10th Annual FDIC Accounting and Auditing Conference

FASB Update

Matt Esposito, *Assistant Director*

October 25, 2016

The views expressed in this presentation are those of the presenter. Official positions of the FASB are reached only after extensive due process and deliberations.

FINANCIAL ACCOUNTING STANDARDS BOARD

Agenda

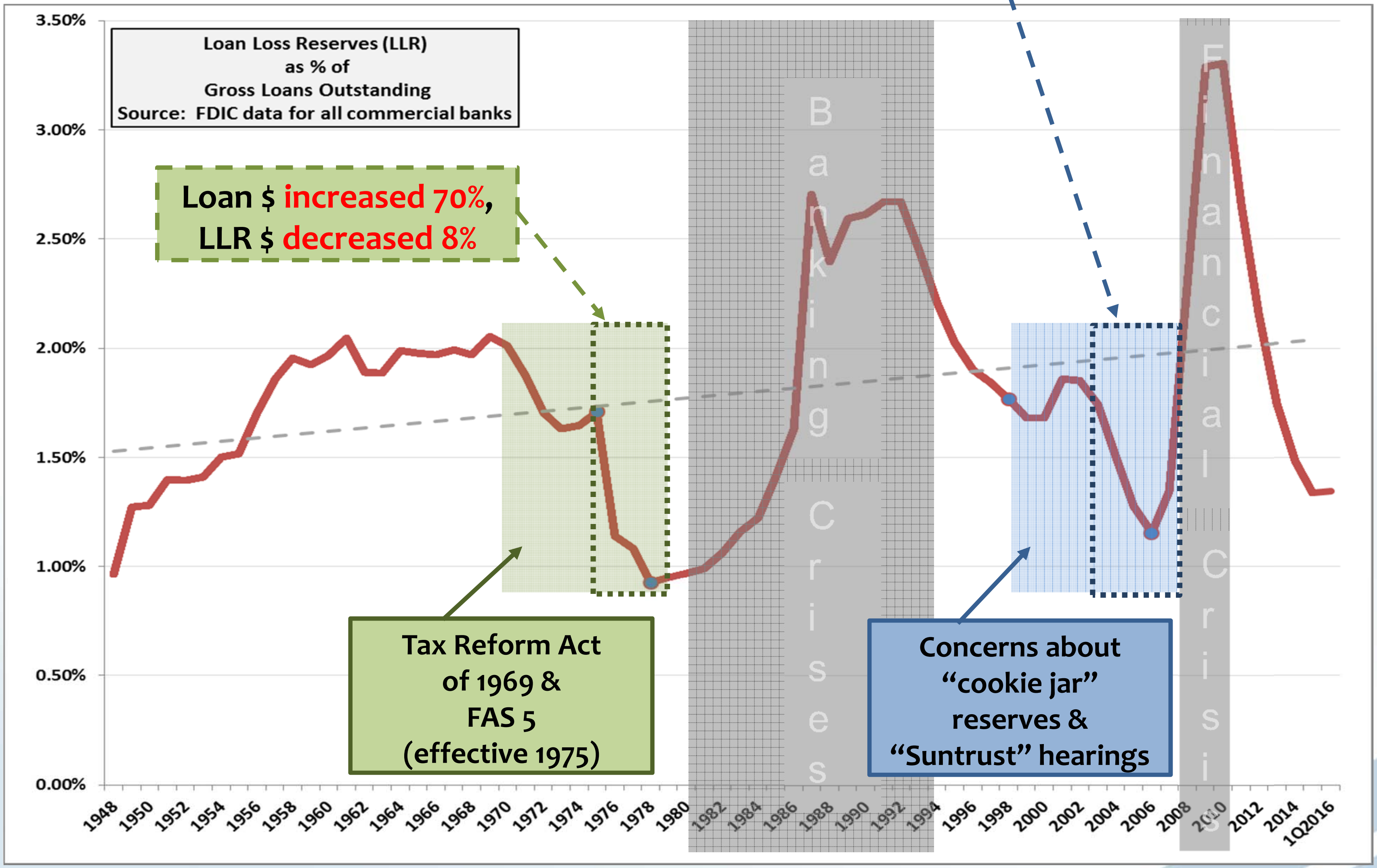
- Credit Losses
- Classification & Measurement
- Leases
- Effective Dates of Final Standards
- Hedging
- Other Topics
- Questions or Comments

Financial Instruments: Credit Losses

FINANCIAL ACCOUNTING STANDARDS BOARD

CECL . . . *Why?*

BC 3 & 11



ASU No. 2016-13

Credit Losses . . . *What's Changing?*

Amortized Cost Model

Various Fair Value Models

Loans		Debt Securities	
Held for Investment	CECL (PCD)	**Held to Maturity**	CECL (PCD)
Held for Sale	Lower of amortized cost basis or market	**Available for Sale**	AFS credit-loss model* (PCD)
		Trading	FV-NI **

* Under the new credit-loss model for AFS, credit losses will be recorded through an allowance. The allowance will be limited to the difference between the debt security's amortized cost basis and its fair value.

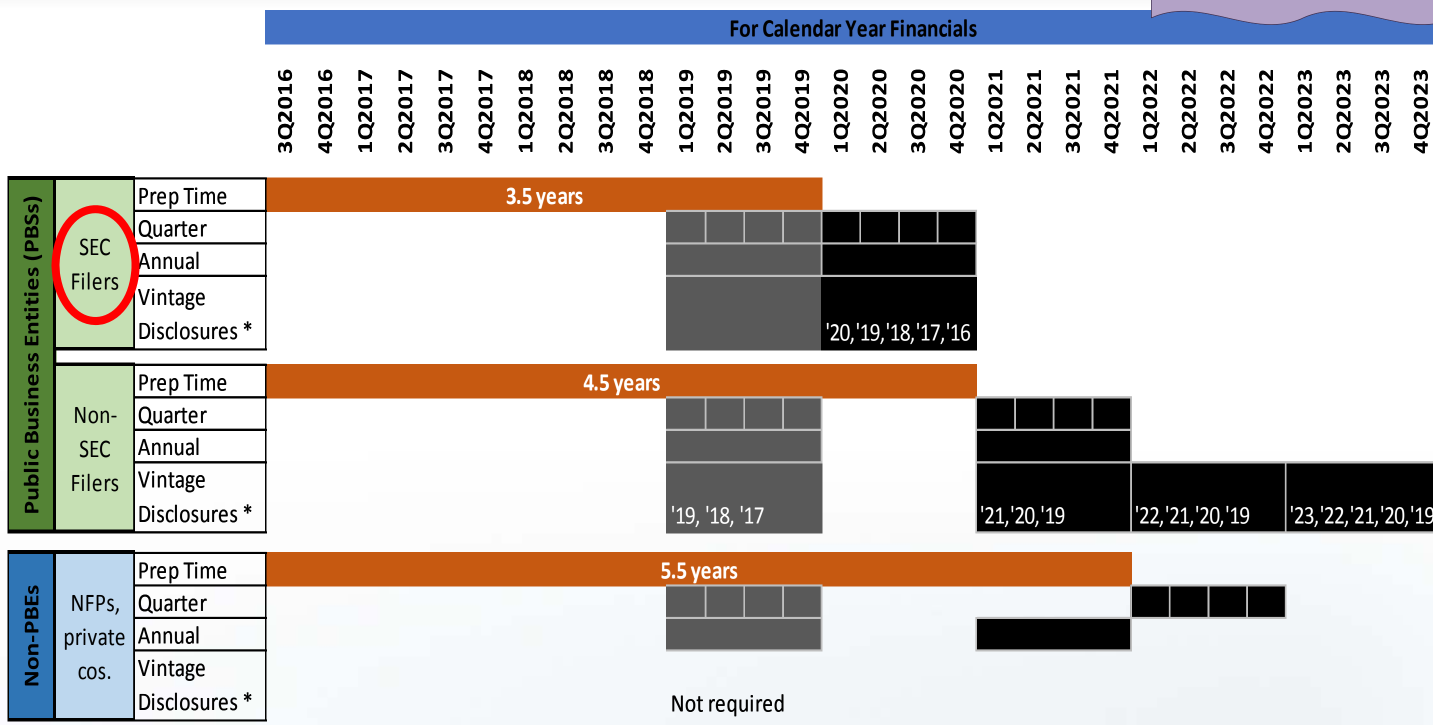
** No change to current GAAP.

