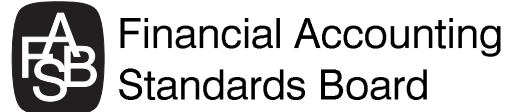


REVISED MINUTES



To: Board Members

From: Salo, ext. 312

Subject: Minutes of October 1, 2003 Agenda **Date:** October 13, 2003
Decision Board Meeting

cc: Bielstein, Smith, Petrone, Polley, Swift, Leisenring, Sutay, Thompson, Gabriele, Intranet, Project Team

Topic: Agenda Decision: Loan Commitments

Basis for Discussion: Memorandum dated September 10, 2003

Length of Discussion: 10:40 a.m. to 11:10 a.m.

Attendance:

Board members present: Herz, Batavick, Crooch, Schieneman, Schipper, Seidman, Trott (by phone)

Board members absent: None

Staff in charge of topic: Laurenzano

Other staff at Board table: Smith, Wilkins, Salo

Outside participants: None

Summary for ACTION ALERT:

The Board added a project to its agenda that would provide clarification of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* (as amended). The project will address the valuation of loan commitments

(including interest rate lock commitments) accounted for as derivatives under Statement 133 (as amended). Currently, there is diversity in practice in determining the fair value of loan commitments that must be accounted for as derivatives, as well as diversity among the issuers of such commitments in whether those commitments can ever be reported as assets.

The key objectives of the project will be to determine what information an issuer should use to determine the fair value of a loan commitment that is accounted for as a derivative under Statement 133 (as amended), and whether a loan commitment should ever be recorded as an asset by the issuer of that commitment.

The Board directed the FASB staff to prepare a proposal of the project's scope and to prepare a timetable for the project.

Matters Discussed and Decisions Reached:

Mr. Laurenzano began discussions by describing the background of the loan commitment issue. He stated that the issue was scheduled to be discussed at the March 15, 2001 Derivatives Implementation Group meeting but was not discussed due to lack of time and was subsequently dropped from the open DIG Issues. The staff's research, resulting from the DIG Issue and technical inquiries in early 2003, has led to the conclusion that there is diversity in practice surrounding this issue. He acknowledged the two prevailing views in practice for determining the fair value of a loan commitment. The first view is that a loan commitment can be reliably valued at its inception by reference to the secondary market price for whole loans as well as published costs to originate loans. They note that borrowers often exercise loan commitments even when they are out of the money, along with other factors that create positive value. The second view is that a valuation methodology should be adopted that excludes the value of any future servicing asset or liability. Proponents of the second view also believe that the loan commitment should never be recognized as an asset because the loan

commitment is a written option to the lender and a written option never has a positive value to the writer of an option.

Mr. Laurenzano stated that the staff recommended that the project to be added would be an Interpretation of Statement 133 (as amended) and that the project should be conducted separately from the current and related Board projects on fair value measurement and revenue recognition. He stated that the project would address two main issues. First, the project would determine what information the issuer should use to determine the fair value of a loan commitment that is accounted for as a derivative under Statement 133 (as amended). Second, the project would address whether a loan commitment should be recorded as an asset by the issuer of that commitment.

The Board members supported the staff's recommendation to add this project to the agenda. (Four Board members agreed: EWT, GMC, KAS, RHH; three Board members disagreed: LFS, GJB, GSS) Some Board members stated that they agree with the addition of an interpretation project for several reasons. First, there is great diversity in practice in the valuation of loan commitments and the recognition of loan commitments as an asset. Second, this is a pressing practice issue. Constituents have voiced their concern through inquiries, and the SEC staff has inquired as to when this issue would be discussed by the FASB. Third, this project is unique in that it has many important accounting issues embedded in it. Some Board members believe that this project is a good opportunity to examine the conceptual framework and how closely the Board's tentative decisions reached in the fair value measurement and revenue recognition projects are following conceptual framework ideas such as the asset and liability approach, along with other issues such as internally generated intangible assets. Some Board members also agree that the detailed accounting issues to be addressed in this project will help the thinking of the Board and the staff in other related projects on the agenda.

Some Board members did not support the staff's recommendation to add this project to the Board's agenda. They did not agree with the addition of the project

for several reasons, primarily relating to the overlap between this issue and the fair value measurement project and the revenue recognition project. One Board member was concerned with the technical feasibility of this project. He expressed the opinion that this project should not be started until other current projects on the Board's agenda have proven working models. Another Board member agreed, and noted that this issue involves reference market issues (wholesale vs. retail), potential intangible assets, and revenue recognition questions that are still under active discussion. Another Board member questioned the rationale for accelerating this single issue when it is likely that more issues of this nature will be addressed in the future in the fair value measurement and revenue recognition projects.

Follow-up Items: None.

General Announcements: None.