

MINUTES



To: Board Members
From: Goodman (ext. 295)
Subject: Minutes of September 14, 2005 Board Meeting: Risk Transfer in Insurance and Reinsurance Contracts **Date:** September 21, 2005
cc: L. Smith, Bielstein, Petrone, Leisenring, Project Team, Carney, Polley, Gabriele, Mahoney, Sutay, FASB Intranet, Upton, Clark, Attmore, Bean

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Topic: Risk Transfer in Insurance and Reinsurance Contracts

Basis for Discussion: Board memorandum dated August 31, 2005

Length of Discussion: 9:05 a.m. to 9:35 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: L. Smith, Golden, Belcher, Trench, and Goodman

Outside participants: Leisenring

Summary of Decisions Reached:

As a starting point for the Board's insurance and reinsurance risk transfer project, the Board agreed to adopt the draft working definitions of insurance terms and related supplemental guidance based on those in Appendixes A and B of IFRS 4, *Insurance Contracts*. The IFRS guidance will be modified to reflect existing U.S. GAAP. The Board directed the staff to maintain a narrow scope for the project, focusing on finite risk insurance and reinsurance contracts. Accordingly, the next phase of the project will examine the potential for bifurcating finite risk contracts into risk and nonrisk components.

Objective of Meeting:

The objective of the meeting was for the Board to consider definitions of insurance contracts, insurance risk, and related terms based on definitions and supplemental guidance provided in IFRS 4.

Matters Discussed and Decisions Reached:

1. Mr. Cropsey stated that the purpose of the meeting was for the Board to consider the draft working definitions of insurance terms and related supplemental guidance based on those in Appendixes A and B of IFRS 4, which would be modified to reflect existing U.S. GAAP. He noted that this is the first step in the project that also will include:

- a. An analysis of simple bifurcation
- b. A review of current U.S. guidance to clarify existing risk transfer criteria for reinsurance
- c. Extension of the reinsurance risk transfer guidance to insurance
- d. Addition of enhanced disclosure requirements.

2. Mr. Cropsey also noted that current U.S. GAAP does not define insurance or distinguish insurance contracts from other contracts with some common features such as financing arrangements and derivatives. Mr. Cropsey stated that the merits of using the IFRS 4 guidance include the following:

- a. The guidance is relatively recent.
- b. The definitions have been exposed twice for public comment.
- c. The IASB does not currently plan to revisit the guidance in Phase II of their insurance contracts project.
- d. The guidance applies to insurance and reinsurance contracts.
- e. Using the guidance allows for early, limited convergence with the IASB's insurance contracts project.

He further noted that IFRS 4 differs from U.S. GAAP in that it treats all contracts that meet the IFRS 4 definition of insurance as insurance contracts, regardless of the issuer. However, the scope of this project would include only contracts issued by insurance enterprises (consistent with current U.S. GAAP).

3. Mr. Cropsey stated that certain contracts currently accounted for as insurance under U.S. GAAP—for example, life insurance contracts that have timing risk but not underwriting risk and high-layer catastrophe insurance contracts that might not produce a reasonable possibility of a significant loss—may not meet the current risk transfer criteria in FASB Statement No. 113, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts*. He added that perhaps modifications to the guidance could be made to ensure U.S. GAAP inclusion of such contracts.

4. Mr. Cropsey said that the definition of an insurance contract in IFRS 4 includes the words “significant insurance risk” and briefly defines them. U.S. GAAP, specifically Statement 113, provides guidance on the transfer of risk for reinsurance contracts. Mr. Cropsey noted that the IASB relies on the description of significant insurance risk in its risk transfer guidance. He noted that the IFRS 4 guidance (paragraph B23) uses the notion of commercial substance as a determining factor of risk transfer. The IFRS 4 definition focuses on insurance with the notion that reinsurance is just another form of insurance.

5. Mr. Cropsey stated that the IASB Phase II Insurance Contracts project is considered a modified joint project, meaning that once an initial discussion document has been prepared by the IASB, the staff will request that the FASB Board add a joint insurance contracts project to its technical agenda.

6. Ms. Schipper inquired whether a narrow scope for the project would entail:
 - a. Retaining the Statement 113 definitions and risk transfer criteria
 - b. Ignoring the inconsistencies for certain insurance contracts noted in paragraph 3 above
 - c. Not taking the separation approach, that is, a contract would be accounted for as insurance in its entirety or as something else (however, Ms. Schipper noted that this specific item was a possibility that would be set aside for later discussion)
 - d. Modifying the IFRS 4 guidance to be consistent with U.S. GAAP.

She stated that if the Board was to agree to a broad scope for the project, she felt that adopting the IFRS 4 definition in its entirety would be conceptually superior to the current U.S. GAAP definition.

7. Mr. Cropsey agreed that the staff recommendation is that the project's scope remain narrow. He added that the staff would not consider changing the Statement 113 risk transfer criterion of *timing and underwriting risk* to be consistent with the IFRS 4 criterion of *timing risk* only. However, he also noted that simple bifurcation of contracts into risk and non-risk components would be analyzed in accordance with the original project plan.

8. Ms. Seidman and Mr. Young agreed with the staff's recommendation but were concerned that the project would not be completed on time if the Board deliberated either (a) the Statement 113 risk transfer criterion of timing and underwriting risk or (b) the inconsistencies for certain insurance contracts as noted in paragraph 3 above.

9. Mr. Trott agreed with the staff's recommendation but stated that the IFRS 4 guidance likely is insufficient to be able to determine what is insurance, that is, whether a contract has transferred significant insurance risk. Mr. Trott noted that the staff's approach (enhancing the current definition with the IFRS 4 definitions) was a good starting point and that improving upon this definition to make it more usable should be the focus. Mr. Batavick generally agreed with Mr. Trott's views.

10. Mr. Crooch supported the current plan.

11. Mr. Herz summarized that most Board members seemed to support the current plan with a few cautionary observations. He agreed with Mr. Trott's views and noted that he believes that paragraphs B23 and B24 of IFRS 4 are unlikely to be sufficient to determine risk transfer. He noted that more work needed to be done on those paragraphs to make them more discriminating. He also noted that the work on bifurcation would require developing the insurance definitions to set a framework for what gets accounted for as insurance or as something else, such as loans or deposits.

12. In response to Ms. Seidman's concern, Mr. Cropsey noted that the staff expects to issue an exposure document in the first quarter of 2006 in accordance with the current technical plan.

Follow-up Items:

None.

General Announcements:

None.