MINUTES

Financial Accounting Standards Board

To:	Board Members
From:	Insurance Contracts Team (Jourdan, ext. 273)
Subject:	Minutes of the January 27, 2010, Board Meeting: Insurance Contracts — **Date:** February 18, 2010
cc:	FASB: Bielstein, Golden, Stoklosa, Chookaszian, Posta, Guasp, Sutay, Klimek, Gabriele, McGarity, Proestakes, Cropsey, Trench, Lott, Hood, Brickman, Galloway (GASB), FASB Intranet; IASB: Leisenring, 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— Policyholder Behavior and Deposit Floor
Basis for Discussion:	Board Memorandum Nos. 36, 36A, and 36B
Length of Discussion:	9:45 a.m. to 10:30 a.m.
Attendance:	
Board members present:	FASB: Herz, Linsmeier, Seidman, Smith, and Siegel IASB: Leisenring
Board members absent:	None
Staff in charge of topic:	Cropsey and Trench
Other staff at Board table:	Golden, Proestakes, Brickman, and Jourdan
Staff participating by phone:	IASB: Clark and van der Veen

Summary of Decisions Reached

Policyholder behavior

The Board discussed contractual features that allow policyholders to take actions that change the amount, timing, uncertainty, or nature of benefits that they will receive (policyholder options). Examples of such features or options include:

1. Options to renew or cancel (with or without a surrender value) a contract
2. Options to terminate or suspend the payment of contract premiums
3. Options to increase or decrease the amount of coverage (with or without further underwriting procedures to assess the risks of any increased coverage).

The Board tentatively decided that an entity should consider policyholder options, as well as options, forwards, and guarantees related to existing coverage, in the measurement of the insurance contract on a look-through basis using the expected value of future cash flows related to the features (to the extent those features are within the boundary of the existing contract). The staff will develop material to identify the boundary of an existing contract for discussion at a future meeting.

The Board asked the staff to do additional analysis as to whether an option pricing model can be used to measure the contract. The staff intends to provide that information to the Board at a future meeting as part of a discussion about risk margins.

Deposit floor

The Board tentatively decided that no deposit floor should be used when measuring an insurance contract (however, scenarios including policyholder withdrawals would be included in estimating the expected contractual cash flows).

Objective of Meeting:

The objectives of this meeting were to discuss (1) the treatment of contractual features that allow policyholders to take actions that change the amount, timing, uncertainty, or nature of benefits that they will receive (policyholder options) and (2) whether a deposit floor should be included when measuring an insurance contract.

The objectives of the meeting were met.

Matters Discussed and Decisions Reached:

Issue 1—Policyholder Behavior

1. Mr. Cropsey stated that the purpose of the discussion was to decide on the accounting for policyholder options included within an insurance contract. Mr. Cropsey noted that at the January 2010 joint meeting, the Boards agreed to only include policyholder options that relate to the existing coverage in the measurement of an insurance contract. He further noted that memorandum 36A included three views for the Board to consider when deciding how to value policyholder options: (a) a market approach, (b) a mathematical model (such as Black Scholes), or (c) a look-through basis approach.

Staff Recommendations

2. The staff recommended that policyholder options, forwards, and guarantees related to an insurance contract's existing coverage should be included in the measurement of that contract on a look-through basis using the expected value of future cash flows (to the extent that those options are within the boundary of the existing contract).

Board Vote

3. The Board tentatively agreed (unanimous) with the staff recommendation, but instructed the staff to conduct additional analysis on whether an option pricing model can be used to measure an insurance contract.

Board Comments

4. Mr. Linsmeier stated that he would like the staff to prepare an analysis that further explains the problems with using an option pricing model to value an insurance contract, as is described in paragraph 9 of memorandum 36A. Mr. Linsmeier stated that he would prefer the components approach described in paragraph 16(b) of that memorandum. Mr. Linsmeier further stated that an option pricing model would not only measure the expected cash flows, but also would integrate measurement of the volatility of the cash flows and the risk margin through measurement of the time value of the option, particularly the volatility component.

5. Mr. Linsmeier stated that there may be more rigor by using an option pricing model because the risk and uncertainty are jointly computed in an option pricing model (rather

than computed independently in the proposed measurement as a risk margin). Mr. Linsmeier added that he could support the staff recommendation, but that his support is contingent on further staff analysis on the potential use of an option pricing model.

6. Ms. Seidman pointed out that the entity also would be selecting the inputs used in an option pricing model and that the option pricing model would not provide any further rigor around the measurement than the building block approach (which includes a risk margin). Ms. Seidman stated that she views an insurance contract as a written option. Ms. Seidman added that the embedded options in a contract should not be viewed differently than the entire insurance contract and proposed that the staff recommendation communicate that when valuing an insurance contract, one should consider all contractual features in the contract when an entity is estimating its expected cash flows.

7. Mr. Herz stated that it would be helpful if the staff conducted a literature search to identify if anyone has written a paper about a similar practice or concept that applies an option pricing model to an insurance contract or a similar contract. Mr. Herz stated that the majority of the option pricing models that he is familiar with deal with financial assets and liabilities and that it may be difficult to include human behavior, which can affect the value of an insurance contract, in those models.

Issue 2—Deposit Floor

8. Mr. Cropsey stated that the purpose of the discussion was to determine whether a deposit floor should be considered when valuing an insurance contract. Mr. Cropsey noted that the Board had already made a decision about a deposit floor in the financial instruments project.

Staff Recommendation

9. The majority of the staff recommended that no deposit floor be used when measuring an insurance contract. Some staff members believe that a deposit floor should be used in instances in which the deposit component is readily identifiable and reflects the minimum liability of the entity.

Board Vote

10. The Board voted four (Herz, Seidman, Siegel, and Linsmeier) to one (Smith) in favor of the staff recommendation.

Board Comments

11. Mr. Herz stated that no deposit floor should be used when measuring an insurance contract because the resulting measurement is a better economic solution. Mr. Herz added that there could be difficulties with implementing a deposit floor because it would need to be done on a contract-by-contract basis.

12. Mr. Linsmeier stated that no deposit floor should be used when measuring an insurance contract. However, he stated that he would like the deposit floor to be disclosed on the face of the financial statements.

<u>Follow-up Items:</u>

None.

<u>General Announcements:</u>

None.