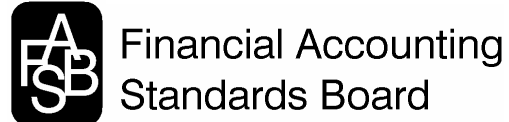


MINUTES



To: Board Members
From: Benson (ext. 446)
Subject: Minutes of the November 29, 2006
Board Meeting: Financial Guarantee Insurance—Disclosure, Effective Date, Transition, and Sweep Issues
Date: December 5, 2006
cc: FASB: L. Smith, Bielstein, MacDonald, Leisenring, Polley, Gabriele, Allen, Glotzer, Sutay, Carney, Project Team, FASB Intranet; GASB: Attmore, Bean

The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue a final Statement or Interpretation.

Topic: Financial Guarantee Insurance—
Disclosure, Effective Date, Transition,
and Sweep Issues

Basis for Discussion: Board memorandum dated November
15, 2006

Length of Discussion: 9:50 a.m. to 11:10 a.m.

Attendance:

Board members present: Herz, Batavick, Crooch, Linsmeier,
Seidman, and Trott

Board members absent: Young

Staff in charge of topic: Trench

Other staff at Board table: L. Smith, Cropsey, and Benson

Outside participants: None

Summary of Decisions Reached:

The Board discussed remaining issues identified during the drafting of the proposed Interpretation of FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises*, for financial guarantee insurance contracts as well disclosures, effective date, transition, and exposure period. Specifically, the Board decided the following:

1. With regard to how prescriptive the accounting guidance within the proposed Interpretation should be in defining the recognition of an *expected loss*, expected loss related to recognition would not be defined.
2. In relation to refundings, include guidance within the proposed Interpretation regarding (a) the accounting treatment for refundings and (b) refundings in which the same financial guarantee insurance entity that insured the retired financial obligation insures the new financial obligation.
3. Exclude mortgage guaranty insurance and credit insurance from the scope of the proposed Interpretation.
4. To not include accounting guidance within the proposed Interpretation relating to purchases and subsequent sales of financial obligations insured by the holder of the financial obligation.
5. Include the following disclosures within the proposed Interpretation in addition to those required in Statement 60 and other related insurance accounting guidance:
 - a. With regard to revenue recognition:
 - (1) Accounting policy
 - (2) Dollar amount of revenue generated from the acceleration of premium recognition due to early terminations for the period.
 - b. For installment premium financial guarantee insurance contracts:
 - (1) The amount recognized in the balance sheet for the current period as premium receivable and unearned revenue (if not separately discernible)
 - (2) The amount of accretion on the premium receivable recorded as a component of investment income for the period (if not separately discernible)

(3) The assumptions used in calculating the balance sheet amounts (receivable only) including the range of discount rates used

(4) A schedule of the expected installment premiums to be earned as follows:

- (a) The remaining quarters for the current annual period
- (b) The four quarters of the subsequent annual period
- (c) The next three annual periods
- (d) The remaining periods aggregated in five-year increments.

c. For the claims and expected claims liabilities, a description of the internal surveillance list used to accrue the expected claim liability (and a description of each category within that list), the criteria used to place an insured financial obligation in each category, and management's process for monitoring and moving a financial obligation between categories. In addition, the following information shall be disclosed in tabular form separated in a manner consistent with how management tracks its portfolio:

- (1) Par outstanding by category
- (2) Debt service outstanding by category
- (3) Number of policies by category
- (4) Remaining average contractual policy term by category
- (5) Current pre-guarantee average rating by category
- (5) Gross claim liability (discounted) by category (gross of reinsurance)
- (6) Expected subrogation (discounted) by category (gross of reinsurance)
- (7) Net claim liability (discounted) by category (gross of reinsurance).

The total net claim liability (discounted) should be reconciled to the amount reported in the balance sheet. The amount of transfers between categories shall be disclosed and described.

d. For claim adjustment liabilities and remediation liabilities, disclose and explain the amounts and nature of these liabilities recorded in the balance sheet and the income statement including assumptions used in calculating these amounts.

