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Session 31TS
NAIC Statutory Reporting Codification

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Summary: Effective January 1, 2002, the NAIC adopted Codification of Statutory Accounting Principles, an attempt to unify the often divergent state requirements for reporting under a single set of rules. This teaching session addresses the requirements under statutory codification that are of interest to actuaries.

Topics include:
- *Policy classification*
- *Deferred taxes*
- *Accident and health issues*
- *Disclosure*
- *State differences*
- *Implementation issues*

Instructors discuss the requirements imposed under statutory codification and the practical issues encountered in complying with the new rules.

MR. ANDREW F. BODINE: This is a teaching session designed for participants that have had no experience with codification. Any views and opinions expressed by the presenters are their own individual opinions and do not represent the views or opinions of their employers, the Society of Actuaries, its co-sponsors, or its committees.

I am a consulting actuary in the Actuarial Services Group with Ernst and Young. Joining me in presenting this session are Jennifer Weiner and Bob Tarnok. Jennifer and Bob are accountants, not actuaries, who have had extensive experience with codification matters. Jennifer Weiner is a CPA in the National Accounting Practice of Ernst and Young. Bob is an officer of Metropolitan Life Insurance Company and employed by its Accounting Division.

Codified accounting principles cover a wide range of accounting topics, many of which are of interest to accounting professionals, but are not generally of interest to actuaries. Many are pertinent to property and casualty insurance. During this session, we'll be focusing on those accounting principles that are of primary interest to life and health actuaries. Jennifer will be starting the session with an overview of the statutory codification principles that became effective on January 1, 2001. Then, I'll follow with some information about policy classifications and insurance contracts. Jennifer will then return to discuss some other areas of significance for actuaries. The most complex area and the one that might be of most interest to you will be deferred tax assets and liabilities. These tax-related entries have been adopted for statutory accounting from existing GAAP accounting practices.

Then Bob Tarnok will tell you something about how state regulators are dealing with codification. He will discuss the New York Insurance Department with which Bob has been very active by representing insurance industry concerns about codification.

MS. JENNIFER WEINER: A comprehensive guide and more comparable financial statements were needed for insurance departments, insurers, and CPAs. It is needed for the insurance departments because it was difficult to analyze the financial statements of different companies where states' prescribed and permitted practices differed, sometimes significantly. It's needed for insurers because there are a lot of inconsistencies resulting from the lack of comprehensive guidance. Insurers first turn to the *Accounting Practices and Procedures Manual*. Then they would go to annual statement instructions, and sometimes the model laws. Then, when statutory guidance did not address specific issues, they would go to GAAP guidance.

It's also needed for CPAs as it helps us to know the different guidance of the different states. There is more codified guidance, and, as we go forward, there is specific guidance for areas where statutory guidance was previously silent.

The Statement of Concept provides the core concepts that were used in drafting the existing guidance. That will be used in developing all new guidance. It also serves as a foundation for identifying the necessary accounting treatment when guidance does not exist. The *Accounting Practices and Procedures Manual* is now one a single guide. Prior to 2001, it comprised three guides: one for life, one for property and casualty, and one for HMOs and fraternals. It's now just one guide consisting of two different and large volumes.

Some of the provisions will be familiar to some actuaries, but not to others, because there is a combination of property and casualty, life and health theory behind it. You might need to get up to speed on some of them. The three fundamental concepts summarized in the Statement of Concepts are conservatism, consistency, and recognition. These now exist as the foundations in promulgating statutory accounting guidance. The NAIC claims that these concepts might be used to determine necessary accounting treatment where no current guidance exists. As you'll see later, they're very specific that guidance should exist. Otherwise you can't admit specific items.

The name of the guide continues to be the *Accounting Practices and Procedures Manual*. By keeping the name the same, there are a lot of efficiencies for certain states in adopting codification. That is because their laws and regulations already refer to the *Accounting Practices and Procedures Manual*; therefore, it was automatically adopted. Most states adopted codification as of January 1, 2001; however, some did so with modifications. The states' prescribed and permitted practices override the NAIC's *Accounting Practices and Procedures Manual*. Bob Tarnok will go into some of the differences and how, particularly in New York, specific rules override the manual.

The Manual consists of the Preamble, Statements of Statutory Accounting Principles (SSAPs), related indexes, and a glossary with appendices, including excerpts from model laws, interpretations of the Emerging Accounting Issues Working Group, Actuarial Guidelines, and so on. GAAP does not become part of the Statutory Accounting Practices (SAP) until the SAP Working Group (SAPWG) or the Emerging Accounting Issues Working Group specifically adopts that specific GAAP guidance.

The Issue Papers are the drafts of the SSAPs, however, they're also good reference material, because they show a comparison between the old statutory guidance and guidance under GAAP. Other relevant guidance includes both the industry and the regulators' comments. This helps us understand how we got to the final guidance and some of the industry concerns.

We thought you might be interested in the development of the guidance. Of course, the Manual has been growing over many years. We're now up to 84 SSAPs and several interpretations or INTs. First, an issue paper is drafted and submitted to the NAIC Statutory Accounting Principles Working Group. After acceptance, it goes through multiple layers of exposure for discussion and approval, and ultimately adoption at the plenary level. In comparison to the adoption of an SSAP or INT, actuarial matters have a longer road to travel. A new actuarial concern is first proposed to the Life and Health Actuarial Task Force, which assigns it to a working group to develop a proposed document. It is then exposed for comments. Approvals take place at several levels just for the document to become accepted actuarial guidance. These review levels are the working group, the Life and Health Actuarial Task Force, the A or B committee (depending upon whether its life or health), and then the Executive Committee in the Plenary. Then, if it is a matter of accounting principle or practice, and not all of them are, it goes to the bottom of the ladder of the process used to add to the Manual.

Table 1 shows a partial list of SSAPs of interest to life and health actuaries. This gives you a flavor of the areas to be covered in this session. This table shows those SSAPs that aren't directly an actuary's responsibility but that might have actuarial implications, such as those related to assets and investments. We also will spend some time on accounting for income taxes. You might ask why we are covering income taxes with actuaries. Income taxes are one of the major changes brought about by codification. We now have the concept of deferred taxes, and actuaries will be called upon to look at the reversal of specific temporary differences since we have specific time limits.

Table 2 also lists the SSAPs on which actuaries have a direct impact or that have a direct impact on actuaries. To cover some of these more actuarial SSAPs first, I will now turn it back over to Andy.

