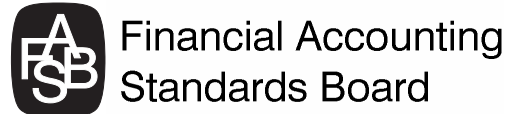


## MINUTES



**To:** Board Members  
**From:** Fair Value Option Team  
(Cronin, ext. 443)  
**Subject:** Minutes of the October 19, 2005 Fair Value Option Board Meeting  
**Date:** October 25, 2005  
**cc:** Bielstein, Smith, Petrone, Leisenring, Fair Value Option Team, Fair Value Measurements Team, Gabriele, Carney, Polley, Swift, FASB Intranet

Topic: A Debtor's Recognition of Changes in Its Creditworthiness in Valuing Liabilities

Basis for Discussion: Board Memorandum No. 9 dated September 27, 2005

Length of Discussion: 9:30 a.m. to 10:00 a.m.

Attendance:

Board members present: Herz, Batavick, Crooch, Schipper, Seidman, Trott, and Young

Staff in charge of topic: Wilkins

Other staff at Board table: Barker, Cronin, Golden, Murphy, L. Smith

Outside participants: None

**Summary of Decisions Reached:**

The Board discussed several approaches for possibly curtailing the debtor's recognition of the portion of a liability's changes in fair value that is attributable to changes in its own creditworthiness in conjunction with reporting liabilities at fair value. The Board rejected any such curtailment regarding the effect of changes in the debtor's creditworthiness. This decision applies to derivative liabilities reported at fair value under FASB Statement No. 133, *Accounting for Derivative*

*Instruments and Hedging Activities*, as well as any other liabilities reported at fair value, such as those for which the fair value option (FVO) will have been elected.

The Board also held preliminary discussions about specific disclosures related to liabilities that are reported at fair value and the portion of the fair value change that is attributable to changes in the debtor's creditworthiness. Although the Board indicated preliminary support for disclosing the difference between the carrying amount of a financial liability and the amount the entity would be contractually required to pay at maturity to the holder of the obligation, no decisions regarding disclosures were made at this time. Instead, disclosures will be addressed comprehensively later in the Board's deliberations on the FVO project.

**Objectives of Meeting:**

The objective of the meeting was for the Board to decide whether it wishes to curtail in some fashion the effect of changes in its own creditworthiness in reporting liabilities at fair value. The objective of this meeting was met.

**Matters Discussed and Decisions Reached:**

***Discussion on Potential Curtailment***

1. Mr. Wilkins stated that the Board originally discussed whether it wished to recognize the portion of the change in fair value of an entity's liabilities that is attributable to a change in the entity's own creditworthiness at its Board meeting in June 2005. At that time, some Board members vocalized the need for additional information in order to reach a decision. In response to this request, the staff met with the Creditworthiness Resource Group in September to obtain the desired information.
2. Mr. Wilkins stated that the staff has identified four possible approaches that warrant the Board's consideration. (Those approaches are described in the attached Board meeting handout.) He noted that the staff maintains its original recommendation that there be no curtailment imposed on the recognition of the

portion of the change of a liability's fair value attributable to changes in the debtor's creditworthiness. This treatment would apply both in the application of the recognition of changes in fair value for derivatives that are in a liability position under Statement 133 as well as those liabilities for which the FVO will have been elected.

3. Ms. Schipper stated that she supports the no curtailment approach because it asserts that a liability that is remeasured at fair value is truly measured at fair value. Ms. Schipper rejected the OCI approach that will remeasure liabilities at fair value but recognize a portion of the change in fair value in other comprehensive income. She stated that it is impracticable to separate the portion of the change due to creditworthiness in an unambiguous and useful manner. Additionally, she noted her belief that there is no conceptual basis for placing items in other comprehensive income. Ms. Schipper noted that the dual-attribute approach is similar to the OCI approach in that it would necessitate pulling out the portion of a change in fair value that is due to creditworthiness. She objected to this approach for the same reasons as she did the OCI approach. Finally, Ms. Schipper said that she does not support the suspension approach because establishing certain triggers would create new bright lines and rules that must be applied.

