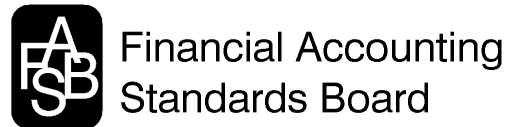


MINUTES



To: Board Members
From: Chesney (ext. 447)
Subject: Minutes of the December 20, 2007 Board Meeting: Statement 133 Hedging **Date:** January 14, 2008
cc: Leisenring, Bielstein, Golden, Cassel, Derivatives Implementation Team, Financial Instruments Team, Lott, Chookaszian, Posta, MacDonald, Mayrhofer, FASB Intranet (e-mail)

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, Interpretation, or FSP.

Topic: Statement 133 Hedging
Basis for Discussion: Board Memorandum No. 5
Length of Discussion: 8:00 – 9:45 a.m.
Attendance:
Board members present: Batavick, Crooch, Herz, Seidman, Smith, and Young
Board members by phone: Linsmeier
IASB members present: Leisenring
Staff in charge of topic: Stoklosa and Malcolm
Other staff at Board table: Drum, Golden, C. Smith, and Wilkins
Outside participants: None

Summary of Decisions Reached:

The Board continued its deliberations of the hedging project to amend FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as follows:

1. *Foreign currency hedge accounting model.* The Board decided to retain the ability that currently exists in Statement 133 for an entity to designate the risk of changes in fair value attributable to changes in foreign currency exchange rates in a fair value hedge. The Board also decided to retain the ability that currently exists in Statement 133 for an entity to designate the risk of changes in functional-currency-equivalent cash flows attributable to changes in foreign exchange rates in a cash flow hedge. The current Statement 133 guidance related to net investment hedges was also retained. For entities hedging its own issued debt at inception, the Board decided to permit an entity to designate foreign currency exchange risk or a combination of foreign currency exchange rate risk and interest rate risk in addition to just designating interest rate risk as the hedged risk.
2. *Dedesignation of hedging relationships.* The Board decided that entities should not be permitted to discontinue fair value hedge accounting or cash flow hedge accounting by simply removing the designation of the hedging relationship.
3. *Reclassification of Amounts in OCI.* The Board decided that entities would not be permitted to elect the fair value option for a debt instrument upon its issuance if the entity designated a cash flow hedge for the forecasted issuance of that debt.
4. *Disclosures.* The Board decided to require the following two disclosures:
 - a. A reconciliation between the carrying value of hedged items at the end of the reporting period and what the carrying value would have been prior to any cumulative fair value adjustments.
 - b. As part of an entity's debt disclosure, (1) that it uses derivative contracts (interest rate swaps) to convert a portion of its fixed rate debt to variable rate debt and

variable rate debt to fixed rate debt, (2) how the maturity structure of the derivatives correspond to the maturity structure of the debt being hedged, and (3) the overall weighted average interest rate on a contractual basis and including the effects of derivatives.

- c. *Effective date and transition.* The Board decided that the proposed Statement should be effective for fiscal years beginning after November 15, 2008, and that earlier application would not be permitted. The Board decided that (1) prospective application of the guidance in the proposed Statement would be required for fair value hedges and (2) limited retrospective application (cumulative catch-up) would be required for cash flow hedges.
- d. *Fair value option election.* The Board decided that a one-time fair value option election be permitted at the initial adoption of the proposed Statement for eligible assets and liabilities currently hedged under Statement 133.

The Board authorized the staff to proceed to a draft of an Exposure Draft for vote by written ballot.

Objective of Meeting:

The objective of the meeting was to discuss (a) the fair value hedging approach in the context of foreign currency hedges, (b) what is meant by dedesignation for cash flow and fair value hedges, (c) how amounts in OCI would be reclassified to earnings upon dedesignation, termination, and occurrence of the forecasted transaction in cash flow hedging situations, (d) what disclosures would be required, and (e) effective date and transition. The objective was met.

