STAFF PAPER

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Project	Insurance Contracts
Paper topic	Separation of Investment Components from the Insurance Contract – Determining Aggregate Premium for the Insurance component

CONTACT(S)			
CONTACT(S)	Christopher Irwin	cgirwin@fasb.org	+1 203 956 3468
	Andrea Silva	alsilva@fasb.org	+1 203 956 3445
	Jennifer Weiner	jmweiner@fasb.org	+1 203 956 5305
	Izabela Ruta	iruta@ifrs.org	+44 20 7246 6957
	Joanna Yeoh	jyeoh@ifrs.org	+44 20 7246 6481

What is this paper about?

1. The purpose of this paper is to ask the boards to consider:
   (a) a principle to identify the investment components that should be separated from insurance contracts, and
   (b) how to measure the premium that is allocated to the investment component. That amount would not be presented as premium in the statement of comprehensive income.
2. This paper does not address the allocation of premiums to individual reporting periods, which the staff plan to address as part of a separate paper.
3. This paper is the second paper of a three paper series addressing separation of investment components from insurance contracts and should be considered together with papers 2F/81F and 2H/81H.

Summary of staff recommendation

4. The staff recommend:

   (a) An investment component in an insurance contract is an amount that the insurer is obligated to pay the policyholder or a beneficiary regardless of whether an insured event occurs; and

   (b) Insurers should exclude from the aggregate premium presented in the statement of comprehensive income the present value of those amounts to be paid to policyholders or their beneficiaries regardless of whether an insured event occurs, measured consistently with the measurement of the overall insurance contract liability.

Staff analysis

5. As discussed in paper 2F/81F, the staff have prepared this series of papers under the presumption that the boards' primary objective for separation of investment components from insurance contracts is as a means to determine total aggregate premiums[1] recognized in the statement of comprehensive income. Accordingly, the staff analysis and recommendations are tailored to this objective.

6. In the analysis that follows, the staff envisaged that an insurer would apply the following process on recognising an insurance contract:

   (a) Step 1: Determine that the contract qualifies to be accounted for as an insurance contract (e.g., meets the definition of an insurance contract) as previously tentatively decided by the boards.

[1] The staff use the term aggregate premiums throughout this paper to refer to the total probability-weighted estimate of premiums or other consideration to be received from the policyholder during the coverage period (i.e., all premiums within the boundary of the contract and as opposed to the portion of that premium recognized in the statement of comprehensive income).

(b) Step 2: Unbundle embedded derivatives[2] and goods and services as previously tentatively decided by the boards.

(c) Step 3: Determine whether there are investment components that should be separated (addressed within this paper).

(d) Step 4: Measure the investment component (addressed within this paper).

Determining investment components within insurance contracts that should be separated

7. Table 1 provides a spectrum of existing products to assist the boards in understanding typical characteristics of different types of products and the balances that may be separated. There are many variations of products that exist in the market today and, as such, the staff do not intend the product spectrum to be representative of all product types. The staff rather intend the product spectrum to help the boards evaluate the potential effects of various alternatives on some common products. This table identifies explicit account balances as defined in the November joint board meeting (column (1)) and balances that would be separated applying the staff recommendations in this paper (column (2)) and appears in Appendix A.

8. The following are alternatives for determining investment components that should be separated from insurance contracts:

(a) Alternative (a): No separation of investment components from the insurance component, an idea previously rejected by the boards;

(b) Alternative (b): Separation of explicit account balances from insurance contracts (as defined at the joint board meeting in November 2011) for the policyholder;

(c) Alternative (c): Separation of amounts which the insurer is obligated to pay the policyholder or a beneficiary regardless of whether an insured event occurs; and

(d) Alternative (d): Separation of the amount of premium received that the insurer estimates it will return (including for claims and benefits) to the policyholder or his or her beneficiary or to the group of policyholders and their beneficiaries.

9. The staff note that there might be numerous other variations of the above identified alternatives, however, have not included others because of a belief that they would result in an arbitrary determination and segregation of investment and insurance components.

Alternative (a): No separation of investment components

10. Separating investment and insurance components of an insurance contract is viewed by some as inconsistent with the notion of the building block approach (i.e., total cash flows in fulfilling all aspects of the contract). Additionally, separation of the different components ignores the interdependency of the components for many contracts (e.g., a policyholder generally cannot surrender one component of the contract without surrendering the entire contract or part of the entire contract). Because of this interdependency, insurance contracts are sometimes difficult to analyse when separated into their components. Depending partially on the measurement basis used for the separated investment component, the additional cost and complexity associated with separation is considered by opponents of separation to be in excess of the benefits. In addition, the potential arbitrariness of deciding which deposits should be measured separately and how to make the subjective estimates to adjust for cross subsidies and to allocate acquisition costs, etc. reduce the decision usefulness of the result.

11. Notwithstanding the arguments against separation of investment components, the boards have rejected this option in their tentative decisions to date. Without

separating the investment components none of the objectives discussed in background paper 2F/81F would likely be achieved.

