MINUTES

Financial Accounting
Standards Board

To: FASB Board Members

From: FAS 115 Team
(Martin x354)

Subject: Minutes of the April 2, 2009 Board Meeting: Proposed FSP FAS 115-a, FAS 124-a, and EITF 99-20-b**,** *Recognition and Presentation of Other-Than-Temporary Impairments*

Date: April 21, 2009

cc: FASB: Golden, Bielstein, Proestakes, Stoklosa, Mechanick, Anderson, Glotzer, Chookaszian, Posta, Lott, C. Smith, Gabriele, Inzano, Maples, Sutay, Mills, FASB Intranet, Clark, Martin, Klimek, Allen; GASB: Reese, Schermann; IASB: Leisenring

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, Interpretation, or FASB Staff Position.

Topic:	Proposed FSP FAS 115-a, FAS 124-a, and EITF 99-20-b**,** *Recognition and Presentation of Other-Than-Temporary Impairments*
Basis for Discussion:	Memorandum No. 2
Length of Discussion:	8:45 a.m. - 10:00 a.m.
Attendance:	
Board members present:	FASB: Herz, Linsmeier, Seidman, Siegel, and Smith
Board members participating by phone:	None

Board members absent:	None
Staff in charge of topic:	FASB: Inzano, Mills, Anderson
Other staff at Board table:	FASB: Golden, Stoklosa, Clark, Fanning, Martin

Summary of Decisions Reached

The Board discussed comment letters received on proposed FSP FAS 115-a, FAS 124-a, and EITF 99-20-b, *Recognition and Presentation of Other-Than-Temporary Impairments.* The Board made the following decisions in response to comment letters and additional feedback received:

Scope

1. The Board decided that the change to existing guidance for determining whether an impairment is other than temporary should be limited to debt securities.

Recognition

2. The Board decided to replace the existing requirement that the entity's management assert it has both the intent and ability to hold an impaired security until recovery with a requirement that management assert:
    a. It does not have the intent to sell the security; and
    b. It is more likely than not it will not have to sell the security before recovery of its costs basis.
3. The guidance will incorporate examples of factors from existing literature that should be considered in determining whether a debt security is other-than-temporarily impaired and how those factors interact with the requirement to assert that the entity does not intend to sell the security and it is more likely than not that the entity will not have to sell the security before recovery of its cost basis.
4. When an entity does not intend to sell the security and it is more likely than not that the entity will not have to sell the security before recovery of its cost basis, it will recognize the credit component of an other-than-temporary impairment of a

debt security in earnings and the remaining portion in other comprehensive income.

5. An entity will be required to recognize noncredit losses on held-to-maturity debt securities in other comprehensive income and amortize that amount over the remaining life of the security in a prospective manner by offsetting the recorded value of the asset unless the security is subsequently sold or there are additional credit losses.
6. The FSP will include guidance stipulating that credit losses should be measured on the basis of an entity's estimate of the decrease in expected cash flows, including those that result from an increase in expected prepayments.
7. The guidance will clarify that existing premiums or discounts and subsequent changes in estimated cash flows or fair value should continue to be accounted for in accordance with existing guidance (for example, 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").

Presentation

8. An entity will be required to present the total other-than-temporary impairment in the statement of earnings with an offset for the amount recognized in other comprehensive income.
9. An entity will be required to present separately in the financial statement where the components of other comprehensive income are reported, amounts recognized in accumulated other comprehensive income related to the noncredit portion of other-than-temporary impairments recognized for available-for-sale and held-to-maturity debt securities.

Disclosures

10. The disclosure requirements of FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, and FSP FAS 115-1 and FAS 124-1,

The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments, will be modified to require an entity to provide the following:

   a. The cost basis of available-for-sale and held-to maturity debt securities by major security type
   b. The methodology and key inputs, such as performance indicators of the underlying assets in the security, loan to collateral value ratios, third-party guarantees, levels of subordination, and vintage, used to measure the portion of an other-than-temporary impairment related to credit losses by major security type
   c. A rollforward of amounts recognized in earnings for debt securities for which an other-than-temporary impairment has been recognized and the noncredit portion of the other-than-temporary impairment that has been recognized in other comprehensive income.

11. Statement 115 and FSP FAS 115-1 and FAS 124-1 will also be modified to require that major security classes be based on the nature and risks of the security and additional types of securities will be included in the list of major security types listed in Statement 115.
12. The above additional disclosures, as well as all existing Statement 115 and FSP FAS 115-1 and FAS 124-1 disclosures, will be required for interim periods.

When adopting the new guidance, an entity will be required to record a cumulative-effect adjustment as of the beginning of the period of adoption to reclassify the noncredit component of a previously recognized other-temporary impairment from retained earnings to accumulated other comprehensive income if the entity does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery. The cost basis used to calculate accretable yield will also be adjusted to reflect this adjustment (that is, the entity will no longer accrete the noncredit component of a previously recognized other-than-temporary impairment through earnings).

