MINUTES

Financial Accounting Standards Board

To:	FASB Board Members
From:	FAS 157 Team (Clark x443)
Subject:	Minutes of the May 27, 2009 Board Meeting: Proposed FSP FAS 157-x, *Improving Disclosures about Fair Value Measurements*
Date:	June 30, 2009
cc:	<u>FASB:</u> Golden, Bielstein, Proestakes, Stoklosa, Mechanick, Anderson, Glotzer, Chookaszian, Posta, Lott, C. Smith, Gabriele, Inzano, Maples, Sutay, Mills, FASB Intranet, Clark, Martin, Klimek, Allen; <u>GASB:</u> Reese, Schermann; <u>IASB:</u> 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.

<u>Topic</u>:	Proposed FSP FAS 157-x, *Improving Disclosures about Fair Value Measurements*
<u>Basis for Discussion</u>:	Proposed FSP FAS 157-x, *Improving Disclosures about Fair Value Measurements*, Memo 1, Supplement to Memo 1, Memo 2
<u>Length of Discussion</u>:	8:00 a.m. – 9:00 a.m.

<u>Attendance</u>:

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: Bhave

Other staff at Board table: FASB: Golden, Proestakes, Anderson, Mills, Clark, Martin

Summary of Decisions Reached

The Board discussed a proposal that would require additional information about fair value measurements used in financial statements and reached the following tentative decisions:

1. *Level of disaggregation.* FASB Statement No. 157, *Fair Value Measurements,* currently requires separate disclosures for each *major category* of assets and liabilities, which is often interpreted in current practice to be equivalent to a line item in the statement of financial position. The Board decided that the level of disaggregation generally should be greater than the line items for assets and liabilities in the statement of financial position. Additional guidance on disaggregation will be discussed at a future Board meeting.
2. *Inputs.* Paragraph 32(e) of Statement 157 requires a discussion of the valuation techniques used to measure fair value. The Board decided to clarify that this discussion should include descriptive disclosures about significant inputs for both Level 2 and Level 3 estimates.
3. *Effect of reasonably possible alternative inputs.* For Level 3 estimates, entities should disclose any significant effect of reasonably possible alternative inputs and how the effect was calculated.
4. *Transfers between levels.* Entities should disclose any significant transfers between Levels 1, 2, and 3 during the reporting period and the reasons the transfers were made.

The Board directed the staff to undertake field visits to obtain feedback from preparers about the operationality of the proposed disclosures, particularly those relating to the level of disaggregation and the effect of reasonably possible alternative inputs for Level 3 estimates.

The Board's goal is to issue a final standard that would be effective for annual and interim periods ending after December 15, 2009.

Matters Discussed and Decisions Reached

1. Mr. Bhave began the meeting by providing background on the FASB project to improve disclosures about fair value measurements in FASB Statement No. 157, *Fair Value Measurements*. He stated that in identifying the proposed additional disclosures, the staff focused on the following objectives:

a. The disclosures should help users better understand how an entity estimates fair values, complies with Statement 157's fair value hierarchy (that is, estimates using Level 1, 2, and 3 inputs), and for fair value measurements using significant unobservable inputs (Level 3), the effect of changes in reasonably possible alternative inputs.

b. The disclosures generally should achieve, to the extent practicable, greater convergence with International Financial Reporting Standard 7, *Financial Instruments: Disclosures*, as amended in March 2009. The recent amendments to that document incorporate into the standard the fair value hierarchy principles of Statement 157 and add additional disclosure requirements.

2. Mr. Bhave stated that the areas upon which the staff has focused on making improvements include four major areas:

   a. The level of disaggregation required for presentation of fair value disclosures under Statement 157

   b. Disclosures about Inputs

   c. Disclosure of the effects of reasonably possible alternative inputs on Level 3 estimates

   d. Disclosure of transfers between levels of the fair value hierarchy.

CHANGES APPLICABLE TO RECURRING AND NONRECURRING FAIR VALUE MEASUREMENTS

Level of Disaggregation

3. Mr. Bhave stated that Statement 157 requires separate disclosures for each *major category* of assets and liabilities. He added that some users have expressed concern that current practice seems to have interpreted the phrase *major category* to be equivalent to the line item in the statement of financial position. Moreover, he stated that users believe that such a high level of aggregation of the required disclosures often renders them not very useful.

4. To address such concerns, the staff recommended that the proposed FSP permit the use of judgment in determining the appropriate level of disaggregation to achieve the disclosure objectives of Statement 157 [mmc1]and to not prescribe specific rules for disaggregation. The staff recommended that the proposed FSP provide the general guidance outlined in paragraph 10 of the meeting handout (see Appendix A).