PCD Allowance for purchased financial assets with credit deterioration determined in similar manner; however, initial allowance added to purchase price, rather than as provision expense.

326-10-65-1

CECL . . . *Who's Affected? When?*

May require more analysis



Time available for implemention
Earliest date adoption permitted
First period adoption required
* For interim-periods, current year-to-date considered to be current-period originations.

"SEC filer" is any entity required to file or furnish its financial statements with either:

- The Securities and Exchange Commission
- An entity subject to Section 12(i) of the Securities Exchange Act of 1934, as amended, the appropriate agency under that Section.

Master Glossary

CECL . . . What's a "PBE"?

"Public Business Entity" <u>meets any</u> of these criteria . . .

- Required to (or voluntarily does) file or furnish its financial statements with Securities and Exchange Commission (SEC)
- Required to file or furnish its financial statements with a <u>regulatory agency other than the SEC</u> in accordance with:
  - the Securities Exchange Act of 1934 (Act), as amended
  - or rules and regulations promulgated under the Act
- Required to file or furnish its financial statements with a <u>foreign or domestic regulatory agency</u>
  - with issuance of securities not subject to contractual restrictions on transfer
- Has issued, or is a conduit bond obligor for, <u>securities that are traded, listed or quoted</u> on an exchange or an OTC market
- Has securities <u>not subject to contractual restrictions on transfer</u>, and <u>required by law, contract, or regulation to both</u> . . .
  - prepare U.S. GAAP financial statements (including notes)
  - make them publically available on a periodic basis

Note: PBEs must be a business entity, so a not-for-profit entity and an employee benefit plan are excluded.

CECL . . . *Top Ten Truths*

Allowance for Credit Losses . . .

- A valuation account
- Deducted from amortized cost basis of financial assets
- Used to present "net amount expected to be collected"
- Changes flow through net income

Book the difference as Allowance

$$A - B = C$$

Amortized cost . . . unpaid principal balance (UPB) lent to a customer adjusted for loan fees and origination expenses, repayments, writeoffs, nonaccrual practices, and certain hedging transactions

Amount expected to be collected. . . remaining amounts expected to be collected on loans

1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10

326-20-30-2
&
326-20-55-5

CECL . . . *Top Ten Truths*

Expected credit losses <u>shall be</u> measured on . . .

- <u>Collective</u> (pool) basis if . . .
  - **Asset <u>has</u> similar risk characteristic(s)** with other financial assets
  - **Risk characteristics** may include (not all inclusive):
    - Credit score/rating (internal or external), asset or collateral type, size, effective interest rate, term, geographical location, borrower industry, vintage, historical or expected loss patterns, reasonable and supportable forecast period
- An <u>individual</u> basis if . . .
  - **Asset <u>does not have</u> similar risk characteristic(s)** with other financial assets
  - For example, a loan in default or a receivable past a delinquency period

. . . But not included in both

1	2	3	4	5	6	7	8	9	10

326-20-30-3 to 6

CECL . . . *Top Ten Truths*

Expected credit losses may be determined using . . .

- Various methods
  - For example: discounted cash flow (DCF), loss rate, roll rate, probability of default, provision matrix
- Not required to . . .
  - Utilize probability-weighted DCF model
  - Reconcile estimation technique with DCF model

Expected credit losses shall be measured over . . .

- Contractual term, considering estimated prepayments
- Contractual term shall not be extended for . . .
  - Expected extensions and renewals
  - Expected modifications, unless TDR anticipated

1	2	3	4	5	6	7	8	9	10

326-20-30-7 to 8

CECL . . . *Top Ten Truths*

<u>Shall</u> consider available information relevant to assessing collectibility . . .

- "information" includes <u>internal, external or combination</u>
  - For "past events, current conditions, and reasonable and supportable forecasts"
  - "Not required to search all possible information . . . not reasonably available"
  - "May find . . . internal information is sufficient"
- Historical credit loss information ("past events") . . .
  - "Generally provides a basis" for assessing expected credit losses
  - "Shall consider adjustments" for differences in . . .
    - Current asset-specific risk characteristics (within a pool)
    - Contractual term (individual or pool)
    - Different economic conditions

1 2 3 4 5 6 7 8 9 10

CECL . . . *Top Ten Truths*

Any approach to estimating collectibility is subjective . . .

- Entities manage credit risk differently
  - Therefore, various methods are permitted
- Varying methods may result . . .
  - From differing degrees of portfolio complexity and entity sophistication
  - In "range of acceptable outcomes" (rare only one acceptable choice)
- Should not default to using only most observable external data
  - If internal market data is more relevant
- Most subjective aspect . . . qualitative adjustments to historical
  - Board expects adjustments for current and future

Various methods, with varying results . . .

326-20-55-18 to 22 Example 1

Fact Pattern:

Year end 20X5

Amort. Cost Basis = $10M

Management expects in 20X6 and 20X7:

- Fall in real estate values
- Rise in unemployment
- Improved underwriting

Management cannot reasonably forecast beyond 20X7

Percentage Loss Rates

Historical loss rate (cumulative)	1.50%
Adjustment for current conditions and reasonable and supportable forecasts	0.15%
Expected loss rate	1.65%
Loan loss reserves	$165K

Dollar Loss Rates

Historical loan losses (cumulative)	$150k
Fall in real estate values	+15K
Rising unemployment	+ 5K
More experienced underwriting	- $1K
Loan loss reserves	$169K

FINANCIAL ACCOUNTING STANDARDS BOARD

326-20-55-28 to 31 Example 3

Actual chargeoffs and expected losses by vintage year and year of loan's life (in thousands)

Year Originated	Year 1	Year 2	Year 3	Year 4	Year 5	Expected Losses
20X0	$1	$20	$14	$8	$2	n/a
20X1	1	22	16	8	4	$ 4
20X2	2	23	18	10	4	14
20X3	2	24	22	12	2	36
20X4	2	26	21	8	2	57
20X5	6	24	16	8	2	56
					Total	$ 167

