Other-Than-Temporary Impairment

Anita Feemster

Manager / Accounting Specialist

Federal Reserve Bank of Kansas City

Supervision and Risk Management

FSP FAS 115-2

- Issued to make OTTI guidance for debt securities more operational
- Issued to improve the presentation and disclosure of OTTI in the financial statements
- Does not change the requirement to determine that an OTTI exists if management does not expect to recover the security's entire cost basis
- Does change the presentation of OTTI in the financial statements for certain securities under certain conditions

FSP FAS 115-2

- When the fair value of an available-for-sale or held-to-maturity security is less than its amortized cost basis, it is impaired
- The impairment is either temporary or other than temporary
- OTTI does not mean permanent
- If the institution does not expect to recover the security’s entire cost basis, OTTI exists

FSP FAS 115-2

- When management has an intent to sell or it is more likely than not it will be required to sell
  - the full OTTI amount is recorded in earnings
- When management has no intent to sell and it is more likely than not that it will not be required to sell, the presentation of the OTTI in the financial statement changes as follows
  - credit-related OTTI is recorded in earnings
  - Noncredit-related OTTI is recorded in other comprehensive income

FSP FAS 115-2

Determination of credit-related loss

- Based on institution management’s best estimate of the amount of OTTI that relates to a decrease in cash flows expected to be collected from the debt security
- One approach for estimating the credit loss portion of an OTTI would be to consider the FAS 114 methodology of measuring impairment based on the present value of expected future cash flows

FSP FAS 115-2

- Effective for 2Q09 reporting, early adoption for 1Q09 reporting was permitted (provided the Fair Value FSP was also early-adopted)
- Cumulative effect adjustment (true up)
  - required to reclassify the noncredit component of a previously recognized OTTI from retained earnings to accumulated OCI if the institution does not have the intent to sell and it is more likely than not that it will not be required to sell before recovery

FSP FAS 115-2

Potential Impact / Issues

- Amount of future impairment write-downs may be substantially reduced, improving earnings and regulatory capital
- Expectations for governance and internal controls for valuations
- Potential increased use of cash flow modeling for valuations