



August 18, 2006

Technical Director  
Financial Accounting Standards Board  
of the Financial Accounting Foundation  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116



LETTER OF COMMENT NO. 7

*Also submitted by email to: director@fasb.org*

**RE: File Reference No. 1325-100  
Bifurcation of Insurance and Reinsurance Contracts for Financial Reporting**

The following comments are submitted on behalf of the Captive Insurance Companies Association (CICA) and the Vermont Captive Insurance Association (VCIA), the two largest, oldest, and most diverse trade associations representing the captive insurance industry. CICA and VCIA would like to thank the Financial Accounting Standards Board (hereafter called "FASB") for inviting comments through its May 26, 2006 Invitation to Comment on the issue of bifurcation of insurance and reinsurance contracts for financial reporting.

CICA and VCIA Background:

CICA was founded in 1972 and is the only trade association for captive insurance companies that has no jurisdictional or commercial ties. VCIA was organized in 1985 and represents the interests of the captive insurance companies in the largest U.S. domicile. Vermont alone regulates as many captive insurance companies as the other U.S. domiciles combined.

CICA and VCIA worked jointly to develop the comments outlined below. We also utilized the counsel of accounting and actuarial professionals serving the captive insurance industry and gave considerable import to the comments of the Reinsurance Association of America.

Hence, we are confident that we speak with authority for the captive insurance industry.

Issues

In your Invitation to Comment (ITC), you requested information about:

- The definition of insurance contract and insurance risk,

- Whether insurance and reinsurance contracts should be bifurcated into insurance and deposit components,
- If so, which insurance and reinsurance contracts would be bifurcated, and
- If so, how insurance and reinsurance contracts would be bifurcated.

As a threshold issue, we considered the question of whether the bifurcation of insurance and reinsurance contracts for financial reporting was a topic of broad concern to the captive insurance industry. Discussions with members of the captive insurance industry quickly convinced us that a majority of captive insurance companies utilize reinsurance as part of their risk strategy, so this issue has broad ramifications for the captive insurance industry.

Bifurcation of insurance and reinsurance contracts for financial reporting would impact captive insurance companies and their owners, making it more costly to operate a captive insurance company, more difficult for captive insurance companies to negotiate satisfactory contract terms with the reinsurance market, and more difficult to compare and understand captive insurance company financial statements.

### **Comments**

We have focused our comments on the central issue – whether insurance and reinsurance contracts should be bifurcated into insurance and deposit components.

*The core question is whether or not the bifurcation methods and approaches described in the ITC would provide users with more “decision useful” and understandable information. All of the information and expertise that we have gathered from the captive insurance industry is unanimous: Bifurcation, as suggested in the ITC, would not provide users with better or more understandable information.*

In fact, we believe that the concept of a bifurcation process is something of a misnomer in that it implies that a contract can be separated cleanly into risk and financial components. It simply is not so. To assume that the components of an insurance contract can be cleanly separated when many large insurance and reinsurance contracts today have a substantial number of “moving parts” belies the complexity of the contract negotiation process.

Although the ultimate decision on “where” to bifurcate will rest with the owner of the insurance contract, it is a virtual certainty that the actuaries and accountants advising that owner will have differing, if not widely variable, opinions on where the appropriate bifurcation point might be. It is our belief that bifurcation will introduce a significant amount of cost, confusion, and complexity into the financial statement preparation process and will require a substantial overhaul of insurance company analysis, including ramifications with insurance regulators.

All that will be accomplished by bifurcation will be the addition of a great deal of time, expense, and complication. Bifurcation will also render useless the historical data maintained by all users of financial statements.

We are particularly concerned that the cost of bifurcation will result in significant increases in the cost of audit and actuarial services and that those increased costs will have a disparate effect on captives and risk retention group, which are typically small insurance companies. We have estimated that the initial bifurcation analysis for each of the policies written, ceded, or assumed by a captive insurance company,

along with the ongoing accounting and actuarial analyses for existing policies, would easily add \$50,000 to \$100,000 to the annual costs of operating a captive insurance company – which are typically \$75,000 to \$100,000. Consequently, the proportional costs to implement and maintain bifurcation are far more damaging to captives and risk retention groups.

It is also our belief that users of financial statements evaluate insurance entities based on their aggregate risk profile, not on individual policy characteristics. If the proposals in your ITC are implemented, entities with similar aggregate risk profiles are likely to report substantially different financial information dependent solely on how their portfolio of risks was assembled.

### **Conclusion**

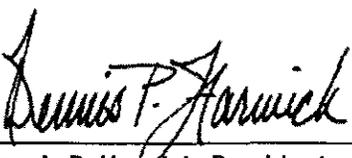
We return to the core question. Would bifurcation as described in the ITC provide users with more decision useful and understandable information? We believe the clear answer to that question is no. Rather, bifurcation, as described in the ITC, would introduce inconsistency, complexity, and extraordinary expense without a corresponding increase in clarity or transparency.

We know that others will also provide you with detailed comments. In particular, we commend to you the thoughts and observations provided by the Reinsurance Association of America for a thorough discussion of the many technical problems with bifurcation.

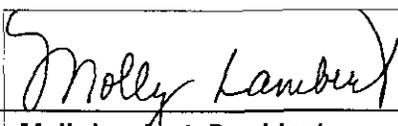
Again, thank you for the opportunity to comment on behalf of the captive insurance industry. If you have any questions about the comments contained in this letter, please contact either of us.

Respectfully submitted,

### **CAPTIVE INSURANCE COMPANIES ASSOCIATION**

By:   
Dennis P. Harwick, President  
Captive Insurance Companies Association  
678 51<sup>st</sup> Ave N  
St. Petersburg, FL 33703  
(727) 374-7146  
[dharwick@CICAworld.com](mailto:dharwick@CICAworld.com)

### **VERMONT CAPTIVE INSURANCE ASSOCIATION**

By:   
Molly Lambert, President  
Vermont Captive Insurance Association  
One Lawson Lane, Suite 320  
Burlington, VT 05401  
(802) 658-8242  
[lambert@vcia.com](mailto:lambert@vcia.com)