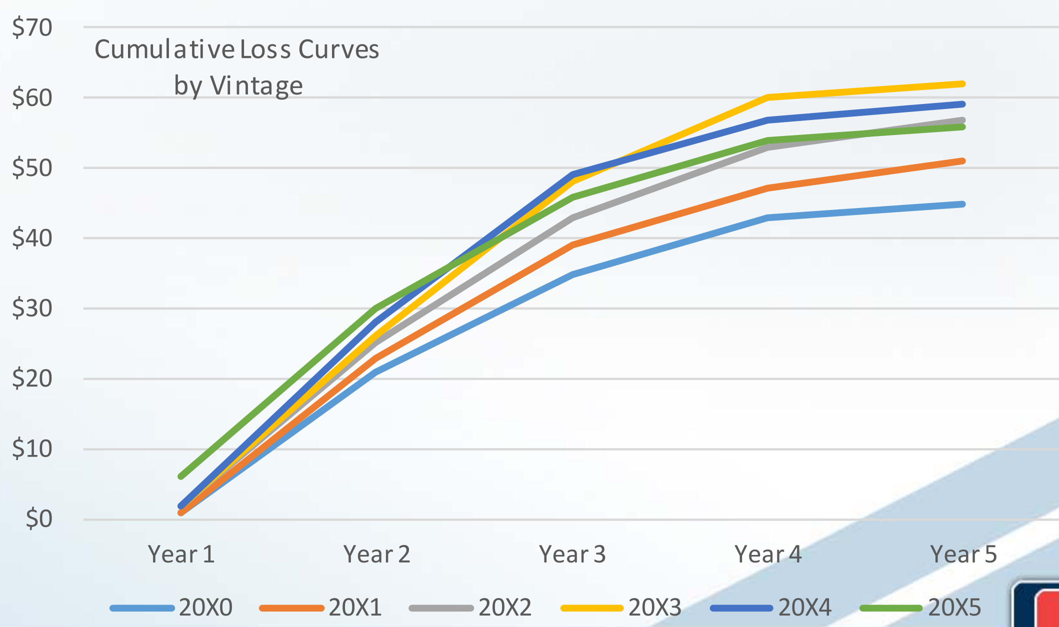
And, given same facts . . . *Vintage Analysis*

Shading represents realization timing of expected losses:

20X6
20X7
20X8 and thereafter

Reasonable & Supportable forecasts

Reversion to historical loss information



326-20-30-8 to 9

CECL . . . *Top Ten Truths*

For periods where forecasts are not supportable . . .

- Entity shall revert to historical credit loss information . . .
  - Reflective of the contractual term
  - "immediately, on a straight-line basis, or using another rational and systematic basis"
  - Shall not adjust for existing and expected future economic conditions
- Not expected to use reversion technique . . .
  - if entity is able to forecast over the estimated life
- Reasoning:
  - Reversion is needed to meet measurement objective:
    - "Amount an entity expects to collect"
  - Not decision useful to ignore certain time periods
    - Merely because an entity is unable to precisely estimate

1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10

326-20-30-10
& Example 8

CECL . . . *Top Ten Truths*

Expected credit losses shall be measured, even if remote

- However, not required to measure when expectation that nonpayment is zero
  - Expectation can't be solely based on current value of collateral
- Board did not explicitly state specific financial assets where nonpayment is zero
  - "Bright-line" approach is not appropriate given nature and characteristics of financial assets change over time
  - However, Board provided Example 8 as one way an entity could evaluate U.S. Treasury securities
    - Not intended to be only applicable to USTs

1	2	3	4	5	6	7	8	9	10

CECL . . . *Top Ten Truths*

Expected credit losses for off-balance sheet credit exposures shall be measured . . .

326-20-30-11

- Over the period entity is exposed to credit risk via a present contractual obligation
  - Unless unconditionally cancellable by issuer, in which case no credit losses are recorded
- When measuring, consider both the likelihood funding will occur and the amount expected to be funded over estimated life of commitment

Collateral-dependent financial assets . . .

326-20-35-4 to 5

- Repayment expected substantially through operation or sale of collateral when borrower is experiencing financial difficulty
- Practical Expedient: Measure expected losses by comparing fair value of collateral to amortized cost

1	2	3	4	5	6	7	8	9	10

Disclosures . . . *Summary of Requirements*

Users want to understand actual credit results compared to original expectation of lifetime losses through disclosure.

Objective

Enable users to understand:

- Credit risk inherent in the portfolio
- How management monitors the credit quality of the portfolio
- Management's initial and updated estimates of expected credit losses

Description of Estimate

- Description of how expected losses are developed
- Factors that influenced the current estimate of CECL, including a discussion of the risk characteristics changes that influenced management's decision that were not considered in the previous period (changes in loss severity, portfolio composition, volume of assets, etc.)
- Reasons for significant changes in the amount of write-offs
- Amount of significant purchases and sales of debt instruments during each period
- Amount of any significant sales or reclassifications to held for sale for financial assets during each period
- For collateral-dependent assets – qualitative discussion of the type of collateral, extent to which collateral secures financial assets, and any changes that impacted how much collateral secures the asset

Quantitative Disclosures

- Disaggregation of credit quality indicators (loan to value, risk rating, geography, etc.) by vintage:
  - Need not exceed more than five annual reporting periods
  - Prior to fifth annual reporting period shown in aggregate
- Reconciliation between purchase price and par value of purchased credit deteriorated (PCD) assets
- Rollforward of the allowance for credit losses

Policy Disclosures

- Policy for charging off uncollectible debt instruments
- Changes to accounting policies or methodology from the prior period
- Policy for accounting for nonaccrual financial assets

Disclosures . . . Credit Quality Indicators (aka Vintage)

326-20-55-79, Example 15 & BC 114

1. *Understand migration within vintages*
2. *Migrations within vintages provides information on changes from historical trends*
3. *Changes from historical trends provides information on changes in estimates*

Current GAAP

	Term Loans	
As of December 31,	**20X5**	**20X4**
Residential Mortgage:		
Risk Rating:		
1 – 2 internal grade	34,614	37,122
3 – 4 internal grade	23,076	24,748
5 internal grade	43,477	44,651
6 internal grade	2,385	2,636
7 internal grade	294	708
Total residential mortgage loans	103,846	109,865
Residential Mortgage loans:		
Current-period gross writeoffs	110	220
Current-period recoveries	11	8
Current-period net writeoffs	99	212

Future GAAP

	Term Loans — Amortized Cost Basis by Origination Year							
As of December 31,	**20X5**	**20X4**	**20X3**	**20X2**	**20X1**	**Prior**	**Revolving Loans**	**Total**
Residential Mortgage:								
Risk Rating:								
1 – 2 internal grade	8,313	7,784	5,925	3,853	5,573	1,291	1,875	34,614
3 – 4 internal grade	5,542	5,190	3,950	2,568	3,716	860	1,250	23,076
5 internal grade	12,673	9,117	6,939	4,512	6,528	1,512	2,196	43,477
6 internal grade	695	500	381	248	358	83	120	2,385
7 internal grade	86	62	47	31	44	10	14	294
Total residential mortgage loans	27,309	22,653	17,242	11,212	16,219	3,756	5,455	103,846
Residential Mortgage loans:								
Current-period gross writeoffs	29	21	16	10	15	14	5	110
Current-period recoveries	-	-	2	5	2	1	1	11
Current-period net writeoffs	29	21	14	5	13	13	4	99

