

Board Meeting Handout
Proposed FSP on Issue 03-1
September 8, 2004
(Revised 9/8, 9:00 a.m.)

The FASB staff will ask the Board to consider the following implementation issues associated with interest rate impaired debt securities evaluated for impairment under paragraph 16 of EITF Issue No. 03-1, “The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments” (Issue 03-1):

1. At what unit of accounting should an investor assert its ability and intent to hold to a forecasted recovery?
2. Although Issue 03-1 states that an investment is impaired if the fair value of the investment is less than its cost, paragraph 16 does not refer to the severity of the impairment. Is there a level of impairment that effectively can be considered temporary that would not create the need for an assertion about the ability and intent to hold an investment until a forecasted recovery?
3. If an interest rate impaired security for which the investor previously had asserted its ability and intent to hold to a forecasted recovery is expected to be sold prior to recovery:
 - a. When is the impairment considered other-than-temporary?
 - b. Are there circumstances for such a change in intent that do not call into question the investor’s intent to hold other securities to recovery?

Issue 1: At what unit of accounting should an investor assert its ability and intent to hold to a forecasted recovery?

The FASB staff will recommend that an investor assert its ability and intent to hold to a forecasted recovery at the individual security level, as stated in paragraph 16 of FAS 115.

Issue 2: Although Issue 03-1 states that an investment is impaired if the fair value of the investment is less than its cost, paragraph 16 does not refer to the “severity” of the impairment. Is there a level of impairment that can effectively be considered temporary that would not create the need for an assertion about the ability and intent to hold an investment until a forecasted recovery?

The FASB staff will recommend three alternatives. Under the first alternative, an entity focus on impairments that have a level of severity in which more than a normal change in interest rates over a relatively short period of time would not eliminate the impairment.

The level of normal interest rate fluctuation can be established by evaluating interest rate volatility, for a six-month period, for debt securities with the same term and credit rating.

Under the second alternative, interest rate impairments of five percent or less of the cost of a debt security would be treated as temporary.

Under the third alternative, an investor considers the severity of the impairment. If the severity of the impairment is minimal, the impairment can effectively be considered temporary.

An investor does not need to assert its ability and intent to hold an investment that is impaired temporarily.

Issue 3(a): If an interest rate impaired security for which the investor previously had asserted its ability and intent to hold to a forecasted recovery is expected to be sold prior to recovery, when is the impairment considered other-than-temporary?

The FASB staff will recommend that the impairment is considered other than temporary when the investor's assertion to hold an investment to a forecasted recovery is changed.

Issue 3(b): If an interest rate impaired security for which the investor previously had asserted its ability and intent to hold to a forecasted recovery is expected to be sold prior to recovery, are there circumstances for such a change in intent that do not call into question the investor's intent to hold other securities to recovery?

The FASB staff will recommend that changes in circumstances, such as discussed in paragraphs 8 and 11 of FAS 115, should not call into question the investor's intent to hold other securities to recovery. The FASB staff will also recommend that the following circumstances not call into question the investor's intent to hold other securities to recovery:

1. Unexpected and significant changes in liquidity needs,
2. Unexpected and significant increases in interest rates that significantly extend the period that a security would need to be held by the investor, and
3. A de minimus volume of sales of securities.

Transition

The FASB staff acknowledges that the effective date for applying paragraph 16 must be delayed prior to September 30, 2004. Therefore, the FASB staff will recommend that the Board issue two separate Board-Directed FSPs:

1. The first FSP, which would be subject to a 45-day comment period, would provide the implementation guidance. The guidance in this proposed FSP would be effective for other-than-temporary impairment evaluations of interest rate impaired debt securities analyzed under paragraph 16 of Issue 03-1 on the last reporting date for reporting periods ending after the final FSP is posted on the FASB website.
2. The second FSP, which would be subject to a 15-day comment period, would delay the effective date for the application guidance contained in paragraph 16 of Issue 03-1.