6. Require application of the proposed Interpretation to the first fiscal year beginning after December 15, 2007 (but include a question within the proposed Interpretation regarding whether the effective date allows sufficient time for implementation).
7. Implement transition guidance that permits a cumulative-effect adjustment (using current information) to retained earnings or to other components of equity or net assets as of the beginning of the year of adoption (but include a question within the proposed Interpretation regarding whether constituents would have the necessary information for retrospective application). Early adoption would not be permitted.
8. Expose the proposed Interpretation for public comment for a period of 90 days, ending no later than April 15, 2007.

The Board agreed to hold a roundtable subsequent to the issuance of the Exposure Draft. The Board also discussed the use of interest rates in discounting the future installment premiums (both the asset and the liability), pre-claims liabilities, and claims liabilities but did not make a decision with regard to this issue. The Board agreed to discuss interest rates used in discounting at a future meeting.

Objective of Meeting:

The objectives of the meeting were for the Board to (1) address several issues identified during drafting of the proposed Interpretation, and (2) determine disclosure requirements, an effective date, and transition guidance. The objectives of the meeting were met.

Matters Discussed and Decisions Reached:

1. Mr. Trench began the discussion by stating that the staff is currently in the process of drafting a proposed Interpretation to clarify Statement 60 for financial guarantee insurance contracts. The proposed Interpretation will include decisions previously reached by the Board at the August 9, 2006 Board meeting (regarding claims recognition) and September 13, 2006 Board meeting (regarding premium revenue recognition, the accounting for installment premiums, and the accounting for deferred acquisition costs). In drafting the proposed Interpretation, several issues were identified that require the Board's consideration. The staff also will request that the Board deliberate proposed

- disclosures, an effective date for the proposed Interpretation, and transition guidance.
2. Issues identified during drafting of the proposed Interpretation include (a) definition of expected loss, (b) interest rates used in discounting, (c) refundings, (d) applicability of the proposed Interpretation to mortgage guaranty insurance and credit insurance, and (e) the accounting treatment for purchases of financial obligations guaranteed by the holder of the financial obligation.

Definition of Expected Loss

3. Mr. Trench stated that in the deliberations concerning a claims recognition approach, the Board concluded that an expected loss approach would provide the best information to users. In doing so, the Board rejected a FASB Statement No. 5, *Accounting for Contingencies*, or Statement 60 approach (both incurred loss approaches). However, the Board felt that a long-duration contract approach under Statement 60 could be modified to obtain an expected loss approach suitable for financial guarantee insurance. The Board concluded that the claims recognition approach should be based on an expected loss model using credit deterioration and the time value of money. Mr. Trench stated that financial guarantee insurance entities commonly use “watch lists” to track deteriorating insured financial obligations. These watch lists contain defined categories that are used to identify the significance of the credit deterioration and to dictate the frequency of internal credit reviews. The Board must determine how prescriptive the accounting guidance should be in order to capture the watch list information on a consistent basis. That is, the Board must determine how specific “expected loss” should be defined in the proposed Interpretation. The staff offered the following views for recognition:
 - a. View A—Categories of watch list items should be defined with prescriptive guidance specifying the level of credit deterioration for each category (including a minimum threshold).
 - b. View B— Specify only a minimum threshold for including an item on the watch list and allow for each entity’s judgment in developing watch list categories (with disclosure of the categories and the entity’s basis for selecting the categories)

c. View C— No attempt at defining categories or a minimum threshold should be made.

4. Mr. Trench stated that the measurement of the expected loss would be consistent across all three views and the total expected loss would be the same (assuming there is no known expected loss below the threshold level that is provided for by the unearned premium liability). However, the amounts of the expected losses reported by category will vary depending on the definition of the categories selected.