FASB FINANCIAL ACCOUNTING STANDARDS BOARD

Financial Instruments: Classification & Measurement

FASB
FINANCIAL
ACCOUNTING
STANDARDS BOARD

Financial Assets–Amendments to current GAAP

- Equity investments measured at each reporting period at fair value through net income, except
  - Equity investments without readily determinable fair value only marked to *observable* price changes
  - Equity method investments
  - Equity investments that result in consolidation of the investee
  - Equity investment in federal home loan bank and federal reserve bank stock
  - Ownership interest in an exchange
- Simplified impairment test for equity investments without readily determinable fair value
- Valuation allowance on deferred tax assets (DTAs) related to an available-for-sale debt security to be assessed in combination with other DTAs
- Current GAAP retained for all other financial assets

Financial Liabilities–Amendments to current GAAP

- Fair value change resulting from own credit for financial liabilities measured under fair value option will be recognized through other comprehensive income (OCI)
- Current GAAP retained for accounting for financial liabilities

Financial Instruments–Disclosure changes

- Private entities not required to disclose fair value of financial instruments not recognized at fair value on balance sheet
- Reduced disclosures for public entities about fair value information of financial instruments not recognized at fair value on balance sheet
- Fair value measurements for financial instruments to be based on exit price notion (current GAAP includes practical expedient to measure fair value of certain financial instruments using entry price notion)
- Financial assets to be presented grouped by measurement category and form
- Financial liabilities to be presented grouped by measurement category

Effective Date for Final Standard

All Public Business Entities

Annual & Interim Reporting Periods beginning after Dec. 15, 2017

Non-Public Business Entities*

Annual Periods beginning after Dec.15, 2018

Non-Public Business Entities*

Annual and Interim Periods beginning after Dec. 15, 2019

Early Application:

Entire standard is available for early application after Dec. 15, 2017

Certain provisions are available for early application upon issuance:

1. Presentation of FV changes due to entity's own credit changes in financial liabilities in OCI
2. Non-Public Business Entities no longer required to disclose fair value of financial instruments not recognized at fair value on B/S

*Includes not-for-profit entities and employee benefit plans

Leases

Purpose

1.25 trillion **of off-balance sheet operating lease commitments for SEC registrants***

Lessee

- Most lease assets and liabilities are off-balance sheet
- Limited information about operating leases

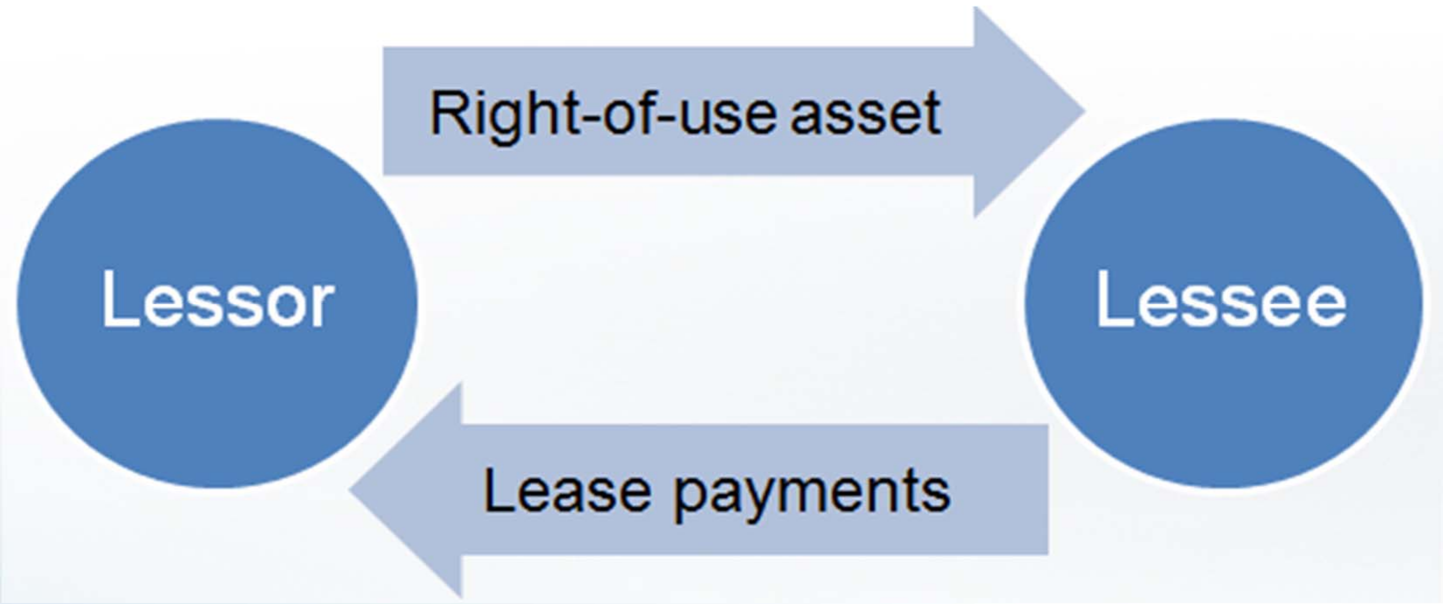
Lessor

- Lack of transparency about residual values
- Consistency with leases and revenue recognition guidance

* Estimate according to the 2005 SEC report on off-balance sheet activities

Right-of-Use Model

A lease is a contract, or part of a contract, that conveys the right to control the use of identified property, plant or equipment (an identified asset) for a period of time in exchange for consideration



Identifying a Lease

- Lease contracts in the scope of Topic 842 involve
  - An identified asset
    - That is explicitly or implicitly specified
    - Supplier has no practical ability to substitute and would not economically benefit from substituting the asset
  - The right to control the use during the lease term
    - Decision-making authority over the use of the asset
    - The ability to obtain substantially all economic benefits from the use of the asset

Lessee Accounting Overview

	Balance Sheet	Income Statement	Cash Flow Statement
Finance	Right-of-use (ROU) asset Lease liability	Amortization expense Interest expense	Cash paid for principal and interest payments
Operating	Right-of-use (ROU) asset Lease liability	Single lease expense on a straight-line basis	Cash paid for lease payments

Classification is similar to the classification in Topic 840

Recognition and measurement exemption for short-term leases

Lessor Accounting Overview

	Balance Sheet	Income Statement	Cash Flow Statement
Sales-Type & Direct Financing	Net investment in the lease	Interest income and any selling profit on the lease[1]	Cash received for leases
Operating	Continue to recognize underlying asset	Lease income, typically on a straight-line basis	Cash received for leases

Classification is similar to the classification in Topic 840

[1] Selling profit is recognized at lease commencement for sales-type leases and over the lease term for direct financing leases (note: selling profit is rare for direct financing leases)