Matters Discussed and Decisions Reached:

FOREIGN CURRENCY HEDGES

1. Mr. Stoklosa said that the proposed fair value hedging model requires designation of all risks as the hedged risk. He also said that the Board decided to permit an exception for entities hedging their own debt and to allow designation of only interest rate risk as the hedged risk for an entity's own debt. Mr. Stoklosa said that the accounting effect of FASB Statement No. 52, *Foreign Currency Translation*, creates a need for a similar exception for foreign currency risk in foreign currency hedges.

Staff Recommendation

2. The staff recommended that the current hedge accounting guidance allowing the designation of only foreign currency risk as the hedged risk be retained for the proposed hedge accounting approach. This would require entities to designate either foreign currency risk or all risks as the hedged risk. For hedges of an entity's own foreign-currency denominated debt, this would allow entities to designate foreign currency risk, both interest rate risk and foreign currency risk, or all risks as the hedged risk, in addition to only interest rate risk. Designation of both interest rate risk and foreign currency risk would have to be documented at the inception of the debt.

Board Vote

3. The Board unanimously supported the staff's recommendation. Ms. Seidman noted that she supported the recommendation on the basis that it is consistent with the proposed fair value approach to hedge accounting.

Board Comments

4. Mr. Young stated that he supports a synthetic instrument approach for interest rate risk; however, he does not support a similar approach for foreign currency risk. Mr. Stoklosa noted that the staff was not making an argument for a synthetic instrument approach for foreign currency hedges. The staff proposed allowing the ability to hedge only foreign currency risk rather than changing the guidance in Statement 52, which allows the isolation of foreign currency risk.
5. Mr. Linsmeier suggested that the model be simplified by not permitting fair value hedges of foreign currency risk. He said these items are marked on a spot-to-spot basis and therefore hedge accounting is not necessary to achieve a hedging result. Mr. Stoklosa agreed and said that while few, if any, use hedge accounting for these items since Statement 52 achieves the same outcome, eliminating these items would cause confusion and would not simplify the proposed approach. Mr. Smith agreed that layering another exception on the ability to hedge only foreign currency risk would add complexity.

DEDESIGNATION OF HEDGING RELATIONSHIPS

6. Ms. Malcolm stated that the Board asked the staff to reevaluate the situations in which a hedge can be terminated. Statement 133 prospectively discontinues hedge accounting if

the forecasted hedged transaction in a cash flow hedge is no longer probable of occurring, the hedged item in a fair value hedge is derecognized, the hedging relationship is no longer effective, or the derivative is terminated or settled. The staff considered these situations to be terminated hedges. Ms. Malcolm noted that Statement 133 also prospectively discontinues hedge accounting if an entity continues to hold an effective derivative and be exposed to the hedged risk, but elects to dedesignate the hedging relationship through documentation. The staff considered these situations to be dedesignated hedges.

Staff Recommendation

7. The staff recommended no changes to current accounting for terminated hedges and that entities entering into an offsetting derivative to effectively terminate a hedging relationship document their intent to terminate the hedge. The staff also recommended that entities no longer be permitted the ability to dedesignate hedges. If the Board decided to allow dedesignation of cash flow hedges, the staff recommended that amounts in OCI associated with the cash flow hedge be reclassified according to the current guidance in Statement 133.

Board vote

8. The Board unanimously supported the staff's recommendation.

Board Comments

9. Mr. Young asked how hedges terminated using an offsetting derivative would be presented in the new disclosures required in the derivatives disclosure project so that users can understand the entity's hedging activities. Mr. Stoklosa noted that both the derivative that formerly was designated as a hedging instrument and the offsetting derivative would be presented as non-hedging derivatives in the entity's derivatives disclosures. Mr. Golden stated that derivatives designated as hedging instruments would have different disclosures than those not part of a hedging relationship, even if the derivatives are the same.
10. Mr. Leisenring noted that, when designating a hedge, entities are not required to ensure or document that they do not hold a derivative that offsets the designated derivative hedging instrument. He asked what would happen if an entity entered into an offsetting derivative and did not document a terminated hedge. Ms. Malcolm noted that the

derivative designated as the hedging instrument would continue to obtain Statement 133 hedge accounting treatment and offset the hedged item or hedged forecasted transaction to the extent it is effective. The offsetting derivative would not obtain Statement 133 hedge accounting treatment and the gains and losses on that derivative not designated as a hedging instrument would flow through earnings.

