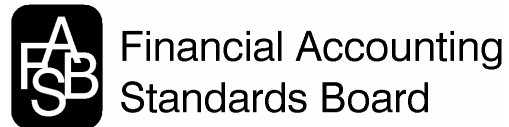


MINUTES



To: Board Members

From: Servicing Rights (Hamilton, ext. 330)

Subject: Minutes of the September 22, 2004 Board Meeting **Date:** September 28, 2004

cc: Bielstein, L. Smith, Petrone, Wilkins, Lott, E. Smith, Laurenzano, Hamilton, Varian, Bullen, Donoghue, Lusniak, Gagon, Hoermann, Thompson, Gabriele, Sutay, 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.

Topics: Subsequent measurement of separately recognized servicing rights and disclosure requirements for separately recognized servicing rights

Basis for Discussion: Board memorandum dated August 25, 2004 and memorandum supplement dated September 15, 2004.

Length of Discussion: 10:55 a.m. to 12:00 p.m.

Attendance:

Board members present: Herz, Batavick, Crooch, Schieneman, Schipper, Seidman, Trott

IASB Board/Staff present: None

Board members absent: Leisenring

Staff in charge of topics: Laurenzano

Other Staff at Board table: Lott, Wilkins, E. Smith, Hamilton

Outside Participants: None

Summary of Decisions Reached:

The Board clarified a decision made at its August 4 meeting that the election to subsequently measure classes of servicing rights at fair value is an irrevocable, one-time election that can be made at any time subsequent to the adoption of the guidance.

The Board decided to retain the disclosures required in paragraph 17(e) of FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, for separately recognized servicing rights subsequently measured at the lower of carrying amount or market (LOCOM).

The Board decided to require the following additional disclosures for all separately recognized servicing rights, which will be separately presented for servicing rights subsequently measured at fair value and subsequently measured at LOCOM:

- A description of the classes of servicing assets and servicing liabilities subsequently measured at fair value or LOCOM, management's rationale for its decision to subsequently measure these classes of servicing assets and servicing liabilities at fair value or LOCOM, a description of the risks inherent in the servicing activity and, if applicable, the instruments used to manage those risks
- A roll forward of the balance of each class of servicing rights for each period that operations are presented, including a description of where each source of activity is reported in the statement of income
- Servicing fees earned during each period that operations are presented
- A description of the valuation techniques used to estimate fair value of the servicing rights
- A sensitivity analysis or stress test showing the hypothetical effect on the fair value of each class of the servicing rights of two or more unfavorable variations from the expected levels for each key assumption

The Board decided that quantitative disclosures relative to the fair value, valuation techniques used to estimate fair value, and sensitivity analysis for risk management instruments related to separately recognized servicing rights will be encouraged, but not required.

Objective of the Meeting:

The objective of the meeting was for the Board to (1) clarify the decision made at the August 4th meeting relative to the subsequent measurement of separately recognized servicing rights and (2) decide what disclosures should be required for separately recognized servicing rights.

Matters Discussed:

August 4 Board Decision

Mr. Laurenzano stated that at the August 4 meeting, the Board decided that the election to remeasure servicing rights at fair value would be applied on a class-by-class basis. Although the Board Memorandum prepared for that meeting recommended that the application of the election be irrevocable, and made only once, upon adoption of the statement, the deliberation on this issue focused on the determination of the classes of servicing rights. As such, the staff would like to clarify the decision made by the Board by asking whether the irrevocable, one-time election should be made upon adoption of the statement or if an enterprise is permitted to make the irrevocable, one-time election at any time subsequent to the adoption of the statement.

The staff recommended that the election to remeasure at fair value be available at any time after adoption based on the reasoning below.

Mr. Laurenzano stated that the Board has already decided that fair value is the most appropriate measurement attribute for servicing rights and as such any subsequent election to use fair value would be considered a preferable method of accounting. He stated that this will also permit enterprises to avail themselves of the election if they subsequently change their business model and decide to manage the risks inherent in servicing rights and would now benefit from the use of fair value. He clarified that the election from LOCOM to fair value is irrevocable.