Sale and Leaseback Transactions

Determine if a sale occurred	▪ Apply Topic 606 ▪ If there is a sale, apply Topic 842 to account for leaseback ▪ Finance leasebacks *preclude* a sale ▪ Repurchase options *do not preclude* a sale if exercisable at the then-prevailing fair value, provided there are alternative assets (that are substantially the same as the transferred asset) readily available in the marketplace
Accounting for the sale / purchase	▪ Gain or loss on sale is recognized same as for the sale of any other nonfinancial asset ▪ Buyer-lessor accounts for purchase consistent with that of other nonfinancial assets

Lessee Disclosures

Qualitative	Quantitative	
▪ Nature of leases ▪ Leases that have not yet commenced but that create significant rights and obligations for the lessee ▪ Significant assumptions and judgments made in application ▪ Main terms and conditions of any sale and leaseback transactions ▪ Whether an accounting policy election was made for the short-term lease exemption	• Finance lease expense, segregated between amortization and interest • Operating lease cost • Short-term lease cost • Variable lease cost • Sublease income • Gains and losses arising from sale and leaseback transactions • Lease payments maturity analysis (similar to that in Topic 840 disclosures)	▪ Separately for Finance and Operating leases: - Cash paid for amounts included in lease liabilities, segregated between operating and financing - Lease liabilities arising from obtaining ROU assets - Weighted-average remaining lease term - Weighted-average discount rate for leases

Lessor Disclosures

Qualitative	Quantitative
▪ Nature of leases ▪ Significant changes in components of net investment in the lease ▪ Residual value risk mitigation ▪ Significant assumptions and judgments made in application	▪ Table of lease income ▪ Lease income related to variable lease payments not included in measurement of lease receivable ▪ Maturity analysis of undiscounted cash flows that comprise the lease receivable ▪ Profit or loss recognized at commencement date ▪ Topic 360 disclosures on PP&E for underlying assets under operating leases

Transition Approach and Practical Expedients

Modified Retrospective Approach *required*

Package of practical expedients:

- Definition
- Classification
- Initial Direct Costs

Also, may elect to use *hindsight* with respect to lease renewals and purchase options

Existing leveraged leases were grandfathered

Effective Date

Public Companies*

- Fiscal years beginning after December 15, 2018, including interim periods within those fiscal years

All Other Organizations

- Fiscal years beginning after December 15, 2019 and interim periods beginning after December 15, 2020

Early Application

- Permitted for all organizations

* "Public Companies" refers to the following: (1) public business entities, (2) a not-for-profit entity that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an-over-the-counter market, and (3) an employee benefit plan that files or furnishes statements with or to the SEC

Effective Dates of Final Standards

Final Standards . . . *Effective Dates*

Beginning of fiscal year:

	2018	2019	2020	2021	2022
Classification and Measurement	Public Business Entities (Annual and Interim)	Non-Public Business Entities* (Annual Periods Only)	Non-Public Business Entities* (Annual and Interim Periods)		
Leases		Public Business Entities (Annual and Interim)	Non-Public Business Entities* (Annual Periods Only)	Non-Public Business Entities* (Annual and Interim Periods)	
Credit Losses			Public Business Entities that **are SEC Filers** (Annual and Interim)	Public Business Entities that **are not SEC Filers** (Annual and Interim) Non-Public Business Entities* (Annual Periods only)	Non-Public Business Entities* (Annual and Interim)

Hedging

*Includes not-for-profit entities and employee benefit plans

- Hedging Exposure Draft issued on September 8th (comment deadline November 22nd)
- Redeliberations and effective date decision to take place after comment period ends

FASB FINANCIAL ACCOUNTING STANDARDS BOARD

Hedging

FINANCIAL
ACCOUNTING
STANDARDS BOARD

Recurring Feedback on Hedge Accounting

<u>Preparers</u>

- "Artificial" restrictions on what qualifies for hedge accounting and in some cases how the change in the fair value of the hedged item is calculated affect business practices
- Component hedging of nonfinancial items would better reflect the way entities manage risks
- Accounting model creates arbitrary ineffectiveness for many interest rate hedging transactions
- Documentation and effectiveness assessments – rigid criteria and extensive testing

Recurring Feedback on Hedge Accounting

<u>Investors:</u> Views among financial statement users vary, but some general themes

- Reported results should enable users to understand risk exposures and risk management strategies of reporting entity
- Increased commodity price volatility of recent years has led users to place increased value on the predictability of margins (nonfinancial users)
- “Ineffectiveness” is hard to understand and difficult to compare among entities
- Moving “in and out” of hedge accounting because of failing to comply with arbitrary rules is not helpful when economics remain the same
- Disclosures that better outline entity’s risk-management strategy are needed
  - Non-GAAP disclosures on economic hedging distorts comparability and would be reduced if complying with hedge accounting was not as burdensome

Project History

May 2007
Added project

June 2008
Issued ED1
(no component risk hedging)

May 2010
Issued ED2
(no component risk hedging for non-financials)

Feb 2011
Issued DP to obtain comments on IASB proposal:
– component risk hedging
– qualitative assessments of effectiveness

2015 - 2016
Re-deliberations

Sept. 8, 2016
Issued ED with comment period ending Nov. 22, 2016

Hedge Accounting – Board Decisions

	Hedge of Nonfinancial Item	Hedge of Financial Instrument
Fair Value Hedge	Hedge of inventory	Swap fixed rate debt to floating
Cash Flow Hedge	Hedge of forecasted purchase or sale of inventory	Swap floating rate debt to fixed

For Qualifying Hedging Relationships*

Fair Value Hedge:

- Derivative marked to fair value through earnings
- NEW: Entire derivative gain or loss is required to be presented in the same income statement line item as hedged item
- Basis of hedged item adjusted for changes in FV attributable to hedged risk--also through earnings
- Basis adjustment offsets derivative mark to earnings

Cash Flow Hedge:

- Derivative marked to fair value
- NEW: Entire derivative gain or loss is deferred in OCI except for amounts excluded from the assessment of effectiveness.
- NEW: Gain or loss previously deferred in OCI is reclassified into earnings in the same income statement line item as hedged item in the reporting period when the hedged item affects earnings.

