MINUTES

Financial Accounting Standards Board

To:	Board Members
From:	Derivatives Disclosures Team (Choi, Ext. 446 and Hoyt, Ext. 298)
Subject:	Minutes of the December 5, 2007 Board Meeting: Redeliberation Issues
Date:	December 10, 2007
cc:	Leisenring, Golden, Bielstein, Lott, MacDonald, Allen, Wilkins, Derivatives Implementation Team, Chookaszian, Posta, Gabriele, Fanzini, Malcolm, Barker, Finden, FASB Intranet, Klimek

Topic:	Derivatives Disclosures: Various Issues that Require Redeliberation
Basis for Discussion:	Board Memorandum 6 dated November 15, 2007
Length of Discussion:	10:00 a.m. to 11:15 a.m. (EST)
Attendance:	
Board members present:	FASB: Herz, Smith, Linsmeier, Batavick, Crooch, Seidman, and Young
Board members absent:	None
Staff in charge of topic:	Stoklosa, Bhave
Other staff at Board table:	Hoyt, Choi
Outside participants:	None

Summary of Decisions Reached:

The Board completed its redeliberations of the Exposure Draft, *Disclosures about Derivative Instruments and Hedging Activities,* as follows:

a. Contingent features in derivative agreements – The Board decided to require a quantitative disclosure about the potential cash outflows an entity would be **required** to make upon the triggering of credit-related contingent features.

b. Notional amounts and leverage factors - The Board decided to require an entity to provide general information about its level of derivative activity.

c. Frequency of disclosures – The Board decided to require the proposed disclosures for both interim and annual reporting periods.

d. Scope exception for *trading* derivatives – The Board decided to require that an entity provide information in tabular format about (1) the location and fair value amounts of derivative instruments reported in the statement of financial position (balance sheet table) and (2) the location and amount of gains and losses on derivative instruments reported in the statement of financial performance (income statement table). The Board decided to permit an entity an option to forgo completing certain portions of the above two tables for derivatives included in an entity's trading activities and not designated as hedging instruments under Statement 133. In place of not completing certain portions of the above two tables, an entity would be required to provide, in tabular format, fair value and gain and loss information about all instruments included in it's trading activities.

e. Tabular disclosure of cumulative adjustments to hedged items in fair value hedges – The Board decided to address the impact of adjusting the carrying amount of hedged items in fair value hedges in the hedging project of Statement 133.

f. Qualitative disclosures that are currently encouraged by paragraph 44 of Statement 133 - The Board decided **not** to require the disclosures currently "encouraged" in paragraph 44 of Statement 133. However, the Board directed the staff to clarify, in the drafting of paragraph 44 of the final Statement that the encouraged disclosure should focus on an entity's market risks and strategies to manage those risks.

g. Effective date and transition - The Board decided that the final Statement should be effective for fiscal periods **beginning after** November 15, 2008, and should be applied on a prospective basis.

The Board authorized the staff to proceed to a draft of a final Statement for vote by written ballot.

Objective of Meeting:

The objective of this meeting was to discuss the following issues as part of the redeliberations of the Exposure Draft of the proposed Statement, *Disclosures about Derivative Instruments and Hedging Activities* (ED):

a. Contingent features in derivative agreements
b. Notional amounts and leverage factors
c. Frequency of disclosures—interim vs. annual
d. Three issues that potentially require a reexposure:
    (1) Scope exception for *trading* derivatives
    (2) Tabular disclosure of cumulative adjustments to hedged items in fair value hedges
    (3) Requiring qualitative disclosures that are currently encouraged by paragraph 44 of Statement 133
e. Effective date and transition.

The objective was met.

Matters Discussed and Decisions Reached:

Issue 1: Contingent Features in Derivative Agreements

1. The Board discussed whether to require disclosures about contingent features included in derivative instruments. Three alternatives were presented for Board member consideration:

    a. Require a footnote at the end of the table that would disclose the percentage of derivative agreements that have a contingent feature which gives the counterparty a right to terminate the instrument at fair value or demand additional collateral from the reporting entity upon occurrence of a specified triggering event

b. Require a qualitative disclosure that would inform users that the entity has derivative contracts that contain contingent features that would require immediate settlement upon a triggering event

c. Require a quantitative disclosure about the potential cash outflows that an entity would be **required** to make upon the occurrence of credit-related events.

2. **Issue 1 Staff Recommendation:** The staff recommended the third alternative - that a quantitative disclosure be required to be made about the potential cash outflows that an entity would be **required** to make upon the occurrence of credit-related events. Based upon concerns expressed by users about the potential impact the triggering of credit-related contingent features could have on a reporting entity's liquidity, especially in times of stress, the staff believes that such a disclosure would provide the necessary information.

