

Interpretation of the Emerging Accounting Issues Working Group

INT 02-07: Definition of Phrase “Other Than Temporary”

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INT 02-07 Dates Discussed

March 18, 2002; June 9, 2002; December 5, 2004; March 13, 2005

INT 02-07 References

SSAP No. 26—Bonds, Excluding Loan-Backed and Structured Securities (SSAP No. 26)

SSAP No. 30—Investments in Common Stock (excluding investments in common stock of subsidiary, controlled or affiliated entities) (SSAP No. 30)

SSAP No. 32—Investments in Preferred Stock (including investments in common stock of subsidiary, controlled or affiliated entities) (SSAP No. 32)

SSAP No. 37—Mortgage Loans (SSAP No. 37)

SSAP No. 39—Reverse Mortgages (SSAP No. 39)

SSAP No. 43R—Loan-backed and Structured Securities (SSAP No. 43R)

SSAP No. 46—Investments in Subsidiary, Controlled, and Affiliated Entities (SSAP No. 46)

SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies (SSAP No. 48)

SSAP No. 68—Business Combinations and Goodwill (SSAP No. 68)

SSAP No. 93—Accounting for Low Income Housing Tax Credit Property Investments (SSAP No. 93)

SSAP No. 97— Investments in Subsidiary, Controlled and Affiliated Entities, A Replacement of SSAP No. 88 (SSAP No. 97)

INT 02-07 Issue

1. The *Accounting Practices and Procedures Manual* makes reference to an “other than temporary” decline in fair value in 9 different SSAPs. The SSAPs stipulate that if the impairment is judged to be other than temporary, the cost basis of the individual asset shall be written down to a new cost basis and the amount of the write-down shall be accounted for as a realized loss. The SSAPs do not define the phrase “other than temporary.” In applying this guidance to a specific situation, the NAIC Staff was informed that Company A has interpreted “other than temporary” to mean permanent impairment. Therefore, because Company A’s management has not been able to determine that its investment in Company B is permanently impaired, no realized loss has been recognized even though the fair value of B’s shares is currently less than one-third of A’s cost.
2. The accounting issues are:
 - a. Should the phrase “other than temporary” be interpreted to mean “permanent?”
 - b. Is it appropriate for reporting entities, independent auditors or state examiners to apply predefined thresholds to the phrase “other than temporary”?
 - c. When management determines that a write-down, accounted for as a realized loss is necessary, how should the amount of the write-down be determined?

INT 02-07 Discussion

3. On June 9, 2002, the working group reached a consensus¹ position regarding each of the accounting issues as noted below. On March 13, 2005 the working group reached a consensus to update paragraph 5 and insert paragraph 6 as shown in tracked changes below.
4. Question a – No. The working group believes that the NAIC consciously chose the phrase “other than temporary” because it did not intend that the test be “permanent impairment.” The fair value of assets may decline for various reasons. The market price may be affected by general market conditions, which reflect prospects for the economy as a whole, or by specific information pertaining to an industry or an individual company. Such declines require further investigation by management. Acting upon the premise that a write-down may be required, management should consider all available evidence to evaluate the fair value of its investment.
5. There are numerous factors to be considered in such an evaluation and their relative significance will vary from case to case. The working group believes that the following are only a few examples of the factors, which, individually or in combination, indicate that a non-interest related decline is other than temporary and that a write-down of the carrying value is required:
- The length of time and the extent to which the fair value has been less than cost;
 - The financial condition and short-term prospects of the issuer, including any specific events which may influence the operations of the issuer such as changes in technology that may impair the earnings potential of the asset or the discontinuance of a segment of the business that may affect the future earnings potential; or
 - The intent and ability of the holder to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.
6. An interest related impairment should be deemed other-than-temporary when an investor has the intent to sell, at the reporting date, an investment before recovery of the cost of the investment. The investor should consider whether its cash or working capital requirements and contractual or regulatory obligations indicate that the investment may need to be sold before the forecasted recovery occurs.
7. Unless evidence exists to support the assertion that the decline in fair value below carrying value is temporary, a write-down accounted for as a realized loss should be recorded. In accordance with the guidance of the SSAPs, such loss should be recognized in the determination of net income for the period in which it occurs. The written down value of the investment in the company becomes the new cost basis of the investment.
8. Question b – No. The working group is aware that certain insurers, independent auditors and state examiners, over time, have developed quantitative thresholds as "rules of thumb" to assist in the evaluation of asset impairment. One rule of thumb in particular suggests that if the fair value of the asset is more than 20% less than its cost then it is considered to be other than temporarily impaired. Another suggests that an asset is other than temporarily impaired if the fair value has been less than cost for more than 6 months. The use of a numerical threshold may provide the basis for a preliminary assumption that – without considering all relevant circumstances – an impairment may have occurred. The working group has no objection to such a "rule of thumb" as an initial step in assessing impairment but quantifying the impairment is only the beginning of the analysis; it cannot appropriately be used as a substitute for a full analysis of

¹ The recommendations provided by the working group were developed in part from SEC Staff Accounting Bulletin No. 59–*Noncurrent Marketable Equity Securities* (SAB 59). As such, readers of this Interpretation should understand that SAB 59 has not been adopted as part of Statutory Accounting Principles as SAB's are not part of the Statutory Hierarchy (see Preamble).

all relevant qualitative considerations. The use of such thresholds removes the ability of management to apply its judgment, a concept inherent to the impairment model.

9. Question c – The cost or carrying value of the asset should be written down to reflect its value in accordance with the relevant SSAP, if an impairment exists. A company's management should follow the impairment guidance in the SSAP pertaining to that particular asset class while considering various factors on a case-by-case basis in determining the amount of the realized loss and/or unrealized loss that needs to be recorded. As the impairment rules did not become effective until January 1, 2001, entities shall use the asset's carrying value as of January 1, 2001 when applying the impairment concept upon adoption of Codification.

INT 02-07 Status

10. No further discussion planned.