

GAAP Chapter 6: UL Products

Concepts

- Scope of SFAS 97
- SFAS 60 vs. SFAS 97 Income Statement Presentation
- SFAS 97 liabilities
- EGP
- SFAS 97 DAC
- Unearned Revenue Liability

Scope of SFAS 97

Products Covered

- UL type contracts
- Certain deferred annuities
- Limited pay contracts

Criteria to be a UL type contract

- Policyholder may vary premiums without consent of insurer
- Contract has stated account balance where premium is deposited, interest is credited, and assessments are debited. The credits and assessments are not fixed and guaranteed.
- Insurer expects that changes in credits and assessments will be based on market conditions, not company experience

For SFAS 97, Premium is not revenue → contract charges is revenue

SFAS 60 vs. SFAS 97 Income Statement Presentation

SFAS 60 Pre-Tax Profit = Premium + Inv Income – Death benefits – Surrender benefits – Increase in reserve – DAC Amortization – Commission – Other expenses

SFAS 97 Pre-Tax Profit = Fee income + Inv Income + Earned deferred revenue – Death benefits in excess of AV released – Credited Interest – Bonus interest – Change in DAC – Commission – Other expenses

SFAS 60 Revenue

- Premium
- Investment Income

SFAS 60 Benefits and Expenses

- Death benefits
- Surrender benefits
- Increase in reserve
- DAC amortization
- Commission
- Other expenses

SFAS 97 Revenue

- Fee income
- Investment income
- Earned deferred revenue

SFAS 97 Benefits and Expenses

- Death benefits in excess of AV released
- Credited Interest
- Bonus interest
- DAC amortization
- Commission
- Other expenses

SFAS 97 Liabilities

- AV = Benefit Reserve
- Unearned Revenue Liability
- SOP 03-1 liability, if necessary
- Premium deficiency liability, if necessary

EGP

EGP = Mortality Margin + Interest Margin + Expense Margin + Surrender Charge +/- Other

Components of EGP

- Mortality Margin = COI Charges – Benefits in Excess of AV
- Expense Margin = charges for contract administration less expenses incurred for contract administration
- Interest Margin = Net investment income less credited interest
- Surrender charges
- Other assessments -- Includes charge for riders, impacts of reinsurance, or SOP 03-1 profits followed by losses liability

Items to exclude from EGP

- Deferred acquisition costs
- Deferred sales inducements
- Unearned revenue
- Income taxes
- Overhead

Assumptions → Same as SFAS 120 – Best estimate with no PAD

SFAS 97 DAC

K for DAC amortization of SFAS 97

$$K = \frac{PV(DeferredExpenses)}{PV(EGP)}$$

Retrospective DAC for SFAS 97

$$DAC_t = (DAC_{t-1} + Capitalized Exp_t)(1+i) - (k * EGP_t)$$

Prospective DAC for SFAS 97

$$DAC_t = k * PV_t(EGP) - PV_t(Def Expenses)$$

Use credited rate to discount EGPs in DAC calculation. Can be initial or current credited rate.

Unearned Revenue Liability

Why URL? → Certain products have front loaded charges (COIs, Premium Loads). GAAP accounting wants to match revenue and expenses, therefore these front loaded charges need to be deferred to later years. This is accomplished through a URL.

K for URL amortization of SFAS 97

$$K = \frac{PV(Deferred Rev)}{PV(EGP)}$$

Retrospective URL for SFAS 97

$$URL_t = (URL_{t-1} + Unearned Revenue_t) * (1+i) - (k * EGP_t)$$

Prospective URL for SFAS 97

$$URL_t = k * PV_t(EGP) - PV_t(Unearned Revenue)$$