Alternative (b): Separation of investment components from contracts, which require the insurer to maintain an explicit account balance (as defined at the joint board meeting in November 2011) for the benefit of the policyholder

12. This alternative would separate explicit account balances as defined in the November joint meeting (as included in paragraph 18(b) of background paper 2F/81F). Such explicit account balances are tracked currently by insurers and there is little to no subjectivity in identifying the amount of the account balance or the premium (and benefits) to be allocated to the investment component and thus not included in the statement of comprehensive income. Additional arguments for and against this alternative were discussed in November and can be found in agenda paper 9A/75A.

13. Some proponents of this alternative observe that it is similar to existing practice under US GAAP and that the separation of other investment components was not identified by stakeholders as a priority improvement that should be sought. Proponents of Alternative (b) believe that other alternatives identified to date for separating investment components do not represent improvements and, accordingly, an alternative that is most consistent with existing practice is appropriate. In particular, some proponents of Alternative (b) believe that this alternative has the advantage of relative simplicity in identifying and determining the investment component to be separated.

14. Some opponents to Alternative (b) note that, although it has the advantage of being simple to determine for many products, it has the result that it would not be applied consistently for all product types. Those opponents note that some of the criticism of existing US GAAP is the existence of numerous models that exist based to address different policy types and that Alternative (b) would, to a certain extent, perpetuate this situation because it would distinguish between

economically similar contracts based on whether an account balance is explicit or implicit.

Alternative (c): Separation of investment components from contracts, which obligate the insurer to pay the policyholder (or beneficiary) regardless of whether an insured event occurs

15. Alternative (c) would likely include each of the account balances that are separated pursuant to Alternative (b)[3] but also include additional investment components. For example, each of the following contracts would require separation of investment components under Alternative (c) but not under Alternative (b):

(a) endowment contracts paying a lump sum to a policyholder or his or her beneficiary at the earlier of a specified date or the policyholder's death; an immediate annuity that provides regular cash payments until the policyholder's death, but if the policyholder dies before the end of a specified period (the 'term certain') the contract provides those payments to a beneficiary until the end of the term certain; and

(b) a traditional whole life contract with a cash surrender value (i.e., paying a fixed amount upon death or a predetermined cash surrender value if the policy surrenders).

16. For some contracts, for example a deferred annuity with a right to annuitize at a predetermined rate, the insurer is obligated to the pay the policyholder the value of their account balance in circumstances where there is no insured event and *if the policyholder does not exercise their unilateral right to annuitize*. The staff believe that for purposes of applying Alternative (c), for any periods prior to a policyholder's exercise of their option to annuitize, the existence of balances payable to the policyholder absent an insured event (e.g., upon a lapse or

[3] In preparation of the product spectrum in Appendix A and otherwise, the staff have not identified any explicit account balances separated pursuant to Alternative (b) that would also not be separated under Alternative (c) (assuming the probability-weighted average of the present value of applicable surrender charges under lapse scenarios is not in excess of the account balance).

expiration of an unexercised right to annuitize) would indicate the existence of an investment component requiring separation. However, for any periods subsequent to the exercise of the option (assuming no term certain payments), there generally would not be an investment component requiring separation (i.e., the previously existing deposit amount would have been used, in effect, to purchase an immediate annuity, which generally would not have an investment component requiring separation).

17. A further difference between Alternatives (b) and (c) is that Alternative (c) would include cash surrender values (determined on a probability-weighted basis reflecting the insurer's expectations of when the cash flows include those cash surrender values). The treatment of cash surrender charges might also result in differences between alternatives (b) and (c).

18. Appendix A further identifies which products might be expected to, generally, have investment components separated under Alternative (c).

19. Proponents of Alternative (c) consider this alternative to best match the definition of insurance contract tentatively decided upon by the boards (i.e., a contract under which the insurer accepts significant risk other than financial risk from the policyholder by agreeing to compensate the policyholder if an insured event adversely affect the policyholder). As described in the ED, uncertainty about whether an insured event occurs, when it occurs, and/or how much the insurer will need to pay if it occurs is the essence of an insurance contract. To the extent that cash flows are payable to the policyholder regardless of whether an insured event occurs, such amounts might reasonably be considered to be related to an investment component.

20. Proponents of Alternative (c) argue that this alternative results in an insurer treating similar contracts similarly regardless of whether there is an explicit account balance. For example the explicit account balance of a universal life

contract would be accounted for similarly to the "implicit[4]" account balance of a traditional whole life contract with a cash surrender value.

21. Opponents of Alternative (c) argue that determining the amount of premium to be allocated to the investment component, other than when there is an explicit account balance, will be more complex and subjective and therefore should not be required. The staff address the determination of premium in the next section (paragraphs 30 through 37) of this paper.

