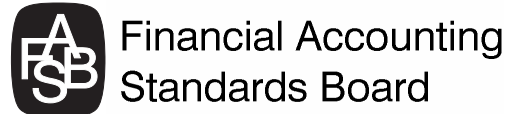


## MINUTES



**To:** Board Members

**From:** Fair Value Option Team  
(Cronin, ext. 443)

**Subject:** Minutes of the December 14, 2005 Fair Value Option and Servicing of Financial Assets Board Meeting      **Date:** December 22, 2005

**cc:** Bielstein, Smith, Petrone, Leisenring, Fair Value Option Team, Fair Value Measurements Team, Gabriele, Carney, Polley, Swift, 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.*

Topic: Fair Value Option and Servicing of Financial Assets

Basis for Discussion: Board Memorandum No. 13 dated December 9, 2005

Length of Discussion: 9:15 a.m. to 9:30 a.m.

Attendance:

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

Staff in charge of topic: Wilkins

Other staff at Board table: L. Smith, Lott, E. Smith, Belcher, Bergstrom

Outside participants: None

**Summary of Decisions Reached:**

The Board discussed financial statement presentation requirements for assets and liabilities reported at fair value due to the reporting entity's having elected fair value as the subsequent measurement attribute. The Board decided:

1. In each statement of financial position presented, an entity should report its assets and liabilities that are subsequently measured at fair value in a manner that separates those reported fair values from the carrying amounts of assets and liabilities subsequently measured using another measurement attribute. To accomplish that separate reporting, an entity may either (a) display separate line items in an entity's statement of financial position for the fair value and non-fair-value carrying amounts or (b) present amounts that aggregate those fair value and non-fair-value amounts provided that those fair value and non-fair-value amounts are separately disclosed parenthetically on the face of the entity's statement of financial position. The following projects will include this requirement: fair value option, servicing rights, life settlements, and hybrid financial instruments. The fair value option project will amend FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, to require that securities reported at fair value in accordance with Statement 115 satisfy this financial statement presentation requirement.
2. For each period for which an income statement is presented, an entity should provide information that will allow users to understand the impact of changes in the fair values of assets and liabilities subsequently measured at fair value as a result of a fair value election. This general principle will be included in the life settlements project, the hybrid financial instruments project, and the FVO project.

**Objectives of Meeting:**

The objective of the meeting was for the Board to consider whether to prohibit the aggregation of heterogeneous amounts (specifically, fair value and non-fair-

value amounts) in both the statement of financial position and the income statement, focusing on those fair value amounts resulting from the optional election of the fair value subsequent measurement attribute. The Board also discussed whether the potential for inconsistency in the display requirements should be eliminated, which could involve changing the display provisions of Statement 115.

**Matters Discussed and Decisions Reached:**

1. At the December 7, 2005 Board meeting, the Board decided that for financial assets and financial liabilities that are reported at fair value pursuant to the forthcoming guidance on the fair value option (FVO) project and the life settlement contracts project, fair value carrying amounts should not be aggregated on the balance sheet with non-fair-value carrying amounts of similar financial assets or similar financial liabilities. However, in three other projects/standards that permit the elective use of an FVO with changes in fair value reported in earnings (namely, Statement 115 and the projects on hybrid financial instruments and servicing rights), such aggregation is not prohibited. Mr. Wilkins noted that the staff was unable to discern a rationale for this disparate treatment and, therefore, wanted Board members to discuss whether they wanted to retain this inconsistency.

2. Board members decided that an entity's display of its elective use of fair value for subsequent measurement should be consistent for life settlements, hybrid financial instruments, servicing rights, Statement 115 trading securities, and instruments discussed in the FVO project. (Please refer to the December 14, 2005 hybrid financial instruments minutes for a detailed account of this discussion.) The Board decided that an entity may either (a) display separate line items in an entity's statement of financial position for the fair value and non-fair-value carrying amounts or (b) present amounts that aggregate those fair value and non-fair-value amounts provided that those fair value and non-fair-value amounts are separately disclosed parenthetically on the face of the entity's statement of financial position.

3. Mr. Wilkins asked the Board to consider whether to include in the FVO Exposure Draft a proposed amendment to Statement 115 that would require similar disclosure on the face of the statement of financial position, either parenthetically or by separate line item, to distinguish between securities that are recorded at fair value and those that are recorded at historical cost. Ms. Seidman proposed an elimination of the Statement 115 Q&As that allow an election for use of the trading category. Therefore, if an entity wants to elect fair value for a security, it must do so according to the provisions of the FVO document, which would result in any election being subject to the same display requirements. Mr. Wilkins noted that this approach would require entities to distinguish between securities that are required to be carried at fair value due to the provisions of Statement 115 and securities that have been elected to receive fair value treatment. He stated that this additional disclosure would add an increased level of complexity to the FVO document.

4. The Board also decided that for each period for which an income statement is presented, an entity should provide information that will allow users to understand the effect of changes in the fair values of assets and liabilities subsequently measured at fair value as a result of a fair value election. (Please refer to the December 14, 2005 hybrid financial instruments minutes for a detailed account of this discussion.)

