

**Session 31**

**Practical Issues of Implementing the  
Proposed Statement of Position,  
“Accounting and Reporting by  
Insurance Enterprises for Certain  
Nontraditional Long-Duration  
Contracts and for Separate Accounts”**

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**September 20, 2002**

**Proposed SOP: Nontraditional Long-  
Duration Contracts and Separate  
Accounts**

**Separate Accounts  
Sales Inducements**

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## **Separate Accounts**

Assets and liabilities reported at fair value as one-line summary totals on the balance sheet if all of the following are true:

- Separate account is legally recognized
- Assets are insulated
- Contract holder directs asset allocation
- Investment performance is passed through to contract holder

## **Separate Accounts**

Floor guarantees do not prevent separate account treatment, but caps do

Value floor guarantees separately, and hold a liability for them in the general account

## **Separate Accounts**

Seed money does not meet the criteria for separate account reporting:

- “Look through” the separate account structure
- Value proportionate interest as if a general account asset
- If contract holders can transfer funds, value them like assets the company may be required to sell

## **Separate Accounts**

Proportionate interest example, accounting for a transferred asset:

### **Assumptions**

- Transfer a bond to the separate account
- Available-for-sale (AFS) treatment in the general account
- Amortized cost = 800, Market value = 1000
- Insurer’s proportionate interest in the separate account is 40%

## **Separate Accounts**

Proportionate interest example, accounting for a transferred asset:

### **Treatment**

- Recognize gain of 120 (60% of 200)
- 40% of bond still recognized as AFS investment
- Remaining unrealized gain is recognized if asset is sold or as the proportionate interest decreases

## **Separate Accounts**

Practical Issues:

- Insulation
- Market value adjusted fixed accounts
- Separate account GICs
- Performance-based fees

## **Sales Inducements**

“Sales inducements are product features that enhance the investment yield to the contract holder on the contract.”

Three main types of sales inducements:

- Day one bonus
- Persistency bonus
- Enhanced yield

## **Sales Inducements**

Liability

- Recognize as a liability when credited or as accrued.
- Do not adjust for anticipated surrender charges, persistency, or other early withdrawal features.

## **Sales Inducements**

Recognize a corresponding sales inducement asset if all of the following are true:

- A liability is held for the sales inducement
- The inducement is identified in the contract at inception
- The inducement amounts are incremental to what the insurer credits on contracts without inducements
- The inducement amounts result in credits higher than what will be credited after the inducement

## **Sales Inducements**

Sales inducement asset

- Recognized as a separate asset on the balance sheet
- Deferred and amortized using the same methodology used for capitalized acquisition costs

## Sales Inducements

### Example

- Fixed Annuity with a persistency bonus of 2% of account value payable at the end of year 4.
- Earned rate = 6.00%
- Credited rate = 4.50%
- Maintenance expenses = 75 per year
- Initial premium = 10,000
- Deferrable acquisition expense = 5% of premium
- Lapse = 3,4,5,6,7,20,10,10,10,100
- Surrender Charge = 7,6,5,4,3,2,1,0,0,0

## Sales Inducements

### Example 1: No accrual, No deferral

	<u>Year</u>					
	<u>1</u>	<u>2</u>	<u>3</u>	<u>4</u>	<u>5</u>	<u>6</u>
<b>Pre-Bonus EGPs</b>	98	107	112	113	115	115
<b>Persistency Bonus</b>	-	-	-	(198)	-	-
<b>EGP Stream for DAC</b>	98	107	112	(85)	115	115
<b>Deferrable Expenses</b>	(500)	-	-	-	-	-
<b>Change in DAC</b>	445	(64)	(71)	81	(73)	(76)
<b>Net Income</b>	43	43	41	(4)	42	39

## Sales Inducements

### Example 2: Accrue for bonus, No deferral

	<u>Year</u>					
	<u>1</u>	<u>2</u>	<u>3</u>	<u>4</u>	<u>5</u>	<u>6</u>
Pre-Bonus EGPs	98	107	112	113	115	115
Accrue Bonus	(51)	(51)	(50)	(47)	0	-
EGP Stream for DAC	48	56	62	66	115	115
Deferrable Expenses	(500)	-	-	-	-	-
Change in DAC	484	(23)	(29)	(34)	(74)	(78)
Net Income	32	33	33	33	41	37

## Sales Inducements

### Example 3: Accrue for bonus, defer and amortize

	<u>Year</u>					
	<u>1</u>	<u>2</u>	<u>3</u>	<u>4</u>	<u>5</u>	<u>6</u>
Pre-Bonus EGPs	98	107	112	113	115	115
Accrue Bonus	(51)	(51)	(50)	(47)	0	-
Defer/Amortize Bonus	29	29	28	26	(21)	(21)
EGP Stream for DAC	76	84	89	92	94	93
Deferrable Expenses	(500)	-	-	-	-	-
Change in DAC	463	(45)	(51)	(55)	(59)	(61)
Net Income	39	40	39	37	35	32

## Sales Inducements

Example 4: Accrue for bonus, defer and amortize

	<u>Year</u>					
	<u>1</u>	<u>2</u>	<u>3</u>	<u>4</u>	<u>5</u>	<u>6</u>
Pre-Bonus EGPs	98	107	112	113	115	115
Accrue Bonus	(101)	(102)	1	4	0	-
Defer/Amortize Bonus	79	81	(20)	(24)	(21)	(22)
EGP Stream for DAC	75	85	93	93	93	92
Deferrable Expenses	(500)	-	-	-	-	-
Change in DAC	464	(45)	(53)	(56)	(59)	(61)
Net Income	39	40	40	37	35	32

## Sales Inducements

Comparison of Balance Sheet Items

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
<b>Example 1</b>						
Sales Ind. Liab.	0	0	0	0	0	0
Sales Ind. Asset	0	0	0	0	0	0
DAC Asset	445	381	311	392	319	243
<i>Net</i>	<b>445</b>	<b>381</b>	<b>311</b>	<b>392</b>	<b>319</b>	<b>243</b>
<b>Example 2</b>						
Sales Ind. Liab.	51	102	151	0	-	-
Sales Ind. Asset	0	0	0	0	0	0
DAC Asset	484	462	433	399	325	247
<i>Net</i>	<b>434</b>	<b>360</b>	<b>281</b>	<b>399</b>	<b>325</b>	<b>247</b>
<b>Example 3</b>						
Sales Ind. Liab.	51	102	151	0	-	-
Sales Ind. Asset	29	57	85	111	90	69
DAC Asset	463	418	368	313	253	192
<i>Net</i>	<b>441</b>	<b>374</b>	<b>301</b>	<b>423</b>	<b>343</b>	<b>260</b>

## Sales Inducements

### Comparison of Balance Sheet Items

	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6
<b>Example 3</b>						
Sales Ind. Liab.	51	102	151	0	-	-
Sales Ind. Asset	29	57	85	111	90	69
DAC Asset	463	418	368	313	253	192
<i>Net</i>	<i>441</i>	<i>374</i>	<i>301</i>	<i>423</i>	<i>343</i>	<i>260</i>
<b>Example 4</b>						
Sales Ind. Liab.	101	203	202	0	-	-
Sales Ind. Asset	79	159	139	116	94	72
DAC Asset	464	418	365	309	250	190
<i>Net</i>	<i>441</i>	<i>374</i>	<i>302</i>	<i>425</i>	<i>344</i>	<i>261</i>

## Sales Inducements

### Practical Issues

- Comparison with similar contracts
- Recoverability and loss recognition
- Shadow treatment