MINUTES

Financial Accounting Standards Board

To:	Board Members
From:	Detling (ext. 354), Wyatt (ext. 284)
Subject:	Minutes of the April 18, 2007 Board Meeting: Issuance of FSP FIN 39-1 "Amendment of FASB Interpretation No. 39"
Date:	May 2, 2007
cc:	Leisenring, Bielstein, L. Smith, Golden, MacDonald, Wilkins, Jacobs, Fanzini, Stoklosa, Carney, Polley, Sutay, Gabriele, Allen, 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.

Topic:	Issuance of FSP FIN 39-1, "Amendment of FASB Interpretation No. 39"
Basis for Discussion:	Board Memoranda 6 and 7 (dated April 5, 2007)
Length of Discussion:	11:00 a.m. to 11:35 a.m.
Attendance:	
Board members present:	FASB: Herz, Batavick, Crooch, Linsmeier, Trott, and Young
Board members absent:	Seidman
Staff in charge of topic:	Wyatt
Other staff at Board table:	Detling, Golden, and L. Smith
Outside participants:	None

Summary of Decisions Reached:

The Board discussed the comment letters received on proposed FASB Staff Position (FSP) FIN 39-a, "Amendment of FASB Interpretation No. 39," and the issuance of the final FSP. The Board decided to permit entities to offset cash collateral receivables or payables that approximate fair value with net derivative positions. The Board also decided that the FSP will be effective for fiscal years beginning after November 15, 2007 and will permit early adoption. The Board directed the staff to proceed to a draft of the final FSP for vote by written ballot.

Objectives of the Meeting:

The objectives of the meeting were to discuss (1) the comment letters received on the proposed FSP, (2) the Technical Application and Implementation Committee's (the Committee) deliberations and basis for its recommendation to issue the FSP as final, and (3) whether the staff should proceed to a draft of the final FSP for vote by written ballot. The objectives were met.

Matters Discussed and Decisions Reached:

1. Mr. Detling opened the meeting by stating that 13 comment letters were received on the proposed FSP. A summary of the comments received was distributed to the Board and posted to the FASB website. Overall, respondents were supportive of the proposed FSP. However, they did raise some specific issues that they believe should be addressed.

Fair Value

2. Mr. Detling stated that many respondents requested guidance on (a) determining whether cash collateral receivables or payables are recognized at fair value and (b) whether cash collateral receivables or payables that approximate fair value can be offset against net derivative positions in master netting arrangements.

3. Mr. Detling stated that the staff believed that diversity could result without additional guidance because the receivable or payable recognized for cash collateral may not have a fair value measurement attribute. It is important for the cash collateral receivables or payables that

are offset to be at fair value to be consistent with paragraph 10 of Interpretation 39 and the Board's reasoning in permitting offsetting. However, the staff did not recommend that the FSP specifically prescribe how to determine fair value because that guidance is contained in FASB Statement No. 157, *Fair Value Measurement*. In order to simplify implementation of the FSP, the staff recommended that the FSP specifically allow offsetting of amounts that approximate fair value for the cash collateral receivable or payable only. The staff also recommended that the FSP require entities to consider the following factors at a minimum in determining whether the amount approximates fair value: frequency of collateral calls, interest rate the contract bears, and frequency of reset of that interest rate.

4. The staff believes that this approach does not create a presumption of fair value and is consistent with FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*, which indicates that (a) the carrying amount of short-term financial instruments may approximate fair value because of the short time between origination and realization and (b) the carrying amount of a loan may be close to fair value if the loan reprices frequently at market rates. The staff had discussed this change with the TA&I committee. Three of the four members of the Committee agreed with the staff recommendation. One member disagreed with explicitly allowing amounts that approximate fair value to be offset because that member believes that that judgment should be left to the preparer.

5. Messrs. Crooch, Linsmeier, and Trott did not agree with the staff recommendation that the FSP should explicitly allow cash collateral amounts that approximate fair value to be offset against net derivative positions and include a list of the things that must be considered in determining if an amount approximates fair value.

