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NEW SEPARATE ACCOUNT ANNUAL STATEMENT BLANK

TEACHING SESSION

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Editors Note: The answers to questions raised at the Teaching Session have been incorporated in the edited text.

I. BACKGROUND FOR CHANGE

Before we get into the discussion of the new Separate Account blank for 1978, it may be useful to take a brief look at the history of the blank. The present blank, which does not differ much from the Life and Accident and Health blank, was adopted in 1962. It was described then as following the traditional format with just the minimum technical changes necessary to reflect the contractual relationship between liabilities and the market value of assets.

Initially the blank required for each separate account (i) separate gain and loss statements, (ii) special statements of condition of assets, liabilities and surplus, (iii) net gain from operations and (iv) separate investment schedules. This individual account reporting was in effect for only the one year.

The Separate Account blank evolved very slowly with only a few changes being made to reflect varying viewpoints. In the very early years there had been a feeling that as the Separate Account business developed innovations could be expected, the relationships within Separate Accounts - assets, liabilities, income, outgo - and relationships with the General Account would become clearer and as experience accumulated, modifications would be made to the blank.

Some people felt that there should be no Separate Account blank that a Separate Account was merely a class of business, a classification of assets, so to speak, and should be included in the regular blank. Others felt that the additional lines, exhibits and schedules required for a combination blank would be a burden to companies which did not have Separate Accounts. The regulators wanted a separate blank for Separate Accounts, partly to minimize the disruption of the reporting for traditional business, and partly because Separate Accounts were felt to need special attention. In any event, the use of a modified Life and Accident and Health blank for the reporting of Separate Accounts has persisted to the present.

By the end of the 1960's it was becoming increasingly clear to both the insurance industry and the regulators that the Separate Account blank was not satisfactory. In response, two industry trade associations, the American Life Convention and the Life Insurance Association of America, appointed a special joint committee to develop a better way to report on Separate Account business. The committee initially developed a proposal for consolidating the Separate Account blank and the Life and Accident and Health blank. This proposal was exposed informally to the National Association of Insurance Commissioners (NAIC) in 1972, but the initial reaction was not favorable. By that time, the advent of variable life insurance seemed near, and the committee turned its attention to the special reporting problems posed by this new form of insurance.

Upon completing its proposal for a variable life insurance blank, the committee (now the American Council of Life Insurance (ACLI) Subcommittee on Annual Statement Reporting of Separate Accounts) was able to return to its original task of the Separate Account blank. Although the variable life insurance blank was, in a sense, a three-year diversion, the committee found that wrestling with the complexity of General Account-Separate Account relationships for this special new product had helped tremendously in understanding the overall issues involved in Separate Account reporting. The committee was able to make rapid progress and complete its proposal by the fall of 1976.

The new Separate Account blank was adopted by the NAIC in June 1977, and will first be used for the 1978 annual statements (to be filed in February 1979). The one-year delay was adopted to permit companies to make an orderly transition in their accounting systems and records. Also, since the revision was so comprehensive, the deferral period provided an opportunity to determine whether any adjustments in the format would be needed.

Appendix I summarizes the investigations and deliberations of the Subcommittee on Annual Statement Reporting of Separate Accounts. A reading of the Appendix will enhance the reader's understanding of the changes introduced in the new blank and the reasons for making these changes.

For ease of reference, we shall refer to the Life and Accident and Health statement (which details the General Account of the company) as the Blue blank and we shall refer to the Separate Account statement as the Green blank. When we talk about "General Account items", we will mean those financial items which are detailed in the Blue blank. We will also define Separate Account <u>business</u> as the total operations relating to contracts under which part or all of the funds are invested in one or more separate accounts.

II. CHANGES IN CONCEPT - AN OVERVIEW

1. Fund of Assets vs. Line of Business

The most fundamental change in the new Separate Account blank is a shift from a "line of business" to a "fund" approach. The present Green blank is a virtual copy of the Blue blank and purports to be a statement of the separate account "business" of the insurer. It implicitly assumes that the separate accounts are themselves engaged in an insurance business that is essentially independent of the business which the insurer transacts through its General Account. The revised blank recognizes that separate accounts are inherently no more than segregated funds of the insurance company's assets, set aside to support certain of the company's contractual obligations. It is possible to view a separate account as an independent entity with respect to the investment of the assets held therein. It is also possible to relate the amount of the separate account assets to the insurer's liabilities that must be supported by those assets. But with respect to insurance operations, it is generally not possible to operate a separate account business independently and without substantial interaction with the general account.

While the title of the present Green blank states that it refers to Separate Account business, different companies have interpreted the term, Separate Account business, in different ways.

At one extreme, companies reported only the transactions of the Separate Accounts themselves. Only the net amounts transferred to Separate Accounts were reported as income received; the only expenses were those incurred by the Separate Account as such, i.e., only the cost of investment transactions and contractual deductions for investment management and administration and for mortality and expense guarantees. plus whatever taxes had to be paid on either interest or capital gains, were reported. The reserves were always equal to the amounts of assets in the Separate Account (excepting seed money) and gains or losses because of mortality were transferred to or from the General Account. Gross considerations, taxes, commissions and expenses of operation were reported in the General Account. This is essentially the reporting method of the revised Green blank, and companies which had used this method should find the new blank more convenient than the old one.

At the other extreme, gross considerations were taken as income into the Separate Account; expenses reported in Exhibit 5 of the Green blank included commissions, any taxes on considerations, and all other expenses relating to the total business of the Separate Account operations, including administrative expenses and the like.

Some companies adopted positions somewhere between these two extremes. For example, a company would effect transfers of funds into the Separate Account operation to take care of administrative expenses which were detailed in the Separate Account statement but not charged against the earnings of the Separate Account.

The revised blank is primarily concerned with Separate Account investment activities and with the flow of funds to and from the General Account. Such insurance functions as sales, premium collection, payment of premium taxes and commissions, contract administration, policyholder service and claims administration - functions which are performed by the insurance company itself, rather than by its segregated asset pool - are to be reported in the Blue blank. To the extent that such operations involve the transfer of funds to or from the Separate Account, it is these associated transfers which are to be reported in the Green blank.

All gross premiums and annuity considerations are to be shown in Exhibit 1 of the Blue blank; the revised Green blank has no comparable exhibit. If all or part of the consideration is to be applied to provide benefits based on the Separate Account, an appropriate net consideration will be shown as a transfer to the Separate Account. If the policyholder subsequently elects to reallocate funds between the general and separate accounts, a transfer of reserves would be reported in the Green blank. The insurer's administrative expenses for its Separate Account business are reported in the Blue blank; the Green blank does not even include an exhibit of insurance expenses but rather provides for the transfer of administration charges to the General Account. Nor does the revised blank include an exhibit of policy and contract claims, since incurred claims are an obligation of the General Account.

The revised Green blank does recognize alternative approaches to investment expenses and taxes. The intent is to provide flexibility to handle different Separate Account investment arrangements including the case where separate accounts are invested entirely in underlying mutual funds. An insurer may assume some or all Separate Account expenses and assess a charge against the Separate Account, in which case the expenses and taxes would be reported in Exhibits 5 and 6 of the Blue blank and the charges transferred would be reported in the Green blank. To the extent that these expenses and taxes are directly charged to the Separate Account, however, they may be reported in Exhibits 4 and 5 of the Green blank.

The revised blank also does not provide for dividend liabilities or accident and health insurance. Dividends are paid out of the general surplus of the company, and are not a charge against separate account assets. Nor do accident and health policies involve separate accounts.

2. Valuation of Investments

The assets of most separate accounts are valued at market. A few companies have established separate accounts to support guaranteed ("fixed") benefits, however, and these accounts must be valued on the same basis as the general account. The asset schedules in the revised blank are essentially the same as in the current blank, except that provision has been made for showing "statement value", which will normally be "market value", but may be "book value" for accounts valued on that basis.

The concept of "not admitted" assets does not fit the valuation of a fund of investments carried at market. Separate accounts are not permitted to "invest" in nonadmissable assets, while the value of any investments held by the account must be recognized (i.e., admitted). An investment may become worthless, in which case its value is zero, but this is not the same as having a non-admitted asset. Similarly, the concept of "unlisted" assets does not apply to separate accounts.

The revised blank also eliminates the distinction between ledger and non-ledger assets. The Separate Account is an investment fund, and book values must be maintained for all assets. The meaningful distinction is between book and statement values. Furthermore, the relationship between the General and Separate Accounts is better disclosed by a reporting of the cash transfers to and from the Separate Account and a reconciliation with the statement values. Thus, the reconciliation of ledger assets is dropped in favor of a reconciliation of cash and invested assets. This new Exhibit 8 is basically a statement of sources and applications of funds, in a single column format. The emphasis on book vs. statement (usually market) values is also reflected in the revised exhibit of capital gains and losses.

3. Other Changes

Separate Account liabilities generally depend on the investment performance of the separate account. Accordingly, the Analysis of Increase in Reserves has been modified by substituting for tabular interest the increase or decrease from investment results. New instructions are provided for completing this page.

