

MINUTES



To: Board Members
From: Goodman (ext. 295)
Subject: Minutes of April 6, 2005 Board Meeting: Risk Transfer in Insurance and Reinsurance Contracts **Date:** April 22, 2005
cc: L. Smith, Bielstein, Petrone, Leisenring, Project Team, Golden, Thuener, Polley, Gabriele, Getz, Mahoney, Sutay, Intranet; IASB: Upton, Leisenring, Clark; GASB: Attmore, Bean

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Topic: Risk Transfer in Insurance and Reinsurance Contracts

Basis for Discussion: Board Memorandum dated March 24, 2005

Length of Discussion: 11:15 a.m. to 12:15 p.m.

Attendance:

Board members present:	Herz, Batavick, Crooch, Schipper, Seidman, Trott, and Young
Board members absent:	None
Staff in charge of topic:	Cropsey
Other staff at Board table:	L. Smith, Golden, Belcher, and Goodman
Outside participants:	Leisenring

Summary of Decisions Reached:

The Board decided to add a project to its agenda to consider risk transfer in insurance and reinsurance contracts. The project will include developing a definition of insurance contracts and exploring simplified approaches to bifurcating insurance contracts.

Objective of Meeting:

The objective of the meeting was for the Board to decide whether to (1) add a project to examine risk transfer for insurance and reinsurance contracts and (2) take a definitional approach.

Matters Discussed and Decisions Reached:

1. Mr. Cropsey opened the meeting by stating that while FASB Statement No. 113, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts*, sets forth certain risk transfer guidance for reinsurance contracts, the Board asked the staff to consider a FASB Staff Position (FSP) on the effect of risk-limiting features on evaluating risk transfer in reinsurance contracts in response to an AICPA request for guidance.
2. Mr. Cropsey noted that the Board's current consideration of risk transfer also is in response to recent concerns about finite-risk and financial insurance and reinsurance arrangements that are designed to transfer a minimal amount of risk but still marginally qualify for insurance or reinsurance accounting. He stated that the National Association of Insurance Commissioners (NAIC) also is currently considering such reinsurance arrangements in response to the recent reports on purported abuses in accounting for reinsurance contracts.
3. Mr. Cropsey presented the following six approaches to a risk transfer project:
 - a. Wait to converge with IASB guidance. Waiting would not address current abuse issues.
 - b. Develop enhanced disclosures. Disclosures may not be sufficient to address current abuse issues.

- c. Provide limited guidance in an FSP in Q&A format for finite risk reinsurance contracts. Such limited-scope guidance would not address risk transfer in insurance accounting.
 - d. Reconsider the risk transfer criteria for reinsurance in Statement 113 and their potential applicability to insurance accounting.
 - e. Define insurance contracts and insurance risk by codifying and enhancing current guidance and develop a simplified approach to bifurcating insurance contracts.
 - f. Strengthen the risk transfer guidance in Statement 113 through simple modifications of the text to emphasize a higher level of required risk transfer than current industry practice—that is, the so-called 10/10 bright-line guideline (a 10 percent probability of a 10 percent loss by the reinsurer on a reinsurance contract). This approach also would not address risk transfer in insurance accounting.
4. Mr. Cropsey stated that the 10/10 bright-line guideline is industry practice, not GAAP, and was established as informal implementation guidance likely based on language in Statement 113 read by some to infer that significant risk transfer is anything greater than trivial or remote.
5. Messrs. Herz, Young, and Smith noted that the incorrect application of insurance accounting guidance is an enforcement issue rather than an accounting issue.
6. Ms. Schipper stated that she supports the Board adding a risk transfer project to the agenda to address allegations that existing guidance does not result in representationally faithful and comparable accounting when applied as written. She further stated that although the IASB is leading the potential joint project to reexamine insurance accounting, the FASB needs to address the specific problems raised by purported abuses in finite risk and financial reinsurance arrangements.
7. Ms. Schipper said that she supports the fifth approach (“e” above) if it entails developing a construct from current guidance and noted that the Board’s task is to separate the accounting for insured risk (that is, insurance) from financial risk (that is, investments or derivatives). She noted that the arithmetic relation between (a) the

premiums paid and (b) the stipulated return or amounts that can be withdrawn—regardless of timing—may serve to distinguish between insured and financial risk.

8. Mr. Cropsey indicated that a simplified bifurcation approach might entail examining non-risk transfer portions of insurance contracts that are defined by the risk-limiting contractual terms rather than examining the contract as a whole. As an example, he stated that if a contract establishes a level of loss that is guaranteed to be paid to the insured (that is, “dollar swapping”), or if losses and a refund of premium to a specified level are guaranteed to be paid to the insured, then those non-risk transfer portions would be bifurcated.

9. Mr. Cropsey said that as part of the simplified bifurcation approach, the staff recommends examining an insurance contract’s variable terms to determine whether they can be used to define a segment of the contract as a financing or non-risk transfer arrangement, rather than examining the probability of dollar swapping at various loss levels.

10. Mr. Cropsey noted that the NAIC is acting quickly to address the purported abuses and potentially considering bifurcation and possibly increasing the 10/10 threshold.

11. Mr. Cropsey stressed that the staff does not recommend codifying the 10/10 guideline.

12. Mr. Young stated that he strongly supports a principles-based approach to risk transfer and would be opposed to codifying any bright lines.

13. Mr. Crooch stated that the Board should ensure that the IASB, as the lead for the potential joint project on insurance accounting, does not perceive the Board’s adding a risk transfer project to its agenda as meddling.

14. Mr. Leisenring stated that he did not think that any of the IASB Board members felt that the FASB’s project was meddling. He stated that, on the contrary, the IASB might adopt some of the FASB’s conclusions.

15. Mr. Trott noted that the special accounting for risk transfer through insurance applies to insureds, which includes both insurers that have reinsurance policies and all other commercial enterprises that have insurance policies.

16. Mr. Young stated that requiring symmetry in the reporting by the insured and the insurer might address the purported abuses, particularly for reinsurance, because the insured and the insurer are both insurance companies with similar risk-assessment tools.

17. Ms. Seidman stated that the Board should codify insurance accounting to help ensure that policyholders know that they are subject to existing guidance on indemnification and risk transfer, specifically in paragraph 44 of FASB Statement No. 5, *Accounting for Contingencies*.

18. Ms. Seidman asked if there might be a simple way to incorporate bifurcation into current guidance.

19. Mr. Belcher noted that paragraph 283 of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and Statement 133 Implementation Issue No. B 26, “Dual Trigger Property and Casualty Insurance Contracts”, set a precedent for bifurcation by specifying that when a contract is based on both an insurable event and on some index, to the extent that the contract does not provide risk transfer, it is accounted for as a derivative, and to the extent that it does provide risk transfer, it is accounted for as insurance.

20. Mr. Herz concluded the meeting by recapping that the Board decided (a) to add a project on risk transfer in insurance and reinsurance contracts and (b) that the project should include developing a definition of *insurance contracts* and exploring simplified approaches to bifurcating insurance contracts.

Follow-up Items:

None

General Announcements:

AICPA guidance for insureds—TPA 1200.06 Note to TIS Section 1200.07 to 1200.16--
Accounting by Noninsurance Enterprises for Property and Casualty Insurance
Arrangements That Limit Insurance Risk—is available at:

www.aicpa.org/download/acctstd/Commercial_Insurance_TPA.pdf

FASB guidance for insureds—paragraph 44 of Statement 5—is available at:

www.fasb.org/pdf/fas5.pdf