TABLE 1
Guidance for Actuaries
Not Direct Actuarial Responsibility

- No. 1 – Disclosure of Accounting Policies, Risks and Uncertainties, and Other Disclosures
- No. 4 – Assets and Nonadmitted Assets
- No. 5 – Liabilities, Contingencies and Impairments of Assets
- No. 7 – Asset Valuation Reserve and Interest Maintenance Reserve
- No. 10 – Income Taxes
- Nos. 26, 30, 31, 32, 36 – Various Guidance on Investments

TABLE 2
Guidance for Actuaries
Direct Actuarial Responsibility

- No. 50 – Classifications and Definitions of Insurance or Managed Care Contracts In Force
- No. 51 – Life Contracts
- No. 52 – Deposit-Type Contracts
- No. 54 – Individual and Group Accident and Health Contracts
- No. 55 – Unpaid Claims, Losses & Loss Adjustment Expenses
- No. 56 – Separate Accounts
- No. 59 – Credit Life and Accident and Health Insurance Contracts
- No. 61 – Life, Deposit-Type and Accident and Health Reinsurance

MR. BODINE: SSAP 50 addresses the classification and definition of contracts by contract type. This product classification structure must be understood in order to evaluate where changes in actuarial treatment might be needed. This is a key SSAP for reference. These classifications are important for identifying which accounting guidance and reserve standards apply to a particular insurance contract. The new guidance on product classification applies to all contracts in force, not just those issued in 2001 and later.

There are four main categories of contracts: life, accident and health, property and casualty, and deposit-type. The life category includes all contracts that have *any* life contingencies, including universal life, limited payment life, and annuities. This is very different from GAAP accounting, which defines life insurance contracts as those with *significant* life contingencies. A&H contracts include managed care insurance and long-term-care insurance. Property and casualty contracts include, but aren't limited to, traditional property and casualty insurance, title insurance, mortgage insurance, and financial guarantee contracts, all of which have their own separate SSAPs.

Deposit-type contracts have their own category. These contracts are those that do not include any mortality or morbidity risk. One example is annuities certain. Significant accounting changes were made for deposit-type contracts, similar to what was done for *FAS 97* requirements. However, accounting changes were not made for contracts that include life contingencies. For product design opportunities, insurers could add some relatively insignificant life contingent risks in order to get life insurance accounting treatment for contracts that would otherwise get accounted for as deposit-type contracts. The principles for categorizing contracts still might not answer every question. Some contracts have both life and health contingencies. The actuary has to face and resolve this decision at the time of getting contract approval.

Once you've categorized your business into the four contract types described in SSAP 50, the actuary then needs to know how to value each contract. We're going to go over the accounting principles for income recognition and policy reserves for four contract types: life, deposit-type, A&H, and credit insurance.

Note that annuities are not a category of their own. Annuities are classified as either life or deposit-type, depending upon whether they have any life contingencies. For GAAP, investment contracts do not include any significant life contingencies. For SAP, any life contingency prevents an annuity from being treated as a deposit-type contract. GAAP specifies that the presence of an annuity purchase rate guarantee in a deferred annuity does not constitute a significant life contingency until conversion to a life annuity is made. Under SAP, the fact that a purchase rate guarantee exists for the future will require life insurance accounting from the issue date. The contract does not change its category when it annuitizes. Thus, some deferred annuities will be treated as investment contracts in GAAP, and the same contracts will be life contracts in SAP.

SSAP 51, paragraph 13 states: "Considerations for supplementary contracts, dividends left on deposit to accumulate interest, and amounts deposited and accumulated for guaranteed interest and group annuity contracts shall be recognized as deposit-type funds or considerations for supplemental contracts, as appropriate." These considerations should be accounted for the same as deposit-type contracts—that is, amounts received as payments for such contracts are recorded directly to an appropriate policy reserve account and are not recorded as revenues. Companies have been struggling with how to account for these considerations where the contracts assume some mortality or morbidity risk, such as GICs with purchase rate guarantees, for which reserves are held in Exhibit 8, not Exhibit 10.

Generally, the valuation reporting requirements for life contracts are the same as the existing NAIC standards. There are a few exceptions. In Schedule T, annuity considerations with any life contingencies will now be included in a column for life contracts, not in the deposit-type fund column. A new column called "Other Considerations" has been added. This column is for unallocated deposits and unallocated annuity considerations that have mortality or morbidity risk, but have not been included in the other columns.

Premiums that are due and uncollected more then 90 days are no longer includable as nonadmitted assets. They are not admitted assets, and they're no longer included as an admitted asset.

The liability for the cost of collection in excess of loading on deferred and uncollected premiums has been eliminated. There is a new requirement, brought over from GAAP, that requires unearned income (that which is both required to be refunded upon contract termination and not already considered in policy reserves), to be deferred and not recognized as income until the services are actually provided. This, of course, is similar to the unearned revenue requirement of GAAP.

SSAP 51 requires compliance with the following NAIC models:

- Appendix A-820 (Std Valuation Law)
- Appendix A-822 (Asset Adequacy)
- Appendix A-821 (CARVM surrender charges)
- Appendix A-830 (XXX)
- Appendix A-585 (UL Model)
- Others (including AGs and ASOPs)

The appendices are meant to extract accounting and reporting guidance from the existing model laws and regulations. They're not meant to replace or change them. The appendices retain the number assigned to the NAIC models for reference, but they are not exact copies of the models. For an example of a major difference from the NAIC model, Appendix 822 was derived from the Model Actuarial Opinion and Memorandum Regulation (AOMR). However, Appendix A-822 is only two pages long, and primarily addresses qualification for Section 7 opinions. This might not be very important in the future because the NAIC has since adopted changes to the model AOMR that eliminates the Section 7 opinions. The revised AOMR has not yet been adopted by any states, but it will be adopted soon.

If your company is not already following the NAIC standards, you'll need to look at the appendices in the Manual to learn what differences might exist between your companies' practices and the codified standards. We can point out several differences between what states accept and what codified standards require.

- For industrial life reserves, some states allow a mortality table older than the 1961 CSO.
- Some states have not adopted the UL Model Regulation.
- Some states have not yet adopted the Annuity 2000 and 1994 GAR tables.

- At least one state has no CARVM guidance, and some states require continuous CARVM, instead of curtate CARVM.
- Appendix 830 incorporates Regulation XXX, not yet directly adopted by some states.

A question has been raised about the need to disclose differences from the NAIC minimum standards when greater reserves are reported in the financial statements. An interpretation was finalized in October 2001 by the NAIC that requires life insurers to compute their reserves in accordance with the NAIC minimum standards and to disclose any material differences from the amounts reported in their financial statements. Just holding higher reserves without disclosing material differences is not acceptable according to the disclosure requirements.

