 billed on installment basis at the end of each month.

Required Journal Entries:

1/1/X1
- Installments booked but deferred and not yet due 120,000
  Written premium 120,000
- Change in unearned premium reserve 120,000
  Unearned premium reserve 120,000

*Initial journal entry written on effective date of policy*

1/30/X1
- Premiums in course of collection 10,000
  Installsments booked but deferred and not yet due 10,000
- Unearned premium reserve 10,000
  Change in unearned premium reserve 10,000

*Monthly journal entry to record installments*
Balance of accounts on 4/30/X1:

- Installments booked but deferred and not yet due: 80,000
- Unearned Premium Reserve: 80,000
- Premiums in course of collection: 40,000
- Written premium: 120,000
- Change in unearned premium reserve: 80,000
- Earned premium: 40,000

If no collections have been made as of 4/30/X1 then paragraph 9.a. would stipulate that the entire balance of $40,000 residing in the premiums in course of collection account would be nonadmitted. As the installments receivable and unearned premium reserve offset one another, no further amounts would be deemed nonadmitted at this point. In fact, as long as any of the premiums in course of collection account are 90 days past the contractual due date of the installment, then all subsequent installment billings would automatically be nonadmitted (i.e., May, June, July receivables of $10,000).

3. Is the staff’s interpretation of SSAP No. 6, paragraph 9.a., as depicted in the above illustrative journal entries consistent with the intent of the SSAP as drafted?

**INT 99-27 Discussion**

4. The working group reached a consensus that the Staff’s interpretation as depicted in the above illustrative journal entries is consistent with the intent of the SSAP.

**INT 99-27 Status**

5. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 99-28: Accounting for SCA Mutual Funds, Broker- Dealers and Similar Entities Under SSAP No. 46

INT 99-28 Dates Discussed
October 4, 1999; December 6, 1999

INT 99-28 References
SSAP No. 46—Investments in Subsidiary, Controlled and Affiliated Entities (SSAP No. 46)

INT 99-28 Issue
1. SSAP No. 46 paragraphs 7.b.ii. and 7.b.iii. identify two equity methods of accounting – statutory and GAAP, respectively – to be used to account for noninsurance subsidiary, controlled or affiliated entities. The selection of a method depends upon whether the noninsurance SCA holds assets primarily for the direct or indirect benefit of the insurer or the noninsurance SCA has significant business operations beyond the holding of assets for the insurer. However, SSAP No. 46 also contains, in paragraph 8, an additional reference relative to whether or not primary operations of the SCA are provided or not provided to the insurance industry.

2. Should paragraph 7.b.ii. or paragraph 7.b.iii. apply to SCA mutual funds, broker-dealers or similar entities? The activities of these entities are investment operations and consequently, they engage in trading activities. Such entities are also highly likely to have third-party customers other than the owner/insurer; therefore, they have significant ongoing operations beyond holding assets for the primary benefit of the insurer. In addition, mutual funds, broker-dealers and similar organizations have their own specialized GAAP accounting, suited to their trading purposes.

INT 99-28 Discussion
3. The working group reached a consensus that SCA mutual funds and broker-dealers that are registered with the Securities and Exchange Commission, and have significant ongoing operations other than holding assets for the reporting entity, follow the valuation guidance outlined in paragraph 7.b.iii. of SSAP No. 46. That is, those entities should be valued using the audited GAAP equity method.

INT 99-28 Status
4. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 99-29: Classification of Step-up Preferred Stock

INT 99-29 Dates Discussed
October 4, 1999; December 6, 1999

INT 99-29 References
SSAP No. 32—Investments in Preferred Stock (excluding investments in preferred stock of subsidiary, controlled, or affiliated entities) (SSAP No. 32)

INT 99-29 Issue

1. A step-up preferred stock is a security with the structure of a preferred stock that has the cash flow characteristics of a debt instrument. Typically, it is structured as a perpetual preferred stock, but includes in its terms a call option that may be exercised at the option of the issuer at a time certain. The terms of the option are such that it is economically certain that the issuer will call the security. For example, the call option might provide that the issuer be required to pay 10 times LIBOR after the option date.

2. Per SSAP No. 32, redeemable preferred stock is defined as preferred stock that must be redeemed by the issuing enterprise or is redeemable at the option of the reporting entity. Perpetual preferred stock is defined as preferred stock with no redemption or sinking fund features and preferred stock redeemable at the option of the issuer.

3. It does not appear that step-up preferred stock meets the definition of a redeemable preferred stock. With respect to the “must” provision, while it is economically certain that the issuer will redeem the stock, the issuer is not legally obligated to do so. As the reporting entity has no rights in the option, it does not qualify in the second part of the definition. Therefore, step-up preferred stock is not considered redeemable preferred stock as defined in SSAP No. 32.

4. A strict reading of the perpetual preferred stock definition further complicates the issue in that step-ups do not have redemption features: thus, they meet the definition of perpetual preferred stock. The valuation of step-up preferred stock would not be consistent with the economic substance of the security if it were valued at market.

5. Review of SVO guidance in the Purposes and Procedures Manual of the NAIC SVO indicates that these securities have more characteristics of debt securities, thus they would be more consistent with the valuation of redeemable preferred stocks. In fact, the SVO office has recently revised its classification of certain securities because the characteristics of the step-up preferred shares are so “debt-like.”

6. Should step-up preferred stock be classified as redeemable preferred stock or perpetual preferred stock?

INT 99-29 Discussion

7. The working group reached a consensus that when securities have characteristics of both debt and equity, the accounting and valuation of such securities should be consistent with SVO guidelines as stipulated in the Purposes and Procedures Manual of the NAIC SVO.
INT 99-29 Status

8. No further discussion is planned.
Appendix B

Interpretation of the Emerging Accounting Issues Working Group

INT 00-01: Investment in Foreign SCA Entity

INT 00-01 Dates Discussed

October 4, 1999; December 6, 1999

INT 00-01 References

SSAP No. 46—Investments in Subsidiary, Controlled, and Affiliated (SCA) Entities (SSAP No. 46)

INT 00-01 Issue

1. SSAP No. 46 defines the accounting for investments in SCA entities. The following guidance is included in paragraph 7 of SSAP No. 46:

   b. If a SCA investment does not meet the requirements for the market valuation approach in paragraph 7 a. or, if the requirements are met, but a reporting entity elects not to use that approach, investments in SCAs shall be recorded as follows:

      i. Investments in insurance SCA entities shall be recorded based on the underlying statutory equity of the respective entity’s financial statements, adjusted for unamortized goodwill as provided for in SSAP No. 68—Business Combinations and Goodwill (SSAP No. 68).

      ii. Investments in noninsurance SCA entities that have no significant ongoing operations other than to hold assets that are primarily for the direct or indirect benefit or use of the reporting entity or its affiliates, shall be recorded based on the underlying equity of the respective entity’s financial statements adjusted to a statutory basis of accounting and the resultant proportionate share of the subsidiary’s adjusted surplus, adjusted for unamortized goodwill as provided for in SSAP No. 68. Examples include but are not limited to: (i) an insurer and a SCA entity that leases autos, furniture, office equipment, or computer equipment to the insurer, (ii) an insurer and a SCA entity that owns real estate property that is leased to the insurer for office space, and (iii) an insurer and an SCA entity which holds investments which an insurer could acquire directly (i.e., “look through” investment subsidiary);

      iii. Investments in noninsurance SCA entities that have significant ongoing operations beyond the holding of assets that are primarily for the direct or indirect benefit or use of the reporting entity or its affiliates shall be recorded based on the audited GAAP equity of the investee. Examples include but are not limited to: (i) a property-casualty or life insurer and a SCA entity that is an oil and gas venture, and (ii) a property-casualty insurer or life insurer and a SCA manufacturer.

2. If a reporting entity has an interest in a foreign company (defined in this context as a company located outside the United States), does the reporting entity use the foreign basis of accounting or the United States (U.S.) basis of accounting? For instance, if a reporting entity is domiciled in South Carolina and they own an insurance company located in Germany, does the company book the statutory equity as defined by German accounting or do they convert the financials to the statutory accounting prescribed or permitted in South Carolina? This scenario is also applicable to noninsurance SCA entities that have
significant ongoing operations beyond the holding of assets that are primarily for the direct or indirect benefit or use of the reporting entity or its affiliates. Does the reporting entity use German GAAP or U.S. GAAP?

INT 00-01 Discussion

3. The working group reached a consensus that entities shall follow the guidance outlined in the Purposes and Procedures Manual of the Securities Valuation Office Part 8, Section 3(g) for investments in foreign SCA entities defined in SSAP No. 46 paragraph 7.b.i. and 7.b.ii. For investments in foreign SCA entities defined in SSAP No. 46 paragraph 7.b.iii., entities shall use audited U.S. GAAP as the basis for valuation.

Part 8 - Section 3

(a) Admitted Asset Equivalent

Pursuant to this method, which may only be used for non-insurance SCA companies, the value of the common stock is limited to the value of those assets of the SCA company that would constitute lawful investments for the insurance company, if acquired or held directly by the insurance company. This is the sole valuation method that permits submission and use of an unaudited financial statement.

(g) Foreign Subsidiary

Pursuant to this provision, insurance companies may apply the Admitted Asset Equivalent method discussed in Section 3 (a) above to insurance companies organized in foreign countries. The basis for the calculation of value will be the financial statements of that insurance company for the most recent fiscal year, prepared by a certified public accountant.

INT 00-01 Status

4. No further discussion is planned.
Appendix B

Interpretation of the Emerging Accounting Issues Working Group

INT 00-02: Accounting for Leveraged Leases Involving Commercial Airplanes Under SSAP No. 22—Leases

INT 00-02 Dates Discussed

December 6, 1999, March 13, 2000

INT 00-02 References

SSAP No. 22—Leases (SSAP No. 22)

INT 00-02 Issue

1. The last sentence of paragraph 16 of SSAP No. 22, states “In cases where the asset being leased is a nonadmitted asset, any net leveraged lease asset shall be nonadmitted.” SSAP No. 4—Assets and Nonadmitted Assets (SSAP No. 4), paragraph 3 defines nonadmitted assets as:

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

Paragraph 4.f., of SSAP No. 20—Nonadmitted Assets, describes the accounting guidance for automobiles, airplanes and other vehicles noting that the undepreciated portion shall be nonadmitted.

2. The first draft of Issue Paper No. 22—Leases, did not contain any accounting guidance for leveraged leases. In January 1996, Interested Parties recommended that the Issue Paper be expanded to include such guidance noting that some insurers engage in this type of activity and that statutory guidance was needed. During the hearing on this subject, the specific example used to describe leveraged lease accounting involved leases for commercial airplanes. At that time, the Codification Working Group agreed with the recommendation from Interested Parties that this type of transaction met the definition of an admitted asset since the transaction was entered into for the purpose of income generation. It is important to note that when this decision was made, it was contemplated that the NAIC Model Investment Law-Defined Limits would be incorporated into codified NAIC SAP, and that model law specifically authorizes income generation assets as admitted assets. Subsequently, leveraged lease accounting was incorporated within SSAP No. 22, but the NAIC Model Investment Law-Defined Limits was not incorporated into SSAP No. 4. Hence, income generation assets were not generally defined as admitted assets in SSAP No. 4, and the basis upon which leveraged leases were considered admitted assets was lost.

3. Questions are being raised by some that were not actively involved in the Codification project about the classification of leveraged leases involving commercial airplanes. Is this an admitted or nonadmitted asset?

INT 00-02 Discussion

4. The working group reached a consensus position that leveraged leases involving commercial airplanes are admitted assets.

INT 00-02 Status

5. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 00-03: Illustration of the Accounting/Reporting of Deposit-Type Contracts in Accordance with SSAPs No. 51, 52 and 56

INT 00-03 Dates Discussed

December 6, 1999, March 13, 2000

INT 00-03 References

SSAP No. 51—Life Contracts (SSAP No. 51)
SSAP No. 52—Deposit-Type Contracts (SSAP No. 52)
SSAP No. 56—Separate Accounts (SSAP No. 56)

INT 00-03 Issue

1. Deposit-type contracts, as defined in SSAP No. 52 may be maintained in the general account or transferred to the separate account of an insurance company. During the process of preparing Blanks proposals to conform the reporting requirements to the SSAPs, the Impact of Codification on NAIC Publications Working Group noted an inconsistency in the reporting of deposit-type contracts between SSAP No. 52 and SSAP No. 56. At the 1999 NAIC Fall National Meeting, SSAP No. 56 was amended to clarify that the requirements of SSAP No. 52 are applicable to separate account deposit-type contracts.

2. Exhibit A is included as an illustration of accounting/reporting of separate account deposit-type contracts in accordance with SSAP Nos. 51, 52 and 56. Is this illustration consistent with the intent of the Codification of Statutory Accounting Principles Working Group?

INT 00-03 Discussion

3. The working group reached a consensus that Exhibit A is consistent with the intent of the SSAPs.

INT 00-03 Status

4. No further discussion is planned.
Illustrative Example of the Accounting/Reporting of Deposit-Type Contracts in Accordance with SSAPs 51/52

NOTE: Entries presented in this illustration may not reflect all accounting entries associated with the activity, e.g., some “due from” or “due to” entries are eliminated to simplify the example.

1. Contractholder surrendered an ordinary life insurance policy and elected to place the proceeds ($100,000) under a supplementary contract without life contingencies (SCWOLC).

   **General Account Statement**
   
   a. Surrender Benefits & Withdrawals $100,000
      Liability for Deposit –Type Contracts $100,000
   
   b. Aggregate Reserves for Life Policies $100,000
      Increase in Aggregate Reserves for Life Policies $100,000

2. Insurer transfers, pursuant to contract provisions, $95,000 to separate account fund for SCWOLC contracts from general account fund for SCWOLC contracts; $5,000 is retained in the general account.

   **General Account Statement**
   
   a. Liability for Deposit –Type Contracts $95,000
      Transfers to Separate Accounts $95,000
   
   b. Transfers to Separate Account $95,000
      Cash $95,000

   **Separate Accounts Statement**
   
   c. Other transfers from General Account (net) $95,000
      Transfers on account of deposit-type contracts $95,000
   
   d. Cash $95,000
      Other Transfers from General Account $95,000
   
   e. Increase in liability for deposit-type contracts $95,000
      Liability for Deposit-Type Contracts $95,000

3. Insurer establishes a $4,000 CARVM valuation allowance for this contract in the separate account fund.

   **Separate Accounts Statement**
   
   a. Liability for Deposit-Type Contracts $4,000
      Increase in liability for deposit-type contracts $4,000
   
   b. Change in expense allowances recognized in reserves $4,000
      Other transfers from General Account (net) $4,000

   **General Account Statement**
   
   c. Transfers to Separate Accounts (net) $4,000
      Transfer to/or (from) Separate Accounts $4,000
4. Insurer’s separate account fund for SCWOLC contracts assets earns $2,000 investment income that is immediately credited to the separate account fund for SCWOLC contracts.

**Separate Accounts Statement**

a. Cash $2,000
   - Net investment income $2,000
b. Increase in liability for deposit-type contracts $2,000
   - Liability for Deposit-Type Contracts $2,000

5. Contractholder is paid a $1,000 SCWOLC contract benefit from the separate account fund. The example has been simplified to show the cash flows from the Separate Account to the General Account and the payment to the contractholder from the General Account.

**General Account Statement**

a. Cash $1,000
   - Liability for Deposit-Type Contracts $1,000
b. Liability for Deposit-Type Contracts $1,000
   - Cash $1,000

**Separate Accounts Statement**

c. Transfers on account of deposit-type contracts $1,000
   - Cash $1,000
d. Liability for Deposit-type Contracts $1,000
   - Increase in liability for deposit-type contracts $1,000

6. Contractholder requests the insurer to purchase a variable annuity contract (insurance product) with $25,000 drawn from the separate account fund supporting the SCWOLC contract (deposit-type contract) and transfer it to a separate fund supporting variable annuities. This example has been simplified and ignores the internal cash exchange.

**General Account Statement**

a. Transfers to Separate Accounts $25,000
   - Premiums and Annuity Considerations $25,000

**Separate Accounts Statement**

b. Liability for Deposit-Type Contracts $25,000
   - Increase in liability for deposit-type contracts $25,000
c. Transfers on account of deposit-type contracts $25,000
   - Other transfers to general account (net) $25,000
d. Other transfers to general account (net) $25,000
   - Net Premiums and Annuity Considerations $25,000
e. Increase in aggregate reserve for life, annuity $25,000
   - Aggregate Reserve for life, annuity $25,000
7. Contractholder in accordance with a Group GIC contract requests that $15,000 be withdrawn from the Group GIC Separate Account fund maintained by the insurer and transferred to the contractholder’s Separate Account fund supporting the SCWOLC contract.

Separate Accounts Statement
a. Liability for Deposit-Type Contracts (GIC) $15,000
   Increase in liability for deposit-type contracts $15,000
b. Transfers on account of deposit-type contracts $15,000
   Cash $15,000
c. Cash $15,000
   Transfers on account of deposit-type contracts $15,000
d. Increase in liability for deposit-type contracts $15,000
   Liability for Deposit-Type Contracts (SCWOLC) $15,000

General Accounts Statement
e. Other transfers to separate account (net) $15,000
   Liability for Deposit-Type Contracts (SCWOLC) $15,000
f. Liability for Deposit-Type Contracts (SCWOLC) $15,000
   Other transfers to separate account (net) $15,000

8. Contractholder is assessed the annual administration fee of $100 for the SCWOLC contract.

Separate Accounts Statement
a. Administration fees $100
   Cash $100
b. Liability for Deposit-type contracts $100
   Increase in liability for deposit-type contracts $100

General Account Statement
c. Cash $100
   Management fees $100
### “T” Accounts

#### General Account Statement

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### Summary of Operations

#### Premiums & Considerations

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Separate Accounts Statement

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### Summary of Operations

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#### Net Invest Inc & Cap Gains

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#### Fees Assoc with Charges for Inv Mgmt etc.

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#### Increase in Agg Res for Life Cont etc.

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<tbody>
<tr>
<td>6e</td>
<td>25,000</td>
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</table>

#### Increase in Liab for Deposit-Type Contracts

<table>
<thead>
<tr>
<th>Xaction Ref.</th>
<th>Debit</th>
<th>Credit</th>
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<tbody>
<tr>
<td>2e</td>
<td>95,000</td>
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</tr>
<tr>
<td>3a</td>
<td>4,000</td>
<td></td>
</tr>
<tr>
<td>4b</td>
<td>2,000</td>
<td></td>
</tr>
<tr>
<td>5d</td>
<td>1,000</td>
<td></td>
</tr>
<tr>
<td>6b</td>
<td>25,000</td>
<td></td>
</tr>
<tr>
<td>7a</td>
<td>15,000</td>
<td></td>
</tr>
<tr>
<td>7d</td>
<td>15,000</td>
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</tr>
<tr>
<td>8b</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>112,000</td>
<td>45,100</td>
</tr>
<tr>
<td>Net</td>
<td>66,900</td>
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</table>
NOTES to FINANCIAL STATEMENTS

19. Separate Accounts

Illustration B:

Reconciliation of Net Transfers To or (From) Separate Accounts

1. Transfers as reported in the Summary of Operations of the Separate Accounts Statement:
   a. Transfers to Separate Accounts $ 25,000
   b. Transfers from Separate Accounts $ 4,000
   c. Net transfers to or (From) Separate Accounts (a) – (b) $21,000

2. Reconciling Adjustments:
   a. ___________________________________  $____________
   b. ___________________________________  $____________
   c. ___________________________________  $____________

3. Transfers as Reported in the Summary of Operations of the Life, Accident & Health Annual Statement

   (1c) + (2) = $ 21,000
## ASSETS

<table>
<thead>
<tr>
<th>Current Year</th>
<th>Prior Year</th>
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<tbody>
<tr>
<td><strong>General Account Basis</strong></td>
<td><strong>Fair Value Basis</strong></td>
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<td>1. Bonds (Schedule D)</td>
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<tr>
<td>2. Stocks (Schedule D):</td>
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</tr>
<tr>
<td>2.1 Preferred stocks</td>
<td></td>
</tr>
<tr>
<td>2.2 Common stocks</td>
<td></td>
</tr>
<tr>
<td>3. Mortgage loans on real estate (Schedule B)</td>
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<tr>
<td>4. Real estate (Schedule A):</td>
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<tr>
<td>4.1 Properties held for the production of income (less $…………encumbrances)</td>
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</tr>
<tr>
<td>4.2 Properties held for sale (less $…………encumbrances)</td>
<td></td>
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<tr>
<td>5. Policy loans</td>
<td></td>
</tr>
<tr>
<td>6. Cash (Schedule E-Part 1)</td>
<td>110,900</td>
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<tr>
<td>7. Short-term investments (Schedule DA)</td>
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</tr>
<tr>
<td>8. Other invested assets (Schedule BA)</td>
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</tr>
<tr>
<td>9. Aggregate write-ins for invested assets</td>
<td></td>
</tr>
<tr>
<td>10. Subtotals—Cash and invested assets (Lines 1 to 9)</td>
<td>110,900</td>
</tr>
<tr>
<td>11. Investment income due and accrued</td>
<td></td>
</tr>
<tr>
<td>12. Receivable for securities</td>
<td></td>
</tr>
<tr>
<td>13. Net adjustment in assets and liabilities due to foreign exchange rates</td>
<td></td>
</tr>
<tr>
<td>14. Aggregate write-ins for other than invested assets</td>
<td></td>
</tr>
<tr>
<td>15. Lines 10 to 14</td>
<td>110,900</td>
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## DETAILS OF WRITE-INS

<table>
<thead>
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<th>Current Year</th>
<th>Prior Year</th>
</tr>
</thead>
<tbody>
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<td><strong>1402</strong></td>
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<tr>
<td><strong>1403</strong></td>
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<tr>
<td><strong>1498</strong></td>
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<tr>
<td><strong>1499</strong></td>
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</table>

**Summary of remaining write-ins for Line 14 from overflow page**

**Totals (Lines 1401 through 1403 plus 1498) (Line 14 above)**

**Totals (Lines 0901 through 0903 + 0998) (Line 9 above)**
<table>
<thead>
<tr>
<th></th>
<th>Current Year</th>
<th>Prior Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Aggregate reserve for life, annuity and accident and health policies and contracts (Exhibit 6, Line 9999999, Col. 2)</td>
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<td></td>
</tr>
<tr>
<td>2. Liability for deposit-type contracts (Exhibit 7, Line 9, Col. 1)</td>
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<tr>
<td>3. Interest Maintenance Reserve</td>
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<tr>
<td>4. Charges for investment management, administration and contract guarantees due or accrued</td>
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<td></td>
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<tr>
<td>5. Investment expenses due or accrued (Exhibit 4, Line 24)</td>
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<tr>
<td>6. Investment taxes, licenses and fees due or accrued, excluding federal income taxes (Exhibit 5, Line 8)</td>
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</tr>
<tr>
<td>7. Federal and foreign income taxes due or accrued (excluding deferred taxes)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>8. Reserve for future federal income taxes</td>
<td></td>
<td></td>
</tr>
<tr>
<td>9. Unearned investment income (Exhibit 2, Line 14, Col. 2)</td>
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</tr>
<tr>
<td>10. Other transfers to general account due or accrued (net) (including $ accrue expense allowances recognized in reserves)</td>
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<td></td>
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<tr>
<td>11. Remittances and items not allocated</td>
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<td></td>
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<tr>
<td>12. Payable for securities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>13. Net adjustment in assets and liabilities due to foreign exchange rates</td>
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<td></td>
</tr>
<tr>
<td>14. Aggregate write-ins for liabilities</td>
<td></td>
<td></td>
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<tr>
<td>15. Total Liabilities (including $ due or accrued net transfers to or (from) the general account)</td>
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<tr>
<td>16. Contributed surplus</td>
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<td></td>
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<tr>
<td>17. Aggregate write-ins for special surplus funds</td>
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<td></td>
</tr>
<tr>
<td>18. Unassigned funds</td>
<td></td>
<td></td>
</tr>
<tr>
<td>19. Surplus (Lines 16 through 18)</td>
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<tr>
<td>20. Totals</td>
<td></td>
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### DETAILS OF WRITE-INS

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<th>Prior Year</th>
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<tr>
<td>1402</td>
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<td></td>
</tr>
<tr>
<td>1403</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1498. Summary of remaining write-ins for Line 14 from overflow page</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1499. Totals (Lines 1401 through 1403 plus 1498) (Line 14 above)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1701</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1702</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1703</td>
<td></td>
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<tr>
<td>1798. Summary of remaining write-ins for Line 17 from overflow page</td>
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<tr>
<td>1799. Totals (Lines 1701 through 1703 plus 1798) (Line 17 above)</td>
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## Appendix B

### ANNUAL STATEMENT FOR THE YEAR 2003 OF THE SEPARATE ACCOUNTS OF THE

**SUMMARY OF OPERATIONS**

<table>
<thead>
<tr>
<th>Description</th>
<th>Current Year</th>
<th>Prior Year</th>
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</thead>
<tbody>
<tr>
<td>1. Transfers to Separate Accounts:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.1 Net premiums and annuity considerations for life and accident and health policies and contracts</td>
<td>25,000</td>
<td></td>
</tr>
<tr>
<td>1.2 Considerations for supplementary contracts with life contingencies</td>
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<td></td>
</tr>
<tr>
<td>1.3 Aggregate write-ins for other transfers to Separate Accounts</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.4 Totals (Lines 1.1 to 1.3)</td>
<td>25,000</td>
<td></td>
</tr>
<tr>
<td>2. Transfers on account of deposit-type contracts (including $110,000 deposits less $41,000 withdrawals)</td>
<td>69,000</td>
<td></td>
</tr>
<tr>
<td>3. Net investment income and capital gains and losses (Exhibit 1, Line 9)</td>
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<td>2,000</td>
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<tr>
<td>4. Aggregate write-ins for other income</td>
<td></td>
<td></td>
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<tr>
<td>5. Totals (Lines 1.4 to 4)</td>
<td>96,000</td>
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**DEDUCT:**

<table>
<thead>
<tr>
<th>Description</th>
<th>Current Year</th>
<th>Prior Year</th>
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<tbody>
<tr>
<td>6. Transfers from the Separate Account on account of contract benefits:</td>
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<td></td>
</tr>
<tr>
<td>6.1 Death benefits</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6.2 Matured endowments</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6.3 Annuity benefits</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6.4 Payments on supplementary contracts with life contingencies</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6.5 Accident and health benefits</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6.6 Surrender benefits and withdrawals for life contracts</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6.7 Aggregate write-ins for other transfers from Separate Accounts on account of contract benefits</td>
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<td></td>
</tr>
<tr>
<td>7. Transfers on account of policy loans</td>
<td></td>
<td></td>
</tr>
<tr>
<td>8. Net transfers from or to Separate Accounts</td>
<td></td>
<td></td>
</tr>
<tr>
<td>9. Other transfers from the Separate Accounts:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>9.1 Federal and foreign income taxes incurred</td>
<td></td>
<td></td>
</tr>
<tr>
<td>9.2 Change in expense allowances recognized in reserves</td>
<td></td>
<td>4,000</td>
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<tr>
<td>9.3 Aggregate write-ins for other transfers from Separate Accounts</td>
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<td></td>
</tr>
<tr>
<td>10. Subtotals (Lines 6.1 to 9.3)</td>
<td>4,000</td>
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</tr>
<tr>
<td>11. Fees associated with charges for investment management, administration and contract guarantees</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>12. Increase in aggregate reserve for life and accident and health policies and contracts</td>
<td>25,000</td>
<td></td>
</tr>
<tr>
<td>13. Increase in reserve for variable dividend accumulations</td>
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</tr>
<tr>
<td>14. Increase in liability for deposit-type contracts</td>
<td></td>
<td>66,900</td>
</tr>
<tr>
<td>15. Increase in reserve for future federal income taxes</td>
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<td></td>
</tr>
<tr>
<td>16. Aggregate write-ins for reserves and funds</td>
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<td></td>
</tr>
<tr>
<td>17. Totals (Lines 10 to 16)</td>
<td>96,000</td>
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</tr>
<tr>
<td>18. Net gain from operations (including 5 ……… unrealized capital gains) (Line 5 minus Line 17)</td>
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### SURPLUS ACCOUNT

<table>
<thead>
<tr>
<th>Description</th>
<th>Current Year</th>
<th>Prior Year</th>
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</thead>
<tbody>
<tr>
<td>19. Surplus, December 31, prior year</td>
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<tr>
<td>20. Net gain from operations (Line 18)</td>
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<td></td>
</tr>
<tr>
<td>21. Surplus contributed or (withdrawn) during year</td>
<td></td>
<td></td>
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<tr>
<td>22. Change in reserve on account of change in valuation basis, (increase) or decrease</td>
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<tr>
<td>23. Transfer from Separate Accounts of the change in expense allowances charged or credited to surplus</td>
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</tr>
<tr>
<td>24. Aggregate write-ins for gains and losses in surplus</td>
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<tr>
<td>25. Surplus, December 31, current year (Page 3, Line 19)</td>
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### DETAILS OF WRITE-INS

<table>
<thead>
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<th>Line</th>
<th>Description</th>
<th>Current Year</th>
<th>Prior Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>01.</td>
<td>Totals (Lines 01.1 through 01.301)</td>
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<tr>
<td>01.</td>
<td>Summary of remaining write-ins (Line 1.3 from overflow page)</td>
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<tr>
<td>01.</td>
<td>Totals (Line 01.301 through 01.303 plus 01.398) (Line 1.3 above)</td>
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<tr>
<td>06.</td>
<td>Totals (Lines 06.301 through 06.703 plus 06.798) (Line 4 above)</td>
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<tr>
<td>06.</td>
<td>Summary of remaining write-ins (Line 4 from overflow page)</td>
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<tr>
<td>06.</td>
<td>Totals (Line 06.703 through 06.707 plus 06.798) (Line 4.7 above)</td>
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<tr>
<td>06.</td>
<td>Summary of remaining write-ins (Line 5.7 from overflow page)</td>
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<tr>
<td>06.</td>
<td>Totals (Line 06.701 through 06.703 plus 06.798) (Line 5.7 above)</td>
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<td>06.</td>
<td>Summary of remaining write-ins (Line 5.3 from overflow page)</td>
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<td>06.</td>
<td>Totals (Line 06.501 through 06.503 plus 06.598) (Line 5.3 above)</td>
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<tr>
<td>06.</td>
<td>Summary of remaining write-ins (Line 6 from overflow page)</td>
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<td>06.</td>
<td>Totals (Line 06.601 through 06.603 plus 06.698) (Line 6.6 above)</td>
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<td>06.</td>
<td>Summary of remaining write-ins (Line 8 from overflow page)</td>
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<td>06.</td>
<td>Totals (Line 06.801 through 06.803 plus 06.898) (Line 8.6 above)</td>
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<tr>
<td>09.</td>
<td>Summary of remaining write-ins (Line 9 from overflow page)</td>
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<td>09.</td>
<td>Totals (Line 09.301 through 09.303 plus 09.398) (Line 9.3 above)</td>
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<td>09.</td>
<td>Summary of remaining write-ins (Line 10 from overflow page)</td>
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<td>09.</td>
<td>Totals (Line 09.101 through 09.103 plus 09.198) (Line 10.1 above)</td>
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<td>09.</td>
<td>Summary of remaining write-ins (Line 11 from overflow page)</td>
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<tr>
<td>09.</td>
<td>Totals (Line 09.501 through 09.503 plus 09.598) (Line 11.5 above)</td>
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<td>09.</td>
<td>Summary of remaining write-ins (Line 12 from overflow page)</td>
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<tr>
<td>09.</td>
<td>Totals (Line 09.901 through 09.903 plus 09.998) (Line 12.9 above)</td>
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<td>Summary of remaining write-ins (Line 16 from overflow page)</td>
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<td>16.</td>
<td>Summary of remaining write-ins (Line 24 from overflow page)</td>
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<tr>
<td>16.</td>
<td>Totals (Line 24.201 through 24.203 plus 24.298) (Line 24.2 above)</td>
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### ASSETS

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<th>Current Year</th>
<th>Prior Year</th>
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</thead>
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<td>Assets</td>
<td>Nonadmitted Assets</td>
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<td>Bonds</td>
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<tr>
<td>2</td>
<td>Stocks:</td>
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<tr>
<td>2.1</td>
<td>Preferred stocks (Schedule D, Part 2, Section 1)</td>
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<tr>
<td>2.2</td>
<td>Common stocks (Schedule D, Part 2, Section 2)</td>
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<tr>
<td>3</td>
<td>Mortgage loans on real estate (Schedule B, Part 1):</td>
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<tr>
<td>3.1</td>
<td>First liens</td>
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<td>3.2</td>
<td>Other than first liens</td>
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<tr>
<td>4</td>
<td>Real estate (Schedule A):</td>
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<tr>
<td>4.1</td>
<td>Properties occupied by the company (less $…… encumbrances)</td>
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<tr>
<td>4.2</td>
<td>Properties held for the production of income (less $…… encumbrances)</td>
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<tr>
<td>4.3</td>
<td>Properties held for sale (less $…… encumbrances)</td>
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<tr>
<td>5</td>
<td>Policy loans</td>
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<tr>
<td>6</td>
<td>Premium notes, including $…… for first year premiums</td>
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<tr>
<td>7</td>
<td>Cash ($…….., Schedule E, Part 1) and short-term investments</td>
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<td>8</td>
<td>Other invested assets (Schedule BA, Part 1)</td>
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<tr>
<td>9</td>
<td>Receivable for securities</td>
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<tr>
<td>10</td>
<td>Aggregate write-ins for invested assets</td>
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<tr>
<td>11</td>
<td>Subtotals, cash and invested assets (Lines 1 to 10)</td>
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<td>Reinsurance ceded:</td>
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<td>Amounts recoverable from reinsurers (Schedule S, Part 2)</td>
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<td>12.2</td>
<td>Commissions and expense allowances due</td>
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<td>12.3</td>
<td>Experience rating and other refunds due</td>
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<td>12.4</td>
<td>Other amounts receivable under reinsurance contracts</td>
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<td>13</td>
<td>Electronic data processing equipment and software</td>
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<tr>
<td>14</td>
<td>Federal and foreign income tax recoverable and interest thereon (including $…… net deferred tax asset)</td>
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<tr>
<td>15</td>
<td>Guaranty funds receivable or on deposit</td>
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<tr>
<td>16</td>
<td>Life insurance premiums and annuity considerations deferred and uncollected on in force business (less premiums on reinsurance ceded and less $…….loading)</td>
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<tr>
<td>17</td>
<td>Accident and health premiums due and unpaid</td>
<td></td>
</tr>
<tr>
<td>18</td>
<td>Investment income due and accrued (Exhibit 2)</td>
<td></td>
</tr>
<tr>
<td>19</td>
<td>Net adjustment in assets and liabilities due to foreign exchange rates</td>
<td></td>
</tr>
<tr>
<td>20</td>
<td>Receivable from parent, subsidiaries and affiliates</td>
<td></td>
</tr>
<tr>
<td>21</td>
<td>Amounts receivable relating to uninsured accident and health plans</td>
<td></td>
</tr>
<tr>
<td>22</td>
<td>Amounts due from agents</td>
<td></td>
</tr>
<tr>
<td>23</td>
<td>Other assets nonadmitted (Exhibit 12)</td>
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</tr>
<tr>
<td>24</td>
<td>Aggregate write-ins for other than invested assets</td>
<td>5,100</td>
</tr>
<tr>
<td>25</td>
<td>Total assets excluding Separate Accounts business (Lines 11 to 24)</td>
<td>5,100</td>
</tr>
<tr>
<td>26</td>
<td>From Separate Accounts Statement</td>
<td>110,900</td>
</tr>
<tr>
<td>27</td>
<td>Total (Lines 25 and 26)</td>
<td>116,000</td>
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### DETAILS OF WRITE-INS

<table>
<thead>
<tr>
<th></th>
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<tr>
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<td>1098.</td>
<td>Summary of remaining write-ins for Line 10 from overflow page</td>
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<td>1099.</td>
<td>Totals (Lines 1001 through 1003 + 1098) (Line 10 above)</td>
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<td>2401.</td>
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<td>Summary of remaining write-ins for Line 24 from overflow page</td>
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<td>2499.</td>
<td>Totals (Lines 2401 through 2403 + 2498) (Line 24 above)</td>
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### Liabilities, Surplus and Other Funds

<table>
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<th>Prior Year</th>
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<td>1. Aggregate reserve for life policies and contracts $..................(Exhibit 8, Line 99999999) less $ . included in Line 6.3 (including $ Modco Reserve)</td>
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<tr>
<td>2. Aggregate reserve for accident and health policies (Exhibit 9, Line 17, Col. 1) (including $......Modco Reserve)</td>
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<tr>
<td>3. Liability for deposit-type contracts (Exhibit 10, Line 14, Col. 1) (including $......Modco Reserve)</td>
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<td>5,000</td>
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<td>4. Policy and contract claims:</td>
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<tr>
<td>4.1 Life (Exhibit 11, Part 1, Line 4.4, Col. 1 less sum of Cols. 9, 10 and 11)</td>
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<tr>
<td>4.2 Accident and health (Exhibit 11, Part 1, Line 4.4, sum of Cols. 9, 10 and 11)</td>
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<td>5. Policyholders' dividends $................................................due and unpaid (Exhibit 7, Line 10)</td>
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<td>6. Provision for policyholders' dividends and coupons payable in following calendar year—estimated amounts:</td>
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<tr>
<td>6.1 Dividends apportioned for payment to $......, 20 ...... (including $...... Modco Reserve)</td>
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<tr>
<td>6.2 Dividends not yet apportioned (including $...... Modco Reserve)</td>
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<tr>
<td>6.3 Coupons and similar benefits (including $...... Modco Reserve)</td>
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<td>7. Amount provisionally held for deferred dividend policies not included in Line 6</td>
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<tr>
<td>8. Premiums and annuity considerations for life and accident and health policies and contracts received in advance less $..............discount; including $.............. accident and health premiums (Exhibit 1, Part 1, Col. 1, sum of Lines 4 and 14)</td>
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<td>9. Policy and contract liabilities not included elsewhere:</td>
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<tr>
<td>9.1 Surrender values on canceled policies</td>
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<td>9.2 Provision for experience rating refunds, including $........................... accident and health experience rating refunds</td>
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<tr>
<td>9.3 Other amounts payable on reinsurace, including $........................... assumed and $............. ceded</td>
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<tr>
<td>9.4 Interest Maintenance Reserve (Page 33, Line 6)</td>
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<tr>
<td>10. Commisions to agents due or accrued-life and annuity contracts $..............accident and health $...... and deposit-type contract funds</td>
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<tr>
<td>11. Commisions and expense allowances payable on reinsurance assumed</td>
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<td>12. General expenses due or accrued (Exhibit 5, Line 12, Col. 5)</td>
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<tr>
<td>13. Transfers to Separate Accounts due or accrued (net) (including ($ 4,800) accrued for expense allowances recognized in reserves)</td>
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<td>(4,000)</td>
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<td>14. Taxes, licenses and fees due or accrued, excluding federal and state taxes (Exhibit 9, Col. 5)</td>
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<td>15. Federal and foreign income taxes, including $.........................on realized capital gains (losses) (including $...net-deferred tax liability)</td>
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<td>16. Unrealized investment income (Exhibit 2, Line 9, Col. 2)</td>
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<tr>
<td>17. Amounts withheld or retained by company as agent or trustee</td>
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<tr>
<td>18. Amounts held for agents' account, including $.............................agents' credit balances</td>
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<tr>
<td>19. Remittances and items not allocated</td>
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<tr>
<td>20. Net adjustment in assets and liabilities due to foreign exchange rates</td>
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</tr>
<tr>
<td>21. Liability for benefits for employees and agents if not included above</td>
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<td></td>
</tr>
<tr>
<td>22. Borrowed money $..........................................................and interest thereon $</td>
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</tr>
<tr>
<td>23. Dividends to stockholders declared and unpaid</td>
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</tr>
<tr>
<td>24. Miscellaneous liabilities:</td>
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</tr>
<tr>
<td>24.1 Asset valuation reserve (Page 34, Line 15, Col. 7)</td>
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<tr>
<td>24.2 Reinsurance in unauthorized companies</td>
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<td></td>
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<tr>
<td>24.3 Funds held under reinsurance treaties with unauthorized reinsurers</td>
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<tr>
<td>24.4 Payable to parent, subsidiaries and affiliates</td>
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<td>24.5 Drafts outstanding</td>
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<td>24.6 Liability for amounts held under uninsured accident and health plans</td>
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<td>24.7 Funds held under coinsurance</td>
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<tr>
<td>24.8 Payable for securities</td>
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</tr>
<tr>
<td>24.9 Capital notes $...... and interest thereon $</td>
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<tr>
<td>25. Aggregate write-ins for liabilities</td>
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<td>26. Total liabilities excluding Separate Accounts business (Lines 1 to 25)</td>
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<tr>
<td>27. From Separate Accounts statement</td>
<td></td>
<td>110,900</td>
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<tr>
<td>28. Total liabilities (Lines 26 and 27)</td>
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<td>111,900</td>
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<tr>
<td>29. Common capital stock</td>
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<td></td>
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<tr>
<td>30. Preferred capital stock</td>
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<td></td>
</tr>
<tr>
<td>31. Aggregate write-ins for other than special surplus funds</td>
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<td></td>
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<tr>
<td>32. Surplus notes</td>
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<td></td>
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<tr>
<td>33. Gross paid in and contributed surplus (Page 3, Line 33, Col. 2 plus Page 4, Line 51.1, Col. 1)</td>
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<tr>
<td>34. Aggregate write-ins for special surplus funds</td>
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<tr>
<td>35. Unassigned funds (surplus)</td>
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<tr>
<td>36. Less treasury stock, at cost</td>
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<tr>
<td>36.1 Shares common (value included in Line 29 $......)</td>
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<tr>
<td>36.2 Shares preferred (value included in Line 30 $......)</td>
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<tr>
<td>37. Surplus (total Lines 31 + 32 + 33 + 34 + 35 - 36) (Including $...... in Separate Accounts Statement)</td>
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<tr>
<td>38. Totals of Lines 29, 30 and 37 (Page 4, Line 55)</td>
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<tr>
<td>39. Totals of Lines 28 and 38 (Page 2, Line 27, Col. 3)</td>
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</table>

#### Details of Write-Ins

| Description                                                                 | | |
|----------------------------------------------------------------------------| | |
| 2501. Totals (Lines 2501 through 2504 plus 2505(Line 25 above) | | |
| 2502. Summary of remaining write-ins for Line 25 from overflow page | | |
| 2503. Summary of remaining write-ins for Line 25 from overflow page | | |
| 2504. Totals (Lines 2501 through 2504 plus 2505(Line 25 above) | | |
| 3101. Totals (Lines 3101 through 3104 plus 3105(Line 31 above) | | |
| 3102. Summary of remaining write-ins for Line 31 from overflow page | | |
| 3103. Summary of remaining write-ins for Line 31 from overflow page | | |
| 3104. Totals (Lines 3101 through 3104 plus 3105(Line 31 above) | | |
| 3401. Totals (Lines 3401 through 3405 plus 3406(Line 34 above) | | |
| 3402. Summary of remaining write-ins for Line 34 from overflow page | | |
| 3403. Summary of remaining write-ins for Line 34 from overflow page | | |
| 3404. Totals (Lines 3401 through 3405 plus 3406(Line 34 above) | | |
| 3405. Summary of remaining write-ins for Line 34 from overflow page | | |
| 3406. Summary of remaining write-ins for Line 34 from overflow page | | |
| 3407. Totals (Lines 3401 through 3405 plus 3406(Line 34 above) | | |
### GENERAL ACCOUNT

#### ANNUAL STATEMENT FOR THE YEAR 2001 OF THE

#### SUMMARY OF OPERATIONS

(Excluding Unrealized Capital Gains and Losses)

<table>
<thead>
<tr>
<th></th>
<th>Current Year</th>
<th>Prior Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Premiums and annuity considerations for life and accident and health policies and contracts (Exhibit 1, Part 1, Line 20-4, Col. 1, less Col. 11)</td>
<td>25,000</td>
<td></td>
</tr>
<tr>
<td>2. Considerations for supplementary contracts with life contingencies</td>
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<td></td>
</tr>
<tr>
<td>3. Net investment income (Exhibit 2, Line 16)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Amortization of Interest Maintenance Reserve (IMR) (Page 33, Line 5)</td>
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</tr>
<tr>
<td>5. Separate Accounts net gain from operations excluding unrealized gains or losses</td>
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<td></td>
</tr>
<tr>
<td>6. Commissions and expense allowances on reinsurance ceded (Exhibit 1, Part 2, Line 26.1, Col. 1)</td>
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<td></td>
</tr>
<tr>
<td>7. Reserve adjustments on reinsurance ceded</td>
<td></td>
<td></td>
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<tr>
<td>8. Miscellaneous Income:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>8.1 Income from fees associated with investment management, administration and contract guarantees from Separate Accounts</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>8.2 Charges and fees for deposit-type contracts</td>
<td></td>
<td></td>
</tr>
<tr>
<td>8.3 Aggregate write-ins for miscellaneous income</td>
<td></td>
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</tr>
<tr>
<td>9. Totals (Lines 1 to 8.3)</td>
<td>25,100</td>
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</tr>
<tr>
<td>10. Death benefits</td>
<td></td>
<td></td>
</tr>
<tr>
<td>11. Matured endowments (excluding guaranteed annual premium payments)</td>
<td></td>
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<tr>
<td>12. Annuity benefits (Exhibit 11, Part 2, Line 6.4, Cols. 4 + 8)</td>
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</tr>
<tr>
<td>13. Disability benefits and benefits under accident and health policies</td>
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<tr>
<td>14. Coupons, guaranteed annual premium payments and similar benefits</td>
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<td></td>
</tr>
<tr>
<td>15. Surrender benefits and withdrawals for life contracts</td>
<td></td>
<td></td>
</tr>
<tr>
<td>16. Group conversions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>17. Interest and adjustments on policy or deposit-type contract funds</td>
<td></td>
<td></td>
</tr>
<tr>
<td>18. Payments on supplementary contracts with life contingencies</td>
<td></td>
<td></td>
</tr>
<tr>
<td>19. Increase in aggregate reserves for life and accident and health policies and contracts</td>
<td>(100,000)</td>
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</tr>
<tr>
<td>20. Totals (Lines 10 to 19)</td>
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<td>21,000</td>
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<tr>
<td>21. Commissions on premiums, annuity considerations and deposit-type contract funds (direct business only) (Exhibit 1, Part 2, Line 31, Col. 1, less Col. 11)</td>
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<td>22. Commissions and expense allowances on reinsurance ceded (Exhibit 1, Part 2, Line 26.2, Col. 1, less Col. 13)</td>
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<tr>
<td>23. General insurance expenses (Exhibit 5, Line 10, Cols. 1 + 2 + 3)</td>
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<td>24. Insurance taxes, licenses, and fees, excluding federal income taxes (Exhibit 6, Line 7, Cols. 1 + 2 + 3)</td>
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<tr>
<td>25. Increase in loading on deferred and uncollected premiums</td>
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<tr>
<td>26. Net transfers to or (from) Separate Accounts</td>
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<tr>
<td>27. Aggregate write-ins for deductions</td>
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<td>28. Totals (Lines 20 to 27)</td>
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<td>21,000</td>
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<tr>
<td>29. Net gain from operations before dividends to policyholders and federal income taxes (Line 9 minus Line 28)</td>
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<tr>
<td>30. Dividends to policyholders</td>
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<td></td>
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<tr>
<td>31. Net gain from operations after dividends to policyholders and before federal income taxes (Line 29 minus Line 30)</td>
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<td></td>
</tr>
<tr>
<td>32. Federal and foreign income taxes incurred (excluding tax on capital gains)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>33. Net gain from operations after dividends to policyholders and federal income taxes and before realized capital gains or (losses) (Line 31 minus Line 32)</td>
<td></td>
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</tr>
<tr>
<td>34. Net realized capital gains or (losses) less capital gains tax and transferred to the IMR (Exhibit 3, Footnote (a), Line 5C)</td>
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<tr>
<td>35. Net income (Line 35 plus Line 34)</td>
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</table>

#### CAPITAL AND SURPLUS ACCOUNT

36. Capital and surplus, December 31, prior year (Page 3, Line 38, Col. 2) | | |
| 37. Net income (Line 35) | | |
| 38. Change in net unrealized capital gains (losses) | | |
| 39. Change in net unrealized foreign exchange capital gain (loss) | | |
| 40. Change in deferred income tax | | |
| 41. Change in nonadmitted assets and related items (Exhibit 12, Line 6, Col. 3) | | |
| 42. Change in liability for reinsurance in unauthorized companies | | |
| 43. Change in reserve on account of change in valuation basis, (increase) or decrease (Exhibit 8A, Line 9999999, Col. 4) | | |
| 44. Change in asset valuation reserve (Page 34, Lines 2 through 4 plus 8, 11 and 12, Col. 7) | | |
| 45. Change in treasury stock (Page 3, Lines 36.1 and 36.2 Col. 2 minus Col. 1) | | |
| 46. Surplus (contributed to) withdrawn from Separate Accounts during period | | |
| 47. Other changes in surplus in Separate Accounts statement | | |
| 48. Change in surplus notes | | |
| 49. Cumulative effect of changes in accounting principles | | |

#### DETAILS OF WRITE-INS

<table>
<thead>
<tr>
<th>Line</th>
<th>Description</th>
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<td>Summary of remaining write-ins for Line 8.3 from overflight page</td>
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<tr>
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<td>Totals (Lines 8.301 through 8.303 plus 8.305)(Line 8.3 above)</td>
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## Cash Flow

### Cash from Operations

<table>
<thead>
<tr>
<th>Description</th>
<th>1 (Current Year)</th>
<th>2 (Prior Year)</th>
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<tbody>
<tr>
<td>1. Premiums and annuity considerations for life and accident and health policies and contracts</td>
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<tr>
<td>2. Charges and fees for deposit-type contracts</td>
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<tr>
<td>3. Considerations for supplementary contracts with life contingencies</td>
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<td></td>
</tr>
<tr>
<td>4. Net investment income</td>
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</tr>
<tr>
<td>5. Commissions and expense allowances on reinsurance ceded</td>
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</tr>
<tr>
<td>6. Fees associated with investment management, administration and contract guarantees from Separate Accounts</td>
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<td>7. Aggregate write-ins for miscellaneous income</td>
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<tr>
<td>8. Total (Lines 1 to 7)</td>
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<tr>
<td>9. Death benefits</td>
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<td></td>
</tr>
<tr>
<td>10. Matured endowments</td>
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</tr>
<tr>
<td>11. Annuity benefits</td>
<td></td>
<td></td>
</tr>
<tr>
<td>12. Disability benefits and benefits under accident and health policies</td>
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<td></td>
</tr>
<tr>
<td>13. Coupons, guaranteed annual pure endowments and similar benefits</td>
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</tr>
<tr>
<td>14. Surrender benefits and withdrawals for life contracts</td>
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</tr>
<tr>
<td>15. Group conversions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>16. Interest and adjustments on policy or deposit-type contract funds</td>
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</tr>
<tr>
<td>17. Payments on supplementary contracts with life contingencies</td>
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<tr>
<td>18. Total (Lines 9 to 17)</td>
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<tr>
<td>19. Commissions on premiums, annuity considerations and deposit-type contract funds</td>
<td></td>
<td></td>
</tr>
<tr>
<td>20. General insurance expenses</td>
<td></td>
<td></td>
</tr>
<tr>
<td>21. Insurance taxes, licenses and fees, excluding federal income taxes</td>
<td></td>
<td></td>
</tr>
<tr>
<td>22. Net transfers to or (from) Separate Accounts</td>
<td>25,000</td>
<td></td>
</tr>
<tr>
<td>23. Aggregate write-ins for deductions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>24. Total (Lines 18 to 26)</td>
<td>125,000</td>
<td></td>
</tr>
<tr>
<td>25. Dividends paid to policyholders</td>
<td></td>
<td></td>
</tr>
<tr>
<td>26. Federal income taxes (excluding tax on capital gains)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>27. Total (Lines 25 to 27)</td>
<td>125,000</td>
<td></td>
</tr>
<tr>
<td>28. Net cash from operations (Line 8 minus Line 28)</td>
<td>(99,900)</td>
<td></td>
</tr>
</tbody>
</table>

### Cash from Investments

<table>
<thead>
<tr>
<th>Description</th>
<th>1 Current Year</th>
<th>2 Prior Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>30. Proceeds from investments sold, matured or repaid:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>30.1 Bonds</td>
<td></td>
<td></td>
</tr>
<tr>
<td>30.2 Stocks</td>
<td></td>
<td></td>
</tr>
<tr>
<td>30.3 Mortgage loans</td>
<td></td>
<td></td>
</tr>
<tr>
<td>30.4 Real estate</td>
<td></td>
<td></td>
</tr>
<tr>
<td>30.5 Other invested assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>30.6 Net gains (losses) on cash and short-term investments</td>
<td></td>
<td></td>
</tr>
<tr>
<td>30.7 Miscellaneous proceeds</td>
<td></td>
<td></td>
</tr>
<tr>
<td>30.8 Total investment proceeds (Lines 30.1 to 30.7)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>31. Total (Line 30.8 minus Line 31)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>32. Cost of investments acquired (long-term only):</td>
<td></td>
<td></td>
</tr>
<tr>
<td>33.1 Bonds</td>
<td></td>
<td></td>
</tr>
<tr>
<td>33.2 Stocks</td>
<td></td>
<td></td>
</tr>
<tr>
<td>33.3 Mortgage loans</td>
<td></td>
<td></td>
</tr>
<tr>
<td>33.4 Real estate</td>
<td></td>
<td></td>
</tr>
<tr>
<td>33.5 Other invested assets</td>
<td></td>
<td></td>
</tr>
<tr>
<td>33.6 Miscellaneous applications</td>
<td></td>
<td></td>
</tr>
<tr>
<td>33.7 Total investments acquired (Lines 33.1 to 33.6)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>34. Net increase (or decrease) in policy loans and premium notes</td>
<td></td>
<td></td>
</tr>
<tr>
<td>35. Total (Line 32 minus Line 33.7 minus Line 34)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Cash from Financing and Miscellaneous Sources

<table>
<thead>
<tr>
<th>Description</th>
<th>1 Current Year</th>
<th>2 Prior Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>36. Cash provided:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>36.1 Surplus notes, capital and surplus paid in</td>
<td></td>
<td></td>
</tr>
<tr>
<td>36.2 Borrowed money $....less amounts repaid $</td>
<td></td>
<td></td>
</tr>
<tr>
<td>36.3 Capital notes $.....less amounts repaid $</td>
<td></td>
<td></td>
</tr>
<tr>
<td>36.4 Deposits on deposit-type contract funds and other liabilities without life or disability contingencies</td>
<td>115,000</td>
<td></td>
</tr>
<tr>
<td>36.5 Other cash provided</td>
<td></td>
<td></td>
</tr>
<tr>
<td>36.6 Total (Lines 36.1 to 36.5)</td>
<td>115,000</td>
<td></td>
</tr>
<tr>
<td>37. Cash applied:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>37.1 Dividends to stockholders paid</td>
<td></td>
<td></td>
</tr>
<tr>
<td>37.2 Interest on indebtedness</td>
<td></td>
<td></td>
</tr>
<tr>
<td>37.3 Withdrawals on deposit-type contract funds and other liabilities without life or disability contingencies</td>
<td>110,000</td>
<td></td>
</tr>
<tr>
<td>37.4 Other applications (net)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>37.5 Total (Lines 37.1 to 37.4)</td>
<td>110,000</td>
<td></td>
</tr>
<tr>
<td>38. Total cash from financing and miscellaneous sources (Line 36.6 minus Line 37.5)</td>
<td>5,000</td>
<td></td>
</tr>
<tr>
<td>40. Cash and short-term investments:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>40.1 Beginning of year</td>
<td>100,000</td>
<td></td>
</tr>
<tr>
<td>40.2 End of year (Line 39 plus Line 40.1)</td>
<td>5,100</td>
<td></td>
</tr>
</tbody>
</table>

### Details of Write-Ins

<table>
<thead>
<tr>
<th>Description</th>
<th>1 Current Year</th>
<th>2 Prior Year</th>
</tr>
</thead>
<tbody>
<tr>
<td>0701. Summary of remaining write-ins for Line 5 from overflow page</td>
<td></td>
<td></td>
</tr>
<tr>
<td>0702. Totals (Lines 0701 through 0703 plus 0706 if more than one)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>0703. Summary of remaining write-ins for Line 7 from overflow page</td>
<td></td>
<td></td>
</tr>
<tr>
<td>0704. Totals (Lines 0701 through 0703 plus 0706 if more than one)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2401. Summary of remaining write-ins for Line 24 from overflow page</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2402. Totals (Lines 2401 through 2403 plus 2406 if more than one)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
ANNUAL STATEMENT FOR THE YEAR 2001 OF THE SEPARATE ACCOUNTS OF THE

EXHIBIT 7—DEPOSIT TYPE CONTRACTS

<table>
<thead>
<tr>
<th></th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total</td>
<td>Guaranteed Interest Contracts</td>
<td>Supplemental Contracts and Annuities Certain</td>
<td>Dividend Accumulations or Refunds</td>
<td>Premium and Other Deposit Funds</td>
<td>Other</td>
</tr>
<tr>
<td>1</td>
<td>Balance at the beginning of the year</td>
<td>15,000</td>
<td>15,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Deposits received during the year</td>
<td>110,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Investment earnings credited to the account</td>
<td>2,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Other net change in reserves</td>
<td>-4,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Fees and other charges assessed</td>
<td>100</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Surrender charges</td>
<td>100</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Net surrender or withdrawal payments</td>
<td>15,000</td>
<td>26,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>Other net transfers to or (from) General Accounts</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>Balance at the end of current year (Lines 1+2+3+4-5-6-7-8)</td>
<td>81,900</td>
<td>0</td>
<td>81,900</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Reconciliation of Exh. 7 to Summary of Operations:

<table>
<thead>
<tr>
<th></th>
<th>Exh. 7, Column 1, Line 9</th>
<th>Exh. 7, Column 1, Line 1</th>
<th>Summary of Operations, Column 1, Line 14</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>81,900</td>
<td>15,000</td>
<td>66,900</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Exh. 7, Column 1, Line 2</th>
<th>Exh. 7, Column 1, Line 7</th>
<th>Summary of Operations, Column 1, Line 2</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>110,000</td>
<td>41,000</td>
<td>69,000</td>
</tr>
</tbody>
</table>
### EXHIBIT 10—DEPOSIT TYPE CONTRACTS

<table>
<thead>
<tr>
<th></th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Guaranteed Interest Contracts</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Supplemental Contracts and Annuities Certain</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Dividend Accumulations or Refunds</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Premium and Other Deposit Funds</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Other</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Balance at the beginning of the year before reinsurance</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2. Deposits received during the year</td>
<td>115,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Investment earnings credited to the account</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Other net change in reserves</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. Fees and other charges assessed</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6. Surrender charges</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7. Net surrender or withdrawal payments</td>
<td>41,000</td>
<td>15,000</td>
<td>26,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8. Other net transfers to or (from) Separate Accounts</td>
<td>69,000</td>
<td>(15,000)</td>
<td>84,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>9. Balance at the end of current year before reinsurance (Lines 1+2+3+4-5-6-7-8)</td>
<td>5,000</td>
<td>0</td>
<td>5,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>10. Reinsurance balance at the beginning of the year</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>11. Net change in reinsurance assumed</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>12. Net change in reinsurance ceded</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>13. Reinsurance balance at the end of the year (Lines 10+11-12)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>14. Net balance at the end of current year after reinsurance (Lines 9-13)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Interpretation of the Emerging Accounting Issues Working Group

INT 00-04: Student Loan Insurance

INT 00-04 Dates Discussed
March 13, 2000; June 12, 2000

INT 00-04 References
SSAP No. 60—Financial Guaranty Insurance (SSAP No. 60)

INT 00-04 Issue
1. In the situation under consideration, an insurer issues a surety bond, to a bank or other lending financial institution, under which the insurer agrees to provide financial guaranty of each student loan made by the bank within specified underwriting criteria, such as to graduate students in specified fields. As each loan is made, the premium for that loan is paid to the insurer by the bank from the proceeds of the loan that are retained by the bank at issuance. Usually repayment of the loan is expected to commence six months after graduation. If and when there is a default in repayment of the loan by the graduate, the insurer pays the bank or lending institution the unpaid principal and interest on the loan, takes possession of the loan, and initiates recovery efforts.

2. The general characteristic of the student loan insurance coverage is financial guaranty of numerous individual personal loans.

3. The accounting issue is whether or not student loan insurance, as described above, is financial guaranty insurance subject to the accounting provisions of SSAP No. 60, particularly with respect to the establishment of a statutory contingency reserve.

INT 00-04 Discussion
4. The working group reached a consensus that student loan insurance, in the situation discussed above, would be subject to the accounting provisions of SSAP No. 60 and the related statutory contingency reserve.

INT 00-04 Status
5. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 00-05: Exemption to Merger Disclosure in SSAP No. 3

INT 00-05 Dates Discussed

March 13, 2000; June 12, 2000

INT 00-05 References

SSAP No. 3—Accounting Changes and Corrections of Errors (SSAP No. 3)

INT 00-05 Issue

1. SSAP No. 3 includes the following guidance related to merger disclosures involving shell companies

   12. For mergers, prior years’ amounts in the Annual Statement shall be restated as if the merger had occurred as of January 1 of the prior year. Additionally, restatement shall be required for the two most recent years included in the Five Year Historical Summary. The Five Year Historical Summary shall include a footnote indicating that the other three years have not been restated. A reporting entity that merges with an entity which effectively is a shell company (i.e., the reporting entity has no outstanding underwriting liabilities) shall be exempt from the above requirements.

2. The issue is whether the merged entity is exempt from all the disclosure requirements or are they simply exempt from restating the two most recent years. Some individuals have interpreted the last sentence of paragraph 12 as no prior year history is required; in other words, they make a “fresh start”.

INT 00-05 Discussion

3. The working group reached a consensus that regardless of whether one of the entities is a “shell company”; the prior period amounts shall only consist of the “non-shell company”.

INT 00-05 Status

4. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 00-06: EITF 97-14: Accounting for Deferred Compensation Arrangements Where Amounts Earned Are Held in a Rabbi Trust and Invested

INT 00-06 Dates Discussed
March 13, 2000; June 12, 2000; September 11, 2000

INT 00-06 References
SSAP No. 13—Stock Options and Stock Purchase Plans (SSAP No. 13)

INT 00-06 Issue

1. This issue addresses the accounting for deferred compensation arrangements where amounts earned by an employee are invested in the stock of the employer and placed in a “rabbi trust.” Certain of those plans allow the employee to immediately diversify into nonemployer securities or to diversify after a holding period (for example, six months); other plans do not allow for diversification. The deferred compensation obligation of some plans may be settled in (1) cash by having the trust sell the employer stock (or the diversified assets) in the open market, (2) shares of the employer's stock, or (3) diversified assets. In other plans, the deferred compensation obligation may be settled only by delivery of the shares of the employer stock.

2. Rabbi trusts are grantor trusts generally set up to fund compensation for a select group of management or highly paid executives. To qualify as a rabbi trust for income tax purposes, the terms of the trust agreement must explicitly state that the assets of the trust are available to satisfy the claims of general creditors in the event of bankruptcy of the employer.

3. This issue does not address the accounting for stock appreciation rights (SARs) even if they are funded through a rabbi trust.

4. The issues are:
   a. Whether the rabbi trust in a deferred compensation arrangement should be consolidated in the financial statements of the employer
   b. How the investment in the employer stock should be recorded
   c. Whether and, if so, how changes in the value of the employer stock held as a trust asset and the deferred compensation obligation should be recorded
   d. The impact on the accounting for assets held by the rabbi trust and the deferred compensation obligation if the employee elects to diversify into nonemployer securities.

INT 00-06 Discussion

5. The working group reached a consensus to adopt the consensus positions of EITF 97-14 with minor modifications. Paragraphs 6 to 9 represent the adopted consensus positions as modified by the working group.
6. The EITF observed that there are four potential scenarios for deferred compensation arrangements covered by this issue:

- Plan A-The plan does not permit diversification and must be settled by the delivery of a fixed number of shares of employer stock.
- Plan B-The plan does not permit diversification and may be settled by the delivery of cash or shares of employer stock.
- Plan C-The plan permits diversification; however, the employee has not diversified (the plan may be settled in cash, shares of employer stock, or diversified assets).
- Plan D-The plan permits diversification and the employee has diversified (the plan may be settled in cash, shares of employer stock, or diversified assets).

7. The EITF reached a consensus that for all of these types of plans, the accounts of the rabbi trust should be consolidated with the accounts of the employer in the financial statements of the employer.

8. The EITF reached the following consensus’s with respect to the various types of plans above.

a. For Plan A, employer stock held by the rabbi trust should be classified in equity in a manner similar to the manner in which treasury stock is accounted for. Subsequent changes in the fair value of the employer's stock should not be recognized. The deferred compensation obligation should be classified as an equity instrument and changes in the fair value of the amount owed to the employee should not be recognized.

b. For Plans B and C, employer stock held by the rabbi trust should be classified in equity in a manner similar to the manner in which treasury stock is accounted for. Subsequent changes in the fair value of the employer's stock should not be recognized. The deferred compensation obligation should be classified as a liability and adjusted with a corresponding charge (or credit) to compensation cost, to reflect the changes in the fair value of the amount owed to the employee.

c. For Plan D, assets held by the rabbi trust should be accounted for in accordance with statutory accounting principles for the particular asset (for example, if the diversified asset is a marketable equity security, that security would be accounted for in accordance with Statement No. 30). The deferred compensation obligation should be classified as a liability and adjusted, with a corresponding charge (or credit) to compensation cost, to reflect changes in the fair value of the amount owed to the employee. Changes in the fair value of the deferred compensation obligation should not be recorded in unrealized gain or losses, even if changes in the fair value of the assets held by the rabbi trust are recorded, pursuant to Statement No. 30, in surplus.

9. This consensus applies to all new awards (including new awards made pursuant to existing arrangements) after January 1, 2001.

INT 00-06 Status

10. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 00-08: EITF 98-5: Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios

INT 00-08 Dates Discussed
March 13, 2000; June 12, 2000; September 11, 2000

INT 00-08 References
SSAP No. 15—Debt and Holding Company Obligations (SSAP No. 15)

INT 00-08 Issue

1. Entities may issue convertible debt securities and convertible preferred stock with a nondetachable conversion feature that is in-the-money at the commitment date (a “beneficial conversion feature”). Those securities may be convertible into common stock at the lower of a conversion rate fixed at the commitment date or a fixed discount to the market price of the common stock at the date of conversion. Opinion 14 addresses an issuer’s accounting for convertible debt with a nondetachable (embedded) conversion feature, the terms of which provide for (a) an initial conversion price that is greater than market value at the date of issuance and (b) a conversion price that does not decrease, except under antidilution protection. Opinion 14 does not explicitly address situations in which the embedded conversion feature is in-the-money at issuance, nor does it explicitly address convertible preferred stock.

2. Certain convertible securities may have a conversion price that is variable based on future events such as a subsequent round of financing at a price lower than the convertible securities’ original conversion price, a liquidation or a change in control of the company, or an initial public offering at a share price lower than an agreed-upon amount. Opinion 14 also does not explicitly address situations in which the conversion terms are contingently adjustable.

3. This issue applies to convertible securities with beneficial conversion features that must be settled in stock and to those that give the issuer a choice of settling the obligation in either stock or cash. This Issue also applies to instruments with beneficial conversion features that are convertible into multiple instruments, for example, a convertible preferred stock that is convertible into common stock and detachable warrants. In addition, this Issue applies to instruments with conversion features that are not beneficial at the commitment date but that become beneficial upon the occurrence of a future event, such as an initial public offering.

4. The issues are:
   a. Issue 1—Whether embedded beneficial conversion features present in convertible securities should be valued separately at the commitment date
   b. Issue 2—If the answer to Issue 1 is to value beneficial conversion features separately, then how an embedded conversion feature should be recognized and measured
   c. Issue 3—How the issuance of convertible securities with beneficial conversion ratios that adjust based on the occurrence of specified future events should be accounted for.
INT 00-08 Discussion

5. The working group reached a consensus to reject the consensus positions reached in EITF 98-5 based upon a recommendation from the Invested Assets Working Group (IAWG). The IAWG reported that they had considered EITF 98-5 in the light of accounting guidance in the Statement of Statutory Accounting Principles No. 26 and 32. While recognizing the conservatism reflected by requiring amortization of premium on a yield to worst basis, neither the members of IAWG nor members of interested persons expressed interest in revising this guidance. The IAWG is of the opinion that any revision to the current accounting guidance for the purpose of accommodating financial instruments within the scope of EITF 98-5, should recognize the equity-like nature of the premium over par or accreted value. IAWG is also of the opinion that full recognition of the equity-like nature of the premium should extend to accounting, reporting, asset valuation reserves, and risk based capital.

INT 00-08 Status

6. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 00-10: EITF 98-14: Debtor’s Accounting for Changes in Line-of-Credit or Revolving-Debt Arrangements

INT 00-10 Dates Discussed

March 13, 2000; June 12, 2000

INT 00-10 References

SSAP No. 15—Debt and Holding Company Obligations (SSAP No. 15)

INT 00-10 Issue

1. A line-of-credit or revolving-debt arrangement is an agreement that provides the borrower with the option to make multiple borrowings up to a specified maximum amount, to repay portions of previous borrowings, and to then reborrow under the same contract. Line-of-credit and revolving-debt arrangements may include both amounts drawn by the debtor (a debt instrument) and a commitment by the creditor to make additional amounts available to the debtor under predefined terms (a loan commitment). In most situations, a debtor incurs costs to establish line-of-credit or revolving-debt arrangements, and some or all of the costs are deferred and amortized over the term of the arrangement.

2. EITF Issue No. 96-19, “Debtor’s Accounting for a Modification or Exchange of Debt Instruments,” provides guidance for modifications to or exchanges of debt instruments by and between a debtor and a creditor in a nontroubled debt situation. EITF Issue 96-19 does not specifically address the accounting for modifications to (for example, changing interest rates, draw-down terms, covenants, or maturity) or exchanges of a line-of-credit or revolving-debt arrangement. Unlike a single debt arrangement, it is unclear how to apply a cash flow calculation similar to Issue 96-19 to line-of-credit and revolving-debt arrangements in which amounts may be outstanding and the lender is committed to lend additional amounts or in which no amounts are drawn down, to determine whether the change is considered substantial.

3. The issue is how to account for modifications to or exchanges of line-of-credit or revolving-debt arrangements, including the accounting for unamortized costs at the time of the change, fees paid to or received from the creditor, and third-party costs incurred.

INT 00-10 Discussion

4. The working group reached a consensus to reject the conclusions reached in EITF 98-14 and expense such costs as incurred.

INT 00-10 Status

5. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 00-11: EITF 98-15: Structured Notes Acquired for a Specified Investment Strategy

INT 00-11 Dates Discussed

March 13, 2000; June 12, 2000; September 11, 2000

INT 00-11 References

SSAP No. 43—Loan-backed and Structured Securities (SSAP No. 43)
SSAP No. 45—Repurchase Agreements, Reverse Repurchase Agreements and Dollar Repurchase Agreements (SSAP No. 45)

INT 00-11 Issue

1. For the purpose of achieving a certain strategic investment result for the investor, structured note securities have been issued in combination with other structured note securities as a unit or a pair. One strategy involves the purchase of two structured notes with opposite interest rate reset provisions. Under that strategy, the fixed coupon rate or maturity date for each structured note would be determined shortly after issuance depending on movements in market interest rates. Following that reset date, the resulting yields on each of the structured note securities will move in opposite directions; however, the average yield of the two securities will generally reflect the market yield of the combined instruments in effect on the issuance date.

2. The issue is whether the investor should account for the two structured note securities together as a unit or account for each security separately.

INT 00-11 Discussion

3. The working group reached a consensus to reject the consensus positions reached in EITF 98-15 based upon a recommendation from the Invested Assets Working Group (IAWG). The IAWG reported that for EITF 98-15, the IAWG observed that the current statutory accounting framework requires the majority of bonds to be valued at amortized cost and not fair value. In such a framework, IAWG believes that EITF 98-15 is simply not necessary. The IAWG also expressed concern that EITF 98-15 would require the Securities Valuation Office (SVO) to engage in activities that are beyond its current scope and expertise. Any attempt on the part of the Emerging Accounting Issues Working Group to promulgate EITF 98-15 into accounting guidance will require the VOSTF to change the mission of the SVO.

INT 00-11 Status

4. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 00-12: EITF 99-4: Accounting for Stock Received from the Demutualization of a Mutual Insurance Company

INT 00-12 Dates Discussed

March 13, 2000; June 12, 2000

INT 00-12 References

SSAP No. 21—Other Admitted Assets (SSAP No. 21)
SSAP No. 28—Nonmonetary Transactions (SSAP No. 28)

INT 00-12 Issue

1. Several mutual insurance companies have recently undergone demutualization transactions and converted to stock enterprises. Others are expected to demutualize over the next few years. In order to effect a demutualization, a company may be required to issue consideration, often in the form of stock, to existing participating policyholders in exchange for their current membership interests. The receipt of such stock has no direct effect on the policyholders’ contractual interests of their insurance policies (for example, it does not alter the cash surrender value of their life insurance policies). However, the governance of the mutual insurance company and, in particular, the participating policyholders’ interest in that governance are modified.

2. The issue is how the receipt of stock from a demutualization should be accounted for.

INT 00-12 Discussion

3. The working group reached a consensus that stock received from a demutualization should be accounted for at fair value with a gain recognized in income from continuing operations.

INT 00-12 Status

4. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 00-13: EITF 99-5: Accounting for Pre-Production Costs Related to Long-Term Supply Arrangements

INT 00-13 Dates Discussed

March 13, 2000; June 12, 2000

INT 00-13 References

No SSAP references

INT 00-13 Issue

1. Manufacturers often incur pre-production costs related to products they will supply to their customers under long-term supply arrangements. For example, the manufacturer may incur costs to perform certain services related to the design and development of the products it will sell under long-term supply arrangements and may incur costs to design and develop molds, dies, and other tools that will be used in producing those products. While practice varies from industry to industry, the supplier may be contractually guaranteed reimbursement of design and development costs, implicitly guaranteed reimbursement of design and development costs through the pricing of the product or other means, or not guaranteed reimbursement of the design and development costs incurred under the long-term supply arrangement.

2. The issues are:

   a. Issue 1—How an entity should account for costs incurred to design and develop products that will be sold under a long-term supply arrangement.

   b. Issue 2—How an entity should account for costs incurred to design and develop molds, dies, and other tools that it will own and that will be used to produce products that will be sold under a long-term supply arrangement.

   c. Issue 3—How an entity should account for costs incurred to design and develop molds, dies, and other tools that it will not own and that will be used to produce products that will be sold under a long-term supply arrangement.

   d. Issue 4—Whether the accounting for Issues 1 through 3 would be affected if a supplier will be reimbursed for design and development costs.

INT 00-13 Discussion

3. The working group reached a consensus to reject the conclusions reached in EITF 99-5 as not applicable to statutory accounting.

INT 00-13 Status

4. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 00-14: EITF 99-6: Impact of Acceleration Provisions in Grants Made between Initiation and Consummation of a Pooling-of-Interests Business Combination

INT 00-14 Dates Discussed

March 13, 2000; June 12, 2000

INT 00-14 References

SSAP No. 68—Business Combinations and Goodwill (SSAP No. 68)

INT 00-14 Issue

1. Changes in equity interests of any of the combining companies within two years of initiation or between initiation and consummation are presumed to have been made in contemplation of effecting the planned combination and, unless that presumption is overcome, will preclude pooling-of-interests accounting. The granting of stock options or a change in the terms of the option is a change in equity interests. A past pattern of employee stock option grants generally would overcome the in-contemplation presumption if the grants were made under the normal terms and conditions of the plan and in normal amounts and timing for each category or class of recipient. However, stock option grants with unusual terms or conditions made between initiation and consummation, generally would not overcome the in-contemplation presumption and would therefore violate the change-in-equity interests condition. Often the terms of stock option grants provide for automatic vesting upon a change in control.

2. Practice views are diverse on the effect on pooling-of-interests accounting of granting stock options that automatically vest upon a change in control after initiation of a business combination.

3. The issue is whether granting stock options (or restricted stock) that provide for automatic vesting upon a change in control, after initiation of the business combination, violates the change-in-equity-interests condition for the instant business combination.

INT 00-14 Discussion

4. The working group reached a consensus to reject the conclusions reached in EITF 99-6 as not applicable to statutory accounting.

INT 00-14 Status

5. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 00-15: EITF 99-7: Accounting for an Accelerated Share Repurchase Program

INT 00-15 Dates Discussed

March 13, 2000; June 12, 2000

INT 00-15 References

SSAP No. 68 - Business Combinations and Goodwill (SSAP No. 68)

INT 00-15 Issue

1. An accelerated share repurchase program is a combination of transactions that permits an entity to purchase a targeted number of shares immediately with the final purchase price of those shares determined by an average market price over a fixed period of time. An accelerated share repurchase program is intended to combine the immediate share retirement benefits of a tender offer with the market impact and pricing benefits of a disciplined daily open market stock repurchase program. The implications of an accelerated share repurchase program for earnings-per-share (EPS) calculations and an entity's ability to account for a business combination as a pooling of interests differ, depending on how the accelerated share repurchase program is accounted for.

2. The following transaction illustrates an accelerated share repurchase program:

   a. Treasury Stock Purchase
   Investment Banker, an unrelated third party, borrows 1,000,000 shares of Company A common stock from investors, becomes the owner of record of those shares, and sells the shares short to Company A on July 1, 1999, at the current market value of $50 per share. Company A pays $50,000,000 in cash to Investment Banker on July 1, 1999, to settle the purchase transaction. The shares are held in treasury. Company A has legal title to the shares, and no other party has the right to vote those shares.

   b. Forward Contract
   Company A simultaneously enters into a forward contract with Investment Banker on 1,000,000 shares of its own common stock. On the October 1, 1999 settlement date, if the volume-weighted average daily market price of Company A's common stock during the contract period (July 1, 1999 to October 1, 1999) exceeds the $50 initial purchase price (net of a commission fee to Investment Banker), Company A will deliver to Investment Banker cash or shares of common stock (at Company A's option) equal to the price difference multiplied by 1,000,000. If the volume-weighted average daily market price of Company A's common stock during the contract period is less than the $50 initial purchase price (net of a commission fee to Investment Banker), Investment Banker will deliver to Company A cash equal to the price difference multiplied by 1,000,000.

3. The issue is how an entity should account for an accelerated share repurchase program.

INT 00-15 Discussion

4. The working group reached a consensus to reject the conclusions reached in EITF 99-7 as not applicable to statutory accounting.
INT 00-15 Status

5. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 00-16: EITF 99-11: Subsequent Events Caused by Year 2000

INT 00-16 Dates Discussed
March 13, 2000; June 12, 2000

INT 00-16 References
SSAP No. 9—Subsequent Events (SSAP No. 9)

INT 00-16 Issue
1. Various Year 2000 (Y2K) failures could occur on January 1, 2000, involving products or systems that an entity did not know would fail prior to the actual failures (that is, based on its documentation and testing, the entity believed it would not have any significant Y2K problems). This Issue provides several cases to illustrate how various transactions could be impacted by Y2K failures. Each case assumes that (a) the company’s year-end is December 31, 1999, (b) based on its documentation and testing, the company believed it would not have any significant Y2K problems, and (c) the loss contingency from the Y2K failure is probable and the effect can be reasonably estimated prior to the issuance of the company’s 1999 financial statements. Those cases are as follows:

   a. On January 1, 2000, the software product sold under warranty by Company A malfunctions due to a Y2K-related problem. Prior to the malfunction, Company A believed its software product was Y2K compliant. All revenue related to this software product had been recognized by Company A in 1999 (or earlier). Is the malfunction of Company A’s software product on January 1, 2000, a subsequent event requiring adjustment in the 1999 financial statements?

   b. Company B sells a product under warranty with embedded software that is “incidental” to the product (for example, an automobile with a built-in diagnostics computer). On January 1, 2000, the embedded software malfunctions due to a Y2K failure causing a warranty problem on the product sold in 1999. Is the malfunction of Company B’s product on January 1, 2000, a subsequent event requiring adjustment in the 1999 financial statements?

   c. Company C has receivable balances (resulting from sales in 1999) outstanding at December 31, 1999, that appear collectible. In January 2000, it becomes apparent that Company C will be unable to collect all amounts due as a result of some of its customers experiencing Y2K failures. During what period should the bad debt be recorded?

   d. Company D (a financial institution) has loans receivable balances outstanding at December 31, 1999, that appear collectible. In January 2000, it becomes apparent that Company D will be unable to collect all amounts due as a result of some of its customers experiencing unexpected Y2K failures. During what period should the provision for bad debt be recorded?

   e. Company E sells a product. On January 1, 2000, Company E’s product malfunctions due to a Y2K failure in the embedded software. Company E has an inventory of that product as of December 31, 1999. Should the inventory valuation (or inventory reserve) at December 31, 1999, be adjusted for the effect of the product malfunction on January 1, 2000?
f. Company F sells a software product. At December 31, 1999, Company F has capitalized software costs associated with the product in accordance with Statement 86. On January 1, 2000, Company F discovers that the product has a malfunction caused by a Y2K failure. Assuming that the malfunction affects the realizability of the product, should the subsequent data available about the software product be used in assessing the capitalized software asset impairment at December 31, 1999?

g. Company G has costs capitalized at December 31, 1999, that relate to software products developed or obtained for internal use. On January 1, 2000, a software product malfunctions due to a Y2K failure. Should the subsequent information be used in evaluating the asset’s realizability at December 31, 1999?

h. Company H has production equipment (that is, a long-lived asset) that has embedded software. On January 1, 2000, the equipment malfunctions due to Y2K problems. Should the subsequent information be used in evaluating the asset's realizability at December 31, 1999, in applying Statement 121?

i. Company I has a contract with Company M to perform invoice services for a two-year period ended December 31, 2000. Invoice services have been provided through December 31, 1999. On January 1, 2000, Company I realizes it will not be able to fulfill its obligation under the contract due to internal Y2K failures. In December 1999, Company I was unaware that it would be unable to fulfill its contract with Company M. When would the contingent obligation related to any contractual damages be recorded? Does the answer vary if contractual damages are specifically called for in the contract?

j. Company J is sued before the issuance of the 1999 financial statements, but after December 31, 1999, for a claim arising from Y2K problems. For example, Company J (a supplier) is sued by one of its customers for that customer's loss of profits for 10 days during which Company J was unable to supply its product. If the loss due to this litigation is probable and an amount can be estimated, in what period should the loss contingency be recognized?

k. Company K (an insurance company) writes policies to provide coverage for business interruption that could occur due to Y2K failures. The policies were issued specifically to cover business interruption as a result of Y2K failures. Prior to the issuance of its 1999 financial statements, Company K receives several claims under those policies related to Y2K failures that resulted in business interruption that occurred on or after January 1, 2000. In what period should the costs for those claims be recognized?

l. Company L (an insurance company) writes policies to provide coverage for product liability claims made against an insured that occur due to Y2K failures. The policies were issued specifically to cover product liability as a result of Y2K failures. Prior to the issuance of its 1999 financial statements, Company L receives several claims under those policies related to Y2K failures that occurred on January 1, 2000. In what period should the costs for those claims be recognized?

2. The issue is when costs or losses associated with Y2K failures that are detected subsequent to the balance sheet date but prior to the issuance of financial statements should be recognized.