3. **Issue 1 Board Vote:** The Board supported the staff's recommendation.

4. **Issue 1 Board Comments:** Ms. Seidman stated that, while she does not object to the staff recommendation, she is concerned that users may overestimate the usefulness of the disclosure. In other words, the disclosure may not meet users' expectations, and therefore could lead to misinterpretation. Moreover, the fair value of the derivative upon the occurrence of a triggering event may be completely different from the fair value as of the reporting date. She also stated that she would like to see in the disclosure a column for collateral already posted by the entity for those derivative contracts with contingent features. Mr. Stoklosa said that while the disclosure does not currently include collateral already posted as of the reporting date, it is something that could be included.

Issue 2: Notional Amounts and Leverage Factors

5. The Board discussed whether to require the disclosure of notional amounts, as well as the disclosure of leverage factors.

6. Comments received from preparer constituents indicated that information on notional amounts could be misleading because they may not appropriately reflect the impact of some common strategies, such as synthetic terminations of derivatives (by entering into offsetting contracts) and ‘rolling’ forward exchange contracts (for example, by entering into four separate 3-month contracts instead of a single 12-month contract).
7. Discussions with users focused on how a disclosure that presents notional amounts on an aggregated basis would provide useful information about the magnitude of an entity’s derivative activities and/or the impact that future changes in the derivative would have on the income statement. Users generally acknowledged that in order for notional information to be useful, information relating to individual characteristics, such as the date the derivative was entered into, the maturity of the derivative, key features about the underlying, etc., would need to be known.
8. Since disclosures about leverage factors are related to disclosures of notional amounts, decisions about leverage factors will correlate to decisions about notional amounts.
9. **Issue 2 Staff Recommendation:** The staff recommended that the final standard **not** require the disclosure of notional amounts of derivative contracts. After evaluating the views of the preparers and users of financial statements, the staff does not believe that disclosing notional amounts on an aggregated basis as contemplated in this project provides useful information. The staff also believes that providing information about notional amounts on an individual derivative basis would be unrealistic.
10. Since the disclosure about leverage factors is related to the disclosure of notional amounts, the staff recommended that the final standard also **not** require the disclosure of the estimated magnitude that leverage factors have on the notional amounts and underlying risk.
11. **Issue 2 Board Vote:** The Board decided to require an entity to provide general information relating to its level of derivative activity. That disclosure would be required in paragraph 44 of Statement 133.
12. **Issue 2 Board Comments:** Mr. Young did not support the staff recommendation. He stated that, while he acknowledged that an aggregate disclosure of notional

amounts is incomplete, the disclosure gives users an idea about the level of an entity's derivative activity as well as some indication of exposure. Mr. Herz acknowledged Mr. Young's argument.

13. Ms. Seidman suggested including a requirement within paragraph 44 for entities to provide general information relating to their level of derivative activity. In making that suggestion, Ms. Seidman said that how an entity would provide that information within the paragraph 44 disclosure should be left up to the entity. The Board agreed with Ms. Seidman's suggestion. Mr. Smith suggested that the staff look into alternative ways for an entity to provide information about its level of derivative activity and include some examples in the final standard.

Issue 3: Frequency of Disclosure—Interim and Annual Reporting Periods

14. The Board discussed whether to require the proposed disclosures on an interim or annual basis. The staff noted that a requirement to disclose for both interim and annual reporting periods is consistent with FASB Statement No. 157, *Fair Value Measurements*, and FASB Statement No. 159, *The Fair Value Option for Financial Assets and Liabilities*. In addition, based on the Board's redeliberations of the ED's proposed disclosure requirements, significant changes have been made to the tabular format disclosures that constituents had concerns about from an operationality perspective. As indicated in the September 26, 2007 Board memorandum, the feedback received from constituents on the revised tabular disclosures was positive and the tables would be much less onerous to prepare on an interim basis. Also, comments received as recently as mid-October from a constituent that uses a large number of derivatives for hedging purposes indicated that implementation of the revised tabular disclosures would not be a problem.

15. In addition, because derivative fair values frequently change, providing information on a quarterly basis would be relevant.

16. **Issue 3 Staff Recommendation:** Based on the above analysis, the staff recommended that the disclosures be required for both interim and annual reporting periods. The staff also believes that (a) from a preparer perspective, the costs of preparing the disclosures on an interim basis would be considerably reduced because

17. **Issue 3 Board Vote:** The Board supported the staff recommendation.

18. **Issue 3 Board Comments:** None.

