MINUTES

Financial Accounting Standards Board

To:	Board Members		
From:	Mills, ext. 317		
Subject:	Minutes from 1/7/09 Board Meeting on amending the Impairment and Interest Income Measurement Guidance of EITF Issue No. 99-20	**Date:**	September 11, 2009
cc:	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.

<u>Topic</u>: Amendments to the Impairment and Interest Income Measurement Guidance of EITF Issue No. 99-20

<u>Basis for Discussion</u>: Proposed FSP EITF 99-20-a

<u>Length of Discussion</u>: 9:30 a.m. to 10:30 a.m.

<u>Attendance</u>:

Board members present: Herz, Seidman, Siegel, Linsmeier, and Smith

Board members absent: None

Staff in charge of topic: Mills

Other staff at Board table: Golden, Stoklosa, Trench

Outside participants: Leisenring (IASB)

Summary of Decisions Reached:

The Board discussed comment letters received on proposed FSP EITF 99-20-a, *Amendments to the Impairment and Interest Income Measurement Guidance of EITF Issue No. 99-20.* The proposed FSP would address certain practice issues in applying the impairment guidance in 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," by making that guidance consistent with FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities.*

The Board considered the issues brought up in the comment letters and affirmed its previous decision to address the practice issue highlighted in the proposed FSP in the short term by issuing a final FSP. The Board acknowledged the other impairment issues raised in the comment letters, noting that it intends to address those issues in its comprehensive project on accounting and reporting for financial instruments.

The Board decided that the final FSP will reiterate and emphasize the principle behind an other-than-temporary impairment assessment and the related disclosure requirements in Statement 115 and other related guidance. In particular, the final FSP will emphasize the need for entities to:

1. Consider guidance in Statement 115, FSP FAS 115-1 and FAS 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments,* and SEC Staff Accounting Bulletin Topic 5M, *Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities,* when determining whether an impairment is other than temporary.

2. Consider all available information, reflecting past events and current conditions, when developing the estimate of future cash flows for determining whether to record an other than temporary impairment. All available information would include, but not be limited to, the remaining payment terms of the instrument and economic factors that are relevant to the collectability of the instrument, such as current prepayment speeds, the current financial condition of the issuer(s), and the value of any underlying collateral.

3. Exercise judgment when assessing whether declines in fair value are indicative of a decline in the cash flows expected from the issuer of the security. For example, an entity should not automatically conclude that a security is not impaired because all of the scheduled payments to date have been received. Nor should an entity automatically conclude that every decline in fair value represents an other-than-temporary impairment.

The Board also affirmed its previous decision that the FSP should be effective for interim and annual reporting periods ending after December 15, 2008, and should be applied prospectively. In addition, the Board decided to clarify that retrospective application to a prior interim or annual reporting period is not permitted.

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

<u>Objective of Meeting</u>:

The objective of the meeting was for the Board to discuss the comment letters received from constituents about the proposed FSP EITF 99-20-a, *Amendments to the Impairment and Interest Income Measurement Guidance of EITF Issue No. 99-20.* The staff also plans to discuss with the Board whether the proposed FSP should be issued as a final FSP and any necessary adjustments to the proposed FSP as a result of the comments received.

<u>Matters Discussed and Decisions Reached</u>:

1. Mr. Mills noted that prior to issuing the proposed FSP, the FASB and IASB organized three roundtables, one each in London, Norwalk, and Tokyo, to obtain input on accounting issues that may require immediate attention, as well as broader financial reporting issues arising from the global financial crisis. Roundtable participants represented the views of investors, preparers, practitioners, regulators, and others. In addition, the FASB and IASB have considered informal input from other organizations, such as the Center for Audit Quality (CAQ), the American Council of Life Insurers, and the U.S. Securities and Exchange Commission (SEC). Many constituents indicated that the other-than-

temporary impairment guidance could be improved (or perhaps eliminated in the long-term) and specifically highlighted that Issue 99-20 has operational issues.

2. Mr. Mills also pointed out, that the majority of respondents supported the proposed FSP, with many emphasizing the need for a broader overhaul of the other-than temporary impairment model in U.S. GAAP. The types of respondents that were in favor of the proposed FSP—subject to certain clarifications—included preparers (financial institutions and related trade associations), auditors, certain regulators, and members of the valuation profession. Many users were not in favor of finalizing the proposed FSP. These respondents expressed concerns about any shift away from fair value in the measurement of financial instruments (that is, the potential for delayed recognition of losses in earnings) and the shortened comment period for the proposed FSP.

