RESCINDED

Outdated – See OCC 2020-11
For more recent information, refer to the Bank Accounting Advisory Series and the FFIEC call report glossary.

OCC Bulletin 2009-11| April 17, 2009

Other-than-Temporary Impairment Accounting: OCC Advisory on Financial Accounting Standards Board Changes

As of January 6, 2012, this guidance applies to federal savings associations in addition to national banks.

Purpose

The purpose of this bulletin is to alert bankers and examiners to recent accounting guidance released by the Financial Accounting Standards Board (FASB) on other-than-temporary impairment (OTTI). This bulletin provides a brief background of the accounting changes and discusses expectations for bank management when determining whether a security has an OTTI. This bulletin also highlights the effect of the accounting changes on regulatory capital requirements.

Background

Accounting

On April 9, 2009, the FASB released FASB Staff Position (FSP) FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*. This FSP amends the existing OTTI guidance in U.S. generally accepted accounting principles (GAAP) for debt securities to make the guidance more operational and to improve the presentation and disclosure of OTTI in the financial statements.

When a bank determines that an OTTI exists but does not intend to sell the debt security or it is more likely than not that the bank will not be required to sell the debt security prior to its anticipated recovery, the FSP changes the presentation and amount of the OTTI recognized in the statement of earnings. The OTTI will be separated into two parts:

- The amount of the total OTTI related to the credit loss on the debt security would be recognized in earnings (i.e., the credit component).
- The amount of the total OTTI related to all other factors would be recognized in other comprehensive income, net of applicable taxes (i.e., the non-credit component).

The FSP states that one way to estimate the credit component of the OTTI would be to consider the methodology described in paragraphs 12–16 of FASB Statement No. 114 (FAS 114), *Accounting by Creditors for Impairment of a Loan*. FAS 114 generally measures an impairment based on the present value of expected future cash flows discounted at the effective interest rate. Other methodologies may be allowable if they represent reasonable measurements of credit impairment.

To

Chief Executive Officers of All National Banks, Department and Division Heads, All Examining Personnel, and Other Interested Parties

The FSP is effective for June 30, 2009, regulatory reports, with early adoption permitted for March 31, 2009, reports. The FASB also released FSP 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* (FSP 157-4). FSP 157-4 provides additional guidance on determining fair value when the volume and level of activity for the asset or liability have significantly decreased. The FSPs on OTTI and fair value must be adopted concurrently.

The transition provisions for the FSP on OTTI require an entity to recognize the cumulative effect of initially applying the FSP as an adjustment to the opening balance of retained earnings, with a corresponding adjustment to accumulated other comprehensive income. That is, for debt securities where OTTI has previously been recognized, the tax-effected amount of the total OTTI related to non-credit factors should be moved out of retained earnings and into accumulated other comprehensive income as of the adoption date. This amount is calculated by comparing the present value of the cash flows expected to be collected with the amortized cost basis. The amortized cost basis of a security for which an OTTI was previously recognized must also be adjusted by the amount of the cumulative effect adjustment before taxes.

The complete guidance on both FSPs is available on the FASB Website: http://www.fasb.org.

Regulatory Capital

The FSP on OTTI may also affect regulatory capital levels and ratios for banks reporting a non-credit component of OTTI. As a result of the FSP on OTTI, the non-credit component of OTTI on debt securities (classified as available-for-sale or held-to-maturity) will now flow through other comprehensive income (OCI), which will not reduce bank earnings. Under existing regulatory capital requirements, the portion of OTTI for debt securities that flows through OCI will not affect bank Tier 1 capital[1] . See the March 31, 2009, supplemental call report instructions for additional reporting details.

Responsibilities of Management

Bank management is responsible for assuring that regulatory reports are accurate at each reporting date and consistent with GAAP. Bank management should update its policies and practices in accordance with the FSPs and maintain appropriate documentation to support their fair value measurements and OTTI assessments. This process should incorporate the relevant accounting guidance for each type of security. As such, bank management must understand the underlying characteristics of securities they hold and the market factors affecting the fair value of the investment. Bank management should have policies to identify and assess securities for OTTI on an instrument-level basis, and should perform the assessments on at least a quarterly basis.

For those securities with fair value less than cost, bank management should have documentation to support whether that impairment is temporary or other than temporary. The longer the security has been impaired and the greater the decline in value, the more robust the documentation should be to support a conclusion of only temporary impairment. Further, the bank's policies and internal controls should clearly address the methodology used on debt securities for the ongoing assessment of credit and non-credit components of

OTTI, as well as the cumulative effect adjustment (e.g., processes used, key assumptions, sources validating key assumptions). In all instances, the determination of the credit component should include a careful assessment of all changes in underlying cash flows. For structured investments, a diligent evaluation of the underlying assets should be incorporated. The bank's methodology and process for assessing securities for OTTI and for determining the credit and non-credit components of OTTI should be periodically reviewed and validated by a party who is independent of the bank's investment management processes. This independent review could be performed by the bank's internal audit staff, a risk management unit of the institution, an external auditor (subject to applicable auditor independence standards), or another contracted third party from outside the institution.

Responsibilities of Examiners

Through the supervisory process, examiners should review the bank's policies and practices governing the fair value measurements and OTTI assessments and the presentation in the regulatory reports. The examiner should also review the bank's documentation for the cumulative effect adjustment required at adoption. The level and depth of examiner reviews should reflect the overall size, condition, and complexity of the investment portfolio, as well as the potential for unrecognized OTTI.

Further Information

You may direct questions regarding this bulletin to Jacob Cooper, Professional Accounting Fellow, Office of the Chief Accountant, at (202) 649-6280; John Vivian, Balance Sheet Risk Specialist, Credit and Market Risk, at (202) 649-6360; or Mark Ginsberg, Risk Expert, Capital Policy, at (202) 649-6370.

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* References in this guidance to national banks or banks generally should be read to include federal savings associations (FSA). If statutes, regulations, or other OCC guidance is referenced herein, please consult those sources to determine applicability to FSAs. If you have questions about how to apply this guidance, please contact your OCC supervisory office.

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[1]See also 12 CFR Part 3, App. A, Sec. 2(a)