The Board decided that the FSP will be effective for interim and annual periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. The Board decided that an entity may early adopt this FSP only if it also elects to early adopt FSP FAS 157-4, *Determining Whether a Market Is Not Active and a Transaction Is Not Distressed.* Additionally, if the entity elects to early adopt FSP FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments,* or FSP FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly,* it must also elect to early adopt this FSP.

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

Objective of the Meeting

The objective of this meeting was to discuss comment letters received on proposed FSP FAS 115-a, FAS 124-a, and EITF 99-20-b, *Recognition and Presentation of Other-Than-Temporary Impairments,* consider the staff's analysis and recommendations, and determine whether to proceed to drafting a final FSP. The objective was met.

Matters Discussed and Decisions Reached

Issue 1: Other-Than-Temporary Impairment Criterion

1. Ms. Inzano presented the overview of the comment letters received and summarized the views expressed by respondents regarding the proposed modification of the other-than-temporary impairment criterion (see the meeting handout for discussion of comments received).
2. **Staff recommendation**: The staff recommended the change to existing guidance for determining whether an impairment is other than temporary be limited to debt securities.
3. **Board vote:** The Board unanimously agreed with the staff recommendation.
4. **Board comments**: Ms. Seidman observed that inclusion of equity securities in the scope of the proposed FSP would avoid increased complexity of the impairment model. However, the feedback received during the comment period indicates that constituents believe that equity securities should not be included in the scope of the FSP and are willing to accept the resulting increase in complexity.
5. **Staff recommendation**: The staff recommended that the Board affirm its decision to replace the requirement for management to assert that it has both the intent and ability to hold an impaired security until recovery with the requirement that management assert that (a) it does

not have the intent to sell the security and (b) it is more likely than not that it will not be required to sell the security before recovery of its cost basis.

6. **Board vote:** Messrs. Herz and Smith and Ms. Seidman voted to affirm the Board's decision. Messrs. Linsmeier and Siegel voted against the decision.
7. **Board comments**: Mr. Linsmeier observed that the list of factors presented by the staff to be considered by the preparer when estimating the period over which the cost basis of the security is expected to recover includes factors that relate to the likelihood that the holder of the security will collect all the contractual cash flows. The Board agreed with Mr. Linsmeier's observation and directed the staff to include clarifying language in the proposed FSP.
8. Messrs. Smith and Herz asked the staff to clarify in the proposed FSP that the phrase "will be required to sell" encompasses not only regulatory and legal requirements, but also other circumstances, such as, for example, liquidity needs.
9. Ms. Seidman asked the staff to clarify in the proposed FSP that the assessment as to whether the entity will be required to sell a security before recovery of its cost basis is to be made in light of all information available to management, including forecasted working capital requirements and contractual and regulatory obligations that may indicate a need to sell the security.
10. Mr. Golden observed that one of the flaws of the current other-than-temporary impairment model is that if the severity and duration of the decline in the fair market value of a debt security is significant, even if the entity is collecting all contractual cash flows associated with the security, management has to make a positive assertion that the entity will hold the security for a very extended period of time, which effectively turns an available-for-sale security into a held-to-maturity security. Mr. Smith supported Mr. Golden's observation.
11. Mr. Linsmeier stated that in his view the current impairment model allows companies to defer recognition of other-than-temporary impairments for a period of time and expressed concern that the proposed modification will create additional bias in the model against recognition of impairment losses in earnings.
12. Mr. Siegel supported Mr. Linsmeier's observation and stated that while the current impairment model is flawed and confusing to many users, the proposed changes will likely result in recognition of fewer other-than-temporary impairments and may negatively affect

investor confidence in the issued financial statements. Mr. Siegel suggested that the Board does not modify the current impairment model until an improved comprehensive remeasurement model for financial instruments is developed. Mr. Siegel stated that until the new model is developed, if the investor does not have the positive intent and ability to hold the security, an other-than-temporary impairment should be recognized in the statement of earnings.

13. Mr. Smith emphasized that if a security's cost basis is higher than its fair value, the entity should perform an impairment analysis and assess expected cash flows. If the entity does not expect to collect all the contractual cash flows associated with the security, the security is other-than-temporarily impaired.

Issue 2: Presentation

14. Ms. Inzano summarized the comments received regarding the presentation of other-than-temporary impairment losses.

15. **Staff recommendation**: The staff recommended that the Board affirm its decision to require that an entity recognize the credit component of an other-than-temporary impairment of a debt security in earnings and the remaining portion in other comprehensive income when the entity does not intend to sell the security and it is more likely than not that the entity will not be required to sell the security prior to the recovery of its cost basis. The staff also recommended that the Board affirm its decision to require that entities present the total other-than-temporary impairment in the statement of earnings with an offset for the amount of the total other-than-temporary impairment that is recognized in other comprehensive income, if any.