Alternative (d): Separation of amounts of premium received that the insurer estimates it will return to the policyholders

22. This alternative would likely include all the investment components that are separated pursuant to Alternative (c). However, alternative (c) includes estimation of the amount which is required to return regardless whether insurance event happens, while alternative (d) includes additional amounts which are paid when insured event happens (effectively the estimation of amounts that the insurer will return to the policyholders). As discussed further in the paragraphs that follow, this alternative would, essentially, preclude the volume information on the statement of comprehensive income that lead to the boards' previous tentative decision on the statement of comprehensive income presentation. Those decisions were consistent with the feedback from users, which lead to the boards' previous tentative decision that volume information was so relevant that it should be required to be presented on the statement of comprehensive income. In alternative (d), as illustrated for two variants below, the amount of premium recognized in the statement of comprehensive income would often be equal to or *less* than the amount of revenue recognized under the proposals of the ED and DP. Accordingly, the staff do *not* believe that these are viable alternatives, especially if the primary objective of separating investment components from the insurance

[4] The staff use the term implicit account balance to refer to account balances that do not meet the definition of an explicit account balance as defined in the November 2011 joint board meeting (included in paragraph 19 of Paper 2F/81F).

contract liability is as a means to determine total aggregate premiums recognized in the statement of comprehensive income.

23. The staff considered two variants of Alternative (d). The distinction between these two approaches is based on whether the investment component is likely to be returned to:

(a) the same policyholder who paid the premiums (Alternative d1), or

(b) to any policyholder (Alternative d2).

24. Alternative (d1), is most likely the case for most life insurance contracts. Alternative (d2) would likely apply to all insurance contracts, including non-life and group contracts).

25. The consequence of Alternative (d1) would be that the supermajority of consideration received for most life insurance products would likely not be recorded as premium income. Essentially, for these contracts, the aggregate premium recognized in the statement of comprehensive income would be limited to an amount representative of the margin plus any acquisition costs (or other fulfilment cash flows payable to parties other than the policyholder or his or her beneficiary). Some commercial and many (proportional) reinsurance non-life insurance contracts, because insured events might reasonably be considered likely to occur, would also likely require separation of investment components (i.e., the probability-weighted cash flows to be paid to the policyholder, which will likely include scenarios where the policyholder is paid significantly more than the insurance contract premiums). Because this alternative is based on individual contracts rather than the portfolio of contracts, this would result in significantly different premiums recognized in the statement of comprehensive income for a portfolio of individual (or group) policies and an economically equivalent portfolio of policies, which would contrast with the basis for other tentative decisions that have focused on the insurer's perspective.

26. The consequences of Alternative (d2) are similar to those of Alternative (d1) but applied to *all* contracts (i.e., the supermajority of consideration for *all* contracts

would likely be recorded as a deposit liability rather than as premium). Although, this alternative is less subjective and arbitrary than some of the other alternatives identified, there would still be some subjectivity required in determining which of the cash flows are estimated to be paid to policyholders rather than other parties. For example, an insurer might incur additional costs to investigate claims, which would result in lower amounts being paid to the population of policyholders (but perhaps have minimal effect on the overall net cash flows).

27. Thus, under Alternative (d1), the premiums recognized on the statement of comprehensive income would be analogous to the margin recognized under the ED/DP proposed presentation for the building block approach. Under Alternative (d2), *all* contracts would be treated analogously to the margin recognized under the ED/DP proposed presentation for the building block approach and, therefore, effectively eliminate the premium allocation approach premium earned volume metric.

Staff recommendation

28. The staff recommend that an insurer separate from insurance contracts investment components which obligate the insurer to pay the policyholder or a beneficiary regardless of whether an insured event occurs (i.e., Alternative (c)). The staff believe that using this definition the insurer would present in the statement of comprehensive income aggregate premiums that exclude those for components that are not integral to the existence of insurance risk in the contract.

Question 1 – Identification of investment component
Do the boards agree that an investment component in an insurance contract should be defined as an amount that the insurer is obligated to pay the policyholder or a beneficiary regardless of whether an insured event occurs?

29. If the boards do not agree with the staff recommendation (e.g., due to the cost or complexity) and continue to support separation of investment components as a means to determine premium to recognize on the statement of comprehensive income, the staff would recommend Alternative (b), *Separation of explicit*

account balances from insurance contracts (as defined at the joint board meeting in November 2011). We do not recommend the boards continue to explore other ways to identify the investment component that would be disaggregated.

Which premiums should be excluded from the statement of comprehensive income?

30. If the boards agree with the staff recommendation in Question 1, a question remains as how to determine the amount that would be excluded from the total aggregate premiums.

31. The staff propose that that the investment component should be regarded as an amount the insurer is obligated to pay to policyholders or their beneficiaries regardless of whether an insured event occurs. The staff think that, after excluding from the aggregate premium the present value of that amount, any consideration estimated to be received by the insurer provides a meaningful representation of the premiums associated with the insurance risk borne under the contract. Furthermore, the staff think that these amounts should be identifiable by using assumptions consistent with those used in the measurement of the overall insurance contract liability.

