MINUTES

Financial Accounting Standards Board

To:	FASB Board Members
From:	Accounting for Financial Instruments Team
Subject:	October 19, 2010 Morning Session Roundtable Minutes: Accounting for Financial Instruments
Date:	March 22, 2010

<u>Topic</u>: Proposed Accounting Standards Update: *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities—Financial Instruments (Topic 825) and Derivatives and Hedging (Topic 815)*

<u>Length of Discussion</u>: 9:00 a.m. to 12:00 p.m.

<u>Attendance</u>:

Outside Participants

Jeff Arricale (via phone)	T. Rowe Price
Paul Beswick	Securities and Exchange Commission
Robert Esson	National Association of Insurance Commissioners
Stacey Friday	Federated Investors, Inc.
Brad Hunkler	American Council of Life Insurers
Krishnan Iyengar	Reval.com
Joyce Joseph	Standard and Poor’s
Bob Laux	Microsoft
Richard Levy	Wells Fargo
Art Lindo	Board of Governors of the Federal Reserve System
Mark Newsome	ING Capital LLC
Enrique Tejerina	KPMG
Aubrey Thacker	Capital One
Robert Traficanti	Citigroup

FASB and IASB Participants

Russ Golden	FASB Board Member
Tom Linsmeier	FASB Board Member
Marc Siegel	FASB Board Member
Larry Smith	FASB Board Member
John Smith	IASB Board Member
Kevin Stoklosa	FASB Assistant Director
Sue Lloyd	IASB Associate Director
Upaasna Laungani	FASB Project Manager
Chris Roberge	FASB Project Manager
Ben Couch	FASB Practice Fellow
Kristy Putnam	FASB Postgraduate Technical Assistant

CLASSIFICATION AND MEASUREMENT

Categories for Financial Instruments

Many participants supported a two category classification model with a trading category that requires measurement at fair value with changes recognized in net income and a held-for-collection category that requires measurement at amortized cost. User participants believed that under this approach, debt securities should be measured at fair value because of the information provided regarding liquidity risks. Other participants noted that liquidity, marketability, and unrealized gain/loss information would be best presented through disclosure while the classification and measurement of financial instruments should be solely focused on management's intent. They asserted that these classifications would most accurately represent the eventual use of the financial instruments and would provide the most relevant information.

Additionally, these participants noted that there are tainting and reclassification issues associated with the current available-for-sale classification in a three category model. Some participants supported allowing reclassifications based on a change in a business strategy.

Some participants supported a three category classification model similar to current U.S. GAAP, with many debt securities falling in the middle category of fair value measurement with changes in fair value recognized in other comprehensive income. The other categories would be trading, measured at fair value with changes recognized in net income, and held for collection, measured at amortized cost. To these participants, certain debt securities do not fit into a trading or held-for-collection category. These instruments are generally liquid, meaning that fair value is relatively easy to calculate; however, entities generally hold these instruments for longer periods, meaning that short-term changes in fair value do not provide useful information. These participants also stressed that an entity's business strategy should be the primary driver of classification.

Equity Securities

Participants generally agreed that equity securities held for trading or other short-term gain should be measured at fair value with changes in fair value recognized in net income. Some users agreed that all equity securities should be measured at fair value with all changes in fair value recognized in net income.

Some participants noted that they make many equity investments in private entities with a strategic intent or plans to hold the investment long-term, not for a market return. They would prefer the changes in fair value of these investments not be recognized in net income but rather other comprehensive income as this would be more reflective of management's business strategy. Some participants noted that in compliance with the Community Reinvestment Act, they purchase private equity securities that must be held and that the business strategy is to meet regulatory guidelines, not for a market return.

One participant noted that it is difficult to discuss classification for specific instruments because there are some instruments that are technically considered equity but that are traded like bond instruments. When making distinctions in classification based on definitions rather than principles, this participant noted that the accounting may not reflect the economics of a transaction.

One preparer participant asked the Boards to further define the term *other comprehensive income* before allowing more items to be recognized in OCI Currently, its purpose seems to be to recognize items that some do not want to recognize in net income, which this participant noted is hard to explain to investors and other users.

Those who supported measuring equity securities at fair value with fair value changes recognized in other comprehensive income generally believed that the current impairment model for equity securities is sufficient.

Initial Measurement—Transaction Costs

One investment company participant expressed concern about the proposed guidance to expense transaction costs because this would affect the expense ratio, which is a key metric for investment companies. This participant favored transaction costs to be included in the cost basis and reflected through unrealized gains/losses in the income statement and noted that it would be difficult to measure transaction costs that are not explicit.

HEDGE ACCOUNTING

Effectiveness Criteria

The majority of participants supported the change to reasonably effective (rather than highly effective) for the qualifying criteria in designating a hedging relationship. Many commented that it would result in a reduction of costs, although most noted that businesses would continue to use existing procedures for hedging activities and aim for highly effective relationships. Most said that the change in qualifying criteria would reduce audit and restatement costs. Some expressed concerns about being able to define *reasonably effective* and asked for additional guidance on this term.

Some user participants noted that information about hedge effectiveness, management's intent in entering into hedging relationships, and how the relationship is managed would be useful information for a user to evaluate an entity's hedging strategy.

Some participants asked for clearer guidance on when quantitative support would be necessary in the current proposal.

Dedesignation

Many participants supported allowing entity to dedesignate and redesignate hedging relationships as a risk management strategy develops or changes over time. Most noted that the inability to dedesignate would increase transaction costs because entities would enter into an offsetting hedging instrument to achieve the same result as dedesignation.

IMPAIRMENT

Forecasting

The majority of participants supported allowing entities to forecast future events when measuring impairment. These participants asserted that requiring a “freezing” of current economic conditions would not convey economic reality. Many participants recommended that a forecast period should not be prescribed.

Timing and Amount of Recognition

Most participants supported an upfront loss recognition model although there were differing opinions on whether the loss estimate would encompass the expected or average life of the loan or the full contractual life of the loan. Some participants supported the concept of a “good-book/bad-book” approach similar to the method discussed by the Joint Expert Advisory Panel on Impairment; however, many said that this approach would not be necessary if an immediate loss was used.

One participant expressed concern that an allocation model would have similar operational problems that entities have encountered with AICPA Statement of Position 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer*. Participants noted that this guidance required precise tracking, which placed a large burden on preparers and many users do not feel they have sufficient transparency into these assets.

Those participants who did not support an upfront recognition of losses noted that pricing includes a consideration of credit, and upfront recognition does not recognize that interest income is designed to offset credit losses over time.

Interest Income

The majority of participants did not support the interest income model as proposed because it co-mingles credit and interest. Most participants would prefer to see this information separate.