Deposit-type contracts are the next category addressed in the Manual. As we've discussed, these are now presented in SAP in the same manner that deferred annuity products are presented in GAAP. Amounts received as payments for such contracts are not reported as revenues, but are reported directly to an appropriate policy reserve account. The actuary will likely be involved in computing interest earned, policy charges, other costs that the insurer recognizes as revenue from such contracts, and interest credited and benefits paid in excess of account values refunded, which the insurer will recognize as a benefits expense. Most actuaries will have used this information in analyzing the change in reserves, but under codification, this detail will now be needed for completion of the blue book. The bottom line will be the same with this presentation as it was previously. The presentation change merely breaks the composite result into its pieces.

SSAP 54 addresses A&H reserves. Many states never adopted the modern Health Insurance Reserve Model Regulation. So new codified standards might imply a change relative to the absence of any prior authority. Codification can represent a real change if you were reporting under a nonmodel basis. You might need to either make changes to your valuation, or not make any changes, but disclose the differences from the codified standards. Although it's not yet an authorized codification standard, the recently completed Health Insurers Reserve Guidance Manual is an excellent reference.

SSAP 54 provides for a premium deficiency reserve to be established with a charge to operations. Some actuaries and regulators believe that a gross premium reserve covered this amount and was an actuarial requirement in the past. Some actuaries did not feel this way. Now it's explicitly required under codification. For the purposes of determining whether a deficiency exists, contracts are grouped in a manner consistent with how policies are marketed, serviced, and measured. A liability is recognized for each grouping, where a premium deficiency is indicated. Deficiencies from one group cannot be offset by profits anticipated in other policy groupings.

Questions have been raised about the use of best estimates for A&H reserves. We should distinguish clearly between reserves, which are amounts held for unaccrued costs (amounts not yet due) and liabilities for accrued costs (amounts currently payable as of the statement date). SSAP 54 can be contrasted with SSAP 55. SSAP 54 states that reserves must meet the provisions of the Appendices, the Actuarial Guidelines, and the Actuarial Standards of Practice. For A&H reserves, which are the amounts addressed, Actuarial Standards of Practice (ASOPs) require actuarial opinions to state that reserves are adequate to meet obligations under moderately adverse conditions, but not to do so to excess. Required tabular reserves probably include such margins, but testing might indicate the need for additions, even to tabular reserves.

SSAP 55 addresses claim liabilities. These are the amounts due as of the statement date. Historically, many actuaries have added a margin to their best estimate in order to make good and sufficient provisions. There are no references in SSAP 55 to compliance with the Appendices, the Actuarial Guidelines or ASOPs, such as the references in SSAP 54.

Guidance for the most common situations is provided in paragraph No. 10 of SSAP 55. You first consider the realistic range of outcomes. You don't have to consider all possible outcomes. Then you choose the best estimate from the most likely outcomes. In the rare situations where no outcomes are more likely than others, and there's a continuous range, you have to use a midpoint. If no range exists, then you use the best estimate.

In October, the NAIC finalized an interpretation that recognized the inherent concept of conservatism in the estimate of claim reserves. The conclusion was that such margins should neither be prohibited nor be required. We expect that company management will continue to include appropriate prudence and exercise careful judgment in determining their best judgment of claim liabilities. There's a new issue paper, No. 116, with respect to A&H claim adjustment expenses, that was finalized in October. This paper clarifies that claim adjustment expenses can be subdivided into cost containment expenses and other expenses. There's a list of items that qualify as cost containment expenses. These are expenses that serve to reduce the number of health services or the cost of such services.

SSAP 56 addresses separate accounts. The main point of this SSAP is that liabilities should be consistent with the bases used for asset values. The standard valuation law interest rate should be used when assets are recorded as held in the general account, but market interest rates should be used when assets are recorded at market. This requirement to value both assets and liabilities at book or to value both assets and liabilities at market applies to new issues after January 1, 2001. It also applies to existing contracts if they undergo substantial modifications after that date.

SSAP 59 addresses credit insurance. Many credit insurers are small and variations of valuation practice have probably existed in the past. Codification might make the valuation and accounting practices clearer and thus affect these insurers. Premium deficiency reserves are discussed similar to the A&H premium deficiency reserves. Paragraph No. 9 of SSAP 59 says, "Policy reserves for contracts where the level of insurance risk is not constant through the contract period shall be recognized over the period of risk in proportion to the amount of protection provided." Various reserve calculation methods can be used, but the chosen method should best represent the nature of the protection provided. The Rule of 78 works well for gross single premium credit life, but it would not work well for net decreasing coverage, such as high interest rate mortgage schedules. So some valuation changes might be in order for credit life insurance. In addition, the NAIC working groups are continuing to discuss the application of the refund liability test and whether it should be applied in aggregate or separately for each contract. The outcome of these discussions could materially affect the credit writers.

SSAP 61 applies to reinsurances. SSAP 61 is derived from the old Chapter 24, which was the reinsurance guidance from the prior *Accounting Practices and Procedures Manual for Life and Health Insurers*. SSAP 61 says that deposit accounting, as provided under SSAP 52, instead of reinsurance accounting, will apply if any significant mortality or morbidity risk is not transferred under a reinsurance agreement.

Appendix A-791 is derived from Chapter 24, Appendix A. This, in turn, was derived from the Life and Health Reinsurance Agreements Model Regulation. The NAIC reinsurance agreements model was widely adopted, so codification probably will not cause much change. Like precodification, all significant risks must be transferred to get insurance reserve credit, and companies should determine if there are any permitted reinsurance reporting practices that vary from the model or codification standards. In 1995, there was set of Q&As developed. These Q&As were intended to clarify the treatment of the reinsurance agreements. They were never adopted because of some controversial items. The Q&As were revised by the Life and Health Actuarial Task Force (LAHTF) in 1999, and they were added to Appendix A-791 in 2001.

This leads us into some comments about the ongoing procedures to update the Manual. The 2001 Manual, which is two black volumes, includes additional guidance that was not in the green printed Manual as of 2000. The additions include SSAPs and Issue Papers that were approved subsequently. Subscribers to the 2001 Manual can download current updates from the NAIC website. This would include those changes that we mentioned that were adopted in October.

New guidance becomes authoritative and is applicable when it is adopted by the NAIC at the plenary level, even though the guidance might not be in the most recently printed Manual. However, new guidance is not authoritative while it’s being discussed prior to its final adoption. All Actuarial Guidelines are incorporated by a general reference to Appendix C of the Manual. Any new guidelines that are adopted become authoritative when they are approved by the NAIC Plenary. There have been a couple of these. There’s Actuarial Guideline 9C that applies to substandard annuities, and the recently approved Actuarial Guideline VL-GMDB dealing with Variable Life Insurance and Variable Universal Life Insurance.

An example of the updating process is SSAP 80, which is just a vehicle that incorporates three recently adopted model regulations, including XXX, to existing SSAPs. SSAP 80 added Regulation XXX to SSAP 51.