THREE ISSUES THAT MAY REQUIRE REEXPOSURE

19. The following three issues (Issues 4-6) have been identified as issues that may require reexposure of the proposed Statement.

Issue 4: Scope Exception for Trading Derivatives

20. At the July 25, 2007 meeting, the Board instructed the staff to explore a scope exception from the tabular disclosure requirements relating to reporting gains and losses on derivative instruments for those derivative instruments that are included in an entity's **trading** book.

21. The staff proposed that the following criteria be met if a scope exception were to be provided:

    a. The derivative instrument is not designated as a hedging instrument under Statement 133

    b. The entity includes the derivative instrument in its trading activities

    c. The entity separately discloses in the footnotes to the financial statements quantitative information about the net gain or loss on trading activities, disaggregated by major type of instruments

    d. The entity provides in the footnotes to the financial statements a qualitative disclosure of the nature of its trading activities and related risks, and how the entity manages those risks.

22. The purpose of the criteria is to allow for a scope exception for derivatives that are included in an entity's trading activities and for which related information is provided elsewhere in the financial statements.

Input received on the proposed definition of trading and the qualifying criteria for the scope exception

23. The staff solicited and received input on the proposed scope exception for the tabular disclosure of income statement gains and losses on trading derivatives. As part of that solicitation, the staff included the following definition of **trading** as one of the criteria for the scope exception. The definition was developed as part of the FASB's project on commodity inventory.

> **Trading –** Buying and selling assets and liabilities with the objective of making a profit by seeking to benefit (i) from favorable price spreads or arbitrage opportunities; or (ii) in a capacity as a market maker or dealer. It involves markets that have willing buyers and sellers of the item at a given price. Positions held as trading are those held intentionally for resale and/or with intent of benefiting from actual or expected price movements or to lock in arbitrage profits. These positions may include, for example, proprietary positions, positions arising from client servicing and market making.

24. The following is a summary of comments received:

   a. An entity may enter into a derivative contract that has no asset or liability at inception, which would not correspond to the notion of "buying and selling of assets and liabilities…"

   b. The definition is too broad. Many activities of a wholesaler or retailer would appear to meet the proposed definition.

   c. The definition seems to indicate that there is an assumption of an inherent liquid market within the trading definition. In other words, it is not clear whether the definition would include only items traded in liquid markets and exclude items from illiquid markets.

   d. It is not clear whether an entity can hold an item in its trading book for long periods (for example, for 5 years) without attempting to sell it and still qualify as being a part of its trading activity.

   e. Why introduce a new definition of *trading* in this project? Why not simply use the definition in Statement 115?

25. Based on the comments received, the staff developed and presented the Board with the following five alternatives to address the trading scope-out issue. Alternatives 1 and 2 would not require reexposure, while alternatives 3, 4, and 5 would potentially require reexposure.

26. Alternatives not requiring reexposure include:

Alternative 1: Providing a scope exception that permits optional alternative disclosures for trading activities but does not include a definition of trading.

a. Under this alternative, entities would rely on the existing guidance (that is, current GAAP) to determine which instruments would be included in an entity's trading activity.

Alternative 2: Not providing for the scope exception for trading derivatives.

27. Alternatives requiring reexposure include:

Alternative 3: Providing a scope exception that permits optional alternative disclosures for trading activities and include a new definition of trading.

Alternative 4: Requiring alternative disclosures for trading activities and including a new definition of trading.

Alternative 5: Requiring alternative disclosures for trading activities but not including a new definition of trading.

28. **Issue 4 Staff Recommendation:** The staff recommends Alternative 1. Under this alternative, the final standard would not include a new definition of **trading**. An entity would be allowed to present alternative income statement disclosures for trading derivatives if, under the entity's current accounting policy, the entity includes in its trading activity both derivative and nonderivative instruments and manages its trading book on a combined basis.

29. **Issue 4 Board Vote:** The Board decided to permit an entity an option to forgo completing certain portions of the income statement table for derivatives included in that entity's trading activities and not designated as hedging instruments under Statement 133. The Board also decided to permit an entity an option to forgo completing certain portions of the balance sheet table for derivatives included in that

entity's trading activities and not designated as hedging instruments under Statement 133. In place of not completing certain portions of the those tables, entities would be required to provide, in tabular format, fair value **and** gain and loss information about all instruments included in an entity's trading activities. The scope exception would not include a definition of **trading**. Rather, the determination of eligibility would depend upon an entity's accounting policy for trading instruments. The Board directed the staff to send the proposed alternative disclosure to a broad constituent group for feedback before finalizing the standard.

