

**FEDERAL RESERVE BANK
OF NEW YORK**

[Circular No. **10635**]
April 26, 1993]

**SUPPLEMENTAL DISCLOSURE OF
ESTIMATED FAIR VALUES**

Comments Requested by June 14

*To All Depository Institutions, and Others
Concerned, in the Second Federal Reserve District:*

Following is the text of a statement issued by the Federal Financial Institutions Examination Council:

The Federal Financial Institutions Examination Council has announced that it is seeking public comment on the implementation of certain disclosure requirements mandated by Section 121 of the Federal Deposit Insurance Corporation Act of 1991 (FDICIA). The Council's four banking agencies have developed a method for insured depository institutions to provide supplemental fair value disclosures for their assets and liabilities, to the extent feasible and practicable, in certain reports filed with the agencies. Comments will be accepted on the proposal for 60 days after its publication in the *Federal Register*.

Printed on the following pages is the text of the FFIEC's official notice on this matter, as published in the *Federal Register* of April 13. Comments should be submitted by June 14, 1993, and should be sent to the FFIEC, as indicated in the notice, or to our Bank Analysis Department.

E. GERALD CORRIGAN,
President.

**FEDERAL FINANCIAL INSTITUTIONS
EXAMINATION COUNCIL****Supplemental Disclosure of Estimated
Fair Values**

AGENCY: Federal Financial Institutions
Examination Council.

ACTION: Request for comment.

SUMMARY: Section 121 of the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA) requires the Federal Reserve Board (FRB), the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), and the Office of Thrift Supervision (OTS) (collectively, the federal banking agencies or the agencies) to develop jointly a method for insured depository institutions to provide supplemental fair value disclosures for their assets and liabilities, to the extent feasible and practicable, in certain reports filed with the agencies. Under generally accepted accounting principles (GAAP), financial statements issued for fiscal years ending after December 15, 1992, by entities with \$150 million or more in total assets must include disclosures about the estimated fair value of financial instruments. Pursuant to external audit regulations to be adopted by the FDIC pursuant to section 112 of FDICIA, insured depository institutions of this size (or of such larger size as the FDIC may determine) will be required to submit annual reports which contain annual financial statements prepared in accordance with GAAP and other disclosures prescribed by the agencies.

The Federal Financial Institutions Examination Council (FFIEC) requests public comment on whether insured depository institutions that will be required to file annual reports pursuant to section 112 of FDICIA should provide supplemental fair value disclosures for their assets and liabilities in those reports in accordance with the method developed jointly by the agencies. Under this method, such institutions would include in their annual financial statements prepared in accordance with GAAP the disclosures about fair values of financial instruments prescribed by Financial Accounting Standards Board Statement No. 107 (FASB 107).
Supplemental unaudited disclosures

about fair values of nonfinancial assets and liabilities would accompany the annual financial statements and would be made by applying the concepts and principles set forth in FASB 107 and other relevant GAAP standards to these assets and liabilities.

The FFIEC also requests public comment on whether it is feasible and practicable for insured depository institutions to include supplemental fair value disclosures for their on- and off-balance sheet assets and liabilities on an annual basis in their "reports of condition" and on the costs associated with making these disclosures. The "reports of condition" are the Consolidated Reports of Condition and Income (Call Reports) filed by insured commercial banks and FDIC-supervised savings banks, the Thrift Financial Report (TFR) filed by insured savings associations, and the Report of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks filed by insured U.S. branches of foreign banks.

DATES: Comments must be received by June 14, 1993.

ADDRESSES: Comments should be directed to Joe M. Cleaver, Executive Secretary, Federal Financial Institutions Examination Council, 2100 Pennsylvania Avenue, NW., suite 200, Washington, DC 20037. (Fax number (202) 634-6556.)

FOR FURTHER INFORMATION CONTACT:

FRB—Gerald A. Edwards, Jr., Assistant Director, (202) 452-2741, or Charles H. Holm, Project Manager, (202) 452-3502, Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System, 20th and Constitution Avenue, NW., Washington, DC 20551.