11. Mr. Leisenring stated that he did not agree with justifying not allowing dedesignation of fair value hedges on the basis that it allows earnings manipulation, since dedesignation results in a prospective change to the hedge accounting; therefore, entities could not guarantee a desired result through dedesignation. Mr. Stoklosa stated that the purpose of not permitting dedesignation is to prevent entities from reporting financial information as if the economics of relationship between the hedging instrument and the hedged item (forecasted transaction) changed when in fact they did not. Mr. Leisenring said that entities could achieve the same effect as dedesignation by terminating the derivative and entering into another similar derivative. Mr. Smith agreed that entities could achieve the same effect by entering into another derivative; however, that is a result of a mixed attribute model and, in this project, we should not promote the ability to pick and choose measurement attributes at will. Ms. Seidman added that not allowing dedesignation is analogous to the irrevocability of the fair value option. Ms. Seidman asked whether entities commonly dedesignate effective hedges. Mr. Young and Mr. Herz both noted that the practice is common.
12. Mr. Herz and Mr. Smith noted that the situations in which a hedge can be terminated and those in which a hedge can be dedesignated should be distinguished within the standard.

RECLASSIFICATION OF DEFERRED GAINS AND LOSSES IN OCI ASSOCIATED WITH CASH FLOW HEDGES

13. Ms. Malcolm reminded the Board of its previous decision to include financial instruments within the scope of the fair value hedging approach, which raises issues regarding the interaction between the proposed hedge accounting model and FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. In situations where an entity designates a cash flow hedge of the forecasted issuance or purchase of a financial instrument and then subsequently elects the fair value option for

that instrument, an entity must determine how to recognize any gains or losses deferred in OCI associated with the cash flow hedge.

14. Ms. Malcolm noted that the staff proposed three alternatives for accounting for the deferred gains and losses:
- a. Require that gains and losses be immediately reclassified to earnings and disclosed when the entity elects the fair value option
 - b. Require entities to reclassify amounts in OCI based on a schedule of how the instrument would have affected earnings if the fair value option was not elected
 - c. Amend Statement 159 to not permit entities the ability to elect the fair value option for financial instruments for which a cash flow hedge had been documented prior to recognizing the asset or liability.

Staff Recommendation

15. The staff recommended that the fair value option not be allowed for items for which cash flow hedges were documented prior to recognition, which avoids the possible earnings manipulation under the first alternative and the need to reclassify on a scheduled basis under the second alternative.

Board Vote

16. The Board unanimously supported the staff's recommendation.

DISCLOSURES

17. Ms. Malcolm noted that the derivatives disclosures project developed a table [see Appendix] that reconciles between the balance sheet carrying value absent any fair value adjustments and the carrying value including fair value adjustments for items involved in fair value hedge accounting and distinguishes fair value adjustments resulting from fair value hedge accounting from other fair value adjustments. Ms. Malcolm noted that this table was not included in the derivatives disclosures project so that the disclosures standard would not need to be reexposed; the table could instead be exposed in the Exposure Draft for the hedging project. During a small group meeting, a Board member suggested that the information be disclosed in the footnote of the related items rather than in a prescribed table. For example, information related to the fair value adjustments of inventory would be included in the inventory footnote.

18. Ms. Malcolm also noted that the Board's previous decision to allow entities to hedge only interest rate risk in its own debt creates a need for more robust debt disclosures. Information that would be useful includes disclosure of the use of derivatives to convert fixed-rate debt to variable-rate debt and variable-rate debt to fixed-rate debt, how the maturity structure of the derivatives correspond to the maturity structure of the hedged debt, and the overall weighted average interest rate on a contractual basis and including the effects of derivatives.

Staff Recommendation

19. The staff recommended that the Board require information included in the table from the derivatives disclosure project to be disclosed, but not to require that the information be presented in tabular form. The staff also recommended that entities be required to disclose within their debt disclosure the use of derivatives to convert fixed-rate debt to variable-rate debt and variable-rate debt to fixed-rate debt, the maturity structure of the derivatives and hedged debt, and the overall weighted average interest rate.