The concept of separately recording "ineffectiveness" will be eliminated from hedge accounting

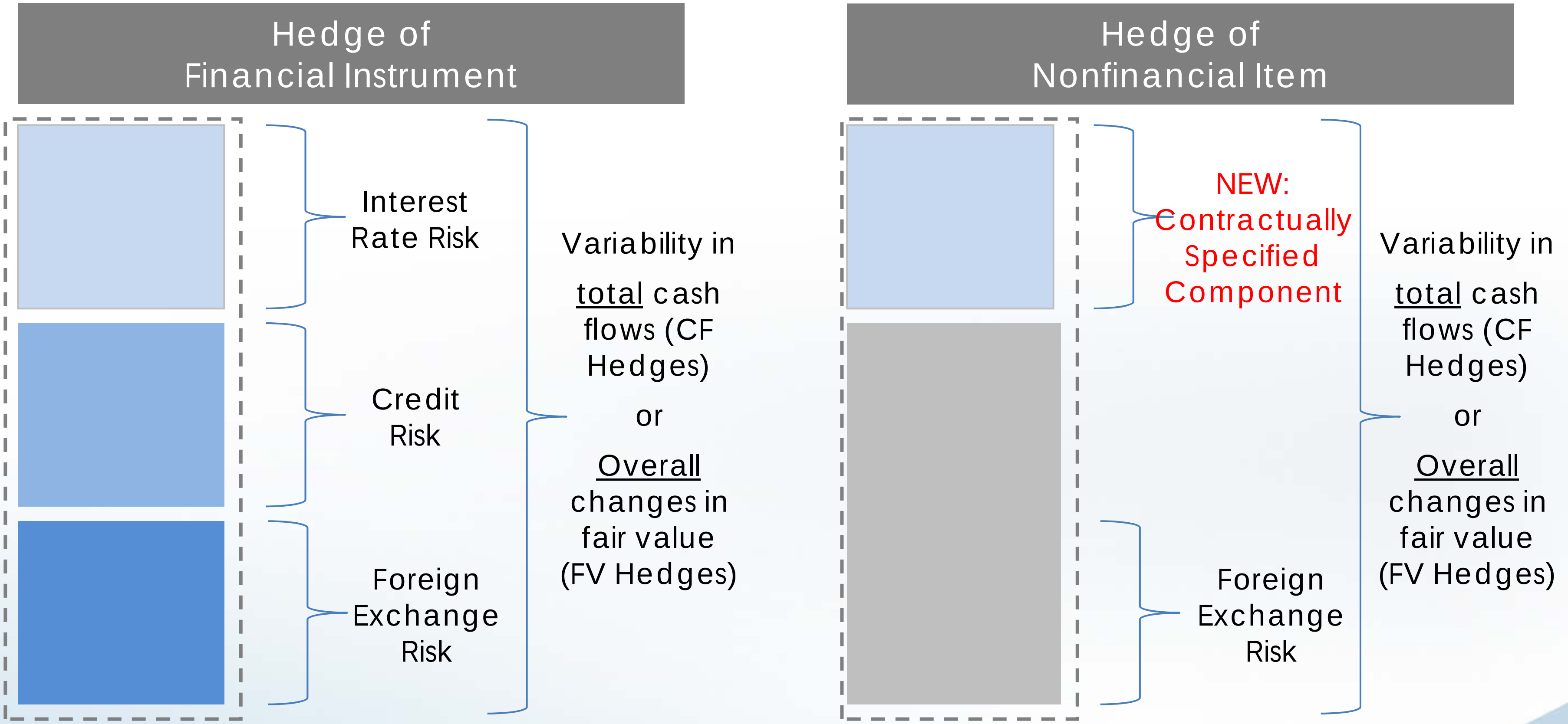
*The highly effective qualifying threshold (80%-125%) of current GAAP will be retained

Hedges of Nonfinancial Items – Board Decisions

- For forecasted purchases or sales of nonfinancial assets, an entity may designate the variability in cash flows of a <u>contractually specified component</u> linked to an index or price as the hedged risk
- This change extends "component hedging" which had previously been reserved for hedges of financial instruments to entities seeking to manage commodity price risk
- Safeguards will be written into the Exposure Draft to ensure the entity actually has exposure to the designated component in the contract
- This change is expected to expand the population of hedging activities that qualify for hedge accounting and more closely align the reported results of a nonfinancial hedge with an entity's risk management objectives

Component Hedging – Board Decisions

What is an entity allowed to designate as the hedged item?



No changes to designated risks for financial instruments. More component hedging would be allowed for nonfinancial items.

Hedges of Interest Rate Risk

What rates can be hedged – Current GAAP

Component hedging of interest rate risk is limited to a list of "benchmark" interest rates:

For both variable rate and fixed rate financial instrument hedges

Allowed
- Overnight Index Swap Rate (OIS)
- U.S. Treasury Rate
- LIBOR Swap Rate

Not Allowed
- SIFMA
- Prime Rate

What rates can be hedged – Board Decisions

- Separate approach for variable rate financial instruments
- Benchmark definition retained for fixed rate – add SIFMA to list

Variable rate financial instrument hedges only

Allowed
- <u>Any</u> Contractually Specified Rate*

Fixed rate financial instrument hedges only

Allowed
- Overnight Index Swap Rate (OIS)
- SIFMA
- U.S. Treasury Rate
- LIBOR Swap Rate

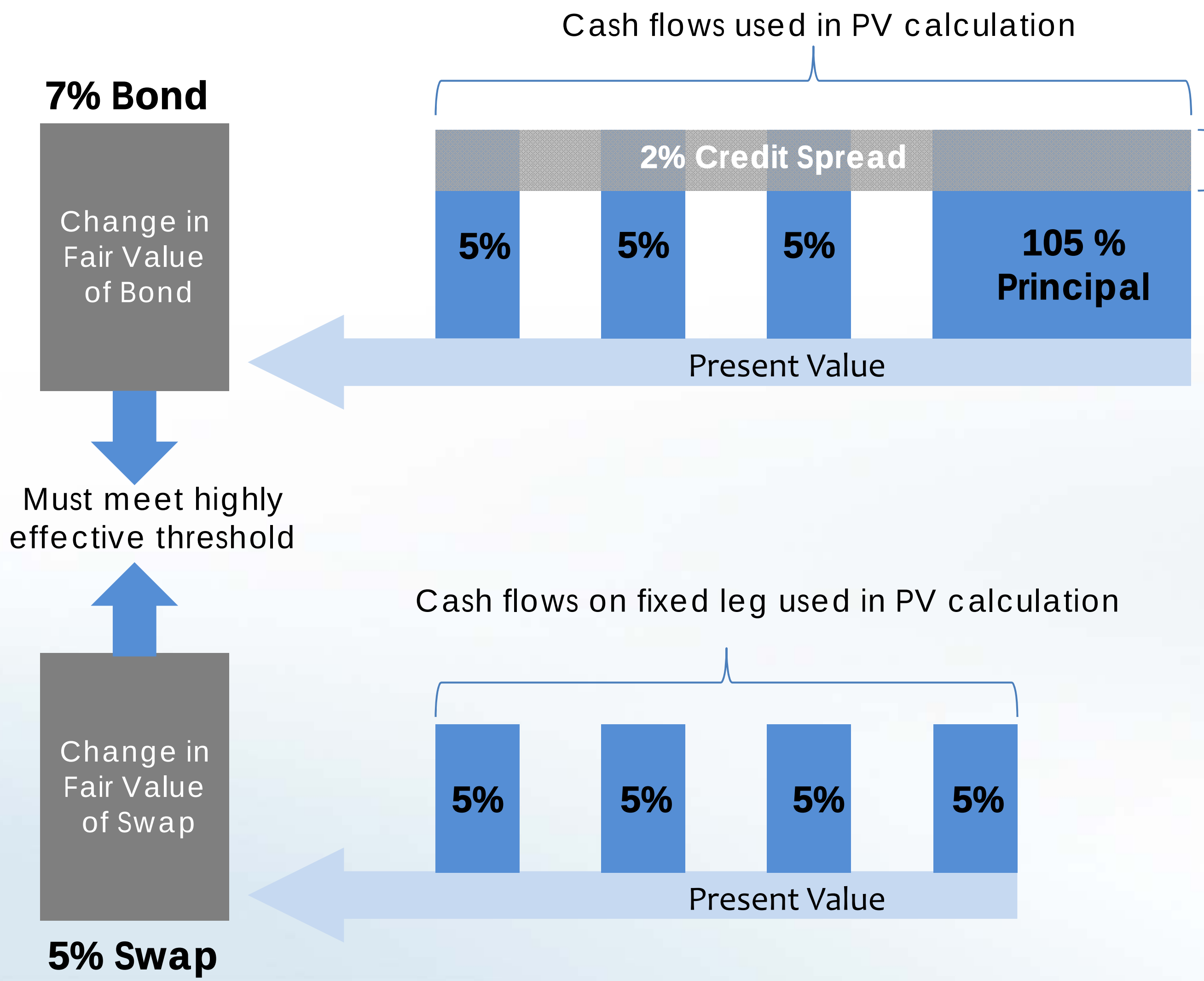
*Extends cash flow hedging to Prime and SIFMA