32. Example 1 illustrates how this definition would be applied and its implication if the investment component would be excluded from the statement of comprehensive income:

> **Example** 1 – An insurer issues a life contract (accounted for under the building block approach) for CU 1000 of premiums (all paid at contract inception) and a death benefit of CU 5000. The policy allows the policyholder to contribute additional premiums into an account balance or to cancel the policy and receive a cash surrender value equal to the account balance (i.e., there are no surrender charges). The account balance is credited with a return based on the performance of specific assets held by insurer and is debited on a daily basis for mortality and expense charges that aggregate to 2.5% per annum of the excess of the death benefit (CU 5000) over the account balance (initially the CU 1000). Unless cancelled by the policyholder, the policy will

> remain in effect as long as the account balance is funded sufficiently to allow for deductions of mortality and expense charges.
>
> The determination of the present value of the amount that would be returned to the policyholder or his or her beneficiary regardless of whether an insured event occurs (i.e. upon either lapse or death) would be based on the CU 1000 day 1 account balance less the present value of any mortality and expense charges estimated to be deducted from this account balance. Therefore, the premium to be recognized in the statement of comprehensive income over the life of the contract in this example will equal the estimated mortality and expense charges. After one year, approximately CU 100 of the account balance has been, effectively, used to purchase term insurance coverage for the year and would be reflected as premium due in the statement of comprehensive income once the insurer became entitled to debit the account balance for this consideration.

33. The amount of premium due for the contract in example 1 is recognized in a manner similar to premium earned for contracts accounted for under the premium allocation approach[5]. The staff believe this results in a meaningful reflection of the contract economics in that these premiums represent the amount of consideration the insurer is entitled to in exchange for satisfying its obligation to provide insurance coverage for the period.

34. Example 1 illustrates that for some contracts separation of investment components applying the definition in staff recommendation would not be very complex. As the account balance is credited with an amount based on the performance of specific assets held by the insurer, the resulting cash flows (e.g., upon a lapse) would be discounted at a rate that reflects the asset dependency. The staff believe that in circumstances such as these, a more detailed analysis of the cash flow scenarios is not necessary because the asset return rate used to project the increase in value of the investment component is the same rate that would be used to discount the cash flows associated with the investment component.

[5] Based on tentative decision of the boards, under the premium allocation approach the premium earnings pattern might require adjustment for any potential differences between the expected timing of benefits and the passage of time, which doesn't occur under the building block approach.

35. However, for other contracts that require separation of investment components under the staff's recommendation, the determination of the premiums to be excluded from the statement of comprehensive income is less straightforward. This is the case when the insurer would be required to estimate the present value of amounts to be paid to policyholders regardless of the occurrence of an insured event. This would require the insurer to determine for each probability weighted scenario which part of the cash flows relates solely to the insured event and which part of the cash paid upon an insured event would occur regardless of whether the insured event occurred). This could be accomplished largely through the use of the model developed for the building block approach and the lapse rate assumptions to determine the cash surrender value when policyholders are expected to surrender their policies. The present value of this amount might be representative of the premiums paid for the investment component.

36. Example 2 illustrates a less straightforward application of the proposed definition:

> **Example 2** – An insurer issues a traditional whole life policy for CU 1000 of premium with a death benefit of CU 5000 that allows the policyholder to cancel the policy and receive a cash surrender value of CU 100 initially and increasing 10% per annum. Assume that the insurer estimates that there is a 25% probability the policyholder cancels the policy after 5 years, a 25% chance the policyholder cancels after 10 years, and a 50% chance the policyholder dies at the 30th anniversary of contract issuance (while the policy is in effect). Further assume the insurer determines the applicable discount rate that reflects the characteristics of the liability is 5%.
>
> Based on the above assumptions, the probability weighted present value of amounts payable to the policyholder regardless of an insured event is CU 273[6]. Backing this amount out of the CU 1000 of premiums would result in CU 627 of premiums for the insurance component that are to be recognized in the statement of comprehensive income (in aggregate).

[6] This amount is calculated as follows. The amount of surrender value payable to the policyholder would be CU 161 (i.e., 100 x 1.1^5) after 5 years, CU 259 (100 x 1.1^{10}) after 10 years, and CU 1745 (100 x 1.1^{30}) after 30 years (i.e., the amount payable after 30 years absent an insured event). The present value of each of these amounts is CU 126, CU 159, and CU 404, respectively. Probability-weighted, this equals CU273.

37. The staff believe that applying the recommended definition of an investment component in paragraph 28 is feasible and workable. Although it would not be complex for some contracts but it might be more complex for the others, the staff believe that the advantages would outweigh the disadvantages and that, as noted above, we think this principle provides a meaningful representation of the premiums associated with the insurance risk borne under the contract. Therefore the staff recommend that an insurer exclude from the aggregate premium presented in the statement of comprehensive income the probability weighted estimate of the present value of those amounts to be paid to policyholders or their beneficiaries regardless of whether an insured event occurs, measured consistently with the measurement of the overall insurance contract liability.

