

**Statutory Accounting Principles Working Group  
Maintenance Agenda Submission Form  
Form A – Non-Substantive**

Issue: Are certain reserves required or suggested?

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Check (applicable entity):

	P/C	Life	Health
Modification of existing SSAP	<input type="checkbox"/>	X	<input type="checkbox"/>
New Issue or SSAP	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

\*Description of Issue:

In May of 2001, the American Academy of Actuaries' Life Financial Reporting Committee (LFRC – formerly the Committee on Life Insurance Financial Reporting) suggested that SSAP 51 paragraph 36 and SSAP 52 paragraph 15 be changed to read, "Additional actuarial liabilities are required for such items as:". The original wording was, "Additional actuarial liabilities are commonly held for such items as:". The intent of LFRC was to clarify valuation requirements. There was no intent of changing any valuation requirements. The LFRC suggestion was adopted on October of 2001.

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\*Existing Authoritative Literature: SSAP 51 paragraph 36, SSAP 52 paragraph 15, "*Valuation of Life Insurance Liabilities*" by Tullis and Polkinghorn, IRC Section 807 e(1)(A), New York Regulation 127

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\*Activity to Date (issues previously addressed by SAPWG, Emerging Accounting Issues WG, SEC, FASB, other State Departments of Insurance or other NAIC groups): This suggestion was originally submitted on April 7, 2000 by R. Thomas Herget, FSA, MAAA, Executive Vice President, PolySystems, Inc. Form A was submitted by the LFRC on 5/18/01. The recommendation was exposed for comment and approved 10/16/01 . Comments were received from interested parties.

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\*Information or issues (included in *Description of Issue*) not previously contemplated by the SAPWG:

One of the items mentioned, in both SSAP 51 paragraph 36 and SSAP 52 paragraph 15, is surrender values in excess of reserves otherwise required or carried. It has come to our attention that the new wording may be interpreted to require additional reserves for annuity products with market value adjustments. This issue may be very significant to companies that have these products.

Annuities with market value adjustments allow surrender values to be increased and/or decreased based on movements of interest rates. Valuation issues of products with these features are discussed in "*Valuation of Life Insurance Liabilities*" by Tullis and Polkinghorn. The treatment of reserves follows the treatment of assets. When assets are marked to market, so are the reserves. This situation may be found with products supported by a separate account. When fixed income assets carried at amortized book value support the product, reserves are calculated ignoring the market value adjustment. In both instances, capital and surplus are properly represented through the consistent valuation of assets and liabilities. In some cases, a result of the latter approach is that the amount available upon surrender will be greater than the reserve. The issue has been handled by the Internal Revenue Code (IRC Section 807 e (1)(A)) by explicitly defining surrender value consistent with this theory:

*(A) In General – The net surrender value of any contract shall be determined – (i) with regard to any penalty or charge which would be imposed on surrender, but (ii) without regard to any market value adjustment on surrender.*

In Regulation 127, the state of New York follows the same approach as the IRC when it defines the surrender value to be compared to the reserve when the supporting assets are held in the general account or in a separate account where the assets are valued at book by:

*...the cash surrender value at the date of valuation, excluding the effect of the market value adjustment.*

However, there is no parallel clarifying definition of surrender value in the Accounting Practices and Procedures Manual.

The changes made to SSAP 51 paragraph 36, SSAP 52 paragraph 15 failed to clarify valuation requirements, as they related to annuities with market value adjustments. Instead, they created a situation where misinterpretation is more likely than before. The clearest way to rectify this situation is to revert to the original language.

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Recommended Conclusion or Future Action on Issue:

Change SSAP 51 paragraph 36 to read:

“Additional actuarial liabilities are ~~required~~ commonly held for such items as:

- a. Provision for either nondeduction of deferred fractional premiums or return of premiums at death of the insured and;
- b. Surrender values in excess of reserves otherwise required or carried;

Change SSAP 52 paragraph 15 to read:

“Additional actuarial liabilities are ~~required~~ commonly held for such items as:”

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Recommending Party:

American Academy of Actuaries' Life Financial Reporting Committee  
David Rockwell, Committee Member  
303 East Wacker Drive  
Chicago, IL 60601-5212  
(312) 665-8902  
drockwell@kpmg.com

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\* Indicates required information before NAIC staff will accept form as a final document.