16. **Board vote:** Messrs. Herz and Smith and Ms. Seidman supported the staff recommendation. Messrs. Linsmeier and Siegel disagreed with the staff recommendation.

17. **Board comments**: Mr. Smith observed that the proposed presentation will significantly increase the amount of information on other-than-temporary impairment losses available to users. Mr. Smith further stated that presentation of both credit and noncredit components of an other-than-temporary impairment loss on the face of the statement of earnings is fundamental to his decision to support the proposed FSP. Ms. Seidman supported Mr. Smith's observation.

18. Ms. Seidman observed that when applying the current other-than-temporary impairment model, a preparer has to make an assessment of whether the decline in the fair value of a security is indicative of an expected loss in the contractual cash flows associated with that security; if the decline in the fair value of a security is due to impairment of the contractual cash flows, an entity has to recognize a loss. However, it is challenging to make this determination in the current environment because a lot of uncertainty exists regarding whether the risk premiums assessed in the market and reflected in the securities' prices are an indication of the impairment of the contractual cash flows associated with the securities. Under the current model this may result in recognition of excessive other-than-temporary impairment losses, which leads to, among other things, distortion of securities' yields. Ms. Seidman further stated that the proposed presentation of other-than-temporary losses and the proposed disclosures will serve to ensure that the entity's determination of whether impairment is temporary or other-than-temporary will be very transparent to users of financial statements. The new information provided will allow users and preparers to have a dialogue regarding the reasonableness of the credit losses recognized by an entity.
19. Mr. Siegel stated that while it is important to provide users information regarding credit and noncredit components of other-than-temporary impairment losses to facilitate a discussion of management's estimates between users and prepares, this information would be more appropriately presented in notes to financial statements. Mr. Siegel added that both credit and noncredit components of other-than-temporary impairment losses should be recognized in the statement of earnings. If an entity does not have a positive intent and ability to hold the security, noncredit losses, including those related to market liquidity, are relevant as the entity may have to sell this security. Mr. Linsmeier supported Mr. Siegel's observations.
20. Mr. Herz observed that current market prices for securities backed by commercial and residential real estate include a high uncertainty premium and, for some of these securities, may not be reflective of the underlying cash flows. Mr. Herz supported Ms. Seidman's observation about importance of a dialogue between users and preparers regarding other-than-temporary impairment losses and that presentation of both credit and noncredit loss components, accompanied by the proposed disclosures, will facilitate this dialogue.

Issue 3: Held-To-Maturity Debt Securities

21. Ms. Inzano summarized the comments received regarding recognition of other-than-temporary impairment losses for held-to-maturity securities.

22. **Staff recommendation:** The staff recommended that the Board retain the requirement in the proposed FSP to recognize noncredit losses on held-to-maturity debt securities in other comprehensive income and amortize that amount over the remaining life of the security in a prospective manner by offsetting the recorded value of the asset.

23. **Board vote:** The Board unanimously agreed with the staff recommendation.

24. **Board comments:** Mr. Smith stated that while he believes recognition of noncredit impairment losses for held-to-maturity securities and their subsequent accretion are confusing and contrary to the held-to-maturity concept, he supports the staff recommendation because the feedback received indicates that users strongly support presentation of all securities in an entity's balance sheet at fair value.

25. Messrs. Herz and Siegel and Ms. Seidman supported Mr. Smith's observation that according to the feedback received by the Board, it is important to users that balance sheet of an entity presents securities at fair value.

Issue 4: Credit Losses

26. Ms. Inzano summarized the comments received regarding estimation of credit portion of other-than-temporary impairment losses.

27. **Staff recommendation:** The staff recommended that the FSP clarify that credit losses should be based on the reporting entity's estimate of the decrease in expected cash flows or the entity's best estimate of the amount of the other-than-temporary impairment that relates to credit deterioration. The staff recommended that the FSP continue to refer FAS Statement No. 114, *Accounting by Creditors for Impairment of a Loan,* as a possible method that could be used to estimate credit losses and to require that investments accounted for in accordance with Issue 99-20 apply the guidance in that Issue. However, the staff did not recommend that the Board prescribe a specific method to be applied for securities that are not subject to Issue 99-20. Also, for some instruments, such as those described in paragraph 14 of FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and*

Extinguishments of Liabilities, because an increase in prepayments would result in a decrease in expected cash flows, the staff recommended that the Board clarify that a decrease in expected cash flows that results from an increase in expected prepayments should be accounted for as a credit loss when an entity is determining the amount of an other-than-temporary impairment related to credit losses that should be recognized in earnings.