Fair Value Hedges of Financial Instruments

In response to various practice issues raised by stakeholders, the Board decided to make targeted improvements to accounting for fair value hedges to more closely align the reported results with the risk management objectives of the entity. Board decisions include the following changes:

- *Total Coupon Issue:* When measuring the change in fair value of the hedged item attributable to interest rate risk, the estimated coupon cash flows used in calculating fair value would be based on either the full contractual coupon cash flows or the benchmark interest rate component of the contractual coupon cash flows of the hedged item determined at hedge inception.
  - Exception: If, at hedge inception, the market yield of the financial instrument is less than the benchmark rate, the total contractual coupon cash flows must be used.
- *Partial Term Hedging:* An entity may apply hedge accounting to a portion of the term of a financial instrument in a fair value hedge of benchmark interest rate risk using a revised methodology to measure the change in the fair value of the hedged item that would make such hedges more achievable.
- *Hedging Callable Debt:* When measuring the change in fair value of the hedged item attributable to interest rate risk, an entity may consider only how changes in benchmark interest rates will affect the exercise of a prepayment option (and not all factors that would affect the exercise of a prepayment option).

Fair Value Interest Rate Risk Hedging – Total Coupon



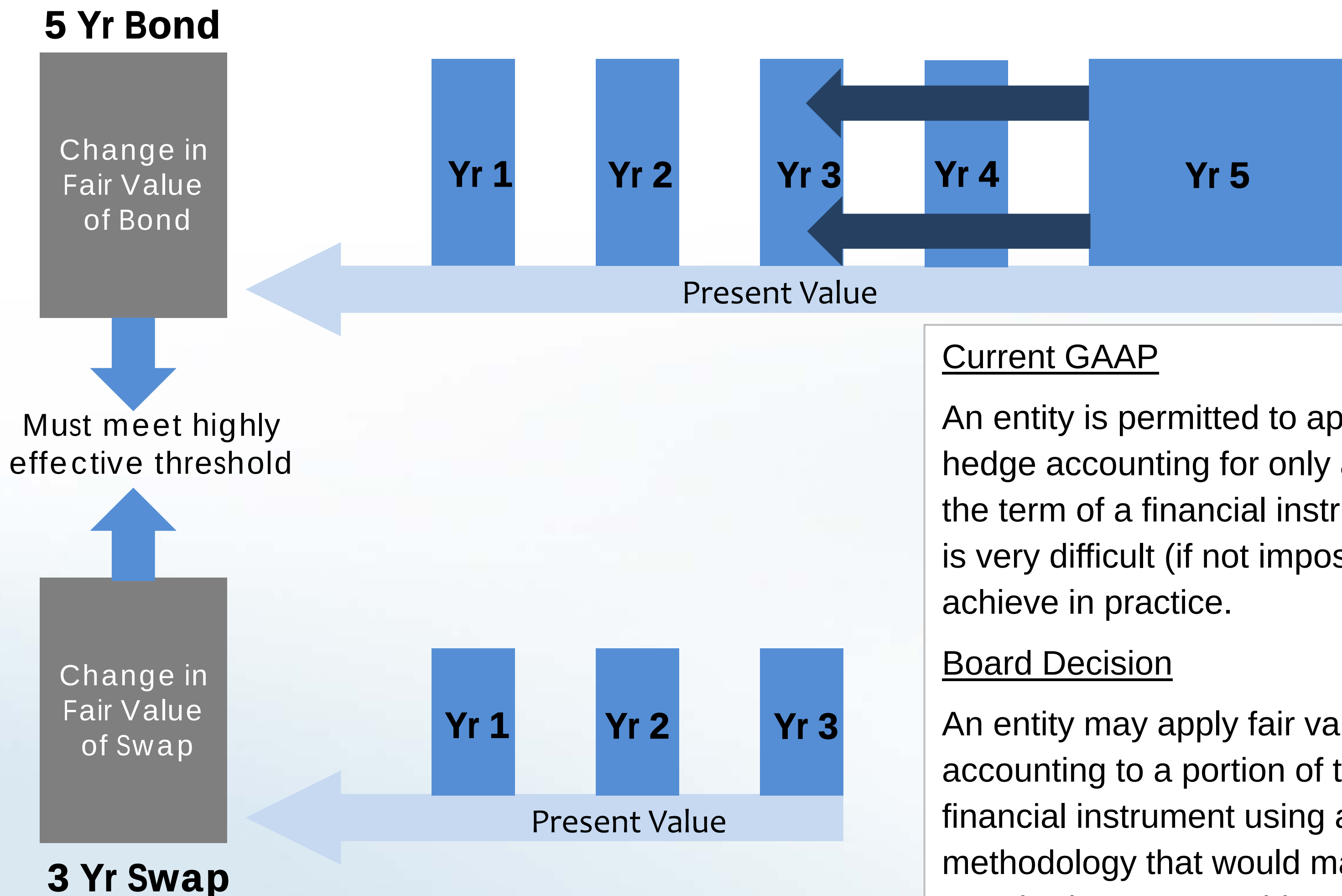
Current GAAP

Hedge of interest rate risk of a fixed rate coupon must include the total coupon cash flows. This requirement was criticized because it includes the credit spread, which is not part of an entity's interest rate risk management strategy and creates "ineffectiveness".

Board Decision

An entity may exclude the credit spread in the fixed rate coupon and measure the hedged item using the benchmark interest rate component of the total coupon determined at hedge inception.