Question 2 – Determination of investment component premiums

Do the boards agree with the staff's recommendation that insurers exclude from the aggregate premium presented in the statement of comprehensive income the present value of those amounts to be paid to policyholders or their beneficiaries

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Appendix A: Spectrum of Products Sold by Insurers

The following table compares possible investment components, as defined under two of the alternatives described in paragraph 8 of this paper, to be separated for purposes of determining the premium to be recognized on the statement of comprehensive income. The columns of this table present the following:

(1) Alternative (b): Separation of investment components from contracts, which require the insurer to maintain an explicit account balance (as defined at the joint board meeting in November 2011) for the benefit of the policyholder

(2) Alternative (c): Separation of investment components from contracts, which obligate the insurer to pay the policyholder (or beneficiary) regardless of whether an insured event occurs (the staff recommendation).

(3) The insurance component after separating (2)

(4) The degree of subjectivity in determining investment component according to Alternative (c)

(5) Current US GAAP Accounting for the whole contract.

Investment Components		Insurance Component[i]	Degree of Subjectivity in Determining Investment Component	Current US GAAP Accounting
Alternative (b)	Alternative (c)			
(1)	(2)	(3)	(4)	(5)
1. GIC (Guaranteed Investment Contract) – *This type of policy guarantees the policyholder principal repayment and a fixed or floating interest rate for a predetermined period of time. (Although products vary, assume that this product has no options to purchase an annuity). This contract typically allows the policyholder to surrender their contract in exchange for the account balance, sometimes less a surrender charge.*				
Entire contract (if it were in scope of insurance contract standard) / N/A – Entire contract accounted for as a financial instrument		None	None	Financial instruments

Investment Components		Insurance Component[i]	Degree of Subjectivity in Determining Investment Component	Current US GAAP Accounting
Alternative (b)	Alternative (c)			
(1)	(2)	(3)	(4)	(5)
2. Deposit Administration (DA) Contract – *This type of policy is a vehicle for group pension plan fund accumulations for an unspecified time, generally with annual interest guarantees. The accumulated value of the fund can be withdrawn at the anniversary date with no withdrawal penalties; however, the fund is charged an annual administration charge by the insurer. There are no specific allocations to individuals within the fund, but at the time of retirement a withdrawal is made from the fund to purchase an immediate annuity for the retiree. Although products vary, assume that the right to annuitize is at a guaranteed rate. Once an immediate annuity is purchased for a participant, benefit payments are guaranteed by the insurer.*				
Entire contract less any value associated with the right to purchase immediate annuities and any purchased annuities		The residual after separating any investment components	Limited	Financial instruments FAS 60 Long-Duration Contracts[iv] for any immediate annuities purchased (accounted for as a separate instrument today)
3. Endowment Contract – *This type of policy is a life insurance contract designed to pay a lump sum after a specified term (on its 'maturity') if the policyholder survives or on death. Some policies also pay out in the case of critical illness. The premium is paid annually or at the beginning of the contract. Endowments can be cashed in early (or surrendered) and the holder then receives the surrender value which is determined by the insurance company depending on how long the policy has been running and how much has been paid in to it.*				
None identified	A probability weighted average of the present value of the lump sum payment payable at maturity and the amounts paid under lapse scenarios (including a hypothetical lapse in any death scenarios)	The residual after separating any investment components	Limited to moderate	FAS 60 Long-Duration Contracts[iv]

Investment Components		Insurance Component[i]	Degree of Subjectivity in Determining Investment Component	Current US GAAP Accounting
Alternative (b)	Alternative (c)			
(1)	(2)	(3)	(4)	(5)
4. Immediate Annuity with Life Contingency – *This type of policy provides the policyholder with regular periodic payments beginning immediately after the policyholder makes an initial deposit. The payments are guaranteed over the life of the policyholder. Contracts are pooled and, therefore, insurers do not track account balances by individual contract holder. The policyholder generally has no right to any balance upon surrender.*				
None identified	None identified	Entire contract	Not applicable	FAS 97 Limited-Pay Contracts[ii]
5. Immediate Annuity with Life Contingency but Term Certain – *This type of policy provides the policyholder with regular periodic payments beginning immediately after the policyholder makes an initial purchase payment. The payments are guaranteed over the life of the policyholder. However, if the policyholder dies before the end of the specified term, payments are made to the designated beneficiary until the end of the term (eg if the policyholder dies with the first 7 years after entering into a contract). Contracts are pooled and, therefore, insurers do not track account balances by individual contract holder. The policyholder generally has no right to any balance upon surrender.*				
None identified	The present value of the amount to be paid during the specified term (i.e., term certain payments).	The residual after separating any investment components	None	FAS 97 Limited-Pay Contracts[ii]
6. Variable Immediate Annuity – *This type of policy provides the policyholder with regular periodic payments beginning immediately after the policyholder makes an initial purchase payment. The payments are guaranteed over the life of the policyholder. The policyholder can allocate the purchase payment(s) to various investment portfolios, and the performance of these portfolios determines the value of the policyholder's account. These products are not typically sold today (although older policies exist). There is generally no surrender value.*				
None identified (the policyholder account is a mechanism for determining the amount of annuity payments to be paid while the policyholder continues to survive)		The whole contract	None	FAS 97 Universal Life-Type Contracts[iii]