ISSUE 1: SHORT-TERM OR COMPREHENSIVE PROJECT

3. The comments from respondents to the proposed FSP varied significantly. Some respondents supported the proposed FSP noting that the proposed FSP creates a single impairment model for debt securities, mitigates certain operational concerns about how Issue 99-20 is applied in practice, and represents a step towards convergence with the IASB.

4. Other respondents disagreed with the proposed FSP stating that it does not serve investors because it moves away from a fair value measure, it subjects the assessment of impairment to significant preparer judgment, and the comment period was too short for such a significant change. However, all of the respondents generally agreed that a single impairment model for debt securities is appropriate, though some would prefer the Issue 99-20 model.

Question for the Board:

5. Does the Board want to finalize the proposed FSP in some form as part of a separate, short-term project focused on aligning the impairment model in Issue 99-20 with the equivalent guidance in Statement 115? Alternatively, does the Board want to consider changes to the impairment guidance in Issue 99-20 as

part of the joint project with the IASB on improving financial reporting of financial assets and financial liabilities?

Staff Recommendation:

6. Mr. Mills summarized the staff's recommended direction of the project as follows:

> The staff recommends that the Board finalize the proposed FSP subject to clarifying edits. While the staff recognizes the concerns of the user (investors) respondents, the staff believes that there should not be different impairment models for assessing similar instruments. Respondents generally noted that with some clarifications, the proposed FSP is operational. The staff believes that finalizing the proposed FSP is appropriate as a short term solution until the Board revisits impairment issues more comprehensively in the broader financial instruments project.

Board Vote:

7. Mr. Herz, Mr. Smith, and Ms. Seidman support the staff recommendation.

Comments:

8. Mr. Herz noted that the majority of the users had mixed views concerning how to proceed. Many users support the ultimate goal of fair value for all financial assets, but they don't like the inconsistency of the two models required by Statement 115 and Issue 99-20. These users, which include mostly direct financial institution investors and analysts, would rather align the two models and address the broader overhaul of the other-than temporary impairment model in the joint project. Herz also noted that general analysts would generally prefer to defer this discussion to the broader fair value project. Mr. Herz added that some users would ideally like to know management's assessment of expected cash flows.

9. Mr. Siegel stated that he is not in favor of proceeding with the proposed FSP. His preference would be to include these issues in the expedited joint project on financial instruments. He is against proceeding with the proposed FSP for several reasons:

a) The FASB and IASB agreed that there needs to be a holistic remodeling on how to approach and think about fair value, impairment models, and financial instruments classification schemes. He does not believe it make sense to provide piecemeal guidance for the narrow group of securities that are the subject of this proposed FSP.

b) In response to comment letters from preparers that indicated that they believe that the market-participants' views of a company's expected cash flow is suspect (that is, a company's underlying assets might be fully performing, but under Issue 99-20, management is required to take an impairment charge on the assets up to 50 cents on the dollar), Mr. Siegel pointed out that he is not surprised that there haven't been many defaults to date, as the balloon payments on principal will not be due until five years down the line. He believes that market participant views about expected cash flows are taking into account that once the principal payments actually become due, it will be difficult for home owners to refinance the loan, and will consequently more likely to default, which is why the fair value of these loans are yet decreasing.

c) Mr. Siegel highlighted that the fact that the fair values of many assets in this market don't match management's assessment of future cash flows, may be an indication that preparers are misapplying the fair value guidance in Statement 157.

d) As discussed in the ITAC comment letter, application of the model in Statement 115 to securities scoped into Issue 99-20 will result in delayed losses, and less investor useful information.

10. Mr. Smith indicated that he supports moving forward with the proposed FSP. Mr. Smith stated that Issue 99-20 is supposed to rely on a Statement 115 model of impairment, however, in practice, a lower of cost or market method of impairment is being used. He thinks that there is a problem with application of the standard and not the standard itself. He stated that it is inappropriate to presume that a company's expected cash flows have decreased simply because the fair market value of an asset has decreased. He believes that in implementing the proposed FSP, emphasis should be put on cash flows and not fair value for making impairment decisions.

11. He noted that in the example concerning the commercial real estate loans where the loans are currently performing, but there will be a balloon in a few years, the issuance of this FSP does not relieve users from assessing the underlying cash flows of those loans for purposes of determining if there is an impairment today.

12. He believes it is important to have one standard that deals with impairment regardless of whether a company qualifies for Statement 115 treatment or that of Issue 99-20.

13. Mr. Linsmeier highlighted that the FASB rules and procedures state that in times of economic crisis, the Board may add to its agenda short-term projects as appropriate. He indicated that the organization's mission is to primarily serve users of financial information by establishing financial reporting that provides the most useful information.