5. Mr. Trench observed that Views A and B were an attempt to provide a threshold for when an expected loss should be recognized. Both of these views ignore the unearned premium liability. Some believe the unearned premium liability represents the unknown liability (or a stand-ready obligation) at inception. However, in order to properly measure this unknown liability after inception, the contract would have to be repriced at each reporting period (essentially measure at fair value). An additional liability would only be established when the claim liability exceeds the unknown liability amount. However, the Board did not choose fair value but rather an expected loss approach pursuant to Statement 60. In so doing, the Board determined that the unknown liability equals the unearned premium liability, which, under Statement 60, is systematically released over time and generally cannot increase. Essentially, Views A and B provide two liabilities while View C provides one liability that is bifurcated. Therefore, in determining the definition of an expected loss and selecting a view, under View C the unearned premium provides the threshold that Views A and B attempt to prescribe. The staff, in presenting Views A and B, believed that an alternative would be to prescribe a threshold in an attempt to provide some level of comparability.

6. Mr. Linsmeier stated that he supports View C, as he does not think there should be minimum threshold criteria. Mr. Trott stated that he supports View C as well. He noted that the Board addressed this issue to explain to constituents that it does not wish to implement a Statement 5 approach. Rather, the Board is introducing a new approach for the second segment of the pre-claim liability. Specifically, there will be an adjustment of the stand-ready obligation to reflect negative variances and expectations that existed upon initially entering into the obligation. When the term *expected losses* is used, it means *probability-weighted expected losses*. With regard to Statement 5, many believe that if there is no expected loss, then a loss should not be recognized. The Board is trying to change that opinion. Mr. Smith asked for clarification of Mr. Trott's statement

regarding the difference between a pre-claim liability and a claim liability. Mr. Trott stated that when an entity has a claim, that entity has assumed the obligation. Mr. Smith further refined his question to Mr. Trott, asking how a partial default is handled and how expected recoveries are included within the estimation of the claim liability. Mr. Trott observed that Mr. Smith's questions are provided for under Statement 60. This method of recording a claim is new; previously there was no way to communicate the negative variances from the initial expectation.

7. Ms. Seidman stated that she was unsure if she supports a probability-weighted notion. To the extent one is using a watch list approach and estimating the likely amount of default within the various probabilities of default, it is not the same probability-weighted approach one would use in an expected value calculation. She did not realize the Board planned to use expected value-type language in the proposed Interpretation. Ms. Seidman and Mr. Crooch stated that they support View C.

8. Mr. Batavick noted that he supports View C, as it is most appropriate to allow companies to determine the pre-claim liability based on credit deterioration or other factors identified in a watch list. The Board decided that View C was most appropriate. That is, no attempt at creating defined parameters or minimum thresholds should be made (all Board members agreed).

Interest Rates Used in Discounting

9. Mr. Trench stated that, for estimates relating to the expected present value of future installment premiums, expected current claims liabilities, and claims (case) liabilities, the Board previously concluded that the time value of money should be reflected in the measurement of these balances. However, the Board has not deliberated at what interest rate to discount the balances and whether or not the selected interest rate should be updated each period. The interest rate selected could represent a published interest rate (such as a risk-free interest rate or LIBOR), an interest rate equal to the rate of return on an investment portfolio (pursuant to Statement 60), or an interest rate based on the criteria in APB Opinion No. 21, *Interest on Receivables and Payables*.

10. The options for changing interest rates include (a) lock-in rate at inception, (b) change the rate each reporting period, or (c) use an approach similar to that prescribed in FASB Statement No. 143, *Accounting for Asset Retirement Obligations* (specifically, increases in the financial obligation would be segregated and discounted at a new

interest rate, and decreases in the financial obligation would be discounted at a weighted average interest rate). Mr. Trench asked the Board to determine what interest rate should be used to determine present value, and whether that interest rate should be updated.

11. The Board decided to discuss the interest rate issue in an educational and information-gathering context and make decisions regarding the interest rates used in discounting at a future meeting. Concerning the claim liability, Mr. Herz stated that he does not favor the Statement 143 approach. Regarding the liability, he does not think there should be a difference between the pre-claim liability and the payable once the claim is fixed; the claim should not trigger a new accounting approach.