Board Vote

20. The Board agreed that the information included in the table developed in the derivatives disclosures project be required, but not necessarily in a tabular form. Mr. Crooch noted that he preferred a tabular format. The Board suggested that the Exposure Draft include examples of the information both in a tabular form and within the related footnote. The Board also voted unanimously to require the proposed debt disclosures.

Board Comments

21. Mr. Smith noted that the information presented in the table is more related to the hedged item than the derivative; therefore, it would make more sense to include it in a footnote related to the hedged item.
22. Mr. Linsmeier suggested that the information be required in a tabular form within the footnote about the hedged item to ensure compliance. Ms. Seidman suggested a compromise that would require the information to be included within the related footnote and in a table if there was not a footnote for the hedged item. Mr. Linsmeier stated that he would accept such a compromise.
23. Mr. Herz reminded the Board to consider that the required information would need to be tagged for XBRL; a table could easily be recreated from the tagged information. Ms.

Seidman stated that the information should be presented such that all information related to the hedged item, including information about the hedging relationship, would be picked up by the tags.

24. Mr. Young noted that the Board has discussed as part of the financial statement presentation project whether items with different measurement bases should be presented separately, which was done for the fair value option. Mr. Young noted that the proposed debt disclosure would result in the information being disclosed separately within the footnotes; however, he asked if the Board should consider presenting hedged debt separately from non-hedged debt in the statement of financial position. Ms. Seidman added that this basis for separate presentation could be true of all hedged items, since most hedged items will be at fair value under this model; the question is really whether any hedged item should be separated from related items that are not hedged. Mr. Golden noted that the objective of the financial statement presentation project is to make volatility more readily apparent for all items on the balance sheet, not just derivatives and items being hedged; the staff had not considered requiring such a change on the financial statements as part of this project. Mr. Herz added that the different disclosures required by FASB Statement No. 157, *Fair Value Measurements*, and Statement 159 will also provide useful information.

EFFECTIVE DATE

Staff Recommendation

25. The staff recommended an effective date of fiscal years beginning after November 15, 2008 and that earlier application should not be permitted. The staff anticipates an Exposure Draft to be issued during the first quarter of 2008 and a final standard to be issued near the end of the second quarter of 2008.

Board Vote

26. The Board unanimously agreed with the staff's recommendation, given that constituents will have the opportunity to comment on the effective date.

Board Comments

27. Mr. Batavick asked whether the staff has spoken with constituents about the practicability of the proposed effective date. Mr. Batavick expressed concern that entities would not

have enough time to inventory all their positions. Mr. Herz agreed that practicability should be considered when determining the effective date, but some constituents preferring early adoption would not want the effective date extended to 2009. Mr. Golden noted that the staff has not had the opportunity to contact constituents; however, in compliance with FASB policy, the Notice to Recipients specifically will request comments on the effective date given the proposed issue date. Mr. Golden stated that delaying the effective date of a simplification standard would not seem to correlate with the notion of a simplification project.

TRANSITION

28. Ms. Malcolm noted that FASB policy requires consideration of retrospective application first for new standards. However, the staff does not believe that retrospective application would be practicable for adopting the proposed model, primarily because retrospective application would be difficult to apply for prior periods during which the derivative and hedged item or forecasted transaction did not qualify for hedge accounting (under the new model).

Staff Recommendation

29. The staff recommended a prospective adoption for fair value hedges, which would require entities to prospectively record in earnings changes in fair value attributable to all risks.
30. The staff recommended a modified retrospective adoption for cash flow hedges, which would require entities to record the difference between the amount in OCI and the amount that would have been in OCI had the hedge been accounted for under the proposed model from inception. The adjustment would capture Board decisions for the new model that are different from current hedge accounting guidance, including requiring ineffectiveness on both underhedges and overhedges to be recorded in earnings. The staff also recommended that amounts in OCI associated with hedges that were not redesignated under the proposed model would be reclassified according to the current guidance in Statement 133.
31. The staff also recommended that the Board require most hedges to be dedesignated and new hedging relationships to be designated at adoption of the proposed standard.