30. **Issue 4 Board Comments:** Mr. Linsmeier expressed some concern with providing a broader alternative disclosure for the income statement table but not for the balance sheet table. In other words, he suggested that it may be just as misleading to allow an entity to provide location and fair value information for derivative instruments only, rather than allowing an entity to provide location and fair value for its non-derivative positions designated as 'trading' as well. The Board agreed with Mr. Linsmeier's concern and directed the staff to resolve the issue in the drafting of the final Statement by requiring the alternative disclosure to also include information about the location and fair value of both derivative and non-derivative instruments included in an entity's trading activities.

31. Ms. Seidman asked the staff to do some preliminary research with respect to the scope exception—specifically, to determine if any entity would elect to use it. She also asked the staff to include a copy of the proposed alternative disclosure for trading activities that was distributed to the Board during the Board meeting. This table is included on the last page of these minutes.

Issue 5: Tabular Disclosures of Cumulative Adjustments to Hedged Items in Fair Value Hedges

32. At the September 26, 2007 meeting, the Board requested the staff to research a proposal to provide an additional table within the tabular disclosures to disclose information that would help users better understand the impact of adjusting the carrying amount of hedged items.

33. The staff developed a proposed table that provides a simple reconciliation between the balance sheet amount for a particular line item at the end of a reporting period with the amount of that line item prior to any cumulative adjustments that resulted from designating all or a portion of that line item as a hedged item in a fair value hedge under Statement 133 and other fair value adjustments (for example, Statement 159 fair value adjustments).

34. **Issue 5 Staff Recommendation:** In view of the possible need for reexposure for the new tabular disclosure about cumulative adjustments to hedged items in fair value hedges and the resulting delay in issuing the final standard for this project, the staff recommended that this issue be addressed in another project on the Board's current agenda, namely, to improve accounting for hedges under Statement 133 (that is, the hedging project). Accordingly, the staff believes that if this issue is transferred to the hedging project for further consideration and exposure, the Board can address this issue effectively without delaying issuance of the final standard for this project.

35. **Issue 5 Board Vote:** The Board supported the staff recommendation to address the impact of adjusting the carrying amount of hedged items in fair value hedges in the hedging project of Statement 133.

36. **Issue 5 Board Comments:** None.

Issue 6: Requiring Qualitative Disclosures that are currently "encouraged" Under Statement 133

37. At the September 26, 2007 meeting, the Board directed the staff to research a proposal to **require,** rather than encourage, the qualitative disclosure of an entity's objectives and strategies for using derivative instruments in the context of an entity's overall risk management profile, as prescribed in paragraph 44 of Statement 133.

38. During October and November 2007, the staff discussed this issue with Board members in small group meetings. Those discussions indicated that some Board members believe that the Board should require qualitative disclosures about an entity's market risks, to provide a better context to the quantitative (tabular) disclosures that would be required under the final standard. Those Board members suggested that the final standard replace the last sentences in paragraph 44 of

Statement 133 about **encouraged** disclosures with a requirement similar to that in SEC's FRR 48. As a result, two alternatives are being presented to the Board for consideration:

a. Include guidance in paragraph 44 of Statement 133 that requires an entity to disclose: (1) its primary market risk exposures including interest rate risk, foreign currency exchange rate risk, commodity price risk, credit risk, and equity price risk and (2) how the entity manages these exposures. The description would clarify the entity's exposures to market risks associated with activities in derivative instruments and other financial instruments. The qualitative disclosure would include the entity's objectives, general strategies, and instruments, if any, used to manage its market risk exposures.

b. Do not require qualitative disclosures about an entity's market risks. That requirement would expand the scope of the current project by bringing back the fourth objective relating to an entity's overall risk exposures and strategies for managing those risks.

39. **Issue 6 Staff Recommendation:** The staff recommended that the final standard **not** require the disclosures encouraged in paragraph 44 of Statement 133. The staff believes that, if the Board were to require a qualitative disclosure of an entity's market risks and credit risks to provide a better context for the tabular disclosures about derivatives, such a requirement may necessitate a reexposure because it was not included in the ED. If so, a reexposure would result in a delay of at least six months before a final standard can be issued, thereby delaying the benefit of the new disclosures. The staff also agrees with those Board members who believe that **requiring** the disclosures that are encouraged by paragraph 44 of Statement 133 essentially expands the scope of the project by bringing back the fourth objective (about an entity's overall risks) that was rejected by a majority of the Board.

40. **Issue 6 Board Vote:** The Board supported the staff recommendation **not** to require the disclosures currently "encouraged" in paragraph 44 of Statement 133. However, the Board directed the staff to clarify, in the drafting of paragraph 44 of the final standard, that the "encouraged" disclosure should focus on an entity's market risks and strategies to manage those risks.