Several questions of an actuarial nature were addressed at the June 2001 NAIC meeting. This slide shows some codification changes being considered that were adopted by the NAIC for exposure. Several of the actuarial items discussed by the SAPWG at the June NAIC meeting were referred to other NAIC Committees or Task Forces for additional review and recommendation.

- Appendix A-821, which lists annuity mortality tables that are acceptable for reserves, does not include the annuity mortality table in Actuarial Guideline 34 (Variable Annuities with GMDB).
- For deficiency reserves, clarification was requested by asking that the reference to "charged" premiums be replaced by "guaranteed" premiums.
- In defining the need for premium deficiency reserves under SSAP No. 54 (A&H Reserves), existing contract reserves are not included among the amounts to be considered. A request was made to correct this oversight.
- Also under SSAP No. 54, clarification was requested as to the grouping of contracts that is permitted for offsetting sufficiencies and deficiencies for premium deficiency reserve purposes.
- Clarification of SSAP No. 59, Credit Life and A&H Reserves, was requested with respect to the method of determining credit A&H contract reserves, as none of the methods that are mentioned follows a method frequently used in practice.
- Also for SSAP No. 59, under a review is whether the credit insurance reserves floor, equal to the amount available as a premium refund in case of contract surrender, is an aggregate or individual policy requirement.

As I mentioned before, Actuarial Guideline VL-GMDB has been adopted, and will now be known as Actuarial Guideline 37.

Several of the actuarial codification changes considered by the SAPWG at the June NAIC meeting were referred to other NAIC Committees or Task Forces for additional review and recommendation. A request has been made to correct this oversight. Also, under SSAP 54, clarification was requested as to the groupings of contracts that would be permitted to offset deficiencies and sufficiency's for premium deficiency reserve purposes. Clarification of SSAP 59 was requested with respect to the method of determining contract reserves as none of the methods that are mentioned in that SSAP follows a method frequently used in practice. Also under SSAP 59, there's a question of whether the credit insurance reserves floor, which is the amount available as a premium refund in case of contract surrender, is an aggregate or an individual policy requirement? That last list of items includes things that are being discussed and subject to later finalization.

MS. WEINER: Although served SSAPs are not necessarily in the actuaries domain, various asset related SSAPs might involve the actuary. We're going to go over a few of them. The other ones that we're not going to go through are securitizations, derivatives, loan-backs and structured securities.

I'd like to give a brief overview of a framework of a major concept of codification. An asset is defined as probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events. This definition started with a GAAP definition, but then became lost somewhere with the nonadmitted concept of SAP. There was a lot of debate between the industry and the regulators in the development of codification. Under the new guidance, all assets will need to be specifically identified as admitted. If an asset is not defined as an admitted asset, then it needs to be nonadmitted. This will require all insurance companies to think through and validate how each of their assets are identified in the codification guidance, especially for some unique assets. That is because we don't have the theory of analogizing like we have in GAAP. In addition to the requirements to not admit certain assets (either because the guidance specifically states they should be nonadmitted or because they are not specifically identified in the guidance), there are specific arbitrary limitations for admitting certain other assets. A main example of this is EDP equipment and operating software are limited to 3% of adjusted capital in surplus. Another example is that net positive goodwill is limited to 10% of adjusted capital and surplus. Deferred taxes also have a limitation that we'll go through in a few minutes.

Note that all of these limitations are based on capital and surplus reported in the last quarterly or annual filing with the state, adjusted to eliminate balances for EDP equipment, net deferred taxes, and net positive goodwill.

One of the items that you should be aware of is the new impairment test that has been added to statutory concepts for invested asset statements. This has been a big debate on the GAAP side and with the SEC, especially in the market that we're in today where a lot of investments are under water. It states that if it is determined that a decline in the fair value of an investment vehicle is other than temporary, and such an impairment has not been recognized by the Securities Valuation Office (SVO), the cost basis of the investment vehicle is written down to fair value as a new cost basis, and the writedown is reported as a realized loss. This is putting the responsibility on management to determine when an asset is impaired rather than waiting for the Standard Valuation Office (SVO) to tell you that it's impaired when they put out their valuations.

The SVO is currently working on updates to its Purposes and Procedures Manual, which would include companies notifying them when they've taken the impairment rights out. In theory, this make sense as it will help the SVO be more proactive in valuing the securities. However, realistically, one company might have an impairment when another company might not. That's because one of the criteria for impairment is whether you intend to hold it for a duration. Some companies might intend to sell it below book value and should take the impairment rights out immediately.

There are a bunch of other criteria that companies need to go through. So one company might determine its impaired while another one might not. It's important to point out the difference between other-than-temporary impairments and day-to-day market fluctuations. An other-than-temporary impairment is considered to have occurred if it is probable that the investor will be unable to collect all amounts due according to the contractual terms of the investment vehicle. There has been a lot of debate on how you determine impairment. Oftentimes, we look towards what the SEC has said just because there is no other guidance out there. We look to see if we expect it to recover within the next six-to-nine months to see if it's other-than-temporarily impaired. This is also very different than being permanently impaired. I think many people have used that as an argument.

Although we have talked about impairments in relation to investment vehicles, this issue also applies to all other types of assets, including receivables and goodwill. Although the NAIC added the requirements for the impairment test, they do not talk about any indicators of impairment. However, GAAP does, and it would be prudent to look towards those indicators when determining how to determine when investments are impaired. Most important for actuaries is that you need to be aware of this impairment criteria when performing asset/liability matching and cash-flow analysis.

Let's move on to taxes, which is one of the biggest codification items. SSAP 10 significantly changes the reporting of income taxes for insurers. We'll go through the basics of the calculations, and then we'll drill down into some of the issues that exist in implementing the standard. SSAP 10 specifically addresses how current and deferred taxes are to be reported in the statutory financial statements. For current taxes, current federal, foreign, and state income taxes are to be included in the Summary of Operations. Current income taxes are defined as current-year estimates of income taxes based on tax returns for the current year and tax contingencies for current and all prior years, to the extent that they have not previously been provided. Deferred taxes are recorded on federal and foreign taxes only. State deferred taxes are not part of the deferred tax calculation. The change in deferred taxes is reported as a change in surplus rather than through the Summary of Operations.

The language concerning current taxes is generally the same as it was for pre-codification except for the language concerning contingencies, which might cause a different treatment for many companies. Some companies did not record a provision for tax contingencies, or if they did provide a contingency or a provision for it, they recorded it through a change in surplus as a change in prior year taxes. After the adoption of codification, companies will need to record that through the Summary of Operations.

