

MINUTES



To: Board Members
From: Murphy (ext. 208)
Subject: Minutes of the June 1, 2005 FVM Board Meeting **Date:** June 7, 2005
cc: Bielstein, L. Smith, Petrone, Fair Value Team, Revenue Recognition Team, Business Combinations Team, Polley, Gabriele, Getz, Mahoney, Sutay, Leisenring (IASB), J. Paul (IASB), G. Ryltsova (IASB), P. Martin (CICA), 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: Proposed FASB Statement, *Fair Value Measurements*: disclosures and block discounts

Basis for Discussion: Memorandum dated May 19, 2005, and audience handout (attached)

Length of Discussion: 11:00 a.m. to 11:40 a.m.

Attendance:

Board members present: **FASB:** Crooch, Herz, Schipper, Seidman, Trott, and Young

IASB: Leisenring

Board members absent: Batavick

Staff in charge of topic: MacDonald

Other staff at Board table: Bielstein, Lott, McBride, Murphy, E. Smith, L. Smith, Thuener, and Wilkins

Outside participants: None

Summary of Decisions Reached

The Board continued redeliberations of the proposed FASB Statement, *Fair Value Measurements*, focusing on issues relating to blocks and disclosures.

The Board reconsidered its previous decision to allow a broker-dealer to use a blockage factor to estimate the fair value of a large position of an unrestricted security with a quoted price in an active market (block). Instead, the Board decided to preclude the use of a blockage factor in all cases. Accordingly, a quoted price in an active market should be used to estimate the fair value of an unrestricted security within Level 1 of the fair value hierarchy, even if an entity (including a broker-dealer or an investment company) holds a large position of the security. A final Statement will make a conforming change to the AICPA Audit and Accounting Guides for broker-dealers and investment companies.

The Board decided that disclosure of unrealized gains or losses relating to assets and liabilities still held at the reporting date should be limited to those assets and liabilities that are remeasured at fair value within the lowest level of the fair value hierarchy. That limited disclosure would be required in all cases. The Board affirmed its earlier decision to also require disclosure of total gains or losses (unrealized and realized) for assets and liabilities held during the period (whether or not those assets and liabilities are still held at the reporting date) and to segregate those gains or losses included in earnings and in accumulated other comprehensive income.

Objective of Meeting

The principal objective of the meeting was to finalize issues relating to blocks and disclosures.

Matters Discussed and Decisions Reached

1. Ms. MacDonald stated that the primary reason for this meeting is to finalize issues discussed by the Board at its April 27, 2005 meeting relating to blocks and disclosures.

Blocks

2. Ms. MacDonald said that at its earlier meeting, the Board generally agreed to allow a broker-dealer to use blockage factors when measuring the fair value of blocks (large positions of securities with quoted prices in active markets) if it both buys and sells blocks as part of its ongoing business activities—subject to further consideration of disclosures about gains or losses on non-block sales out of the blocks. She explained that the staff discussed those disclosures with constituents, users, and others. In those discussions, some expressed concerns that the conditions for using blockage factors would be overly restrictive because with respect to block trading activities, predominant practice is to buy in blocks but sell in pieces. While in many cases the pieces will be sold at a discount, they will not meet internal thresholds for a block. Further, those conditions would preclude the use of blockage factors for blocks that are acquired through other trading activities.

3. Ms. MacDonald said that as a basis for considering the specific disclosure issues, a threshold issue is whether to reconsider the conditions for using blockage factors to, for example, allow the use of blockage factors if a broker-dealer “transacts” or otherwise “holds” blocks. She noted that the alternative would be to preclude the use of blockage factors, thereby requiring the use of a quoted price in an active market, without adjustment (PxQ) in all cases.

4. Mr. Young said that based on recent discussions with users, he supports the alternative PxQ approach. He explained that the pattern among broker-dealers is to buy wholesale and sell retail. Given that pattern, users would prefer a PxQ approach because it would avoid the measurement uncertainty associated

with blockage factors and result in increased transparency in the financial statements, enhancing communication to users.