Fair Value Interest Rate Risk Hedging – Partial Term



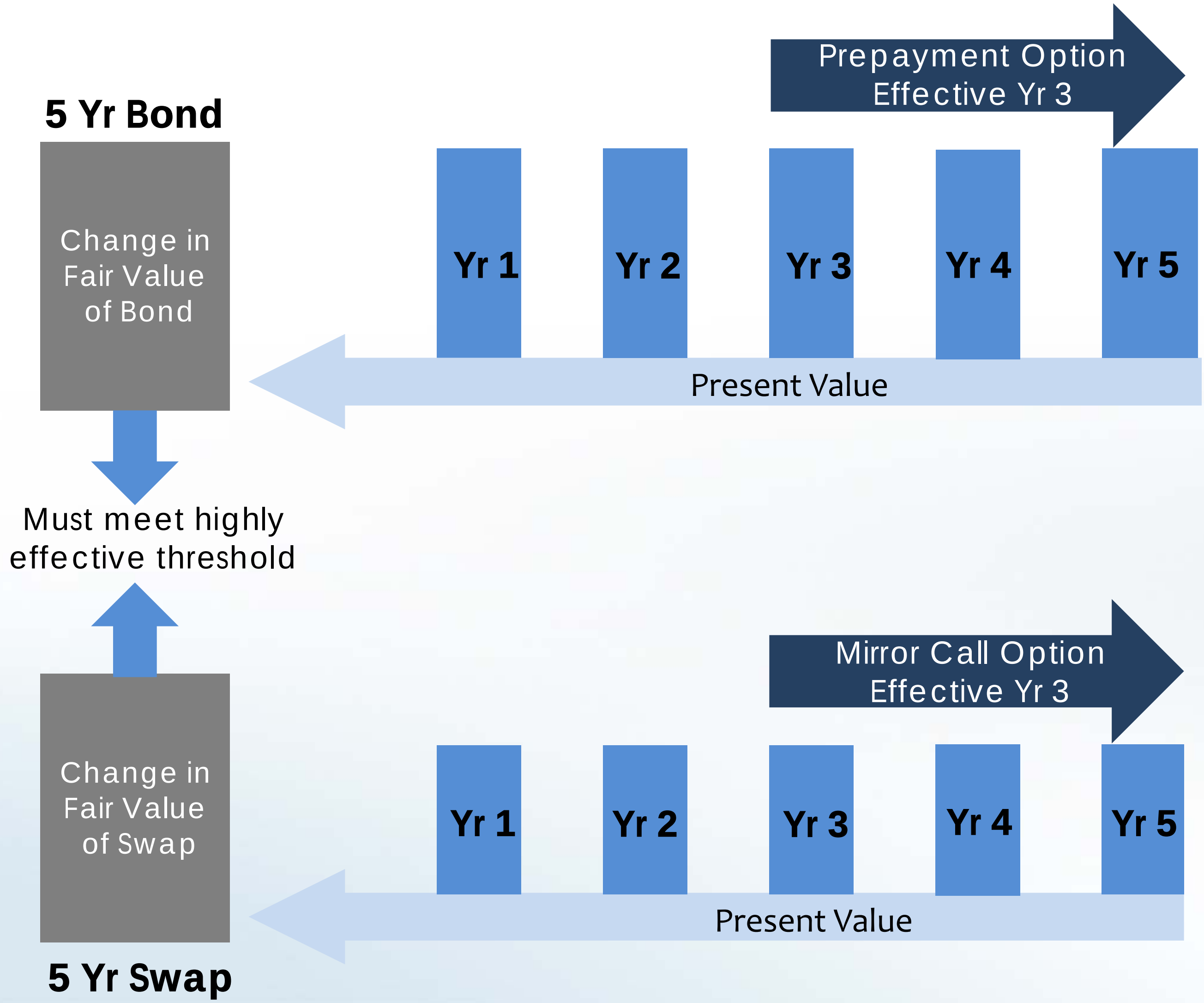
<u>Current GAAP</u>

An entity is permitted to apply fair value hedge accounting for only a portion of the term of a financial instrument, but it is very difficult (if not impossible) to achieve in practice.

<u>Board Decision</u>

An entity may apply fair value hedge accounting to a portion of the term of a financial instrument using a revised methodology that would make partial term hedges more achievable.

Fair Value Interest Rate Risk Hedging – Callable Debt



<u>Current GAAP</u>

An entity must consider all factors when assessing the exercise of a prepayment option, which makes hedging past the call or put date difficult.

<u>Board Decision</u>

When measuring the change in the fair value of the hedged item, an entity may only consider how changes in interest rates affect the exercise of the prepayment option.

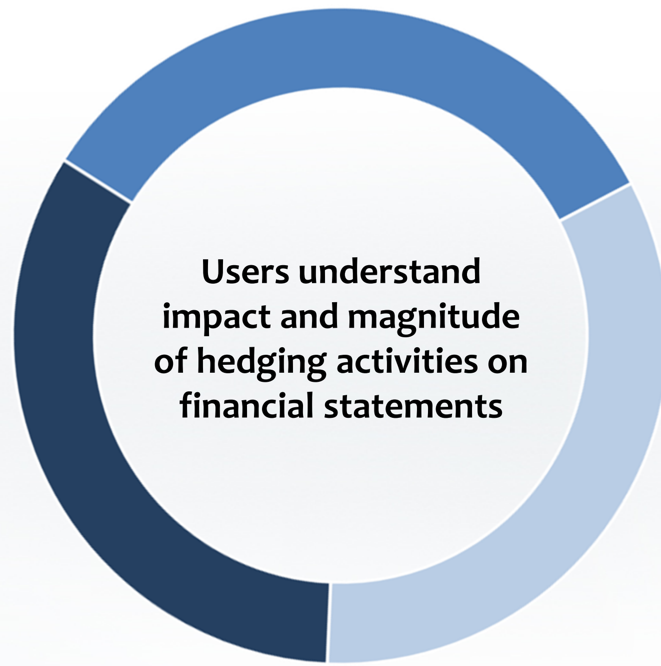
Other Simplifications

- *Qualitative Testing:* An initial quantitative assessment of hedge effectiveness would be required (same as current GAAP) unless the hedging relationship meets the requirements to assume perfect effectiveness at hedge inception (for example, the shortcut method). However, in all subsequent periods, an entity may elect to qualitatively assess hedge effectiveness unless facts and circumstances change.
- *Hedge Documentation:* An entity would be able to complete the initial quantitative testing portion of hedge documentation at any time after hedge designation but before or at the required three-month effectiveness testing period using data as of hedge inception. The timing of the preparation of all other hedge documentation elements would not change.
- *Shortcut Method:* An entity would be able to apply a long-haul method if use of the shortcut method was not or is no longer appropriate as long as:
  - The hedge was highly effective for the periods during which the shortcut criteria were not met
  - The entity documented at hedge inception which long-haul method it would use

Overview of Board Disclosure Decisions

Board decided to amend disclosure requirements to align information provided with changes to the overall hedging model and provide information to users that focuses on the magnitude of the effect of hedging on financial statements

1. An entity would be required to provide additional disclosure related to cumulative basis adjustments for fair value hedges.
2. Certain tabular disclosures required in Topic 815 would be amended to focus on the impact of hedge accounting on income statement line items.
3. An entity would be required to provide enhanced qualitative disclosures describing quantitative hedging goals, if any, set to achieve hedge accounting objectives.



Other Topics

FINANCIAL ACCOUNTING STANDARDS BOARD

Other Topics

- Agenda Consultation ITC – Includes Discussion of:
  - Distinguishing liabilities from equity
  - Intangible assets, including research and development
  - Pensions and other postretirement benefit plans
  - Reporting performance reporting
- Debt and Equity – targeted amendments
- Interest Income on Purchased Callable Debt Securities
- Consolidation
- Revenue Recognition

Questions or Comments