Transfer transactions affect both the Blue and Green blanks but to avoid duplicate reporting, and also to avoid complicating the Blue blank, the details of the transfers are shown only in the Green blank. Aggregate transfer items are netted and shown in inserts on the liabilities page, in the summary of operations and in the reconciliation of cash and invested assets. These same net totals would be included as single line entries on Page 3, Page 4 and Exhibit 12 of the Blue blank respectively.

Certain items due from the general account may appear as negative liabilities, rather than assets, in the separate account balance sheet. Since Separate Account assets are included on page 2 of the Blue blank, this treatment avoids artificially inflating the total company assets.

III. SUMMARY OF CHANGES TO THE GREEN BLANK

The new Separate Account statement blank reports only the operations of the Separate Accounts themselves. It assumes that the administration of the contracts is reflected in the Blue blank - hence, administrative expense does not appear in the new Green blank, considerations are net of loading and the expenses and taxes are those associated with Separate Account investment operations. (Any expenses and taxes charged against loading are reported in the Blue blank.) The new Green blank does not carry over from the old Green blank the Gross Premium Exhibit, the Dividends to Policyholders Exhibit, the Accident and Health Reserve Exhibit, the Claims Exhibit, and the Reconciliation of Ledger Assets. Exhibits relating to Non-Admitted Assets are not appropriate to a Separate Account operation.

There is no provision for any reinsurance entries - these are activities of the General Account. Also omitted are the Policy Exhibit and the Annuity Exhibit. Annuity Exhibit items relating to the Separate Account are to be included in the Annuity Exhibit in the Blue blank.

The only schedules carried over into the new Green blank are the investment Schedules A, B, D and E, with BA and DA added. Companies which maintain Canadian Separate Accounts will find a need for the Special Deposit Schedule.

In a number of places the new blank allows for the reporting of items peculiar to book value separate accounts. These are special separate accounts which involve not only the gains and losses and varying investment income of the Separate Account but also guarantees against loss of principal and of minimum investment income returns.

Receipts other than income from investments are handled as a transfer from the General Account. Similarly, amounts providing for the payment of annuity benefits, including surrender benefits and various other payments, appear as transfers from the Separate Account to the General Account. When eventually paid, these items are reported in the Blue blank. The assets and liabilities are strictly those which arise from the operations of the Separate Accounts themselves, i.e., contract reserves and items related to the making of investments, including investment expenses and taxes due or accrued. Unpaid charges for investment management, administrative expense and contract guarantees would also appear on the liability page.

IV. SEPARATE ACCOUNT ITEMS REPORTED IN THE BLUE BLANK

Considerations received with respect to Separate Account business would be reported in the Blue blank in various places: to wit, Exhibit 1, Exhibit 12, and the Summary of Operations. Amounts paid in by contractholders, but not booked as considerations received, would be reported as "annuity and other deposit funds" and would appear in Exhibit 12 but not in the Summary of Operations. The administrative expenses for the Separate Account business would appear in Blue blank Exhibit 5. Their offsets would be found in the loading and in the transfers from the Separate Account of contractual charges for expenses and expense guarantees or as otherwise specifically provided for in the pricing structure. Some or all investment expenses could also appear in Exhibit 5 of the Blue blank and would be offset by the contractual charges for investment management.

Adjustments to Separate Account funds to make up for mortality losses, or to withdraw mortality gains, would be reported as transfers in the Blue blank. Benefit amounts withdrawn from the Separate Account but not yet paid would appear in the Blue blank as liabilities. Incurred but not yet made transfers to or from the Separate Account would appear as positive or negative net amounts on the liability page of the Blue blank. In addition, the Blue blank contains entry lines for the total assets reported in the Green blank and for the total liabilities in the Green blank. Further, any surplus reported in the Green blank will be included in the company's total surplus funds.

For a consideration to be reported in the Separate Account Statement it must have been received by the General Account and the net portion transferred to the particular Separate Account. A consideration received by the General Account but not transferred to a particular separate account would be reported as a suspense account liability in the Blue blank.

Appendix IV shows changes to the 1978 Blue blank to accomodate the revised Separate Account blank.

V. DETAILED DESCRIPTION OF THE NEW GREEN BLANK (See Appendix II for examples of completed pages 2-4 and Exhibits 1-8 and blank samples of pages 5 and 6.

corresponding item in the Blue blank and comes from column 3, Line 10, of Exhibit 2. This amount is net of interest deemed uncollectable.

If the amount receivable on investments sold exceeds the amount payable on investments purchased, the net amount is entered in Item 10 on page 2, otherwise on Page 3, Item 14. Total assets, Item 14, is entered also in the 1978 Blue blank at Page 2, Item 27A.

2. The Liabilities and Surplus Page.

As noted earlier, the liabilities shown here are strictly those of the Separate Account. Supporting exhibits will be noted for each of the appropriate liability items.

Item 1 on Page 3 is the aggregate reserve for contracts with life contingencies. Exhibit 6 provides the detail for this liability. This item would include supplementary contracts with life contingencies. Exhibit 7 provides the detail for the next item, supplementary contracts without life contingencies. Exhibit 6, Exhibit 6A, and Exhibit 7 are straightforward and show the amounts of reserve liabilities at year-end, reflecting investment results after deductions for any contractual investment management and administrative expense charges, mortality and expense guaranty charges, incurred federal income taxes and provision for future federal income taxes (to be discussed below).

Item 3 is the liability for annuity and other deposit funds. The instructions specify "Include the liability for any deposit which is not properly includable in Exhibit 6 or Exhibit 7." Suppose an insurance company receives a large payment from a retirement fund or a group contractholder which is not earmarked for the immediate purchase of annuities, but rather is to be held in the Separate Account as part of a fund accumulated for employee benefits. If this payment is reported as a deposit fund amount and carried as an Item 3 liability, then it would not appear in the Summary of Operations as an item of consideration; it would appear only in the Reconciliation, Exhibit 8, Line 1.2. Payouts from such funds will be netted out in Line 1.2 of Exhibit 8 and will not appear in the Summary of Operations. However, investment earnings on these funds are included in the investment income in Exhibits 1, 2 and 3 and in the Summary of Operations. Increases in these funds from investment income also appear in the Summary of Operations (Item 11).

In the operation of Separate Accounts, charges, usually in the form of percentages of assets, are made for investment management and administration expenses and for contract guarantees. Frequently these are deducted and transferred to the General Account on a daily basis, but Item 6 has been included for any amounts which may have been deducted but not yet transferred to the General Account.

Investment expenses due or accrued appear in Item 7 and are detailed in Exhibit 4. Investment taxes due or accrued appear in Item 8 and Exhibit 5; federal income taxes due or accrued are reported in Item 9.

1. The Asset Page.

In this discussion of the Asset Page items of the new Separate Account blank, reference will be made to the associated Schedules. The first asset item (Item 1.1) is long-term bonds, detailed in Schedule D. This is a change from the old blank in that the new Schedule D shows only long-term bonds, i.e., bonds whose maturities at time of acquisition were over one year. Short-term bonds, those maturing in one year or less, appear in new Schedule DA, and their total is reported as Item 1.2 on the Asset Page. Normally, amortized values are used in lieu of market values on short-term bonds.

The Green blank Schedule D is almost the same as that in the Blue blank but Part 6, relating to subsidiary, controlled or affiliated companies, has been deleted. There are a few other minor changes. Accrual of discount and amortization of premium are interest income items and enter into Exhibit 2. These items also enter into the calculation of realized and unrealized capital gains and losses as adjustments to the original cost of securities to obtain the adjusted cost at the time of sale. Note also that the statement value in Schedule D is normally the market value. In the normal case, the book value of a bond shown in Schedule D would be adjusted for accrual of discount or amortization of premium. It is not expected that the book value of a security in the Separate Account Statement would be written up or down to reflect its current market value. Schedule D will still include the section on long-term bonds purchased and disposed of within the year. Repurchase agreement securities should be listed in Schedule DA if the period of the agreement does not exceed one year.

Preferred and common stocks are entered at Items 2.1 and 2.2 respectively on the Asset Page. The listings of preferred and common stocks as shown in the new Separate Account Schedule D are essentially unchanged from the old Green blank.

Item 3, mortgage loans on real estate, comes from Schedule B.

Item 4, real estate, is listed in Schedule A. Real estate assets of a Separate Account would ordinarily be investment real estate. An entry for company - occupied property would not be expected in a Separate Account and none is provided for. While a Separate Account would very quickly dispose of any properties acquired in satisfaction of debt there is always the possibility that a foreclosure may occur too late in the year to permit disposal and provision is made for any such item.

Item 8 and Schedule BA have been provided for any investment in other assets such as real estate partnerships. Because of the possible varied nature of investments listed in Schedule BA, provision has been made for depreciation, accrual of discount, and amortization of premium to be used where appropriate.

