



## Board Meeting Handout

### Proposed FSP EITF 99-20-a

January 7, 2009

#### PURPOSE OF THIS MEETING

1. The staff plans to discuss with the Board the comment letters received from constituents about the proposed FSP EITF 99-20-a, *Amendments to the Impairment and Interest Income Measurement Guidance of EITF Issue No. 99-20*. The staff also plans to discuss with the Board whether the proposed FSP should be issued as a final FSP and any necessary adjustments to the proposed FSP as a result of the comments received.

#### COMMENT LETTER SUMMARY

2. Prior to issuing the proposed FSP, the FASB and IASB organized three roundtables, one each in London, Norwalk, and Tokyo, to obtain input on accounting issues that may require immediate attention, as well as broader financial reporting issues arising from the global financial crisis. Roundtable participants represented the views of investors, preparers, practitioners, regulators, and others. In addition, the FASB and IASB have considered informal input from other organizations, such as the Center for Audit Quality (CAQ), the American Council of Life Insurers, and the U.S. Securities and Trade Commission (SEC). Many constituents indicated that the other-than-temporary impairment guidance could be improved (or perhaps eliminated in the long-term) and specifically highlighted that Issue 99-20 has operational issues.

3. On December 19, 2008, the Board issued the proposed FSP for comment. The comment period ended on December 30, 2008. As of January 6, 2009, 346 comment letters were received. A comment letter summary has been prepared and is included on the FASB

website as part of the project summary web page for this project. The following table provides the demographics of the respondents:

| <b>Type of Respondent</b>                           | <b>Number</b> |
|---|---------------|
| User  | 10            |
| Preparer  | 307           |
| Other (e.g., regulators, valuation firms, academic) | 9             |
| Financial Institution - Industry Organization       | 18            |
| Accounting Firm/Auditors – Industry Organization    | 2             |
| <b>TOTAL</b>  | <b>346</b>    |

4. With the exception of user respondents, the majority of respondents supported the proposed FSP, with many emphasizing the need for a broader overhaul of the other-than-temporary impairment model in U.S. GAAP. The types of respondents that were in favor of the proposed FSP—subject to certain clarifications—included preparers (financial institutions and related trade associations), auditors, certain regulators, and members of the valuation profession. Many users were not in favor of finalizing the proposed FSP. These respondents expressed concerns about any shift away from fair value in the measurement of financial instruments (that is, the potential for delayed recognition of losses in earnings) and the shortened comment period for the proposed FSP.

## **ISSUES FOR CONSIDERATION**

### **Background**

5. The proposed FSP was issued in response to concerns raised by constituents regarding the impairment models in FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, and EITF Issue No. 99-20, “Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets.” These constituents pointed out that

these different impairment models result in inconsistent accounting for similar financial instruments. The proposed FSP amended the impairment guidance in Issue 99-20 to achieve a more consistent determination of whether an other-than-temporary impairment has occurred for debt securities classified as available-for-sale or held-to-maturity.

### **Issue 1—Short-Term or Comprehensive Project**

6. The comments from respondents to the proposed FSP varied significantly. Some respondents supported the proposed FSP noting that the proposed FSP (a) creates a single impairment model for debt securities, (b) mitigates certain operational concerns about how Issue 99-20 is applied in practice, and (c) represents a step towards convergence with the IASB. Other respondents disagreed with the proposed FSP stating that (a) it does not serve investors because it moves away from a fair value measure, (b) it subjects the assessment of impairment to significant preparer judgment, and (c) the comment period was too short for such a significant change. However, all of the respondents generally agreed that a single impairment model for debt securities is appropriate, though some would prefer the Issue 99-20 model.

### **Question for the Board**

7. Does the Board want to finalize the proposed FSP in some form as part of a separate, short-term project focused on aligning the impairment model in Issue 99-20 with the equivalent guidance in Statement 115? Alternatively, does the Board want to consider changes to the impairment guidance in Issue 99-20 as part of the joint project with the IASB on improving financial reporting of financial assets and financial liabilities?

### **Staff recommendation**

8. The staff recommends that the Board finalize the proposed FSP subject to clarifying edits. While the staff recognizes the concerns of the user respondents, the staff believes that there should not be different impairment models for assessing similar instruments. Respondents generally noted that with some clarifications, the proposed FSP is operational. The staff believes that finalizing the proposed FSP is appropriate as a short term solution

until the Board revisits impairment issues more comprehensively in the broader financial instruments project.