Investment Components		Insurance Component[i]	Degree of Subjectivity in Determining Investment Component	Current US GAAP Accounting
Alternative (b)	Alternative (c)			
(1)	(2)	(3)	(4)	(5)
7. Variable Deferred Annuity – *This type of policy provides the policyholder with regular periodic payments beginning at a future date. The period before this date is the accumulation phase. During the accumulation phase, the policyholder invests the purchase payment(s) in various investment portfolios, and the performance of these portfolios determines the value of the policyholder's account. The payments are guaranteed over the life of the policyholder. If the policyholder dies before receiving payments, a designated beneficiary is guaranteed to receive a specified amount. The policy can be surrendered in exchange for the account value during the accumulation phase but there is no surrender value once periodic payments begin.*				
Accumulation amount (i.e., contributions plus credited return) during the accumulation phase; none thereafter	Accumulation amount (i.e., contributions plus credited return) during the accumulation phase; thereafter, the present value of the specified amount guaranteed to be paid during the term certain	The residual after separating any investment components	Limited to moderate	FAS 97 Universal Life-Type Contracts in the accumulation phase FAS 60 Long-Duration Contracts[iv] in the payout phase

Investment Components		Insurance Component[i]	Degree of Subjectivity in Determining Investment Component	Current US GAAP Accounting
Alternative (b)	Alternative (c)			
(1)	(2)	(3)	(4)	(5)
8. Fixed Deferred Annuity – *This type of policy provides the policyholder with regular periodic payments beginning at a future date. The period before this date is the accumulation phase, during which, the purchase payments earn a guaranteed rate of interest. The payments are guaranteed over the life of the policyholder. The policy can be surrendered in exchange for the account value during the accumulation phase but there is no surrender value once periodic payments begin.*				
Accumulation amount (i.e., contributions plus credited return) during the accumulation phase; none thereafter		The residual after separating any investment components (ie none in the accumulation phase, the whole contract thereafter)	None or limited	FAS 97 Investment Contracts[v] FAS 60 Long-Duration Contracts[iv] in the payout phase

Investment Components		Insurance Component[i]	Degree of Subjectivity in Determining Investment Component	Current US GAAP Accounting
Alternative (b)	Alternative (c)			
(1)	(2)	(3)	(4)	(5)
9. Equity indexed annuity – *This type of policy is a deferred fixed annuity contract with a guaranteed minimum interest rate plus a contingent return based on some internal or external equity index, such as the Standard & Poor's (S&P) 500 Index. Equity-indexed annuities typically have minimal mortality risk. Equity-indexed annuities often do not have specified maturity dates; therefore, the contracts remain in the deferral (accumulation) phase until the customer either surrenders the contract or elects annuitization. Customers typically can surrender the contract at any point in time, at which time they receive their account value, as specified in the contract, less any applicable surrender charges. The account value is defined in the policy as generally the greater of the policyholder's initial investment plus the equity-indexed return or a guaranteed floor amount (calculated as the policyholder's initial investment plus a specified annual percentage return).*				
Accumulation amount (i.e., contributions plus credited return) during the accumulation phase; none thereafter	Accumulation amount less the probability weighted average of the present value of the applicable surrender charges under lapse scenarios during the accumulation phase; none thereafter	The residual after separating any investment components	None or limited	FAS 97 Investment Contracts[v]

	Investment Components		Insurance Component[i]	Degree of Subjectivity in Determining Investment Component	Current US GAAP Accounting
	Alternative (b)	Alternative (c)			
	(1)	(2)	(3)	(4)	(5)
10. Equity-Indexed Life Insurance Contracts – *This type of policy combines term life insurance coverage with an investment feature, similar to universal life contracts. Death benefit amounts are based on the amount selected by the policyholder plus the account value. Charges for the cost of insurance and administrative costs are assessed periodically against the account. The policyholder's account value, maintained in the insurance entity's general account (not a separate account), is based on the cumulative deposits credited with positive returns based on the S&P 500 Index or some other equity index. An essential component of the contract is that the cash surrender value is also linked to the index. The death benefit amount may also be dependent on the cumulative return on the index.*					
	Accumulation amount (i.e., contributions plus credited return)	Accumulation amount less the probability weighted average of the present value of the applicable surrender charges under lapse scenarios (including a hypothetical lapse in any death scenarios)	The residual after separating any investment components	None or limited	FAS 97 Universal Life-Type Contracts[iii] (after unbundling any embedded derivatives)