Item 9, investment income due and accrued, is identical to the

Item 10, reserve for future income taxes, warrants special discussion. In the usual situation, where contract values depend on the market values of Separate Account assets, recognition of potential capital gains taxes is essential. Equity requires that provision for capital gains taxes be assessed against contracts in force when the market value increases, rather than the contracts in force when the appreciated assets are sold. This is done by establishing as a reserve liability of the Separate Account an amount equal to the tax that would be incurred if the assets were disposed of at their statement (market) values, and excluding this amount in determining the contract reserves and benefits. Changes in this reserve also enter into the Analysis of Increase in Reserves.

Item 18 shows total liabilities. The inside item on this line, due or accrued net transfers to or from the General Account, can be positive or negative. If the inside figure is positive, the Separate Account owes transfer funds to the General Account. The total liabilities figure in Item 18 is also entered in Item 25A, From Separate Accounts Statement, of Page 3 of the Blue blank.

If the Separate Account owes funds to the General Account, then the amount owed will have been included in the total liability Item 25A, on Page 3 of the Blue blank. However, the amount owed by the Separate Account would also appear as a negative liability in Item 14A on Page 3 of the Blue blank. This will offset the amount of liability for the transfer included in Item 25A on Page 3 of the Blue blank. This treatment avoids inflating both assets and liabilities in the Blue blank.

3. Exhibits 1 through 5.

Since Exhibit 1 depends on Exhibits 2 through 5, we will begin with Exhibit 2. The columns in Exhibit 2 adjust investment income to an incurred basis as does the present Exhibit 3. Unlike the present Exhibit 3, however, it does not provide a non-admitted column for doubtful interest due. Rather, the new Exhibit 2 provides that interest deemed uncollectable is to be excluded from the items in column 3, with the footnote showing such interest in total only. The figures in Exhibit 2, column 1, include accrual of discount less amortization of premium, with details provided in the footnotes. Accrued interest on a purchase may, as a practical matter, be booked as a negative amount of interest received during the year; it will wash out when the first interest payment is received.

Exhibit 3 develops total net realized and unrealized asset gains and losses. There is no provision for increases or decreases in book value, as provided for in the present Exhibit 4. All gains and losses are "to be calculated on the basis of original cost adjusted, as appropriate, for accrual of discount or amortization of premium and for depreciation", as noted in the instructions.

For assets held at the end of the year column 3 of Exhibit 3 shows the change during the year in net unrealized gains and losses.* For assets which have been disposed of during the year, column 3 includes, as a negative item, the total unrealized gain (or loss) from the date of acquisition to the beginning of the year. Adding columns 3 and 4, the total unrealized gain or loss on these assets is netted with the total realized gain or loss on these same assets to produce, in column 5, the net change during the year. This is also the reason for the wording of the headings in Exhibit 3, which mean just what they say and no more. The operation of the Exhibit becomes obvious upon close examination of the arithmetic.

Exhibit 4 is labeled "Investment Expenses". While it provides for the various items which appear in Exhibit 5 of the old Green blank, it seems unlikely that many of these items would contain entries. Entries under "Real estate expenses" and "Investment expenses not included elsewhere" would be expected, because these would be regarded as direct expenses chargeable to the investment operations of the Separate Account.

Investment expenses or taxes incurred by the Separate Accounts may be paid directly from the Separate Accounts, e.g., real estate expenses and taxes, or may be paid through the General Account and reimbursed from the Separate Account. Liability items for unpaid expenses and taxes may be owing to the General Account or directly to some outside agency or jurisdiction.

A certain degree of flexibility has been designed into Exhibits 4 and 5 and into the new Green blank generally, in order to permit companies to reflect properly the way they operate. If a company were to show its Separate Account expenses as incurred by the General Account, these could be included in the appropriate lines of Exhibit 5 of the Blue blank with a negative entry (Line 9.2, Investment expenses not included elsewhere) equal to a corresponding positive entry in Exhibit 4 of the Green blank. The total expenses of the company should equal the total of Blue blank Exhibit 5 and Green blank Exhibit 4. There is, in addition, provision for the transfer of charges for investment management from the Green blank to the Blue blank.

To illustrate the flexibility of Exhibit 4, suppose a company allocates part of the expenses of its common stock investment department to Separate Accounts. It could then report these expenses on a line-by-line basis in Green blank Exhibit 4 or in a lump sum under investment expenses not included elsewhere. Note that it is possible for Exhibit 4 to be entirely blank, where no expenses are paid directly by the Separate Accounts and all expenses paid through the General Account are meant to be covered by the investment management charge against the Separate Account assets.

Exhibit 5 provides for entry of the various taxes which appear in the corresponding exhibits of the Blue blank and the old Green blank. Ordinarily, one would expect entries only under real estate taxes and, perhaps, under all other taxes.

* For assets acquired during the year, the change is since acquisition; for assets held at the beginning of the year, the change is since the preceding year-end.

Exhibit 1 is unchanged from the present Green blank Exhibit 2 (except for sources) and is a straightforward accounting for investment income and capital gains and losses less (i) investment expenses, (ii) investment taxes, and (iii) depreciation on real estate and other invested assets.

4. Summary of Operations; Surplus Account

The Summary of Operations (Page 4) is intended to trace the operations of the Separate Accounts during the year on an accrual basis. The Surplus Account is intended to trace the development of surplus from the preceding year-end to the current year-end.

A majority of separate accounts are operated on a zero-surplus basis. Investment results flow through to the contractholder and charges for expenses and guarantees are deducted as contractual amounts and transferred to the General Account. Similarly, mortality gains and losses are usually offset by transfers to or from the General Account. Seed money provided by the company for a newly established Separate Account is a likely source of surplus. If a company prefers to have mortality gains accumulate in the Separate Account, the amount of this accumulation would be deemed surplus.

The income and outgo items in the Summary of Operations refer only to transactions involving the funds invested in the various Separate Accounts. As noted earlier, these items are not concerned with loading, commissions, taxes on considerations, and the actual expenses of the administration of Separate Accounts which would include items such as collection expense, underwriting and the making of payments. Taxes incurred on investment income and capital gains are charged to the Separate Accounts.

Under Item 1 lines are provided for the amounts of considerations for annuities, for supplementary contracts with life contingencies and for supplementary contracts without life contingencies. The annuity considerations are net of loading and all items are considered to be transfers from the General Account. Companies which have followed the practice of bringing considerations directly into the Separate Account without showing them in the Blue blank will be faced with a change in procedure. As noted earlier the Summary of Operations income items do not include "annuity or other deposits" - funds which are not treated as considerations.

Item 2 is the net investment income and capital gains and losses from Exhibit 1, line 9.

Item 5 provides for transfers from the Separate Account on account of contract benefits. These are shown separately for annuities, for supplementary contracts with life contingencies and for supplementary contracts without life contingencies. The instructions require that Annuity benefits, Item 5.1, include any amounts transferred because of surrenders, partial surrenders and death benefits. (The amount transferred to the Blue blank on account of a benefit payment may not be the same as the actual payment reported in the Blue blank. For example, if death occurs in the early years of a typical individual variable annuity contract, the amount transferred will be the contract fund, but the death benefit payable may be greater if the sum of considerations paid exceeds the amount of the contract fund.)

Item 6 provides for the net transfer of reserves from or to Separate Accounts. The instructions state that this item "excludes transfers related to the payment of benefits." This item is intended to provide for the transfer of reserves under certain separate or combination fixed and variable contracts between fixed and variable funds as requested by the contractholder. Its purpose is to prevent such transfers from inflating the amounts of consideration in the General Account and in the Separate Account. In the 1978 Blue blank these transfers will be included in Item 24A, pages 4 and 5 and in Item 13A, Page 6.

Item 7 provides for other transfers from the Separate Accounts with Item 7.1 providing for charges for investment management, administration and contract guarantees. These items are usually in the form of deductions of percentages of assets. Gains or losses from the difference, if any, between the charges transferred and the actual costs incurred by the General Account will, therefore, be reflected in the Blue blank. Item 7.2 provides for federal income taxes incurred. The taxes arising from the operations of the Separate Account are properly charged directly to the Separate Account, but are transferred to the General Account because a life insurance company is taxed as a whole, and the Separate Account is not a separate taxpayer.

Items 9 and 10 reflect the amounts of investment income and capital gains credited to contracts with life contingencies and supplementary contracts without life contingencies respectively. The items on these lines would, of course, be net of mortality gains and losses. Item 11 provides for reporting the portion of the investment income and capital gains and losses included in Item 2 which is credited on Annuity and other deposit funds; as previously noted, these deposits are treated as liabilities of the Separate Account and have not entered the Separate Account as considerations.

Item 12, increase in reserve for future federal income taxes, accounts for the part of net capital gains and losses which is set aside for possible future income taxes, as discussed earlier. Note that if there is a decrease in taxable unrealized capital gains during the year, this item will be negative.