12. Mr. Trott stated that in terms of the receivable, he thinks that the Board should follow guidance in Opinion 21 for both selecting the interest rate (looking at the credit of the insured) and locking in the interest rate at inception. Concerning the pre-claim liability, the question is how close the Board wants to get to a fair value approach. If the objective is to show the impact of the negative changes in credit, then the Board should elect to freeze the interest rate to eliminate the impact of changing interest rates. He stated that once there is a default, he thinks there is a new liability; it is no longer a pre-claim liability. He would choose to determine the claim liability that ought to be recorded based on the then-existing interest rate of the insurer. Mr. Trott stated that he views the pre-claim liability as an adjustment of the stand-ready obligation. Once a claim is filed, the stand-ready obligation no longer exists as the insurer is now obligated to make payments. Mr. Smith asked Mr. Trott to clarify the “then-existing” interest rate. Mr. Trott stated that for both the pre-claim and claim liabilities, it would be the credit of the insurance company. In determining an appropriate interest rate, once there is a switch from an asset to a liability, the question of which entity’s credit determines that interest rate switches as well. Mr. Smith stated that under Mr. Trott’s approach, upon default, the insurer is stepping in the shoes of the borrower and any cash payments due under the borrowing from that point forward are the cash flows associated with the claim. Mr. Trott agreed and observed that he believes a default is a significant event. Mr. Trott noted that he would fix the interest rate adjusted as of the default date.

13. Ms. Seidman noted that the cash flows that the insurer might have to pay out are affected by the creditworthiness of the borrower (insured). That dispersion is communicated through the watch list. The credit risk of the borrower should not be included in that interest rate. She stated that she favors locking in the interest rate at

inception. The question of how much the insurer must pay and the estimated occurrence of default is already communicated within the watch list. Thus, there is no reason to continually update the interest rate for changes in the insurer's creditworthiness or general changes in interest rates. The important issue is how much the insurer must pay out on the insured entity's behalf, not the volatility of interest rates.

14. Ms. Seidman stated that she does not think the character of the liability fundamentally changes upon default; only the estimate continues to change. Mr. Smith added that in a conversation with Mr. Trench, Mr. Trench explained that as the insured entity nears default, the recorded liability of expected losses should be nearing the defaulted amount. Thus, on the day of default, the liability is already substantially recorded. Ms. Seidman noted that it is difficult to decide when the interest rate should be adjusted if the liability is gradually increased to the default amount before the actual default.

15. Mr. Trott stated that he thinks the negotiations (in the case of property and casualty insurance) between the insured and the insurer include the amount and timing of the insured payments. In many cases, there is likely a significant negotiation as to the time frame in which the insured entity's liability will be paid. Mr. Trott noted that the insurer likely calculates the claim on a discounted basis using the interest rate at inception of the claim, similar to a note payable. Mr. Trench responded that with financial guarantors, there is not a negotiation involving the principal and interest to be paid, as the principal and interest are set according to a schedule. Mr. Trott stated that in settling a claim involving the time value of money, he thinks it is appropriate to use accounting guidance in Opinion 21 for the interest rate, based upon the credit and interest conditions that exist at the time the claim is settled. Mr. Trench agreed that insurers should be using Opinion 21 to determine the interest rate.

16. Ms. Seidman stated that concerning Mr. Trott's approach, it is unclear whether an entity is able to identify a clear demarcation between a pre-claim liability and the claim that resembles a note payable. She suggested that a more reasonable approach may include identifying significant changes in the amounts the insurer expects to pay, such as when an entity moves from one category to another within the watch list. Mr. Smith stated that Ms. Seidman's idea is similar to the Statement 143 model that the Board previously dismissed. Ms. Seidman responded that the Statement 143 model is not equivalent to her suggested model, as the Statement 143 model requires different accounting for selecting an interest rate when the change in estimated payments by the

insurer is favorable versus unfavorable. Mr. Smith responded that the different accounting arises because it is difficult to determine the specific cash flows associated with an unfavorable change in estimated payments. Ms. Seidman suggested that the Board consider a model in which the interest rate is locked in upon an entity's inclusion on a watch list, and a reassessment of the interest rate upon default.