Deferred taxes, as I said, are computed for only federal and foreign taxes and are based on the identification of temporary differences, which we'll discuss in further detail later. Temporary differences are then grouped into those that resulted in a deferred tax asset (DTA) and those that resulted in a deferred tax liability (DTL). The DTAs and DTLs are then computed by multiplying these differences times the enacted statutory tax rate or what a company expects to be their enacted statutory tax rate, which we'll discuss shortly. A temporary difference is determined by the difference between the tax and statutory bases of an item expected to reverse in future years. The calculation is based on a balance sheet approach of where a tax and statutory balance sheet is compared item by item or group by group, which we'll also touch on. Permanent differences, such as tax-exempt income, meals and entertainment, expenses disallowed, and penalties or permanent differences, are not included in the calculation. What is excluded specifically by the SSAP in the definition of temporary differences is the asset valuation reserve (AVR), interest maintenance reserve (IMR), and for property/casualty companies, the schedule of provision.

There are some examples that give rise to temporary differences on the asset side. I am not going to go through all of those. On the liability side of the balance sheet, there are also common temporary differences that include tax versus statutory reserves, both for life and property and casualty companies. Then UPR salvage and subrogation and discount on tax reserves for property/casualty companies. There are liability differences common to all insurers, such as deferred compensation, accrued vacation, post-retirement benefits, and contingent liabilities.

After the temporary differences have been identified by comparing the tax and statutory balance sheets, gross DTAs and DTLs are computed using the enacted tax rates. Deferred tax assets are future deductible temporary differences times the enacted rate. Deferred tax liabilities are future taxable temporary differences times the enacted tax rate. Then, the enacted tax rate should be the insurers rate, that, based on existing laws, the company believes will be in effect at the time the temporary difference is reversed. It is also what the company expects the enacted rate to be when they reverse. As I said before, DTAs are limited. They're limited as to their admitted asset status. An insurer will admit DTAs in a three-part test. The first part of the test is recognizing the gross DTA, reversing in one year what could be realized through carryback to recover amounts that were previously paid, regardless of an net operating losses (NOL) position. The second part equals what is remaining in the DTA reversing in one year and expected to be realized in one year. We'll cover what realized means in a minute. That is limited to 10% of adjusted capital and surplus shown on the most recently filed statement. Then, the remaining DTA can be admitted to the extent it offsets gross DTLs. So, if the company figures out that their gross DTLs are greater than their gross DTAs, because of this last step, they can just net the two and basically be done except for some disclosure requirements.

A comparable component in GAAP is the valuation allowance established for deferred tax assets. However, for GAAP there is no specified time limit on when the temporary difference must reverse. Therefore, statutory is much more stringent than GAAP in this area.

The most burdensome provision of SSAP 10 is the need to determine how much of the asset reverses in the following year. The second is how much will be realized either through recoveries of taxes paid during the carryback period, via projected net income, or through the reduction in future taxes payable as a result of an interim item reversing? Although scheduling is not specifically required, companies need to determine the temporary differences that are going to reverse in one year. Therefore, they might have to schedule this out. To make a determination, companies might need to schedule, for at least one year out, and determine what they think is going to reverse. Then they will also have to do a second part to determine what they think they will be realized.

To estimate the portion of the deferred tax asset that will reverse in one year, the actuary will likely be asked to provide tax reserves and statutory reserves at the balance sheet date and at a date one year out. If the excess of the statutory reserves over tax is smaller at the end of the year than at the beginning of the year, a portion of the beginning-of-year DTA will have reversed and can be used to support a deferred tax asset being admitted. Statutory reserves don't usually use a lapse assumption. In this case, we believe that lapse assumptions should be considered when determining what your reserves will be one year out, as that is the companies expectation of what actually will happen. As actuaries, you might find it interesting or strange that the DTA and DTL does not reflect the time value of money between the date of the balance sheet and the date when the deferred tax item is going to reverse. This is also true for GAAP. Deferred taxes are computed without discounting.

There are several possible approaches to perform the calculations to determine what reverses in the following year. You might want to run the company valuation systems for the subsequent year and adjust for the decrements. You might want to use existing projection systems, or you might want to create spreadsheets to estimate the reversals.

Actuaries responsible for statutory financial reporting are also familiar with the six categories of life insurance reserves specified in Section 807(c) of the Internal Revenue Code. Codification, by no means, is expected to change the way that you calculate the tax reserves, but any impact on the statutory reserve used as a ceiling for tax could have an impact on the deductible tax reserve. The required disclosure of company differences between the NAIC standard and what companies use will invite closer scrutiny of the tax reserves. An introduction of deferred tax assets and liabilities into SSAP accounting might make the computations more frequent because it will have to be done on a quarterly basis or at least estimated on a quarterly basis.

The controversial question is, what does the term *expected to be realized* mean when used in Paragraph 10? Some people thought that it just meant reverse as it does in the first paragraph or in the first step of the computation of admitted DTAs. To put it in context with the rest of the paragraph, the guidance is allowing an entity to admit additional gross DTAs for temporary differences that are expected to be realized within one year of the balance sheet date. This can happen after considering those amounts that can be recovered through loss carrybacks for existing temporary differences that reverse by the end of the subsequent calendar year. The SSAP working group determined that the phrase *expected to be realized* encompasses a reasonable expectation as to the value of the DTA. While the calculation starts with the enacted tax rate, the admissible amounts are limited to the lesser of the amount calculated using the enacted tax rate and that's calculated using the with and without methodology described in a question and answer that was released at the October 16 meeting. In fact, as for this concept, and a few other concepts that I'm going to talk about, there are still tentative conclusions that were adopted at the October 16 meeting. These conclusions will be discussed further at the December 8-12 NAIC meeting. SSAP 10 Q&A is like a 35-page interpretation document. Companies that are affected by it need to read the whole thing, but it's pretty encompassing. For example, if there's a taxable loss in the subsequent year, and no amounts can be recovered through carrybacks, the DTA would not be realized, as it would only be increasing the NOL and the company would not be reducing the taxes that it expects to pay. Companies that are always in a perpetual loss situation and expect to have losses in the future won't be able to admit any DTA unless they have carrybacks or can offset them with gross DTL. Blue Cross/Blue Shield entities that will utilize special deductions to reduce the amount of taxable income will encounter this issue. Because management knows the company will have zero regular taxable income after the special deduction, it cannot expect to realize any regular tax benefit from the reversal.

Let's discuss some of the issues that have arisen when implementing SSAP 10. There's a heavy administrative burden in scheduling a reversal of the DTAs. For instance, on the life reserves, are actuaries going to have to estimate what amount of reserves are to reverse in one year? This will require some assumptions regarding lapses and mortality within each block of business. Depending on the facts and circumstances, reasonable estimates rather than exact calculations might be in order. There have been several questions on the measurement of DTAs associated with nonadmitted assets and the grouping of assets in liabilities for measurement. The staff working group concluded that the DTAs are computed using a statutory balance sheet approach using enacted rates. The resulting DTA is then subject to the admissibility test specified in the SSAP. Essentially, by using the statutory balance sheet approach, some people might calculate DTAs by using just pure investments, or they might go down to using common stock, preferred stock and bonds. They also might go even further down and use specific assets such as U.S. Treasuries or whatever is in the blank. But, if you use that for one item, you should use that for all items. So if you're using that for investments, you should also be using that for reserves when considering your DTAs and DTLs. Therefore, you are doing it by line of business versus just by Exhibit 8 summary totals or Exhibit 10 summary totals.