Item 16 shows the net gain from operations. This line will frequently be zero, since all investment income, capital gains and losses have been accounted for. Nevertheless, there may be instances where this line will not be zero, such as where seed money is maintained in the account by a company or where a company wishes to have the charges for mortality and/or expense guarantees accumulate in the Separate Account. If adjustments for mortality gains and losses have not been made by year-end, there would be a gain or loss from operations from this source.

Mortality gains and losses can be handled in either of two ways.

(1) If the Separate Accounts are being reported on a zero gain from operations basis, then any net gain from mortality should be transferred to the General Account, or, if a loss, a transfer of an offset amount should be made from the General Account. In either case, one of the blank lines in Item 7, appropriately captioned, may be used. An offset to a mortality loss would, of course, be a negative entry.

(2) If mortality gains or losses are to be permitted to flow through to the gain from operations and the Surplus Account is to be kept at zero then a counterbalancing entry must appear in the Surplus Account on page 4. Since surplus in a Separate Account cannot be permitted to be negative, a counterbalancing contribution to surplus from the General Account must be made.

Items 17 through 23 trace the changes in the Surplus Account from the beginning of the year to the end of the year.

5. Analysis of Increase in Reserves

Page 6, the Analysis of Increase in Reserves, has been changed from the current format so as to be more meaningful in showing the operations of the Separate Account.

To the reserves at the end of the preceding year (Item 1) add tabular net considerations (Items 2 and 3).

Item 4, Increase or decrease from investment results after provision for federal income taxes, corresponds to tabular interest in the Blue blank. Moreover, the instructions provide for the use of formulas to approximate the amounts in this item in a manner similar to that of the Blue blank. The formulas would be used where the required amounts are not available from other sources. This item relates to reserves - not assets - and, hence, will not necessarily equal the amount entered in Item 2 on Page 4. It should be kept in mind that this item is, in effect, <u>after</u> deducting Exhibit 4 expenses and Exhibit 5 taxes but <u>before</u> deducting contractual charges; these are reflected in Item 12. Note carefully that the federal income taxes deducted are not only those incurred in the year, but also the year's increase or decrease in the provision for future capital gains taxes arising from unrealized capital gains. (The subject of future income taxes was discussed earlier.)

Item 5, tabular less actual reserve released, is unchanged in concept from the Blue blank and can be derived by the formula given in the Instructions. In any case, it should be a balancing item.

Item 6 provides for changes in valuation bases.

The instruction for Item 9, Net transfers of reserves from (+) or to (-) Separate Accounts, states "exclude transfers related to the payment of contract benefits." As mentioned earlier, combined fixed and variable contracts and some separate fixed and companion variable contracts provide that the contractholder can, under more or less limited conditions, transfer amounts from the variable fund to the fixed fund or vice versa. The purpose of this line is to provide for such transfers.

Item 10, reserves released by terminations (net), has an instruction which says that the computation should be on a net basis so as to take account of revivals, increases, changes, etc. This line is essentially the same as that in the present blank.

Item 11 provides for transfers for annuity and supplementary contract benefit payments.

Item 12, charges for investment management, administration and contract guarantees, is intended solely for contractual charges. The Instructions state that the item should exclude "amounts deducted in determining net investment income and charges for taxes attributable to investment gains and income." These amounts would have been deducted in the calculation which provides the increase or decrease from investment results after provision for federal income taxes, which is entered in Item 4 of the Analysis. The Analysis of Increase in Reserves does not include analysis of the progress of annuity and other deposit funds, since these funds are not reserves.

6. Exhibit 8 - Reconciliation of Cash and Invested Assets

Exhibit 8, Reconciliation of Cash and Invested Assets, corresponds in concept to Exhibit 12 of the Blue blank. Exhibit 12 analyzes increases and decreases in ledger assets; it deals with book values. The Separate Account Statement, however, is, by and large, concerned with market values. It was necessary to find a way of checking the items listed on the Green blank Asset Page. One way to do this is to account for ins and outs and develop an increase in cash which can then be used in a reconciliation between years for cash and invested assets, the subtotal appearing in Item 8A of Page 2, Assets. This item does not include accruals of investment income, receivables for investments sold and similar adjusting items. It will be helpful to go through Exhibit 8 line by line.

Line 1 provides for the amounts of transfers to the Separate Account for net considerations (Line 1.1) and for annuity and other deposit funds (Line 1.2). Note that this includes the amounts of funds received as annuity and other deposits (net of withdrawals), funds which were earlier called an increase in liabilities and which do not enter the Summary of Operations as considerations. Since there are no considerations due and deferred or paid in advance reflected in the items in Line 1, this is strictly a cash item.

Line 2 is also a cash item. It shows only investment income collected without adjustments for accruals or paid in advance, without any accrual of discount or amortization of premium and without any deduction for depreciation. This item comes from Exhibit 2, column 1, adjusted to exclude the footnoted accrual of discount less amortization of premium.

Line 4 shows considerations received on disposal of short-term bonds net of purchases. The purpose of providing for a net entry is to avoid showing inflated figures for acquisitions and disposals, since short-term bonds are turned over rapidly during the year.

Lines 5 and 6 show, respectively, the amounts received on disposal of investments and the cost of new investments, in both cases excluding short-term bonds reported in Line 4.

Line 7 provides for transfers from the Separate Account to the General Account for various purposes. Included here are transfers for federal income and capital gains taxes. As noted earlier, these taxes would be paid through the General Account, since the Separate Account is not a separate taxpayer.

Line 8 is for investment expenses, such as real estate expenses and mortgage correspondent fees, paid directly by the Separate Account.

Line 9 provides for taxes (other than income taxes) arising directly from investments and paid directly by the Separate Account, e.g., taxes on investment real estate.

Line 12 provides for entry of seed money contributed to Separate Accounts net of withdrawals. If the total amount of seed money contributed during the year to all Separate Accounts exceeds the total amount withdrawn, enter the net figure with a plus (+) sign; otherwise, with a minus (-) sign.

Note that Line 14 provides for entry of an inside figure, net transfers from general account. This should agree with Item 32A of Exhibit 12 of the 1978 Blue blank.

Line 15 adjusts for investments acquired but not yet paid for or investments sold but for which payment has not yet been received at year-end. These items would have been reported in Lines 4,5 and 6 but would not have been reflected in the cash account. Note that only the net increase (or decrease) is reported in Line 14. Line 17 yields the increase in cash during the year.

The second part of Exhibit 8, Reconciliation Between Years, reconciles the total cash and invested assets from one year end to the next. Line 18 shows the cash and invested assets as of December 31st of the previous year which is reported in Item 8A of column 2 on Page 2 of the new Green statement. To this is added the increase in cash, Line 19, and the cost of invested assets acquired, Line 20; the adjusted cost of assets disposed of, Line 21, is subtracted. Line 22, accrual of discount less amortization of premium, is added, and Line 23, depreciation, is subtracted. Adding Line 24, the increase in net unrealized gains, yields cash and invested assets as of December 31st of the current year, Line 27, which should agree with Item 8A of column 1 on Page 2.

VI TRANSITION ARRANGEMENTS FOR 1978 - GREEN BLANK

Because the Separate Account Statement for 1978 is so different from the present Green blank, it could present problems for companies which have not completed their Separate Account statements on a fund basis, but rather have stressed the Separate Account business aspect. Such companies might have included in their 1977 Separate Account Statements items such as commissions, issue expenses, administrative expenses generally, contributions to contingency funds or any of a number of other items which would not find a place in the new Green blank. Consequently, the year for which the new blank would first be required was set as the year following the date of adoption to permit companies to study the new blank, to decide what changes would have to be made, and, most importantly, to make required changes in their record-keeping and accounting trails. The Subcommittee on Annual Statement Reporting of Separate Accounts felt, however, that companies could still be faced with problems traceable to the fact that the new Separate Account blank, like the current version, asks for certain data for both the current year and the preceding year. If a company had to use the new format for 1977 figures as well as for 1978, part of the advantage of postponing the effective date for a year would be lost. Because of that, the NAIC accepted the Subcommittee's suggestions for transitional arrangements for 1978 which would ease the problem for companies faced with a change in their reporting basis. The subcommittee's suggestions, as adopted, appear in Appendix III.

Most importantly, for the 1978 Statement only, the Summary of Operations is to be omitted for the previous year, i.e., for 1977. The asset and liability items for the previous year will be required, however, and a certain amount of restatement of 1977 figures may be necessary. At the same time, however, it was recognized that the existence of two sets of figures for total assets and total liabilities as of the end of 1977 would be confusing. For this reason the total assets for the previous year, the total liabilities, and the amount of surplus should agree with the corresponding totals in the 1977 Separate Account Annual Statement. On a line-by-line basis, however, companies are asked to restate their previous year (1977) assets and liabilities to the extent necessary to meet the requirements of the new format. Since it is expected that the restated assets and liabilities will not add to the established totals of assets and liabilities, the companies are authorized to enter additional asset and liability items as necessary to reconcile to the 1977 totals, writing in additional lines as required with appropriate captions. Adopting this approach means also that the Separate Account items entered in the 1977 column of the Blue blank will not have to be changed.

