MINUTES

To:	Board Members
From:	Insurance Contracts Team (Jones, ext. 384)
Subject:	Minutes of the July 19, 2010, Joint Board Meeting: Insurance Contracts — **Date:** August 3, 2010
cc:	FASB: Bielstein, Golden, Stoklosa, Chookaszian, Posta, Guasp, Sutay, Klimek, Gabriele, McGarity, Proestakes, Lott, Hood, Brickman, Jones, Handy, Montgomery, Galloway (GASB), FASB Intranet; IASB: Clark, van der Veen, Hack, Jordan, Teixeira

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 Accounting Standards Update.

Topic:	Insurance Contracts—Unbundling, Unit-Linked Contracts, Simplified Measurement, and Residual Margin for Investment Contracts with a Discretionary Participating Feature
Basis for Discussion:	FASB Memo Nos. 52—52D / IASB Agenda Papers 3—3D
Length of Discussion:	10:30 a.m. to 2:00 p.m. (EST)
Attendance:	
Board members present:	FASB: Herz, Smith, Siegel, Seidman and Linsmeier (by video) IASB: Tweedie, Cooper, Danjou, Engström, Finnegan, Gomes, Kalavacherla, König, McConnell, McGregor, Pacter, Smith, Yamada, and Wei-Guo

Board member absent:	None
Staff in charge of topic:	van der Veen
Other staff at Board table:	IASB: Clark, Hack, and d'Eri
Staff participating by video:	FASB: Golden, Proestakes, Handy, Montgomery, and Jones

<u>Type of Document and Timing Based on the Technical Plan:</u>

The Board met to discuss issues relating to the development of an Exposure Draft addressing insurance contracts.

Please refer to the current technical plan for information about the expected release dates of exposure documents and final standards.

<u>Summary of Decisions Reached:</u>

At this meeting, the Boards discussed:

1. Unbundling
2. Unit-Linked Contracts
3. Measurement Approach for Short-Duration Contracts
4. Investment Contracts with a Discretionary Participating Feature

Unbundling

The IASB and FASB decided tentatively to require unbundling on the basis of the following principle:

> *If a component is not closely related to the insurance coverage specified in a contract, an insurer shall account for that component as if it were a separate contract and apply the relevant standard to that component (i.e., shall unbundle that component).*

The Boards also agreed to specify the most common examples of components that are not closely related to the insurance coverage, namely:

1. An investment component reflecting an account balance that meets both of the following conditions:
    a. The account balance is credited with an explicit return (i.e., it is not an implicit account balance, for example derived by discounting an explicit maturity value at a rate not explicitly stated in the contract)
    b. The crediting rate for the account balance is based on the investment performance of the underlying investments, namely a specified pool of investments for unit-linked contracts, a notional pool of investments for index-linked contracts or a general account

pool of investments for universal life. That crediting rate must pass on to the individual policyholder all investment performance, net of contract fees and assessments.

2. An embedded derivative that is separated from its host contract in accordance with existing bifurcation guidance.
3. Contractual terms relating to goods and services that are not closely related to the insurance coverage but have been combined in a contract with that coverage for reasons other than economic.

In clarifying how to unbundle the account balance, the IASB Exposure Draft will clarify that an insurer shall regard all charges and fees assessed against the account balance, as well as cross-subsidy effects included in the crediting rate, as belonging to either the insurance component or another component, not as part of the investment component.

(Vote – IASB: 11 to 3; FASB: unanimous)

Unit-Linked Contracts

The Boards discussed accounting mismatches arising from the measurement of unit-linked contracts. The current draft of the IASB Exposure Draft defines those contracts as contracts for which some or all of the benefits are determined by the price of units in an internal or external investment fund (i.e., a specified pool of assets held by the insurer or a third party and operated in a manner similar to a mutual fund).

The discussion focused on the following items held in such funds:

1. The insurer's own shares
2. Owner-occupied real estate, owned by the fund and occupied by the insurer.

Regarding those own shares, the Boards tentatively decided that an insurer should recognize them and measure them at fair value through profit or loss.

The FASB did not make a decision on owner-occupied real estate.

For owner-occupied real estate, the IASB tentatively decided that an insurer:

1. Should measure this asset at fair value
2. Recognize changes in that fair value through profit or loss to the extent those changes relate to the interest of unit-linked contract holders in the pool of assets
3. Recognize in other comprehensive income those changes in fair value attributable to the insurer's own interest in the pool of assets.

(Vote – IASB: 10 to 4)

The Boards also decided not to provide guidance on issues that might arise if subsidiaries are held in a fund underlying unit-linked contracts.

The Boards tentatively decided that an insurer should present:

1. Assets and liabilities associated with unit-linked contracts as single line items in the statement of financial position and not commingle them with the insurer's assets
2. Income and expense arising from the pool of assets underlying unit-linked contracts as a single line item and not commingle them with income and expense arising from the insurer's other assets.

(Vote – IASB: unanimous; FASB: unanimous)

Measurement Approach for Short-Duration Contracts

The Boards discussed remaining issues relating to the measurement model for short-duration contracts (premium allocation model).

The IASB affirmed its previous decision to require, rather than merely permit, the application of the premium allocation model for the pre-claims liability of short-duration contracts and decided tentatively to apply it to short-duration contracts incorporating both of the following features:

1. The coverage period is approximately 12 months or less. (Vote – IASB: 12 to 2)
2. The contracts do not contain embedded options or guarantees that are not separated under the bifurcation requirements and also have a significant impact on the variability of cash flows during the coverage period. (Vote – IASB: 11 to 3)

The IASB discussed whether to include the following third condition and decided not to include it: the insurer is unlikely to become aware of events during the coverage period that could cause significant decreases in the expected cash outflows.

Regarding the treatment of acquisition costs under the premium allocation model, the IASB decided tentatively:

1. To defer incurred incremental acquisition costs associated with insurance contracts that are measured and presented using that model
2. To present those deferred acquisition costs as a deduction from the unallocated premium liability.

(Vote – IASB: unanimous)

The IASB also decided tentatively:

1. That an insurer should accrete interest on the contract position (expected present value of remaining premiums less unallocated premium obligation). The IASB noted that such interest might often be immaterial.
2. To use a current rate to accrete interest to an unallocated premium liability.

(Vote – IASB: 12 to 2)

The FASB will continue its deliberations on the premium allocation model during its meeting on July 28.

Investment Contracts with a Discretionary Participating Feature

The IASB discussed the treatment of the residual margin associated with the measurement of an investment contract containing a discretionary participating feature. The IASB tentatively decided that an insurer should recognize that residual margin in profit or loss over the life of the contract in a systematic way that best reflects the asset management services, as follows:

1. On the basis of passage of time, but
2. If the insurer expects to provide asset management services in a pattern that differs significantly from passage of time, it shall release the residual margin on the basis of the fair value of assets under management.

(Vote – IASB: unanimous)

The FASB decided in an earlier meeting not to include investment contracts with discretionary participating features within the scope of the insurance contracts project.

Next Steps

The IASB expects to publish an Exposure Draft, *Insurance Contracts,* at the end of July.

General Announcements: None