17. Mr. Linsmeier stated that a present obligation does not exist until a default has occurred. Prior to default, the obligation is simply a probabilistic event. He also stated that he thinks the probability of expected loss should not change with interest rates in the pre-claim period.

18. Mr. Smith observed that in establishing the installment premium receivable and the related unearned revenue, these amounts should be equal. The Board agreed. Ms. Seidman stated that the liability should be calculated first and discounted at an interest rate reflecting the credit of the insurer (focusing on the fair value of the obligation). Mr. Smith disagreed because he believes the receivable is simply a surrogate for cash and the creditworthiness of the borrower should drive the measurement of the installment premium.

19. The Board agreed to decide the interest rate issue at a later meeting. Therefore, no decisions were made concerning the interest rate used in discounting.

Refundings

20. Mr. Trench stated that *refundings* is a term used by financial guarantee insurance entities to describe the early retirement of an outstanding financial obligation (usually in reference to an insured municipal bond). For a financial guarantee insurance entity, the insurance contract is terminated when the original insured financial obligation is retired. Premiums for insurance contracts for municipal bonds are single, upfront payments that are nonrefundable. Since the insurance contract is terminated when the underlying financial obligation is retired, the remaining unearned premium is earned immediately and any remaining deferred acquisition costs are expensed.

21. Mr. Trench stated that the first issue the Board must decide on is whether to provide specific guidance regarding the treatment of the remaining unearned premium and deferred acquisition costs when the insured financial obligation has been retired early. That is, the Board must determine whether to make such guidance explicit in the proposed Interpretation. The Board agreed to include explicit guidance regarding the treatment of refundings.

22. The second issue concerning refundings is whether guidance should be included in the proposed Interpretation for refundings in which the same financial guarantor insures the new financial obligation. The Board also must decide whether the premium received is similar to the premium that would be received for an unassociated insurance contract (taken directly from the Board meeting handout).

23. Mr. Batavick stated that the unearned premium and deferred acquisition costs should be taken off of the insurer's books once the refunding occurs. It would be difficult to devise a model that takes into consideration a rollover of the obligation. He stated that the Board should have simple guidance regarding the cancelled contract, in which the unearned premium and deferred acquisition costs are taken off the books once the contract is cancelled. Upon rollover of the contract, the premium should be calculated at the current market rate. Mr. Batavick added that the Board should not include guidance for when the premium is not calculated at the market rate and suggested some type of disclosures related to refundings (which are discussed later). The Board decided to give explicit guidance in the proposed Interpretation concerning rollover of a contract, with the assumption that the premium is calculated at the current market rate (all Board members agreed).

Applicability of Proposed Interpretation to Mortgage Guaranty Insurance and Credit Insurance

24. Mr. Trench stated that, at the beginning of the project, the staff provided the Board with an analysis of the similarities and differences between financial guarantee insurance, mortgage guaranty insurance, and credit insurance. The Board concluded that an accounting model should first be developed for financial guarantee insurance contracts. Once this had been completed, the staff planned to ask the Board if the financial guarantee insurance accounting model should be applied to mortgage guaranty insurance and credit insurance.

25. He stated that there are three potential approaches to addressing this question:
- a. Approach A—Include mortgage guaranty insurance and credit insurance within the scope of the proposed Interpretation.
 - b. Approach B—Include a question within the proposed Interpretation asking constituents whether mortgage guaranty insurance and credit insurance should be included within the scope and the rationale for the response.

c. Approach C—Mortgage guaranty insurance and credit insurance contracts are different from financial guarantee insurance contracts and should not be included within the scope of the proposed Interpretation.