Another question that has caused some problems is, what is the meaning of the term *taxes paid*? The working group concluded the term *taxes paid* means the total tax that was or will be reported on the reporting entity's federal income tax returns or is paid or is expected to be paid to a parent company when they're part of a consolidated return. When a company is part of a consolidated return, it should first determine amounts on a separate return basis, considering amounts they actually paid to the parent. However, when determining the carryback, it should determine amounts that are in accordance with the tax-sharing agreement and what amounts can actually be recovered from the parent.

Finally, the use of tax-planning strategies in the determination of admissible DTAs has generated many questions. Specifically, can they be used in admitting a DTA? Tax-planning strategies under GAAP are used to prevent an item such as an NOL, a capital loss or an alternative minimum tax (ATM) credit carryforward from expiring unused. This is not the case under statutory, but the question is, can you use strategies to control the reversal of an item, such that it can be recognized within one year of the balance sheet date, and then treated as an asset? The NAIC needs to determine that the tax planning strategy is prudent, feasible, and available, and, if implemented, it would result in realization of a DTA within one year of the balance sheet date. While the entity does not necessarily have to implement the strategy within the 12-month period, it must have the ability to implement the strategy within the 12-month period. Although it might not normally implement the strategy, the company needs to demonstrate that it would do so if it were in a situation to prevent these from expiring.

There are many other issues in SSAP 10. We've touched on some of them that might be of interest to the actuary. Keep in mind that you'll probably be called on to help determine what the reversal of reserves are, and you'll need to know how much time you need to devote to that. In addition, codification has had a direct impact on statutory financial reports, but actuaries need to consider the indirect impact of codification changes on other areas of their operation. For example, cash-flow testing, embedded value or appraisal must be amended to incorporate deferred tax items and impairments of investments. The company must decide whether to keep internal records for deposit-type products in current premium style or switch to margin style that will be used in the annual statement. Validations and models will also be affected. In situations where statutory is used for GAAP, because GAAP results approximate statutory results, steps might be needed to preclude an inadvertent GAAP change because statutory has changed.

Finally, but not least important, is that everyone must understand the external audiences, and how they will view these changes. I will turn it over to Bob to discuss these issues.

MR. ROBERT TARNOK: Before I cover how states have reacted to codification, one of the things that's obvious is the significant number of accounting changes resulting from codification. One of the underlying concerns that the NAIC had was how codification was going to affect statutory surplus. The underlying guideline was that the NAIC wanted codification to be as surplus neutral as possible from an industry perspective.

Codification was effective for January 1, 2001. This is different than prior rule changes in statutory accounting, which normally happen at the end of the year. So in each of the quarters, we can gauge how companies are reporting the effects of codification. The NAIC used its database to look at how companies were recording the opening adjustments for codification through surplus. As you can see, it wasn't quite surplus neutral for life insurance companies or property and casualty companies. There was a 4% increase in statutory surplus for life companies, and about a half a percent decrease in surplus for property and casualty companies. This is a little bit deceptive because the NAIC was using the information from quarterly financial statements. These financial statements are prepared on a state basis. There are significant differences in certain states. These numbers are somewhat understated in terms of the impact of NAIC codification. Table 3 depicts the first quarter results. The NAIC has also come out with the second quarter results, which are pretty much in line with the first quarter.

TABLE 3
1Q 2001 Codification Impact

	Life	**Health**	**Property**
Surplus (millions)	$8,688	$(105)	$(2,052)
Percentage	3.88%	–0.60%	–0.56%

The second surprise from the NAIC perspective was the number of states not reporting any accounting change. If you understood what Andy and Jennifer have presented so far, you can see that it would be pretty unusual for a company not to have some effect due to codification, especially when you get to areas like deferred income taxes. Table 4 shows that there are a number of companies, at least through the first and second quarter, that are still not reporting any changes, or any effects due to codification, which the NAIC finds quite unusual. We're not really sure what's going on. Some of the small companies might not have been in tune with what has been happening for a number of years at the NAIC, and they might not really understand the impact that the SSAPs have on statutory reporting.

TABLE 4
1Q 2001 Codification Notes

Many companies reported no change.			
	Life	**Health**	**Property**
Number	424	266	866
Percentage	40%	58%	37%
Exclude impact of SSAPs not adopted by certain states.			

Let's address the states' adoption of codification. As Jennifer indicated, one of the things that codification cannot do is trump any state insurance law or regulation. So insurance companies need to understand codification, but they also need to understand the various state laws and regulations that directly or indirectly give certain accounting guidance. The process that most states have gone through has been the review of their particular laws and regulations to find out if there are any particular areas where statutory accounting is mentioned. They must also decide whether or not they agree with making changes to the laws. In a number of states, it's clear that there are no references to statutory accounting. Some states don't have nonadmission rules embedded in their statutory laws or regulations. The only thing that those states needed to do was send out some guidance or adopt laws or regulations that referenced the manual. Other states, where accounting was sort of hardwired into accounting law or regulation, have adopted changes to their particular laws or regulations. It's hard to gauge the status of all the states. We've had a couple of informal surveys. The best estimate that I have is there are about 35 states where there aren't differences among statutory laws and regulations, NAIC codification, or where states' specific laws and regulations have been changed.

One of the requirements of codification is Appendix A-205. This is the place where, if there are differences between state laws/regulations and NAIC rules, you could see the effects on statutory income and statutory capital and surplus. There is one thing that you should keep in mind if you're analyzing statutory, quarterly, or annual reports. Appendix A-205 is one of the documents or areas you might want to consider in terms of gaining an understanding of the real basis on which the quarterly or annual reports are being submitted. It is up to each insurance company to list out what its differences are, whether they are prescribed practices by each state, or whether they are practices that are permitted by individual states.

