MINUTES

Financial Accounting Standards Board

To:	Board Members		
From:	Reager (ext. 393)		
Subject:	Minutes of the January 30, 2008 Board Meeting: Financial Guarantee Insurance—Redeliberations	**Date:**	February 5, 2008
cc:	Leisenring, Golden, Bielstein, MacDonald, Cosper, Cropsey, Klimek, Stoklosa, Chookaszian, Posta, Lott, Sutay, Allen, Gabriele, Mayer, Finden (GASB), FASB Intranet		

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 or Interpretation.

Topic:	Financial Guarantee Insurance—Redeliberations
Basis for Discussion:	Board handout dated January 30, 2008
Length of Discussion:	10:00 a.m. to 11:00 a.m.
Attendance:	
Board members present:	Herz, Batavick, Linsmeier, Seidman, Smith, Crooch, and Young
Board members absent	None
Staff in charge of topic:	Trench
Other staff at Board table:	Golden, Cropsey, Stoklosa, Cosper, and Reager
Outside participants:	Leisenring

Summary of Decisions Reached:

The Board concluded redeliberations of the FASB Exposure Draft, *Accounting for Financial Guarantee Insurance Contracts*. Disclosures, effective date, and transition were discussed. The Board decided that:

1. An insurance enterprise should disclose the premium receivable (asset), the unearned premium revenue (liability), and the run-off of the unearned premium revenue (liability) using the contractual term. However, in instances where the expected term is used to measure those assets or liabilities, the related disclosures should reflect the expected term.

2. An insurance enterprise is not required to display the accretion of the premium receivable (asset) as investment income. However, disclosure of the amount of accretion will be required as well as the line item in which it is reported in the income statement.

3. An insurance enterprise should disclose the weighted-average discount rate used to measure the claim liability, a schedule of future expected cash receipts related to the premium receivable (asset), and where the accretion on the claim liability is recognized in the income statement. In addition, an insurance enterprise should disclose information about potential recoveries as part of the disclosures related to the surveillance list. An insurance enterprise will not be required to disclose information about the remaining quarters of the current annual period for the schedule of run-off of the unearned premium revenue (liability) and the schedule of expected future cash receipts. However, an insurance enterprise should disclose information about the four quarters of the subsequent annual period, the next four annual periods, and the remaining periods aggregated in five-year increments.

4. An insurance enterprise should disclose a rollforward of the premium receivable (asset). That rollforward should include the beginning premium receivable (asset) balance, new business written during the

period, cash receipts received during the period, adjustments, and the ending premium receivable (asset) balance. As part of the adjustments, a separate display of the adjustment for changes in prepayment assumptions that affect the expected term is required.

5. The final Statement should be effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. In addition, certain disclosures related to the surveillance list are required for the first quarter after issuance of the final Statement. These disclosures pertain to a description of the surveillance list used, including (a) a description of each surveillance category, (b) the insurance enterprise's policies for placing an insured financial obligation in and monitoring each surveillance category, (c) the insurance enterprise's policies for avoiding or mitigating claim liabilities, the related expense and liability reported during the period for those risk mitigation activities, and a description of where that expense is reported in the statement of income and the statement of financial position, and (d) a schedule of insured financial obligations included on the surveillance list at the end of each period detailing, at a minimum, the following for each surveillance category: number of financial guarantee insurance contracts, insured contractual payments outstanding (segregating principal and interest), and remaining weighted-average term.

6. Consistent with the Exposure Draft, the guidance should be applied to existing and future financial guarantee insurance contracts issued by an insurance enterprise as of the beginning of the fiscal year in which the guidance is initially applied. An insurance enterprise should recognize the cumulative effect of initially applying the guidance as an adjustment to the opening balance of retained earnings for that fiscal year. An insurance enterprise also should disclose in the first interim period of the fiscal year in which the guidance is initially applied the cumulative effect of the change on retained earnings in the statement

of financial position. The cumulative-effect adjustment is the difference between the amounts recognized in the statement of financial position before the initial application of the Statement and the amounts recognized in the statement of financial position at initial application, measured using information that is current at that date. The discount rates should reflect the relevant risk-free rate at the date the Statement is initially applied.

The Board directed the staff to proceed to a draft of a final Statement for vote by written ballot.

<u>Objective of Meeting</u>:

The objective of the meeting was for the Board to conclude redeliberations of the Exposure Draft on accounting for financial guarantee insurance contracts. The objective of the meeting was met.

<u>Matters Discussed and Decisions Reached</u>:

Issue 1—Disclosures

1. The discussion regarding disclosure was split between (a) updating disclosures for decisions reached during redeliberations, (b) additional disclosures requested by respondents to the Exposure Draft, and (c) additional disclosures identified during redeliberations.