Investment Components		Insurance Component[i]	Degree of Subjectivity in Determining Investment Component	Current US GAAP Accounting
Alternative (b)	**Alternative (c)**			
(1)	**(2)**	**(3)**	**(4)**	**(5)**
11. Variable Universal Life – *This permanent life insurance policy provides the policyholder with a death benefit in exchange for premium payments. The terms are not fixed or guaranteed with respect to premium amounts, expense assessments, or benefits accruing to the policyholder. However, a minimum premium is required to keep the policy in force and provide coverage at the specified amount. The policyholder can allocate premiums to a variety of investment portfolios, and the premiums accumulate and build a cash value. The cash value is referred to as an account balance. The account balance serves as the basis for determining the amount of insurance protection and also identifies the amount which the policyholder can withdraw or borrow against. Any assets allocated to the investment portfolios are subject to market risk and fluctuate in value. A decrease in the policy's cash value may reduce the policy's death benefit.*				
Accumulation amount (i.e., contributions plus credited return)	Accumulation amount less the probability weighted average of the present value of the applicable surrender charges under lapse scenarios (including a hypothetical lapse in any death scenarios)	The residual after separating any investment components	None or limited	FAS 97 Universal Life-Type Contracts[iii]

Investment Components		Insurance Component[i]	Degree of Subjectivity in Determining Investment Component	Current US GAAP Accounting
Alternative (b)	Alternative (c)			
(1)	(2)	(3)	(4)	(5)
12. Universal Life – *This permanent life insurance policy provides the policyholder with a death benefit in exchange for premium payments. The terms are not fixed or guaranteed with respect to premium amounts, expense assessments, or benefits accruing to the policyholder. However, a minimum premium is required to keep the policy in force and provide coverage at the specified amount. The premiums accumulate and build a cash value. The cash value is referred to as an account balance. The account balance serves as the basis for determining the amount of insurance protection and also identifies the amount which the policyholder can withdraw or borrow against. The cash value may grow at a variable rate that may be adjusted as frequently as monthly or at a minimum rate specified in the contract.*				
Accumulation amount (i.e., contribution less charges plus amounts credited)	Accumulation amount less the probability weighted average of the present value of the applicable surrender charges under lapse scenarios (including a hypothetical lapse in any death scenarios)	The residual after separating any investment components	None or limited	FAS 97 Universal Life-Type Contracts[iii]

Investment Components: Alternative (b) (1)	Investment Components: Alternative (c) (2)	Insurance Component[i] (3)	Degree of Subjectivity in Determining Investment Component (4)	Current US GAAP Accounting (5)
13. Participating Insurance Contracts – *In addition to offering a death benefit, the policy is designed to share the excess of profits from underlying assets and liabilities of the insurer with policyholders. In most cases policyholders do not share only investment returns but also expenses. If the policyholder exits before the maturity of the contract, he will get only the surrender value. On death, the policyholder receives a guaranteed amount.*				
Accumulation amount (i.e., contribution less charges plus amounts credited)	Accumulation amount less the probability weighted average of the present value of the applicable surrender charges under lapse scenarios (including a hypothetical lapse in any death scenarios)	The residual after separating any investment components	None or limited	FAS 97 Universal Life-Type Contracts[iii]
14. Traditional Whole Life Insurance – *This is a permanent life insurance policy with a fixed amount of insurance coverage over the entire life of the insured, provided that premiums are paid as specified in the policy. Premiums typically remain level over the life of the insured. The premiums accumulate and build a cash value against which the policyholder can withdraw and borrow.*				
None identified	A probability weighted average of the present value of the Cash Surrender Value paid under lapse scenarios (including a hypothetical lapse in any death scenarios)	The residual after separating any investment components	None or limited	FAS 60 Long-Duration Contracts[iv]

Investment Components		Insurance Component[i]	Degree of Subjectivity in Determining Investment Component	Current US GAAP Accounting
Alternative (b)	Alternative (c)			
(1)	(2)	(3)	(4)	(5)
15. Term Insurance – *Life insurance coverage is provided for a specified term and does not include the accumulation of cash value. The policy might allow for renewal without evidence of insurability. Premiums may either increase each time the policy is renewed (but will not exceed the maximum premiums stated in the policy) or will be level over a fixed period of time. Although a minority of longer term contracts have a cash surrender value, assume that the policyholder has no right to any balance upon surrender.*				
None identified	None identified	Entire contract	Not applicable	FAS 60 Long-Duration Contracts[iv] *or* FAS 60 Short-Duration Contracts[vi]
16. Long-Term Care – *This type of policy covers services needed by those with chronic illness or disability. If the policyholder pays premiums and meets the carrier's criteria for benefit payment, the policyholder is reimbursed for covered long-term care services up to the amount of daily benefit after a specified waiting period. The policyholder generally has no right to any balance upon surrender.*				
None identified	None identified	Entire contract	Not applicable	FAS 60 Long-Duration Contracts[iv]
17. Long-Term Disability – *This policy protects the policyholder against loss of income as a result of the partial or total inability to work as a result of injury, illness, or disease. The duration may last a specified number of years or until age 65. Premiums typically remain level over the life of the contract. The insurer typically turns into an immediate annuity when policyholder becomes disabled. The policyholder generally has no right to any balance upon surrender.*				
None identified	None identified	Entire contract	Not applicable	FAS 60 Long-Duration Contracts[iv]

