Statutory Issue Paper No. 33

Disclosures about Fair Value of Financial Instruments

STATUS
Finalized March 16, 1998

Original SSAP and Current Authoritative Guidance: SSAP No. 27

Type of Issue:
Common Area

SUMMARY OF ISSUE

1. Though disclosures about market values of certain investments are currently made in schedules included in the Annual Statements for Property and Casualty Insurance Companies and for Life and Accident and Health Insurance Companies, the annual statements contain no disclosures of fair values of other financial instruments. Furthermore, there are no specific disclosure requirements in the current statutory guidance requiring fair value disclosures in the financial statements. GAAP has specific disclosure requirements for the fair value of financial instruments. This issue paper establishes statutory accounting principles for disclosures about fair value of financial instruments that are consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts).

SUMMARY CONCLUSION

2. A financial instrument shall be defined 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.

3. Examples of the financial instruments, which encompass both assets and liabilities recognized and not recognized in the statement of financial position, to which this issue paper apply include but are not limited to short-term investments, bonds, common stock, preferred stocks, mortgage loans, derivatives, financial guarantees written, standby letters of credit, notes payable and deposit-type contracts.

4. A reporting entity shall disclose in the notes to the financial statements the fair value of all financial instruments, summarized by type of financial instrument, for which it is practicable to estimate fair value, except for certain financial instruments named in paragraph 8 of FASB Statement No. 107, Disclosure about Fair Value of Financial Instruments (FAS 107), (which is excerpted in the Relevant GAAP Guidance section in paragraph 14 below). Fair value disclosed in the notes shall be presented together with the related admitted values in a form that makes it clear whether the fair values and admitted values represent assets or liabilities and to which line items in the Statement of Assets, Liabilities, Surplus and Other Funds they relate. Separate disclosure of this information in the notes is required even if such information is presented elsewhere in the financial statements. Unless specified

estimate the fair value of financial instruments. Fo

11. Paragraph 4 above requires the disclosure of the fair value of all financial instruments if it is practicable to estimate those values. In the context of this issue paper, practicable means that an estimate of fair value can be made without incurring excessive costs. It is a dynamic concept: what is practicable for one entity might not be for another; what is not practicable in one year might be in another. For example, it might not be practicable for an entity to estimate the fair value of a class of financial instruments 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. Practicability, that is, cost considerations, also may affect the required precision of the estimate; for example, while in many cases it might seem impracticable to estimate fair value on an individual instrument basis, it may be practicable for a class of financial instruments in a portfolio or on a portfolio basis. In those cases, the fair value of that class or of the portfolio should be disclosed. Fina

obligations that ends with the delivery of cash or an ownership interest in an entity. Any number of obligations to deliver financial instruments can be links in a chain that qualifies a particular contract as a financial instrument.

---

b. Conveys to that second entity a contractual right[3] (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.

---

[3] Contractual rights encompass both those that are conditioned on the occurrence of a specified event and those that are not. All contractual rights that are financial instruments meet the definition of asset set forth in Concepts Statement 6, although some may not be recognized as assets in financial statements—may be "off-balance-sheet" —because they fail to meet some other criterion for

Insurance Enterprises, and No. 97, Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments

d. Lease contracts as defined in FASB Statement No. 13, Accounting for Leases (a contingent obligation arising out of a canceled lease and a guarantee of a third-party lease obligation are not lease contracts and are included in the scope of this Statement)

e. Warranty obligations and rights

f. Unconditional purchase obligations as defined in paragraph 6 of FASB Statement No. 47, Disclosure of Long-Term Obligations

g. Investments accounted for under the equity method in accordance with the requirements of APB Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock

h. Minority interests in consolidated subsidiaries

i. Equity investments in consolidated subsidiaries

j. Equity instruments issued by the entity and classified in stockholders' equity in the statement of financial position.

9. Generally accepted accounting principles already require disclosure of or subsequent measurement at fair value for many classes of financial instruments. Although the definitions or the methods of estimation of fair value vary to some extent, and various terms such as market value, current value, or mark-to-market are used, the amounts computed under those requirements satisfy the requirements of this Statement and those requirements are not superseded or modified by this Statement.

Disclosures about Fair Value of Financial Instruments

10. An entity shall disclose, either in the body of the financial statements or in the accompanying notes, the fair value of financial instruments for which it is practicable to estimate that value. An entity also shall disclose the method(s) and significant assumptions used to estimate the fair value of financial instruments.

11. Quoted market prices, if available, are the best evidence of the fair value of financial instruments. If quoted market prices are not available, management's best estimate of fair value may be based on the quoted market price of a financial instrument with similar characteristics or on valuation techniques (for example, the present value of estimated future cash flows using a discount rate commensurate with the risks involved, option pricing models, or matrix pricing models).

12. In estimating the fair value of deposit liabilities, a financial entity shall not take into account the value of its long-term relationships with depositors, commonly known as core deposit intangibles, which are separate intangible assets, not financial instruments. For deposit liabilities with no defined maturities, the fair value to be disclosed under this Statement is the amount payable on demand at the reporting date. This Statement does not prohibit an entity from disclosing separately the estimated fair value of any of its nonfinancial intangible and tangible assets and nonfinancial liabilities.

13. For trade receivables and payables, no disclosure is required under this Statement when the carrying amount approximates fair value.

14. If it is not practicable for an entity to estimate the fair value of a financial instrument or a class of financial instruments, the following shall be disclosed:

This page intentionally left blank.