Since some companies will find it necessary to write in additional asset and liability items on pages 2 and 3, some way had to be provided to dispose of those items in the Summary of Operations for 1978 so that they will not appear on the asset and liability pages in the 1978 column. Accordingly, such companies are authorized to write additional lines in the Summary of Operations and/or the Surplus Account to record the disposition of any of the special items which appear in the 1977 column and will not appear in the 1978 column. Appropriate captions should be supplied.

There is another, minor problem that occurs in 1978. Short-term bonds are reported in Schedule DA and the investment income and capital gains exhibits also distinguish short-term bonds. As of the end of 1977, however, companies are not required to separate their short-term securities. To avoid extra work with respect to short-term securities owned as of December 31, 1977 and disposed of during 1978, provision has been made to include them with long-term bonds and to identify the actions with appropriate footnotes.

VII TRANSITION ARRANGEMENTS FOR 1978 - BLUE BLANK

Because of the change in reporting of assets and liabilities and because the Separate Account Summary of Operations may very well be of a different character in 1978 as opposed to 1977, some of the 1978 entries in the Blue blank as respects the Separate Account business may not be strictly comparable with the corresponding entries for 1977. If a company feels that the noncomparability is material, the company is authorized to insert a footnote stating that certain items in column 1 on Page 4 of the 1978 Blue blank are not entirely consistent with corresponding items in column 2, properly laying the blame on required changes in the annual statement reporting of the company's Separate Account business. Note the use of the term, "Separate Account business", because in this case reference is made to the change in accounting for the Separate Account business and not of the Separate Accounts, since some of the Separate Account <u>business</u> transactions which had been reported in the Green blank for 1977 should be reported in the Blue blank for 1978.

APPENDIX I

Short History of the Investigations and Deliberations of the ACLI Subcommittee on Annual Statement Reporting of Separate Accounts.

Editors Note: The material in this appendix was presented orally at the Teaching Session. It is not essential to the description of the changes in the Separate Account blank, but is presented here for readers who wish to have a fuller understanding of the reasoning which led to the adoption of the final form of the 1978 Separate Account blank.

After completing its work on the Variable Life Insurance (VLI) blank, the Subcommittee on Annual Statement Reporting of Separate Accounts considered five different possible approaches to revising the statutory reporting with respect to Separate Accounts. It was able to eliminate two of these fairly quickly, while the other three required more careful analysis.

The subcommittee reviewed the 1972 ALC-LIAA draft consolidation of the Blue and Green blanks. The general approach of the 1972 proposal entailed reporting the entire business of the company in essentially the present Blue blank, while disclosing supplemental information on Separate Account assets and liabilities (but not operations or transactions) in a new Exhibit 15. Having now worked through the complicated relationships involved in variable life insurance, the subcommittee had no difficulty in recognizing the inadequacies of the earlier proposal. It was apparent that an effective consolidation would entail substantial modification of the Blue blank. The combination of both clarifying the separate account principles and consolidating the reporting forms seemed to be too much to handle at one time. Nor did the subcommittee find the 1972 proposal helpful in determining the approach to be used for a suitable non-consolidated Green blank.

The subcommittee also considered a suggestion that a distinction might be made, for financial reporting purposes, between variable annuities and unallocated Separate Account funding contracts. The thought was that the characteristics of variable annuities were more similar to those of variable life insurance than of the unallocated contracts. Accordingly, it might be simpler, and produce more meaningful results, if the VLI blank were modified to include variable annuities, while a revised Green blank would cover the various types of unallocated contracts. It was noted, however, that many group contracts entail both unallocated funds and variable annuities for individual particupants, and that deferred variable annuities have many similarities to unallocated funding contracts. The subcommittee felt it unnecessary to pursue this suggestion.

The subcommittee then identified three basic approaches which might be followed:

(a) A "fund" approach, which recognizes that a Separate Account is a pool of segregated assets set aside to measure and fund certain contractual obligations of the insurance company, where the amounts of the obligations are related to the investment performance of the account. The segregated assets must at least equal the associated statutory reserves, and to that extent the assets are not subject to other obligations of the company. The primary objective of a "fund" approach would be to provide financial information concerning the segregated asset accounts themselves.

(b) A "line of business" approach, which recognizes that the segregation of assets and liabilities changes the nature of the risk assumed by the insurance company in connection with contracts involving Separate Accounts. The primary objective of a "line of business" approach would be to provide financial information concerning the impact on the insurance company of operations involving Separate Account contracts.

(c) A "clean-up" approach which would have as its primary objective maintaining the flexibility of the present Green blank while eliminating or modifying the inappropriate material. This approach would recognize that various types of contracts involving Separate Accounts, with significantly different characteristics, are currently being issued, and additional types are still being developed. Although the present Separate Account blank includes many inappropriate items (exhibits, schedules, columns and lines), it permits substantial flexibility for a company to provide financial information on a basis which it feels to be suitable for its products and operations.

The present Green blank is in most respects a duplicate of the Blue blank and includes numerous exhibits, schedules, columns and lines which have no connection to Separate Accounts. During the fall of 1975, the subcommittee reviewed the existing form to determine the items which were clearly inapplicable and should be eliminated. As a control, the Green blanks filed by 65 companies for the year 1974 were checked to confirm that these items were not useful. The inapplicable items fell into several distinct categories:

Lines of Business: Separate Accounts are inherently not involved in individual, group or credit accident and health insurance or in industrial or credit life insurance. Separate Accounts would be involved in individual (ordinary) and group variable life insurance, but the new VLI blank covered these activities. Removal of material relating to the inapplicable lines of business would result in elimination of Exhibit 9, the Exhibit of Life Insurance, Schedule H, Schedule O, sections A, D, E and F of Exhibit 8, and columns from pages 5 and 6 and from Exhibits 1, 5, 6, 7, 8 and 11. A number of lines would also be deleted or reworded.

Reinsurance: Since Separate Accounts are pools of segregated assets, neither the assets nor the associated liabilities can be reinsured. Removal of material relating to reinsurance would result in elimination of Schedule S, considerable simplification of Exhibit 1, and deletion of a number of other lines.

Types of Assets: Various types of assets which are shown in the Life and Accident and Health Statement are,by their nature, either not possible or not legal for Separate Accounts. The items identified as being in this category were: non-admitted assets other than investment adjustments, premium notes, collateral loans, deferred and uncollected premiums, advance premiums, cash on hand, properties occupied by the company, and investments in affiliates. Removal of material relating to these inapplicable classes of assets would result in elimination of Exhibit 14, Schedule of All Other Deposits and Schedule C, and in deletion or rewording of various other lines.

Miscellaneous: Separate Accounts do not have capital or stockholders, nor do they involve the mandatory securities valuation reserve. There can be no deferred dividend separate account contracts. Any surrender values on cancelled contracts would not be held in the Separate Account.

It was clear that merely making these changes would result in a considerable simplification and clarification of the Green blank. A mock-up of pages 2 through 14 and Schedule T reflecting all of the changes to these pages was prepared and studied by the subcommittee. The mock-up illustrated the extent to which the present blank could be clarified and simplified without raising any conceptual issues, and served as a useful reference in considering the possible need for changes in the underlying format.

The subcommittee then considered several more basic issues. Particular attention was given to the question of whether the book value based system for reporting on investment activities (as embodied in Exhibits 2, 3, 4, 12 and 13 and Schedules A, B and D) should be modified. Also reviewed were questions relating to what extent, and under what circumstances, premiums, dividends and expenses associated with Separate Account contracts should be reported in the Green blank.

As an important supplement to its consideration of reporting principles, the subcommittee reviewed the practices of various companies with respect to completing the present Green blank. It was observed that companies currently vary substantially in their treatment of almost all types of contracts in general use. A "fund" approach appeared to be used more heavily than a "line of business" approach, but often both approaches were followed in a single statement, depending on the type of contract or type of transaction. The subcommittee agreed that the present blank (even if "cleaned up") did not present meaningful information and could not be used for any analytic purposes, because of the wide variations in treatment of similar transactions.

It was felt that the diversity of reporting practices arose primarily because of the lack of an appropriate blank, and the necessity for companies to make independent attempts to use the form without adequate instructions. Since accommodations to the present blank had already been made, any approach other than "clean-up" would require changes in procedures for many companies. In addition to the costs of revising procedures, changes always raise the possibility that new problems will be created.

Nevertheless, the subcommittee concluded that the present degree of flexibility and ambiguity could not be continued, and that the "clean-up" approach must be rejected. In addition to theoretical considerations, there were important practical reasons for this conclusion.

The Subcommittee believed that the state regulators would insist on uniformity and comparability of reporting and were expecting the subcommittee to work toward this objective. The present diversity is accepted in large measure because of the blatant unsuitability of the blank. The developing "regulatory tests" program administered by the NAIC Central Office merely added further impetus to this natural direction. The present project would probably be the industry's best opportunity to assure that the inevitable changes would be appropriate and would cause minimal expense, disruption or undesirable side effects.