Investment Components: Alternative (b) (1)	Investment Components: Alternative (c) (2)	Insurance Component[i] (3)	Degree of Subjectivity in Determining Investment Component (4)	Current US GAAP Accounting (5)
18. Property-Casualty Contract with Experience Account – *Under policies with this type of feature (typically certain reinsurance, group, and some other commercial products), the policyholder's premiums are deposited into an account, and there is no risk sharing with the funds of other policyholders. The balance in the account reflects the policyholder's actual loss experience and earns investment income. At the end of the policy term (or upon cancelation), any principal and interest that has not been paid out for losses is returned to the insured.*				
Balance of experience account	The present value of the payments from the experience account	The residual after separating any investment components	None or limited	FAS 60 Short-Duration Contracts[vi]
19. Health Insurance Contract with Savings Account – *Under policies with this type of feature, a portion of the policyholder's premiums are allocated to a member's personal medical savings account. Funds deposited are available for the exclusive benefit of the member and his or her dependants and shall be transferred to another medical scheme with a personal medical savings account when such member changes medical schemes. Sometimes the amount deposited is credited with some interest.*				
If the personal medical savings account is credited with an explicit return, the balance of that account; otherwise, none	The present value of the payments from the personal medical savings account	The residual after separating any investment components	None or limited	FAS 60 Short-Duration Contracts[vi] or FAS 60 Long-Duration Contracts[iv]

Investment Components		Insurance Component[i]	Degree of Subjectivity in Determining Investment Component	Current US GAAP Accounting		
Alternative (b)	Alternative (c)					
(1)	(2)	(3)	(4)	(5)		
20. Property-Casualty Contract with Loss-Sensitive Premiums – *Under policies with this type of feature (typically certain reinsurance and commercial products), the final premium is dependent on the actual losses of the policyholder during the period that the policy is in effect. The policy places a ceiling on the policyholder's costs if losses are high, and it requires the payment of a minimum premium in the event that losses are low. The policyholder has a right to any premiums paid that are above both the minimum premium and the level of premium associated with the policyholder's experience under the contract but might need to wait until all losses are settled .*						
None identified	The present value of the excess of any premiums above the minimum premium (because that amount is paid either as claims or as a refund of premium.)	The residual after separating any investment components	None or limited	FAS 60 Short-Duration Contracts[vi]	Yes	

[i] The insurance component would necessarily also exclude any unbundled derivatives or service components required by tentative board decisions.

[ii] FAS 97 Limited-Payment Contracts – Benefit liabilities are accrued on the basis of certain assumptions as premium revenue is recognized. Premium revenue generally is recognized *except that gross premiums in excess of the net premium are deferred* and recognized in income in a constant relationship with insurance in force. The liability for future policy benefits is measured in accordance with the provisions of FAS 60 (see endnote iv. below). The profit on the contract is embedded in the account value and the unearned revenue liability.

[iii] FAS 97 Universal-Life Type Contracts – The liability for policyholder benefits equals the account balance if one exists or an implicit account balance or the cash value available for the policyholder, plus other adjustments. The profit on the contract is embedded in the account value and the unearned revenue liability. The estimated gross profit calculation used for the subsequent measurement of deferred acquisition costs, considers all cash flows related to the contract. The unearned revenue liability is recognized in income over the period benefited using the same assumptions and factors used to amortize capitalized acquisition costs.

[iv] FAS 60 Long-Duration Contracts – Benefit liabilities are accrued on the basis of certain assumptions as premium revenue is recognized. Premium revenue is recognized when due. The liability for future policy benefits is measured as the present value of estimated future policy benefits to be paid to or on behalf of policyholders and related expenses less the present value of estimated future net premiums to be collected from policyholders and is accrued when premium revenue is recognized. The assumptions for measuring insurance benefit liabilities (such as investment return, mortality, termination, and expense assumptions) are locked in at inception and unlocked or reset only if a premium deficiency emerges. The discount rate is based on the estimated pre-tax investment yields (net of related invested expenses) expected at the contract issue date, adjusted for adverse deviation. The profit on the contract is embedded in the policyholder liability and the unamortized acquisition costs. Cash flows are included only for current insurance contracts and any existing ongoing obligation to service policyholders. Changes in the liability for future policy benefits are recognized in income of the period in which changes occur. The additional liability recorded for insurance contracts in which an insurance benefit feature results in an expectation of profits in the early years followed by losses in the later years is recognized in earnings similar to the amortization of capitalized acquisition costs. The benefit ratio is readjusted at each reporting period for actual and current future projections. Liabilities for unpaid claims and claims adjustment expenses are accrued when insured events occur.

[v] FAS 97 Investment Contracts – Amounts received as payments are not reported as revenues but are instead reported as liabilities and accounted for in a manner consistent with the accounting for interest bearing or other financial instruments. Capitalized acquisition costs are amortized using the interest method. That method recognizes acquisition and interest costs as expenses at a constant rate to net policy liabilities.

[vi] FAS 60 Short-Duration Contracts – Premium is recognized as revenue over the period of the contract in proportion to the amount of insurance protection provided. A claims liability is measured as claims are incurred, whether or not those claims have been reported. Short-duration contracts give rise to two distinct liabilities: the unearned premiums and the claims liability.