MINUTES

Financial Accounting Standards Board

To: FASB Board Members

From: Maladtsova (x384)

Subject: May 9, 2011, Roundtable Minutes: Offsetting, Norwalk Morning Session **Date:** October 26, 2011

Topic: Proposed Accounting Standards Update: *Offsetting*

Length of Discussion: 9:00 a.m. to 12:00 p.m.

Attendance:

Outside Participants:

Linda Bergen	The Clearing House Association
Rose Cammarata-Barr	CME Group Inc.
Joseph Cascio	Ernst &Young
Chip Currie	PricewaterhouseCoopers LLP
Richard Dinkel	Koch Industries, Inc.
Michael Fehrman	Institute of International Finance
Randall Hartman	Constellation Energy Group, Inc.
Mike Kobida	CME Clearing
Samuel Lynn	Goldman Sachs
Steve Merriett	Federal Reserve Board
Jenifer Minke-Girard	SEC
Mona Nag	Morgan Stanley
Mark Newsome	ING Group
Dan Palomaki	International Swaps and Derivatives Association
Doug Pittera	UBS
Donald Robertson	Moody's Corporation
Laurin Smith	JPMorgan Chase & Co.
Enrique Tejerina	KPMG LLP
Bob Uhl	Deloitte Touche Tohmatsu Limited
Matt Waldron	CFA Institute

FASB and IASB Participants:

Leslie F. Seidman	FASB Chairman
Daryl E. Buck	FASB Board Member
Russell G. Golden	FASB Board Member

Thomas J. Linsmeier	FASB Board Member
R. Harold Schroeder	FASB Board Member
Marc A. Siegel	FASB Board Member
Lawrence W. Smith	FASB Board Member
Patricia McConnell	IASB Board Member
John T. Smith	IASB Board Member
Holly H. Barker	FASB Project Manager
Susan M. Cosper	FASB Technical Director
Melissa A. Maroney	FASB Project Manager
Chandy C. Smith	FASB Senior Investor Liaison
Kevin M. Stoklosa	FASB Assistant Director
Barbara Davidson (via video)	IASB Senior Technical Manager
Christian Kusi Yeboah	IASB Senior Technical Manager
Sue Lloyd (via video)	IASB Director of Capital Markets

Offsetting Criteria

1. Participants discussed the advantages and disadvantages of using gross and net presentation. Those who favored the gross presentation believe it allows for the right level of transparency and that it is better for uncollateralized instruments.

2. One participant noted that net presentation is misleading if competitors have different business models, relationships between netted derivatives may change, and if the accounting will change economics, then maybe accounting is not right today.

3. Those who favored net presentation believe that gross presentation is misleading from a credit risk and liquidity perspective and does not better inform users on counterparty risk. They also believe that presentation should reflect market exposure and that investors cannot make conclusions on market risk based on the balance sheet size.

4. One participant noted that neither net nor gross give any information on market risk. That information is in the footnotes.

5. Some participants believe that the U.S. GAAP model allows for the best presentation and that it is impossible to present relative derivative information for the derivatives on the face of the balance sheet. They believe that a special model for derivatives has its merits because it reflects the way derivatives are settled and managed. They believe that net presentation is better aligned with the Conceptual Framework. They noted that derivatives are not subject to stay in bankruptcy law and are not

available to general creditors even on a going concern basis. They also noted that derivatives are not offset in jurisdictions that do not have an ISDA opinion and that there has been no demand for a change in the model absent convergence.

6. A Board member asked if there was any concern that people only started asking about gross numbers last year. A participant responded that people only started asking because there is a potential change coming.

7. One participant noted that this project is a real concern of U.S. banks because the leverage ratio is based on total assets. The ratio is kept close to GAAP because GAAP is an independent measure. It would be an unprecedented move to change the ratio.

8. That participant also noted that neither gross nor net shows market risk, but the net numbers are used more often. Another participant agreed that the credit risk information from net numbers is not perfect, but it is good information.