5. Mr. Crooch, Ms. Schipper, and Mr. Trott said that they continue to support the PxQ alternative for the reasons set out in the dissent to the fair value measurements ED. They said that they would not consider the alternative of using blockage factors in the absence of predominant practice of both buying and selling in blocks.

6. Mr. Herz explained that in the ED, his understanding was that blocks were sold in blocks, not pieces. Accordingly, he initially supported the use of blockage factors. To him, the key condition for determining whether to allow the use of blockage factors centers on how the broker-dealer carries out the disposal activity. In the absence of predominant practice of selling in blocks, he has serious concerns about the use of blockage factors. Moreover, while in some cases, a broker-dealer might also sell in blocks, it would be difficult to operationalize an exception to allow the use of blockage factors in those relatively limited situations. Largely for those reasons, Mr. Herz said that he supports the alternative PxQ approach.

7. Ms. Seidman affirmed her earlier decision to allow the use of blockage factors. She said that she would clarify that decision in the context of broker-dealers that “transact” in blocks. In situations in which a large position of a security is held, a quoted price in an active market might not be realizable for the position in its entirety. She indicated that the block issue is a reference market issue that centers on what is being measured, considering relevant marketplace participants. A broker-dealer that regularly transacts in blocks should apply the fair value hierarchy and, because the quotes from Level 1 are not from the “block market,” the quote should be adjusted (primarily because of differences in liquidity) according to Level 2 of the hierarchy. In that regard, she noted that the relevant marketplace participants depend on the business activity (for example, market-making activities and block-trading activities versus other types of investors).

8. Mr. Herz said that Mr. Batavick agrees with Ms. Seidman.

9. Messrs. Crooch, Herz, Trott, and Young and Ms. Schipper decided not to allow a broker-dealer to use a blockage factor to estimate the fair value of a large position of an unrestricted security with a quoted price in an active market (block). Instead, the quoted price should be used without adjustment in all cases. Mr. Batavik and Ms. Seidman disagreed with that decision.

10. All Board members agreed that the Board's revised decision does not require limited reexposure of the ED.

11. In particular, Ms. Schipper said that it is unlikely the Board would receive any new information that it has not previously considered since the project's inception in 2001, referring to the considerable information in staff memorandums, Board meeting minutes, roundtable minutes, and the voluminous project archives. Ms. Seidman agreed. She emphasized that the ED solicited input from constituents on this contentious issue and that the dissent to the ED clearly set out the minority Board view that is now the majority Board view.

Fair Value Disclosures

12. Ms. MacDonald stated that the other disclosure issues focus on unrealized gains or losses relating to assets or liabilities that are still held at the reporting date that are remeasured during the period, as well as total gains or losses relating to all assets or liabilities that are remeasured during the period regardless of whether they are still held at the reporting date.

Unrealized Gains and Losses

13. Ms. MacDonald said that at its meeting on April 27, 2005, the Board decided to require disclosures about unrealized gains or losses relating to fair value remeasurements below Level 1 whenever that information is available. In considering those disclosures further, the staff questions whether they will provide useful information to users, considering situations in which there are omissions because that information is not available. In particular, such omissions could be misleading. She said that in follow-up discussions, some constituents indicated that a disclosure objective focusing on quality of earnings could be achieved within reasonable cost-benefit constraints by focusing those

disclosures on the lowest level of the fair value hierarchy. Ms. MacDonald asked for Board views on whether to revise those disclosures.

14. Ms. Schipper said that she affirmed her earlier decision to require disclosures of unrealized gains or losses relating to fair value remeasurements below Level 1 (by disclosure level) whenever that information is available.

15. Mr. Trott said that he prefers disclosures of unrealized gains or losses relating to fair value remeasurements below Level 1 (by disclosure level) whenever that information is available but that he would compromise at the lowest level (or lowest two levels, if the Board adds a new Level 5).