*Note: The following additional issues and related questions for the board are only relevant for today's meeting if the Board decides to proceed with the proposed FSP to amend Issue 99-20.*

## **Issue 2—Scope of Short-Term Project**

9. A significant number of respondents that supported issuance of the proposed FSP stated that the guidance in the proposed FSP represented a good starting point for revisiting impairment guidance for financial instruments. However, these respondents noted that additional amendments and guidance were necessary for year-end 2008. The suggested changes include:

- a. Reconsidering the triggers for impairment such as:
  - i. Eliminating the 'intent and ability to hold' requirement of Statement 115 and replacing it with objective evidence of a credit event
  - ii. Modifying the language in paragraph 16 of Statement 115 that indicates that **all** cash flows be collectable as originally scheduled or estimated by indicating that "an insignificant delay or insignificant shortfall in amount of payments does not automatically result in OTTI (similar to paragraph 8 of Statement 114)
- b. Reconsidering the use of fair value to measure impairments and instead use the amount of loss recognized in earnings based on the difference between the carrying amount of the instrument and the present value of the estimated future cash flows discounted at the instrument original effective interest rate.
- c. Reconsidering the prohibition against reversals of other-than-temporary impairments

- d. Permitting the effective date for recent transfers to held-to-maturity and available-for-sale to be the same effective date used by the IASB (that is, from 1 July 2008)
- e. Clarifying the definition of fair value such as:
  - i. That liquidity risk referred to in FSP FAS 157-3 is not based on distressed sales
  - ii. Remove market participants' perspective

10. Respondents who opposed the proposed FSP suggested the that the Board under take a project to broadly reconsider Statement 115, including giving consideration to requiring that all financial instruments be accounted for at fair value accompanied by robust disclosures; thus, eliminating the need for other-than-temporary impairment guidance.

#### **Question for the Board**

11. Does the Board want to broaden the scope of the proposed FSP for any of the items noted above?

#### **Staff recommendation**

12. The staff recommends that the Board not alter the scope of the proposed FSP. The staff notes that the FASB and the IASB have jointly agreed to expeditiously consider disclosures about incurred losses and reversals of other-than-temporary impairments. The Boards have also added a project to consider improvements to financial reporting for financial assets and financial liabilities. That project will include a reconsideration of impairments of financial assets (for example, whether there are better alternatives to impairment tests, or if not, what should trigger impairment and how should the impairment be measured and presented and/or disclosed).

#### **Issue 3—Changes to Proposed FSP**

13. One respondent raised concerns regarding the removal of the words “market participant” from Issue 99-20. Specifically, this respondent noted that “the removal of those words may unduly diminish the use of market-based information, including fair value, in determining an

other-than-temporary impairment.” Further, this respondent stated that a connection should be retained to market participants’ views to inform and regulate the exercise of management’s judgment. This respondent pointed out that in certain instances, “it is reasonable to expect entities to consider market consensus views regarding the future performance of the underlying collateral in determining an other-than-temporary impairment.”

### **Question for the Board**

14. Does the Board want the staff to provide additional clarifying language in paragraph 13 of Issue 99-20 to indicate that:

- a. It is inappropriate to automatically conclude that a security is not impaired because all of the scheduled payments to date have been received. However, it is also inappropriate to automatically conclude that every decline in fair value represents an other-than-temporary impairment. Further analysis is often required to assess whether declines in fair value represent declines in the expected cash flows from the issuer of the security.
- b. The holder must consider all available information, reflecting past events and current conditions, when developing the estimate of future cash flows. All available information would include the remaining payment terms of the instrument (which, for a security backed by nontraditional loans, could be significantly different from the payment terms in prior periods), economic factors that are relevant to the collectibility of the instrument, such as current prepayment speeds, the current financial condition of the issuer(s) and the value of any underlying collateral.

### **Staff recommendation**

15. The staff recommends including the additional language to avoid any misinterpretation of the removal of the reference to market participants.

*Other changes*

16. The staff has made other clarifying changes to the proposed FSP and the amendments to Issue 99-20.

**Question for the Board**

17. Does the Board agree with those changes?

**Staff recommendation**

18. The staff recommends making the proposed changes.

**Issue 4—Effective Date and Transition**

19. The proposed FSP is effective for interim and annual reporting periods ending after December 15, 2008, and applied prospectively. Respondents who favored the proposed FSP supported the proposed effective date and transition. However, respondents did raise concerns about reversal of previous other-than-temporary impairments taken in prior periods. Those respondents suggested that the Board clarify the effective date and transition guidance in the proposed FSP by expressly prohibiting retrospective application. They added that the Board should explicitly indicate that entities (for example nonpublic banking entities) that have filed regulatory reports that include an other-than-temporary impairment should not be permitted to reverse that impairment.

**Question for the Board**

20. Does the Board want to explicitly state that retrospective application is not allowed and that this would apply, for example, to nonpublic enterprises that have recorded OTTI for regulatory reports?

**Staff recommendation**

21. The staff recommends that the Board indicate that retrospective application is prohibited, but that no specific guidance be provided with respect to regulatory reports.

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**Question for the Board**

Does the Board authorize the staff to proceed to ballot the final FSP?