The Board unanimously supported the staff's recommendation.

Disclosures

Mr. Laurenzano stated that the current disclosure requirements for servicing rights are listed in paragraphs 17(e) and 17(g) of Statement 140. He stated with the decisions reached to date in this project, specifically the option to choose to remeasure servicing rights at fair value, the staff believes that the disclosure requirements should be modified to address the fair value of servicing rights and the lack of comparability the alternative measurements create.

Mr. Laurenzano stated that the staff has provided the Board with separate disclosure requirements for servicing rights remeasured at fair value and servicing rights remeasured at LOCOM. These disclosures would replace the disclosure requirements currently listed in paragraph 17(e) of Statement 140.

Mr. Laurenzano summarized the suggested disclosures for both servicing rights remeasured at LOCOM and servicing rights remeasured at fair value:

- A description of the classes of servicing rights measured at fair value or LOCOM and management's rationale for this accounting policy decision.
- A roll forward of the balance of each class of servicing rights for each period that operations are presented.
- The Fair Value of the instruments used to manage the risk inherent in the servicing assets, including a description of those risks.
- A description of the valuation techniques used to estimate fair value of the servicing rights and instruments used to manage the risks inherent in those rights.
- A sensitivity analysis or stress test showing the hypothetical effect on the fair value of each class of servicing rights and the relevant instruments used to manage the risks inherent in the servicing rights.
- A composition of servicing income reported in operations during the period and a description of where these amounts are reported in the statement of income.

Mr. Laurenzano stated, in addition to these disclosures, the existing disclosure requirements for servicing rights carried at LOCOM relative to the impairment analysis, risk stratification and valuation allowance should be carried forward for servicing rights carried at LOCOM only. He stated that in order to resolve comparability issues created by the option to choose a subsequent measurement

attribute, the staff recommends that servicing rights carried at LOCOM also be required to disclose the fair value of the servicing rights and the unrealized gain or loss at the beginning and end of the period for which operations are presented.

Mr. Laurenzano stated that the staff is aware of concerns raised regarding some of these disclosures and would like to comment on these concerns before the Board deliberates the disclosures. Mr. Laurenzano stated that the staff added a requirement to disclose the fair value, as well as a sensitivity analysis, for instruments used to manage the risks inherent in servicing rights. He stated that disclosure of this information is currently not required for derivatives or cash instruments used to manage these risks. He stated that some have argued that it is inappropriate to address the disclosure of these instruments based solely on their use and have suggested that this type of disclosure be discussed as part of a broader project to address disclosures of all such instruments or in the fair value option project.

Mr. Laurenzano stated that the staff has suggested including these disclosures because they will significantly aid users of the financial statements with understanding the risks inherent in the activity and the instruments an entity uses to manage those risks, as well as how much income statement exposure exists for this activity as a whole. He stated that the staff also believes that since this is a self-contained project relative to the fair value option project, it is appropriate to revisit disclosures of instruments used to manage the risks associated with this asset.

Mr. Laurenzano stated that if the Board does not support such quantitative disclosure, the staff would recommend requiring qualitative disclosure of the risk management instruments, along with an encouragement to disclose the quantitative information. He stated that encouraged quantitative disclosures have been included in other Statements similar to the disclosure recommendation in FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*.

Mr. Laurenzano stated that the staff is also aware of some concerns expressed over the relevance of the sensitivity analysis disclosures. He stated that

currently, the fair value of servicing rights must be obtained as part of the impairment testing. In addition to the fair value determination, sensitivity analysis is currently required for servicing rights; however, enterprises are permitted to include this information in disclosures for other related retained interests. He stated that the staff's recommendation is to require the sensitivity analysis for servicing rights separate from other retained interests. He stated that the staff believes that similar sensitivity analysis for the risk management instruments will assist in obtaining a more complete picture of an enterprises exposure to these risks and changes in underlying inputs.

