**MINUTES**

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

Topic: 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)*

Length of Discussion: 1:00 to 4:00 p.m.

Attendance:

*Outside Participants*

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| Paul Beswick | Securities and Exchange Commission |
| Fred Cannon | Keefe, Bruyette and Woods |
| Ann Cavanaugh | BlackRock |
| Wanda Deleo | Federal Housing Finance Agency |
| Conrad Dixon | HSBC |
| Wallace Enman | Moody’s Investor Services |
| John Gallagher | Institute of International Finance |
| Kevin Guckian | Ernst and Young |
| Walter Ielusic | Financial Executives International |
| Art Lindo | Board of Governors of the Federal Reserve System |
| Raj Mehra | Middleburg Bank |
| Dan Palomaki | International Swaps and Derivatives Association |
| Hal Schroeder | Carlson Capital |
| Mark Scoles | Grant Thornton |

*FASB and IASB Participants*

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| 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 |

## HEDGE ACCOUNTING

### *Effectiveness*

The majority of participants supported the change to reasonably effective (rather than highly effective) for a hedging relationship and said that it would result in a reduction of costs. Many participants asked for additional guidance on what would be deemed reasonably effective.

Many participants did not support the removal of the short-cut and critical-terms match methods, stating that it would increase costs and operation difficulties in complying with hedge accounting guidance. Some participants also expressed concern that the proposal could cause artificial ineffectiveness to be recognized because of the requirement to recognize underhedges for cash flow hedging relationships.

One participant noted that hedge accounting in general is confusing and hard for investors to understand and, therefore, should be eliminated by requiring fair value measurement of all financial instruments. User participants stated that they would prefer more transparent disclosures regarding an entity's hedging strategies.

### *Dedesignation*

Many participants supported allowing entity to dedesignate and redesignate hedging relationships as an entity's risk management strategies develop or change 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, as prescribed in the proposed guidance, would not convey economic reality and would not be a complete expected loss model.

Some user participants noted that although assets are priced considering lifetime assumptions, impairment is a more precise measure than pricing. Because of this, auditors and preparers may disagree about the reasonableness of the impairment amount. Requiring entities to forecast lifetime losses would result in more costs and time to measure and audit the impairment amount but not necessarily result in better information for users.

### *Timing and Amount of Recognition*

Some participants supported an upfront loss recognition model and some supported a model that would allocate losses over the 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 lifetime losses were recognized immediately.

### *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.

## CLASSIFICATION AND MEASUREMENT

### *Loan Assets*

Most participants opposed measuring loan assets at fair value and reasoned that cash flow is a more important metric to analyze these instruments because they are not managed on a fair value basis. There was agreement among some participants on both sides of this debate that disclosure of fair value information and sensitivity analysis would provide useful information.  Some of these participants preferred that the fair value information be disclosed in the notes to the financial statements, others felt it should be presented parenthetically on the face of the financial statements, and a few participants supported a dual presentation with two statements—one based on amortized cost and one based on fair value. One user stated that fair value information is important on the face of the financial statements because of trend information. By including fair value information on the face of the financial statements, some feel the information will be subject to more rigor by preparers. Some preparers stated that information in the notes to the financial statements received equal rigor and attention to information included on the face of the statements.

Some preparers noted that there are operational concerns with recognizing fair value information in the financial statements and they believed it would take longer to issue financial statements with this requirement.  Many that had this view were concerned about the amount of time required to gather fair value information about illiquid and commercial loans.

The participants who supported measuring loan assets at fair value noted that fair value should not be discounted because some participants are concerned about reliability and it would provide investors with decision-useful information.

### *Categorization of 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 as disclosures while the classification and measurement of financial instruments should be solely focused on management's intent. They asserted that this would most accurately represent the eventual use of the financial instruments and would be the most relevant information.

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.

***Initial Measurement—Transaction Costs***

One investment company preparer 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. Another concern was that the expensing of transaction costs could cause book-to-tax differences for many investment companies, which would affect distribution amounts to shareholders. This participant favored transaction costs being included in the cost basis and recognized through unrealized gains/losses in the income statement and noted that it would be difficult to measure transaction costs that are not explicit.