5. **Board vote:** All Board members agreed.

6. **Board comments:** Mr. Smith stated that although he agrees with including a principle that governs the level of disaggregation, he is concerned about the ambiguity of the requirement in IFRS 7 that, "an entity group assets and liabilities into classes that are appropriate to the nature of the information disclosed." He questioned how constituents would evaluate the *appropriateness* of the classes and asked whether the staff would include specific characteristics to help constituents evaluate that appropriateness.

7. Mr. Bhave stated that the intent of the language is that the classes presented be appropriate to the disclosure objectives. Those objectives include providing users with information demonstrating how an entity complied with the hierarchy in Statement 157. He added that the level of disclosure should be greater as you move to Level 3. Mr. Linsmeier also expressed concerned about the requirements' lack of specificity. He added that the language used in IFRS 7, as amended, is not specific enough to communicate the intent of the disclosure requirement. He noted that the only suggested level of disaggregation in the IFRS 7 language (see Appendix A) is by accounting class (trading securities, available-for-sale securities, or loans). Mr. Bhave noted that the disaggregation prescribed in 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*, (which relates to the definition of *major category*) would not be changed.

8. Ms. Seidman stated that the key point in the staff's memo is that the disclosures in Statement 157 are not meant to serve all purposes. That is, they are intended to provide insight into the fair value measurement for various types of items. She added that disclosure specificity, as relates to disaggregation, should be based on the different methods by which an entity estimates fair value. For example, if had an entity had loans, the entity would disaggregate by the different approaches used to estimate the value of the loan portfolio.

9. Mr. Herz provided the following example:

> An entity has loans held for investment, the fair value estimates of which fall into Level 1, 2, and 3 of the hierarchy. The Level 2 estimates all related to residential

loans; the Level 3 estimates all related to commercial loans. One of the Level 3 estimates, the value of which makes up 30 percent of the total, is a loan given to Thailand.

Mr. Herz stated that the intent of the guidance is that the entity disaggregate by fair value hierarchy level. Within those levels, the entity would disaggregate by type of loan—that is, residential (Level 2) and commercial (Level 3). He added that further disaggregation would be needed (by geographic area), to show the commercial loan (Level 3) to Thailand.

10. Mr. Linsmeier stated that the process of disaggregation would first involve disaggregating by level in the fair value hierarchy and then breaking down the disclosure, within those levels, by concentration of significant input. He suggested that the Board could contemplate requiring disclosure by concentration of risk. Mr. Bhave stated that the staff was not sure if it was appropriate to incorporate risk disclosures into the project on disclosures about fair value measurements.

11. Mr. Smith emphasized the need to provide specificity about how an entity should disaggregate. He reiterated that the language around the appropriateness of classes presented in the statement of financial position does not clearly communicate how an entity should determine the appropriate level of disaggregation.

12. Mr. Siegel stated that the staff's illustration of the proposed disclosure requirements does not bother him as long as those items presented are material to the portfolio of the entity. He emphasized the need for disaggregation to show the significant inputs. He added that because entities use differing assumptions, this level of disaggregation is appropriate, assuming the items being disclosed are material. Mr. Linsmeier agreed.

13. Mr. Herz stated that the key questions are (a) how detailed the disclosure should be and (b) in what manner the disclosure should be disaggregated. He added that the problem now is people disaggregate by balance sheet line item, don't relate the fair value measurements to the methodologies by which the measurements were made, and don't include information about the sensitivity of such measurements to changes in significant inputs.

14. Mr. Golden stated that the staff is trying to communicate, without prescribing the levels of

disaggregation, the following:

a. First, disaggregate by the accounting for the particular item; that is, AFS, trading, etc.

b. Second, within that line item, disaggregate by Level 1, 2, or 3; that disaggregation helps to communicate the subjectivity of the estimate

c. Third, within the level, by methodology

d. Fourth, within the methodology, by significant input (other than methodology)

He added that the sensitivity would then examine changes in the significant inputs. He added that the guidance would be clarified to communicate the staff's intention. Ms. Seidman stated that the entity would also determine which inputs are material and, as such, require disclosure.

15. Mr. Herz stated it would be helpful to include an example that illustrates what a disclosure would look like given a particular set of facts and circumstances. In this way, entities would be provided with an example of what an entity might do in meeting the disclosure objectives.