Ms. Seidman asked the staff to clarify whether the sensitivity disclosure is required for servicing rights or retained interests under Statement 140. Mr. Laurenzano stated that the sensitivity analysis disclosure is required for all retained interests in securitized financial assets under paragraph 17(g) of Statement 140. Ms. Seidman asked whether the staff is proposing that a sensitivity analysis be required for all separately recognized servicing rights, regardless of whether the servicing rights are separately recognized as part of a securitized transaction. Mr. Laurenzano stated that this is the staff's recommendation. Mr. Laurenzano reiterated that, if the Board does not support requiring quantitative disclosures related to risk management instruments for servicing rights, the Board could encourage such disclosures.

Mr. Trott stated that he would support encouraging, but not requiring, quantitative disclosures for risk management instruments related to servicing rights. Ms. Seidman agreed with Mr. Trott.

Ms. Schipper stated that, while she does not support the decisions reached in this project, specifically, the optionality allowed constituents to subsequently measure separately recognized servicing rights at fair value or LOCOM, she does not intend to directly object to all of the staff recommendations.

Ms. Schipper expressed concern that the detailed disclosures recommended by the staff could set a precedent for future disclosures required for financial instruments; servicing rights, while not financial instruments, behave in a manner similar to financial instruments. Ms Schipper and Mr. Herz expressed concern that, while such disclosures may be useful to a specific set of users, requiring all

of the staff recommended disclosures for servicing rights could be considered an ad-hoc, piecemeal approach to providing disclosure guidance, which has been a complaint of certain constituents. She expressed her preference for a more conceptual approach to determining disclosure requirements.

Mr. Schienemann commented that the detailed disclosures recommended by the staff will be useful to a specific set of financial statement users. He stated that as disclosures become more general they often become less useful to users of financial statements. He stated that the detailed disclosures address specific user concerns with regard to servicing rights, namely a company's exposure to losses and its risk management activities to mitigate that exposure. He believes that these disclosures are of primary importance to financial statement users who focus on servicing rights.

Ms. Seidman stated that when determining what disclosures to require for servicing rights, the Board should also keep in mind whether it would recommend such disclosures for "other financial instruments" in the fair value option project. Her emphasis when determining what disclosures should be required for separately recognized servicing rights, while keeping in mind the fair value option project, is comparability between separately recognized servicing rights subsequently measured at fair value and those subsequently measured at LOCOM.

Mr. Trott suggested that the Board discuss and decide whether to support each staff-recommended disclosure first for servicing rights subsequently measured at fair value and next for servicing rights subsequently measured at LOCOM.

Mr. Batavick asked whether an enterprise that does not hold a material amount of servicing rights would be required to satisfy all disclosure requirements if it wanted to voluntarily disclose information on servicing rights. Mr. Herz stated that, as the disclosure would be voluntary because the separately recognized servicing rights are not material, an enterprise would not be required to satisfy all disclosure requirements for servicing rights.

Disclosures for Servicing Rights Subsequently Measured at Fair Value¹

Disclosure 1—Staff Recommendation: The classes of servicing assets and servicing liabilities subsequently measured at fair value and management’s rationale for its decision to subsequently measure these classes of servicing assets and servicing liabilities at fair value

Mr. Trott proposed including Disclosure 4 in Disclosure 1. He recommended that the qualitative and quantitative disclosures in Disclosure 4 be required for servicing assets and liabilities and proposed requiring qualitative disclosures as well as encouraging, but not requiring, quantitative disclosures for risk management activities.

The Board supported the staff’s recommendation and recommended including Disclosure 4 in Disclosure 1. The Board recommended requiring qualitative and quantitative disclosures in Disclosure 4 for servicing assets and liabilities as well as requiring qualitative disclosures and encouraging, but not requiring, quantitative disclosures for risk management activities.

Disclosure 2—Staff Recommendation: The activity in the balance of each class of servicing assets and servicing liabilities—including the beginning and ending balances, additions (through purchase or asset transfer at their initial fair value), disposals, change in fair value during the period from a) disposition at fair value, b) payment on the underlying assets and c) change in the valuation inputs—for each period for which results of operations are presented

Ms. Seidman stated that the CFA Institute proposed a similar disclosure requirement for items remeasured at fair value during the fair value roundtable (held September 21, 2004). Ms. Seidman proposed that the Board not explicitly require this disclosure for servicing rights and instead address whether such a disclosure should be required for all items that are remeasured at fair value in the fair value measurement project.