It also noted that the Internal Revenue Service was beginning to give more careful scrutiny to separate account activites. While changes in the blank could possibly accelerate IRS consideration of some potential issues, it was felt that the present diversity presented a substantially greater danger. Inconsistent treatment of similar transactions in different companies could severely hinder attempts to resolve problems on a uniform industry-wide basis, and could increase the likelihood of a sequence of determinations on narrow issues and individual cases which, in the aggregate, might cause major problems for the industry.

In addition, Illinois and Massachusetts had adopted regulations requiring certified public accountants to audit and express opinions on statutory basis financial statements. It seemed likely that this trend could continue. The accounting profession has an ongoing concern with the consistency and comparability of audited financial statements. While no immediate problems were anticipated, the present degree of diversity might become unsatisfactory, particularly with respect to different clients of the same accounting firm.

The subcommittee then considered the "line of business" approach. It concluded that this approach would not give consistent or meaningful answers and would create significant problems.

Separate Account business can not, in general, be operated independently of the General Account, and, thus, complete line of business reporting within the Green blank would not be feasible. While the Separate Account can retain the gain from favorable mortality and expense experience the General account must bear any losses from unfavorable experience (except to the limited extent that Separate Account surplus may have been contributed or retained from previous gains). Thus, for example, a negative asset share (or statutory loss) arising upon issue of a variable annuity will normally have to be borne by the General Account and be reflected in the Blue blank.

A more fundamental problem arises, however, in the case of contracts which directly involve both the General Account and a Separate Account. Some contracts may use Separate Accounts to fund nonvariable benefits.

Other contracts permit the owner to designate a portion of the premium to be applied to purchase variable benefits, to change the designation from time to time, or even to transfer existing benefits or reserves between fixed and variable funds. The resulting need to allocate expenses, taxes, etc., under a line of business approach would create substantial practical problems, while the results in many cases would not be meaningful.

Section 801(g)(3) of the Internal Revenue Code requires a separate accounting for "various income, exclusion, deduction, asset, reserve, and other liability items properly attributable to such segregated assets accounts." The subcommittee considered whether this might require the use of a line of business approach. It was pointed out, however, that a separate accounting on the company's books does not necessarily mean that these items must be reported in a separate statutory blank. Also, the law refers to segregated asset accounts rather than to segregated asset account business, and, thus appeared more likely to require, rather than prohibit, a fund approach. The subcommittee concluded that a line of business approach was not required, and could not be effectively implemented.

Finally, the subcommittee considered the fund approach. It would involve some changes in procedures for most companies (particularly in showing on a "flow-through" basis in the Blue blank transactions which presently are reported directly in the Green blank, but the modifications would not be massive and could be accepted. The approach did not appear to present any theoretical problems. The Metropolitan Life Insurance Company volunteered to attempt to put its Separate Account figures into the format of a preliminary "fund approach" draft prepared by the subcommittee in February of 1976. It was able to do so without substantial difficulty and the subcommittee found the results to be meaningful.

Accordingly, in April, 1976, the subcommittee unanimously adopted the following recommendation to its parent committee:

> "The ACLI Subcommittee on Annual Statement Reporting of Separate Accounts believes that a cosmetic modification of the present "green blank" is not sufficient, particularly from a regulatory point of view. Within the relatively near future the NAIC will want a meaningful separate account statement and a uniform system of reporting. The Subcommittee feels that the ACLI should proceed now to develop such a statement, rather than waiting for such a statement to be imposed on the industry in the future.
>
> "The Subcommittee recommends that the principal objective of a new statement should be to provide information concerning the financial condition and affairs of the separate accounts themselves, rather than of the separate account business of the company. This approach recognized fully that separate accounts consist of assets of the insurer set aside and separately invested to measure and fund certain contractual obligations of the insurer, and are not themselves entities

engaged in the business of insurance.

"The Subcommittee believes that such a 'fund' approach will meet the needs of the regulatory authorities and will be sufficiently flexible to accommodate current and foreseeable products involving separate accounts. The separate account is not responsible for insurance functions, such as collection of premiums, payment of commissions, and administrative and claims expenses, and such insurance items would be appropriately reflected in the Life and Accident and Health Statement. The separate account is an investment vehicle and a separate account blank utilizing a "fund" approach to report changes in assets and associated liabilities can adequately reflect the responsibilities of the separate account."

APPENDIX II

Examples of completed Pages 2-4 and Exhibits 1-8
and blank samples of Pages 5 & 6
of the
1978 Separate Account Annual Statement

Annual Statement for the Year 1978 of the Separate Accounts
of the ABC Life Insurance Company

ASSETS

		1 Current Year	2 Previous Year
1.	Bonds:		
	1.1 Long-term bonds (Schedule D)	1,540,000	1,000,000
	1.2 Short-term bonds (Schedule DA)	200,000	100,000
2.	Stocks (Schedule D):		
	2.1 Preferred stocks	1,006,000	1,000,000
	2.2 Common stocks	10,070,000	10,000,000
3.	Mortgage loans on real estate (Schedule B)	100,000	100,000
4.	Real estate (Schedule A):		
	4.1 Properties acquired in satisfaction of debt (less $ . . . 0. . .encumbrances)	0	0
	4.2 Investment real estate (less $ . . . 0. . .encumbrances)	95,000	100,000
5.			
6.			
7.	Cash on deposit (Schedule E)	61,800	50,000
8.	Other invested assets (Schedule BA)	0	0
8A.	Subtotals, cash & invested assets, (Items 1 to 8 inclusive)	13,072,800	12,350,000
9.	Investment income due and accrued	1,400	1,300
10.	Receivable for investments sold (net)	0	1,000
11.	Net adjustment in assets and liabilities due to foreign exchange rates	0	1,000
12.			
13.			
14.	Totals	13,074,200	12,353,300

State basis of valuation:
Market Value

Annual Statement for the Year 1978 of the Annuity Separate Accounts
of the ABC Life Insurance Company

LIABILITIES AND SURPLUS

	1 Current Year	2 Previous Year
1. Aggregate reserve for contracts with life contingencies (Exhibit 6)	975,535	800,000
2. Supplementary contracts without life contingencies (Exhibit 7)	115,100	100,000
3. Liability for annuity and other deposit funds	11,877,965	11,233,240
4.		
5.		
6. Charges for investment management, administration and contract guarantees due or accrued	600	60
7. Investment expenses due or accrued (Exhibit 4)	0	0
8. Investment taxes, licenses & fees due or accrued, excluding federal income taxes (Exhibit 5)	0	0
9. Federal income taxes due or accrued (excluding deferred taxes)	0	0
10. Reserve for future federal income taxes	0	0
11. Unearned investment income (Exhibit 2, Col. 2)	0	0
12. Other transfers to general account due or accrued (net)	0	0
13. Remittances and items not allocated	0	0
14. Payable for investments purchased (net)	0	0
15. Net adjustment in assets and liabilities due to foreign exchange rates	0	0
16.		
17.		
18. Total liabilities (including $ . . . 600 . . . due or accrued net transfers to (+) or from (–) the general account)	12,969,200	12,133,300
19. Special surplus funds:		
(a) Company participation in separate accounts	105,000	220,000
(b)		
(c)		
20. Unassigned surplus	0	0
21. Surplus (total items 19 and 20)	105,000	220,000
22. Totals	13,074,200	12,353,300

Annual Statement for the Year 1978 of the
of the ABC Life Insurance Company

SUMMARY OF OPERATIONS

	1 Current Year	2 Previous Year
1. Transfers from the general account:		
1.1 Net annuity considerations	125,000	
1.2 Considerations for supplementary contracts with life contingencies	10,000	
1.3 Considerations for supplementary contracts without life contingencies	10,000	
1.4		
1.5		
1.6 Totals (Items 1.1 to 1.5)	145,000	
2. Net investment income and capital gains and losses (Exhibit 1)	577,100	
3.		
4. Totals (Items 1.6 to 3)	722,100	
DEDUCT:		
5. Transfers from the separate account on account of contract benefits:		
5.1 Annuity benefits	1,000	
5.2 Payments on supplementary contracts with life contingencies	500	
5.3 Payments on supplementary contracts without life contingencies	200	
5.4		
6. Net transfer of reserves from (+) or to (–) separate accounts	–500	
7. Other transfers from the separate accounts:		
7.1 Charges for investment management, administration and contract guarantees	9,540	
7.2 Federal income taxes incurred	0	
7.3		
8. Subtotals (Items 5 to 7)	10,740	
9. Increase in aggregate reserve for contracts with life contingencies	175,535	
10. Increase in aggregate reserve for supplementary contracts without life contingencies	15,100	
11. Investment income and capital gains and losses credited on annuity and other deposit funds	505,725	
12. Increase in reserve for future federal income taxes	0	
13.		
14.		
15. Totals (Items 8 to 14)	707,100	
16. Net gain from operations (Item 4 minus Item 15)	15,000	