28. **Board vote:** Messrs. Herz and Smith and Ms. Seidman supported the staff recommendation. Messrs. Linsmeier and Siegel did not support the staff recommendation.
29. **Board comments:** Mr. Linsmeier asked the staff to clarify that in referring to Statement114, the Board did not intent to prescribe an incurred loss model for determining whether there has been a credit loss on a debt security; rather, credit losses are to be estimated using the measurement guidance in Statement 114. Ms. Seidman and Messrs. Herz, Smith and Siegel supported Mr. Linsmeier's observation.
30. Mr. Siegel emphasized that it is important to communicate to users that credit portion of other-than-temporary impairment losses that will be recognized in accordance with the proposed guidance will represent management's estimate of expected cash flows, which may be different from market participants' estimates, and that the noncredit losses recognized by an entity may include losses that reflect market participant's estimates of the future cash flows expected to be received from the security.
31. Ms. Seidman observed that the proposed disclosures are designed to provide sufficient transparency to allow users to evaluate the reasonableness of management's estimation of credit and noncredit portions of other-than-temporary impairment losses.

Issue 5: Subsequent Accounting

32. Ms. Inzano stated that a number of respondents requested that the Board provide additional guidance for subsequent accounting for noncredit portions of other-than-temporary impairment loss recognized in other comprehensive income.

33. **Staff recommendation:** The staff recommended that the FSP clarify that existing premiums or discounts and subsequent changes in estimated cash flows or fair value should continue to be accounted for in accordance with existing guidance (for example, a favorable change in estimated cash flows for a security accounted for in accordance with Issue 99-20 would be

reflected as an adjustment of the accretable yield). The staff did not consider additional specific guidance or examples necessary.

34. **Board vote:** The Board unanimously agreed with the staff recommendation.

Issue 6: Presentation of Noncredit Losses and Disclosures

35. Ms. Inzano summarized the comments received regarding presentation of the noncredit portion of other-than-temporary impairment losses and disclosures.

36. **Staff recommendation:** The staff recommended that the Board require entities to separately present in the financial statement where the components of other comprehensive income are reported, amounts recognized in accumulated other comprehensive income related to held-to-maturity and available-for-sale debt securities for which the noncredit portion of an other-than-temporary impairment was recognized in other comprehensive income. The staff also recommended the Board require the additional disclosures (see the meeting handout for examples of some of the proposed disclosures).

37. **Board vote:** The Board unanimously agreed with the staff recommendation.

38. Mr. Golden observed that the proposed disclosures are a fundamental improvement to the proposed FSP and have been added as a response to the feedback received from users. Mr. Golden did not believe that reexposure of the proposed FSP was necessary.

39. **Board vote:** The Board unanimously agreed that the proposed FSP would not be reexposed.

Issue 7: Scope of the Short-Term Project

40. Ms. Inzano stated that a significant number of respondents that supported issuance of the proposed FSP recommended that the Board take this opportunity to make additional changes to other-than-temporary impairment guidance that are not within the scope of this project (see the meeting handout for the list of the changes suggested by respondents).

41. **Staff recommendation:** The staff recommended that the Board not expand the scope of the proposed FSP. The staff noted that the FASB and the IASB have a joint project on agenda 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 and how the impairment should be

measured and presented and/or disclosed). The FASB also has a separate project to consider allowing recoveries of other-than-temporary impairments.

42. **Board vote:** The Board unanimously agreed with the staff recommendation.

Issue 8: Effective Date and Transition

43. Ms. Inzano summarized the comments received regarding effective date of the proposed FSP and the transition method.

Transition

44. **Staff recommendation:** The staff recommended that the Board require that entities record a cumulative effect adjustment as of the beginning of the period of adoption to reclassify the noncredit component of a previously recognized other-than-temporary impairment from retained earnings to other comprehensive income if the entity does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery.

45. **Board vote:** The Board unanimously agreed that the staff recommendation.

46. **Board comments:** Mr. Smith observed that it is imperative that treatment of other-than-temporary impairment losses prior to and subsequent to the issuance of the proposed guidance be comparable.

47. Ms. Seidman stated that she supports the staff recommendation because the feedback received indicates that users believe that cumulative effect adjustment will serve to provide useful information.

Effective Date

48. **Staff recommendation:** The staff recommended that the FSP be applied for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. Earlier application for periods ending before March 15, 2009 would not be permitted.

49. The Board discussed the effective date of the proposed FSP in conjunction with the effective dates of proposed FSP FAS 157-e, *Determining Whether a Market is Not Active and a Transaction is Not Distressed,* and FSP FAS 107-b and APB 28-a, *Interim Disclosures About Fair Value of Financial Instruments*. See the April 2, 2009 meeting minutes for proposed FSP FAS 107-b and APB 28-a for the Board decision.

Follow-up Items

The Board directed the staff to proceed with ballot drafting of the proposed FSP.

General Announcements

None.