INT 00-16 Discussion

3. The working group reached a consensus to reject the conclusions reached in EITF 99-11 as not applicable due to the fact that the effective date of the Accounting Practices and Procedures Manual is January 1, 2001.
INT 00-16 Status

4. No further discussion is planned.
INT 00-17 Appendix B

Interpretation of the Emerging Accounting Issues Working Group

INT 00-17: EITF 99-13: Application of Issue No. 97-10 and FASB Interpretation No. 23 to Entities that Enter into Leases with Governmental Entities

INT 00-17 Dates Discussed

March 13, 2000; June 12, 2000

INT 00-17 References

No SSAP reference

INT 00-17 Issue

1. Governmental entities typically fund major real property improvements, such as airports and transit or port facilities, through the issuance of tax-exempt bonds that will be repaid from rental payments under a lease agreement with the lessee of the improvements. The lessee typically is the general contractor during the construction period for the improvement, seeking reimbursement from the bond trustee as funds are spent to complete the project. The lessee’s involvement during the construction period may take various forms, such as guaranteeing the construction debt or providing construction financing directly or indirectly. While each arrangement will differ in form and in the degree to which the lessee is required to be involved, a guarantee of the underlying financing would require the lessee to be considered the owner of the project under Issue No. 97-10, “The Effect of Lessee Involvement in Asset Construction,” because a lessee providing a guarantee to parties other than the lessor (except for environmental risks) is an automatic indication of ownership under that Issue. There also may be other forms of lessee involvement during the construction period, such as a date-certain lease provision, that cause the lessee to fail the 90 percent “maximum guarantee” test in Issue 97-10, thereby causing the lessee to be deemed the owner of the construction project for financial reporting purposes. Finally, other aspects of the arrangement between the governmental lessor and the lessee could be automatic indicators under Issue 97-10 that the lessee should be considered for accounting purposes to be the owner of the project during the construction period.

2. If the lessee was considered the owner of the construction project based on Issue 97-10, application of Statement 98 when construction is completed would result in the transaction being treated as a financing transaction (that is, the property and related “financing” would remain on the lessee’s balance sheet) if the lessee has guaranteed the underlying financing (which is a form of continuing involvement prohibited by Statement 98). Other aspects of the arrangement also may cause the transaction to be accounted for as a financing or by the deposit method under Statement 98. If the transaction is accounted for as a financing or by the deposit method, the leasing literature is not applicable. However, Statement 13 and Interpretation 23 contain criteria whereby certain leases with governmental entities are accounted for as operating leases without regard to the classification criteria in paragraph 7 of Statement 13.

3. The issue is whether projects involving the construction of government-owned properties that involve a lease of the completed improvements that would be classified as an operating lease under Interpretation 23 should be excluded from the scope of Issue 97-10.

INT 00-17 Discussion

4. The working group reached a consensus to reject the conclusions reached in EITF 99-13 as not applicable to statutory accounting.
INT 00-17 Status

5. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 00-18: EITF 99-15: Accounting for Decreases in Deferred Tax Asset Valuation Allowances Established in a Purchase Business Combination as a Result of a Change in Tax Regulations

INT 00-18 Dates Discussed

March 13, 2000; June 12, 2000

INT 00-18 References

No SSAP reference

INT 00-18 Issue

1. On June 25, 1999, new consolidated tax return regulations were issued that changed the rules for utilizing certain net operating loss carryforwards and carrybacks (NOLCs) by eliminating the requirement to apply the limitations on the separate return limitation year losses to situations in which a change in ownership as defined in Section 382 of the Internal Revenue Code (Section 382) has occurred within six months of a target company becoming a member of a consolidated group. As a result of the new tax regulations, only the loss limitation of Section 382 applies in those circumstances. The change in tax regulations requires an entity to reevaluate the need for an existing valuation allowance for deferred tax assets relating to NOLCs acquired in a prior business combination. In the event that the valuation allowance is reduced or eliminated, there appears to be conflicting guidance about whether the effect of the adjustment should be (a) included in operations (pursuant to paragraph 27 of Statement 109) or (b) applied first to reduce to zero any goodwill related to the acquisition, second to reduce to zero other noncurrent intangible assets related to the acquisition, and third to reduce income tax expense (pursuant to paragraph 30 of Statement 109).

2. The issue is whether to effect the change in tax law or regulation that results in a decrease in a valuation allowance that initially was recorded in the allocation of the purchase price in a purchase business combination should be included in income from continuing operations pursuant to paragraph 27 of Statement 109 or as an adjustment to the purchase price allocation pursuant to paragraph 30 of Statement 109.

INT 00-18 Discussion

3. The working group reached a consensus to reject the conclusions reached in EITF 99-15 as not applicable to statutory accounting.

INT 00-18 Status

4. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 00-19: EITF 99-18: Effect on Pooling-of-Interests Accounting on Contracts Indexed to a Company’s Own Stock

INT 00-19 Dates Discussed

March 13, 2000; June 12, 2000

INT 00-19 References

SSAP No. 68—Business Combinations and Goodwill (SSAP No. 68)

INT 00-19 Issue

1. A company enters into a contract indexed to its own shares. The contract may provide for physical share settlement, net share settlement, or cash settlement. The consensus in Issues No. 96-13, Accounting for Derivative Instruments Indexed to, and Potentially Settled in, a Company’s Own Stock and No. 99-3, Application of Issue No. 96-13 to Derivative Instruments with Multiple Settlement Alternatives require such contracts to be classified as equity instruments or as assets or liabilities, depending on the contracts’ provisions for settlement. It is not clear how entering into a contract indexed to a company’s own shares affects the company’s ability to account for a business combination as a pooling of interests.

2. The issues are:

   a. Issue 1—Whether the sale or purchase of a contract that is indexed to a company’s own shares is an alteration of equity interests that must be evaluated to determine whether it represents a violation of paragraph 47 (c) of Opinion 16.

   b. Issue 2—For contracts indexed to a company’s own shares and settled within two years before initiation or between initiation and consummation of the business combination, whether any resulting shares received (or synthetically received) are presumed to be tainted treasury shares under paragraph 47(d) of Opinion 16 and whether any resulting shares issued (or synthetically issued) can “cure” existing tainted treasury shares.

   c. Issue 3—For contracts indexed to a company’s own shares that are settled after consummation of a business combination that can result in the issuer receiving its common shares (or synthetically receiving its common shares), whether the contract must be reevaluated to determine whether it represents an intention to acquire treasury shares that is part of combination and a violation of paragraph 48(a) of Opinion 16 (as interpreted by SAB 96).

INT 00-19 Discussion

3. The working group reached a consensus to reject the conclusions reached in EITF 99-18 as not applicable to statutory accounting.

INT 00-19 Status

4. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 00-20: Application of SEC SAB No. 99, Materiality to the Preamble of the AP&P Manual

INT 00-20 Dates Discussed

June 12, 2000; September 20, 2000; June 11, 2001; October 16, 2001

INT 00-20 References

Preamble

INT 00-20 Issue

1. In summary, SEC Staff Accounting Bulletin No. 99, Materiality (SAB No. 99) addresses two issues; 1) may a company or auditor assume the immateriality of items that fall below a percentage threshold set by management or its auditors to determine whether amounts and items are material to the financial statements? and 2) may a company make intentional immaterial misstatements in its financial statements? The SEC staff answers each question as NO and gives numerous references to FASB guidelines to support their opinion.

2. The issue is whether the responses outlined in SAB No. 99 can be applied to statutory accounting and the concept of Materiality as defined in paragraphs 44 to 49 of the Preamble?

INT 00-20 Discussion

3. At the 2000 Spring National Meeting, the Statutory Accounting Principles Working Group (SAPWG) reviewed SAB No. 99 for incorporation into the Accounting Practices and Procedures Manual. The SAPWG determined that no modifications to the Preamble were warranted and referred the issue to the NAIC/AICPA Working Group for their consideration. The SAPWG felt the SAB had applicability to management of reporting entities, independent auditors and State Examiners. The NAIC/AICPA WG reviewed the SAB and determined that an interpretation of the Preamble was a more effective way to adopt the SAB for statutory accounting. The NAIC/AICPA WG felt that the AP&P Manual reached a larger audience than the A/S Instructions or Examiner’s Handbook.

4. The working group reached a consensus to adopt an interpretation of the concept of materiality based on certain matters outlined in SAB No. 99. The working group believes the responses below provide additional support for the concepts delineated in Section VI of the Preamble. The SAB contains numerous references to SEC guidelines and GAAP pronouncements that are not reflected in this interpretation as such matters are not necessarily applicable or appropriate for statutory financial reporting. The interpretative responses (as modified by this interpretation) are as follows:

QUESTION: Paragraph 49 of the Preamble states “The provisions of this Manual need not be applied to immaterial items.” May a reporting entity’s management, state examiner or independent auditor of the entity’s financial statements assume the immateriality of items that fall below a percentage threshold set by management, state examiner or independent auditor to determine whether amounts and items are material to the financial statements?

INTERPRETIVE RESPONSE No. Over time, the NAIC is aware that reporting entities have developed quantitative thresholds as “rules of thumb” to assist in the preparation of their financial statements, and that state examiners and independent auditors also have used these thresholds in
their evaluation of whether items might be considered material to users of a reporting entity’s financial statements. One rule of thumb in particular suggests that the misstatement or omission of an item that falls under a 5% of surplus threshold is not material in the absence of particularly egregious circumstances, such as self-dealing or misappropriation by senior management. Exclusive reliance on this or any percentage or numerical threshold has no basis in the accounting literature or the law.

The use of a percentage as a numerical threshold, such as 5% of surplus, may provide the basis for a preliminary assumption that - without considering all relevant circumstances - a deviation of less than the specified percentage with respect to a particular item on the reporting entity’s financial statements is unlikely to be material. The NAIC has no objection to such a “rule of thumb” as an initial step in assessing materiality. But quantifying, in percentage terms, the magnitude of a misstatement is only the beginning of an analysis of materiality; it cannot appropriately be used as a substitute for a full analysis of all relevant considerations. Materiality concerns the significance of an item to users of the reporting entity’s financial statements. A matter is “material” if there is a substantial likelihood that a reasonable person would consider it important.

QUESTION: May a reporting entity make intentional immaterial misstatements in its financial statements?

INTERPRETIVE RESPONSE No. In certain circumstances, intentional immaterial misstatements are unlawful.

Each reporting entity must make and keep books, records, and accounts, that, in reasonable detail, accurately and fairly reflect the acquisitions and dispositions of assets of the reporting entity and must maintain internal control that is sufficient to provide reasonable, but not absolute, assurances that, among other things, transactions are recorded as necessary to permit the preparation of financial statements in conformity with the revised Accounting Practices and Procedures Manual. In this context, determinations of what constitutes “reasonable assurance” and “reasonable detail” are based not on a “materiality” analysis but on the level of detail and degree of assurance that would satisfy prudent individuals in the conduct of their own affairs. It is unlikely that it is ever “reasonable” for a reporting entity to record misstatements or not to correct known misstatements as part of an ongoing effort directed by or known to senior management for the purpose of “managing” reported results or financial position.

The National Commission on Fraudulent Financial Reporting, also known as the Treadway Commission, in its 1987 report,

The tone set by top management - the corporate environment or culture within which financial reporting occurs - is the most important factor contributing to the integrity of the financial reporting process. Notwithstanding an impressive set of written rules and procedures, if the tone set by management is lax, fraudulent financial reporting is more likely to occur.

Statement on Auditing Standards No. ("SAS") 54, "Illegal Acts by Clients," and SAS No. 82, "Consideration of Fraud in a Financial Statement Audit" provide guidance to the independent auditor. Pursuant to paragraph 38 of SAS 82, if the independent auditor determines there is evidence that fraud may exist, the independent auditor must discuss the matter with the appropriate level of management. The auditor must report directly to the audit committee fraud involving senior management and fraud that causes a material misstatement of the financial statements. Paragraph 4 of SAS No. 82 states that "misstatements arising from fraudulent financial reporting are intentional misstatements or omissions of amounts or disclosures in
financial statements to deceive financial statement users." SAS No. 82 further states that fraudulent financial reporting may involve falsification or alteration of accounting records; misrepresenting or omitting events, transactions or other information in the financial statements; and the intentional misapplication of accounting principles relating to amounts, classifications, the manner of presentation, or disclosures in the financial statements. The clear implication of SAS No. 82 is that immaterial misstatements may be fraudulent financial reporting.

Independent auditors that learn of intentional misstatements may also be required to (1) re-evaluate the degree of audit risk involved in the audit engagement, (2) determine whether to revise the nature, timing, and extent of audit procedures accordingly, and (3) consider whether to resign.

Intentional misstatements also may signal the existence of reportable conditions or material weaknesses in the reporting entity’s system of internal accounting control designed to detect and deter improper accounting and financial reporting.

An auditor is required to report to the audit committee any reportable conditions or material weaknesses in a reporting entity’s system of internal accounting control that the auditor discovers in the course of the examination of the registrant's financial statements.

INT 00-20 Status

5. No further discussion planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 00-21: Disclose Requirement of SSAP No. 10 Paragraphs 17 & 18

ISSUE NULLIFIED BY SSAP 10 QUESTION AND ANSWER IMPLEMENTATION GUIDE WHICH CAN BE FOUND AS EXHIBIT A TO SSAP 10.

INT 00-21 Dates Discussed
June 12, 2000; September 11, 2000

INT 00-21 References
SSAP No. 10—Income Taxes

INT 00-21 Issue
1. The following guidance is included in paragraphs 17 and 18 of SSAP No. 10—Income Taxes (SSAP No. 10):

17. Statutory financial statement disclosure shall be made in a manner consistent with the provisions of paragraphs 43—45 and 48 of FAS 109. However, required disclosures with regard to a reporting entity's valuation allowance shall be replaced with disclosures relating to the nonadmittance of some portion or all of a reporting entity's DTAs. The financial statements shall include the disclosures required by paragraph 47 of FAS 109 for non-public companies. Paragraphs 18 to 23 describe the disclosure requirements as modified for the difference between the requirements of FAS 109 and those prescribed by this statement.

18. The components of the net DTA or DTL recognized in a reporting entity’s balance sheet shall be disclosed as follows:

   a. The total of all DTAs (admitted and nonadmitted);
   b. The total of all DTLs;
   c. The total DTAs nonadmitted as the result of the application of paragraph 10; and
   d. The net change during the year in the total DTAs nonadmitted.

2. Paragraph 17 indicates that paragraph 43 of FAS 109: Accounting for Income Taxes (FAS 109) is adopted but is silent as to the issue of a public or nonpublic enterprise. Paragraph 43 of FAS 109 reads as follows:

43. The components of the net deferred tax liability or asset recognized in an enterprise's statement of financial position shall be disclosed as follows:

   a. The total of all deferred tax liabilities measured in procedure (b) of paragraph 17
   b. The total of all deferred tax assets measured in procedures (c) and (d) of paragraph 17
   c. The total valuation allowance recognized for deferred tax assets determined in procedure (e) of paragraph 17.

The net change during the year in the total valuation allowance also shall be disclosed. A public enterprise shall disclose the approximate tax effect of each type of temporary difference and carryforward that gives rise to a significant portion of deferred tax liabilities and deferred tax assets (before allocation of valuation allowances). A nonpublic enterprise shall disclose the types of significant temporary differences and carryforwards but may omit disclosure of the tax...
effects of each type. A public enterprise that is not subject to income taxes because its income is
taxed directly to its owners shall disclose that fact and the net difference between the tax bases
and the reported amounts of the enterprise's assets and liabilities.

3. The issues are:

   a. Should entities use their own judgement to determine whether they are a public or
      nonpublic enterprises as those terms are not defined in the SSAP?

   b. As noted in paragraph 17 of SSAP No. 10, there is a specific reference to require the
      nonpublic disclosure of paragraph 47 of FAS 109; therefore should there be specific
      guidance for paragraph 43?

INT 00-21 Discussion

4. The working group reached a consensus to adopt a requirement that all entities complete the
   provisions of SSAP No. 10 paragraph 18 following the public enterprises guidelines outlined in paragraph
   43 of FAS 109. The rationale for the recommendation is that it is important for analysts to see this level of
detail every year rather than every three years when an examination is completed. In addition, as the
concept of deferred income taxes is new to the regulators, the working group feels that additional
disclosure is appropriate.

INT 00-21 Status

5. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 00-22: Application of SSAP No. 10 to Admissibility of Deferred Tax Assets

ISSUE NULLIFIED BY SSAP 10 QUESTION AND ANSWER IMPLEMENTATION GUIDE WHICH CAN BE FOUND AS EXHIBIT A TO SSAP 10.

INT 00-22 Date Discussed
June 12, 2000; September 11, 2000

INT 00-22 References
SSAP No. 10—Income Taxes (SSAP No. 10)

INT 00-22 Issue

1. SSAP No. 10, paragraph 10.a., provides that a reporting entity may admit deferred tax assets (DTAs) in an amount equal to federal income taxes paid in prior years that can be recovered through loss carrybacks for existing temporary differences that reverse by the end of the subsequent calendar year. The NAIC staff have received several inquires as to the practical application of this admissibility guidance.

2. The primary question that arises is whether or not the reporting entity is required to project a tax net operating loss (NOL) for future periods before admitting any DTAs in accordance with paragraph 10.a. Interpreted literally, it appears the reporting entity is required to estimate a tax NOL for the subsequent tax year. However, the following practical application concerns arise when estimating a tax NOL:

   a. An entity may not be able to estimate their tax NOL or tax obligation for the subsequent tax year. While taxable entities currently estimate their tax on a quarterly basis to ensure proper quarterly tax payments are made to the Internal Revenue Service, the entity may not be able to reasonably estimate the annual tax.

   b. An entity will be able to admit the same amount of DTA for loss carrybacks pursuant to paragraph 10.b.i. of SSAP No. 10, provided the entity is not limited to the ten percent of statutory capital and surplus described in paragraph 10.b.ii.

   c. It is uncertain whether or not the benefit of estimating a tax NOL for the subsequent tax year will exceed the costs involved (i.e., subjectivity in estimates) in performing the estimation.

INT 00-22 Discussion

3. The working group reached a consensus that paragraph 10.a. of SSAP No. 10 does not require a reporting entity to project a tax NOL for future periods. Rather, the reporting entity may admit DTAs equal to the amount of taxes paid in prior years (the tax years before the NOL year) that can be recovered through loss carrybacks for existing temporary differences that reverse by the end of the subsequent calendar year, regardless of whether or not the reporting entity anticipates a tax NOL in the following tax year. Generally, the reporting entity must carry back the entire amount of the NOL to the applicable tax years before the NOL year (the carryback period), and then carry forward any remaining NOL (the carryforward period). The reporting entity can, however, choose not to carry back an NOL and carry it
forward only. The NOL year is the year in which the NOL occurred. The reporting entity cannot deduct any part of the NOL remaining after the carryforward period. This interpretation is illustrated as follows:

**Assumptions:**

1. ABC Company paid Year 2001 taxes in the amount of $300,000. The entire $300,000 may be carried back pursuant to the two year carryback period provided by the current IRS provisions. Year 2001 was the first year in which the company paid income taxes. The company does not expect to generate a tax NOL in 2002.
2. ABC Company has $10,000,000 of gross DTAs at 12/31/01, $2,000,000 of which is expected to reverse by 12/31/02. The $2,000,000 is significantly less than 10% of the company’s adjusted capital and surplus.
3. ABC Company has $8,000,000 of gross deferred tax liabilities (DTLs) at 12/31/01.

ABC Company will admit the following DTAs at 12/31/01 pursuant to SSAP No. 10:

| Paragraph 10.a. | $300,000 | (Taxes paid in prior year which are eligible for NOL carryback.) |
| Paragraph 10.b. | 1,700,000 | ($2,000,000 worth of DTAs reversing in 2002 less $300,000 from paragraph 10.a.) |
| Paragraph 10.c. | 8,000,000 | (Amount of DTAs offset against existing DTLs.) |
| Total           | 10,000,000 |

**INT 00-22 Status**

4. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 00-23: Reinsurance of Deposit Type Contracts

INT 00-23 Dates Discussed

June 12, 2000; September 11, 2000

INT 00-23 References

Appendix A-791, Life and Health Reinsurance Agreements (A-791)
Appendix A-785, Credit for Reinsurance (A-785)
SSAP No. 50—Classifications and Definitions of Insurance or Managed Care Contracts In Force (SSAP No. 50)
SSAP No. 52—Deposit-Type Contracts (SSAP No. 52)
SSAP No. 61—Life, Deposit-Type and Accident and Health Reinsurance (SSAP No. 61)

INT 00-23 Issue

1. In the situation under consideration, an insurer issues a guaranteed interest contract or funding agreement to an institutional customer that provides for the accumulation of a deposit at a fixed or variable interest rate. The contract either has a specific maturity date or it has a notice period for withdrawal (for example 180 days) in lieu of a specific maturity date. Depending on the customer, the contract may provide for interim contract withdrawals for interest accumulated, for specific events (such as 401K plan benefit payments), or for any event with certain notice periods. The contracts may or may not have a market value adjustment or surrender charge for certain types of early withdrawals.

2. These contracts sold to institutions may or may not include life contingent purchase rate guarantees for annuitization. It depends upon the state in which the contract form is filed and the domiciliary state of the issuer as to whether that language is required for form approval. If the language is included in the form, there is no annuitant listed on the schedule page, but one could be announced by the policyholder at a later date. It is not the intention of the policyholder or the expectation of the issuer that annuities will be purchased to settle the terms of the contract. Instead, it is always expected to be settled in cash at the withdrawal date.

3. For this situation, the state in which the contract form is filed does not require language for life contingent purchase rate guarantees for annuitization to be included in the contract, so it is not in the contract.

4. The liability under this contract is ceded from the insurer to an affiliated insurance entity under a 100% coinsurance agreement that meets the transfer of appropriate economic risks under A-791 for guaranteed interest contracts of credit risk, reinvestment risk and disintermediation risk. In addition, the reinsurance contract meets the other accounting requirements listed in A-791.

5. The assuming insurer is licensed to transact insurance or reinsurance or is accredited as a reinsurer in the domiciliary state of the ceding insurer, so it meets the criteria to receive reinsurance credit under A-785.

6. The accounting issue is how to account for the liability that has been ceded on the issuer’s balance sheet when the contract does not contain life contingent purchase rate guarantees for annuitization.
7. There is conflicting reporting guidance promulgated between SSAP No. 52, paragraph 10, which allows the deduction to be made from the policy or claim reserves of the ceding insurer for the amount ceded and SSAP No. 61, paragraph 49, which does not allow the deduction to be made from the policy or claim reserves of the ceding insurer and instead requires a receivable to be established by the ceding insurer.

8. SSAP No. 50 paragraphs 43, 44 and 45, indicate that contracts that do not incorporate insurance risk (i.e., do not have any life or disability contingencies) should be accounted for as deposit-type contracts. SSAP No. 52 paragraph 2 further defines insurance risk “A mortality or morbidity risk is present, if, under the terms of the contract, the reporting entity is required to make payments or forego required premiums contingent upon the death or disability (in the case of life and disability insurance contracts) or the continued survival (in the case of annuity contracts) of a specified individual or group of individuals.” Based on this definition, it appears the contract described above meets the definition of a deposit type contract and should be accounted for in accordance with SSAP No. 52.

9. SSAP No. 52, paragraph 10 indicates that “Policy reserves shall be increased for reinsurance assumed and decreased for reinsurance ceded as further described in SSAP No. 61.” This reference would lead a knowledgeable reader to come to the reasonable conclusion that the ceding insurer would decrease its reserve liability held for the ceded contracts by the amount ceded to the reinsurer.

10. However, there is conflicting language in SSAP No. 61 as it relates to SSAP No. 52, paragraph 10. SSAP No. 61, paragraph 18 indicates “All reinsurance agreements covering insurance products that transfer significant mortality or morbidity risk shall follow the guidance for reinsurance accounting contained in this statement. All reinsurance covering insurance products that do not transfer significant mortality or morbidity risk, or covering deposit-type contracts as defined in SSAP 52 shall follow the guidance contained in SSAP 61 paragraph 49.”

11. SSAP 61 paragraph 49 states “To the extent that a reinsurance contract does not, despite its form, provide for sufficient transfer of risk, or reinsures deposit-type contracts, amounts exchanged between the parties are to be accounted for and reported as follows:

   a. At the outset of the reinsurance contract, the net consideration exchanged between the parties shall be recorded as an asset by the payer for the net considerations and as a liability by the receiver.”

12. It further goes on in paragraph 49b. to state: “No deduction shall be made from the policy or claim reserves on the balance sheet, schedules and exhibits.”

INT 00-23 Discussion

13. The working group reached a consensus to allow a ceding insurer to reduce deposit-type contract reserves for the amount ceded, provided the criteria in Appendices A-785 and A-791 are met.

INT 00-23 Status

14. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 00-24: EITF 98-13: Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee and EITF 99-10: Percentage Used to Determine the Amount of Equity Method Losses

INT 00-24 Dates Discussed
June 12, 2000; September 11, 2000

INT 00-24 References
SSAP No. 46—Investments in Subsidiary, Controlled, and Affiliated Entities (SSAP No. 46)

INT 00-24 Issue

1. EITF 98-13 ISSUE - Topic No. D-68, “Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of an Investee,” provides the FASB staff position that Opinion 18 requires an investor that owns common (or other voting) stock and also (a) owns debt securities (including mandatorily redeemable preferred stock), (b) owns preferred stock, or (c) has extended loans to the investee to continue to report losses. Paragraph 13 of Statement 114, as amended by Statement 118, provides that when a loan is impaired, a creditor shall measure impairment based on the present value of expected future cash flows discounted at the loan's effective interest rate. Paragraph 12 of Statement 115 provides that investments in both debt securities not held to maturity and equity securities that have readily determinable fair values shall be carried at fair value.

2. EITF 99-10 ISSUE - Topic No. D-68, “Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of an Investee,” provides the FASB staff position on an investor's accounting when more than one type of interest is held. Specifically, the FASB staff announced that Opinion 18 requires that when an investor owns common stock and also (a) owns debt securities (including mandatorily redeemable preferred stock), (b) owns preferred stock, or (c) has extended loans to the investee (collectively referred to as "other investments"), the equity method investor should continue to report losses up to the investor's investment carrying value, including any additional financial support made or committed to by the investor. Issue No. 98-13, “Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee,” provides guidance on the interaction between the applicable literature for those instruments and Opinion 18 for situations in which an investee is incurring losses and (a) an investor is not required to advance additional funds to the investee and (b) previous losses have reduced the common stock investment account to zero. However, neither Topic D-68 nor Issue 98-13 provides guidance on how an investor should calculate the amount of equity method losses or subsequent income in that circumstance.

3. The issue is, when an investor is required to account for a common stock investment using the equity method, how the equity method loss pickup from the application of Opinion 18 (when the carrying amount of the common stock has been reduced to zero) interacts with the applicable literature relating to investments in the other securities of the investee (either Statement 114 or Statement 115), and if an investor owns common stock and “other investments” in an investee and is not required to advance additional funds to the investee and if previous losses have reduced the common stock investment account to zero, how additional equity method losses should be measured and recognized by the investor.
INT 00-24 Discussion

4. The working group reached a consensus to adopt the final conclusions reached in EITF 98-13 and 99-10 with modification as follows:

5. The EITF reached a consensus that in situations where (a) an investor is not required to advance additional funds to the investee and (b) previous losses have reduced the common stock investment account to zero, the investor should continue to report its share of equity method losses in its statement of operations to the extent of and as an adjustment to the adjusted basis of the other investments in the investee. The order in which those equity method losses should be applied to the other investments should follow the seniority of the other investments (that is, priority in liquidation). For each period, the adjusted basis of the other investments should be adjusted for the equity method losses, then the investor should apply SSAP No. 46 to the other investments, as applicable.

6. For purposes of this consensus, other investments in the investee include, but are not limited to, preferred stock, debt securities, and loans to the investee (collectively referred to as loans and securities). The cost basis of the other investments is the original cost of those investments adjusted for the effects of other-than-temporary write-downs, unrealized gains and losses, and amortization of any discount or premium on debt securities or loans. The adjusted basis is the cost basis adjusted for the valuation allowance account for an investee loan and the cumulative equity method losses applied to the other investments. Equity method income subsequently recorded should be applied to the adjusted basis of the other investments in reverse order of the application of the equity method losses (that is, equity method income is applied to the more senior securities first).

7. When the investor has loans and securities of the investee that are within the scopes of SSAP No. 46, the investor should perform the following in order to determine the amount of equity method loss to report at the end of a period:
   a. Apply SSAP No. 46 to determine the maximum amount of equity method losses.
   b. Determine whether the adjusted basis of the other investment(s) in the investee is positive.
      i. When the adjusted basis is positive, the adjusted basis of the other investments should be adjusted for the amount of the equity method loss based on its seniority. For investments accounted for in accordance with SSAP No. 30, this adjusted basis becomes the security’s basis from which subsequent changes in fair value are measured.
      ii. When the adjusted basis reaches zero, equity method losses should cease being reported; however, the investor should continue to track the amount of unreported equity method losses for purposes of applying SSAP No. 46. (If one of the other investments is sold at a time when its carrying value exceeds its adjusted basis, the difference between the cost basis of that other investment and its adjusted basis at the time of sale represents equity method losses that were originally applied to that other investment but effectively reversed upon its sale. Accordingly, that excess represents unreported equity method losses that should continue to be tracked before future equity method income can be reported.
   c. After applying SSAP No. 46, apply SSAP No. 30 to the adjusted basis of the other investments in the investee, as applicable. Apply appropriate statutory accounting principles to other investments that are not within the scope of SSAP No. 30.

8. The EITF reached a consensus that an investor should not recognize equity method losses based solely on the percentage of investee common stock held by the investor.
9. The EITF observed that an entity should utilize a single entity-wide approach to determine the amount of its equity method losses when previous losses have reduced the common stock investment account to zero and that the selected policy should be disclosed in the footnotes to the financial statements.

10. The provisions of these consensus’s are effective for interim or annual periods beginning after January 1, 2001.

11. Refer to Exhibit 00-24A for an example that illustrates application of these consensus’s.

INT 00-24 Status

12. No further discussion is planned.
Exhibit 00-24A
ILLUSTRATION OF THE APPLICATION OF THE INT 00-24 CONSENSUS’S

XYZ Investment in ABC Company

1. ABC Company is a life insurance company, formed January 2, 20X1 to sell health insurance in the state of New York. On January 2, 20X1, XYZ Insurance Company invested $500,000 in ABC, and purchased 100,000 shares of common stock at par, and 40,000 shares of preferred stock at par. ABC Preferred stock is non-voting, 5% cumulative.

2. XYZ determined it has obtained a controlling interest in ABC as XYZ owns 50% of the voting interests of ABC. XYZ accounted for its investment in ABC Insurance Company under the statutory equity method of accounting. The following table is selected information from the financial statements of ABC Insurance Company.

<table>
<thead>
<tr>
<th></th>
<th>1/2/20X1</th>
<th>12/31/20X1</th>
<th>12/31/20X2</th>
<th>12/31/20X3</th>
<th>12/31/20X4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Capital and Surplus:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Common stock, $1 par, 200,000 shares issued and outstanding</td>
<td>$ 200,000</td>
<td>$ 200,000</td>
<td>$ 200,000</td>
<td>$ 200,000</td>
<td>$ 200,000</td>
</tr>
<tr>
<td>Preferred stock, $10 par, 100,000 shares issued and outstanding</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>Surplus Notes</td>
<td>$ 130,000</td>
<td>($ 180,000)</td>
<td>($ 630,000)</td>
<td>($1,430,000)</td>
<td>($ 500,000)</td>
</tr>
<tr>
<td>Total Capital and Surplus</td>
<td>$1,200,000</td>
<td>$1,330,000</td>
<td>$1,520,000</td>
<td>$1,070,000</td>
<td>$ 270,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>12/31/20X5</th>
<th>12/31/20X6</th>
<th>12/31/20X7</th>
<th>12/31/20X8</th>
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</thead>
<tbody>
<tr>
<td>Capital and Surplus:</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Common stock, $1 par, 200,000 shares issued and outstanding</td>
<td>$ 200,000</td>
<td>$ 200,000</td>
<td>$ 200,000</td>
<td>$ 200,000</td>
<td>$ 200,000</td>
</tr>
<tr>
<td>Preferred stock, $10 par, 100,000 shares issued and outstanding</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>Surplus Notes</td>
<td>$ 500,000</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>Unassigned Funds (Surplus)</td>
<td>($1,980,000)</td>
<td>($1,830,000)</td>
<td>($1,280,000)</td>
<td>($430,000)</td>
<td>$ 820,000</td>
</tr>
<tr>
<td>Total Capital and Surplus</td>
<td>($280,000)</td>
<td>$ 370,000</td>
<td>$ 920,000</td>
<td>$1,770,000</td>
<td>$3,020,000</td>
</tr>
</tbody>
</table>

3. At 1/2/20X1, XYZ recorded the following entry to record its investment in ABC:

- Investment in ABC Common stock $ 100,000
- Investment in ABC Preferred stock $ 400,000
- Cash $ 500,000

To record initial investment in ABC Insurance Company.
4. During the year ended 12/31/20X1, ABC had statutory net income before dividends of $200,000. At 12/31/20X1, ABC declared and paid a 5% preferred dividend, and a common stock dividend of $.10 per share. XYZ recorded the following entries:

Cash $ 20,000
    Dividend Income $ 20,000
To record preferred dividend income from ABC Insurance Company for 20X1.

Investment in ABC Common stock $ 75,000
    Unrealized Gain/Loss $ 75,000
To record 20X1 unrealized gain on investment in ABC Common. (($200,000 - $50,000) * 50%)

Cash $ 10,000
    Unrealized Gain/Loss $ 10,000
        Dividend Income $ 10,000
        Investment in ABC Common stock $ 10,000
To record 20X1 dividend on ABC Common. (100,000 shares * $.10)

5. During the year ended 12/31/20X2, ABC issued an 8% surplus note of $500,000. XYZ purchased 100% of the surplus note. During that same year, ABC incurred a statutory net loss before dividends of $250,000. At 12/31/20X2, ABC declared and paid a 5% preferred dividend, and a common stock dividend of $.05 per share. No interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

Investment in ABC Surplus Notes $ 500,000
    Cash $ 500,000
To record investment in ABC Insurance Company surplus notes.

Cash $ 20,000
    Dividend Income $ 20,000
To record preferred dividend income from ABC Insurance Company for 20X2.

Unrealized Gain/Loss $ 150,000
    Investment in ABC Common stock $ 150,000
To record 20X2 unrealized loss on investment in ABC Common. (($-250,000 - $50,000) * 50%)

Cash $ 5,000
    Unrealized Gain/Loss $ 5,000
        Dividend Income $ 5,000
        Investment in ABC Common stock $ 5,000
To record 20X2 dividend on ABC Common. (100,000 shares * $.05)
6. During the year ended 12/31/20X3, ABC Insurance Company incurred a statutory net loss before dividends of $400,000. ABC Insurance Company did not declare any dividends, and no interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividends Receivable</td>
<td>$20,000</td>
</tr>
<tr>
<td>Dividend Income</td>
<td>$20,000</td>
</tr>
</tbody>
</table>

To record preferred dividend income from ABC Insurance Company for 20X3.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unrealized Gain/Loss</td>
<td>$182,000</td>
</tr>
<tr>
<td>Investment in ABC Preferred stock</td>
<td>$172,000</td>
</tr>
<tr>
<td>Investment in ABC Common stock</td>
<td>$10,000</td>
</tr>
</tbody>
</table>

To record 20X3 unrealized loss on investment in ABC Common and Preferred.

Total net loss and preferred stock dividend ($450,000).

Common stock component reduces the Investment in ABC Common stock component to $0. (20,000 * 50%)

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total net loss and preferred dividend (-$400,000 - $50,000)</td>
<td>$450,000</td>
</tr>
<tr>
<td>Less amount used to reduce common stock investment to $0</td>
<td>$20,000</td>
</tr>
<tr>
<td>Amount remaining to be allocated to investment in preferred</td>
<td>$430,000</td>
</tr>
<tr>
<td>XYZ ownership % of preferred</td>
<td>40%</td>
</tr>
<tr>
<td>XYZ reduction in investment in preferred</td>
<td>$172,000</td>
</tr>
</tbody>
</table>

7. During the year ended 12/31/20X4, ABC Insurance Company incurred a statutory net loss before dividends of $750,000. ABC Insurance Company did not declare any dividends, and no interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividends Receivable</td>
<td>$20,000</td>
</tr>
<tr>
<td>Dividend Income</td>
<td>$20,000</td>
</tr>
</tbody>
</table>

To record preferred dividend income from ABC Insurance Company for 20X4.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unrealized Gain/Loss</td>
<td>$458,000</td>
</tr>
<tr>
<td>Investment in ABC Preferred stock</td>
<td>$228,000</td>
</tr>
<tr>
<td>Investment in ABC Surplus note</td>
<td>$230,000</td>
</tr>
</tbody>
</table>

To record 20X4 unrealized loss on investment in ABC Preferred and Surplus Notes.

Total net loss and preferred stock dividend ($800,000).

Common stock component reduces the Investment in ABC Preferred stock component to $0. (570,000 * 40%)

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total net loss and preferred dividend (-$750,000 - $50,000)</td>
<td>$800,000</td>
</tr>
<tr>
<td>Less amount used to reduce preferred stock investment to $0</td>
<td>$570,000</td>
</tr>
<tr>
<td>Amount remaining to be allocated to investment in surplus note</td>
<td>$230,000</td>
</tr>
<tr>
<td>XYZ ownership % of surplus note</td>
<td>100%</td>
</tr>
<tr>
<td>XYZ reduction in investment in ABC Surplus Notes</td>
<td>$230,000</td>
</tr>
</tbody>
</table>
8. During the year ended 12/31/20X5, ABC Insurance Company incurred a statutory net loss before dividends of $500,000. ABC Insurance Company did not declare any dividends, and no interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

- **Dividends Receivable**: $20,000
- **Dividend Income**: $20,000

To record preferred dividend income from ABC Insurance Company for 20X5.

- **Unrealized Gain/Loss**: $270,000
- **Investment in ABC Surplus note**: $270,000

To record 20X5 unrealized loss on investment in ABC Surplus Notes.

Total ABC net loss and preferred stock dividend ($500,000 - $50,000).

Surplus Note component calculated as:

- Total net loss and preferred dividend ($500,000 - $50,000): $550,000
- XYZ ownership % of ABC Surplus Note: 100%

Amount of unrealized loss recognized in 20X5: $270,000
Amount of unrealized loss suspended: $280,000

9. Since XYZ has not guaranteed any liabilities of ABC, the reduction they would recognize is limited to their remaining investment in ABC Surplus Notes. Therefore, they would only recognize a 20X5 unrealized loss on their investment in ABC of $270,000.

10. During the year ended 12/31/20X6, ABC Insurance Company realigned their marketing efforts and modified the products they were selling. ABC also issued an additional 8% surplus note of $500,000. This surplus note was purchased by an unaffiliated third party. During the year ended 12/31/X6, ABC Insurance Company had statutory net income before dividends of $200,000. ABC Insurance Company did not declare any dividends on common stock, but declared and paid current and dividends in arrears on preferred. XYZ recorded the following entries:

- **Cash**: $80,000
- **Dividends Receivable**: $60,000
- **Dividend Income**: $20,000

To record preferred dividend income from ABC Insurance Company for 20X6, and receipt of preferred dividends receivable for 20X3, 20X4 and 20X5.

11. XYZ did not record any change in their investment in ABC Surplus Notes, ABC Preferred or ABC Common, since ABCs’ net income after preferred dividends did not exceed the losses accumulated during the period that XYZ suspended recording unrealized losses.

12. The following amounts were tracked:

Total ABC net income and preferred stock dividend ($200,000 - $50,000).

Surplus Note component calculated as:

- Total net income and preferred dividend ($200,000 - $50,000): $150,000
- XYZ ownership % of ABC Surplus Note: 50%

Amount of unrealized loss suspended in 20X5: $75,000
Remaining amount of unrealized loss suspended: $280,000

13. During the year ended 12/31/20X7, ABC Insurance Company had statutory net income before dividends of $600,000. At 12/31/20X7, ABC declared and paid a 5% preferred dividend. No interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:
14. During the year ended 12/31/20X8, ABC Insurance Company had statutory net income before dividends of $900,000. At 12/31/20X8, ABC declared and paid a 5% preferred dividend. No interest or principal repayments of the surplus note were approved. XYZ recorded the following entries:

Cash $ 20,000
Dividend Income $ 20,000
To record preferred dividend income from ABC Insurance Company for 20X8.

Total ABC net income and preferred stock dividend ($900,000 - $50,000).
Surplus Note component calculated as:
- Total net income and preferred dividend ($900,000 - $50,000) $550,000
- XYZ ownership % of ABC Surplus Note 50%
- 20X8 amount of unrealized gain on investment in ABC Surplus Note $275,000

Investment in ABC Surplus Notes $ 425,000
Unrealized Gain/Loss $ 425,000
To record 20X8 unrealized gain on investment in ABC Surplus Notes.

15. During the year ended 12/31/20X9, ABC Insurance Company had statutory net income, before interest on surplus notes and dividends, of $1,400,000. The Commissioner approved one year’s interest payment on the surplus notes. At 12/31/20X9, ABC declared and paid a 5% preferred dividend, and a $.10 dividend per share on Common stock. XYZ recorded the following entries:

Cash $ 20,000
Dividend Income $ 20,000
To record preferred dividend income from ABC Insurance Company for 20X9.

Cash $ 40,000
Interest Income $ 40,000
To record surplus notes interest income from ABC Insurance Company for 20X9. ($500,000 * 8%)

Investment in ABC Surplus Notes $ 5,000
Investment in ABC Preferred Stock $ 400,000
Investment in ABC Common Stock $ 130,000
Unrealized Gain/Loss $ 535,000
To record 20X9 unrealized gain on investment in ABC Common, Preferred and Surplus Notes.
Components computed as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Net Income net of preferred stock dividend and interest on surplus notes</td>
<td>$ 1,270,000</td>
</tr>
<tr>
<td>($1,400,000 - $50,000 - $80,000)</td>
<td></td>
</tr>
<tr>
<td>Less amount needed to restore investment in surplus notes</td>
<td>($ 10,000)</td>
</tr>
<tr>
<td>Amount available for preferred stock and common stock investment restoration</td>
<td>$ 1,260,000</td>
</tr>
<tr>
<td>Amount needed to restore preferred stock component</td>
<td>($ 1,000,000)</td>
</tr>
<tr>
<td>Amount available to restore common stock component</td>
<td>$ 260,000</td>
</tr>
<tr>
<td>Surplus Notes component ($10,000 * 50%)</td>
<td>$ 5,000</td>
</tr>
<tr>
<td>Preferred Stock component ($1,000,000 * 40%)</td>
<td>$ 400,000</td>
</tr>
<tr>
<td>Common stock component ($260,000 * 50%)</td>
<td>$ 130,000</td>
</tr>
<tr>
<td>Cash</td>
<td>$ 10,000</td>
</tr>
<tr>
<td>Unrealized Gain/Loss</td>
<td>$ 10,000</td>
</tr>
<tr>
<td>Dividend Income</td>
<td>$ 10,000</td>
</tr>
<tr>
<td>Investment in ABC Common stock</td>
<td>$ 10,000</td>
</tr>
</tbody>
</table>

To record 20X9 dividend on ABC Common. (100,000 shares * $.10)
INT 00-25 Appendix B

Interpretation of the Emerging Accounting Issues Working Group

INT 00-25: EITF 97-4: Deregulation of the Pricing of Electricity

INT 00-25 Dates Discussed
June 12, 2000; September 11, 2000

INT 00-25 References

No SSAP reference

INT 00-25 Issue

1. Several state legislatures and regulatory commissions have recently approved, and others including federal legislators are currently considering, changes to laws and regulations governing the pricing of electricity. Specifically, those changes relate to the element of the total price of a kilowatt of electricity that is intended to cover its production (“generation”) cost, as opposed to the portion intended to cover the transmission cost to a local area or the portion intended to cover the cost of distribution to individual residences or businesses.

2. The nature of these regulatory changes has been to move away from a pricing model that has prices set by a regulator based on allowable cost toward and ultimately to a pricing model that has prices set by competitive market forces. Because market-based prices are ultimately expected to be lower than the former allowable cost-based regulated pricing, the impact of these regulatory changes on companies that generate electricity has been to transform some of their investment in generation operations into what has been referred to as “stranded costs.”

3. Statement 71 specifies three criteria that must be met in order to reflect the effects of rate regulation in a regulated enterprise’s financial statements. If all of the criteria are met, the enterprise will recognize assets and liabilities that are not recognized by enterprises in general. These assets and liabilities are often referred to as “regulatory assets” and “regulatory liabilities.” An example of a regulatory asset of a utility is the cost to repair damage from an ice storm, if the regulator provides that these specific expenditures will be recovered from customers by inclusion of that cost in the determination of future rates. An example of a regulatory liability of a utility is a gain on the early extinguishment of debt if the regulator provides that this specific gain will be passed through to customers by inclusion of that gain in the determination of future rates. If some of an enterprise's operations are regulated and other operations are not, then Statement 71 should be applied to the portion of an enterprise's operations that meets the three criteria. Statement 101 addresses how an enterprise that ceases to meet the criteria for application of Statement 71 to all or part of its operations should report that event in its general-purpose financial statements.

4. The issues are:
   a. When an enterprise should stop applying Statement 71 to the separable portion of its business whose product or service pricing is being deregulated once legislation is passed or a rate order is issued (whichever is necessary to effect change in the jurisdiction) that has the effect (either immediately or at some point in the future) of deregulating the rates charged to customers
   b. How an enterprise should evaluate whether to continue to recognize all or some portion of the regulatory assets and regulatory liabilities, respectively, that (a) originated from the

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separable portion of the business whose pricing is being deregulated and (b) exist at the
date Statement 101 is applied

c. How an enterprise should evaluate whether to establish additional regulatory assets and
regulatory liabilities related to expenses and obligations, respectively, that will originate
from the separable portion of the business whose pricing is being deregulated but that
will arise subsequent to applying Statement 101.

**INT 00-25 Discussion**

5. The working group reached a consensus to reject the conclusions reached in EITF 97-4 as not
applicable to statutory accounting.

**INT 00-25 Status**

6. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 00-26: EITF 98-3: Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business

INT 00-26 Dates Discussed

June 12, 2000; September 11, 2000

INT 00-26 References

SSAP No. 28—Nonmonetary Transactions (SSAP No. 28)
SSAP No. 68—Business Combinations and Goodwill (SSAP No. 68)

INT 00-26 Issue

1. The basic principle contained in Opinion 29 is that an exchange of nonmonetary assets should be recorded at fair value. Certain modifications to that basic principle are contained in paragraphs 20-23 of Opinion 29. Paragraph 21(b) provides that accounting for an exchange of productive assets for similar productive assets should be based on the recorded amount of the nonmonetary assets relinquished. Paragraph 4 of Opinion 29 states that that Opinion is not applicable to business combinations.

2. Opinion 16 provides accounting guidance for business combinations. Paragraph 1 of Opinion 16 states that “a business combination occurs when a corporation and one or more incorporated or unincorporated businesses are brought together into one accounting entity. The single entity carries on the activities of the previously separate, independent enterprises.”

3. It is not clear whether exchanges of certain types of assets, for example, radio stations, cable systems, and hotels, are considered exchanges of productive assets or business combinations.

4. The issues are whether the exchange of assets or groups of assets involving the receipt of a consolidated business can be considered an exchange of similar productive assets accounted for at historical cost pursuant to paragraph 21 of Opinion 29 and how a “business” should be defined.

INT 00-26 Discussion

5. The working group reached a consensus to adopt the conclusions reached in EITF 98-3 with modification. Opinion 29 is adopted with SSAP No. 28. Although Opinion 16 is rejected in SSAP No. 68, the issues raised in EITF 98-3 are applicable to statutory accounting and SSAP No. 28. The conclusions of EITF 98-3 are adopted as follows:

6. The EITF reached a consensus that the guidance below should be used to evaluate whether a business has been received in a nonmonetary exchange transaction.

7. A business is a self-sustaining integrated set of activities and assets conducted and managed for the purpose of providing a return to investors. A business consists of (a) inputs, (b) processes applied to those inputs, and (c) resulting outputs that are used to generate revenues. For a transferred set of activities and assets to be a business, it must contain all of the inputs and processes necessary for it to continue to conduct normal operations after the transferred set is separated from the transferor, which includes the ability to sustain a revenue stream by providing its outputs to customers.
8. The elements necessary for a transferred set to continue to conduct normal operations will vary by industry and by the operating strategies of the transferred set. An evaluation of the necessary elements should consider:

**Inputs**
- a. Long-lived assets, including intangible assets, or rights to the use of long-lived assets.
- b. Intellectual property.
- c. The ability to obtain access to necessary materials or rights.
- d. Employees.

**Processes**
- e. The existence of systems, standards, protocols, conventions, and rules that act to define the processes necessary for normal, self-sustaining operations, such as (i) strategic management processes, (ii) operational processes, and (iii) resource management processes.

**Outputs**
- f. The ability to obtain access to the customers that purchase the outputs of the transferred set.

9. A transferred set of activities and assets fails the definition of a business if it excludes one or more of the above items such that it is not possible for the set to continue normal operations and sustain a revenue stream by providing its products and/or services to customers. However, if the excluded item or items are only minor (based on the degree of difficulty and the level of investment necessary to obtain access to or to acquire the missing item(s)), then the transferred set is capable of continuing normal operations and is a business. The assessment of whether excluded items are only minor should be made without regard to the attributes of the transferee and should consider such factors as the uniqueness or scarcity of the missing element, the time frame, the level of effort, and the cost required to obtain the missing element. If goodwill is present in a transferred set of activities and assets, it should be presumed that the excluded items are minor and that the transferred set is a business.

10. The assessment of whether a transferred set is a business should be made without regard to how the transferee intends to use the transferred set. In other words, it is not relevant to the evaluation of whether the transferred set is a business whether the transferee will actually operate the set on a stand-alone basis or intends to continue using the transferred set in the same manner as the transferor.

11. If all but a de minimis amount of the fair value of the transferred set of activities and assets is represented by a single tangible or identifiable intangible asset, the concentration of value in the single asset is an indicator that an asset rather than a business is being received.

12. The level of working capital or the adequacy of financing necessary to conduct normal operations in the transferred set is not an indicator either way as to whether the set meets the definition of a business. Likewise, if the planned principal operations of the transferred set have commenced, the presence and/or expectation of continued operating losses while the set seeks to achieve the level of market share necessary to attain profitability is not an indicator of whether or not the set is a business. However, if the transferred set is in the development stage and has not commenced planned principal operations, the set is presumed not to be a business.

13. The determination of whether a transferred set of assets and activities is or is not a business is a three-step process. First, one must identify the elements included in the transferred set. Second, one must compare the identified elements in the transferred set to the complete set of elements necessary for the transferred set to conduct normal operations in order to identify any missing elements. Third, if there are missing elements, one must make an assessment as to whether the missing elements cause one to conclude that the transferred set is not a business. That assessment is based on the degree of difficulty or
the level of investment (relative to the fair value of the transferred set) necessary to obtain access to or to acquire the missing elements. If the degree of difficulty and level of investment necessary to obtain access to or to acquire the missing elements are not significant, then the missing elements are considered minor and their absence would not cause one to conclude that the transferred set is not a business. The determination of the degree of difficulty or level of investment necessary to obtain access to or to acquire the missing elements requires significant judgment and is dependent on the particular facts and circumstances.

**INT 00-26 Status**

14. No further discussion is planned.
Appendix B

Interpretation of the Emerging Accounting Issues Working Group

INT 00-27: EITF 98-9: Accounting for Contingent Rent

INT 00-27 Dates Discussed

June 12, 2000; September 11, 2000

INT 00-27 References

SSAP No. 22—Leases (SSAP No. 22)

INT 00-27 Issue

1. Some rental agreements provide for minimum rental payments plus contingent rents based on the lessee’s operations, such as a future specified sales target. The literature is unclear as to how contingent rent based on future specified targets should be accounted for in reporting periods prior to achievement of the target.

2. Paragraph 19(b) of Statement 13 provides guidance on how the lessor should account for an operating lease and states that “rent shall be reported as income over the lease term as it becomes receivable according to the provisions of the lease”. Paragraph 15 of Statement 13 provides guidance on how the lessee should account for an operating lease and states that “normally, rental on an operating lease shall be charged to expense over the lease term as it becomes payable” (emphasis added). In addition, paragraph 13 of Statement 29 states that “contingent rentals shall be included in the determination of income as accruable”.

3. With regard to interim period financial statements, paragraph 11 of Opinion 28 states that “revenue from products sold or services rendered should be recognized as earned during an interim period on the same basis as followed for the full year.” In addition, paragraph 17 of Opinion 28 states that “the amounts of certain costs and expenses are frequently subjected to year-end adjustments even though they can be reasonably approximated at interim dates. To the extent possible such adjustments should be estimated and the estimated costs and expenses assigned to interim periods so that the interim periods bear a reasonable portion of the anticipated annual amount.”

4. The issues are:
   a. How a lessor should account for contingent rental income that is based on future specified targets.
   b. How a lessee should account for contingent rental expense that is based on future specified targets.

INT 00-27 Discussion

5. The working group reached a consensus to adopt the final conclusions reached in EITF 98-9 with modification. The conclusions of EITF 98-9 are adopted as follows:

6. With respect to lessors’ accounting for contingent rent, entities shall follow the revenue guidelines outlined in Question 8 of SEC SAB No. 101 - Revenue Recognition in Financial Statements. The working group will expect entities that have not applied this accounting to report a change in accounting principle in accordance with SSAP No. 3 by no later than the first fiscal quarter of the fiscal year beginning January 1, 2001.
7. The applicable provision of SEC SAB No. 101 is as follows: (Question 8 excerpted from full text of SEC SAB No. 101):

**Question 8**

Facts: Company A owns and leases retail space to retailers. Company A (lessor) renews a lease with a customer (lessee) that is classified as an operating lease. The lease term is one year and provides that the lease payments are $1.2 million, payable in equal monthly installments on the first day of each month, plus one percent of the lessee's net sales in excess of $25 million if the net sales exceed $25 million during the lease term (*i.e.*, contingent rental). The lessee has historically experienced annual net sales in excess of $25 million in the particular space being leased, and it is probable that the lessee will generate in excess of $25 million net sales during the term of the lease.

Question: Should the lessor recognize any rental income attributable to the one percent of the lessee’s net sales exceeding $25 million before the lessee actually achieves the $25 million net sales threshold?

Interpretive Response: No. The working group believes that contingent rental income “accrues” (*i.e.*, it should be recognized as revenue) when the changes in the factor(s) on which the contingent lease payments is (are) based actually occur.

8. With respect to lessees’ accounting for contingent rent, the EITF reached a consensus that a lessee should recognize contingent rental expense (in annual periods as well as in interim periods) prior to the achievement of the specified target that triggers the contingent rental expense, provided that achievement of that target is considered probable. Previously recorded rental expense should be reversed into income at such time that it is probable that the specified target will not be met.

**INT 00-27 Status**

9. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 00-28: EITF 99-12: Determination of the Measurement Date for the Market Price of Acquirer Securities Issued in a Purchase Business Combination

INT 00-28 Dates Discussed

June 12, 2000; September 11, 2000

INT 00-28 References

SSAP No. 68—Business Combinations and Goodwill (SSAP No. 68)

INT 00-28 Issue

1. Opinion 16 appears to include contradictory guidance about the date that should be used to value equity securities issued to effect a business combination accounted for using the purchase method. Paragraph 74 of Opinion 16 states that “the market price for a reasonable period before and after the date the terms of the acquisition are agreed to and announced should be considered in determining the fair value of securities issued.” However, paragraph 94 of Opinion 16 refers to determining the cost of an acquired company as of the date of acquisition, which is defined in paragraph 93 as, “ordinarily . . . the date assets are received and other assets are given or securities are issued.” This Issue addresses that apparent contradiction.

2. The interval between initiating and completing a business combination may involve an extended period of time. Although management of the companies involved may agree to and announce the terms of a business combination at the initiation date, internal or external contingencies, such as the need to obtain shareholder or regulatory approvals, may exist and prevent concurrent consummation of the combination. Because of the length of time that may be required to resolve those contingencies, the market price of the securities that are expected to be issued to effect a purchase business combination may fluctuate. As a result, the total cost of the acquired company assigned by the acquirer may vary significantly depending on the date that is used to value the securities that are issued.

3. The issues are:

   a. The date that should be used to value marketable equity securities of the acquirer issued to effect a business combination accounted for using the purchase method when the number of the acquirer’s shares or amount of other consideration is not subject to change pursuant to the existing terms of the acquisition agreement

   b. The date that should be used as the measurement date to value equity securities of the acquirer issued in a purchase business combination if the number of the acquirer’s shares or amount of other consideration to be issued could change pursuant to a formula in the initial acquisition agreement.

INT 00-28 Discussion

4. The working group reached a consensus to adopt the final conclusions reached in EITF 99-12 with modification. Although Opinion No. 16 is rejected in SSAP No. 68, the issues identified in EITF 99-12 are applicable to paragraph 3 of SSAP No. 68. The issue of cost is defined as:
3. The statutory purchase method of accounting is defined as accounting for a business combination as the acquisition of one entity by another. It shall be used for all purchases of SCA entities including partnerships, joint ventures, and limited liability companies. The acquiring reporting entity shall record its investment at cost. Cost is defined as the sum of: (a) any cash payment, (b) the fair value of other assets distributed, (c) the fair value of any liabilities assumed, and (d) any direct costs of the acquisition.

5. As shown in subsection b of the excerpted paragraph above, SSAP No. 68 does not address the timing issues raised in EITF 99-12 of “other assets distributed”.

6. The modifications to the conclusions reached in EITF 99-12 are as follows:

7. The EITF reached a consensus on Issue 1 that the value of the acquirer’s marketable equity securities issued to effect a purchase business combination should be determined, pursuant to the guidance in paragraph 74 of Opinion 16, based on the market price of the securities over a reasonable period of time before and after the terms of the acquisition are agreed to and announced. In other words, the date of measurement of the value of the acquirer’s marketable equity securities should not be influenced by the need to obtain shareholder or regulatory approvals. EITF members observed that the reasonable period of time referred to in paragraph 74 of Opinion 16 is intended to be very short, such as a few days before and after the acquisition is agreed to and announced. EITF members also observed that in transactions involving a hostile tender offer, the measurement date for the value of the acquirer's marketable equity securities occurs when the proposed transaction is announced and sufficient shares have been tendered to make the offer binding or when the proposed acquisition becomes nonhostile, as evidenced by the target company’s agreement to the purchase price.

8. The EITF also reached a consensus that if the purchase price (the number of shares or the amount of other consideration) is subsequently changed as a result of further negotiations or a revised acquisition agreement, a new measurement date for valuing the acquirer’s marketable equity securities that will be issued to effect the combination is established as of the date of the change. The working group clarified that if the change in the number of shares or other consideration is not substantive, a new measurement date does not result from the change.

9. The EITF addressed the accounting for contingent consideration issued to effect a purchase business combination in Issue No. 97-8, “Accounting for Contingent Consideration Issued in a Purchase Business Combination.” The measurement guidance in this Issue is to be applied to the acquirer’s equity securities issued to effect a business combination accounted for using the purchase method, including those instruments that meet the criteria in Issue 97-8 for recording as part of the cost of the business acquired. (EITF 97-8 was adopted by the working group in INT 99-10)

10. The EITF reached a consensus on Issue 2 that if the application of the formula results in a change to the number of shares or the amount of other consideration to be issued in the purchase business combination, then the first date on which the number of acquirer shares and the amount of other consideration become fixed without subsequent revision is the measurement date. That is, the measurement date is the earliest date, from the date the terms of the acquisition are agreed to and announced to the date of final application of the formula pursuant to the acquisition agreement, on which subsequent applications of the formula do not result in a change in the number of shares or the amount of other consideration. For example, assume the terms of a purchase business combination are agreed to and announced on March 1, 1999. Also assume that the purchase agreement includes a formula arrangement that specifies that an adjustment will be made to the number of shares issued in the business combination if the average closing security price for the 10 days ending June 30, 1999, is less than $16. If the 10-day average closing security price drops below $16 for the first time on June 1, 1999, and does not subsequently recover to an amount equal to or greater than $16 from June 1, 1999 through June 30, 1999, June 1, 1999 is the measurement date. However, if the originally announced number of shares or amount of other consideration does not change as a result of final application of the formula, then the initial date...
that the terms were agreed to and announced is the measurement date. The EITF noted that a new measurement date does not occur as a result of the application of a nonsubstantive formula in the original agreement.

11. As another example, assume that the terms of the acquisition are agreed to and announced on March 31, 1999. The number of shares to be issued in the business combination is equal to $20 million divided by the June 30, 1999 closing market price of the acquirer's common stock; however, if the June 30, 1999 closing market price of the acquirer's common stock is less than $16 or greater than $24, the exchange ratio is adjusted as follows: (a) if the closing market price is less than $16, the acquirer will issue 1,250,000 shares of its common stock for the outstanding common shares of the target company, and (b) if the closing market price is greater than $24, the acquirer will issue 833,000 shares of its common stock for the outstanding common shares of the target company. The variable exchange ratio represents a formula and, as a result, if the stock price changes during the period from March 31, 1999 through June 30, 1999, but remains within the $16-$24 range, the measurement date is June 30, 1999. However, if the acquirer's closing common stock price exceeds $24 on June 1, 1999, and remains above $24 through June 30, 1999, the number of shares to be issued in the transaction becomes fixed on June 1, 1999, and that date is the measurement date.

12. The EITF also reached a consensus that the securities should be valued based on market prices a few days before and after the measurement date determined in Issue 2 but that the measurement period would not include any dates after the date the business combination is consummated.

13. The EITF reached a consensus that the consensus reached on Issue 1 should only be applied prospectively to purchase business combinations consummated on or after January 1, 2001. The EITF reached a consensus that the consensuses reached on Issue 2 should be applied prospectively to purchase business combinations initiated on or after January 1, 2001. An entity should apply its existing policy prior to the effective date of the consensus on Issue 2.

**INT 00-28 Status**

14. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 00-29: EITF 99-17: Accounting for Advertising Barter Transactions

INT 00-29 Dates Discussed
June 12, 2000; September 11, 2000

INT 00-29 References
SSAP No. 29—Prepaid Expenses (SSAP No. 29)

INT 00-29 Issue

1. It has become increasingly popular for Internet companies to enter into transactions in which they exchange rights to place advertisements on each others’ web sites. In some of these transactions, no cash is exchanged between the parties. In other transactions, similar amounts of cash are exchanged between the two parties. Some entities record an equal amount of revenue (for the web space they own and “sell”) and expense (for the web space they “purchase” from the other entity). There is no overall effect on net income or cash flows, although the timing of the revenue and expense may differ. Although this Issue is written in the context of Internet companies, it also applies to advertising barter transactions in other industries.

2. Currently, many Internet companies report net losses and net operating cash outflows and there is a belief that the market capitalization of many Internet companies is based on revenues. To the extent that revenues include barter transactions for which there is no ultimate realization in cash and no overall effect on net income, the practice may lead to overstated revenues and artificially inflated market capitalization.

3. The issue is: whether barter transactions that involve a nonmonetary exchange of advertising should result in recorded revenues and expenses at the more readily determinable fair value of the advertising surrendered or received in the exchange, or book value, because fair value cannot be determined within reasonable limits.

INT 00-29 Discussion

4. The working group reached a consensus to adopt the final conclusion reached in EITF 99-17 with modification as follows:

5. The EITF reached a consensus that revenue and expense should be recognized at fair value from an advertising barter transaction only if the fair value of the advertising surrendered in the transaction is determinable based on the entity’s own historical practice of receiving cash, marketable securities, or other consideration that is readily convertible to a known amount of cash for similar advertising from buyers unrelated to the counterparty in the barter transaction. An exchange between the parties to a barter transaction of offsetting monetary consideration, such as a swap of checks for equal amounts, does not evidence the fair value of the transaction. If the fair value of the advertising surrendered in the barter transaction is not determinable within the limits of this Issue, the barter transaction should be recorded based on the carrying amount of the advertising surrendered, which likely will be zero.

6. A period not to exceed six months prior to the date of the barter transaction should be used to determine whether a historical practice exists of receiving cash or marketable securities for similar advertising. If economic circumstances have changed such that prior (but not more than six months old) transactions are not representative of current fair value for the advertising surrendered, then a shorter, more representational period should be used. In addition, it is inappropriate to consider cash transactions...
subsequent to the barter transaction to determine fair value (that is, there is no look back allowed to value and record past barter transactions).

7. For advertising surrendered for cash to be considered “similar” to the advertising being surrendered in the barter transaction, the advertising surrendered must have been in the same media and within the same advertising vehicle (for example, same publication, same website, or same broadcast channel) as the advertising in the barter transaction. In addition, the characteristics of the advertising surrendered for cash must be reasonably similar to that being surrendered in the barter transaction with respect to:

   a. Circulation, exposure, or saturation within an intended market
   b. Timing (time of day, day of week, daily, weekly, 24 hours a day/7 days a week, and season of the year)
   c. Prominence (page on website, section of periodical, location on page, and size of advertisement)
   d. Demographics of readers, viewers, or customers
   e. Duration (length of time advertising will be displayed).

8. The quantity or volume of advertising surrendered in a qualifying past cash (or near-cash) transaction can only evidence the fair value of an equivalent quantity or volume of advertising surrendered in subsequent barter transactions. In other words, a past cash transaction can only support the recognition of revenue on advertising barter transactions up to the dollar amount of the cash transaction. When the cash transaction has been used to support an equivalent quantity and dollar amount of barter revenue, within the limits of this Issue, that transaction cannot serve as evidence of fair value for any other barter transaction.

9. Entities shall disclose the amount of revenue and expense recognized from advertising barter transactions for each income statement period presented. In addition, if an entity engages in advertising barter transactions for which the fair value is not determinable within the limits of this Issue, information regarding the volume and type of advertising surrendered and received (such as the number of equivalent pages, the number of minutes, or the overall percentage of advertising volume) shall be disclosed for each income statement period presented.

10. The EITF observed that the consensus described above should be applied to transactions on or after January 1, 2001.

INT 00-29 Status

11. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 00-30: Application of SSAP No. 51 Paragraph 6 to Waiver of Deduction on Flexible Premium Universal Life Insurance Policies

INT 00-30 Dates Discussed

September 12, 2000; December 4, 2000

INT 00-30 References

*SSAP No. 51—Life Contracts* (SSAP No. 51)

INT 00-30 Issue

1. 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. That being the case, when an individual qualifies for “waiver” due to disability, entities cease to calculate and make the deductions from the account value that would otherwise be made, except for the disability. It appears that paragraph 6 of SSAP No. 51 requires premiums and considerations waived be reported as a benefit, and are to be included in premium income.

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.

2. The issue is whether the second sentence require entities to calculate the amount of the deduction and include that amount as premium income as well as a benefit paid?

INT 00-30 Discussion

3. The working group reached a consensus to consider the waiver of the deduction to be neither revenue nor benefit paid, therefore a calculation of the amount of the deduction need not be made for flexible premium universal life insurance policies.

INT 00-30 Status

4. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 00-31: Application of SSAP No. 55 Paragraph 12 to Health Entities

INT 00-31 Dates Discussed

September 12, 2000; December 4, 2000

INT 00-31 References

SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses (SSAP No. 55)

INT 00-31 Issue

1. The following guidance is included in paragraph 12 of SSAP No. 55:

   12. If a reporting entity chooses to anticipate salvage and subrogation recoverables (including amounts recoverable from second injury funds, other governmental agencies, or quasi-governmental agencies, where applicable), the recoverables shall be estimated in a manner consistent with paragraphs 8 through 10 of this statement and shall be deducted from the liability for unpaid claims or losses.

2. Although SSAP No. 55 is a “common” paper, it is unclear as to whether the Statutory Accounting Principles Working Group (SAPWG) intended the accounting guidance for anticipating salvage and subrogation recoverables to be applicable to Individual and Group Accident and Health Contracts. Furthermore, the difference between subrogation and coordination of benefits (COB) needs to be defined and accounting guidance needs to be clarified.

3. The issues are:

   Issue 1 - Does paragraph 12 and the accounting guidance for anticipating salvage and subrogation recoverables extend to Individual and Group Accident and Health Contracts?
   
   Issue 2 - Should COB and subrogation recoverables be accounted for consistently?

INT 00-31 Discussion

4. The working group reached a consensus upon the definition of subrogation and COB:

   Subrogation - Assuming the legal rights of a person for whom expenses or a debt has been paid. Typically, subrogation occurs when an insurance company which pays its insured client for injuries and losses then sues the party which the injured person contends caused the damages to him/her.

   Coordination of benefits (COB) - COB provisions eliminate overinsurance and establish a prompt and orderly claims payment system when a person is covered by more than one group insurance and/or group service plan. Plans are permitted, but not required to include a COB provision. However, if a plan elects to use a COB provision, it must follow the standard COB rules.

5. The working group reached a consensus that the accounting guidance for subrogation contained in paragraph 12 of SSAP No. 55 be applied to Individual and Group Accident and Health Contracts and that if a reporting entity chooses to anticipate COB recoverables, the recoverables should be estimated in a manner consistent with paragraphs 8 through 10 of SSAP No. 55 and shall be deducted from the liability for unpaid claims or losses. A separate receivable shall not be established for these recoverables. In addition, these recoverables are also subject to the impairment guidelines established in SSAP No. 5—
Liabilities, Contingencies and Impairments of Assets and an entity shall not reduce its reserves for any recoverables deemed to be impaired.

**INT 00-31 Status**

6. No further discussion is planned.
Appendix B

Interpretation of the Emerging Accounting Issues Working Group

INT 00-32: EITF 00-8 Accounting by a Grantee for an Equity Instrument to Be Received in Conjunction with Providing Goods or Services

INT 00-32 Dates Discussed

September 12, 2000; December 4, 2000

INT 00-32 References

SSAP No. 13—Stock Options and Stock Purchase Plans (SSAP No. 13)

INT 00-32 Issue

1. Entities often sell goods or provide services in exchange for equity instruments issued by the purchaser of the goods or services. From the standpoint of the entity granting the equity instruments (the purchaser or grantor), appropriate accounting guidance for those transactions exists in Statement 123 and Issue No. 96-18, “Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services.” Paragraph 8 of Statement 123 states that those transactions should be measured at the fair value of the consideration received or the fair value of the equity instruments issued, whichever is more reliably measurable. Issue 96-18 addresses the measurement date from the standpoint of the grantor in those transactions.

2. While certain of those transactions that involve the contemporaneous exchange of equity instruments for goods or services do not create practice issues, others are more complex in that the exchange spans several periods and the issuance of the equity instruments is contingent upon service or delivery of goods that must be completed by the grantee (that is, the goods or services provider) in order to vest in the equity instrument. Additionally, transactions are becoming common in practice where a fully vested, nonforfeitable equity instrument issued to a grantee contains terms that may vary based on the achievement of a performance condition 1 or certain market conditions. For example, a fully vested stock option may be issued to a grantee that contains a provision that the exercise price will be reduced if the grantee completes a project by a specified date. In certain cases, the fair value of the equity instruments to be received may be more reliably measurable than the fair value of the goods or services to be given as consideration. Currently, there are mixed views in practice about the appropriate date or dates to be used by the grantee to measure revenue under some of those complex transactions.

3. The issues are:

a. Issue 1—For transactions in which an entity provides goods or services in exchange for equity instruments, what date(s) the grantee (the provider) should use to measure the fair value of those equity instruments for revenue recognition purposes

b. Issue 2—For transactions in which any of the terms of the equity instruments are subject to adjustment after the measurement date (that is, the terms of the equity instrument are subject to adjustment based on performance above the level committed to in a performance commitment, performance after the instrument is earned, or market conditions), how the grantee should account for an increase in fair value as a result of an adjustment (upon resolution of the contingency after the measurement date) as revenue.
INT 00-32 Discussion

4. The working group reached a consensus to adopt the consensus positions reached in EITF 00-8 with minor modifications. The modifications were made to replace GAAP references with the applicable SSAP references and to modify the effective date to January 1, 2001. The modified positions are outlined in paragraphs 5 through 10.

5. The Task Force reached a consensus on Issue 1 that the grantee should measure the fair value of the equity instruments using the stock price and other measurement assumptions as of the earlier of either of the following dates:

   a. The date the parties come to a mutual understanding of the terms of the equity-based compensation arrangement and a commitment for performance by the grantee to earn the equity instruments (a “performance commitment”) is reached,

   b. The date at which the grantee’s performance necessary to earn the equity instruments is complete (that is, the vesting date).

The earlier of the above dates is hereafter referred to as the measurement date.

6. The Task Force reached a consensus on Issue 2 that if on the measurement date the quantity or any of the terms of the equity instrument are dependent on the achievement of a market condition, then the grantee should measure revenue based on the fair value of the equity instruments inclusive of the adjustment provisions. That fair value would be calculated as the fair value of the equity instruments without regard to the market condition plus the fair value of the commitment to change the quantity or terms of the equity instruments if the market condition is met. That is, the existence of a market condition that, if achieved, results in an adjustment to an equity instrument generally affects the value of the instrument. Pricing models have been adapted to value many of those path-dependent equity instruments.

7. Also on Issue 2, the Task Force reached a consensus that if on the measurement date the quantity or any of the terms of the equity instruments are dependent on the achievement of grantee performance conditions (beyond those conditions for which a performance commitment exists), changes in fair value of the equity instrument that result from an adjustment to the instrument upon the achievement of a performance condition should be measured as additional revenue from the transaction using a methodology consistent with “modification accounting”. That is, the adjustment should be measured at the date of the revision of the quantity or terms of the equity instrument as the difference between (a) the then-current fair value of the revised instruments utilizing the then-known quantity and terms and (b) the then-current fair value of the old equity instruments immediately before the adjustment. Changes in fair value of the equity instruments after the measurement date unrelated to the achievement of performance conditions should be accounted for in accordance with any relevant literature on the accounting and reporting for investments in equity instruments, such as SSAP No. 26.

8. The following example illustrates the application of this measurement date guidance for a transaction in which a performance commitment exists prior to the time that the grantee’s performance is complete and the terms of the equity instrument are subject to adjustment after the measurement date based on the achievement of specified performance conditions.

On 1/1/X2, Company grants Service Provider 100,000 options with a life of 2 years. The options vest if Service Provider advertises products of Company on Service Provider’s web site for 18 months ending 6/30/X3. Company also agrees that if Service Provider provides 3 million “hits” or “click-throughs” during the first year of the agreement, the life of the options will be extended from 2 years to 5 years. If Service Provider fails to provide the agreed upon minimum of 18 months of advertising through 6/30/X3, Service Provider will pay Company specified monetary
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damage that, in the circumstances, constitute a “sufficiently large disincentive for nonperformance.”

Service Provider would measure the 100,000 stock options for revenue recognition purposes on the performance commitment date of 1/1/X2 using the 2-year option life. Assume that at the measurement date (1/1/X2) the fair value of the options is $400,000. On 12/1/X2, Service Provider has provided 3 million “hits” and the life of the option is adjusted to 5 years. Service Provider would measure additional revenue pursuant to the achievement of the performance condition as the difference between the fair value of the adjusted instrument at 12/1/X2 (that is, the option with the 5-year life assumed to be $700,000) and the then fair value of the old instrument at 12/1/X2 (that is, the option with the 2-year life, which is assumed to be $570,000). Accordingly, additional revenue of $130,000 would be measured. The remaining $170,000 increase in fair value of the instrument should be accounted for in accordance with the relevant literature on the accounting and reporting for investments in equity instruments, such as SSAP No. 26.

9. This Issue does not address when revenue is recognized. However, the Task Force observed that a liability (deferred revenue) or revenue would be recognized in the same period(s) and in the same manner as it would if the enterprise was to receive cash for the goods or services instead of the equity instruments.

10. The Task Force reached a consensus that this Issue applies to all grants and to modifications of existing grants that occur after January 1, 2001. “Modifications of existing grants” does not include changes to the quantity or terms of an equity instrument that occur when any originally unknown quantity or term becomes known pursuant to the terms of the original instruments.

INT 00-32 Status

11. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 01-01: Application of SSAP No. 6 Paragraph 9 a. to de minimus Receivable Balances of Group Accident and Health Policies

INT 01-01 Dates Discussed

December 4, 2000; March 26, 2001

INT 01-01 References

SSAP No. 6—Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers (SSAP No. 6)

INT 01-01 Issue

1. The following guidance is contained in paragraph 9a of SSAP No. 6:

   9. Nonadmitted amounts are determined as follows:

      a. Uncollected Premium—To the extent that there is no related unearned premium, any uncollected premium balances which are over ninety days due shall be nonadmitted. If an installment premium is over ninety days due, the amount over ninety days due plus all future installments that have been recorded on that policy shall be nonadmitted;

2. The last sentence of this paragraph is a new NAIC accounting principle for group accident and health contracts and appears to overlook the situation where the substantial preponderance of an installment has been paid. This can have an unduly punitive effect in the case of companies engaged in group accident and health business. In this case, insured groups are typically billed on a monthly installment basis. The amount of the bill is based on the insurer’s records of the customers’ membership. It is not unusual that a customer will subsequently remit its payment based on its own membership records which, due to frequent changes in the customer’s employee base, may vary from that of the insurer. Such variances are normal in this type of business and are typically resolved through a reconciliation process in the normal course of business. Such reconciliation process is generally the result of:

   a. The addition or deletion of members within the group (i.e., hiring and termination activities of the group policyholder) including collection of information necessary to complete a certificate record (e.g. SSN, HIPAA prior eligibility status, etc.);
   b. Status changes by enrollees due to life events (i.e., marriage, divorce, birth of child, etc.);
   c. Apportionment of remittances related to affiliated multiple legal entities (i.e., large national accounts);
   d. Inadequate documentation from a group policyholder; and
   e. Open enrollment documentation not provided by a group on a timely basis.

3. This reconciliation process is performed by the insurer and, once agreement is reached, a correcting bill (or credit memorandum) is issued to adjust or clear the residual balance. In certain circumstances, especially for larger groups or for groups with complicated membership records, the
reconciliation of membership records will not be completed before the residual balance has aged more than ninety days from the due date of the original billing. When that is the case, a strict interpretation of SSAP No. 6, paragraph 9a requires that the customer’s entire current balance be nonadmitted because of the existence of the *de minimus* balance.

4. This result is particularly punitive when, as is often the case, the customer routinely remits payment on a timely basis but where minor residual balances remain on the account aging pending agreement between the insurer and customer in relation to membership reconciliation issues. It should also be noted that, because billing is typically on a monthly basis in group accident and health business, it is unlikely that there will be a significant unearned premium balance to be applied to the more current receivable balance, thereby increasing the magnitude of the effect described above.

5. The accounting issue is whether it is appropriate that the existence of a *de minimus* over ninety-day balance on a group accident and health contract should cause the entire balance of the recorded future installments to be deemed nonadmitted.

**INT 01-01 Discussion**

6. The working group reached a consensus that the existence of a nonadmitted *de minimus* over ninety-day balance would not cause future installments that have been recorded on that policy to also be nonadmitted. The scope of this interpretation is limited to group accident and health contracts as described in the accounting issue. For purposes of this interpretation, installment premiums include monthly billed premiums on group accident and health policies. The working group also noted that the *de minimus* over ninety day balance itself would still be treated as nonadmitted as it is over ninety days old and that pursuant to SSAP No. 6 paragraph 10, the entire current balance is subject to a collectibility analysis.

**INT 01-01 Status**

7. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 01-03:  Assets Pledged as Collateral or Restricted for the Benefit of a Related Party

INT 01-03 Dates Discussed
December 4, 2000; March 26, 2001; June 11, 2001

INT 01-03 References
SSAP No. 4—Assets and Nonadmitted Assets (SSAP No. 4)

INT 01-03 Issue

1. Holding companies and their subsidiaries often issue debt securities. In certain circumstances, the debt is collateralized using the invested assets of a related party (hereafter as defined within SSAP No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties). The assets of the subsidiary or sister insurance entity may be pledged as collateral or otherwise restricted for this purpose.

2. Per review of the Preamble and SSAP No. 4, there is no direct reference that requires an entity to nonadmit assets involved in situations described above.

3. The accounting issue is if a related party pledges as collateral certain assets of the reporting entity should such assets be nonadmitted by the reporting entity?

4. The working group reached a consensus that if assets of an insurance entity are pledged or otherwise restricted by the action of a related party, the assets are clearly not under the exclusive control of the insurance entity. It follows that if these assets are pledged for the benefit of others, then the assets are not available to satisfy policyholder obligations. Although the specific instruction is not given, these assets are unavailable to satisfy policyholder obligations due to encumbrances or other third party interests and therefore should not be recognized on the balance sheet.

INT 01-03 Status

5. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 01-04: SSAPs No. 18 and 33 and Issues Surrounding Securitizations

INT 01-04 Dates Discussed

December 4, 2000; March 26, 2001

INT 01-04 References

SSAP No. 18—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (SSAP No. 18)

SSAP No. 33—Securitizations (SSAP No. 33)

INT 01-04 Issue

1. Paragraph 5b. of SSAP No. 33 is more limiting than Paragraph 3b. of SSAP No. 18 and paragraph 9b of SFAS 125—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (FAS 125).

2. Paragraph 3b. of SSAP No. 18 states the following:

   3. Except as discussed in paragraph 35, a transfer of a group of financial assets, or a portion of a financial asset in which the transferor surrenders control over those financial assets shall be accounted for as a sale to the extent that consideration other than beneficial interests in the transferred assets is received in exchange. The transferor has surrendered control over transferred assets if, and only if, all of the following conditions are met:

   b. Either (i) each transferee obtains the right, free of conditions that constrain it from taking advantage of that right (see paragraph 14), to pledge or exchange the transferred assets or (ii) the transferee is a qualifying special-purpose entity as defined in paragraph 9 of SSAP No. 33 and the holders of beneficial interests in that entity have the right, free of conditions that constrain them from taking advantage of that right (see paragraph 14), to pledge or exchange those interests; and

3. Paragraph 5b. of SSAP No. 33 states the following:

   5. The transferor has surrendered control if, and only if, all of the following conditions are met:

   b. The transferee is a qualifying special-purpose entity and the holders of beneficial interests in that entity have the right—free of transferor-imposed conditions that constrain them from taking advantage of that right—to pledge or exchange those interests; and

4. Paragraph 9 of SSAP No. 33 states the following:

   9. A qualifying special-purpose entity (including a CMO special-purpose entity) as used in this statement must meet all of the following conditions:

   a. It is a trust, corporation, or other legal vehicle whose activities are permanently limited by the legal documents establishing the special-purpose entity to:

      i. Holding title to transferred financial assets;
ii. Issuing beneficial interests (If some of the beneficial interests are in the form of
debt securities or equity securities, the transfer of assets is a securitization.);

iii. Collecting cash proceeds from assets held, reinvesting proceeds in financial
instruments pending distribution to holders of beneficial interests, and otherwise
servicing the assets held; and

iv. Distributing proceeds to the holders of its beneficial interests.

b. It has a standing at law distinct from the transferor. Having standing at law depends in
part on the nature of the special-purpose entity. For example, generally, under U.S. law, if
a transferor of assets to a special-purpose trust holds all of the beneficial interests, it can
unilaterally dissolve the trust, and thereby resume control over the individual assets held
in the trust, and the transferor can effectively assign its interest and its creditors can
reach it. In that circumstance, the trust has no standing at law, is not distinct, and thus is
not a qualified special-purpose entity. A special-purpose entity that has distinct standing
at law may still be an affiliate of the transferor.

5. Paragraph 9b. of FAS 125 states the following:

9. A transfer of financial assets (or all or a portion of a financial asset) in which the
transferor surrenders control over those financial assets shall be accounted for as a sale to the
extent that consideration other than beneficial interests in the transferred assets is received in
exchange. The transferor has surrendered control over transferred assets if and only if all of the
following conditions are met:

b. Either (1) each transferee obtains the right—free of conditions that constrain it from
taking advantage of that right (paragraph 25)—to pledge or exchange the transferred
assets or (2) the transferee is a qualifying special-purpose entity (paragraph 26) and the
holders of beneficial interests in that entity have the right—free of conditions that
constrain them from taking advantage of that right (paragraph 25)—to pledge or
exchange those interests.