I am the chair of the Life Insurance Council of New York (LICONY) Accounting Committee. Codification has been on its radar screen for approximately two years. During 2000, there was an effort to change certain of the New York State insurance laws to conform to codification. There were four areas that were highlighted, including deferred tax assets and goodwill. Because there was certain language embedded in New York insurance law, insurance companies domiciled in New York would not be able to admit goodwill in accordance with the SSAP or admit deferred tax assets in accordance with the SSAP. The effort in 2000 was not successful. There were no changes made to the insurance law. In 2001, we realized that insurance companies were going to need to know the exact differences. The New York State Insurance Department did not want to leave it up to the individual companies to go through the laws and compare them to the SSAPs. One of the major efforts that the department (working with certain associations such as LICONY) made during 2001 was the development of a listing of the differences between NAIC codification and the New York way of reporting on a so-called codified basis. The Department has issued Regulation 172. Regulation 172 has approximately 21 exceptions to NAIC codification, including deferred taxes, goodwill, and EDP equipment. Again, that did not change New York law, but basically it gave the companies filing in New York the guidance on how to adopt codification for filing in New York.

It also required disclosure of A-205 reconciliation between New York codification and NAIC codification on a quarterly basis. The NAIC requires that reconciliation only annually. The New York Insurance Department, working with the trade associations, realized that the goal was to try to get New York law and regulations consistent with the NAIC principles—there would be no differences and companies could be viewed on a similar basis. In order to do that, one of the goals was to try to monitor the effects of the differences between NAIC codification and New York codification on a quarterly basis. Thus, a Regulation 172 requirement was a quarterly filing of these differences. The trade associations, such as LICONY, along with the Department, used that as a guide and as ammunition when going to Albany to try to get the laws and the regulations changed.

I mentioned the impact codification had on total industry surplus. I also mentioned that this was not a clear picture because it was based on companies who filed with their individual states. One of the efforts taken by the trade associations, the industry, and the New York State Insurance Department was to try to figure out what impact these 21 differences had. What was the difference between the NAIC and New York State codification? LICONY conducted an informal survey of approximately 19 companies. It asked the companies to provide their reconciliation between the NAIC and state codified basis accounting, as filed with the NAIC or as filed with the department, on a quarterly basis. There was an approximate $2.6 billion increase (Table 5). In other words, if the laws and regulations were changed in New York, then New York companies would be able to report approximately $2.6 billion higher surplus. Perhaps that helps you understand the total industry impact of codification.

TABLE 5
LICONY Regulation 172 Survey

Capital & Surplus	$ Change (millions)	% Change
> $1 Billion	$2,412	10.23%
$50 Million – $1 Billion	174	8.48
< $50 Million	5	4.21
Total	$2,591	10.06%

Working through 2001, the department and the industry (basically the companies that are domiciled in New York) received New York law and recommended and proposed a number of changes to New York insurance law. It's obvious that they included the major items that I mentioned before: deferred tax assets, EDP equipment, positive goodwill. There were also some technical differences between the language in New York law and the SSAPs regarding investment income, depreciable life on real estate, and some other minor differences. We had, in effect, proposed hardwire changes to New York law to get it to totally conform to NAIC codification. The good news is the New York State Insurance Department sided with the industry and is very active in promoting this particular bill. The bad news is that accounting and politics don't seem to have a very good match. This bill has been in Albany, and there are some reasons why this hasn't been pushed forward. As you may know, New York State had a budget issue this year, and obviously, with the events surrounding September 11, there have been other, more important activities in Albany. The recent development regarding this bill is that the assemblyman in charge of the insurance industry is trying to link this with some other insurance proposals, such as investment in community development projects. Some companies haven't been viewing that too favorably, but we are still trying to work with Albany to get this bill passed before year-end. Unfortunately, it's quite questionable whether this will be enacted before year-end. The message is be prepared if you are a New York company or if you need to file on a New York basis because you have to supply supplemental information to New York. Be prepared and recognize where New York law differs from NAIC codification.

Obviously, when you are making changes to surplus, those changes will have an impact on risk-based capital (RBC), which has become somewhat of a measurement tool for the regulators. In some instances, companies are being compared side-by-side. There are some changes that have occurred relative to codification and RBC. There has been a recalibration of certain RBC factors for year-end reporting in 2001. There was also a debate as to whether deferred tax assets should be or should not be included in total adjusted capital. The preliminary views of the Life Risk-Based Capital Working Group, and the Property and Casualty Risk-Based Working Group differed. The Life RBC Working Group wanted the deferred tax assets included in total adjusted capital. Property and Casualty Risk-Based Capital Working Group did not. It went up to a higher authority and the concession was that, for 2001, it would be included, but on the risk-based capital worksheets, it would be shown as a separate item to give regulators an indication of how deferred tax assets are affecting risk-based capital.

The other question is, because you have accounting differences between the NAIC and the states, in terms of certain accounting differences, where states have not totally adopted codification, how do you file your risk-based capital? Because it's a state requirement, you have to file in conformity with your state. Therefore, you're going to have differences if people are using RBC to measure companies against one another. One of the things that certain companies are looking at is disclosing the amounts that are used to calculate risk-based capital on both bases. So you could put in this information as an additional disclosure in the footnotes to give the readers of the financial statements comparable data.

For the most part, in terms of rating agencies, codification has not been that critical an issue. I've talked to a couple of the rating agencies, and they are interested in trying to get companies to report on the same basis so they can do comparisons. To the best of my knowledge, very few, if any, rating agencies' changes are occurring for codification. However, the best advice is for companies to assess early. Hopefully, companies have been doing this on a quarterly basis in terms of understanding codification and the impact and the views rating agencies might have on the change in surplus. As discussed earlier, it appears that at least 1,500 companies haven't done that yet.

Finally, what are some of the areas of current NAIC focus? We talked a lot about the changes to date and the SSAPs that are out there today. What is happening at the NAIC currently, and what kind of changes can we expect? The SSAPs dealing with affiliate reporting, namely SSAP 46 and SSAP 48, have always been difficult areas for the industry and the NAIC. There are many issues that come out of those SSAPs in terms of valuing these companies. The NAIC is currently taking a hard look at both of those SSAPs, and it may dispose of those two SSAPs and come up with entirely new guidance regarding accounting for affiliates. Another issue companies with foreign insurance subsidiaries relates to: how do you value or account for your investment in foreign subsidiaries? The NAIC, at one point, concluded that companies should apply U.S. statutory accounting principles to a foreign subsidiary and account for it that way. Obviously, for those companies that have significant investments in foreign insurance subsidiaries, that could be a very painful and perhaps impossible exercise. So there has been significant debate around that particular issue.

For any GAAP announcement that comes out, the Statutory Accounting Principle Working Group needs to react to that pronouncement. Over the last year, there have been at least two pronouncements that have significant impact for companies that are reporting on a GAAP basis. You may be familiar with the first one, the infamous *FAS 133*, GAAP derivatives pronouncement. For that pronouncement, the Statutory Accounting Working Group has formed a subgroup. The subgroup comprises both regulators and insurance representatives. In terms of derivative accounting, there were no changes made from the prior guidance under codification. In other words, when codification came into effect on January 1, 2001, the old derivative guidance and the old manual was just incorporated into the new manual. But the NAIC realized that it was going to have to take a hard look at that because of *FAS 133*. At this point in time, there is an exposure draft out on the statutory version of *FAS 133*. If you have been involved in any way with *FAS 133*, from an actuarial perspective, you know that it is a bear. For example, there are major issues surrounding embedded derivatives. Some of you might have been called in to try to value, on a GAAP basis, embedded derivatives, which have to be separated from certain insurance contracts.

