

MINUTES



Financial Accounting
Standards Board

To: Board Members

From: Statement 140 Amendment Team
(Kapko, Ext. 317)

Subject: Minutes of the April 13, 2005 Board Meeting (QSPE's) **Date:** April 20, 2005

cc: Bielstein, Smith, Petrone, Leisenring, Romas 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: Comment Period, Transition and Effective Date, and Definition of a Participating Interest

Basis for Discussion: Memorandum 45, dated April 1, 2005; Memorandum 46, dated April 1, 2005; Memorandum 47, dated April 5, 2005; and Memorandum 48 dated April 12, 2005

Length of Discussion: 9:00 a.m. to 11:20 a.m.

Attendance:

Board members present:	Trott, Schipper, Batavick, Crooch, Young, and Seidman
Board members absent:	Herz
Staff in charge of topic:	Donoghue and Lusniak
Other staff at Board table:	L.Smith, E. Smith, Laurenzano, Lott, Wilkins, Kapko, Varian, and Bergstrom
Outside participants:	Leisenring

Summary of Decisions Reached

At today's meeting, the Board completed deliberations on the issues presented in the Servicing Rights, Beneficial Interests, and QSPE projects.

The Board decided for all three projects—

- a. To expose the Exposure Drafts for a comment period of 60 days.
- b. To require that the application of the measurement provisions be effective at the earlier of fiscal years beginning after December 15, 2005 or fiscal years that begin during the quarter in which the final Statement is issued.

Specifically, the Board decided for the QSPE project—

- a. To require that the derecognition provisions for a transfer of a portion of a financial asset be applied prospectively :
 - For public companies—all transfers of financial assets occurring after the end of the first fiscal quarter that begins after the issuance of the final Statement
 - For privately held companies—all transfers that occur in the first fiscal year that begins after the issuance of the final Statement.
- b. To require (a) that a participating interest be defined as proportionate ownership of the cash flows of the original financial asset that does not involve recourse or subordination by any party to the transaction and is an interest in a single, original financial asset and (b) that each resulting participating interest meet all of the conditions of paragraph 9 of FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, (in particular, paragraph 9(b)).

Objectives of the Board Meeting

The objectives of the meeting were for the Board (1) to decide on the effective date, transition, and comment period for the Exposure Drafts to amend Statement 140 as

well as the other Statement 140-related Exposure Draft and (2) to discuss potential refinements to the definition of a participating interest.

Matters Discussed and Decisions Reached:

The following paragraphs summarize the Board's views on the major issues discussed at the meeting. The views and matters presented in these minutes may not be in the specific order in which they were discussed at the meeting.

1. The staff presented a joint recommendation for the comment period and the effective dates for decisions related to measurement that will be used in each project's Exposure Draft. In regard to the length of the comment period, the staff recommended a comment period of 60 days. In making this recommendation, the staff asked the Board to reconsider the staff's previous recommendation in the QSPE project for a 45-day comment period. The staff noted that the longer comment period is recommended because (a) three separate Exposure Drafts amending Statement 140 will be issued concurrently and (b) additional guidance has been provided for the isolation requirement, the requirements for transferring portions of financial assets, and the accounting for portions of transferred assets held by the transferor. Six Board members agreed to a 60-day comment period. Mr. Herz was not present and did not provide Mr. Trott with his proxy on this issue.

2. The staff recommended that the measurement provisions that will be included in each of the three Exposure Drafts be drafted as follows:

The application of the measurement provisions will be effective at the earlier of fiscal years beginning after December 15, 2005, or fiscal years that begin during the quarter in which a final Statement is issued.

3. The staff indicated that while this recommendation could make the measurement guidance applicable soon after or even before the expected issuance date of the final Statements, the staff believes that the application of the measurement provisions should not be overly burdensome because the fair value information is already required to be obtained for initial recognition and subsequent impairment analysis and disclosure. The staff noted that some constituents have already indicated that they would like to apply

the measurement provisions as soon as possible. All of the Board members present agreed with the staff's proposed effective date for the measurement provisions included in the three Exposure Drafts. Mr. Herz had provided Mr. Trott with an affirmative proxy on this issue.