FDIC—Robert F. Storch, Chief, Accounting Section, Division of Supervision, Federal Deposit Insurance Corporation, 550 17th Street, NW., Washington, DC 20429, (202) 898-8906.

OCC—Christine A. Tate, Professional Accounting Fellow, Office of the Chief National Bank Examiner, Office of the Comptroller of the Currency, 250 E Street, SW., Washington, DC 20219, (202) 874-5411.

OTS—Robert J. Pomeranz, Office of Thrift Supervision, 1700 G Street, NW., Washington, DC 20552, (202) 906-5650.

SUPPLEMENTARY INFORMATION:

I. Statutory Requirements

Section 37(a)(3)(D) of the Federal Deposit Insurance Act (the FDI Act) (12 U.S.C. 1831n(a)(3)(D)), as added by section 121 of FDICIA (Pub. L. 102-242, 105 Stat. 2251), calls upon the federal banking agencies to develop jointly a method for insured depository

institutions to provide supplemental disclosure of the estimated fair market value of assets and liabilities, to the extent feasible and practicable, in certain reports filed with the agencies.

II. GAAP Requirements

On December 16, 1991, the Financial Accounting Standards Board (FASB) issued Statement No. 107, "Disclosures about Fair Values of Financial Instruments." A financial instrument is defined in this accounting standard as—

Cash, evidence of an ownership interest in an entity, or a contract that both:

a. Imposes on one entity a contractual obligation (1) to deliver cash or another financial instrument to a second entity or (2) to exchange other financial instruments on potentially unfavorable terms with the second entity;

b. Conveys to that second entity a contractual right (1) to receive cash or another financial instrument from the first entity or (2) to exchange other financial instruments on potentially favorable terms with the first entity.

The FASB's summary of Statement No. 107 notes that it requires—

All entities to disclose the fair value of financial instruments, both assets and liabilities recognized and not recognized in the statement of financial position, for which it is practicable to estimate fair value. If estimating fair value is not practicable, this Statement requires disclosure of descriptive information pertinent to estimating the fair value of a financial instrument * * *.

This Statement is effective for financial statements issued for fiscal years ending after December 15, 1992, except for entities with less than \$150 million in total assets in the current statement of financial position. For those entities, the effective date is for fiscal years ending after December 15, 1995.

According to FASB 107, the term "practicable" means that "an estimate of fair value can be made without incurring excessive costs." As an example, the accounting standard observes that—

it might not be practicable for an entity to estimate the fair value of a class of financial instrument for which a quoted market price is not available because it has not yet obtained or developed the valuation model necessary to make the estimate, and the cost of obtaining an independent valuation appears excessive considering the materiality of the instruments to the entity.

Thus, larger banking and thrift organizations (i.e., those with \$150 million or more in total assets) that issue financial statements that are prepared in accordance with GAAP are now required to include additional information relating to the estimated fair values of financial instruments as part of their year-end financial statements. The disclosures would not normally be

included in their quarterly GAAP financial statements. Furthermore, FASB 107 does not require estimated fair value disclosures for nonfinancial assets and liabilities (i.e., on- and off-balance sheet assets and liabilities that are not financial instruments), but such disclosures are not prohibited.

III. Supplemental Fair Value Disclosures in Annual Reports Under Section 112 of FDICIA

Section 112 of FDICIA, which adds a section 36 to the Federal Deposit Insurance Act (12 U.S.C. 1831m), requires insured depository institutions with total assets of \$150 million or more, or such higher level as the FDIC may prescribe, to submit to the agencies annual reports which contain annual financial statements prepared in accordance with GAAP and "such other disclosure requirements as the Corporation and the appropriate Federal banking agency may prescribe."¹ In certain circumstances, an insured depository institution that is a subsidiary of a holding company may satisfy the requirement for an annual report containing annual financial statements and other disclosures under section 112 by submitting financial statements and other disclosures for its parent holding company on a consolidated basis.