6. The accounting issue is if a reporting entity transfers assets to an entity that does not meet the
definition of a qualified special-purpose entity as described in paragraph 9 of SSAP No. 33, but does meet
the requirements for surrender of control under paragraph 3b. (i) of SSAP No. 18, would the transaction
be accounted for as a sale?

**INT 01-04 Discussion**

7. The working group reached a consensus that if the transaction meets the criteria outlined in SSAP
No. 18, then the transaction would be accounted for as a sale.

**INT 01-04 Status**

8. No further discussion planned.
Appendix B

Interpretation of the Emerging Accounting Issues Working Group

INT 01-05: Classification of Accrued Interest on Policy Loans

INT 01-05 Dates Discussed

December 4, 2000; March 26, 2001

INT 01-05 References

SSAP No. 49—Policy Loans (SSAP No. 49)

INT 01-05 Issue

1. Paragraph 7 of SSAP No. 49 provides the accounting guidance for recognition of interest income on policy loans. Paragraph 8 of that same statement describes when policy loan accrued interest shall be reclassified from Investment Income Due and Accrued to be included in the unpaid policy loan balance.

7. Interest income on policy loans shall be recorded as earned and included in investment income consistent with SSAP No. 34—Investment Income Due and Accrued. For interest received before it is earned, unearned interest income shall be recorded as a liability in accordance with SSAP No. 5—Liabilities, Contingencies and Impairments of Assets.

8. Accrued interest income on policy loans that is past due 90 days or more shall be reclassified from Investment Income Due and Accrued and included in the unpaid balance of the policy loan as defined in paragraph 4.

2. The accounting issue is may a company include accrued interest that is less than 90 days past due as a part of the policy loan balance rather than carrying the accrued interest as Investment Income Due and Accrued?

INT 01-05 Discussion

3. The working group reached a consensus to allow interest to be reclassified from Accrued Investment Income Due and Accrued to be included in the unpaid policy loan balance earlier than when the interest is 90 days past due. All accrued interest that is 90 days past due would be included in the policy loan balance. This is a classification issue and would not result in any amounts being admitted that would otherwise be nonadmitted.

INT 01-05 Status

4. No further discussion planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 01-07: EITF 98-2: Accounting by a Subsidiary or Joint Venture for an Investment in the Stock of Its Parent Company or Joint Venture Partner

INT 01-07 Dates Discussed

December 4, 2000; March 26, 2001

INT 01-07 References

SSAP No. 46—Investments in Subsidiary, Controlled and Affiliated Entities (SSAP No. 46)

INT 01-07 Issue

1. A subsidiary or joint venture may purchase the stock of its parent company or joint venture partner for various reasons, including to provide stock-based compensation to employees of the subsidiary or joint venture, to hedge the cost and cash requirements of stock appreciation rights, or to hold as an investment.

2. Authoritative guidance addresses the accounting for such an investment in consolidation. Paragraph 13 of ARB 51 states that shares of a parent company held by a subsidiary should not be treated as outstanding stock in the consolidated balance sheet of the parent. However, accounting guidance does not directly address the accounting for such an investment in the separate financial statements of the subsidiary or joint venture.

3. FAS No. 115 addresses the accounting and reporting for certain investments in debt and equity securities. Paragraph 3 of FAS No. 115 states that "this Statement establishes standards of financial accounting and reporting for investments in equity securities that have readily determinable fair values ...” In addition, paragraph 4 of Statement 115 states that "this Statement does not apply . . . to investments in consolidated subsidiaries.” It does not address the reverse situation, that is, an investment by the subsidiary in the parent.

4. The issues are:

   Issue 1 - How a subsidiary should account for an investment in the stock of its parent company in the separate financial statements of the subsidiary

   Issue 2 - How a joint venture should account for an investment in the stock of its joint venture partner in the separate financial statements of the joint venture.

INT 01-07 Discussion

5. The working group reached a consensus to reject the positions reached in EITF 98-2 as these issues are already provided for in paragraphs 14 and 15 of SSAP No. 46. It should be noted that the Securities Valuation Office provides a worksheet for both of these reciprocal ownership elimination computations.

INT 01-07 Status

6. No further discussion planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 01-08: EITF 99-16: Accounting for Transactions with Elements of Research and Development Arrangements

INT 01-08 Dates Discussed
December 4, 2000; March 26, 2001

INT 01-08 References

Issue Paper No. 99—Nonapplicable GAAP Pronouncements (IP No. 99)

INT 01-08 Issue

1. FAS No. 68 establishes standards of financial accounting and reporting for an enterprise that is a party to a research and development arrangement through which it can obtain the results of research and development funded partially or entirely by others. Statement 68 states that an enterprise shall determine the nature of the obligation it incurs when it enters into an arrangement with other parties that fund its research and development. If the enterprise is obligated to repay any of the funds provided by the other parties regardless of the outcome of the research and development, the enterprise shall estimate and recognize that liability. To the extent that the financial risk associated with the research and development has been transferred, because repayment of any of the funds provided by the other parties depends solely on the results of the research and development having future economic benefit, the enterprise shall account for its obligation as a contract to perform research and development for others.

2. Transactions have developed in which a sponsor (the "Sponsor") capitalizes a new company ("Newco") with cash and rights to certain technology developed by the Sponsor, in exchange for Newco Class A and Class B common stock. The Class B common shares convey essentially no financial interest to the Sponsor and, other than certain blocking rights, provide the Sponsor essentially no voting rights. The Sponsor subsequently distributes the Newco Class A common stock to its shareholders subject to a purchase option held by the Sponsor. The Sponsor then receives funds from Newco to perform research and development activities. Other potential structures designed to achieve similar objectives also exist.

3. The issue is how the Sponsor should account for the research and development arrangement.

INT 01-08 Discussion

4. The working group reached a consensus to reject the positions reached in EITF 99-16 as not applicable to statutory accounting. The interpreted statement FAS No. 68 was deemed not applicable in IP No. 99.

INT 01-08 Status

5. No further discussion planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 01-09: EITF 99-19: Reporting Revenue Gross as a Principal versus Net as an Agent

INT 01-09 Dates Discussed

December 4, 2000; March 26, 2001

INT 01-09 References

No SSAP reference

INT 01-09 Issue

1. Diversity exists regarding whether a company should report revenue based on (a) the gross amount billed to a customer because it has earned revenue from the sale of the goods or services or (b) the net amount retained (that is, the amount billed to a customer less the amount paid to a supplier) because it has earned a commission or fee. The issue often arises with companies that sell goods or services over the Internet. Many of those companies do not stock inventory and may arrange for third-party suppliers to drop-ship merchandise on their behalf. Those companies also may offer services that will be provided by a third-party service provider. However, the issue is not limited to companies that sell products or services over the Internet. For example, the issue may arise in, but is not limited to, transactions related to advertisements, mailing lists, event tickets, travel tickets, auctions (and reverse auctions), magazine subscription brokers, and catalog, consignment, or special-order retail sales.

2. How companies report revenue for the goods and services they offer has become an increasingly important issue because some investors may value certain companies on a multiple of revenues rather than a multiple of gross profit or earnings. Net income generally does not differ based on whether a company reports revenue on the gross amount billed to the customer or the net amount retained.

3. The issue is whether a company should report revenue based on (a) the gross amount billed to a customer because it has earned revenue from the sale of the goods or services or (b) the net amount retained (that is, the amount billed to the customer less the amount paid to a supplier) because it has earned a commission or fee.

INT 01-09 Discussion

4. The working group reached a consensus to reject the positions reached in EITF 99-19 as not applicable to statutory accounting. As the EITF specifically excludes insurance and reinsurance transaction, the working group believes the remaining issues are not prevalent in the insurance industry.

INT 01-09 Status

5. No further discussion planned.
Appendix B

Interpretation of the Emerging Accounting Issues Working Group

INT 01-10: EITF 00-1: Investor Balance Sheet and Income Statement Display under the Equity Method for Investments in Certain Partnerships and Other Ventures

INT 01-10 Dates Discussed

December 4, 2000; March 26, 2001

INT 01-10 References

SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies (SSAP No. 48)

INT 01-10 Issue

1. GAAP Opinion No. 18 addresses only investments in common stock of corporations and does not directly address investments in unincorporated entities. However, investors in unincorporated entities such as partnerships and other unincorporated joint ventures generally account for their investments using the equity method of accounting by analogy to Opinion 18 if the investor has the ability to exercise significant influence over the investee. Paragraph 19(c) of Opinion 18 requires investments accounted for by the equity method to be displayed as a single amount in the investor's balance sheet and the investor's share of the investee's earnings or losses to be displayed as a single amount in the investor's income statement. In contrast, if (a) the investor holds an undivided interest in each asset, (b) the investor is proportionately liable for each liability, and (c) no other separate legal entity exists, then the investor's accounting for those rights and obligations is outside the scope of Opinion 18. In those circumstances, the investor displays, on a proportionate gross basis, those assets and liabilities in the investor's balance sheet and the related results of operations in the investor's income statement. However, for entities subject to SOP 78-9, the guidance in paragraph 11 of SOP 78-9 should be applied. That guidance requires real property owned by undivided interests that is subject to joint control, as defined therein, to be presented in the same manner as investments in noncontrolled partnerships (that is, generally using the equity method).

2. However, there is a longstanding practice in the construction industry and in the extractive industries of investors displaying investments in separate legal entities (that is, they do not own an undivided interest as described in paragraph 1 accounted for using the equity method of accounting on a proportionate gross basis). Under that practice, the investor presents its proportionate share of the investee's revenues and expenses in each major revenue and expense caption of the investor's income statement and may also present its proportionate share of the investee's assets and liabilities separately in each major asset and liability caption of the investor's balance sheet.

3. The issue is whether there are circumstances in which proportionate gross presentation is appropriate under the equity method of accounting for an investment in a legal entity.

INT 01-10 Discussion

4. The working group reached a consensus to reject the positions reached in EITF 00-01 as this issue is currently addressed in SSAP No. 48.

INT 01-10 Status

5. No further discussion planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 01-11: EITF 00-10: Accounting for Shipping and Handling Fees and Costs

INT 01-11 Dates Discussed

December 4, 2000; March 26, 2001

INT 01-11 References

No SSAP reference

INT 01-11 Issue

1. Shipping and handling costs are incurred by most companies that sell goods; however, diversity in practice exists regarding the income statement classification of amounts charged to customers for shipping and handling, as well as for costs incurred related to shipping and handling. Many sellers charge customers for shipping and handling in amounts that exceed the related costs incurred. Some display the charges to customers as revenues and the costs as expenses, while others net the costs and revenues.

2. The components of shipping and handling costs, and the determination of the amounts billed to customers for shipping and handling, may differ from company to company. Some companies define shipping and handling costs as only those costs incurred for a third-party shipper to transport products to the customer. Other companies include as shipping and handling costs a portion of internal costs, for example, salaries and overhead related to the activities to prepare goods for shipment. In addition, some companies charge customers only for amounts that are a direct reimbursement for shipping and, if discernible, direct incremental handling costs; however, many other companies charge customers for shipping and handling in amounts that are not a direct pass-through of costs.

3. For the purpose of this Issue, "shipping" is understood to be those costs that are incurred to physically move the product from the seller's place of business to the buyer's designated location. Shipping costs generally comprise payments to third-party shippers but may also be costs incurred directly by the seller. "Handling" is understood to be those costs incurred to store, move, and prepare the products for shipment. Generally, handling costs are incurred from the point the product is removed from finished goods inventory to the point the product is provided to the shipper and often include an allocation of internal overhead.

4. The issues are:

   Issue 1 - How a seller of goods should classify in the income statement amounts billed to a customer for shipping and handling

   Issue 2 - How a seller of goods should classify in the income statement costs incurred for shipping and handling.

INT 01-11 Discussion

5. The working group reached a consensus to adopt the consensus positions of EITF 00-10 with certain modifications. Although the issues raised in the EITF are not prevalent in the insurance industry, adoption of the consensus position does not violate any of the principles that define the Statement of Concepts. The modified EITF consensus is as follows:
6. The Task Force reached a consensus on Issue 1 that all amounts billed to a customer in a sale transaction related to shipping and handling, if any, represent revenues earned for the goods provided and should be classified as revenue. The Task Force was not asked to reach a consensus on Issue 2.

7. The Task Force reached a consensus that the consensus on Issue 1 should be applied as of January 1, 2001. Upon application of the consensus, comparative financial statements for prior periods should be reclassified to comply with the classification guidelines of this Issue. If it is impracticable to reclassify prior-period financial statements, disclosure should be made of both the reasons why reclassification was not made and the effect of the reclassification on the current period.

**INT 01-11 Status**

8. No further discussion planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 01-12: EITF 00-14: Accounting for Certain Sales Incentives

INT 01-12 Dates Discussed

December 4, 2000; March 26, 2001

INT 01-12 References

No SSAP reference

INT 01-12 Issue

1. Existing generally accepted accounting principles do not provide specific guidance on the accounting for sales incentives many companies offer (on either a limited or a continuous basis) to their customers. Sales incentives offered by companies have various forms including discounts, coupons, rebates, and free products or services.

2. This Issue addresses the recognition, measurement, and income statement classification for sales incentives offered voluntarily by a vendor without charge to customers that can be used in, or that are exercisable by a customer as a result of, a single exchange transaction. Sales incentives within the scope of this Issue include offers that can be used by a customer to receive a reduction in the price of a product or service at the point of sale. This Issue also addresses vendor offers that entitle a customer to receive a reduction in the price of a product or service by submitting a form or claim for a refund or rebate of a specified amount of the purchase price charged to the customer at the point of sale. This Issue also covers offers by a vendor for a free product or service when the customer purchases another specified item if the vendor will deliver that free product or service to the customer at the point of sale of the specified item. This Issue also addresses sales incentives offered by manufacturers to customers of retailers or other distributors.

3. This Issue does not address coupons, rebates, and other forms of rights for free or significantly discounted products or services received by a customer in a prior exchange transaction that were accounted for by the vendor as a separate element in that prior exchange. The issue of when a discount right on services to be delivered is an element of an exchange transaction is within the scope of a future issue on accounting for multiple-element revenue arrangements. This Issue does not address vendor offers for free or significantly discounted products or services that become exercisable by the customer as a result of a single exchange transaction but will be delivered by the vendor at a future date. Free products or services to be delivered by the vendor at a future date may be a separate element in the exchange (and will be addressed in the future issue described above) and not a return or refund of some portion of the purchase price charged to the customer at the point of sale. This Issue does not address the accounting for offers of free or discounted products or services that are exercisable after a customer has transacted a specified cumulative level of purchases, for example, "point" and loyalty programs. Incentives that require a customer to transact a specified volume of purchases will be addressed in a future issue on accounting for "point" and other loyalty programs. Further, this Issue excludes the accounting for sales incentives offered by a company as consideration for goods or services received by the company offering the incentive, for example, the accounting for certain discounts offered to employees.

4. The issues are:

   Issue 1 - For a sales incentive offered voluntarily by a vendor and without charge to customers that can be used in, or that becomes exercisable by a customer as a result of, a single
exchange transaction and that will not result in a loss on the sale of a product or service, when to recognize and how to measure the cost of the sales incentive

Issue 2 - For a sales incentive offered voluntarily by a vendor and without charge to customers that can be used in, or that becomes exercisable by a customer as a result of, a single exchange transaction and that will result in a loss on the sale of a product or service, when to recognize and how to measure the cost of the sales incentive

Issue 3 - For a sales incentive offered voluntarily by a vendor and without charge to customers that can be used in, or that becomes exercisable by a customer as a result of, a single exchange transaction, how the cost of the sales incentive should be classified in the income statement.

INT 01-12 Discussion

5. The working group reached a consensus to reject the consensus positions of EITF 00-14 as most insurance companies are specifically prohibited by state statute from entering into the transactions described in this issue (e.g.; rebating).

INT 01-12 Status

6. No further discussion planned.
INT 01-13 Appendix B

Interpretation of the Emerging Accounting Issues Working Group

INT 01-13: EITF 00-15: Classification in the Statement of Cash Flows of the Income Tax Benefit Received by a Company upon Exercise of a Nonqualified Employee Stock Option

INT 01-13 Dates Discussed
December 4, 2000; March 26, 2001

INT 01-13 References

SSAP No. 69—Statement of Cash Flow (SSAP No. 69)

INT 01-13 Issue

1. If a company recognizes compensation expense for an employee stock option, the income tax benefit that results from the deduction triggered by exercise of that option (up to the amount of the deduction that equals the amount recognized as compensation expense) reduces income tax expense in the income statement. Statement 95 requires the income tax benefit that reduces income tax expense to be classified as an operating cash flow. However, typically for a fixed stock option accounted for under Opinion 25, no compensation expense is recognized. The income tax benefit that results from the deduction triggered by exercise of that option does not reduce income tax expense but, rather, is credited to equity (additional paid-in capital). Diversity in practice has developed for the classification in the statement of cash flows under the indirect method of the income tax benefit that has been credited to equity. Some companies classify the income tax benefit as an operating cash flow, while others classify the cash flow effects as a financing activity. For some companies, it is difficult, if not impossible, to determine the amount and the classification of the income tax benefit in the statement of cash flows.

2. The issues are:

   Issue 1 - In the statement of cash flows under the indirect method, how a company should classify the reduction of income tax paid as a result of the deduction triggered by employee exercise of stock options (the income tax benefit realized) if the income tax benefit realized is credited to equity and does not reduce income tax expense

   Issue 2 - Whether disclosure of the amount of the income tax benefit realized should be required if that benefit is not presented as a separate line item in the statement of cash flows.

INT 01-13 Discussion

3. The working group reached a consensus to reject the consensus positions of EITF 00-15 as not applicable to statutory accounting. SSAP No. 69 requires the direct method and therefore the issues raised in EITF 00-15 are not applicable.

INT 01-13 Status

4. No further discussion planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 01-14: EITF 00-16: Recognition and Measurement of Employer Payroll Taxes on Employee Stock-Based Compensation

INT 01-14 Dates Discussed

December 4, 2000; March 26, 2001

INT 01-14 References

SSAP No. 13—Stock Options and Stock Purchase Plans (SSAP No. 13)

INT 01-14 Issue

1. Topic No. D-83, "Accounting for Payroll Taxes Associated with Stock Option Exercises," requires that payroll taxes incurred in connection with stock-based compensation be recognized as an expense, but it does not address the timing of that expense recognition. Costs incurred by companies for employer payroll taxes on employee stock-based compensation have become more significant for U.S. companies as a result of the increased use of options as a form of employee compensation and the rapid growth in the market value of underlying stocks in certain market sectors. Consequently, the predominant current practice of recognizing those costs when the event that triggers payment to the taxing authority occurs (for an option, that event is employee exercise), has been called into question.

2. This Issue addresses how an entity should account for employer payroll taxes on stock-based compensation under Opinion 25 and Statement 123. That stock-based compensation may be in the form of options to buy the employer entity's stock, restricted stock awards, stock appreciation rights, or other arrangements covered by that literature. This Issue does not address the accounting consequences under Opinion 25 of an employer recovering from employees some or all of the employer's obligation for those payroll taxes.

3. The issue is when an employer should recognize a liability and corresponding cost for employer payroll taxes on employee stock compensation.

INT 01-14 Discussion

4. The working group reached a consensus to adopt the position of EITF 00-16 as an interpretation of SSAP No. 13. The adopted EITF 00-16 position is as follows:

The Task Force reached a consensus that a liability for employee payroll taxes on employee stock compensation should be recognized on the date of the event triggering the measurement and payment of the tax to the taxing authority (for a nonqualified option in the United States, generally the exercise date).

INT 01-14 Status

5. No further discussion planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 01-15: EITF 00-17: Measuring the Fair Value of Energy-Related Contracts in Applying Issue No. 98-10

INT 01-15 Dates Discussed
December 4, 2000; March 26, 2001

INT 01-15 References
No SSAP reference

INT 01-15 Issue

1. Issue No. 98-10, "Accounting for Contracts Involved in Energy Trading and Risk Management Activities," indicates that when the trading criteria in the consensus are met, energy contracts, including "energy-related contracts" such as tolling, transportation, and storage contracts, should be accounted for at fair value. Frequently, quoted market prices in active markets are not available for these contracts, and companies must use other techniques to estimate fair value. Issue 98-10 does not provide explicit guidance on estimating fair value, and in current practice various methods are used. As a result, two companies in similar circumstances might apply different methods to estimate the fair value of their energy-related contracts and may arrive at widely different values. Those differences lead to the question of whether some of the methods used in practice yield estimated amounts that are not representative of fair value.

2. For energy contracts required to be marked to fair value in accordance with Issue 98-10, the issue is whether certain specified methodologies may be considered unacceptable methods for estimating the fair value of such an energy-related contract.

INT 01-15 Discussion

3. The working group reached a consensus to reject the position of EITF 00-17 as not applicable to statutory accounting.

INT 01-15 Status

4. No further discussion planned.
Appendix B

Interpretation of the Emerging Accounting Issues Working Group

INT 01-16: Measurement Date for SSAP No. 8 Actuarial Valuations

INT 01-16 Dates Discussed

March 26, 2001; June 11, 2001

INT 01-16 References

SSAP No. 8—Pensions (SSAP No. 8)

Note: The guidance from this Interpretation applicable to pensions was incorporated into SSAP No. 89—Accounting for Pensions, A Replacement of SSAP No. 8, in paragraph 16.e.

SSAP No. 14—Postretirement Benefits Other Than Pensions (SSAP No. 14)

INT 01-16 Issue

1. SSAP No. 8 adopts Statement of Financial Accounting Standards Number 87—Employers’ Accounting for Pensions (FAS 87) with modifications as noted in paragraph 15 of SSAP No. 8. SSAP No. 8 does not specifically address measurement date. The following is excerpted from FAS 87, paragraphs 52 and 53:

Measurement Dates

52. The measurements of plan assets and obligations required by this Statement shall be as of the date of the financial statements or, if used consistently from year to year, as of a date not more than three months prior to that date. Requiring that the pension measurements be as of a particular date is not intended to require that all procedures be performed after that date. As with other financial statement items requiring estimates, much of the information can be prepared as of an earlier date and projected forward to account for subsequent events (for example, employee service). The additional minimum liability reported in interim financial statements shall be the same additional minimum liability (paragraph 36) recognized in the previous year-end statement of financial position, adjusted for subsequent accruals and contributions, unless measures of both the obligation and plan assets are available as of a more current date or a significant event occurs, such as a plan amendment, that would ordinarily call for such measurements.

53. Measurements of net periodic pension cost for both interim and annual financial statements shall be based on the assumptions used for the previous year-end measurements unless more recent measurements of both plan assets and obligations are available or a significant event occurs, such as a plan amendment that would ordinarily call for such measurements.

2. Is it appropriate to utilize June 30 actuarial valuations in determining the overfunded (asset) or underfunded (liability) portion of the defined benefit plan in the preparation of December 31 NAIC statutory basis financial statements?

INT 01-16 Discussion

3. The working group reached a consensus that it would not be appropriate to utilize June 30 actuarial valuations in determining the overfunded (asset) or underfunded (liability) portion of the SSAP No. 8 or SSAP No. 14 plan in the preparation of December 31 NAIC statutory basis financial statements. As such, entities shall perform its actuarial analysis consistent with the three month guideline contained within FAS 87.
INT 01-16 Status

4. No further discussion is planned.

5. During 2003, the Statutory Accounting Principles Working Group developed SSAP No. 89—Accounting for Pensions, A Replacement of SSAP No. 8 (SSAP No. 89). Paragraph 16.e. of SSAP No. 89 incorporated the guidance of this INT 01-16.
Appendix B

Interpretation of the Emerging Accounting Issues Working Group

INT 01-17: Accounting for Nonqualified Retirement Plans, Nonvested Ancillary Benefits Within Retirement Plans, and Protected Benefits Such as Early Retirement Subsidies in Retirement Plans

ISSUE NULLIFIED BY SSAP No. 89

INT 01-17 Dates Discussed

March 26, 2001; June 11, 2001

INT 01-17 References

SSAP No. 8—Pensions (SSAP No. 8)

INT 01-17 Issue

1. Calculations of the Projected Benefit Obligation (PBO) and Service Cost (SC) under SSAP No. 8 are identical to calculations under the Statement of Financial Accounting Standards Number 87—Employers’ Accounting for Pensions (FAS 87), except for the treatment of nonvested benefits. Under FAS 87, a participant’s status as pre- or post-vested in benefits receives no differential treatment. SSAP No. 8 contains clauses that indicate nonvested benefits are to be ignored until the employee becomes eligible and vested.

2. A defined benefit plan covered by ERISA is a type of deferred compensation arrangement. A plan’s primary purpose must be to provide replacement income to a participant following retirement. The benefits that are to be received may or may not become vested (although this term is often used, the legal term is “nonforfeitable”) prior to actual retirement. A plan is only required to provide nonforfeitalibility provisions if the plan seeks qualification under the Internal Revenue Code. On the other hand, in order to remain nonqualified, the plan may only cover a select group of highly compensated employees. In substance, nonqualified plans are identical to deferred compensation plans, where the only difference may be that a nonqualified plan is provided solely at the discretion of the employer and whether or not to participate in a deferred compensation plan may be predicated on a decision of the employee. Both qualified and nonqualified plans are nearly universal throughout the insurance industry.

3. A more narrowly defined term in qualified plans is “protected” benefits under Internal Revenue Code Section 411(d)(6). These are the benefits that the employer cannot take away through amendment (including termination) of the plan. Examples of protected benefits are alternative forms of payment, retirement-type subsidies (e.g., early retirement benefits) and qualified pre-retirement joint and survivor benefits (this is the only ancillary benefit that is protected). Protected benefits need not be nonforfeitable. For example, an early retirement subsidy applicable to a currently accrued benefit cannot be taken away through an amendment to the plan. However, the participant may lose their right to collect the subsidy if they terminate prior to becoming eligible to receive it.

4. Example: Assume a plan has a subsidized early retirement benefit (defined benefit plans almost universally do) that is only payable if retirement occurs directly from active employment. The PBO under FAS 87 for a participant is $200,000, where $50,000 of this is due to the subsidized early retirement benefit. i.e., if we assume the person retires at normal retirement, the PBO would only be $150,000. It is not clear whether the PBO should be $150,000 or $200,000 under SSAP No. 8. The $50,000 is not a nonforfeitable benefit, i.e., if the person terminates prior to becoming eligible for the early retirement benefit, they only receive a benefit worth $150,000. However, the $50,000 is a protected benefit that cannot be taken away through a plan amendment. As long as the participant remains in active
employment and eventually become eligible, they will have a right to receive this benefit. For a second example, assume the subsidized early retirement benefit in the prior example is available no matter when the participant terminated employment. (The common 1/15th, 1/30th reduction used in integrated plans is a subsidized early retirement benefit that is typically available to previously terminated participants.) In this case, the early retirement subsidy is nonforfeitable and the entire $200,000 would be the PBO under SSAP No. 8.

5. In addition to replacement income at retirement, retirement plans contain a variety of ancillary benefits, most of which are not nonforfeitable. For example, all death and disability benefits except for the qualified pre-retirement joint and survivor benefit might only become nonforfeitable once the triggering event (death or disability) occurs. Some plans do provide nonforfeitality provisions to these ancillary benefits, but that is rare. The easiest test as to whether an ancillary benefit is nonforfeitable is whether or not the participant still receives that benefit when the triggering event happens after termination of employment. The qualified pre-retirement joint and survivor death benefit is one such benefit that is still available after termination of employment. Nearly all defined benefit plans contain ancillary benefits that do not become nonforfeitable.

6. Nonqualified plans typically do not have nonforfeitality provisions connected with any benefit, including the main retirement benefit. The reason for this is the application of the constructive receipt standard under the Internal Revenue Code. Under this standard, there must be a “substantial risk of forfeiture” in order to avoid constructive receipt. At the point when the benefits lose this substantial risk of forfeiture, i.e., become nonforfeitable, the value of the benefits becomes taxable income to the participant even though no benefits have been paid. Therefore, most nonqualified plans do not contain provisions for nonforfeitality, i.e., the benefits never vest prior to payment. Typically, the only situation where there is nonforfeitality is when a “secular trust” is used to fund the benefits. These trusts are owned by the participant and income taxes must be paid on employer’s contributions to the trust and the earnings thereon. A similar type of trust which is used more often to fund nonqualified benefits is a “rabbi trust.” These do not invoke such taxation because they are available to creditors (and policyholders) in the event of bankruptcy (or insolvency), which is a sufficient condition to invoke a “substantial risk of forfeiture.”

7. Another aspect of nonforfeitality that is often overlooked is that it only applies to living participants. If a participant dies, they may not have any benefits due to them. For example, assume a plan does not contain any ancillary death benefits other than the required qualified pre-retirement joint and survivor benefit. If a single participant dies prior to retirement, the estate will receive nothing from the plan. In accounting terms, assume the PBO associated with this person is $500,000. This represents the present value of the projected retirement benefit accrued to date. Within that present value calculation are assumptions discounting the value for the probability of not receiving anything upon death. If the participant dies, the PBO reverts to zero and there is a $500,000 unrecognized gain that is amortized. Even though the participant was 100% vested in a retirement benefit worth $500,000, there is no guarantee that the plan is responsible to pay it, unless the participant lives to receive it.

8. As a separate example, assume the same facts except that the plan contains an ancillary death benefit equal to the present value of the retirement benefit, not discounted for pre-retirement mortality. Assume the amount paid out upon death is $600,000 and the PBO associated with the value of this death benefit is $100,000. The aggregate PBO under FAS 87 would be $600,000. Whether the participant lives until retirement or dies prior to retirement, a benefit will be paid out in the future that is worth $600,000 today as long as the participant remains employed. Under SSAP No. 8, only $500,000 would be valued in the PBO because the death benefit is not a nonforfeitable benefit.

9. For married participants, the same loss of benefits can occur upon death, except that there is a minimum death benefit equal to the qualified pre-retirement joint and survivor annuity. This death benefit may only be worth 40-45% of the retirement benefit. So, in the case of a plan that contains a death benefit described in the second example above, part of the extra $100,000 (e.g., 45% of it) is a nonforfeitable
benefit for married participants, whereas the remaining part is not nonforfeitable, similar to the single participant’s situation.

10. Summarizing, there are many aspects of vesting beyond a vesting schedule applied to the normal retirement benefit. Also, most nonqualified plans never have any vesting applied. In addition, there are benefits associated with retirement benefits that are protected, but not vested (i.e., if the participant stays in employment until eligible, they have the right to receive them, but if they terminate sooner, they may lose those rights).

11. Returning to SSAP No. 8, the following are the references to vesting:

Paragraph 2: “...with a modification to exclude nonvested employees. Therefore, the cost related to services rendered prior to becoming eligible and vested in the plan...”

12. This could be referring to both nonvested retirement benefits and to ancillary benefits. However, the confusion here is the use of the term “nonvested employees” rather than “nonvested benefits”. An employee can be vested in one benefit while not vested in another. The protected benefits that are not nonforfeitable (e.g., subsidized early retirement benefits) may also be included in this statement because of the reference to “becoming eligible”.

Paragraph 15(a): “Calculation of the pension obligation shall exclude non-vested employees. Partially vested employees are included only to the extent of their vested amounts;”

13. Again, the confusing aspect of this is the reference to employees, rather than benefits. In this case, the statement “...extent of their vested amounts;” could mean that ancillary benefits are amounts that would not be included. After all, every participant is a “partially vested employee” when all benefits are considered.

14. The accounting issue is when applying SSAP No. 8 to calculations for the accounting of defined benefit plans:

Issue 1 - Should nonvested, ancillary benefits (primarily death and disability benefits) be ignored in the PBO and SC prior to the triggering event (e.g., death or disability) of these benefits?

Issue 2 - Should protected, nonvested benefits (e.g., retirement-type subsidies such as early retirement benefits) be ignored in the PBO and SC prior to becoming eligible for these benefits?

Issue 3 - Should nonvested, nonqualified benefits be ignored prior to retirement or when there is no longer a substantial risk of forfeiture?

INT 01-17 Discussion

15. The working group reached the following consensus’s on the three issues raised:

Issue 1 - Should nonvested, ancillary benefits (primarily death and disability benefits) be ignored in the PBO and SC prior to the triggering event (e.g., death or disability) of these benefits?

The working group reached a consensus that nonvested, ancillary benefits should not be ignored in the PBO and SC prior to the triggering event of these benefits. A liability for these benefits should be accrued in accordance with the guidance in FAS 87 (use of a general vesting standard rather than an Internal Revenue Service income tax vesting standard).
Issue 2 - Should protected, nonvested benefits (e.g., retirement-type subsidies such as early retirement benefits) be ignored in the PBO and SC prior to becoming eligible for these benefits?

The working group reached a consensus that protected, nonvested benefits should not be ignored in the PBO and SC prior to the employee becoming eligible for these benefits. A liability for these benefits should be accrued in accordance with the guidance in FAS 87 (use of a general vesting standard rather than an Internal Revenue Service income tax vesting standard).

Issue 3 - Should nonvested, nonqualified benefits be ignored prior to retirement or when there is no longer a substantial risk of forfeiture?

The working group reached a consensus that nonvested, nonqualified benefits should not be ignored in the PBO and SC prior to retirement or when there is no longer a substantial risk of forfeiture. A liability for these benefits should be accrued in accordance with the guidance in FAS 87 (use of a general vesting standard rather than an Internal Revenue Service income tax vesting standard).

INT 01-17 Status

16. No further discussion planned.
Appendix B

Interpretation of the Emerging Accounting Issues Working Group

INT 01-18: Consolidated or Legal Entity Level – Limitations on EDP Equipment, Goodwill and Deferred Tax Assets Admissibility

INT 01-18 Dates Discussed

March 26, 2001; June 11, 2001

INT 01-18 References

SSAP No. 16—Electronic Data Processing Equipment and Software (SSAP No. 16)
SSAP No. 19—Furniture, Fixtures and Equipment; Leasehold Improvements Paid by the Reporting Entity as Lessee; Depreciation of Property and Amortization of Leasehold Improvements (SSAP No. 19)
SSAP No. 68—Business Combinations and Goodwill (SSAP No. 68)
SSAP No. 79—Depreciation of Nonoperating System Software – An Amendment to SSAP No. 16—Electronic Data Processing Equipment and Software (SSAP No. 79)

INT 01-18 Issue

1. Case Number 1: The reporting entity has several wholly-owned insurance company subsidiaries. The reporting entity will account for its investment in these subsidiaries at their underlying statutory equity in accordance with SSAP No. 46—Investments in Subsidiary, Controlled and Affiliated Entities.

2. Case Number 2: A reporting entity has deferred tax assets (DTAs) in excess of those that are allowed to be admitted in accordance with the guidance in SSAP No. 10—Income Taxes (SSAP No. 10) paragraph 10. The reporting entity files a consolidated tax return with one or more affiliates. Those affiliates have deferred tax liabilities (DTLs) that exceed the remaining DTAs available for admission after application of paragraphs 10a. and 10b. of SSAP No. 10—Income Taxes (SSAP No. 10) at the affiliates’ legal entity level.

3. The accounting issues are:

Case Number 1:

When applying the limitations described in paragraph 10.b.ii of SSAP No. 10, paragraph 4 of SSAP No. 16, and paragraph 7 of SSAP No. 68 to the parent reporting entity's adjusted capital and surplus, is the reporting entity required to exclude any net deferred tax assets, EDP equipment and operating system software, and net positive goodwill included in its insurance subsidiaries’ valuation? Or, is the limitation calculated solely based on the legal entity's adjusted capital and surplus?

The effect of looking solely at the legal entity is to allow for the "stacking" of intangibles, so that the parent reporting entity may effectively have more than the defined limitations “invested” in deferred tax assets, EDP equipment and operating system software and goodwill. These assets are limited at each subsidiary legal entity level.
Case Number 2:

Can the reporting entity offset its DTAs against existing gross DTLs of an affiliated entity? This offset would be pursuant to the allowance of an offset against existing DTLs under SSAP No. 10 paragraph 10c. This offset would occur only after application of sections 10a and 10b for both the reporting entity and the affiliate. The premise for the offset is that both entities file a consolidated federal income tax return and that future deductible items of the reporting entity are, by current tax law, able to offset future income items of the affiliate. The affiliates for this purpose would have to have a tax sharing agreement that required payment from one affiliate to another for loss usage.

INT 01-18 Discussion

4. The working group reached a consensus as follows:

Case Number 1:

The working group reached a consensus that in applying the limitations described in paragraph 10.b.ii of SSAP No. 10, paragraph 4 of SSAP No. 16, and paragraph 7 of SSAP No. 68 to the parent reporting entity’s adjusted capital and surplus, the reporting entity shall not exclude any net deferred tax assets, EDP equipment, operating system software, and net positive goodwill included in its insurance subsidiaries valuation.

Case Number 2:

The working group reached a consensus that the reporting entity shall not offset its DTAs against existing gross DTLs of an affiliated entity.

INT 01-18 Status

5. No further discussion planned.
**INT 01-19: Measurement of Deferred Tax Assets Associated with Nonadmitted Assets**

**ISSUE NULLIFIED BY SSAP 10 QUESTION AND ANSWER IMPLEMENTATION GUIDE WHICH CAN BE FOUND AS EXHIBIT A TO SSAP 10.**

**INT 01-19 Dates Discussed**

March 26, 2001; June 11, 2001

**INT 01-19 References**

SSAP No. 10—Income Taxes

**INT 01-19 Issue**

1. An entity may have certain assets, such as property and equipment and prepaid commissions, which are nonadmitted assets for statutory reporting purposes, but have a tax basis that is expected to result in future tax deductions.

2. The accounting issue is how should an entity measure the deferred taxes for the future tax effects associated with nonadmitted assets?

3. For example, assume the following information:

An entity has Furniture, Fixtures and Equipment (FFE) with an original cost of $1,000, accumulated depreciation for book purposes of $200, and accumulated depreciation for tax purposes of $400. Statutory surplus is $10,000. Also assume an effective tax rate of 35%.

**Alternative I – Measure DTAs/(DTLs) before nonadmitted assets:**

<table>
<thead>
<tr>
<th>Statutory Before Nonadmitted</th>
<th>Tax Difference (DTLs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Original cost $1,000</td>
<td>$1,000</td>
</tr>
<tr>
<td>Accumulated Depreciation 200</td>
<td>400</td>
</tr>
<tr>
<td>Basis $800</td>
<td>$600 $200 (70)</td>
</tr>
</tbody>
</table>

The effect of Alternative I is to reduce statutory surplus by $870. That is, $800 for FFE and $70 for the deferred tax liability as a result of calculating deferred taxes prior to nonadmitted assets.
**Alternative II – Measure DTAs/(DTLs) after nonadmitted assets:**

<table>
<thead>
<tr>
<th></th>
<th>Statutory After Nonadmitted</th>
<th>Tax Difference</th>
<th>DTA (DTLs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Original cost</td>
<td>$ -0-</td>
<td>$1,000</td>
<td></td>
</tr>
<tr>
<td>Accumulated Depreciation</td>
<td>-0-</td>
<td>400</td>
<td></td>
</tr>
<tr>
<td>Basis</td>
<td>$ -0-</td>
<td>$ 600</td>
<td>$600</td>
</tr>
</tbody>
</table>

The effect of Alternative II is to reduce surplus by $590 ($800 decrease for nonadmitted asset and $210 increase for DTA), provided the resulting DTA meets the admissibility test in paragraph 10 of SSAP 10.

**INT 01-19 Discussion**

4. The working group reached a consensus that a reporting entity’s balance sheet shall include DTAs resulting from the expected future tax consequences of temporary differences generated by statutory accounting practices, as defined in paragraph 11 of FAS 109. DTAs are computed using a “balance sheet” approach whereby differences between statutory and tax basis balance sheets are treated as temporary differences. Nonadmitted assets with a tax basis create temporary differences as discussed in paragraph 6b. of SSAP 10. The future tax benefits associated with nonadmitted assets embody the three characteristics of an asset as described in FASB Concepts Statement 6. That is, 1) they represent future economic benefit that contribute to future economic cash flow; 2) the enterprise can obtain and control others’ access to it; and 3) the transaction or event giving rise to the entity’s right to control it has occurred. These characteristics are the characteristics of assets as also reflected in SSAP No.4. Accordingly, a DTA for a nonadmitted asset should be calculated under the “balance sheet” approach, Alternative II, using enacted rates applied to the difference between the statutory basis after the asset is nonadmitted and the tax basis of that asset. The resulting DTA is then subject to the admissibility tests included in SSAP 10.

**INT 01-19 Status**

5. No further discussion planned.
Appendix B

Interpretation of the Emerging Accounting Issues Working Group

INT 01-20: Utilization of Tax Planning Strategies for the Admissibility of Deferred Tax Assets

ISSUE NULLIFIED BY SSAP 10 QUESTION AND ANSWER IMPLEMENTATION GUIDE WHICH CAN BE FOUND AS EXHIBIT A TO SSAP 10.

INT 01-20 Dates Discussed
March 26, 2001; June 11, 2001

INT 01-20 References
of SSAP No. 10—Income Taxes

INT 01-20 Issue
1. An entity may have available certain actions or tax planning strategies that are prudent and feasible. However, the entity ordinarily might not take such actions, but for the expiration of an unused operating loss or other tax credit carryforward or for other valid reasons. In all cases the implementation of these strategies are entirely within the control of the entity. The tax planning strategy, if implemented, is expected to result in realization of deferred tax assets (DTAs) within one year of the balance sheet date. Accordingly, the DTAs are recoverable or realizable within one year of the balance sheet date, but the entity, in some circumstances, may not choose to take the action(s) necessary to realize the DTAs within that one year period. Absent the expiration of a carryforward, the strategy can be implemented in a subsequent year.

2. The accounting issues is whether an entity is expected to implement a tax planning strategy within one year of the balance sheet date in order to support the realizability of a tax asset within one year of the balance sheet date?

INT 01-20 Discussion
3. The working group reached a consensus that an entity needs to demonstrate that it has a prudent and feasible tax planning strategy available that, if implemented, would result in realization of deferred tax assets (DTAs) within one year of the balance sheet date. The entity must also have the intent to implement such strategy. In such circumstances an entity may recognize as admitted assets, the related DTAs that are recoverable as a result of the available tax planning strategy in accordance with paragraphs 10a and 10b.(i) of SSAP No. 10, even though the entity may not implement that strategy within the 12 month period. This approach is similar to that outlined in Paragraph 22 of FAS 109, Accounting for Income Taxes that states:

22. In some circumstances, there are actions (including elections for tax purposes) that (a) are prudent and feasible, (b) an enterprise ordinarily might not take, but would take to prevent an operating loss or tax credit carryforward from expiring unused, and (c) would result in realization of deferred tax assets. This Statement refers to those actions as tax-planning strategies. An enterprise shall consider tax-planning strategies in determining the amount of valuation allowance required. Significant expenses to implement a tax-planning strategy or any significant losses that would be recognized if that strategy were implemented (net of any recognizable tax benefits associated with those expenses or losses) shall be included in the valuation allowance.

FAS 109 defines a tax planning strategy as:
An action (including elections for tax purposes) that meets certain criteria (paragraph 22) and that would be implemented to realize a tax benefit for an operating loss or tax credit carryforward before it expires…

**INT 01-20 Status**

4. During the June 11, 2001, the working group determined that a comprehensive implementation guide for SSAP No. 10 was needed rather than addressing this and several other issues individually. Therefore, further discussion planned at a future meeting.
Appendix B

Interpretation of the Emerging Accounting Issues Working Group

INT 01-21: SSAP Nos. 16, 19, 68 and 79 – Reestablishment of Previously Expensed Software and Furniture, Fixtures and Equipment and Goodwill

INT 01-21 Dates Discussed

March 26, 2001; June 11, 2001

INT 01-21 References

SSAP No. 16—Electronic Data Processing Equipment and Software (SSAP No. 16)
SSAP No. 19—Furniture, Fixtures and Equipment; Leasehold Improvements Paid by the Reporting Entity as Lessee; Depreciation of Property and Amortization of Leasehold Improvements (SSAP No. 19)
SSAP No. 68—Business Combinations and Goodwill (SSAP No. 68)
SSAP No. 79—Depreciation of Nonoperating System Software – An Amendment to SSAP No. 16—Electronic Data Processing Equipment and Software (SSAP No. 79)

INT 01-21 Issue

1. Prior to January 1, 2001, some reporting entities elected to expense software and furniture, fixtures and equipment when these items were purchased. Some of these purchases are material in amount. Under the rules effective prior to Codification, this was acceptable statutory practice.

2. The following is excerpted from Chapter 8 of the Accounting Practices and Procedures Manual for Life and Accident and Health Insurance Companies (statutory guidance prior to SSAP No. 16, 19 and 79):

   Application systems software, such as language processors, library routines and debugging aids, and other computer software are not considered operating system software and may be expensed when purchased or established as a nonadmitted asset and written off over a period of years not to exceed the software’s expected useful life (See Chapter 9).

3. The language in the Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies did not mention the option of expensing when purchased; it simply stated that application systems software .... may not be recognized as admitted assets.

4. The transition guidance in SSAP Nos. 16, 19 and 79 do not provide for grandfathering of prior purchases of software, and furniture, fixtures and equipment. Therefore, a strict interpretation of these SSAPs would suggest that reporting entities recompute the net asset value (cost less the appropriate depreciation) and report this amount on their 2001 statutory financial statements, and then nonadmit the net asset.

5. The accounting issue is whether reporting entities are required to recompute the net asset value (cost less the appropriate depreciation) and report this amount on their 2001 statutory financial statements, and then nonadmit the net asset.

INT 01-21 Discussion

6. The working group reached a consensus that reporting entities who purchased and immediately expensed software and furniture, fixtures and equipment prior to January 1, 2001 shall not be required to compute and reestablish the net asset value of the asset, and nonadmit and subsequently depreciate the asset on the 2001 and subsequent statutory financial statements.
INT 01-21 Status

7. No further discussion planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 01-22: Use of Interim Financial Statements in Computing Reporting Entity’s Investment in Subsidiary Under the GAAP Equity Method

INT 01-22 Dates Discussed

March 26, 2001; June 11, 2001

INT 01-22 References

SSAP No. 46—Investments in Subsidiary, Controlled, and Affiliated Entities (SSAP No. 46)

INT 01-22 Issue

1. A reporting entity records its investment in subsidiary utilizing the GAAP equity method. Both the reporting entity and the subsidiary have December 31 year ends; however, the subsidiary’s December 31 financial statements are not completed in time for the reporting entity to use those financial statements to compute its value of its investment in subsidiary. The reporting entity has historically used the subsidiary’s unaudited GAAP September 30 financial statements to compute their ownership at December 31, and the subsidiary’s audited GAAP December 31 financial statements to compute their ownership at March 31, so that the lag in reporting is consistent from period to period.

2. The accounting issue is does the reporting entity need to require that the subsidiary’s September 30 financial statements be audited in order to comply with the requirement in SSAP No. 46, paragraph 7 b. iii?

INT 01-22 Discussion

3. The working group reached a consensus that a reporting entity does not need to require the subsidiary’s interim financial statements to undergo audit. However, the subsidiary’s financial statements must be audited on an annual basis, and any audit adjustments resulting in a change in the reporting entity’s value of its investment in the subsidiary shall be reflected in the reporting entity’s financial statements immediately upon receipt of the audit report. The change shall be included in the reporting entity’s unrealized gain/loss account. Due to the lag in reporting, the reporting entity may continue to use unaudited GAAP financial statements to compute its investment in subsidiary value for its June, September and December statutory financial statements.

INT 01-22 Status

4. No further discussion planned.
INT 01-23 Appendix B

Interpretation of the Emerging Accounting Issues Working Group

INT 01-23: Prepaid Legal Insurance Premium Recognition

INT 01-23 Dates Discussed

March 26, 2001; June 11, 2001

INT 01-23 References

SSAP No. 53—Property Casualty Contracts - Premiums (SSAP No. 53)
SSAP No. 54—Individual and Group Accident and Health Contracts (SSAP No. 54)

INT 01-23 Issue

1. Insurance Company X is a property casualty insurer specializing in insuring and administering prepaid legal expense plans. Insurance Company X is one of a handful of insurance companies, which provide this type of insurance within the United States. The legal plans are established through group policies purchased by companies who in turn offer coverage to electing employees. The plans are offered as an employee benefit to help certificate holders more cost effectively solve their legal problems. For a small monthly premium, employees may consult with and/or receive representation from a plan attorney regarding any one of several covered services (such as will preparation, divorce, child adoption etc).

2. The contracts operate similarly to group health insurance contracts in that:

- the insurance is offered by the sponsoring organization as an elective employee benefit,
- the participating employee are considered the certificate holder, while the employer is considered the policyholder,
- premiums are based on the number of certificate holders,
- the sponsoring company provides regular enrollment information to the insurer,
- 90% of attorneys used in delivery of the plan benefits are ARAG plan attorneys, and
- employees pay premiums through payroll withholding.

3. The group policies are written for a set period, generally one year (and can be up to three-years), with the sponsoring company as the group policyholder. Policies may be canceled by the policyholder with 45 days notice.

4. Insurance Company X sends monthly premium bills to participating employers based on the previous month’s actual employee count. Monthly premium installments are withheld from the participating employee’s paycheck and are remitted to Insurance Company X, along with a detailed listing of the number of plan participants that month. Premium amounts vary from month to month depending on the number of employees participating in the plan that month.

5. The accounting issue is whether premiums for prepaid legal insurance should follow the guidelines of SSAP No. 53 paragraph 5 or SSAP No. 54 paragraph 2?

INT 01-23 Discussion

6. The working group reached a consensus that the premium recognition requirements of SSAP No. 54 paragraph 2 are more consistent with the operations of prepaid legal insurance as described in this interpretation. In essence, this consensus represents a “form over substance” opinion. Prepaid legal is classified in form as property/casualty insurance whereas the substance of the insurance coverage is more analogous to group health business.
INT 01-23 Status

7. No further discussion planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 01-24: Application of SSAP No. 46 and 48 to Certain Noninsurance Subsidiary, Controlled or Affiliated Entities

INT 01-24 Dates Discussed

May 3, 2001; June 11, 2001; October 16, 2001

INT 01-24 References

SSAP No. 46—Investments in Subsidiary, Controlled, and Affiliated Entities (SSAP No. 46)
SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies (SSAP No. 48)

INT 01-24 Issue

1. SSAP No. 46 and SSAP No. 48 provide guidance as to the valuation of noninsurance subsidiary, controlled and affiliated (SCA) entities. SSAP No. 46 prescribes the use of either the Statutory Equity Method (as described in paragraph 7.b.ii) or the GAAP Equity Method (as described in paragraph 7.b.iii.) for the valuation of noninsurance SCA investments. SSAP No. 48 directs users to one of the equity methods in SSAP No. 46 for investments in joint ventures, partnerships and limited liability companies, except for limited partnerships with a minor ownership interest. In order to provide further guidance as to the application of SSAP No. 46 and SSAP No. 48, the working group was asked to interpret several specific SCA arrangements.

2. The accounting issue is whether the following SCA arrangements should be valued under the Statutory Equity Method or the GAAP Equity Method?

   Issue 1 - Insurance Company A owns 100% of a third party administrator, TPA1. TPA1 processes claims for noninsurance companies and for Medicare and Medicaid programs. TPA1 does not process claims for Insurance Company A.

   Issue 2 - Insurance Company A owns 100% of a company that processes insurance claims, TPA2. TPA2 processes claims for Insurance Company A, Insurance Company B, Insurance Company C and Insurance Company D. TPA2 owns the EDP equipment and software necessary to provide administrative services to its customers. Insurance Companies B, C and D are not affiliates of Insurance Company A. The processing of claims for Insurance Company A constitutes 20% of the business (revenues) of TPA2.

   Issue 3 - Insurance Companies A, B, C and D each own 25% of a company, TPA3, that provides administrative services, including all EDP processing, to Insurance Companies A, B, C and D. TPA3 owns the EDP equipment and software and furniture, fixtures and equipment necessary to provide administrative services to its customers. TPA3 does not provide administrative services to any other entities. Insurance Companies A, B, C and D are not part of the same insurance holding company system. The processing that TPA3 does for each of Insurance Companies A, B, C and D constitutes 25% of its business and revenues.

   Issue 4 - Insurance Company A owns 100% of a company, TPA4, that provides administrative services, including EDP processing, to Insurance Company A, Insurance Company B, Bank C and Manufacturing Company D. TPA4 owns the EDP equipment and software necessary to provide administrative services to its customers. Insurance Company A, Insurance Company B, Bank C and Manufacturing Company D are not affiliates, i.e.
none of the four companies are related to one another. The processing that TPA4 does for Insurance Company A represents 40% of TPA4’s business and revenues.

Issue 5 - Insurance Company A owns 100% of a company, TPA5, that provides claims administration services, including EDI processing, to Insurance Company A, Insurance Company B, numerous self-insured companies and Medicare. TPA5 owns the EDI equipment and software necessary to provide administrative services to its customers. Insurance Company A, Insurance Company B and the self-insured companies are not affiliates, i.e. they are not related to one another. Insurance Companies A and B may provide stop-loss coverage to some of the self-insured companies for whom TPA5 provides claims administration services. The processing that TPA5 does for Insurance Company A represents 51% of TPA5’s business and revenues.

Issue 6 - Insurance Company A holds a 18.77% Partnership Interest in LP A. This fund was organized for the primary purpose of investing in investment vehicles and commodity pools as a “fund of funds” investment manager. The insurer is a limited partner. The general partner is not affiliated with the insurer. Quoting from the limited partnership agreement Section 3.1 – “The general partner shall be vested with the complete control of the business of the fund. The limited partners have no responsibility for the management of the fund and shall have no authority or right to act on behalf of the fund or to bind the fund in connection with any matter.” The largest holding on their 12/31/99 audited GAAP financials was $293.6 million of “Investments in limited partnerships and investment funds, at fair value.” Beyond that they have $28.0 million of cash and cash equivalents and $90k of dividends and interest receivable.

Issue 7 - Insurance Company A holds a 25% Partnership Interest in LP B. Similar to the LP A above, LP B is another limited partnership investment where the insurer owns greater than a 10% interest. The LP fund was organized primarily for the purpose of making investments in media businesses. The fund’s general partner is not affiliated with the insurer. The general partner manages all of the affairs of the Fund, i.e., controls the business activities of the fund. The largest holding on their 12/31/99 unaudited GAAP financials (assume for this example that audited statements are not and will not be prepared) was $194.0 million of “Portfolio investments at fair value”. This was made up of a combination of partnership and stock investments. Total assets were $200.8 million at 12/31/99.

Issue 8 - Insurance Company A holds a 25% Partnership Interest in LLP C. LLP C is a real estate development limited partnership in which the insurer holds a 25% interest as a limited partner. The LLP’s general partner is not affiliated with the insurer. The general partner manages the affairs of partnership including decisions on properties to acquire and/or develop. Assets of the partnership include real estate properties, both residential and commercial. Total assets of the partnership are $1 billion and total liabilities $500 million, primarily outside debt. LLP C prepares annual audited GAAP financial statements, however, they are not completed prior to the insurer filing its annual financial statements.

INT 01-24 Discussion

3. The working group reached the following:

Issue 1 - The working group reached a consensus that Insurance Company A would value its investment in TPA1 under the GAAP Equity Method.

Issue 2 - The working group was unable to reach a consensus on this issue.
Issue 3 - The working group reached a consensus that Insurance Companies A, B, C and D would value their respective investment in TPA3 under the Statutory Equity Method.

Issue 4 - The working group was unable to reach a consensus on this issue.

Issue 5 - The working group reached a consensus that Insurance Company A would value its investment in TPA5 under the Statutory Equity Method.

Issue 6 - The working group reached a consensus that Insurance Company A would value its investment in LP A under the GAAP Equity Method.

Issue 7 - The working group reached a consensus that Insurance Company A would value its investment in LP B under the GAAP Equity Method. The working group also reached a consensus that Insurance Company A would nonadmit the assets as audited GAAP financials are not available.¹

Issue 8 - The working group reached a consensus that Insurance Company A would value its investment in LLP C under the GAAP Equity Method. INT 01-22 speaks to the timing of the GAAP audits.

INT 01-24 Status

4. No further discussion planned.

¹ The Statutory Accounting Principles Working Group adopted a nonsubstantive modification to SSAP No. 48 to incorporate a grandfathering provision for investments made prior to January 1, 2001 on December 10, 2001.
Appendix B

Interpretation of the Emerging Accounting Issues Working Group

INT 01-25: Accounting for U.S. Treasury Inflation-Indexed Securities

INT 01-25 Dates Discussed

June 11, 2001; October 16, 2001; September 10, 2002; December 8, 2002

INT 01-25 References

SSAP No. 26—Bonds, excluding Loan-backed and Structured Securities (SSAP No. 26)

INT 01-25 Issue

1. Treasury inflation-indexed securities are direct obligations of the United States government, and are backed by the full faith and credit of the government. The principal is protected against inflation. Since the principal is indexed to the Consumer Price Index and grows with inflation, the investor is guaranteed that the real purchasing power of the principal will keep pace with the rate of inflation (Based on the Reference CPI-U, which has a three-month lag). Although deflation could cause the principal to decline, Treasury will pay at maturity an amount that is no less than the par amount as of the date the security was first issued.

2. Interest is also protected from inflation. The investor will receive semiannual interest payments, based on a fixed semiannual interest rate applied to the inflation-adjusted principal, so that the investor is guaranteed a real rate of return above inflation.

Summary of the Structure and Index:

Principal amount. The principal amount of Treasury inflation-indexed securities will be adjusted for changes in the level of inflation. The inflation-adjusted principal amount of the securities can be calculated daily. However, the inflation adjustment will not be payable by Treasury until maturity, when the securities will be redeemed at the greater of their inflation-adjusted principal amount or the principal amount of the securities on the date of original issuance (i.e., par).

Index. The index for measuring the inflation rate will be the nonseasonally adjusted CPI-U (U.S. City Average All Items Consumer Price Index for All Urban Consumers). CPI-U was selected by Treasury because it is the best known and most widely accepted measure of inflation.

Interest payments. Every six months Treasury will pay interest based on a fixed rate of interest determined at auction. Semiannual interest payments are determined by multiplying the inflation-adjusted principal amount by one-half the stated rate of interest on each interest payment date.

Payment at maturity. If at maturity the inflation-adjusted principal is less than the par amount of the security (due to deflation), the final payment of principal of the security by Treasury will not be less than the par amount of the security at issuance. In such a circumstance, Treasury will pay an additional amount at maturity so that the additional amount plus the inflation-adjusted principal amount will equal the par amount of the securities on the date of original issuance. Initially, the securities will be issued with a 10-year maturity; however, Treasury expects to issue other maturities over time.
Stripping. The securities will be eligible for the STRIPS program (Separate Trading of Registered Interest and Principal of Securities) as of the first issue date. Unlike the conventional STRIPS program, however, interest components stripped from different inflation-indexed securities, at least initially, will not be interchangeable or fungible with interest components from other securities, even if they have the same payment or maturity date.

3. The accounting issue is how should changes to inflation-adjusted principal be recorded?

4. At the September 10, 2002 and December 8, 2002 the working group expanded this interpretation to address specific questions regarding U.S. Treasury Inflation-Indexed Securities purchased at either a premium or discount and how the inflation adjustment interacts with any such premium or discount, as well as the calculation of each of these amounts.

5. The following example will be used to highlight issues concerning the amortization of premium and inflation adjustment for a typical security:

Assume:
Par value of TIP security $500,000
Inflation factor at date of purchase 1.12075
Price at date of purchase 102.96875
Original issue date 6/30/X0
Purchase date 06/30/X6
Maturity date 06/30/X10

Amount of inflation adjustment at date of purchase
($500,000 * .12075) $60,375
Total purchase price ($500,000*1.12075*1.0296875) $577,011
Premium at date of purchase ($577,011 - $500,000 - $60,375) $16,636

6. The issues are:
Issue a. – If accretion or amortization should be recognized over the period of time the security is owned.

Issue b. – Assuming that at the end of the accounting period, 12/31/X6, the inflation factor is 1.13000, what the correct book value of the security would be.

Issue c. – Assuming that at the end of the accounting period, 12/31/X6, the inflation factor is 1.12000, what the correct value of the security would be.

Issue d. – How changes in accounting treatment would be handled.

INT 01-25 Discussion

7. At its October 16, 2001 meeting, the working group reached a consensus that the inflation adjustment be recognized as an unrealized gain until such time as it is paid, at which time it should be recognized as a realized gain. If there is a deflation adjustment, such amounts should only be recognized to the extent of any previously recognized inflation adjustment for that particular security, (reduce any unrealized gain on that security to zero) as the investor is guaranteed at maturity to receive at least the par amount of the security. (See paragraph 8 c. below for amendments to this paragraph adopted at the December 8, 2002 meeting.)
8. At its December 8, 2002 meeting, the working group reached a consensus on the following issues related to the purchase of a treasury inflation-indexed security at either a premium or a discount, how the inflation adjustment interacts with any such premium or discount, as well as the calculation of each of these amounts.

Issue a. – The $16,636 premium paid for the security should be amortized over the remaining life of the security. Therefore, if the inflation adjustment factor never changed from the 1.12075 at date of purchase, the security would have a book value at maturity of $560,375, the amount the reporting entity would receive at maturity date ($500,000*1.12075).

Issue b. – The reporting entity should record the unrealized gain/loss based on the difference in the inflation factor times the par amount, and amortize the premium over the remaining life of the security.

Issue c. – In the case where the inflation factor is reduced to a factor not less than 1.0000, the reporting entity should reflect the change in the inflation adjustment as well as amortization of premium. Paragraph 7 of this interpretation is amended as follows:

7. The working group reached a consensus that the inflation adjustment be recognized as an unrealized gain until such time as it is paid, at which time it should be recognized as a realized gain. If there is a deflation adjustment, such amounts should only be recognized to the extent the inflation factor is not reduced to an amount less than 1.0000 of any previously recognized inflation adjustment for that particular security, (reduce any unrealized gain on that security to zero) as the investor is guaranteed at maturity to receive at least the par amount of the security.

Issue d. - A change in accounting principle should be recorded per the requirements of SSAP No. 3—Accounting Changes and Corrections of Errors. Paragraph 5 of that statement:

5. The cumulative effect of changes in accounting principles shall be reported as adjustments to unassigned funds (surplus) in the period of the change in accounting principle. The cumulative effect is the difference between the amount of capital and surplus at the beginning of the year and the amount of capital and surplus that would have been reported at that date if the new accounting principle had been applied retroactively for all prior periods.

In the specific question noted, if the reporting entity is currently recognizing both amortization of premium as well as the change in the inflation adjustment factor as amortization of premium, there should not be a cumulative effect on surplus to record.

INT 01-25 Status

9. No further discussion planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 01-26: SSAP No. 51 and Reserve Minimum or Required Amount

INT 01-26 Dates Discussed

June 11, 2001; October 16, 2001

INT 01-26 References

SSAP No. 51—Life Contracts (SSAP No. 51)

INT 01-26 Issue

1. SSAP No. 51 adopts Appendix A-820—Minimum Life and Annuity Reserve Standards (A-820) on minimum standards for life and annuity contracts.

2. The accounting issue is if a state requires a higher standard, like a more conservative mortality table, or a company chooses a higher standard even when not required by their state, would the difference between the amount as reported and the reserve required by SSAP No. 51 and Appendix A-820 be included in the footnote reconciliation required by Appendix A-205—Illustrative Disclosure of Differences Between NAIC Statutory Accounting Practices and Procedures and Accounting Practices Prescribed or Permitted by the State of Domicile?

INT 01-26 Discussion

3. The working group reached a consensus that a difference would have to be disclosed 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 basis. The working group is of the opinion that although the A-820 standard is viewed as a minimum one, it nevertheless represents the baseline from which deviations are measured. The determination of whether difference meets the standard of materiality is subjective. The Preamble provides further guidance on the criterion of materiality.

INT 01-26 Status

4. No further discussion planned.

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1 This issue applies to contracts issued January 1, 2001 and thereafter.
Interpretation of the Emerging Accounting Issues Working Group

INT 01-27: Accounting Change versus Correction of Error

INT 01-27 Dates Discussed
June 11, 2001; October 16, 2001

INT 01-27 References
SSAP No. 3—Accounting Changes and Corrections of Errors (SSAP No. 3)

INT 01-27 Issue
1. SSAP No. 3 provides accounting guidance defining a change in accounting principle and a correction of an error. The NAIC Accounting Practices and Procedures Manual (the AP&P manual) authorizes a change resulting from the adoption of a Statement of Statutory Accounting Principles (SSAP) to be accounted for as a change in accounting principle in accordance with SSAP No. 3. However, the AP&P manual does not define the accounting period in which changes must be adopted.

2. The accounting issue is if additional changes related to the adoption of Statements of Statutory Accounting Principles are identified during subsequent quarters in the calendar year that were not recognized during the 1st quarter, should such changes be accounted for as a change in accounting principle or a correction of an error?

INT 01-27 Discussion
3. The working group reached a consensus that the cumulative effect of changes in accounting principles shall be reported as adjustments to unassigned funds (surplus) in the fiscal year of the change in accounting principle. The cumulative effect is the difference between the amount of capital and surplus at the beginning of the year and the amount of capital and surplus that would have been reported at that date if the new accounting principle had been applied retroactively for all prior periods. For example, adjustments to an amount recorded as of January 1, 2001 would be recorded as changes in accounting principle rather than corrections of an error through the period of 2001.

INT 01-27 Status
4. No further discussion planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 01-28: Margin for Adverse Deviation in Claim Reserve

INT 01-28 Dates Discussed

June 11, 2001; October 16, 2001

INT 01-28 References

SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses (SSAP No. 55)

INT 01-28 Issue

1. SSAP No. 55 paragraph 10 directs management to record its “best estimate” of its unpaid claim liability. The term best estimate is generally understood not to prohibit any margin for adverse deviation. In general, practicing actuaries have included a margin for adverse deviation in their claim reserves for both life and A&H business. Paragraph 29 of the Preamble speaks to conservatism. It states, “… the concept of conservatism should be followed when developing estimates as well as establishing accounting principles for statutory reporting.”

2. Actuarial Standard of Practice No. 5, Incurred Health and Disability Claims covers in course of settlement and incurred but unreported (IBNR) liabilities for Accident and Health (A&H) insurance. A new version of the standard was effective on May 1st, 2001. Section 3.3c states that the actuary should consider “… what margin for uncertainty, if any, might be appropriately included [in the unpaid claim liability].” The NAIC’s Life and Health Actuarial Task Force is working on a Health Reserves Guidance Manual. The current draft of the manual contains a significant section on conservatism in reserves.

3. The likely interpretation of SSAP No. 55 paragraph 10 is in conflict with current practice, the concept of conservatism, actuarial standards of practice and the draft Health Reserves Guidance Manual. It may lead to confusion and a significant lowering of A&H reserves under codification.

4. The accounting issue is what is the desired role, if any, of the margin for adverse deviation in the calculation of claim reserves?

INT 01-28 Discussion

5. The working group reached a consensus that the concept of conservatism is inherent to the estimation of reserves and as such should not be specifically prohibited in the consideration of management’s best estimate. On the other hand, the working group does not believe there should be a specific requirement to include a provision for adverse deviation in claims as the application of estimates varies greatly from company to company and requires the careful judgement of management.

6. No further discussion planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 01-29: SSAP No. 59 and Application to Credit Life

INT 01-29 Dates Discussed
October 16, 2001; December 10, 2001

INT 01-29 References
SSAP No. 59—Credit Life and Accident and Health Insurance Contracts (SSAP No. 59)

INT 01-29 Issue
1. SSAP No. 59 states the following in paragraph 12:

   For credit accident and health contracts, the policy reserve recorded shall not be less than the gross unearned premium reserve. In addition, for all credit contracts in the aggregate, if the premium refund liability exceeds the aggregate recorded reserve, an additional liability shall be established. This premium refund (excess) liability may include consideration of commission, premium tax, and other expenses recoverable.

2. The accounting issues are:
   a. Does SSAP No. 59 paragraph 12 require an excess reserve for the surrender values (premium refund) in excess of the mortality reserves?
   b. If so, may the surrender values be net of commissions, premium taxes, etc.?
   c. Are any excess reserves to be calculated on a policy by policy basis or aggregated? If aggregated, what policies are to be grouped for comparison?

INT 01-29 Discussion
3. The working group reached a consensus that SSAP No. 59 paragraph 12 requires an excess reserve to be established for the surrender values (premium refund) in excess of the mortality reserves. As such, the surrender values may be net of commissions, premium taxes, etc. Also, the excess reserve is calculated on an aggregated basis by combining all credit life and accident and health policies and certificates.

INT 01-29 Status
4. No further discussion is planned.
INT 01-31 Appendix B

Interpretation of the Emerging Accounting Issues Working Group

INT 01-31: Assets Pledged as Collateral

INT 01-31 Dates Discussed

October 16, 2001; December 10, 2001; March 18, 2002

INT 01-31 References

SSAP No. 4—Assets and Nonadmitted Assets (SSAP No. 4)
SSAP No. 5—Liabilities, Contingencies and Impairment of Assets (SSAP No. 5)
SSAP No. 18—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (SSAP No. 18)
SSAP No. 33—Securitization (SSAP No. 33)
SSAP No. 45—Repurchase Agreements, Reverse Repurchase Agreements and Dollar Repurchase Agreements (SSAP No. 45)
INT 99-02: Accounting for Collateral in Excess of Debt Principal (INT 99-02)

INT 01-31 Issue

1. Insurers may enter into certain transactions that require the granting of a security interest in certain assets to another party to serve as collateral for their performance under a contract. The arrangement is commonly referred to as a pledge, typically accomplished by delivery of assets to the secured party or to an independent custodian. In these transactions, the pledging insurer typically (1) continues to receive the income on the pledged collateral and (2) can remove and substitute other securities with little or no advance notice to the secured party as long as they comply with related investment quality and market value agreement provisions. Examples include collateral pledged under investment, derivative, debt obligations and policyholder transactions.

2. Specific examples of collateral pledged for derivative and investment transactions include but are not limited to: (1) securities posted with a broker as margin for futures and options transactions, (2) securities pledged to secure credit exposure with swap counterparties, (3) securities pledged under reverse repurchase agreements or securitizations that are accounted for as secured borrowing transactions and (4) securities pledged under securities lending transactions.

3. Specific examples of collateral pledged for debt obligations and policyholder transactions include but are not limited to assets pledged to secure (1) debt borrowings from or insurance contracts issued to banking entities and (2) insurance contracts issued to governmental entities such as municipalities.

4. Under these transactions, the fair value of the securities pledged as collateral may exceed the contract balance (swap fair value, advance balance, policyholder account balance, etc). For this interpretation, this excess carrying value of securities pledged over the corresponding asset or contract balance is called the “overcollateralization” amount.

5. The accounting issue is whether the assets pledged as collateral under the various transactions mentioned above should be considered admitted assets.

INT 01-31 Discussion

6. The working group reached a consensus that if the collateral had not been pledged in the examples described above, it is assumed the underlying asset would be recorded as an admitted asset under SSAP No. 4 (e.g. they are readily marketable assets available to meet both current and future needs).
policyholder obligations). In addition, it is assumed that the asset would not be considered impaired under SSAP No. 5 due to a default, market value decline, or other loss contingency.

7. Therefore, for the examples described above, the pledging insurer would record the collateral (including the overcollateralization amount) as an admitted asset until they have committed a contract default that has not been cured in accordance with the contract provisions. This accounting is in accordance with the provisions of SSAP Nos. 18, 33 and 45. This consensus of reporting collateral as an admitted asset is further supported by SSAP Nos. 4 and 5 since generally, the insurer can readily substitute pledged assets. Additionally, an insurer may typically unwind the transaction allowing the assets to be available to the pledging insurer to meet policyholder obligations. Furthermore, no event has occurred to indicate an impairment or potential loss contingency with respect to such pledged assets. The fact that some pledged assets may constitute an overcollateralization amount does not change this analysis. Accordingly, all assets pledged in support of these type transactions should also be admitted.

8. At the time of an uncured default, the provisions of paragraph 10 of SSAP No. 18 shall be used to determine the appropriate accounting treatment for the collateral. If the secured party utilizes collateral to offset all or a portion of the liability owed by the pledging insurer as a result of the default, then the collateral amount utilized to offset the liability shall be removed from the balance sheet. At the same time, the amount of the liability that was offset should be removed from the balance sheet since that obligation has been satisfied through the secured party’s utilization of that collateral. To the extent that an uncured default remains without the secured party utilizing the collateral to offset the obligation, the pledging insurer should only record an admitted asset for the amount of collateral that it can redeem.

INT 01-31 Status

9. The consensus position of this interpretation is consistent with the position of the NAIC Invested Asset (E) working group. This interpretation will be reviewed by the FAS 140 Subgroup of the NAIC Statutory Accounting Principles (E) working group in conjunction of its consideration of incorporating GAAP pronouncement FAS 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, a replacement of FASB Statement 125 into the statutory accounting model. As such, this interpretation is subject to amendment pending disposition of the FAS 140 Subgroup’s review of collateral and FAS 140 in its entirety.
INT 01-32: EITF 01-10: Accounting for the Impact of the Terrorist Attacks of September 11, 2001

INT 01-32 Dates Discussed
October 16, 2001; December 10, 2001; March 9, 2003; June 22, 2003

INT 01-32 References
SSAP No. 1—Disclosure of Accounting Policies, Risks & Uncertainties, and Other Disclosures (SSAP No. 1)
SSAP No. 5—Liabilities, Contingencies and Impairments of Assets (SSAP No. 5)
SSAP No. 65—Property and Casualty Contracts (SSAP No. 65)

INT 01-32 Issue
1. The terrorist attacks of September 11, 2001 (the September 11 events), resulted in a tremendous loss of life and property. Secondarily, those events interrupted the business activities of many entities and disrupted the U.S. economy at many levels. In the past, businesses have incurred losses as a result of catastrophes such as earthquakes, hurricanes, and even other terrorist attacks. However, the September 11 events are unprecedented in the United States in terms of the magnitude of the losses incurred and the number of entities affected. In fact, as a direct result of the September 11 events, the U.S. Secretary of Transportation issued a Federal ground stop order that closed the U.S. air travel system for over 24 hours. The Task Force noted that the September 11 events have an effect on many companies' financial statements for the period ended September 30, 2001. Clearly, the importance of the accounting for the impact of those events pales in comparison to the gravity of the events themselves. As a result, the Task Force was initially reluctant to address this Issue. However, the Task Force observed that timely accounting guidance would be helpful to companies in capturing data, planning how to communicate with investors, and so forth. The Task Force also noted that without such guidance, financial statement preparers and auditors would be faced with individually resolving the difficult questions in this Issue. Accordingly, the Task Force concluded that it should expeditiously address and resolve this Issue.

2. The Air Transportation Safety and System Stabilization Act (the Act) was enacted prior to September 30, 2001 in direct response to the September 11 events and the disruption caused by them. The Act provides for:
   a. Compensation to air carriers and victims for direct and incremental losses incurred resulting from the September 11 events
   b. Loan guarantees provided to air carriers by the U.S. government
   c. Reimbursement of increases in certain insurance premiums incurred by air carriers and certain other entities, and
   d. Limitations on liabilities incurred or to be incurred by air carriers as a result of the September 11 events.

3. The Act compensates air carriers for direct and incremental losses incurred during the period from September 11, 2001 to December 31, 2001. Each air carrier is entitled to receive the lesser of its direct and incremental losses for the period or its allocation of the aggregate compensation available under the Act. The Act does not specifically define the terms "direct" or "incremental," but states that "the term 'incremental loss' does not include any loss that the President determines would have been incurred if the terrorist attacks on the United States…had not occurred" (Section 107(3)). Initial estimates of an air carrier's losses as a result of the September 11 events are determined by comparing the air carrier's...
Appendix B

earnings forecast for the period from September 11, 2001 to December 31, 2001 (computed prior to the September 11 events) to its earnings forecast for the same period computed after the September 11 events.

4. This Issue provides accounting and disclosure guidance for losses incurred as a result of the September 11 events and related insurance and other recoveries and federal assistance (in the form of direct compensation available to air carriers under the Act).

5. The accounting issues are:

   Issue 1—How losses or costs resulting from the September 11 events should be classified in the statement of operations.

   Issue 2(a)—When asset impairment losses resulting from the September 11 events should be recognized.

   Issue 2(b)—When liabilities for other losses or costs resulting from the September 11 events should be recognized.

   Issue 3—How insurance recoveries of costs and losses incurred as the result of the September 11 events should be classified in the statement of operations and when those recoveries should be recognized.

   Issue 4—How federal assistance (in the form of direct compensation received by air carriers under the Act) should be classified in the statement of operations and when that assistance should be recognized.

   Issue 5—What disclosures should be made in the footnotes to the financial statements regarding the losses and costs incurred as a result of the September 11 events.

INT 01-32 Discussion

6. At its December 10, 2001 meeting, the working group reached a consensus to adopt the positions in EITF 01-10 as follows (the working group reached a consensus to the following amendments to paragraphs 6a. and 6b. and the subparagraph on Issue 5 in paragraph 7 at its June 22, 2003 meeting).

   a. Issues 1-5 are applicable in the case where an insurer is an insured that suffered damages, other than losses as an insurer, as a result of the terrorist attacks of September 11th;

   b. Issue 5 of the EITF 01-10 is applicable to insurers who suffered losses as an insurer; and

   c. If both cases are applicable, disclosure of such should be presented independently.

7. The consensus position of the EITF is as follows (the response to Issue 5 has been modified to synchronize with statutory accounting terminology):

   The Task Force observed that the consensuses reached on this Issue with regard to the classification of losses incurred and related insurance or other recoveries are limited to the September 11 events and should not be applied by analogy in other cases. The Task Force observed that the income statement classification of other catastrophic losses incurred, whether as a result of terrorist attacks or other causes, should be determined after careful consideration of all facts and circumstances and the requirements of Opinion 30. In addition, while the remainder of this Issue prescribes classification in the statement of operations within continuing operations (as opposed to extraordinary classification), that should not be interpreted to preclude costs, losses, and related recoveries from being classified in discontinued operations if the requirements of Opinion 30, paragraphs 13-17, are met.
On Issue 1, the Task Force reached a consensus that losses or costs resulting from the September 11 events should be classified as part of income from continuing operations in the statement of operations. The Task Force observed that if those losses or costs meet the criteria for disclosure of unusual or infrequently occurring items in paragraph 26 of Opinion 30, they should be reported as a separate item in income from continuing operations, either on the face of the statement of operations or in the footnotes to the financial statements. In addition, the disclosures described in paragraph 26 of Opinion 30 should be made.

Task Force members expressed mixed views regarding whether losses or costs incurred as a result of the September 11 events meet the Opinion 30 criteria to be classified as an extraordinary item in the statement of operations. Some Task Force members expressed the view that none of the losses or costs incurred as a result of the September 11 events meet those criteria. Those Task Force members suggested that although the September 11 events were unusual in nature (as described in paragraph 21 of Opinion 30) for many businesses, those events did not meet the infrequency of occurrence criteria (in paragraph 22 of Opinion 30). Those Task Force members noted that terrorist acts have occurred in the U.S. in the past and believe that, unfortunately, they can reasonably be expected to recur in the U.S. in the foreseeable future. They believe that the magnitude of the September 11 events is the only distinguishing factor that might cause one to conclude that certain losses or costs incurred as a result of those events should be classified as an extraordinary item in the statement of operations. However, based on the guidance in Opinion 30, the magnitude of an event has no bearing on whether the related losses or costs are classified as an extraordinary item.

Other Task Force members expressed the view that the magnitude of the September 11 events is an inseparable aspect of the evaluation of whether those events meet the criteria in Opinion 30 to be classified as an extraordinary item. Those Task Force members pointed to a number of facts to support their position that the September 11 events not only meet the unusual nature criteria (in paragraph 21 of Opinion 30) but also meet the infrequency of occurrence criteria (in paragraph 22 of Opinion 30). Those facts include (a) the magnitude of the losses incurred, (b) the number of entities affected, (c) the unprecedented Federal ground stop order that closed the U.S. air travel system for over 24 hours, and (d) the unprecedented cooperative efforts being undertaken by the U.S. and other nations to prevent similar future attacks. As a result of the foregoing considerations, those Task Force members believe that the September 11 events are of a type not reasonably expected to recur in the foreseeable future and that at least some of the losses and costs incurred as a result of those events qualify for classification as an extraordinary item in the statement of operations.

Opinion 30 provides for separate classification of the impact of certain events as extraordinary because the events are so unusual and infrequent that the statement of operations is more meaningful when the complete impact of those events is distinguished from the rest of the activity reflected in the statement of operations. The Task Force concluded that regardless of whether the September 11 events meet the criteria in Opinion 30 to be considered extraordinary, the effects of those events were so wide-ranging and had such a pervasive impact on U.S. businesses and the U.S. economy that the foregoing communication objectives of Opinion 30 with respect to extraordinary items could not be met. The Task Force agreed that despite the incredible nature of the September 11 events, extraordinary item financial reporting treatment would not be an effective way to communicate the financial effects of those events and, therefore, should not be used in this case. The Task Force noted that it would be impossible to isolate and therefore distinguish (in a consistent way) the effects of the September 11 events in any single line item on companies' financial statements because of the inability to separate losses that are directly attributable to the September 11 events from those that are not. For example, impairment of long-lived assets as a result of the September 11 events would in many cases be impossible to measure separately from impairment due to the general economic slowdown that was generally acknowledged to be under way. (The September 11 events probably contributed to the speed and
depth of the economic slowdown, but determining the portion of the slowdown directly attributable to the September 11 events would be extremely subjective and difficult if not impossible.) In addition, the Task Force observed that the most significant financial statement impact of the September 11 events to many companies might be lost or reduced revenues. The measurement of an extraordinary item under Opinion 30 does not reflect any estimate of lost or reduced revenues.

The Task Force noted that its primary objective in addressing this Issue was to provide financial statement users with decision useful information about the financial effects of the September 11 events by providing preparers and auditors with operational guidance that would be straightforward and consistently applied. The Task Force observed that it might have been possible to create operational guidance by limiting the losses or costs classified as extraordinary to those that clearly meet the Opinion 30 criteria for extraordinary classification (that is, those that could be clearly measured and irrefutably attributed to the September 11 events). However, the Task Force agreed that investors and financial statement users would not be well served by separately reporting only that part of the effects of the September 11 events as an extraordinary item. Under that approach, a possibly significant portion of the impact of the September 11 events would be classified within income from continuing operations (that is, the amount presented as an extraordinary item would be incomplete and might be only a small part of the total financial statement impact of the September 11 events). The Task Force noted that financial statement users are interested in understanding the whole impact of the September 11 events on each company and concluded that financial statement users would be better served by not separating a part of that impact and reporting it in a separate line item outside of income from continuing operations. That approach also is consistent with the broader objective of providing financial reports that communicate effectively and clearly.

On Issue 2(a), the Task Force observed that Appendix B of Statement 121 includes a table listing the existing FASB and APB authoritative literature that, in addition to Statement 142, provides guidance relating to impairment of assets and disposal of assets. The Task Force agreed that the guidance in that literature should be used to determine when an asset impairment loss resulting from the September 11 events should be recognized and how that impairment loss should be measured.

On Issue 2(b), the Task Force reached a consensus that liabilities for losses and other costs should be recognized when the recognition criteria in paragraph 63 of Concepts Statement 5 have been met. That is, those liabilities should be recognized when:

a. The item meets the definition of a liability. Paragraph 35 of Concepts Statement 6 defines liabilities as "probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events" (footnote references omitted).

b. The liability can be measured with sufficient reliability.

c. The information about the liability is capable of making a difference in user decisions.

d. The information about the liability is representationally faithful, verifiable, and neutral.

