Statutory Accounting Principles (E) Working Group

**Maintenance Agenda Submission Form**

**Form A**

## **Issue: Update** Reporting Deposit-Type Contracts

**Check (applicable entity):**

 P/C Life Health

Modification of existing SSAP [x]  [x]  [x]

New Issue or SSAP [ ]  [ ]  [ ]

Interpretation [ ]  [ ]  [ ]

Description of Issue: This agenda item has been drafted in response to questions identified by the Financial Stability (EX) Task Force in developing liquidity disclosure changes to the 2019 life blank, and the noted inability to fully identify and assess deposit-type contracts - (particularly guaranteed investment contracts) - within the statutory financial statements. From information received, it appears that in some instances deposit-type contracts are being reported along with life contracts in Exhibit 5 – Aggregate Reserves for Life Contracts or in Exhibit 6 – Aggregate Reserves for Accident and Health Contracts, rather than in Exhibit 7 – Deposit-Type Contracts.

This issue has been raised as payout requests for deposit-type contracts are significantly different than payouts generated by an insured event (mortality or morbidity). The Task Force identified that information on liabilities, particularly those that can be called with little or no surrender penalty, must be known to properly complete liquidity assessments.

After various discussions, it is anticipated that guaranteed investment contracts (GICs) are reported as a life contract or accident and health contract (and not a deposit-type contract) for one of the following reasons:

* The GIC was a “supplemental” contract formed from the proceeds of a life / A&H insurance contract.
* The GIC, although absent mortality or morbidity risk, was written on a life / A&H insurance “paper.”
* The state insurance department has approved the GIC to be classified as a life / A&H insurance contract.
* Contracts may be designed as GICs, but could potentially have mortality / morbidity components, which qualifies the contract to be reported as a life or A/H insurance contract.

The purpose of this agenda item is to solicit information regarding the reporting of GICs (and other deposit-type contracts) as life or A/H contracts in the reporting exhibits, and consider revisions to statutory accounting and reporting instructions to ensure that information regarding all GICs can be separately identifiable and aggregated from the financial statements.

Existing Authoritative Literature:

SSAP No. 50—Classifications of Insurance or Managed Care Contracts

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.

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**.

### 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**:

1. Supplemental contracts
2. Lottery payouts
3. Structured settlements
4. Guaranteed interest contracts
5. Income settlement options
6. Dividend and coupon accumulations
7. Annuities certain
8. Premium and other deposit funds
9. Funding Agreements without well-defined class-based (e.g. age, gender) annuity purchase rates defining either specific or maximum purchase rate guarantees (see SSAP No. 15, paragraph 19, paragraph 20 of this statement and SSAP No. 52—Deposit-Type Contracts, paragraph 21.)

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.).

SSAP No. 51R—Life Contracts

### Policy Reserves

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

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

### Supplemental Benefits

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

SSAP No. 52—Deposit-Type Contracts

1. 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.
2. 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.
3. Due to the absence of mortality and/or morbidity risk and the discretionary characteristics noted in paragraph 3, 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. 51R*—*Life Contracts,* accident and health contracts established in *SSAP No. 54R—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*.
4. 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:
5. Supplemental contracts
6. Lottery payouts
7. Structured settlements
8. Guaranteed interest contracts
9. Income settlement options
10. Dividend and coupon accumulations
11. Annuities certain
12. Premium and other deposit funds

### Income Recognition

1. 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.(INT 00-03)

### Policy Reserves

1. 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. 5R—Liabilities, Contingencies and Impairments of Assets* (SSAP No. 5R). The actuarial methodologies referred to in paragraph 8 meet the criteria required for reasonable estimates in SSAP No. 5R.
2. 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.
3. 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.
4. Statutory policy reserves for those group annuity contracts or other contracts that, in whole or in part, establish the insurer’s obligations by reference to a segregated portfolio of assets not owned by the insurer shall be established in accordance with the guidance in Appendix A-695. Statutory policy reserves for those contracts with nonlevel premiums or benefits, or contracts with secondary guarantees shall be established in accordance with the guidance in Appendix A-830. Statutory policy reserves for those group life contracts utilizing a separate account that meet the requirements outlined in paragraph 1 of Appendix A-200 shall be computed in accordance with the guidance in that appendix.
5. Policy reserves shall be increased for reinsurance assumed and decreased for reinsurance ceded as further described in *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance*.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups): Agenda Item 2018-28: Updates to Liquidity Disclosures, and proposed revisions to *SSAP No. 51R—Life Contracts*, *SSAP No. 52—Deposit-Type Contracts* and *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance*, were adopted by the SAPWG during the Fall 2018 National Meeting. This agenda item was developed in response to Financial Stability (Ex) Task Force recommendations to enhance existing disclosures on annuity actuarial reserves and deposit-type liabilities.

**Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group:** None

**Convergence with International Financial Reporting Standards (IFRS):** Not applicable.

Staff Recommendation:

NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive, and expose this agenda item with a request for comments on why GICs, or other deposit-type contracts, are reported in Exhibit 5 – Life Contracts or Exhibit 6 – Accident and Health Contract, instead of Exhibit 7 – Deposit Type Contracts. With exposure, a referral will be sent to the Life Actuarial Task Force to inform them of the inquiry and request their comments. Although NAIC staff recommends delaying revisions to statutory accounting or reporting instructions until better knowing why these classifications occur, it is anticipated that clarification may be considered to ensure that separate reserve recognition, which is already required in SSAP No. 51R, requires separate reporting on the appropriate exhibit.

Staff Review Completed by:

Julie Gann, NAIC Staff – January 2019

Status:

On April 6, 2019, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed this agenda item with a request for comments on why guaranteed investment contracts (GICs), or other deposit-type contracts, are reported in Exhibit 5 – Life Contracts or Exhibit 6 – Accident and Health Contract, instead of Exhibit 7 – Deposit Type Contracts. With exposure, the Working Group directed a referral to the Life Actuarial (A) Task Force to inform them of the exposure and request comments.

On August 3, 2019, the Statutory Accounting Principles (E) Working Group exposed this agenda item with the inclusion of the items and questions noted below, with a request for additional comments from industry and state insurance regulators, and directed notifications of the exposure with a request for comments to the Financial Stability (EX) Task Force and the Life Actuarial (A) Task Force on the reporting of insurance contracts that do not have a mortality or morbidity risk.

1. **Classification at Issuance** – The interested parties noted that because a contract was life-contingent at issue, it is reported in Exhibit 5, and then it remains in Exhibit 5 after the death of the annuitant.

**Question** – Is it appropriate to classify products based on original issuance when the original risks are no longer present in the contract? Is this simply past industry practice, or is there direction that prevents reclassification to the category that most appropriately reflects the risk? Preliminary information received from the Financial Stability (EX) Task Force (FSTF) staff has noted that this practice will make it more difficult to properly aggregate and assess deposit-type contracts, and that this assessment is important as the payouts for deposit-type contracts are significantly different than payouts generated by an insured event. The Task Force has identified that information on liabilities, particularly those that can be called quickly with little or no surrender penalty, is of critical importance to liquidity assessments.

1. **State Approval** – The interested parties noted that state insurance departments have the discretion to approve or require a contract to be classified as a life or A/H insurance contract.

**Question** – If a state directs reporting differently than what is stipulated in the AP&P Manual, is that being captured as a permitted or prescribed practice? (The provisions in SSAP No. 1 require permitted / prescribed practice reporting when it results in different statutory reporting. Examples included in SSAP No. 1 include gross or net presentation, financial statement reporting lines, etc.)

1. **Annuity Guidance** – The interested parties cited existing annuity guidance in paragraph 20 of *SSAP No. 50—Classifications of Insurance or Managed Care Contracts.* Per this guidance, contracts containing well-defined class-based (e.g., age / gender) annuity purchase rates used in defining either a specific or maximum purchase rate guarantee would constitute an annuity contract containing a life contingency that would require it to be classified as a life contract.

**Question** – NAIC staff agrees with the citation from interested parties on annuities in paragraph 20 of *SSAP No. 50—Classifications of Insurance or Managed Care Contracts.* However, with the intent to have more explicit product breakouts to allow for better assessment, is it time to clarify / revise this guidance to result with the appropriate breakouts created by FSTF? It was noted that the current concepts were established a long time ago and there is a focus on non-traditional insurance liabilities (which includes funding agreements) for liquidity risk assessment as they can have higher run risk.

1. **Materiality of Issue** – Although the interested parties cite a “common” scenario, without information in the financial statements, there is no current ability to identify the extent contracts with no remaining mortality or morbidity risk are reflected as life contracts.

**Question** – To what extent are deposit-type contracts captured in an exhibit other than Exhibit 7? Is it possible to receive information from companies regarding this population for assessment purposes?

*Excerpt from SSAP No. 50, paragraph 20:*

1. 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. The contract shall be issued to or for the benefit of an identifiable individual or group of individuals. **Such a contract containing well-defined class-based (e.g. age, gender) annuity purchase rates used in defining either a specific or maximum purchase rate guarantee would constitute an annuity contract containing a life contingency that would require it to be classified as a life contract.** Some examples of contracts issued for the benefit of a group of individuals include pension plan sponsors purchasing contracts for the benefit of their plan participants, employers or associations purchasing contracts for the benefit of their employees or members, and collective trusts purchasing contracts for the benefit of participating pension plans and their plan participants. **The main types of annuity contracts with life contingencies are discussed below.**
2. 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;
3. 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;
4. 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;
5. 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;
6. 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;
7. 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.

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