14. He highlighted that the majority of users do not approve of this change. While agreeing that this FSP aligns the securities scoped into Issue 99-20 with other securities that require Statement 115 treatment, Mr. Linsmeier believes that the other-than-temporary impairment model in the proposed FSP is not consistent with the majority of users' views of the fair values of assets of companies, as evidenced by the majority of stock of financial institutions being traded well below book value.

15. Mr. Linsmeier added that he believes the Board should rethink these issues within the framework proposed in the broader financial instruments project. He indicated that he does not believe that preparers will be able to accurately develop future cash flow projections, and get those amounts audited prior to earnings announcements due at the end of the week.

16. Mr. Linsmeier expressed concerns about the potential that issuing this FSP will allow companies to defer losses this period and smooth out earnings in future periods when the economy has recovered. He believes this would consequently undermine investor confidence in financial reporting.

17. Ms. Seidman stated that the current model is a mixed attribute model. Instruments not carried at fair value whose changes are recorded in earnings are subject to varying impairment models. She believes that there is no distinction in practice between temporary and other-than-temporary assessments of

impairment. All impairments are going through the income statement, which is partially due to the lack of visibility of market participants' assumptions about cash flow.

18. Ms. Seidman indicated that the proposed FSP should remind investors that the model proposed in Issue 99-20 was not meant to support a lower of cost or market approach in valuing securities.

19. Ms. Seidman believes that the staff shouldn't change the wording in Issue 99-20 in the proposed FSP. Instead she supports the idea of making modest clarifying edits on how Issue 99-20 was intended to be applied. She highlighted her belief that entities need to use judgment, looking at the contractual terms of the securities and current financial conditions of the borrower. Existing guidance in auditing literature and SEC law shows how to disclose effects of these securities. If the fair value of securities decreases and the issuer doesn't write down the assets, the issuer will have to disclose why they didn't take write-downs on each asset. This will give investors enough information to make an informed decision on whether management's assessment is appropriate.

20. Mr. Herz mentioned that he does not like the current accounting for other-than-temporary impairments. He believes the staff work to simplify the current accounting by eliminating investment buckets, transfers, and multiple impairment approaches.

21. Mr. Herz stated that Topic 5M instructs preparers to examine the length, time, and extent to which the market value of the financial instrument has been below cost and the ability of the investor to hold the security until maturity. Topic 5M additionally calls for preparers to have sufficient evidence to support why a preparer wouldn't take an impairment. Mr. Herz noted that simple corroboration that loans are performing is not sufficient in impairment testing.

22. Mr. Herz supports moving forward with this FSP, subject to clarifying edits, to remind constituents of the original reason why Issue 99-20 was implemented in addition to providing consistency on how to account for these securities.

23. Mr. Leisenring addressed the notion that some have about Statement 115 allowing delayed recognition of losses. He questioned why so much emphasis is being placed on the location of impairment-related losses. He stated that even if the losses don't directly flow through to the income statement, investors should be intelligent enough to examine other comprehensive income thoroughly. He stated that to assume that investors wouldn't take this precaution is saying that the U.S. financial markets aren't efficient.

24. Mr. Linsmeier highlighted that investors still closely examine and make investment decisions based on earnings announcements, which include the impact of net income on EPS, not other comprehensive income.

ISSUE 2: SCOPE OF SHORT-TERM PROJECT

25. Mr. Mills stated that a significant number of respondents that supported issuance of the proposed FSP believed that the document represented a good starting point for revisiting impairment guidance for financial instruments.

26. However, these respondents additionally noted that additional amendments and guidance were necessary for year-end 2008. The suggested changes include:

a. Reconsidering the triggers for impairment such as:

   i. Eliminating the ‘intent and ability to hold’ requirement of Statement 115 and replacing it with objective evidence of a credit event

   ii. Modifying the language in paragraph 16 of Statement 115 (which indicates that all cash flows be collectable as originally scheduled or estimated) to say that “an insignificant delay or insignificant shortfall in amount of payments does not automatically result in OTTI” (similar to paragraph 8 of Statement 114)

b. Reconsidering the use of fair value to measure impairments and instead use the amount of loss recognized in earnings based on the difference between the carrying amount of the instrument and the present value of the estimated future cash flows discounted at the instrument original effective interest rate.

c. Reconsidering the prohibition against reversals of other-than-temporary impairments

d. Permitting the effective date for recent transfers to held-to-maturity and available-for- sale to be the same effective date used by the IASB (that is, from 1 July 2008)

e. Clarifying the definition of fair value by:

   i. Adding that liquidity risk referred to in FSP FAS 157-3 is not based on distressed sales

   ii. Remove market participants’ perspective

27. Mr. Mills noted that respondents who opposed the proposed FSP suggested the that the Board broadly reconsider Statement 115, give consideration to requiring all financial instruments be accounted for at fair value, enhance disclosure requirements, and thus, eliminate the need for other-than-temporary impairment guidance.