6. Mr. Trott stated that the FSP should require that the cash collateral receivables or payables be at fair value in order to be offset against net derivative positions. He did not believe that the guidance should try to word around the issue by explicitly stating that it would be acceptable to offset if an amount approximates fair value. The judgment about whether an amount is at fair value should be left to the preparer.

7. Mr. Linsmeier stated that he was concerned with permitting offsetting of amounts that approximate fair value. Constituents asked for guidance on how to determine if an amount recognized for cash collateral receivables or payables is at fair value. He did not believe that allowing amounts that approximate fair value to be offset would solve the issue. The staff recommendation would shift the questions on implementation from the meaning of the term fair value to the three factors that should be considered in determining whether an amount approximates fair value. Additionally, Mr. Linsmeier stated that the attributes for collateral receivables or payables that are eligible to be offset would be mixed between true fair value amounts and amounts that are close to fair value (but not truly fair value) by allowing amounts that approximate fair value to be offset.

8. Mr. Linsmeier stated that the term *fair value* was not precisely defined before Statement 157. That Statement defines it precisely but in this case the Board would be making an exception by permitting offsetting of amounts that are just close to fair value. If the Board does not explicitly allow offsetting of amounts that approximate fair value, then constituents will make the determination themselves. If the amount is close to fair value, then they will let it go. If it is not sufficiently close, then they can elect the fair value option if they choose.

9. Mr. Golden stated that constituents are concerned because the cash collateral receivables or payables do not have a fair value measurement attribute. There is no requirement to record these cash collateral receivables or payables at fair value. Therefore, some may believe that the amounts recognized cannot be offset. However, in most cases because of the terms of the agreement, the amount recognized will be the fair value of the receivable or payable. In other words, the carrying value and the fair value would be the same amounts or very close to the same amounts. Mr. Smith stated that the staff was trying to describe the term fair value in a way that would allow preparers to implement the standard. Mr. Smith stated that the staff believed that the receivables or payables are at fair value or so close to fair value that the difference is miniscule and to prevent offsetting of those amounts seems inappropriate.

10. Ms. Wyatt and Mr. Smith explained that some have expressed a view that entities may not be able to elect the fair value option for cash collateral receivables or payables because their terms often make them similar to demand deposits and the fair value option cannot be

elected for demand deposits of depository institutions. As a result, the staff believes that they may not have a fair value measurement attribute.

11. Mr. Linsmeier also questioned whether implementation issues might arise regarding how frequently a contract needs to have collateral calls in order to be considered approximately fair value. Ms. Wyatt and Mr. Smith stated that the staff understood that those questions would not arise. The staff was attempting to provide some principles and allow constituents to use judgment in making that determination. Constituents believe that permitting offsetting of amounts that approximate fair value will simplify implementation of the FSP.

12. Messrs. Smith and Golden stated that the Committee believed that netting is the most appropriate financial reporting and that is the reason for permitting offsetting. Mr. Trott stated that he was unsure whether net reporting was necessarily better. Some might argue that gross reporting is better because the cash flows are based on the gross amounts in the individual contracts. Mr. Linsmeier stated that it is not obvious that net reporting is better because a user may want to assess market risk. While net reporting may better reflect credit risk, gross reporting better reflects market risk.

13. Mr. Linsmeier stated that he believed it is possible that an entity could choose to not offset collateral by making a judgment that the amount recognized is not at fair value or an amount that approximates fair value. This could occur whether the FSP requires the amount recognized to be at fair value to be offset or if the FSP allows offsetting of amounts that approximate fair value. Mr. Linsmeier stated that the FSP may effectively be giving entities an option to not offset amounts recognized for cash collateral receivables or payables but still offset derivatives. Mr. Golden stated that he did not believe that the judgment about whether an amount recognized is at fair value or an amount that approximates fair value would be treated as an option. If an entity that has elected to offset derivatives in a master netting arrangement determines that an amount recognized for cash collateral receivables or payables is at fair value or approximately fair value the entity would have to offset it. The entity would have to apply its election consistently. Mr. Golden stated that he would be more concerned about allowing entities to elect the fair value option on the receivables or payables because then it would allow entities to choose which amounts to offset.