The Task Force further observed that the provisions of Statement 5 and other applicable literature (including Interpretation 14) should be followed in determining when to recognize losses incurred. The Task Force noted that under that literature, many of the losses and costs that entities expect to incur as a result of the September 11 events will not qualify for immediate recognition as a liability. For example, the costs of restoring a facility (whether capitalizable or not) to a condition suitable for occupancy should be recognized as the restoration efforts occur. Thus, the fact that an entity intends to incur costs as a result of the September 11 events (or may even be compelled to incur those costs to stay in business) does not necessarily mean that those costs should be immediately recognized as a liability.
The Task Force observed that an entity may be required to continue making operating lease payments on equipment or facilities that are temporarily unusable as a result of the September 11 events. The Task Force reached a consensus that under the requirements of Statement 5 (and Interpretation 14), an entity should recognize a liability as of September 11 for such operating lease rentals provided that the period of time that the equipment or facilities will be unusable can be reasonably estimated. The Task Force also noted that as a result of the September 11 events an entity may temporarily idle equipment or facilities that are not unusable. The Task Force reached a consensus that operating lease expense (if any) on temporarily idled equipment or facilities should be recognized in accordance with paragraph 15 of Statement 13 and related guidance during the period the equipment or facilities are idled. That is, no change in the recognition principles for operating rentals on such equipment or facilities is appropriate under generally accepted accounting principles even though they have been temporarily idled. The Task Force noted that the foregoing consensuses with respect to recognition of operating lease expenses on temporarily unusable and temporarily idled equipment or facilities are subject to further consideration in EITF Issue No. 99-14, "Recognition by a Purchaser of Losses on Firmly Committed Executory Contracts," and that it will not be constrained in that Issue by the consensuses reached in this Issue. The Task Force observed that entities should continue to recognize depreciation expense on capitalized equipment or facilities that are temporarily unusable or temporarily idled. That is, no change in the recognition principles for depreciation of equipment or facilities is appropriate under generally accepted accounting principles even if they are temporarily unusable or temporarily idled. The examples in Exhibit 01-10A provide additional guidance on when to recognize losses incurred.

On Issue 3, the Task Force noted that in accordance with the guidance in paragraph 4 of Interpretation 30, any insurance recoveries resulting from losses or costs incurred as a result of the September 11 events should be classified in a manner consistent with the related losses (that is, within income from continuing operations). With respect to the timing of recognition of insurance recoveries, the Task Force reached a consensus that entities should follow the guidance in paragraph 3 of Interpretation 30 (for recoveries in connection with property and casualty losses) or paragraphs 140 and 141 of SOP 96-1 (for recoveries in connection with environmental obligations), as applicable. That guidance generally requires that an asset relating to the insurance recovery should be recognized only when realization of the claim for recovery of a loss recognized in the financial statements is deemed probable (as that term is used in Statement 5). In addition, under the requirements of paragraph 17 of Statement 5, a gain (that is, a recovery of a loss not recognized in the financial statements or an amount recovered in excess of a loss recognized in the financial statements) should not be recognized until any contingencies relating to the insurance claim have been resolved (see Examples 7 and 8 in Exhibit 01-10A for further guidance regarding recognition of insurance recoveries). The Task Force observed that in some circumstances, costs or losses may be recognized in the statement of operations in a different (earlier) period than the related recovery.

On Issue 4, the Task Force reached a consensus that federal assistance (in the form of direct compensation under the Act) received by air carriers should be classified as part of income from continuing operations in the statement of operations. Further, the Task Force reached a consensus that when recognized in the statement of operations, such federal assistance should not be netted against losses or costs incurred by air carriers as a result of the September 11 events or reported as operating revenue (and thereby included in gross margin). That is, such federal assistance received by air carriers under the Act should be reported on a "gross" basis in the statement of operations (for example, as a separate line item or in other nonoperating income). With respect to the timing of recognition, the Task Force reached a consensus that federal assistance in the form of direct compensation provided under the Act should be recognized by air carriers when the compensated losses are incurred, provided that collection of (and the air carrier’s right to retain) the federal assistance is probable (as that term is used in Statement 5). The Task Force noted that
because the Act does not define direct and incremental losses, the question of which losses are eligible for compensation, and therefore the amount of federal assistance recognized at any given date, depends on the facts and circumstances and how the Act is interpreted. The Task Force further noted that in any case, the amount of compensation recognized by an air carrier should not exceed the lesser of its actual direct and incremental losses incurred or its maximum allocation of the aggregate compensation under the Act.

On Issue 5, the working group adopted the Task Force’s consensus with certain modifications as indicated below and concluded that entities should follow the guidance set forth in paragraph 26 of Opinion 30 pertaining to presentation and disclosure of unusual items, if applicable to losses suffered as an insured. Additionally, all entities as applicable should, at a minimum, disclose the following information as a separate footnote to the financial statements in all periods affected by the September 11 events:

a. A description of the nature and amounts of losses recognized as a result of the September 11 events and the amount of related insurance recoveries (if any), including reinsurance recoveries recognized.

b. A description of contingencies (in the case of an insured) or unpaid claims or losses (in the case of an insurer) resulting from the September 11 events that have not yet been recognized in the financial statements but that are reasonably expected to impact the entity's financial statements in the near term. SSAP No. 5 provides further discussion of recognition of contingencies and disclosure guidance as an insured and SSAP No. 55 presents further discussion of recognition of unpaid claims or losses and disclosure guidance as an insurer.

c. Applicable disclosures related to risks and uncertainties pursuant to SSAP No. 1—Disclosure of Accounting Policies, Risks & Uncertainties, and Other Disclosures, paragraphs 10 through 16.

d. Applicable disclosures about environmental obligations (and recoveries) pursuant to paragraphs 152, 153, 157, 158, and 159 of AICPA Statement of Position 96-1, Environmental Remediation Liabilities.

The Task Force observed that the above disclosure requirements are intended to supplement relevant disclosures required by existing authoritative literature and are important to the transparency of the financial statements because of the pervasive effects of the September 11 events.

INT 01-32 Status

7. No further discussion is planned.
INT 01-33 Dates Discussed
October 16, 2001; December 10, 2001

INT 01-33 References
SSAP No. 62—Property and Casualty Reinsurance (SSAP No. 62)

INT 01-33 Issue

1. The terrorist attacks of September 11, 2001 (the September 11 events), resulted in a tremendous loss of life and property. Secondarily, those events interrupted the business activities of many entities and disrupted the U.S. economy at many levels. In the past, businesses have incurred losses as a result of catastrophes such as earthquakes, hurricanes, and even other terrorist attacks. However, the September 11 events are unprecedented in the United States in terms of the magnitude of the losses incurred and the number of entities affected. The September 11 events have an effect on many companies' financial statements for the period ended September 30, 2001. Clearly, the importance of the accounting for the impact of those events pales in comparison to the gravity of the events themselves.

2. Several large reinsurers and reinsurance brokers had either home offices or branch offices located in the World Trade Center or the immediate vicinity; these companies include, but are not limited to, Guy Carpenter, Aon Re, Folksam Re, St. Paul Re, Scor Re, Zurich Re, Transatlantic Re, and GE Re. Paragraph 23 of SSAP No. 62 states that a reinsurance contract must be finalized and executed within nine months of the effective date of the contract or become subject to retroactive accounting treatment. All reinsurance contracts effective on January 1, 2001 must be executed by September 30, 2001 to satisfy these requirements.

3. The accounting issue is whether the Statutory Accounting Principles WG contemplated the extenuating and catastrophic circumstances, such as the September 11 events, when it established the nine-month rule in SSAP No. 62 paragraph 23. If not, would it be appropriate to create a one-time extension to the nine-month rule for those entities directly affected by the September 11 events?

INT 01-33 Discussion

4. The working group reached a consensus that allows an extension until December 31, 2001 of the nine-month rule for the 2001 year. This extension is only granted to those reporting entities who were directly affected by the September 11 events, or to those reporting entities whose reinsurers or reinsurance brokers were directly affected. This extension applies to all contracts which commenced in 2001 and therefore would need to be finalized, reduced to written form, and signed by the parties within nine months of the commencement date or December 31, 2001 whichever is longer.

5. Further, it is the responsibility of the reporting entity to document in their files the actual date of execution/completion of the reinsurance agreement and the reason for any delay as it relates to the September 11 events.

INT 01-33 Status

6. No further discussion is planned.
Appendix B

Interpretation of the Emerging Accounting Issues Working Group

INT 02-01: Disclosure Requirements Under SSAP for Differences Between A-785 and Individual State Requirements as a Result of September 11th

INT 02-01 Dates Discussed

December 10, 2001; March 18, 2002

INT 02-01 References

SSAP No. 1—Disclosure of Accounting Policies, Risks & Uncertainties, and Other Disclosures (SSAP No. 1)
SSAP No. 62—Property and Casualty Reinsurance (SSAP No. 62)
Appendix A-785—Credit for Reinsurance (A-785)

INT 02-01 Issue

1. SSAP No. 1 requires disclosure when a state of domicile permitted or prescribed practices differs from NAIC statutory accounting practices and procedures. As a result of the events of September 11th and the related insurance and reinsurance claims, some states are allowing US insurers to take credit for reinsurance ceded to an alien reinsurer when its trust account provides less than 100% collateralization at December 31, 2001. The provisions for taking credit under reinsurance contracts are provided in A-785.

2. The accounting issue is whether the action taken by some states to allow US insurers to take credit for reinsurance ceded to alien insurers when the trust account provides less than 100% collateralization is a required to be disclosed under paragraph 7 of SSAP No. 1 at December 31, 2001?

INT 02-01 Discussion

3. The working group reached a two-fold consensus, which shall only be applied to the narrow fact circumstances described in this interpretation. First, the provisions of A-785 do not provide specific guidance as to the timing of trust funding and therefore the underlying trust deed must be studied in order to determine compliance with paragraph 11 c.ii.(a)(1) of A-785. Traditionally, the underlying trust deed allows for assets to be contributed to the fund within a certain number of days after the liabilities attributable to business ceded by US domiciled ceding insurers has been determined. An insurer would be allowed to take credit for those liabilities ceded to the unauthorized alien insurer so long the conditions of the underlying trust deed are being met. The determination as to compliance with the conditions contained within the trust deed shall be determined by the consultation with the primary state regulator of the trust deed.

4. Second, if a state directs an entity not to take credit for reinsurance ceded to an unauthorized alien reinsurer when its trust account may be less than fully funded, but it has been determined by the domiciliary regulator and the NAIC that substantial compliance with the conditions of the underlying trust agreement has been achieved, the entity must disclose the surplus impact on its financial statements under SSAP No. 1. The working group does not believe that taking credit under A-785 when the trust account is less than 100% collateralized but the timing provisions of the underlying trust agreement are being substantially complied with is a departure from NAIC statutory accounting practices and procedures.

INT 02-01 Status

5. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 02-02: SSAP No. 6 and Billing of Premium Before Effective Date

INT 02-02 Dates Discussed

December 10, 2001; March 18, 2002

INT 02-02 References

SSAP No. 4—Assets and Nonadmitted Assets (SSAP No. 4)
SSAP No. 6—Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers (SSAP No. 6)
SSAP No. 53—Property Casualty Contracts - Premiums (SSAP No. 53)
SSAP No. 54—Individual and Group Accident and Health Contracts (SSAP No. 54)

INT 02-02 Issue

1. Oftentimes, insurance coverages under certain property/casualty and health contracts are effective for one-month periods, and the related premiums are billed in advance of the effective date of coverage.

2. The accounting issue is whether premiums billed prior to the effective date of coverage can be reported as an asset and if a liability for advance premiums is necessary.

INT 02-02 Discussion

3. The working group reached a consensus that a premium billing in advance of the effective date does not meet the third requirement of SSAP No. 4, paragraph 2 regarding the occurrence of the transaction or event giving rise to the entity’s right to or control of the benefit. Therefore, an asset/receivable should not be recognized on the financial statements until the effective date of the underlying policy/contract (i.e. the effective date of the contract gives rise to the entity’s right). The mailing of a premium billing has no determination in the reporting of such premiums as an asset.

4. Further, the mailing of a premium billing prior to the effective date does not result in the recognition of a liability for advance premiums. Advance premiums are only recognized when the reporting entity receives cash payment for premiums prior to the effective date of the contract. In the event that the reporting entity bills and receives payment for premiums prior to the effective date, the reporting entity will recognize the receipt of cash with a corresponding credit to advance premiums (in this case a receivable is not recognized as the payment is received prior to the effective date).

INT 02-02 Status

5. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 02-03: Accounting for the Impact of the Terrorist Attacks of September 11th on Commercial Mortgage Loans

INT 02-03 Dates Discussed

December 10, 2001; March 18, 2002

INT 02-03 References

SSAP No. 36—Troubled Debt Restructuring (SSAP No. 36)

INT 02-03 Issue

1. The terrorist attacks of September 11, 2001, resulted in a tremendous loss of life and property. Secondly, those events interrupted the business activities of many entities and disrupted the U.S. economy at many levels. The economic uncertainty that the attacks have interjected into the real estate market has caused a great deal of uncertainty, at least temporarily, in appraisals of certain types of real estate, including, but not limited to, office building, hotels, and retail. This temporary economic disruption warrants consideration for temporary relief from specific requirements of statutory accounting related to troubled debt restructuring, in particular, the recognition of a permanent impairment at the time of a non-market driven modification of loan terms.

2. Paragraph 2 of SSAP No. 36 defines a troubled debt restructuring as a debt restructuring whereby the creditor, for economic or legal reasons related to a debtor's financial difficulties, grants a concession to the debtor that it would not otherwise grant. Many troubled debt restructurings involve the temporary or permanent modifications of terms to reduce or defer the cash payments required of the debtor in the near term in an attempt to temporarily help the debtor improve its financial condition, so that the debtor will eventually be able to pay the creditor. Per paragraph 10 of SSAP No. 36, mortgage debt with modified terms is accounted for at the fair value of the collateral, as determined by acceptable appraisal methodologies. If the fair value of the loan is less than the recorded investment (including accrued interest, net deferred loan fees or costs, and unamortized premium or discount), a new cost basis shall be established equal to the fair value, with the difference being recorded as a permanent impairment or a realized loss in the statement of operations.

3. One example of an industry that has incurred a temporary setback is the hotel industry, due to the severe, but hopefully, temporary disruption in both personal and corporate travel. The uncertainty of the long-term impact of the unprecedented events of September 11th on hotels has made it extremely difficult for insurance companies to obtain current appraisals at reasonable long-term investment values for mortgage loans collateralized by hotel properties. Additionally, the current valuation difficulties in the real estate market and the current accounting ramifications of loan modifications may encourage companies to make non-economic decisions because of the permanent nature of the losses under SSAP No. 36. For example, companies might consider allowing a borrower to default under the contractual terms of a mortgage loan, because the impairment could be considered temporary under SSAP No. 37, instead of restructuring the terms of the loan to maximize debt recovery and recording a realized loss or a permanent write-down under SSAP No. 36.

4. The accounting issue is, in light of the terrorist attacks of September 11, 2001, and their negative impact on commercial mortgage loans, would be appropriate for reporting entities to be granted a limited waiver of the permanent write-down requirements of paragraph 10 of SSAP No. 36?
5. Under the limited waiver that is being proposed, a commercial mortgage loan with restructured terms shall still be accounted for at the fair value of the underlying collateral. The difference between the fair value of the loan and the recorded investment in the mortgage loan shall be recognized as an impairment by creating a valuation allowance with a corresponding charge to unrealized loss. For reporting entities required to maintain an Asset Valuation Reserve (AVR), the unrealized gain or loss on impairments shall be included in the calculation of the AVR. If some or all the impairment is considered to be “other than temporary”, a direct write down shall be recognized as a realized loss, and a new cost basis will be established. This new cost basis shall not be changed for subsequent recoveries in value. The limited waiver would be effective for reporting periods commencing December 31, 2001, and would end December 31, 2002.

INT 02-03 Discussion

6. The working group reached a consensus that it would not be appropriate for reporting entities to be granted a limited waiver of the other than temporary impairment requirement stipulated in paragraph 10 of SSAP No. 36. Although the events of September 11 have interrupted the business activities of many entities and disrupted the U.S. economy at many levels, it would be very difficult to separate and quantify the effects of September 11 versus the general downturn in the economy. The working group felt the requested waiver was too broad and inconsistent with the impairment guidelines for other types of invested assets.

INT 02-03 Status

7. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 02-04: Recognition of CARVM and CRVM Expense Allowances by the Assuming Reinsurer in a Modified Coinsurance Agreement

INT 02-04 Dates Discussed
December 10, 2001; March 18, 2002

INT 02-04 References
SSAP No. 61—Life, Deposit-Type and Accident and Health Reinsurance (SSAP No. 61)

INT 02-04 Issue

1. Under a Modified Coinsurance agreement, the ceding insurer retains the reserves subject to reinsurance as well as the assets supporting those reserves. When the reinsured retains assets in excess of the assets needed to support the reserves, such excess is payable to the assuming company. This typically occurs with modified coinsurance of separate accounts business when reserves are carried on a modified basis such as commissioners' reserve valuation method (CRVM) or commissioners' annuity reserve valuation method (CARVM). The assets covering the excess of the reserves on a full, unmodified basis over the modified basis reserves, referred to as CARVM, CRVM or modification reserve expense allowances, are retained by the ceding company and payable to the assuming company.

2. Under statutory accounting, an insurer’s modification reserve expense allowances (surplus) held in its separate accounts are transferred from separate accounts to the general account by means of a transfer payable/receivable with changes in the transferred amount recorded in the income statement. The transfer payable/receivable related to the expense allowances is reduced over time as fees are collected and the expense allowances diminish to zero.

3. All separate account reinsurance transactions, however, are recorded in or through the general account and not in the separate accounts. Assets or the funds held in separate accounts are net of reinsurance transactions to the extent that funds are moved into or out of separate accounts by the reinsurance.

4. The issue is how the assuming reinsurer should account for the CRVM/CARVM expense allowances belonging to the assuming company when the ceding company holds the assets supporting the full account balance (prior to modification for CRVM/CARVM expense allowances) in its separate accounts.

INT 02-04 Discussion

5. The working group reached a consensus that the assuming company records the CRVM/CARVM expense allowances in Page 3, Line 13A, “Transfers to Separate Accounts due or accrued (net)” and includes them in the caption disclosure: “Including $_______, accrued for expense allowances recognized in reserves net of reinsurance”. Period changes are recorded in the Summary of Operations, Line 24A, “Net transfers to or (from) Separate Accounts”.

INT 02-04 Status

6. No further discussion planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 02-05: Accounting for Zero Coupon Convertible Bonds

INT 02-05 Dates Discussed

March 18, 2002; June 9, 2002; September 10, 2002; December 8, 2002

INT 02-05 References

SSAP No. 26—Bonds, excluding Loan-backed and Structured Securities (SSAP No. 26)

INT 02-05 Issue

1. There has been an increase in the purchasing of convertible bonds by insurers recently. The market of convertible bonds is going to extreme features and has forced an issue related to accounting for such securities. To help understand the potential issues on statutory accounting related to convertible bonds, it is best to start with GAAP to better understand the economics of the instrument.

2. For illustrations accompanying this interpretation, assume the following facts:

<table>
<thead>
<tr>
<th>Type of Security</th>
<th>Commercial Convertible Bond</th>
</tr>
</thead>
<tbody>
<tr>
<td>Par value</td>
<td>$1,000,000</td>
</tr>
<tr>
<td>Annual coupon rate</td>
<td>5%</td>
</tr>
<tr>
<td>Maturity date</td>
<td>10 years from date of purchase</td>
</tr>
<tr>
<td>Convertible features</td>
<td>Convertible to 10,000 common shares of issuer</td>
</tr>
<tr>
<td>Strike Price</td>
<td>$100 per share</td>
</tr>
<tr>
<td>Current Price</td>
<td>$70 per share</td>
</tr>
</tbody>
</table>

Generally Accepted Accounting Practice (GAAP)

3. A convertible bond really consists of a bond and an embedded derivative in the form of a warrant. Under GAAP, the holder accounts for the two components separately. The bond and warrants are fair valued at date of purchase. The bond is typically classified as available for sell (AFS) or held to maturity (HTM) and the scientific method of amortization is used on any premium or discount. This amortization of the premium or discount produces a market yield when combined with the coupon rate. In addition, the available for sale is marked to market with the unrealized gains and losses recorded as a component of equity in other comprehensive income. The warrant is fair valued at each reporting date and classified as trading with the adjustments to market recorded through the income statement, as it is considered a derivative (no hedge).

4. For GAAP, assuming a purchase price was $900,000 at 1/1/x1 and the fair value of the warrants was $150,000 at 1/1/x1, the following entries would be recorded during the year:

At 1/1/X1:

<table>
<thead>
<tr>
<th>Purchase Price</th>
<th>Bond Fair Value</th>
<th>Yield</th>
<th>Warrant Fair Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>$900,000</td>
<td>$750,000</td>
<td>8.87%</td>
<td>$150,000</td>
</tr>
</tbody>
</table>

© 2004 National Association of Insurance Commissioners
At 12/31/X1:
  Bond Fair Value $780,000
  Warrant Fair Value $200,000

Entries 1/1/X1:
  Bonds-AFS $750,000
  Warrants-Trading $150,000
  Cash ($900,000)

Entries 12/31/X1:
  Cash (coupon rate) $50,000
  Bonds-AFS (amortization) $16,554
  Investment income ($66,554)

  Record discount accretion and cash from coupon rate

  Bonds-AFS 13,446
  Warrants-Trading 50,000
  Unrealized gains-OCI (13,446)
  Realized gains (50,000)

  Mark AFS and Trading to market

Statutory Accounting Practice (SAP)

5. Under statutory accounting (SSAP No. 26), a convertible bond is accounted for as a bond. Thus, it ignores the embedded instrument and places no value on it. For example, the following is how the above example would be accounted for:

At 1/1/X1:
  Purchase Price $900,000
  Bond Value $900,000
  Yield 6.3835%
  Warrant Value $0

Entries 1/1/X1:
  Bonds-AFS $900,000
  Cash ($900,000)

Entries 12/31/X1:
  Cash (coupon rate) $50,000
  Bonds (amort) $7,451
  Investment Income ($57,451)

  Record discount accretion and cash from coupon rate

6. Notice that the computed yield decreased between GAAP and SAP. The difference is inherently the amortization of the warrant’s fair value at the date of purchase to zero using the scientific method. Thus, if the bond does reach the end of the ten years without conversion, this technique was correct because the value of the warrant was zero at the end of the 10-year term. If the value of the warrant was near zero anytime prior to the end of the ten-year term, the Company in essence was able to defer the loss on the warrant and amortize it slowly into the income statement.
7. If the warrant increased in value and began to exceed the par value significantly but the company (since it is at the Company’s option) decided not to exercise the conversion, then it has a security recorded at amortized cost in Schedule D as a bond when its characteristics more closely resemble an equity instrument.

**When a Negative Yield Results**

8. The following is another example of a convertible bond, but the coupon rate is zero and the purchase price is at a premium (above par value). Thus, the insurer purchased a $1,000,000 zero coupon (which is typically purchased at a discount) convertible bond for $1,150,000. Therefore, the warrants have significant value (so much so it more than offsets the implicit rate of the bond).

<table>
<thead>
<tr>
<th></th>
<th>Par value</th>
<th>$1,000,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Coupon rate</td>
<td>0%</td>
<td></td>
</tr>
<tr>
<td>Maturity</td>
<td>10 years</td>
<td></td>
</tr>
<tr>
<td><strong>Convertible into 10,000 common shares of issuer</strong></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**At 1/1/X1:**

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchase Price</td>
<td>$1,150,000</td>
</tr>
<tr>
<td>Bond Value</td>
<td>$1,150,000</td>
</tr>
<tr>
<td>Yield</td>
<td>-1.3879%</td>
</tr>
<tr>
<td>Warrant Value</td>
<td>-</td>
</tr>
</tbody>
</table>

**Entries 1/1/X1:**

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Bonds</td>
<td>$1,150,000</td>
</tr>
<tr>
<td>Cash</td>
<td>($1,150,000)</td>
</tr>
</tbody>
</table>

**Entries 12/31/X1:**

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash (coupon rate)</td>
<td>-</td>
</tr>
<tr>
<td>Bonds (amort)</td>
<td>(15,961)</td>
</tr>
<tr>
<td>Interest Income</td>
<td>15,961</td>
</tr>
</tbody>
</table>

**Record discount accretion and cash from coupon rate**

9. The result is an overall negative yield. In essence, the amortization of value of the warrant at date of purchase exceeds the discount on the bonds.

10. The accounting issue is how to account for the premium paid on a zero coupon convertible bond that produce a negative yield as a result of the value of a warrant exceeding the bond discount (the above example). Fundamentally, is it amortized into income using a negative yield or written off at the date of purchase?

**INT 02-05 Discussion**

11. The working group reached a consensus that the premium paid for a zero coupon convertible bond shall be written off immediately so that a negative yield is not produced.

12. The working group reached a consensus that the full amount of the premium should be recorded as amortization within investment income on the date of purchase.

**INT 02-05 Status**

13. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 02-06: Indemnification in Modeled Trigger Transactions

INT 02-06 Dates Discussed

March 18, 2002; June 9, 2002

INT 02-06 References

SSAP No. 62—Property and Casualty Reinsurance (SSAP No. 62)

INT 02-06 Issue

1. A modeled trigger securitization will have the recovery under the securitization and the determination of whether the securitization is triggered based upon a model of the losses of the ceding company as opposed to the ceding company’s actual losses. While such models are designed to correlate highly with the ceding company’s actual losses, there is no absolute guarantee that they will respond perfectly to such losses, and there is a small but finite risk that the model will produce no recoveries even after the company has sustained losses on the portfolio of risks that the securitization was designed to cover.

2. Should reinsurance accounting be allowed for modeled trigger securitizations where there is high correlation between the model and the actual losses of a company? Note that this issue is different, although related, to a future question regarding the accounting for index based insurance linked derivatives.

INT 02-06 Discussion

3. The working group reached a consensus that the modeled trigger securitization transaction does not appear to result in the kind of indemnification (in form and in fact) required by SSAP No. 62, and therefore does not appear to be eligible for reinsurance accounting. Modeled trigger transactions should be evaluated as securitization transactions rather than as reinsurance transactions and should therefore receive the accounting treatment recommended for securitization transactions as ultimately adopted by the Statutory Accounting Principles working group.

INT 02-06 Status

4. No further discussion planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 02-07: Definition of Phrase “Other Than Temporary”

INT 02-07 Dates Discussed

March 18, 2002; June 9, 2002

INT 02-07 References

SSAP No. 26—Bonds, excluding Loan-backed and Structured Securities (SSAP No. 26)
SSAP No. 30—Investments in Common Stock (SSAP No. 30)
SSAP No. 32—Investments in Preferred Stock (SSAP No. 32)
SSAP No. 37—Mortgage Loans (SSAP No. 37)
SSAP No. 39—Reverse Mortgages (SSAP No. 39)
SSAP No. 43—Loan-backed and Structured Securities (SSAP No. 43)
SSAP No. 46—Investments in Subsidiary, Controlled, and Affiliated Entities (SSAP No. 46)
SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies (SSAP No. 48)
SSAP No. 68—Business Combinations and Goodwill (SSAP No. 68)

INT 02-07 Issue

1. The Accounting Practices and Procedures Manual makes reference to an “other than temporary” decline in fair value in 9 different SSAPs. The SSAPs stipulate that if the impairment is judged to be other than temporary, the cost basis of the individual asset shall be written down to a new cost basis and the amount of the write-down shall be accounted for as a realized loss. The SSAPs do not define the phrase “other than temporary.” In applying this guidance to a specific situation, the NAIC Staff was informed that Company A has interpreted “other than temporary” to mean permanent impairment. Therefore, because Company A’s management has not been able to determine that its investment in Company B is permanently impaired, no realized loss has been recognized even though the fair value of B’s shares is currently less than one-third of A’s cost.

2. The accounting issues are:
   a. Should the phrase “other than temporary” be interpreted to mean “permanent?”
   b. Is it appropriate for reporting entities, independent auditors or state examiners to apply predefined thresholds to the phrase “other than temporary”?
   c. When management determines that a write-down, accounted for as a realized loss is necessary, how should the amount of the write-down be determined?

INT 02-07 Discussion

3. The working group reached a consensus\(^{1}\) position regarding each of the accounting issues as follows:

4. Question a – No. The working group believes that the NAIC consciously chose the phrase “other than temporary” because it did not intend that the test be “permanent impairment.” The fair value of assets

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\(^{1}\) The recommendations provided by the working group were developed in part from SEC Staff Accounting Bulletin No. 59—Noncurrent Marketable Equity Securities (SAB 59). As such, readers of this Interpretation should understand that SAB 59 has not been adopted as part of Statutory Accounting Principles as SAB’s are not part of the Statutory Hierarchy (see Preamble).
may decline for various reasons. The market price may be affected by general market conditions, which reflect prospects for the economy as a whole, or by specific information pertaining to an industry or an individual company. Such declines require further investigation by management. Acting upon the premise that a write-down may be required, management should consider all available evidence to evaluate the fair value of its investment.

5. There are numerous factors to be considered in such an evaluation and their relative significance will vary from case to case. The working group believes that the following are only a few examples of the factors, which, individually or in combination, indicate that a decline is other than temporary and that a write-down of the carrying value is required:

   a. The length of time and the extent to which the fair value has been less than cost;
   b. The financial condition and short-term prospects of the issuer, including any specific events which may influence the operations of the issuer such as changes in technology that may impair the earnings potential of the asset or the discontinuance of a segment of the business that may affect the future earnings potential; or
   c. The intent and ability of the holder to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

6. Unless evidence exists to support the assertion that the decline in fair value below carrying value is temporary, a write-down accounted for as a realized loss should be recorded. In accordance with the guidance of the SSAPs, such loss should be recognized in the determination of net income for the period in which it occurs. The written down value of the investment in the company becomes the new cost basis of the investment.

7. Question b – No. The working group is aware that certain insurers, independent auditors and state examiners, over time, have developed quantitative thresholds as "rules of thumb" to assist in the evaluation of asset impairment. One rule of thumb in particular suggests that if the fair value of the asset is more than 20% less than its cost then it is considered to be other than temporarily impaired. Another suggests that an asset is other than temporarily impaired if the fair value has been less than cost for more than 6 months. The use of a numerical threshold may provide the basis for a preliminary assumption that – without considering all relevant circumstances – an impairment may have occurred. The working group has no objection to such a "rule of thumb" as an initial step in assessing impairment but quantifying the impairment is only the beginning of the analysis; it cannot appropriately be used as a substitute for a full analysis of all relevant qualitative considerations. The use of such thresholds removes the ability of management to apply its judgment, a concept inherent to the impairment model.

8. Question c – The cost or carrying value of the asset should be written down to reflect its value in accordance with the relevant SSAP, if an impairment exists. A company's management should follow the impairment guidance in the SSAP pertaining to that particular asset class while considering various factors on a case-by-case basis in determining the amount of the realized loss and/or unrealized loss that needs to be recorded. As the impairment rules did not become effective until January 1, 2001, entities shall use the asset’s carrying value as of January 1, 2001 when applying the impairment concept upon adoption of Codification.

INT 02-07 Status

9. No further discussion planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 02-08: Application of A-791 to YRT Reinsurance of a Block of Business

INT 02-08 Dates Discussed

March 18, 2002; June 9, 2002; September 10, 2002; December 8, 2002

INT 02-08 References

SSAP No. 61—Life, Deposit-Type and Accident and Health Reinsurance (SSAP No. 61)
Appendix A-791—Life and Health Reinsurance Agreements (A-791)

INT 02-08 Issue


2. The accounting is if a reporting entity enters into a YRT reinsurance treaty on an in force block of business that results in a gain, would the reporting entity follow the deferral guidance as outlined in A-791 paragraph 3, or would the entity be allowed to record the entire gain as income immediately?

INT 02-08 Discussion

3. The working group reached a consensus that paragraph 19 of SSAP No. 61 requires that YRT reinsurance agreements comply with certain of the risk transfer provisions of A-791; paragraphs 46 through 48 of SSAP No. 61 apply to indemnity reinsurance; and therefore YRT reinsurance agreements shall also be subject to the deferral guidance in paragraph 3 of A-791. Since YRT only transfer the mortality or morbidity risks to the reinsurer, the recognition of income shall be reflected on a net of tax basis, as gains emerge based on the mortality or morbidity experience.

4. The working group reached a consensus that the application of said guidance shall be applied on a prospective basis for all treaties entered into on or after January 1, 2003.

INT 02-08 Status

5. No further discussion planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 02-10: Statutory Audit Report Notes and the Reporting Requirements Related to Disclosures Containing Multiple Year Information

INT 02-10 Dates Discussed

March 18, 2002; June 9, 2002

INT 02-10 References

Preamble
SSAP No. 65—Property and Casualty Contracts (SSAP No. 65)
SSAP No. 84—Certain Health Care Receivables and Receivables Under Government Insured Plans (SSAP No. 84)

INT 02-10 Issue

1. SSAP No. 65 paragraph 42 requires a five-year rollforward for asbestos and environmental reserves on both a gross and net basis. Therefore, in accordance with paragraph 55 of the Preamble, it appears that the notes to the statutory audit report would include a five-year asbestos and environmental disclosure and that the auditor’s opinion would also address the five-year disclosure.

2. Paragraph 65 of AU 508, Reports on Audited Financial Statements, of the Statement on Auditing Standards (AU 508) indicates that when comparative financial statements are presented, an auditors’ report must contain either an expression of opinion regarding the financial statements “taken as a whole” or an assertion to the effect that an opinion cannot be expressed. The phrase “taken as a whole” applies to all periods presented on a comparative basis with those of the current period. AU 551, Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents, of the Statement on Auditing Standards (AU 551) requires specific reporting on the five-year note if it is considered to be supplemental information to the two-year audited financial statements. As a result, the auditors’ opinion may need to be modified to encompass the 5-year footnote disclosure of asbestos and environmental reserves if included in the notes to the audited financial statements. Further, a modification would be required if other auditors previously audited the statutory financial statements during the 5-year disclosure period.

3. The accounting issue is whether the five-year disclosure of asbestos and environmental reserves is required for both the annual statement blank and the audited statutory financial statement, or can the audited statutory financial statement provide only a two-year comparative disclosure regarding the asbestos and environmental reserve rollforward, on both a gross and net basis? Since a five-year footnote disclosure may require an independent auditor to modify the audit opinion to encompass comparative information for all years presented in the footnotes, and possibly having to audit amounts that not previously audited for separate report disclosure, was this the original intent of the disclosure requirement?

INT 02-10 Discussion

4. The working group reached a consensus that the SSAP No. 65 disclosure of asbestos and environmental reserves over a five-year period is applicable only to the annual statement blank whereas the two-year disclosure requirement is applicable to the two-year audited statutory financial statement report. This consensus shall be applied to all current and future SSAPs which include disclosure requirements in excess of two years.
5. The working group also reached a consensus that the notes to the audited statutory financial statement shall include certain items not included in the notes to the annual statement blank. This is due to the fact that many of the SSAPs contain disclosures that are only required in the audit report as well as the fact that many of the SSAP disclosures are satisfied by information included in certain annual statement schedules and exhibits\(^1\). For example, SSAP No. 55 contains 7 different disclosure requirements for property and casualty entities. Annual statement Schedule P satisfies 4 of the SSAP No. 55 disclosures; therefore the annual statement notes only include 3 of the SSAP No. 55 disclosures. The audited financial statements do not contain a Schedule P therefore the audited notes shall include all 7 of the SSAP No. 55 disclosures.

INT 02-10 Status

6. No further discussion planned.

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\(^1\) Paragraph 55 of the Preamble states “To the extent that disclosures required by a SSAP are made within specific notes, schedules, or exhibits to the annual statement, those disclosures are not required to be duplicated in a separate note. Annual statutory financial statements which are not accompanied by annual statement exhibits and schedules (e.g., annual audit report) shall include all disclosures required by the SSAPs based on the applicability, materiality and significance of the item to the insurer. Certain disclosures, as noted in individual SSAPs, are required in the annual audited statutory financial statements only”.
Interpretation of the Emerging Accounting Issues Working Group

INT 02-11: Recognition of Amounts Related to Earned but Unbilled Premium

INT 02-11 Dates Discussed

June 9, 2002; September 10, 2002

INT 02-11 References

SSAP No. 53—Property Casualty Contracts-Premiums (SSAP No. 53)

INT 02-11 Issue

1. ABC Insurance Company (ABC) writes workers compensation policies subject to adjustment via payroll audits. ABC records Earned but Unbilled Premium (EBUB) in accordance with the SSAP 53 paragraphs 9-12. ABC handles all business through a TPA who charges service fees based on a percentage of collected premium. In addition, ABC pays its agents commissions based on a percentage of collected premiums. Despite the provisions outlined in paragraph 11 of SSAP No. 53, ABC does not record a liability for accrued service fees or commissions when the EBUB is recorded as an asset, but rather handles these liabilities on a cash basis. ABC justifies its cash basis accounting based on paragraph 3(c) of SSAP No. 5. ABC proposes that the definition of a liability has not been met as ABC believes the transaction or other event obligating the entity has not yet happened until the premium has been collected.

2. The accounting issue is whether ABC should recognize all of the requisite liabilities associated with the recognition of the EBUB receivable.

INT 02-11 Discussion

3. The working group reached a consensus that ABC’s treatment of the transaction violated the conservatism and recognition principles inherent in the SAP Statement of Concepts. If an entity feels comfortable enough in their ability to collect the premium that an asset is recorded then it appears that they should also book the associated liabilities. Further, in this case the definition of a liability has been met. The transaction or event that obligates the entity is the earning of the premium rather than the collection of the premium. Once an estimate of the premium has been made and the entity feels certain that it will be collected, it should also book the liabilities that will be due when they receive the cash. If the premiums were unearned and the policyholder had the ability to cancel, the definition of a liability has not been met. Nevertheless, in this case, paragraph 11 of SSAP No. 53 is clear and on point.

INT 02-11 Status

4. No further discussion planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 02-13: EITF 00-4: Majority Owner's Accounting for a Transaction in the Shares of a Consolidated Subsidiary and a Derivative Indexed to the Minority Interest in That Subsidiary

INT 02-13 Dates Discussed

June 9, 2002; September 10, 2002

INT 02-13 References

Issue Paper No. 99—Nonapplicable GAAP Pronouncements (IP No. 99)

INT 02-13 Issue

1. A controlling majority owner (parent) holds 80 percent of a subsidiary's equity shares. The remaining 20 percent (the minority interest) is owned by an unrelated entity (the minority interest holder). Simultaneous with the acquisition of the minority interest, the minority interest holder and the parent enter into a derivative contract that is indexed to the subsidiary's equity shares. The terms of the derivative contract may be any of the following:

   Derivative 1—The parent has a fixed-price forward contract to buy the other 20 percent at a stated future date

   Derivative 2—The parent has a call option to buy the other 20 percent at a fixed price at a stated future date, and the minority interest holder has a put option to sell the other 20 percent to the parent under those same terms, that is, the fixed price of the call is equal to the fixed price of the put option

   Derivative 3—The parent and the minority interest holder enter into a "total return swap." The parent will pay to the counterparty (initially the minority interest holder) an amount computed based on the London Interbank Offered Rate (LIBOR), plus an agreed spread, plus, at the termination date, any net depreciation of the fair value of the 20 percent interest since inception of the swap. The counterparty will pay to the parent an amount equal to dividends paid on the 20 percent interest and, at the termination date, any net appreciation of the fair value of the 20 percent interest since inception of the swap. At the termination date, the net change in the fair value of the 20 percent interest may be determined through an appraisal or the sale of the stock.

2. The issues are:

   Issue 1(a)—How an enterprise that owns a controlling majority ownership interest (80 percent) in a business and separately enters into a derivative transaction with the owner of the other 20 percent at the same time the minority owner purchases its interest should account for that arrangement.

   Issue 1(b)—How an enterprise that acquires a controlling majority ownership interest (80 percent) in a business and separately enters into a derivative transaction with the seller (owner of the other 20 percent) at the same time the parent purchases its interest should account for that arrangement.

   Issue 2—How an enterprise that sells a 20 percent minority interest of a 100 percent owned subsidiary to a third party and simultaneously enters into, with that same party, a derivative transaction of the nature described above should account for that arrangement.
INT 02-13 Discussion

3. The working group rejected the consensus positions of EITF 00-4 as not applicable to statutory accounting.

INT 02-13 Status

4. No further discussion planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 02-14: EITF 00-6: Accounting for Freestanding Derivative Financial Instruments Indexed to, and Potentially Settled in, the Stock of a Consolidated Subsidiary

INT 02-14 Dates Discussed

June 9, 2002; September 10, 2002

INT 02-14 References

Issue Paper No. 99—Nonapplicable GAAP Pronouncements (IP No. 99)

INT 02-14 Issue

1. A parent company may enter into freestanding contracts that are indexed to, and sometimes settled in, the stock of a consolidated subsidiary. The subsidiary may or may not be wholly owned by the parent company. Further, the counterparty to the contract may or may not also hold shares of the subsidiary at the inception of the contract. Examples of these contracts include written put options, written call options (and warrants), purchased put options, purchased call options, forward sales contracts, and forward purchase contracts. These contracts may be settled using a variety of settlement methods, or one of the parties to the transaction may have a choice of settlement methods. The settlement methods include one or more of the following:

   Physical settlement—the party designated in the contract as the buyer delivers the full stated amount of cash to the seller, and the seller delivers the full stated number of the subsidiary's shares to the buyer.

   Net-share settlement—the party with a loss delivers to the party with a gain shares of the subsidiary with a current fair value equal to the gain.

   Net-cash settlement—the party with a loss delivers to the party with a gain a cash payment equal to the gain, and no shares are exchanged.

2. This Issue addresses freestanding derivative contracts entered into by a parent company that are indexed to, and potentially settled in, the stock of a consolidated subsidiary and that are not addressed in Issue No. 00-4, "Majority Owner's Accounting for a Transaction in the Shares of a Consolidated Subsidiary and a Derivative Indexed to the Minority Interest in That Subsidiary."

3. The issue is how freestanding derivative instruments entered into by a parent company that are indexed to, and potentially settled in, the stock of a consolidated subsidiary should be classified and measured in the consolidated financial statements.

INT 02-14 Discussion

4. The working group rejected the consensus positions of EITF 00-6 as not applicable to statutory accounting.

INT 02-14 Status

5. No further discussion planned.
Appendix B

Interpretation of the Emerging Accounting Issues Working Group

INT 02-15: EITF 00-11: Lessors' Evaluation of Whether Leases of Certain Integral Equipment Meet the Ownership Transfer Requirements of FASB Statement 13

INT 02-15 Dates Discussed

June 9, 2002; September 10, 2002

INT 02-15 References

SSAP No. 22—*Leases* (SSAP No. 22)

INT 02-15 Issue

1. Paragraph 2 of Interpretation 43 states that Statement 66 "applies to all sales of real estate, including real estate with property improvements or integral equipment." Some have interpreted that guidance to mean that integral equipment (as defined in Interpretation 43) should be considered real estate for other accounting evaluations outside the scope of Statement 66, including, for example, lease accounting evaluations. For any lease of real estate to be classified as a sales-type lease by the lessor, paragraph 7(a) of Statement 13 must be met. Paragraph 7(a) of Statement 13 (as amended by Statement 98) states:

   The lease transfers ownership of the property to the lessee by the end of the lease term. . . .

   *This criterion is met in situations in which the lease agreement provides for the transfer of title at or shortly after the end of the lease term in exchange for the payment of a nominal fee, for example, the minimum required by statutory regulation to transfer title. [Emphasis added.]*

2. In the United States, real property (land and buildings) transfers are addressed in state law. Recording a document of transfer in local land records evidences transfer of ownership of real property. Transfers of personal property (tangible, moveable goods) are addressed in Article 2 of the Uniform Commercial Code (U.C.C.). Although Article 2 of the U.C.C. provides a set of guidelines for determining when title to personal property has passed, there is generally no system for recording or registering title. Fixtures are a hybrid form of property, defined as personal property that is closely associated with the real property to which it is attached. Transfers of fixtures without the concurrent transfer of the underlying real property may not be subject to either a statutory title registration system or Article 2 of the U.C.C.

3. The issues are:

   Issue 1—Whether integral equipment subject to a lease should be evaluated as real estate under Statement 13

   Issue 2—If integral equipment subject to a lease is evaluated as real estate under Statement 13, how the requirement in paragraph 7(a) of Statement 13 for the transfer of ownership should be evaluated when no statutory title registration system exists for the leased assets.

INT 02-15 Discussion

4. The working group reached a consensus to adopt the consensus positions of EITF 00-11 with certain modifications for GAAP references and its effective date as follows:
a. Issue 1 – Integral equipment subject to a lease should be evaluated as real estate under SSAP No. 22. SSAP No. 22 was intended to conform the requirements of Statement 13 with respect to sales-type leases of real estate to the requirements of Statement 66 with respect to sales of real estate. In order to maintain that conformity, integral equipment should be evaluated as real estate for purposes of SSAP No. 22 (because SSAP No. 77 defines integral equipment as real estate for purposes of SSAP No. 40).

b. Issue 2 – Integral equipment or property improvements for which no statutory title registration system exists, the criterion in SSAP No. 22 (that the lease transfers ownership of the property to the lessee by the end of the lease term) is met in lease agreements that provide that, upon the lessee's performance in accordance with the terms of the lease, the lessor shall execute and deliver to the lessee such documents (including, if applicable, a bill of sale for the equipment) as may be required to release the equipment from the lease and to transfer ownership thereto to the lessee. This criterion is also met in situations in which the lease agreement requires the payment by the lessee of a nominal amount (for example, the minimum fee required by statutory regulation to transfer ownership) in connection with the transfer of ownership. Notwithstanding the foregoing guidance, a provision in a lease agreement that ownership of the leased property is not transferred to the lessee if the lessee elects not to pay the specified fee (whether nominal or otherwise) to complete the transfer of ownership is a purchase option. Such a provision would not satisfy SSAP No. 22.

c. The consensuses in this Interpretation should be applied to (a) leases for which lease inception occurs after January 1, 2003, and (b) leases modified after January 1, 2003, that meet the criteria in paragraph 9 of Statement 13 to be considered as new agreements. Companies shall disclose the effect on the balance sheet and the income statement resulting from a change in lease classification under (b), above, for leases that at inception would have been classified differently had the guidance in this Issue been in effect at the inception of the original lease.

INT 02-15 Status

5. No further discussion planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 02-16: EITF 01-9: Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor’s Products)

INT 02-16 Dates Discussed
June 9, 2002; September 10, 2002

INT 02-16 References
Issue Paper No. 99—Nonapplicable GAAP Pronouncements (IP No. 99)

INT 02-16 Issue

1. The purpose of EITF 01-9 is to codify and reconcile the following EITFs, which address the accounting for consideration given by a vendor to a customer (including both a reseller of the vendor’s products and an entity that purchases the vendor’s products from a reseller):

   EITF 00-14, “Accounting for Certain Sales Incentives” (Paragraphs 10, 16, 22–25, 27, and 28)

   Issue 3 of EITF 00-22, “Accounting for ‘Points’ and Certain Other Time-Based or Volume-Based Sales Incentive Offers, and Offers for Free Products or Services to be Delivered in the Future” (Paragraphs 30–33)

   EITF 00-25, “Vendor Income Statement Characterization of Consideration Paid to a Reseller of the Vendor’s Products” (Paragraphs 9–14 and 16–21)

2. EITF 01-9 applies to vendors that derive their revenue from sales of services as well as those that derive their revenue from sales of products.

3. Consideration (including sales incentives) offered by a company (vendor) on either a limited or a continuous basis to a customer may take various forms including discounts, coupons, rebates, and “free” products or services. EITF 01-9 contemplates that vendor consideration may be given to direct or indirect customers of the vendor. For example, a vendor may sell its products to a distributor who in turn resells the products to a retailer. Consideration paid by the vendor to the retailer in that example is within the scope of this Issue. EITF 01-9 also addresses sales incentives offered by manufacturers to customers of retailers or other distributors. Thus, the scope of Issue 01-9 includes vendor consideration to any purchasers of the vendor’s products at any point along the distribution chain, regardless of whether the purchaser receiving the consideration is a direct customer of the vendor. Examples of arrangements within the scope of EITF 01-9 include, but are not limited to, sales incentive offers labeled as discounts, coupons, rebates, and “free” products or services as well as arrangements labeled as slotting fees, cooperative advertising, and buydowns.

4. The issues are:

   Issue 1—A vendor may give a customer a sales incentive or other consideration. Under what circumstances is that consideration (a) an adjustment of the selling prices of the vendor’s products or services and therefore characterized as a reduction of revenue when recognized in the vendor’s income statement or (b) a cost incurred by the vendor for assets or services received from the customer and therefore characterized as a cost or expense when recognized in the vendor’s income statement?
Issue 2—If cash consideration given by a vendor to a customer is characterized as a reduction of revenue when recognized in the vendor’s income statement based on the guidance for Issue 1 and that reduction results in “negative revenue,” should the negative revenue amount be recharacterized as an expense in the vendor’s income statement?

Issue 3—Under what circumstances should up-front nonrefundable consideration given by a vendor to a customer be recognized as an asset of the vendor rather than an immediate charge in the vendor’s income statement?

Issue 4—If a vendor offers a sales incentive voluntarily and without charge to customers that is exercisable by a customer as a result of a single exchange transaction, when should the vendor recognize and how should the vendor measure the cost of the sales incentive if it will not result in a loss on the sale of a product or service?

Issue 5—For the sales incentive described in Issue 4, when should the vendor recognize and how should the vendor measure the cost of the sales incentive if it will result in a loss on the sale of a product or service?

Issue 6—If a vendor offers a customer a rebate or refund of a specified amount of cash consideration that is redeemable only if the customer completes a specified cumulative level of revenue transactions or remains a customer for a specified time period, when should the vendor recognize and how should the vendor measure the cost of the offer?

**INT 02-16 Discussion**

5. The working group reached a consensus to reject the consensus positions of EITF 01-09 as not applicable as most insurance companies are specifically prohibited by state statute from entering into the transactions described in this issue (e.g., rebating).

**INT 02-16 Status**

6. No further discussion planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 02-17: EITF 01-13: Income Statement Display of Business Interruption Insurance Recoveries

INT 02-17 Dates Discussed

June 9, 2002; September 10, 2002

INT 02-17 References

SSAP No. 24—Discontinued Operations and Extraordinary Items (SSAP No. 24)

INT 02-17 Issue

1. During the discussion of EITF 01-10, Accounting for the Impact of the Terrorist Attacks of September 11, 2001, the FASB EITF noted that existing authoritative literature does not specifically address the income statement classification and display of business interruption (BI) insurance recoveries.

2. Existing authoritative GAAP guidance relating to insurance recoveries includes FASB Interpretation No. 30, Accounting for Involuntary Conversions of Nonmonetary Assets to Monetary Assets (Interpretation 30) and Statement of Position 96-1, Environmental Remediation Liabilities (SOP 96-1). Interpretation 30 provides guidance on the accounting for involuntary conversions of nonmonetary assets (such as property or equipment) to monetary assets (such as insurance proceeds). That Interpretation provides broad guidance relating to the recognition, measurement, and classification of related insurance recoveries. Interpretation 30 requires recognition of a gain or loss on an involuntary conversion of a nonmonetary asset to a monetary asset that is measured as the difference between the carrying amount of the nonmonetary asset and the amount of monetary assets received. As such, the insurance recoveries are recorded in the same financial statement line as the related loss.

3. SOP 96-1 provides guidance on the income statement display of environmental remediation costs and related recoveries (such as insurance recoveries). Paragraph 149 of that SOP states that "environmental remediation-related expenses should be reported as a component of operating income in income statements that classify items as operating or nonoperating. Credits arising from recoveries of environmental losses from other parties should be reflected in the same income statement line" (emphasis added).

4. In the case of both involuntary conversions of nonmonetary assets and recoveries of environmental losses, the insurance proceeds represent a recovery of a loss recognized in the financial statements. Both Interpretation 30 and SOP 96-1 require display of the insurance recoveries as a reduction of the recognized loss. BI insurance differs from other types of insurance coverage in that it is designed to protect the prospective earnings or profits of the insured entity. That is, BI insurance provides coverage if business operations are suspended due to the loss of use of property and equipment resulting from a covered cause of loss. BI insurance coverage generally provides for reimbursement of certain costs and losses incurred during the reasonable period required to rebuild, repair, or replace the damaged property. The types of costs and losses covered typically include:

   a. Gross margin that was "lost" or not earned due to the suspension of normal operations
   b. A portion of fixed charges and expenses in relation to that lost gross margin
   c. Other expenses incurred to reduce the loss from business interruption (for example, rent of temporary facilities and equipment, use of subcontractors, and so forth).
5. The guidance in Interpretation 30 and SOP 96-1 specifically applies only to recoveries of certain types of losses and costs that have been recognized in the income statement. Issues regarding the income statement display of BI insurance recoveries arise because a portion of the recoveries represents a reimbursement for "lost margin" rather than a recovery of losses or other costs incurred.

6. The issue is how BI insurance recoveries should be displayed in the statement of operations.

**INT 02-17 Discussion**

7. The working group adopted the consensus positions of EITF 01-13 with certain modifications for GAAP references as follows:

   a. An entity may choose how to classify BI insurance recoveries in the statement of operations, as long as that classification is not contrary to existing statutory accounting principles. The following information should be disclosed in the notes to the financial statements in the period(s) in which BI insurance recoveries are recognized:

      i. The nature of the event resulting in business interruption losses
      ii. The aggregate amount of BI insurance recoveries recognized during the period and the line item(s) in the statement of operations in which those recoveries are classified (including amounts defined as an extraordinary item pursuant to SSAP No. 24).

**INT 02-17 Status**

8. No further discussion planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 02-18: Accounting for the Intangible Asset as Described in SSAP No. 8
Paragraph 9 d.v. and 9 f.

ISSUE NULLIFIED BY SSAP No. 89

INT 02-18 Dates Discussed
September 10, 2002; December 8, 2002; March 9, 2003

INT 02-18 References
SSAP No. 8—Pensions (SSAP No. 8)

INT 02-18 Issue

1. SSAP No. 8—Pensions (SSAP No. 8) models many of its provisions after FASB Statement No. 87, Employers’ Accounting for Pensions (FAS 87) and FASB Statement No. 132, Employers’ Disclosures about Pensions and Other Postretirement Benefits (FAS 132). Specifically, the minimum accrued benefit liability that is to be reflected on a reporting entity’s financial statements under FAS guidance must be at least as large as the unfunded Accumulated Benefit Obligation (ABO). If the unfunded ABO is larger than the net amount recognized on the financial statements, then an additional amount must be reflected to bring the accrued benefit liability up to the level of the unfunded ABO. This additional amount may be offset by any existing intangible asset (based on the outstanding unrecognized prior service cost, which includes the unrecognized transition obligation). However, in paragraph 2 of SSAP No. 8, any intangible asset shall be considered a nonadmitted asset. Some interested parties believe this contradicts the concept of deferring or amortizing the incremental liability set up January 1, 2001 as described in paragraph 19 of SSAP No. 8 (see examples, particularly example III). Also, in paragraph 37 of FAS 87, only the amount of the additional minimum liability that is in excess of the intangible asset shall be a reduction of equity (or a liability on the balance sheet). The rules under SSAP No. 8 appear to require a company to recognize the entire additional minimum liability, regardless of the existence of any intangible asset.

2. See examples I, II and III attached which are generated in Disclosure under SSAP No. 8. Examples I and II show disclosure for a qualified plan, while example III shows disclosure for a non-qualified plan (SERP or EXCESS plan). Please note that these examples may occur for either a qualified plan or a non-qualified plan. In these examples, each plan generates an additional minimum liability and uses an intangible asset as an offset to the additional minimum liability. Since paragraph 2 of SSAP No. 8 states that any intangible asset shall be considered a nonadmitted asset, then the entire additional minimum liability would need to be recorded on the balance sheet of the reporting entity. In the view of some interested parties, this treatment contradicts the concept of deferring or amortizing the incremental liability set up January 1, 2001 as described in paragraph 19 of SSAP No. 8 (see examples, particularly example III).

3. In examples I, the (accrued) liability is the “net amount recognized” of ($23,000,000) shown under the “Reconciliation of funded status” section. Under FAS 87, if the accumulated benefit obligation exceeds the fair value of assets, the company may need to recognize more liability than the (accrued) liability on the balance sheet. In the example, the “accrued benefit liability” line of the “Amounts recognized in statements of financial position consist of” section is equal to the unfunded accumulated benefit obligation of ($30,000,000) ($104,000,000 – $134,000,000). However, the “accrued benefit liability” is made up of two parts, the (accrued) liability plus the additional minimum liability. In this example, the (accrued) liability is ($23,000,000) and the additional minimum liability is ($7,000,000) (($30,000,000) – ($23,000,000)).
4. Under paragraph 37 of FAS 87, an intangible asset is allowed to offset the additional minimum liability of ($7,000,000), which is shown in our example in the “intangible asset” line of the “Amounts recognized in statements of financial position consist of” section. For a reporting entity that does not follow SSAP No. 8, the total (accrued) liability on the balance sheet is ($23,000,000), since the additional minimum liability is entirely offset by the intangible asset. This results in a zero amount in the “accumulated other comprehensive income” line of the “Amounts recognized in statements of financial position consist of” section. For a reporting entity that follows SSAP No. 8, the same ($23,000,000) (accrued) liability is on the balance sheet, but it also includes an additional ($7,000,000) since an intangible asset is categorized as a nonadmitted asset.

5. Example II shows a similar situation. However, here the intangible assets does not entirely offset the additional minimum liability and the company has to recognize ($4,000,000) in “accumulated other comprehensive income” in addition to the ($14,000,000) on the balance sheet. The reporting entity that follows SSAP No. 8 would also have the intangible asset of $27,000,000 categorized as a nonadmitted asset, therefore increasing liabilities by another $27,000,000 up to $45,000,000.

**INT 02-18 Discussion**

6. The working group reached a consensus to require reporting entities to recognize the entire minimum pension liability in the financial statement. Further, any intangible asset offsetting the minimum pension liability shall be nonadmitted and charged to surplus.

7. The working group reached a consensus to allow a reporting entity that utilizes an actuarial valuation as of a date prior to the financial statement date to measure plan assets and obligations, and determines that an additional minimum liability is required to be established in accordance with paragraph 37 of FAS No. 87, and if the reporting entity contributes amounts to the plan to fund that additional minimum liability prior to the financial statement date, such amount funded may be used to reduce the additional minimum liability recognized in the reporting entity’s financial statements.

**INT 02-18 Status**

8. No further discussion is planned.
XYZ Company Retirement Program

Example I

SSAP No. 8 Footnote Disclosure

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<th>Qualified Pension Benefits</th>
<th>2001</th>
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<tbody>
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<tr>
<td>Projected benefit obligation at beginning of year</td>
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</table>

| **Change in plan assets** | | |
| Fair value of plan assets at beginning of year | $100,000,000 |
| Actual return on assets (net of expenses) | (6,000,000) |
| Employer contributions | 12,000,000 |
| Participant contributions | 0 |
| Benefit payments | (2,000,000) |
| Settlements | 0 |
| Business combinations | 0 |
| Divestitures | 0 |
| **Fair value of plan assets at end of year** | $104,000,000 |

| **Reconciliation of funded status** | | |
| Funded status | ($65,000,000) |
| Unrecognized transition obligation/(asset) | 27,000,000 |
| Unrecognized prior service cost | 0 |
| Unrecognized actuarial loss/(gain) | 14,000,000 |
| **Net amount recognized** | ($23,000,000) |

| **Amounts recognized in statements of financial position consist of:** | | |
| Prepaid benefit cost | $0 |
| Accrued benefit liability (includes additional minimum liability) | (30,000,000) |
| Intangible asset | 7,000,000 |
| Accumulated other comprehensive income | 0 |
| **Net amount recognized** | ($23,000,000) |

| **Assumptions as of December 31** | 2001 |
| Discount rate | 7.25% |
| Expected return on assets | 9.00% |

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<th>Amounts recognized in statements of financial position consist of:</th>
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<td>Actual return on assets (net of expenses)</td>
<td>0</td>
</tr>
<tr>
<td>Employer contributions</td>
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<tr>
<td>Participant contributions</td>
<td>0</td>
</tr>
<tr>
<td>Benefit payments</td>
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<td>Settlements</td>
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<tr>
<td>Business combinations</td>
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<tr>
<td>Divestitures</td>
<td>0</td>
</tr>
<tr>
<td>Fair value of plan assets at end of year</td>
<td>$0</td>
</tr>
<tr>
<td><strong>Reconciliation of funded status</strong></td>
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<tr>
<td>Funded status</td>
<td>($12,000,000)</td>
</tr>
<tr>
<td>Unrecognized transition obligation/(asset)</td>
<td>7,000,000</td>
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<tr>
<td>Unrecognized prior service cost</td>
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<tr>
<td>Unrecognized actuarial loss/(gain)</td>
<td>1,000,000</td>
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<tr>
<td>Net amount recognized</td>
<td>($4,000,000)</td>
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<td><strong>Amounts recognized in statements of financial position consist of:</strong></td>
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</tr>
<tr>
<td>Prepaid benefit cost</td>
<td>$0</td>
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<tr>
<td>Accrued benefit liability (includes additional minimum liability)</td>
<td>(11,000,000)</td>
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<tr>
<td>Intangible asset</td>
<td>7,000,000</td>
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<tr>
<td>Accumulated other comprehensive income</td>
<td>0</td>
</tr>
<tr>
<td>Net amount recognized</td>
<td>($4,000,000)</td>
</tr>
<tr>
<td>Assumptions as of December 31</td>
<td>2001</td>
</tr>
<tr>
<td>---------------------------------------------</td>
<td>-----------------------</td>
</tr>
<tr>
<td>Discount rate</td>
<td>7.25%</td>
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<tr>
<td>Expected return on assets</td>
<td>9.00%</td>
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<tr>
<td>Rate of compensation increase</td>
<td>Graded; 3.00% - 6.50%</td>
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</tbody>
</table>
Interpretation of the Emerging Accounting Issues Working Group

INT 02-19: EITF 01-1: Accounting for a Convertible Instrument Granted or Issued to a Nonemployee for Goods or Services or a Combination of Goods or Services and Cash

INT 02-19 Dates Discussed

September 10, 2002; December 8, 2002

INT 02-19 References

SSAP No. 28—Nonmonetary Transactions (SSAP No. 28)

INT 02-19 Issue

1. Questions sometimes arise about the appropriate recognition and measurement by an issuer for a convertible instrument that is issued to a nonemployee in exchange for goods or services or a combination of goods or services and cash. The convertible instrument contains a nondetachable conversion option that permits the holder to convert the instrument into the issuer's stock.

2. Opinion 14, and Issues No. 98-5, "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios," and No. 00-27, "Application of Issue No. 98-5 to Certain Convertible Instruments," address an issuer's accounting for a conversion option for which the issuer's stock is the underlying when that conversion option is embedded in a debt or preferred stock instrument that is issued in a financing transaction. Statement 123 and Issue No. 96-18, "Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services," address the issuer's accounting for equity securities (including convertible securities that are in equity form or that can be converted into equity securities) issued in exchange for goods or services.

3. The issues are:

   Issue 1-For a convertible instrument issued in exchange for goods or services (or a combination of goods or services and cash), whether the intrinsic value of the conversion option should be measured under the Issue 98-5 model, as interpreted by Issue 00-27, at (a) the commitment date for the instrument as defined in Issue 00-27, (b) the measurement date under Issue 96-18, or (c) the later of the two dates

   Issue 2-If a convertible instrument is issued in exchange for goods or services (or a combination of goods or services and cash), how to measure the fair value of that instrument

   Issue 3-Whether distributions paid or payable on a convertible instrument issued or granted in exchange for goods or services (or a combination of goods or services and cash) should be recognized as a financing cost (that is, interest expense or dividends) or as a cost of the goods or services received or receivable from the counterparty

   Issue 4-A company issues a convertible instrument for cash proceeds that indicate that the instrument includes a beneficial conversion option. The purchaser of the instrument also provides (receives) goods or services to (from) the issuer that are the subject of a separate contract. The issue is whether any goods or services provided (received) by the purchaser should be accounted for as an adjustment to the consideration for the convertible instrument.
INT 02-19 Discussion

4. The working group reached a consensus to adopt the consensus positions of EITF 02-19 with certain modifications to refer to the guidance in SSAP No. 28 and to incorporate guidance in EITF 96-18 regarding the measurement date. EITF 96-18 was previously rejected by the working group in INT 99-13 in the context of SSAP No. 13—Stock Options and Stock Purchase Plans, however, the measurement guidance included in Issue 1 of EITF 96-18 is adopted in this INT.

   a. On Issue 1, the EAIWG reached a consensus that if a convertible instrument is issued in exchange for goods or services, the measurement date under Issue 96-18 should be used both to measure the fair value of the convertible instrument and to measure the intrinsic value, if any, of the conversion option. Issue 96-18 states that the measurement date is the earlier of either of the following:
      
      1. The date at which a commitment for performance by the counter party to earn the convertible instrument is reached (a “performance commitment”); or
      2. The date at which the counter party’s performance is complete.

   b. On Issue 2, the EAIWG believes it is impracticable to provide detailed guidance on determining the fair value of a convertible instrument. However, in order to promote consistent application of the accounting guidance cited in this Issue to convertible instruments, the EAIWG reached a consensus on the following guidelines for determining the fair value of convertible instruments:
      
      i. Consistent with SSAP No. 28, the fair value of an equity instrument shall be determined based on either the fair value of the consideration received or the fair value of the equity instruments issued, whichever is more reliably measurable. Accordingly, if the fair value of the goods or services received is reliably determinable, and the issuer has not recently issued similar convertible instruments, the fair value of the goods or services should be used to measure the transaction.

      ii. Recent issuances of similar convertible instruments for cash to parties that only have an investor relationship with the issuer may provide the best evidence of fair value of the convertible instrument.

      iii. If reliable information about (a) or (b), above, is not available, the fair value of the convertible instrument should be deemed to be no less than the fair value of the equity shares into which it can be converted.

   c. On Issue 3, the EAIWG reached a consensus that once the instrument is considered "issued" for accounting purposes, distributions paid or payable should be characterized as financing costs. Prior to that time, distributions paid or payable under the instrument should be characterized as a cost of the underlying goods or services. The EAIWG observed that the accretion of a discount on a convertible instrument resulting from a beneficial conversion option does not begin until the instrument is issued for accounting purposes.

   d. On Issue 4, the EAIWG reached a consensus that the terms of both the agreement for goods or services and the convertible instrument should be evaluated to determine whether their separately stated pricing is equal to the fair value of the goods or services and convertible instrument. If that is not the case, the terms of the respective transactions should be adjusted. The convertible instrument should be recognized at its fair value with a corresponding increase or decrease in the purchase or
sales price of the goods or services. The EAIWG acknowledged the difficulty in evaluating whether the separately stated pricing of a convertible instrument is equal to its fair value. The EAIWG noted that if an instrument issued to a goods or services provider (or purchaser) is part of a larger issuance, a substantive investment in the issuance by unrelated investors (who are not also providers or purchasers of goods or services) may provide evidence that the price charged to the goods or services provider represents the fair value of the convertible instrument.

**INT 02-19 Status**

5. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 02-20: Due Date for Installment Premiums Under an Agency Relationship

ISSUE NULLIFIED BY NONSUBSTANTIVE REVISIONS TO SSAP NO. 6 ADOPTED BY THE STATUTORY ACCOUNTING PRINCIPLES WORKING GROUP

INT 02-20 Dates Discussed

September 10, 2002; December 8, 2002

INT 02-20 References

SSAP No. 6—Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due From Agents and Brokers

INT 02-20 Issue

1. Paragraph 7 c. of SSAP No. 6 states that the determination of the due date for installment premium is governed by the contractual due date of the installment. Certain reporting entities with installment premium balances due from an agent have interpreted this guidance to require that the due date of the installment is governed by the contractual due date of the installment from the agent.

2. The accounting issue is whether the due date for installment premiums from an agent is governed by the contractual due date of the installment from the agent or by the due date from the insured.

INT 02-20 Discussion

3. Paragraph 7 a. of SSAP No. 6 states that the due date for original and deposit premiums is governed by the effective date of the underlying contract and not the agent/reporting entity contractual relationship. There is no overriding reason why installment premiums would be treated in a less conservative fashion than original and deposit premiums. Therefore, the due date for installment premium balances due from an agent should be governed by the contractual due date of said premiums from the insured.

INT 02-20 Status

4. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 02-21: Accounting for Prepaid Loss Adjustment Expenses and Claim Adjustment Expenses

INT 02-21 Dates Discussed

September 10, 2002; December 8, 2002

INT 02-21 References

SSAP No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses (SSAP No. 55)

INT 02-21 Issue

1. NAIC staff has received several inquiries relating to guidance included in Chapter 11 of the Property/Casualty Accounting Practices and Procedures Manual concerning the treatment of unpaid loss adjustment expenses (LAE). This guidance states that the liability for LAE should be established regardless of any payments made to third party administrators, management companies, etc.

2. It appears from discussion with various regulators that this guidance was a significant change upon adoption in 1988, but the guidance was not included within SSAP No. 55. However, Paragraph 17 of Issue Paper No. 55—Unpaid Claims, Losses and Loss Adjustment Expenses states, “the statutory principles outlined in the conclusion above are consistent with the current statutory guidance for recording a liability for unpaid claims and unpaid losses and loss/claim adjustment expenses.” These two statements appear contradictory.

3. The accounting issues are when establishing the liability for unpaid loss adjustment expenses, should the liability be established in a manner to include estimated expenses to adjust all unpaid claims, regardless of whether the reporting entity has paid an outside party for these responsibilities? Further, whether this requirement should also apply to claim adjustment expenses under accident and health contracts?

INT 02-21 Discussion

4. The working group reached a consensus that the liability for unpaid LAE should be established regardless of any payments made to third party administrators, management companies or other entities. This is consistent with the concepts of conservatism and consistency in the Statement of Concepts. The establishment of the liability for LAE gross of any amounts paid to these entities results in more meaningful financial statements in that the financial condition of the reporting entity is more appropriately stated.

5. Further, the liability for claim adjustment expenses on indemnity accident and health contracts should be established in an amount necessary to adjust all unpaid claims irrespective of payments made to third party administrators, etc. This supports the concept of consistency found in the Preamble, as there is no overriding difference between unpaid LAE for property/casualty insurers and unpaid claim adjustment expenses of health entities. The working group will consider the applicability of this guidance to managed care contracts in a separate interpretation.

INT 02-21 Status

6. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 02-22: Accounting for the U.S. Terrorism Risk Insurance Program

INT 02-22 Dates Discussed

December 8, 2002, March 9, 2003

INT 02-22 References

SSAP No. 35—Guaranty Fund and Other Assessments (SSAP No. 35)
SSAP No. 62—Property and Casualty Reinsurance (SSAP No. 62)
SSAP No. 63—Underwriting Pools and Associations Including Intercompany Pools (SSAP No. 63)

INT 02-22 Issue

1. The Terrorism Risk Insurance Act of 2002 establishes a temporary Federal program in the Department of the Treasury that provides for a system of shared public and private compensation for insured losses resulting from acts of terrorism, i.e., subject losses. The Terrorism Insurance Program (or the “Program”) requires that all entities that meet the definition of an insurer under the act (generally, commercial property/casualty insurers that are licensed in the U.S.) participate in the Program. The Program becomes effective upon enactment and runs through December 31, 2005. (For purposes of the act, there is a “Transition Period” that runs from enactment through December 31, 2002, and three “Program Years” that run from January 1st through December 31st of 2003, 2004, and 2005, respectively.) The amount of compensation paid to participating insurers under the Program is 90% of subject losses, after an insurer deductible, and subject to an annual cap. The deductible under the Program is 1% for the Transition Period, 7% for Program Year 1, 10% for Program Year 2, and 15% for Program Year 3. In each case, the deductible percentage is multiplied times the insurer’s direct earned premiums from the calendar year immediately preceding the respective Transition or Program year. The annual cap limits the amount of terrorism losses paid by insurers and the amount of Federal reimbursement and is $100 billion for Program Year 1 (combined with the Transition Period), Program Year 2, and Program Year 3

2. The Program provides for the establishment of a mandatory surcharge on all covered policyholders to provide for recoupment of defined losses paid by the Department of Treasury. To the extent that the amount of Federal financial assistance exceeds the amount recovered through the mandatory surcharge, the Department of Treasury may impose a second surcharge. The two surcharges combined may not exceed 3% of the annual premium charged for the insured policy. The Program provides that the Department of the Treasury shall collect the surcharges and further provides that insurers shall collect the surcharges and remit such amounts collected to the Department of Treasury.

3. The issues are:

   Issue 1: Does the Program result in a transfer of underwriting risk for terrorism losses to the Department of Treasury and, if so, how should the recovery from the Department of Treasury for terrorism losses be accounted for by insurers?

   Issue 2: How should the imposition of the surcharges on policyholders by the Department of Treasury be accounted for by insurers?
INT 02-22 Discussion

4. The working group reached a consensus as follows:

   Issue 1: Because the Program results in losses from acts of terrorism (above the defined insurer deductibles) being paid by the Department of Treasury, there is a transfer of insurance risk and accordingly, the recovery of such losses should be reported as reinsured losses.

   Issue 2: Because the terrorism loss risk-spreading premium is imposed on policyholders as a surcharge and the Department of Treasury provides for insurers to collect the surcharge “and remit amounts collected to the Secretary,” the surcharge generally meets the requirements of paragraph 10 of SSAP No. 35 and should be accounted for as such.

INT 02-22 Status

5. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 03-01: Application of SSAP No. 35 to the Florida Hurricane Catastrophe Fund

INT 03-01 Dates Discussed

March 9, 2003; June 22, 2003

INT 03-01 References

SSAP No. 35—Guaranty Fund and Other Assessments (SSAP No. 35)

INT 03-01 Issue

1. Balance-sheet treatment of assessments to property and casualty companies by the Florida Hurricane Catastrophe Fund (“FHCF”) is governed by SSAP No. 35—Guaranty Fund and Other Assessments (SSAP No. 35). This request for interpretation or interim guidance seeks recognition of a gross asset and limitation, given certain conditions, of the assessment liability required by SSAP No. 35.

2. The FHCF is a practical measure imposed by government to mitigate the financial shock attendant on the occurrence or prospect of extreme weather in developed areas with dense population. Risks from hurricanes faced by residential property insurers are clear and present; the necessity to maintain insurance capacity to cover the consequences of hurricanes is the object of the FHCF, which pays residential policyholders’ hurricane-related claims through reinsurance provided to primary companies. Depending on the severity of the weather catastrophe, the FHCF is empowered to issue debt in the form of revenue bonds for payment of residential property-casualty claims in Florida.

3. Such debt issuance in the wake of a hurricane will result in assessments for service of that debt over long periods of time to most primary property and casualty companies doing business in Florida. (Premium revenue from virtually all lines, save for workers’ compensation, is subject to the assessment.) The aggregate magnitude of FHCF assessments to subject companies is dependent on a number of variables, most prominent among which are the extent of damage caused by the weather event, the amount of capital on hand, and costs of debt and its issuance. Assessments to individual companies will be levied as a percentage of their premium in the year prior to assessment. Companies that have exited the Florida market are no longer subject to FHCF assessment and companies entering the Florida market after the event are subject to the assessment.

4. The accounting issues are:

   Issue 1: The nature of FHCF debt and allocation of the consequent debt service, which are the principal drivers of FHCF assessments.

   Issue 2: The absence of treatment of the revenue received by subject companies that elect to recover the assessment in a rate filing.

5. With respect to issue one, FHCF revenue bonds are likely to be issued in decades-long maturities. Allocation of that debt service to individual companies is dependent on those companies’ status in, or share of, the Florida property-casualty market.

6. With respect to issue 2, conditions of Paragraph 10 of SSAP No. 35 do not appear to contemplate the “deemed-approved” election or surcharge available to subject insurers for rate elements to cover the amount of FHCF assessments made to those subject insurers. Although such rate elements can be and are
separately identified on many insurers’ premium billings, insurers subject to the FHCF are themselves liable for assessments rather than being collectors and remitters of assessment amounts. Balance-sheet presentation of a liability for FHCF assessments, in the event of their declaration, would appear to be required, therefore, if SSAP No. 35 is applicable.

7. Further, with respect to issue 2, collections by subject insurers would yield revenue, perhaps diminished by some proportion of uncollectibles, as an admitted asset. Because of the nature of the relationship between the subject insurer and the FHCF, SSAP No. 64—Offsetting and Netting of Assets and Liabilities (SSAP No. 64) would appear to preclude netting of such cash against FHCF assessments. It is crucial to note, however, that SSAP No. 35, Paragraph 9 admits, in the presence of policy surcharges, the possibility of an admitted asset existing in relation to assessments “paid before premium tax credits are realized or policy surcharges are collected ….”

8. SSAP No. 5—Liabilities, Contingencies and Impairments of Assets, and SSAP No. 35, Paragraph 4., draw attention to the future period within which the reporting entity may be able to reliably estimate the amount of FHCF assessments for recognition as a liability. This Interpretation identifies the major variables for calculation of the aggregate amount of the FHCF assessment: amount of damages, capital on hand, costs of debt and issuance. In addition to these variables, and necessary for allocating that aggregate assessment to individual subject companies, is the individual company’s share of the market. That is, both the total market and the individual subject company’s share of the market, both clearly subject to change, are used in allocation of the aggregate amount of the assessment. It is these latter factors, crucial in determining the FHCF assessment to a subject entity, which preclude reliable estimation of FHCF assessments beyond the near future.

9. In practice, the time horizon of subject insurers’ business plans and the dynamics of the property and casualty market suggest strongly that the amount of yearly FHCF assessments to a subject entity may be reliably or reasonably estimated through three years in the future but that such reliability diminishes with greater prospect. Unless management has reason and information to support reliable estimation through a future period longer than three years, it is reasonable to presume that quantification of a liability for FHCF assessments should extend through no less than three years in the future.

INT 03-01 Discussion

10. The working group reached a consensus as follows:

   a) Assessments made by the FHCF are presumed to be reasonably estimable through no less than three years in the future;

   b) An asset shall be allowed for deemed-approved rate elements or surcharges that have been imposed by the reporting entity and filed with the regulator and that are specifically intended to match the period stated within a., to recoup FHCF assessments, which asset shall be reduced by amounts not expected to be collected by the reporting entity; and

   c) Disclosure is made of the remaining term of the assessment.

INT 03-01 Status

11. No further discussion is planned
Interpretation of the Emerging Accounting Issues Working Group

INT 03-02: Modification to an Existing Intercompany Pooling Arrangement

INT 03-02 Dates Discussed
March 9, 2003; June 22, 2003

INT 03-02 References
SSAP No. 61—Life, Deposit-Type and Accident and Health Reinsurance (SSAP No. 61)
SSAP No. 62—Property and Casualty Reinsurance (SSAP No. 62)
SSAP No. 63—Underwriting Pools and Associations Including Intercompany Pools (SSAP No. 63)

INT 03-02 Issue

1. Insurance groups that utilize intercompany pooling arrangements often modify these arrangements from time to time for various business reasons. These business reasons commonly include mergers, acquisitions, dispositions or a restructuring of the group’s legal entity structure. As an insurance group’s business objectives and strategies evolve, it may be necessary for the insurance group’s legal entity structure to similarly evolve in order to address the insurance group’s business needs.

2. SSAP No. 63—Underwriting Pools and Associations Including Intercompany Pools (SSAP No. 63), paragraphs 5 and 7, defines and describes intercompany pooling as an arrangement among affiliated entities whereby “all of the pooled business is ceded to the lead entity and then retroceded back to the pool participants in accordance with their stipulated shares.” This arrangement is established through “a conventional quota share reinsurance agreement…” Therefore, in order to effectuate a modification to the existing intercompany pooling arrangement, companies must either 1) amend the existing reinsurance agreement, or 2) execute new agreements. The latter scenario may entail executing at least two agreements: a commutation of the existing agreement, and a new quota share agreement(s) that covers both past and future periods.

3. To illustrate, in order to effectuate a relatively simple modification, such as changing pooling participation percentages without changing the pool participants, companies often simply amend the existing pooling agreement. Alternatively, in order to effectuate a more complex modification, such as changing (by adding or removing) the number of pool participants, a company must commute the existing pooling agreement and execute a new quota share agreement(s). In conjunction with executing the appropriate reinsurance agreements, a transfer of assets and liabilities amongst the impacted affiliates is also required in order to implement the new reinsurance agreement(s). At issue is the appropriate valuation basis to be used for assets and liabilities that are transferred pursuant to the new reinsurance agreement(s).

4. Since SSAP No. 63 does not specifically address modifications to intercompany pooling arrangements, insurance groups that modify their intercompany pooling arrangements must refer elsewhere in Statutory Accounting Principles (SAP) for relevant guidance. The obvious guidance for such transactions is SSAP No. 62—Property and Casualty Reinsurance (SSAP No. 62) since an intercompany pooling arrangement is, by definition, affiliated reinsurance. There is, however, a minority opinion that SSAP No. 25—Accounting for and Disclosures about Transactions with Affiliates and Other Related Parties (SSAP No. 25) appears to apply due to the affiliated nature of these transactions. Since the guidance and intent of SSAP No. 62 and SSAP No. 25 provide for different valuation bases, this
interpretation serves to provide definitive guidance as to which SSAP is relevant for these transactions and, therefore, clarify the appropriate valuation basis to be used for assets and liabilities transferred pursuant to a modification to an intercompany pooling arrangement.

SSAP No. 62 Approach:
5. This approach refers to the guidance and statutory accounting intent from SSAP No. 62 since intercompany pooling arrangements are defined and established through reinsurance. Further, since modifications to intercompany pooling agreements typically involve the transfer of net liabilities incurred since the inception of the existing pooling agreement (i.e., prior to the effective date of the new agreement), the retroactive reinsurance accounting guidance in paragraphs 27 through 33 of SSAP No. 62 is applicable. Paragraph 27 states that this special accounting treatment is warranted “due to the potential abuses involving the creation of surplus to policyholders and the distortion of underwriting results…” However, paragraph 30(d) specifically applies to intercompany reinsurance arrangements, and amendments to intercompany reinsurance agreements, since the reinsurance agreement is among companies 100% owned by a common parent. This paragraph allows prospective accounting treatment for intercompany reinsurance agreements that do not result in a gain in surplus as a result of the transaction.

6. To provide historical perspective, prior to the adoption (with modification) of FASB Statement No. 113—Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts (FAS 113) as SAP, paragraph 30(d) was added as one of the SAP modifications. The intent of adding paragraph 30(d) was to specifically exclude intercompany reinsurance agreements among entities 100% owned by a common parent from retroactive reinsurance accounting requirements as a result of amending or modifying these agreements, provided there is no surplus gain. The presumption in this intent was that there would be no gains to the ceding entity resulting from implementing amendments or modifications to these types of reinsurance agreements.

7. Therefore, based on the foregoing guidance and background, the statutory accounting intent is to avoid surplus gains for the ceding entity as a result of implementing a modification to an intercompany pooling arrangement. On that basis, such a modification does not represent an economic transaction to the insurance group or to the impacted companies. As such, the transfer of both the assets and the liabilities valued at statutory book value ensures that there is no impact to surplus as a result of implementing a modification to an existing pooling arrangement.

SSAP No. 25 Approach:
8. An approach different from that which refers to reinsurance accounting guidance is to refer to the guidance in SSAP No. 25 since some may view a modification to an intercompany pooling agreement as a related party transaction involving the exchange of assets or liabilities. In this case, paragraphs 10 through 14 of SSAP No. 25 would appear applicable. This guidance specifies differing valuation bases, depending on whether the transaction is considered an economic or a non-economic transaction. Paragraph 10 states that “…The appearance of permanence is also an important criterion is assessing the economic substance of a transaction. In order for a transaction to have economic substance and thus warrant revenue (loss) recognition, it must appear unlikely to be reversed…” Since insurance groups often modify intercompany pooling arrangements, this type of transaction is not permanent, and may be construed as a non-economic transaction. Paragraph 14(b) states that “non-economic transactions . . . shall be recorded at the lower of existing book value or fair value at the date of the transaction.”