¹ The staff is still required to draft the proposed amendment and receive Board approval before the issuance of an Exposure Draft. As such, the wording of the proposed disclosures may change.

Mr. Trott stated that this disclosure is already required for servicing rights subsequently measured at LOCOM in Statement 140. He supported requiring this disclosure for servicing rights subsequently measured at fair value.

Ms. Seidman commented that certain recommendations in Disclosure 2 are not required in Statement 140, including, “change in valuation inputs.” Mr. Laurenzano stated that certain disclosures were added to Disclosure 2 in order to allow for the beginning of period balance to roll forward to the end of period balance for servicing rights subsequently measured at fair value.

Mr. Lott stated that, in order for the beginning of period balance to roll forward to the end of period balance, an enterprise’s change in method of valuing separately recognized servicing rights subsequently measured at fair value will have to be included in Disclosure 2.

Mr. Herz asked if any Board members objected to Disclosure 2, inclusive of Mr. Lott’s suggestion to include an enterprise’s change in method of valuing separately recognized servicing rights subsequently measured at fair value. [Six Board members did not object; one objected: Seidman. Ms. Seidman believes that this type of disclosure should be addressed in the broader context of the fair value measurement project.]

Disclosure 3—Staff Recommendation: The unrealized gain or loss on the servicing assets and servicing liabilities at the beginning and end of the period

Mr. Trott did not support the staff recommendation because he believes that the information necessary to determine the unrealized gain or loss is already disclosed, albeit indirectly, in Disclosure 2. Ms. Seidman and Ms. Schipper agreed with Mr. Trott.

The Board did not support the staff recommendation.

Disclosure 4—Staff Recommendation: The fair value of the instruments used to manage the risks inherent in servicing rights (offset the impact on operations of a change in fair value of the servicing rights) the risks inherent in the servicing

rights, including a description of the risks being hedged, at the beginning and end of the period

The Board recommended that Disclosure 4 be included in Disclosure 1 and that the qualitative disclosures related to risk management activities be required and the quantitative disclosures related to risk management activities be encouraged, but not required.

Disclosure 5—Staff Recommendation: A description of the valuation techniques used to estimate fair value of the servicing rights and instruments that manage the risks inherent in servicing rights (including the methodology and model validation techniques) as well as quantitative and qualitative information about the inputs used in the model (discount rates, prepayments)

Ms. Seidman stated that because this disclosure is already required in Statement 140 for separately recognized servicing rights that are recognized as a result of a securitization, she supports the staff's recommendation.

Mr. Herz, supported the staff recommendation because it provides additional information on the valuation techniques used by an enterprise to value potentially volatile instruments.

Mr. Laurenzano commented that, consistent with the Board's recommendation in Disclosure 1, the disclosures related to risk management activities in Disclosure 5 should be encouraged, but not required, contingent upon whether an enterprise has disclosed the quantitative information related to risk management activities encouraged, but not required, in Disclosure 1. In other words, if an enterprise has elected to disclose the quantitative information related to risk management activities encouraged, but not required, in Disclosure 1, then the entity is encouraged, but not required, to disclose a description of the valuation techniques used to estimate fair value of the instruments used to manage the risks inherent in servicing rights as well as quantitative and qualitative information about the inputs used in the model.

Ms. Seidman commented that the fair value measurement project would potentially require similar disclosures for risk management activities for those instruments that are measured at fair value.

The Board supported the staff recommendation inclusive of Mr. Laurenzano's recommendation that a description of the valuation techniques as well as quantitative disclosures related to risk management activities are encouraged, but not required; an enterprise is encouraged to disclose this information if it has elected to disclose quantitative information relative to risk management activities in Disclosure I.