16. Mr. Proestakes asked Mr. Linsmeier if he believed that the sensitivity analysis should drive the level of disaggregation. Mr. Linsmeier stated that this is a question that the Board will need to address. He added that the disclosures for Level 2 fair value measurements given by Royal Bank of Scotland in its most recent 10-K are not particularly useful. Ms. Seidman stated that, by definition, Level 2 fair value measurements are based on observable market data and do not require significant adjustment. She sees nothing else that the Board could require other than disclosure of significant inputs into Level 2 fair value measurements.

17. Mr. Smith stated that he does not object to exposing the staff recommendation; however, he stated that the FASB will receive feedback from constituents stating that the complexity of inputs and models relating to Level 3 fair value measurements is so great that it is impracticable for entities to comply with the proposed disclosure requirement. He added that the FASB has heard similar comments during the due process associated with other projects in which sensitivity analyses were included as part of proposed disclosure packages.

18. Ms. Seidman stated that if she were preparing the disclosure, she'd start with the sensitivity analysis, look at what inputs are most significant and least observable, complete the analysis,

and then figure out what other assets are related to the input(s) being examined. She added that she would organize the required disclosure in that manner. Mr. Linsmeier agreed that the sensitivity analysis would help an entity determine which inputs are most uncertain.

19. Mr. Herz stated that the key objective seems to be for users to understand where inputs and methodologies lead to uncertainties in the valuation. Mr. Bhave emphasized that one would expect more disclosure and disaggregation for Level 3 relative to Level 2. Mr. Linsmeier added that he agrees; however, he emphasized that disclosures about Level 2 fair value estimates should be sufficiently granular—that is, the movement should not be toward the level of aggregation with which Level 1 fair value estimates are presented.

20. Mr. Smith suggested that the FASB undertake field visits to solicit constituent input before exposing the proposed FSP. Other Board members agreed. Mr. Linsmeier emphasized the need to solicit input from constituents of varying sizes and industries. He added that the staff should ask constituents how they could meet the disclosure objectives in the most cost-beneficial manner. Mr. Herz added that this is necessary because the issues associated with the guidance will be different for large and small institutions. Large(r) institutions will struggle with finding the correct level of disaggregation—that is, finding a manner in which to provide enough information so that users are provided with useful information while at the same time avoiding providing too much information. Small(er) institutions will struggle with finding the human capital possessing the expertise to help the entity comply with the proposed disclosure requirements.

21. Mr. Linsmeier emphasized the need for the staff to revise the proposed guidance to articulate more clearly the objective of the proposed disclosure requirements.

Disclosure about Inputs

22. Mr. Bhave stated that there appears to be some confusion in practice about whether the introductory sentence to paragraph 32 of Statement 157 is a requirement—that is, whether an entity must discuss the significant inputs used in estimating fair value. He added that the staff believes a more explicit requirement to discuss the inputs would lessen any confusion and improve the disclosure. He acknowledged that FSP FAS 157-4 has made some changes

to clarify that a discussion of inputs is necessary. However, he stated that to emphasize further the need for more robust disclosures about inputs used in a valuation technique, the staff is recommending that the proposed FSP include language similar to that in paragraph 27 of IFRS 7 to emphasize the need for more robust disclosures about inputs used in a valuation technique. He clarified that the proposed additional guidance would clarify that disclosures about inputs apply to both Level 2 and Level 3 estimates.

23. **Board vote:** All Board members agreed.

Disclosure of the Effect of Reasonably Possible Alternative Inputs on Level 3 Estimates

24. Mr. Bhave stated that users have indicated that with respect to fair values estimated using Level 3 inputs, information about the effect on fair value of reasonably possible alternative inputs would be relevant to their analysis of the reporting entity's expected future cash flows. IFRS 7, as amended, now requires this information for Level 3 fair values of financial instruments. He added that the staff believes that similar information for fair value estimates that use Level 3 inputs would be useful because it would indicate a range of values under different reasonably possible alternative scenarios. In the context of this proposed disclosure, the term reasonably possible is intended to have the same meaning as that in FASB Statement No. 5, *Accounting for Contingencies*. The proposed disclosure would include a description of how the effect was calculated. To help further analysis by users, entities would be required to include quantitative disclosure about the significant inputs used as well as reasonably possible alternative inputs.

25. The staff recommended that with respect to fair values estimating using Level 3 inputs, entities be required to disclose information about the effect on fair value of reasonably possible alternative inputs, including quantitative disclosure about the significant inputs used in the determination of fair value and reasonably possible alternative inputs.

26. **Board vote:** All Board members agreed.