9. It appears that this guidance is intended to address matters involving discrete or isolated transfers of assets and/or liabilities between affiliates rather than transfers of assets and liabilities effected in relation to executing reinsurance transactions (the guidance for which is SSAP No. 62). Additionally, application of this guidance would result in a change to the surplus of the insurance group as a result of implementing a modification to an existing intercompany pooling arrangement. As previously stated, the statutory accounting intent is to avoid surplus gains for the insurance group as a result of implementing a modification to an intercompany pooling arrangement.
10. The accounting issues are:
   
a. What is the relevant guidance for modifications to intercompany pooling arrangements?
   b. What is the appropriate valuation basis to be used for assets and liabilities that are transferred among affiliates in conjunction with the execution of a new reinsurance agreement(s) that serves to substantively modify an existing intercompany pooling arrangement?

INT 03-02 Discussion

The working group reached a consensus as follows:

11. SSAP No. 62 provides accounting for property and casualty reinsurance agreements including specific guidance on intercompany pooling agreements. SSAP No. 62 provides two methods of accounting for changes in intercompany pooling agreements, depending on whether or not the pooling results in a gain in surplus.

12. The appropriate valuation basis to be used for assets and liabilities that are transferred among affiliates in conjunction with the execution of a new reinsurance agreement(s) that serves to substantively modify an existing intercompany pooling arrangement is statutory book value for assets and statutory value for liabilities. Book value is defined in the glossary of the *Accounting Practices and Procedure Manual*.

INT 03-02 Status

13. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 03-03: Admissibility of Investments Recorded Based on the Audited GAAP Equity of the Investee when a Qualified Opinion is Provided

INT 03-03 Dates Discussed
March 9, 2003; June 22, 2003; September 14, 2003; December 7, 2003

INT 03-03 References
SSAP No. 46—Investments in Subsidiary, Controlled, and Affiliated Entities (SSAP No. 46)
SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies (SSAP No. 48)

INT 03-03 Issue
1. Both SSAP No. 46—Investments in Subsidiary, Controlled, and Affiliated Entities (SSAP No. 46), and SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies (SSAP No. 48), require certain investments to be recorded based on the audited United States generally accepted accounting principles (GAAP) equity of the investee. However, SSAP No. 46 and SSAP No. 48 do not identify whether the audit opinion of the GAAP report used to obtain the underlying GAAP equity of the investee must provide an unqualified opinion.

2. Certain situations may exist in which a qualified opinion is provided due to a GAAP departure, while information is available to determine the appropriate balances under a GAAP basis of accounting. For example, a qualified opinion would be given if a cost sharing agreement requires the cost basis of accounting to be used to value investments in a limited partnership in which the reporting entity owned more than a 5% interest, as GAAP requires such investments to be recorded based upon the GAAP equity method. Since the notes to the financial statements disclose the market value of investments held by the limited partnership, information is readily available to allocate the unrealized appreciation on investments to determine what the appropriate GAAP equity balance would be. A qualified opinion could also result if the unrealized appreciation on investments is not allocated in accordance with a partnership agreement.

3. The accounting issue is how should investments that are recorded based on the audited GAAP equity be valued if the underlying equity is obtained from audited financial statements in which other than an unqualified GAAP opinion is provided.

INT 03-03 Discussion
4. The working group reached a consensus that the reporting entity shall record investments that require audited GAAP equity in the manner described below when the audit opinion on the GAAP financial statements contains the following language:

   i. The investment shall be nonadmitted if the audit opinion contains a disclaimer of opinion for the most recent statement of financial position presented in the financial statements.

   ii. The investment shall be nonadmitted if the audit opinion contains a qualified opinion due to a scope limitation that impacts the most recent statement of financial position presented in the financial statements and the impact of the scope limitation cannot be quantified. However, if the impact of the scope limitation is quantified in the audited financial statements or the audit opinion, the investment shall be admitted and the reporting entity’s valuation of the investment...
shall be determined based on the GAAP equity of the investee, adjusted to exclude the impact of the quantified scope limitation.

iii. The investment shall be nonadmitted if the audit opinion contains a qualified opinion due to a departure from GAAP that impacts the most recent statement of financial position presented in the financial statements and the impact of such departure is not quantified in either the auditor’s report or the footnotes to the financial statements. However, if the impact of the departure from GAAP is quantified in the audited financial statements or the audit opinion, the investment shall be admitted and the reporting entity’s valuation of the investment shall be determined based on the GAAP equity of the investee, adjusted to exclude the impact of the quantified departure from GAAP.

iv. The investment shall be nonadmitted if the audit opinion contains an adverse opinion due to a departure from GAAP that impacts the most recent statement of financial position presented in the financial statements and the impact of such departure is not quantified in either the auditor’s report or the footnotes to the financial statements. However, if the impact of the departure from GAAP is quantified in the audited financial statements or the audit opinion, the investment shall be admitted and the reporting entity’s valuation of the investment shall be determined based on the GAAP equity of the investee, adjusted to exclude the impact of the quantified departure from GAAP.

v. The investment shall be nonadmitted if the audit opinion contains explanatory language indicating that there is substantial doubt about the investee’s ability to continue as a going concern.

INT 03-03 Status

5. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 03-04: EITF 01-3: Accounting in a Business Combination for Deferred Revenue of an Acquiree

INT 03-04 Dates Discussed

March 9, 2003; June 22, 2003

INT 03-04 References

SSAP No. 68—*Business Combinations and Goodwill* (SSAP No. 68)

INT 03-04 Issue

1. FASB Statement No. 141—*Business Combinations* (FAS 141) requires that an acquiring enterprise allocate the cost of an entity acquired in a business combination to the individual assets acquired and liabilities assumed based on their estimated fair values at date of acquisition. In some cases, the balance sheet of an acquired entity immediately before the acquisition date includes deferred revenue.

2. The accounting issues are:

   - Issue 1—Whether the deferred revenue of an acquired entity represents a liability that should be recognized by the acquiring entity when the business combination is recorded and, if so, how the amount assigned to that liability should be measured;

   - Issue 2—How the recognized liability should be presented in the acquiring entity's balance sheet;

   - Issue 3—Whether the amortization of an exclusivity arrangement that was acquired and recognized as an intangible asset in a business combination should be recognized as an expense or as a reduction of revenue.

INT 03-04 Discussion

3. The working group reached a consensus to reject the consensus positions of EITF 01-3 as not applicable to statutory accounting.

INT 03-04 Status

4. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 03-05: EITF 01-07: Creditor’s Accounting for a Modification or Exchange of Debt Instruments

INT 03-05 Dates Discussed
March 9, 2003; June 22, 2003

INT 03-05 References
SSAP No. 18—Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (SSAP No. 18)

INT 03-05 Issue

1. When a creditor and a debtor agree to modify the terms of an existing debt instrument or to exchange debt instruments (other than in a troubled debt restructuring), each must determine whether the modification or exchange should be accounted for as (a) the creation of a new debt instrument and the extinguishment of the original debt instrument or (b) the continuation of the original debt instrument (as modified). Guidance for making that determination is provided for creditors in FASB Statement 91—Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases - an amendment of FASB Statements No. 13, 60 and 65 and a rescission of FASB Statement No. 17 (FAS 91) and for debtors in FASB EITF 96-19—Debtor’s Accounting for a Modification or Exchange of Debt Instruments (EITF 96-19)

Debtor Accounting

2. EITF 96-19 requires a debtor to account for a modification of the terms of an existing debt instrument or an exchange of debt instruments (other than a troubled debt restructuring) as an extinguishment of the original debt instrument if the new debt instrument is substantially different from the existing debt instrument. EITF 96-19 provides the following definition of substantially different:

From the debtor’s perspective, an exchange of debt instruments between or a modification of a debt instrument by a debtor and a creditor in a nontroubled debt situation is deemed to have been accomplished with debt instruments that are substantially different if the present value of the cash flows under the terms of the new debt instrument is at least 10 percent different from the present value of the remaining cash flows under the terms of the original instrument. EITF 96-19 also provides guidance for use in calculating the present value of the cash flows for purposes of applying the 10 percent test.

Creditor Accounting

3. Paragraph 12 of FAS 91 states that:

If the terms of the new loan resulting from a loan refinancing or restructuring other than a troubled debt restructuring are at least as favorable to the lender as the terms for comparable loans to other customers with similar collection risks who are not refinancing or restructuring a loan with the lender, the refinanced loan shall be accounted for as a new loan. This condition would be met if the new loan’s effective yield is at least equal to the effective yield for such loans. Any unamortized net fees or costs and any prepayment penalties from the original loan shall be recognized in interest income when the new loan is granted.
4. Paragraph 13 of FAS 91 states that if "the refinancing or restructuring does not meet the condition set forth in paragraph 12 or if only minor modifications are made to the original loan contract, the unamortized net fees or costs from the original loan and any prepayment penalties shall be carried forward as a part of the net investment in the new loan". Thus, FAS 91 requires a creditor to account for the modified debt instrument as a new debt instrument if the following two criteria are met: (a) the modified debt instrument's effective yield is at least equal to the effective yield for a comparable loan to a debtor with similar collection risks who is not refinancing or restructuring and (b) modifications of the original debt instrument are more than minor. However, FAS 91 and the related interpretive literature do not provide factors to be considered or criteria to be used in evaluating whether a modification of a debt instrument is more than minor.

5. The foregoing provisions of FAS 91 preclude a creditor from accounting for a loan refinancing or restructuring as a new debt instrument if the terms of the new loan are not at least as favorable to the lender as the terms for comparable loans to other customers with similar collection risks who are not refinancing or restructuring. In those fact patterns, the definition of minor is irrelevant. Accordingly, those fact patterns are not within the scope of this Issue. Consistent with the scope of FAS 91, this Issue only applies to transactions between a creditor and a debtor.

6. The accounting issue is how a creditor should evaluate whether a modification of the terms of a debt instrument as a result of a refinancing or restructuring (other than a troubled debt restructuring) is more than minor under paragraph 13 of FAS 91.

INT 03-05 Discussion

7. EITF 01-7 DISCUSSION

The Task Force reached a consensus that a modification of a debt instrument should be considered more than minor under paragraph 13 of Statement 91 if the present value of the cash flows under the terms of the new debt instrument is at least 10 percent different from the present value of the remaining cash flows under the terms of the original instrument. The Task Force reached a consensus that if the difference between the present value of the cash flows under the terms of the new debt instrument and the present value of the remaining cash flows under the terms of the original debt instrument is less than 10 percent, a creditor should evaluate whether the modification is more than minor based on the specific facts and circumstances (and other relevant considerations) surrounding the modification.

The Task Force reached a consensus that the guidance in Issue 96-19 should be used to calculate the present value of the cash flows for purposes of applying the 10 percent test.

8. The working group reached a consensus to adopt the consensus position of EITF 01-7.

INT 03-05 Status

9. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 03-06: EITF 01-12: The Impact of the Requirements of FASB Statement No. 133 on Residual Value Guarantees in Connection with a Lease

INT 03-06 Dates Discussed

March 9, 2003; June 22, 2003

INT 03-06 References

SSAP No. 86—Accounting for Derivative Instruments and Hedging, Income Generation, and Replication (Synthetic Asset) Transactions (SSAP No. 86)
SSAP No. 22—Leases (SSAP No. 22)

INT 03-06 Issue

1. Paragraph 5(h) of FASB Statement No. 13—Accounting for Leases (FAS 13) defines the estimated residual value of leased property as "the estimated fair value of the leased property at the end of the lease term." A lessor may obtain a residual value guarantee from the lessee, from an independent third party, or from both. In some lease arrangements, the lessee may be required to guarantee the residual value of the leased property and provide a third party guarantee of the residual value. Alternatively, some leases require the lessee to reimburse the lessor for the cost of obtaining a third party guarantee of the residual value. Under FAS 13, the lessor and lessee must account for residual value guarantees based on the stated amount of the guarantee, rather than the estimated deficiency to be made up by the guarantor (lessee and/or third party). Residual value guarantees may be structured in a variety of ways. However, such guarantees are usually settled on a net basis. Consider the following example:

Company A (the lessor) leases a car to a lessee for a period of three years. The lease qualifies as a direct financing lease for Company A based on the requirements of FAS 13. Minimum lease payments under paragraph 5(j)(ii) of FAS 13 include a residual value guarantee purchased by Company A from Company B. The terms of the residual value guarantee provided by Company B call for Company B to pay Company A any shortfall between $5,000 (the expected retail value of the car in 3 years based on current market conditions) and the "Blue Book" retail value of the car (based on the retail value for that year, make, and model, assuming the car is in good condition with normal mileage). If the "Blue Book" retail value of the car in 3 years is more than $5,000, Company B is not required to make any payment to Company A.

Company A may also follow a common practice in the automobile leasing industry and require the lessee to return the car in good condition, subject to ordinary wear and tear. In that circumstance, the lessee would be required to pay a penalty to Company A if the lessee returned the car in worse condition than required under the contract. That penalty could in some cases be established based on the "Blue Book" discount related to greater than ordinary wear and tear for a car of that year, make, and model. In addition, in that circumstance, the lessee would be required to pay Company A a penalty for excessive mileage that in some cases could be established based on the difference between the "Blue Book" value for a vehicle (of that year, make, and model) with high mileage versus a vehicle with normal mileage.

2. For purposes of this Issue, assume that the residual value guarantee contract in the above example meets the FAS 133 definition of a derivative because (a) it contains an underlying (the "Blue Book" retail value of the car) and a payment provision ($5,000 minus the "Blue Book" retail value of the car), (b) it requires an initial investment that is smaller than would be required for other types of contracts that would
be expected to have a similar response to changes in market factors (assumed in this example), and (c) its terms require net cash settlement.

3. FASB Statement No. 133—*Accounting for Derivative Instruments and Hedging Activities* (FAS 133) did not amend any aspect of FAS 13. However, except as provided in paragraph 10(f), it also did not exclude residual value guarantees from its scope. As a result, there is a scope overlap between FAS 13 and FAS 133 with respect to the accounting for residual value guarantees that (a) are subject to the requirements of FAS 13, (b) meet the definition of a derivative in FAS 133, and (c) either are not explicitly excluded from the scope of FAS 133 or do not qualify for one of the scope exceptions in FAS 133. That scope overlap does not extend to the accounting for residual value guarantee obligations by third-party residual value guarantors and the accounting for contracts that, although labeled as residual value guarantees, are not in the scope of FAS 13 (for example, because there is not a true transfer of risk from the lessor to a third-party guarantor or because the settlement under the contract is not sufficiently specific to the leased property).

4. Under the FAS 13 lease accounting model, a lessor's gross investment in a sales-type or direct financing lease includes both the guaranteed and unguaranteed portion of the residual value of the leased property. The present value of the lessor's investment in the lease is accreted to the future value of the lease over the lease term using the interest method. If an other-than-temporary decline in the estimated residual value occurs during the lease term, the lessor is required to recognize a loss by adjusting the estimated residual value. However, under the provisions of FAS 13, a guarantee of the residual value would preclude any loss recognition by the lessor with respect to the residual value (even in the event of an other-than-temporary decline in the estimated residual value) to the extent of the guarantee provided that the guarantor's performance is probable.

5. Paragraph 5(j)(i)(b) of FAS 13 requires a lessee to include any guarantee of the residual value to be realized by the lessor in minimum lease payments (based on the stated amount of the guarantee, rather than an estimate of any deficiency to be made up). That requirement affects the lease classification tests performed by the lessee under paragraph 7 of FAS 13 and also affects the amount capitalized and the amount recognized as an obligation by the lessee in the event the lease is a capital lease. If the lessee obtains a third-party residual value guarantee on behalf of the lessor (or reimburses the lessor for its cost to obtain a third-party residual value guarantee), Interpretation 19 requires the amount paid by the lessee to obtain the third-party guarantee to be accounted for as an executory cost (that is, not included in the lessee's minimum lease payments).

6. The accounting issues are:
   - Issue 1—How to resolve the scope overlap between FAS 13 and FAS 133 with respect to residual value guarantees
   - Issue 2—Whether a third-party residual value guarantor should account for a residual value guarantee under the requirements of FAS 133.

**INT 03-06 Discussion**

7. The working group reached a consensus to reject the guidance in EITF 01-12 as not applicable to statutory accounting.

**INT 03-06 Status**

8. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 03-07: EITF 00-19: Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, A Company’s Own Stock

INT 03-07 Dates Discussed

March 9, 2003; June 22, 2003

INT 03-07 References

SSAP No. 86—Accounting for Derivative Instruments and hedging, Income Generation, and Replication (Synthetic Asset) Transactions (SSAP No. 86)

INT 03-07 Issue

1. For a number of business reasons, a company may enter into contracts that are indexed to, and sometimes settled in, its own stock. Examples of these contracts include written put options, written call options (and warrants), purchased put options, purchased call options, forward sale contracts, and forward purchase contracts. These contracts may be settled using a variety of settlement methods, or the issuing company or counterparty may have a choice of settlement methods. The settlement methods are:

- Physical settlement-the party designated in the contract as the buyer delivers the full stated amount of cash to the seller, and the seller delivers the full stated number of shares to the buyer
- Net-share settlement-the party with a loss delivers to the party with a gain shares with a current fair value equal to the gain
- Net-cash settlement-the party with a loss delivers to the party with a gain a cash payment equal to the gain, and no shares are exchanged.

2. The contracts described above may be either freestanding or embedded in another financial instrument. A freestanding contract is entered into separate and apart from any of the company's other financial instruments or equity transactions, or it is entered into in conjunction with some other transaction and is legally detachable and separately exercisable.

3. This Issue applies only to freestanding derivative financial instruments (for example, forward contracts, options, and warrants). This Issue applies to security price guarantees or other financial instruments indexed to, or otherwise based on, the price of the company's stock that are issued in connection with a purchase business combination and that are accounted for as contingent consideration only if those instruments meet the criteria in Issue No. 97-8, "Accounting for Contingent Consideration Issued in a Purchase Business Combination," for recording as part of the cost of the business acquired in a purchase business combination (see discussion of Issue 97-8 in the STATUS section). This Issue does not address the accounting for either the derivative component or the financial instrument when the derivative component is embedded in and not detachable from the financial instrument. This Issue also does not address the accounting for contracts that are issued (a) to compensate employees or (b) to acquire goods or services from nonemployees when performance has not yet occurred. However, this Issue applies to contracts issued to acquire goods or services from nonemployees when performance has occurred. This Issue does not address the accounting for contracts that are indexed to, and potentially settled in, the stock of a consolidated subsidiary (see discussion of Issue No. 00-6, "Accounting for Freestanding Derivative Financial Instruments Indexed to, and Potentially Settled in, the Stock of a Consolidated Subsidiary," and Issue No. 00-4, "Majority Owner's Accounting for a Transaction in the
Shares of a Consolidated Subsidiary and a Derivative Indexed to the Minority Interest in That Subsidiary," in the STATUS section).

4. The FASB EITF observed that, pursuant to paragraphs 11(a) and 12(c) of FASB Statement No. 133—Accounting for Derivative Instruments and Hedging Activities (FAS 133), if an embedded derivative is indexed to the reporting entity's own stock and would be classified in stockholders' equity if it was a freestanding derivative, that embedded derivative is not considered a derivative for purposes of FAS 133. The FASB EITF reached a consensus that for purposes of evaluating under FAS 133 whether derivatives indexed to a company's own stock that are embedded in a debt instrument would be classified in stockholders' equity if freestanding, the requirements of paragraphs 12-32 of this Issue do not apply.

5. The accounting issue is how freestanding contracts that are indexed to, and potentially settled in, a company's own stock should be classified and measured by the company.

**INT 03-07 Discussion**

6. The working group reached a consensus to reject the guidance in EITF 00-19 as not applicable to statutory accounting.

**INT 03-07 Status**

7. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 03-08: EITF 01-6: The Meaning of “Indexed to a Company’s Own Stock”

INT 03-08 Dates Discussed
March 9, 2003; June 22, 2003

INT 03-08 References
SSAP No. 86—Accounting for Derivative Instruments and hedging, Income Generation, and Replication (Synthetic Asset) Transactions (SSAP No. 86)

INT 03-08 Issue

1. Some financial instruments are freestanding and require or permit the purchase or sale of the issuing company's stock (for example, an option or a warrant), while other financial instruments have embedded features within a host contract that require or permit the purchase or sale of the issuing company's stock (for example, the conversion option in convertible debt). Those freestanding financial instruments and those financial instruments that have embedded features within a host contract (hereafter collectively referred to as instruments) may be indexed to the issuing company's stock, may contain contingency provisions, or may meet the definition of a derivative in FASB Statement No. 133—Accounting for Derivative Instruments and Hedging Activities (FAS 133). The instruments addressed in this Issue are those for which settlement is based on changes in the issuing company's stock price and one or more defined contingencies provided that once the contingencies have occurred, the instrument's settlement amount is based solely on the issuing company's stock.

2. Paragraph 11(a) of FAS 133 requires that a reporting entity (that is, the issuer) shall not consider instruments issued or held by that reporting entity that are both (a) indexed to its own stock and (2) classified in stockholders' equity in its statement of financial position to be derivatives for purposes of that Statement. Issue No. 00-19, “Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock,” provides guidance for issuers regarding the classification and measurement of a derivative financial instrument indexed to, and potentially settled in, the issuer's own stock.

3. The accounting issues are:
   - Issue 1—Whether instruments within the scope of this Issue are considered issued for accounting purposes by the issuer and the holder
   - Issue 2—Whether instruments within the scope of this Issue are considered indexed to a company's own stock within the meaning of Issue 00-19 and paragraph 11(a) of

INT 03-08 Discussion

4. The working group reached a consensus to reject the guidance in EITF 01-6 as not applicable to statutory accounting.

INT 03-08 Status

5. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 03-10: EITF 01-14: Income Statement Characterization of Reimbursements Received for “Out-Of-Pocket” Expenses Incurred

INT 03-10 Dates Discussed

September 14, 2003; December 7, 2003

INT 03-10 References

Issue Paper No. 99—Nonapplicable GAAP Pronouncements (IP No. 99)

INT 03-10 Issue

1. AICPA Statement of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts* (SOP 81-1) is deemed not applicable for statutory accounting purposes in IP No. 99. EITF 01-14: *Income Statement Characterization of Reimbursements Received for “Out-Of-Pocket” Expenses Incurred* (EITF 01-14) interprets SOP 81-1.

2. EITF 01-14 states the following

   Entities that provide services as part of their central ongoing operations generally incur incidental expenses that in practice are commonly referred to as "out-of-pocket" expenses. Those expenses often include, but are not limited to, expenses related to airfare, mileage, hotel stays, out-of-town meals, photocopies, and telecommunications and facsimile charges. In some cases, the service provider and the customer agree that the customer will reimburse the service provider for the actual amount of such expenses incurred. In other cases, the parties negotiate a single flat fee that is intended to compensate the service provider for both professional services rendered and out-of-pocket expenses incurred.

   The scope of this Issue excludes transactions for which guidance is provided under categories (a) and (b) of the GAAP hierarchy, including:

   - Sales of financial assets, including debt and equity securities, loans, and receivables
   - Lending transactions
   - Insurance and reinsurance premiums
   - Transactions of broker-dealers that are within the scope of the AICPA Audit and Accounting Guide, Brokers and Dealers in Securities, and reimbursements received for expenses incurred in other specialized industries for which the accounting for such reimbursements is addressed in AICPA accounting and auditing guides.

3. The issue is whether reimbursements received for out-of-pocket expenses incurred should be characterized in the income statement as revenue or as a reduction of expenses incurred.

INT 03-10 Discussion

4. The working group reached a consensus to reject the consensus position of EITF 01-14 as not applicable to statutory accounting, as the EITF specifically excluded from its scope insurance and reinsurance transactions and the interpreted statement SOP 81-1 was deemed not applicable in IP No. 99.

INT 03-10 Status

5. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 03-11: EITF 02-3: Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities.

INT 03-11 Dates Discussed

September 14, 2003; December 7, 2003

INT 03-11 References

SSAP No. 86—*Accounting for Derivative Instruments and Hedging, Income Generation, and Replication (Synthetic Asset) Transactions* (SSAP No. 86)

INT 03-11 Issue

1. EITF 02-3: *Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities* (EITF 02-3) Issue

Issue No. 98-10, "Accounting for Contracts Involved in Energy Trading and Risk Management Activities," Issue No. 00-17, "Measuring the Fair Value of Energy-Related Contracts in Applying Issue No. 98-10," and Topic No. D-105, "Accounting in Consolidation for Energy Trading Contracts between Affiliated Entities When the Activities of One but Not Both Affiliates Are within the Scope of Issue No. 98-10," address various aspects of the accounting for contracts involved in energy trading and risk management activities. The purpose of this Issue is to address certain issues related to energy trading activities, including (a) gross versus net presentation in the income statement, (b) whether the initial fair value of an energy trading contract can be other than the price at which it was exchanged, and (c) additional disclosure requirements for energy trading activities.

**Reporting Gains and Losses on Energy Trading Contracts**

In Issue 98-10, the Task Force reached a consensus that energy trading contracts should be marked-to-market (that is, measured at fair value determined as of the balance sheet date) and that gains and losses (realized and unrealized) related to energy trading contracts could be shown either gross or net in the income statement. The Task Force had previously reached a tentative conclusion that gains and losses on energy trading contracts should be reported net in the income statement. However, in reversing that tentative conclusion on income statement presentation, the Task Force considered comment letters from several energy trading companies contending that a gross presentation was appropriate in certain circumstances in which settlement of energy trading contracts required physical delivery of the underlying commodity (instead of net cash settlement). The Task Force was asked to reconsider the consensus in Issue 98-10 that allows companies to use either the gross or the net method of presentation for reporting gains and losses on energy trading activities in the income statement.

**Recognition of Unrealized Gains and Losses at Inception of an Energy Trading Contract**

Issue 98-10 defines the fair value of an energy contract in footnote 2 (consistent with Statements 107, 125, and 133) as "the amount at which that contract could be bought or sold in a current transaction between willing parties, that is, other than in a forced or liquidation sale" (emphasis added). For some energy contracts that are required to be recorded at fair value, no quoted market prices or similar current transactions exist on which to base a fair value measurement. In Issue 00-17, the Task Force reiterated this point by stating that "the price at which an energy contract is exchanged normally is its initial fair value." The Task Force further noted that
"valuation models, including option-pricing models, should be used only when market transactions are not available to evidence fair values" (emphasis added).

Questions have been raised about whether unrealized gains or losses may be reported at inception of energy trading contracts, absent evidence from quoted market prices or other current market transactions with similar terms and counterparties. The FASB staff questions the appropriateness of such gains, in light of the guidance in Issue 00-17, in transactions for which fair value is determined in a manner other than by reference to quoted market prices or current market transactions for similar contracts. In particular, the FASB staff notes that while the Task Force observed that fair value should be based on the best information available in the circumstances, the consensus also notes that "current market transactions also may provide evidence for recognition of 'dealer profit' . . . ." The FASB staff interprets the Task Force's consensus to indicate that a dealer profit, or unrealized gain or loss at inception of the contract, may not be recognized unless it is evidenced by quoted market prices or other current market transactions.

Disclosure
Issue 98-10 does not address disclosure, other than an SEC Observer comment requiring registrants to disclose their policy for presentation of gains and losses in the income statement, including presentation on a gross or net basis. However, other accounting literature provides guidance that should be followed by entities involved in energy trading activities. For example, Opinion 22 requires a description of all significant accounting policies of the reporting entity, and SOP 94-6 requires disclosures about estimates used in the determination of the carrying amounts of assets and liabilities if those estimates are particularly sensitive to change in the near term. The Task Force was asked to clarify the application of Opinion 22 and SOP 94-6 to an entity's energy trading operations and provide for any other disclosures that may be useful to financial statement users.

2. The accounting issues are:

   Issue 1—Whether gains and losses on energy trading contracts should be reported gross or net in the income statement;
   Issue 2—Whether recognition of unrealized gains and losses at inception of an energy trading contract is appropriate in the absence of quoted market prices or current market transactions for contracts with similar terms;
   Issue 3—What disclosure requirements of energy trading activities should be.

INT 03-11 Discussion

3. EITF 02-3 interprets Issue 98-10, which is incorporated in SSAP No. 86. The working group reached a consensus to reject the consensus position of EITF 02-3 as the transactions described in Issue 1 and Issue 3 are not consistent with the statutory accounting guidance in SSAP No. 86. The appropriate accounting guidance can be found in SSAP No. 86.

INT 03-11 Status

4. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 03-12: EITF 02-4: Determining Whether a Debtor's Modification or Exchange of Debt Instruments is within the Scope of FASB Statement No. 15

INT 03-12 Dates Discussed

September 14, 2003; December 7, 2003

INT 03-12 References

SSAP No. 36—Troubled Debt Restructuring (SSAP No. 36)

INT 03-12 Issue

1. FASB Statement No. 15, Accounting by Debtors and Creditors for Troubled Debt Restructurings is (FAS 15) adopted with modification in SSAP No. 36. EITF 02-4: Determining Whether a Debtor's Modification or Exchange of Debt Instruments is within the Scope of FASB Statement No. 15 (EITF 02-4) interprets FAS 15.

2. EITF 02-4:

   Paragraph 2 of Statement 15 states that "a restructuring of debt constitutes a troubled debt restructuring for purposes of this Statement if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider." Paragraph 61 of Statement 15 further explains that the determination of whether a debt restructuring is a troubled debt restructuring should focus on whether those economic and legal considerations "in effect compel the creditor to restructure a receivable in ways more favorable to the debtor than the creditor would otherwise consider."

   Statement 15 provides a list of characteristics or factors that may be present in a troubled debt restructuring (paragraph 5). That Statement also includes a list of characteristics or factors that, if present, indicate that a modification or exchange of debt should not necessarily be considered a troubled debt restructuring even if the debtor is experiencing financial difficulty (paragraph 7). Paragraphs 61 and 62 of the basis for conclusions of Statement 15 provide additional guidance further clarifying the meaning of troubled debt restructuring for purposes of that Statement.

   Some have raised questions about whether certain modifications or exchanges of debt instruments should be accounted for by the debtor as troubled debt restructurings in accordance with Statement 15. For example, some have questioned whether, based on the guidance in paragraph 5(c)(3) of Statement 15, a transaction involving a reduction in the face amount of a debt instrument should always be considered a troubled debt restructuring. Others have questioned whether a transaction meeting the criterion in paragraph 7(d), in which the debtor issues new marketable debt with an effective interest rate based on its market price that is at or near current market rates for nontroubled debt, should always be considered a nontroubled debt restructuring. A working group was formed to address this issue.

3. The accounting issue is whether any single characteristic or factor, taken alone, is determinative of whether a modification or exchange is a troubled debt restructuring under FAS 15 for a debtor.
INT 03-12 Discussion

4. The working group reached a consensus to adopt the consensus position of EITF 02-4 as an interpretation of SSAP No. 36.

INT 03-12 Status

5. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 03-13: EITF 02-6: Classification in the statement of Cash Flows of Payments Made to Settle an Asset Retirement Obligation within the Scope of FASB Statement No. 143

INT 03-13 Dates Discussed
September 14, 2003; December 7, 2003

INT 03-13 References
SSAP No. 67—Other Liabilities (SSAP No. 67)
SSAP No. 69—Statement of Cash Flow (SSAP No. 69)
Issue Paper No. 99—Nonapplicable GAAP Pronouncements (IP No. 99)

INT 03-13 Issue

1. FASB Statement No. 143—Accounting for Asset Retirement Obligations (FAS 143) is rejected as not applicable to statutory accounting in IP No. 99. FASB Statement No. 95, Statement of Cash Flows is rejected in SSAP No. 69. AICPA Statement of Position 96-1, Environmental Remediation Liabilities (SOP 96-1) is adopted in SSAP No. 67. FASB EITF 02-6: Classification in the Statement of Cash Flows of Payments Made to Settle an Asset Retirement Obligation within the Scope of FASB Statement No. 143 (EITF 02-6) interprets FAS 143, FAS 95 and SOP 96-1.

2. EITF 02-6 states the following.

   Statement 143 addresses the accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. Statement 143 provides for recognition of a liability for a legal obligation associated with the retirement of a long-lived asset that results from the acquisition, construction, development, and (or) the normal operation of a long-lived asset. The initial recognition of a liability for an asset retirement obligation increases the carrying amount of the related long-lived asset by the same amount as the liability. In periods subsequent to initial measurement, period-to-period changes in the liability are recognized for the passage of time (accretion) and revisions to the original estimate of the liability. Additionally, the capitalized asset retirement cost is subsequently allocated to expense using a systematic and rational method over its useful life.

   Statement 95 requires cash receipts and payments in a statement of cash flows to be classified as operating, investing, or financing activities. Statements 143 and 95 do not provide specific guidance on the classification of the cash outflows incurred upon settlement of the liability for the asset retirement obligation within an enterprise's statement of cash flows. Because asset retirement costs have aspects of more than one class of cash flows, questions have arisen about the proper classification of such cash outflows.

3. The accounting issue is how the cash paid upon settlement of an asset retirement obligation should be classified in an enterprise's statement of cash flows.

4. The EITF reached a consensus that a cash payment made to settle an asset retirement obligation should be classified in the statement of cash flows as an operating activity.
INT 03-13 Discussion

5. The working group reached a consensus to reject the consensus position of EITF 02-6 as not applicable to statutory accounting.

INT 03-13 Status

6. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 03-14: EITF 02-7: Unit of Accounting for Testing Impairment of Indefinite-Lived Intangible Assets

INT 03-14 Dates Discussed

September 14, 2003; December 7, 2003

INT 03-14 References

SSAP No. 68—Business Combinations and Goodwill (SSAP No. 68)

INT 03-14 Issue

1. FASB Statement No. 142—Good will and Other Intangible Assets (FAS 142), was rejected in SSAP No. 68. FASB EITF 02-7: Unit of Accounting for Testing Impairment of Indefinite-Lived Intangible Assets (EITF 02-7) interprets FAS 142

2. EITF 02-7

1. Statement 142 requires that an intangible asset that is not subject to amortization be tested for impairment annually, or more frequently, if events or changes in circumstances indicate that the asset might be impaired. Statement 142 requires recognition of the excess of the carrying amount of an intangible asset over its fair value as an impairment loss and does not permit restoration of those losses in future periods.

2. Questions have arisen on what the appropriate unit of accounting is when testing indefinite-lived intangible assets for impairment. Some entities acquire intangible assets in separate transactions; however, those individual assets are collectively used in a manner that suggests they represent one asset. For example, an entity might acquire, in separate transactions, contiguous easements to support development of a single gas pipeline. In fact patterns such as those, the question is whether the collection of legal rights should be deemed a single unit of accounting for impairment testing purposes (an easement supporting a pipeline) or whether each individually acquired legal right should be separately tested for impairment. Questions also have been raised as to when, if ever, different indefinite-lived intangible assets should be combined into a single "unit of accounting" for impairment testing purposes. An example is whether it is ever appropriate to combine (a) different trade names, (b) a trade name and a different type of indefinite-lived intangible asset such as an easement, or (c) all indefinite-lived intangible assets and test the combined asset for impairment.

3. The accounting issue is what the unit of accounting should be for purposes of testing indefinite-lived intangible assets for impairment pursuant to paragraph 17 of Statement 142.

4. The EITF reached a consensus that separately recorded indefinite-lived intangible assets, whether acquired or internally developed, should be combined into a single unit of accounting for purposes of testing impairment if they are operated as a single asset and, as such, are essentially inseparable from one another. The Task Force agreed that determining whether several indefinite-lived intangible assets are essentially inseparable is a matter of judgment that depends on the relevant facts and circumstances and that certain named indicators should be considered in making that determination. The Task Force agreed that none of the indicators should be considered presumptive or determinative.

5. The EITF reached a consensus that if, based on a change in the way in which intangible assets are used, a company combines as a unit of accounting for impairment testing purposes indefinite-lived intangible assets that were previously tested for impairment separately, those intangible assets should
be separately tested for impairment in accordance with paragraph 17 of Statement 142 prior to being combined as a unit of accounting.

6. The EITF reached a consensus that the guidance in this Issue should be applied upon the initial application of Statement 142; however, for entities that applied Statement 142 early, the guidance in this Issue should be applied for impairment testing of indefinite-lived intangible assets performed after March 21, 2002.

**INT 03-14 Discussion**

7. The working group reached a consensus to reject the consensus of EITF 02-7 as the issue is on FAS 142, which has been rejected for statutory accounting in SSAP No. 68.

**INT 03-14 Status**

8. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 03-15: EITF 02-8: Accounting for Options Granted to Employees in Unrestricted, Publicly Traded Shares of an Unrelated Entity

INT 03-15 Dates Discussed

September 14, 2003; December 7, 2003

INT 03-15 References

Issue Paper No. 99—Nonapplicable GAAP Pronouncements (IP No. 99)

INT 03-15 Issue

1. FASB EITF 02-8: Accounting for Options Granted to Employees in Unrestricted, Publicly Traded Shares of an Unrelated Entity (EITF 02-8) references FASB Statement No. 57, Related Party Disclosures, FASB Statement No. 123, Accounting for Stock-Based Compensation, FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities, FASB Interpretation No. 44, Accounting for Certain Transactions involving Stock Compensation and APB Opinion No. 25, Accounting for Stock Issued to Employees.

2. EITF 02-8

Some entities issue stock options to their employees in which the underlying shares are stock of an unrelated entity. Consider the following example:

Company A awards an option to an employee. The terms of the option award provide that, if the employee remains employed by Company A for 3 years, the employee may exercise the option and purchase 1 share of common stock of Company B, a publicly traded entity, for $10 from Company A. Company B is unrelated to Company A and, therefore, is not a subsidiary or accounted for by the equity method.

The option award in the above example is not within the scope of Statement 123 because the underlying stock is not an equity instrument of the employer/grantor. The option award also is not subject to Opinion 25 as Interpretation 44 states, "Opinion 25 does not apply to the accounting by an employer for awards based on stock of an entity other than the employer. . . ." (paragraph 13).

3. The accounting issue is how the employer should account for the awarding of stock options.

4. The EITF reached a consensus that the option award in the above example meets the definition of a derivative in Statement 133 and, therefore, should be accounted for by the employer as a derivative under that Statement. As such, it should be recorded at its fair value at inception. Subsequent changes in the fair value of the derivative should be included in the determination of net income. After vesting, the option would continue to be accounted for as a derivative under Statement 133.

5. The EITF observed that Statement 133 does not specify the income statement characterization of changes in fair value of the option award in the above example. The Task Force reached a consensus that changes in fair value of the option award prior to vesting should be characterized as compensation expense in the employer's income statement. The Task Force also reached a consensus that changes in fair value of the option award after vesting may be reflected elsewhere in the employer's income statement.
INT 03-15 Discussion

6. The working group reached a consensus to reject the consensus of EITF 02-8 as not applicable to statutory accounting as this EITF addresses what is presumed to be a rare occurrence.

INT 03-15 Status

7. No further discussion is planned.
Interpretation of the Emerging Accounting Issues Working Group

INT 03-16: Contribution of Stock

INT 03-16 Dates Discussed

September 14, 2003; December 7, 2003

INT 03-16 References

SSAP No. 68—Business Combinations (SSAP No. 68)
SSAP No. 72—Surplus & Quasi-Reorganizations (SSAP No. 72)
SSAP No. 28—Nonmonetary Transactions (SSAP No. 28)
SSAP No. 46—Investments in Subsidiary, Controlled and Affiliated Entities (SSAP No. 46)

INT 03-16 Issue

1. Should a business combination that occurs through a capital contribution be treated differently than one that occurs through a purchase, specifically as regards the application of SSAP No. 68 and the admissibility of goodwill? SSAP No. 68 mixes its use of terms in its description of a business combination – purchase, acquisition, acquired, acquiring. Does the use of the term purchase in some sentences preclude the use of the Statutory Purchase Method for other than the purchase of an entity? SSAP Nos. 25, 28 & 72 discuss the issue of capital contributions, nonmonetary / nonreciprocal transfers, and transactions involving affiliates (both economic and non-economic transactions).

2. If a Company receives the stock of an affiliated company as a capital contribution, rather than through a purchase, is it appropriate to account for the combination using the Statutory Purchase Method of Accounting described in SSAP No. 68?

INT 03-16 Discussion

3. The working group reached a consensus that a capital contribution transaction does not meet the definition of a purchase transaction. SSAP No. 68 is not applicable to this transaction. The working group determined an interpretation of SSAP No. 68 is not necessary. The appropriate accounting guidance to be followed for this transaction can be found in SSAP No. 25, SSAP No. 28 or SSAP No. 46, depending on additional information about the transaction.

INT 03-16 Status

4. No further discussion is planned.
INT 03-18: Accounting for a change in the additional minimum liability in SSAP No. 8—Pensions (SSAP No. 8)

INT 03-18 Issue

1. The combination of poor asset returns and low interest rates at the end of 2002 forced numerous insurers with defined benefit plans to be in an additional minimum liability position. Some insurers recorded the change in the additional minimum liability directly to surplus while others recorded the change as a component of net income.

2. The following is excerpted from SSAP No. 8:

**Defined Benefit Plans**

2. A defined benefit plan defines the amount of the pension benefit that will be provided to the plan participant at retirement or termination. For such benefit plans, reporting entities shall adopt FASB Statement No. 87, Employers’ Accounting for Pensions (FAS 87) with a modification to exclude non-vested employees. Therefore, the cost related to services rendered prior to becoming eligible and vested in the plan are recognized as a component of the net periodic pension cost in the period the employee becomes vested. Any intangible asset or prepaid expense resulting from adoption of the provisions of this statement shall be considered a nonadmitted asset, as such an asset cannot be readily converted to cash to satisfy policyholder obligations.

**Disclosures**

9. The following disclosures shall be made for defined benefit pension plans for which the reporting entity is directly liable:

   f. The amount included in income for the period arising from a change in the additional minimum pension liability recognized pursuant to paragraph 37 of FAS 87;

3. The Statutory Accounting Principles Working Group has proposed changes in the accounting for pensions in Statutory Issue Paper No. 123–Accounting for Pensions, A Replacement of SSAP No. 8 (Issue Paper No. 123) which prescribes that the recording of a change in the additional minimum liability should be recorded directly to surplus. The accounting issue is, if reporting entities that included the change in the additional minimum liability, as a component of net income in 2002 should be permitted to recognize the reversal of that additional minimum liability as a component of net income if the changes in Issue Paper No. 123 are adopted in an SSAP?
INT 03-18 Discussion

4. The working group reached a consensus that additional minimum pension liability amounts previously expensed through income shall not be reversed through income in a subsequent period. Changes in accounting principle are reported as adjustments to unassigned funds (surplus) in accordance with SSAP No. 3—Accounting Changes and Corrections of Errors.

INT 03-18 Status

5. No further discussion is planned.
Appendix C

Actuarial Guidelines

Introduction

The NAIC Life and Health Actuarial Task Force has been asked on many occasions to assist a particular state insurance department in interpreting a statute dealing with an actuarial topic relative to an unusual policy form or situation not contemplated at the time of original drafting of a particular statute. The Life and Health Actuarial Task Force, in developing its interpretation or guideline, must often consider the intent of the statute, the reasons for initially adopting the statute and the current situation. The Life and Health Actuarial Task Force feels that for those situations which are sufficiently common to all states, that the publishing of actuarial guidelines on these topics would be beneficial to the regulatory officials in each state and would promote uniformity in regulation which is beneficial to everyone. To this end, the Life and Health Actuarial Task Force has developed certain actuarial guidelines and will continue to do so as the need arises. The guidelines are not intended to be viewed as statutory revisions but merely a guide to be used in applying a statute to a specific circumstance.

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Actuarial Guideline I

INTERPRETATION OF THE STANDARD VALUATION LAW RESPECT TO THE VALUATION OF POLICIES WHOSE VALUATION NET PREMIUMS EXCEED THE ACTUAL GROSS PREMIUM COLLECTED

1. The purpose of this guideline (items 2 and 3 below) is to clarify the intent of the Standard Valuation Law.

2. The method of valuation promulgated by the model legislation adopted by the NAIC in December 1976 for the valuation of life insurance policies whose valuation net premiums exceed the actual gross premiums collected is a change in method of reserve calculation and not a change in reserve standards.

3. For policies so valued the maximum permissible valuation interest rate and the applicable mortality basis specified is that in effect at the date of issue of such policies.
RESERVE REQUIREMENTS WITH RESPECT TO INTEREST RATE GUIDELINES ON ACTIVE LIFE FUNDS HELD RELATIVE TO GROUP ANNUITY CONTRACTS

As part of the determination of the aggregate minimum group annuity reserves, a computation must be made of minimum reserves for deposit administration group annuity funds with interest rate guarantees including all such funds pertaining to possible purchase of group annuities whether such funds are held in a separate account or in a general account, whether shown as premiums, advance premiums, auxiliary funds, etc. and whether the liability is shown in Exhibit 8 or elsewhere. In making such computations, the procedure and minimum standards described below shall be applicable for the December 31 calendar year “y” valuation giving recognition to the dates deposits were made. Where appropriate and with the approval of the commissioner, recognition may be given to the extent and time of application of active life funds to purchase annuities, expense assessments against the funds, and excess of purchase price over minimum reserves. In no event shall the reserve be less than the transfer value, if any, of the fund. Approximate methods and averages may be employed with the approval of the commissioner.

To the extent that the application of these valuation procedures and standards would require a company to establish aggregate minimum reserves for group annuities and related funds in excess of reserves which it would not otherwise hold if these valuation procedures and standards did not apply, such company shall set up additional reserve liability shown in its general account or in a separate account, whether shown in Exhibit 8 or elsewhere.

The valuation procedures and standards specified in this guideline shall not be applicable to the extent that the valuation procedures and standards relating to reserves for deposit administration group annuity funds with interest rate guarantees (i.e., group annuity and guaranteed interest contracts) in the amendments to the Standard Valuation Law adopted by the National Association of Insurance Commissioners in December 1980, or in later NAIC amendments, have become applicable in a jurisdiction.

For funds receive:

(1) Prior to calendar year 1976, follow the procedure used at that time.

(2) In calendar year 1976 or later, follow the minimum standards described below:

   (a) Contracts having no guaranteed interest rates in excess of 6% on future contributions to be received more than one year subsequent to the valuation date.

   The minimum reserve shall be equal to the sum of the minimum reserves for funds attributable to contributions received in each calendar year.

   Where \( V_y = \) Minimum reserve for funds attributable to contributes received in calendar year \( y \).

   \[ V_y = \frac{C_y \times (1 + i_{gy})^n}{(1 + i_{py})^n} \]

   \( C_y = \) Portion of guaranteed fund attributable to contributions received in calendar year \( y \)

   \( i_{gy} = \) Interest rate guaranteed under the contract with respect to funds attributable to contributions received in calendar year \( y \).

   \( i_{py} = \) Lowest of:
Appendix C

(1) The net new money rate credited by the company on group annuity funds attributable to contributions received in calendar year y less .005; or

(2) \( i_{gy} \); or

(3) \( i_{my} \), where

(i) \( i_{my} \) = for calendar years \( y + 1 \) through \( y + 10 \), the values shown in the table of values of \( i_{my} \) distributed each year by the Central Office of the National Association of Insurance Commissioners;

(ii) \( i_{my} \) = for calendar years \( y + 11 \) and later, .060.

\[ n = \] Number of guarantee years, and fractions thereof, remaining as of the December 31 valuation.

(b) Contracts having guaranteed interest rates in excess of 6% on future contributions to be received more than one year subsequent to the valuation date.

The same procedures as set forth under (a) above shall be used except that the deduction under (1) of \( i_{py} \) shall be .01 instead of .005 and \( i_{my} \) for calendar years \( y + 1 \) through \( y + 10 \) shall be reduced by .005.

Table of Values of \( i_{my} \)

(Effective for the December 31, 1977 Valuation)

<table>
<thead>
<tr>
<th>Calendar Year y in Which Contributions Were Received</th>
<th>Value of ( i_{my} ) for Calendar Years y + 1 Through y + 10</th>
</tr>
</thead>
<tbody>
<tr>
<td>1976</td>
<td>.089</td>
</tr>
<tr>
<td>1977</td>
<td>.087</td>
</tr>
<tr>
<td>1978</td>
<td>.081</td>
</tr>
<tr>
<td>1979</td>
<td>.084</td>
</tr>
<tr>
<td>1980</td>
<td>.100</td>
</tr>
<tr>
<td>1981</td>
<td>.124</td>
</tr>
<tr>
<td>1982</td>
<td>.145</td>
</tr>
</tbody>
</table>
Actuarial Guidelines

Actuarial Guideline III

INTERPRETATION OF MINIMUM CASH SURRENDER BENEFIT UNDER STANDARD NONFORFEITURE LAW FOR INDIVIDUAL DEFERRED ANNUITIES

Section 6 of the model bill as written does not require that cash surrender benefits to be paid; but where they are paid, it requires that such cash surrender benefits grade into maturity value using an interest rate not more than one percent higher than the rate specified in the contract for accumulating net considerations. While this method will be suited for contracts having a sales load at issue, it may create a problem for contracts having surrender charges for cash surrender.

For contracts providing cash surrender values, the cash surrender value at maturity shall be at least equal to the minimum nonforfeiture amount at maturity as defined in Section 4. For purposes of calculating cash surrender values prior to maturity, the term “maturity value” in the Standard Nonforfeiture Law for Individual Deferred Annuities shall mean the cash surrender value at maturity.
ACTUARIAL INTERPRETATION REGARDING MINIMUM RESERVES FOR CERTAIN FORMS OF TERM LIFE INSURANCE

Scope

This interpretation recommended by the NAIC Technical Task Force to Review Valuation and Nonforfeiture Value Regulation deals only with term life insurance without cash values which the owner has the unilateral right to maintain in force until its stated expiry date, subject only to the payment of required premiums which vary (generally increasing on a per $1000 basis) during the term of the policy and under which premium rates are guaranteed to the stated final expiry. This interpretation applies only to such term plans valued on the 1958 CSO Mortality Table for the current term period.

Ten-year renewable term, five-year renewable term and one-year renewable term to a stated age with generally increasing premiums are titles commonly given to such policies, but this interpretation concerns itself with the actual coverage provided and is not controlled by the name given the coverage.

Background Information

Historically, reserves on one-year renewable term policies have consisted of a basic reserve for the current term period of one-half the cost of insurance for the current term period, plus a deficiency reserve, if any. The application of the Commissioners Reserve Valuation Method to determine basic reserves and deficiency reserves for such policies is subject to varying interpretations as noted in Walter O. Menge’s paper, “Commissioners Reserve Valuation Method” written at the time of construction of the Standard Valuation Law.

...the adaptation of the commissioners reserve valuation method to fit policies for which the gross premium varies from year to year becomes a problem of generalization which, from a purely theoretical viewpoint, has an infinite number of possible solutions, some of which are practical and others of which are impractical.1

and

For these reasons, it seems desirable not to formulate at this time any fixed rules for the valuation of these unusual types of policies and riders. The second paragraph of Section 4 of the Standard Valuation Law does not define the method of valuation of such contracts but requires that the method used, whatever it may be, must be consistent with that employed for uniform premium policies providing uniform insurance benefits, thus leaving open the possibility of a choice of several consistent methods.2

Acceptable Approaches

Two approaches to “consistent” reserves are suggested. The unitary policy approach considers such policies as variable premium policies up to the mandatory expiry date. Under this approach the valuation net premiums are a uniform percentage of gross premiums with the percentage fixed at issue date. If appropriate deficiency reserves are held, this approach has great appeal. However, it is susceptible to manipulation and illogical results. Reserves according to this approach should be acceptable only if the company can demonstrate that actual reserves, including deficiency reserves, for all renewable term business valued using this approach are of the same general magnitude as would occur using an approved method as defined below.

The other approach is to hold policy reserves for only the current period of years (not necessarily equal to the renewal period) during which the required premium per $1000 remains level, including deficiency
reserves if appropriate. Additional reserves are established where net premiums, calculated on a basis which reflects current mortality, exceed gross premiums for future periods of level premiums. Although not speaking directly to valuation problems in this instance, the Hooker Committee report said:

The question was raised whether a policy providing term insurance for several years, automatically followed by permanent insurance, should be considered as two separate policies for the purpose of the Act. In the Committee’s opinion, the respective portions may be treated separately if the portion providing permanent insurance takes the Company’s regular rate at the then attained age. The rated age provision in the law appears to cover this point. However, the Committee draws a distinction between policies providing purely term insurance followed by permanent insurance at the company’s published rate at the attained age of conversion, and the policies providing for an initial premium such that the increased premium at a subsequent duration differs from that for a new policy at the attained age. The latter case obviously constitutes a single policy to which the formula should be applied at the outset.

The second sentence of the above quotation lends support to the approach of separating successive periods of level premiums.

Under this interpretation, an approved method is any method which produces reserves greater than or equal to the sum of policy reserves, including deficiency reserves, for the current period of level premiums calculated on the basis of the applicable mortality and interest standards and reserve method specified in the Standard Valuation Law plus additional reserves calculated according to the following applied uniformly to all such policies.

The present value of the excess of test premiums for future periods of level premiums for which gross premiums are guaranteed over the respective gross premiums, such test premiums and present values being calculated on the Commissioners’ 1980 Standard Ordinary Mortality Table with Ten-Year Select Mortality Factors and 4 1/2 percent interest. For each plan of insurance with separate rates for smokers and nonsmokers an insurer may substitute the 1980 CSO Smoker and Nonsmoker Mortality Tables with Ten-Year Select Mortality Factors for the Commissioners’ 1980 Standard Ordinary Mortality Table with Ten-Year Select Mortality Factors.

In case a future gross premium exceeds the test premium, the excess shall be considered zero and not a negative amount. This is in accordance with the principle of anticipating no future profits but providing for all future losses.

**Reinsured Business**

If reinsurance is assumed under an agreement in which the reinsurer reserves the right to raise premiums to a level at least as great as the net valuation premiums, the reinsurer is not required to establish deficiency reserves or additional reserves, and the ceding company is not permitted to take credit for such reserves on the portion of the business which is required.

If a reinsurance agreement guarantees future reinsurance premiums, the reinsurer should establish deficiency reserves and additional reserves as required by this interpretation for the period for which reinsurance premiums are guaranteed, and the ceding company may take credit for such reserves against its deficiency and additional reserves on the portion of the business which is reinsured to the extent permitted by law.
Appendix C

Adequacy of Reserves

Although the above alternative is acceptable as meeting the intent of the Standard Valuation Law, this does not in any way relieve the certifying actuary of the insurance company from exercising his own best judgment with respect to the appropriate reserves. In particular, the actuary should consider term contracts of this nature when he states his opinion that aggregate reserves “make a good and sufficient provision for all unmatured obligations of the company guaranteed under the terms of its policies” and “include provision for all actuarial reserves and related statement items which ought to be established.”

References

2. Ibid., p. 300.
Actuarial Guidelines

Actuarial Guideline V

INTERPRETATION REGARDING ACCEPTABLE APPROXIMATIONS FOR CONTINUOUS FUNCTIONS

Text

For reserves and values using continuous functions:

(a) \[ \overline{D}_x = \int_0^1 D_{x+t} \, dt \]

By assuming that \( D_{x+t} \) is linear for \( 0 < t < 1 \)

\[ \overline{D}_x = (D_x + D_{x+1})/2. \]

By assuming that the deaths in the year of age \( x \) to \( x+1 \) are uniformly distributed over that year of age,

\[ \overline{D}_x = [(\delta-d)/\delta^2]D_x + [(i-\delta)/\delta^2]D_{x+1} \]

where: \( d = iv = i/(1+i) \)

\( \delta = \) force of interest

\( i = \) interest rate

(b) \[ \overline{C}_x = \int_0^1 D_{x+t} \mu_{x+t} \, dt \]

By assuming that deaths in the year of age \( x \) to \( x+1 \) are uniformly distributed over that year of age,

\[ \overline{C}_x = (i/\delta)C_x. \]

By assuming that the total deaths are concentrated at the middle of the year of age,

\[ \overline{C}_x = (1+i)^{1/2}C_x \text{ or } (1+i/2)C_x. \]

Background Material

The actuarial mathematics used in calculating net premiums, reserves, and nonforfeiture values for life insurance policies was first developed using two basic assumptions. These basic assumptions are: (1) that all death benefits are payable at the end of the policy year of death and (2) that all gross premiums due under the policy are payable annually at the beginning of the policy year. Actuarial values which are calculated under these two basic assumptions are described as being calculated using curtate functions. For any specific mortality table and interest rate, all the necessary actuarial values are uniquely defined for a policy using curtate functions.

The Standard Valuation Law and the Standard Nonforfeiture Law define minimum reserves and minimum nonforfeiture values, respectively, for life insurance policies using curtate functions. These two model laws originated in the early 1940s when almost all insurance companies were using the two basic
assumptions inherent in the curtate functions. However, the wording of the model laws does not prohibit insurance companies from using other assumptions if the resulting reserves and nonforfeiture values will always be at least as large as the minimum amounts defined in these laws.

Nowadays, many insurance companies do prefer to use alternative assumptions in computing the reserves and nonforfeiture values for their life insurance policies. These companies consider the alternative assumptions more appropriate for their policies. These alternative assumptions are: (1) that all death benefits are payable immediately upon death and (2) that all gross premiums due under the policy are payable continuously throughout the policy year.

Actuarial values which are calculated under both of the alternative assumptions, pertaining to death benefits and gross premiums, are described as being calculated using continuous functions. However, the underlying mathematics for continuous functions involves two integrals, representing the actuarial functions $C_x$ and $D_x$, which must be approximated. In the past, there has been some disagreement among actuaries as to which approximations for the two integrals are the most suitable. Because of the use of different approximations for these two integrals, actuaries have obtained different numerical amounts for the necessary actuarial values using continuous functions even though these actuaries were working with the same mortality table and interest rate.

Some insurance companies prefer to calculate their reserves and nonforfeiture values assuming: (1) that death benefits are payable immediately upon death and (2) that all gross premiums due under the policy are payable annually at the beginning of the policy year. Thus, these companies are using the alternative assumption pertaining to death benefits and the basic assumption pertaining to gross premiums. The underlying mathematics for the combination of these two assumptions involves the integral $C_x$, which must be approximated. Thus, the use of these two assumptions together gives rise to essentially the same problem as using continuous functions.
INTERPRETATION REGARDING USE OF SINGLE LIFE OR JOINT LIFE MORTALITY TABLES

DRAFT 20 JUNE 1983

The Standard Valuation Law and the Standard Nonforfeiture Law for Life Insurance apply to policies which provide joint life insurance benefits as well as to policies which provide single life insurance benefits. References in these laws to plans such as “nineteen-year premium whole life” or “a whole life policy...with uniform premiums for the whole of life” are to be interpreted as references to such plans based on the same life status(es) as the policy for which minimum reserves or nonforfeiture benefits are being determined. For example, if the net level annual premium on the nineteen-year premium whole life plan is needed to calculate the minimum reserve for a policy which insures two lives and pays a death benefit at the first death, the premium is to be that for a policy which insures two lives and pays a benefit at the first death. The same principle would apply to a policy which insures only one life, or a policy which pays a benefit at the first death of more than two lives. The principle also applies to a policy that pays a benefit on the death of t-th life of n lives (t is greater than 1 but less than or equal to n).

Background Material

The great majority of life insurance policies provide single life insurance benefits. These policies identify one specific individual as the named insured. A death benefit under the basic policy is payable if this named insured dies while the policy is in force. Usually, there are no further gross premiums due on and after the death of this named insured. The basic policy may provide endowment benefits which are conditional on the survival of this named insured. The policy does not contain any provisions whereby the amount of the death benefits, endowment benefits or gross premiums are affected by the survival or nonsurvival of any other persons besides the insured, except possibly in the settlement option provisions or in the provisions of an attached term insurance rider which requires an extra premium.

In contrast to policies which provide single life insurance benefits, policies which provide joint life insurance benefits depend on the survival or nonsurvival of two or more named insureds. Until quite recently, virtually all policies which provided joint life insurance benefits were written on the whole life insurance plan. Such policies paid the face amount as a death benefit on the death of the first of the named insureds to die, provided that the policy was then in full force. No further gross premiums were due after the death, and the policy terminated upon payment of the death benefit.

Recently, there has been increasing interest in plans providing joint life insurance benefits, and insurance companies have developed a variety of new life insurance plans. For example, some policies provide for payment of a death benefit only on the death of the last to die of the named insureds.

The Standard Valuation Law and the Standard Nonforfeiture Law clearly apply to policies which provide joint life insurance benefits as well as to policies which provide single life insurance benefits. Both of these model laws define an “expense allowance” which is added to the present value of the future guaranteed insurance benefits under the policy, and which affects the modified premiums used for computing minimum reserves and the adjusted premiums used for computing minimum nonforfeiture values. A different amount of “expense allowance” is defined for nonforfeiture values than that defined for reserves, but the principle is much the same.

Insurance companies are allowed to select “expense allowances” for use in computing their reserves and nonforfeiture values up to the level of the “expense allowances” defined in these model laws. A higher “expense allowance” would produce reserves or nonforfeiture values which are less than the minimum defined in the model laws, and therefore state insurance departments cannot permit companies to use a higher amount as an “expense allowance.”
Appendix C

The wording of these model laws is generally clear and precise in defining the “expense allowances” which are permitted for policies which provide single life benefits. However, the proper level of the “expense allowances” for policies providing joint life insurance benefits is not so clear. The “expense allowance” defined in the Standard Valuation Law depends on the modified net premium for a policy on the 20-payment whole life insurance plan, and the “expense allowance” defined in the Standard Nonforfeiture Law depends on the adjusted premium for a policy on the ordinary life plan.

Actuaries have had different opinions as to how to apply the joint life insurance mortality tables in order to obtain the modified net premium and the adjusted premium required by model laws, so as to calculate the “expense allowances” which are appropriate under those laws. The question has become increasingly important with the development of the new plans providing joint life insurance benefits.
Actuarial Guidelines

Actuarial Guideline VII

INTERPRETATION REGARDING CALCULATION OF EQUIVALENT LEVEL AMOUNTS

Text

Pure endowments will not be considered in the determination of equivalent level amounts for valuation and nonforfeiture purposes.

Background Material

The “Background Material” section relating to the previous actuarial guideline went into some detail concerning the “expense allowances” defined in the Standard Valuation Law and the Standard Nonforfeiture Law. See Actuarial Guideline VI, “Interpretation Regarding Use of Joint Life Insurance Tables.”

This Actuarial Guideline VII is also concerned with the level of these “expense allowances” defined in these model laws. The most common plans of life insurance provide a level face amount as the death benefit, during the period the policy is in full force. These plans do not provide for any benefit which is payable as a pure endowment. (A pure endowment benefit pays a specified amount of pure endowment to the policyholder if the insured is still alive on the specified maturity date and if the policy is still in full force on this maturity date.) However, policies which provide for a death benefit which varies with the duration and policies which provide one or more endowment benefits can be legally written in most states.

The Standard Valuation Law and the Standard Nonforfeiture Law do apply to such policies with varying death benefits or pure endowment benefits. In fact, the wording of the model laws shows that considerable thought was given to the treatment of these kinds of policies. In the case of both model laws, the present value of future guaranteed benefits under the policy clearly includes both the death benefits and the “expense allowances” defined under these model laws.

The Standard Nonforfeiture Law includes a paragraph which reads as follows:

In the case of a policy providing an amount of insurance varying with duration of the policy, the equivalent uniform amount thereof for the purpose of this Section shall be deemed to be the uniform amount of insurance provided by an otherwise similar policy, containing the same endowment benefit or benefits, if any, issued at the same age and for the same term, the amount of which does not vary with duration and the benefits under which have the same present value at the date of issue as the benefits under the policy; provided, however, that in the case of a policy providing a varying amount of insurance issued on the life of a child under age ten, the equivalent uniform amount may be computed as though the amount of insurance provided by the policy prior to the attainment of age ten were the amount provided by such policy at age ten.

While the wording of the above paragraph is rather complex, the meaning seems to be actuarially precise. The paragraph defines an “equivalent uniform amount” which affects the “expense allowance” defined in the law. The phrase “containing the same endowment benefit or benefits, if any” effectively means that pure endowment benefits are to be ignored in computing this “equivalent uniform amount.” This “equivalent uniform amount” or “equivalent level amount” becomes a sort of weighted average of the death benefits provided by the policy, an average which is not affected in any way by the pure endowment benefits which may be provided by the policy.

The Standard Valuation Law is not nearly so clear on this point. It contains wording as follows:

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Reserves according to the Commissioners Reserve Valuation Method for (1) life insurance policies providing for a varying amount of insurance—shall be calculated by a method consistent with the principles of the preceding paragraph—.

(Note that the quoted wording refers back to the preceding paragraph in the Standard Valuation Law. It does not intend to refer to the paragraph quoted from the Standard Nonforfeiture Law.)

Most actuaries have interpreted the Standard Valuation Law so as to use an “equivalent level amount” which is not affected by any pure endowments included in the policy. They would then use this “equivalent level amount” to calculate the “expense allowance” defined in the model law. This “equivalent level amount” is also a weighted average of the death benefits provided by the policy, in the same fashion as the “equivalent uniform amount” used in applying the Standard Nonforfeiture Law. Some insurance companies use the same “equivalent level amount,” for the purpose of the Standard Valuation Law, as the “equivalent uniform amount” defined in the Standard Nonforfeiture Law. Other companies use a very similar calculation to obtain a special “equivalent level amount,” for the purpose of the Standard Valuation Law, based only on the death benefits provided on and after the first policy anniversary.

Some actuaries have felt that the wording of the Standard Valuation Law permits an alternate calculation of the “equivalent level amount” which would be affected by pure endowment benefits. Such an “equivalent level amount” would be used to calculate an “expense allowance” under the Standard Valuation Law, even though the “equivalent level amount” no longer has the character of a weighted average of the death benefits provided by the policy.

The inclusion of the pure endowment benefits in the calculation of the “equivalent level amount” would affect the level of the “expense allowance” defined in the Standard Valuation Law, and therefore, it would affect the level of the minimum reserves required by the policy. Typically, the denominator of the fraction used in calculating the “equivalent level amount” would remain the same, but the numerator of this fraction would be increased because of this inclusion. Thus, the “equivalent level amount” itself and the resulting “expense allowance” defined in the Standard Valuation Law would also be increased with the inclusion. The end result of the inclusion would be lower minimum reserves at every duration.

If the amounts and maturity dates of the new pure endowment benefits were carefully selected, a considerable degree of reduction in the reserve factors would probably be possible.

This actuarial guideline would expressly prohibit including the pure endowment benefits in determining the “equivalent level amount” for either valuation or nonforfeiture purposes. As explained under “Background,” the need for this actuarial guideline arises primarily for valuation purposes under the Standard Valuation Law. The wording of the Standard Nonforfeiture Law is sufficiently precise that this actuarial guideline is virtually a truism for the purpose of calculating nonforfeiture values.

The purpose of this actuarial guideline is to assist state insurance departments and insurance company actuaries by identifying a method of calculating “equivalent uniform amounts” and “expense allowances” which is not considered proper and which will not be accepted.
Actuarial Guidelines

Actuarial Guideline VIII

THE VALUATION OF INDIVIDUAL SINGLE PREMIUM DEFERRED ANNUITIES

Text

With respect to those states which have enacted the 1976 amendments to the Standard Valuation Law; individual single premium deferred annuity reserves shall at least equal the greatest of any of the discounted values of all guaranteed future benefits including cash surrender values available after the date of valuation, such benefits discounted to the valuation date at the maximum permissible statutory interest rate. This method applies to all individual single premium deferred annuities which are subject to the provisions of the Standard Valuation Law in those states which have enacted the 1976 amendments. For those states which have not yet enacted the 1976 amendments this interpretation is a method of valuing individual single premium deferred annuities.
Appendix C

Actuarial Guideline IX

FORM CLASSIFICATION OF INDIVIDUAL SINGLE PREMIUM IMMEDIATE
ANNUITIES FOR APPLICATION OF THE VALUATION AND NONFORFEITURE LAWS

Text

Solely for the purposes of the applicable Valuation and Nonforfeiture Laws, an individual single premium annuity shall be considered to be immediate, as opposed to deferred, provided:

1. The first annuity payment is due not more than thirteen months from the annuity issue date;

2. succeeding payments under the annuity, after the initial payment, are due at regular intervals no less frequently than annually;

3. in the case of a fixed benefit annuity, the total guaranteed payments due in any contract year are not greater than 115% of the total guaranteed payments due in the immediately preceding contract year. In the case of variable annuities and indexed annuities, the same characteristic would be required for the underlying pattern of payments, before adjustments which are made solely because of the performance of the separate account associated with a variable annuity or the changes in the associated index. (This characteristic is not intended to prevent or reduce any lawful nonguaranteed payments under the annuity which are in the nature of dividends or excess interest credits.)
Actuarial Guidelines

Actuarial Guideline IX-A

USE OF SUBSTANDARD ANNUITY MORTALITY TABLES IN VALUING IMPAIRED LIVES UNDER STRUCTURED SETTLEMENTS

Text

The Standard Valuation Law permits modifications of annuity mortality tables. Solely for the purpose of valuing:

1. Periodic benefits arising from settlements of various forms of claims pertaining to court settlements or out of court settlements from tort actions, such as arising from accidents or medical malpractice;
2. Settlements involving similar action such as workers’ compensation; or
3. Settlements of long term disability claims where a temporary or life annuity has been used in lieu of continuing disability payments.

A substandard annuity mortality table may be used where the annuitant (or measuring life) is the injured party and there are relevant hospital records, treating physicians’ reports, and/or independent medical evaluations from those medical doctors that are or have been involved in the care of the injured party, that have been used during the underwriting process and have been retained in the underwriting file of the company as proof of the individual’s impaired health and shortened longevity.

In such case the insurer may modify the statutory annuity mortality table or tables cited in Section 3a of the Standard Valuation Law or in any regulation promulgated pursuant to such section so as to reflect the longevity based on a medical doctor’s written evaluation or records as indicated above. The table may be modified by a percentage of standard mortality or by a specified number of extra deaths or by a combination thereof, provided that the mortality table so adjusted produces reserves that are at least as great as the minimum reserves indicated below. The percentage extra mortality or the specified number of extra deaths may vary by duration. A rated up age with the standard annuity table which is approximately equivalent to the actual age on the substandard annuity table may be used only if the procedure is modified to produce reserves that at each duration are at least as great as the minimum reserves indicated below.

The fact that a company has held minimum reserves as herein described shall in no way relieve the actuary from considering whether such reserves are adequate.

Minimum Reserves

The minimum reserves for applicable annuity contracts are the reserves obtained by making a constant addition to the mortality rate of the otherwise applicable valuation mortality table such that the expectation of life on the adjusted valuation table is greater than or equal to the average of the expectations of life indicated by or obtained from information given by the company’s medical directors or underwriters during the underwriting and pricing process. The constant addition to the mortality table herein described shall be made as of the issue date and, once determined, held constant for the period of time that the contract remains in force. The addition of a constant to the valuation mortality rate produces a gradually declining percentage extra mortality such that reserves will grade into standard reserves at the end of the standard valuation mortality table thereby making the reserve more conservative (closer to standard) each year that the annuitant or measuring life lives.

For annuitants (measuring lives) other than the injured person in such settlements, the actual age and a standard annuity mortality table specified in Section 3A of the Standard Valuation Law or in any
subsequent regulation promulgated thereto or any modification of such table which produces reserves at least as high as those that would be produced under the standard table based on the actual age must be used.

For contracts not included in one of the three categories described in the first paragraph of the Guideline, standard reserves at the actual age shall be held.

Where an insurer uses a modified table with higher mortality rates or a rated age with an unmodified table for impaired lives under structured settlements, such insurer shall maintain records of actual to expected mortality to monitor the appropriateness of the substandard mortality.

Background

Structured settlements take their name from the fact that the settlements, which arise from tort action, including workers’ compensation claims, are frequently structured to fit the circumstances of the injured party and/or the injured party’s dependents. The injured party and/or dependents are apt to be much younger than normal retirement age such that the payments may well stretch out for 30, 40, and 50 years or more. Some payments are certain; others are contingent upon the measuring life being alive at the time of payment.

The volume of structured settlement business has boomed in recent years. Periodic and deferred payments have been encouraged and even mandated in some states as a means of controlling costs under malpractice claims and ensuring that the monies would be available in future years and not squandered as could happen with lump sum payments. Periodic and deferred payments may be a result of settlement of automobile claims, other accidents involving tort action, as well as workers’ compensation claims and medical malpractice claims, where the individual(s) upon which the tort or other action was based may well be substandard.

At the time of the adoption of the NAIC 1980 revisions of the Standard Valuation Law (SVL), structured settlement business was relatively minor, and how to treat such business was not explicitly covered in the SVL.

The SVL allows for modification of the standard annuity mortality table specified in the minimum valuation standard. Any modification had traditionally been such as to result in higher reserves. If lower reserves were produced, it could render the minimum meaningless.

In case of structured settlements, the injured party may be highly substandard. If an insurance company had to set up reserves on a standard table, or on a basis that grades into standard mortality too rapidly, it could result in either an excessive price for the payments or it could result in such a level of surplus strain to the insurer. If the price reflects the actual expected mortality, that the coverage might not be offered at all. To encourage settlements involving periodic payments, it is recommended that, in the limited area involving the injured party, the table may be modified so as to reflect the expected mortality based on the relevant medical records, reports and/or evaluations described earlier.

Since this is an area with little experience, it is required that an insurer monitor the experience in order to be able to justify its choice of adjusted mortality assumption.

It is recognized that at issue the vast bulk of the liability normally pertains to payments that are certain and not contingent upon survival, since the vast majority of substandard contracts contain a certain period and most of the benefits either fall within that certain period or are guaranteed to be paid. It is also noted that the interest discount factor in the early durations is far more important than the mortality element. The selection of the interest discount factor is the subject of Guideline IX-B.
Because experience and methodology are still emerging for substandard annuities, it is expected that this whole subject will be reviewed again in the not too distant future, both as it applies to whether the criteria herein established for settlement annuities are too conservative and also whether or how it might be acceptable to apply similar standards to substandard non-settlement annuities.

Effective Date

Where the requirements of this Guideline produce higher reserves than those calculated by an insurer, such insurer may continue its present procedures for the 1989 year end valuation, but must comply with this Guideline for 1990 and later issues for the 1990 and later valuations and for all of its business by the 1993 year end valuation.
**Actuarial Guideline IX-B**

**CLARIFICATION OF METHODS UNDER STANDARD VALUATION LAW FOR INDIVIDUAL SINGLE PREMIUM IMMEDIATE ANNUITIES, ANY DEFERRED PAYMENTS ASSOCIATED THEREWITH, SOME DEFERRED ANNUITIES, AND STRUCTURED SETTLEMENTS CONTRACTS**

**Text**

1. Solely for the purpose of applying the Standard Valuation Law, an annuity shall be considered as a series of payments not less frequently than annually over five years or more wherein the payments in any one contract or calendar year (at the option of the insurer) do not exceed 115% of the payments in the immediately preceding contract or calendar year. An immediate annuity is an annuity wherein the first payment begins in thirteen months or less from issue and a deferred annuity is an annuity wherein the first payment begins more than thirteen months after issue. A series of payments over less than five years otherwise qualifying as an annuity shall be considered equivalent to a lump sum. Any payments in a year in excess of 115% of the prior year’s payments may be considered as a lump sum or equivalent thereto or may be considered as part of a new annuity depending on the circumstances. Some contracts may consist of combinations of annuities and of lump sums.

2. Where the deferred income payments are guaranteed and there are no cash settlement options, the reserve shall be based on the present value of the income payments based on an appropriate annuity mortality table and the valuation rate of interest in accordance with the Standard Valuation Law based on the issue year method and a guarantee duration equal to the number of years from the date of issue to the date the first payment begins.

3. At the time benefit payments begin, whether under single premium immediate annuity contracts, supplementary contracts providing for annuity payments or deferred annuity contracts (with the first payment deferred more than thirteen months), the insurer may use the valuation interest rate for the calendar year in which (a) the deferred contract was issued or (b) the consideration was received or (c) the payments begin, but must apply such procedure elected in a consistent manner.

4. Individual structured settlements vary considerably in payment pattern and duration. These contracts may provide for both level and/or increasing periodic payment schedules, as well as lump sum benefit payments. In valuing individual structured settlements, a split of all or a portion of the lump sum payments from the annuity payments may be appropriate. Such splits should be at the discretion of the valuation actuary. However, splits not in accordance with (5)(a) or (5)(b) and with (6)(a) below would require valuation in accordance with procedure (6)(b) or (6)(c) below.

5. For a block of single premium immediate annuities, deferred annuities without cash settlement options, structured settlement business with the annuity portion having no cash settlement options, or other contracts having some portion with periodic payments without cash settlement options, issued in a given calendar year, the calendar year valuation interest rate appropriate for single premium immediate annuities where the first payment begins in thirteen months or less after issue and for Plan Type A contracts without cash settlement options based on the date to first payment where the first payment begins more than thirteen months after issue may be used provided:

   a. The guaranteed payment under each contract in the block due in any contract or calendar year (at the option of the insurer) after the first is not greater than 115% of the guaranteed payment due in the immediately preceding contract or calendar year, and once payments
begin such payments are not less frequent than annually and are payable over five years or more; or

b. The total guaranteed payments under all contracts combined included in the block due in any calendar year after the first are not greater than 110% of the total guaranteed payments due in the immediately preceding calendar year but only contracts having payments not less frequent than annually for at least five years shall be included.

The year to year comparison of benefits may be made before or after considering the effect of mortality or any certain period, but the actuary should be prepared to indicate which method is used.

6. If a block of immediate annuities, deferred annuities without cash settlement options, structured settlement contracts with the annuity portion having no cash settlement options, or other contracts having some portion with periodic payments without cash settlement options fails the test described in (5) above, then one of the following procedures must be used:

a. The block must be divided into components so that the contracts/payments satisfying the tests are included in one or more components and those not satisfying the tests are included in another component or other components. The Plan Type A valuation interest rate or rates may be used for the component or components which satisfies the test. The Plan Type A guarantee duration is the number of years from the date of issue or date of purchase to the date that the first annuity payment is due. The maximum valuation interest rate for any payment included in a component which does not satisfy the test shall be determined using the guarantee duration of the lump sum payment including installments over less than five years and on the assumption that the payment is made under a contract of Plan Type A. The Plan Type A guarantee duration of a lump sum payment is the number of years from the date of issue or date of purchase to the date that payment or the first installment payment is due. Year of issue valuation interest factors must be used. The actuary should be prepared to describe the components and justify the choice of valuation interest rate or rates for the component or components of the block which, if included, would cause the block to fail the test.

b. The reserves for each contract for each valuation year shall be the greater of the “level interest rate reserves” and of the “graded interest rate reserves.” Graded interest rate reserve factors for each separate year of issue for all future payments of such year of issue, whether periodic or lump sum payments, shall be graded in a manner that produces reserves at least as great as the method described in the balance of this paragraph.

(i) Step one, calculate the present value of future benefits at issue for each contract using the appropriate level Plan Type A interest rate for contracts without cash settlement options for the guarantee duration corresponding to the number of years from the date of issue or date of purchase to the date that the first payment is due. Call this value PV (0), and call reserves at successive durations using the appropriate (level) Plan Type A interest rate “level interest rate reserves.”

(ii) Step two, solve for “X percent” such that the present value of future benefits at issue for each contract is equal to PV (0) (calculated in Step one), using “X percent” as the valuation interest rate for the first twenty contract years after issue and thereafter the Type A interest rate for contracts without cash settlement options for guarantee durations of more than twenty years. However, “X percent” shall not be greater than 115% of the appropriate Type A interest rate in step one; where such limit is effective, the present value at issue will be greater than PV (0).
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(iii) For each valuation year calculate “graded interest rate reserves” based on the assumption that the valuation interest rate during the first twenty contract years is “X percent” as calculated in step two and thereafter is the Plan Type A interest rate for contracts without cash settlement options for guarantee durations of more than twenty years.

(iv) In lieu of the individual contract valuation above, a group valuation may be made as for example on the assumption that all contracts issued during a given year are issued as a single contract on July 1, and once X% is determined for such year, it need not be redetermined; or

c. Any other method producing reserves at least as great as (a) or (b) and specifically approved by the Commissioner.

7. Where the requirements of this guideline produce higher reserves than those calculated by an insurer in good faith based on a more liberal interpretation, such insurer may continue its present procedures for the 1989 year end valuation but must comply with this guideline for 1990 and later issues for the 1990 and later year end valuations and for all its inforce, subject to the 1980 amendments to the NAIC Model Standard Valuation Law, by the 1993 year-end valuation.

8. The examiner should request that the insurer demonstrate that the assets are sufficient for the liabilities by cash flow projections of the supporting assets and the liabilities under various interest scenarios, in particular for declining interest rates.

9. The examiner should note that date of acquisition and the yields of the supporting assets and compare such with the date of issue of the structured settlements and the valuation interest rates. If such differ, the examiner may request a new valuation using the date of acquisition of the majority of the supporting assets as the date of issue of remaining payments. This is especially important where, for example, an insurer during 1986 exchanged high yielding assets originally acquired in 1982 for low yielding assets acquired in 1986. Also, many of the high yielding assets may have been called during 1986. Also, due to the long-term nature, often as many as 30, 40, and 50 years, the increasing nature of the payments and the lump sum payments, the value of future payments with a single fixed interest rate may actually increase after issue. The result is that there is a large reinvestment risk and large liabilities may exist after all the original supporting investments have matured and new investments acquired.

10. The procedures above are interim procedures pending a reconstitution of the valuation laws.

Background

Current Actuarial Guideline IX provides guidance for determining what is an immediate annuity but it does not advise how contracts failing to meet the test should be treated for valuation purposes. Three examples of failing contracts are: (1) annual payments increasing 120% each year, (2) level payments payable biannually, (3) level annual payments with extra lump sum payments equal to four times a regular annual payment payable every five years. These examples are not practical examples for annuity payments beginning at normal retirement ages such as 60, 65 or 70 under individual or group retirement programs, but combinations of irregular payments and increasing regular payments are practical under structured settlements.

At the time of the adoption of the NAIC 1980 revisions of the Standard Valuation Law, structured settlement business was relatively minor, and how to treat such business was not explicitly covered in the SVL. The volume of structured settlement business has boomed in recent years. Periodic and deferred payout was encouraged and even mandated in some states as a means of controlling costs under malpractice claims and ensuring that the monies would be available in future years and not squandered as
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could happen with lump sum payments. Periodic and deferred payments may result in settlement on automobile claims, other accidents involving tort action as well as medical malpractice claims and workers’ compensation claims such that the individuals may well be substandard.

Where payments are contingent on the individual being alive, under a related guideline, substandard annuity mortality tables may be recognized for valuation based on a written evaluation of the injured individual’s longevity by a medical doctor. For all other annuitants, substandard annuity mortality tables should not be recognized as such is contrary to the establishment of minimum reserves for such annuitants. However, the vast bulk of reserves for structured settlements is based on certain payments, such that the valuation interest rate is by far the more important factor. This guideline covers valuation procedures and valuation interest rates leaving application of substandard annuity mortality table to Guideline IX-A.

Structured settlements take their name from the fact that the settlements are frequently structured to fit the circumstances of the injured party and/or the injured party’s dependents. The injured party and/or dependents are apt to be much younger than normal retirement age such that the payments may well stretch out for 30, 40, and 50 years or more. Lump sum payments may be scheduled to coincide with particular events such as college for dependent children.

The 1980 changes in the SVL initiated a set of valuation interest factors for each year of issue so as to roughly have the factor correspond to the investment rates at the time at which monies are received and invested. In 1980 the emphasis in the dynamic valuation interest rate was on the valuation interest rates for group guaranteed interest contracts (GIC). Group GIC’s generally have had a guaranteed interest period of 5-10 years with a lump sum available at the end of the period. Any renewal of an interest guarantee and period is generally considered as a new issue for valuation purposes, whether the year of issue or the change in fund method is used.

Most retirement annuities under individual or group programs had level or slightly increasing payments with payments beginning at age 60, 65 or 70, such that for annuities in course of payments, there should be little reinvestment risk and reserves should decrease.

There is a large reinvestment risk in case of structured settlements. There is also a risk that the original assets may be called or exchanged for lower yielding assets.