Pursuant to section 121 of FDICIA, the agencies have developed jointly a method for these insured depository institutions to provide supplemental disclosure of the estimated fair values of their on- and off-balance sheet assets and liabilities, to the extent feasible and practicable, in their annual reports under section 112. FASB 107 forms the basis for the agencies' supplemental fair value disclosure method.

Thus, the method developed jointly by the agencies for insured depository institutions that will be subject to the FDIC's external audit regulations implementing section 112 of FDICIA addresses financial instruments separately from nonfinancial assets and liabilities. Under this method, the annual GAAP financial statements that will be contained in the annual reports these institutions must submit to the agencies under section 112 would include the disclosures about financial instruments that are prescribed by FASB 107.

In addition, under the agencies' method, supplemental unaudited disclosures about fair values of nonfinancial assets and liabilities would

¹ The FDIC has issued proposed regulations to implement section 112 of FDICIA. See 57 FR 42516, September 15, 1992.

accompany the annual financial statements in the annual reports of these institutions. These supplemental unaudited disclosures would be made by applying the concepts and principles set forth in FASB 107 and other relevant GAAP standards to the nonfinancial assets and liabilities. Accordingly, institutions that will be subject to the regulations implementing section 112 would disclose the fair value of those nonfinancial assets and liabilities, both recognized and not recognized in the balance sheet, for which it is feasible and practicable to estimate fair value. If estimating fair value is not feasible and practicable for certain nonfinancial assets and liabilities, descriptive information pertinent to estimating the fair value would be disclosed. Section 112 provides the authority for annual reports to contain such supplemental unaudited disclosures.

The FFIEC specifically requests comment on whether it is feasible and practicable for institutions to provide supplemental unaudited disclosures about fair values of nonfinancial assets and liabilities in the annual reports that will be required to be filed with the agencies under section 112. When responding to this question, commenters should note that nonfinancial assets include foreclosed real estate which, under GAAP, must be carried on the balance sheet at the lower of (1) the fair value of the asset minus the estimated costs to sell or (2) the cost of the asset.

IV. Reports of Condition

The "reports of condition" are the Consolidated Reports of Condition and Income (Call Reports) filed by insured commercial banks and FDIC-supervised savings banks, the Thrift Financial Report (TFR) filed by insured savings associations, and the Report of Assets and Liabilities of U.S. Branches and Agencies of Foreign Banks filed by insured U.S. branches of foreign banks. These reports are designed to serve the supervisory, regulatory, and economic policy needs of the agencies and, as such, are not primarily accounting documents.

As mentioned in section II. above, the supplemental disclosures about fair values of financial instruments prescribed by FASB 107 would normally be included only in an entity's year-end GAAP financial statements, not in the quarter-end GAAP financial statements for the first three quarters of its fiscal year. As a consequence, the FFIEC believes that it would impose excessive costs and, therefore, not be feasible and practicable for insured depository institutions to make

supplemental disclosures of the estimated fair values of on- and off-balance sheet assets and liabilities in reports of condition at quarter-end report dates other than at an institution's fiscal year-end.

Furthermore, most of the insured depository institutions that will be subject to the regulations implementing section 112 of FDICIA are subsidiaries of holding companies. To the extent permissible under these regulations, the annual reports of these institutions under section 112 will likely contain consolidated annual financial statements and other disclosures of the institutions' holding companies rather than those of the individual institutions themselves. This means that the supplemental fair value disclosures that institutions will include in their annual reports in accordance with the method developed by the agencies (and discussed in section III. above) will for the most part be presented on a consolidated holding company basis. When preparing consolidated financial statements and disclosures, on- and off-balance sheet assets and liabilities of individual insured depository institution subsidiaries of the holding company that result from intercompany transactions are eliminated. Consequently, for purposes of the annual reports under section 112, fair values will be estimated only for those assets and liabilities of a subsidiary institution that are not eliminated in consolidation. Since reports of condition are prepared on an individual institution basis, insured depository institutions that will be subject to section 112 would incur additional costs to estimate the fair values of their assets and liabilities that were eliminated as part of the holding company consolidation. Furthermore, additional costs may be incurred if fair values are required to be estimated on an individual institution basis since greater disaggregation of asset pools and groups of liabilities would be necessary and because materiality thresholds may be lower for individual institutions than for the consolidated entity. To the extent that these additional costs are excessive, it would not be feasible and practicable for institutions subject to section 112 of FDICIA to provide supplemental fair value disclosures in any of their reports of condition, including the year-end report.