That amount, on a GAAP basis, needs to be run through the income statement. The good news is the statutory version of *FAS 133* will not require bifurcation of embedded derivatives. The only thing that, from a statutory perspective, companies will need to worry about are the changes relative to free-standing derivatives and hedge accounting.

The other group that is also a subgroup of the Statutory Accounting Working Group is the group addressing *FAS 140*. *FAS 140* replaced *FAS 125*. It covers when companies should de-recognize assets and show extinguishment of liabilities. From a statutory perspective, that working group has just been formed. It's at the beginning stages of trying to prepare a grid of what the statutory guidance currently states versus what *FAS 140* accounting guidance states? At the next meeting, the working group will go over that grid. I'll turn it back over to Andy to wrap up the formal part of the session.

MR. BODINE: We've come to the end of our presentation. We've provided you an overview of codification. We've reviewed policy classifications and some specific SSAPs related to reserves and income for contracts other than property and casualty. We reviewed some other areas of significance to many life and health actuaries, especially with respect to deferred taxes. We've discussed some state differences and regulatory considerations. We'll now take questions.

FROM THE FLOOR: This is probably for Jennifer and pertains to reversals. I've heard that one of the differences between tax and statutory reserves is the treatment of due and deferred net premiums. I've heard one tax accountant suggest that because due and deferred net premiums are related to the current policy year, the whole amount of those is a one-year reversal. I'm not sure I agree with that. I'd be interested in what you think of it.

MS. WEINER: I'll actually have to think through that one.

FROM THE FLOOR: I have a second question for Andy. On deposit-type contracts, it says that you book the premium to an appropriate reserve account. On immediate annuities, the premium that you collect might be less than the initial reserve, because your pricing interest rates are higher than the reserve interest rate. Where in the financial statement do you book the difference between the initial premium and the reserve that is larger than that initial premium?

MR. BODINE: I don't know of any specific place to put it. Where the reserve is different, I imagine the difference just decreases surplus by the excess of the reserves over the premium collected.

FROM THE FLOOR: I discussed this quite a bit with some accountants last year, and we didn't get very far.

MR. TARNOK: I'd like to go back to your question of doing deferred. If I had to guess, there'd be a short-cut methodology that certain companies might use rather than going through the extensive exercise of separating it out.

MR. J. HARVEY CAMPBELL: In calculating the deferred tax liability or asset, you take the enacted rate times the timing difference. How could you bring in the small companies deduction into that calculation?

MS. WEINER: There was a lot of debate on what "expected to be realized" means. You would not only just use the enacted rate, but actually the rate at which you expect to reverse at. You would, for small life companies, use the lower rate. I think it's a lower percentage. That's the rate that you would actually use for the reversals. That has been the debate over the last year. A conclusion was reached at the October 16, 2001 meeting, and it will be finalized at the December meeting.

MR. LARRY J. BRUNING: With regard to classifying products as either deposit-type or life, in the case of annuities, is the driving issue the guaranteed settlement options in the contract or the fact that you provide a death benefit that's different than the cash surrender value in the contract?

MR. BODINE: It's whether there is a life contingent settlement option that would be the driving fact that would put it into the deposit-type or the life category. If there is a life contingent guaranteed settlement option, it would be a life contract.

FROM THE FLOOR: So if you refiled all your products and only offered certain-only settlements, then would they get the deposit-type accounting treatment?

MR. BODINE: That's right. If you redesigned your contracts and eliminated life contingent settlement options, and had certain-only options, they would be deposit-type contracts.

MR. BRUNING: I have a second question on that same issue. Say that your company has previously classified annuities as deposit-type contracts, which stems mainly from the fact that we were a stock company and were following GAAP accounting principles. You might then move it over into life. Then, for RBC purposes, when you calculate the C-4 component, I believe you have to go to schedule T and take the total life premium, which gets a factor of .02. If you happen to write $1.5 billion of annuity premium, that has quite an impact on the RBC calculation. Am I looking at that right or not?

MR. BODINE: I think you're probably looking at it correctly. I know the Life RBC Working Group, and other RBC Working Groups have addressed changes that result from codification. They've made broad overall factor adjustments. That would affect some companies more than it would affect other companies. With your particular situation, you probably would have quite a significant impact as a result of codification.

MS. WEINER: Just as a follow up to that. When you work through the calculation, it is initially included on that line item that gets the factor. But if you continue to work through it, it actually gets backed out later. For RBC purposes, for that situation, you don't necessarily have an effect. You will have an effect because we're not sure how premium taxes, because of Schedule T, will cause it to fall and what will be assessed. Companies used to put it in deposit-type; therefore, they didn't have premium taxes on that column in Schedule T. When you work through the whole calculation and RBC, I believe it gets backed out, even though it's initially included.

MR. BRUNING: I hope that's the case. I might not have the current spreadsheet to see where it backs out. I couldn't see where it was. I have one last question. Let's say you are establishing your reserves according to the standard valuation law that has been adopted by states, and you're putting up the minimum reserve. Let's say you want to reinsure off a part of that risk or a component of that reserve. Perhaps the reserve is due to free withdrawals or something like that. We've had an audit where they've challenged the fact that risk has been transferred. We've tried to make the argument that if there is a minimum reserve requirement, you have to establish the reserve. There's risk there if you have to establish it, so why can't you cede that risk and meet the definition of risk transfer. Do you have any comments on that?

MR. BODINE: My initial reaction is that there are risks that are labeled as significant risks and that are ceded by various types of contracts. You should be able to identify in your reinsurance contract the significant risks and be able to cede them. Is there anyone else who might better be able to answer the gentlemen's question?

MS. WEINER: When I'm looking at the risk transfer criteria for reinsurance, I see the reinsurer as being at risk of having a loss. Although they're taking on the risk, the premium being paid for the reinsurance is equal to the risk that they're at. They're never at risk of any loss. Although I'm ceding off my minimum reserves, I'd have to then look at premiums and everything else that is being paid, like the probability of loss and the actuarial probability of the different occurrences happening. Now there are a lot of situations where risk transfer does not meet that GAAP criteria for risk transfer, but it will meet the statutory criteria for risk transfer. So there are instances where you'll be accounting for the reinsurance differently between GAAP and statutory one and surplus relief, although we never say that as I guess finite risk. The other one is actual reinsurance.