Guideline IX-B would split up the contract and treat that portion of the payments meeting the test as an annuity and any excess payments separately for purposes of determining the appropriate valuation interest factors based on the duration to first payment of such excess. The guideline also offers a new dual interest procedure as an alternative to splitting the payments.

The guideline recognizes that the use of the statutory formulae with the rates determined based on the date of purchase may be inappropriate where the assets have been exchanged or acquired in later years. It is suggested that the examiner may wish to adjust the issue year for selection of the valuation interest factors so as to make them consistent with the date of investment.

It is recognized that these procedures for determining statutory formulae reserves are only temporary while the Special Committee on Valuation is developing a new statutory formula to go along with a valuation of liabilities based on the supporting assets and the actuary’s best judgment to account for reasonable deviations.
Appendix C

Actuarial Guideline IX-C

USE OF SUBSTANDARD ANNUITY MORTALITY TABLES IN VALUING IMPAIRED LIVES UNDER INDIVIDUAL SINGLE PREMIUM IMMEDIATE ANNUITIES

The NAIC model Standard Valuation Law, Section 4a, A(2), permits modifications of annuity mortality tables approved by the commissioner. In states which have adopted this or similar Standard Valuation Law language, this guideline provides for modifications of annuity mortality tables solely for the purpose of valuing:

Individual single premium immediate annuities not covered by Guideline IX-A, but for which medical records indicate the expectation of life has been reduced and for which the premium charged reflects such reduction,

a substandard annuity mortality table may be used where the annuitant (or measuring life) has relevant hospital records, treating physicians' reports, and/or independent medical evaluations from those medical doctors that have been used during the underwriting process and have been retained in the underwriting file of the company as proof of the individual's impaired health and shortened longevity. The medical assessment must support at least a 25% reduction in the expectation of life (based on either the current valuation table or the company’s pricing table, consistently applied) compared to a normally healthy individual at the same age and gender.

In such case the insurer may modify the statutory annuity mortality table or tables cited in Section 3a of the Standard Valuation Law or in any regulation promulgated pursuant to such section so as to reflect the longevity based on a medical doctor's written evaluation or records as indicated above. The table may be modified by a percentage of standard mortality or by a specified number of extra deaths or by a combination thereof, provided that the mortality table so adjusted produces reserves that are at least as great as the minimum reserves indicated below. The percentage extra mortality or the specified number of extra deaths may vary by duration. A rated up age with the standard annuity table which is approximately equivalent to the actual age on the substandard annuity table may be used only if the procedure is modified to produce reserves that at each duration are at least as great as the minimum reserves indicated below.

The fact that a company has held minimum reserves as herein described shall in no way relieve the actuary from considering whether such reserves are adequate.

Minimum Reserves

The minimum reserves for applicable annuity contracts are the reserves obtained by making a constant addition to the mortality rate of the otherwise applicable valuation mortality table. The amount of the constant addition is determined as follows:

1) Calculate the present value of future benefits at issue for each contract using a rated up age, the applicable valuation mortality table, and the appropriate level Plan Type A interest rate for contracts without cash settlement options. The rated up age must produce an expectation of life under this valuation mortality table whose percent reduction from the actual age expectation of life under this table is not greater than the percent reduction in the expectation of life, supported by the medical assessment above, which qualified the contract to utilize the mortality adjustments provided by this actuarial guideline.

2) Solve for the constant addition to the true age mortality rates such that the present value of future benefits at issue is equal to or greater than the present value obtained in 1). The base mortality table and the valuation interest rate shall be the same as used in 1).
The constant addition to the mortality table herein described shall be made as of the issue date and, once determined, held constant for the period of time that the contract remains in force. The addition of a constant to the valuation mortality rate produces a gradually declining percentage extra mortality such that reserves will grade into standard reserves at the end of the standard valuation mortality table thereby making the reserve more conservative (closer to standard) each year that the annuitant or measuring life lives.

Where an insurer uses a modified table with higher mortality rates or a rated age with an unmodified table for impaired lives under individual single premium immediate annuities, such insurer shall maintain records of actual to expected mortality to monitor the appropriateness of the substandard mortality. The appointed actuary must comment on the appropriateness of the substandard mortality and report any material deviations. Such comments and report should be provided in the actuarial memorandum which supports the annual actuarial opinion.

Background

Guideline IX-A provides a methodology to allow less than a standard reserve to be held at issue for certain kinds of pay-out annuities and for grading the reserve toward standard reserves over the remaining lifetime of the annuitant using the “constant extra death” method (CED). The longer the annuitant lives, the closer reserves get to standard reserves.

Guideline IX-A says, “Because experience and methodology are still emerging for substandard annuities, it is expected that this whole subject will be reviewed again in the not too distant future, both as it applies to whether the criteria herein established for settlement annuities are too conservative and also whether or how it might be acceptable to apply similar standards to substandard non-settlement annuities”.

It has now been almost 11 years since Guideline IX-A was adopted and it appears the industry has done a responsible job of underwriting and valuing substandard annuities covered by Guideline IX-A. Structured settlement mortality studies done by the Society of Actuaries bear this out. (See the 1995-1996 Reports of the Society of Actuaries, starting on page 395.)

Guideline IX-A has been successful in allowing structured settlements to be priced fairly and has benefited injured parties and society in general. There is no evidence that there has been any strain to insurance companies from under reserving due to Guideline IX-A.

For some time, a number of companies have had a significant and increasing opportunity to provide immediate annuities at less than a standard price to a growing number of potential clients not covered by Guideline IX-A. However, the potential price reductions that the industry can give consumers, perhaps 15% to 25% of the single premium on some cases, depending on the benefit stream desired, are greatly reduced because of the current requirement to hold standard reserves. The initial statutory strain (loss) on highly substandard cases can easily exceed 50% or 100% of the single premium, which requires a significantly increased price to the customer over what could be charged if less than standard reserves were permitted. With Guideline IX-A type reserves, the strain might be reduced to something closer to 10%.

The population is aging and the need for fairly priced single premium immediate annuity benefits is substantially increasing. Forcing companies to hold standard reserves results in many people being overcharged (for the extra cost of capital associated with the higher reserve) at a time in their life when they may have the greatest need.

Since this is an area with little experience, it is required that an insurer monitor the experience in order to be able to justify its choice of an adjusted mortality assumption. It is recognized that the initial liability pertains to a large extent to payments that are certain and not contingent upon survival. This is because
the majority of non-settlement substandard contracts contain a certain period and most of the benefits fall within that certain period. It is also noted that the interest discount factor in the early durations is far more important than the mortality element. The selection of the interest discount factor is the subject of Guideline IX-B.

Because the standard annuity valuation table is an aggregate table, there is some concern that carving out the substandard lives may cause the table to be inadequate for the remaining lives. As a result, it is recommended that an individual life have a significant impairment before use of a substandard valuation table is allowed. For this purpose, significant has been defined as a medical condition that reduces the expectation of life of the individual by at least 25% compared to a normal, healthy life. The reasoning is that not very many lives that are significantly substandard (i.e. greater than a 25% reduction in the expectation of life) are contained in the underlying mortality of individual non-settlement annuity mortality tables. Thus, treating them separately will not diminish the adequacy of the standard table. For convenience, either the applicable individual annuity valuation table or the company’s pricing table can be used to measure the change in the expectation of life.

A public policy issue was discussed wherein this actuarial guideline could be viewed as rewarding unhealthy behavior. However, this actuarial guideline would benefit others who were simply unfortunate to be in an impaired condition. It was noted that it would be difficult or impossible to carve out those with intentionally unhealthy behavior. Ultimately it was believed that this actuarial guideline provides for reasonable public policy to facilitate lower single premiums for substandard annuitants.

Effective Date

This Guideline will be effective for contracts issued on or after January 1, 2001.
Text

For contracts which provide cash surrender benefits, the NAIC Model Law prescribes a basis for determination of minimum cash surrender benefits. That law does not require that a company grant additional amounts in excess of the amounts guaranteed in the contract, either in the form of excess interest credits or otherwise. When such additional amounts have been credited to the contract, the question of how the Model Law applies to such amounts must be considered.

Under one interpretation the portion of the maturity values which would arise from such amounts may be discounted to the date of surrender at an interest rate 1% higher than the rate specified in the contract for accumulating such amounts. This interpretation would permit a surrender charge against such amounts on the same basis as the surrender charge which may be applied to the contractually guaranteed portion of the interest credited to the contract.

Under another interpretation such amounts could not be treated as providing a portion of the maturity value and, therefore, would be included in the phrase “any additional amounts credited by the company to the contract.” This interpretation would require that the cash surrender value be increased by 100% of the accrued value of such amounts.

By providing for a surrender charge to be made in determining the minimum cash surrender value, the Model Law enables a company to provide for recovery of all or part of any (1) excess first year expenses not yet recovered, and (2) potential investment losses at surrender. The reason for permitting surrender charges to be made against accumulated amounts of contractually guaranteed interest are equally valid reasons for permitting surrender charges against any non-guaranteed interest credited. If such surrender charges were not permitted, companies offering such contracts may be discouraged from crediting as much additional interest as they might if the additional interest were to contribute to the minimum cash surrender value in the same manner as do the interest amounts derived from the rates guaranteed in the contract.

In view of the above considerations, the following guidelines are recommended:

I. Treatment of Amounts of Excess Interest Credited to Deferred Annuity Contracts

The NAIC Standard Nonforfeiture Law for Individual Deferred Annuities shall be interpreted to permit the portion of the maturity value which would arise from the amounts of interest credited in excess of the minimum rates guaranteed in the contract to be discounted to the date of surrender at an interest rate 1% higher than the rate specified in the contract for accumulating such amounts, provided such excess interest is declared prior to the period for which it is to be effective, and provided such excess interest accrues over the effective period. Amounts of excess interest treated in accordance with the above interpretation shall not be included by the phrase “additional amounts credited by the company to the contract” in Section 6 of the Model Law.

II. Treatment of Dividends Credited to Deferred Annuity Contracts

No single rule can be given for the treatment of dividends credited to deferred annuity contracts. The contractual wording of the applicable dividend option must be taken into account together with the appropriate provisions of the NAIC Standard Nonforfeiture Law for Individual Deferred Annuities.
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If the dividend option in effect provides that dividends be left on deposit at interest, without any further qualification, then the cash surrender value should be increased by the full accumulated amount. In this case, the phrase “increased by any additional amounts credited by the company to the contract” applies and no surrender charge may be made.

In other cases, the dividends may be added, directly or indirectly, to the contractual value and made subject to the surrender charge provision. This would be the case when dividends are applied to purchase additional paid-up benefits or applied as premiums.

Contracts may contain other provisions or variations of these provisions. In such cases, the terms of the contract and the provision of the NAIC Standard Nonforfeiture Law for Individual Deferred Annuities should be taken into account.
Section 5-C of the Standard Nonforfeiture Law for Life Insurance May be Made Operational for One or More Plans at a Time Provided That:

A. Sales are discontinued in this state on all like plans using rates and values generated by past requirements;

B. Sales are discontinued in all other states which have enacted the new legislation on all like plans using rates and values generated by past standards, provided the state of sale has allowed changes to 1980 requirements on a plan-by-plan basis;

C. Once the new law has been made operational for one plan, the new law shall be operational for all subsequent new plans of the same generic form to be marketed in this state unless the insurer can demonstrate to the Commissioner’s satisfaction the need to continue the prior set of requirements;

“Like plans,” as mentioned in Sections A and B, refers to plans with the same benefits, including cash values, and with the same premium paying period and pattern of premiums;

“Generic form,” as mentioned in Section C, refers to generic groups, such as ordinary vs. group, term vs. permanent, flexible cash value vs. fixed cash value, separate account vs. fixed account.
Appendix C

Actuarial Guideline XII

INTERPRETATION REGARDING VALUATION AND NONFORFEITURE INTEREST RATES

ACTUARIAL GUIDELINE XII WAS WITHDRAWN ON MARCH 7, 1993
Preamble

At its December 1976 meeting, the NAIC adopted the Commissioners’ Annuity Reserve Valuation Method (CARVM) and incorporated it in its Model Standard Valuation Law. CARVM is now included in the laws of nearly all of the states. Differences in interpretation of CARVM have developed in practice, particularly on whether and under what conditions surrender charges may be taken into account in determining CARVM reserves. This guideline is intended to clarify which surrender charge factors may be taken into account and which are to be disregarded under CARVM.

Reserves according to CARVM depend in part upon the present values of “future guaranteed benefits, including guaranteed nonforfeiture benefits.” It has always been recognized that this phrase, as used in the NAIC Model Standard Valuation Law, includes cash surrender values based on contractual guarantees after reduction for any contractual surrender charges available to the insurer. This is illustrated in the Proceedings. See Proceedings of the National Association of Insurance Commissioners, Vol. 1 (1977), 538-45.

Guideline

The phrase, “future guaranteed benefits, including guaranteed nonforfeiture benefits,” as used in CARVM include the cash surrender values based on contractual guarantees after reduction for any surrender charges available under the contract.

In recent years, annuity contracts with contingent surrender charges have become more prevalent. For example, a contract may provide the option to surrender without surrender charge if the rate at which interest is credited falls below a specified rate, referred to in this guideline as the “bail-out” rate. Contingent surrender charges may not be available upon cash surrender at future contract anniversaries, and it is not consistent with the conservative nature of CARVM to reduce the value of future guaranteed benefits on account of such contingent surrender charges.

The value of future guaranteed benefits under CARVM may not be reduced by contingent surrender charges which may not be available upon cash surrender.

There may be some contracts with contingent surrender charges with bail-out rates which are so low that it would not be contrary to the conservative intent of CARVM to treat such surrender charges as available. The calendar year statutory valuation interest rate for life insurance policies with guarantee duration in excess of twenty years, which is used in the Standard Valuation Law in connection with the definition of guaranteed duration for most annuities and guaranteed interest contracts, provides an appropriate measure for this purpose. Whether or not such surrender charges should be treated as available should be determined as of December 31, 1984 for contracts in force at the date and as of the date of issue for contracts subsequently issued.

For contracts issued on and after January 1, 1985, contingent surrender charges with bail-out rates less than or equal to the calendar year statutory valuation interest rate for life insurance policies with guarantee duration in excess of twenty years issued in the same year may be treated as available. For contracts issued prior to January 1, 1985, contingent surrender charges with bail-out rates less than or equal to 6.00% (the calendar year statutory valuation interest rate for life insurance policies with guarantee duration in excess of twenty years issued in 1984) may be treated as available.
Appendix C

There are some contracts with contingent surrender charges with bail-out rates which are a function of an external index whose future values are not known. Judgment is required to determine whether or not such surrender charges may be treated as available. Comparison to the calendar year statutory valuation interest rate for life insurance policies with guarantee duration in excess of twenty years may be useful.

For contracts with contingent surrender charges with bail-out rates which are a function of an external index, a judgment as to the availability of the surrender charges may be made by comparing historical values of the function with corresponding values of the calendar year statutory valuation interest rate for life insurance with guarantee duration in excess of twenty years. If the values of the function have generally been less than or equal to the valuation rates, then the surrender charges may be treated as available.

For the purpose of this guideline, in the case of a variable annuity that offers the policyholder a choice of multiple investment options, a surrender charge that may be waived for all the accounts of the contract by reference to one or more of the accounts will be treated as a contingent surrender charge that may not be available upon cash surrender with respect to the entire contract. If no surrender charge is imposed on transfers among the accounts, and the surrender charge may be waived for one account, provided the formula for the availability of the waiver is set at the date of issuance, then the surrender charge will be treated as a contingent surrender charge that may not be available upon cash surrender with respect to the entire contract.

Since this guideline is intended to apply to all contracts in force that are subject to CARVM, its application may work an undue hardship on some insurers who have, on the basis of a good faith interpretation of CARVM, held reserves less than required by this guideline. In cases of severe hardship, state insurance commissioners may wish to permit insurers to conform on a gradual basis.
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Actuarial Guideline XIV

SURVEILLANCE PROCEDURE FOR REVIEW OF THE ACTUARIAL OPINION FOR LIFE AND HEALTH INSURERS

To assist regulators in their responsibility for surveillance of life and health insurers, the NAIC adopts the following interim procedure for use of the Actuarial Opinion to be used until such time as model legislation and/or regulations are adopted and become effective.

1. The regulator should accept Actuarial Opinions only from qualified actuaries. The educational and experience standards established by the American Academy of Actuaries for this purpose offers evidence that an individual is so qualified.

2. The regulator should determine if an opinion is qualified in any respect, or omits items from the outline provided in the Instructions to the Blank. If so, a follow up with the actuary rendering the opinion as to the nature of the qualification or omission is appropriate if the opinion does not provide a satisfactory explanation.

3. The regulator should examine the circumstances where the actuary rendering the opinion differs from the prior actuary, and ascertain the reasons for the change. In some cases the regulator may wish to discuss the change with the current and prior actuaries.

4. The regulator should, if desired, obtain for reviews, documentation supporting the Actuarial Opinion. Except in matters of professional discipline, the regulator’s use of these documents should be considered within the department’s guidelines for confidential information.

5. The regulator may require that the actuary furnish an Actuarial Report supporting the Actuarial Opinion. The report should conform to the standards of the American Academy of Actuaries with respect to Actuarial Reports (Opinion 3 to the Guides to Professional Conduct). It should document the methodology and approach to assumptions used in making the opinions and, additionally, provide specific details in reference to items in 6 through 10 below if such details are required by the regulator.

6. In the Actuarial Report, the actuary providing the opinion should refer to the NAIC Insurance Regulatory Information System (IRIS) ratios, point out ratio values outside the prior year’s range of usual values, and provide explanations for those which are significant.

7. In the Actuarial Report, the actuary providing the opinion should make specific reference to the extent to which the good and sufficient analysis considered all the unmatured obligations of the company, in aggregate, guaranteed under the terms of its policies. (Note: To the extent that the insurer declares guarantees more favorable than those in the policy, such declared guarantees shall be used in the calculation of all the unmatured obligations.)

8. In the Actuarial Report, the actuary providing the opinion should make specific reference as to whether the good and sufficient analysis, with respect to annuities and other products with benefits (guaranteed or non-guaranteed) sensitive to interest rates, considered future insurance and investment cash flows as they would emerge under a reasonable range of future interest rate scenarios, and, if so, what those considerations were.

9. In the Actuarial Report, the actuary providing the opinion should make specific reference as to whether the good and sufficient analysis considered the inter-relationships of assumptions with respect to guaranteed benefit payments, future expenses, policyowner dividends, and post-issue premium or benefit adjustments, especially among persistency, mortality, morbidity, inflation, and interest rates, and, if so, what those considerations were.
10. In the Actuarial Report, the actuary providing the opinion should document the extent to which
the opinion is influenced by a continuing business assumption, and, if the impact is material,
comment on the company’s plan of operations with regard to this assumption as it affects
assumed expenses and interest rates, and future reserve requirements.

11. A review of the documentation obtained in (4) above, undertaken or sponsored by the regulator,
should:

   a. Be done by a qualified reviewer;

   b. Emphasize an examination of the appropriateness of the actuary’s work process,
      methodology, and approach to assumptions.

12. If at any time during the review, the regulator requires more information deemed to be material to
the development of the opinion, the company would be expected to comply with requests for such
information.
ILLUSTRATIONS GUIDELINE FOR VARIABLE LIFE INSURANCE MODEL REGULATION

Any sales illustration shown or furnished in connection with the sale of variable life insurance must conform with the following requirements except that these requirements only apply to the variable portion of contracts with fixed and variable funding options. Item 9 specifically pertains to variable life insurance contracts offering both fixed and variable funding options.

1. The hypothetical interest rates used to illustrate accumulated policy values must be an annual effective gross rate after brokerage expenses and prior to any deduction for taxes, expenses and contract charges.

2. If illustrations of accumulated policy values are shown then for the highest interest rate used, one illustration must be based solely upon guarantees contained in the policy contract being illustrated. (For example, if the illustration includes the effect of mortality charges and administrative charges which are below the guaranteed maximums for such charges, an illustration must be prepared which involves the effect of the maximum charges.)

3. Except for illustrations contained in the prospectus, the pattern of premium payments used in an illustration should be the initial pattern requested by the proposed policyholder at inception or upon changes in face amount requested by the policyholder.

4. If the illustrated policy contract provides for a variety of investment options, the illustration may either use an asset charge which is reasonably representative or use the asset charge of a particular option. The illustration should clearly identify the asset charge and either label it “hypothetical” or identify the fund.

5. The illustration must disclose the transaction charges which will be levied against the contract because of transactions requested in accordance with rights and privileges specified in the policy contract. Any charge for the exercise of a right or privilege upon which the illustration is based must be reflected in the illustrated values. The nature of any other such charges must be disclosed in a clear statement accompanying such illustrations. (For example, a charge to switch from one investment option or death benefit option to another.)

6. A clear statement must be made following the Table of Illustrated Accumulated Policy Values that use of hypothetical investment results does not in any way represent actual results or suggest that such results will be achieved and must indicate that the policy values which actually arise will differ from those shown whenever the actual investment results differ from the hypothetical rates illustrated. Assumptions upon which illustrations are based must be clearly disclosed.

7. Any sales illustration to a prospective policyholder must reflect the policy being presented accurately. Misleading statements or captions or other misrepresentations are prohibited.

8. The requested sales illustration must be printed clearly and legibly on hard paper copy. An illustration displayed on a computer screen may be used in addition to, but not as a substitute for, hard paper copy.

9. In connection with variable life insurance contracts offering both fixed and variable funding options:
   a. An illustration of the variable funding option must comply with these guidelines;
Appendix C

b. If an illustration of the fixed funding option is shown, accumulated policy values must be shown on the basis of guaranteed rates. One or more additional rates may also be shown but such rates may not exceed current rates;

c. A summary illustration may be given in which results from comparable illustrated and hypothetical interest rates are combined. Such summary must cross-reference to the accompanying separate illustrations of the fixed and variable funding options.

10. Nothing herein shall prohibit the distribution to the prospective policyholder of illustrations in addition to those required by Article VII of the NAIC Model Variable Life Insurance Regulation provided that, except for Item 3 which shall only apply to required illustrations under Article VII, such additional illustrations comply with the standards set forth herein.
Text

When CRVM reserves are being calculated, it is necessary to determine the value of $19P_{x+1}$. The Standard Valuation Law permits the use of Select Mortality Factors with the 1980 CSO Table. While the maximum valuation interest rate for any policy is level for all durations, the law permits the use of other interest rates as long as the resulting reserves are not less than those according to the minimum standard. Thus, it is possible to calculate reserves by the CRVM method using split interest rates, i.e., interest rates that are not the same at all durations.

When either Select Mortality Factors or split interest are involved, the “net level annual premium on the nineteen-year premium whole life plan” is the renewal net level premium for a 20-payment life valued on the full preliminary term basis. That is $19P_{[x]+1}$ should be used instead of, for example, $19P_{[x+1]}$.

Background Information:

The Report of the Society of Actuaries Committee on Specifications for Monetary Values - 1980 CSO Tables recommended this approach. This Report was accepted by the Board of Governors of the Society and forwarded to the NAIC early in 1984. This approach is logical because it is consistent with the calculation of the “net level annual premium equal to the present value, at the date of issue, of such benefits provided for after the first policy year, divided by the present value, at the date of issue, of an annuity of one per annum payable on the first and each subsequent anniversary of such policy on which a premium falls due.....” (See Section 4 of the Standard Valuation Law, emphasis added.)
Actuarial Guideline XVII

CALCULATION OF CRVM RESERVES WHEN DEATH BENEFITS ARE NOT LEVEL

Text

In the definition of the Commissioners’ Reserve Valuation Method, the Standard Valuation Law (Section 4) refers to the “net level annual premium on the nineteen-year premium whole life plan for insurance of the same amount....” The law does not define “the same amount” for cases when death benefits are not level. For policies issued after the operative date of Section 5-c of the Standard Nonforfeiture Law for Life Insurance (Section 5-c provides for the use of the 1980 CSO Table, among other things) “the same amount” is to be taken as the renewal nine-year arithmetic average, i.e., the arithmetic average of the death benefit at the beginning of each of policy years 2 through 10, inclusive.

Background Information

The Report of the Society of Actuaries Committee recommended this approach. Walter O. Menge in his paper Commissioners Reserve Valuation Method, RAIA XXXV (see p 277ff, especially p 283), defined an “equivalent level renewal amount” which has been accepted and still is the appropriate function for policies issued before the operative date of Section 5-c of the Standard Nonforfeiture Law for Life Insurance. The Society Committee indicated that the strongest factor that weighed in its conclusion was the effect on reserves for such plans as jumping juvenile. Menge noted the similarity between his definition of “equivalent level renewal amount” and the definition of “equivalent uniform amount” in Section 5 of the Standard Nonforfeiture Law for Life Insurance. In the same way, the function prescribed above is consistent with the “average amount of insurance” in Section 5-c of the Standard Nonforfeiture Law for Life Insurance. A principal reason for the change in the Standard Nonforfeiture Law was to simplify calculations, and this guideline will also have that result.
CALCULATION OF CRVM RESERVES ON SEMI-CONTINUOUS, FULLY CONTINUOUS OR DISCOUNTED CONTINUOUS BASIS

Text

The Standard Valuation Law uses the “excess of (a) over (b)” in the definition of the modified net premiums in Section 4. If reserves are calculated on a basis other than curtate, i.e., using semi-continuous, fully continuous or discounted continuous functions, the excess of (a) over (b) may be calculated using the same basis (semi-continuous, etc.).

Background Information

The Report of the Society of Actuaries Committee recommended this approach. The excess of (a) over (b) is sometimes referred to as the initial expense allowance. Basing this expense allowance on curtate functions is conservative as this results in the smallest amount of expense allowance. Also, the expense allowance is the same regardless of which type of functions are used. On the other hand, the use of curtate functions when the basic calculation is based on other functions can result in complications in calculation. The difference in the resulting reserves does not justify the additional complication.
Appendix C

Actuarial Guideline XIX

1980 CSO MORTALITY TABLE WITH TEN-YEAR SELECT MORTALITY FACTORS

Text

The Standard Valuation Law and the Standard Nonforfeiture Law for Life Insurance make reference to the Commissioners’ 1980 Standard Ordinary Mortality Table with Ten-Year Select Mortality Factors. The Ten-Year Select Mortality Factors referred to are those developed by the Society of Actuaries Special Committee to Recommend New Mortality tables for Valuation (see Report on p. 617ff and table of Ten-Year Select Mortality Factors on p. 669 of TSA XXXIII).

The NAIC model regulation regarding mortality tables independent of sex refers to certain specific tables which are blends of the male and female mortality rates of the 1980 CSO Table and specifies that these tables may be used with or without Ten-Year Select Mortality Factors. The Ten-Year Select Mortality Factors to be used with these blended tables are to be determined by use of the formula in the letter from Robert J. Johansen to Ted Becker reproduced on p. 457 of NAIC Proceedings 1984 Vol. I.

Background Information

The published report of a committee of the Society of Actuaries contains two sets of alternative select mortality factors. While that committee recommended that the alternative factors not be adopted, their publication has caused some confusion.
Text

The tables of uniform seniority and the “Ultimate 1xx Tables” in Appendix 5 of the Report of the Society of Actuaries Committee on Specifications for Monetary Values - 1980 CSO Tables are acceptable for use in calculating reserves or nonforfeiture values for joint life policies on the 1980 CSO basis. These tables from Appendix 5 of the report are reproduced on the following pages of this Actuarial Guideline. These tables are numbered A5-1, A5-6 and A5-7 to coincide with the page numbers of those tables in Appendix 5 of the Society Committee report. (These are the only tables considered necessary for the purpose of this guideline.)

Other methods of calculating joint life functions may also be acceptable. In particular, it is acceptable to calculate “exact” joint life functions using published 1980 CSO mortality rates for the actual ages and genders of the lives to be insured.
1980 CSO and 1980 CET TABLES

Tables showing the deduction to be made from the age of the older of two lives in order to obtain the equivalent equal ages. The equivalent equal ages are then used to enter tables of functions derived from tables based on one male and one female of the same age.

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It is not appropriate to apply values from the FEMALE/FEMALE column so that a negative joint equal age results. In such situations equivalent equal age zero should be used.

January 1, 1984
### 1980 CSO AND 1980 CET TABLES

#### ULTIMATE 1XX TABLES

**MALE/FEMALE - JOINT EQUAL AGES**

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# ULTIMATE 1xx TABLES

## MALE/FEMALE - JOINT EQUAL AGES

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Text

The Standard Valuation Law used the “excess of (a) over (b)” in the definition of the modified net premiums in Sec. 4. If the excess of (a) over (b) is negative, and the policy is issued on or after Jan. 1, 1987 the excess is to be taken as zero.

The Standard Valuation Law defines (a) as a net level premium, subject to a maximum. The net level premiums for the policy are a uniform percentage of the respective gross premiums such that the present value at issue of the net level premiums payable on and after the first anniversary is equal to the present value at issue of the benefits provided for by the policy after the first anniversary. The net level premium used in determining (a) is the net level premium payable on the first anniversary. The maximum for (a) is the net level premium on the 19-year premium whole life plan for a policy with level premiums issued at an age one year higher than the age at issue of the policy.

The value of (a) is to be calculated as defined in the Standard Valuation Law, even if the resulting reserves are not equal to reserves according to the full preliminary term method.

Background Information

The Report of the Society of Actuaries Committee on Specifications for Monetary Values—1980 CSO Tables recommended that a negative excess of (a) over (b) be taken as zero. Walter O. Menge in his paper Commissioners Reserve Valuation Method, RAIA XXXV (see pp. 260 and 261) pointed out the illogic of a negative excess, if used, would result in CRVM reserves that are greater than net level premium reserves. This principle has been recognized since Menge wrote his paper, but some actuaries are not aware of the paper.

Defining the net level premiums as being a uniform percentage of the respective gross premiums is consistent with the definition in Menge’s paper. Since the denominator of (a) is the present value of an annuity commencing on the first anniversary, the logical value for (a) is the net level premium (as defined) payable on the first anniversary.

In his paper, Menge indicates that CRVM reserves are equal to full preliminary term reserves unless the value of (a) is the maximum defined in the Standard Valuation Law, or unless the excess of (a) over (b) is negative. Menge does not appear to have considered the case where the gross premium for the first policy year does not equal the gross premium for the second policy year. For such policies a literal application of the Standard Valuation Law does not result in full preliminary term reserves.
Appendix C

Actuarial Guideline XXII

INTERPRETATION REGARDING NONFORFEITURE VALUES FOR POLICIES WITH INDETERMINATE PREMIUMS

Text

Indeterminate premium policies provide that premiums after issue will be determined by the insurer based on then current assumptions as to future experience. The policies also provide a schedule of maximum premiums which the premiums actually charged will not exceed.

The minimum nonforfeiture values for an indeterminate premium policy are the greater of those assuming that the gross premiums for the policy are (i) those according to the schedule of gross premiums based on current assumptions at issue and illustrated to prospective policyholders, or (ii) those according to the schedule of maximum gross premiums included in the policy:

Background Information

Indeterminate premium policies are a fairly recent development in life insurance. They can serve a legitimate function by enabling a nonparticipating policy to include a safety margin that need not be called upon unless it is needed. Indeterminate premiums are sometimes used to avoid deficiency reserve requirements. In general, regulators have not objected to this.

Section 6 of the Standard Nonforfeiture Law for Life Insurance refers to “any plan of life insurance which provides for future premium determination, the amounts of which are to be determined by the insurance company based on then estimates of future experience....” This is a direct reference to the types of life insurance policies commonly known as indeterminate premium plans (see “Detailed Analysis of Recommended Changes in the Standard Valuation Law and the Standard Nonforfeiture Law for Life Insurance; NAIC Proceedings - 1981 Vol. II, p. 831). The Standard Nonforfeiture Law for Life Insurance provides that minimum nonforfeiture values for such policies are to be computed by a method consistent with the principles of the Law as determined by regulations promulgated by the commissioner.

Section 5 and Section 5-c of the Standard Nonforfeiture Law for Life Insurance each provide that “the adjusted premiums for any policy shall be calculated on an annual basis and shall be....(a) uniform percentage of the respective premiums specified in the policy for each policy year...” Indeterminate premium policies provide for two amounts of premiums for each year: the actual premium to be charged and the maximum amount of the actual premium. This raises the question of which premium is to be used in setting adjusted premiums as a uniform percentage of the gross premiums.

The maximum premiums have the advantage that they are known at the time the policy is issued. However, use of maximum premiums to determine minimum values can lead to manipulation. A level premium whole life policy has a readily determined set of minimum values in accordance with the Standard Nonforfeiture Law for Life Insurance. If the policy has indeterminate premiums and the premiums illustrated to the customer (with proper disclosure of their indeterminate nature) are level for life, there should be no change in the minimum values. If the minimum values were determined by reference to the maximum premiums and not to the schedule of premiums on the current assumptions, introduction of maximum premiums that increase by duration would result in lower minimum values.

This guideline was written with policies other than universal life insurance in mind. However, it is possible to design a fixed premium universal life insurance policy to which this guideline would be applicable.
GUIDELINE CONCERNING VARIABLE LIFE INSURANCE SEPARATE ACCOUNT INVESTMENTS

A variable life insurance separate account shall be deemed to have sufficient net investment income and readily marketable assets to meet anticipated obligations under policies funded by the account, as required by [statutory reference for state], if, and only if, it can be demonstrated to the satisfaction of the Commissioner that the sum of the market value of readily marketable assets in the account at the date of valuation, plus the anticipated net investment income for the calendar year following the date of valuation exceeds by at least 15% the anticipated death benefits, surrenders, withdrawals and other such obligations payable from current account values during the same period. For the purposes of this demonstration, readily marketable assets means cash or those investments which have readily ascertainable market value and which can be marketed before the close of the next business day; net investment income excludes capital gains or losses; and the value of the anticipated death benefits, surrenders, withdrawals and other such obligations payable during the calendar year following the date of the valuation shall not be estimated at less than 10% of the market value of the account assets at the date of valuation.

If a variable life insurance separate account is divided into separate series, portfolios or other investment subdivisions, each series, portfolio or investment subdivision shall comply with this subsection.
GUIDELINES FOR VARIABLE LIFE NONFORFEITURE VALUES

Minimum cash surrender values for variable life insurance policies shall be determined separately for the basic policy and any benefits and riders for which premiums are paid separately. The methods pertain to a basic policy and any benefits and riders for which premiums are not paid separately.

Minimum cash surrender values for variable life policies may be determined using option B (Retrospective Method), C (Prospective Method), or D (Maximum Charge Method).

A. Definitions

1. “Valuation Rate” as used in this guideline means the higher of the Assumed Investment Rate (AIR) or guaranteed interest rate included in the policy, if any, otherwise the highest valuation interest rate allowed under the Standard Nonforfeiture Law.

2. “Net Cash Surrender Value” means the maximum amount payable to the policyowner upon surrender.

3. “Cash Surrender Value” means the Net Cash Surrender Value plus any amounts outstanding as policy loans.

4. “Policy Value” means the amount to which separately identified interest credits and or investment return and mortality, expense, or other charges are made under a variable life insurance policy.

5. “Accumulation Rate” means the net investment return and/or any interest credits applied towards the policy value.

B. Retrospective Method

The minimum cash surrender value (before adjustment for indebtedness and dividend credits) available on a valuation date shall be equal to the value using the Accumulation Rate through that date of the premiums paid minus the accumulation through that date of (i) the benefit charges, (ii) the averaged administrative expense charges for the first policy year and any insurance-increase years, (iii) actual administrative expense charges for other years, (iv) initial and additional acquisition expense charges not exceeding the initial or additional expense allowances, respectively, (v) any service charges actually made (excluding charges for cash surrender or election of a paid-up nonforfeiture benefit) and (vi) any deductions made for partial withdrawals; all accumulations being at the Accumulation Rate at which changes in policy values have been made unconditionally to the policy (or has been made conditionally, but for which the conditions have since been met), and minus any unamortized unused initial and additional expense allowance.

Accumulation for the premiums and for all charges referred to in items (i)-(vi) above shall be based on the Accumulation Rate for the applicable account(s) from and to such dates as are consistent with the manner in which such Accumulation Rate is credited in determining the policy value.

The benefit charges shall include the charges made for mortality and any charges made for riders or supplementary benefits for which premiums are not paid separately. If benefit charges are substantially level by duration and develop low or no cash values, then the Commissioner shall have the right to require higher cash values unless the insurer provides adequate justification that the cash values are appropriate in relation to the policy’s other characteristics.
The administrative expense charges shall include charges per premium payment, charges per dollar of premium paid, periodic charges per thousand dollars of insurance, periodic per policy charges, and any other charges permitted by the policy to be imposed without regard to the policyowner’s request for services. The averaged administrative expense charges for any year shall be those which would have been imposed in the year if the charge rate or rates for each transaction or period within the year had been equal to the arithmetic average of the corresponding charge rates which the policy states will be imposed in policy years through twenty in determining the policy value.

The initial acquisition expense charges shall be the excess of the expense charges, other than service charges, actually made in the first policy year over the averaged administrative expense charges for that year. Additional acquisition expense charges shall be the excess of the expense charges, other than service charges, actually made in an insurance-increase year over the averaged administrative expense charges for that year. An insurance-increase year shall be the year beginning on the date of increase in the amount of insurance by policyowner request (or by the terms of the policy).

Service charges shall include charges permitted by the policy to be imposed as a result of a policyowner’s request for a service by the insurer (such as the furnishing of future benefit illustrations) or of special transactions.

The initial expense allowance shall be the allowance provided by Items (ii), (iii), (iv) of Section 5, or by Items (ii) and (iii) of Section 5c(1), as applicable, of the Standard Nonforfeiture Law for Life Insurance, as amended in 1980, for a fixed premium, fixed benefit endowment policy with a face amount equal to the initial face amount of the variable life insurance policy, with level premiums paid annually until the highest attained age at which a premium may be paid under the variable life insurance policy, and maturing on the latest date permitted under the policy, if any, otherwise at the highest age in the valuation mortality table. The unused initial expense allowance shall be the excess, if any, of the initial expense allowance over the initial acquisition expense charges as defined above.

If the amount of insurance is subsequently increased upon request of the policyowner (or by the terms of the policy), an additional expense allowance and an unused additional expense allowance shall be determined on a basis consistent with the above and with Section 5c(5) of the Standard Nonforfeiture Law for Life Insurance, as amended in 1980, using the face amount and the latest maturity date permitted at that time under the policy.

The unamortized unused initial expense allowance during the policy year beginning on the policy anniversary at age x + t (where “x” is the issue age) shall be the unused initial expense allowance multiplied by \( \bar{a}_{x+t}/\bar{a}_x \) where \( \bar{a}_{x+t} \) and \( \bar{a}_x \) are present value of an annuity of one per year payable on policy anniversaries beginning at ages x + t and x, respectively, and continuing until the highest attained age at which a premium may be paid under the policy, both on the mortality guaranteed in the policy and the Valuation Rate for the policy. An unamortized unused additional expense allowance shall be the unused additional expense allowance multiplied by a similar ratio of annuities, with \( \bar{a}_x \) replaced by an annuity beginning on the date as of which the additional expense allowance was determined.

(Note: The drafters chose a whole life initial expense allowance for several reasons. Variable life insurance is generally considered a permanent life insurance plan and most companies encourage a premium level which will provide lifetime insurance protection. Every variable life insurance policy of which the drafters are aware has a “net level premium” that could be computed which would guarantee permanent protection using some suitable interest assumption. As a result, it is expected that most variable life insurance policies will be sold as permanent plans.

Traditional whole life insurance, which is accorded a permanent plan expense allowance by the Standard Nonforfeiture Law (SNFL), is much more flexible than is often realized. Premiums may be stopped with term coverage resulting, policy loans can result in “stop and go” premiums, or a vanishing premium
Appendix C

arrangement can be effected, all without the permanent plan expense allowance being affected. The SNFL
does not require cash values for many forms of term insurance. All other permanent plans develop an
expense allowance greater than that for whole life insurance under the SNFL.

The alternative of basing the initial expense allowance on a policyowner’s “planned premium” was
considered but rejected as artificial and subject to substantial manipulation by agents and/or insurers.)

C. Prospective Method

The minimum cash surrender value (before adjustment for indebtedness and dividend credits) available
on a date as of which interest is credited to the policy shall be equal to [(1) - (2) - (3) - (4)] where:

(1) is the present value of all future benefits;

(2) is the present value of future adjusted premiums. The adjusted premiums are calculated as
described in Sections 5 and 5a or in Section 5c(1), as applicable, of the Standard Nonforfeiture Law for Life Insurance, as amended in 1980. If Section 5c(1) is applicable, the nonforfeiture net level premium is equal to the quantity \( PVFB/\alpha_x \), where \( PVFB \) is the
present value of all benefits at issue assuming future premiums are paid by the policyowner and all guarantees contained in the policy or declared by the insurer, and
using the Valuation Rate.

\[ \alpha_x \] is the present value of an annuity of one per year payable on policy
anniversaries beginning at age \( x \) and continuing until the highest attained age at which a
premium may be paid under the policy.

(3) is the present value of any quantities analogous to the nonforfeiture net level premium
which arise because of guarantees declared by the insurer after the issue date of the
policy. \( \alpha_x \) shall be replaced by an annuity beginning on the date as of which the
declaration became effective and payable until the end of the period covered by the
declaration.

(4) is the sum of any quantities analogous to (2) which arise because of structural changes in
the policy.

(Note: Structural changes are those changes which are separate from the automatic workings of the
policy. Such changes usually would be initiated by the policyowner and include changes in the
guaranteed benefits, changes in latest maturity date, or changes in allowable premium payment period.)

Future benefits are determined by (1) projecting the policy value, taking into account future premiums, if
any, and using the guaranteed interest rate, if any; otherwise, the lesser of the AIR, if any, or the highest
state approved nonforfeiture interest rate, and using the mortality, expense deductions, etc. contained in
the policy or declared by the insurer; and (2) taking into account any benefits guaranteed in the policy or
by declaration which do not depend on the policy value.

All present values shall be determined using (i) an interest rate (or rates) specified by the Standard
Nonforfeiture Law for Life Insurance, as amended in 1980, for policies issued in the same year and (ii)
the mortality rates specified by the Standard Nonforfeiture Law for Life Insurance, as amended in 1980,
for policies issued in the same year or contained in such other table as may be approved by the
Commissioner for this purpose.

(Note: The types of quantities included in (3) are increased current interest rate credits guaranteed for a
future period, decreased current mortality rate charges guaranteed for a future period, or decreased current
expense charges guaranteed for a future period.)
D. Maximum Charge Method

(1) Definitions: Wherever used in this Section, the terms have the respective meanings set forth or indicated in this paragraph.

(a) Policy Value is equal to gross premiums paid (excluding separate identified premiums for riders or supplementary benefits which are not credited to policy value) plus net investment income (which may be positive or negative and may vary based on policy loans) less the following as specified in the policy: (i) administrative charges (which may be taken in part from premiums and in part from policy value), (ii) acquisition and other charges, (iii) deferred acquisition and other charges, (iv) benefit charges, (v) service charges, (vi) partial withdrawals, and (vii) partial surrender charges.

(b) Benefit Charges made to the Policy Value are mortality charges made for life insurance on the insured person or persons and any charge made for riders and supplementary benefits.

(c) Service Charges made to the Policy Value are charges for transactional costs such as partial withdrawals, reallocations of policy values and benefit illustrations. Transactional charges shall not be assessed unless specifically permitted by law or regulation for transactions made under mandatory policy provisions.

(d) Administrative Charges is a per policy charge made regularly to the Policy Value (or deducted from premiums on scheduled premium policies) for the cost of administration. This charge may not exceed $5.00 per month in 1986. In subsequent years the limit for any new or in force policy shall be the product of $5.00 and the ratio (not to exceed 2.00) of (1) the Consumer Price Index (for all urban households) for the September preceding the year for which the determination is being made to (2) the Consumer Price Index for September 1986. The Commissioner may allow a higher charge upon an insurer demonstrating a justification.

(e) Acquisition and Other Charges are deducted from gross premiums before they are credited to Policy Value and/or made to the Policy Value. They may be expressed as a percentage of premium or a dollar amount per $1,000 of insurance or a dollar amount per premium payment or a per policy charge (other than the Administrative Charge). They do not include charges made as a reduction in investment return. These charges may vary by premium size, policy size and by policy year.

(f) Excess First Year Acquisition and Other Charges shall be the maximum excess of (A) over (B) based on the assumption that any premium (other than a single premium) payable in the first policy year is also payable during the entire premium paying period. (A) is the Acquisition and Other Charge made in the first policy year and (B) is the arithmetic average of the corresponding charges which the policy states would be made in policy years two through twenty.

(g) Excess Acquisition and Other Charges for a Face Amount Increase shall be the maximum excess of (A) over (B) based on the assumption that the net level whole life annual premium for the increase (as defined in (j) below) applies throughout the remaining premium paying period. (A) is the Acquisition and Other Charge for the increase, and (B) is the arithmetic average of the
corresponding charges which the policy states would be made in the nineteen policy years following the increase.

(h) Net Investment Return is the actual amount credited to Policy Value net of investment expenses and/or other charges made as a reduction in investment return.

(i) The net level whole life annual premium at issue is based on the assumption of level insurance and level annual premium for life, the mortality table rate used to calculate the maximum mortality charges and an interest rate based on the higher of 4% or that specified in the policy.

(j) The net level whole life annual premium for an increase in the face amount of insurance shall be determined as of the date of the increases as though such increase were a separate policy under (i) above. Only increases in the face amount requested by the policyowner and increases in the face amount pursuant to the terms of the policy (e.g. an option to purchase or a cost of living increase) shall give rise to such a premium and the associated Excess Acquisition and Other Charges for a Face Amount Increase. Increases for this purpose shall not include increases in face amount resulting from a change in the death benefit option or changes in death benefit pursuant to policy terms that do not affect the face amount. Increases for this purpose shall be reduced by the amounts of any earlier decrease by reason of a partial withdrawal, but not a decrease resulting from a change in the death benefit option.

(k) Surrender Charge is a deferred charge made to the Policy Value in the event of a full or partial surrender of the policy, reduction in the face amount of insurance or premium, or a lapse.

(l) Cash Surrender Value is the Policy Value less any Surrender Charge, before reduction for outstanding loans or other amounts due under the policy.

(m) Deferred Acquisition and Other Charges are Acquisition and Other Charges deducted from the Policy Value after the first policy year.

(2) Cash Surrender Values determined in accordance with this subparagraph shall meet minimum requirements.

(a) If Acquisition and Other Charges do not exceed the sum of:

(1) 90% of premiums received up to the net level whole life annual premium at issue (regardless of when received).

(2) 10% of all other premiums received.

(3) 90% of the net level whole life annual premium for increases in the face amount of insurance as defined in 1(j).

(4) $10 per $1,000 of initial face amount in the first policy year.

(5) $1 per $1,000 of face amount in subsequent policy years.

(6) $10 per $1,000 of any increase in the face amount of insurance other than an increase resulting from a change in the death benefit option. Increases
up to the amount of earlier decreases are included here but not in (3) above.

(7) $200 per policy in the first year.

(b) A surrender charge may be established provided that the initial surrender charge together with the actual Acquisition and Other Charges made in the first policy year (and on premiums up to the net level whole life annual premium if received after the first year) do not exceed the sum of (1), (2) in the first year, (4) and (7) in (a) above. Additional surrender charges may be established after issue in connection with an increase in face amount provided that any such additional surrender charge and any Acquisition and Other Charges made in connection with such increase do not exceed the sum of (3) and (6) in (a) above.

(c) A Deferred Acquisition and Other Charge may be charged against the Policy Value in any policy year after the first, such that the total of all such charges imposed to date plus the surrender charge for that year does not exceed the maximum initial surrender charge. The Deferred Acquisition and Other Charges in any one year may not exceed the maximum allowable surrender charge for that year. Similar Deferred Acquisition and Other Charges may be imposed with respect to an increase in face amount.

(d) The maximum allowable surrender charge for any year shall be the maximum initial surrender charge multiplied by $a_{x+t}/a_x$, where “x” is the issue age and “t” is the number of years since issue. Similar maximums shall be determined with respect to any additional surrender charges, with x and t based on the date of increase.

(Note: The minimum cash value methods B, C, or D are not intended to prohibit the current practice of allowing the imposition of additional surrender charges defined as follows. In the case of combination general account and separate account variable life products, additions or amounts derived from more favorable interest, mortality, and expense than those guaranteed in the policy on the general account fund and credited within 12 months prior to surrender may be subject to forfeiture upon surrender.)

E. Minimum Paid-Up Nonforfeiture Benefits

If a variable life insurance policy provides for the optional election of a paid-up nonforfeiture benefit, it shall be such that its present value shall be at least equal to the cash surrender value provided by the policy on the effective date of the election. The present value shall be based on mortality and interest standards at least as favorable to the policyowner as (1) the mortality and interest basis, if any, specified in the policy for determining the policy value, or (2) the mortality and interest standards permitted for paid-up nonforfeiture benefits by the Standard Nonforfeiture Law for Life Insurance, as amended in 1980. In lieu of the paid-up nonforfeiture benefit, the insurer may substitute, upon proper request not later than sixty days after the due date of the premium in default, an actuarially equivalent alternative paid-up nonforfeiture benefit which provides a greater amount or longer period of death benefits, or, if applicable, a greater amount or earlier payment of endowment benefits.

(Note: It is possible that policies will have secondary guarantees. Such guarantees should be taken into consideration when computing minimum paid-up nonforfeiture benefits.)

Ever since the adoption of the original Standard Nonforfeiture Law (SNFL) in 1942, provision has been made for nonforfeiture calculations on the basis of substandard mortality. (See Sections 5.5a. and 5c, Paragraph 8(e) of SNFL.)
Appendix C

While this provision has been used infrequently in the past, it is anticipated the substandard mortality will be more frequently utilized in variable life insurance, given its flexible nature, to reflect the mortality classification assigned to the policy by the insurer.

A charge may be made at the surrender of the policy provided that the result after the deduction of the charge is not less than the minimum cash surrender value required by this guideline.)
CALCULATION OF MINIMUM RESERVES AND MINIMUM NONFORFEITURE VALUES FOR POLICIES WITH GUARANTEED INCREASING DEATH BENEFITS BASED ON AN INDEX

A. Valuation – Text

For a policy where premiums are fixed in amount at issue which provides for whole life insurance with the amount of death benefit adjusted periodically with the Consumer Price Index or another cost of living index, the value of the minimum reserve at any time shall be based on the maximum valuation interest rate for the year of issue and an acceptable mortality table for life insurance statutory reserves and based on the death benefit and premium pattern adjusted as provided in the policy by reasonable annual increases based on the index. The present value of future benefits component shall be further adjusted each year by the ratio of the then current amount of death benefit to the initially projected amount of death benefit. If the policy provides for future premiums and such premiums are also adjusted periodically with the Consumer Price Index or another cost of living index, the present value of future premiums component shall likewise be further adjusted each year by the ratio of the then current amount of death benefit to the initially projected amount of death benefit. The assumption as to what is a reasonable annual increase in death benefits based on the index must not be less than the maximum valuation interest rate for the year of issue less:

1. 2.0% If the annual increase is limited to an annual and non-cumulative maximum of 0% through 5.0%
2. 1.5% If the annual increase is limited to an annual and cumulative maximum of 0% through 5.0%.
3. 1.5% If the annual increase is limited to an annual and non-cumulative maximum of 5.01% through 10.0%.
4. 1.25% If the annual increase is limited to an annual and cumulative maximum of 5.01% through 10.0%.
5. 1.0% For all other plans.

The term “annual and non-cumulative maximum” refers to a maximum where each annual increase is limited to the lower of the maximum or the increase in the index without carry forward of excess index increases.

The term “annual and cumulative maximum” refers to a maximum where each annual increase is limited to the lower of the maximum or the increase in the index with carry forward of excess index increases.

In no event shall the assumption as to an annual increase based on the index be less than 1.0%.

This guideline for valuation shall be effective immediately for policies issued on or after January 1, 1991.

B. Nonforfeiture – Text

1. FOR POLICIES WHERE ANY DEATH BENEFIT FOR ANY POLICY YEAR WOULD EXCEED $10,000 EVEN IN ABSENCE OF ANY ANNUAL INCREASES BASED ON THE INDEX
Appendix C

For a policy where premiums are fixed in amount at issue which provides for whole life insurance with the amount of death benefit adjusted periodically with the Consumer Price Index or another cost of living index, the value of the minimum nonforfeiture benefit at any time shall be based on the maximum nonforfeiture interest rate for the year of issue and an acceptable mortality table for life insurance nonforfeiture and based on the death benefit and premium pattern adjusted as provided in the policy by reasonable annual increases based on the index. The present value of future benefits component shall be further adjusted each year by the ratio of the then current amount of death benefit to the initially projected amount of death benefit. If the policy provides for future premiums and such premiums are also adjusted periodically with the Consumer Price Index or another cost of living index, the present value of future premiums component shall likewise be further adjusted each year by the ratio of the then current amount of death benefit to the initially projected amount of death benefit. The assumption as to what is a reasonable annual increase in death benefits based on the index must not be less than the maximum valuation interest rate for the year of issue less:

a. 2.0%  If the annual increase is limited to an annual and non-cumulative maximum of 0% through 5.0%.
b. 1.5%  If the annual increase is limited to an annual and cumulative maximum of 0% through 5.0%.
c. 1.5%  If the annual increase is limited to an annual and non-cumulative maximum of 5.01% through 10.0%.
d. 1.25%  If the annual increase is limited to an annual and cumulative maximum of 5.01% through 10.0%.
e. 1.0%  For all other plans.

The term “annual and non-cumulative maximum” refers to a maximum where each annual increase is limited to the lower of the maximum or the increase in the index without carry forward of excess index increases.

The term “annual and cumulative maximum” refers to a maximum where each annual increase is limited to the lower of the maximum or the increase in the index with carry forward of excess index increases.

In no event shall the assumption as to an annual increase based on the index be less than 1.0%.

2. FOR POLICIES WHERE ANY DEATH BENEFIT FOR ANY POLICY YEAR WOULD NOT EXCEED $10,000 IN ABSENCE OF ANY ANNUAL INCREASES BASED ON THE INDEX

For a policy where premiums are fixed in amount at issue which provides for whole life insurance with the amount of death benefit adjusted periodically with the Consumer Price Index or another cost of living index, the unadjusted value of the minimum nonforfeiture benefit at any time shall be based on a level death benefit, an acceptable mortality table for life insurance nonforfeiture and a nonforfeiture interest rate equal to:

a. 4.5%  If the annual increase based on the index is limited to a maximum of 0% through 5.0%.
b. 4.25%  If the annual increase based on the index is limited to a maximum of 5.01% through 10.0%.
The present value of future benefits component shall be further adjusted each year by the ratio of the then current amount of death benefit to the initially projected amount of death benefit. If the policy provides for future premiums and such premiums are also adjusted periodically with the Consumer Price Index or another cost of living index, the present value of future premiums component shall likewise be further adjusted each year by the ratio of the then current amount of death benefit to the initially projected amount of death benefit.

For purposes of this guideline multiple policies on a single life shall be aggregated and only those policies aggregating not more than $10,000 shall be considered under II.B.

This guideline for nonforfeiture shall be effective immediately for policies issued on or after January 1, 1991.

BACKGROUND

A number of companies are marketing individual life insurance policies with guaranteed increasing death benefits tied in to a consumer price index or another cost of living index and are for low initial amounts of insurance sold through funeral directors to provide for burial expenses. Some of the policies provide for graded death benefits such as the return of premium with or without interest for the early policy years or for a fixed scheduled increase in death benefits prior to the operation of the index. In some cases there is a maximum on the increase for any year. The vast majority of such policies are single premium policies but some are annual premium policies (generally limited payment). The annual premium may or may not be subject to adjustment with the index.

Since the changes in the index are not known at issue, but from past experience, increases within a given range can be expected with a high probability, it is necessary to assume some increases and then to continually adjust the present value of future benefits component and, if appropriate, the present value of future premiums component in the reserve and nonforfeiture calculation.

Theoretically the same assumed increases in the death benefits should be used for both valuation and nonforfeiture. This guideline so provides for policies where the amount of death benefit in any given policy year would exceed $10,000 even if there were no increases based on the index. For practical purposes this may mean that such policies are not marketable for higher amounts as it is most likely that such policies will not qualify under the IRS Section 7702. The cash value accumulation test to qualify thereunder requires a minimum interest rate of 4% and an assumed level amount of death benefits.

In the case of policies for an initial amount of insurance of $5,000 or less, the IRS rules provide an exception to the prohibition of assuming increasing death benefits. However, since many of the policies for very low amounts of initial face amount of insurance would require relatively high expenses if underwritten, many of the policies are issued with simplified underwriting or on a guaranteed issue basis with lower amounts of death benefits in the early policy years, some of the resulting annual increases are such as would disqualify many of the policies for the exception. Therefore it is recommended that policies for low amounts of insurance be allowed to qualify under the cash value accumulation test by permitting the nonforfeiture values to be based on a level death benefit and 4% or higher interest and requiring such values to be updated as increases based on the index take place. The amount in this guideline is set at $10,000 to allow for future adjustments and for different patterns of benefits for low amounts.

For single premium policies, the value of nonforfeiture benefits based on a level death benefit and a net assumed nonforfeiture interest rate equal to the maximum nonforfeiture interest rate less an assumed increase based on the index and such factors then adjusted by the projected increases will approximate factors based on assumed increases and the maximum nonforfeiture interest rate. However, the net
interest rate is likely to be less than 4%. Thus the procedure of assuming a level death benefit and a net assumed rate of not less than 4% for policies of low amounts of insurance is apt to produce lower cash values than the procedure for large amounts of insurance. Such lower values can be justified based upon the fact that the highly specialized market is prearranged funeral expenses for very small amounts of insurance per policy.

To emphasize the qualification with the IRS rules for the very low amounts of insurance, the nonforfeiture guideline for small amount policies is stated in terms of the net rate, a level death benefit and continual adjustment.

For solvency purposes, reserves should be conservative. The same rules apply for reserve regardless of the size of the policy. That is, lower reserves are not permitted for policies with very low amounts of insurance per policy.

Paragraph 5c(3) of the Model Standard Nonforfeiture Law states that unscheduled changes do not need to be taken into account until the time of the change. The changes guaranteed according to an index are a hybrid, i.e. the changes are scheduled but the amount of the change is not known until the index is determined. Thus the changes must be recognized at issue. This guideline is a hybrid with increases assumed at issue either explicitly or implicitly but with further adjustments made at the time the increase based on the index is determined.
Preamble

The model Standard Nonforfeiture Law for Life Insurance contains Section 5-C, which defines new mortality and interest rate components to be used as the minimum standard for nonforfeiture values for life insurance policies. The Commissioners 1980 Standard Ordinary Table, or that table with Ten-Year Select Factors, is identified in Section 5-C as the applicable mortality table component for ordinary life insurance policies (although there is a provision for other alternate mortality tables to be permitted by regulation). Section 5-C also incorporates “dynamic” interest rates, as the applicable interest rate component. In addition, Section 5-C contains a new and different formula to be used in computing the adjusted premiums that define minimum nonforfeiture values.

Section 5-C contains a mandatory operative date, but there is also language permitting companies to elect an early operative date under certain conditions.

The model Standard Valuation law contains a cross reference to operative date for Section 5-C of the Standard Nonforfeiture Law for Life Insurance. After such operative date, there are mortality and interest rate components defined for use as the minimum standard for computing reserves. The Commissioners 1980 Standard Ordinary Table, or that table with Ten-Year Select Factors, is identified as the applicable mortality table component for ordinary life insurance policies (although there is a provision for other alternate mortality tables to be permitted by regulation). “Dynamic” interest rates determine the applicable interest rate component, but a lower maximum interest rate is defined for reserves than for nonforfeiture values.

Generally, the applicable mortality rates are lower and the applicable interest rates higher after the operative date. Thus, the reserves defined under the minimum standard would be lower for policies issued on or after the operative date.

Text

Under no circumstances can an insurance company elect an operative date for the purpose of Section 5-C of the Standard Nonforfeiture Law for Life Insurance, if such operative date would be in a calendar year prior to the calendar year in which that company furnished written notice of election of an operative date under that law.

Background Material

The purpose of this actuarial guideline is to ensure consistency and provide guidance in the election of this operative date.

Historically, insurance companies have been allowed to elect early operative dates so as to pass along the benefits of improved mortality rates and current interest rates to policyholders who purchase new life insurance policies. These new policies would typically have lower nonforfeiture values and would require lower reserves, and net premiums would be lower also. The expectation is that the lower net premiums might allow the company to reconsider its gross premium rates for these new policies issued after the operative date, and in many cases to lower the new gross premium rates.
Appendix C

A second reason for allowing the election of an early operative date would be to allow insurance companies and state insurance departments more time to prepare and review new life insurance policies, which are to be introduced into the marketplace. If every life insurance policy had to be changed over on the same mandatory operative date, it would be a great burden on the resources of all the parties involved.
ACCELERATED BENEFITS

PURPOSE

This guideline is designed to cover the actuarial aspects of accelerated benefits. Three general categories of accelerated benefits are covered:

I) non-discounted acceleration of benefits

II) actuarially discounted acceleration of benefits

III) interest accrual approach to financing acceleration of benefits

In addition, there is a separate section to cover the special considerations for a policy lien approach, which is Section IV.

General considerations which apply to any method of determining accelerated benefits are given in Section V.

I. NON-DISCOUNTED ACCELERATION OF BENEFITS

A. Description

The type of plans considered in this subsection are those which provide for a defined event triggering one time acceleration of some or all of the death benefit of the base contract or rider, in such a way that every dollar of acceleration has a non-discounted matching reduction in the amount payable on death. These plans have been available in four forms, via

1. A contract integrating the acceleration feature with other, more traditional, features;

2. A rider attached to a regular contract at time of issue, to provide acceleration;

3. A rider, as in (2), but which may be attached to inforce contracts of the same company; or

4. A policy acting similar to the rider in (3) above, but for which the acceleration is applicable to inforce contract of other companies.

B. Reserves

1. Reserving Approach

Payment of benefits earlier than death itself is an early payment rather than a different payment. The basic reserve structure and requirements for regular life insurance need not be disturbed. Therefore, the CRVM methodology is acceptable, as is any other reserving methodology allowable for life insurance when determining the reserves needed for policies with an accelerated benefit or when determining the reserves for the accelerated benefit by itself.

2. General Consideration
A reserve formula should consider all relevant factors.

Approximations to develop a single decrement table which utilize all relevant factors except for voluntary termination rates are acceptable for policies and riders subject to this subsection provided it can be demonstrated that the approximations used produce essentially similar reserves, conservative reserves, or immaterial reserves. The calculations should take into account the reduction in life insurance benefits due to prior acceleration. However, in no event shall the reserves for the accelerated benefit and the life insurance benefit when taken together be less than the reserves for the life insurance benefit assuming no acceleration feature prior to payment of any accelerated benefits.

In the development and calculation of reserves for policies and riders subject to this subsection, due regard shall be given to the applicable policy provisions, marketing methods, administrative procedures and all other considerations which have an impact on projected claims costs, including, but not limited to the following:

a. Definition of acceleration events,

b. Premium waiver provision,

c. Marketing method,

d. Underwriting procedures,

e. Delay in eligibility for benefit,

f. Maximum benefit,

g. Optional nature of benefit, and/or

h. Guaranteed insurability options.

II. ACTUARILY DISCOUNTED ACCELERATION OF BENEFIT

A. Description

The products that are allowable under this type of approach generally provide for an acceleration of the death benefit payable under a life insurance policy, with an appropriate actuarial adjustment in the amount of money paid to the policyholder that represents the amount of money foregone by the Company by paying out the death benefit early. These products have no additional premium payable. This product can be made available at issue of the contract or after issue of the contract. It can either be a separate rider or part of the integrated policy. The interest rate or interest rate methodology used for discounting must be specified in the contract or rider or in the actuarial memorandum.

B. Reserves

The application of standard valuation law and CRVM reserves is appropriate for these policies. No additional reserves need be held as long as the actuary is convinced that the method used to discount the death benefit reflects sound actuarial principles.
If the actuary is convinced that the discounting procedure does not appropriately reflect these conditions, he or she should determine a reserve such that reserves are adequate for the life insurance benefits based on aggregates. There is nothing in this benefit design that changes that equation.

III. INTEREST ACCRUAL APPROACH TO FINANCING ACCELERATION OF BENEFITS

A. Description

Under this approach, the insurer accrues an interest charge on the accelerated benefit to account for lost investment income from the date of acceleration to the date of death. The interest may be accrued until death or may be required to be paid in cash periodically, or may be offset against the policy’s remaining death benefit.

1. Alternative methods of including an interest accrual option:
   a. A benefit of this type may be provided either as an integral part of a life insurance policy or as a rider to a life insurance policy.
   b. If offered as a rider to a life insurance policy, such rider may be attached to either a new policy or to an existing policy.

2. Alternative Benefit Designs using this option: The rider or policy form should specify whether interest accruing on prior accelerated benefit payment needs to be paid in cash or whether additional accelerated benefit payments will be made to cover such interest accruals as they become due. Either approach is equally acceptable.

B. Interest Accrual Rate

1. The rider or policy form or the actuarial memorandum should specify the method used to determine the rate(s) of interest to be charged.

2. The specification of the method should be clear and unambiguous.

3. The method used for determining the interest rate should be included in the Actuarial memorandum.

C. Reserves

1. Prior to the occurrence of an event qualifying the policy for accelerated benefits, minimum statutory reserves for policies containing interest accrual provisions are the same as for policies with identical death benefits that do not contain interest accrued lien provisions, provided that the method of determining the interest rate to be charged, as specified in the rider or policy provisions or actuarial memorandum, results in an interest rate at least equal to the valuation interest rate applicable to the policy. If such is not the case, an extra reserve may be necessary on such policies, if it is determined that the aggregate reserves are not good and sufficient.

2. Following the occurrence of a qualifying event, accrued interest is an asset of the company for statutory reporting purposes. However, the valuation actuary should make certain that reserves in the aggregate are adequate to assure that such aggregate accrued interest is provided for. This will assure that such accrued
interest assets can be held as admitted assets. The insurer’s valuation actuary may voluntarily increase the statutory reserve liability on each such policy in order to eliminate the need to non-admit a portion of the accrued interest policy lien or policy loan.

IV. BENEFIT PAYMENT LIENS

This section deals specifically with benefit payment liens and their effect on future policy premiums and benefits.

A. The presence of a lien against the policy does not require a pro-rata reduction in the policy premiums or other values.

B. Amount of lien computed as of the date of death may be deducted from the death benefit.

C. Access to non-forfeiture benefits upon surrender or through future policy loans may be restricted to any excess of the cash surrender value over the sum of any outstanding loans and the lien.

D. If the lien approach is used and RPU is available as a non-forfeiture benefit, the amount of RPU may be calculated as if no lien existed and the lien may continue to apply, provided that the lien continues to satisfy any percentage and dollar maximums and minimums specified in the contract. Alternatively, RPU may be made unavailable while the lien exists, provided an ETI benefit is available. Alternatively, the excess, if any, of the cash surrender value over the sum of outstanding loans and the lien may be applied in calculating the amount of the RPU, provided an ETI benefit is available. If the choice of methods is not left as an option to be the policyholder, the rider or policy form should specify which method will apply.

E. If the lien approach is used an ETI is available as a non-forfeiture benefit, the period of ETI may be calculated as if no lien existed and the lien may continue to apply, provided that the lien continues to satisfy any percentage and dollar maximums and minimums specified in the contract.

F. If the lien approach is used, any accelerated death benefit payment may first be applied toward repaying the portion of any outstanding policy loans which causes the sum of the accelerated death benefit and policy loans to exceed the cash value. Alternatively, outstanding policy loans may be retained and the lien that would otherwise be allowed may be reduced by any outstanding policy loans at the time of acceleration. If the choice of methods is not left as an option to the policyholder, the rider or policy form should specify which method will apply.

G. The rider or policy form accelerated benefit lien provisions may specify that the existence of a benefit lien will not prevent termination of the policy in accordance with the regular policy termination provisions.

H. If a policy terminates while subject to a lien, the insurer shall extinguish the lien without further recourse to the policyholder unless the policy or rider clearly indicates otherwise. In the event that the policy is reinstated, the lien may also be reinstated with interest accrued as if the policy had never terminated.

I. The policyholder should have the option of paying all or part of any premium or accrued interest that would be capitalized under the terms of the rider or policy provisions in cash,
as well as the option of repaying all or part of any lien in cash, in order to prevent the lien
from causing the policy to terminate.

V. GENERAL CONSIDERATIONS

The items below should be considered, where applicable, for all types of accelerated benefits:

A. The rider or policy form should specify whether any premium becoming due after the
initial accelerated benefit payment is established needs to be paid in cash or whether
additional accelerated benefit payment will be made to cover such premiums as they
become due. Either approach is equally acceptable.

B. The rider or policy form may specify any percentage and dollar minimum and maximum
payments that may be accelerated. Any dollar or percentage minimums or maximums is
equally acceptable. If no maximum is specified, it will be assumed to be 100% of the
death benefit.

C. The accelerated benefit may include a reasonable expense charge for administrative
expenses and risks assumed by the company. If the available amount of the initial
accelerated benefit is less than the maximum allowed, the rider or policy form should
specify how such initial amount will be determined.

D. The rider or policy form should specify the actions required, if any, to prevent policy
termination if premium or interest expected to be capitalized would result in a total
accelerated benefit payment exceeding the percentage or dollar maximum amount
specified in the rider or policy form. Any such excess may be required to be paid in cash
within an appropriate grace period in order to prevent policy termination. The rider or
policy form may also specify that future premiums or interest becoming due must be paid
in cash. If not specifically addressed, the rider or policy should remain inforce and be
administered with no change from the premium or interest requirement that existed
immediately prior to the time at which the maximum was reached and the accelerated
benefit would not be increased beyond the maximum specified in the rider or policy
form.

E. The rider or policy form may specify whether the accelerated benefit provision would
apply to the original base insurance policy death benefit or the current insurance policy
death benefit. If not specifically addressed, the rider or policy form should be
administered as if maximums are automatically increased, but not automatically
decreased.

F. The rider or policy form may specify that an accelerated benefit is not available unless
established prior to the policyholder’s election of or lapse to ETI or RPU. If not
specifically addressed, the rider or policy forms should be administered to provide an
accelerated benefit after election of or lapse to ETI or RPU.

G. The rider or policy form may specify that an accelerated benefit is not available if the
policy has an irrevocable beneficiary or is assigned when accelerated benefits are initially
claimed. Alternatively, the irrevocable beneficiary or assignee must provide a signed
acknowledgement of concurrence for payout. The rider or policy form may specify that
the policy may not be assigned (except to the insurer) after an accelerated benefit has
been paid.
Appendix C

Actuarial Guideline XXVIII

STATUTORY CLAIM RESERVES FOR GROUP LONG-TERM DISABILITY CONTRACTS WITH A SURVIVOR INCOME BENEFIT PROVISION

Background

Many of the major writers of group long-term disability income insurance have included survivor benefits in such contracts. Provisions related to the survivor benefit include minimum disability periods, benefit amounts defined in terms of a number of months of disability benefits and a specified percentage of the monthly disability benefit.

This benefit is sometimes overlooked in the valuation process or ignored as being trivial in amount.


Text

Claim reserves for survivor income benefits contained in group long-term disability contracts must be established based on the design of the survivor income benefit including the minimum period of disability before the spouse of a disabled person becomes eligible for a survivor income benefit and the amount of the benefit. A suitable approximation to the sum of the reserves for the basic disability benefit and the reserve for the survivor income benefit can be calculated by computing the reserve for the basic disability at an interest rate less than the maximum valuation interest rate.

Before any approximation can be accepted, rigorous testing of the approximation to the combined reserves for both the basic disability claim and the survivor income benefit must be performed. Tests indicated that basic disability reserves and survivor income benefit based on a 12-month disability requirement and a maximum survivor income benefit duration of 24 months with a survivor income benefit of .667 of the disability income with all reserves based on a valuation interest rate of 5.5% can be adequately approximated by basic disability reserves alone but calculated at a 3.5% valuation interest rate.

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GUIDELINE CONCERNING RESERVES OF COMPANIES IN REHABILITATION

Preamble

The life insurance and annuity contracts of life insurance companies can be restructured by court order in rehabilitation proceedings. The contract restructuring may take the form of reduction in account values and/or guaranteed interest crediting premiums. Typically, the court order imposes restrictions on surrender of the contract while the company is in rehabilitation. These restrictions can include bans on surrenders while a rehabilitation plan is being developed and temporary limitations on the cash that can be obtained upon surrender. These restrictions are intended to prevent en masse surrenders while the company faces liquidity problems.

Several issues have arisen as to the interpretation of the Standard Valuation Law in these circumstances. The issues relate to the interpretation of the Commissioners’ Reserve Valuation Method (CRVM) and the Commissioners’ Annuity Reserve Valuation Method (CRVM), the determination of the guaranteed nonforfeiture benefits provided in the restructured contract and identification of the issue date of the contract after restructuring.

The Standard Valuation Law does not specifically address minimum reserve requirements after a contract has been restructured by court order. The minimum reserve requirements should be interpreted in the context of court-ordered contract restructuring to result in the most appropriate reserves under the particular circumstances. In general, this should be left to the regulators to determine.

Guideline

The phrase “future guaranteed benefits, including guaranteed nonforfeiture benefits,” as used in CARVM, includes the cash surrender values based on contractual guarantees after reduction for any surrender charges available under the contract. In general, the value of future guaranteed benefits under CARVM may not be reduced by contingent surrender charges which may not be available upon cash surrender. See Guideline Covering the Commissioners’ Annuity Reserve Valuation Method (CARVM) (1985).

Whether or not a court-imposed temporary restriction on the availability of cash on surrender is taken into account under CARVM depends upon whether the rehabilitation plan specifies that the restriction is a reduction in the guaranteed nonforfeiture benefits in the restructured contracts. If the rehabilitation plan imposes a distinct temporary charge to ensure liquidity as opposed to changing common surrender charges that are historically used to determining nonforfeiture benefits, the temporary charges will not reduce guaranteed nonforfeiture benefits for purposes of CARVM.

A similar rule applies for purposes of reporting those reserves on life insurance contracts entitled “For surrender values in excess of reserves otherwise required.”

For life insurance contracts, CRVM does not dictate that a particular method must be applied after a contract has been restructured. In the case of policies providing for a varying amount of insurance or requiring the payment of varying premiums, reserves are calculated by a method consistent with CRVM applicable to policies providing for a uniform amount of insurance and requiring the payment of uniform premiums.

A method consistent with CRVM adopted for purposes of a rehabilitation program should consider the valuation bases and expense allowance prior to restructuring as well as after restructuring. Depending upon the types of changes to the restructured contract, it may or may not be appropriate to take into account the guaranteed benefits and premium structure prior to restructuring.
Appendix C

The issue date for purposes of determining the applicable mortality tables and interest rates also depends on the circumstances. For example, it may be appropriate to treat annuity contracts as newly issued so that reserves are required to be recomputed using more current discount rates. However, in the same rehabilitation plan it may be inappropriate to treat a restructured level premium whole life contract as newly issued. Accordingly, whether a contract is treated as having a new issue date after contract restructuring depends upon the terms of the rehabilitation plan and the restructured contracts. In general, contracts are not treated as newly issued unless the rehabilitation plan or state filing for the restructured contracts so provides.

Similarly, the appropriate CRVM expense allowance will depend upon the terms and the intent of the restructuring and rehabilitation plan. Depending upon the types of changes to the restructured contract, it may be appropriate to carry forward an unamortized expense allowance based on original policy date. In other cases, a new unamortized expense allowance would be calculated as of the restructure date. In general, a new unamortized expense allowance is not calculated unless the rehabilitation plan or the state filing for the restructured contract so provides.
GUIDELINE FOR THE APPLICATION OF PLAN TYPE TO GUARANTEED INTEREST CONTRACTS (GICS) WITH BENEFIT RESPONSIVE PAYMENT PROVISIONS USED TO FUND EMPLOYEE BENEFIT PLANS.

Background Material

Guaranteed Interest Contracts (GICs) that are used to fund employee benefit plans often times contain a provision that allows individual participants to voluntarily move funds on a book value basis to other investment opportunities. These contracts also allow for the withdrawal of funds on a book value basis to provide employee benefits such as a death benefit to a surviving beneficiary, disability benefits and benefits paid upon bona fide termination of employment. In the situations described above, the individual participant is to be distinguished from the policyholder. Typical contractual language is as follows:

1. Withdrawal for Redirection of Investments - Subject to the provisions of Subsection____above, the contract owner shall direct the withdrawal and transfer to the contract owner of the pro rata amounts from the accumulation accounts for the purpose of redirecting an employee investment to an equity fund in accordance with the provision of the Plan.

2. Withdrawal for Plan Benefit Payments - Subject to the provisions of Subsection____above, the contract owner shall direct the withdrawal and transfer to the contract owner of the pro rata amounts from the accumulation account due to distribution made to participants (or to their beneficiaries, in case of the participant’s death) under the Plan.

Both examples of contractual language make reference to the “provisions of the Plan.” Plan provisions reduce the disintermediation (C-3) risk, from the insurance company standpoint, associated with GICs. For example, plan provisions may restrict the opportunity for the 401 (k) plan participant to move funds from the GIC option to a competing “guarantee of principal” option within the plan.

The Standard Valuation Law utilizes a concept known as Plan Type to distinguish between different levels of voluntary withdrawal rights by policyholders. Voluntary withdrawal rights are contractual policyholder rights which may be exercised at the option of the policyholder and do not include such items as scheduled contractual payouts or payouts upon termination. The greater the level of voluntary withdrawal right afforded to the policyholder, the more conservative is the resulting valuation interest rate. Plan Types are designated in the Standard Valuation Law as with Plan Type A, Plan Type B or Plan Type C and are defined as follows:

1. Plan Type A is a plan under which the policyholder may not withdraw funds, or may withdraw funds at any time but only (a) with an adjustment to reflect changes in interest rates or asset values since receipt of the funds by the insurance company, (b) without such an adjustment but in installments over five years or more, or (c) as an immediate life annuity.

2. Plan Type B is a plan under which the policyholder may not withdraw funds before expiration of the interest rate guarantee, or may withdraw funds before such expiration but only (a) with an adjustment to reflect changes in interest rate or assets values since receipt of the funds by the insurance company, or (b) without such an adjustment but in installments over five years or more. At the end of the interest rate guarantee, funds may be withdrawn without such adjustment in a single sum or installments over less than five years.
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3. Plan Type C is a plan under which the policyholder may withdraw funds before expiration of the interest rate guarantee in a single sum or installments over less than five years either (a) without adjustment to reflect changes in interest rates or asset values since receipt of the funds by the insurance company, or (b) subject only to a fixed surrender charge stipulated in the contract as a percentage of the funds.

Text

For purposes of the application of the Standard Valuation Law to Guaranteed Interest Contracts (GICs) with benefit responsive provisions, the withdrawal of funds at book value for the purpose of redirecting or withdrawing an employee investment shall be considered a withdrawal by the policyholder unless the underlying plan or GIC contain written provisions which are designed to reduce the C-3 risk to the insurance company. As an example, a provision which meets this criteria would include both the following:

1. No direct transfer to competing funds, whether such funds are alternate funds of the insurance company or not. This provision prohibits direct transfer of funds from the GIC option to a competing plan option that offers either a guarantee of principal or to an option in which the risk of loss of principal is small such as a money market fund or short-term bond fund. Any transfer to such an option must first go through an non-competing plan option and reside there for at least 90 days or three months.

and

2. For GICs that fund plan investment options where interest is allocated to plan participants based on how much of their account balance is in each particular interest rate “cell,” participants are not allowed to redirect any of the balance they have in a GIC funding a particular cell to a competing fund until the GIC’s maturity date.

In addition, the valuation actuary must be satisfied that the GIC provisions designed to reduce the C-3 risk are administered by the insurer in the designed manner.

This requirement may be fulfilled by obtaining from the appropriate insurance company officer a certificate of intent regarding the insurance company administration of the provisions.

In addition, the valuation actuary must periodically review the actual experience under the contract to verify the appropriateness of the Plan Type assumption with reference to this Guideline.
Actuarial Guidelines

Actuarial Guideline XXXI

VALUATION ISSUES VS. POLICY FORM APPROVAL

Background

Occasionally, the NAIC Life and Health Actuarial Task Force addresses valuation (reserve) issues related to a policy form or benefit design that has not been accepted or approved by a particular state. The development of reserving methods or providing guidance concerning reserve questions for such policy forms is necessary because the annual statement filed in each state, including states for which a particular policy form has not been approved for use, must reflect appropriate reserve for all policy forms and associated benefits.

Text

The adoption of an Actuarial Guideline by the NAIC Life and Health Actuarial Task Force dealing with a reserve issue associated with a particular policy form or benefit does not represent an endorsement for the approval of the particular policy form or benefit.
Appendix C

Actuarial Guideline XXXII

RESERVE FOR IMMEDIATE PAYMENT OF CLAIMS

Background Material

Section 5 Reserve Valuation Method—Life Insurance and Endowment Benefits of the NAIC Standard Valuation Law refers to an annual premium in defining the commissioners reserve valuation method. However, it has been general practice to hold an additional reserve where fractional premiums are paid and any fractional premium not yet due in the policy year of death is waived and to hold a further additional reserve for the refund of any premium paid beyond the end of the month in the policy year of death. These additional reserves are called for in the Miscellaneous Section of Exhibit 8 of the annual statement. These additional reserves are generally included in the basic reserves where an insurer uses an assumption of continuous payment of premiums.

Although Section 7 of the NAIC Standard Nonforfeiture Law for Life Insurance explicitly permits in calculating nonforfeiture “the assumption that any death benefit is payable at the end of the policy year of death,” there is no similar explicit permission to use such assumption in the NAIC Standard Valuation Law. The annual statement instructions are silent on any adjustment. A long time ago some life insurance policies provided that claims would be paid at the end of the policy year of death. However, for many years many policies have provided that claims will be paid immediately upon satisfactory proof of death. In fact, some states require that interest shall accrue from date of death.

Many insurers have held a reserve for immediate payment of claims either by an adjustment to curtate reserves or by including provision therefore in the basic reserves calculated on a continuous payment of claims basis.

Text

RESERVES FOR IMMEDIATE PAYMENT OF CLAIMS

I. Reserves based on either fully continuous functions or on semi-continuous functions where the death portion reflects approximately one half of one year’s valuation rate of interest are considered as making appropriate provision for immediate payment of claims.

II. Where the basic reserves are based on curtate functions with no provision for immediate payment of claims:

1. For any policy where the contract calls for payment of death claims at the end of the policy year in which death occurs, no adjustment to curtate reserves need be made.

2. For any policy where the contract calls for payment of death claims immediately upon receipt of due proof of death of the insured, the death portion of curtate reserves shall be increased by one third of one year’s valuation rate of interest. (Approximations may be used to split the total curtate reserves into death portion and the pure endowment portion.)

3. For any policy where the contract provides for payment of interest on the death proceeds from date of death to date of payment, the death portion of curtate reserves shall be increased by one half of one year’s valuation rate of interest. (Approximations may be used to split the total curtate into the death portion.)

III. Where an insurer pays interest on death proceeds at an earlier point than as required by contract, it is appropriate that the statutory formula reflect such practice.
IV. Where the actual formula reserves are more conservative than minimum statutory formula reserves, an insurer using curtate functions without provision for immediate payment of claims must demonstrate compliance with minimum statutory formula reserves adjusted in accordance with II above.

V. This guideline shall apply to all new life insurance policies issued beginning January 1 following the date the guideline is adopted.

VI. The guideline shall be applicable to policies issued prior to the date the guideline is adopted with any additional reserve graded in as follows for the years following the date the guideline is adopted:

1. First year 20%
2. Second year 40%
3. Third year 60%
4. Fourth year 80%
5. Fifth and later years 100%
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Actuarial Guideline XXXIII

DETERMINING CARVM RESERVES FOR ANNUITY CONTRACTS WITH ELECTIVE BENEFITS

Background Information

1. Introduction

The Standard Valuation Law (SVL) defines the methods and assumptions which are to be used in determining minimum statutory formula reserves. This law establishes the standards for annuity contracts and includes the criteria for the interest and mortality assumptions to be used in determining minimum formula contract reserves. The 1980 revisions to the SVL provide for the maximum statutory formula reserve interest rate to be determined through a dynamic formula in order to incorporate changes in economic conditions, liquidity needs and the risks inherent in certain types of contracts.