In addition, entities with less than \$150 million in total assets are not required to provide the supplemental fair value disclosures prescribed by FASB 107 in financial statements prepared in accordance with GAAP until their fiscal years ending after

December 15, 1995. In deciding to delay the effective date of FASB 107 for smaller entities until year-end 1995, the FASB stated that the three-year delay would "provide sufficient time for those entities to develop the systems necessary to provide the required [fair value] disclosures in light of the experience gained by larger entities on the use of various methods and assumptions for estimating fair value." This indicates that those smaller insured depository institutions (i.e., those not subject to section 112 of FDICIA) that issue annual financial statements prepared in accordance with GAAP would incur excessive costs if they had to include these fair value estimates in their GAAP financial statements prior to year-end 1995. Therefore, the FFIEC believes that it would not be feasible and practicable for smaller insured depository institutions to provide supplemental fair value disclosures in their reports of condition before year-end 1995.

Finally, there is no general statutory requirement for all institutions with less than \$150 million in total assets to prepare GAAP financial statements and file them with the federal banking agencies.² Thus, many smaller depository institutions will not be subject to the supplemental fair value disclosure requirements of FASB 107. As a result, the FFIEC believes it may not be possible for smaller insured depository institutions to estimate the fair values of their financial instruments and their on- and off-balance sheet nonfinancial assets and liabilities, either at year-end 1995 or thereafter, without incurring excessive costs.

Thus, based on the factors discussed above and any other considerations that may be relevant, the FFIEC requests public comment on whether it is feasible and practicable for both larger and smaller insured depository institutions to include supplemental disclosures of the estimated fair values of their on- and off-balance sheet assets and liabilities in their reports of condition. In this regard, the FFIEC specifically requests comment on the amount of additional costs (both start-up and annual) that individual

² Pursuant to section 12(b) or (g) of the Securities Exchange Act of 1934 (15 U.S.C. 78(b) (g)), insured depository institutions which have securities registered on a national securities exchange or which have total assets exceeding \$1 million and a class of equity security held by 500 or more stockholders are required to register these securities with the appropriate federal banking agency. Fewer than 300 institutions with less than \$150 million in total assets have securities that are registered with the agencies. These institutions prepare GAAP financial statements and file them with the agencies.

depository institutions expect that they would incur if they were required to estimate these fair values for purposes of their reports of condition. If institutions and other commenters believe that it would be feasible and practicable to report estimated fair values in the reports of condition, it would be helpful if these commenters would indicate a format (such as a condensed, abbreviated format) that they believe should be used for these disclosures in reports of condition.

V. Request for Comment

In addition to the issues for which comment was specifically requested at the end of sections III. and IV. above, the FFIEC invites comment on all aspects of the method developed jointly by the agencies (and discussed in section III. above) for insured depository institutions that will be subject to the FDIC's external audit regulations to provide supplemental fair value disclosures in their annual reports under section 112 of FDICIA. It would also be helpful to the agencies if banking and thrift organizations that submit comments to the FFIEC enclose with their comments a copy of the FASB 107 estimated fair value disclosures that appear in their annual reports for 1992.

Dated: April 8, 1993.

Joe M. Cleaver,

*Executive Secretary, Federal Financial
Institutions Examination Council.*

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