However, the staff acknowledged that the hedged risk of certain current hedges would also be eligible for hedging under the proposed model; the staff recommended that dedesignation not be required for these hedges. These hedges would prospectively be accounted for according to the proposed model.

Board Vote

32. The Board agreed with the transition methods proposed. However, the Board decided that examples of current hedges that would meet the new requirements and those that would fail the new requirements, including examples of hedges currently accounted for using the shortcut method, should be included in the Exposure Draft.

Board Comments

33. Ms. Seidman clarified that current hedges that would qualify for the dedesignation exception, including those accounted for using the shortcut method, would still prospectively be accounted for according to the proposed model. Ms. Malcolm noted that, since the proposed model reduces the level of required effectiveness to achieve hedge accounting, the staff does not anticipate hedges of an entity's own debt accounted for under the shortcut method to fail the proposed requirements for hedge accounting; these hedges would not need to be dedesignated. However, dedesignation of other hedges accounted for using the shortcut method would be required.
34. Mr. Smith asked what the documentation requirements would be for ongoing effectiveness testing and how they would affect determining whether current hedges would need to be dedesignated. Mr. Golden added that, if the basis for certain hedges under current guidance would change once the proposed approach is adopted, entities would need to reevaluate and redocument their hedges. If the basis for hedging would not change, entities would not need to redocument their hedges, but the accounting for those hedges prospectively would follow the adopted standard.
35. Mr. Herz suggested the staff include examples of the dedesignation exception in the standard. Mr. Smith added that the staff should include examples of a current hedge that would fail the requirements of the proposed standard and a current hedge that would still be allowed, as well as examples of hedges currently accounted for using the shortcut method.

36. Ms. Seidman noted that interest rate swaps that are currently effective in hedging interest rate risk would not be effective in hedging changes in fair value attributable to all risks. Mr. Leisenring and Ms. Seidman stated that these hedges would not be effective since credit risk would not be hedged by the interest rate swap. Mr. Stoklosa stated that these current hedges might be effective under the proposed model depending on the volatility of the credit spread. Mr. Stoklosa noted that in these situations a quantitative analysis of effectiveness may be needed to demonstrate the hedge would be reasonably effective.
37. Mr. Linsmeier added that changes in credit might add a greater degree of ineffectiveness in earnings to the hedge, but there may still be offset from the derivative. However, Mr. Linsmeier stated that this greater degree of ineffectiveness would allow second-guessing of hedging activities in periods of unusual markets; ongoing effectiveness testing would need to be required either for each quarter or not at all in order to avoid second-guessing and restatements.
38. Mr. Golden reminded the Board that it has already decided that ongoing effectiveness testing would only be required if circumstances change such that the hedge might no longer be effective. Mr. Linsmeier stated that the Board should reconsider its previous decisions, since users are more concerned with the risk of the entire entity, not just the offset of two instruments. Mr. Stoklosa added that the Board also decided that ineffective hedges would be considered terminated. Mr. Linsmeier stated that, in his opinion, hedge accounting should be required as long as both sides of the hedge are still in place.
39. Mr. Golden noted that other accounting guidance requires reassessment, such as impairments and depreciation lives. Mr. Herz suggested the Exposure Draft seek comments on whether the Board's decisions about ongoing effectiveness testing are operational for both fair value hedges and cash flow hedges. Mr. Smith added that the Exposure Draft should discuss Mr. Linsmeier's concerns in order to allow constituents to provide specific comments on these issues.
40. Mr. Linsmeier clarified that his concerns apply to both fair value hedges and cash flow hedges; amounts deferred in OCI associated with cash flow hedges might be second-guessed. Mr. Herz noted that he was bothered by the income statement effects for cash flow hedges. Mr. Stoklosa noted that the ongoing measurement of the difference between the perfect derivative and the actual derivative would create an income statement

impact for the ineffective portion. Ms. Malcolm stated that she was troubled by situations where the cash flow hedge is significantly underhedged if effectiveness is not re-evaluated.