4. Messrs. Batavick, Trott, and Crooch expressed their support for the no curtailment approach. Mr. Crooch noted that his support for this approach is due to the fact that a decision to measure financial instruments at fair value means that an instrument's value should incorporate all of the characteristics that are embodied in that particular security. Mr. Batavick agreed with Ms. Schipper that the other approaches have conceptual and implementation issues.

5. Ms. Seidman noted that her concerns—about the lack of understandability of the financial statements taken as a whole when there is a gain being recognized from a deterioration of creditworthiness—do not appear to be widely shared among the participants in the Creditworthiness Resource Group. Therefore, she stated that she does not object to the no curtailment approach. Ms. Seidman

also requested that a question be added in the notice for recipients that highlights this issue and asks for additional feedback because it is important to raise the awareness of this issue outside of the financial services community (since the FVO will be available to all entities). Additionally, she stated that she would like to express her views in a new paragraph in the basis for conclusions.

6. Mr. Herz endorsed Ms. Seidman's suggestion to highlight this issue in the notice for recipients. He noted the importance of soliciting additional feedback from other constituents since most of the participants at the Creditworthiness Resource Group meeting worked in the financial services industry and because most of their conversation revolved around the treatment for derivatives.

7. Mr. Young stated that the small subset of users that participated in the Creditworthiness Resource Group meeting did not support the fair value representation. He noted that comments made at that meeting indicated that sell-side analysts prefer to use the contractual obligation amount. Mr. Young stated that the dual-attribute approach would be the only acceptable option from a user perspective. Mr. Young noted that the original goal of the FVO project was to avoid reporting volatility in earnings that resulted from different measurement attributes. He expressed his concern that this elective option could potentially create a more complex set of financial statements by detracting from transparency. Mr. Trott noted that the FASB received information from the CFA Institute that specifically addressed this concern. He said that it specifically stated that the recognition of changes in credit standing was neither counterintuitive nor confusing.

8. Ms. Seidman stated that not all assets are recognized and that even the ones that are recognized might not be measured for impairment using a current fair value approach. Therefore, a lag or a mismatch could arise as to the recognition of the cause of the deterioration of creditworthiness.

9. Ms. Schipper stated that the Board has already received several types of due process input on this issue. For example, the FASB received a number of comment letters on its Exposure Draft of the fair value measurement (FVM)

Statement, which contained the same notion as presented in the no curtailment approach. She also pointed out that constituents were given an opportunity to express their views on this topic at public roundtable meetings for the FVM Statement in September 2004. Mr. Herz noted that much of this input was divided and related specifically to the FVM project.

### ***Discussion on Disclosure Requirements***

10. Mr. Wilkins stated that the second issue involves two disclosures that were discussed at the June meeting. He noted that those potential disclosures would be appropriate given the fact that the Board has decided not to curtail the recognition in earnings of the portion of a change in fair value that is due to a change in creditworthiness of the debtor. He also noted that those two disclosures would be convergent with the IASB requirements in this area. He noted that the staff intends to comprehensively address the area of disclosure later in the FVO project; therefore, this preliminary discussion focuses on only a portion of the total disclosures that might be required as a result of this project.

11. Ms. Schipper expressed her support for the first disclosure, which would show the difference between the carrying amount and the amount the entity would be contractually required to pay at maturity to the holder of the obligation. She said that she would need to give more thought to cases where a liability does not have a contractual maturity date. Ms. Schipper stated that she is not in favor of the second disclosure, which would display the amount of change during the period and cumulatively in the fair value of the financial liability that is attributable to changes in credit risk. She noted that although the FASB could prescribe a calculation, she is unable to come up with the economic basis for that calculation. Furthermore, several calculations could be developed, each of which could be described as separating out this portion of the fair value, and none of which would be conceptually defensible. She recognized that this disclosure requirement must be considered in context of the FVM project. Also, she noted that there is work being done on FASB Interpretation No. 39, *Offsetting of*

*Amounts Related to Certain Contracts*, which could potentially lead to another package of disclosures.

12. Ms. Seidman also expressed her support for the first disclosure. In regard to the second disclosure, which she noted has been controversial in the world arena, she would prefer to include a more principle-based disclosure that requires an entity that has designated a financial liability for the fair value option and experiences a significant change in creditworthiness to disclose an approximation of the amount of change attributable to a change in credit risk. Thus, this disclosure would have very limited applicability for only those situations in which an issuer's creditworthiness has changed significantly.