Issue 1A—Updating Disclosures for Decisions Reached during Redeliberations

2. **Staff Recommendation:** The staff recommended that the Board modify the disclosures to be consistent with the decisions reached-to-date during redeliberations (see paragraphs 26(b)(1), 26(b)(2), and 26(c) of Appendix A of the Board handout).

3. **Board Vote:** An insurance enterprise should disclose the premium receivable (asset) and the unearned premium revenue (liability) and the run-off of the unearned premium revenue (liability) using the contractual term. However, in

instances where the expected term is used to measure those assets or liabilities, the related disclosures should reflect the expected term.

4. The Board also voted that an insurance enterprise is not required to display the accretion of the premium receivable (asset) as investment income. However, disclosure of the amount of accretion is required as well as the line item in which it is reported in the income statement.

5. **Board Comments**: None.

Issue 1B—Additional Disclosures Requested by Respondents

6. **Staff Recommendation:** The Board should provide specific disclosure requirements for the weighted-average discount rate used to measure the claim liability, a schedule of future expected cash receipts related to the premium receivable (asset), and disclosure of the accretion related to the claim liability (see paragraphs 26(f)(1), 26(d), and 26(f)(2), respectively, of Appendix A of the Board handout).

7. The staff also recommended that information regarding potential recoveries should be disclosed as part of the surveillance list (see paragraph 26(g)(4)(d) of Appendix A of the Board handout).

8. **Board Vote:** An insurance enterprise should disclose the weighted-average discount rate used to measure the claim liability, a schedule of future expected cash receipts related to the premium receivable (asset), and where the accretion on the claim liability is recognized in the income statement. In addition, an insurance enterprise should disclose information about potential recoveries as part of the disclosures related to the surveillance list. An insurance enterprise will not be required to disclose information about the remaining quarters of the current annual period for the schedule of run-off of the unearned premium revenue (liability) and the schedule of expected future cash receipts. However, an insurance enterprise should disclose information about the four quarters of the subsequent annual period, the next four annual periods, and the remaining periods aggregated in five-year increments.

9. **Board Comments:** Mr. Trench commented that requiring a sensitivity analysis would not be appropriate due to the narrow scope of the project and the lack of a disclosure framework. He also stated that explicitly requiring disclosure of the accounting policy for accretion is not necessary. He said that this disclosure is self evident, as it is part of the premium revenue recognition accounting policy. Therefore, an explicit requirement is not necessary.

10. Ms. Seidman agreed with the staff's recommendations. However, she pointed out that with regard to the disclosure requirements in paragraphs 26(c)(1) and 26(d)(1) of Appendix A of the Board handout (both of these paragraphs require the disclosure of the remaining quarters of the current annual period for the schedule of the future run-off of the unearned premium revenue [liability] and the schedule of expected future cash receipts related to the premium receivable [asset], respectively), the disclosure of the remaining quarters of the current annual period is not necessary. Ms. Seidman stated that only annual disclosures are needed and disclosure of the four subsequent quarters is appropriate.

11. Mr. Young asked, in relation to the sensitivity analyses, if the claim liability could be compared to the par outstanding. Mr. Trench stated that within the surveillance list disclosures there would be disclosure by surveillance category of the total claim amounts for each category, as well the amount of principle and interest outstanding for each category. However, he noted that this information would not be provided on a contract-by-contract basis.

12. Mr. Smith pointed out that the goal of the disclosures related to paragraphs 26(c) and 26(d) in Appendix A was to provide relevant information in five-year increments. He stated that, based on Ms. Seidman's changes to those paragraphs to remove the disclosure requirement of the remaining quarters of the current annual period (paragraphs 26(c)(1) and 26(d)(1)), the time period in paragraphs 26(c)(3) and 26(d)(3) of Appendix A should be the next four annual periods.

Issue 1C—Additional Disclosures Identified during Redeliberations

13. **Staff Recommendation:** Provide disclosure of a rollforward of cash receipts related to the premium receivable (asset) from period to period.

14. **Board Vote:** An insurance enterprise should disclose a rollforward of the premium receivable (asset). That rollforward should include the beginning premium receivable (asset) balance, new business written during the period, cash receipts received during the period, adjustments, and the ending premium receivable (asset) balance. As part of the adjustments, a separate display of the adjustment for changes in prepayment assumptions that affect the expected term is required.