26. The Board decided to limit the scope of the proposed Interpretation to financial guarantee insurance (all Board members agreed). That is, mortgage guaranty insurance and credit insurance contracts will not be included in the scope of the proposed Interpretation.

The Accounting Treatment for Purchases and Subsequent Sales of Financial Obligations Guaranteed by the Holder

27. Mr. Trench stated that the next issue for the Board's deliberation involves whether an extinguishment occurs when a financial guarantor purchases a financial obligation for which it has provided insurance. If an extinguishment has occurred, how should the subsequent sale of the financial obligation be accounted for? The staff has noted that this issue is not limited to the financial guarantee insurance industry. Thus, the Board must determine whether to address this issue within the proposed Interpretation.

28. Mr. Trott stated that he prefers to address the issue in another project. He questioned why financial guarantee insurance entities would buy obligations that they also insure. Mr. Smith suggested that the financial guarantor might buy its own insured debt because the guarantor would be able to acquire it at a discount and avoid future payments on it. Mr. Herz noted that a financial guarantor might buy debt it has insured because it would have the ability to liquidate it. Mr. Trench observed that in purchasing a security that the financial guarantee entity has insured, there is certain knowledge gained through the underwriting process on that security. In addition, the rating agencies view the securities as AAA-rated regardless of the fact that they are insured by the holder because the rating agencies are concerned with the strength of the financial guarantee entity backing the security.

29. Ms. Seidman stated that she would not like to address the issue within the proposed Interpretation. She suggested the issue be considered as a future EITF topic. The Board decided to address the issue outside of the financial guarantee insurance project (all Board members agreed).

Proposed Disclosures

30. Mr. Trench stated that the proposed disclosure requirements would begin with clarifying that the disclosure requirements in Statement 60 and other related insurance accounting guidance are applicable to financial guarantee insurance contracts.

31. The staff proposed the following additional disclosures (taken directly from the Board meeting handout):

a. With regard to revenue recognition:

(1) Accounting policy

(2) Dollar amount of revenue generated from the acceleration of premium recognition due to early terminations for the period.

(3) Process used to evaluate instances where accelerated premium revenue recognition due to early terminations has occurred and whether the insurance premium on the refunding issue is based on current market rates

(4) The aggregate amount of premium related to the new issuances that resulted from the retirement of existing issuances.

b. For installment premium financial guarantee insurance contracts:

(1) The amount recognized in the balance sheet for the current period as premium receivable and unearned revenue (if not separately discernible)

(2) The amount of accretion on the premium receivable recorded as a component of investment income for the period (if not separately discernible)

(3) The assumptions used in calculating the balance sheet amounts (receivable only) including the range of discount rates used

(4) A rollforward of the expected present value of future installment premiums detailing the balance at the beginning of the period, premiums originated during the period, premiums received (cash), other adjustments to the beginning balance (with explanations for the adjustment), and the ending balance

(5) A schedule of the expected installment premiums to be earned as follows:

- (a) The remaining quarters for the current annual period
- (b) The four quarters of the subsequent annual period
- (c) The next three annual periods
- (d) The remaining periods aggregated in five-year increments.

c. For the claims and expected claims liabilities, a description of the internal surveillance list used to accrue the expected claims liability (and a description of each category within that list), the criteria used to place an insured financial obligation in each category, and management's process for monitoring and moving a financial obligation between categories. In addition, the following information shall be disclosed in tabular form separated in a manner consistent with how management tracks its portfolio:

- (1) Par outstanding by category
- (2) Debt service outstanding by category
- (3) Number of policies by category
- (4) Remaining average contractual policy term by category
- (5) Current pre-guarantee average rating by category
- (5) Gross claim liability (discounted) by category (gross of reinsurance)
- (6) Expected subrogation (discounted) by category (gross of reinsurance)
- (7) Net claim liability (discounted) by category (gross of reinsurance).