41. **Issue 6 Board Comments:** None.

Issue 7: Effective Date and Transition

42. The Board discussed the effective date and transition of the final Statement. The staff presented two scenarios to the Board. If the Board chose not to reexpose the documents, based on the decisions discussed above, the final standard would be issued sometime in January 2008. However, if the Board chose to reexpose the document, the staff anticipated the final standard would be issued in June 2008.
43. **Issue 7 Staff Recommendation:** The staff recommended that the final standard should be effective for fiscal periods beginning after November 15, 2008. The staff recommended the effective date of November 15 instead of December 15 so that disclosures would be provided in first quarter 2009 financial statements by some of the major derivative dealers who have a November 30 fiscal year-end. The staff recommends that guidance be required on a prospective basis.
44. **Issue 7 Board Vote:** The Board supported the staff recommendation that the final standard should be effective for fiscal periods **beginning after** November 15, 2008, and should be applied on a prospective basis.
45. **Issue 7 Board Comments:** None.

<u>Follow-up Items:</u>

None.

<u>General Announcements:</u>

None.

Attachment 1

Optional Alternative Disclosure
Trading Activities' Impact on the Statement of Financial Performance
for the year ended December 31, 2010

Type of Instrument	Trading Revenue	
	2010	2009
Fixed Income/Interest rate	XX,XXX	XX,XXX
Foreign Exchange	XX,XXX	XX,XXX
Equity	XX,XXX	XX,XXX
Commodity	XX,XXX	XX,XXX
Credit	XX,XXX	XX,XXX
Other	XX,XXX	XX,XXX
Total	XX,XXX	XX,XXX

Income Statement Line Item	Trading Revenue	
	2010	2009
Principal/Proprietary Transactions	XX,XXX	XX,XXX
Asset Management Income	XX,XXX	XX,XXX
Other Income	XX,XXX	XX,XXX
Total	XX,XXX	XX,XXX

The revenue related to each category includes realized and unrealized gains and losses on both derivative instruments and nonderivative instruments

Also disclose qualitative/descriptive information about the nature of the entity's trading activities and related risks, and how the entity manages those risks.

Attachement 2

Optional Alternative Disclosure
Trading Activities in the Statement of Financial Position

In millions of dollars

As of December 31	2010		2009	
	Bal. Sheet Classification(1)	Fair Value	Bal. Sheet Classification(1)	Fair Value
Trading Assets				
U.S. Government Securities	Trading Assets	XX,XXX	Trading Assets	XX,XXX
Corporate Securities	Trading Assets	XX,XXX	Trading Assets	XX,XXX
Equity Securities	Trading Assets	XX,XXX	Trading Assets	XX,XXX
Loans Receivable	Trading Assets	XX,XXX	Trading Assets	XX,XXX
Trading Derivatives in Asset Position				
Interest rate contracts	Trading Assets	XX,XXX	Trading Assets	XX,XXX
Foreign exchange contracts	Trading Assets	XX,XXX	Trading Assets	XX,XXX
Equity contracts	Trading Assets	XX,XXX	Trading Assets	XX,XXX
Commodity contracts	Trading Assets	XX,XXX	Trading Assets	XX,XXX
Credit contracts	Trading Assets	XX,XXX	Trading Assets	XX,XXX
Other contracts	Trading Assets	XX,XXX	Trading Assets	XX,XXX
Total Trading Assets		XX,XXX		XX,XXX
Trading Liabilities				
Short positions from sale of securities	Trading Liabilities	XX,XXX	Trading Liabilties	XX,XXX
Debt/Loans Payable	Trading Liabilities	XX,XXX	Trading Liabilties	XX,XXX
Trading Derivatives in Liability Position				
Interest rate contracts	Trading Liabilities	XX,XXX	Trading Liabilities	XX,XXX
Foreign exchange contracts	Trading Liabilities	XX,XXX	Trading Liabilities	XX,XXX
Equity contracts	Trading Liabilities	XX,XXX	Trading Liabilities	XX,XXX
Commodity contracts	Trading Liabilities	XX,XXX	Trading Liabilities	XX,XXX
Credit contracts	Trading Liabilities	XX,XXX	Trading Liabilities	XX,XXX
Other contracts	Trading Liabilities	XX,XXX	Trading Liabilities	XX,XXX
Total Trading Liabilities		XX,XXX		XX,XXX

(1) If a category of trading assets or liabilities is included in multiple line items (for example, investments, loans, debt, etc), the entity is required to disclose the amount included in each line item.

Also disclose qualitative/descriptive information about the nature of the entity's trading activities and related risks, and how the entity manages those risks.