Disclosure 6—Staff Recommendation: A sensitivity analysis or stress test showing the hypothetical effect on the fair value of the servicing rights, as well as the instruments used to manage the risks inherent in these assets of two or more unfavorable variations from the expected levels for each key assumption that is reported under (5) above independently from any change in another key assumption, and a description of the objectives, methodology, and limitations of the sensitivity analysis or stress test

Ms. Seidman acknowledged that Disclosure 6 is a proposed expansion of an existing disclosure requirement in Statement 140, which already requires a sensitivity analysis for retained interests in securitizations. She supports the staff's recommendation primarily because it is an existing requirement for retained interests, of which certain servicing rights are a subset, in Statement 140 and because it provides comparability between separately recognized servicing rights subsequently measured at fair value and those subsequently measured at LOCOM.

Mr. Crooch commented that, while he would not necessarily support a sensitivity analysis disclosure for other financial instruments, he believes the disclosure is beneficial for servicing rights due, in part, to the relative volatility of servicing rights.

Mr. Trott stated that he does not believe a sensitivity analysis is a useful disclosure for separately recognized servicing rights. He believes that much of

the information that would be provided by a sensitivity analysis is already provided in Disclosure 2.

Mr. Herz asked if a sensitivity analysis is required, whether a separate sensitivity analysis should be presented for risk management activities or whether an enterprise should be allowed to present one sensitivity analysis with the net effects of servicing rights and related risk management instruments presented together.

No Board members objected to requiring a sensitivity analysis for separately recognized servicing rights subsequently measured at fair value and encouraging, but not requiring, a separate sensitivity analysis for risk management activities related to separately recognized servicing rights; an enterprise is encouraged to disclose a sensitivity analysis for risk management activities related to servicing rights if it has elected to disclose quantitative information relative to risk management activities in Disclosure 1.

Disclosure 7—Staff Recommendation: The composition of the servicing income (expense)—including servicing fees, changes in fair value of servicing rights and the instruments used to manage the risks inherent in servicing rights—reported in operations during the period

Ms. Seidman stated that she does not support this disclosure because much of the information is already disclosed in Disclosure 2, and it would not provide information that improves comparability between classes servicing rights.

Mr. Herz proposed requiring disclosure of servicing fees earned during a period in Disclosure 2 because it would provide information on the earnings flow of separately recognized servicing rights subsequently measured at fair value that is not disclosed elsewhere. Ms. Seidman commented that earnings flow is not a required disclosure for other financial instruments. Mr. Herz commented that, while servicing rights are similar to financial instruments, there is also an existing performance obligation, which is why he believes disclosure of earnings flow is important for servicing rights.

Mr. Laurenzano proposed incorporating a description of where servicing income (expense) is reported in the statement of income during a period in Disclosure 2.

The Board did not support the staff recommendation. The Board recommended requiring disclosure of servicing fees earned and a description of where servicing income (expense) is reported in the statement of income during a period in Disclosure 2. [Six Board members did not object; one objected: Seidman. Ms. Seidman believes that this type of disclosure should be addressed in the broader context of the fair value measurement project.]

Disclosures for Servicing Rights Subsequently Measured at LOCOM²

Disclosure 1—Staff Recommendation: The classes of servicing assets and servicing liabilities not subsequently measured at fair value and management’s rationale for its decision not to subsequently measure these classes of servicing assets and servicing liabilities at fair value

The Board supported the staff’s recommendation and recommended including Disclosure 4 in Disclosure 1. The Board recommended requiring qualitative and quantitative disclosures in Disclosure 4 for servicing assets and liabilities as well as requiring qualitative disclosures and encouraging, but not requiring, quantitative disclosures for risk management activities.

Disclosure 2—Staff Recommendation: The activity in the balance of each class of servicing assets and servicing liabilities—including the beginning and ending balances, additions (through purchase or asset transfer at their initial fair value), amortization, disposals, and impairment (recoveries)—for each period for which results of operations are presented

Mr. Trott commented that this disclosure is already required for servicing rights in Statement 140. Mr. Laurenzano asked if the Board would also support its decision for servicing rights subsequently measured at fair value to require

² The staff is still required to draft the proposed amendment and receive Board approval before the issuance of an exposure draft. As such, the wording of the proposed disclosures may change.

disclosure of servicing fees earned and a description of where servicing income (expenses) is reported in the statement of income during a period.