Effective Date for Recognition and Derecognition Issues

4. Ms. Lusniak stated that for the derecognition provisions, the staff recommends that the Board require that the final Statement to amend Statement 140 be effective:

- For public companies—all transfers of financial assets occurring after the end of the first fiscal quarter that begins after the issuance of the final Statement
- For privately held companies—all transfers that occur in the first fiscal year that begins after the issuance of the final Statement.

5. Ms. Lusniak stated that the staff initially recommended that the change in the initial measurement of a transferor's beneficial interest to fair value should be aligned with the amendment to the derecognition provision in order to avoid confusion and expense for preparers. However, after considering the effective dates of both the beneficial interests and servicing rights projects, the staff believes that it may be helpful to measure both beneficial interests and servicing rights at fair value beginning on the same date to avoid measuring the servicing rights at fair value while delaying measuring the new beneficial interests at fair value for up to six-months. The six Board members present agreed with the staff recommendation.

Transition Issues

6. Ms. Lusniak stated that there are two requirements on which the Board needs to make decisions about transition:

- The requirement to use a QSPE to divide financial assets into derecognizable portions unless the portions qualify as participating interests
- The requirement to initially measure beneficial interests at fair value.

7. She stated that the staff believes that those requirements should be applied to all beneficial interests issued and transfers of financial assets occurring after the date the amendment is applied. The question for the Board is whether they should be applied to beneficial interests and transfers that were issued or occurred prior to the date the amendment is effective. There are three general possibilities for transition of both requirements:

- a. **Grandfather**—Do not change the accounting for previous transfers.
- b. **Restate**—Change the accounting for previous transfers as of the date of the transfer and restate previously issued financial statements.
- c. **Cumulative catch-up**—Change the accounting for previous transfers as of the date this amendment is applied and report the effects on income as a cumulative effect adjustment.

8. Ms. Lusniak stated that the staff recommends that the Board follow the established protocol in previous Statement 140 amendments and make the amendments to the derecognition and measurement provisions effective prospectively. Six Board members agreed to the staff recommendation. Mr. Herz was not present and did not provide a proxy for his vote.

Participating Interests

9. Ms. Donoghue stated that the Board previously asked the staff to look into the possibility of expanding the definition of a participating interest. On Mr. Trott's suggestion, the Board discussed Questions 1 and 2 together. The questions that Ms. Donoghue asked the Board to consider were:

Question 1—Should the definition of a participating interest include proportionate apportionments of specifically identified cash flows¹ of an original financial asset that meet all of the following requirements:

- a. Include no recourse to the transferor
- b. Have no subordination

¹ As the term is used in IAS 39, paragraph 16(a).

- c. Initially result from separating the rights to receive specified contractual cash flows of an original financial asset
- d. Do not contain an embedded derivative (as defined in FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*)
- e. Do not incorporate any terms not present in the original financial asset?

Question 2—Should the definition of a participating interest include an exception that would allow proportionate apportionments of interest-only and principle-only strips (I/O and P/O) when the interest meets all of the following:

- a. The I/O and P/O strips initially result from separating the rights to receive contractual cash flows of an original financial asset
- b. The I/O and P/O strips do not contain an embedded derivative (as defined in Statement 133)
- c. The I/O and P/O strips do not incorporate any terms not present in the original financial asset?

10. Ms. Donoghue stated that the staff recommends that the Board not broaden the definition of a participating interest.

11. Ms. Seidman stated that she continues to object to the initial decision to require a QSPE for transfers of portions of financial assets that are not participating interests as originally defined and that she could support an adoption of the approach in IAS 39, *Financial Instruments: Recognition and Measurement*, in total but not with the additional restrictions proposed by the staff. She stated that expanding the definition as the staff suggested would only make the standard more complex. Ms. Seidman indicated that she agrees with the staff recommendation not to include these exceptions because that is more consistent with the requirement to use a QSPE when the portion transferred is not pro rata, has recourse, or has subordination. She reiterated that she would unwind the decision to require a QSPE.