27. **Board comments**: Ms. Seidman stated that the staff should examine the financial reports of entities that file using IFRS to see how they are approaching the requirement in IFRS 7, as amended, to disclose the effects of reasonably possible alternative inputs on Level 3 fair

value measurements. She added that it would be important to understand how the entities are complying with that requirement in a cost-beneficial manner.

28. Mr. Smith emphasized the need to discuss with field visit participants if such a requirement is operational in practice and if so, how participants would go about complying with the requirement. Mr. Linsmeier agreed and added that it is likely the Board will hear that many constituents do not know how to perform a sensitivity analysis. He also emphasized that the proposed requirement is not forward looking—that is, the requirement seeks to examine uncertainties around Level 3 fair value measurements at the balance sheet date.

Disclosure Exception

29. Mr. Bhave stated that the staff believes that disclosure of the effect of reasonably possible alternative inputs for Level 3 estimates would not be practicable for fair value estimates that are based on the net asset value of a hedge fund or private equity fund. He added that the staff, therefore, recommends that the Board provide a sensitivity disclosure exception for such estimates.

30. **Board vote:** All Board members agreed.

31. **Board comments**: Ms. Seidman questioned whether, like the sensitivity disclosure, the Level 3 roll forward required by Statement 157 should not be applicable to an investor that has Level 3 fair value measurements that are based on the net asset value of the underlying fund. Mr. Mills stated that the roll forward still may be useful to investors as it separately presents cash and non-cash changes in fair value. Other Board members agreed.

32. Mr. Linsmeier began to discuss the interaction of the project on measuring interests in alternative investments with the fair value hierarchy in Statement 157. He suggested that the Board would need to provide guidance on which level in the fair value hierarchy such measurements fall. The Board decided to defer discussion of that issue until the next meeting at which the project on measuring interests in alternative investments is discussed, as the subject of discussion is outside the scope of the project on improving disclosures about fair value measurements.

CHANGES APPLICABLE ONLY TO RECURRING FAIR VALUE MEASUREMENTS

Transfers Between Levels

33. Mr. Bhave stated that users have indicated that information on any significant transfers between Levels 1, 2, and 3 of the fair value hierarchy during the reporting period and the reasons for those transfers would be useful. He added that IFRS 7, as amended, required disclosure of such information. Thus, the staff recommended that the proposed FSP require a disclosure regarding transfers between levels of the fair value hierarchy, similar to that required by IFRS 7, as amended.

34. **Board vote:** All Board members agreed.

35. **Board comments:** Mr. Smith stated that the reasons for transfers between categories of the fair value hierarchy are inherent in the definitions of Levels 1, 2, and 3, as detailed in Statement 157. Those reasons need not be disclosed. However, he did not object to exposing the document with the staff proposal.

EFFECTIVE DATE

36. The staff recommended that the proposed FSP be effective for interim and annual periods ending after December 15, 2009.

37. **Board vote:** The Board deferred making a firm decision on the effective date of the proposed FSP until a later meeting. However, Board members agreed that the goal is to have the guidance issued in time to be effective for interim and annual periods ending after December 15, 2009.

38. **Board comments:** Ms. Seidman emphasized the importance of having the guidance issued in time for fiscal years ended 2009 because the proposed guidance would require entities to implement systems changes.

<u>Follow-up Items</u>

The Board directed the staff to undertake field visits with various constituents to seek input regarding the necessary level of disaggregation and the effect of reasonably possible alternative inputs of Level 3 fair value measurements.

General Announcements

None.

Excerpts from May 27, 2009, Board Meeting Handout

Proposed FSP FAS 157-x, *Improving Disclosures about Fair Value Measurements*

10. Therefore, the staff recommends that the proposed document permit the use of judgment in determining the appropriate level of disaggregation to achieve Statement 157's disclosure objectives and not prescribe specific rules for disaggregation. The staff recommends that the proposed document provide the following general guidance (which is consistent with the guidance in IFRS 7):

> A reporting entity shall group assets and liabilities into classes that are appropriate to the nature of the information disclosed and that take into account the characteristics of assets and liabilities. Disclosures for each class of assets and liabilities would often require further disaggregation of line items in the statement of financial position such as trading securities, available–for-sale securities, or loans. A reporting entity shall provide sufficient information to permit reconciliation to the line items presented in the statement of financial position.
>
> When determining the appropriate level of disaggregation, the entity may consider the materiality of the instrument as well as the uncertainty and subjectivity of the fair value estimates. For example, the level of disaggregation and the extent of disclosure generally shall be greater for Level 3 inputs.