

## MINUTES



**To:** Board Members

**From:** Statement 140 Amendment Team  
(Bergstrom, Ext 296)

**Subject:** Minutes of the June 15, 2005 Board Meeting (QSPE's)      **Date:** June 15, 2005

**cc:** Bielstein, Smith, Petrone, Leisenring, Project Team, Mahoney, Thompson, Vincent, Sutay, Gabriele, Swift, Polley, Getz, FASB Intranet (e-mail)

*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 Amendments to Paragraphs 35 and 40(a) of Statement 140: QSPEs

Basis for Discussion: Memorandum 50, dated June 10, 2005

Length of Discussion: 10:40 a.m. to 11:05 a.m.

Attendance:

Board members present:	Herz, Batavick, Crooch, Schipper, Seidman, Trott, and Young
Board members absent:	None
Staff in charge of topic:	Donoghue
Other staff at Board table:	L. Smith, E. Smith, Laurenzano, Lusniak, Lott, Golden, and Bergstrom
Outside participants:	Leisenring

### **Summary of Decisions Reached**

The Board discussed a proposal to amend FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, to allow qualifying SPEs to hold passive derivative financial instruments that do not initially exceed the amount of beneficial interests issued (including those that are held by the transferor, its affiliates, or its agents) and that are not expected to exceed them subsequently. Currently, Statement 140 limits the amount of derivatives a qualifying SPE can hold to an amount that does not initially exceed the amount of beneficial interests issued or sold to parties other than the transferor, its affiliates, or its agents and that is not expected to exceed them subsequently. The Board concluded that the original limit would no longer be necessary given the Board's decisions on the measurement of hybrid financial instruments that are included in the soon-to-be-issued Exposure Draft on accounting for hybrid financial instruments.

### **Objectives of the Board Meeting**

The objectives of the meeting were for the Board to decide whether to amend the current requirements in Statement 140 that a qualifying SPE be limited to holding only passive derivative financial instruments that pertain to beneficial interests held by parties other than the transferor, its affiliates, or its agents and is not expected to exceed them subsequently and to decide whether to include those amendments in the Exposure Draft to Statement 140 for the QSPE project. The objectives of the meeting were met.

### **Matters Discussed and Decisions Reached:**

1. Ms. Donoghue began the discussion by asking whether Statement 140 should continue to limit a qualifying SPE to holding passive derivative financial instruments that do not initially have a notional amount that exceeds the amount of beneficial interests issued to third parties and that are not expected

to exceed them subsequently. Ms. Donoghue presented a staff recommendation that the Board consider this issue before the issuance of the QSPE and the hybrid financial instruments Exposure Drafts because a change of this significance should be handled by an amendment to Statement 140, rather than through an FSP or other means.

2. Ms. Donoghue recommended that the Board include an amendment to Statement 140 in the soon-to-be-issued Exposure Draft on qualifying SPEs that would allow a qualifying SPE to hold passive derivative financial instruments that pertain to all beneficial interests issued by the qualifying SPE (both those issued to the transferor, its affiliates, or its agents and those issued to outside third parties). She cited the following reasons.

- a. Limiting the derivatives a qualifying SPE can hold to an amount that does not initially exceed the amount of beneficial interests issued to parties other than the transferor, its affiliates, or its agents and that is not expected to exceed them subsequently is inconsistent with the Board's previous decision in the QSPE project to treat a beneficial interest held by the transferor as a new financial asset to the transferor, similar to a beneficial interest held by a third party.
- b. The existing prohibition on a qualifying SPE from holding passive derivative financial instruments related to a transferor's beneficial interest was developed largely to prevent abusive structures that may be utilized because FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and the related Statement 133 Implementation Issue No. D1, "Application of Statement 133 to Beneficial Interests in Securitized Financial Assets," exempts holders of beneficial interests from the requirement to bifurcate embedded derivatives and reports changes in fair value in the income statement. That exemption would have permitted an entity to avoid reporting changes in the

fair value of a derivative financial instrument by bundling derivatives with other financial assets, transferring them to a qualifying SPE, and taking back a majority of its beneficial interests.

- c. The proposed changes to Statements 133 and 140 that are included in the hybrid financial instruments project would no longer allow that type of structure because they give a transferor the option to either fair value its entire beneficial interest on an ongoing basis or to bifurcate any embedded derivative and measure them at fair value on an ongoing basis.
- d. This amendment would simplify the accounting for certain transfers of financial assets under Statement 140 and would simplify the transferor's accounting for derivatives related to beneficial interests issued by a qualifying SPE.

3. Ms. Donoghue explained the staff's recommended changes to the language in paragraphs 39 and 40 (b) of Statement 140. Mr. Trott agreed with the staff's recommendation to include the changes in the QSPE Exposure Draft. However, he expressed concern about the interaction of the proposed amendments to Statement 140 that are being exposed separately in the hybrid financial instruments and QSPE projects. He expressed concern about whether the amendments resulting from the hybrid financial instruments project would require that a transferor's interest in a passive derivative always be reported at fair value. He noted that he believes the hybrid financial instruments project would require ongoing remeasurement at fair value but pointed out that the amendments included in the hybrid financial instrument project, as well as those in the QSPE project, are not yet final. He also mentioned that his support for the amendment is conditional on both projects being completed as planned. Ms. Schipper expressed similar concerns and noted that her support is also contingent upon the outcome of the hybrid financial instruments project.

4. Ms. Seidman agreed that the staff's recommendation is a logical extension of the majority of the Board's decisions related to changing the initial measurement of a transferor's retained beneficial interest. However, she noted that the Board's intent in Statement 133 was always to require that beneficial interests be evaluated for embedded derivatives. Consequently, the nullification of the Implementation Issue D1 exemption should not affect this issue. She also observed that the majority Board decision to initially measure all beneficial interests at fair value upon a sale is only a momentary remeasurement, not an ongoing requirement. Because embedded derivatives must be subsequently measured at fair value, she was not convinced that the day 1 decision addresses this issue either. However, Ms. Seidman was not opposed to including the changes in the Exposure Draft for the QSPE project and expressed her expectation that constituents would evaluate this change carefully and inform the staff if there were other reasons that the Board should not change the existing guidance on passive derivatives.

5. The Board unanimously agreed to support the staff's recommend changes to the QSPE Exposure Draft.

**Follow-up Items:**

None

**General Announcements:**

None.