13. In addition to Ms. Schipper and Ms. Seidman, Mr. Crooch also expressed his support for the first disclosure. He stated that he supports the second disclosure for convergence purposes but that he has concerns as to whether the disclosure would be comparable across entities.

14. Mr. Young noted his belief that these disclosures are too narrow and therefore supports more thorough disclosure of situations in which remeasurement has impacted earnings with respect to both assets and liabilities.

15. Mr. Batavick stated that he would prefer the information in the first disclosure, if practicable, to be located on the face of the financial statements as opposed to in a footnote. Mr. Herz concurred with that preference. In regard to the second disclosure, Mr. Batavick stated that he has not seen evidence to suggest that the portion of a change in fair value due to a change in credit risk can be reliably isolated. However, he asserted that he would be open to further exploration of Ms. Seidman's suggestion to disclose the effect of any significant changes in creditworthiness. Mr. Herz also indicated his support for Ms. Seidman's suggestion and noted that both significant increases and decreases in fair value should be disclosed.

16. Mr. Wilkins stated that the Board members' views expressed on the two proposed disclosures would be considered as preliminary and those two

disclosures would be included as a part of the comprehensive discussion of all disclosures for the FVO project. Mr. Trott stated his desire to coordinate further discussions on this issue in order to avoid requesting effectively the same information in three different places.

**Follow-up Items:**

17. None

**General Announcements:**

18. None.



Financial Accounting Standards Board

**Board Meeting Handout  
Fair Value Option Project  
October 19, 2005**

The Board will discuss whether it wishes to curtail in some fashion the debtor's recognizing the effect of changes in its own creditworthiness in reporting liabilities at fair value (primary issue). This issue applies to derivative liabilities reported at fair value under FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and those liabilities for which the fair value option (FVO) will have been elected. The Board will also consider whether some special disclosures should be required for liabilities that are reported at fair value through earnings if it decides not to curtail the debtor's recognition in earnings of the effect of changes in its creditworthiness on the fair value of its liabilities (secondary issue).

**Primary Issue**

The Board will consider the following four alternatives regarding the possible curtailment on recognizing the effect of changes in the debtor's own creditworthiness:

1. ***The OCI Approach*** — The portion of the change in the liability's fair value attributable to changes in the debtor's creditworthiness would be reported in accumulated other comprehensive income (OCI), while the remainder of the change in fair value would be reported in earnings.
2. ***The Suspension Approach*** — The fair value measurement attribute would be applied to the debtor's liability until a triggering event or circumstance (such as the debtor's filing for bankruptcy) arose that would

---

The staff prepares Board meeting handouts to facilitate the audience's understanding of the issues to be addressed at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect the views of the FASB or its staff. Official positions of the FASB are determined only after extensive due process and deliberations.

preclude the continued use of the fair value measurement attribute for liabilities, at which time another measurement attribute (perhaps one that excluded the effect of changes in the debtor's creditworthiness) would need to be applied.

3. ***The Dual-Attribute Approach*** — Debtors would be prohibited from ever using the fair value measurement attribute for reporting their liabilities (but not assets) but could use a fair value-derived attribute that excluded the effect of changes in the debtor's creditworthiness.
4. ***The No Curtailment Approach*** — The entire change in the fair value of liabilities would be treated consistently without any differentiation regarding the components of the overall change.

### **Secondary Issue**

If the Board decides not to curtail the debtor's recognizing in earnings the effect of changes in its creditworthiness in reporting liabilities at fair value when the FVO has been elected, the Board will consider whether to require additional disclosures regarding the liabilities reported at fair value (due to election of the FVO or application of Statement 133 to derivative liabilities). Two possible disclosures the Board might consider, both of which are required by the IASB, are as follows:

1. Disclosure of the difference between the carrying amount of the financial liability and the amount the entity would be contractually required to pay at maturity to the holder of the obligation (Cf. IAS 32, par. 94(h)(ii))
2. Disclosure of the amount of change during the period and cumulatively in the fair value of the financial liability that is attributable to changes in credit risk. (Cf. IAS 32, par. 94(h)(i))