15. **Board Comments:** Mr. Linsmeier agreed with the staff's recommendation. However, he questioned the presentation of the adjustments in the rollforward of cash receipts (that is, the accretion of the premium receivable [asset] is presented separately and all other adjustments are grouped together). He pointed out that one aspect raised by Board members was the concern about the effects of changes in the expected term. Mr. Trench asked Mr. Linsmeier whether he envisioned including requirements to separately disclose the various components of the "adjustment" line item. Mr. Linsmeier stated that he was most concerned with the separate disclosure of the adjustments related to changes in the expected term. He further stated that adjustments related to changes in the expected term should be separately presented and that there is no need to prescribe the types of adjustments or separately display those adjustments not related to changes in the expected term. Ms. Seidman agreed that the adjustment related to changes in the expected term should be specifically mentioned and more prominently displayed.

Issue 2—Effective Date

16. **Staff Recommendation:** The final Statement should be effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. The staff also recommends that early application should not be permitted.

17. **Board Vote:** The final Statement should be effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. In addition, certain disclosures related to the surveillance list are required for the first quarter after issuance of the final Statement. These disclosures pertain to a description of the surveillance list used, including (a) a description of each surveillance category, (b) the insurance enterprise's policies for placing an insured financial obligation in and monitoring each surveillance category, (c) the insurance enterprise's policies for avoiding or mitigating claim liabilities, the related expense and liability reported during the period for those risk mitigation activities, and a description of where that expense is reported in the statement of income and the statement of financial position, and (d) a schedule of insured financial obligations included on the surveillance list at the end of each period detailing, at a minimum, the following for each surveillance category: number of financial guarantee insurance contracts, insured contractual payments outstanding (segregating principal and interest), and remaining weighted-average term.

18. **Board Comments:** Mr. Herz questioned whether there were any aspects of the disclosures that were important (such as the surveillance list) and that could be done on an accelerated basis. Mr. Trench stated that there is information contained within the non-GAAP operating supplements regarding surveillance lists but not in the proposed aggregated format. He further stated that requiring the disclosures related to the surveillance list (specifically, the total claim liability balance) may be problematic as evidenced by the numerous approaches employed in current practice to recognize and measure the claim liability (the issue that led to the financial guarantee insurance contracts project).

For example, companies with an unallocated reserve or a general reserve would not be able to apply the surveillance list disclosure requirements regarding the total claim liability by category. Mr. Trench commented that, because of the diversity in practice, a situation may be created whereby certain insurance companies will be able to provide information at a contract level while other insurance companies will not have that ability. For this reason, requiring the disclosures related to the surveillance list before the provisions of the Statement are effective could be problematic and construed as early adoption of the provisions of the final Statement by those insurance companies that use a claim liability approach that includes a general reserve.

19. Mr. Trench offered that the other disclosures related to the surveillance list (not including the total claim amount) could be provided early regardless of the claim liability approach currently used (paragraphs 26(g)(1)–26(g)(4)(c) of Appendix A of the Board handout).

20. Mr. Herz stated that companies could disclose more specific information regarding claim amounts if that information is available. In instances where that specific information is not available, the company could explain its current accounting policy for claim liabilities. He stated that if he was an investor he would want to know a company's exposures. Mr. Golden stated that diversity exists in practice today on how the claim liability is recognized and measured. He further stated that most of paragraph 26(g) could be applied early and paragraph 26(g)(4)(d) (total claim liability) could be disclosed pursuant to a company's existing policy.

21. Ms. Seidman stated that waiting until 2009 for disclosures is too long. She further stated that she supported earlier application of the disclosures related to the surveillance list. Ms. Seidman commented that disclosure of the total claim liability should be made by companies to the extent practicable or in as much detail as is practicable. Mr. Golden pointed out that based on the timing of issuance of the final Statement, disclosure of this information would be difficult in the first quarter of 2008.

22. Mr. Batavick did not agree with a piecemeal adoption because it increases complexity, especially when a significant amount of information is already provided voluntarily. Mr. Trench pointed out that the key difference is that requiring the disclosures under GAAP subjects those disclosures to an independent audit. Mr. Smith agreed with an early effective date for the disclosures related to the surveillance list in this instance because (a) the number of industry participants are limited and they actively follow this project and (b) the current economic conditions that are impacting the industry make these disclosures very important in understanding that impact. Therefore, he stated that all of the disclosures except for the total claim liability amounts for the surveillance list should be effective the first practicable quarter after the pronouncement has been issued (second quarter). Mr. Smith also pointed out that he believes voluntary disclosure will be provided regarding the total claim liability amounts by category.