9. Participants were not in agreement on whether they would prioritize a converged approach over a presentation approach they believe would be best for presentation on the face of the balance sheet.

Simultaneous Settlement and Unconditional and Legally Enforceable Right of Setoff

10. Participants briefly discussed the operationality of “simultaneous” netting. They believe it is very difficult to tell if something is settled at the same time.

11. Participants were concerned with the operationality of “unconditional.” Additional legal analysis would be needed to understand whether an unconditional right exists, and participants were not aware of any law firms that would be able to issue an opinion of unconditional. Participants noted that an alternative would be to say “current” and “insolvency” instead of unconditional. They also noted that currently IFRS preparers look to FASB Interpretation No. 41, Offsetting of Amounts Related to Certain Repurchase and Reverse Repurchase Agreements, to explain the IAS 32, Financial Instruments: Presentation, requirement for an unconditional right of offset.

Collateral

12. Participants discussed collateral issues. Some agreed that a distinction for collateral was necessary and supported setoff for clearinghouses and ISDA

master netting agreements. Participants said that if collateral is tantamount to settlement, then they consider it settlement. Many supported netting of collateral, noting that collateral drives the fair value of derivative instruments and that banks manage risks by taking posted collateral into account. One participant noted that netting collateral should be allowed for derivative instruments but should not be allowed for repurchase and reverse-repurchase agreements.

Linked Presentation

13. Participants discussed linked presentation and what that could entail. There was no consensus on whether a linked presentation would be a better option than gross or net presentation on the face of the balance sheet. One participant noted that users want both information, and one set without the other is misleading. As a result, some participants were in favor of linked presentation, or parenthetical presentation on the face of the balance sheet. Some suggested presenting a gross number in parenthesis. One participant suggested limiting linked presentation to derivatives and repurchase and reverse-repurchase agreements.

Unit of Account and Disclosures

14. Participants discussed the unit of collateral issues as they related to payment netting. Some suggested that credit risk, CVA and DVA disclosures should be addressed in a separate project. A number of participants disagreed with the requirements in paragraphs 12c and 12d of the Exposure Draft because they don't believe it is appropriate to have to search for accidental offsetting, and they noted that breaking out payment netting and close-out netting may be impossible as these amounts relate to the exact same transactions. Also, there are operational difficulties for providing disclosures by "class" of instrument (disclosures should be for derivative assets and liabilities because that's how netting agreements are written). Some participants suggested limiting the disclosures in the table to derivatives and repurchase and reverse-repurchase agreements. Participants also did not see the merits of disclosing different types of conditional rights.

15. Participants suggested some of the following changes:

    a. Disclosing cash collateral posted
    b. Disclosing net credit position by key counterparty

c. Disclosing non-cash collateral
d. Stratification by counterparty
e. Introducing a scope limitation to only include information that is pertinent to understanding risk management of netting arrangements.

<u>Transition and Costs</u>

16. Participants were concerned with how the proposed amendments would impact regulators and state and local agencies. One participant noted that the proposed amendments may create issues with the implementation of Basel III, but another noted that if U.S. GAAP and IFRS are the same, Basel committee may revisit use of non-accounting numbers for leverage calculations.

17. Participants did not agree with the proposed changes to receivables and payables from unsettled regular-way trades. They also noted that there are no systems right now to accommodate the proposed changes because receivables and payables are not individually tracked unless something fails. Because these items are only grossed when failures occur, it would be hard to adopt the amendments retrospectively.

18. Participants also noted that they had concerns about the time that would be required to update systems to comply with the proposed offsetting criteria. Some said that they would require a couple of years to implement the necessary systems to make payment netting requirements operational. This time would also be necessary to understand and apply the following:

    a. Legal opinions
    b. Payment netting
    c. Trade date receivable/payable netting
    d. Scope of disclosures will have an impact
    e. Several years to implement before comparatives start.

19. Some participants noted that if the Boards wanted a faster implementation period, then they should not require a retrospective approach. Participants were split in their views on whether this project should be effective with the other major projects as part of a big bang approach, or whether this project should be effective sooner.