41. Mr. Smith suggested that the staff include in the Exposure Draft both examples of what the Board decided and examples of alternatives to that decision in order to obtain information helpful for redeliberations.

TRANSITION - FAIR VALUE OPTION

42. Ms. Malcolm stated that entities may not have elected the fair value option for eligible items that are currently being hedged in a fair value hedging relationship. These items would no longer be measured at fair value if the hedges would not meet the requirements of hedge accounting pursuant to the proposed standard or if the entity did not choose to designate new hedging relationships. Ms. Malcolm noted that entities should be given an opportunity to achieve fair value accounting for items eligible for the fair value option.

Staff Recommendation

43. The staff recommended that a one-time opportunity to elect the fair value option be allowed at adoption of the proposed standard. The staff recommended that the election be permitted for all eligible items, not just those that are currently being hedged in fair value hedging relationships. Ms. Malcolm noted that the reasons for a broad election are that entities may have intended to apply fair value hedge accounting to items that are not currently being hedged and that entities could designate fair value hedges just prior to adopting the proposed standard in order to be permitted the opportunity to elect the fair value option.

Board Vote

44. Messrs. Crooch, Herz, and Smith agreed with the staff's recommendation. Messrs. Batavick, Linsmeier, Seidman, and Young voted to allow the fair value option only for items hedged at the time the proposed standard is adopted. The Board decided to seek comments on this issue.

Board Comments

45. Ms. Seidman noted that feedback from users about the elective nature of the fair value option indicate that there would be no persuasive argument for allowing a broad election for all eligible items. Mr. Herz argued that the more robust disclosures required as part of

fair value accounting would be desirable for users. Ms. Seidman suggested that the Exposure Draft include an opportunity to elect the fair value option for items currently in fair value hedges and seek comments from constituents.

46. Mr. Herz asked whether there would be additional disclosures related to transition. Mr. Stoklosa stated that the staff had not planned additional disclosures. Ms. Smith stated that disclosures of hedges under Statement 133 that would no longer qualify for hedge accounting would be helpful to users. Ms. Malcolm noted that a meaningful disclosure would be difficult since some positions may be closed if they no longer qualify for hedge accounting. Mr. Linsmeier suggested seeking comments from investors about transition disclosures.

ADDITIONAL ITEMS

47. Mr. Linsmeier suggested that the proposed new hedge accounting guidance prescribe the geography in the statement of comprehensive income of gains and losses on hedging instruments. Mr. Linsmeier suggested that the gains and losses on the hedging instrument should be included with the line item of the hedged item or hedged forecasted transaction. Mr. Linsmeier noted that much of the Board's decisions on this project have simplified hedge accounting for preparers, but addressing the geography of gains and losses from hedging activities would simplify hedge accounting for users.
48. Mr. Young asked whether disclosures about terminated cash flow hedges would be required. Ms. Malcolm noted that Statement 133 already requires termination of cash flow hedge accounting and disclosure of reclassifications when hedged forecasted transactions are determined probable not to occur. Ms. Seidman added that disclosures of the expected impacts on earnings of hedging activities for the twelve months following the reporting date are also required.
49. Mr. Stoklosa asked the Board whether the staff should proceed with drafting an Exposure Draft. The staff anticipated issuing the Exposure Draft on February 15, 2008, with a 45-day comment period ending March 31, 2008. Mr. Golden noted that the comment period would need to end by this date in order to issue a final standard by June 30, 2008. Ms. Seidman stated that such a short comment period would not be sufficient due process, regardless of the objectives and timing of the staff and Board. Mr. Smith suggested at

least a 60-day comment period. Mr. Batavick stated that the hedging project would need to be prioritized.

50. The Board agreed the staff should proceed with drafting an Exposure Draft but the comment period ending date would not be determined until the Exposure Draft is ready to be issued. Ms. Seidman and Mr. Batavick both stated that they will be writing an alternative view to be included in the proposed standard.

FOLLOW-UP ITEMS

51. The staff will begin drafting an Exposure Draft for vote by written ballot.