SURPLUS ACCOUNT

17. Surplus, December 31, previous year	220,000	
18. Net gain from operations (from Item 16)	+15,000	
19. Surplus contributed (+) or withdrawn (-) during year	–130,000	
20. Change in reserve on account of change in valuation basis, increase (-) or decrease (+)	0	
21.		
22.		
23. Surplus, December 31, current year (Item 21, page 3)	105,000	

Annual Statement for the Year 1978 of the Separate Accounts of the ____________________

ANALYSIS OF OPERATIONS BY LINES OF BUSINESS
(GAIN AND LOSS EXHIBIT)

	(1) Total	Ordinary (2) Individual Annuities	Ordinary (3) Supplementary Contracts	(4) Group Annuities
1. Transfers from the general account:				
1.1 Net annuity considerations				
1.2 Considerations for supplementary contracts with life contingencies				
1.3 Considerations for supplementary contracts without life contingencies				
1.4				
1.5				
1.6 Totals (Items 1.1 to 1.5)				
2. Net investment income and capital gains and losses (Exhibit 1)				
3.				
4. Totals (Items 1.6 to 3)				
DEDUCT:				
5. Transfers from the separate account on account of contract benefits:				
5.1 Annuity benefits				
5.2 Payments on supplementary contracts with life contingencies				
5.3 Payments on supplementary contracts without life contingencies				
5.4				
6. Net transfer of reserves from (+) or to (−) separate accounts				
7. Other transfers from the separate accounts:				
7.1 Charges for investment management, administration and contract guarantees				
7.2 Federal income taxes incurred				
7.3				
8. Subtotals (Items 5 to 7)				
9. Increase in aggregate reserve for contracts with life contingencies				
10. Increase in aggregate reserve for supplementary contracts without life contingencies				
11. Investment income and capital gains and losses credited on annuity and other deposit funds				
12. Increase in reserve for future federal income taxes				
13.				
14.				
15. Totals (Items 8 to 14)				
16. Net gain from operations (Item 4 minus Item 15)				

ANALYSIS OF INCREASE IN RESERVES DURING THE YEAR
(GAIN AND LOSS EXHIBIT)

	(1) Total	Ordinary (2) Individual Annuities	Ordinary (3) Supplementary Contracts	(4) Group Annuities
1. Reserve Dec. 31 of previous year				
2. Tabular net considerations for annuities and supplementary contracts with life contingencies				
3. Considerations for supplementary contracts without life contingencies				
4. Increase (+) or decrease (−) from investment results after provision for federal income taxes				
5. Tabular less actual reserve released				
6. Increase in reserve on account of change in valuation basis				
7. Other increases (net)				
8. Totals (Items 1 to 7)				
9. Net transfers of reserves from (+) or to (−) separate accounts				
10. Reserves released by terminations (net)				
11. Transfers on account of annuity and supplementary contract payments				
12. Charges for investment management, administration and contract guarantees				
13.				
14. Total deductions (Items 9 to 13)				
15. Reserve Dec. 31 of current year				

Annual Statement for the Year 19 78 of the Separate Accounts
of the ABC Life Insurance Company

EXHIBIT 1 – NET INVESTMENT INCOME AND CAPITAL GAINS AND LOSSES

1.	Gross investment income (Exhibit 2, Col. 5, Line 10)	587,100
2.	Capital gains and losses (Exhibit 3, Col. 5, Line 10)	15,000
3.	Total investment income and capital gains and losses (Line 1 plus Line 2)	602,100
4.	Investment expenses (Exhibit 4, Line 9)	15,000
5.	Investment taxes, licenses and fees, excluding federal income taxes (Exhibit 5, Line 6)	5,000
6.	Depreciation on real estate & other invested assets	5,000
7.		
8.	Total (Lines 4 – 7)	25,000
9.	Net Investment Income and Capital Gains and Losses - Line 3 less Line 8 (to Item 2, Page 4)	577,100

EXHIBIT 2 – GROSS INVESTMENT INCOME

		Collected During Year (1)	CURRENT YEAR Unearned (2)	CURRENT YEAR Due & Accrued† (3)	Previous Year (3) - (2) (4)	Earned During Year (1) - (2) + (3) - (4) (5)
1.1	Long-term bonds	* 60,000	0	1,000	800	60,200
1.2	Short-term bonds	** 50,000	0	0	0	50,000
2.1	Preferred stocks	‡ 60,000	0	0	0	60,000
2.2	Common stocks	400,000	0	0	0	400,000
3.	Mortgage loans	*** 7,000	0	400	500	6,900
4.	Real estate	§ 10,000	0	0	0	10,000
5.	Cash on deposit	0	0	0	0	0
6.	Other invested assets (Schedule BA)	0	0	0	0	0
7.	Options‡	0	0	0	0	0
8.	. . . .					
9.	. . . .					
10.	Totals	587,000	0	1,400	1,300	587,100

* Includes $. . .0. . .accrual of discount less $. . .0. . .amortization of premium and less $. . .0. . .paid for accrued interest on purchases

‡ Excludes $. . .0. . .paid for accrued dividends on purchases.

** Includes $. . 50,000. . . . .accrual of discount less $. . .0. . .amortization of premium and less $. . .0. . .paid for accrued interest on purchases.

*** Includes $. . .0. . .accrual of discount less $. . .0. . .amortization of premium and less $. . .0. . .paid for accrued interest on purchases.

§ Excludes $. . .0. . .interest on encumbrances.

† Excludes $. . .0 . . .deemed uncollectable.

EXHIBIT 3 – CAPITAL GAINS AND LOSSES ON INVESTMENTS*

		Unrealized Capital Gains (or Losses)			Net Realized Capital Gains (+) or Losses (-) During Year	Net Gains (+) or Losses (-) (3) + (4)
		Beginning of Year (1)	End of Year (2)	Increase (+) or Decrease (-) (3)	(4)	(5)
1.1	Long-term bonds	20,000	60,000	+40,000	0	+40,000
1.2	Short-term bonds	0	0	0	0	0
2.1	Preferred stocks	2,000	8,000	+6,000	0	+6,000
2.2	Common stocks	–400,000	–500,000	–100,000	+70,000	–30,000
3.	Mortgage loans	0	0	0	0	0
4.	Real estate	0	0	0	0	0
5.	Cash on deposit	0	0	0	0	0
6.	Other invested assets (Schedule BA)	0	0	0	0	0
7.	Foreign exchange	1,000	0	–1,000	0	–1,000
8.	Options	0	0	0	0	0
9.	....					
10.	Totals	–377,000	–432,000	–55,000	+70,000	+15,000

*Adjustments due to amortization to be reported in Exhibit 2. Adjustments due to depreciation on real estate and other invested assets to be reported in Exhibit 1.

Annual Statement for the Year 1978 of the Separate Accounts
of the ABC Life Insurance Company

EXHIBIT 4 – INVESTMENT EXPENSES

		Amount
1.	Rent	
2.	Salaries and wages	
3.1	*Contributions for benefit plans for employees	
3.2	Payments to employees under non-funded benefit programs	
3.3	Other employee welfare	
3.4	. . . .	
4.1	Legal fees and expenses	
4.2	Fees of public accountants and consulting actuaries	
4.3	. . . .	
5.1	Traveling expenses	
5.2	Postage, express, telegraph and telephone	
5.3	Printing and stationery	
5.4	Cost or depreciation of furniture and equipment	
5.5	Rental of equipment	
5.6	. . . .	
6.1	Books and periodicals	
6.2	Bureau and association dues	
6.3	Insurance, except on real estate	
6.4	Miscellaneous losses	
6.5	Collection and bank service charges	
6.6	Sundry general expenses	
6.7	. . . .	
7.1	. . . .	
7.2	. . . .	
8.1	Real estate expenses	
8.2	Investment expenses not included elsewhere	15,000
8.3	. . . .	
9.	Investment Expenses Incurred (To Exhibit 1, Line 4)	15,000
	Reconciliation with Exhibit 8	
10.	Investment expenses unpaid December 31, previous year	0
11.	Investment expenses unpaid December 31, current year	0
12.	Investment expenses paid during year (9 + 10 - 11) (To Exhibit 8, Line 8)	15,000

*Includes $ on account of prior service

EXHIBIT 5 – INVESTMENT TAXES LICENSES AND FEES (EXCLUDING FEDERAL INCOME TAXES)

	Amount
1. Real estate taxes	5,000
2. State insurance department fees	
3. Other state taxes, including $__________ Social Security	
4. U.S. Social Security taxes	
5. All other taxes	______
6. Taxes, Licenses and Fees Incurred (To Exhibit 1, Line 5) Reconciliation with Exhibit 8	5,000
7. Taxes, licenses and fees unpaid December 31, previous year	0
8. Taxes, licenses and fees unpaid December 31, current year	0
9. Taxes, licenses and fees paid during year (6 + 7 - 8) (To Exhibit 8, Line 9)	5,000

NOTE: Canadian and other foreign taxes are included appropriately in Lines 1, 2, 3 and 5.