Question for the Board:

28. Does the Board want to broaden the scope of the proposed FSP for any of the items noted above?

Staff Recommendation:

29. The staff recommends that the Board not alter the scope of the proposed FSP. The staff notes that the FASB and the IASB have jointly agreed to expeditiously consider disclosures about incurred losses and reversals of other-than-temporary impairments. The Boards have also added a project to consider improvements to financial reporting for financial assets and liabilities. That project will include a reconsideration of impairments of financial assets (for example, whether there are better alternatives to impairment tests, or if not, what should trigger impairment and how should the impairment be measured and presented and/or disclosed).

Board Vote:

30. The Board unanimously voted in favor of the staff recommendation to consider these issues for the broader joint financial instruments project.

ISSUE 3: CHANGES TO THE PROPOSED FSP

31. Mr. Mills stated that a respondent raised concerns regarding the removal of the words “market participant” from Issue 99-20. Specifically, this respondent stated that “the removal of those words may unduly diminish the use of market-based information, including fair value, in determining an other-than-temporary impairment.” The respondent additionally stated that a connection should be retained to market participants’ views to inform and regulate the exercise of management’s judgment. This respondent pointed out that in certain instances, “it is reasonable to expect entities to consider market consensus views regarding the future performance of the underlying collateral in determining an other-than-temporary impairment.”

Questions for the Board:

32. Does the Board want the staff to provide additional clarifying language in paragraph 13 of Issue 99-20 to indicate that:

a) It is inappropriate to automatically conclude that a security is not impaired because all of the scheduled payments to date have been received. However, it is also inappropriate to automatically conclude that every decline in fair value represents an other-than-temporary impairment. Further analysis is often required to assess whether declines in fair value represent declines in the expected cash flows from the issuer of the security.

b) The holder must consider all available information, reflecting past events and current conditions, when developing the estimate of future cash flows. All available information would include the remaining payment terms of the instrument (which, for a security backed by nontraditional loans, could be significantly different from the payment terms in prior periods), economic factors that are relevant to the collectability of the instrument, such as current prepayment speeds, the current financial condition of the issuer(s) and the value of any underlying collateral.

33. The staff has made other clarifying changes to the proposed FSP and the amendments to Issue 99-20. Does the Board agree with those changes?

Staff Recommendations:

34. The staff recommends including the additional language to avoid any misinterpretation of the removal of the reference to market participants

35. The staff recommends making the proposed changes.

Board Vote:

36. The Board unanimously agreed that only clarifying edits should be made to the FSP.

Comments:

37. Mr. Herz reference SEC Topic 5M in clarifying the language proposed in the FSP, as it uses strong words that should give clarity to preparers on how to evaluate all available information.

38. Mr. Golden proposed that the staff describe in the background of the FSP how the Board conducted due process procedures, as this FSP wasn't conducted within a normal-length due process period. He also suggested that the staff include in the background the existing requirements and all the relevant literature issued by the SEC, PCAOB, and other boards that have interests in this issue.

39. Mr. Linsmeier and Mr. Herz both agreed that preparers cannot simply disregard the fact that market prices are below cost in assessing fair value.

ISSUE 4: EFFECTIVE DATE AND TRANSITION

40. Mr. Mills noted that the proposed FSP is currently effective for interim and annual reporting periods ending after December 15, 2008, and should be applied prospectively. Constituents who were in favor of issuing the proposed FSP supported the proposed effective date and transition. However, some constituents also raised concerns about the reversal of previous other-than-temporary impairments taken in prior periods. They suggested that the Board clarify the effective date and transition guidance in the proposed FSP by expressly prohibiting retrospective application, and recommended that the Board explicitly indicate that entities (for example nonpublic banking entities) that have filed regulatory reports that include an other-than-temporary impairment should not be permitted to reverse that impairment.

Questions for the Board:

41. Does the Board want to explicitly state that retrospective application is not allowed and that this would apply, for example, to nonpublic enterprises that have recorded OTTI for regulatory reports?

42. Does the Board authorize the staff to proceed to ballot the final FSP

Staff Response:

43. The staff recommends that the Board indicate that retrospective application is prohibited, but that no specific guidance be provided with respect to regulatory reports.

44. The staff recommends that the Board authorizes the issuance of this FSP.

Board Vote:

45. All Board Members unanimously agreed with the staff recommendation.

46. Mr. Herz, Ms. Seidman, and Mr. Smith would vote to authorize the staff to move forward with the proposed FSP.

Follow-up Items:

47. None

General Announcements:

48. None