The Board supported the staff's recommendation. The Board also supported requiring disclosure of servicing fees earned and a description of where servicing income (expenses) is reported in the statement of income during a period in this disclosure. [Six Board members did not object; one objected: Seidman. Ms. Seidman believes that this type of disclosure should be addressed in the broader context of the fair value measurement project.]

Disclosure 3—Staff Recommendation: The fair value of recognized servicing assets and servicing liabilities at the beginning and end of the period for which it is practicable to estimate that value and the unrealized gain or loss on the servicing assets and servicing liabilities at the beginning and end of the period

Ms. Seidman supported the staff recommendation. She believes this is the key disclosure for comparability purposes, between servicing rights subsequently measured at fair value and those subsequently measured at LOCOM.

The Board supported the staff's recommendation.

Disclosure 4—Staff Recommendation: The fair value of the instruments used to manage the risks inherent in servicing rights (offset the impact on operations of a change in fair value of the servicing rights) the risks inherent in the servicing rights, including a description of the risks being hedged, at the beginning and end of the period

The Board recommended that Disclosure 4 be included in Disclosure 1 and that the qualitative disclosures related to risk management activities be required and the quantitative disclosures related to risk management activities be encouraged, but not required.

Disclosure 5—Staff Recommendation: A description of the valuation techniques used to estimate fair value of the servicing rights and the instruments that manage the risks +

inherent in servicing rights (including the methodology and model validation techniques) as well as quantitative and qualitative information about the inputs used in the model (discount rates, prepayments)

The Board supported the staff recommendation. The Board recommended that a description of the valuation techniques as well as quantitative disclosures related to risk management activities be encouraged, but not required; an enterprise is encouraged to disclose this information if it has elected to disclose quantitative information relative to risk management activities in Disclosure 1.

Disclosure 6—Staff Recommendation: The risk characteristics of the underlying financial assets used to stratify recognized servicing assets for purposes of measuring impairment in accordance with paragraph 63 of Statement 140

Mr. Laurenzano commented that this disclosure is already required for separately recognized servicing rights subsequently measured at LOCOM in Statement 140.

The Board supported the staff's recommendation

Disclosure 7—Staff Recommendation: The activity in any valuation allowance for impairment of recognized servicing assets—including beginning and ending balances, aggregate additions charged and recoveries credited to operations, and aggregate direct write-downs charged against the allowances—for each period for which results of operations are presented

Mr. Laurenzano commented that this disclosure is already required for separately recognized servicing rights subsequently measured at LOCOM in Statement 140.

The Board supported the staff's recommendation.

Disclosure 8—Staff Recommendation: A sensitivity analysis or stress test showing the hypothetical effect on the fair value of each class of the servicing assets and servicing liabilities, as well as the instruments used to manage the risks inherent in these assets of two or more unfavorable variations from the expected levels for each key assumption that is reported under (5) above independently from any change in another key assumption, and a description of

the objectives, methodology, and limitations of the sensitivity analysis or stress test

No Board members objected to requiring a sensitivity analysis for separately recognized servicing rights subsequently measured at fair value and encouraging, but not requiring, a separate sensitivity analysis for risk management activities related to separately recognized servicing rights; an enterprise is encouraged to disclose a sensitivity analysis for risk management activities related to servicing rights if it has elected to disclose quantitative information relative to risk management activities in Disclosure 1.

Disclosure 9—Staff Recommendation: The composition of the servicing income (expense)—including servicing fees, amortization and impairment of servicing rights, and change in fair value of the instruments used to manage the risks inherent in servicing rights —reported in operations during the period

The Board did not support the staff recommendation. The Board recommended requiring disclosure of servicing fees earned and a description of where servicing income (expense) is reported in the statement of income during a period in Disclosure 2. [Six Board members did not object; one objected: Seidman. Ms. Seidman believes that this type of disclosure should be addressed in the broader context of the fair value measurement project.]

Follow-up Items:

The Board asked that the staff begin drafting the proposed amendment to Statement 140.

General Announcements:

None