The total net claim liability (discounted) should be reconciled to the amount reported in the balance sheet. The amount of transfers between categories shall be disclosed and described.

d. For claim adjustment liability and remediation liabilities, disclose and explain the amounts and nature of these liabilities recorded in the balance sheet and the income statement including assumptions used in calculating these amounts.

32. Mr. Trench noted that the staff contacted several users to provide insight into which proposed disclosures they believe are most relevant. For the most part, the users believe the non-GAAP information provided in the operating supplements provides them with sufficient information. However, these users did specifically indicate that requiring and creating uniformity for a rollforward of

installment premiums and claims recognition would be useful. The staff inquired whether there was any disclosure that they would like to see. None of the users indicated any additional needs regarding disclosures. Mr. Trench asked whether the Board agreed with the proposed disclosures.

33. Mr. Trott stated that he did not agree with all of the disclosures. He requested that disclosure b(4) concerning a rollforward of the installment receivable be eliminated. As the staff proposes to disclose expected installment premiums, it is unnecessary to additionally disclose the rollforward that is already relayed on the balance sheet. The Board decided to exclude disclosure b(4) (all Board members agreed).
34. Ms. Seidman stated that the combination of disclosures a(2), a(3), and a(4) requires more information than necessary. The Board decided that disclosures a(3) and a(4) should be eliminated, as the information presented in those disclosures is too onerous for the reporting entity (all Board members agreed).

Effective Date

35. Mr. Trench stated that the staff observed that decisions reached by the Board will result in significant changes and resources to implement the proposed premium revenue recognition accounting guidance (including the accounting for installment of premium insurance contracts). As such, the staff proposes an effective date for the proposed Interpretation for the first fiscal year beginning after December 15, 2008, in order to allow sufficient time to implement the proposed accounting guidance (with earlier adoption permitted).
36. Ms. Seidman objected to delaying the effective date until after December 15, 2008. Mr. Batavick asked Mr. Trench why the staff proposed an effective date for fiscal years beginning after December 15, 2008. Mr. Trench responded that some of the necessary changes may require more than six months for financial guarantee entities to implement. Also, analysts have told the staff that an extra year to prepare for the final Interpretation would help them in understanding how the changes will impact their analyses of the financial guarantors. The Board decided to make the proposed Interpretation effective as of December 15, 2007 (all Board members agreed). In addition, the Board decided to include a question for constituents regarding the proposed effective date in the Exposure Draft.

Transition

37. Mr. Trench stated that the following proposed transition guidance should be included in the Exposure Draft:

The guidance in this Interpretation shall be applied through a cumulative-effect adjustment to retained earnings or to other components of equity or net assets in the statement of financial position as of the beginning of the year of adoption. The entity shall disclose the cumulative effect of the change on retained earnings or on other components of equity or net assets in the statement of financial position. Retrospective application is not permitted.

The staff proposed the transition above because significant judgment and estimation would be required to calculate prior period balances. As such, the ability to make judgments and estimates for prior periods in the current period may include hindsight. Therefore, the staff has recommended a cumulative-effect adjustment to opening retained earnings in the year of adoption.

38. Ms. Seidman and Mr. Trott supported requiring a cumulative-effect adjustment, using the current rate at adoption to calculate the cumulative effect. Mr. Smith noted that the proposed transition guidance should be explicit with regard to the use of current rates in determining the cumulative-effect adjustment to avoid confusion. Mr. Trott stated that what was proposed is different from a cumulative catch-up adjustment (retrospective application would require including previously-matured contracts in the adjustment). Mr. Crooch added that amounts on the balance sheet as of the effective date would be adjusted for the proposed new accounting. Mr. Herz suggested the proposed Interpretation include an example of a cumulative effect adjustment.
39. Mr. Linsmeier questioned why Board members do not support retrospective application. Mr. Trott responded that it would be impractical to require retrospective application, as an entity would need to change the accounting and make necessary assumptions for all insured obligations outstanding. Ms. Seidman added that such a requirement would require speculation, and hindsight would inevitably factor into the retrospective estimates. Mr. Smith suggested the Board ask a question in the Exposure Draft of the proposed Interpretation concerning the ease of retrospective application. The Board decided to tentatively require cumulative-effect adjustment and include a question in the Exposure Draft concerning retrospective application (all Board members agreed).

