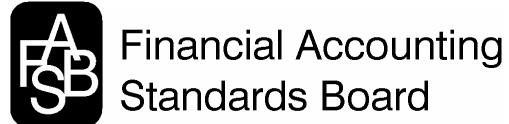


MINUTES



To: Board Members
From: Goodman (ext. 295)
Subject: Minutes of December 20, 2005 Board Meeting: Risk Transfer in Insurance and Reinsurance Contracts—Bifurcation **Date:** January 4, 2005
cc: FASB: L. Smith, Bielstein, Petrone, MacDonald, Leisenring, Project Team, Golden, Belcher, Polley, Gabriele, Carney, Mahoney, Sutay, Intranet; IASB: Upton, Leisenring, Clark; 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, Interpretation, or FSP.

Topic: Risk Transfer in Insurance and Reinsurance Contracts: Bifurcation

Basis for Discussion: Board Memorandum dated December 7, 2005

Length of Discussion: 10:20 a.m. to 10:55 a.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: Belcher, Golden, Goodman, Smith, and Trench

Outside participants: Leisenring

Summary of Decisions Reached:

The Board directed the staff to further develop approaches for bifurcating insurance and reinsurance contracts into financing and insurance components. The Board approved the issuance of an Invitation to Comment (a neutral staff discussion document) soliciting constituent feedback on bifurcation approaches and related implementation issues. The Invitation to Comment is scheduled for issuance in the first quarter of 2006.

Objective of Meeting:

The objective of the meeting was for the Board to consider whether to further develop approaches for bifurcating insurance and reinsurance contracts into financing and insurance components and whether to issue an Invitation to Comment soliciting constituent feedback on bifurcation approaches and related implementation issues.

Matters Discussed and Decisions Reached:

Issue 1: Whether to Further Explore Bifurcation Approaches

1. Mr. Cropsey stated that the purpose of the meeting was for the Board to consider issues related to clarifying and/or strengthening the existing insurance risk transfer guidance in FASB Statement No. 113, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts*. He stated that although some constituents assert that the existing guidance is adequate, the fact that it has been misapplied indicates that the guidance may need clarification. He asked the Board whether the staff should further explore bifurcation approaches as a possible solution to accounting for insurance and reinsurance contracts with conditions or features that limit risk transfer, adding that while the staff did not identify any simple bifurcation approaches, it did note the following possible approaches:
 - a. Confidence level insurance risk transfer model—This model would effectively designate as a deposit the portion of an insurance or reinsurance contract for which an amount of claims is likely to be paid. This approach is similar in concept to a statutory accounting approach recently proposed by the New York Insurance Department (NYID). The NYID's proposed approach utilizes a specific

confidence level as a means of determining the risk and nonrisk components. Also, there is a GAAP precedent based on a similar notion for bifurcating insurance contracts in Statement 133 Implementation Issue No. B26, “Embedded Derivatives: Dual-Trigger Property and Casualty Insurance Contracts.” The guidance in this Implementation Issue applies to both the policyholder (ceding company) and the insurer (reinsurer).

- b. Proportional insurance risk transfer model—This model utilizes the ratio of insurance risk transferred to the total risk in the underlying contract(s). This ratio would be applied to the expected cash flows of a contract to determine the risk transfer and financing components.

Board Decision and Rationale

2. The Board agreed that the staff should further explore bifurcation approaches as a possible solution to accounting for insurance and reinsurance contracts with conditions or features that limit insurance risk transfer. Mr. Batavick and Ms. Seidman agreed because they believe that current accounting for certain insurance and reinsurance contracts does not reflect the underlying economics of those contracts. Mr. Crooch noted that the Board has an obligation to help financial statement users understand the impact of the different components of insurance and reinsurance contracts. Mr. Trott noted that simply adopting an IFRS 4, *Insurance Contracts*, based definition of insurance contracts, including the notion of commercial substance, is not sufficient to address risk transfer in certain insurance and reinsurance contracts. Ms. Schipper noted that the confidence level risk transfer model could apply to both insurance and reinsurance contracts but the proportional insurance risk transfer model would likely only apply to reinsurance.
3. Although Mr. Young agreed conceptually with bifurcation, he disagreed with pursuing bifurcation at this time because the user community has expressed its desire for an incremental change to the current accounting that addresses finite risk contracts in an expeditious manner. Mr. Herz responded that the only possible quick fixes, such as imposing a bright line rule, are unsatisfactory.

4. Mr. Leisenring stated his concern about (a) providing safe harbors and (b) distinguishing derivatives from financing and insurance in bifurcating the elements in an insurance contract. Ms. Seidman responded that the Board ultimately may have to revisit the current guidance in FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, on bifurcating derivatives from insurance contracts with financing components.

Issue 2: Whether to Issue an Invitation to Comment

5. Mr. Cropsey asked the Board whether it agrees that issuing an initial neutral discussion document, such as an Invitation to Comment (ITC) soliciting comments from constituents, would be the appropriate next step in further exploring bifurcation. The ITC would include issues such as:
 - a. What approaches to bifurcation would be most effective in improving transparency in and usefulness of financial statements?
 - b. What contracts would be appropriate for bifurcation—that is, what, if any, safe harbors should be developed for contracts that would not require bifurcation analysis?
 - c. How would bifurcated contracts be accounted for?

Board Decision and Rationale

6. The Board agreed to issue an ITC. Ms. Seidman noted that the ITC will give the Board early constituent input on the cost-benefit and operability of bifurcation approaches as well as on whether those approaches provide useful information to financial statement users. Mr. Herz and Ms. Schipper expressed their preference for the document to be issued earlier than March 2006. Mr. Batavick thought that the proposed timing was aggressive. Mr. Batavick and Mr. Trott noted the importance of encouraging the helpful cooperation of the insurance industry and actuarial profession in assessing bifurcation approaches and related issues. Mr. Young disagreed for the reasons noted in paragraph three above.

Follow-up Items:

None.

General Announcements:

None.