14. Mr. Herz stated that Interpretation 39 permits but does not require entities to offset. The FSP requires entities that have chosen to offset derivatives to offset cash collateral receivables or payables that are at fair value or approximately fair value. This follows the election under Interpretation 39. If an entity chooses to offset, then the entity would be required to offset amounts that are at fair value or approximate fair value. Mr. Herz stated that he believes the original problem is the optionality of Interpretation 39. If the Board believes that offsetting is the best financial reporting then it should be required. Mr. Smith stated that the staff has not researched what would occur if Interpretation 39 were modified to require offsetting of fair value amounts in master netting agreements.

15. Mr. Batavick agreed with the staff recommendation. He stated that he believes that permitting offsetting is the most appropriate financial reporting treatment. Although he believed that the solution the staff recommended is not a pure solution, the end result is the correct one. Most entities have elected to offset and this change will increase comparability.

16. Mr. Young stated that while he disagreed with the optionality in Interpretation 39, he believed that it is not really an issue since the vast majority of reporting entities will elect to offset anyway. Messrs. Herz and Young stated that amounts that approximate fair value should be permitted to be offset. They did not believe that the FSP should provide detailed guidance on what factors an entity should consider in determining if an amount approximates fair value. Mr. Herz read Ms. Seidman's proxy vote. Ms. Seidman agreed with the staff recommendation but requested that the illustrations be removed. The Board agreed that the final FSP should permit offsetting of amounts that approximate fair value but should not include a list of factors that should be considered in determining if an amount approximates fair value.

Transition and Effective Date

17. Mr. Detling stated that some respondents stated that early adoption should be allowed and/or that the effective date should be extended one year. The staff recommended that the effective date should be extended to fiscal years beginning after November 15, 2007 and early adoption should be permitted. The staff recognized that permitting early adoption is not

consistent with the transition harmonization guidelines. However, the staff believes that allowing early adoption would increase comparability particularly in the financial services industry given that many preparers are already offsetting cash collateral receivables or payables against net derivative positions because they determined that the receivables or payables met the criteria in paragraph 10 of Interpretation 39. Allowing early adoption would permit preparers that were uncertain to apply the guidance in the FSP sooner. The staff discussed these recommendations with the TA&I committee, all of whom agreed. Mr. Trott stated that since offsetting is an option under Interpretation 39, he believed it was appropriate to allow early adoption. The Board agreed with the staff recommendation that the FSP should be effective for fiscal years beginning after November 15, 2007 and permit early adoption. Messrs. Linsmeier and Young did not agree with permitting early adoption.

Other Issues

18. Mr. Detling stated that the comment letter summary provided a summary of the other comments received. The staff provided an analysis of those comments and staff recommendations to modify (or not modify) the proposed FSP based on those comments in the comment letter analysis memorandum. The TA&I Committee agreed with the staff's recommendations on all other comments received.

19. The Board agreed with the other staff recommendations. The Board also agreed with Ms. Seidman's request that the illustrations that were included in the proposed FSP should not be included in the final FSP because they are unnecessary. The Board instructed the staff to proceed to a draft of FSP FIN 39-1 "Amendment of Interpretation 39" for vote by written ballot.

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

None.

<u>General Announcements</u>:

Mr. Golden stated that the staff had originally planned to issue the Exposure Draft on Financial Guarantees with a 90-day comment period because it was planned to be issued in early 2007. Since the staff had made changes to the Exposure Draft based on the understandability initiative it took longer to finalize the document, the staff requested that the Board reduce the comment period to 60 days so that the document could be finalized by the end of the year. Most parties who would be affected by the document have been closely following the issue and, therefore, will likely be able to provide meaningful comments within the 60-day period. The Board agreed with the staff recommendation. The Board advised the staff to reach out to users who might be impacted to ensure they are aware of the change in comment period length.