

PROPOSED FASB STAFF POSITION

No. TB 85-4-a

Title: Accounting for Life Settlement Contracts by Investors

Comment Deadline: August 1, 2005

Introduction

1. The Board directed the FASB staff to issue this FASB Staff Position (FSP) to provide initial and subsequent measurement guidance for investments in life settlement contracts.

Background and Scope

2. A life settlement contract for purposes of this FSP is a contract between the owner of a life insurance policy (the insured) and a third party (life settlement provider) and has the following characteristics: (a) the life settlement provider does not have an insurable interest (an interest in the survival of the insured, which is required to support the issuance of an insurance policy), (b) the life settlement provider pays the insured an amount in excess of the current cash surrender value of the life insurance policy, and (c) the contract pays the face value of the life insurance policy to the life settlement provider when the insured dies. This FSP addresses transactions in which a broker facilitates settlement transactions between the insured and the life settlement provider, as well as transactions that do not involve a broker.

3. Prior to the issuance of this FSP, life settlement providers accounted for life settlement contracts in accordance with FASB Technical Bulletin No. 85-4, "Accounting for Purchases of Life Insurance," which requires the use of the cash surrender value for investments in life insurance. Adherence to the accounting guidance in Technical Bulletin 85-4 resulted in life settlement providers expensing, on the date of purchase, the difference between the purchase price of life settlement contracts and their cash surrender value.

Issue

4. Questions have arisen as to the appropriateness of applying the guidance in Technical Bulletin 85-4 to life settlement contracts because it requires the immediate expensing upon purchase of the difference between the purchase price of life settlement contracts and their cash surrender values.

FASB Staff Position

5. The Board believes that the application of the guidance in Technical Bulletin 85-4 to life settlement contracts is inappropriate given the investing activity that the life settlement provider is conducting. The Board believes that the use of a cost accumulation

model (investment method) is more appropriate for this activity and better reflects the economic substance of life settlement contracts. Under the investment method the initial investment costs and continuing costs (policy premiums and direct external costs, if any) are capitalized. No income is recognized until the insured dies, at which time the difference between the carrying cost of a life settlement contract and the face value of its underlying life insurance policy should be recognized. When the carrying amount of the life settlement contract equals the underlying life insurance policy's face value, all future premiums and direct external costs shall be expensed.

Disclosures

6. The objective of the disclosures required by this FSP is to provide users of financial statements with information about the composition of a life settlement provider's portfolio of life settlement contracts and its evaluation of that portfolio.

7. The Board believes that the following disclosures should be provided as of the date of the statement of financial position and that these disclosures should be grouped by remaining expected term from that date, as well as in the aggregate:

- a. The number of life settlement contracts in the grouping
- b. The carrying value of the settlement contracts
- c. The face value (death benefits) of the life insurance policies underlying the contracts.

8. The maximum life insurance premiums required to be paid for these life settlements, within 1 year from the date of the most recent statement of financial position presented, also should be disclosed in total.

Effective Date and Transition

9. The guidance in this FSP shall be applied to fiscal years beginning after [the date the FSP is finalized]. Earlier application is permitted. Upon adoption of this FSP, the measurement guidance should be retrospectively applied.

10. The disclosure requirements of this FSP shall be applied as of the most recent statement of financial position presented.