The SVL defined methodology for annuity contracts, the commissioners annuity reserve valuation method (CARVM), requires that reserves be the greatest of the respective excesses of the present values, at the date of valuation, of the future guaranteed benefits, including guaranteed nonforfeiture benefits, provided for by such contracts at the end of each respective contract year, over the present value, at the date of valuation, of any future valuation considerations derived from future gross considerations, required by the terms of such contracts, that become payable prior to the end of such respective contract year. Such reserves are established to adequately fund all guaranteed contract obligations, including those obligations which are optional to the contract owner and which may not have yet been elected.

Industry practices and methods of reserving under CARVM for annuity contracts with multiple benefit streams have not been found to be consistent. These range from a low reserve equal to the cash surrender value to a reserve representing the greatest actuarial present value of the future benefit streams under all potential annuity or other nonforfeiture benefit election options using a conservative rate of interest.

The major purpose of this Actuarial Guideline is to provide clarification and consistency in applying CARVM to annuities with multiple benefit streams. Some of the areas requiring clarification include: the valuation of annuitization benefits; the application of incidence rates in CARVM; the application of the integrated benefit stream approach in CARVM; how to determine valuation interest rates and mortality tables for multiple benefit streams; and certain practical considerations regarding multiple benefit streams.

2. Annuitzation Benefits

Varying forms of contracts provide that the cash value available to the contract owner is less than the amount available to purchase an annuitization option under the terms of the contract.

For purposes of this Actuarial Guideline, “accumulation fund” is defined as the policy value which is used to purchase an annuity option under the terms of the contract.

Frequently there are significant discontinuities in the reserves, both upward and downward, at the time a settlement option is elected, between the reserve held immediately prior to the settlement as compared to the reserve required for the greatest actuarial present value of the annuitization option elected.
One of the most significant reasons for discontinuities in the reserve patterns at the time of election is the difference in the SPIA valuation rate available at the time of election as compared to the valuation rate used based on the date of issue of the original SPDA contract. Another significant reason is the difference between the guaranteed purchase rate contained in the contract and used for reserve development as compared to the rate actually used to purchase the annuity option at the time of election.

3. Application of Incidence Rates in CARVM

Since CARVM was adopted, there has been an increase in the types of benefits offered under certain annuity contracts, including enhanced death benefits, nursing home benefits, and various partial withdrawal provisions. For some of these benefit types, the SVL is not explicit as to whether incidence tables prescribed under the SVL may be used to determine such benefits, versus requiring consideration of all contract owner options available under the contract, and choosing the set of incidence rates which produce the greatest present value.

4. Integrated Benefit Stream Approach

CARVM requires that reserves be based on the greatest present value of all potential future guaranteed benefits. For annuity contracts offering more than one type of potential benefit stream, the SVL is not explicit regarding whether or how blends of more than one type of benefit must be considered under CARVM.

Under the integrated benefit stream approach, any potential benefit stream must be considered, including blends reflecting the interaction of more than one type of benefit. Such potential benefit streams include all types of benefits for which the greatest present value concept is required. Additionally, adjustments must be made to all such potential benefit streams to reflect those benefit types for which prescribed incidence tables are required (e.g., death benefits).

For example, consider an annuity contract offering surrender, annuitization and death benefits. Potential benefit streams that would be considered include surrender streams, annuitization streams, and streams reflecting blends of surrender and annuitization benefits. All such streams would also be adjusted to reflect death benefits and to discount all benefits for survivorship (based on the mortality table prescribed in the SVL).

5. Valuation Interest Rates

For annuities offering more than one type of benefit, the SVL is not explicit as to how valuation interest rates should be determined. The SVL is also not explicit as to how valuation interest rates should be determined for certain types of benefits offered under annuity contracts, such as death and nursing home benefits.

Purpose

The purpose of this Actuarial Guideline is to codify the basic interpretation of CARVM and does not constitute a change of method or basis from any previously used method, by clarifying the assumptions and methodologies which will comply with the intent of the SVL. This Actuarial Guideline shall apply to all annuity contracts subject to CARVM, where any elective benefits (as defined below) are available to the contract owner under the terms of the contract. However, life or health insurance riders attached to an annuity contract, where all components of the rider (e.g., premiums, benefits, contract charges, accumulation values and other components) are separate and distinct from the components of the annuity contract should be treated as a separate life or health insurance contract not subject to this Actuarial Guideline. While this Actuarial Guideline applies to all annuity contracts subject to CARVM, in the event an actuarial guideline or regulation dealing with reserves is developed for a specific annuity product...
design, the product specific actuarial guideline or regulation will take precedence over the Actuarial Guideline.

Definitions

1. Elective and Non-Elective Benefits in CARVM

For purposes of determining reserves under CARVM, each benefit available under the annuity contract must be placed into one of the two categories defined as follows:

Non-Elective Benefits: Benefits that are payable to contract owners or beneficiaries only after the occurrence of a contingent or scheduled event independent of a contract owner’s election of an option specified in the contract, including (but not limited to) death benefits, accidental death benefits, disability benefits, nursing home benefits, and benefits payable under either a deferred or immediate annuity contract (with or without life contingencies), where no benefit options are available under the terms of the contract.

Elective Benefits: Benefits that do not fall under the non-elective benefits category (i.e., benefit options that may be freely elected under the terms of the contract). Elective benefits include (but are not limited to) full surrenders, partial withdrawals, and full and partial annuitizations.

In some cases it may not be clear whether some benefits are elective or non-elective. For example, some annuity contracts offer benefits which vary depending upon the age of retirement. In such cases, the Valuation Actuary should use judgment in making this determination, by considering factors such as the degree to which contract owner actions would be influenced by the availability of the benefit.

2. Elective and Non-Elective Incidence Rates in CARVM

For non-elective benefits, incidence rates from tables prescribed by the SVL should be applied to determine the payment of non-elective benefits and to discount, for survivorship, all benefit payments included in an Integrated Benefit Stream, as defined below. If no incidence tables are prescribed by the SVL, then company or industry experience (with margins for conservatism) may be used, as appropriate. Annuity mortality tables prescribed by the SVL should be used to determine all mortality based benefits under the contract (including, but not limited to, annuitizations and death benefits) and to discount other types of benefit payments for survivorship.

For elective benefits, incidence rates should not be based on tables reflecting past company experience, industry experience or other expectations. Instead, every potential guaranteed elective benefit stream required to be reserved by CARVM must be considered in the determination of integrated benefit streams as defined below. This is accomplished by considering trial sets of guaranteed elective benefit incidence rates, either through numerical testing or analytical means, to determine which trial set produces the “greatest present value” as described in Text paragraph 1 below. Theoretically, this means that all possible elective benefit incidence rates between 0% and 100% should be considered. However, in practice, such a greatest present value will typically occur by assuming an incidence rate of either 0% or 100%.

3. Integrated Benefit Stream

An integrated benefit stream is one potential blend of guaranteed elective and non-elective benefits available under the contract, determined as the combination of A and B, where:
A equals one potential stream of one or more types of guaranteed elective benefits available under the terms of the contract, based upon a chosen set of elective benefit incidence rates; and

B equals the stream of all guaranteed non-elective benefits provided under the terms of the contract, recognizing the guaranteed elective benefit stream under consideration in A above, and the non-elective incidence rates defined in 2. above.

Both A and B above should be discounted for survivorship, based on the non-elective incidence rates defined in 2. above.

Text

1. Greatest Present Value

All guaranteed benefits potentially available under the terms of the contract must be considered in the valuation process and analysis and the ultimate policy reserve held must be sufficient to fund the greatest present value of all potential integrated benefit streams, reflecting all guaranteed elective and non-elective benefits available to the contract owner. Each integrated benefit stream available under the contract must be individually valued and the ultimate reserve established must be the greatest of the present values of these values, based on valuation interest rate(s) as defined in Section 3 below.

2. Examples of Integrated Benefit Streams That Must Be Considered

A. Cash Value Streams

One mandatory set of integrated benefit streams for a deferred annuity with cash settlement values which must always be considered is any possible blend of future guaranteed partial withdrawals and full surrenders available under the contract, as specified in the SVL, accumulated at the guaranteed credited interest rate(s) and discounted at the valuation rate(s) of interest defined in section 3 below, with appropriate recognition of all guaranteed non-elective benefits available under the contract.

B. Annuitization Streams

A second mandatory set of integrated benefit streams that must be considered is any possible blend of future guaranteed full or partial annuitization elections, as specified in the SVL, available to the contract owner at each election date required by CARVM, with appropriate recognition of all guaranteed non-elective benefits available under the terms of the contract. In determining the integrated benefit streams to value the annuitization option, the guaranteed purchase rates contained in the contract, as well as any other contract provisions, excluding any current purchase rates which may be applicable, are applied to the accumulation fund.

C. Other Elective Benefit Streams

In addition to the cash value and annuitization streams described above, all other possible guaranteed elective benefits available under the contract, including blends of more than one type of guaranteed elective benefit, must be considered in a manner consistent with the mandatory cash value and annuitization streams, with appropriate recognition of all guaranteed non-elective benefits available under the contract.
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3. Determination of Valuation Interest Rates

Section 4b of the SVL determines valuation rates for an annuity contract based on the following Parameters:

A. The basis of valuation (issue year or change in fund);
B. Whether or not the annuity provides for cash settlement options;
C. Whether interest is guaranteed on premiums received more than 12 months following issue (or the valuation date for change in fund basis);
D. The guarantee duration; and
E. The Plan Type.

Parameters A, B and C above should be determined at a contract level. Additional requirements regarding the change in fund basis of valuation are set forth in Section 5 below. Parameters D and E should be determined at a benefit level, as set forth in Section 4 below.

Under a contract level determination, parameters are set based on the characteristics of the contract as a whole. Under a benefit level determination, parameters are set based on the characteristics of each benefit, resulting in potentially different valuation rates for each benefit type comprising the integrated benefit stream.

4. Determination of Guarantee Duration and Plan Type

Guarantee duration and Plan Type are based upon the specific characteristics of each individual benefit type that comprise the integrated benefit stream, as follows:

A. For portions of the integrated benefit stream attributable to full surrender and partial withdrawal benefits, the Plan Type should be based upon the withdrawal characteristics of the benefit, as stated in the contract. This may result in a Plan Type A, B or C under the 1980 amendments of the SVL. The guarantee duration is the number of years for which interest rates are guaranteed in excess of the calendar year statutory valuation interest rate for life insurance policies with guarantee duration in excess of twenty (20) years.

B. For portions of the integrated benefit stream attributable to full and partial annuitization benefits, the determination of the valuation interest rate involves the use of the appropriate Plan Type and weighting factor as determined by the SVL, with the guarantee duration as the number of years from the original date of issue or date of purchase, to the date the annuitization is assumed to commence. If the underlying assumption is that the contract owner may withdraw funds only as an immediate life annuity or as installments over 5 years or more, this will generally result in a Plan Type A, under the 1980 amendments of the SVL, with the valuation interest rate changing as different assumed annuitization dates determine guarantee durations which will fall into different guarantee duration bands under the SVL. An assumed annuitization option which has a non-life contingent payout period of less than five (5) years shall be considered a Plan Type C, with the valuation interest rate changing as different assumed annuitization dates determine guarantee durations which will fall into different guarantee duration bands under the SVL.

C. For portions of the integrated benefit stream attributable to non-elective benefits, since the underlying assumption is that no withdrawal is permitted, Plan Type A should generally be used, with a guarantee duration determined as the number of years from issue or purchase to the date non-elective benefits may first be paid. In most cases, the guarantee duration should be less than five years, since non-elective benefit coverage...
usually begins immediately after issue, with benefits payable commencing in the first contract year.

5. Change in Fund Basis

As indicated by section 4b.C.(1)(c)(vi) of the SVL, a company may elect to value annuity contracts with cash settlement options on either an issue year basis or on a change in fund basis. Annuity contracts with no cash settlement options must be valued on an issue year basis. The issue year basis or change in fund basis should be determined for the contract as a whole, and thus must be consistently applied to all portions of all integrated benefit streams available under the annuity contract. The election of issue year or change in fund basis must be made at the issuance of the contract and must not change during the term of the contract without the prior written approval of the commissioner.

6. Purchase Rates

Contracts may provide, as contractual guarantees, the use of preferential purchase rates to those listed in the contract. As an example, a contract may provide that the company will offer, at the time of annuitization, the rates offered to new purchasers of immediate annuities if such rates will provide a higher annuity benefit than would result from the contractually guaranteed rates provided in the contract. This creates a contract guarantee which must be valued under CARVM. Ignoring this benefit in determining reserves will produce reserves less than the statutory formula reserves required under CARVM. Valuation of this benefit, however, is complicated by the fact that the company does not currently know what the exact rate will be at the time of the settlement election. In order to determine conservative statutory formula reserves, if use of future unknown rates are guaranteed, the company shall establish reserves not less than the contract’s accumulation fund value, on the valuation date, reduced by an “expense allowance” not to exceed 7% of such fund. This section does not require the calculation of a reserve for the annuitization of business based upon current purchase rates pursuant to the “annuitization streams” described in Paragraph 2.B. above.

Likewise for contracts which provide for additional amounts during the payout period over those guaranteed at the commencement of the annuity payments, the reserve during the deferred period shall not be less than the contract’s accumulation fund reduced by an expense allowance not to exceed 7% of such fund.

7. Practical Considerations

The major purpose of this Actuarial Guideline is to provide clarification and consistency in applying CARVM to annuities with multiple benefit streams. However, in practice there may be other acceptable methods of applying CARVM which are substantially consistent with the methods described in this Actuarial Guideline. Such methods may also be used, with prior regulatory approval.

Additionally, in applying this Actuarial Guideline there may theoretically be an infinite number of contract owner options that are possible under the contract. However, it may not be practical, possible or even appropriate to test every conceivable combination of potential integrated benefit streams theoretically available under the contract. This Actuarial Guideline requires that the actuary consider, not necessarily test, all potential integrated benefit streams to determine to what extent each contract owner option has a material impact on the reserve. In practice, the actuary may be able to eliminate some potential integrated benefit streams by analytical methods. The actuary may also be able to demonstrate the reserve adequacy of certain approximations. For example, in certain situations it may be shown that a CARVM reserve ignoring non-elective
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benefits, plus an “add-on” reserve for non-elective benefits, is a reasonable approximation for the theoretically correct CARVM reserve.

Effective Date

This guideline shall be effective on December 31, 1998 affecting all contracts issued on or after January 1, 1981. A company may request a grade-in period for contracts issued prior to December 31, 1998 from the domiciliary commissioner upon satisfactory demonstration that the method and level of current reserves held for such contracts are adequate in the aggregate. This phase-in will require establishment of no less than 33 1/3% of the additional reserves resulting from the application of this guideline on December 31, 1998, no less than 66 2/3% on December 31, 1999, and 100% by December 31, 2000.
Actuarial Guideline XXXIV

VARIABLE ANNUITY MINIMUM GUARANTEED DEATH BENEFIT RESERVES

I. Background

The purpose of this Actuarial Guideline is to interpret the standards for the valuation of reserves for Minimum Guaranteed Death Benefits (MGDBs) included in variable annuity contracts. This Guideline codifies the basic interpretation of the Commissioners Annuity Reserve Valuation Method (CARVM) by clarifying the assumptions and methodologies which will comply with the intent of the Standard Valuation Law (SVL).

For many years the industry has struggled with the issue of applying a uniform reserve standard to variable annuities in general, and to MGDBs in particular. Three regulatory sources are often looked to for guidance. First, the SVL requires that CARVM be based on the greatest present value of future guaranteed benefits. Second, Actuarial Guideline XXXIII requires that “each benefit stream available under the contract must be individually valued and the ultimate reserve established must be the greatest of the present values of these values.” Third, the NAIC model Variable Annuity Regulation (VAR) states that the “reserve liability for variable annuities shall be established pursuant to the requirements of the Standard Valuation Law in accordance with actuarial procedures that recognize the variable nature of the benefits provided and any mortality guarantees.”

This Guideline interprets the standards for applying CARVM to MGDBs in variable annuity contracts, employing methods that recognize the variable nature of the benefits. It clarifies standards for developing integrated benefit streams, where MGDBs are integrated with other benefits such as surrenders and annuitizations. It also clarifies standards for determining the level of reserve to be held in the General Account.

This Guideline requires that MGDBs be projected by assuming an immediate drop in the values of the assets supporting the variable annuity contract, followed by a subsequent recovery at a net assumed return until the maturity of the contract. The projection should reflect the contractual definition of the MGDB and any contractual limitations, such as provisions that terminate the MGDB at a given age and those that restrict the MGDB to a given multiple of contract contributions. The immediate drops and assumed returns used in the projection vary by five asset classes in order to reflect the risk/return differentials inherent in each class.

This Guideline also interprets the mortality standards to be applied to projected MGDBs in the reserve calculation. As part of the study of mortality experience under variable annuities during the deferral period, the Society of Actuaries’ Task Force on Mortality Guarantees in Variable Products will be validating the appropriateness of this mortality standard and, if necessary, recommend an alternative course of action.

In addition, this Guideline clarifies standards for reserve methods for reinsurance transactions involving MGDBs. Unlike the annuity writer, the reinsurer may not be able to integrate the MGDB with other base contract benefits, since the reinsurer does not normally reinsure any aspects of the variable annuity other than the death benefit. The reinsurer and the direct writer do face identical fund performance risks, so it is appropriate that the reinsurer’s reserve method incorporate the same immediate drops and recoveries as the direct writer. Similarly, the reinsurer’s reserve method should include a future projection of MGDB levels, to appropriately assess future death benefit obligations. Furthermore, just as the direct writer’s reserve calculation
should recognize the underlying asset charges, the reinsurer’s reserve calculation should recognize reinsurance premiums.

Finally, there are some companies that have not applied CARVM in calculating variable annuity reserves. For example, some companies have held a reserve equal to the account value. Such companies may be able to demonstrate that their reserves meet or exceed the levels set by applying this Guideline, and that no additional MGDB reserves are required. Alternatively, other companies which have held a reserve equal to the cash surrender value may need to hold an additional MGDB reserve such that their total reserve is at least equal to the levels set by applying this Guideline. In these situations, the company must determine an appropriate allocation of the total reported reserve between the General and Separate Accounts.

II. Scope

This Guideline applies to variable annuity contracts which provide a Minimum Guaranteed Death Benefit that has the potential to exceed the account value, whether or not the MGDB exceeds the account value on the valuation date. This Guideline does not apply to group variable annuity contracts which are not subject to CARVM. Currently offered MGDBs falling under the scope of this guideline include, but are not limited to, provisions commonly referred to as Return of Premium, Roll-ups, Ratchets and Resets. However, the actuary should also exercise judgment in determining the applicability of this Guideline. For example, it may be inappropriate to utilize this Guideline for a contract with an MGDB where the associated net amount at risk (NAR) decreases when the underlying funds experience a drop in market value or a period of underperformance.

III. Definitions

“Reduced Account Value”: The account value on the valuation date, reduced by the sum of the immediate drops for each asset class, as defined in Section IV.D.

“Projected Reduced Account Value”: The Reduced Account Value, projected into the future using the Net Assumed Returns for each asset class, as defined in Section IV.D. The determination of the Projected Reduced Account Value need not reflect future partial withdrawals.

“Projected Net Amount at Risk”: The projected death benefit resulting from the MGDB and the Projected Reduced Account Value, less the Projected Reduced Account Value.

“Projected Unreduced Account Value”: The projected account value, without reduction for an immediate drop, projected using a return based on the valuation rate less appropriate asset based charges.

“Base Benefit Streams”: The streams of projected benefits reflecting the Projected Unreduced Account Values and ignoring MGDBs.

“Integrated Benefit Stream”: Streams which reflect the Base Benefit Streams discounted for survivorship and the MGDBs discounted for mortality.

“Calculation Period”: The periods for which the Integrated Benefit Streams are projected in the Integrated Reserve calculation, consisting of successive periods, beginning with the remainder of the contract year following the valuation date and ending with the period from the valuation date to the maturity date of the contract.

IV. Text
A. General Methodology

The valuation of reserves for MGDBs involves two CARVM reserve calculations: a Separate Account Reserve and an Integrated Reserve. The Integrated Reserve represents the total reserve held by the company in support of the entire variable annuity contract. The additional reserve held for the MGDB, which equals the excess of the Integrated Reserve over the Separate Account Reserve, but not less than zero, is held in the General Account.

B. Separate Account Reserve Calculation

The Separate Account Reserve represents the reserve that would be held in the absence of the MGDB.

C. Integrated Reserve Calculation

The Integrated Reserve is a CARVM reserve determined using all contract benefits, including the MGDB. It equals the greatest present value, as specified in the SVL and the VAR, of future Integrated Benefit Streams available under the terms of the contract.

The integration of the MGDB with other contract benefits in the determination of future Integrated Benefit Streams is accomplished by combining three separate benefit streams A, B and C described below. These future Integrated Benefit Streams are determined over all Calculation Periods, and are discounted at the valuation interest rate (discussed further in Section IV.E.).

- A is the stream of Projected Net Amounts at Risk paid to those expected to die during the Calculation Period, based on valuation mortality (discussed further in Section IV.E.).
- B is the benefit stream of Projected Unreduced Account Values paid to those expected to die during the Calculation Period, based on valuation mortality.
- C is the Base Benefit Streams provided during the Calculation Period, and is discounted for survivorship based on valuation mortality.

The greatest present value occurs in the Calculation Period in which the present value of the future Integrated Benefit Streams is maximized (as opposed to the present values of A, B and C being individually maximized).

The Integrated Reserve is also subject to the asset adequacy analysis requirement in subsection G.

D. Immediate Drops and Assumed Returns

The Projected Net Amount at Risk described in Section IV.C. is determined by assuming an immediate drop in the supporting asset values, followed by a subsequent recovery based upon a net assumed return.

For example, the Reduced Account Value after the immediate drop would equal the account value on the valuation date, multiplied by (1 - Immediate Drop Percentage). The Projected Reduced Account Value “n” years later would equal the Reduced Account Value multiplied by (1 + Net Assumed Return)^n. The projection should continue until the maturity of the contract.
To determine the immediate drop and net assumed return, the Separate Account funds supporting the variable annuity contracts on the valuation date should be allocated to the five asset classes as follows:

- Equity Class
- Bond Class
- Balanced Class
- Money Market Class
- Specialty Class

Descriptions of these classes are contained in Appendix III. Since these descriptions are broad in nature, the ultimate determination of the appropriate fund classifications, for purposes of this Guideline, is the responsibility of the appointed actuary.

The Immediate Drop Percentages and Gross Assumed Returns for each asset class are shown in Appendix I. The Gross Assumed Returns shown do not include deductions for asset based charges. Each company should deduct its own asset based charges from those shown to obtain the Net Assumed Returns to be used in determining the Projected Reduced Account Values.

Many variable annuity contracts provide for various types of Fixed Account options, in which underlying guarantees, consistent with General Account annuities, are provided. The fixed account should be projected as a separate asset class, with an Immediate Drop Percentage equal to zero and a Net Assumed Return equal to the guaranteed rate(s).

The Immediate Drop for each contract is determined by taking the sum of the immediate drops for each asset class. The Net Assumed Return for each contract is determined by taking the weighted average of the Net Assumed Returns for each asset class, based upon the allocation of the total account value between the asset classes.

E. Valuation Mortality and Interest

The mortality basis used to discount projected death benefits is the 1994 Group Annuity Mortality Basic Table (1994 GAMB), increased by 10% for margins and contingencies, without projection. This table, referred to as the 1994 Variable Annuity MGDB Mortality Table, is shown in Appendix II.

The valuation interest rates used for both the Separate Account Reserve and the Integrated Reserve should be annuity valuation interest rates, consistent with those required in the SVL and the VAR.

F. Reinsurance Reserve

1. Reinsurance Ceded

For contracts which reinsurance some or all of the MGDB, an Integrated Reserve net of reinsurance must be calculated. This reserve should be calculated as outlined in Section IV.C., with the Integrated Benefit Streams being modified to reflect both the payment of future reinsurance premiums and the recovery of future reinsured death benefits. This is accomplished by treating the future reinsurance
premium as an additional benefit and reducing the MGDB in the benefit stream of the Integrated Reserve calculation by future reinsurance recoveries.

Similar to the formula demonstrated in Section IV.C., the determination of future Integrated Benefit Streams including the impact of reinsurance is accomplished by combining four separate benefit streams: \( A' \), \( B' \), \( C \), and \( D \), described below. These future Integrated Benefit Streams are determined over all Calculation Periods, and are discounted at the valuation interest rate.

- \( A' \) is the stream of Projected Net Amounts at Risk paid to those expected to die during the Calculation Period, based on valuation mortality. It is equal to benefit stream \( A \) defined in Section IV.C., reduced by future Projected Net Amounts at Risk reinsurance recoveries.

- \( B' \) is the benefit stream of Projected Unreduced Account Values paid to those expected to die during the Calculation Period, based on valuation mortality. It is equal to benefit stream \( B \) defined in Section IV.C., reduced by future Projected Unreduced Account Values reinsurance recoveries.

- \( C \) is as defined in Section IV.C.

- \( D \) is the stream of future projected reinsurance gross premiums during the Calculation Period, determined using Projected Reduced Account Values and discounted for survivorship, using valuation mortality.

The greatest present value occurs in the Calculation Period in which the present value of the future Integrated Benefit Streams, net of reinsurance, is maximized. This Calculation Period does not necessarily have to be the same as the Calculation Period which maximizes the Integrated Benefit Streams before consideration of reinsurance.

The reinsurance reserve credit the ceding company is entitled to is equal to the difference between the Integrated Reserve before any consideration of reinsurance and the Integrated Reserve net of reinsurance. The Integrated Reserve net of reinsurance may be greater than the Integrated Reserve before any consideration of reinsurance (i.e., the reserve credit may be negative).

2. Reinsurance Assumed

The reserve for reinsurers assuming MGDB risk is the maximum difference, at each Calculation Period, between the present value of the reinsured death benefits and the present value of reinsurance premiums.

Referring to the formulas above, the reinsured death benefit is the difference between the combination of benefit streams \( A' \) and \( B' \), and the combination of benefit streams \( A \) and \( B \), while benefit stream \( D \) represents the stream of reinsurance premiums defined above (i.e., \( A-A'+B-B' \)). Each of these benefit streams is discounted using valuation mortality and interest assumptions consistent with those used by the ceding company.

The greatest present value occurs in the Calculation Period in which the difference between the present value of the reinsured death benefits and the present value of reinsurance premiums is maximized. This Calculation Period
Appendix C

does not necessarily have to be the same as the Calculation Period which maximizes the Integrated Reserve, either before or after consideration of reinsurance.

G. Asset Adequacy Analysis Requirement

The Projected Reduced Account Value, and consequently, the Projected Net Amount at Risk need not reflect future partial withdrawals. There is also the possibility that other risks may not be reflected in the reserve calculations described above. Therefore, the appointed actuary shall perform a standalone asset adequacy analysis of the total reserve held for all of the contracts falling within the scope of this Guideline. Such analysis shall be performed reflecting the assets supporting the total reserve held for the contracts and all benefits and guarantees associated with the variable annuity contracts, as well as all expenses and charges associated with the variable annuity contracts. The analysis shall be performed on an aggregate basis, consistent with the requirements of Section 6 of the NAIC Model Actuarial Opinion and Memorandum Regulation, including the requirement that the analysis conform to the Actuarial Standards of Practice as promulgated from time to time by the Actuarial Standards Board. However, no separate actuarial opinion is required by this Guideline. If such analysis reveals a reserve shortfall, the total reserves held for the contracts must be increased accordingly.

Where Minimum Guaranteed Death Benefits are reinsured, the asset adequacy analysis may reflect the reinsurance. However, if the inclusion of reinsurance would increase the Integrated Reserve, then reinsurance must be reflected in the asset adequacy analysis.

H. Effective Date

This Guideline affects all contracts issued on or after January 1, 1981. Where the application of this Guideline produces higher reserves than the company had otherwise established by their previously used interpretation, such company must comply with this Guideline effective December 31, 1998. However, such company may request a grade in period, of not to exceed three (3) years, from the domiciliary Commissioner upon satisfactory demonstration of the previous interpretation and that such delay of implementation will not cause a hazardous financial condition or potential harm to its policyholders.
### Immediate Drop Percentages and Gross Assumed Returns

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### APPENDIX II

**1994 Variable Annuity MGDB Mortality Table**

**FEMALE Age Last Birthday**

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### APPENDIX II

**1994 Variable Annuity MGDB Mortality Table**

**MALE Age Last Birthday**

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© 2004 National Association of Insurance Commissioners
## APPENDIX II

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APPENDIX III

Description of Asset Classes

Equity Class

Although equity funds have a broad range of investment objectives, all invest primarily in publicly traded securities, such as common stocks, preferred stocks and convertible securities. The choice of securities purchased by the portfolio manager will be guided by the fund objective (such as Growth of Capital or Income, or Approximating an Index), the capitalization of the companies issuing the stock (e.g., small, medium or large) or the target region (domestic U.S., Pacific Rim, Latin America, etc.). Although some equity funds maintain a general strategy, allowing a portfolio manager great latitude in purchase, other equity funds have become quite specific in their investment objectives. All equity funds, however are somewhere on the high end of the risk/return scale.

Bond Class

Investment objective is usually to provide a high level of income consistent with moderate fluctuations in principal value. The objective is accomplished through investments in fixed income securities, such as U.S. government securities, foreign government securities, or publicly traded debt securities issued by U.S. or foreign corporations. Since most bonds are assigned ratings by private Rating Agencies, the specific objectives of the funds are often described by the funds’ tolerance for instruments at the various rating levels. Funds that focus predominantly on safety will tend to use more U.S. Government securities, while a fund that focuses predominantly on income may tend to use more lower investment grade instruments. All bond funds, however, are somewhere in the midrange of the risk/return scale.

Balanced Class

Investment objective is to seek a maximum total return over time, consistent with an emphasis on both capital appreciation and income. Typically, these funds will contain 50%-75% stocks, with the remaining assets invested in bonds and cash equivalents. However, balanced funds grant the portfolio manager the latitude to shift the asset allocation depending on a current analysis of market trends. Beside the term “Balanced,” common terms for this fund type include “Total Return,” “Adviser’s” and “Asset Allocation.”

Money Market Class

Investment objective is to achieve maximum current income consistent with liquidity and preservation of capital. These funds typically aim to maintain a stable net asset value of $1 per share. The assets contained in this fund typically have a stated maturity of less than thirteen months with an average maturity of less than 90 days. Common assets held include U.S. Government obligations, certificates of deposit, time deposits and commercial paper.

Specialty Class

Investment objective is to seek a maximum total return with an emphasis on long term capital appreciation, and sometimes current income. Typically, this fund type will invest most of its assets in common stocks or debt instruments of companies that operate within a specified industry. Commonly, specialty funds invest in utilities, natural resources and real estate, although there is a broad range of possible industries to choose from. The key difference between a specialty fund and an equity or bond fund is the targeted approach to investing. In a specialty fund, no effort is made to diversify outside the target industry.
Actuarial Guidelines

Actuarial Guideline XXXV

THE APPLICATION OF THE COMMISSIONERS ANNUITY RESERVE METHOD TO EQUITY INDEXED ANNUITIES

Background

The purpose of this Actuarial Guideline is to interpret the standards for the valuation of reserves for equity indexed annuities. This Guideline codifies the interpretation of the Commissioners Annuity Reserve Valuation Method (CARVM) by clarifying the computational methodologies which will comply with the intent of the Standard Valuation Law (SVL).

Equity indexed deferred annuity products provide policyholders with a minimum guaranteed interest accumulation rate on a portion of all premium payments and a portion of the growth, if any, of an equity based index such as the S&P 500. While there is no “typical” equity indexed product, there are design features that are common to most products. Some of these features are a participation rate guaranteed for one or more years, a cap on the portion of the index growth that is credited to policyholders, and a policy term which defines a time period for which current guarantees are applicable.

Equity indexed immediate annuity products provide policyholders with a minimum guaranteed annuitization rate and an opportunity to receive larger periodic payments based on the growth, if any, in an equity index. The product design may include features such as a participation rate, cap or term.

While contract parameters such as participation rate and cap are guaranteed for a period of time, growth of the underlying index is not. Index growth may be positive or negative. This combination of guaranteed parameters and unknown equity index growth makes the application of CARVM to these products problematic.

CARVM defines minimum statutory reserves as “the greatest of the respective excesses of the present value, at the date of valuation, of the future guaranteed benefits, including guaranteed nonforfeiture benefits, … over the present value, at the date of valuation, of any future valuation considerations derived from future gross considerations, required by the terms of such contract, that become payable prior to the end of such respective contract year. The future guaranteed benefits shall be determined by using the mortality table, if any, and the interest rate, or rates, specified in such contracts for determining guaranteed benefits.”

In order that all insurers issuing equity indexed annuity products establish reserves for statutory reporting purposes that are consistent with CARVM minimum statutory formula reserves requirements, this actuarial guideline identifies a computational method that is deemed to be consistent with CARVM in situations when specific operational criteria called “Hedged as Required” criteria are met. In addition, two computational methods are defined that are deemed to be consistent with CARVM in the event the “Hedged as Required” criteria are not met.

Two forms of the “Hedged as Required” criteria are provided. The “basic” criteria are applicable when an insurer uses long dated options to hedge the equity risk embedded in an equity indexed annuity. The second set of criteria is applicable when an insurer uses an option replication strategy.

Scope

This Actuarial Guideline applies to all equity indexed annuity contracts, regardless of the date of issue, that are subject to CARVM.
Appendix C

Computational Methods

Computational methods deemed to be consistent with CARVM can be classified into two groups, Type 1 methods and Type 2 methods. The following computational method is considered a Type 1 method: the Enhanced Discounted Intrinsic Method (EDIM). Type 1 computational methods are deemed to be consistent with CARVM if the applicable “Hedged as Required” are met. The following methods are considered Type 2 methods: the Commissioners Annuity Reserve Method with Updated Market Values (CARVM with UMV) and the Market Value Reserve Method (MVRM). Also, an adaptation of the MVRM, known as the Black-Scholes Projection Method (BSPM), is recognized. For a complete description of these methods, please consult Attachment 1.

General Requirements on the Use of Certain Computational Methods

The MVRM and EDIM computational methods are both based on a future value. In the case of MVRM, a projected index is determined. The projected index is then used to determine end of term and interim benefit amounts. CARVM is applied to these benefit amounts. In the case of EDIM, the end of term guaranteed value (a future value) is used to determine an interest rate for calculating terminal reserves for the guaranteed benefits after the initial terminal reserve. Determination of the “term” is an essential component of both computational methods.

The EDIM, MVRM and the BSPM adaptation of the MVRM computational methods are considered acceptable interpretations of CARVM under the following conditions:

1. The policy form design features a single dominant benefit which is the most likely benefit to be provided under the policy form with the determination of the single dominant benefit based on a consideration of product features such as the pattern of guaranteed participation rates, surrender charges, vesting rates, spread deductions, and marketing/advertising material.

2. The point in time associated with the single dominant benefit most likely to be provided under the contract is used as the terminal point of the current term for purposes of applying the computational method and complying with the “Hedged as Required” criteria, if applicable.

3. The appointed actuary has demonstrated to the satisfaction of the regulatory officials in each state in which the insurer is required to submit a statutory financial statement, prior to the use of the MVRM or EDIM computational methods, that the requirements above have been met.

Variations from the MVRM and EDIM as described in Attachment 1, are not acceptable interpretations of CARVM. The BSPM is considered an acceptable adaptation of the MVRM.

Type 1 Methods

A Type 1 computational method is deemed to be consistent with CARVM if an insurer using the method complies with the applicable “Hedged as Required” criteria (Attachment 2) and provides a certification as to compliance with the criteria. The certification must be signed by the appointed actuary. The certification shall be provided with each annual and quarterly statutory financial statement filed with the appropriate insurance regulatory official in each state in which the insurer does business.

For purposes of determining compliance with the “equivalence of characteristics” requirement in the “Hedged as Required” criteria, the current term of an equity indexed deferred annuity policy will be determined based on the requirements in the section captioned “General Requirements on Use of Certain Computational Methods.” For purposes of applying a Type 1 computational method, the time horizon for
present value calculations should be based on the current term of the policy based on the requirements in the section captioned “General Requirements on Use of Certain Computational Methods.”

The Enhanced Discounted Intrinsic Method (EDIM) requires an initial reserve amount that is determined by methods that are not specifically included in the EDIM. For purposes of compliance with statutory minimum formula reserve requirements, the initial reserve under EDIM must be set at least equal to the initial reserve produced by either CARVM with UMV, or the MVRM with assumptions used to compute any necessary option market values reasonable as of the date of issue of the policy. The insurer must provide a certification (Attachment 3) as to the reasonableness of the assumptions.

Type 2 Methods

The use of Type 2 method is not conditioned upon the requirement to meet the “Hedged as Required” criteria. However, an insurer using a Type 2 method must provide a certification (Attachment 4) signed by the appointed actuary with each annual and quarterly statutory financial statement filed with the appropriate insurance regulatory official in each state in which the insurer does business. This certification deals with the assumptions underlying the option market values included in the calculation of reserves using a Type 2 method and the consistency in assumptions between these option market values and the statement value of any options owned by the insurer to support the equity indexed annuity business being valued.

For purposes of applying the MVRM and the BSPM recognized adaptation computational methods, the time horizon for present value calculations should be based on the requirements in the section captioned “General Requirements on Use of Certain Computational Methods.”

Required Change in Method

In the event an insurer that is using a Type 1 computational method for a block of business fails to meet the applicable “Hedged as Required” criteria, the required actuarial certification must disclose this fact. If the reason for failing the “Hedged as Required” criteria is not corrected within one quarterly financial reporting of the initial disclosure of the failure in the actuarial certification, the insurer must use a Type 2 computational method for determining minimum statutory formula reserves for this block of business.

If at a later date, the insurer can demonstrate to the satisfaction of its domiciliary commissioner that it is meeting the applicable “Hedged as Required” criteria, the insurer may, with the approval of the domiciliary commissioner, resume using a Type 1 computational method. In addition, the insurer must notify the appropriate regulatory official in each state in which the insurer does business subject to the change in computational method.

Optional Change in Method

An insurer using either a Type 1 or Type 2 computational method for a block of business, may with the approval of its domiciliary commissioner and after notifying the appropriate regulatory official in all the other states in which the insurer writes this block of business, use a computational method of the other type. If the change in computational methods involves a change from a Type 2 computational method to a Type 1 computational method, the request to the domiciliary commissioner for approval of the change in method must be accompanied with a demonstration of compliance with the applicable “Hedged as Required” criteria.
Appendix C

Plan Type

The use of either a Type 1 computational method or a Type 2 computational method requires a determination of Plan Type for purposes of determining the maximum valuation interest rate. Design features unique to equity indexed annuities, such as an equity enhanced surrender values, vesting schedules, or participation rate, should not used to determine the Plan Type of a policy form. Only those design features specifically identified in Section 4b. Paragraph C of the NAIC Model SVL may be used to assign a Plan Type to a policy form.

The definition of Plan Type A and Plan Type B in the NAIC Model SVL includes the phrase “with an adjustment to reflect changes in interest rates or asset values since receipt of the funds by the insurance company...” The reference to “change in ... asset values” does not include changes in policy values due to changes in the equity index underlying the policy form.

Other Regulatory Requirements

The guidance provided in this Actuarial Guideline concerning statutory minimum formula reserves for equity indexed annuity products supersedes the valuation guidance in Sections 5 and 6 of the NAIC Interest-Indexed Annuity Contracts Model Regulation.

Asset Adequacy Testing of Reserves

To the extent required by law, regulation, or regulatory requirements, reserves established for equity indexed annuity policies must be tested for adequacy using appropriate methods and assumptions.
ATTACHMENT 1
Description of Computational Methods

CARVM-UMV

Step 1: For each duration and each benefit at which an index-based benefit is available, determine the market value of the appropriate call option. The appropriate call option is one that exactly hedges the floor of the benefit at that point in time. This means that the payoff of the call option should exactly equal the difference between the specific benefit available at that point in time (reflecting all relevant contract features) and the guaranteed floor of that benefit. The market value should be determined using an appropriate option pricing technique, such as Black-Scholes or a stochastic scenario method.

Step 2: The market value of all of the call options are projected forward at the appropriate valuation interest rate to the point in time at which the call option would expire. The valuation interest rate should be consistent with the requirements of any applicable Actuarial Guidelines or regulations, such as Actuarial Guideline XXXIII or Actuarial Guideline IX-B.

Step 3: The future guaranteed benefits for each benefit at each time point are determined by adding the guaranteed floors of the benefit to the amounts determined in Step 2.

Step 4: Now a CARVM calculation can be performed. The CARVM calculation should be in accordance with Actuarial Guideline XXXIII and any other applicable regulations or Actuarial Guidelines.

MVRM

Step 1: Calculate the projected index value at the end of the “term” which would produce a benefit at the end of the “term” equal to the sum of (1) the contract guarantee at that time, and (2) the current market value of the call option(s) which would fully hedge the index-based benefit, accumulated at the appropriate valuation interest rate. This calculation should be performed assuming equal annual percentage increases in the index. The call options used are those with maturity dates coterminous with the setting of participation rates, spread, or any other method of determining index-based benefits. The valuation interest rate used to accumulate the call options should be consistent with the requirements of any applicable Actuarial Guidelines or regulations, such as Actuarial Guideline XXXIII or Actuarial Guideline IX-B. Note that the “term” referred to above should be consistent with the “term” described in this Actuarial Guideline.

Step 2: From the current level of the index and the projected level of the index at the end of the term, calculate an implied compound constant growth rate of the index from the valuation date to the end of the term. Use this implied growth rate to project the level of the index at intermediate anniversaries.

Step 3: All annuity benefits can now be determined from the index levels.

Step 4: Now a CARVM calculation can be performed. The CARVM calculation should be in accordance with Actuarial Guideline XXXIII and any other applicable regulations or Actuarial Guidelines.

MVRM Using Black-Scholes Projection Method

This is an adaptation of the basic MVRM approach to accommodate products for which the participation rate, spread, or any other benefit determination method is redetermined during the term (particularly annually).

Step 1: Calculate the cost of a full hedging call option as a percentage of the account value for the period that the benefit determination is guaranteed, accumulate the percentage to the end of that period at the risk-free interest rate, and use the accumulated percentage cost as the projected growth rate of the account.
value during the period. Perform the same type of calculation for each successive period within the term, giving recognition to the benefit guarantees, forward interest rates, forward index volatility, and index dividend levels.

Step 2: Determine the index level which would provide the projected account level on each anniversary on the basis of the participation rate, spread, or other benefit determination method used.

Step 3: All annuity benefits can now be determined from the index levels.

Step 4: Now a CARVM calculation can be performed. The CARVM calculation should be in accordance with Actuarial Guideline XXXIII and any other applicable regulations or Actuarial Guidelines.

EDIM

Step 1: The Fixed Component at issue is the formula reserve produced by either CARVM-UMV or MVRM. The Fixed Component at the end of the term is the floor of the benefit actually being hedged.

Step 2: The intermediate values of the Fixed Component are found by solving for an interest rate that would accumulate the initial value to the ending value. For example, assume you purchase options assuming that 90% of policyholders will surrender at maturity, and that 10% of policyholders will annuitize at maturity. The Fixed Component is the sum of (1) 90% of the Fixed Component that grows to the floor of the surrender benefit; and (2) 10% of the Fixed Component that grows to the floor of the annuitization benefit.

Step 3: The Equity Component is equal to the discounted intrinsic value of the options. The discounted intrinsic value of the options is found by taking the intrinsic value at the valuation date, and discounting at the valuation rate for the number of years from the valuation date to the end of the term. The valuation interest rate used to discount the intrinsic value of the call options should be consistent with the requirements of any applicable Actuarial Guidelines or regulations, such as Actuarial Guideline XXXIII or Actuarial Guideline IX-B.

Step 4: The reserve is the sum of a Fixed Component and an Equity Component.
In order to use a Type 1 computational method, the appointed actuary needs to certify quarterly that it meets either the “Basic” or “Option Replication” criteria.

**Basic**

1. Required equivalence of characteristics between the option contracts held and the options imbedded in the products with respect to specific contract features such as: Index, averaging features, option type, strike price, term, etc.

2. The amount of hedge purchased, at or near the contract issuance, must be greater than or equal to a Specified Percentage of the product’s account value, at contract issuance. The Specified Percentage varies by the length of the option guarantee (some annual ratchet products may have a term of several years, but the participation rates are only guaranteed for one year, so the “term” for this purpose is 1 year), and allows the company to assume no more than 3% per year of elective benefit decrements, unless the Commissioner agrees to a higher limit. For example, for a five-year point-to-point product, the Specified Percentage would be: SP% = (1 - .03)^5 = 86%.

3. The Company must have a specific plan for hedging risks associated with interim death benefits, early surrenders, etc.

4. The Company must have a system in place that is used to monitor the effectiveness of the company’s hedging strategy.

5. The Company must have a stated maximum tolerance for differences between the expected performance of the hedge and the actual results of the hedge.

**Option Replication**

1. Required equivalence of characteristics between the target of an option replication strategy employed, and the options imbedded in the liabilities with respect to specific contract features such as: index, averaging features, option type, strike price, term, etc.

2. At the end of each quarter, the notional amount of the target of the option replication strategy must be greater than or equal to the sum of the Specified Percentages of each contract's account value. The Specified Percentage varies by the length of the remaining option guarantee (some annual ratchet products may have a term of several years, but the participation rates are only guaranteed for one year, so the “term” for this purpose is 1 year), and allows the company to assume no more than 3% per year of elective benefit decrements, unless the Commissioner agrees to a higher limit. For example, if a point-to-point contract has five years remaining, the Specified Percentage for that contract would be: SP% = (1 - .03)^5 = 86%. Appropriate assumptions for non-elective decrements such as mortality may be added to the assumption for elective decrements.

3. The company must have a specific plan for hedging risks associated with interim death benefits, early surrenders, etc.

4. The Company must have system in place that is used to monitor the effectiveness of the company’s hedging strategy.

5. The Company must have a stated maximum tolerance for differences between the expected performance of the hedge and the actual results of the hedge. The maximum tolerance test and compliance evaluation test must meet the following minimum requirements. The compliance
Appendix C

evaluation criteria will be a retrospective correlation test performed at least on a weekly basis. The Company will compare the change in the market value, from the beginning of the calendar quarter, of the hedge portfolio with the change in the market value of the options embedded in the liability portfolio. The maximum dollar amount of difference permitted between these two changes is 10% of the beginning of period market value of the options embedded in the liabilities. If the difference exceeds this limit, the following steps must be taken:

- If for a second time during a quarter the dollar amount of difference exceeds 10% of the beginning of period market value of the options embedded in the liabilities, but is less than 25% of the beginning of period market value of the options embedded in the liabilities, the Company must notify the Commissioner of Insurance in each state in which the insurer is licensed. The notification must indicate the dollar amount of reserves being hedged by the option replication strategy.

- If at any of the weekly intervals, the difference between the two changes exceeds 25% of the beginning of period market value of the options embedded in the liabilities, the Company must notify the Commissioner of Insurance in each state in which the insurer is licensed. The notification must indicate the dollar amount of reserves being hedged by the option replication strategy and the impact on surplus of reporting the reserves based on the CARVM-UMV.

- If at any point in time during the quarter the difference between the two changes exceeds 35% of the beginning of period market value of options embedded in the liabilities, the insurer is deemed to be out of compliance with the "Hedged as Required" criteria, and the Company must notify the Commissioner of Insurance in each state in which the insurer is licensed. The notification must indicate the dollar amount of reserves being hedged by the option replication strategy and the impact on surplus of reporting the reserves based on the CARVM-UMV.

Drafting Note: The requirements discussed above deal with the situation in which the actual hedge underperforms relative to the expected hedge performance. The ability of an insurer to over-hedge may be constrained by other components of a state’s regulatory framework including the state’s investment article and regulations concerning the use of derivative instruments. For purposes of this Drafting Note, over-hedged means that at a particular point in time, the hedge portfolio exceeds the portfolio of liabilities being hedged. If over-hedged, the excess hedging instruments are excluded from the measurements required in Item 5 of the Hedged as Required Criteria.
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ATTACHMENT 3
Reasonableness of Assumptions Certification

The following certification must be filed in conjunction with each quarterly and annual statutory financial statement filed with the appropriate regulatory official in each state in which the insurer does business. The certification must be signed by the appointed actuary.

I, (state name and professional designation), am the appointed actuary for (company name). I have reviewed the assumptions underlying the values assigned to all equity options used in the determination of the initial statutory reserves under the Enhanced Discounted Intrinsic Method for all equity indexed deferred annuity products issued or reinsured by (company name) and reported in the statutory financial statement as of (the date of valuation). The assumptions used to determine such option market values are reasonable in light of the relevant economic conditions prevalent at the time of issue of each policy valued using the Enhanced Discounted Intrinsic Method.

__________________________
(Name of actuary)

__________________________
(Signature of actuary)

__________________________
(Date of certification)
ATTACHMENT 4
Reasonableness and Consistency of Assumptions Certification

The following certification must be filed in conjunction with each quarterly and annual statutory financial statement filed with the appropriate regulatory official in each state in which the insurer does business. The certification must be signed by the appointed actuary.

I, (state name and professional designation), am the appointed actuary for (company name). I have reviewed the assumptions underlying the values assigned to all equity options used in the determination of statutory reserves for all equity indexed annuity products issued or reinsured by (company name) insurance company and reported in the statutory financial statement as of (the date of valuation). The assumptions used to determine such option market values are:

1. reasonable in light of current relevant economic conditions as of the date of valuation, and
2. are consistent with the comparable assumptions used to determine the statement value of any derivative instruments used to hedge the equity indexed based obligations embedded in the equity indexed annuities subject to this certification

__________________________________________
(Name of actuary)

__________________________________________
(Signature of actuary)

__________________________________________
(Date of certification)
THE APPLICATION OF THE COMMISSIONERS RESERVE VALUATION METHOD TO EQUITY INDEXED LIFE INSURANCE POLICIES

Background

The purpose of this Actuarial Guideline is to clarify statutory and regulatory requirements for the valuation of reserves for equity indexed universal life insurance policies. This Guideline codifies the interpretation of the Commissioners Reserve Valuation Method (CRVM) by clarifying the computational methodologies that are deemed to comply with the intent of the Standard Valuation Law (SVL) and the Universal Life Insurance Model Regulation. These methodologies will be deemed to be consistent with CRVM.

Equity indexed universal life insurance policies include interest credits that are a combination of a guaranteed interest rate and an interest rate based on a percentage of the increase in an equity index, such as the S&P 500. Currently, there are only a few products in the market and the product designs have been straightforward. As new product designs emerge, this Actuarial Guideline may have to be revised.

In order that all insurers issuing equity indexed universal life insurance policies establish reserves for statutory reporting purposes that are consistent with CRVM minimum statutory formula reserves, this Actuarial Guideline identifies a computational method deemed to be consistent when specific operational criteria called “Hedged as Required” criteria are met. In addition, two other computational methods are defined that are deemed to be consistent with CRVM in the event the “Hedged as Required” criteria are not met.

Scope

This Actuarial Guideline applies to all equity indexed universal life insurance policies, regardless of the date of issue, that are subject to CRVM and would otherwise be subject to the reserve requirements under the Universal Life Insurance Model Regulation.

Definitions

Appointed Actuary. The appointed actuary, for purposes of this guideline, is the actuary appointed by the company’s board of directors to provide opinions in accordance with Standard Valuation Law and the model Actuarial Opinion and Memorandum regulation.

Credited. Index-based benefits will be considered to be credited when they are added to the fund and treated in the same manner as other interest credits to the fund.

Term. An index-based benefit crediting period.

Computational Methods

Computational methods deemed to be consistent with CRVM can be classified into three groups, Type 1 methods, Type 2a methods and Type 2 methods. The following computational method is considered a Type 1 method: the Implied Guarantee Rate Method (IGRM). Type 1 computational methods are deemed to be consistent with CRVM only if the “Hedged as Required” criteria are met. The following is considered a Type 2a method: the Commissioners Reserve Valuation Method with Updated Average Market Value (CRVM with UAMV). The following is considered a Type 2 method: the Commissioners Reserve Valuation Method with Updated Market Value (CRVM with UMV). For a complete description of these methods, consult Attachment 1.
The minimum reserve for equity indexed life insurance policies is the statutory reserve calculated under the Universal Life Insurance Model Regulation for an identical policy with no guaranteed index-based benefits. If the reserve produced by Type 1, Type 2a or Type 2, as appropriate, is greater than the minimum reserve, then that Type 1, Type 2a or Type 2 reserve is the minimum reserve.

Type 1 Methods

A Type 1 computational method is deemed to be consistent with CRVM if an insurer using the method complies with the “Hedged as Required” Criteria (Attachment 2) and provides a certification (Attachment 3) as to compliance with the criteria. The appointed actuary must sign the certification. The certification shall be provided with each annual and quarterly statutory financial statement filed with the appropriate insurance regulatory official in each state in which the insurer writes or reinsures equity indexed universal life insurance business.

For purposes of determining compliance with the “equivalence of characteristics” requirement in the “Hedged as Required” criteria, the current term of an equity indexed universal life insurance policy is one year or less. This should be interpreted consistently when a separate index-based benefit guarantee is made on each premium received.

The IGRM computational method is deemed to be consistent with CRVM under the following conditions:

1. The implied guaranteed rate for terms after the first, determined at issue using the method of Attachment 1, paragraph 3 of the IGRM method, is less than or equal to the appropriate maximum valuation interest rate.
2. Index-based benefit terms cannot be greater than one year. This should be interpreted consistently when a separate index-based benefit guarantee is made on each premium received.
3. The appointed actuary has demonstrated at time of filing or in conjunction with a change to a Type 1 Method, to the satisfaction of the regulatory officials in each state in which the insurer writes or reinsures equity indexed universal life insurance business, prior to the use of the IGRM that the requirements in (1) and (2) above have been met.

Type 2a Methods

A Type 2a computational method is deemed to be consistent with CRVM if an insurer using the method complies with Type 2a Prerequisite Criteria below, and provides Reasonableness and Consistency of Assumptions Certification (Attachment 4). The appointed actuary must sign the certification. The certification shall be provided with each annual and quarterly statutory financial statement filed with the appropriate insurance regulatory official in each state in which the insurer writes or reinsures equity indexed universal life insurance business.

Type 2a Prerequisite Criteria are as follows:

1. At issue, the policy satisfies (a) or (b) as follows:
   
   (a) The implied guaranteed rate for terms after the first, determined at issue using the method of Attachment 1, paragraph 3 of the CRVM with UAMV method, is less than or equal to the appropriate maximum valuation interest rate; or

   (b) Policies with identical renewal guarantees issued in three of the past five years would have satisfied condition 1 for the Type 1 method.
2. Index-based benefit terms cannot be greater than one year. This should be interpreted consistently when a separate index-based benefit guarantee is made on each premium received.

3. The appointed actuary has demonstrated at time of filing or in conjunction with a change to a Type 2a Method, to the satisfaction of the regulatory officials in each state in which the insurer writes or reinsures equity indexed universal life insurance business, prior to the use of the CRVM with UAMV that the requirements in (1) and (2) above have been met.

**Type 2 Methods**

The use of a Type 2 method is not conditioned upon the requirement to meet the “Hedged as Required” criteria or the Type 2a Prerequisite Criteria. However, an insurer using a Type 2 method must provide a certification (Attachment 5) signed by the appointed actuary with each annual and quarterly statutory financial statement filed with the appropriate insurance regulatory official in each state in which the insurer writes or reinsures equity indexed universal life insurance business. This certification deals with the assumptions underlying the option market values included in the calculation of reserves using a Type 2 method and the consistency in assumptions between these option market values and the statement value of any options owned by the insurer to support the equity indexed universal life insurance business being valued.

**Required Change in Method**

In the event an insurer that is using a Type 1 computational method for a block of business fails to meet the applicable “Hedged as Required” criteria, the required actuarial certification must disclose this fact. If the reason for failing the “Hedged as Required” criteria is not corrected within one quarterly financial reporting period of the initial disclosure of the failure in the actuarial certification, the insurer must choose to use a Type 2a or a Type 2 computational method for determining minimum statutory formula reserves for this block of business.

If, at a later date, the insurer can demonstrate to the satisfaction of its domiciliary commissioner that it is meeting the applicable “Hedged as Required” criteria, the insurer may, with the approval of the domiciliary commissioner, resume using a Type 1 computational method. In addition, the insurer must notify the appropriate regulatory official in each state in which the insurer does business subject to the change in computational method.

**Optional Change in Method**

An insurer using either a Type 1, Type 2a or Type 2 computational method for a block of business may, with the approval of its domiciliary commissioner and after notifying the appropriate regulatory official in all the other states in which the insurer writes this block of business, use a computational method of another type. If the change in computational methods involves a change from a Type 2 or Type 2a computational method to a Type 1 computational method the request to the domiciliary commissioner for approval of the change in method must be accompanied with a demonstration of compliance with the applicable “Hedged as Required” criteria. If the change in computational methods involves a change from a Type 2 computational method to a Type 2a or Type 1 computational method, the request to the domiciliary commissioner for approval of the change in method must be accompanied with a demonstration of compliance with the “Type 2a Prerequisite Criteria” or the requirements specified in the section captioned “Type 1 Methods.”

**Asset Adequacy Testing of Reserves**

To the extent required by law, regulation, or regulatory requirements, reserves established for equity indexed life policies must be tested for adequacy using appropriate methods and assumptions.
Implied Guaranteed Rate Method (IGRM)

To use this computational method, companies must satisfy the “Hedged as Required” criteria, which are set out in Attachment 2. On the asset side, options will be held in accordance with the rules of the NAIC Accounting and Procedures Manual.

The following describes how the IGRM works:

1. Issue date calculations:

Calculate an implied guaranteed rate, determined at issue, for the period of the initial term equal to: (a) the guaranteed interest rate for the period of the initial term; plus (b) the accumulated option cost expressed as a percent of the policy value to which the indexed benefit is to be applied. The accumulated option cost, determined at issue, is the option cost, which will provide the index-based benefit in excess of any other interest rate guarantee for the initial term, accumulated to the end of the term at the appropriate maximum valuation rate. The option cost should be as of the issue date.

Calculate an implied guaranteed rate, determined at issue, for the terms after the first. The implied guaranteed rates for terms after the first term will be based on historical moving average option costs according to (3) below.

Using the Universal Life Insurance Model Regulation, with the guaranteed interest rates equal to the implied guaranteed rates, calculate the Guaranteed Maturity Premium, Guaranteed Maturity Fund, and net premium for the policy based on guarantees at issue.

2. Valuation date calculations:

Calculate the implied guaranteed rate for the current term based on the current term’s index-based benefit and the option cost at the start of the current term that will provide the indexed benefit, in excess of any other interest rate guarantee, for the current term. The method of calculating the current term implied guaranteed rate is the same as for calculating the rate for the initial term. The implied guaranteed rate for terms after the current is not recalculated as long as neither the interest rate guarantees nor the index-based benefit guarantee have changed. (If guarantees have improved, then the new implied guaranteed rates for future terms will be based on option costs determined at issue according to (3) below.)

Continue the calculation of the reserve according to the Universal Life Insurance Model Regulation. Use the recalculated current term implied guaranteed rate and the implied guaranteed rate for future terms, as determined according to (3) below, when computing future guaranteed benefits at the valuation date. Do not recalculate the Guaranteed Maturity Premium, Guaranteed Maturity Fund, or net premium. This section should be interpreted consistently when a separate index-based benefit guarantee is made on each premium received.

In determining reserves, the net premiums, as determined in Section 1 above, are payable over the period that benefits are projected to be available, but not beyond the end of the net premium payment period determined at issue.

3. Index-based benefit guarantees beyond the current term should be handled as follows:
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Calculate an implied guaranteed rate, determined at issue, for the terms after the current term equal to: (a) the guaranteed interest rate for the period of the term; plus (b) the accumulated option cost expressed as a percent of the policy value to which the indexed benefit is to be applied. The accumulated option cost is the historical moving average cost of the option whose term begins at the beginning of the term, which will provide the index-based benefit in excess of any other interest rate guarantee for the term, accumulated for the length of the term at the appropriate maximum valuation rate.

The historical moving average cost of the option will be calculated based on the averages over the sixty months previous to the calendar year of issue of each of the following items: (a) 3% plus the annualized daily actual index volatility as the estimated implied volatility for a one year European At-The-Money option, e.g. if the average index volatility is 15%, the implied volatility for the base case option cost is 18%; (b) index dividend rate; and (c) risk free rate. The base case cost is for a one year European At-The-Money option and must be adjusted to the characteristics of the policy.

In those states that require, by regulation, that the policy valuation interest rates not exceed the “minimum guaranteed interest rate” in the policy, the “minimum guaranteed interest rate” for IGRM is the implied guaranteed rate.

Commissioners Reserve Valuation Method Updated Average Market Value (CRVM with UAMV)

To use this computational method, companies must satisfy the Type 2a Prerequisite Criteria. On the asset side, options will be held in accordance with the rules of the NAIC Accounting and Procedures Manual. Similarly, reinsurance reserve credit will be in accordance with the rules of the NAIC Accounting and Procedures Manual.

The following describes how the CRVM with UAMV works:

1. Issue date calculations:

   Calculate an implied guaranteed rate, determined at issue, for the period of the initial term equal to: (a) the guaranteed interest rate for the period of the initial term; plus (b) the accumulated option cost expressed as a percent of the policy value to which the indexed benefit is to be applied. The accumulated option cost, determined at issue, is the option cost that will provide the index-based benefit in excess of any other interest rate guarantee for the initial term, accumulated to the end of the term at the appropriate maximum valuation rate. The option cost should be as of the issue date.

   Calculate an implied guaranteed rate, determined at issue, for the terms after the first. The implied guaranteed rates for terms after the first term will be based on historical moving average option costs according to (3) below.

   Using the Universal Life Insurance Model Regulation, with the guaranteed interest rates equal to the implied guaranteed rates, calculate the Guaranteed Maturity Premium, Guaranteed Maturity Fund, and net premium for the policy based on guarantees at issue.

2. Valuation date calculations:

   When calculating the present value of future guaranteed policy benefits at the valuation date by projecting a fund equal to the greater of the Guaranteed Maturity Fund or the policy value, this fund should be projected to the end of the current term at the guaranteed interest rate and added to the accumulated option cost for the current term. The option cost should be determined as of the valuation date.
The option should provide for the index-based benefit in excess of any other interest rate guarantee for the current term based on a fund equal to the greater of the Guaranteed Maturity Fund or the policy value. The option cost should be accumulated to the end of the current term at the appropriate maximum valuation rate in accordance with the SVL.

This combined amount should then be projected forward using the implied guaranteed rates for future terms, as determined according to (3) below.

The implied guaranteed rates for terms after the current are recalculated on the valuation date. The implied guaranteed rates for future terms will be based on historical moving average option costs on the valuation date according to (3) below.

Do not recalculate the Guaranteed Maturity Premium, Guaranteed Maturity Fund, or net premium. This section should be interpreted consistently when a separate index-based benefit guarantee is made on each premium received.

In determining reserves, the net premiums, as determined in Section 1 above, are payable over the period that benefits are projected to be available, but not beyond the end of the net premium payment period determined at issue.

3. Index-based benefit guarantees beyond the current term should be handled as follows:

Calculate an implied guaranteed rate, determined either at issue or at a valuation date, for the terms after the current term equal to: (a) the guaranteed interest rate for the period of the term; plus (b) the accumulated option cost expressed as a percent of the policy value to which the indexed benefit is to be applied. The accumulated option cost is the historical moving average cost of the option whose term begins at the beginning of the term, which will provide the index-based benefit in excess of any other interest rate guarantee for the term, accumulated for the length of the term at the appropriate maximum valuation rate.

The historical moving average cost of the option will be set equal to the option cost calculated based on the averages of each of the following items over the sixty months previous to the calendar year of the determination date: (a) 3% plus the annualized daily actual index volatility as the estimated implied volatility for a one year European At-The-Money option, e.g. if the average index volatility is 15%, the implied volatility for the base case option cost is 18%; (b) index dividend rate; and (c) risk free rate. The base case cost is for a one year European At-The–Money option and must be adjusted to the characteristics of the policy.

In those states that require, by regulation, that the policy valuation interest rates not exceed the “minimum guaranteed interest rate” in the policy, the “minimum guaranteed interest rate” for CRVM with UAMV is the implied guaranteed rate.

CRVM with Updated Market Value (UMV) Method

CRVM with UMV applies the Universal Life Insurance Model Regulation to equity indexed life insurance policies using the following methods:

1. Issue date calculations:

When calculating the present value of future guaranteed policy benefits at issue by projecting fund values, the fund should be projected to the end of the initial term at the guaranteed interest rate and added to the accumulated option cost for the initial term. This combined amount should then be projected forward, using the policy guarantees to determine future death and endowment benefits. The option should provide for the indexed benefit in excess of any other interest rate
guarantee for the initial term. The option cost should be as of the issue date. The option cost should be accumulated to the end of the initial term at the appropriate maximum valuation rate in accordance with the SVL. Any index-based benefit guarantees beyond the initial term should be determined as described in (3) below.

Using this method of determining the present value of future guaranteed benefits, calculate the Guaranteed Maturity Premium, Guaranteed Maturity Fund, and net premium for the policy based on guarantees at issue.

2. Valuation date calculations:

When calculating the present value of future guaranteed policy benefits at the valuation date by projecting a fund equal to the greater of the Guaranteed Maturity Fund or the policy value, this fund should be projected to the end of the current term at the guaranteed interest rate and added to the accumulated option cost for the current term. The option cost should be determined as of the valuation date. This combined amount should then be projected forward, using the policy guarantees to determine future death and endowment benefits. The option should provide for the index-based benefit in excess of any other interest rate guarantee for the current term, based on a fund equal to the greater of the Guaranteed Maturity Fund or the policy value. The option cost should be accumulated to the end of the current term at the appropriate maximum valuation rate in accordance with the SVL. Any index-based benefit guarantees beyond the current term should be treated as described in (3) below. Do not recalculate the Guaranteed Maturity Premium, Guaranteed Maturity Fund, or net premium. This section should be interpreted consistently when a separate index-based benefit guarantee is made on each premium received.

In determining reserves, the net premiums, as determined in Section 1 above, are payable over the period that benefits are projected to be available, but not beyond the end of the net premium payment period determined at issue.

3. Index-based benefit guarantees beyond the current term should be handled as follows:

At the time of calculation, fund values projected to the end of the current term should be further projected to the end of the next term at the guaranteed interest rate. This should be added to the accumulated option cost for that term. This should be done successively for each subsequent term, using the appropriate option cost for each term. The option for each term should provide for the index-based benefit in excess of any other interest rate guarantee for the term. The cost for each option should recognize the current relevant economic condition on the calculation date and be priced as if the term began on that date. The option cost for each future term should be accumulated to the end of the term at the appropriate maximum valuation rate in accordance with the SVL.
In order to use a Type 1 computational method, the appointed actuary needs to certify quarterly that it meets either the “Basic” or “Option Replication” criteria.

Basic

1. Required equivalence of characteristics between the option policies held and the options embedded in the policies for the current term with respect to specific policy features such as: index; averaging features; option type; strike price; term; etc.

2. The amount of hedge owned must substantially cover the greater of the account value or reserve. “Substantially” is measured by the guarantees in the specific policy (some policies may have longer term guarantees than others), and allows the company to assume no more than 6% per year of elective benefit decrements, unless the Commissioner agrees to a higher limit. Benefit decrements due to charges in the policy should be taken into account in the same way as they are in the indexed interest formula in the policy (i.e., if indexed interest is credited on an average fund value, then it is the projected average fund value on each policy which should be hedged.)

3. The company must have a specific plan for hedging risks associated with death benefits, early surrenders, unexpected premium payment patterns, and other potentialities. This plan must be available at issue and updated at every valuation date, or as often as the valuation actuary requirements may warrant.

4. The company must have a system in place that is used to monitor the effectiveness of its hedging strategy.

5. The company must have a stated maximum tolerance for differences between expected performance of the hedge and the actual results of the hedge.

Option Replication

1. Required equivalence of characteristics between the target of an option replication strategy employed and the options imbedded in the liabilities for the current term with respect to specific policy features such as: index; averaging features; option type; strike price; term; etc.

2. At the end of each quarter, the notional amount of the target of the option replication strategy must substantially cover the greater of the account value or reserve. “Substantially” is measured by the guarantees in the specific policy (some policies may have longer term guarantees than others), and allows the company to assume no more than 6% per year of elective benefit decrements, unless the Commissioner agrees to a higher limit. Benefit decrements due to charges in the policy should be taken into account in the same way as they are in the indexed interest formula in the policy, (i.e., if indexed interest is credited on an average fund value, then it is the projected average fund value on each policy which should be hedged.)

3. The company must have a specific plan for hedging risks associated with death benefits, early surrenders, unexpected premium payment patterns and other potentialities. This plan must be available at issue and updated at every valuation date, or as often as the valuation actuary requirements may warrant.

4. The company must have a system in place that is used to monitor the effectiveness of the company’s hedging strategy.
5. The company must have a stated maximum tolerance for differences between the expected performance of the hedge and the actual results of the hedge. The maximum tolerance test and compliance evaluation test must meet the following minimum requirements. The compliance evaluation criterion will be a retrospective correlation test performed at least on a weekly basis. The company will compare the change in the market value, from the beginning of the calendar quarter, of the hedge portfolio with the change in the market value of the target of the option replication strategy. The maximum dollar amount of difference permitted between these two changes is 10% of the beginning of period market value of the target of the option replication strategy. If the difference exceeds this limit, the following steps must be taken:

- If for a second time during a quarter the dollar amount of difference exceeds 10% of the beginning of period market value of the target of the option replication strategy, but is less than 25% of the beginning of period market value of the target of the option replication strategy, the company must notify the Commissioner in each state in which the insurer is licensed. The notification must indicate the dollar amount of reserves being hedged by the option replication strategy.

- If at any of the weekly intervals the difference between the two changes exceeds 25% of the beginning of period market value of the target of the option replication strategy, the company must notify the Commissioner in each state in which the insurer is licensed. The notification must indicate the dollar amount of reserves being hedged by the option replication strategy and the impact on surplus of reporting the reserves based on CRVM with UMV, or CRVM with UAMV if the conditions for that method are satisfied.

- If at any point in time during the quarter the difference between the two changes exceeds 35% of the beginning of period market value of target of the option replication strategy, the insurer is deemed to be out of compliance with the “Hedged as Required” criteria, and the company must notify the Commissioner in each state in which the insurer is licensed. The notification must indicate the dollar amount of reserves being hedged by the option replication strategy and the impact on surplus of reporting the reserves based on the CRVM with UMV, or CRVM with UAMV if the conditions for that method are satisfied.

The requirements discussed above deal with the situation in which the actual hedge underperforms relative to the expected hedge performance. The ability of an insurer to over-hedge may be constrained by other components of a state’s regulatory framework including the state’s investment article and regulations concerning the use of derivative instruments. For purposes of this Guideline, over-hedged mean that at a particular point in time, the hedge portfolio exceeds the portfolio of liabilities being hedged. If over-hedged, the excess hedging instruments are excluded from the measurements required in Item 5 of the Hedged as Required Criteria.
Attachment 3
Reasonableness of Assumptions Certification
for Implied Guaranteed Rate Method

The following certification must be filed in conjunction with each quarterly and annual statutory financial statement filed with the appropriate regulatory official in each state in which the insurer does business. The appointed actuary must sign the certification.

I, (state name and professional designation) am the appointed actuary for (company name). The company meets the Hedged as Required criteria for policies reserved under the Implied Guarantee Rate Method. I have reviewed the assumptions underlying the values assigned to all equity index options used in the determination of the implied guaranteed rate used in the calculation of reserves under the Implied Guaranteed Rate Method for all equity indexed universal life insurance policies issued or reinsured by (company name) and reported in the statutory financial statement as of (the date of valuation).

The assumptions at the start of the current term used to determine such option values for the current term are:

1. Reasonable in light of current relevant economic conditions at the start of the current term; and
2. Consistent with the comparable assumptions used to determine the statement of value of any derivative instruments as of the valuation date used to hedge the equity index-based obligations embedded in the equity indexed life policies subject to this certification.

The assumptions at issue used to determine equity index option values for terms subsequent to the current term are:

1. Determined in accordance with the Implied Guaranteed Rate Method
2. Based on quantitative data for the base case option (1-year European At-The-Money) of 3% plus ___.% average annualized daily actual volatility over the 60 months previous to the calendar year of issue.
3. Reasonably adjusted to reflect the following variances from the base case due to benefit design and capital market reasons (all material adjustments should be listed)
   a. skew adjustments
   b. _______________(to be described by appointed actuary)
4. Reliant on the following source(s) for assumptions not prescribed by this Actuarial Guideline:
   a. _______________(to be described by appointed actuary)

__________________________________________
(Name of actuary)
__________________________________________
(Signature of actuary)
__________________________________________
(Date of certification)
Actuarial Guidelines

Attachment 4

Reasonableness and Consistency of Assumptions Certification
for Commissioners Reserve Valuation Method with Updated Average Market Value

The following certification must be filed in conjunction with each quarterly and annual statutory financial statement filed with the appropriate regulatory official in each state in which the insurer does business. The appointed actuary must sign the certification.

I, (state name and professional designation) am the appointed actuary for (company name). I have reviewed the assumptions underlying the values assigned to all equity index options used in the determination of statutory reserves using a Type 2a computational method for all equity indexed universal life insurance policies issued or reinsured by (company name) insurance company and reported in the statutory financial statement as of (the date of valuation).

The assumptions used to determine such option values for the current term are:

1. Reasonable in light of current relevant economic conditions as of the date of valuation; and
2. Consistent with the comparable assumptions used to determine the statement of value of any derivative instruments as of the valuation date used to hedge the equity index-based obligations embedded in the equity indexed life policies subject to this certification.

The assumptions used to determine equity index option values for terms subsequent to the current term are:

1. Determined in accordance with the Commissioners Reserve Valuation Method with Updated Average Market Value
2. Based on quantitative data for the base case option (1-year European At-The-Money) of 3% plus ___.__% 60-month moving average annualized daily actual volatility
3. Reasonably adjusted to reflect the following variances from the base case due to benefit design and capital market reasons (all material adjustments should be listed)
   a. skew adjustments
   b. _______________ (to be described by appointed actuary)
4. Reliant on the following source(s) for assumptions not prescribed by this Actuarial Guideline:
   a. _______________ (to be described by appointed actuary)

__________________________________________
(Name of actuary)

__________________________________________
(Signature of actuary)

__________________________________________
(Date of Certification)
Attachment 5
Reasonableness and Consistency of Assumptions Certification
for Commissioners Reserve Valuation Method with Updated Market Value

The following certification must be filed in conjunction with each quarterly and annual statutory financial statement filed with the appropriate regulatory official in each state in which the insurer does business. The appointed actuary must sign the certification.

I, (state name and professional designation) am the appointed actuary for (company name). I have reviewed the assumptions underlying the values assigned to all equity index options used in the determination of statutory reserves using a Type 2 computational method for all equity indexed universal life insurance policies issued or reinsured by (company name) insurance company and reported in the statutory financial statement as of (the date of valuation). The assumptions used to determine such option values are:

1. Reasonable in light of current relevant economic conditions as of the date of valuation; and
2. Consistent with the comparable assumptions used to determine the statement of value of any derivative instruments as of the valuation date used to hedge the equity index-based obligations embedded in the equity indexed life policies subject to this certification.

__________________________________________
(Name of actuary)

__________________________________________
(Signature of actuary)

__________________________________________
(Date of Certification)
Background

This guideline’s primary focus is to clarify the appropriate projection assumptions and methodologies used to determine statutory reserve liabilities for Guaranteed Minimum Death Benefits (GMDBs) offered with variable life insurance products.

For many years, insurance companies have not applied uniform reserve standards to variable life insurance policies in general, and to GMDBs in particular. Four regulatory sources are often looked to for guidance. First, the Standard Valuation Law (SVL) requires that CRVM be based on the present value of future guaranteed benefits. Second, the Variable Life Insurance Model Regulation as revised in 1983 and again in 1989 states “Reserve liabilities for variable life insurance policies shall be established under [SVL] in accordance with actuarial procedures that recognize the variable nature of the benefits provided and any mortality guarantees.” Third is the Universal Life Insurance Model Regulation and most recently the Valuation of Life Insurance Policies Model Regulation.

GMDBs are common features of variable life products. Recently, reserve methods for universal life secondary guarantees have been clarified in the Valuation of Life Insurance Policies Model Regulation. These secondary guarantees are similar to GMDBs offered with variable life policies. A Guaranteed Minimum Death Benefit is any guarantee which provides death benefit protection which would not otherwise be provided in the absence of such a guaranteed benefit or provision. An example of a GMDB is a policy in which death benefits continue in-force even if the policy value is zero. This benefit may be contingent on additional qualifications being met, such as cumulative premiums meeting some limit.

Additional examples of GMDBs are provided below. This list is not intended to include all types of GMDBs.

- A Minimum Death Benefit Provision or No Lapse provision where death benefits are guaranteed to remain in-force for a period of time even if the policy value is not greater than zero subject only to certain conditions being met such as cumulative premiums meeting a minimum amount, or if a theoretical policy value is sufficient to meet a minimum amount.
- Death Benefits that are guaranteed to be at least as large as the original face amount, regardless of investment performance which might generate negative Paid Up Additions on a traditional fixed premium variable life insurance policy.

The Variable Life Insurance Model Regulation defines the reserve methodology for variable life policies. However, currently two versions of the model regulation exist and this results in inconsistent treatment by state. These two versions include the 1983 revisions and the 1989 revisions to the model regulation. Many states have not passed either revision and therefore require direct interpretation of SVL. In practice, companies have interpreted these regulations inconsistently with regard to assumptions and/or application to current products available today. The 1983 version of the regulation treats flexible premium policies differently than scheduled premium policies. The 1983 version of the regulation did not anticipate the types of GMDBs available today which require contingent conditions to be met to maintain a death benefit guarantee, for instance specified premiums must be paid. Thus, confusion exists with regard to which valuation method is appropriate. The 1989 version makes no distinction between the scheduled premium and flexible premium policies.
This Guideline codifies the basic interpretation of reserve liabilities for variable life GMDBs by clarifying the projection assumptions and methodologies that comply with the SVL. Minimum valuation standards that may be used to determine this reserve and are not specifically addressed in this guideline are defined by SVL and other applicable state regulations. This guideline focuses on the methodology of the 1989 revisions to interpret SVL, as we believe the 1989 revision more appropriately considers the types of products and GMDBs available today.

Interpretations of both the 1983 and 1989 versions reflect the comments made in the December 1972 report which concluded that an acceptable GMDB reserve system should have the following characteristics:

1. The GMDB reserve should be held in the general account of the company so that it will be backed by the general assets of the company, most of which are debt obligations valued at amortized cost and, therefore, are of a fixed dollar nature. It would not be proper to hold the GMDB reserve in the separate account, assuming the reserve is not supported by fixed dollar assets but by assets that are moving in the opposite direction from the risk, i.e. value moving downward while the risk increases and vice versa.

2. The GMDB reserve should be adequate to cover the GMDB death claims for the next year in all but the most extreme circumstances so that the regulatory authorities can be assured the company will not run into financial trouble from this source before the next annual statement is filed.

3. The GMDB reserve should react slowly but steadily through an extended period of poor investment experience of the separate account.

4. The GMDB reserve should not cause unnecessary fluctuations in surplus by increasing too rapidly in a sharp market downswing. Also, the reserve should not decrease too rapidly in a sharp market upswing after a period of poor market performance.

This guideline maintains the four principles above in interpreting the Standard Valuation Law as it relates to variable life business and the methods defined in both the 1983 and 1989 versions of the Variable Life Insurance Model Regulation.

Reserve methodologies which recognize the variable nature of GMDB are defined in the Variable Life Insurance Model Regulation and include a One-Year Term reserve recognizing a 1/3 drop in separate account assets, the Attained Age Level Reserve (AALR) methodology and in the 1983 version, a methodology for flexible premium policies. Reserves for GMDBs are held in the general account.

This guideline recognizes the following principles when determining appropriate reserves for GMDB.

- Determine the guaranteed death benefits which are not valued in the basic policy reserves.

- Establish a reserve for these benefits over the period of time in which revenue is collected to pay for such benefits; however, no greater than the period of time these guaranteed benefits are provided.

- Collected revenue should not be de-minimus in order to reduce the reserve.

- The reserve established is in addition to basic reserves

This guideline interprets the standards for applying these methodologies. This guideline also interprets the projection assumptions to be applied to determine excess guaranteed death benefits. The guideline
clarifies the use of the AALR methodology for flexible premium variable life policies with contingent GMDB benefit structures similar to specified premium contracts. This guideline is based on the belief that the 1983 revisions did not anticipate these types of GMDB benefits on flexible premium contracts. Thus, it makes sense to interpret the 1983 revisions for these types of GMDB benefits by applying the AALR methodology when there is a contingent GMDB structure. For flexible premium plans with other types of GMDBs, the flexible premium language of the 1983 revision is used where applicable.

The AALR methodology, along with the one-year term reserve is generally consistent with the principles above in that additional reserves are established in recognition of all death benefit guarantees not reflected in basic reserves. If multiple guarantees exist all guarantees must be valued and the greatest additional reserve is held. Consecutive GMDBs are treated as a single guarantee. These reserves are funded over the period of time GMDB Revenue will be collected through either policy charges or premiums, however, not to exceed the GMDB benefit period. The AALR methodology funds any GMDB Revenue deficiency over the period of time the Revenue is collected, however, no longer than the end of the guarantee period.

GMDB reserves are held in addition to basic reserves unless the appointed actuary provides satisfactory documentation to the state of domicile insurance department stating why such reserves are redundant. For example, for traditional variable life product designs where reserves are generally determined on a tabular basis and use an assumed interest rate (AIR), if basic reserves are determined based on at least the guaranteed face amount, (i.e. ignoring any negative additions) then the guaranteed death benefit is fully reflected in the basic reserves; therefore, an additional GMDB reserve is redundant. Neither this guideline nor the 1989 amendments specifically address traditional variable life product designs, nor does this guideline specifically exclude these designs from its scope.

An additional purpose of this guideline is to emphasize the impact of Sections 3A(3) and 3A(4) in the Valuation of Life Insurance Policies Model Regulation (“XXX”) relative to reserving for variable life and variable universal life products.

**Scope**

The guideline applies to all variable life insurance contracts to which the Standard Valuation Law applies and which provide Guaranteed Minimum Death Benefits (GMDBs) either explicitly or implicitly.

**Definitions**

*Attained age level reserve (AALR):* The AALR is a methodology described in the 1983 and 1989 revisions to the Variable Life Insurance Model Regulation.

*Catch-up provision:* A Catch-up provision is a provision in the policy that gives the policyholder the right to catch up on any contingent requirements in order to maintain the GMDB.

*Guaranteed Period:* The guaranteed period is the period of time over which a GMDB is guaranteed regardless of the basic guarantees in the policy. A policy may have multiple guaranteed periods and GMDBs.

*Guaranteed Minimum Death Benefit (GMDB):* A Guaranteed Minimum Death Benefit (GMDB) is any guarantee which provides continued death benefit protection which would not otherwise be provided in the absence of such a guaranteed benefit or provision. A policy may have multiple GMDBs.

*One-Year Term (OYT) reserve:* The OYT reserve covers a period of no more than one year following a 1/3–asset drop. This reserve is fully described in the 1989 revision to the Variable Life Insurance Model...
Appendix C

Regulation. This guideline clarifies the methodology and the assumptions used to determine OYT reserves.