23. Mr. Linsmeier pointed out that modification of the wording in the introduction of paragraph 26(g) would be necessary if earlier application is required. He also pointed out that the comment letters had raised an issue with regard to the surveillance list and that the terms *surveillance list* or *watch list* are too specific. Mr. Trench clarified that the Exposure Draft stated that the assumptions used to measure the claim liability should be consistent with an entity's surveillance list. Mr. Trench also stated that a surveillance list is described in the Exposure Draft and, to address the concerns raised in the comment letters, the wording can be switched (that is, a description would be provided and reference would be made to a surveillance or watch list as an example). Ms. Seidman stated that the intention of the Board was not to create significant changes in the way companies monitor their book of business. Mr. Trench pointed out that several comment letters stated that the Exposure Draft prescribed a surveillance list. He clarified that *that* was not the case.

24. Mr. Young questioned whether there was sufficient information regarding the gross amount of the claim and related reinsurance. Mr. Golden pointed out that the proposed disclosure requirement related to the surveillance list

25. Mr. Cropsey stated that the discount is the other gross to net adjustment related to the claim liability and it is currently not required to be disclosed. Ms. Seidman commented that disclosure of the remaining principal and interest represents the undiscounted claim liability and the net claim liability is the discounted claim liability (therefore, the difference is the discount). Mr. Trench agreed with Ms. Seidman's comment.

26. Mr. Herz stated that the final Statement, specifically the disclosure requirements related to the surveillance list, would not cover credit default swaps issued by insurance enterprises. Mr. Herz suggested that the staff research disclosures related to derivative instruments and compare these disclosures to those required for the surveillance list for financial guarantee insurance contracts. Mr. Golden stated that the staff performed preliminary research and determined that FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure*

Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, requires disclosure similar to the surveillance list disclosures. However, he pointed out that Interpretation 45 does not require disclosure when the asset or liability being guaranteed is not held by the guaranteed party (which is the case for most credit default swaps). Mr. Golden stated that he believes that this disclosure would be useful for credit default swaps and should not be limited to only those guarantees where the guaranteed party holds the asset or liability. He further stated that the question is whether this disclosure should be included in the financial guarantee insurance contracts project, the derivative disclosures project, or a separate project. Mr. Golden commented that the issue is much broader than the financial guarantee insurance contracts project and inclusion in the derivative disclosures project would delay that project since re-exposure would be required.

27. Mr. Linsmeier questioned whether a purchased credit default swap would be included under the financial guarantee insurance contracts project. Mr. Trench stated that it would be covered if the credit default swap were used to provide a recovery for an insurance contract.

28. Mr. Young asked if insurance companies currently provide disclosures for credit default swaps similar to those in Interpretation 45. Mr. Trench stated that some insurance companies do provide these disclosures.

29. Ms. Seidman commented that one possibility is to include Interpretation 45-type disclosures for credit default swaps in the derivatives disclosure project. Mr. Stoklosa stated that the derivatives disclosure project currently does not include requirements similar to Interpretation 45 for information related to credit default swaps. Ms. Seidman questioned the ability to scope a separate project related to this issue. Mr. Stoklosa commented that there is currently a definition in FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, for credit indexed contracts that would assist in scoping such a project.

Issue 3—Transition

30. **Staff Recommendation:** A limited retrospective transition approach should be applied as described in the Exposure Draft (updated for the decisions reached regarding the discount rates).

31. **Board Vote:** Consistent with the Exposure Draft, the guidance should be applied to existing and future financial guarantee insurance contracts issued by an insurance enterprise as of the beginning of the fiscal year in which the guidance is initially applied. An insurance enterprise should recognize the cumulative effect of initially applying the guidance as an adjustment to the opening balance of retained earnings for that fiscal year. An insurance enterprise also should disclose in the first interim period of the fiscal year in which the guidance is initially applied the cumulative effect of the change on retained earnings in the statement of financial position. The cumulative-effect adjustment is the difference between the amounts recognized in the statement of financial position before the initial application of the Statement and the amounts recognized in the statement of financial position at initial application, measured using information that is current at that date. The discount rates should reflect the relevant risk-free rate at the date the Statement is initially applied.

32. **Board Comments:** None.

General Announcements:

33. The Board directed the staff to proceed to a draft of a final Statement for vote by written ballot.

Board Handout Correction:

34. Mr. Trench stated that in the table on page 5 of the Board handout (under the column heading "Topic/Circumstances" in the second box down from the top), a Board decision related to the accounting for the premium receivable (asset) when changes in prepayment assumptions occur was described such that changes in prepayment assumptions would flow through the income

statement. However, that was not the decision reached by the Board. Mr. Trench clarified that there were discussions whether these changes should be reflected in the income statement, but the ultimate decision was that changes in prepayment assumptions will be accounted for on a prospective basis.