**Follow-up Items:**

None.

**General Announcements:**

None.



Financial Accounting Standards Board

**Board Meeting Handout  
Fair Value Option Project  
November 22, 2005**

The Board will discuss the following issues regarding the scope of the fair value option (FVO) project and the election of the FVO:

**ADDRESSING THE SCOPE OF THE PROJECT IN TWO PHASES**

The Board will discuss splitting the FVO project into two phases: Phase 1 would address creating an FVO for financial assets and financial liabilities, whereas Phase two would address creating an FVO for selected nonfinancial items.

**SCOPE EXCEPTION FOR LIABILITIES FOR INCOME TAXES**

The Board will consider whether the liability for income taxes (both current and deferred) should be explicitly excluded from the scope of the project. The staff is recommending that the FVO election not be available for the liability for income taxes (both current and deferred). The principal reason for the staff's recommendation is its belief that permitting the liability for income taxes to be reported at fair value with changes recognized in earnings would significantly undermine FASB Statement No. 109, *Accounting for Income Taxes*.

**APPLYING THE FVO TO UNRECOGNIZED FIRM COMMITMENTS  
INVOLVING FINANCIAL INSTRUMENTS**

The Board will consider permitting the FVO election for financial firm commitments that would otherwise not be recognized at inception under GAAP, thereby effectively permitting the recognition of an otherwise unrecognized firm commitment involving the exchange of one financial instrument for another financial instrument. (An example of a financial firm commitment that would

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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.

otherwise be unrecognized is a forward contract to purchase a loan that satisfies the definition of a *firm commitment* in FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, if it is not accounted for as a derivative (that is, it requires gross settlement involving the delivery of a financial instrument not readily convertible to cash.) Because of the difficulties in gauging the level of constituent interest in this issue, the staff recommends that the Exposure Draft (for Phase 1 if the Board decides to split the project into two phases) not include provisions that permit the FVO election for financial firm commitments that would otherwise not be recognized at inception under GAAP. However, the staff further recommends that the notice to recipients include a multi-part question asking for information that the Board would find useful in making a decision about this issue.

**AVAILABILITY OF THE FVO ELECTION BY NONPUBLIC ENTITIES THAT HAVE ELECTED THE STATEMENT 126 EXCEPTION**

FASB Statement No. 126, *Exemption from Certain Required Disclosures about Financial Instruments for Certain Nonpublic Entities*, amends FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*, to make the fair value disclosures optional for entities that meet all of the following criteria: (1) the entity is a nonpublic entity, (2) the entity's total assets are less than \$100 million on the date of the financial statements, and (3) the entity has no instrument that, in whole or in part, is accounted for as a derivative contract under Statement 133 other than commitments related to the origination of mortgage loans to be held for sale during the reporting period. The Board will consider whether to make the FVO election available to nonpublic entities that have elected the Statement 126 exception from disclosing the fair value of all financial instruments. Because the FVO election may be applied on an instrument-by-instrument basis, the staff recommends that the Board affirm that the FVO election can be applied by entities that have elected the Statement 126 exception.

**REQUIRED TIMING AND DOCUMENTATION OF THE FVO ELECTION** The

Board will consider the following issues and provide further explicitness as to its previous deliberations:

1. ***The irrevocability of the FVO election.*** Implicit in the Board's earlier deliberations was that the FVO election was irrevocable, that is, once an entity elected to use fair value as the subsequent measurement attribute for a specific asset or liability, that item must continue to be reported at fair value until derecognition, such as when the asset is sold or the liability is settled. The staff recommends that the Board reaffirm that the FVO election is irrevocable.
2. ***Concurrent documentation.*** The Board previously decided that the FVO election must be made at the entity's initial recognition of the affected asset or liability. Because an election must be made by a specified point in time, the staff believes that decision implicitly incorporates a notion that concurrent documentation is required to support the entity's election. The staff recommends that the Board reaffirm that concurrent documentation is required to support the entity's election of the FVO at initial recognition of the affected asset or liability.
3. ***Interaction with business combinations.*** Business combinations accounted for under FASB Statement No. 141, *Business Combinations*, are accounted for by the purchase method. Those business combinations involve the acquisition of assets and the assumption or incurrence of liabilities, which constitutes the initial recognition of those assets and liabilities for purposes of electing the FVO. The staff recommends that the Board affirm that the acquiring entity's decision whether to elect the FVO for specific assets acquired and liabilities assumed or incurred is not affected by any previous election of the FVO by the entity that was acquired in the business combination.
4. ***Interaction with changes in consolidation.*** If a subsidiary is newly consolidated, such consolidation represents the initial recognition of those

assets and liabilities by the consolidated reporting entity. Additionally, sometimes a variable interest entity (VIE) is newly consolidated because the “parent” company becomes its primary beneficiary under FASB Interpretation No. 46, *Consolidation of Variable Interest Entities*. The staff recommends that the Board decide that when the assets, liabilities, and noncontrolling interests of an investee (or VIE) are newly consolidated, the FVO may be elected (as permitted by the scope of the project) at the time that consolidation is determined to be required.