40. Mr. Trott stated that the Board also must determine whether to allow early adoption of the proposed Interpretation. He noted that a negative effect of allowing early adoption would be non-comparability between firms. However, allowing early adoption would provide investors with better information sooner. Mr. Herz stated that he does not think early adoption is necessary because there will not be an opportunity for firms to early adopt, given the proposed effective date.

Exposure Period

41. Mr. Trench stated that, based on the expected timing of the exposure of the proposed Interpretation (fourth quarter 2006), the staff recommends a 90-day exposure period or a period ending no later than April 15, 2007, depending on the release date of the Exposure Draft. The Board decided to expose the proposed Interpretation for 90 days, with a period ending no later than April 15, 2007 (all Board members agreed).

Request for a Roundtable

42. Mr. Trench stated that based on feedback from the industry and analysts, the staff would like the Board to consider holding a roundtable meeting, and if so, the timing of that roundtable. Mr. Trott suggested that a question be included in the proposed Interpretation regarding revenue recognition for insured zero-coupon bonds (or bullet payments). Specifically, the question would address how many zero-coupon bonds are insured and what the premium would be in subsequent periods (recognizing the change in time and expected losses). Ms. Seidman added that the Board also should include a question regarding items that are prepayable and how prepayment affects the term. Mr. Herz stated that he supports holding a roundtable. In talking with several industry and user representatives who object to the proposed Interpretation, he is unsure whether the proposed Interpretation should be exposed at all with the currently proposed revenue recognition model.
43. Ms. Seidman agreed with Mr. Herz that constituents do not seem to support the revenue recognition accounting that was previously agreed upon by the Board. She stated that she plans to write an alternative view on the revenue recognition model for the Exposure Draft if the other Board members wish to proceed with the Exposure Draft as they originally voted. Specifically, her alternative view will

suggest that, in broad terms, when an instrument is prepayable and an entity can reliably estimate the payments, those factors should be considered in establishing the denominator in the revenue recognition calculation. In addition, risk reduction should be determined by the reduction in the amount of exposure outstanding and the passage of time, given the nature of the items being insured.

44. Mr. Linsmeier stated that if the obligation is not a zero coupon bond, the passage of time is tied with interest payments and principal payments. Thus, there is a component of the passage of time in the currently proposed revenue recognition model. In addition, there is a time value of money consideration in both the asset and liability (regarding future installment premiums) that reflects the passage of time. He stated that he is concerned that the level yield model overemphasizes the timing aspect.
45. Mr. Batavick stated that he thinks it would be better to expose the proposed Interpretation with the currently proposed revenue recognition model and include questions regarding the appropriateness of the proposed revenue recognition model. That way, the Board will be able to gather complete information concerning constituent views of the proposed revenue recognition model before redeliberating that model. Mr. Linsmeier stated that the questions in the proposed Interpretation should indicate that there are two aspects of time in the current proposed revenue recognition model, and that the Board would like commentary explaining why constituents believe the Board has insufficiently captured the timing element. The Board agreed to hold a roundtable and use the exposure period to gather information concerning the appropriateness of the revenue recognition model. Mr. Smith noted that the Board should forego its normal requirement that all roundtable participants submit a comment letter, as the expectation is that one of the comment letters received from a trade organization will represent a majority of the industry participants. The Board agreed to forego the requirement that all roundtable participants submit a comment letter **to enable people from different companies to attend the meeting even if their company did not submit a letter, as long as they are represented by a letter submitted by an organization to which they are a member..**

Follow-up Items:

The Board will address issues related to interest rates used in discounting at the December 6, 2006 Board meeting.

General Announcements:

The Board will hold a roundtable subsequent to the issuance of the Exposure Draft of the proposed Interpretation.