MINUTES

To:	FASB Board Members
From:	Accounting for Financial Instruments Team
Subject:	September 18, 2013 Joint Board Meeting—Accounting for Financial Instruments: Classification and Measurement
Date:	September 24, 2013

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 an Accounting Standards Update or a Statement of Financial Accounting Concepts.

Topic: Accounting for Financial Instruments: Classification and Measurement

Basis for Discussion:
FASB: Memorandums 240–246
IASB: Agenda Papers 6–6F

Length of Discussion: 4:34 a.m. to 7:18 a.m. EDT

Attendance:

Board members present: FASB: Golden, Buck, Smith, Kroeker, Linsmeier, Schroeder, and Siegel

IASB: Hoogervorst, Mackintosh, Cooper, Danjou, Edelmann, Engström, Finnegan, Kabureck, Kalavacherla, McConnell, Ochi, Scott, Suh, Tokar, and Zhang

Board members absent: FASB: None

IASB: Gomes

Staff in charge of topic: FASB: Gupta and Milone

IASB: Feygina

Other staff at Board table: FASB: Cosper and Esposito

IASB: Lloyd and Dasgupta

Outside participants: None

Type of Document and Timing Based on the Technical Plan:

The Board met to discuss issues relating to the development of an Accounting Standards Update addressing the accounting for financial instruments. The Board issued an Exposure Document in the first quarter of 2013.

Summary of Decisions Reached:

The IASB and the FASB discussed clarifications and improvements to the solely principal and interest (P&I) condition in the Boards' recent Exposure Drafts.

Agenda Paper 6B

The staff presented the key observations on amortized cost as a measurement basis. The discussion was for educational purposes. No tentative decisions were made.

Agenda Paper 6C

The IASB and the FASB discussed the meaning of "principal" for the purposes of the application of the solely P&I condition. The Boards tentatively decided that principal should be described as the amount transferred by the holder for the financial asset on initial recognition.

Agenda Paper 6D

The IASB and the FASB discussed the meaning of "interest" for the purposes of the application of the solely P&I condition, including the meaning of "time value of money" and the application of that concept to regulated interest rates, and tentatively decided to clarify the meaning of interest.

Specifically, the Boards tentatively decided:

1. To clarify that de minimis features should be disregarded for classification;
2. To emphasize the underlying conceptual basis for the solely P&I condition—that is, the notion of a basic lending-type return;
3. To confirm that time value of money and credit risk are typically the most significant components of a basic lending-type return, however, not the only possible components;

4. To clarify that a basic lending-type return also generally includes consideration for liquidity risk and profit margin and consideration for costs associated with holding the financial asset over time (such as servicing costs);
5. To emphasize what are not the components of a basic lending-type return and why (for example, indexation to equity prices); and
6. To clarify the meaning of the time value of money, specifically:
   a. To clarify the objective of the consideration for the time value of money—that is, to provide consideration for just the passage of time, absent return for other risks and costs associated with holding the financial asset over time
   b. To articulate the factors relevant to providing consideration for the passage of time—notably, the tenor of the interest rate and the currency of the instrument
   c. To clarify that both qualitative and quantitative approaches could be used to determine whether the interest rate provides consideration for just the passage of time, if the time value of money component of the interest rate is modified (for example, by an interest rate tenor mismatch feature) but do not prescribe when each approach should be used
   d. To not allow a fair value option in lieu of the quantitative assessment.

The Boards also tentatively decided to accept regulated interest rates as a proxy for the consideration for the time value of money if those rates provide consideration that is broadly consistent with consideration for the passage of time and do not introduce exposure to risks or volatility in cash flows that are inconsistent with the basic lending-type relationship.

The IASB also tentatively decided to provide guidance on how the quantitative assessment of a financial asset with a modified time value of money component should be performed—that is, by considering the contractual (undiscounted) cash flows of the instrument relative to the benchmark instrument—and to replace the “not more than insignificant” threshold in the Boards’ proposals with the “not significant” threshold (that is, a financial asset with the modified time value of money component of the interest rate would meet the solely P&I condition if its contractual cash flows could not be significantly different from the benchmark instrument’s cash flows).

The FASB directed the staff to perform further analysis of the operational aspects of this assessment.

Agenda Paper 6E

The IASB and the FASB discussed the application of the solely P&I condition to financial assets with contingent features.

The Boards tentatively decided to clarify that the nature of the contingent trigger event in itself does not determine the classification of the financial asset. In addition, the Boards tentatively decided that in clarifying the guidance on contingent features no distinction should be made between contingent prepayment and extension features and other types of contingent features.

The IASB also tentatively decided to confirm that a contingent feature that results in contractual cash flows that are not solely P&I is inconsistent with the solely P&I condition unless the feature is non-genuine.

The FASB tentatively decided that if a contingent feature results in contractual cash flows that are not solely P&I but those non-P&I cash flows have a remote probability of occurrence, such a feature is consistent with the solely P&I condition. If the occurrence of non-P&I cash flows no longer remains remote, an entity will be required to reclassify the financial asset into the fair value through profit or loss (FVPL) category. However, reclassifications out of the FVPL category will be prohibited.

The FASB directed the staff to perform further analysis of contingent features that provide protective rights to the holder.

Agenda Paper 6F

The IASB and the FASB discussed the application of the solely P&I condition to financial assets with prepayment and extension features.

For contingent prepayment features, the Boards tentatively decided to clarify that the nature of the contingent trigger event in itself does not determine the classification of the financial asset. The Boards tentatively decided that no distinction should be made between contingent prepayment and extension features and other types of contingent features.

With one exception (see the following tentative decision), the IASB also tentatively decided to confirm that a prepayment feature that results in contractual cash flows that are not solely P&I is inconsistent with the solely P&I condition unless the feature is non-genuine.

Notwithstanding the previous tentative decision, the IASB tentatively decided to provide an exception for financial assets that meet the following conditions:

1. The financial asset is acquired or originated with a significant premium or discount.
2. The financial asset is prepayable at the amount that represents par and accrued and unpaid interest (and may include reasonable additional compensation for the early termination of the contract).
3. The fair value of the prepayment feature on initial recognition of the financial asset is insignificant.

Such financial assets will be eligible for classification at other than FVPL (subject to the business model assessment).

The FASB tentatively decided that if a prepayment feature results in contractual cash flows that are not solely P&I but those non-P&I cash flows have a remote probability of occurrence, such a feature is consistent with the solely P&I condition. If the occurrence of non-P&I cash flows no longer remains remote, an entity will be required to reclassify the financial asset into the fair value through profit or loss (FVPL) category. However, reclassifications out of the FVPL category will be prohibited.

The FASB's tentative decision is subject to further analysis of contingent features that provide protective rights to the holder, as discussed above.

Next Steps

At a future meeting, the Boards will consider additional matters related to the solely P&I condition including items raised at today's meeting. After the Boards make decisions on clarifying the solely P&I condition, the staff will ask the FASB whether the FASB would like to retain that condition for classifying financial assets or to pursue a different approach. The Boards will also discuss the business model criteria at a subsequent meeting.