16. Mr. Crooch indicated that he prefers to retain the disclosures in paragraph B22 of the ED, that is, disclosures of unrealized gains or losses, segregated by those gains or losses included in earnings versus accumulated other comprehensive income (not disclosure level).

17. Ms. Seidman said that she shares the staff's concerns about disclosures of incomplete and potentially misleading information. She said that consistent with a quality of earnings objective, she would prefer to require disclosures of unrealized gains or losses relating to fair value remeasurements within that part of the fair value hierarchy with which users of financial statements would be most concerned—Level 4 or, if the Board adds a new Level 5, Levels 4 and 5 (subject to the Board's decisions on minimum reliability thresholds in its new agenda project).

18. Mr. Young generally agreed with Ms. Seidman.

19. Mr. Herz said that he generally agrees with Ms. Seidman.

20. Mr. Herz said that Mr. Batavick also agrees with Ms. Seidman.

21. Ms. MacDonald said that in view of Board preferences, a final Statement would require disclosures of unrealized gains or losses relating to fair value remeasurements within the lowest level (or levels) of the fair value hierarchy (by disclosure level) in all cases.

Total Gains or Losses

22. Ms. MacDonald said that at its meeting on April 27, 2005, the Board decided to require disclosures about total gains or losses (by major category of asset), segregating those gains or losses included in earnings and accumulated other comprehensive income. She said that in considering those disclosures further, the staff questions whether they would achieve a disclosure objective focusing on quality of earnings. She said that, at this time, the staff seeks Board views on whether to retain those disclosures and, if so, the disclosure objective.

23. All Board members agreed to retain those disclosures, thereby requiring disclosures of total gains or losses (realized and unrealized) by major asset (liability) category, segregating those gains or losses included in earnings and in accumulated other comprehensive income.

24. Ms. Schipper clarified that the disclosure objective is to show the entity's wealth change due to changes in economic conditions. She said that previous Board decisions indicate that the issue of realized versus unrealized is not what is important. Rather, information that shows whether an entity's wealth has changed is what is important. She added that fair value measurements reflect shifts in economic conditions without regard to whether the entity has transacted.

Follow-up Items:

25. None.

General Announcements:

26. None.



FAIR VALUE MEASUREMENT PROJECT
June 1, 2005 Board Meeting

The Board will discuss the need to revise or otherwise clarify certain of its decisions reached at the April 27, 2005 meeting relating to blocks and fair value disclosures.

1. BLOCKS

- a. *Conditions for using blockage factors.* The Board decided to allow an exception to PxQ for a broker-dealer that **both buys and sells** blocks as part of its ongoing business activities to measure the fair value of blocks using a blockage factor (block discount). The Board will discuss whether to (1) clarify the exception so that it applies more broadly (for broker-dealers that buy, sell, or otherwise hold blocks) or (2) eliminate the exception.
- b. *Disclosures.* For blocks that are measured using a blockage factor (block discount), the Board will discuss whether to require disclosures about gains or losses on securities sold out of the block in pieces that do not meet an internal threshold for a block (non-block sales). The Board will separately consider whether to require disclosures of (1) gains or losses realized on non-block sales and (2) gains or losses that would have been realized had the securities been sold in blocks.

2. FAIR VALUE DISCLOSURES

- a. *Unrealized gains or losses.* The Board decided to require disclosures about unrealized gains or losses relating to assets and liabilities that are still held at the reporting date below Level 1, but only if that information is available. The Board will discuss whether to limit those disclosures to unrealized gains or losses within Level 4 and, if so, whether to require those disclosures in all cases.
- b. *Total gains or losses.* The Board decided to require disclosures about total gains or losses relating to all assets and liabilities that are held during the period (whether or not those assets and liabilities are still held at the reporting date), segregating those gains or losses included in earnings and in OCI and by disclosure level. The Board will discuss whether to affirm that decision and, if so, clarify the related disclosure objective.