12. Ms. Schipper, Mr. Batavick, Mr. Crooch, and Mr. Trott agreed with the staff recommendation not to broaden the definition of a participating interest. Mr. Trott stated that Mr. Herz had given him his proxy and that Mr. Herz would like to expand the definition of a participating interest to include at least I/Os and P/Os. Mr. Young agreed

with Mr. Herz and supported including IOs and POs in the definition of a participating interest.

13. Ms. Donoghue then asked the Board whether the definition of a participating interest should allow disproportionate sharing of cash flows among third-party interest holders as long as the transferor has only a fully proportionate share, there is no direct form of recourse, and there is no subordinate interest held by the transferor. She stated that the staff recommends that the Board allow participating interests to convey disproportionate interests among third-party interest holders, but only when the transferor has a fully proportionate interest and does not provide recourse or subordination. The staff believes that the requirement to use a QSPE should be based on a need to provide assurance that the transferor cannot effectively control transferred assets even though the conditions in paragraph 9 have been met. She also noted that the Board cannot control all the risks that transferees incur.

14. Mr. Trott stated that he does not agree with the staff. He believes that if the transferor participates 50 percent of a loan to 3 different transferees using different tranches, that the risks associated with the cash flows have been changed and should only be issued from a QSPE. Therefore, Mr. Trott believes that the Board should require a QSPE unless all of the participating interests have equal risks. He noted that he is not concerned about the ability of the transferees to subsequently reconfigure their interests because that would not involve the transferor. He also noted that the issue for the Board is whether or not to allow the transferor to divide and reconfigure the interests transferred to third parties and stated that he does not think that the Board should allow the transferor to create disproportionate interests without first transferring the original financial assets to a QSPE. Ms. Seidman stated that if the majority of the Board holds the view that disproportionate interests are akin to recourse, then the answer to this question should be consistent with that view. Therefore, Ms. Seidman agreed with Mr. Trott on this issue. Ms. Schipper, Mr. Batavick, Mr. Crooch and Mr. Young also agreed with Mr. Trott. The Board decided not to allow participating interests to convey disproportionate interests to third-party interest holders.

15. Ms. Donoghue then asked the Board if Statement 140 should provide specific guidance on how to apply paragraph 9(b) to participating interests in pools of financial assets and whether a participating interest should be restricted to an interest in a single original financial asset. She stated that the staff recommends that the Board require (a) that a participating interest be defined as proportionate ownership of the cash flows of the original financial asset that does not involve recourse or subordination by any party to the transaction and is an interest in a single original financial asset and (b) that each resulting participating interest meets all of the conditions of paragraph 9 (in particular, paragraph 9(b)) of Statement 140. She said that the staff believes that a QSPE was designed for transfers involving pools of financial assets when it is unclear that a transferee has received a portion of the transferred financial asset that it can control. While it may be possible to create some participating interests in pools of financial assets that would, in fact, convey control over identifiable portions of original financial assets to a transferee, the staff has not been able to articulate those circumstances in a manner that would not be misread.

16. Six Board members agreed with the staff recommendation. Ms. Seidman agreed and noted that the unit of account is the individual portion.

17. Ms. Donoghue asked Board members whether the staff should proceed with drafting the Exposure Draft. She also inquired whether any Board members plan to provide an alternative view.

18. Mr. Trott, Ms. Schipper, Mr. Batavick, Mr. Crooch and Mr. Young all stated that the staff should go forward and that they were not planning to provide an alternative view.

19. Mr. Herz had previously informed Mr. Trott that he plans to provide an alternative view. Ms. Seidman stated that the staff should begin drafting and that she will provide an alternative view on the Board's decision to require a QSPE for certain transfers of portions of financial assets and the notion that a QSPE enhances isolation. She also plans to provide an alternative view on the decision to measure beneficial retained interests at fair value.

Follow-up Items:

None.

General Announcements:

None.