*Policy Value:* Policy value means, as of the valuation date, the greater of (a) zero and (b) the amount to which separately identified interest credits and/or investment return and mortality, expense, or other charges are made under a variable life insurance policy. Subsequent to the valuation date, “policy value” means the amount determined in accordance with the procedures specified in this guideline.

*Projection Assumptions:* The Projection Assumptions are used to determine guaranteed death benefits. This projection of policy values uses the following assumptions:

1. Cost of insurance rates are equal to the minimum valuation mortality.
2. The GMDB is assumed to be in effect for the maximum period of the GMDB. All minimum requirements necessary to maintain the GMDB in force subsequent to the valuation date are assumed to be met at the latest point in time sufficient to maintain the GMDB through its maximum period. Contingent requirements, if any, required to reinstate or catch-up as of the valuation date are assumed to occur on the valuation date. If the GMDB would continue in effect subsequent to the valuation date with no additional actions required, contingent requirements are assumed not to resume until the latest point in time which would prevent the termination of the GMDB.
3. The general account policy values and separate account policy values are projected at the valuation interest rate. The assumed investment rate, if any, is used when determining the OYT reserve.
4. The guaranteed period covered is determined assuming all contingent requirements are met.
5. Policy options and benefits are assumed to continue unchanged as of the valuation date. Examples include fixed and variable account allocation and the death benefit option.
6. The projection of policy values is made for the entire guarantee period, regardless of whether projected policy values are positive or negative at any point in the projection. Any negative policy value would be set to zero.

The policy value is projected forward from the valuation date with valuation interest rate credits, any payments required to maintain the guarantee and valuation mortality charges (and no other credits or charges). The Guideline stipulates that “A death benefit in the absence of the guarantee is assumed to be provided as long as the projected policy value is greater than zero,” and “Any negative policy value would be set to zero.” An AALR need not be established for a VUL policy to provide for any period during which there would be a death benefit in the absence of the guarantee, since this benefit would be provided for by the policy’s basic reserve. This means that for an AALR to develop, the mortality charges must exceed the required payments plus interest credits by enough to reduce the policy value to zero during the guarantee period. Surrender charges are not relevant to this determination.

*GMDB Revenue:* GMDB Revenue is policy charges or premium, either implicit or explicit. These charges or premiums may or may not be explicitly stated to cover GMDB benefits. An example of an implicit premium is a positive premium necessary to maintain a target policy value in order to maintain benefits.

*Term cost:* Term costs are based on the guaranteed minimum death benefits in excess of the death benefits that would be provided in absence of such guarantee based on a projection of policy values using the Projection Assumptions defined above. These costs are then discounted to the valuation date. The term
costs are based on minimum valuation mortality standards and a discount rate not to exceed the maximum valuation interest rate.

1/3-Asset Drop: A 1/3 reduction in separate account assets that is used in the calculation of the one-year term reserve. This 1/3 drop is not applied to fixed account assets.

Text

1. Basic Reserves:

Basic Reserves include the reserve held for death benefits provided in the absence of a GMDB. Reserve liabilities for variable life insurance policies shall be established consistent with the methodologies described in the Standard Valuation Law and in accordance with actuarial procedures that recognize the variable nature of the benefits provided and any mortality guarantees. Reserve methods described in the Variable Life Insurance Model Regulation and the Universal Life Insurance Model Regulation may be appropriately utilized to determine reserve liabilities such that application of these methods is consistent with the principles of the Standard Valuation Law.

2. Guaranteed Minimum Death Benefit Reserves:

Additional reserves are required to provide for liabilities of GMDB provisions which provide benefits that would not be provided in the absence of the guarantee. In measuring these liabilities, the basic reserve provides for death benefits which occur in the absence of the guarantee. GMDB reserves provide for the contingency of death occurring when the guaranteed minimum death benefit exceeds the death benefit that would be paid in absence of the guarantee. A consistent reserve methodology should be used regardless of whether a contract has scheduled premiums or flexible premiums.

When a contract provides multiple GMDBs and/or multiple guarantee periods, a reserve is established based on the guaranteed period which produces the greatest reserve as of the valuation date. Consecutive GMDBs are treated as a single guarantee period. The reserve methodology reflects all potential guarantee periods assuming that contingent requirements are met such as: contingent premiums paid, Catch-up Provisions or any pre-funding of contingent requirements.

For a policy under the 1989 revisions or a flexible premium policy with contingent GMDBs similar to a specified premium contract under the 1983 revision, the GMDB reserve equals the greater of (1) and (2) where (1) equals “the aggregate total of term costs” (OYT) which covers a period of no more than one year following a 1/3-Asset Drop, and (2) equals the AALR as described below.

For a flexible premium policy under the 1983 revisions not covered above, (where the GMDB guarantee is not contingent on any policyholder requirement), reserve liabilities for any guaranteed minimum death benefit shall be maintained in the general account of the insurer and shall be not less than the aggregate total of the term costs, if any, covering the period provided for in the guarantee not otherwise provided for by the reserves held in the separate account assuming a 1/3-asset drop, projected at the valuation interest rate.

   a) One Year Term Reserves (OYT):

   This reserve component equals the “aggregate total of term costs”, if any, covering a period of one full year from the valuation date, or, if less, covering the period of time death benefits are provided which are not otherwise provided for by the basic reserves. This reserve assumes any contingent requirements to maintain the GMDB are met by reflecting any Catch-up Provisions or any pre-funding of contingent requirements.
“Aggregate total term costs” equals the present value of guaranteed minimum death benefits in excess of death benefits that would be provided in absence of such guarantee, if any, prior to the end of one full year or the end of the guaranteed period if sooner. A death benefit in the absence of the guarantee is assumed to be provided as long as the projected policy value is greater than zero. Death benefits are determined by projecting the policy value following a 1/3-Asset Drop and using the Projection Assumptions defined above. Present values are determined using valuation mortality rates and the maximum valuation interest rate.

b) Attained Age Level Reserves (AALR):

This reserve component allows for funding GMDBs over no longer than the guaranteed period. This reserve assumes contingent requirements are met to maintain the GMDB and reflect any prepaid contingent requirements or Catch-up provisions. A death benefit in the absence of the guarantee is assumed to be provided as long as the projected policy value is greater than zero. This reserve component exists until no later than the end of the guarantee period if, on any prior valuation date, projected policy values resulted in guaranteed minimum death benefits in excess of death benefits that would be provided in absence of such guarantee. To the extent long term favorable investment performance results in redundant reserves, the valuation actuary may request permission from the state of domicile insurance department to release all or a portion of the redundant GMDB reserves. This projection of policy value is based on the Projection Assumptions defined above and does not incorporate a 1/3-Asset Drop.

The AALR reserve component shall not be less than zero and shall equal the “residue,” as described in paragraph (1) below, of the prior year’s AALR on the contract, with any such “residue,” increased or decreased by a “payment” computed on an attained age basis as described in paragraph (2) below.

(1) The “residue” of the prior year’s AALR on each variable life insurance contract shall not be less than zero and shall be determined by adding interest at the maximum valuation interest rate to such prior year’s reserve, deducting the tabular claims based on the “excess”, if any, of the guaranteed minimum death benefit over the death benefit that would be payable in absence of such guarantee, and dividing the result by the tabular probability of survival. Hence, tabular costs are only deducted for years where, in the absence of the guarantee, coverage would be less than the guaranteed coverage.

(2) The “payment” used to increase or decrease the “residue” above shall be computed so that the present value of a level payment of that amount each year over the future period for which GMDB Revenue will be collected under the contract is equal to (A) minus (B) minus (C), where, (A) is the present value of future guaranteed minimum death benefits. The future guaranteed minimum death benefits are the projected future death benefits including the GMDB. (B) is the present value of the projected future death benefits that would be payable in the absence of the GMDB. The guaranteed benefit for (A) and (B) should be calculated for the life of the policy. Both (A) and (B) are calculated based on the Projection Assumptions. (C) is any “residue,” as described in paragraph (1) above, of the prior year’s AALR on such variable contract. Minimum standards of valuation mortality assumptions and maximum valuation interest rates are used to determine present values and net level payments. The period of time in which GMDB Revenue will be collected is limited to the period of time policy values are sufficient to collect policy charges or the period of time contingent requirements will be paid to maintain the GMDB. In no event will the time...
period be greater than the time to the end of the guarantee period. It should also be noted that the “payment” may be negative resulting in the reserve running off over the remaining guarantee period.

c) Other Flexible Premium Policies under the 1983 revisions not included above:

The present value of potential guaranteed minimum death benefits in excess of death benefits that would be provided in absence of such guarantee is determined by using minimum standards of valuation mortality assumptions and maximum valuation interest rates.

3. Issues:

Sections 3A(3) and 3A(4) of “XXX” state the following:

3A(3): This regulation shall not apply to any variable life insurance policy that provides for life insurance, the amount or duration of which varies according to the investment experience of any separate account or accounts.

3A(4): This regulation shall not apply to any variable universal life insurance policy that provides for life insurance, the amount or duration of which varies according to the investment experience of any separate account or accounts.

The language of these sections is clear. The reserving for variable life and variable universal life is in no way affected by the provisions of “XXX.” In particular, the 19-year select factors and the “X” factor are not applicable to the calculation of reserves for variable life and variable universal life products.

Effective Date

This guideline affects all variable life insurance contracts issued. Where the application of this Guideline produces higher reserves than the company had otherwise established by their previously used interpretation, such company must comply with this guideline effective December 31, 2001. However, such company may request a grade in period, not to exceed three (3) years, from the domiciliary Commissioner upon satisfactory demonstration of the previous interpretation and that such delay of implementation will not cause a hazardous financial condition or potential harm to its policyholders.

Retroactive application of the guideline to in-force policies to develop the current residue portion of the AALR will generally not be feasible. Therefore, the residue as of 12/31/2000 should be set equal to the greater of the amount established by the company under its current method or $0 if the company did not previously calculate an AALR.
Introduction

The revised version of the Model was adopted by the NAIC in March 1999. Since that date, some questions have been raised regarding whether and how the Model applies to various product designs. The purpose of this guideline is to provide direction as to the application of the Model to such products. Specifically, this guideline provides examples of various policy features that constitute “guarantees” and gives directions on how to reserve for these guarantees in accordance with the Model.

Obviously, new policy designs will emerge subsequent to the development of this document. No statute, regulation, or guideline can anticipate every future product design, and common sense and professional responsibility are needed to assure compliance with both the letter and the spirit of the law. While the Model is a complex regulation, its intent is clear: reserves need to be established for the guarantees provided by a policy. Policy designs which are created to simply disguise those guarantees or exploit a perceived loophole must be reserved in a manner similar to more typical designs with similar guarantees.

Text

The following product designs have been brought to the attention of the NAIC’s Life and Health Actuarial Task Force. The list below specifies reserving approaches which the Task Force regards as being most consistent with the letter and spirit of the Model.

1. An initial level premium rate is guaranteed for 10 years followed by increased guaranteed premiums for an additional 20 years. However, the company cannot increase premiums after year 10 (i.e., the initial premium continues to be charged) unless some specified event occurs.

The initial reserve segment is 30 years. Since the contract contains provisions that limit the company’s ability to increase premiums, then the initial premium should be treated as guaranteed for the entire 30 year period. It would be contrary to the conservative nature of statutory accounting to treat this policy the same as one in which the ability to raise premiums is unrestricted.

2. A term policy has an illustrated level premium for 30 years, the first 10 of which are guaranteed. Additionally, there is a refund option which provides that a specified refund will be paid if the premium ever increases. The refund must be requested within a limited time (e.g., 30 days) of receiving notice of the increase. Coverage terminates if the option is exercised.

This example differs from the one above in that there is no specified event that has to occur in order for the company to impose a premium increase; however, the company must provide an additional benefit to the policyholder if it exercises this right. Thus the company does not have an unrestricted right to impose an increase after 10 years. If the contract contains provisions that require that additional benefits be provided to the policyholder in the event of a premium increase, even if these benefits are lost if not claimed within a stated time frame, then the initial premiums should be treated as guaranteed for the entire 30 year period. It would be contrary to the conservative nature of statutory accounting to treat this policy the same as one in which the ability to raise premiums does not require that additional benefits be provided. Therefore, the initial segment for this policy is 30 years.
3. An initial level premium rate is guaranteed for 10 years followed by increased guaranteed premiums for an additional 20 years. However, after year 10 the policyholder is protected against premiums being increased above the initial level, with the protection provided by a second company through either reinsurance, a second policy issued to the consumer, or an agreement between the companies.

The combined reserves of the direct writer and the second company should be no less than the amount which the direct writer would hold if a) there were no second company and b) the initial reserve segment were 30 years. If this condition is not met, reserve credits for the direct writer should be disallowed. The reserve held by the direct writer should be based on the initial level premium being guaranteed for 30 years.

4. A product has relatively high gross premiums but with a guaranteed dividend or guaranteed refund schedule, or by some other means guarantees a low net cost to the policyholder.

The net amount of premium (i.e., gross premium less dividends or refunds) should be used in the reserve calculation. That represents the amount the insured actually pays for coverage.

For products reinsured on either a coinsurance or modified coinsurance basis, the reinsurer’s reserve calculation should also be based on the net premium (i.e., gross premiums less dividends or refunds guaranteed to be paid to the policyholder).

5. a) A re-entry term product has an initial rate guarantee for 10 years, with loose or non-existent re-entry underwriting, allowing the policyholder to re-enter for an additional 20 years at specified favorable rates. b) A universal life policy has provisions such that, if the UL policy lapses prior to the 10th policy anniversary because the actual accumulation value (or cash value, depending on design) falls below zero but stipulated premiums have been paid, a substitute policy is guaranteed to be issued providing the same amount of insurance coverage at the same stipulated premium for the remainder of the 10-year period plus an additional 20 years.

The reentry periods and premiums should be treated as a continuation of the initial guarantees for reserve calculation purposes. The initial reserve segment applicable to the original policy should be 30 years if the stipulated premium for the substitute policy is not high enough to trigger a new reserve segment. When the substitute policy is issued, reserves should be determined as if the coverage had been issued at the issue age and issue date of the original policy. Effectively, the company has guaranteed coverage for 30 years at the time the initial policy is issued, and the reserves established should reflect that guarantee.

6. A reinsurance treaty provides for 30 years of level premiums on a current scale but directly guarantees those premiums for only the first 10 years. However, if the reinsurer increases the premiums after 10 years, the reinsurer agrees to increase the expense allowance such that the net payments (premium minus allowance) by the direct writer remains unchanged.

Relative to the reinsurer’s reserve calculation, the initial reserve segment should be 30 years and the valuation premium should be level over that period. In this instance, the additional “expense allowance” has no relationship to the expenses actually incurred by the direct writer in administering the reinsured policies. Although a bona fide expense allowance would typically not be considered in determining the valuation premiums and reserve segments, in this instance the additional “expense allowance” has no relationship to the expenses actually incurred by the direct writer in administering the reinsured policies.”

7. A universal life policy has a cumulative “premium catch-up provision” in which the coverage is guaranteed to remain in force as long as a stipulated premium is paid each year, and if the insured
is paying less than is required to maintain the guarantee, there is an unlimited right to make up past premium deficiencies.

XXX requires that “when a policy contains more than one secondary guarantee, the minimum reserve shall be the greatest of the respective minimum reserves at that valuation date of each unexpired secondary guarantee, ignoring all other secondary guarantees.” Since secondary guarantees with “catch-up” provisions are capable of being reinstated up to the end of the secondary guarantee period, they constitute “unexpired secondary guarantees” which must be incorporated into the calculation of “the greatest of the respective minimum reserves at that valuation date of each unexpired secondary guarantee, ignoring all other secondary guarantees.”

The basic and deficiency reserves for a secondary guarantee with a catch-up provision should be computed as if the stipulated premium requirement had been met. The basic reserve shall be reduced by the product of a) the “catch-up amount,” if any, which would be required on the valuation date and b) the ratio of the “initial” (i.e., before adjustment) basic reserve to the sum of the “initial” basic and deficiency reserves. In no event shall the “reduced” basic reserve be reduced below zero. The deficiency reserve shall be reduced by the product of a) the “catch-up amount,” if any, which would be required on the valuation date and b) the ratio of the “initial” deficiency reserve to the sum of the “initial” basic and deficiency reserves. In no event shall the “reduced” deficiency reserve be reduced below zero.

If a universal life policy with a “premium catch up provision” has a shadow account below the level necessary to maintain the secondary guarantee, then the reserve for the secondary guarantee shall be valued according to this example. The basic and deficiency reserves, before deduction for the catch-up amount, shall be calculated as specified in Example #8.

8. A universal life policy guarantees the coverage to remain in force as long as the accumulation of premiums paid satisfies the secondary guarantee requirement.

First, the minimum gross premiums (determined at issue) that will satisfy the secondary guarantee requirement must be derived.

Second, for purposes of applying Sections 7B and 7C of the Model, the “specified premiums” are the minimum gross premiums derived in “Step One.”

Third, a determination should be made of the amount of actual premium payments in excess of the minimum gross premiums. For policies utilizing shadow accounts, this will be the amount of the shadow account. For policies with no shadow accounts but which specify cumulative premium requirements, this excess will be the amount of the cumulative premiums paid in excess of the cumulative premium requirements; the cumulative premium payments and requirements should include any interest credited under the secondary guarantee (with interest credited at the rate specified under the secondary guarantee).

Fourth, a determination should be made of the single payment necessary at the valuation date to fully fund the remaining secondary guarantee assuming that the minimum gross premiums have been paid, up through the valuation date, during the secondary guarantee period. The result from “Step Three” should be divided by this number.

Fifth, compute the net single premium on the valuation date for the coverage provided by the secondary guarantee for the remainder of the secondary guarantee period, using any valuation table and select factors authorized in Section 5A of the Model.
Sixth, the “net amount of additional premiums” is determined by multiplying the ratio from “Step Four” by the difference between the net single premium from “Step Five” and the basic and deficiency reserve, if any, computed in “Step Two.”

Seventh, a “reduced deficiency reserve” should be computed by multiplying the deficiency reserve, if any, by the one minus the ratio from “Step Four,” but not less than zero. This “reduced deficiency reserve” is the deficiency reserve to be used for purposes of Section 7D(1).

Eighth, the actual reserve used for purposes of Section 7D(1) is the lesser of: (1) the net single premium from “Step Five,” and (2) the amount of the excess from “Step Six” plus the basic reserve and the deficiency reserve, if any, computed in “Step Two.” Reduce this result by the applicable policy surrender charges, i.e., the account value less the cash surrender value. If the resulting amount is less than the sum of the basic and deficiency reserve from Step #2, then the basic and deficiency reserves to be used for the purposes of Section 7D(1) are those calculated in Step #2, and no further calculation is required.

Ninth, an “increased basic reserve” should be computed by subtracting the “reduced deficiency reserve” in “Step Seven” from the reserve computed in “Step Eight.” This “increased basic reserve” is the basic reserve to be used for purposes of Section 7D(1).

Effective Date

With the exception of “Step Three” through “Step Nine” of Item #8, the application of this guideline shall be retroactive to the earlier of a state’s adoption of the revised Model or the statutory accounting practices and procedures as set forth in the NAIC Accounting Practices and Procedures Manual. All of Item #8 shall be applicable to policies and certificates issued on or after the later of the date of a state’s adoption of the revised Model and January 1, 2003.
RESERVES FOR VARIABLE ANNUITIES WITH GUARANTEED LIVING BENEFITS

I. Background

The purpose of this Actuarial Guideline (Guideline) is to interpret the standards for the valuation of reserves for guaranteed living benefits included in variable deferred and immediate annuity contracts (VAGLBs). This Guideline provides an interpretation of the National Association of Insurance Commissioners’ (NAIC) Model Standard Valuation Law (SVL) for VAGLBs and is intended to be temporary.

The methodology does not specifically address how “base variable annuity reserves” (i.e., reserves for variable annuity contracts calculated by ignoring VAGLBs) should be calculated. Rather, it only addresses the calculation of reserves for VAGLBs to be held in the General Account.

In addition, this Guideline interprets the standards for the valuation of reserves when the VAGLB risk is reinsured.

II. Scope

This Guideline applies to variable deferred and immediate annuity contracts that provide one or more guaranteed living benefits. This Guideline does not apply to those group annuity contracts that are not subject to the Commissioners’ Annuities Reserve Valuation Method (CARVM).

VAGLB designs falling under the scope of this Guideline include, but are not limited to, currently offered provisions commonly referred to as Guaranteed Minimum Accumulation Benefits (GMABs), Guaranteed Minimum Income Benefits (GMIBs), Guaranteed Minimum Withdrawal Benefits (GMWBs), and Guaranteed Payout Annuity Floors (GPAFs).

III. Text

A. Aggregate Reserves for Contracts with VAGLBs

The Aggregate Reserves for Contracts with VAGLBs are the total reserves held by the company in support of the variable annuity contracts with VAGLBs, and equals the sum of 1 and 2, where:

1. equals the aggregate reserves for the variable annuity contracts ignoring both the future revenues and benefits from the VAGLBs and after comparison to the cash value of the contracts. For the purpose of determining future revenues and benefits for VAGLBs, a charge should be imputed in the event that there are no explicit VAGLB charges.

and

2. equals the VAGLB reserve, determined as the sum of the aggregate VAGLB charges from the date of issue to the valuation date for VAGLB benefits in-force (i.e., contracts still in-force and still eligible for the VAGLB) and subject to the asset adequacy analysis requirement in subsection C. In the event that there are no explicit VAGLB charges, a charge should be imputed.

The VAGLB reserve must be held in the General Account. (This is in addition to any amounts in item 1 that are required to be held in the General Account).

B. Reserve for Ceded and Assumed Reinsurance
If all or a portion of the VAGLB risk is reinsured on a proportional basis, the ceding company is entitled to a corresponding proportional reinsurance reserve credit based on the VAGLB reserve held before consideration of reinsurance.

Adjustments may need to be made to the reserve credit taken by ceding companies where the underlying reinsurance treaty contains non-proportional elements.

For companies where VAGLB risk is assumed, the aggregate VAGLB reserves for contracts with VAGLBs will be the sum of a) the aggregate direct VAGLB charges in proportion to the amount of reinsurance from the issue date of the contract to the effective date of the reinsurance contract and b) gross reinsurance premiums from the effective date of the reinsurance contract to the valuation date for VAGLB benefits in force (i.e. contracts still in force and eligible for the VAGLB) and subject to the asset adequacy analysis requirement in subsection C.

C. Asset Adequacy Analysis Requirement

The appointed actuary must perform a standalone asset adequacy analysis of the VAGLB reserve. If such analysis reveals a reserve shortfall, VAGLB reserves must be increased. Such analysis shall be performed reflecting the following:

1. all VAGLB benefits and expenses,

2. all VAGLB charges, and

3. the assets supporting the VAGLB reserves.

The analysis shall be performed on an aggregate basis for all contracts with VAGLBs, consistent with the requirements of the NAIC Model Actuarial Opinion and Memorandum Regulation, including the requirement that the analysis conform to the Actuarial Standards of Practice as promulgated from time to time by the Actuarial Standards Board. However, no separate actuarial opinion is required by this Actuarial Guideline.

Where the VAGLB is reinsured, the asset adequacy analysis may reflect the reinsurance. However, if the inclusion of reinsurance in the asset adequacy analysis would increase the VAGLB reserve, then reinsurance must be reflected in the analysis.

IV. Applicability

This Guideline is effective December 31, 2002 and affects all contracts issued on or after January 1, 1981.

Since the requirements of this Guideline are intended to be temporary, this Guideline is in effect until no later than January 1, 2006.
GUIDELINE FOR VALUATION RATE OF INTEREST FOR FUNDING AGREEMENTS AND GUARANTEED INTEREST CONTRACTS (GICS) WITH BAIL-OUT PROVISIONS

PURPOSE

The purpose of this Guideline is to interpret the Standard Valuation Law (SVL) for assignment of appropriate valuation interest rates to risks embedded in bail-out provisions under Funding Agreements and Guaranteed Interest Contracts.

BACKGROUND

Funding Agreements (FAs) and other types of Guaranteed Interest Contracts (GICs) typically issued to tax-exempt municipal bonds, money market funds and securities lending funds, often contain bail-out provisions that allow the contractholders to get their money back at full book value. Such provisions may be triggered by the credit rating downgrade of the issuer below a given level or may be at a given period’s notice to the contractholder, e.g. 7, 30, 90 or 180 days’ notice. The contract language for these provisions may be as follows:

1. In the event that the investment provider (i.e. the insurance company) is downgraded below A-/A3 by S & P and/or Moody’s respectively, the contract holder has the right to terminate the contract and receive the remaining principal and accrued interest without penalty. [In most cases the issuer has the alternate option to provide a replacement contract or post collateral or do a credit wrap.]

2. Each party has the right to terminate the contract before maturity by giving the other at least 7/30/90 or 180-days notice in writing. At such termination the principal and accrued interest is payable with no penalty.

Contracts with downgrade provision

The bulk of the contracts issued with a downgrade provision are fixed rate FAs or GICs issued in connection with tax-exempt municipal bonds. These contracts can be short-term or long-term. Short-term contracts typically have an average life of around one-year, and are intended for municipal bond funds for construction, acquisition, housing, tax revenue anticipation notes (TRANS), etc. In these types of funds the cash-flow projections are provided when the case is underwritten, but there may be variability in the actual withdrawals. Any outstanding principal and interest is payable at maturity.

Long-term contracts are issued in connection with the debt service reserve (DSR) or the float fund of the bond issue, and mature at the same time as the bonds, which can be as long as 30 years. The float fund takes in deposits, and pays out the half-yearly interest and principal (if any is due) on the bonds. It runs to near zero about twice a year, after each half-yearly coupon payment. The DSR is a contingent fund for a rainy day to prevent a missed coupon or principal payment on the bond. The DSR has a single deposit that is typically 10% of the bond issue.
Contracts with put provision

FAs or GICs with put provisions are generally issued to money market funds subject to Rule 2a-7 of the Investment Company Act. Rule 2a-7 provides guidelines on liquidity, requiring funds available at book value subject to certain notification periods. Additionally, these contracts usually have downgrade provisions. Even if the downrade provision is not in the contract, it can be assumed that the put will be exercised on downgrade, since a certain level of credit is also a Rule 2a-7 requirement.

Typically, these FAs or GICs guarantee a floating rate of interest linked to an index like LIBOR, which is paid out and reset periodically. Most contracts have fixed maturity dates when the principal is returned. Generally the FAs or GICs are the higher yielding assets of the money market funds, and therefore puts are not expected to be exercised.

Risks

Both the downgrade and the put provisions present liquidity or concentration type of risks to the issuer, i.e. if a critical event occurs, a substantial part of the whole block of business is likely to be liquidated. Sufficient asset liquidity, prudent A/L management, cash flow testing, hedging strategies, etc. can mitigate these risks. Also, companies generally have contractual provisions providing alternative options.

Downgrade provision:
The main risk here is that, upon downgrade to the trigger level, a company may have to realize its assets at a market loss in order to pay out at book. If the downgrade happens in a falling interest rate environment there is no risk of a market loss as the underlying assets are likely to be at a higher market value. On the other hand if the downgrade occurs in a rising interest rate environment, market value losses would occur when the company sells assets to pay out liabilities at book value.

Companies have written provisions in their contracts that provide alternate options to paying at book value in a rising interest rate environment:

“Novation/Assignment” option: The novation/assignment option allows the company to transfer its liabilities to another funding agreement provider that meets the credit rating requirements of the contractholder. In a rising interest rate environment, the new provider should be willing to pay a “premium” to assume a liability crediting a below market interest rate. In a perfectly efficient market this “premium” should precisely offset the market value loss upon the sale of the asset. In practice, however, it is less likely that the “premium” would fully offset the market value loss since:

• The new provider may view the liability risk somewhat differently
• The new provider may try and take advantage of the situation of the downgraged company
• There may be a large volume of these types of contracts in the market, etc.

However, the “premium” payable by the new provider could provide a substantial offset against the market value loss incurred by the downgraded company.

“Collateralization” option: This option allows the company to post assets as collateral for the benefit of the contractholder, as an alternative to payment at book value. The collateral posted would have to meet the credit requirements of the contractholder, which could be government or agency securities. Usually the collateral posted is required to have a cushion, typically ranging from 102% to 105%.

Upon trigger of the downgrade provision, the company would need to have suitable assets in its portfolio that are available for use as collateral, and also acceptable to the contractholder. In addition, there will be administrative and custodial expenses/fees of establishing and monitoring collateral levels. In some states there may also be legal restrictions on encumbering assets that back policyholder claims.
If the downgraded company can overcome the above constraints, then collateralization is another alternative of maintaining the contract and not having to pay out at book value.

“Credit Wrap” option: Under this arrangement the contract is issued out of a separate account which is guaranteed by a financial guarantee insurer. Effectively, the credit rating of the guarantor passes through to meet the credit requirement of the FA or GIC. [A number of FAs or GICs requiring a higher credit rating are currently being written in this way.]

The contract being wrapped has to meet certain criteria before the financial guarantee insurers are willing to wrap. Generally, the guarantor would also require higher credit rated securities in the separate account, which could be government or agency, and would require these in the 102% to 105% range. There will also be administrative and custodial expenses of establishing and monitoring the separate account in addition to the wrap fee payable to the mono-line insurer.

Although at significant cost, this option does provide the downgraded company a viable alternative to paying out at book value.

Put provision:
The put provision is not tied to a particular event but can contractually be exercised by giving the required days’ notice. It has been argued that this provision is there to meet the Rule 2a-7 liquidity requirements and in practice is unlikely to be exercised, particularly since the FAs or GICs are one of the higher yielding assets of the money market portfolio. However, it is a contractual option and if, for example, the issuer were in financial difficulties, it will be exercised. Past experience suggests this is the case.

The put provision therefore presents a liquidity or concentration risk similar to that of downgrade—it is likely to be exercised in bulk upon happening of a critical event. Similar considerations apply, i.e. in a rising interest rate environment market value losses would occur when the company sells assets to pay out liabilities at book value.

Reserves

For reserving the Standard Valuation Law applies. However, when the SVL was enacted, these types of bail-out provisions did not exist, and were therefore not addressed explicitly. The purpose of this Guideline is to interpret the SVL for assignment of appropriate valuation interest rates to risks embedded in these bail-out provisions.

Other Actuarial Guidelines have provided similar interpretations. For example, Guideline XIII addresses interest bailout provisions under annuity contracts, Guideline XXX provides for participant directed withdrawal provisions under GICs, and Guideline XXXIII covers the elective and non-elective benefits under individual annuity contracts.

Plan Types

The SVL utilizes a concept known as Plan Type, which was designed to distinguish between the various levels of disintermediation risks—the greater the disintermediation risk for a company, the more conservative is the resulting valuation rate. Plan Types designated in the model SVL are defined as follows:

Plan Type A: At any time policyholder may withdraw funds only (1) with an adjustment to reflect changes in interest rates or asset values since receipt of the funds by the insurance company, or (2) without such adjustment but in installments over five years or more, or (3) as an immediate life annuity, or (4) no withdrawal permitted.
Plan Type B: Before expiration of the interest rate guarantee, policyholder may withdraw funds only (1) with an adjustment to reflect changes in interest rates or asset values since receipt of the funds by the insurance company, or (2) without such adjustment but in installments over five years or more, or (3) no withdrawal permitted. At the end of interest rate guarantee, funds may be withdrawn without an adjustment in a single sum or installments over less than five years.

Plan Type C: Policyholder may withdraw funds before expiration of interest rate guarantee in a single sum or installments over less than five years either (1) without adjustment to reflect changes in interest rates or asset values since receipt of the funds by the insurance company, or (2) subject only to a fixed surrender charge stipulated in the contract as a percentage of the fund.

TEXT

For the purpose of the application of the Standard Valuation Law to FAs and GICs, the annuities and GIC valuation interest rates are to be used. The bailout provisions described above shall be treated as a withdrawal by the policyholder at book value, and the underlying contracts shall be classified as Plan Type C.

However, for contracts containing written provisions that allow the insurance company alternate options to paying out at book value, the valuation actuary may use a valuation rate of interest higher than Type C. In no event may the valuation interest rate be greater than that applicable to similar contracts with no put or bailout provisions. If a provision requires over-collateralization and/or use of high credit quality assets, this should be adequately reflected in the reserves.

If a higher interest rate than Type C is used, the valuation actuary must be satisfied and be able to demonstrate that the written provisions substantially reduce the liquidity risk. In addition, the valuation actuary must be satisfied, and should periodically review, that there are other risk management measures in place to reduce the liquidity or concentration risk, taking into consideration at least the following:

- Readily liquidated assets at nil or minimal market-value loss
- Cash-flow testing results
- Standby lines of credit available and other liquidity facilities established
- Hedges in place with liquidity options
- High credit quality assets available for use as collateral.
APPENDIX TO GUIDELINES
NEW YORK STATE INSURANCE DEPARTMENT
MAXIMUM RESERVE VALUATION AND MAXIMUM LIFE POLICY NONFORFEITURE INTEREST RATES

The maximum reserve valuation and nonforfeiture interest rates, prescribed by Sections 4217 and 4221(k) of the New York Insurance Law, are specified in "Table A through Table H Rates" noted below. Such rates vary from year to year based on Moody’s corporate bond yield averages for 12 and 36 months ending on June 30, and weighting factors prescribed by Section 4217. The Moody’s averages are provided for years 1981 to present in the attached Appendix.

New! Clarification on Fixed Annuity Reserves Interest Rates
We note that there has been some concern over the appropriate maximum valuation interest rate for flexible premium deferred annuities (FPDA). Section 4217(c)(4)(D)(iii) of the New York Insurance Law does not allow the use of the additional .05 weighting factor for annuities that guarantee interest rates on future considerations received more than twelve months beyond the valuation date. Accordingly, for flexible premium deferred annuities the weighting factors shown in Section 4217(c)(4)(D)(iii)(I) or 4217(c)(4)(D)(iii)(II) should be used. For convenience, maximum valuation interest rates for such FPDAs are shown in Table D (issue year basis) and Table G (change in fund basis). The rates shown in Table E and Table H are not appropriate for FPDAs.

- General Information
- Table A through Table H Rates
- Appendix (Moody’s Averages)
- Regulation 128 and Discontinued 30 year US Treasury Bond

Disclaimer
This notice is to be used for informational purposes, as an aid in complying with the law.
TO: ALL AUTHORIZED LIFE INSURANCE COMPANIES, ACCREDITED LIFE REINSURERS, FRATERNAL BENEFIT SOCIETIES AND CHARITABLE ANNUITY SOCIETIES

SUBJECT: MAXIMUM RESERVE VALUATION AND MAXIMUM LIFE POLICY NONFORFEITURE INTEREST RATES


The maximum valuation and nonforfeiture interest rates, prescribed by Sections 4217 and 4221(k) of the New York Insurance Law for future years, will vary from year to year depending on Moody’s corporate bond yield averages.

The maximum valuation interest rates for issues, purchases and changes-in-fund of years 1982 through 2003 (and other years where shown) are outlined below. The maximum valuation and nonforfeiture interest rates for Ordinary Life Insurance are shown in Category A, except for Single Premium Life Insurance, as defined in Section 4217(c)(4)(B)(vi), the maximum valuation interest rates for which are shown in Category B.

Please refer to Sections 4217 and 4221 of NY Insurance Law, Regulation 147 and Regulation 151 for definitions and explanations of valuation interest rate, guarantee duration, plan type and product category. Regulation 151 has been effective since February 28, 2001 and is available on our web site.

This notice is to be used for informational purposes, as an aid in complying with the law and can be found at the New York Insurance Department website: http://www.ins.state.ny.us/ilifemax.htm.
## Appendix C

### A. ORDINARY LIFE INSURANCE (Except as covered in B)

<table>
<thead>
<tr>
<th>Issue Year</th>
<th>Guarantee Duration</th>
<th>Maximum Reserve Valuation Interest Rate</th>
<th>Maximum Nonforfeiture Interest Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1979-1981</td>
<td>10 Years or less</td>
<td>4.50%</td>
<td>5.50%</td>
</tr>
<tr>
<td></td>
<td>More than 10 years, up to 20</td>
<td>4.50</td>
<td>5.50</td>
</tr>
<tr>
<td></td>
<td>More than 20 years</td>
<td>4.50</td>
<td>5.50</td>
</tr>
<tr>
<td>1982</td>
<td>10 Years or less</td>
<td>6.75%</td>
<td>8.50%</td>
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<tr>
<td></td>
<td>More than 10 years, up to 20</td>
<td>6.25</td>
<td>7.75</td>
</tr>
<tr>
<td></td>
<td>More than 20 years</td>
<td>5.50</td>
<td>7.00</td>
</tr>
<tr>
<td>1983</td>
<td>10 Years or less</td>
<td>7.25%</td>
<td>9.00%</td>
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<td></td>
<td>More than 10 years, up to 20</td>
<td>6.75</td>
<td>8.50</td>
</tr>
<tr>
<td></td>
<td>More than 20 years</td>
<td>6.00</td>
<td>7.50</td>
</tr>
<tr>
<td>1984</td>
<td>10 Years or less</td>
<td>7.25%</td>
<td>9.00%</td>
</tr>
<tr>
<td></td>
<td>More than 10 years, up to 20</td>
<td>6.75</td>
<td>8.50</td>
</tr>
<tr>
<td></td>
<td>More than 20 years</td>
<td>6.00</td>
<td>7.50</td>
</tr>
<tr>
<td>1985</td>
<td>10 Years or less</td>
<td>7.25%</td>
<td>9.00%</td>
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<tr>
<td>1986</td>
<td>10 Years or less</td>
<td>7.25%</td>
<td>9.00%</td>
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<td>6.75</td>
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<td></td>
<td>More than 20 years</td>
<td>6.00</td>
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<tr>
<td>1987</td>
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C. Single Premium Immediate Annuities and annuity benefits arising from life insurance policies and annuity and guaranteed interest contracts with cash settlements options.

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F. Other Annuities and Guaranteed Interest Contracts, without cash settlement options, valued on the “Issue Year” basis.

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## Appendix C

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APPENDIX

The maximum reserve valuation interest rates are based on reference interest rates, which are averages of corporate bond earnings published by Moody’s Investors Service, Inc., and weighting factors prescribed by Section 4217, which defines running averages of the published monthly yield rates for 12-month and 36-month periods.

The following table shows the 12-month and 36-month yield averages for recent years:

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<tr>
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<td>1987</td>
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<td>10.32</td>
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<td>10.09%</td>
<td>9.93%</td>
<td>9.93%</td>
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<tr>
<td>1990</td>
<td>9.52</td>
<td>9.97</td>
<td>9.52%</td>
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<tr>
<td>1991</td>
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<tr>
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<td>6.71%</td>
<td>7.29%</td>
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The maximum nonforfeiture interest rate for Life Insurance, under Section 4221(k), for a particular issue year, is equal to 125% of the maximum reserve valuation interest rate for the same issue year, rounded to the nearer ¼%.

Should the computed maximum reserve valuation interest rate for Life Insurance (other than Single Premium Life Insurance covered in Category B) for a particular issue year be different from the actual maximum reserve valuation interest rate for the next previous issue year by less than ½%, then the maximum reserve valuation interest rate for such particular issue year will be the same as that for such next previous issue year.

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Appendix C

Regulation 128 and Discontinued 30 Year US Treasury Bond

To the extent Regulation 128 references the 30-year spot rate, the spot rate associated with the longest available Treasury bond (e.g., that maturing 2/15/31) should be used.

Disclaimer
This notice is to be used for informational purposes, as an aid in complying with the law.
Appendix D  
GAAP Cross-Reference to SAP  
As of December, 2003

Introduction

As expressed in the Statement of Concepts, Statutory Accounting Principles (SAP) utilizes the framework established by Generally Accepted Accounting Principles (GAAP).

Appendix D includes GAAP pronouncements that have been considered in the development of SAP and include all issued pronouncements in categories a, b and c of the GAAP Hierarchy. This listing is current to GAAP as of December 2003 (November 1, 2003 for Opinions of the FASB Emerging Issues Task Force (EITF)).

The NAIC Codification of Statutory Accounting Principles Working Group (Statutory Accounting Principles Working Group as of January 1, 2000 (SAPWG)) addressed all GAAP pronouncements included in categories a, b and c issued though 1996 during the initial drafting of the SSAPs. As documented in the Policy Statement on the Maintenance of Statutory Accounting Principles (included in Appendix F), the SAPWG will continue to review new GAAP guidance for applicability to SAP. Beginning January 1, 1999, the NAIC Emerging Accounting Issues Working Group (EAIWG) has addressed the EITF opinions issued subsequent to 1996. The positions of the EAIWG are documented in an interpretation (INT) as indicated by reference in the last column of the GAAP Cross-Reference to SAP chart. Appendix B includes the full text of EAIWG INTs issued through December 7, 2003.

A “pending” comment within the NAIC Status column indicates that the NAIC has not yet completed its deliberation of the GAAP pronouncement.

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# STATUTORY ACCOUNTING PRINCIPLES

## GAAP CROSS-REFERENCE TO STATUTORY ACCOUNTING PRINCIPLES

### CATEGORY A GAAP

#### FASB STATEMENTS

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### STATUTORY ACCOUNTING PRINCIPLES
**GAAP CROSS-REFERENCE TO STATUTORY ACCOUNTING PRINCIPLES**

#### CATEGORY B GAAP
**AICPA STATEMENTS OF POSITION**

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### STATUTORY ACCOUNTING PRINCIPLES
#### GAAP CROSS-REFERENCE TO STATUTORY ACCOUNTING PRINCIPLES

#### CATEGORY B GAAP

**AICPA STATEMENTS OF POSITION**

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<td>99-1</td>
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#### STATUTORY ACCOUNTING PRINCIPLES

**GAAP CROSS-REFERENCE TO STATUTORY ACCOUNTING PRINCIPLES**

**CATEGORY C GAAP**

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## STATUTORY ACCOUNTING PRINCIPLES
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| 86-39               | Gains from the Sale of Mortgage Loans with Servicing Rights Retained | Nullified by FAS 122, FAS 125 & FAS 140 |                                         |                     |
| 86-40               | Investments in Open-End Mutual Funds That Invest in U.S. Government Securities | | N/A |                     |
| 86-41               | Carryforward of the Corporate Alternative Minimum Tax Credit         | Nullified by FAS 109 |                                         |                     |
| 86-42               | Effect of a Change in Tax Rates on Assets and Liabilities Recorded Net-of-Tax in a Purchase Business Combination | Nullified by FAS 109 |                                         |                     |
| 86-43               | Effect of a Change in Tax Law or Rates on Leveraged Leases           | Complete | Adopt | 22                  |
| 86-44               | Effect of a Change in Tax Law on Investments in Safe Harbor Leases   | | N/A |                     |
| 86-45               | Imputation of Dividends on Preferred Stock Redeemable at the Issuer’s Option with Initial Below-Market Dividend Rate | No EITF Consensus |                                         |                     |
| 86-46               | Uniform Capitalization Rules for Inventory under the Tax Reform Act of 1986 | | N/A |                     |
| 87-1                | Deferral Accounting for Cash Securities That Are Used to Hedge Rate or Price Risk | Resolved by FAS 133 |                                         |                     |
| 87-2                | Net Present Value Method of Valuing Speculative Foreign Exchange Contracts | Nullified by FAS 133 | Complete | Reject | 31 |
| 87-3                | (Not Used)                                                          |                                         |                                         |                     |
| 87-4                | Restructuring of Operations: Implications of SEC Staff Accounting Bulletin No. 67 | | N/A |                     |
| 87-5                | Troubled Debt Restructurings: Interrelationship between FASB Statement No. 15 and the AICPA Savings and Loan Guide | Nullified by FAS 114 |                                         |                     |
| 87-6                | Adjustments Relating to Stock Compensation Plans                     | Nullified by FIN 44 | Complete | Adopt | 13 |

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<td>87-7</td>
<td>Sale of an Asset Subject to a Lease and Nonrecourse Financing: “Wrap-Lease Transactions”</td>
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<td>87-9</td>
<td>Profit Recognition on Sales of Real Estate with Insured Mortgages or Surety Bonds</td>
<td>Complete</td>
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<td>87-10</td>
<td>Revenue Recognition by Television (Barter) Syndicators</td>
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<tr>
<td>87-11</td>
<td>Allocation of Purchase Price to Assets to Be Sold</td>
<td>Nullified by FAS 144 Complete Reject 68</td>
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<td>87-12</td>
<td>Foreign Debt-for-Equity Swaps</td>
<td>Complete</td>
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<td>87-13</td>
<td>Amortization of Prior Service Cost for a Defined Benefit Plan When There Is a History of Plan Amendments</td>
<td>Resolved by Q&amp;A 87, Question 20</td>
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<td>87-14</td>
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<td>87-15</td>
<td>Effect of a Standstill Agreement on Pooling-of-Interests Accounting</td>
<td>Nullified by FAS 141 Complete Reject 68</td>
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<td>87-16</td>
<td>Whether the 90 Percent Test for a Pooling of Interests is Applied Separately to Each Company or on a Combined Basis</td>
<td>Nullified by FAS 141 Complete Reject 68</td>
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<td>87-17</td>
<td>Spinoffs or Other Distributions of Loans Receivable to Shareholders</td>
<td>Codified in EITF 01-2</td>
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<td>87-18</td>
<td>Use of Zero Coupon Bonds in a Troubled Debt Restructuring</td>
<td>Complete</td>
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<td>87-19</td>
<td>Substituted Debtors in a Troubled Debt Restructuring</td>
<td>Complete</td>
<td>Adopt/M</td>
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<td>87-20</td>
<td>Offsetting Certificates of Deposit against High-Coupon Debt</td>
<td>Superseded by EITF 96-19</td>
<td>N/A</td>
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<tr>
<td>87-21</td>
<td>Change of Accounting Basis in Master Limited Partnership Transactions</td>
<td>Complete</td>
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<td>46</td>
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<td>87-22</td>
<td>Prepayments to the Secondary Reserve of the FSLIC</td>
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<td>87-23</td>
<td>Book Value Stock Purchase Plans</td>
<td>Complete</td>
<td>Adopt</td>
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<td>87-24</td>
<td>Allocation of Interest to Discontinued Operations</td>
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<td>87-25</td>
<td>Sale of Convertible, Adjustable-Rate Mortgages with Contingent Repayment Agreement</td>
<td>Resolved by FAS 125 &amp; FAS 140</td>
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<td>GAAP Pronouncement</td>
<td>Name</td>
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<td>87-26</td>
<td>Hedging of Foreign Currency Exposure with a Tandem Currency</td>
<td>Nullified by FAS 133</td>
<td>Reject</td>
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<td>87-27</td>
<td>Poolings of Companies That Do Not Have a Controlling Class of Common Stock</td>
<td>Nullified by FAS 141</td>
<td>Reject</td>
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</tr>
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<td></td>
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<td>87-28</td>
<td>Provision for Deferred Taxes on Increases in Cash Surrender Value of Key-Person Life Insurance</td>
<td>Resolved by FAS 109</td>
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<td>87-29</td>
<td>Exchange of Real Estate Involving Boot</td>
<td>Codified in EITF 01-2</td>
<td>Adopt</td>
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<td>87-30</td>
<td>Sale of a Short-Term Loan Made under a Long-Term Credit Commitment</td>
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<td>87-31</td>
<td>Sale of Put Options on Issuer’s Stock</td>
<td>Codified in EITF No. 96-13</td>
<td>Adopt</td>
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<td>87-32</td>
<td>(Not Used)</td>
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<tr>
<td>87-33</td>
<td>Stock Compensation Issues Related to Market Decline</td>
<td>Nullified by FIN 44</td>
<td>Adopt</td>
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<td>87-34</td>
<td>Sale of Mortgage Servicing Rights with a Subservicing Agreement</td>
<td>Complete</td>
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<td>88-1</td>
<td>Determination of Vested Benefit Obligation for a Defined Benefit Pension Plan</td>
<td>Complete</td>
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<td>8, 89</td>
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<td>88-2</td>
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<td>88-3</td>
<td>Rental Concessions Provided by Landlord</td>
<td>Resolved by FTB 88-1 and EITF 88-10 and 94-3</td>
<td>Adopt/M</td>
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<td>88-4</td>
<td>Classification of Payment Made to IRS to Retain Fiscal Year</td>
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<tr>
<td>88-5</td>
<td>Recognition of Insurance Death Benefits</td>
<td>Complete</td>
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<td>88-6</td>
<td>Book Value Stock Plans in an Initial Public Offering</td>
<td>Complete</td>
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<td>88-7</td>
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<td>88-8</td>
<td>Mortgage Swaps</td>
<td>Nullified and Resolved by FAS 133</td>
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<td>88-9</td>
<td>Put Warrants</td>
<td>Complete</td>
<td>Adopt</td>
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<td>88-10</td>
<td>Costs Associated with Lease Modification or Termination</td>
<td>Nullified and Resolved by FAS 146</td>
<td>Complete</td>
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<tr>
<td>88-11</td>
<td>Allocation of Recorded Investment When a Loan or Part of a Loan Is Sold</td>
<td>Complete</td>
<td>Adopt</td>
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<td>88-12</td>
<td>Transfer of Ownership Interest as Part of Down Payment under FASB Statement No. 66</td>
<td>Complete</td>
<td>Adopt</td>
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<td>88-13</td>
<td>(Not Used)</td>
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<tr>
<td>88-14</td>
<td>Settlement of Fees with Extra Units to a General Partner in a Master Limited Partnership</td>
<td>No EITF Consensus</td>
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<td>88-15</td>
<td>Classification of Subsidiary’s Loan Payable in Consolidated Balance Sheet When Subsidiary’s and Parent’s Fiscal Years Differ</td>
<td>No EITF Consensus</td>
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<td>88-16</td>
<td>Basis in Leveraged Buyout Transactions</td>
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<td>88-17</td>
<td>Accounting for Fees and Costs Associated with Loan Syndications and Loan Participations</td>
<td>Partially nullified by FAS 125 and superseded by EITF 97-3</td>
<td>Complete</td>
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</tr>
<tr>
<td>88-18</td>
<td>Sales of Future Revenues</td>
<td>Complete</td>
<td>Reject</td>
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<tr>
<td>88-19</td>
<td>FSLIC-Assisted Acquisitions of Thrifts</td>
<td>Complete</td>
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<td>88-20</td>
<td>Difference between Initial Investment and Principal Amount of Loans in a Purchased Credit Card Portfolio</td>
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<td>88-21</td>
<td>Accounting for the Sale of Property Subject to the Seller’s Preexisting Lease</td>
<td>Complete</td>
<td>Reject</td>
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<td>88-22</td>
<td>Securitization of Credit Card and Other Receivable Portfolios</td>
<td>Complete</td>
<td>Adopt</td>
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<td>88-23</td>
<td>Lump-Sum Payments under Union Contracts</td>
<td>Complete</td>
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<td>88-24</td>
<td>Effect of Various Forms of Financing under FASB Statement No. 66</td>
<td>Complete</td>
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<td>88-25</td>
<td>Ongoing Accounting and Reporting for a Newly Created Liquidating Bank</td>
<td>N/A</td>
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<tr>
<td>88-26</td>
<td>Controlling Preferred Stock in a Pooling of Interests</td>
<td>Nullified by FAS 141</td>
<td>Complete</td>
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<tr>
<td>88-27</td>
<td>Effect of Unallocated Shares in an Employee Stock Ownership Plan on Accounting for Business Combinations</td>
<td>Nullified by FAS 141</td>
<td>Complete</td>
<td>68</td>
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<tr>
<td>GAAP Pronouncement</td>
<td>Name</td>
<td>Status</td>
<td>Disposition</td>
<td>SSAP or INT Number</td>
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<td>89-1</td>
<td>Accounting by a Pension Plan for Bank Investment Contracts and Guaranteed Investment Contracts</td>
<td>Resolved by FAS 110 and SOP 94-4</td>
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<td>89-2</td>
<td>Maximum Maturity Guarantees on Transfers of Receivables with Recourse</td>
<td>Nullified by FAS 125 &amp; FAS 140</td>
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<td>89-3</td>
<td>Balance Sheet Presentation of Savings Accounts in Financial Statements of Credit Unions</td>
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<tr>
<td>89-4</td>
<td>Accounting for a Purchased Investment in a Collateralized Mortgage Obligation Instrument or in a Mortgage-Backed Interest-Only Certificate</td>
<td>Superseded by EITF 99-20</td>
<td>Complete</td>
<td>Reject 43</td>
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<tr>
<td>89-5</td>
<td>Sale of Mortgage Loan Servicing Rights</td>
<td>Superseded by EITF 95-5</td>
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<tr>
<td>89-6</td>
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<td>89-7</td>
<td>Exchange of Assets or Interest in a Subsidiary for a Noncontrolling Equity Interest in a New Entity</td>
<td>Codified in EITF 01-2</td>
<td>Complete</td>
<td>Reject 68</td>
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<tr>
<td>89-8</td>
<td>Expense Recognition for Employee Stock Ownership Plans</td>
<td>Nullified by SOP 93-6</td>
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<td>89-9</td>
<td>Accounting for In-Substance Foreclosures</td>
<td>Nullified by FAS 114</td>
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<td>89-10</td>
<td>Sponsor’s Recognition of Employee Stock Ownership Plan Debt</td>
<td>Superseded by SOP 93-6</td>
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<td>89-11</td>
<td>Sponsor’s Balance Sheet Classification of Capital Stock with a Put Option Held by an Employee Stock Ownership Plan</td>
<td>Complete</td>
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<td>89-12</td>
<td>Earnings-per-Share Issues Related to Convertible Preferred Stock Held by an Employee Stock Ownership Plan</td>
<td>Superseded by SOP 93-6</td>
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<td>89-13</td>
<td>Accounting for the Cost of Asbestos Removal</td>
<td>Complete</td>
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<tr>
<td>89-14</td>
<td>Valuation of Repossessed Real Estate</td>
<td>Complete</td>
<td>Adopt</td>
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<tr>
<td>89-15</td>
<td>Accounting for a Modification of Debt Terms When the Debtor is Experiencing Financial Difficulties</td>
<td>Superseded by EITF 02-4</td>
<td>Complete</td>
<td>Adopt/M 36</td>
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<tr>
<td>89-16</td>
<td>Consideration of Executory Costs in Sale-Leaseback Transactions</td>
<td>Complete</td>
<td>Adopt</td>
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<td>89-17</td>
<td>Accounting for the Retail Sale of an Extended Warranty Contract in Connection with the Sale of a Product</td>
<td>Nullified by FTB 90-1</td>
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<tr>
<td>89-18</td>
<td>Divestitures of Certain Investment Securities to an Unregulated Commonly Controlled Entity under FIRREA</td>
<td>Complete</td>
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</table>
## Appendix D

### STATUTORY ACCOUNTING PRINCIPLES

**GAAP CROSS-REFERENCE TO STATUTORY ACCOUNTING PRINCIPLES**

**CATEGORY C GAAP**

**CONSENSUS OPINIONS OF THE EMERGING ISSUES TASK FORCE**

<table>
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<th>GAAP Pronouncement</th>
<th>Name</th>
<th>Status</th>
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<th>SSAP or INT Number</th>
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<tr>
<td>89-19</td>
<td>Accounting for a Change in Goodwill Amortization for Business Combinations Initiated Prior to the Effective Date of FASB Statement No. 72</td>
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<tr>
<td>89-20</td>
<td>Accounting for Cross Border Tax Benefit Leases</td>
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<td>90-1 (Not Used)</td>
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<tr>
<td>90-2</td>
<td>Exchange of Interest-Only and Principal-Only Securities for a Mortgage-Backed Security</td>
<td>Nullified by FAS 125 and FAS 140</td>
<td>Complete</td>
<td>Reject</td>
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<tr>
<td>90-3</td>
<td>Accounting for Employers’ Obligations for Future Contributions to a Multiemployer Pension Plan</td>
<td>Complete</td>
<td>Adopt</td>
<td>8, 89</td>
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<tr>
<td>90-4</td>
<td>Earnings-per-Share Treatment of Tax Benefits for Dividends on Stock Held by an Employee Stock Ownership Plan</td>
<td>Nullified by FAS 144</td>
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<tr>
<td>90-5</td>
<td>Exchanges of Ownership Interests between Entities under Common Control</td>
<td>Complete</td>
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<tr>
<td>90-6</td>
<td>Accounting for Certain Events Not Addressed in Issue No. 87-11 Relating to an Acquired Operating Unit to Be Sold</td>
<td>Nullified by FAS 144</td>
<td>Complete</td>
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<td>90-7</td>
<td>Accounting for a Reload Stock Option</td>
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<tr>
<td>90-8</td>
<td>Capitalization of Costs to Treat Environmental Contamination</td>
<td>Complete</td>
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<tr>
<td>90-9</td>
<td>Changes to Fixed Employee Stock Option Plans as a Result of Equity Restructuring</td>
<td>Nullified by FIN 44</td>
<td>Complete</td>
<td>Adopt</td>
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<tr>
<td>90-10</td>
<td>Accounting for a Business Combination Involving a Majority-Owned Investee of a Venture Capital Company</td>
<td>Resolved by FAS 141</td>
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<td>90-11</td>
<td>Accounting for Exit and Entrance Fees Incurred in a Conversion from the Savings Association Insurance Fund to the Bank Insurance Fund</td>
<td>No longer technically helpful</td>
<td>Complete</td>
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<td>90-12</td>
<td>Allocating Basis to Individual Assets and Liabilities for Transactions within the Scope of Issue No. 88-16</td>
<td>Complete</td>
<td>Reject</td>
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</tr>
<tr>
<td>90-13</td>
<td>Accounting for Simultaneous Common Control Mergers</td>
<td>Complete</td>
<td>Reject</td>
<td>68</td>
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<tr>
<td>90-14</td>
<td>Unsecured Guarantee by Parent of Subsidiary’s Lease Payments in a Sale-Leaseback Transaction</td>
<td>Complete</td>
<td>Adopt</td>
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<tr>
<td>90-15</td>
<td>Impact of Nonsubstantive Lessors, Residual Value Guarantees, and Other Provisions in Leasing Transactions</td>
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<td>Reject</td>
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</tr>
<tr>
<td>90-16</td>
<td>Accounting for Discontinued Operations Subsequently Retained</td>
<td>Nullified by FAS 144</td>
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<td>GAAP Pronouncement</td>
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<td>Disposition</td>
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<tr>
<td>90-17</td>
<td>Hedging Foreign Currency Risks with Purchased Options</td>
<td>Affirmed by FAS 133; no longer necessary</td>
<td>Complete</td>
<td>Reject</td>
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<td>90-18</td>
<td>Effect of a “Removal of Accounts” Provision on the Accounting for a Credit Card Securitization</td>
<td>Complete</td>
<td>Reject</td>
<td>N/A</td>
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<td>90-19</td>
<td>Convertible Bonds with Issuer Option to Settle for Cash upon Conversion</td>
<td>Complete</td>
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<td>90-20</td>
<td>Impact of an Uncollateralized Irrevocable Letter of Credit on a Real Estate Sale-Leaseback Transaction</td>
<td>Complete</td>
<td>Adopt</td>
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<td>90-21</td>
<td>Balance Sheet Treatment of a Sale of Mortgage Servicing Rights with a Subservicing Agreement</td>
<td>Complete</td>
<td>Adopt</td>
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<td>90-22</td>
<td>Accounting for Gas-Balancing Arrangements</td>
<td>No EITF Consensus</td>
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<td>91-1</td>
<td>Hedging Intercompany Foreign Currency Risks</td>
<td>Nullified by FAS 133</td>
<td>Complete</td>
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<td>91-2</td>
<td>Debtor’s Accounting for Forfeiture of Real Estate Subject to a Nonrecourse Mortgage</td>
<td>Complete</td>
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<td>91-3</td>
<td>Accounting for Income Tax Benefits from Bad Debts of a Savings and Loan Association</td>
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<tr>
<td>91-4</td>
<td>Hedging Foreign Currency Risks with Complex Options and Similar Transactions</td>
<td>Resolved by FAS 133</td>
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<tr>
<td>91-5</td>
<td>Nonmonetary Exchange of Cost-Method Investments</td>
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<tr>
<td>91-6</td>
<td>Revenue Recognition of Long-Term Power Sales Contracts</td>
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<td>Reject</td>
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<tr>
<td>91-7</td>
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<td>91-8</td>
<td>Application of FASB Statement No. 96 to a State Tax Based on the Greater of a Franchise Tax or an Income Tax</td>
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<td>91-9</td>
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<td>91-10</td>
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<tr>
<td>92-2</td>
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<td>92-3</td>
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<td>92-4</td>
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<td>92-5</td>
<td>Amortization Period for Net Deferred Credit Card Origination Costs</td>
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<td>92-6 (Not Used)</td>
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<td>92-7</td>
<td>Accounting by Rate-Regulated Utilities for the Effects of Certain Alternative Revenue Programs</td>
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<td>92-8</td>
<td>Accounting for the Income Tax Effects under FASB Statement No. 109 of a Change in Functional Currency When an Economy Ceases to Be Considered Highly Inflationary</td>
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<td>92-9</td>
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<td>92-10</td>
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<td>92-12</td>
<td>Accounting for OPEB Costs by Rate-Regulated Enterprises</td>
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<td>92-13</td>
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<td>Accounting for Barter Transactions Involving Barter Credits</td>
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<tr>
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<tr>
<td>94-4</td>
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<td>94-6</td>
<td>Accounting for the Buyout of Compensatory Stock Options</td>
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<td>94-7</td>
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## STATUTORY ACCOUNTING PRINCIPLES
### GAAP CROSS-REFERENCE TO STATUTORY ACCOUNTING PRINCIPLES

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<td>94-10</td>
<td>Accounting by a Company for the Income Tax Effects of Transactions among or with Its Shareholders under FASB Statement No. 109</td>
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<tr>
<td>95-1</td>
<td>Revenue Recognition on Sales with a Guaranteed Minimum Resale Value</td>
<td>N/A</td>
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<td>95-2</td>
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<td>95-3</td>
<td>Recognition of Liabilities in Connection with a Purchase Business Combination</td>
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<td>95-5</td>
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<td>95-6</td>
<td>Accounting by a Real Estate Investment Trust for an Investment in a Service Corporation</td>
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<td>95-7</td>
<td>Implementation Issues Related to the Treatment of Minority Interests in Certain Real Estate Investment Trusts</td>
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<tr>
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<td>Accounting for Contingent Consideration Paid to the Shareholders of an Acquired Enterprise in a Purchase Business Combination</td>
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<tr>
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<tr>
<td>95-10</td>
<td>Accounting for Tax Credits Related to Dividend Payments in Accordance with FASB Statement No. 109</td>
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<tr>
<td>95-11</td>
<td>Accounting for Derivative Instruments Containing Both a Written Option-Based Component and a Forward-Based Component</td>
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<tr>
<td>95-12</td>
<td>Pooling of Interests with a Common Interest in Joint Venture</td>
<td>Nullified by FAS 144</td>
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<tr>
<td>95-13</td>
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<td>95-14</td>
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<td>95-15</td>
<td>Recognition of Gain or Loss When a Binding Contract Requires a Debt Extinguishment to Occur at a Future Date for a Specified Amount</td>
<td>Superseded by EITF 96-19</td>
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<tr>
<td>95-16</td>
<td>Accounting for Stock Compensation Arrangements with Employer Loan Features under APB Opinion No. 25</td>
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<td>Accounting and Reporting for a Discontinued Business Segment When the Measurement Date Occurs after the Balance Sheet Date but before the Issuance of Financial Statements.</td>
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<td>95-19</td>
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<td>95-21</td>
<td>Accounting for Assets to Be Disposed Of Acquired in a Purchase Business Combination</td>
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#### Consensus Opinions of the Emerging Issues Task Force

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<tr>
<td>96-23</td>
<td>The Effects of Financial Instruments Indexed to, and Settled in, a Company’s Own Stock on Pooling-of-Interests Accounting for a Subsequent Business Combination</td>
<td>Resolved by FAS 141</td>
<td>N/A</td>
<td>INT 99-5</td>
</tr>
<tr>
<td>97-1</td>
<td>Implementation Issues in Accounting for Lease Transactions, including Those involving Special-Purpose Entities</td>
<td>Complete</td>
<td>N/A</td>
<td>INT 99-6</td>
</tr>
<tr>
<td>97-2</td>
<td>Application of FASB Statement No. 94 and APB Opinion No. 16 to Physician Practice Management Entities and Certain Other Entities with Contractual Management Arrangements</td>
<td>Complete</td>
<td>N/A</td>
<td>INT 99-7</td>
</tr>
<tr>
<td>97-3</td>
<td>Accounting for Fees and Costs Associated with Loan Syndications and Loan Participations after the Issuance of FASB Statement No. 125</td>
<td>Complete</td>
<td>Reject</td>
<td>INT 00-25</td>
</tr>
<tr>
<td>97-4</td>
<td>Deregulation of the Pricing of Electricity—Issues Related to the Application of FASB Statements No. 71 and 101</td>
<td>Complete</td>
<td>N/A</td>
<td>INT 99-8</td>
</tr>
<tr>
<td>97-5</td>
<td>Accounting for the Delayed Receipt of Option Shares upon Exercise under APB Opinion No. 25</td>
<td>Resolved by FIN 44</td>
<td>N/A</td>
<td>INT 99-9</td>
</tr>
<tr>
<td>97-6</td>
<td>Application of Issue No. 96-20 to Qualifying Special-Purpose Entities Receiving Transferred Financial Assets Prior to the Effective Date of FASB Statement No. 125</td>
<td>Nullified by FAS 140</td>
<td>Complete</td>
<td>INT 99-10</td>
</tr>
<tr>
<td>97-7</td>
<td>Accounting for Hedges of the Foreign Currency Risk Inherent in an Available-for-Sale Marketable Equity Security</td>
<td>Complete</td>
<td>N/A</td>
<td>INT 99-11</td>
</tr>
<tr>
<td>97-8</td>
<td>Accounting for Contingent Consideration Issued in a Purchase Business Combination</td>
<td>Complete</td>
<td>Adopt</td>
<td>INT 99-12</td>
</tr>
<tr>
<td>97-9</td>
<td>Effect on Pooling-of-Interests Accounting of Certain Contingently Exercisable Options or Other Equity Instruments</td>
<td>Nullified by FAS 141</td>
<td>Complete</td>
<td>INT 99-13</td>
</tr>
<tr>
<td>97-10</td>
<td>The Effect of Lessee Involvement in Asset Construction</td>
<td>Complete</td>
<td>Reject</td>
<td>INT 99-14</td>
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<tr>
<td>97-11</td>
<td>Accounting for Internal Costs Relating to Real Estate Property Acquisitions</td>
<td>Complete</td>
<td>Adopt</td>
<td>INT 99-15</td>
</tr>
<tr>
<td>GAAP Pronouncement</td>
<td>Name</td>
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<td>97-12</td>
<td>Accounting for Increased Share Authorizations in an IRS Section 423 Employee Stock Purchase Plan under APB Opinion No. 25</td>
<td>Complete</td>
<td>Adopt</td>
<td>INT 99-17</td>
</tr>
<tr>
<td>97-13</td>
<td>Accounting for Costs Incurred in Connection with a Consulting Contract or an Internal Project That Combines Business Process Reengineering and Information Technology Transformation</td>
<td>Complete</td>
<td>Adopt</td>
<td>INT 99-18</td>
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<tr>
<td>97-14</td>
<td>Accounting for Deferred Compensation Arrangements Where Amounts Earned Are Held in a Rabbi Trust and Invested</td>
<td>Complete</td>
<td>Adopt/M</td>
<td>INT 00-6</td>
</tr>
<tr>
<td>97-15</td>
<td>Accounting for Contingency Arrangements Based on Security Prices in a Purchase Business Combination</td>
<td>Pending</td>
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<td>98-1</td>
<td>Valuation of Debt Assumed in a Purchase Business Combination</td>
<td>Complete</td>
<td>N/A</td>
<td>INT 99-20</td>
</tr>
<tr>
<td>98-2</td>
<td>Accounting by a Subsidiary or Joint Venture for an Investment in the Stock of Its Parent Company or Joint Venture Partner</td>
<td>Complete</td>
<td>Reject</td>
<td>INT 01-7</td>
</tr>
<tr>
<td>98-3</td>
<td>Determining Whether a Transaction Is an Exchange of Similar Productive Assets or a Business Combination</td>
<td>Complete</td>
<td>Adopt/M</td>
<td>INT 00-26</td>
</tr>
<tr>
<td>98-4</td>
<td>Accounting by a Joint Venture for Businesses Received at Its Formation</td>
<td>No EITF Consensus</td>
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<tr>
<td>98-5</td>
<td>Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios</td>
<td>Complete</td>
<td>Reject</td>
<td>INT 00-8</td>
</tr>
<tr>
<td>98-6</td>
<td>Investor's Accounting for an Investment in a Limited Partnership When the Investor Is the Sole General Partner and the Limited Partners Have Certain Approval or Veto Rights</td>
<td>Removed from EITF Agenda</td>
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<td>98-7</td>
<td>Accounting for Exchanges of Similar Equity Method Investments</td>
<td>Codified in EITF 01-2</td>
<td>Adopt</td>
<td>INT 99-21</td>
</tr>
<tr>
<td>98-8</td>
<td>Accounting for Transfers of Investments That Are in Substance Real Estate</td>
<td>Complete</td>
<td>Adopt</td>
<td>INT 99-22</td>
</tr>
<tr>
<td>98-9</td>
<td>Accounting for Contingent Rent</td>
<td>Complete</td>
<td>Adopt/M</td>
<td>INT 00-27</td>
</tr>
<tr>
<td>98-10</td>
<td>Accounting for Contracts Involved in Energy Trading and Risk Management Activities</td>
<td>Superseded by EITF 02-3</td>
<td>Adopt/M</td>
<td>INT 00-24</td>
</tr>
<tr>
<td>98-11</td>
<td>Accounting for Acquired Temporary Differences in Certain Purchase Transactions That Are Not Accounted for as Business Combinations</td>
<td>Pending</td>
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</tr>
<tr>
<td>98-12</td>
<td>Application of Issue No. 96-13 to Forward Equity Sales Transactions</td>
<td>Complete</td>
<td>Adopt/M</td>
<td>86</td>
</tr>
<tr>
<td>98-13</td>
<td>Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee</td>
<td>Complete</td>
<td>Adopt/M</td>
<td>INT 00-24</td>
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<td>GAAP Pronouncement</td>
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<tr>
<td>98-14</td>
<td>Debtor's Accounting for Changes in Line-of-Credit or Revolving-Debt Arrangements</td>
<td>Complete</td>
<td>Reject</td>
<td>INT 00-10</td>
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<tr>
<td>98-15</td>
<td>Structured Notes Acquired for a Specified Investment Strategy</td>
<td>Complete</td>
<td>Reject</td>
<td>INT 00-11</td>
</tr>
<tr>
<td>99-1</td>
<td>Accounting for Debt Convertible into the Stock of a Consolidated Subsidiary</td>
<td>Complete</td>
<td>Adopt/M</td>
<td>86</td>
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<tr>
<td>99-2</td>
<td>Accounting for Weather Derivatives</td>
<td>Complete</td>
<td>Adopt/M</td>
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<tr>
<td>99-3</td>
<td>Application of Issue No. 96-13 to Derivative Instruments with Multiple Settlement Alternatives</td>
<td>Complete</td>
<td>Adopt/M</td>
<td>86</td>
</tr>
<tr>
<td>99-4</td>
<td>Accounting for Stock Received from the Demutualization of a Mutual Insurance Company</td>
<td>Complete</td>
<td>Adopt</td>
<td>INT 00-12</td>
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<tr>
<td>99-5</td>
<td>Accounting for Pre-Production Costs Related to Long-Term Supply Arrangements</td>
<td>Complete</td>
<td>N/A</td>
<td>INT 00-13</td>
</tr>
<tr>
<td>99-6</td>
<td>Impact of Acceleration Provisions in Grants Made between Initiation and Consummation of a Pooling-of-Interests Business Combination</td>
<td>Nullified by FAS 141</td>
<td>N/A</td>
<td>INT 00-14</td>
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<tr>
<td>99-7</td>
<td>Accounting for an Accelerated Share Repurchase Program</td>
<td>Complete</td>
<td>N/A</td>
<td>INT 00-15</td>
</tr>
<tr>
<td>99-8</td>
<td>Accounting for Transfers of Assets that are Derivative Instruments but that are not Financial Assets</td>
<td>Complete</td>
<td>Adopt/M</td>
<td>86</td>
</tr>
<tr>
<td>99-9</td>
<td>Effect of Derivative Gains and Losses on the Capitalization of Interest</td>
<td>Complete</td>
<td>Adopt/M</td>
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<tr>
<td>99-10</td>
<td>Percentage used to Determine the Amounts of Equity Method Losses</td>
<td>Complete</td>
<td>Adopt</td>
<td>INT 00-24</td>
</tr>
<tr>
<td>99-11</td>
<td>Subsequent Events Caused by Year 2000</td>
<td>Complete</td>
<td>N/A</td>
<td>INT 00-16</td>
</tr>
<tr>
<td>99-12</td>
<td>Accounting for Formula Arrangements under Issue No. 95-19</td>
<td>Complete</td>
<td>Adopt/M</td>
<td>INT 00-28</td>
</tr>
<tr>
<td>99-13</td>
<td>Application of Issue No. 99-10 and FASB Interpretation No. 23 to Entities that Enter into Leases with Governmental Entities</td>
<td>Complete</td>
<td>N/A</td>
<td>INT 00-17</td>
</tr>
<tr>
<td>99-14</td>
<td>Recognition of Losses on Firmly Committed Executory Contracts</td>
<td>Complete</td>
<td>N/A</td>
<td>INT 00-18</td>
</tr>
<tr>
<td>99-15</td>
<td>Accounting for Decreases in Deferred Tax Asset Valuation Allowances Established in a Purchase Business Combination As a Result of a Change in Tax Regulations</td>
<td>Complete</td>
<td>N/A</td>
<td>INT 00-18</td>
</tr>
<tr>
<td>99-16</td>
<td>Accounting for Transactions with Elements of Research and Development Arrangements</td>
<td>Complete</td>
<td>N/A</td>
<td>INT 01-8</td>
</tr>
<tr>
<td>99-17</td>
<td>Accounting for Advertising Barter Transactions</td>
<td>Complete</td>
<td>Adopt</td>
<td>INT 00-29</td>
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<tr>
<td>GAAP Pronouncement</td>
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<tr>
<td>99-18</td>
<td>Effect on Pooling-of-Interests Accounting of Contracts Indexed to a Company's Own Stock</td>
<td>Resolved by FAS 141</td>
<td>Complete</td>
<td>N/A</td>
</tr>
<tr>
<td>99-19</td>
<td>Reporting Revenue Gross as a Principal versus Net as an Agent</td>
<td>Complete</td>
<td>N/A</td>
<td>INT 01-9</td>
</tr>
<tr>
<td>99-20</td>
<td>Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets</td>
<td>Pending</td>
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</tr>
<tr>
<td>00-1</td>
<td>Investor Balance Sheet and Income Statement Display under the Equity Method for Investments in Certain Partnerships and Other Ventures</td>
<td>Complete</td>
<td>Reject</td>
<td>INT 01-10</td>
</tr>
<tr>
<td>00-2</td>
<td>Accounting for Web Site Development Costs</td>
<td>Complete</td>
<td>Adopt/M</td>
<td>82</td>
</tr>
<tr>
<td>00-3</td>
<td>Application of AICPA Statement of Position 97-2 to Arrangements That Include the Right to Use Software Stored on Another Entity's Hardware</td>
<td>Complete</td>
<td>Adopt/M</td>
<td>81</td>
</tr>
<tr>
<td>00-4</td>
<td>Majority Owner's Accounting for a Transaction in the Shares of a Consolidated Subsidiary and a Derivative Indexed to the Minority Interest in That Subsidiary</td>
<td>Complete</td>
<td>N/A</td>
<td>INT 02-13</td>
</tr>
<tr>
<td>00-5</td>
<td>Determining Whether a Nonmonetary Transaction is an Exchange of Similar Productive Assets</td>
<td>Complete</td>
<td>Adopt/M</td>
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</tr>
<tr>
<td>00-6</td>
<td>Accounting for Freestanding Derivative Financial Instruments Indexed to, and Potentially Settled in, the Stock of a Consolidated Subsidiary</td>
<td>Complete</td>
<td>N/A</td>
<td>INT 02-14</td>
</tr>
<tr>
<td>00-7</td>
<td>Application of Issue No. 96-13 to Equity Derivative Instruments That Contain Certain Provisions That Require Net Cash Settlement If Certain Events outside the Control of the Issuer Occur</td>
<td>Complete</td>
<td>Adopt/M</td>
<td>86</td>
</tr>
<tr>
<td>00-8</td>
<td>Accounting by a Grantee for an Equity Instrument to Be Received in Conjunction with Providing Goods or Services</td>
<td>Complete</td>
<td>Adopt/M</td>
<td>INT 00-32</td>
</tr>
<tr>
<td>00-9</td>
<td>Classification of a Gain or Loss from a Hedge of Debt That Is Extinguished</td>
<td>Complete</td>
<td>Adopt/M</td>
<td>86</td>
</tr>
<tr>
<td>00-10</td>
<td>Accounting for Shipping and Handling Fees and Costs</td>
<td>Complete</td>
<td>Adopt/M</td>
<td>INT 01-11</td>
</tr>
<tr>
<td>00-11</td>
<td>Meeting the Ownership Transfer Requirements of FASB Statement No. 13 for Leases of Real Estate</td>
<td>Complete</td>
<td>Adopt/M</td>
<td>INT 02-15</td>
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<tr>
<td>00-12</td>
<td>Accounting by an Investor for Stock-Based Compensation Granted to Employees of an Equity Method Investee</td>
<td>Pending</td>
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<td>00-13</td>
<td>Determining Whether Equipment Is &quot;Integral Equipment&quot; Subject to FASB Statements No. 66 and No. 98</td>
<td>Complete</td>
<td>Adopt</td>
<td>77</td>
</tr>
<tr>
<td>00-14</td>
<td>Accounting for Certain Sales Incentives</td>
<td>Complete</td>
<td>Reject</td>
<td>INT 01-12</td>
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<tr>
<td>GAAP Pronouncement</td>
<td>Name</td>
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<tr>
<td>00-15</td>
<td>Classification in the Statement of Cash Flows of the Income Tax Benefit Received by a Company upon Exercise of a Nonqualified Employee Stock Option</td>
<td>Complete</td>
<td>N/A</td>
<td>INT 01-13</td>
</tr>
<tr>
<td>00-16</td>
<td>Recognition and Measurement of Employer Payroll Taxes on Employee Stock-Based Compensation</td>
<td>Complete</td>
<td>Adopt</td>
<td>INT 01-14</td>
</tr>
<tr>
<td>00-17</td>
<td>Measuring the Fair Value of Energy-Related Contracts in Applying Issue No. 98-10</td>
<td>Superseded</td>
<td>N/A</td>
<td>INT 01-15</td>
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<tr>
<td>00-18</td>
<td>Accounting Recognition for Certain Transactions involving Equity Instruments Granted to Other Than Employees</td>
<td>No EITF</td>
<td>Consensus</td>
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<tr>
<td>00-19</td>
<td>Determination of Whether Share Settlement Is within the Control of the Issuer for Purposes of Applying Issue No. 96-13</td>
<td>Complete</td>
<td>N/A</td>
<td>INT 03-07</td>
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<td>00-20</td>
<td>Accounting for Costs Incurred to Acquire or Originate Information for Database Content and Other Collection of Information</td>
<td>No EITF</td>
<td>Consensus</td>
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<tr>
<td>00-21</td>
<td>Accounting for Multiple-Element Revenue Arrangements</td>
<td>No EITF</td>
<td>Consensus</td>
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<tr>
<td>00-22</td>
<td>Accounting for &quot;Points&quot; and Certain Other Time-Based or Volume-Based Sales Incentive Offers, and Offers for Free Products or Services to Be Delivered in the Future</td>
<td>No EITF</td>
<td>Consensus</td>
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<tr>
<td>00-23</td>
<td>Issues Related to the Accounting for Stock Compensation under APB Opinion No. 25 and FASB Interpretation No. 44</td>
<td>Pending</td>
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<tr>
<td>00-24</td>
<td>Revenue Recognition: Sales Arrangements That Include Specified-Price Trade-in Rights</td>
<td>No EITF</td>
<td>Consensus</td>
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<tr>
<td>00-25</td>
<td>Vendor Income Statement Characterization of Consideration Paid to a Reseller of the Vendor's Products</td>
<td>Codified in</td>
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<td>EITF 01-9</td>
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<tr>
<td>00-26</td>
<td>Recognition by a Seller of Losses on Firmly Committed Executory Contracts</td>
<td>No EITF</td>
<td>Consensus</td>
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<tr>
<td>00-27</td>
<td>Application of Issue No. 98-5 to Certain Convertible Instruments</td>
<td>No EITF</td>
<td>Consensus</td>
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<tr>
<td>01-1</td>
<td>Accounting for a Convertible Instrument Granted or Issued to a Nonemployee for Goods or Services or a Combination of Goods or Services and Cash</td>
<td>Complete</td>
<td>Adopt/M</td>
<td>INT 02-19</td>
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<tr>
<td>01-2</td>
<td>Interpretations of APB Opinion No. 29</td>
<td>Complete</td>
<td>N/A</td>
<td>INT 03-06</td>
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<tr>
<td>01-3</td>
<td>Accounting in a Business Combination for Deferred Revenue of an Acquiree</td>
<td>Complete</td>
<td>N/A</td>
<td>INT 03-04</td>
</tr>
<tr>
<td>01-4</td>
<td>Accounting for Sales of Fractional Interests in Equipment</td>
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<tr>
<td>01-5</td>
<td>Application of FASB Statement No. 52 to an Investment Being Evaluated for Impairment That Will Be Disposed Of</td>
<td>Pending</td>
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<td>Status</td>
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<td>01-6</td>
<td>The Meaning of &quot;Indexed to a Company's Own Stock&quot;</td>
<td>Complete</td>
<td>N/A</td>
<td>INT 03-08</td>
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<td>01-7</td>
<td>Creditor's Accounting for a Modification or Exchange of Debt Instruments</td>
<td>Complete</td>
<td>Adopt</td>
<td>INT 03-05</td>
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<tr>
<td>01-8</td>
<td>Determining Whether an Arrangement Is a Lease</td>
<td>No EITF Consensus</td>
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<td>01-9</td>
<td>Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor’s Products)</td>
<td>Complete</td>
<td>N/A</td>
<td>INT 02-16</td>
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<td>01-10</td>
<td>Accounting for the Impact of the Terrorist Attacks of September 11, 2001</td>
<td>Complete</td>
<td>Adopt/M</td>
<td>INT 01-32</td>
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<tr>
<td>01-11</td>
<td>Application of Issue No. 00-19 to a Contemporaneous Forward Purchase Contract and Written Put Option</td>
<td>No EITF Consensus</td>
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<td>01-12</td>
<td>The Impact of the Requirements of FASB Statement No. 133 on Residual Value Guarantees in Connection with a Lease</td>
<td>Complete</td>
<td>N/A</td>
<td>INT 03-06</td>
</tr>
<tr>
<td>01-13</td>
<td>Income Statement Display of Business Interruption Insurance Recoveries</td>
<td>Complete</td>
<td>Adopt</td>
<td>INT 02-17</td>
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<td>01-14</td>
<td>Income Statement Characterization of Reimbursements Received for &quot;Out-of-Pocket&quot; Expenses Incurred</td>
<td>Complete</td>
<td>N/A</td>
<td>INT 03-10</td>
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<tr>
<td>02-2</td>
<td>When Separate Contracts That Meet the Definition of Financial Instruments Should Be Combined for Accounting Purposes</td>
<td>No EITF Consensus</td>
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## STATUTORY ACCOUNTING PRINCIPLES
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#### CATEGORY C GAAP

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Note: SSAP No. 24 adopts guidance related to the definition of extraordinary items and terminology relevant to the disposal of a segment and the criteria for recording a related loss. It rejects all interpretations related to the accounting and reporting of discontinued operations, extraordinary items, and unusual or infrequently occurring events and transactions.
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