Annual Statement for the Year 1978 of the Separate Accounts
of the ABC Life Insurance Company

EXHIBIT 6 – AGGREGATE RESERVE FOR CONTRACTS WITH LIFE CONTINGENCIES

1 Valuation Standard (Indicate mortality basis, assumed investment rate or interest basis, and valuation method by years of issue and indicate whether immediate, deferred or both)	2 Total	3 Ordinary	4 Group
A. ANNUITIES (excluding supplementary contracts with life contingencies)			
1.			
2..			
3.			
4.			
5.			
6.			
7.			
8.			
9.			
10. Totals			
B. SUPPLEMENTARY CONTRACTS WITH LIFE CONTINGENCIES:			
1.			
2.			
3.			
4.			
5. Totals			
C. Miscellaneous Reserves			
1. For surrender values in excess of reserves otherwise required and carried in this schedule.			
2.			
3.			
4. Totals			
D. Grand Totals (to Item 1, Page 3)	975,535		

EXHIBIT 6A – CHANGES IN BASIS OF VALUATION DURING THE YEAR

(Including supplementary contracts set up on a basis other than that used to determine benefits)

1 Description of Valuation Class	Valuation Bases 2 Changed From	 3 Changed To	4 Increase in Actuarial Reserve Due to Change
1.			
2.			
3.			
4.			
5. Total (Item 6, Page 5)			

EXHIBIT 7 – SUPPLEMENTARY CONTRACTS WITHOUT LIFE CONTINGENCIES

1 Assumed Investment Rate	2 Present Value of Amounts Not Yet Due
1. ....3.75%.........	115,100
2.	
3.	
4.	
5. Totals (To Item 2, Page 3)	115,100

Annual Statement for the Year 1978 of the Annuity Separate Account
of the ABC Life Insurance Company

EXHIBIT 8 – RECONCILIATION OF CASH AND INVESTED ASSETS

Development of Increase in Cash

1. Transfers to separate account on account of:	
1.1 Net considerations for annuities and supplementary contracts	145,000
1.2 Annuity and other deposit funds (net)	139,000
1.3	
1.4	
2. Investment income collected (Exh. 2, Col. 1 less accrual of discount plus amortization of premium)	537,000
3.	
4. Consideration on disposal of short term bonds net of purchases	–50,000
5. Consideration on disposal of investments (excluding short term bonds)	500,000
6. Cost of investments acquired (excluding short term bonds)	1,100,000
7. Transfers from separate account on account of:	
7.1 Contract benefits	1,700
7.2 Transfer of reserves (net)	–500
7.3 Investment management, administration, and contract guarantees	9,000
7.4 Federal income taxes	0
7.5	
7.6	
8. Investment expenses (Exhibit 4, Line 12)	15,000
9. Investment taxes, licenses and fees, excluding federal income taxes (Exh. 5, Line 9)	5,000
10.	
11. Funds from operations (Lines 1+2+3+4+5-6-7-8-9-10)	140,800
12. Surplus contributed (+) or withdrawn (-) during year	–130,000
13.	
14. Total funds (includes $143,800 net transfers from general account) (Lines 11+12+13)	10,800
15. Increase in payable for investments acquired, net of receivable for investments sold	1,000
16.	
17. Increase in cash (Lines 14+15+16)	11,800

Reconciliation Between Years

18. Cash and invested assets December 31st of previous year	12,350,000
19. Increase in cash (Line 17)	11,800
20. Cost of invested assets acquired	1,550,000
21. Adjusted cost of assets disposed of	830,000
22. Accrual of discount less amortization of premium (Exh. 2, Col. 1 footnotes)	50,000
23. Depreciation on real estate and other invested assets (Exh. 1, Line 6)	5,000
24. Increase in net unrealized gains (Exh. 3, Col. 3, Line 10 less Line 7)	–54,000
25.	
26.	
27. Cash and invested assets December 31st of current year (Lines 18+19+20-21+22-23+24+25+26)	13,072,800

APPENDIX III

SEPARATE ACCOUNT BLANK
SPECIAL TRANSITIONAL INSTRUCTIONS
(FOR 1978 STATEMENT ONLY)

The following special instructions, for the 1978 statement only, are intended to minimize the problems of transition from the company's 1977 Annual Statement of the Separate Account Business to the 1978 Annual Statement of the Separate Account, and to avoid the need to restate any items in the previous year columns on pages 2, 3 and 4 of the 1978 Life and Accident and Health Statement.

ASSETS - PAGE 2
LIABILITIES AND SURPLUS - PAGE 3

Total assets for the previous year (Page 2, Column 2, Item 14), total liabilities (Page 3, Column 2, Item 18) and surplus (Page 3, Column 2, Item 21) should agree with the corresponding totals in Column 1 of the 1977 Annual Statement of the Separate Account Business of the insurer.

The amounts of individual items in Column 2 on each page should be restated, if necessary, to be consistent with the amounts reported in Column 1. If the totals of the restated items do not agree with reported Previous Year Totals, write in the differences at Page 2, Column 2, Item 13 and Page 3, Column 2, Item 17 and following Item 19, adding one or more lines, as necessary, and using appropriate captions.

SUMMARY OF OPERATIONS AND SURPLUS ACCOUNT - PAGE 4

Column 2 (Previous Year) shall be omitted. The amounts entered in Column 1, Items 17 and 23, should agree with Page 3, Item 21, Columns 2 and 1, respectively. Write in additional lines in the Summary of Operations and/or the Surplus Account, as necessary, to record the disposition of any transitional difference items entered at Page 2, Column 2, Item 13 and Page 3, Column 2, Item 17 and following Item 19.

SHORT-TERM BONDS OWNED ON DECEMBER 31, 1977 - EXHIBIT 2,
EXHIBIT 3 AND SCHEDULE DA - PART 2

Short-term bonds owned on December 31, 1977, and disposed of during 1978 may be included in Schedule D - Part 4 and the words "Included with long-term bonds" written in Schedule DA - Part 2. If this is done, then the symbol "††" should follow the words "Long-term bonds" on line 1.1 of Exhibits 2 and 3 and a footnote "†† Includes short-term bonds owned on December 31, 1977" should be added to Exhibits 2 and 3.

RECONCILIATION OF CASH AND INVESTED ASSETS - EXHIBIT 8

Note that line 18 is to agree with Page 2, Column 2, Item 8A.

INTERRELATIONSHIP WITH LIFE AND ACCIDENT AND HEALTH STATEMENT

If a company finds that, because of the change in reporting for its separate account business, any items in the Current Year column on Page 4 of its Life and Accident and Health Statement are materially not comparable with the corresponding items shown in the Previous Year column, the following footnote shall be inserted at the bottom of Page 4 of the company's 1978 Life and Accident and Health Statement:

> "Because of required changes in the annual statement reporting of the company's separate account business, certain items shown above in Column 1 are not entirely consistent with the corresponding items in Column 2."

APPENDIX IV

Revision of the Life and Accident and Health Blank
to Accommodate the Proposed Revision of the Separate Account Blank

1. Pages 4 and 5. Renumber item 24A to become item 24B. Add a new item 24A captioned, "Net transfer to Separate Accounts (excluding Variable Life Insurance)."

2. Page 6. Change item 13A to read, "Net transfers to Separate Accounts (excluding Variable Life Insurance)." Add item 13B, "Net transfers to Variable Life Insurance Separate Accounts."

3. Exhibit 1, Exhibit 11, Exhibits of Annuities (page 16) and Schedule F. Change the note in the upper right corner of these pages to read, "The figures on this page pertain to the entire company business, including Separate Account Business, if any."

4. Pages 42 and 43 (Schedules O and S). Change the note in the upper right corner of page 42 to read, "The figures in Schedule O do not include Separate Account items, if any. The information on Schedule S pertains to the entire company business, including Separate Account business, if any." Change the note in the upper right corner of page 43 to read. "The information on this page pertains to the entire company business, including Separate Account business, if any."

5. Exhibit 12. Renumber item 32A to become item 32B. Add a new item 32A, captioned "Net transfers to Separate Accounts (excluding Variable Life Insurance)."

6. Instructions - Page 3. Add the following instruction:

Item 14A - From Separate Accounts Statement

Enter the due or accrued net transfers to (+) or from (-) the Separate Accounts (excluding Variable Life Insurance). This item should agree with the insert shown in Item 18 on Page 3 of the Separate Accounts Statement.

7. Instructions - Page 6. Delete the instructions for item 13A and add the following instruction:

Items 13A and 13B - Net Transfers to Separate Accounts

Include: Net transfers to (+) or from (-) Separate Accounts of net premiums, considerations, dividend accumulations and reserves.

8. Page 3. Add lines 14A and 14B on page 3 of the Life and Accident and Health blank, as follows:

14A. Transfers to separate accounts due or accrued, excluding variable life insurance (net).

14B. Transfers to variable life insurance, separate accounts due or accrued (net).